

8th February 2022

Armour Energy

Warroon-1 delivers free-flowing gas

Armour Energy Limited (ASX:AJQ) is a junior energy producer and explorer with assets across northern, southern and eastern Australia. On a strategy of increasing its focus on its Surat and Cooper basins programmes, the company is progressing well through the initial phase of Surat workover activity. We highlight the innovative financing and partnering agreements enabling the company to undertake the production enhancement strategy, capturing upside whilst preserving capital and minimising equity dilution. Initial results are encouraging with Warroon-1 'free-flowing' gas, with rates increasing as the clean-up activity continues. The gas operating environment underpins a strong economic opportunity with a continuing supply squeeze and persisting high prices. AJQ remains well positioned to benefit from planned work programmes over the next 12 months. Success in the Surat campaign, in particular, can deliver tangible production upside and lift confidence weightings across what will likely be a multi-year prospect portfolio.

Business model

Armour Energy is a junior oil and gas company holding a production base with expansion options; and an extensive exploration portfolio across three Australian states. The portfolio consists of exploration and development plays, reflecting a mix of relatively moderate risk and early exploration-stage prospects with significant, success-case growth potential. The company has commenced its production expansion plan for the Surat Basin, funded by innovative partnering/financing deals (*refer RaaS note – 6 December*).

Warroon-1 free flowing gas is a strong outcome

The Surat production enhancement campaign is progressing through the post-frack clean-up phase with strong initial encouragement from the Warroon-1 (W-1) well. The re-stimulation was successfully completed, noting the 'frack size' is nearly 3.5x greater than that conducted previously (Nov-2020). The well began free-flowing gas quite quickly after the commencement of clean-up and with only some 10% of the stimulation fluid pumped out the well is delivering 325mcf/d and climbing as more fluid is recovered. Clean-up operations are expected to continue over the next three-five weeks before indicating a post-frack, stable production rate. We previously highlighted (*RaaS Flash Note – 31-Jan*) that the Myall Creek-2 well was undergoing a 30-day test with initial gas rates ranging between 200-300mcf/d. Success will flow through to the remaining frack and drilling opportunities in the portfolio. There is inherent upside on delivering more gas through a plant with ullage and operating on a dominantly fixed-cost basis.

Valuation

We retain a risked valuation of \$265mn (14cps) ascribed to AJQ noting the **significant NAV premium to the reference share price (2.0cps)**, which reflects an overly discounted value of the Queensland assets awaiting success outcomes from the current production enhancement activity. **Comparative reserve metrics highlight the relative undervaluing of the company's reserves base to peers but gas in the ground needs to be developed – a re-rating likely awaits tangible delivery of the gas growth strategy.** In our view, the most attractive assets in the current gas market are those already in production with incremental (and material) growth opportunities. We note that AJQ fits that template.

Share Details

ASX code	AJQ
Share price (7-Feb)	\$0.019
Market capitalisation	\$36M
Shares on issue	1,872M
Net debt (31-Dec)	\$32M
Free float	~69%

Share Performance (12 months)



Upside Case

- Above-expectation results from Surat production enhancement programme...more gas, higher price, lower capex
- Successful demerger and IPO of Northern Basins' assets supporting stronger balance sheet and working capital for growth projects
- Persisting tightness in gas markets driving 'stronger for longer' gas prices

Downside Case

- Gas growth is not delivered to expectation
- Current operating environment persists and all projects continue to be impacted by COVID-related restrictions
- Senior Secure Amortising Notes covenants require additional equity capital or asset divestment

Catalysts

- Continuing positive results from the Surat drilling and evaluation programme current under way
- Definition and progress on the demerger proposal

Company Contact

Brad Lingo (CEO) +61 7 3303 0620
blingo@armourenergy.com.au

RaaS Advisory Contact

Andrew Williams +61 417 880 680
andrew.williams@raasgroup.com

FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

ABN 99 614 783 363

Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

ABN 92 168 734 530

AFSL 456663

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Contact Details, BR and RaaS

BR Head Office: Suite 5GB, Level 5, 33 Queen Street, Brisbane, QLD, 4000

RaaS. 20 Halls Road Arcadia, NSW 2159

P: +61 414 354712

E: finola.burke@raasgroup.com

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