TAYLOR COLLISON

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Comet Ridge Limited (COI)

BUY - Target Price $0.50

$0.30

Big reserves numbers highlight the upside value

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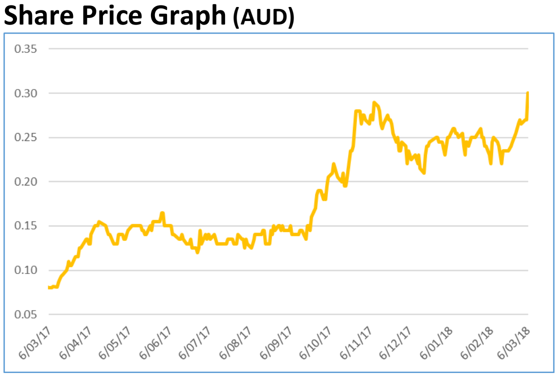
Summary (AUD)

Market Capitalisation	**$202M**
Share Price (intra-day 7-Mar)	**$0.30**
52 week low (09-Mar-17)	$0.08
52 week high (6-Mar-18)	$0.325
Ave Monthly Vol (year rolling)	10.8M

Key Financials – Quarterly data

Quarter End (A$'000)	**1Q17 Act**	**2Q17 Act**	**3Q17 Act**	**4Q17 Act**
Receipts (inc interest)	**4**	**9**	**7**	**11**
Payments for exploration	*(229)*	*(689)*	*(1,270)*	*(2,406)*
Payments for admin	*(603)*	*28*	*(585)*	*(507)*
Net Operating Cashflow	**(830)**	**(652)**	**(1,848)**	**(2,902)**
Net proceeds from asset sales		*(6)*	*(1)*	*(1)*
Other				*(62)*
Net Investing Cashflow	**20**	**(6)0**	**(1)**	**(63)**
Net Proceeds from share issues		*4,953*		*12,610*
Change in borrowings				
Net Financing Cashflow		**4,953**		**12,610**
Net Change in cash held	**(810)**	**1,816**	**(1,849)**	**9,645**
Cash at end quarter	**1,739**	**6,034**	**4,190**	**13,835**
Expected spend next period				1,803

Share Price Graph (AUD)



Source: Yahoo Finance

Our View

From recently success field work with strong gas flow rates (Mira-6 horizontal now at 700mcfpd) Comet Ridge has declared a quantum upgrade in 2P reserves which we believe underpin the commerciality of the Mahalo Project. We see the company declaring a project sanction through 1H18 with first gas perhaps as soon as early 2019. There's only supportive data from the macro environment with demand remaining strong and prices rising. The share price has already captured some of the value creation but we suggest there is still significant upside to be crystallised on delivering the next commercial steps (project definition) towards first gas.

Key Points

- **Not surprising, reserves are massively upgraded** – The company has declared audited 2P reserves of 172PJ (gross 430PJ), an increase of 473% and definitively commercial in our view. Importantly the increases in reserves and resources were delivered cheaply – 1.25c/gj (2P basis) or 0.6c/gj (2P+2C basis). The Mira-6 (Hz) gas rates are continuing to improve and reported at >0.7mmcfd. The gas curve is steeper than in corresponding wells and it seems the under-reamed wells are contributing to water drawdown and higher flows. We suggest Mira-6 could deliver a peak rate close to 1mmcfd, which would be a strongly positive result.
- **COI is heading towards project definition –** The data points a commercial threshold, so the next logical step is to move through feasibility and engineering studies towards a project sanction. As we have noted previously the success of the Mira-6 could delay FEED-FID timing (at least from our former assumptions) as the JV assesses the option of longer reach horizontal completions, however, we remain confident a sanction decision can be achieved by end 2Q18 for field work to commence in the latter part of the calendar year. COI continues to be on the cusp of project definition and a further share price re-rating in the near term.
- **It's not all about Mahalo –** The company is strongly bullish on its Galilee Basin options and has now finalised a farm-out deal that could see a well targeting the deep, conventional potential sometime in CY2018. We suggest though that the share price will likely be driven by Mahalo events at least in the short-term.
- **Value is crystallising with more to come –** We maintain our NAV at $0.56/share based on the look through value from a Mahalo development scenario. We set our Target price at $0.50/share against our ascribed value of Mahalo reserves and resources and a defined Galilee Basin farm-in. Further definition of a Mahalo development plan could deliver material upside to NAV, especially on this project which we value on an unrisked basis at >$1.20/share.
- **We retain our rating at BUY** and see potential total returns of 67% against the reference share price.

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Big reserves numbers support a commercial outcome with still more to come

COI released update reserves estimates for its Mahalo gas asset (COI 40%) on 6-March, post the field work undertaken through the late part of 2017.

- 2P volumes of 172PJ (net) [430PJ gross] - an increase of 473%; with
- 3P volumes of 374PJ (net) [935PJ gross] – an increase of 71%

The target of the field work has delivered as intended with a significant conversion of 3P to 2P, whilst also growing the total gas reserves and remaining resource.

These are quite simply very good numbers and we believe Mahalo is now definitively well above the commercial threshold.

Let's put this in context -

- Cooper Energy - Sole gas project (100%), offshore, 2P reserves ~250PJ, capex (inc FEED) ~$355mn (upstream only)
- Comet Ridge - (assumed) Mahalo gas project (40%), onshore, 2P reserves ~430PJ (gross), capex (inc FEED) estimated ~$300mn.

2P volumes are by definition commercial (being deemed as 'producible/recoverable') and bankable and at 430PJ could support a 12-15-year long project, we think.

Figure 1: Big increases in reserves and a commercial threshold has been reached we suggest.

COI Net Equity Share [2]	Gas Reserves (PJ) [3]			Gas Contingent Resources (PJ)		
Category	1P [4]	2P	3P	1C	2C	3C
5 Mar 2018 certification: Mahalo Gas Project (ATP 1191)	18	172	374	224	385	389
2 Dec 2015 certification: Mahalo Gas Project (ATP 1191)	-	30	219	112	232	372
Increase (PJ)	*18*	*142*	*155*	*112*	*153*	*17*
Increase (%)	*N/A*	*473%*	*71%*	*100%*	*66%*	*5%*

Source: Company data

Given the cost of the recent field work at $4.49mn, the gross 2P addition of 355PJ works out at about 1.25c/gj on a 2P basis and 0.6c/gj on a 2P+2C basis and on any calculation that is cheap reserves addition.

We find the 3P declaration interesting as we have assumed Mahalo could be a 1000PJ (gross) project opportunity. We continue to feel confident on the ultimate recovery and think Mahalo could eventually deliver significantly above 1000PJ given the 2C estimate of >960PJ (gross).

We also note that for a gas field, sometimes the only difference between 2P and 3P can be a gas sales contract, although we suspect the next tranche of conversion to 2P will need (say) another production result and more core holes, which would be readily deliverable through, we assume, the first phase of any gas development.

Although the reserves upgrade is very significant we have retained our risk weightings on the projects with no change to our NAV, which, we suggest, are ahead of the project timeline and we need further clarity on capex, timing, the makeup of the financing and sales agreements.

We value the stock at $0.56/share noting COI has now secured the farm-out for its Galilee Basin assets.

The share price may already reflect an expectation of the next event (a FID on a Stage-1 development) but with very few realistic ways to play the east coast gas thematic, COI continues to look an attractive investment.

We maintain our rating at BUY and our **Target Price at $0.50/share** in line with our Mahalo and Galilee asset values (rounded), in expectation of crystallising more details on Mahalo and the potential drilling in the Galilee Basin.

The next step…a development plan

A positive reserves outcome should seamlessly lead to a FEED process on a Stage-1 development. We anticipate this should be completed quickly and cheaply given the extent of 'pre-FEED' analysis already undertaken by the company, although the success of the Mira-6 Hz could add more options for consideration through this engineering phase.

The positive nature of the field work has perhaps delivered more options for the project in that the strong success of the Mira-6 Hz is suggesting the development plan could be amended for 'longer' horizontal wells, perhaps 1500-1800m completion in coal. Although these wells would take incrementally longer to drill and complete (perhaps 2-3 days per well), fewer wells would be required for any given flow rate and the EUR (expected ultimate recovery) per well would increase, which would necessitate changes to the drilling pattern.

These are potentially positive issues and could/should have upside impact on the economics, but the engineering issues would have to be worked through.

We suggest the critical focus through FEED will be on well design (horizontal vs vertical) and spacing with most of the above ground engineering seemingly well understood.

The company has indicated previously Mahalo is likely to be a multi-stage project - a 25TJpd first stage (~9PJpa) to take advantage of the existing under-utilised infrastructure in the immediate area, pipeline and processing plants, expanding ultimately to 100TJpd (36PJpa), we assume after two years.

It's a smart way to do it. A cheap first phase, perhaps $60mn (COI net $24mn) to generate cash flow to support the expansion and minimise equity dilution and debt financing. Ultimately a full field development could take (say) $250mn (COI net $100mn) - TC estimate only.

Our capex remains a bit vague at this stage and dependent on how the JV views development drilling options our estimates may be at the higher end of the potential range. We await the FEED process and more project definition.

We had suggested the JV could be in a FEED process now with the potential for a FID at the end of March. However, this seems unlikely and we think a go decision could be delivered by end 2Q'18. This slight pushback should has no NAV implications as field work (drilling) would be unlikely to commence until around end 3Q'18 in any case as we see it. The next 3-4 months is effectively design and planning time.

With COI being retained as the operator through the next phase of field work, we are confident activity will be timely and cost efficient.

What does a reserves boost do for COI?

Buying an oil and gas investment is about buying the reserves or the potential for reserves to be developed and COI has delivered on that next step.

The sector maps out in two distinct groupings – large caps with long life reserves and steady production (although HZN.AX is anomalous in this regard) and a second group with critical mass reserves in or near development and we'd highlight **Comet Ridge,** Cooper Energy, Elk Petroleum and Senex Energy in particular with large reserves bases to capitalisation and on the cusp of next phase developments.

Figure 2: Climbing the metrics ladder…there's ample remaining upside as a Mahalo project gets defined and financed

Company	Ticker	Share Price	Issued Shares mn	Capitalisation A$mn	EV A$mn	Reserves* 2P Mboe	MCap/2P A$/boe	EV/2P A$/boe	EV/2P A$/mcfe	EV/2P US$/boe
Horizon Oil	**HZN**	0.15	1302.0	189	309	7	25.71	42.12	7.02	32.96
Oil Search	**OSH**	7.22	1523.6	11,001	14,337	459	23.97	31.23	5.21	24.44
Woodside	**WPL**	29.00	900.4	26,111	32,178	1334	19.57	24.12	4.02	18.87
Beach Energy	**BPT (Adj)**	1.33	2276.2	3,027	3,973	232	13.05	17.13	2.85	13.40
Santos	**STO**	5.06	2082.9	10,540	13,905	848	12.43	16.40	2.73	12.83
AWE Ltd	**AWE**	0.95	625.3	591	623	81	7.26	7.66	1.28	5.99
Comet Ridge	**COI**	0.30	673.5	202	196	28	7.17	6.95	1.16	5.44
Senex Energy	**SXY**	0.39	1447.3	564	482	84	6.76	5.78	0.96	4.52
Cooper Energy	**COE (Adj)**	0.32	1601.1	504	300	54	9.32	5.55	0.93	4.34
Tap Oil	**TAP**	0.05	426.0	23	15	3	8.05	5.31	0.89	4.16
Petsec Energy	**PSA (Adj)**	0.10	322.3	32	35	9	3.43	3.72	0.62	2.91
Elk Petroleum	**ELK**	0.09	1342.4	124	309	85	1.46	3.65	0.61	2.85

Source: Company data, IRESS data (closing prices 6-Mar), * Reserves adjusted against production data where applicable

Whilst we don't suggest all reserves should be priced towards the top of the range, beneath Santos a case can be made that mid-cap stocks are currently priced below historical and long-run finding and development costs and that makes sector aggregation highly possible, as we have seen with the Mitsui bid for AWE Ltd.

East coast gas plays in particular are attractive investments with a strongly supportive macro environment and rising commodity prices.

We also note a recent (8-Feb) reserves downgrade Origin Energy (ORG.AX) took over its Ironbark reserves (Queensland CSG) despite rising spot gas prices, which should theoretically make more gas cross the commercial threshold.

Ironbark was a late stage CSG acquisition, which has been impaired by $360mn and as we understood it, represented reserves cover for APLNG. Volumes were written down by ~120PJ (to 129PJ), which is $3.00/gj, whilst Mahalo reserves have been added for ~$0.01/gj.

What we can infer, even if only at the margin:

- LNG projects continue to be reserves constrained with implications for the value of these projects, reserves cover and extension/expansion gas...it's simply not there;
- Sweet spots at APLNG, GLNG (STO) and QCLNG (Shell) will need to be produced a little bit harder for a little bit longer, with we think, negative implications to ultimate gas recoveries;
- Ironbark seems to be an expensive development with ORG talking about *'low permeability drilling techniques'* which means after the sweet spots the cost base for these LNG projects is going to rise pretty significantly; and
- These projects must still be in the market for more gas through ownership and/or contract.

APLNG is a 30% partner with COI at Mahalo and we'd suggest the company is still being priced as 'cheap gas' in the market.

It all adds up to a bit more of a supply squeeze and opportunity set for those with in development, near development and maybe even conceptual development reserves and resources.

Figure 3: COI total reserves and resources base. The company is not just about Mahalo, but is likely to be driven by positive news about this asset through the remainder of 2018

Comet Ridge Limited – Net Recoverable Reserves and Resources

Location	Project	COI Interest	Reserve (PJ) [1]			Contingent Resource			Prospective Resource (PJ) [2]
			1P[4]	2P	3P	1C	2C	3C	
Bowen Basin, QLD	Mahalo Gas Project (ATP 1191)	40%	18	172	374	224	385	389	-
Galilee Basin, QLD	Gunn Project Area 5 (ATP 744P)	100%	-	-	-	-	67	1,870	597 [3]
Galilee Basin, QLD	Albany Structure (ATP 744P)	100%	-	-	-	56	153	417	-
Gunnedah Basin, NSW	PEL 6 PEL 427 PEL 428	22½% 50% 60%	-	-	-	-	-	474	2,101
Total			**18**	**172**	**374**	**280**	**605**	**3,150**	**2,698**

Source: Company data,

Valuation, Target Price and Outlook

Putting a value on COI still remains a subjective exercise with timing and capex estimates still to be determined. Our estimates are underpinned by a significant number of assumptions and a probability weighted confidence assessment of ultimate commercial outcomes. But gas to surface with building gas rates and upgraded 2P/3P reserves is at least a good start.

We run a risk weighted NAV which looks at a Mahalo development in two parts

1. a two-stage project that commercialises (gross) 540PJ - risked at 75% ($0.32/share)
2. a 'remainder' value - risked at 10% ($0.08/share)

That calculates out to be $0.40/share on a stand-alone, ungeared basis.

We feel we have enough confidence to model a Mahalo development scenario to provide at least a nominal gas unit NPV ($/gj) that could be applied to other assets in the portfolio.

We use a unit NPV of $1.47/gj as the base point for assigning value to other parts of the portfolio. Note that probability weightings (Pr) are assigned on a discretionary basis and serve only to highlight how far along the commercial pathway we believe each opportunity to be at this time.

Figure 4: COI NAV - Mahalo naturally supports the target price

		Pr	Risked A$mn	A$/share
Mahalo Project	40%	75%	$214	$0.32
Mahalo (Contingent))	40%	10%	$57	$0.08
Galilee Basin	100%	5%	$84	$0.12
Gunnedah Basin	Various	5%	$10	$0.02
Exploration assets	Various			
			$366	**$0.54**
Net Cash/(debt)			$14	$0.02
Corporate costs			($2)	($0.00)
TOTAL			**$378**	**$0.56**
Shares on issue (mn)	674			

A project scenario that commercialises only 540PJ (from 935PJ at 3P) with upside from remainder and 2C volumes.

Source: Analyst assumptions

We maintain our rating at BUY and our **Target Price at $0.50/share** in line with our Mahalo and Galilee asset values (rounded), in expectation of crystallising development details on Mahalo and the commencement of drilling-in the Galilee Basin after securing a farm-out deal with Vintage Energy.

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