

1st February 2022

Armour Energy

Off and running in the Surat

Armour Energy Limited (ASX:AJQ) is a junior energy producer and explorer with assets across northern, southern and eastern Australia. With 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. 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*).

A Surat ‘first look’ is very encouraging

The anticipated Surat production enhancement campaign is making good progress as per the recent operational update with significant encouragement from the Warroon-1 (W-1) fracture re-stimulation and Myall Creek-2 (MC-2) workover activity. The W-1 re-stimulation has been successfully completed with clean-out and stabilisation activity under way. We note the ‘frack size’ is nearly 3.5x greater than that conducted previously (Nov-2020) ... the well is being given a strong chance to flow. Preliminary results are likely to be to hand in three-four weeks. The MC-2 well has been completed and reconnected to the gas-gathering infrastructure with a 30-day test under way. Initial gas rates ranging between 200-300mcf/d are very positive and encouraging. The previously undeveloped Tinowon-C zone, representing ‘new bypassed pay’, has been completed and is ready for future stimulation works. A decision on the timing and priority of any fracking will be made post the testing period. Kincora output has remained broadly steady through the current workover period at around 5.0TJ/d and we highlight the inherent upside that can be captured on improving gas throughput in 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 (1.9cps)**, 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 (31-Jan)	\$0.019
Market capitalisation	\$35.6M
Shares on issue	1,872M
Forecast net debt at 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

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FINANCIAL SERVICES GUIDE

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Effective Date: 6th May 2021

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