

Warrego Energy Limited (ASX: WGO)

Drilling update

Overview

As of 16th July 2019 Warrego and Strike were 3,617 m (70%) into the 5,200 m West Erregulla-2 well. Drilling rates are expected to increase once the remaining 200m of the Kockatea shale is drilled and we expect the Wagina secondary gas target should be intersected later this week. Open hole wireline logs will be run to evaluate the significance of earlier elevated gas readings before the section is cased and drilling continues to the main gas targets of the Kingia and High Cliff formations at ~4,700m and planned TD of 5,200m. We retain our base case valuation of \$0.17/share (range \$0.05-0.43) and upside potential on exploration success at WE of \$0.63/sh., discussed in our report of 19th March, pending conclusion of drilling and testing.

Key points

Waitsia analogue: Warrego has a 50% non-operated interest in EP 469, adjacent to the large (786 bcf gross 2P) Waitsia gas project (Beach/ Mitsui), ~300 km north of Perth. The West Erregulla-2 well is targeting the same formations that are productive at Waitsia. Gross mid-case resource estimates range from 377-1,163 bcf, depending upon the assessor.

Deep well: West Erregulla-2 (WE-2), at 5,200 m planned total depth, will be the deepest onshore well in Australia. The well spudded on 1st June and was expected to take 60 days to drill and a further two weeks to test. Drilling thus far has been reasonably uneventful, apart from delays due to slow rates of penetration through the Kockatea shale. We estimate TD will probably be reached during the second week of August, with testing to follow.

Intermediate results: WE-2 had three targets; a low probability 7.2 mmbbl in-place oil target at ~2000, which was not successful, the basal Wagina gas target (247 bcf mid-case at 4,100m), yet to be penetrated, and the primary Kingia/High Cliff formations at 4,700-5,200 m. The well has encountered elevated gas shows in the Lesueur and Woodada formations above 3,370m. Porosity, based on visual inspection, was described as "fair to good".

Key risk likely to be reservoir quality: The intermediate results are directionally positive; with gas shows indicating the presence of gas charge. Whether gas is trapped in the Kingia / High Cliff is yet to be determined. The main question, however, whether sufficient porosity and permeability have been preserved at depth, remains unchanged and cannot be answered until WE-2 is logged and tested. Warrego's May 2019 raising means it is fully funded for WE-2, with Strike paying the first \$11m and Warrego paying 50% of the anticipated \$5+m extra.

Near term news flow: After early drilling reports at an approximately weekly schedule, Strike, as operator, is following an event-driven cycle. The next report is likely to be around 24th July, depending upon drilling rates, when the current section reaches intermediate depth and logging is underway. We think TD is unlikely to be reached until the second week of August, to be followed by approximately two weeks of testing.

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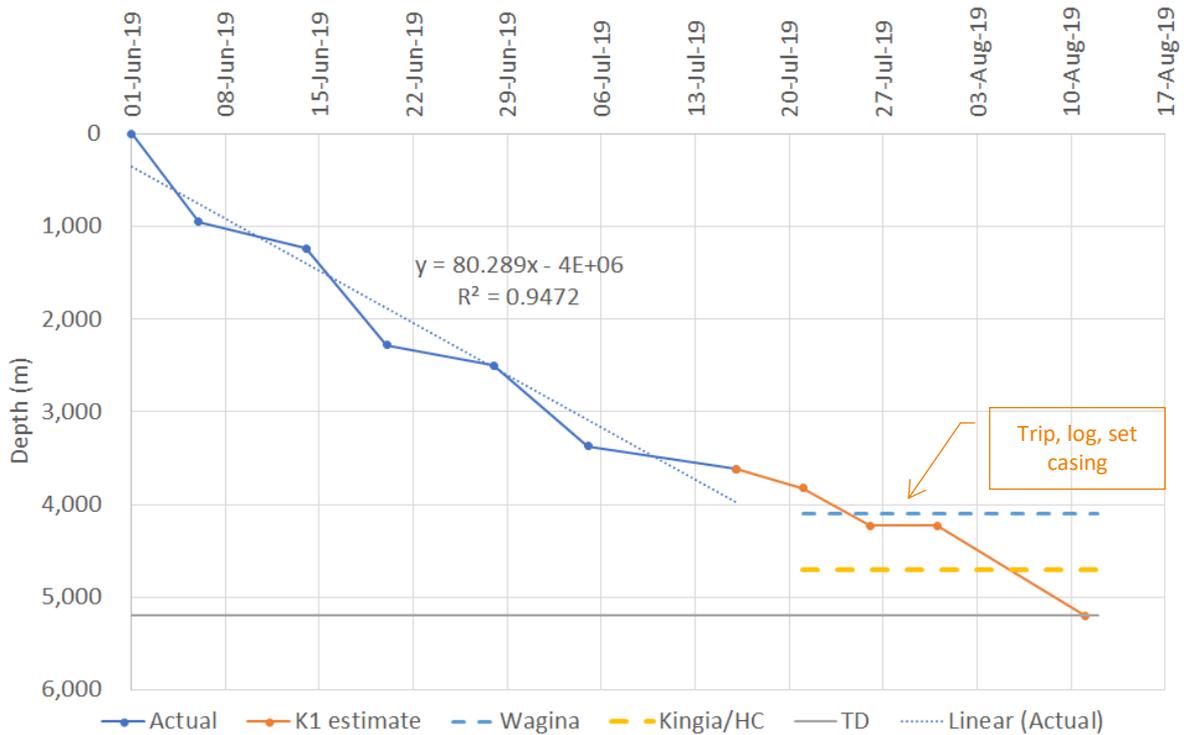
Closing price as of 19th July 2019,

CAPITALIZATION	
Last price	\$0.093
52-week range	\$0.078-0.175
Capitalization	\$61m
Cash: 31 Mar	\$4m
Debt: 31 Mar	\$5m
EV	\$60m
Shares ("")	660.0m
Options/rights	7.7m
Conv Notes	~10m
Balance date	June
RESERVES AND PRODUCTION	
1P (30 Jun 19)	0.00 MMboe
2P "	0.00 MMboe
3P "	0.00 MMboe
2C "	0.00 MMboe
FY17a	0.00 MMboe
FY18e	0.00 MMboe
FY19e	0.00 MMboe
SHAREHOLDERS (%)	
Board	59.9
* excludes \$6.6m placement+SPP June	
LEADERSHIP	
Chairman	Greg Columbus
MD/CEO	Dennis Donald

Disclosure: This is a commissioned research report and K1 Capital will receive a fee for preparing this report.

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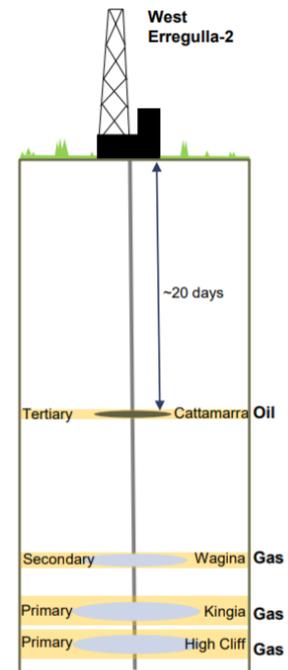
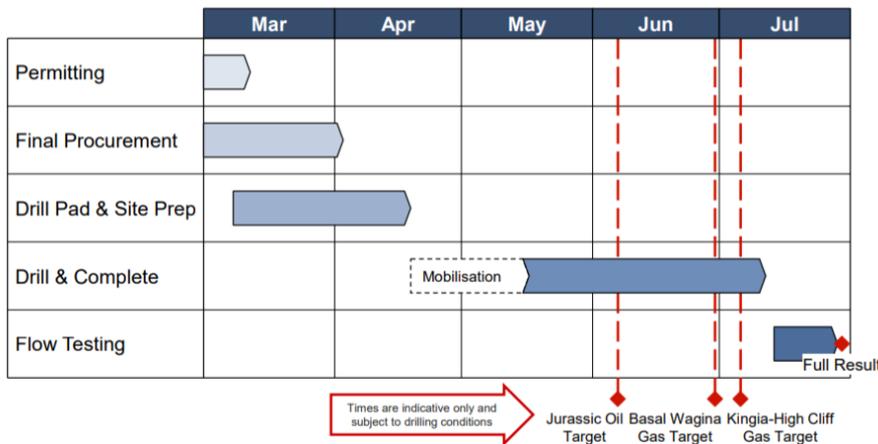
Figure 1 Estimated time-depth curve for West Erregulla-2



Source: Actual data from company announcements, forecast from K1 Capital estimate

Figure 2 West Erregulla-2 “pre-drill” drilling schedule

- WE-2 is on track for spud in May 2019
- All approvals have been granted including 'permission to drill' letter from Resource Minister
- Easternwell 106 mobilising from Queensland under a rig mobilisation cost sharing arrangement with neighbouring major operator
- Campaign to drill, case and complete the well is ~60 days with a two week flow test booked on success



Source: Strike Energy Limited, April 2019 Activities Update, 3rd April 2019, p 12

Table 1 Financial Summary (June year end, working interest basis, AUD currency)

	Units	FY18A	FY19E	FY20E	FY21E	FY22E	Units	FY18A	FY19E	FY20E	FY21E	FY22E	
CPI, forex & prices							P&L						
US inflation rate	% pa	2.10	2.15	2.20	2.20	2.20	Sales revenue	-	-	-	-	-	
Australian inflation rate	% pa	2.05	2.35	2.50	2.50	2.50	Other revenue	-	-	-	-	-	
Inflation Factor - US	-	0.985	1.005	1.028	1.050	1.073	Production costs	-	-0	-0	-0	-0	
\$US/\$A forex (base)	\$US/\$A	0.78	0.72	0.70	0.70	0.70	Royalties & prod purchases	-	-0	-0	-0	-0	
Brent	\$US/bbl	63	69	67	71	75	Admin	-2	-2	-2	-2	-2	
Nat Gas (Henry Hub)	\$US/mmBtu	2.9	2.9	2.7	3.0	3.1	Other	-0	0	-	-	-	
Nat Gas (Wallumbilla)	\$US/mmBtu	6.4	6.9	6.7	7.1	7.5	EBITDA	-2	-2	-2	-2	-2	
Received prices							Deprec & Amort						
Oil	\$US/bbl	36.0	36.5	37.0	41.8	46.7	EBIT	-0	-0	0	0	0	
Condensate	\$US/bbl	-	-	-	-	-	Net Interest Expense	0	-0	0	0	0	
Gas	\$US/mmBtu	2.9	2.9	2.7	2.9	3.1	EBT	-2	-2	-2	-2	-2	
LPG	\$US/bbl	-	-	-	-	-	Tax expense	-	0	1	1	1	
LNG	\$US/t	-	-	-	-	-	Minorities / preferred dividend	9	-1	-	-	-	
Electricity	\$US/MWh	-	-	-	-	-	Normalized NPAT	7	-2	-1	-1	-1	
CO2e	\$US/t	-	-	-	-	-	Abnormals	-27	-0	2	-	-	
Total	\$US/boe	28.3	28.6	28.5	31.9	35.3	Reported NPAT	-20	-2	1	-1	-1	
Net production by project							Cash flow statement						
-	mmboe	-	-	-	-	-	EBITDA	-2	-2	-2	-2	-2	
-	mmboe	-	-	-	-	-	Change in work cap	-	-	-	-	-	
-	mmboe	-	-	-	-	-	Deferred tax	-	-	-	-	-	
-	mmboe	-	-	-	-	-	Other operating items (tax, e	1	-0	0	0	0	
-	mmboe	-	-	-	-	-	Operating cash flow	-1	-2	-2	-2	-2	
-	mmboe	-	-	-	-	-	PPE capex	-0	-0	-	-	-	
-	mmboe	-	-	-	-	-	Exploration capex	-10	-0	-6	-12	-12	
-	mmboe	-	-	-	-	-	Development capex	-	-0	-0	-	-	
-	mmboe	-	-	-	-	-	Other investing items	1	0	2	-	-	
Lochend Cardium tigr	mmboe	0.00	0.00	0.00	0.00	0.00	Investing cash flow	-8	0	-4	-12	-12	
Total	mmboe	0.00	0.00	0.00	0.00	0.00	Inc/(Dec) in Equity	5	7	13	11	-	
Net production by product							Balance sheet						
Oil	mmbbl	0.00	0.00	0.00	0.00	0.00	Inc/(Dec) in Borrowings	-	0	-	-	-	
Condensate	mmbbl	-	-	-	-	-	Dividends paid	-	-	-	-	-	
Gas	PJ	0.00	0.00	0.00	0.00	0.00	Other financing items	1	5	-0	0	-	
LPG	mmbbl	-	-	-	-	-	Financing Cash Flow	6	12	13	11	-	
LNG	Mt	-	-	-	-	-	Net Inc/(Dec) in Cash	-4	11	7	-3	-14	
Electricity	TWh	-	-	-	-	-	Free cash flow	-9	-2	-6	-14	-14	
CO2e	Mt	0.00	0.00	0.00	0.00	0.00	Cash & cash equivalents						
Total	mmboe	0.00	0.00	0.00	0.00	0.00		0	11	18	15	1	
Total production	kboed	0.00	0.00	0.00	0.00	0.00	Other current assets	0	22	23	28	32	
Production growth	%	-	61.8	18.5	-22.1	-26.4	PPE, Exp & Dev	0	0	7	19	31	
Revenue							Other non-current assets						
Oil	M\$A	0	0	0	0	0	Total Assets	5	36	51	65	67	
Condensate	M\$A	-	-	-	-	-	Short term debt	-	-	-	-	-	
Gas	M\$A	0	0	0	0	0	Other current liabilities	1	1	1	1	1	
LPG	M\$A	-	-	-	-	-	Long term debt	-	0	0	0	0	
LNG	M\$A	-	-	-	-	-	Other non-current liabilities:	0	8	10	14	18	
Electricity	M\$A	-	-	-	-	-	Total Liabilities	1	9	11	15	18	
CO2e	M\$A	-	-	-	-	-	Minorities	0	0	0	0	0	
Total modelled	M\$A	0	0	0	0	0	Total shareholders equity (4	27	40	50	49	
Total reported	M\$A	-	-	-	-	-	Total Funds Employed	4	27	40	50	49	
Revenue growth	%	-	0.0	0.0	0.0	0.0	Net debt	-0	-11	-18	-15	-1	
Operational metrics							Business metrics						
Revenue	\$A/boe	-	-	-	-	-	EBITDA margin %	-	-	-	-	-	
Production & transpo	\$A/boe	-	-	-	-	-	EBIT margin %	-	-	-	-	-	
Royalties & prod pur	\$A/boe	-	-	-	-	-	Normalized NPA %	-	-	-	-	-	
Admin	\$A/boe	-	-	-	-	-	Revenue growth %	-	-	-	-	-	
EBITDA margin	\$A/boe	-	-	-	-	-	EBITDA growth %	-	-22.8	21.5	2.2	2.6	
D&A	\$A/boe	-	-	-	-	-	EBIT growth %	-	-23.3	20.7	2.3	2.7	
Tax and financing	\$A/boe	-	-	-	-	-	Normalized RO ₁ %	151.4	-5.5	-2.5	-2.0	-2.0	
Normalized NPAT	\$A/boe	-	-	-	-	-	Normalized RO ₂ %	197.9	-7.3	-3.2	-2.6	-2.8	
Resource/production years	-	-	-	-	-	-	Fully diluted shares (million)	88	972	972	972	972	
Product mix	% liquids	-	-	-	-	-	Wtd diluted shares (million)	74	525	972	972	972	
Change vs. prior report							Leverage						
USD/AUD (average)	\$US/\$A	-	-	-	-	-	Net Debt / Book %	-1	-39	-44	-30	-2	
Brent USD	\$US/bbl	-	-	-	-	-	Net Debt / (ND+ %	-1	-64	-79	-42	-2	
Brent AUD	\$A/bbl	-	-	-	-	-	Net Debt / Total %	-1	-29	-35	-23	-1	
Production	mmboe	-	-	-	-	-	EBIT Interest cc x	-	-150.8	-	-	-	
Revenue	\$m	-	-	-	-	-	Debt / Free Cas x	-	-0.0	-0.0	-0.0	-0.0	
Cash opex (-ve = inc)	\$m	-	-	-	-	-	Valuation metrics						
EBITDA	\$m	-	-	-	-	-	Norm. EPS	c/sh	9.5	-0.4	-0.1	-0.1	-0.1
Normalized NPAT	\$m	-	-	-	-	-	EPS growth	%	-	-104	-65	1	6
Cash (YE)	\$m	-	-	-	-	-	PER	x	1.0	-25.0	-72.5	-71.5	-67.5
Debt (YE, +ve = inc.)	\$m	-	-	-	-	-	Op Cash flow	c/sh	-1.2	-0.3	-0.2	-0.2	-0.2
Capex (+ve = inc.)	\$m	-	-	-	-	-	Price/Op Cash	x	-8.2	-27.2	-50.8	-50.1	-47.3
							EV/EBITDA	x	-	-	-	-	-

Source: company data and K1 Capital forecasts

\$A currency unless otherwise noted. Nominal \$ basis. Year ending June.

Figure 3 Base case valuation summary

NPV @ 10.0% WACC+country factor Valuation as of 30 Jun 2019	Net volume mmboe	NPV value \$/US/boe	Risk factor %	Risked value M\$A	Risked value \$/A/sh	Unrisked value \$/A/sh	WACC %	Risked value \$/A/sh
Projects (DCF model valuation)	0.0			0	0.00	0.00		
Lochend Cardium tight oil	0.0	19.20	20	0	0.00	0.00	10.0	
Exploration / Appraisal	245.2			115	0.15	2.20		
EP 469 discovered gas	6.1	-	2	-	-	-		
West Erregulla Deep	99.3	4.80	10	67	0.09	0.91		
EP 469 Jurassic oil	9.4	7.90	8	9	0.01	0.14		
STP-EPA-0127	-	-	-	0	0.00	0.00		
Tesorillo (Spain) conv. gas	73.9	5.80	5	31	0.04	0.82		
Uruguay conventional	56.5	3.05	4	8	0.01	0.33		
Other (corporate, cash, debt, etc)				14	0.02	0.02		
Corporate costs				-4	-0.01	-0.01		
Hedging & Investments				-	-	-		
Franking credits (@ 0 %)				-	-	-		
Cash				11	0.01	0.01		
Additional Equity				6	0.01	0.01		
Debt				-0	-0.00	-0.00		
Minorities / Other				2	0.00	0.00		
Equity Valuation @ base case	-			129	0.170	2.20	Previous 0.17	
Equity Valuation @ spot prices Mkt Cap @ current share price	@ \$US63/bbl real Brent & 0.71 f (and undiluted share count)			-	-	-	0.00	
Total shareholder return (%)				61	0.093	n/a		
Number of shares (undiluted)	000,000			660.0				
Number of shares (diluted)	000,000			745.1				

0.71 USD: AUD spot and 0.70 USD: AUD long term exchange rate (prev. 0.75 long term)

Valuation reference date 30th Jun 2019 (prev. 31st Dec 2018)

Per share valuation based on estimated post June 2019 capital raising share count of 660m shares plus assumed remainder of \$10m total equity raising in 2019 (\$3.4m), plus unlisted May 2021 options (7.0m).

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1.1 Appendix 1

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