

Warrego Energy Limited (ASX: WGO)

WE-3 drilling update – hard slogging

Overview

Drilling of the West Erregulla-3 well continues, although progress has been slower than planned due to mud-motor failures and well head pressure test problems. We estimate drilling is ~6-7 weeks behind schedule, with the Wagina, Kingia and High Cliff formations now expected to be intersected in early December. Drilling of WE-4 will commence after completion of WE-3, with WE-5 expected to follow WE-4. Our valuation is unchanged at \$0.31/sh, with upside to \$0.40 using STX's 2C resource assessment for the JV development, and \$0.55/sh when fully derisked.

Key points

Drilling progress:

- 21st Sep: well spudded, planned TD of ~5,000 m, similar to WE-2.
- 29th Sep: drilling of 26" surface section to 1,210 m completed as planned
- 14th Oct: mud-motor parted from drill string, unable to be recovered, side-track required; depth not disclosed.
- 26th Oct: mud-motor parted from drill string at 1,629 m, (unrelated to 14th Oct parting), further side-track required.
- 12th Nov: first intermediate section cased to 2,462 m, shallower than previously planned due to the impact of side-tracks on rig mast capacity.
- 16th Nov: Pressure test of casing connection unsuccessful, drilling halted
- 23rd Nov: Drilling recommenced following arrival of parts. Planned depth of 2nd intermediate section is 3,750-4,150 m.

Delays disappointing but not critical: We estimate drilling of WE-3 is ~6-7 weeks behind schedule. The additional cost to the JV is difficult to estimate, given some costs will likely be to the drilling company's account, but we think it will be ~\$3-5m, shared 50/50 between Warrego and Strike. This appears manageable within existing funding capacity.

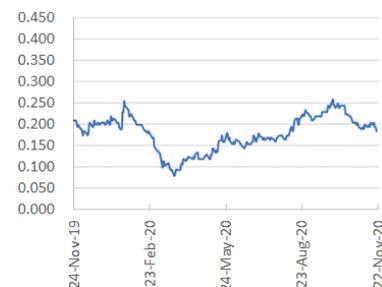
Ongoing gas marketing: Whilst WE-3 drilling is underway Warrego remains active pursuing additional gas sales for the mid-2022 to end-2023 period. We think interest will be strong given the WE project is already underpinned by announced gas sales agreements and buyer risk can be further reduced by concluding arrangements after project FID occurs around end Q1 2021.

Share price catalysts: Near term news flow will relate to drilling progress, including penetration of the Wagina, Kingia and High Cliff reservoirs, now expected in December. Flow testing of WE-3 and spudding of WE-4 should follow early in the new year, with spudding of WE-5 in Q2 2021, with resource upgrades and conversion to reserves after completion of drilling.

Relative valuation: WGO continues to offer cheaper entry into the WE field than STX, even allowing for STX's operatorship and interest in other Perth Basin acreage, trading at a discount of ~50-60% to Strike on market capitalization, EV and resource metrics.

MiFID II compliance statement: Bridge Street Capital Partners have acted as Corporate Advisors to WGO and received fees from WGO for services provided.

SHARE PRICE PERFORMANCE



Closing price as of 20th Nov 2020

CAPITALIZATION	
Last price	\$0.185
52-week range	\$0.075-0.42
Capitalization	\$177m
Cash: 30 Sep*	\$11.4m
Debt: 30 Sep	\$0m
EV	\$166m
Shares	958.5m
Options/rights	18.1m
Conv Notes	-
Balance date	June
RESERVES AND PRODUCTION	
1P (18 May 20)	0.0 MMboe
2P "	0.0 MMboe
3P "	0.0 MMboe
2C "	42.7 MMboe
FY20a	0.00 MMboe
FY21e	0.00 MMboe
FY22e	0.00 MMboe
SHAREHOLDERS (%)	
Board	37
Institutions	22
Retail	41
Total	100
* excludes \$32m placement Oct 2020	
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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2. Valuation

Table 1 Warrego valuation scenarios

Case	Description	\$A m net	\$A/share
Base	WE phased development (RISC resource assessment) ~700 bcf gas (gross) two phase development, Phase 1 \$4.5/GJ real domgas pricing (~\$3.5/GJ for STX CSBP GSA), toll processing. Phase 1 at 80 TJ/d (CSBP and additional uncontracted sales) from late 2022 (Alcoa contract from 2024) supported by Kingia 2C resources, 80% project risk (prev. 70%). Phase 1+2 at 115 TJ/d from 2026 supported by Kingia 3C resources, Phase 2 at 60% project risk factor (prev. 50%).	309 risked	0.31 risked
		390 de-risked	0.39 de-risked
B1	WE Strike 2C resource assessment Base case with ~1,187 bcf Kingia/HC 2C resources. Phase 1 as for Base (80% risk), ~200 TJ/d Phase 2 from 2026 (at 60% risk), 273 bcf Wagina 2U.	406 risked	0.40 risked
		550 de-risked	0.55 de-risked

Table 2 Base case valuation summary

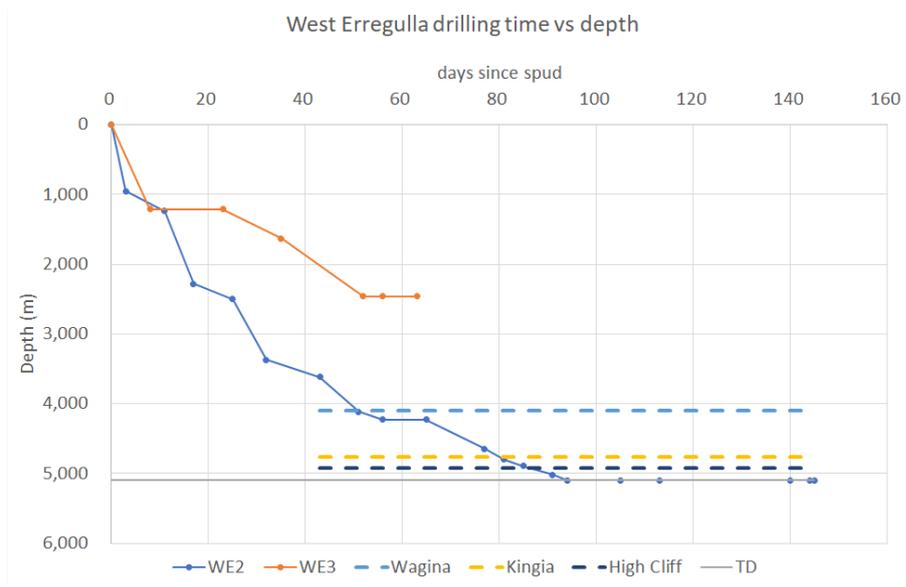
NPV @ 10.0% WACC+country factor	Net volume	NPV value	Risk factor	Risk value	Risk value	Unrisked value	Project WACC	Risk value
Valuation as of 31 Dec 2020	PJe	\$/GJ	%	M\$A	\$/sh	\$/sh	%	\$/sh
Projects (DCF model valuation)	341.0			207	0.21	0.29		
WE - tolling (Phase 1)	189.7	0.97	80	144	0.14	0.18	10.0	
WE - tolling (Phase 2+)	151.3	0.69	60	63	0.06	0.10	10.0	
Lochend Cardium tight oil	0.0	2.38	20	0	0.00	0.00	10.0	
Exploration / Appraisal	671.0			92	0.09	0.92		
EP 469 discovered gas	37.6	-	2	-	-	-		
West Erregulla - Dongara	32.9	0.83	30	8	0.01	0.03		
West Erregulla - Wagina	12.0	0.83	50	5	0.00	0.01		
West Erregulla - Kingia	41.3	0.83	50	17	0.02	0.03		
West Erregulla - High Cliff	37.6	0.83	50	16	0.02	0.03		
EP 469 Jurassic oil	57.5	2.10	8	10	0.01	0.12		
STP-EPA-0127	-	-	-	0	0.00	0.00		
Tesorillo (Spain) conv. gas	452.1	1.55	5	35	0.03	0.70		
El Romeral	-	-	-	1	0.00	0.00		
Other (corporate, cash, debt, etc)				10	0.01	0.03		
Corporate costs				-30	-0.03	-0.03		
Hedging & Investments				-	-	-		
Franking credits (@ 0 %)				0	0.00	0.02		
Cash				40	0.04	0.04		
Additional Equity				1	0.00	0.00		
Debt				-	-	-		
Minorities / Other				-1	-0.00	-0.00		
Equity Valuation @ base case	-			309	0.310	1.24	Previous	
Equity Valuation @ spot prices	@ \$US45/bbl real Brent & 0.73 f			-	-	-	0.30	
Mkt Cap @ current share price	(and undiluted share count)			18,493	18,500		0.00	
Total shareholder return (%)					n/a			
Number of shares (undiluted)	000,000			999.6	@ valuation date			
Number of shares (diluted)	000,000			1,007.7	for fully funded development			

Notes: 0.71 USD: AUD spot and 0.70 USD: AUD long term exchange rate. WE development based on RISC resource assessment.

3. Drilling progress

We estimate WE-3 is ~6-7 weeks behind schedule.

Figure 1 WE2 and WE-3 time-depth comparison (as of 23rd November 2020)



Source: K1 Capital analysis based on company announcements.

4. Relative valuation

The market continues to value Warrego at a discount of ~50-60% to Strike in market capitalization terms, as shown in Figure 2 below, despite both companies having a 50% share in the same principal asset (West Erregulla).

Figure 2 Relative market capitalization of Warrego and Strike



Source: K1 Capital analysis of ASX data. Closing price data to 20th November 2020.

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