

Oil prices and M&A on the up

Australis Oil & Gas (ASX:ATS) is an oil and gas producer/developer, with a strategic and controlling position in the emerging Tuscaloosa Marine Shale (TMS) oil play, onshore US. The TMS is an Eagle Ford-equivalent but early-stage oil play with gross recoverable oil potential of around 7bn barrels – this is likely to be the next big thing. Australis represents a highly-leveraged and attractive exposure to the transformational potential of the TMS oil play. The US onshore plays are progressing through a changing operating model, with the focus on improving productivity through long-horizontal completions. Whilst production returns have improved, in-ground investment is falling. We see this as an exercise in producing out the NPV of the assets and operators are seeking ways to build reserves and new growth including M&A. Although recent transactions are at the scale-end in relatively low-risk plays, at some point operators will need to look to next-generation plays for higher-margin growth and earnings. ATS operating data continues to underscore the quality of the TMS, with production tracking according to the model type curve which is considered to be as good as if not better than more highly-developed plays in the Bakken, Eagle Ford, Powder River and DJ Basin. The macro environment supports the contention of ‘next big thing’ and the current phase of M&A could represent the beginning of the wave. Industry news points to potentially accelerating consolidation at scale, which at some stage translates to a squeeze on mid-cap operators and an increasing focus on plays like the TMS – proven, underdeveloped, with a relatively inexpensive entry position. The company continues to pursue partnering opportunities.

Business model

Australis Oil & Gas (ATS) is a development and production company, focused on progressing its strategic position in the emerging Tuscaloosa Marine Shale (TMS) oil play, onshore US. The company holds some 65,800 net acres within the TMS Core which compares favourably with more established and mature provinces like the Bakken, Permian and Eagle Ford. As an emerging play, the operating model is still evolving with type curves and well recoveries becoming better defined. The oil-prone nature and relatively low production costs suggest material upside can be delivered through continuing activity and learning curve optimisation.

Higher oil prices can promote more in-field activity

The TMS is an under-drilled and under-developed play in a relative and absolute sense, however, the data to date demonstrates production and earnings characteristics on a par with the more intensively developed areas. The quarterly data continues to confirm the type curve model and utility increasing with material improvements in uptime and decline rates in-line with the model. Activity remains capital constrained although rising oil prices provide some flexibility in workover programmes and lease management. Some 59% of the lease portfolio is held by production. Operations remain profitable and oil prices are expected to remain strong through the short-term at least. Delivering a material growth outlook remains dependent on financing, however, successful partnering negotiations could deliver a major re-rating of the play and the company over the next 12-24 months.

We maintain our NAV at \$276m (\$0.22/share)

Our NAV remains at \$276m or \$0.22/share but note oil prices are currently trading above our forecast deck and are expected to stay high at least through the short-term. Valuing pre-development assets is a subjective exercise, particularly considering financing and timing uncertainties, but the well performance data continues to de-risk the economics of the TMS play, increasing confidence in the commercial potential. The resource opportunity remains massive based on consistent geology and the next 12 months could deliver material re-rating outcomes. We value the reserves and resources against the WTI forward curve with a premium for LLS and overlay a discretionary RaaS risk generating a low-high NAV range. We set a mid-point valuation of \$276mn (\$0.22ps) with an upside case to \$356mn (\$0.28ps) against a reference share price of \$0.019ps. Partnering success could unlock material reserves value and deliver valuation upside well in excess of our base case...such is the nature and attraction of oil plays in the US onshore.

Energy

10 November 2023

Share details

| | |
|-------------------------|---------|
| ASX code | ATS |
| Share price (9-Nov) | \$0.019 |
| Market capitalisation | \$23M |
| Shares on issue | 1,261M |
| Net debt (as at 30-Sep) | ~\$5.1M |
| Free float | ~47% |

Share Performance (12 months)



Upside Case

- Securing a partner to underpin funding for an expanded drilling programme to drive production and earnings growth
- Oil price upside - the company is a highly leveraged exposure to oil price
- Continuing positive look-through from third-party activity further de-risking the operating model as an analogue to already developed plays

Downside Case

- Finance constrained with risk to lease holdings
- Oil price downside – crude oil prices are strongly sensitive to the current supply uncertainties
- Weaker and slower outcomes from third-party drilling and continuing higher perceived risks to the play

Board of Directors

| | |
|-------------------|------------------------|
| Ian Lusted | Managing Director/CEO |
| Jon Stewart | Non-Executive Chairman |
| Graham Dowland | Executive Director/CFO |
| Alan Watson | Non-Executive Director |
| Stephen Scudamore | Non-Executive Director |

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M&A Activity Is Rising...Next Gen Plays Must Come To The Fore

A quarterly result underpinned by stronger realised oil prices offsetting production decline. Industry M&A is increasing and at some stage, big oil consolidation will push through to next generation plays like the TMS and perhaps sooner than we anticipate.

Partnering discussions are continuing and we await material progress on this financing option.

Exhibit 1: Sep quarter results highlight the oil price sensitivity of ATS (financials in US\$)

| Production and financials | | 4Q 22 | 1Q 23 | 2Q 23 | 3Q 23 | ΔQoQ |
|--|---|----------------|----------------|----------------|----------------|-------------|
| <p>Lower sales volumes through natural decline and downtime associated with workover activity in the period... ...significantly higher realised oil prices offset the production decline such that reported revenue was flat Q-Q. Netback was lower on higher workover activity.</p> <p>Well productivity remained broadly in-line with the modelled type curve.</p> <p><u>Consensus forecasts suggest stronger crude oil pricing on the forward curve.</u></p> | Production volumes (kb)* | 84.3 | 75.4 | 73.3 | 69.3 | (5%) |
| | Sales volumes (kb) | 83.3 | 76.2 | 73.0 | 69.0 | (5%) |
| | Net sales revenue (\$mn) | 5.3 | 4.4 | 4.2 | 4.2 | |
| | Field netback (\$mn) | 2.8 | 1.7 | 2.4 | 2.0 | |
| | <i>Netback (pre/post hedging) (\$/b)</i> | <i>33 / 42</i> | <i>22 / 27</i> | <i>33 / 40</i> | <i>29 / 36</i> | |
| | EBITDA (\$mn) | 1.1 | 0.1 | 0.8 | 0.6 | |
| | Cash (\$mn) | 7.8 | 5.4 | 3.7 | 3.9 | |
| | Debt (\$mn) | 12.0 | 11.0 | 10.0 | 9.0 | |
| | Capex (\$mn) | (0.7) | (0.9) | (0.4) | (0.6) | |
| | Realised oil price (US\$/b) | 85 | \$77 | \$74 | \$83 | 12% |
| <i>(after hedging)</i> | <i>80</i> | <i>73</i> | <i>72</i> | <i>77</i> | <i>7%</i> | |
| Corporate | | 4Q 22 | 1Q 23 | 2Q 23 | 3Q 23 | ΔQoQ |
| <p>ATS continues to manage its lease position within the financial constraints of the company. There are ~4,600 acres subject to expiry through the remainder of 2023.</p> | TMS Core holdings (acres) | 79,600 | 77,200 | 73,300 | 65,800 | (10%) |
| | <i>Held by production</i> | <i>49%</i> | <i>50%</i> | <i>53%</i> | <i>59%</i> | |
| | <i>Net drilling locations</i> | <i>300</i> | <i>280</i> | <i>280</i> | <i>230</i> | |
| | Net oil resource [2P + 2C] (Mb) | 153 | 120 | 120 | 120 | |
| <p>Hedging remains in place as follows with the portfolio continuing to transfer the weighting towards zero-cost collars.</p> | Period | 4Q 23 | 1Q 24 | 2Q 24 | 2024 | 2025 |
| | Volumes (kb) | 11 | 9 | 9 | 25 | 12 |
| | Swap price (\$/b) | \$65 | \$70 | \$68 | \$67 | \$66 |
| | Volumes | 17 | 15 | 14 | 56 | 24 |
| | Low collar price (\$/b) | \$63 | \$54 | \$57 | \$55 | \$49 |
| | High collar price (\$/b) | \$87 | \$87 | \$87 | \$85 | \$81 |
| Cash and debt position | The cash balance as at 30-Sep is \$3.9mn / Outstanding debt balance is \$9mn. Capex for the period totalled \$0.55mn covering a small land management programme. | | | | | |

Source: Company data; *Analyst commentary*; * remaining 2023 hedging

The company continues to pursue its stated corporate strategy – the securing of its low-cost entry (acreage retention) into a proven but underdeveloped shale play, capitalising on management’s expertise and record of success, then leveraging that position by securing financing through partnering to accelerate and optimise production growth.

Waiting for deals to crystallise is a frustrating position on both corporate and investing levels but we understand the sometimes long-dated nature of data due diligence and negotiations...and in some ways the process is akin to a duck swimming, with all the activity occurring below the surface and out of sight. Whilst there has been no material announcement as yet with respect to ongoing discussions, the macro elements continue to remain supportive of the play potential, particularly in terms of its nominal appeal to other shale play operators.

We can point to a strengthening market for aggregation, with a number of consolidation deals announced through the reporting period, perhaps pointing to a greater sense of urgency on the part of acquirers to lock in longer-term growth potential.

Although the deals are currently being struck in the mature and highly developed shale plays, that is the nature of initial M&A activity – bigger companies will look to acquire and build in areas where the drilling

opportunities are well known and; financial and production outcomes are highly predictable. For that, read low-risk.

As the opportunities of scale get swallowed, the focus for new investment migrates to next generation plays...the pace of this process is difficult to predict, but it seems self-evident that cashed up sellers, with technical knowledge will be looking to reinvest in what they know best.

We highlight commentary/observations made from various industry newswires and mainstream articles over the course of the reporting period to illustrate the M&A activity across US shale plays and how that is evolving.

US onshore oil and gas production is a high-decline-rate play and probably more so than conventional operations need to stay ahead of the decline and reserves replacement curves to deliver growth. Historically that has meant a high level of free cash flow reinvestment to, at a minimum, keep the 'tank topped up' in reserves and drilling opportunities – that is nothing new.

We note the trend to underinvestment in the plays that has been evident for a number of years as operators have transitioned to 'capital return' investments rather than capital growth opportunities. It is difficult to maintain dividends and buy-backs; and reinvest in drilling for growth.

The challenge is, that it's becoming more difficult to replace production let alone generate growth through new drilling alone. This has been illustrated in the most recent [EIA Drilling Productivity Report \(Oct-2023\)](#) which shows new-well oil production ranging from 1 – 1.8kdb per well versus 'legacy well production' decline of 50 - >300kdb...that's a lot of new wells that need to be drilled to achieve no-growth production outcomes.

Data cited across the Bakken, Eagle-Ford, Niobrara and Permian oil plays.

Constraints to applying more reinvestment capital have been *"...the shift producers have made in reallocating cash flow from new drilling to shareholder returns. These returns have been very popular with investors but have come at a price for reserves replacement"*. Interesting commentary on [rbenenergy.com](#) that showed a reversal of trends with recent reserves replacement ratios (+200% in 2022) and finding costs (c.US\$10b) showing marked improvements *"...achieved with a (capital) reinvestment rate of 39%, a 10-year low"*.

On closer inspection there is a caveat to these headline statistics with a material contribution to the lift in reserves likely coming from a reversal of oil-price related write-downs taken through 2019-2020, noting *"...the percentage of reserves replaced through finding and development activities (new wells) has been declining while the cost of exploiting existing fields and development of new fields has been rising"*.

Whilst the mechanics of shale drilling has evolved, particularly in the application of horizontal drilling and increased fracking efficiencies, this is really only providing a sugar hit through working existing assets harder. The benefits of doing more for less have underpinned improvements in operating margins, but ultimately that cash flow has to fund increasingly more aggressive drilling campaigns on lower quality targets or acquisitions to (re)build drilling inventory.

There appears to be a growing view that the consolidation wave in the US is only just beginning, largely being driven new, high-quality acreage disappearing and for major oil companies, limited and expensive new discoveries in international assets.

An article in the [Financial Times](#) suggested that the recent Exxon and Chevron acquisition offers represent an *"...an arms race"* with Chevron's CEO indicating *"...that demand for oil will continue to grow beyond 2030"*.

We note recent [OPEC](#) commentary stating *"...oil demand will continue expanding until at least 2045"*.

However, for every bull there is a bear and the [IEA World Energy Outlook to 2030](#) suggests that oil and gas demand growth will peak within the next seven years.

M&A at any scale has a cascading effect on other operators to increase their asset bases – the food chain is in operation and at some point, attention from cashed up sellers, or operators looking to grow organically need to start deploying capital in next generation assets of which ATS in the TMS is a leveraged opportunity.

Through the recent US quarterly reporting period, the benefits of production consolidation are becoming strongly evident.

Exhibit 2: Financial Summary

| AUSTRALIS Oil & GAS LTD | | ATS | | | | | |
|-----------------------------------|---------------|------------------------------------|----------------|-----------------------------|----------------|----------------|----------------|
| YEAR END | | Dec | | | | | |
| NAV | A\$m | \$0.22 | | | | | |
| SHARE PRICE | A\$cps | \$0.019 priced as of close trading | | | | | |
| MARKET CAP | A\$m | 24 | | | | | |
| ORDINARY SHARES | M | 1,261 | | | | | |
| OPTIONS | M | | | | | | |
| COMMODITY ASSUMPTIONS | | 2021 | 2022 | 2023E | 2024E | 2025E | |
| Realised oil price | US\$/b | 68.99 | 96.62 | 75.40 | 72.70 | 69.01 | |
| Realised oil price after hedging | US\$/b | 55.89 | 81.78 | 74.41 | 72.10 | 68.83 | |
| Exchange Rate | A\$:US\$ | 0.7514 | 0.6946 | 0.6819 | 0.6873 | 0.6829 | |
| RATIO ANALYSIS | | 2021 | 2022 | 2023E | 2024E | 2025E | |
| Shares Outstanding | M | 1,238 | 1,261 | 1,261 | 1,261 | 1,261 | |
| EPS (pre sig items) | UScps | (0.2) | 0.2 | (0.0) | 0.0 | 0.0 | |
| EPS | Acps | (0.3) | 0.2 | (0.1) | 0.0 | 0.1 | |
| PER | x | | | nm | nm | nm | |
| OCFPS | Acps | 0.3 | 0.8 | 0.1 | 0.2 | 0.3 | |
| CFR | x | | 19.4x | 7.9x | 6.8x | | |
| DPS | Acps | | | | | | |
| Dividend Yield | % | | | | | | |
| BVPS | Acps | | | 8.3 | 8.0 | 8.0 | |
| Price/Book | x | | | 0.2x | 0.2x | 0.2x | |
| ROE | % | | | nm | nm | nm | |
| ROA | % | | | nm | nm | nm | |
| (Trailing) Debt/Cash | x | | | | | | |
| Interest Cover | x | | | | | | |
| Gross Profit/share | Acps | 0.3 | 0.5 | 0.1 | 0.1 | 0.1 | |
| EBITDAX | A\$m | 3.7 | 8.8 | 4.3 | 5.3 | 4.5 | |
| EBITDAX Ratio | % | | | | | | |
| EARNINGS | | US\$000s | 2021 | 2022 | 2023E | 2024E | 2025E |
| Revenue | | 22,909 | 28,378 | 20,762 | 18,628 | 15,878 | |
| Cost of sales | | (17,341) | (19,097) | (18,160) | (16,709) | (14,307) | |
| Gross Profit | | 5,568 | 9,281 | 2,602 | 1,918 | 1,571 | |
| Other revenue | | | | | | | |
| Other income | | 769 | 841 | 250 | 250 | 250 | |
| Exploration written off | | | | | | | |
| Finance costs | | (1,906) | (1,113) | (1,047) | (1,009) | (544) | |
| Impairment | | | | | | | |
| Other expenses | | (6,839) | (7,042) | (2,304) | (792) | (785) | |
| EBIT | | (502) | 3,080 | 547 | 1,377 | 1,036 | |
| Profit before tax | | (2,408) | 1,967 | (500) | 368 | 492 | |
| Taxes | | | | | | | |
| NPAT Reported | | (2,408) | 1,967 | (500) | 368 | 492 | |
| Underlying Adjustments | | | | | | | |
| NPAT Underlying | | (2,408) | 1,967 | (500) | 368 | 492 | |
| CASHFLOW | | US\$000s | 2021 | 2022 | 2023E | 2024E | 2025E |
| Operational Cash Flow | | 4,304 | 7,750 | 1,237 | 1,975 | 1,599 | |
| Net Interest | | (1,199) | (1,217) | (1,397) | (880) | (432) | |
| Taxes Paid | | | | | | | |
| Other | | 43 | 144 | 1,000 | 1,000 | 1,250 | |
| Net Operating Cashflow | | 3,148 | 6,677 | 840 | 2,095 | 2,417 | |
| Exploration | | (571) | 0 | (500) | (500) | (500) | |
| PP&E | | (80) | (374) | (100) | (100) | (100) | |
| Petroleum Assets | | (1,066) | (2,264) | (1,000) | (1,000) | (500) | |
| Net Asset Sales/other | | 505 | 0 | 0 | 0 | 0 | |
| Net Investing Cashflow | | (1,212) | (2,638) | (1,600) | (1,600) | (1,100) | |
| Dividends Paid | | | | | | | |
| Net Debt Drawdown | | (4,505) | (5,239) | (4,000) | (4,000) | (4,000) | |
| Equity Issues/(Buyback) | | 7,898 | | | | | |
| Other | | | | | | 1,000 | |
| Net Financing Cashflow | | 2,980 | (5,243) | (4,500) | (4,500) | (3,500) | |
| Net Change in Cash | | 4,916 | (1,204) | (5,260) | (4,005) | (2,183) | |
| BALANCE SHEET | | US\$000s | 2021 | 2022 | 2023E | 2024E | 2025E |
| Cash & Equivalents | | 9,253 | 7,848 | 2,588 | (1,417) | (3,600) | |
| O&G Properties | | 55,522 | 57,016 | 57,016 | 57,016 | 57,016 | |
| Exploration & Evaluation | | 13,379 | 13,238 | 13,238 | 13,238 | 13,238 | |
| Total Assets | | 90,828 | 90,383 | 83,695 | 78,000 | 74,292 | |
| Debt | | 16,697 | 11,870 | 8,000 | 4,000 | | |
| Total Liabilities | | 28,991 | 24,344 | 12,690 | 9,036 | 5,176 | |
| Total Net Assets/Equity | | 61,837 | 66,039 | 71,005 | 68,964 | 69,116 | |
| Net Cash/(Debt) | | (7,444) | (4,022) | (5,412) | (5,417) | (3,600) | |
| Gearing dn/(dn+e) | | | | | | | |
| NET PRODUCTION | | 2021 | 2022 | 2023E | 2024E | 2025E | |
| Crude Oil | kb | 410 | 347 | 279 | 258 | 231 | |
| Nat Gas | mmcf | | | | | | |
| TOTAL | kboe | | | | | | |
| Product Revenue | US\$m | 22.9 | 28.4 | 20.8 | 18.6 | 15.9 | |
| Cash Costs | US\$m | (14.4) | (16.2) | (13.5) | (11.2) | (9.5) | |
| Ave Price Realised | US\$/b | 55.89 | 81.78 | 74.41 | 72.10 | 68.83 | |
| Cash Costs | US\$/b | (35.12) | (46.57) | (48.37) | (43.26) | (41.30) | |
| Cash Margin | US\$/b | 20.77 | 35.21 | 26.04 | 28.84 | 27.53 | |
| RESOURCES and RESERVES | | Reserves | | Contingent Resources | | | |
| kb unless otherwise stated | | 1P | 2P | 3P | 1C | 2C | 3C |
| Proved Developed | Producing | 2,475 | | | | | |
| | Non-Producing | 29 | | | | | |
| Probable Developed | Producing | 631 | | | | | |
| | Non-Producing | | | | | | |
| Possible Developed | Producing | | 812 | | | | |
| | Non-Producing | | | | | | |
| Oil | kb | | | | 21,070 | 117,058 | 211,981 |
| Gas | Bcf | | | | 9 | 66 | 145 |
| TOTAL | kboe | 2,504 | 3,135 | 3,947 | 21,072 | 117,069 | 212,005 |
| EQUITY VALUATION | | Risked Range | | | Low | Mid | High |
| A\$m | | Low | Mid | High | per share | | |
| Reserves | | \$68 | \$85 | \$107 | \$0.05 | \$0.07 | \$0.08 |
| Contingent Resources | | \$71 | \$202 | \$260 | \$0.06 | \$0.16 | \$0.21 |
| | | \$139 | \$287 | \$367 | \$0.11 | \$0.23 | \$0.29 |
| Net Cash/(debt) | | | (\$6) | | | | |
| Corporate costs | | | (\$5) | | | | |
| TOTAL | | \$128 | \$276 | \$356 | \$0.10 | \$0.22 | \$0.28 |

Source: RaaS Advisory, Company data, priced close of trading (9-Nov)



FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

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AFSL 456663

Effective Date: 6th May 2021



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