

Expanding across the East

As mentioned in our initiation report, Real Energy is expanding its operations across the Australian East Coast to address the highly lucrative market opportunity. In addition to its legacy acreage – the Windorah Gas Project in the Cooper Basin – RLE was also awarded a tenement in the Surat Basin in October 2019. Recently, an independent study revealed substantial prospective resource play of 694PJ in this permit area. In our view, this presents a further upside potential to RLE if it is able to convert substantial resources to reserves at the acreage.

Windorah has potential partners

Ever since it received the licence for pipeline construction, the Windorah Gas Project has been attracting potential partners to the tenement. Currently, RLE is in talks with two prospective funding partners, both of which are presently conducting due diligence. We believe that this funding will substantially de-risk the project by supporting the development of the acreage. If RLE is able to secure the funding, it can accelerate the development of the gas pipeline to Mt. Howitt. In addition, RLE can undertake horizontal fracking, which could substantially boost the production potential.

Reiterating valuation of A\$0.15–0.25 per share

We reiterate our valuation for RLE at A\$0.15 per share base case and at A\$0.25 optimistic case using a DCF approach for the Windorah Gas Project. We have retained our basic assumptions from the time of initiation. For conservatism's sake, we have not included Project Venus in our estimations. However, given the promising nature of the tenements adjacent to Project Venus, we believe it presents a potential source for further re-rating of RLE in the medium term.

Year to Dec (AUD)	2018A	2019A	2020F	2021F	2022F
Sales (m)	0.2	-0.8	0.1	20.0	23.9
Adjusted EBITDA (m)	-1.3	-2.2	-1.3	13.1	15.6
Adjusted Net Profit (m)	-1.3	-2.2	-0.9	9.2	10.9
EBITDA Margin	NM	NM	NM	65.5%	65.3%
RoA	-4.5%	-6.7%	-2.5%	21.5%	21.1%
EPS	-0.56c	-0.73c	-0.72c	1.51c	1.87c
EV/Sales	119.4x	NM	72.8x	NM	NM
EV/EBITDA	NM	NM	NM	NM	NM
P/E	-17.5x	-5.0x	-8.4x	0.8x	0.7x

Source: Company, Pitt Street Research

Share Price: A\$0.023

ASX: RLE

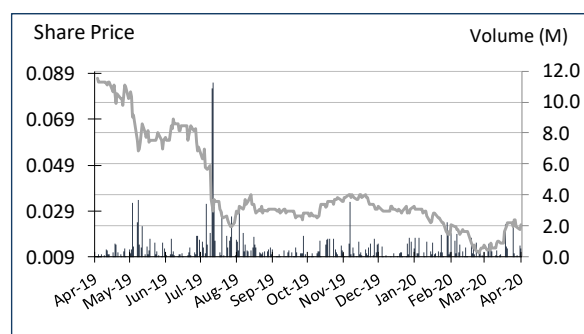
Sector: Oil and gas exploration

22 April 2020

Market Cap. (A\$ m)	8.1
# shares outstanding (m)	353.2
# shares fully diluted	418.6
Market Cap Ful. Dil. (A\$ m)	9.6
Free Float	100%
52-week high/low (A\$)	\$0.087 - \$0.011
Avg. 12M daily volume ('000)	632
Website	realenergy.com.au

Source: Company, Pitt Street Research

Share price (A\$) and avg. daily volume (k, r.h.s.)



Source: Thomson, Pitt Street Research

Valuation metrics	
Fair valuation (A\$)	0.15–0.25
WACC	8.4%
Assumed terminal growth rate	0.5%

Source: Pitt Street Research

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Table of Contents

Project Venus: Sharing the love	3
<i>The Surat Basin is an arena for prolific unconventional gas plays.....</i>	<i>4</i>
Update on Windorah gas project	5
<i>Valuing Real Energy.....</i>	<i>6</i>
<i>Analyst Qualification.....</i>	<i>7</i>
General advice warning, Disclaimer & Disclosures	8



Project Venus: Sharing the love

As mentioned in our initiation report, RLE was awarded a permit in October 2019 to develop coal seam gas (CSG) acreage in the Surat Basin. The acreage, titled Project Venus, is structured as a 50:50 joint venture (JV) between RLE and Strata-X Energy (TSX.V: SXE) (ASX: SXA). Notably, the permit was granted by the Queensland government for a non-cash consideration.

The acreage – which spans an area of 154 sq km – lies within 6 km of a gas pipeline connected to the East Coast gas markets. This provides RLE the opportunity to generate early cash flows, granted the company is able to convert substantial gas resources to reserves.

In December 2019, the results of an independent review, conducted by MHA Petroleum Consultants, revealed a substantial prospective resource play in the permit area. As per the study, Project Venus has the best estimate for total prospective resource of 694PJ or 658Bcf (Figure 1). Separately, the tenement also includes a fully cored well, which demonstrated coal seams with gas contents of up to 13 cubic metres per tonne.

Independent study revealed substantial prospective gas resource

Figure 1: Prospective recoverable gas resource

Estimates gross 100% prospective gas volume			
Unit of measurement	Low	Best	High
Bcf	526	658	789
PJ	555	674	832

Estimates net to Strata-X prospective gas volume ¹			
Unit of measurement	Low	Best	High
Bcf	237	296	355
PJ	250	312	374

¹Net figures to SXA 50% share, less royalty

Source: Company

Walloon subgroup coal measures present across the tenement

Project Venus is characterised by substantial Walloon Subgroup coal measures across the tenement, which is RLE's primary focus in the area. Additionally, the acreage includes a Permo-Triassic pervasive gas play, which is another area of interest.

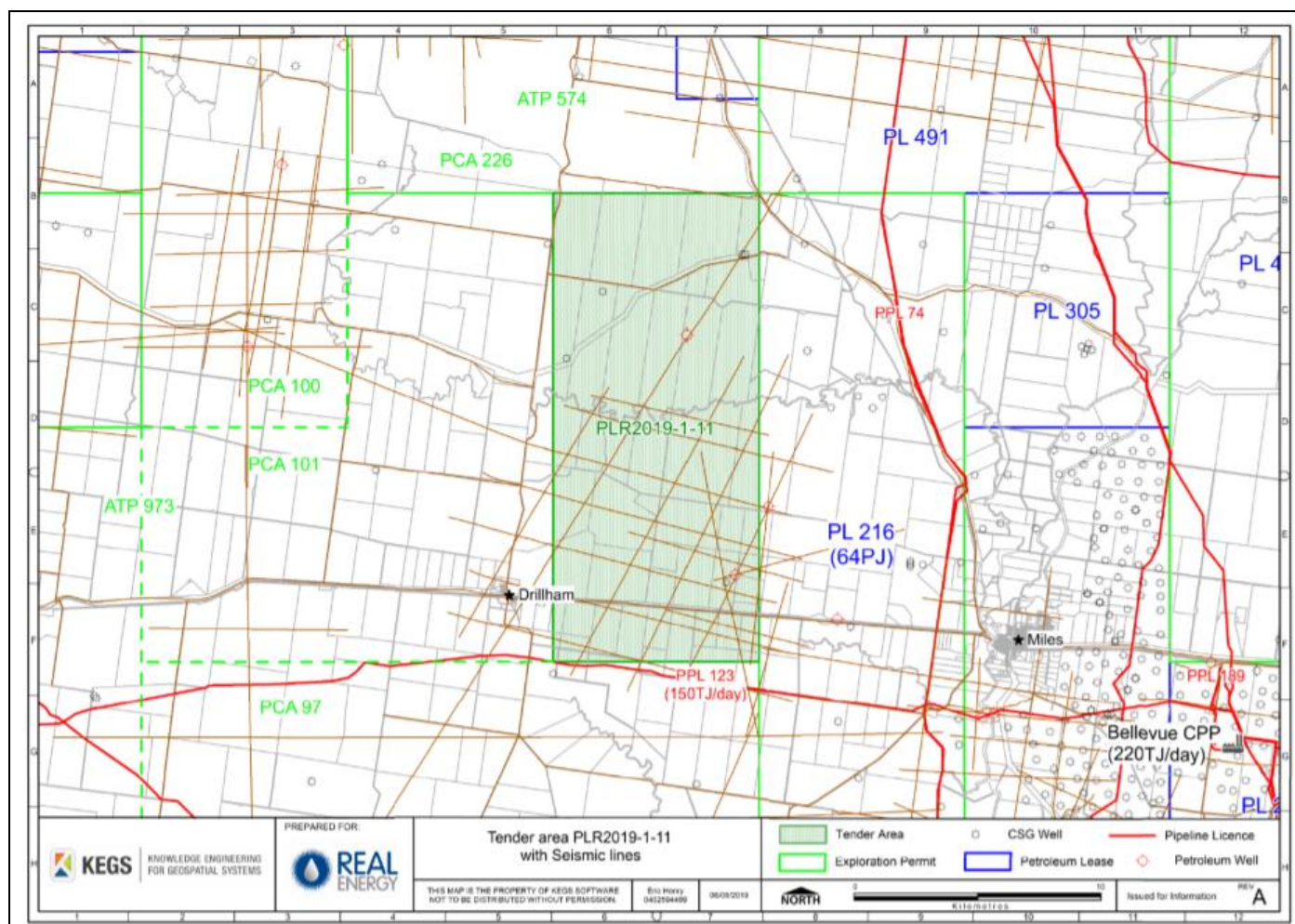
Notably, the CSG fields surrounding the permit area have demonstrated substantial 2P reserves of >1,200PJ (Figure 2). We believe this is indicative of the abundance of CSG play in the region.

The company plans to start field work in FY20 in order to fast-track the development of the acreage, leveraging the existing gas infrastructure. While QGC's Bellevue processing facility is located approximately 20 km east of Project Venus, APA's Peat/Scotia Lateral Pipeline (PL 74) is only 7.5 km to the east. In our view, this will lend Project Venus substantial speed to market once the company is able to establish material reserves at the acreage.

The project is also in close proximity to the three major LNG export projects on the Australian East Coast – Queensland Curtis LNG (QCLNG), Gladstone LNG (GLNG) and Australia Pacific LNG (APLNG). In our view, these projects represent a significant market opportunity for Project Venus.



Figure 2: 2P reserves in the adjacent fields as of 31 December 2018



Source: Company

The Surat Basin is an arena for prolific unconventional gas plays

Surat Basin is a well-researched basin for unconventional gas plays, with a number of operators active in the region, including major players such as Santos, Arrow Energy and Asia Pacific LNG Pty Ltd. As per the latest data released by the Queensland government, the basin had 5,153 wells and produced 546.6PJ of CSG in the six-month period ended December 2018. Furthermore, Surat basin had 27,147PJ (25,597Bcf) of CSG reserve as of 31 December 2018.

The following projects give an overview of the value accretion potential in the basin:

- **Senex's Atlas and Roma North projects:** Senex holds approximately 2,000 sq km of gas acreage in the Surat Basin, including the Atlas and Roma North projects. Notably, in its January 2020 market update, Senex revealed production outperformance at both of these projects. While production at Project Roma North (which spans over an area of 370 sq km) exceeded 13.5TJ/day, production at Project Atlas (spanning 58 sq km) surpassed 6.5TJ/day in the early ramp-up phase.
- **Central Petroleum's Project Range:** Another close peer to RLE's acreage in Surat Basin is Central Petroleum's Project Range. Awarded in August

2018, the Project Range tenement (spanning 77 sq km) has revealed 270PJ of 2C contingent gas resources.

We believe the above-mentioned cases demonstrate the high potential for CSG of the region and RLE's acreage. In our view, this can provide substantial upside potential to RLE in the medium term.

Update on Windorah gas project

Since our initiating report on RLE in November 2019, the company has renewed its ATP927 permit for the Windorah Gas project. The permit has now been extended to 30 September 2023. Moreover, as part of the renewal process, RLE relinquished some areas in the ATP927 acreage, including ATP927 East (Figure 3 and Figure 4). However, RLE has retained the areas with the deepest sections of Permian formations (purple area in Figure 3).

Figure 3: Original acreage under ATP927

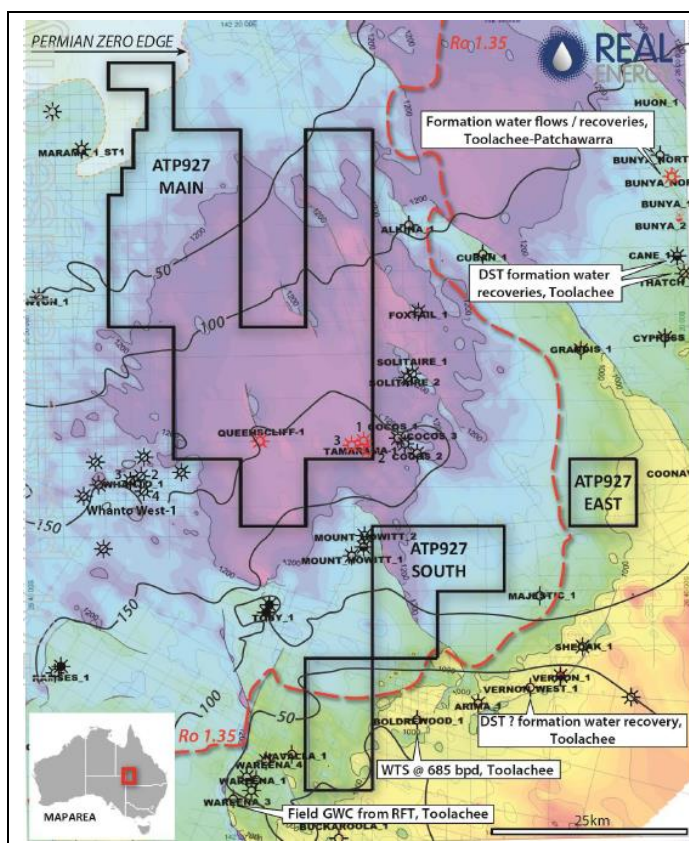
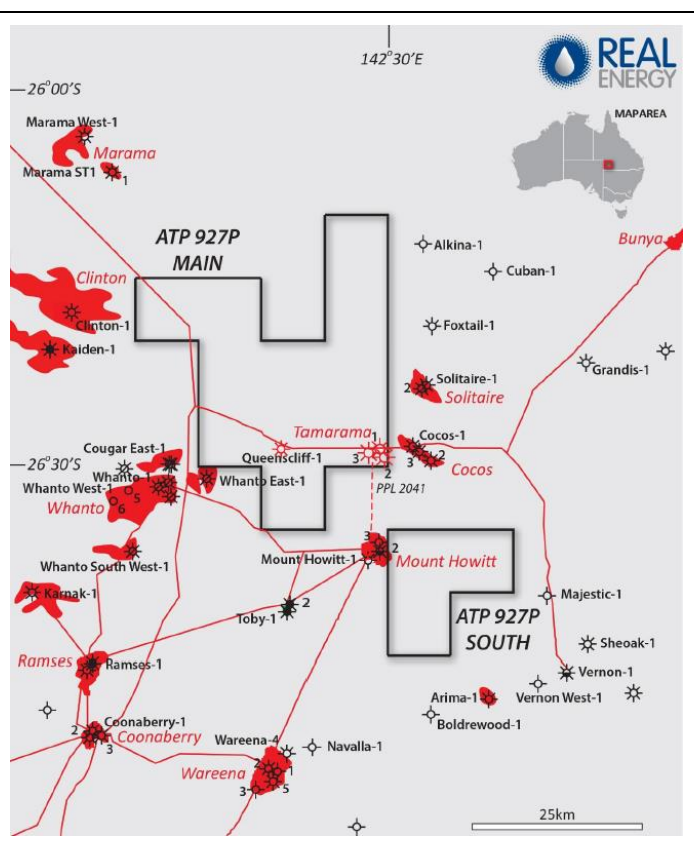


Figure 4: Updated acreage after renewal in 2019



Source: Company

Active interest from two potential funding partners provides scope for significant de-risking of the project

Currently, RLE is in the process of securing a funding partner for developing the acreage and is in talks with two potential partners. Notably, both parties are currently conducting due diligence. In our view, this interest is indicative of the potential that investors see in the Windorah Gas project. Furthermore, the onboarding of a funding partner will significantly help de-risk the project, as RLE will be able to undertake horizontal fracking, thereby boosting the value of the acreage.



Valuing Real Energy

We continue to maintain our basic assumptions for the DCF calculation as detailed in our initiation report of November 2019. Even though RLE reduced its acreage in the Windorah Trough, the area still under the permit is positioned to provide substantial upside potential to RLE in the short-medium term. Consequently, we reiterate our initial valuation for RLE at A\$0.15 base case and A\$0.25 optimistic case (Figure 5).

Figure 5: Discounted cash flow valuation for Real Energy

Valuation (AUD)	Base Case	Bull Case
Value of Windorah to RLE	48,553	86,174
Net debt (cash)	(3,279)	(3,279)
Equity value (A\$)	51,832	89,453
Share outstanding (FY20E)	353,194	353,194
Implied price (A\$ cents)	0.15	0.25
Current price (A\$ cents)	0.023	0.023
Upside (%)	638%	1101%

Source: Pitt Street Research

Moreover, with the recent interest from not one, but two potential funding partners, we believe RLE is on track for rapid commercialisation. Consequently, we have retained our assumption for production to commence at Windorah Gas Project in FY21.

However, for the sake of conservatism, we have not included Project Venus in our DCF calculation. We will wait for RLE to receive the authority to prospect, start field work and discover material resource at the acreage before including it in our calculation. However, once substantial resources have been established at the Surat Basin tenement, it is set to provide considerable upside potential for re-rating.

Risks

We see four main risks related to Real Energy's investment thesis:

- Exploration risk: RLE is yet to begin exploration at its ATP 1194PA permit area in the Cooper Basin, and the PLR2019-1-11 permit area in the Surat Basin. Hence, there is a risk that the company may not discover substantial gas reserves at these acreages.
- Execution risk: Though RLE has discovered gas at its four quasi-exploratory wells in the ATP 927P permit area, there is still risk associated with establishing commercial flow rates at future wells. RLE will also need to secure gas sales agreements to start production at its Tamarama wells.
- Funding risk: As RLE continues with the development of its Windorah Trough project, it will require substantial finances to fund its operations. Both the exploration of new wells and production at current wells would require additional funds, which RLE will have to secure through either a farm-in arrangement or by raising debt.
- Price risk: LNG prices may come under pressure as the proposed gas import terminals come online on the Australian East Coast. Driven by the looming gas shortage in the East Coast market, the government approved the construction of five import terminals, which will have a total capacity of 500PJ21.

Analyst Qualifications

Stuart Roberts, lead analyst on this report, has been an equities analyst since 2002.

- Stuart obtained a Master of Applied Finance and Investment from the Securities Institute of Australia in 2002. Previously, from the Securities Institute of Australia, he obtained a Certificate of Financial Markets (1994) and a Graduate Diploma in Finance and Investment (1999).
- Stuart joined Southern Cross Equities as an equities analyst in April 2001. From February 2002 to July 2013, his research speciality at Southern Cross Equities and its acquirer, Bell Potter Securities, was Healthcare and Biotechnology. During this time, he covered a variety of established healthcare companies, such as CSL, Cochlear and Resmed, as well as numerous emerging companies. Stuart was a Healthcare and Biotechnology analyst at Baillieu Holst from October 2013 to January 2015.
- After 15 months over 2015–2016 doing Investor Relations for two ASX-listed cancer drug developers, Stuart founded NDF Research in May 2016 to provide issuer-sponsored equity research on ASX-listed Life Sciences companies.
- In July 2016, with Marc Kennis, Stuart co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Life Sciences companies.
- Since 2018, Stuart has led Pitt Street Research's Resources Sector franchise, spearheading research on both mining and energy companies.

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