

3rd March 2021

Armour Energy

Unlocking value

Armour Energy Limited (AJQ.ASX) is a junior energy producer and explorer with assets across northern, southern and eastern Australia. The company has been listed on the ASX since April 2012. Armour is proposing a demerger and separate listing of its Northern basins oil and gas assets into a new company (McArthur Oil & Gas Ltd) through an in-specie distribution to existing shareholders to be separately listed through an IPO and capital raising in late-2021. The key aims are to “...unlock unrecognised value” whilst independently financing both AJQ and McArthur to pursue and accelerate the commercial opportunities inherent in their respective portfolios.

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, dominantly focussed on exploring for gas. The portfolio consists of exploration plays, reflecting a mix of moderate risk and early exploration stage with transformational potential. The company is looking to leverage its production growth plan at Kincora to repair its balance sheet and service a more aggressive exploration strategy, without recourse to equity markets. Financing is always a concern at the small end and the company's high working interests provide options through partnering.

Demerging can support price discovery

Armour Energy is proposing to unlock the value of its asset base by demerging and separately listing its Northern basins assets into a new vehicle to be called McArthur Oil & Gas Ltd through an in-specie distribution to shareholders and IPO. Existing AJQ shareholders will receive a minimum 33.35% holding in the new company via a 'return of capital' and priority application for shares in the IPO.

Whilst asset diversification can be beneficial through providing meaningful growth options, in small energy companies with constrained capital resources, multiple plays can often lead to assets being effectively stranded for long periods, capping comparative valuations as the marginal investment dollar seeks leverage through cleaner and purer exposures to the desired play...in this case the northern basins including the McArthur-Beetaloo options, the cornerstone of the Federal Government's gas led economic recovery.

The northern assets already host conventional discoveries at Glyde and Cow Lagoon, have a current portfolio of 193 leads and prospects with 4.3Tcf of Prospective Resource potential; and up to ~34Tcf and 1.2Bnb across the entire acreage spread. Demerging can also assist Armour by retiring a significant portion (or all) of its existing debt. In this case separating the parts could realise a greater sum.

Valuation

We assign a risked valuation of \$131m (10cps) to AJQ. The reference share price (4.1cps) in our view reflects the discount the market is applying to the production growth strategy, likely on financing and corporate risks. The company has a number of deliverable outcomes, particularly pertaining to Kincora production expansion that have the potential to re-rate market sentiment and crystallise asset values as ascribed.

Share details

ASX Code	AJQ
Share Price (intraday)	\$0.041
Market Capitalisation	\$45.9M
Shares on issue	1,276M
Net debt at 31 Dec	\$44.6M
Free float	~69%

Share price performance (12-months)



Upside Case

- Above expectation results from Kincora gas growth programme...more gas, higher price, lower capex
- Northern Australia success and securing a farm-in partner for the NT assets. Referred success from regional exploration would help to crystallise value
- Success opens alternate financing options, improves the balance sheet and restricts dilution

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

- Positive results from the Kincora drilling and evaluation programme
- 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

Effective Date: 26th November 2018

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- complaint processes

Contact Details, BR and RaaS

BR Head Office: Level 14, 344 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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