Research as a Service

Empire Energy Group Ltd

Update Report

Carpentaria – on the road to first gas

Energy

2 June 2023

Empire Energy Group Limited (ASX:EEG) is an oil and gas producer/developer, with onshore Northern Territory (NT) and US oil/gas production assets. EEG has the largest tenement position in the highly prospective Greater McArthur Basin, which includes the Beetaloo Sub-basin. The NT energy basins are fast developing as strategic high-calorific gas bolsters for east coast Australia's future domestic requirements, growing Gladstone LNG ullage and potential supply for Darwin's expanding LNG export terminals, amid funding support from Territory and Federal governments. The updated Carpentaria testing data and reserves upgrades are strongly bullish. Testing data has delivered a confirmed IP30 gas rate of 3mmcfd/1,000m which is the nominal commercial threshold. Importantly, given the high-calorific/low-CO_2 nature of the gas, the threshold flow translates to 3.5TJd - less gas to deliver the required energy content with further optimisation to come. Upgraded Contingent Resources for EP-187 point to LNG scale gas potential sufficient to support an economic case. EEG continues to represent a pure, independent, and highly leveraged exposure to the transformational potential of the NT basins and is firmly on the development pathway. With the regulatory clarity now delivered, the way is clear for EEG to underpin a final investment decision (FID) and first gas over the next 18 months to two years, on an early-mover gas project.

Business model

Empire Energy Group Limited (EEG) is an oil and gas development and production company, focused on maturing its portfolio of onshore, long-life oil and gas opportunities. The key asset is the substantial tenement holdings across the world-class McArthur-Beetaloo basins in the NT where the latest testing and evaluation data further underpins the commercial case in support of an early gas development option. In practical terms, we suggest the company can be considered to be in a pre-development phase, particularly with upgraded resource data, sufficient to underpin economic planning and an accelerated path to first gas.

The data looks increasingly better

Testing at the Capentaria-2H (C-2H) well is complete and the results are very strong. The well has produced an aggregate of 323TJ of high-calorific gas over 127 days of testing, and has confirmed the IP30 commercial benchmark of 3mmcfd/1,000m (3.5TJd). Extrapolating these results to a development well scenario (~3,000m hz) would imply gas output of ~1PJ over the first four months of production and a revenue payback period of around 12 months. There remains significant upside from design optimisation in our view and a high degree of confidence that the data supports commerciality. The recent resource upgrades provide LNG-scale gas potential in EP-187 and first EUR assumptions to highlight the strengthening economic case. FEED studies and environmental applications are underway for next-phase work. We believe the data to be commercially supportive and are increasingly confident a first project can be sanctioned around end-2023, with material de-risking across the portfolio across the next 12 months.

Upgrading the NAV to $916mn ($1.19/share) on lower risk gas

We upgrade our valuation on new testing data and materially higher contingent resources which build confidence in the economic and commercial case. With further re-rating events to come, a project sanction could be delivered by end 2023. We raise our base-case (mid-point) valuation to $916mn ($1.19/share [*previously $0.79/share*]) with an upside case to $1.57/share. The success case at Carpentaria continues to build and could deliver further valuation upside well in excess of our base case.

Share Details

ASX code	EEG
Share price (1-Jun)	$0.20
Market capitalisation	$155M
Shares on issue	773M
Cash (current)	$16.3M
Free float	~47%

Share Performance (12 months)

Upside Case

- Success cases at currently evaluating Carpentaria (-2H, -3H and -4V) wells delivering above-expectation testing data
- Further definition and acceleration of the early-production opportunity
- Securing a binding off-take agreement and/or partner to offset market perceptions of future equity dilution

Downside Case

- Testing results from C-3H fall below expectations
- Capex inflation impacting project returns and potentially slowing progress to first gas
- Continuing financing reliance through equity issues on weaker field data resulting in excessive share dilution

Board of Directors

Alex Underwood	Managing Director / CEO
Peter Cleary	Non-Executive Chair
Dr John Warburton	Non-Executive Director
Louis Rozman	Non-Executive Director
Paul Fudge	Non-Executive Director

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***Analyst holds shares**

Beetaloo Gas On The Cusp

Timing is everything and that's a big week just passed.

The company has released updated Carpentaria testing results and a major resource upgrade. We suggest the data is **quite bullish and points to an accelerating path to commerciality.**

What has been delivered?

In our view -

- Confirmation of the critical commercial flow rates; and
- Material upgrades in contingent resources with:
    - First estimates of the EUR range; and
    - An estimate of 'well locations' required to support the development of the gas resources.

We recognise that the data can still be considered to be somewhat preliminary in nature – the well design (including stimulation programmes) is not fully defined, the number of completed and tested wells is limited and the implied outputs from horizontal completions have been extrapolated.

But we suggest the error envelope around the data is shrinking and the commercial case is becoming more robust.

The pathway is clear, so what's next?

There's still more to come through 2023;

- Return to testing at C-3H;
- Front End Engineering & Design ("FEED"): including engineering, economic modelling, preliminary costings for both capex and opex for an **early-stage development (up to 25 TJ/d) – with the potential to $110-137mn pa of sales revenue per annum in a $12-15/gj market;**
- Subsurface design planning (*finalising well and fracking designs*);
- Securing gas sales and transportation agreements (*discussions ongoing with multiple parties*);
- Financing for pilot (Macquarie Bank credit facility already in place);
- Obtain government approvals: NT Petroleum Production Licence;
- Negotiate Northern Land Council ("NLC") Production Agreement; and
- FID on a first-stage project by end-2023.

Timeline and activities outlined as per EEG Managing Director's AGM presentation (30-May).

The risk continues to unwind

With further encouragement from Carpentaria testing, particularly as the development well design is yet to be optimised and the nominal flow rate threshold for commerciality (on normalisation) having been reached, the infield activity is delivering the technical confidence.

Upgraded contingent resource estimates, with the EUR range, will further underpin FEED studies. We believe environmental applications are underway for next phase work.

With the Code of Conduct in place and implementation of all of the recommendations from the Pepper (Fracking) Inquiry, the regulatory environment looks set.

There are always more boxes to tick but in combination with small companies being exempt from gas price restrictions, the pathway (and roadmap) to first gas looks defined.

More gas at lower risk translates to more value – we upgrade

What the testing data (and C-4V) delivers is more gas certainty across the key EP-187 permit which is the focus of activity.

After adjusting for recent data, we upgrade our valuation range for EEG to $0.96-1.48/share **with a mid-point (base case) of $1.19/share**, noting the closing share price of $0.20/share (1-Jun) represents an 88% discount to the low end of the NAV range and in isolation can be considered a risk weighting of ~78% to our assigned value of the 2C resources.

Given the magnitude of the upgrade:

- **+217%** @ 1C – to 304PJ; and
- **+270%** @ 2C – to 1,739PJ

…attributable to EP-187 only, we have adjusted our valuation methodology to focus on this immediate area of clear economic and commercial interest – effectively ascribing zero value to the Prospective Resources across the remainder of the portfolio.

There is always an intrinsic value to prospectivity, but given the focus of the company will be firmly across delivering a first project based on the Carpentaria potential, targeting end-2023 for a FID, the operating capacity of the company to adequately evaluate the remainder of the portfolio in a timely fashion is limited (refer **Exhibit 2**).

Ascribing even a token value to the potential given the magnitude of the nominal resource (41.6Tcf at 2U) can blur the immediate value opportunity unfolding at Carpentaria.

These 2U volumes are associated with the portfolio ex-EP 187 and ex-Pangaea tenements and represent longer-dated gas potential. The geological confidence level is relatively high on the look-through, but commercial realisation will require extensive drilling campaigns.

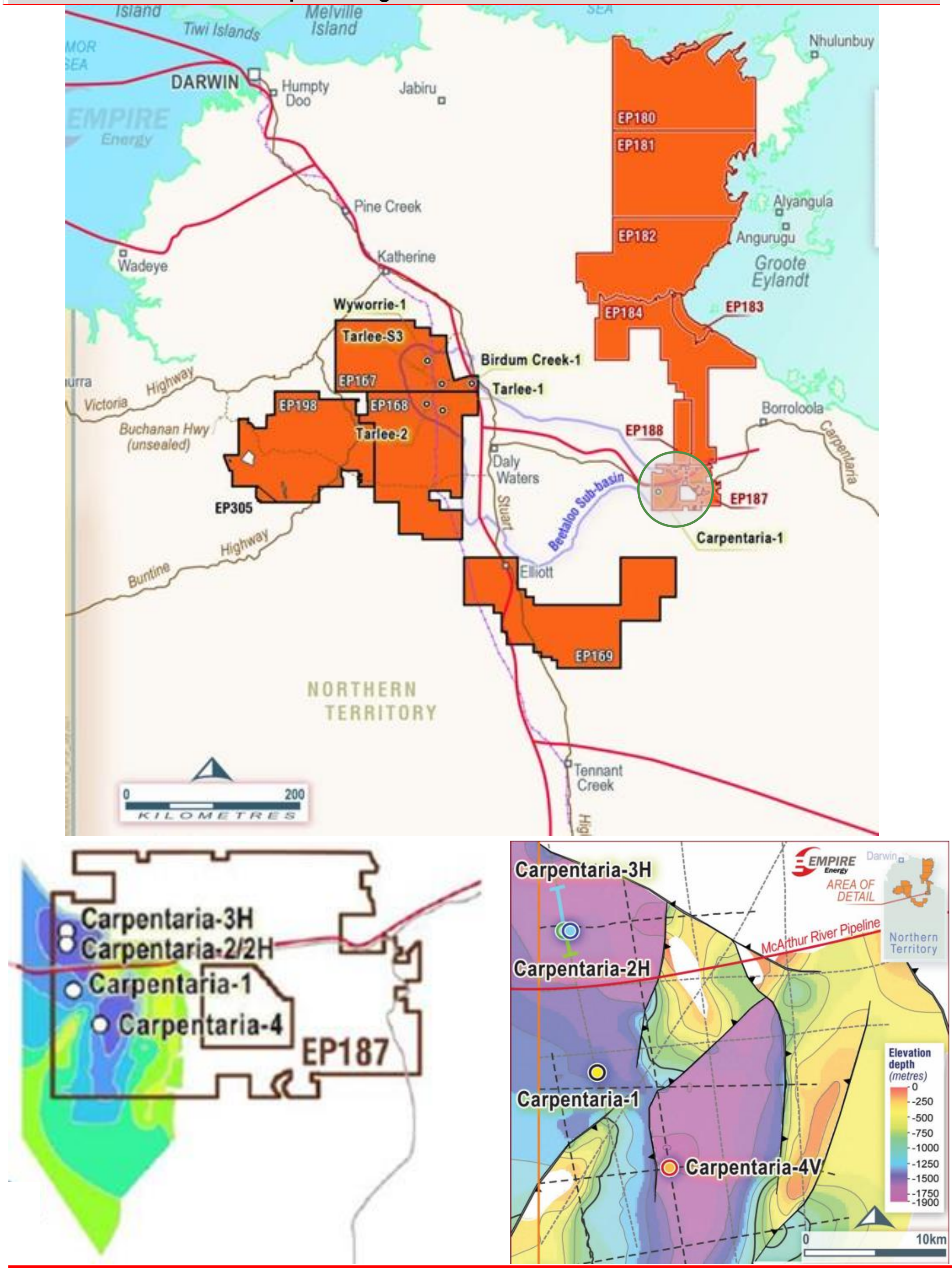
Exhibit 1: Lower-risk gas with flow data – the value resides in EP-187

			Risked range (A$m)			
		Pr	Low	Mid	High	
Northern Territory						
EP-187						
Contingent Resources		30%	$720	$770	$946	2C volumes upgraded to 1,739PJ (from 637PJ) of which 1,364PJ (from 455PJ) are attributed to the immediate Carpentaria Block of which 50% are attributable to the mid-Velkerri B zone.
Prospective Resources		5%	$41	$103	$217	
US Onshore			$27	$38	$42	Lower on a weaker forward curve benchmark.
			$788	**$9119**	**$1,205**	
Net cash/(debt)				$15		
Corporate				($10)		
TOTAL			**$793**	**$916**	**$1,210**	
Shares issued (mn)	773		**$1.03**	**$1.19**	**$1.57**	

Source: RaaS analysis; Risked ranges based on discretionary RaaS risk adjustments

It's interesting to highlight as per commentary from the Managing Director's AGM address (30-May), that the upgraded Contingent Resource estimate represents gas *"…to an LNG scale"*, which is an easier way to consider the context of the opportunity currently in front of EEG.

Exhibit 2: EP-187 is a small part of a greater whole



Source: Company data

The Beetaloo Will Flow Gas – Carpentaria Demonstrates This Is So

The published results pertain to the Carpentaria-2H (C-2H) well, which was tested in two stages with a pause for pressure build up and soaking in between.

- 51 days over Q322;
- 76 days over Q1-Q223; and
- The gas composition remains consistent across the 21 frack stages – ~83% C_1, ~14% $C_{2\text{-}5+}$, <1% CO_2, ~2% other inerts – this is very low CO_2 and high calorific gas

The C-2H well was the first of the lateral tests in this area and was only completed with a c.930m horizontal stage and a somewhat experimental frack campaign which sought to evaluate four different styles.

Exhibit 3: Fracking remains to be optimised – there will be operational improvement

Frack style	Carpentaria-2H No. Stages	Carpentaria-3H No. Stages	
Horizontal completion	927m	2,632m	C-3H fracked over a 2,000 m length
Slickwater	7	3	Fewer slickwater fracks
Crosslinked gels	8	16	
Hybrid (slickwater + crosslinked gels)	4	21	C-3H **preferred methodology**
HVFR (High viscosity friction reduction)	2	Nil	Note - HVFR results are notionally poor
Total Stages	**21**	**40**	

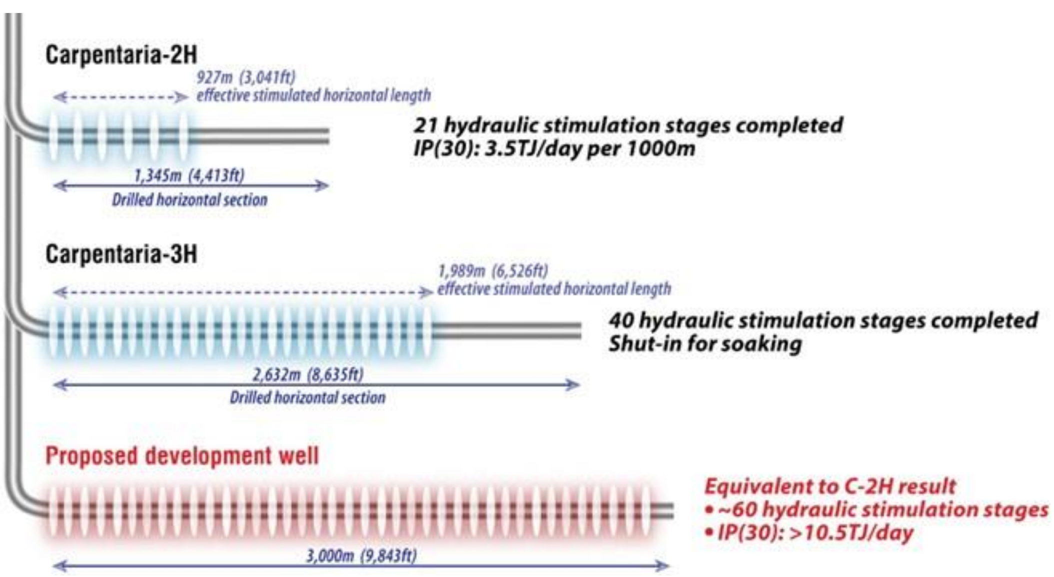
Source: Company data

Without reported contribution data, we can only draw broad assumptions that future wells are likely to use either of, or a combination of hybrid and gel fracks only, given this is where the critical focus was put in the C-3H well after reviewing the C-2H results.

The data makes a bullish case

- Over 127 days, the well produced 323TJ (0.3PJ) of high calorific gas;
- The second stage (post soak) IP30 rate was confirmed at 3.0mmcf/1,000m (3.5TJ) which is the accepted number required to underpin commerciality;
- C-2H has been suspended as a future producer; and
- Extrapolating the results to a development well model (c.3,000m hz section) would deliver output of ~1PJ over an equivalent time frame (127 days).

Exhibit 4: There's still a scale up to deliver



Source: Company data

We acknowledge that up-scaling does not always deliver linear improvements akin to simple extrapolation, particularly where there can be geological variation, but uncertainty in the mathematical scale-up is somewhat offset by the likely material improvements that will be generated from optimising the frack style in any development case.

On that basis we are confident that the C-2H results do represent a realistic operational outlook.

With a return to testing at C-3H (post-soak) we would be surprised if the data is not at least similar to the C-2H estimates, if not better in comparative terms.

On the extrapolated basis the broad economic opportunity can be readily demonstrated:

- ~1PJ at a range of $10-15/gj would generate $10-15mn over the same time frame (127 days), versus a development well budget of ~$20mn on a single well basis.

  On a batched basis, providing economies of scale we'd expect unit drilling costs to be materially lower, perhaps delivering a completed cost reduction of up to 25% (*EEG estimate*).

EEG has used $10/gj which we see as an extremely conservative price assumption given what is happening in spot markets and anecdotally being discussed for term gas.

What should be noted here is that EEG from this point, will be referencing flow rates in energy terms (gj, TJ, PJ) rather than or at least along-side volume estimates (cubic feet), which is more appropriate for the domestic market which trades gas on a contained energy basis and highlights the high-calorific nature of Carpentaria gas.

The higher the calorific value of the gas, the less physical gas is required to sell an equivalent amount of energy and that is a good thing.

Dry, low-CO_2 gas usually converts at a multiplier of 1.055 (gj/mcf) – the EEG data suggests a conversion ratio of 1.15 and on a simplistic outlook, that means 9% more bang for the buck.

There's always a point of caution:

- The data set is not yet deep enough to be absolute (defined type curves etc); and
- The C-3H well is longer and has fewer frack styles so will likely be a nominally better representation of what the end game can look like with further testing to come.

Although one well does not represent an absolutely definitive economic case, we suggest the data can be considered as strongly indicative and clearly at or close to the commercial threshold – we would also note that the current indicative flow rate hurdle, likely references a lower gas price and gj/mcf ratio.

The company has highlighted (AGM Presentation) that the C-2H data was completed without production tubing and *"…free-flowed through 4½" (114mm) casing. Empire is likely to move to 5½ (140mm)"* in a production scenario – a 50% increase in cross sectional pipe area.

The positive side is that the data:

- **Meets the current threshold flow rate**;
- There are **likely material design optimisations** to be delivered;
- **The calorific value adds operating margin** (less gas per energy unit); and
- **It's very low CO_2** (0.9%) – so processing will be relatively easy and for that read inexpensive.

A Material Increase In Lower Risk Gas

Complementing the recent testing data, EGG has released an **updated and upgraded Contingent Resource** estimate for EP187 (only), where all of its Carpentaria, drilling, testing and seismic works have been undertaken over the last couple of years.

Unsurprisingly after the testing data, the upgrades are pretty big:

- **+217%** @ 1C – to 304PJ
- **+270%** @ 2C – to 1,739PJ

…specifically attributable to the areas of interest in EP-187

We had considered that the updated data may have included some modest, initial 'P' estimates given the suite of testing results but Netherland Sewell as the certifiers are known for their conservative rigour and would likely want to see something tangible in terms of an offtake agreement (in principle).

We do comment though, that sometimes the only real difference between certifying gas as a resource [C] versus reserve [P] is a gas agreement – the operational data does lend a high degree of confidence that Beetaloo gas can be produced economically.

In combination with the flow data, **these resource estimates do set a pretty solid and relatively low-risk base for commercial progress.**

What is material and new is the release of and estimated **EUR range** (Expected Ultimate (gas) Recovery/per well) and the number of drilling locations required to fully commercialise the resource estimate – the drilling locations part of the equation provides a flavour for drilling/completion capex over the life of resource.

The EUR's range from 6.2 to 9.3PJ per well.

On a simple metric in a $10 to $15/gj market, these assumptions imply a revenue range of **$62 – 140mn per well** on a current (one-well) cost of around $20mn, but on a batched drilling outcome of (likely) $15mn/well.

Exhibit 5: Context – Projected EURs are sufficient to deliver a material operating margin.

EP187 Contingent Resources	1C	2C	3C	
TOTAL PJ	304	1,739	3,507	
EUR/development well	6.2	7.9	9.3	The range is wide, but >6PJ per well on as a base case should deliver significant operating margin on relatively low unit capex.
Indicative Unit Well Cost				
Pilot Well ($20mn)	$3.23/gj	$2.53/gj	$2.15/gj	
Full Field Well ($15mn)	$2.42/gj	$1.90/gj	$1.61/gj	Batching wells in a full field development is modelled to deliver around a 25% reduction in unit costs

Source: Company data – note that EEG holds EP-187 at 100% working interest

With relatively low unit drilling costs and we'd suggest low cash lifting and processing costs – negligible water and CO_2 issues effectively means raw gas = sales gas, all-in-costs at the well head are likely to be very low.

Exhibit 6: Big resources numbers can translate to a big development – an FID by end-2023?

Reservoir	Unrisked Contingent Resources (100% and Net) Sales Gas (BCF)			Unrisked Contingent Resources (100% and Net) Sales Gas (PJ)		
	Low Estimate (1C)	Best Estimate (2C)	High Estimate (3C)	Low Estimate (1C)	Best Estimate (2C)	High Estimate (3C)
Velkerri C	125	718	1,448	148	852	1,717
Velkerri B	131	732	1,476	156	868	1,750
Velkerri Intra A/B	-	7	14	-	8	16
Velkerri A	-	10	20	-	12	24
Total*	**256**	**1,467**	**2,958**	**304**	**1,739**	**3,507**

Source: Company data

As noted previously, we recognise that the data can be considered to still be somewhat preliminary in nature but we suggest; the data is robust and the error margin reducing.

The 2C estimate includes all the shale zone targets in the sequence (there are four), but the key intervals as recognised are the Velkerri-C and -B shales which represent 99% of the volumes; and with all of the recent works being conducted on the Velkerri-B zone (50% of the total - 868PJ @ 2C), even a very conservative view can translate to a potential NAV well in excess of the current share price (refer **Exhibit 1**).

Exhibit 7: Financial Summary

EMPIRE ENERGY GROUP LTD		EEG		
YEAR END		Dec		
NAV	A$mn	$1.19		
SHARE PRICE	A$cps	$0.20	priced as of close trading	1-Jun
MARKET CAP	A$mn	155		
ORDINARY SHARES	M	773		
OPTIONS	M	10		

nm = not meaningful
na = not applicable

COMMODITY ASSUMPTIONS		2020	2021	2022E	2023E
Realised oil price	US$/b	39.48	67.98	94.25	79.69
Realised gas price	US$/mcf	1.96	3.72	6.42	2.69
Exchange Rate	A$:US$	0.6989	0.7514	0.6946	0.6757

RATIO ANALYSIS		2020	2021	2022E	2023E
Shares Outstanding	M	324	612	773	773
EPS (pre sig items)	UScps		(2.41)	(0.54)	(0.64)
EPS	Acps	(2.73)	(2.41)	(0.54)	(0.64)
PER	x		na	na	na
OCFPS	Acps	(0.61)	(5.35)	37.40	2.60
CFR	x		na	na	na
DPS	Acps				
Dividend Yield	%				
BVPS	Acps	13.4	23.8	23.7	24.4
Price/Book	x			0.8x	0.8x
ROE	%			na	na
ROA	%			na	na
(Trailing) Debt/Cash	x				
Interest Cover	x				
Gross Profit/share	Acps	3.7	5.7	5.9	2.7
EBITDAX	A$M	2.9	3.0	6.7	3.0
EBITDAX Ratio	%				

EARNINGS	A$000s	2020	2021	2022E	2023E
Revenue		6,464	8,502	12,662	7,652
Cost of sales		(5,266)	(5,005)	(8,135)	(5,585)
Gross Profit		**1,198**	**3,497**	**4,527**	**2,068**
Other revenue					
Other income		1,039	1,606	1,927	296
Exploration written off					
Finance costs		(755)	(568)	(677)	(669)
Impairment		0	0	(2,705)	0
Other expenses		(8,682)	(14,332)	(8,511)	(6,817)
EBIT		(7,013)	(11,305)	(1,851)	(3,707)
Profit before tax		**(7,485)**	**(10,835)**	**(3,983)**	**(4,749)**
Taxes		(200)	(213)	(213)	(200)
NPAT Reported		**(7,684)**	**(11,048)**	**(4,196)**	**(4,949)**
Underlying Adjustments		0	0	0	0
NPAT Underlying		**(7,684)**	**(11,048)**	**(4,196)**	**(4,949)**

CASHFLOW	A$000s	2020	2021	2022E	2023E
Operational Cash Flow		**(1,970)**	**(7,044)**	**13,796**	**1,701**
Net Interest		(755)	(568)	(677)	(452)
Taxes Paid		(200)	(213)	(187)	(120)
Other					
Net Operating Cashflow		**(2,924)**	**(2,460)**	**20,082**	**1,356**
Exploration		(856)	0	0	(4,181)
PP&E		(12)	0	(133)	(5)
Petroleum Assets		(12,841)	(12,965)	(54)	0
Net Asset Sales/other		0	0	0	0
Net Investing Cashflow		**(12,841)**	**(24,443)**	**(50,419)**	**(12,000)**
Dividends Paid					
Net Debt Drawdown		(1,845)	(817)	(793)	(500)
Equity Issues/(Buyback)		17,640	39,359	28,928	0
Other					
Net Financing Cashflow		**15,795**	**38,542**	**28,550**	**(500)**
Net Change in Cash		**29**	**11,639**	**(1,786)**	**(11,144)**

BALANCE SHEET	A$000s	2020	2,021	2022E	2023E
Cash & Equivalents		14,146	25,650	24,092	12,948
O&G Properties		46,442	34,900	85,635	97,931
PPE + ROU Assets		1,716	1,306	1,328	860
Total Assets		**66,563**	**158,823**	**207,710**	**207,480**
Debt		7,824	8,027	8,127	7,311
Total Liabilities		**36,327**	**49,502**	**80,240**	**80,067**
Total Net Assets/Equity		**30,236**	**109,320**	**127,470**	**127,413**
Net Cash/(Debt)		6,322	17,622	15,965	5,636
Gearing dn/(dn+e)					

NET PRODUCTION		2020	2021	2022E	2023E
Crude Oil	kb	2	2	2	2
Nat Gas	mmcf	1,630	1,676	1,727	1,727
TOTAL	**kboe**	**273**	**282**	**290**	**290**
Product Revenue	A$mn	6.5	8.5	12.7	7.7
Cash Costs	A$mn	(5.3)	(5.0)	(8.1)	(5.6)
Ave Price Realised	A$/boe	23.64	30.17	43.66	26.41
Cash Costs	A$/boe	(19.26)	(17.76)	(28.05)	(19.27)
Cash Margin		**4.38**	**12.41**	**15.61**	**7.14**

RESOURCES and RESERVES	Contingent Resources			Prospective Resources		
	1C	2C	3C	1U	2U	3U
Northern Territory						
EP 187						
Carpentaria				566	1,282	2,284
East Carpentaria				1,020	1,878	3,782
South Carpentaria				204	383	668
TOTAL PJ				**1,790**	**3,543**	**6,734**
Carpentaria						
Velkerri C	113	666	846			
Velkerri B	120	678	844			
Intra Velerri A/B		8	16			
Velkerri A/B		12	24			
TOTAL PJ	**233**	**1,364**	**1,730**			
Carpentaria East						
Velkerri C	35	185	871			
Velkerri B	36	190	906			
Intra Velerri A/B						
Velkerri A/B						
TOTAL PJ	**71**	**375**	**1,777**			
Aggregate PJ	304	1,739	3,507			
US Onshore						
Gas (bcf)	28	38	42			

EQUITY VALUATION	Risked Range			Low	Mid	High
A$mn	Low	Mid	High		A$/share	
Northern Territory						
EP-187						
Scenario Weighting	720	770	946	$0.93	$1.00	$1.22
Prospective Resources	41	103	217	$0.05	$0.13	$0.28
US Onshore						
Appalachian	27	38	42	$0.03	$0.05	$0.05
	788	**911**	**1,205**	**$1.02**	**$1.18**	**$1.56**
Net cash/(debt)		15				
Corporate costs		(10)				
TOTAL	**793**	**916**	**1,210**	**$1.03**	**$1.19**	**$1.57**
Shares on issue (mn)	773 mn					

Source: RaaS Advisory, company data

FINANCIAL SERVICES GUIDE

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If you have a complaint about our service you should contact your representative and tell them about your complaint. The representative will follow BR's internal dispute resolution policy, which includes sending you a copy of the policy when required to. If you aren't satisfied with an outcome, you may contact AFCA, see below. BR is a member of the Australian Financial Complaints Authority (AFCA). AFCA provide fair and independent financial services complaint resolution that is free to consumers.

Website: www.afca.org.au; Email: info@afca.org.au; Telephone: 1800931678 (free call)

In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

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