

24th November 2021

Armour Energy Ltd

Progressing Surat options

Armour Energy Limited (ASX:AJQ) is a junior energy producer and explorer with assets across northern, southern and eastern Australia. Pending the successful demerger and IPO of its Northern Basins' assets via McArthur Oil & Gas ('MOG'), AJQ will benefit from a restructured balance sheet after the injection of up to \$40mn (asset transaction proceeds) and stronger focus on its Surat and Cooper basins programmes on an independently funded basis. We highlight recent innovative financing agreements enabling the company to return to its production enhancement strategy, capturing upside whilst preserving capital and minimising equity dilution. The gas operating environment continues to underpin a strong economic opportunity from a supply squeeze and higher prices; and AJQ remains well positioned to benefit from planned work programmes over the next 12 months. The company is continuing to evaluate and build what will likely be a multi-year prospect portfolio with drill-ready opportunities.

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 moderate risk and early exploration stage prospects with significant, success case growth potential. The company is looking to leverage its production expansion plan in the Surat Basin via specific partnering arrangements to service a more aggressive exploration strategy, without recourse to equity markets.

Back to the field ... it's gas season

Armour will return to the field from mid-December with the frack evaluation of Warroon-1 to be followed by Myall Creek-2 in early January. The time is right to refocus on production growth and exploration opportunities particularly around Kincora and the Cooper Basin where there remains transformative oil and gas potential to be chased. Armour has entered into separate partnerships to fund work activities across the Walloon-1 and Myall Creek-2 wells with results to hand across late-2021 through to Q1 2022. By using innovative financing agreements, Armour will retain exposure to the expected production upside without the capital cost. A success case should flow through to production growth quite rapidly. Additionally, Armour has secured a farm-in arrangement (non-binding) with Gas2Grid (ASX:GGX) for work carries to the value of \$12mn, covering the drilling of three new wells, frack evaluation of the Riverside-1 (or Riverside North-1 [new well]) and financial underpinning of a 400km² 3D seismic programme. These farm-in activities are scheduled to commence from Q1 2022 concurrently with the Warroon and Myall Creek programmes. These deals are consistent with the company's previously announced strategy to seek partners as a mechanism to accelerate and finance production growth opportunities.

Valuation

Our NAV (pre-MOG IPO) has been downgraded from equity dilution on capital raising through the recent quarter, offset somewhat by more favourable commodity prices and an improving debt position. **We assign a risked valuation of \$299mn (14cps) to AJQ (previously \$269mn/16cps) noting the significant NAV premium to the reference share price (2.3cps).** We maintain that the most attractive assets in the current market are those already in production with incremental growth opportunities. AJQ fits that template. The success case from the upcoming stimulation and drilling campaigns should flow directly through the remainder of the development portfolio.

Share Details

ASX code	AJQ
Share price (intraday)	\$0.023
Market capitalisation	\$43.1M
Shares on issue	1,872M
Forecast net debt at 31-Dec	\$28M
Free float	~69%

Share Price Performance (12-months)



Upside Case

- Above expectation results from Kincora gas growth programme ... more gas, higher price, lower capex
- Successful divestment 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

- Positive results from the Surat drilling and evaluation programme
- Definition and progress on the demerger proposal

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FINANCIAL SERVICES GUIDE

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AFSL 456663

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- complaint processes

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