Thursday, 4 November 2021

# RESEARCH REPORT

HALF YEAR RESULTS & PRODUCTION GUIDANCE

CORPORATE CONNECT

## Calima Energy

Increasing our Target

**SHARE PRICE & ESTIMATED FUTURE PRICE**

| | |
|---|---|
| 12-Month Target* | $0.71 |
| Price | $0.24 |
| Implied Return | 184% |

*Implied Return

## 1. Summary

**In August 2021, we initiated coverage on Calima Energy ("Calima" or the "Company"), forecasting a value of A$0.025/share which translates to 0,26/share if one accounts for the 20:1 share consolidation completed on the 30th August 2021. The Company's share price has risen substantially from $0.173/share at the beginning of September to $0.25/share on the 11th of October with no sign of stopping.**

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. In addition, Calima acquired Blackspur, a producing oil company which had previously delivered over 5,000 barrels of oil equivalent per day (boe/d) at its peak in 2018.

The goal of Calima Energy is to continue to extract value from Blackspur's two shallow depth producing fields, Brooks and Thorsby, while advancing its exploration asset in the Montney.

### August operational update shows improvements in key financial metrics

Despite the lower realised oil and gas price, which fell by 5.4% and 19.7% respectively in August, Calima managed to show improvement in its key business metrics. Average production improved by 6% m.o.m, while Operating netback, improved by 12% to A$2.8m. While net debt also increased this was only on account of the Leo drilling campaigns as production from the three Leo wells is anticipated to commence in November.

In terms of the average production growth, this is a good result. However, July's 3,291boe/d production was from only two Sunburst wells which contributed for the entire month. Gemini 3, and 4 only started in the middle and end of the month respectively. August therefore had the benefit of the full contribution from the two Gemini wells and the new wells at Brooks.

We expect higher production in November due to the contribution by the new Thorsby wells which will be drilled in August/September which will see Calima meet its 2021 production guidance of 4,500 boe/d.

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**Company data**

| | |
|---|---|
| ASX code | CE1 |
| ASX price | $0.24 |
| Shares on issue (post consolidation) | 514.08M |
| Market capitalisation | $125.9m |
| Cash on hand | $2.24M[1] |
| 12-month price range | $0.12 –0.2750 |

[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 |

**Table 1: August Production and Operational Update**

| | Jul | Aug | %Ch |
|---|---|---|---|
| **Average Production (boe/d)** | 3,291 | 3,493 | 6% |
| **Net Revenue (A$M)** | 4.9 | 5 | 2% |
| **Operating Netback[1] (A$M)** | 2.5 | 2.8 | 12% |
| **Funds Flow[1] (A$M)** | 2.2 | 2.4 | 9% |
| **Capital Expenditures (A$M)** | 2.7 | 3.8 | 41% |
| **Net Debt (A$M)** | 17.2 | 18.6 | 8% |
| **Realised Oil Price (C$/bbl)** | 74.17 | 70.15 | -5.4% |

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# Calima Energy | Increasing our Target

## 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** | | | | | | | |
| **Output** | | | | | | | |
| **Valuation Ratios** | | | | | | | |
| P/E (Basic EPS) | x | nm | 2.1x | 1.6x | 2.0x | 1.8x | 1.9x |
| P/E (Diluted EPS) | x | nm | 2.2x | 1.6x | 2.0x | 1.8x | 1.9x |
| P/OCF | x | nm | 2.2x | 1.5x | 1.8x | 1.6x | 1.7x |
| P/FCFE | x | nm | 3.0x | 3.0x | 4.1x | 3.3x | 3.2x |
| P/S | x | 4.1x | 1.2x | 0.9x | 1.0x | 0.9x | 1.0x |
| P/BV | x | 0.1x | 1.1x | 0.6x | 0.5x | 0.4x | 0.3x |
| EV/Sales | x | 34.2x | 0.9x | 0.4x | 0.1x | -0.2x | -0.5x |
| EV/EBITDA | x | nm | 1.1x | 0.4x | 0.2x | -0.2x | -0.6x |
| EV/EBIT | x | nm | 1.1x | 0.4x | 0.2x | -0.2x | -0.7x |
| DCF Value Per Share | A$ | - | 0.71 | 0.80 | 0.93 | 1.02 | 1.11 |
| **Per Share Data** | | | | | | | |
| EPS (Basic, Reported) | A$ / cent | (5.90) | 11.92 | 16.08 | 12.81 | 14.21 | 13.34 |
| EPS (Fully Diluted, Reported) | A$ / cent | (5.90) | 11.27 | 16.08 | 12.81 | 14.21 | 13.34 |
| Net Cash Per Share | A$ | 0.00 | 0.06 | 0.16 | 0.23 | 0.31 | 0.39 |
| Free Cash Flow to Firm (Per Share) | A$ | (0.08) | 0.06 | 0.09 | 0.07 | 0.08 | 0.08 |
| Free Cash Flow to Equity (Per Share) | A$ | (0.08) | 0.08 | 0.08 | 0.06 | 0.07 | 0.08 |
| **Margin Ratios** | | | | | | | |
| EBITDA Margin | % | -1211% | 82% | 82% | 80% | 80% | 80% |
| EBIT Margin | % | -2389% | 81% | 80% | 77% | 76% | 75% |
| PBT Margin | % | -2441% | 81% | 80% | 76% | 76% | 75% |
| Net Profit Margin | % | -2441% | 56% | 56% | 53% | 53% | 52% |
| **Return Ratios** | | | | | | | |
| Return on Equity (RoE) | % | -11% | 70% | 52% | 28% | 24% | 18% |
| Return on Assets (RoA, Pre-Tax) | % | -10% | 87% | 66% | 38% | 33% | 26% |
| **Growth Metrics** | | | | | | | |
| Revenue Growth | % | | 41283% | 36% | -17% | 12% | -5% |
| EBITDA Growth | % | | 2886% | 36% | -19% | 12% | -4% |
| EBIT Growth | % | | 1500% | 35% | -20% | 11% | -6% |
| PBT Growth | % | | 1467% | 35% | -20% | 11% | -6% |
| Net Profit Growth (Reported) | % | | 1057% | 35% | -20% | 11% | -6% |
| Fully Diluted EPS Growth (Reported) | % | | 291% | 43% | -20% | 11% | -6% |
| **Liquidity Ratios** | | | | | | | |
| Cash Ratio | % | 99% | 669% | 1173% | 1651% | 4421% | 5873% |
| Current Ratio | % | 105% | 780% | 1307% | 1767% | 4684% | 6137% |
| Quick Ratio | % | 105% | 780% | 1307% | 1767% | 4684% | 6137% |
| **Enterprise Value** | | | | | | | |
| Share Price (Current market Price) | A$ | 0.010 | 0.250 | 0.250 | 0.250 | 0.250 | 0.250 |
| Number of Shares Outstanding - Adjusted (Ye | m | 513,231,482 | 513,231,482 | 513,231,482 | 513,231,482 | 513,231,482 | 513,231,482 |
| Market Capitalization | A$ | 5,132,315 | 128,307,871 | 128,307,871 | 128,307,871 | 128,307,871 | 128,307,871 |
| **Enterprise Value (EV)** | **A$** | **8,968,701** | **100,242,025** | **52,707,044** | **16,912,706** | **(25,732,235)** | **(66,602,383)** |

## 2. Advancing the New Calima

### Completion of Brooks Gemini Sunburst

As stated in our August report, 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$10-$C13/boe. Capital expenditure (CAPEX) is 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. Overall, the Brooks infrastructure has the capacity to process up to ~7,000bbl/d of oil.

On 3 September, Calima revealed that all four Gemini Sunburst wells were now completed and achieved their initial 30-day production rates, “IP30”. The average of the IP30 rates was 176 boe/d (75% oil) per well.

The total cost of the four well program was $C4.8m, or $1.2m per well, which is slightly higher than our initial guidance of C$1m per well. However, this cost included drilling, completing, equipping and tie-in.

Each well was drilled on average in slightly less than a week and brought into production an average of 25 days after spudding. In aggregate, these four wells are currently producing 650boe/d (89% oil).

### Next Steps at Brooks

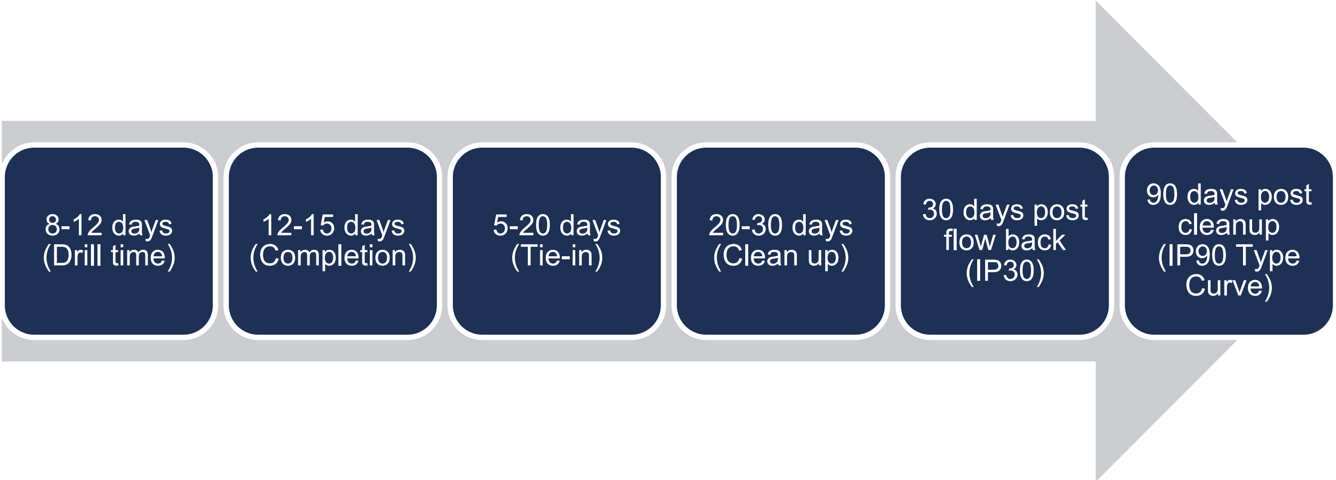
Calima has begun the licensing process to bring on more wells in the Brooks area which it expects to still drill in this quarter. These wells may include both the Sunburst and the Glauconitic Formation wells and will contribute to 2022 production rates. As there are around 140 net locations in the greater Brooks area, the aim is to continue mineral leasing and continue to add more lands than what is drilled each year.

### Three Thorsby Wells by December

On the 27th of September, Calima revealed that it completed the drilling of its #3 well at Leo. The #2 well was drilled horizontally to a depth of 3,680m and indicated that the well was within the expected resevoir quality. The Leo Sparky Wells have been optimised and will average 3,800MD.

Prior to this drill program, 11 Sparky wells had beend drilled, averagiing 3,400MD with an average of 0.75tonnes of sand per metre over the horizontal length. The Leo 1,2 and 3 Sparky wells have been optimised and will average 3,800MD and are consequently budged at a cost of $3.2m per well compared to $2.5m per well averaged by those previously drilled.

In terms of the time frame, each well is anticipated to be able to produce at full potential within 60-90 days, or between mid-January to mid-February 2022.




The Leo wells will come online in Q4. IP90 production rates per well are modelled at 274-460bbl/d with an NPV @10% of C$6.5-9.0m based on EURs of 352,000-462,000boe and 80% oil.

### Next Steps at Thorsby

The Flow testing of the three Leo wells is expected to commence in mid-November.

## Reserve Growth and Cash Flows

Calima shares offer its investors a combination of positive reserve growth and increasing free cash flows. This is to be expected by the speed and relatively low capex that Calima is able to drill new wells.

The company's half year results showed updated reserves of 21.43m boe (proven and probable) and an additional 4.2m boe of possible reserves. This compares to

**Table Showing Growth in Calima's Reserves (working interest after royalties)**

| | **30 June 2021** | **31 Dec 2021** |
|---|---|---|
| | **Boe (mboe)** | **Boe (mboe)** |
| PDP | 5,167 | 5,432 |
| PDNP | 176 | 132 |
| PU | 10,723 | 11,141 |
| **1P** | **16,066** | **16,696** |
| Probable | 5,368 | 5,818 |
| **2P** | **21,434** | **22,514** |
| Possible | 4,280 | |
| **3P** | **25,714** | |

The plan is to develop 64 gross wells over the next five years. **Around 94% of the undeveloped Brooks and Thorsby acreage does not have reserves booked, representing significant upside potential.**

## Maximising value for Montney

### Summary

Calima was incorporated as an exploration company that was focused on the Montney Formation. The Montney has over 60,000ac of Montney rights in the liquid-rich part of Northeast British Columbia. We viewed this property as only a land play, with replacement costs of C$85M.

In our Initial report, dated 26 August 2021, viewed the Montney as an out of the money option. As such it was not included in our valuation, but we acknowledged that it could add significant upside potential.

### Calima's assets

Calima has initiated a process to maximise value at its Montney assets and has initiated a process to consider alternatives to extracting value from this asset. To this end, Peters & Co have been retained by Calima to assist in the review.

In 2019, Calima drilled 3 wells, retrieving 240m of Montney core from Calima 1. Calima 2 and 3 were 2,500m horizontal wells with 92 stage completions. Calima 2 yielded a gas rate of 10.2MMcf/d during testing and a long-term reservoir monitoring confirmed a pressure-depth ratio of 11.5kpa/m (19,382kpa reservoir pressure). Since this time the Montney assets have been maintained in a development ready state, with all major approvals in place to construct a short tie in pipeline from the Calima 2 and 3 wells to the Tommy Lakes infrastructure.

Tommy Lakes in turn has an infrastructure capacity in excess of 50Mmcfd and 2,500 bod (~11,000boed). Calima's acquisition of the Tommy Lakes infrastructure, gave it a replacement value in excess of A$85M and provides and immediate sales tie-in to the NorthRiver Midstream, which provides access to all major gas pipeline networks as can be seen in Figure 2:.

### What's the value?

Calima intends to sell part or all of its interest in the Montney project. We do not yet apply the full potential value to these assets until there is a tangible deal on the table.

However, pre-Blackspur in April 2021, we calculate that the company had an EV of A$4.9M

**Figure 1: Map showing Montney assets**

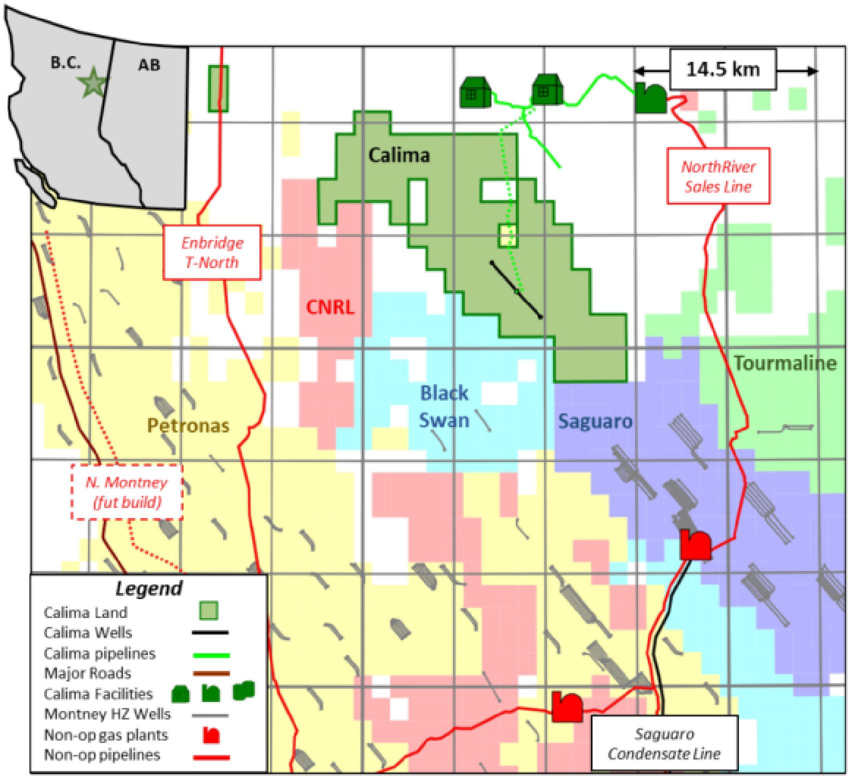
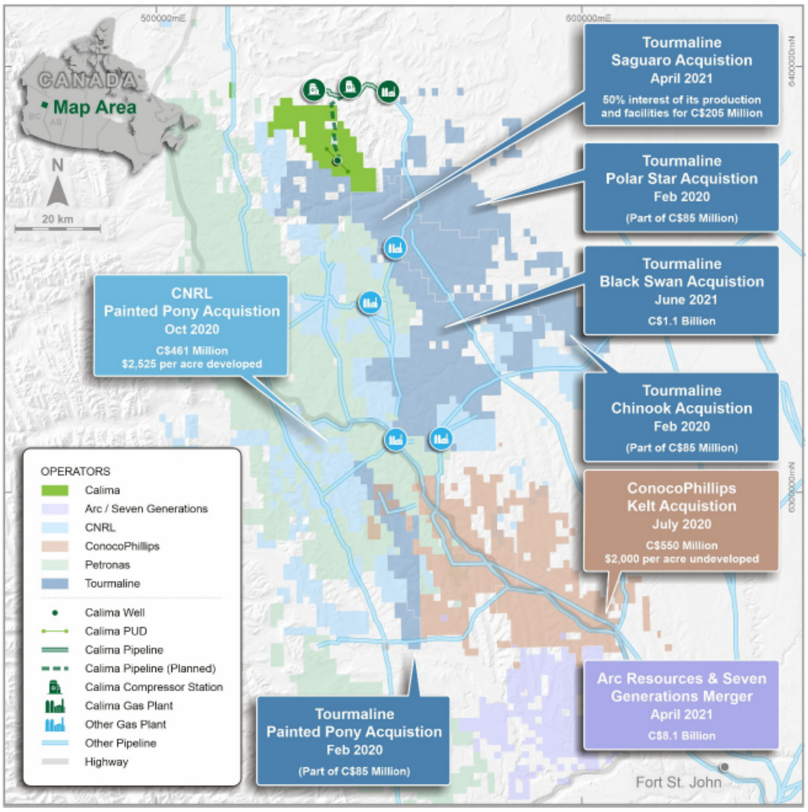



**Figure 2: Tommy Lakes infrastructure capacity**



and a market cap of $15M when it held only the Montney assets. Since this time, the share price has been primarily driven by value extracted from Blackspur and improvements in the oil price. From April to October, oil prices have improved around 28%. A rising tide lifts all boats so applying a 28% mark up on 15M, gives **Montney a value of A$19.2M or 0.04cps, which we now incorporate into our share price target.**

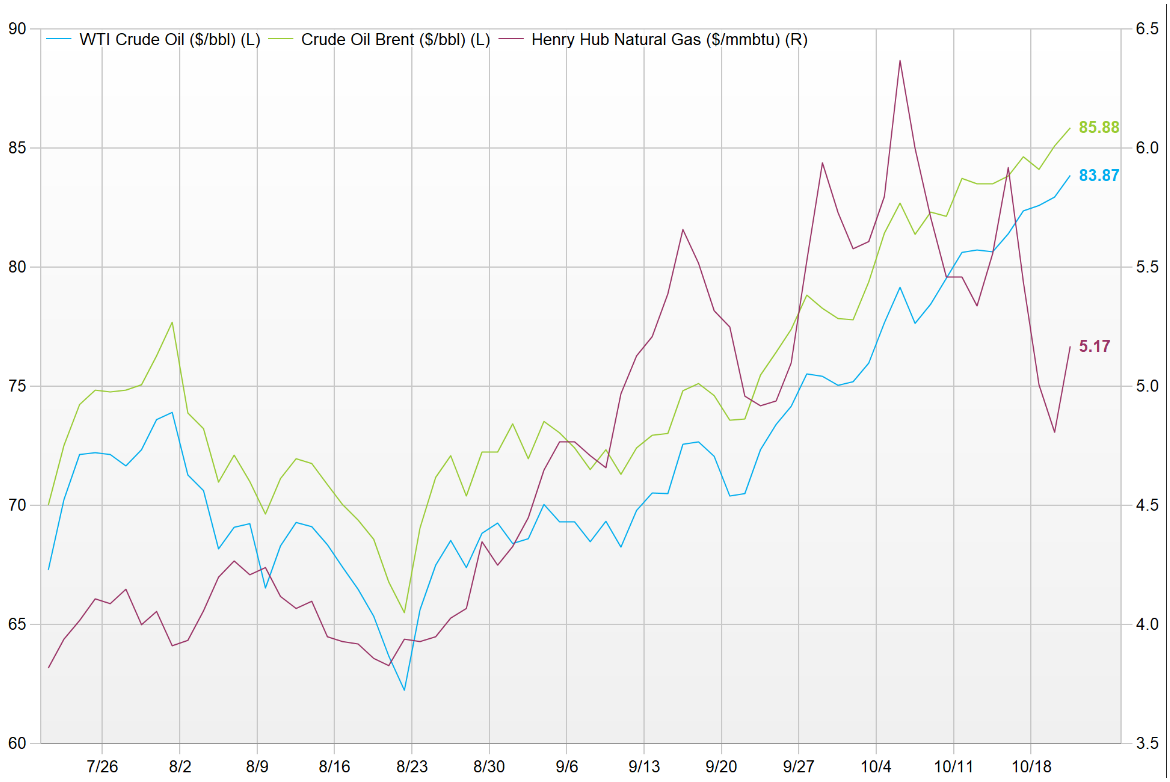
## 3. Sector analysis

### The oil and gas market

At the time of publishing our August report, the price of crude oil had moved beyond $74.49/bbl and then pulled back sharply to under $70/bbl. We however indicated that our forecasts contemplated that the prices would remain above $62/bbl for the forecast horizon. However, given how strongly oil prices have rebounded (oil prices hit seven-year highs on 4 October), we have revised our target price higher.

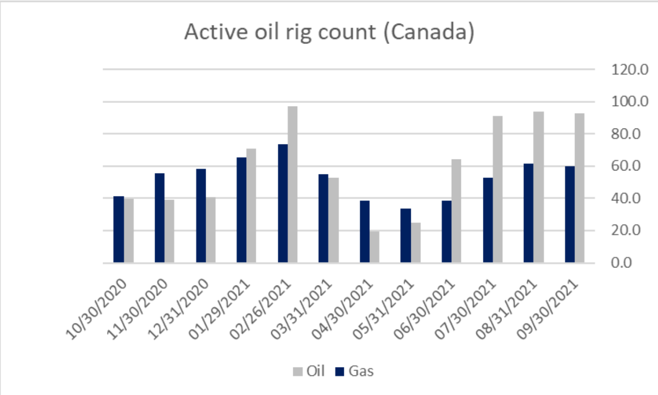
WTI prices spiked to $78.38 on 4 October before closing at $77.61/bbl. This price indicates that not only has oil rebounded from its 2020 pandemic lows, but it has recovered from years of low prices before that. Essentially this is the best price scenario for oil since 2014.

**Chart 1: Brent Crude oil price**



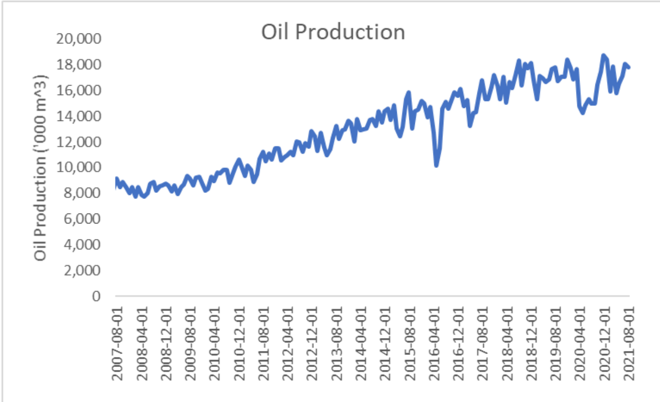

*Source 1: FactSet*

**Chart 2: Canadian oil rig count**




*Source 2: Baker Hughes, Factset*

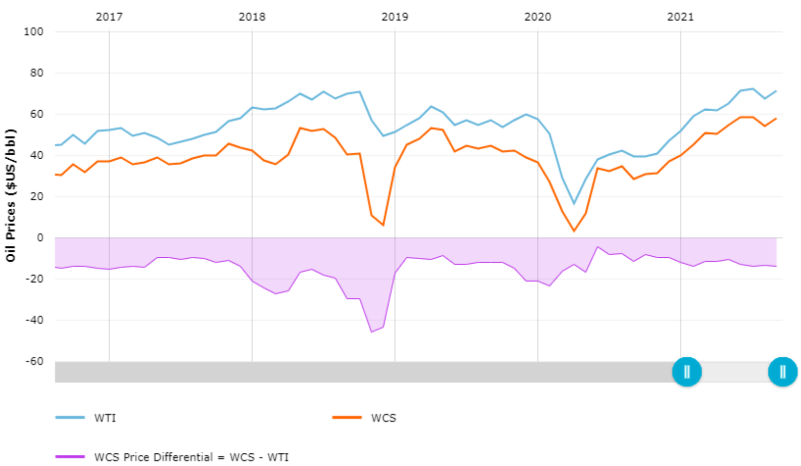
**Chart 3: Canadian oil production**




*Source 3: 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. The WTI price was quoted $71.65/bbl in September, representing an 80.8% increase from a year earlier. Meanwhile, the Western Canada Select (WCS) was the price obtained for many Alberta-based oil producers, which averaged $58.02/bbl over the same period, which represents an increase of 104.1% higher from a year earlier. Thus, the WTI/WCS differential stands at $13.63 at the last assessment taken in September.

**Chart 4: WCS-WTI differential**




*Source 4: Alberta Economic Dashboard*

While both oil prices are trending in the same direction, the Canadian price is recovering faster, causing the differential to narrow. This is a signal that Canadian producers could continue to step up production as the US demands more oil. This further corroborates our view that Calima may continue to accelerate the rate of converting its 2P to 1P reserves and accelerate its production plan beyond its current guidance, taking advantage of the market signals.

### 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

We've increased our target price from A$0.25 to A$0.71 per share. This increase is due to a number of key factors including:

1) Added value from the Montney to which we've applied A$0.04 per share
2) The speed at which Calima can bring on new production, especially now that oil prices have recovered.
3) The subsequent reduction in debt owing to the added production has increased the company's free cash flow.

**Potential Increase of 180%++**

Based on the available set of assumptions, provided in Table 1, our 1-year target price based on a DCF valuation is estimated at A$0.71 (+184%) from the current market price of A$0.25 on 26 October 2021.

We view our valuation and target price as conservative. With high commodity prices, and ability to quickly bring on production, the company could be expected to accelerate its production program beyond its targeted 5,500boe/d in 2022. This in turn will accelerate the conversion of 2P reserves to 1P reserves and improve cash flows, translating into stronger revenue growth and earnings.

The Montney also remains an unknown quantity. The company has taken positive steps to monetise the asset by selling part or all of its stake. In August, we chose not to attribute any value to the Montney assets. In the current environment, where oil assets have increased across the board, our nominal $0.04cps attribution might turn out to be too conservative, especially if the company manages to attract a buyer for the asset. Such an event would prove highly accretive to our current valuation.

## 5. 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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