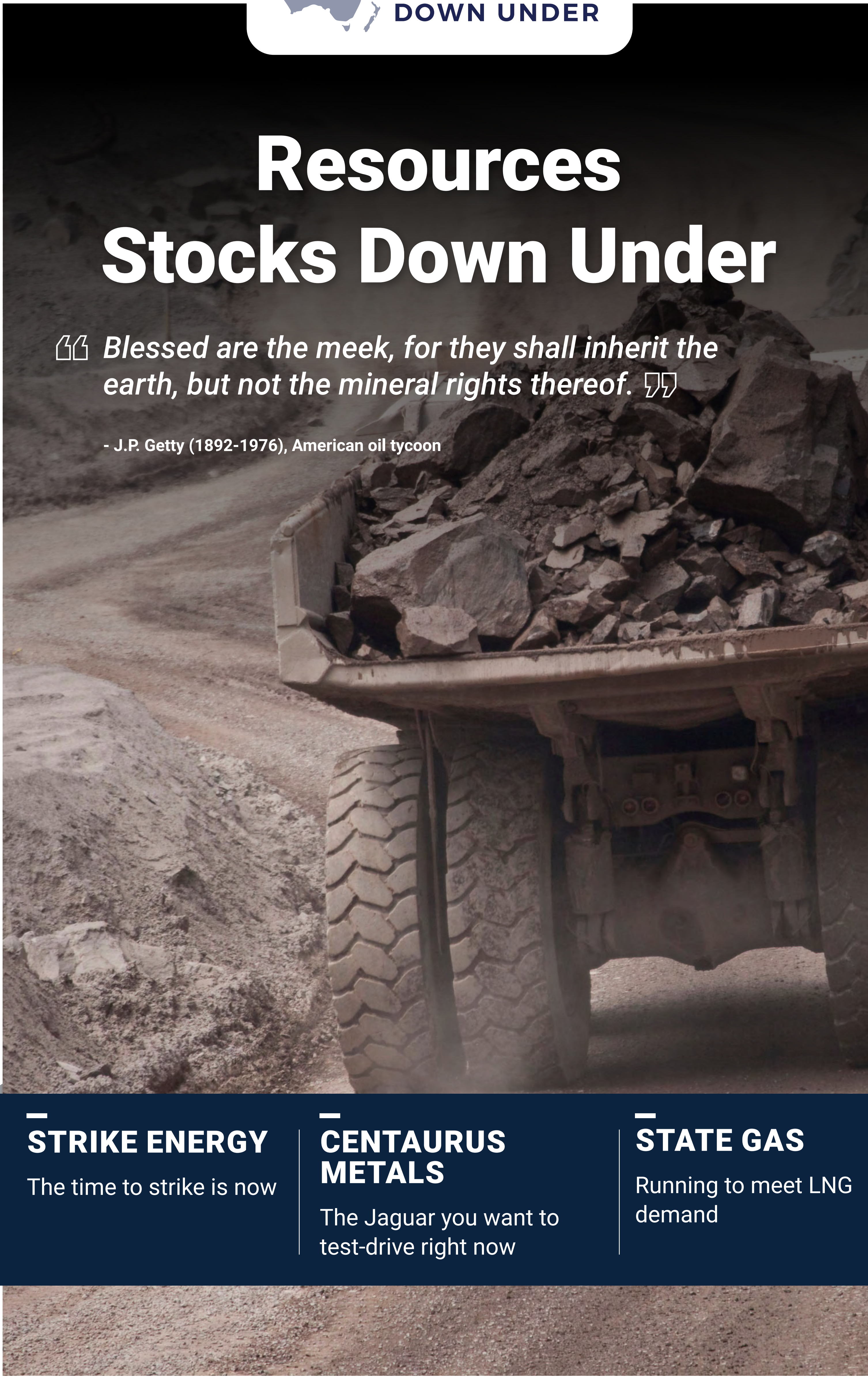
STOCKS DOWN UNDER

15 OCTOBER 2020



Resources Stocks Down Under

“Blessed are the meek, for they shall inherit the earth, but not the mineral rights thereof.”

- J.P. Getty (1892-1976), American oil tycoon

STRIKE ENERGY

The time to strike is now

CENTAURUS METALS

The Jaguar you want to test-drive right now

STATE GAS

Running to meet LNG demand

STRIKE ENERGY

The time to strike is now

Stocks Down Under rating: ★★★★

ASX: STX
Market cap: A$ 465M

52-week range: A$0.08 / A$0.30
Share price: A$ 0.27

Founded in 2007, Strike Energy has gas assets in both the Cooper and Perth basins, but its focus is centred on its West Erregulla project in the Perth Basin, regarded by many industry observers as one of Australia's most significant gas discoveries of the last 30 years. We believe West Erregulla's prime location and drilling outcomes to date will provide the groundwork in Strike's mission to become a leader in low-cost natural gas production with the help of its joint venture partner, Warrego Energy. Strike's share price tanked to 9 cents in March, but West Erregulla is prompting a re-rating.

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52-week range: A$0.07 / A$0.73
Share price: A$ 0.63

This experienced explorer has turned a new leaf with ongoing work at its almost 10-year-old Jambeiro Iron Ore Project and its newly-acquired Jaguar Nickel Project in Brazil. With a revitalised iron ore sector and emerging demand for nickel, Centaurus' fortunes look set to change in the coming years. After a slow start to 2020, the company's share price has rebounded smartly from its 8 cent low in March.

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Share price chart

Source: Tradingview

Strike and Warrego align for 2022

Strike operates the West Erregulla gas project in a joint venture with Warrego Energy (ASX:WGO), which we wrote about in Stocks Down Under on 3 September 2020. Although West Erregulla is one of Australia's largest gas discoveries, it only makes up a small part of Strike's Perth Basin tenement areas, with its southern tenements stretching all the way to Walyering (11 km from Cataby, best known for its extensive mineral sand deposits and Iluka's ilmenite mine). Following a successful campaign at West Erregulla-2, which saw a flow-rate of 69 million cubic feet per day during gas testing in 2019, Strike has aligned with Warrego to establish a single gas processing plant as part of the Phase 1 development of the site. The maiden Final Investment Decision (FID), when it gets made in the March quarter of calendar 2021, is expected to transform Strike from explorer to producer.

Further south from the West Erregulla bonanza, 2D and 3D seismic data are providing a strong outlook for the South Erregulla and Walyering prospects, with an opportunity to target 1,686 PJ of conventional gas resources. Strike made an agreement recently with Talon Petroleum (ASX:TPD) to initiate drilling in mid-2021. WA's Perth Basin has become a competitive playing field for emerging gas producers, so Strike is busy leveraging its success at West Erregulla to shore up its position in the region.

WA market provides a timely opening

The initial drilling and flow-testing campaign completed at West Erregulla-2 in November 2019 indicated a higher reservoir quality than Mitsui's neighbouring Waitsia gas project, which has helped to make the company's 'Greater Erregulla' vision much more concrete. Strike believes the ongoing assessment work at the West Erregulla 3 (the northern block area) and 4 (central east to WE-2) wells will enable it to take advantage of the blip in gas exploration activities during COVID-19 in the short-term, which has seen several gas explorers announcing delays this year.

Woodside Petroleum (ASX:WPL) announced long-term delays and investment concerns in March due to higher costs at its Browse and Scarborough gas projects. In the same month, the American major Chevron (NYSE:CVX), which has been progressing its Gorgon LNG development on Barrow Island, reduced its capital investment by 20% in a blow to its construction timeline. Woodside's projects currently make up 70% of the total prospective gas resources required in WA for the current decade. Failing any production changes from Woodside and Chevron, Strike (and Warrego) is on track to step in and fill the gap.

As WA's market drastically changes and demand is set to tighten, Strike has a price advantage in that Australian LNG margins are improving against the cost pressure experienced by producers in the US. And this is especially true for gas producers in the Perth Basin, which has a $1.10 GJ cost advantage versus similar regions due to the established infrastructure and transport links to Perth. If Strike and Warrego can meet the funding expectations, they will potentially have a lot of gain from West Erregulla for a long time to come.

First gas potentially in 2022

Unlike many of its peers, Strike has largely remained on track. While internal prospects for the company are looking up, macroeconomic events continue to impact the energy market, so now is the time for the company to strike in order to meet the predicted mid-decade shortfalls. It's fair to say that all hopes are on West Erregulla now that Strike's Cooper Basin project is yet to generate a technical or commercial breakthrough. West Erregulla has a current Net Present Value of A$272m at a discount rate of 10%.

Strike is fully funded going into its Final Investment Decision next year and has managed to secure a $28m bank facility to finance pre-development expenditure. The size the West Erregulla project will take is dependent on exploration success at WE 3, 4 and 5, with a drilling date at WE-5 not yet set. Given what has been achieved to date, however, we remain optimistic. With Strike maybe only two years away from its first commercial gas production, this stock is four star in our book.

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Turning towards clean and efficient nickel

Centaurus' newest acquisition, the Jaguar Nickel Sulphide Project in Brazil, is situated right within Vale territory. While Vale SA (NYSE:VALE) is perhaps best known for its iron ore operations in Brazil's southern Minas Gerais state, it is also a big player in the northern state of Para, where its Carajas Iron Ore Mine is the world's largest. Jaguar is only about 60 km to the east. Centaurus acquired Jaguar from Vale in April this year in a plan that should benefit both parties. Vale gets to offload a deposit that it thinks is too small for its corporate needs. Centaurus gets a potential company-maker once its gets drilling on the largely untested 600m-long Onca Rosa prospect. Jaguar's maiden JORC resource estimate of 48 million tonnes at 1.08% nickel for 517,000 tonnes shows that this project covers one of the largest near-surface nickel deposits anywhere in the world. Think about it folks … 80% of this high-grade resource is sitting within 200m of the surface. Wow!

Jaguar is not Centaurus' first foray into Brazil. That was the Jambeiro Iron Ore Project in the famous 'Iron Quadrangle' in Minas Gerais. Jambeiro got all the way to a Pre-Feasibility Study completed in 2013. While the timing is still not perfect given COVID-19's impact on Brazil, Centaurus is now hoping to fast-track Jambeiro given the way iron ore prices have recently rebounded. Furthermore,Brazilian markets are more ameniable to iron ore deals, especially now that President Jair Bolsonaro has allowed more commercial mining to progress.

An updated PFS shows Jambeiro with a resource estimate of 43.3 million tonnes at 29.1% iron for a mine-life of 18 years. As Jambeiro is only 110km from Ipatinga, a noted steel making region in Minas Gerais, there's room for Centaurus to capitalise on both domestic and export markets.

Jambeiro: tailings not an issue

Lingering fears from Vale's 2015 and 2019 dam disasters has meant that operators face greater levels of scrutiny and a potential community backlash. The events at Samarco Mariana and Brumadinho threatened iron ore supply in the region, with Vale decommissioning ten dams and reducing output to 40 million tonnes per year. There are clearly a few positive lessons for incoming miners to learn, and while the Vale disasters might still have repercussions in a dampened market, Centaurus' updated project design at Jambeiro shows that the company is fully aware of the tailings issue, with all tailings to be dry stacked. Since Centaurus is looking for funding for the project, which has a capital cost of A$53m, any perceived advantage is key. The company has done most of the groundwork for Jambeiro, so it's in a better position to find support with its existing permits.

No matter how long Electric Vehicle adoption takes, the demand for nickel in the medium term will far outweigh current levels of nickel production, with the company estimating that demand from battery producers will vary between 750,000 to 2 million tonnes. Nickel demand for batteries is currently only 145,000 tonnes, or 6% of the total nickel market. The aim of the company's present scoping study is to prove that it can deliver on its strategy to become a clean nickel producer by 2024. Centaurus is looking towards further financial opportunities to meet the demand for key battery metals, including the conversion of its concentrate into nickel sulphide and nickel metal products.

All that hard work might finally pay off

When the majors, like Vale, are selling, it's always a good idea to look at the buyer. The big company will have done a lot of hard work that the smaller player can now benefit from. What's good about Centaurus right now is not just what Vale did for it at Jaguar, but what it has done indirectly by helping to raise the price of iron ore.

Jambeiro, which has a post-tax Net Present Value of A$119m (at an 8% discount) and an Internal Rate of Return of 32%, is in many ways a more promising project than Jaguar given the location in an establishing mining region. However, Jaguar could be the turnaround for Centaurus that no-one was expecting. The acquisition of a 'mini-mine' like Jaguar is a definite turnaround for the company in that such nickel resources are rare globally, and the momentum toward base metals is increasing as 2020 progresses. With a September quarter cash in hand of A$26.9m, Centaurus gets a four star rating from us as we believe it is well-placed to get its pre-development activities off the ground quickly.

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Source: Tradingview

Surat Basin a prospective super-gas region

In the latest round of the Queensland government's permit handouts, State Gas has been chosen as preferred tenderer for Rolleston West, also known as Block 5. The new block is just north of the company's wholly-owned gas project at Reid's Dome, 50km from the town of Rolleston in Central Queensland. Conventional gas was first discovered at Reid's Dome way back in 1955, with little exploration or even coal-seam gas (CSG) work prior to State Gas getting involved. Recent drilling has indicated a large CSG endowment at Reid's Dome, potentially signalling a new future at the project and for the Eastern Australian domestic market. The addition of Block 5, also highly prospective for CSG, has the potential to quadruple the company's resource.

Like other gas explorers in the state, State Gas' strategy is to unlock the value of Reid's Dome and meet domestic demand forecasts. The availability of both conventional gas and CSG in the Surat also aids the company's planned creation of a 'super-gas' region close to Queensland's existing state gas pipeline which runs from Bowen to Gladstone. Unlike competitors like Senex Energy (ASX:SXY), State Gas will not be constricted to the domestic market. The increased resource and optionality of import/export has left the company confident that it can meet demand in an ever-volatile global energy market.

Reid's Dome expanding at the best time

Block 5 is a welcome addition after State Gas' Phase 1 successes at several wells. In the last quarter, the company embarked on a Phase 1 plan to confirm the presence of CSG at Reid's Dome. It has so far confirmed the producibility of the Aldinga East-1A, Serocold-1 and Nyanda-4 wells. Aldinga and Serocold confirmed gas-bearing coals (including a new conventional gas discovery at Cattle Creek), while Nyanda includes a significant CSG resource needed to support the potential CSG project. In a September update, State Gas reported that the Nyanda flow-rate was approaching 500 million standard cubic feet per day. That's encouraging, but first gas production is still a long way off, with current Phase 2 measures, including appraisal drilling and planning, expected to take until late 2021.

Although the infrastructure is there for regular gas, State Gas will be anxious to meet the growing demand for liquid natural gas (LNG) as oil demand falls globally. If anything, the dampening effect the Pandemic has had on demand will likely continue to push out supply problems in the long term, with some LNG projects either postponed or cancelled. There is a bearish outlook on the likelihood of any LNG project being built in the future because of worsening cost competition and environmental concerns, but State Gas believes LNG production will be needed to stabilise power generation in the region as coal gets the boot and renewables are slow to come online. And as State Gas is not restricted to domestic contracts, it also sees Asia's largely unaffected LNG market as another entry.

This company is clearly Boy Scout-prepared – the relatively recent inclusion of Richard Cottee as Executive Chairman will likely help this company fast-track a gas-to-market strategy with its diversified gas reserves. Cottee was the man, you'll recall, who helped turn Queensland Gas Company into a $5.4bn behemoth. Even with the COVID setback, State Gas has timed its development exquisitely, with production set to be completed just when the market needs it. LNG is forecast to recover in 2021, with demand gradually surpassing supply by 2023/24.

Bring on 2023

Despite a slow start from COVID-19, State Gas looks to have a number of advantages of its side, including a reduction in Bass Strait gas production, and a rebound in Asian LNG demand, conditions which will provide positive change for the domestic gas market. The mere mention of Block 5 has already brought in interest from customers while the company waits for the authority to prospect the area.

The company had a net loss of $3.5m and a net cash operation outflows of $1.2m in the June quarter, although some of that is down to COVID-19 disruptions and a redesign of the pump system after flooding and technical setbacks in late 2019/early 2020.

With October's capital raising of $9.5m, State Gas is well-positioned to progress its Phase 2 milestones. The company's timeline for gas-to-market by 2023 is still a long way off, but if it can continue with its success, like it has in 2020, we believe the stock is headed for the big time. Four stars.

Pitt Street Research Pty Ltd

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