Monday, 16 August 2021

RESEARCH REPORT

INITIATING COVERAGE

CORPORATE CONNECT

Calima Energy

Blackspur Acquisition is Transformative

SHARE PRICE & ESTIMATED FUTURE PRICE

12-Month Target*	$0.025
Price	$0.01
Implied Return	150%

*Implied Return

1. Summary

We initiate coverage on Calima Energy ("Calima" or the "Company") on a free cash flow ("FCF") basis with a value of AUD0.025/share.

Calima is an Australian listed exploration and production (E&P) company, and a Canadian oil and gas pure play. Its assets include a large-scale liquids rich gas play in the Montney fairway in British Columbia, a well-established oil and gas producing region with a supportive energy production policy.

On April 30, 2021, Calima completed the acquisition of Blackspur Oil ("Blackspur'). Blackspur was caught out in a poor oil environment while laden with a heavy debt burden and Calima was able to capitalise on the opportunity, acquiring the target at a deep discount of C$61.5m, including C$40.0m in debt. This is against over C$200m invested by Blackspur since inception in 2012. The acquisition is earnings accretive and has raised Calima's status to the realm of a mid-tier, ASX-listed oil producer.

Our one-year price target of AUD0.025/share implies an upside of over 2.5x.

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Company data

ASX code	CE1
ASX price (16 August 2021)	$0.01
Shares on issue	10.2 Bn
Market capitalisation	$97m
Cash on hand	$1.7M[1]
12-month price range	$0.030 –0.012

[1] Cash = Total Cash and Cash Equivalents Per 2020 Cash Flow Statement

Key personnel

Jordan Kevol	MD & CEO
Mark Freeman	Finance Director
Braydin Brosseau	CFO - Canada
Glenn Whiddon	Chairman

Blackspur: Cash flow from re-capitalising oil assets

Blackspur was incorporated in 2012 and grew organically to deliver over 5,000 barrels of oil equivalent per day (boe/d) at its peak in 2018. At the time of the acquisition Blackspur production was ~2,500 boe/d Calima has provided guidance for the combined company for 2021 of 4,500boe/d (exit rate 2021). 2022 guidance has been left unchanged at 5,500 boe/d exit; however, there is an expectation this will be revised upward in the next few months as oil prices continue to increase. As drilling continues to demonstrate success, and with the continued repayment of net debt, Calima is targeting to be nearly debt free before year-end 2022.

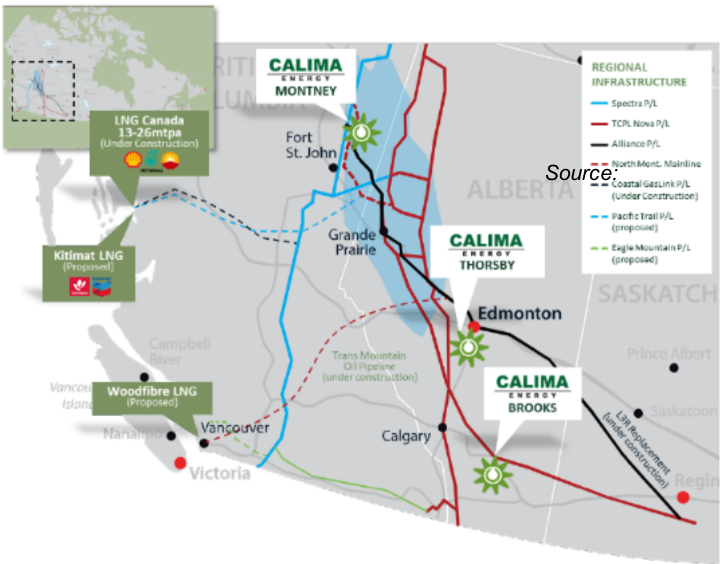
Blackspur offers two shallow-depth producing fields, Brooks and Thorsby, which are both oil weighted (55-72% oil). With average drill/complete/equip costs of C$1.0m to C$2.5m respectively per field. With West Texas Intermediate ("WTI") expected to remain above $45/bbl for the foreseeable future, production is expected to be highly cash generative.

Canada: An established energy market

On a macro level, Canada is a highly established oil and gas market, though in recent years investment has fallen off. The Canadian Association of Petroleum Producers (CAPP) is forecasting an increase in upstream oil and gas investment of 14% in 2021, with capital investment predicted to be C$3.6bn higher this year, reaching C$27.3bn, in alignment with the higher oil prices.

Calima will benefit from strong market fundamentals enhanced by three world-class liquified natural gas (LNG) projects in close proximity to Calima's Montney assets and a robust outlook for oil prices over the medium term.

Figure 1: Map showing position of assets owned by Calima and key pipeline infrastructure



Source:

Contents

Tables

Charts

Financial valuation summary

Table 1: Calima valuation

Financial Year Ended 31st Dec
Calima Energy (CE1)

		Year 2020	Year 2021	Year 2022	Year 2023	Year 2024	Year 2025
Financial & Operating Information							
Assumptions							
Commodity Prices							
Brent Crude Oil Price	**US$/Bbl**	**41.96**	**64.04**	**65.95**	**62.9**	**62.04**	**61.7**
Exchange Rate	**A$/ US$**	**1.34**	**1.34**	**1.34**	**1.34**	**1.34**	**1.34**
Total Share - Oil Production							
Paradise Oil Well	Bopd	23	23	23	23	23	23
Montney wells and Pad 1	Bopd	0	0	0	0	0	0
Montney wells and Pad 2	Bopd	0	0	0	0	0	0
Blackspur - Brooks	Bopd	1512	2160	2520	2646	2947.968	2764.8
Blackspur - Thorsby	Bopd	812	1160	1160	1421	1583.168	1484.8
Total Production - Gas							
Paradise Oil Well	Mmscfd	0	0	0	0	0	0
Montney wells and Pad 1	Mmscfd	0	0	0	0	0	0
Montney wells and Pad 2	Mmscfd	0	0	0	0	0	0
Blackspur - Brooks	Mmscfd	3402	4950	5775	6063.75	6755.76	6336
Blackspur - Thorsby	Mmscfd	3486	4980	4980	6100.5	6796.704	6374.4
Share - Natural Gas Liquid (NGL) Production							
Paradise Oil Well	bbls	0	0	0	0	0	0
Montney wells and Pad 1	bbls	0	0	0	0	0	0
Montney wells and Pad 2	bbls	0	0	0	0	0	0
Blackspur - Brooks	bbls	21	15	17.5	18.375	20.472	19.2
Blackspur - Thorsby	bbls	7	10	10	12.25	13.648	12.8
1P Reserves							
Reserve Replacement Ratio - Oil	%	0%	40%	60%	60%	60%	60%
Reserve Replacement Ratio - Gas	%	0%	40%	60%	60%	60%	60%
2P Reserves							
Reserve Replacement Ratio - Oil	%	0%	40%	60%	60%	60%	60%
Reserve Replacement Ratio - Gas		0%	40%	60%	60%	60%	60%
Net Interest							
Paradise Oil Well	%	86%	86%	86%	86%	86%	86%
Montney wells and Pad 1	%	86%	86%	86%	86%	86%	86%
Montney wells and Pad 2	%	86%	86%	86%	86%	86%	86%
Blackspur - Brooks	%	94%	94%	94%	94%	94%	94%
Blackspur - Thorsby	%	100%	100%	100%	100%	100%	100%

Financial Year Ended 31st Dec
Calima Energy (CE1)

		Year 2020	Year 2021	Year 2022	Year 2023	Year 2024	Year 2025
Financial & Operating Information							
Output							
Valuation Ratios							
P/E (Basic EPS)	x	nm	0.8x	1.8x	1.7x	1.6x	1.7x
P/E (Diluted EPS)	x	nm	0.8x	1.8x	1.7x	1.6x	1.7x
P/OCF	x	nm	0.8x	1.5x	1.4x	1.3x	1.3x
P/FCFE	x	nm	1.2x	5.5x	4.6x	3.6x	3.3x
P/S	x	82.7x	0.5x	0.9x	0.8x	0.8x	0.8x
P/BV	x	0.4x	0.9x	0.6x	0.4x	0.3x	0.3x
EV/Sales	x	98.3x	0.7x	0.4x	0.1x	-0.3x	-0.6x
EV/EBITDA	x	nm	0.8x	0.5x	0.1x	-0.4x	-0.8x
EV/EBIT	x	nm	0.9x	0.5x	0.1x	-0.4x	-1.0x
Per Share Data							
EPS (Basic, Reported)	A$ / cent	(0.30)	1.18	0.55	0.57	0.62	0.58
EPS (Fully Diluted, Reported)	A$ / cent	(0.30)	1.18	0.55	0.57	0.62	0.58
Net Cash Per Share	A$	0.00	0.00	0.01	0.01	0.01	0.02
Free Cash Flow to Firm (Per Share)	A$	(0.00)	0.01	0.00	0.00	0.00	0.00
Free Cash Flow to Equity (Per Share)	A$	(0.00)	0.01	0.00	0.00	0.00	0.00
Margin Ratios							
EBITDA Margin	%	-1211%	82%	80%	80%	80%	80%
EBIT Margin	%	-2389%	76%	73%	69%	67%	65%
PBT Margin	%	-2441%	76%	72%	69%	67%	65%
Net Profit Margin	%	-2441%	53%	51%	48%	47%	45%
Return Ratios							
Return on Equity (RoE)	%	-11%	67%	40%	29%	24%	18%
Return on Assets (RoA, Pre-Tax)	%	-10%	83%	50%	39%	34%	25%
Growth Metrics							
Revenue Growth	%		41283%	4%	9%	12%	-4%
EBITDA Growth	%		2886%	2%	8%	12%	-4%
EBIT Growth	%		1422%	-1%	4%	9%	-8%
PBT Growth	%		1390%	-2%	4%	9%	-8%
Net Profit Growth (Reported)	%		1003%	-2%	4%	9%	-8%
Fully Diluted EPS Growth (Reported)	%		500%	-53%	4%	9%	-8%
Liquidity Ratios							
Cash Ratio	%	99%	650%	962%	1325%	4232%	5833%
Current Ratio	%	105%	750%	1062%	1430%	4502%	6106%
Quick Ratio	%	105%	750%	1062%	1430%	4502%	6106%
Enterprise Value							
Share Price (Current market Price)	A$	0.010	0.010	0.010	0.010	0.010	0.010
Number of Shares Outstanding - Adjusted (Year End)	m	2,191,911,208	10,268,000,000	10,268,000,000	10,268,000,000	10,268,000,000	10,268,000,000
Market Capitalization	A$	21,919,112	102,680,000	102,680,000	102,680,000	102,680,000	102,680,000
Enterprise Value (EV)	**A$**	**25,755,498**	**73,548,848**	**43,262,367**	**6,713,586**	**(39,397,807)**	**(83,975,380)**

Source 1: Corporate Connect

Calima Energy | Blackspur Acquisition is Transformative

Investment thesis

We maintain our positive outlook both on the oil and gas sector and on Calima Resources in particular. Our rationale is summarised in the points that follow:

Management

The management team can make or break a company. In the junior/ mid-cap space the right management team becomes even more critical as these companies generally have fewer resources, less liquid stocks and therefore less margin for error.

More recently, Calima's management team identified a potential target and executed a deal that was immediately earnings accretive, providing shareholders with a producing asset at a deep discount. In essence, the opportunity Calima's management was able to identify in Blackspur was transformative for the Company.

Jordan Kevol, former CEO of Blackspur, has now been appointed CEO of Calima. We remain partial to this appointment as it creates continuity for Blackspur's projects and a smooth integration of Blackspur into Calima.

Oil and gas sector

The oil and gas sector was particularly hard hit in the first half of last year at the height of the Covid-19 pandemic. Prior to this, the sector had been battling severe under-investment with annual production declining at a rate of 6-7% for the last five years.

Notwithstanding the global drive towards cleaner fuel sources, any commodity that is downtrodden has only one way to go. As of 21 June 2021, the price of WTI was at was at 73.66/bbl, representing an increase of 81.42% year on year (y.o.y). While the price has since pulled back to under $70/bbl, we forecast that Brent Crude oil prices will remain above $62/bbl over our forecast horizon.

Valuation

Our assessment is that Calima is trading at 150% discount to fair price when valued on a DCF basis. When` considered against its peers we note that, on an EV/1P basis, Calima is trading at a 15.9 multiple when calculated on a Net Asset Value (NAV) basis, which compares to its ASX-listed peers who trade at an average of 15.9. When taking into account Calima's net debt, this multiple drops to 7.5, which is below its ASX-listed peers who have an average Enterprise Value/Proven Reserves (EV/1P) multiple of 11.6. When considering Calima on an Enterprise Value/Proven and Probable Reserves (EV/2P) multiple, the results confirm that Calima trades at a discount to its peers.

There is not sufficient publicly available information to conduct an NAV or Sum of the Parts valuation. But another value consideration is that Calima acquired Blackspur for a total consideration of $C65.1m, including the debt, whereas the company had already spent over $C200m on developing the facilities and production.

Cash generative

Calima can respond to rising energy prices by accelerating its drilling programs due to Blackspur's ability to convert wells from spud to on-stream in one to three months. The combination of a strong balance sheet, a rising oil price environment and low-cost producing assets gives Calima an estimated payback period for its type wells of around six months at an oil price of $60/bbl.

ESG compliance

Calima has an investment in H_2Sweet, which boasts an innovative proprietary regenerative hydrogen sulphide removal process. With this technology, Calima currently has lower carbon dioxide (CO_2) emission rates at Brooks and a realised positive economic and environmental benefit. Calima looks to advance the commercialization and sale of this technology to other operators.

Blue sky potential

Calima is well diversified in terms of its projects and the timing of its developments. For example, its Montney project has over 60,000 acres of rights in the liquid-rich part of Northeast British Columbia. As a development asset, we consider this project as an "out of the money" option. We do, however, acknowledge that the Montney region is becoming strategic for gas due to the construction of Canadian LNG. Furthermore, there are another three potential LNG export facilities: Woodfibre and Ksi Lisims: with Pieridae proposed on the east coast, Calima's assets could become a strategic play and an attractive proposition for a prospective buyer.

2. The new Calima

Strong cash generative potential

The Covid-19 pandemic has had a profound effect on many industries, but it may be argued that no industry has been so profoundly affected as the oil and gas market. Indeed, the oil world has become accustomed to shocks over the years. In fact, 2020's price collapse was the third in 12 years! However, none of these shocks hit the industry with quite the ferocity as we witnessed last year.

Pressure on oil came from all sides: a decline in global oil demand as the pandemic slashed fuel consumption, especially in the transport sector. This was further aggravated by a supply shock due to the end of restraints on production from OPEC producers and Russia (OPEC+) and poor capital discipline, which contributed to an excessive supply of share, poor returns and a major shake out and consolidation.

To this end, Calima management's fiscal discipline and patience is to be applauded as these characteristics enabled the company to acquire Blackspur- an oil-weighed, mid-cap producer that was caught out by an over leveraged balance sheet in a dismal oil market.

The acquisition was earnings accretive and offers significant upside potential for Calima investors. Furthermore, it provides Calima's management with significant operational flexibility to respond to rising energy prices in the following ways:

- Exposure to the rising oil price and the North American gas market, which is also trending higher to north of three dollars
- Enabling Calima to respond to rising energy prices by accelerating its drilling programs, due to Blackspur's ability to convert wells from spud to on-stream in one to three months
- Blackspur's low breakeven ($26 WTI) and low production cost provide robust operating netbacks, driving significant operating profit and generating free cash flow
- With a strong balance sheet and increasing cash flow, Calima could act as an asset consolidator in the region that, for the last few years, has been underfunded
- Calima's once primary asset, the Montney, can now take its place as an "out of the money" option. Prior to the acquisition, Calima was only producing from its Paradise well and owned a development ready asset, the Montney asset in British Columbia. Now, as the company is accelerating its production, the Montney gives shareholders a liquids-rich, gas-weighted option play for free as we do not price it into our valuation.

Pennies on the dollar

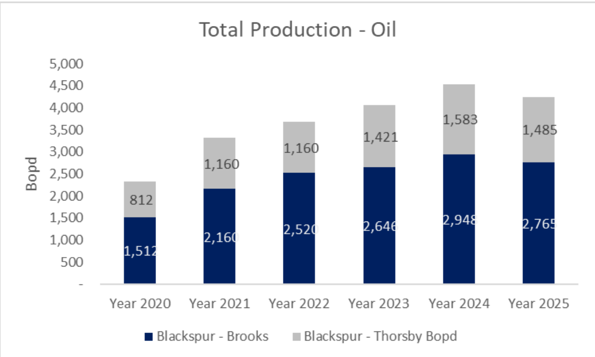
At the time that Blackspur was acquired, the company had already spent over C$200m on corporate and asset acquisitions, infrastructure, drilling and completion of wells, undeveloped land, and seismic. Blackspur had previously produced more than 5,000 boe/d from its oil-weighted assets (Q3 2018). In the end, Calima bought Blackspur for pennies on the dollar – a total consideration of C$61.5m at a time when the oil price was less than half of what it is today.

The sharp increase in oil prices allowed Calima to raise A$38m. The lion's share of this capital has been used to pay down Blackspur's debt, unburdening the company's balance sheet. The combination of a strong balance sheet, a rising oil price environment and low-cost, producing assets gives Calima an estimated single well payback period of around six months. For the believers that oil could head back to $100/bbl, this would reduce the well payback period to a mere three months.

Production guidance for Blackspur at YE 2021 is at 4,500boe/d, revised upwards from the initial 3,400boe/d. 2022 guidance has been left at 5,500boe/d, but there is expectation that this will be revised upward in the next few months as oil prices continue to rise, drilling success and continued paydown of debt, with a target to be below C$5m by end of 2022.

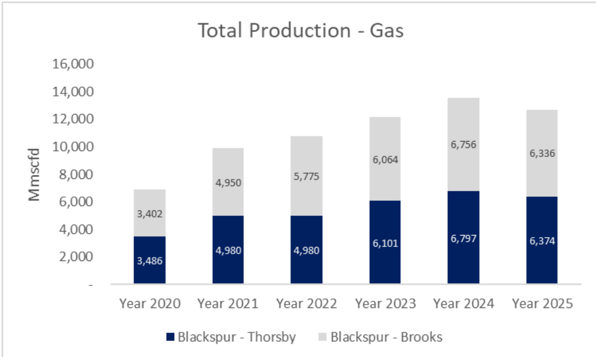
This means that Calima is expected to grow cash flow quickly. As such, we are factoring higher production rates going forward and growing 2P reserves at a rate of 40-60%p.a.

Chart 1:Oil production outlook for Blackspur



Source 2: Calima Management, Corporate Connect

Chart 2: Gas production outlook for Blackspur



Source 3: Calima Management, Corporate Connect

Brooks asset overview

Calima's Brooks asset has significant infrastructure with year-round access. Its land mass is 53,093 acres across 83 net sections. At the time of acquisition, 48 wells had been drilled from two of its formations, the Sunburst and Glauconitic formations. Total production at the time of acquisition was 1,860boe/d (>70% oil), with Sunburst accounting for 1,100boe/d and Glauconitic the remaining 750boe/d.

The Sunburst Formation represents a significant catalyst due to its shallow formation depth and the fact that Blackspur has its own dedicated self-owned and operated infrastructure. **The operating expense (OPEX) cost base is estimated at ~C$10/boe at a capital expenditure (CAPEX) of less than C$1m per well with the ability to be drilled in a week** and without necessitating hydraulic fracturing, which would add to the costs. Brooks infrastructure has the capacity to process up to ~7,000bbl/d of oil.

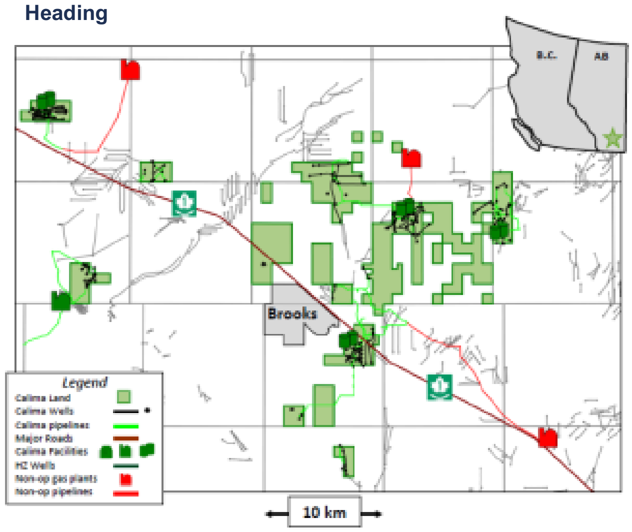
The Glauconitic Formation has sands with greater variation in thickness and is lower reservoir quality than its Sunburst counterpart. It does require hydraulic fracturing and, therefore, costs C$2.2m but recovers 20% more volume than Sunburst.

One hundred and forty-seven wells have been identified at Brooks which will drive growth going forward. Of these, 35 wells have already been booked including 16 in Sunburst and 17 in Glauconitic Proven Undeveloped Reserves (PUDs) with three new Sunburst wells already having been drilled in the first quarter of 2021 and another four Sunburst wells drilled after the acquisition in the second quarter of 2021.

Table 2: Brooks' reserves as at 31 Dec 2019

Reserve Detail (mboe)	
PDP	3,352
Proved Undeveloped	5,720
Total Proved	**9,072**
Total Proved & Probable	**11,621**

Heading



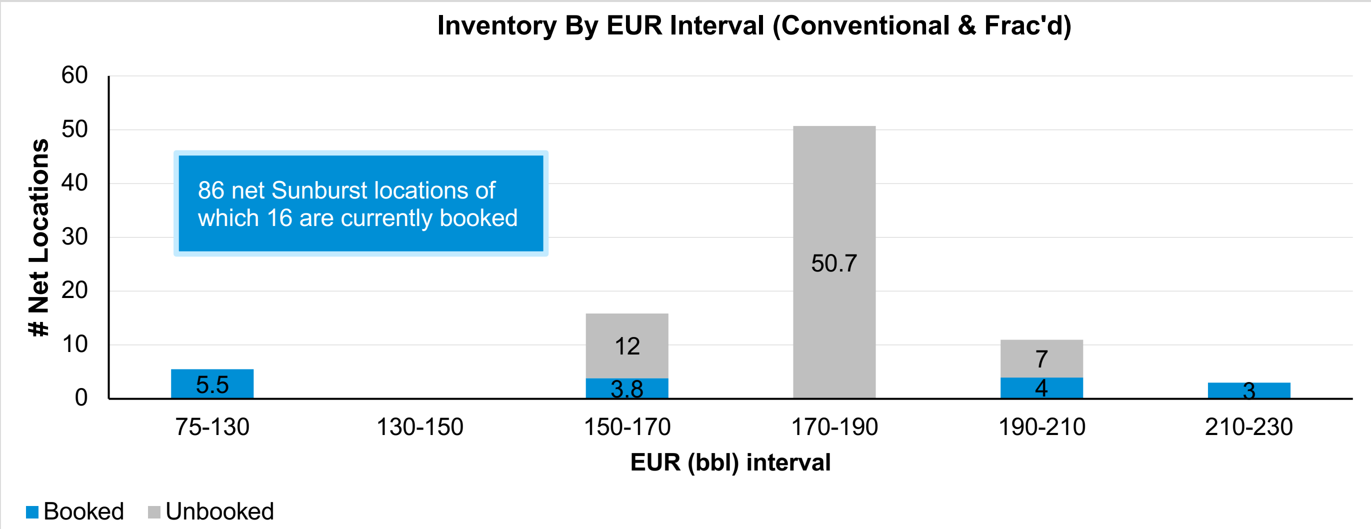
Source / Notes

"500% rate of return, very economic, very quick turnaround.

We can get these wells into production within 30 days and therefore Sunburst is our focus in the Brooks area and is the entirety of our [June/July] drilling program."

Brooks Economics

Inventory by EUR Interval



Source: Calima Energy

Brooks Economics

			Sunburst Well	
			Conventional	Frac'd
			$60 WTI	$60 WTI
Resource	EUR-Oil & Liquids/Well	Mbbl	168	198
	EUR-Gas/Well	MMcf	301	275
	Total EUR	Mboe	218	81%
	% Liquids (Oil & Gas)	%	77%	17%
Economics	Ave Royalty Rate	%	17%	17%
	Capex/Well	$M	C$1,000	C$2,200
	F&D	$/boe	C$4.59	C$9.04
	BTAX IRR	%	>500%	92%
	BTAX NPV10	$M	C$3,245	C$2,752
	P/I 10%	x	3.2	1.3
	Payout	Years	0.5	1.2
	IP90 Oil (Wellhead)	Bbl/d	139	148
	Netback (Yr 1)	$/boe	C$34.04	C$37.42
	Recycle Ratio	X	7.4	4.1
	Breakeven to WTI	US$/bbl	$30.82	$35.31

Source: Calima Energy

Thorsby asset overview

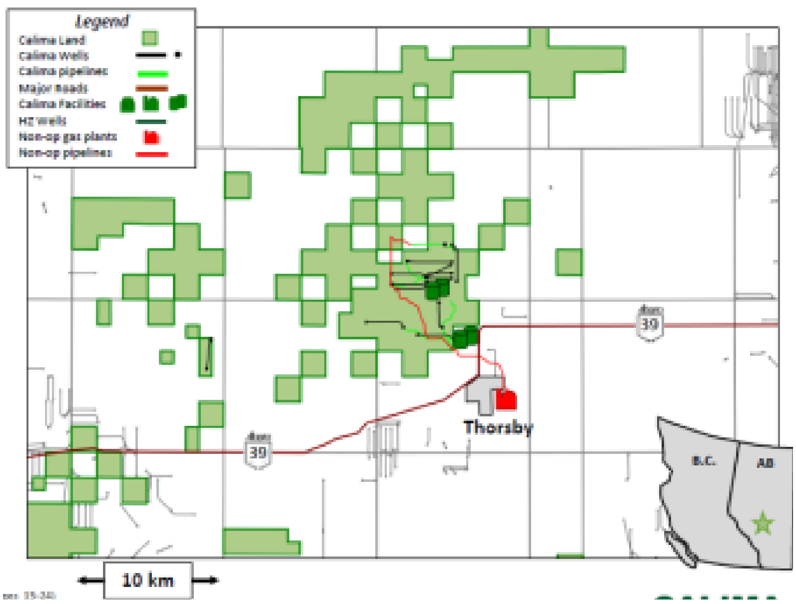
The Thorsby asset is 78% weighted towards oil and comprises 108 net sections that will be developed through a network of multi-well pads, targeting the Sparky Formation. To date, Blackspur has drilled 11 wells in this area, averaging 3,400m measured depth(MD). The Sparky Formation typically requires multi-stage fracturing bringing the drilling and completion cost to around C$2.5mm per well.

More than C$5mm has been spent in developing infrastructure on the Thorsby property. Production capacity of the Blackspur infrastructure is 3,000 bbl/d with current production at 850 boe/d.

Table 3: Thorsby's reserves

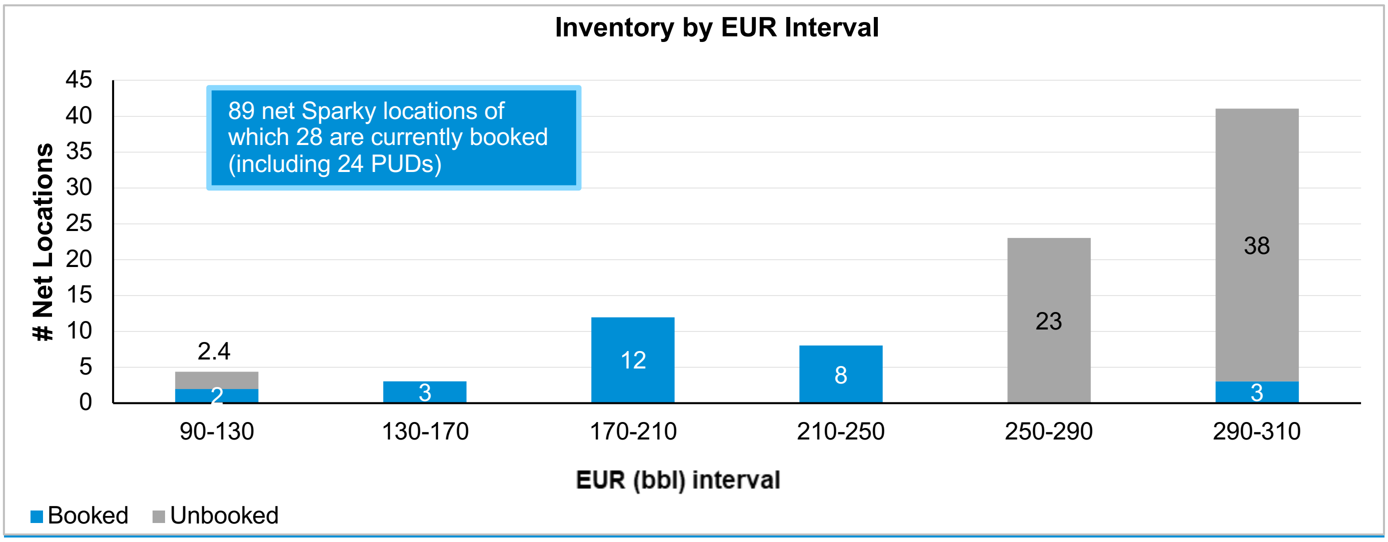
Reserve Detail (mboe)	
PDP	2,071
Proved Undeveloped	5,554
Total Proved	**7,625**
Total Proved & Probable	**10,893**

Figure 2: Thorsby land map



Source: Calima Energy

Thorsby Inventory by EUR Interval



Source: Calima Energy

Thorsby Economics

On the 19th of August, Calima updated their economics for Sparky Wells. The payback period is 5-10 months and the NPV at 10% is ~C$6.5 - $8.8 million. Well economics are summarised below:

			Sparky Type Curve Economics		
			Tier 1 (a)	Tier 2 (b)	Illustrative 40 T/Stage (c)
			$70 WTI	$67 WTI	$70 WTI
Resource	EUR-Oil & Liquids/Well	Mbbl	318	283	360
	EUR-Gas/Well	MMcf	543	412	614
	Total EUR	Mboe	409	35200%	46200%
	% Liquids (Oil & Gas)	%	78%	80%	78%
Economics	Ave Royalty Rate	%	17%	17%	17%
	Capex/Well	$M	C$2,500	C$2500	C$3,200
	F&D	$/boe	C$6.11	$7.11	C$6.93
	BTAX IRR	%	>500%	442%	270%
	BTAX NPV10	$M	C$7,810	C$6,516	C$8,772
	P/I 10%	x	3.1	2.6	2.7
	Payout	Months	5	6	10
	IP90 Oil (Wellhead)	Bbl/d	336	274	460
	Netback (Yr 1)	$/boe	C$42	C$43.5	C$41.2
	Recycle Ratio	X	6.9	6.1	5.9
	Breakeven to WTI	US$/bbl	US$34	$35.10	$33.22

Source: Calima, updated 19 August 2021

H_2Sweet – a useful ESG angle

Calima and Macrotek, a global fabrication innovator, have a joint venture (JV) called H_2Sweet, which was incorporated in 2019. The JV has a product (the Sulfcat ® system) that is a process to remove hydrogen sulphide (H_2S) from oil and gas production at a more economical cost than competing technologies. H2Sweet is also said to enable Calima to lower its CO_2 emission rates at Brooks and realise positive economic and environmental benefits.

From the H_2Sweet website (https://www.h2sweet.ca/), it appears that the technology has only been deployed internally at Blackspur, which was met with immense success. We are cognisant of the fact that the desulphurisation processes is a billion-dollar annual market per year. Breakthroughs and research into improvements in these processes are rare. As such, the long-term vision for H_2Sweet is to deploy this process in global oil and gas companies and become a meaningful player in this market.

We have not included this optionality in our valuation as it is at an early stage. However, the book value for the company is estimated at C$0.4m and little capital investment is anticipated. As such, H2Sweet could provide a nice enticement for Calima and fetch multiple times its book value if commercialised successfully. Otherwise, it will continue to offer Calima's assets a way to reduce its carbon emissions in a cost-effective way.

Hedging strategy – limiting downside risk

Following the acquisition of Blackspur, Calima implemented a hedging strategy. We see this as a positive sign that management is not speculating on the oil price. Furthermore, the hedging position is consistent with the company's policy of covering larger capex with covered amounts for crude oil.

The hedging in place for the remainder of 2021 includes 200kbbl WTI swaps at at an average price of C$62.50/bbl, and Western Canadian Select (WCS) differential swaps on 276mbbl at an average differential of (C$17.73)/bbl, which has a negative impact of C$2.4m. There is also 500mmcf of gas hedged at an AECO price of C$2.70/gj, which has a negative impact of C$0.3m.

The hedging in place for 1H 2021 includes 164kbbl WTI swaps at at an average price of C$76.75/bbl, and WCS differential swaps on 237mbbl at an average differential of (C$17.38)/bbl, which has a negative impact of C$2.4m. There is also 500mmcf of gas hedged at an AECO price of C$2.70/gj, which has a negative impact of C$0.3m.

Despite the price of crude being north of $70/bbl, we see the hedging strategy as positive as it protects the downside. Calima benefits from a low breakeven price of $26/bbl WTI in a low-priced oil environment.

"As decisions are made to drill more wells, the Company will protect the capital on each well by executing hedges on expected cumulative production that is required to achieve payback on the capital invested. Both Sunburst and Sparky wells have payback periods of six to nine months.

In addition, the Company will progressively layer in WTI and WCS swaps to the extent that approximately 50% of forecast production for the forward 12-month period is protected with fixed price terms, thereby ensuring robust netbacks at current prices, while still maintaining upside exposure to rising energy prices."

The Montney – an oil-weighted option

Background

Calima was incorporated as an exploration company that was focused on the Montney Formation. The key attraction of this asset was that the siltstone formation was thicker than most other opportunities in North America and saturated with oil and gas. This makes it amenable to multi-stage hydraulic fracturing and recent advances has made it possible to develop these siltstones. Once developed this asset could become the most active oil and gas play in Canada.

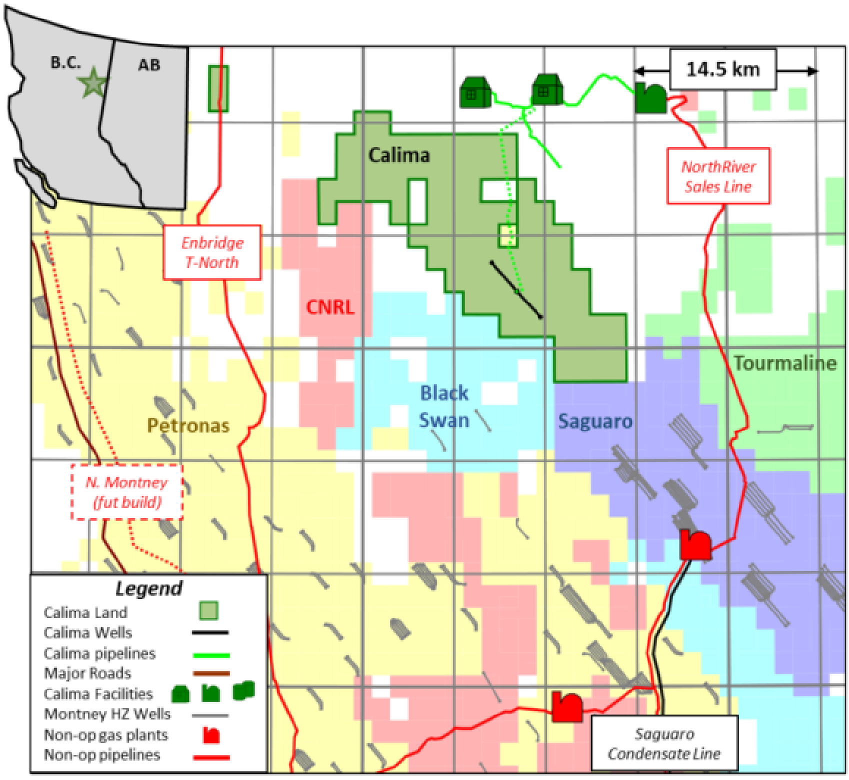
What does Calima have?

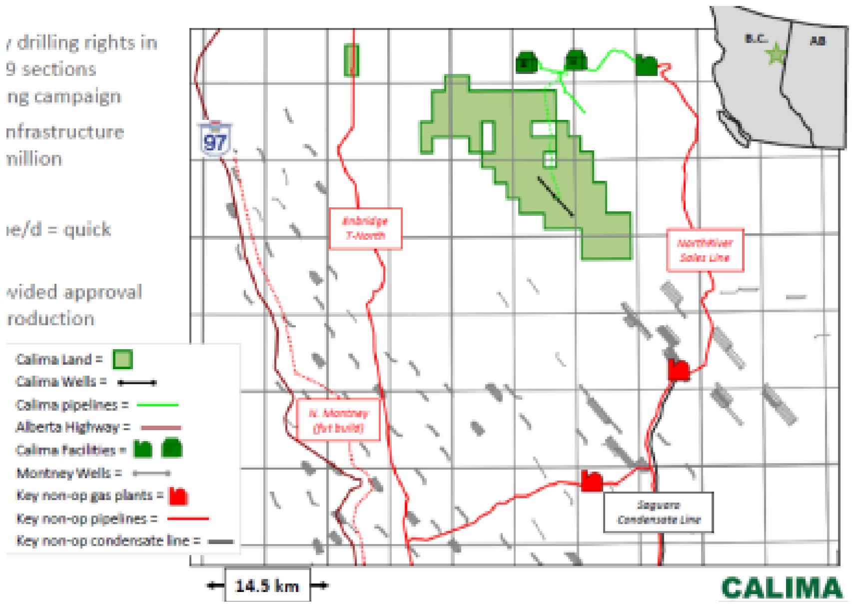
Calima has over 60,000ac of Montney rights in the liquid-rich part of Northeast British Columbia. It is a land play, assembled between 2014 and 2018, which through a successful drill program in 2019 enabled Calima to convert 60% of the core acreage into ten-year leases.

Calima's management refers to its Montney project as a "development ready" asset. It has the approvals to construct and operate a multi-well production facility, which includes the permit to construct a pipeline connecting the Calima well-pad with the regional pipeline and processing infrastructure. It is envisioned that the pipeline will connect both the existing and future Calima wells to the Tommy Lakes infrastructure (also owned by Calima), with a capacity to transfer up to 50mmcf/d of liquids rich gas and 1,500bbl/d of wellhead condensate.

The company estimates the replacement costs of these facilities at $C85.

The project boasts a large resource, mostly of the prospective variety.





Montney Resources

	Prospective Resource	Contingent Resource (2C)		
		Dev on hold	Dev Pending	Total Contingent
Natural Gas (mcf)	1,677,610	638,220	248,401	886,621
Total Liquids (mbbl)	83,896	31,997	12,442	44,339
Total BOE (Mbbl)	363,498	138,267	53.542	192,109

Source: Calima Energy

The Contingent Resource (2C) will be elevated to "development pending" once funding is secured and will all be categorized as 2P reserves. The Estimated Ultimate Recovery (EUR) is 8.4bcf per well which yields 50 bbls per Mmcf of high value liquids.

Significant corporate activity

Beyond Calima, the Montney Formation is an extremely active oil and gas formation. Over the last 12 months, six significant merger and acquisition (M&A) activities have occurred, with combined investment of over $C10.5bn, including Calima's immediate neighbours, Blackswan/ Tourmaline, CNRL and Saguaro. We summarise some of the transactions below:

- Tourmaline - C$1.1bn +purchase of Black Swan as well as C$85m purchase of acreage from Painted Pony, Polar Star and Chinook
- CNRL's C$461m purchase of Painted Pony
- Saguaro's 50% sale of its production, assets and facilities to Tourmaline for C$205m.

The natural question is whether Calima's project also has the potential to be bought out since it's in such close proximity to these deals.

Management has been actively seeking a JV partnership to help develop the asset or, alternatively, to be bought out. We believe this asset should be treated as an "out of the money" option. The reality is, due to the recent shake out of the Canadian oil industry, companies can pick up producing and near-producing assets for pennies on the dollar. It does not make reasonable business sense for consolidators to acquire a development asset in this environment. As such, we have not priced this asset into our valuation. We acknowledge that the valuation might have significant upside risk potential if management was somehow able to monetise the Montney asset.

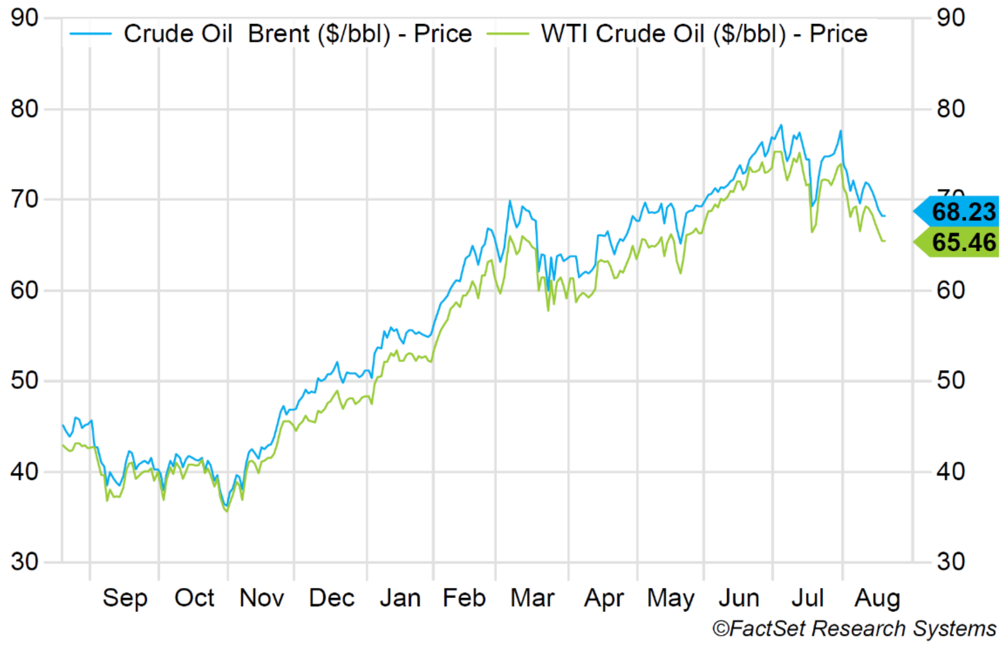
Notwithstanding the above, we do acknowledge that the Montney region is becoming strategic for gas due to the construction of Canadian LNG. There are another three potential LNG export facilities: Woodfibre and Ksi Lisims: with Pieridae proposed on the east coast, Calima's assets could become a strategic play and an attractive proposition for a prospective buyer.

3. Sector analysis

The oil and gas market

In 2020, oil took the prize as the worst-performing commodity, even falling behind coal. From June 2020, the Brent oil price benchmark had been hovering at $45/bbl and was unable to break the $50/bbl barrier until finally it did at the beginning of 2021. Oil and gas are a depleting resource that had suffered an annual production decline rate of 6-7% for the last five years. Add to this five years of low capital spending and investments with capex expenditure having fallen 23% y.o.y in 2020. The result is that we are now faced with an industry characterised by severe underinvestment, reflected in this latest price rally. **As of 21 June 2021, the price of Brent Crude was at 74.49/bbl, representing an increase of 65.5% y.o.y.** The price has since come back to below $70/bbl, which was to be expected as OPEC negotiations were finalised and the economy in China started to cool. Our forecasts remain above $62/bbl for Brent Crude for our forecast horizon.

Chart 3: Brent Crude oil price



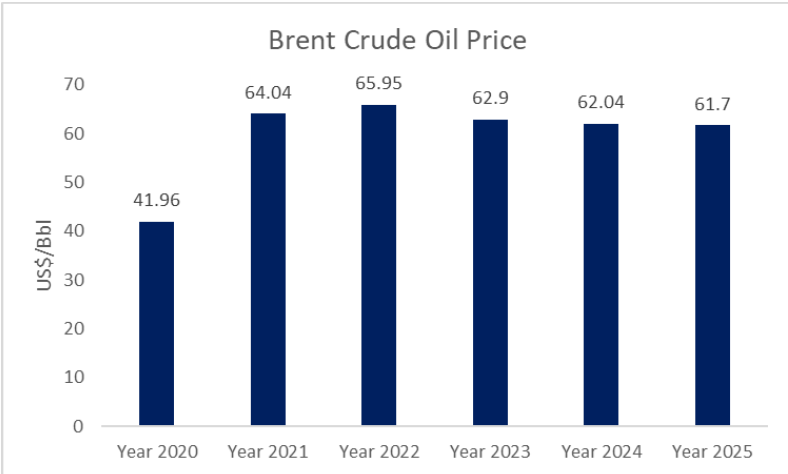
Source 4: FactSet

Since the start of the year, the biggest question mark as to whether the current trajectory would continue was the impasse between OPEC and non-OPEC producers. Now settled, Saudi will increase output by 2m bbl/d from August until the end of the year. Not unexpectedly, oil prices have pulled back sharply, falling 2% on the news of the settlement. On the 18th of August, oil fell to $66/bbl, the lowest level since May.

The COVID Delta variant in areas of low vaccination rates in the US have sparked a potential demand crisis. Add to this the recent announcement that China's plans to cool the economy and the chaotic Taliban takeover in Afghanistan which threatens another migrant crisis has served to keep the dollar in the demand and in turn has put a break on any oil-price rally. The dollar is now at a nine-month high, suppressing dollar-priced commodities.

We have therefore scaled back our oil prices, expecting an average of $64/bbl in 2021 and 66/lb in 2022. Higher oil production in 2H2021 is expected to cause inventory drawdowns to slow, leading to some price pressure in 2022.

Chart 4: Corporate Connect Brent Crude forecast price

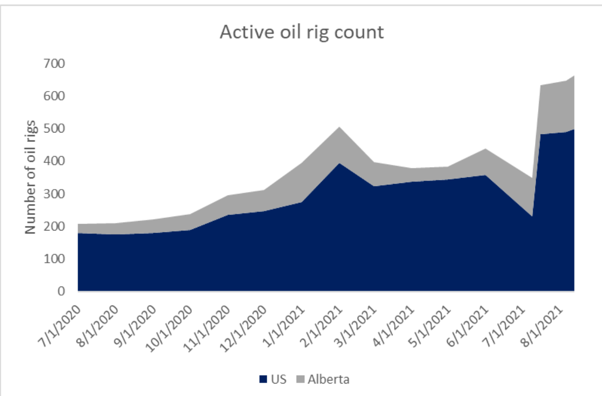


Source 5: FactSet

Following drill rates remains critical to longevity of the positive calls on oil prices. A rising oil environment provides a great incentive for US (and Canadian) producers to increase the pace of their drill programs. During the first week of July, oil production in the US broke 11.3m bbl/day. This was not only due to an uptick in shale, but also from oil drilling in the Gulf of Mexico, which is scaling up from previously low levels.

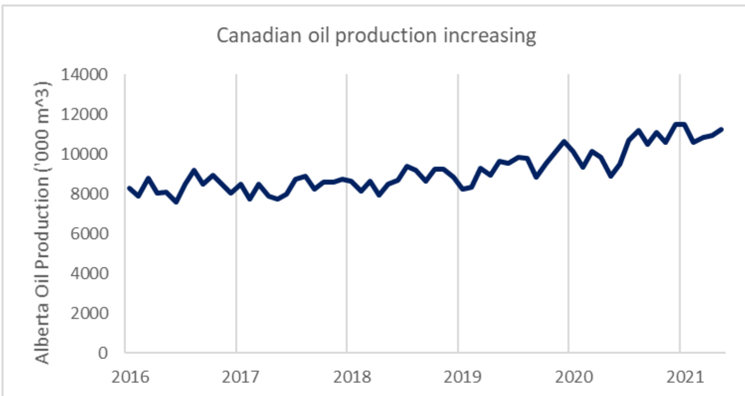
Canada's drilling is rising from a low base led by higher oil prices, which has increased the rate of conversions of 2P reserves to 1P reserves as Canadian oil and gas producers invest in drilling more wells. As of the 13 August 2021, Canada's oil rig count reached 164 (16 July:150), up 5% from the prior week. Similarly, the US oil rig count has increased to 500 (16 July: 484). This means that the absolute production has increased. However, we note that the rate of increase has declined in August compared with July. In July the change the change in a week from the 9th of July to the 16th saw an increase of 27% w.o.w and 110% w.o.w for Canada and the US respectively in the oil rig count.

Chart 5: Canadian and US oil rig count



Source 6: Baker Hughes, Alberta Economic Dashboard

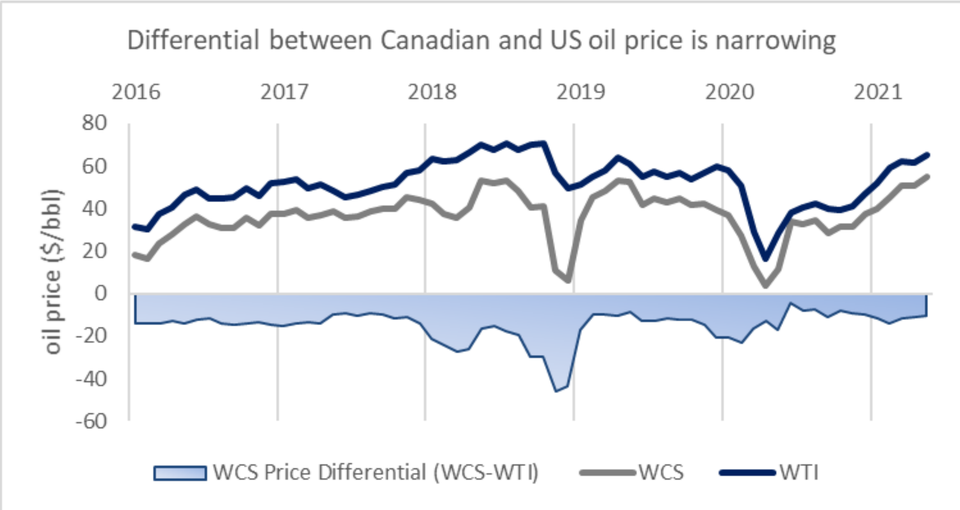
Chart 6: Canadian oil production



Source 7: Alberta Economic Dashboard

The WTI price of oil is often regarded as a world reference, with WCS expressed in CAD$/bbl usually trading at a discount to WTI. We note that the WCS-WTI differential is narrowing, a positive signal that US demand is increasing that, in turn, is leading to rising demand for Canadian oil.

Chart 7: WCS-WTI differential



Source 8: Alberta Economic Dashboard

Risks for Canadian oil market

Way before the 2020 oil crisis, the Canadian oil and gas sector was facing a crisis, spurred by under-investment starting in 2014. As governments plugged the transition to a green economy, more carbon taxes came into play and new regulations were designed to accelerate this transition, which created increased uncertainty in the oil and gas market in Canada, and deterred investment.

The challenges of 2020 are well documented. The year started with a Saudi/Soviet price war, which pushed prices low, followed by an unprecedented response to COVID-19 which sent oil prices into the red.

Right now, the Canadian market is in recovery phase, with M&A activity having picked up markedly. There are still major challenges ahead including the impact of the proposed new Clean Fuel Standard regulations, expected to come into effect in 2022, and the Canadian Government's recently announced climate plan that will see the carbon tax surge from $50 per tonne in 2022, to $170 per tonne by 2030, which could adversely affect the industry and deter investment.

Pipeline capacity constraints remain an issue. However, two export pipeline projects are funded and due to be completed: the Trans Mountain expansion and the Enbridge's Line 3 replacement. Keystone XL remains in jeopardy with the new Biden Administration in Washington. In addition, the $40 billion LNG Canada project is now almost two years into construction, with hopes of opening by 2025.

Uncertainty in Canada's oil industry continues to prevail. However, it is noteworthy that the recent M&A activity has been largely driven by domestic companies using foreign and institutional investors. However, as investor appetite for US shale wanes, the Montney natural gas play could move into the spotlight. In July 2020 ConocoPhillips acquired additional acreage in the Montney from Kelt Exploration, which could be seen as a gradual return of foreign investment into Canada's oil sector.

4. Valuation

We evaluated Calima in two ways, the first method was using fundamental analysis to provide a discounted cash flow valuation and the second method was a relative valuation looking at how Calima is performing relative to its immediate peers. The first valuation method provides clarity on the company's operations and whether it is trading at an inherent discount to the company's true value. The latter approach considers whether a re-rating, relative to peers, is likely imminent.

Discounted Cash Flow Valuation

Results

Potential Increase of 150%

Based on the available set of assumptions, provided in Table 1, the DCF valuation for 2021 stands at A$0.025 (+150%) from the current market price of A$0.01.

Key assumptions and comments

- We have assumed an aggressive CAPEX profile over the forecast period of A$35.3m every year (2022-2025) as the company is still in an exploration stage and would be expected to continue to spend to explore assets. This valuation is therefore sensitive to the capex assumption.

Table 4: Sensitivity of DCF valuation to changes in CAPEX estimates

Sensitivity of DCF Valuation to Changes in Capex Estimates						
0.026		Year 2021	Year 2022	Year 2023	Year 2024	Year 2025
Changes in Capex Assumptions	-15%	0.030	0.034	0.039	0.044	0.049
	-10%	0.029	0.033	0.037	0.042	0.047
	0%	0.025	0.029	0.033	0.038	0.042
	10%	0.022	0.026	0.029	0.033	0.038
	15%	0.021	0.024	0.027	0.031	0.035
	20%	0.019	0.022	0.025	0.029	0.033

Source 9: Corporate Connect

- Calima is generating a lot of operating cash over the next five years because of an average earnings before interest, taxes, depreciation and amortisation (EBITDA) margin of 80%. We believe that this is sustainable as companies in this sector are maintaining these kinds of margins. Woodside Petroleum is a good example of such a company and a good peer comparison.
- For the weighted average cost of capital (WACC), we have applied a new parameter, the “Company Specific Risk Premium”, which is assumed to be 5% since most of the assets held by the company are in exploration stage. This puts our discount rate at 13-14%, which impacts the overall valuation. The WACC falls to 8% without this factor.
- We further use Stern’s market risk premium of 4.7%. There are, however, arguments that for Canadian-based oil companies, this premium should be lower, and a recent paper suggests using a market risk premium of 1.8%. Applying a 1.8% valuation changes the WACC to 9%.

Table 5: Sensitivity of DCF valuation changes in the WACC

Sensitivity of DCF Valuation to Changes in the WACC						
0.025	2020	2021	2022	2023	2024	2025
WACC	8%	0.047	0.051	0.056	0.060	0.066
	9%	0.040	0.044	0.049	0.053	0.058
	13%	0.025	0.029	0.033	0.038	0.042

Source 10: Corporate Connect

Calima Energy | Blackspur Acquisition is Transformative

Relative valuation

Our peer analysis shows that Calima is undervalued on both an EV/2P and an EV/1P reserve basis. Furthermore, Calima presents a compelling offer in both Australia and Canada. Furthermore, as Calima's reserves are oil weighted it presents a greater ability to unlock cash flow compared to some of its peers whose reserves may be gas weighted. The oil to gas ratio is important particularly as oil is on an increasing trend as the volume conversion ratio of oil (bbl/d) to gas (mcf/d) is 6:1, however the price of oil is around 22 times the price of gas.

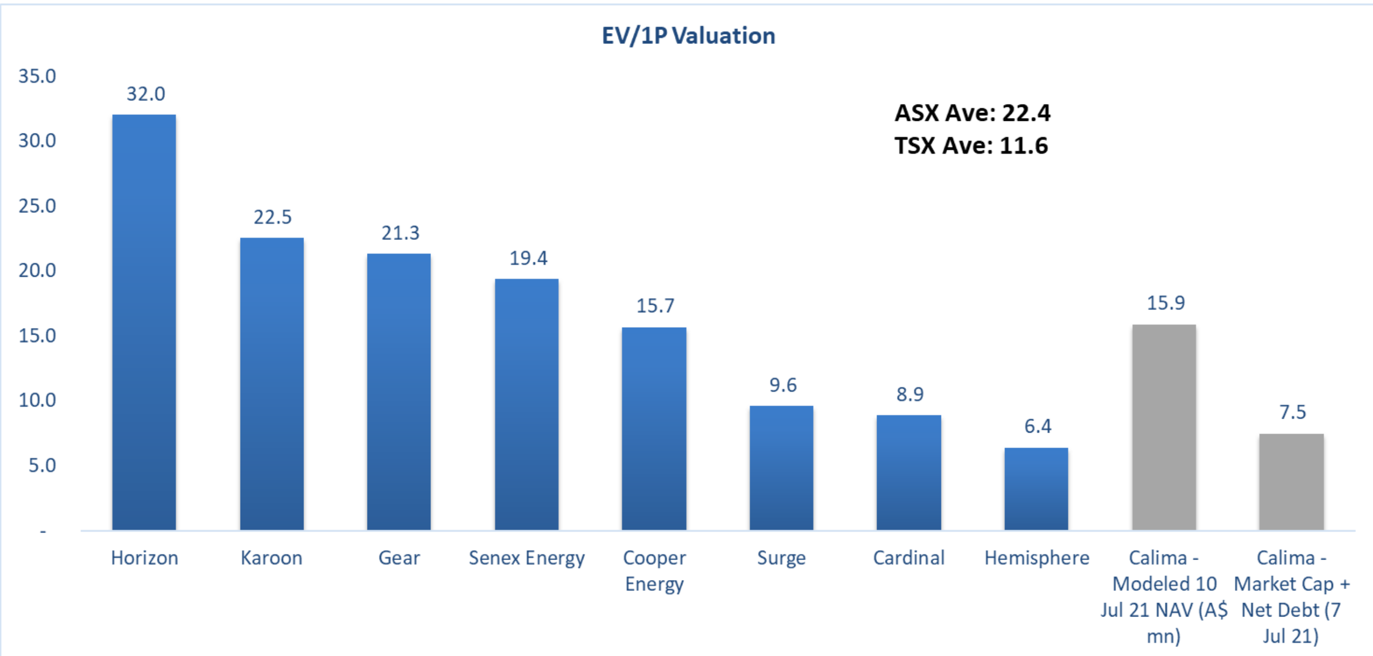
Table 6: Peer comparison table

		'EV (27th Apr 2021)		Reserves & Resources (Mmboe)				Multiples		Production		EV/Production
Company	Market	A$m	C$m	1P	2P	2C	2P+2C	EV/1P	EV/2P	MMboe/pa	boe/d	
Cooper Energy	ASX	592	556	36	50	35	85	15.7	11.1	4.02	11,014	50,526
Senex Energy	ASX	804	756	39	134	10	144	19.4	5.6	3.9	10,685	70,731
Karoon	ASX	767	721	32	36	101	137	22.5	20.0	5.7	15,616	46,168
Horizon	ASX	109	102	3	8	26	34	32.0	12.6		4,100	24,990
Hemisphere	TSX		75	12	15			6.4	5.0		1,685	44,510
Gear	TSX		254	12	21			21.3	11.9		5,875	43,234
Surge	TSX		548	57	82			9.6	6.7		17,000	32,235
Cardinal	TSX		665	75	99			8.9	6.7		18,350	36,240
Tamarack	TSX		1130		162				7.0		21,500	52,558

Company	Market	A$m	C$m	1P	2P	2C	2P+2C	Implied EV/1P	Implied EV/2P	2021 MMboe/pa	2021boe/d	EV/Production
Calima - Modeled 10 Jul 21 NAV (A$ mn)	ASX	265		17	23	192	215	15.9	11.8	1.8	5,023	52,824
Calima - Market Cap + Net Debt (7 Jul 21)	ASX	125		17	23	192	215	7.5	5.6	1.8	5,023	24,905

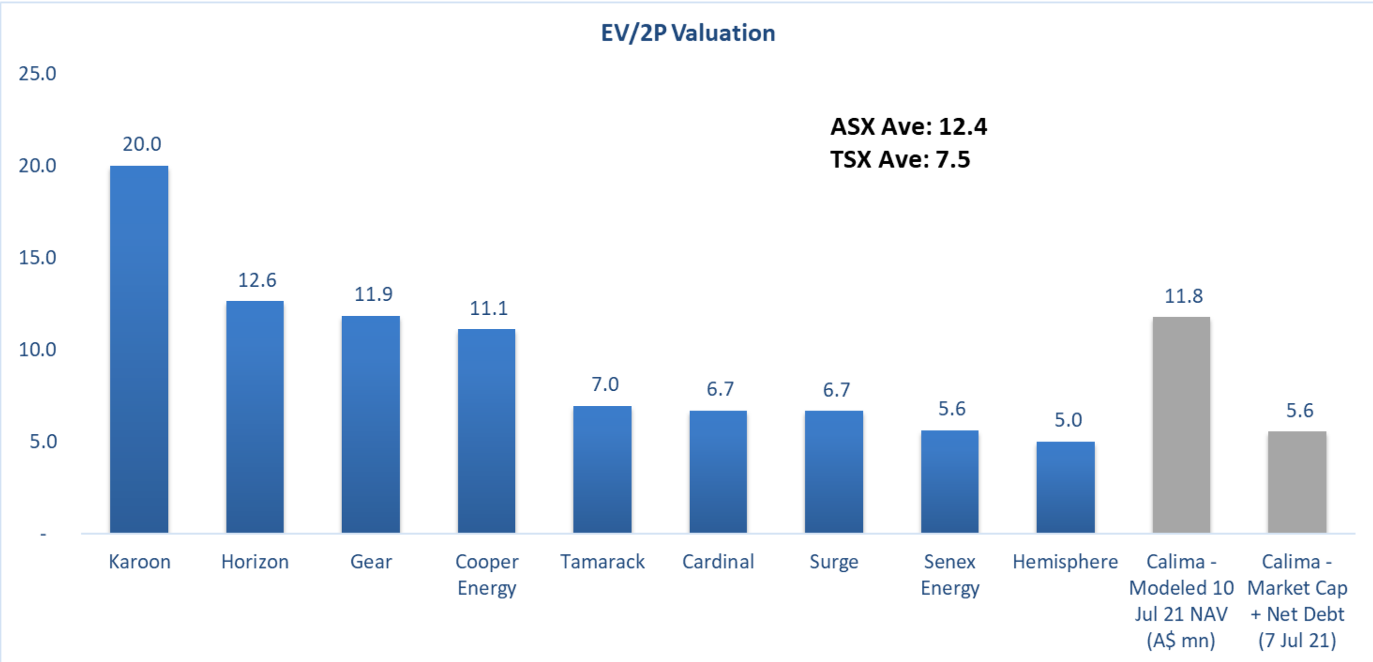
Source 11: FactSet, Company Presentations, Corporate Connect

Chart 8: EV/1P comparison



Source: FactSet, Company Sources, Corporate Connect

Chart 9: EV/2P comparison



Source: FactSet, Company Sources, Corporate Connect

5. Management team

It is always imperative to consider the management team of any business. In the case of a junior oil and gas play, the right management team with a history of being able to return value to shareholders is critical.

With respect to Calima, it is a strong mix of technical skills and financial/capital market experience. We see Mr. Jordan Kevol's appointment as CEO as a positive sign that Blackspur, which is now arguably Calima's *raidon d'etre*, will continue to be run by someone who knows the projects intimately.

Jordan Kevol, CEO	Jordan was a founder of Blackspur and has been the President and CEO since 2012. He has a Bachelor of Science (Geology) with 16 years' public and private Canadian junior E&P experience. Jordan is also a Director of Source Rock Royalties and is the CEO of the merged company.
Glenn Whiddon, Chairman	Glenn was formerly Executive Chairman, Chief Executive Officer and President of Grove Energy Limited, a European and Mediterranean oil and gas exploration and development company, with operations in Italy, Romania, Slovenia, Tunisia, the UK and Dutch North Seas. In 2002 Grove's Market capitalisation was less than C$5 million. In April 2007, Grove was acquired by Stratic Energy Limited, a TSX-listed oil and gas company, for C$150 million.
Mark Freeman, Finance Director	A Chartered Accountant with more than 20 years' experience in corporate finance and the resources industry. He has experience in strategic planning, business development, mergers and acquisitions, North American gas commercialisation, project development and general management. He has worked with several successful public resource companies and since 2015 has been providing strategic advice to TSV Montney Limited. A graduate of the University of Western Australia with a Bachelor of Commerce, Mark also has a Graduate Diploma in Applied Finance from the Securities Institute of Australia.
Braydin Brosseau, CFO Canada	Braydin is a Chartered Professional Accountant, Chartered Accountant, with 15 years' experience in finance, accounting, treasury, tax, strategic planning and M&A. He has worked with a number of public and private E&P and Asset Management companies and been the Chief Financial Officer of Blackspur Oil Corp. since September 2014. Previous experience was also gained at West Valley Energy Corp., Aston Hill Financial Inc., and PwC LLP. Braydin has a Bachelor of Commerce (Distinction) from the University of Saskatchewan.
Brett Lawrence, Non-Executive Director	Brett is a 15-year veteran of the oil and gas industry and has a Master of Petroleum Engineering, a Bachelor of Engineering (Mining) and Bachelor of Commerce (Finance) from Curtin University in Western Australia. He worked with Apache Energy for over eight years, performing roles in drilling engineering, reservoir engineering, project development and commercial management, and has held senior roles in the commercial, financial and corporate arenas with various ASX-listed public companies.
Lonny Tetley, Non-Executive Director	Lonny is a securities lawyer and partner at Burnet, Duckworth, and Palmer LLP with over 15 years' experience in corporate finance and in the oil and gas industry. He serves on the Board of a few companies including Certarus Ltd., Beyond Energy Services & Technology Corp. and Accelerate Financial Technologies Inc. Lonny is also a member of the Private Funds Independent Review Committee of Deans Knight Capital Management Ltd.

6. Terminologies used

Mbbls	=	Thousand Barrels
Mmscf	=	Million Standard Cubic Feet
Mboe	=	Thousand Barrel Oil Equivalent
Bopd	=	Barrel Oil Per Day
Mmscfd	=	Million Standard Cubic Feet Per day
Boepd	=	Barrel Oil Equivalent Per Day
Mmstb	=	Million Stock Tank Barrels
Bscf	=	Billion Standard Cubic Feet

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