



## Time to shine

Brookside Energy Ltd (ASX: BRK) is a Perth-based energy company with exposure to the most productive oil and natural gas plays (STACK and SCOOP) in Oklahoma's Anadarko Basin. BRK has a strategy based on three pillars focused on 1) operated drilling, 2) producing property acquisitions and 3) land & leasing. The three pillars strategy has positioned Brookside to take advantage of the oil and gas cycle at every level while minimising downside risk. This approach has allowed BRK to grow in the Anadarko Basin using an asset-light model.

### Acquisition momentum continuing

Since our last update, the Orion Project JV has continued its acquisition momentum by purchasing its third producing asset, the Thelma Well located within the SCOOP Play. After buying this well, the JV has managed to unlock its untapped reservoirs by implementing low-cost workover operations, which have led to improved rates and expected cashflows. On the recently acquired Mitchell Well, gas sales have commenced and the first load of oil is expected to be sold in the current 4Q20, which demonstrate that management's acquisition and workover strategies are working out.

### Oil price expected to continue its rally

Global oil and gas prices have recovered significantly since their 2Q20 lows. More recently, oil price rally has been further accelerated by the availability of a COVID vaccine. In our view, oil prices will likely continue to recover into 2021. With some airlines keen to resume international flights from July 2021, coupled with the imminent rollout of COVID vaccines, we think near-term demand for crude oil are very strong, and as such we expect oil prices to continue its near-term rally as the market continues to reprice the commodity based on robust underlying demand drivers. We think this market dynamic will translate into higher realised price points for BRK, thereby helping drive a material uplift in its future financial and operational performance.

### Valuation remains intact at A\$0.015 per share

We have revised our DCF model by incorporating the new Thelma Well acquisition and its expected cashflows from oil and gas sales. Also, we have adjusted our near-term oil and gas pricing forecasts to be in line with our view of the market outlook. On per share basis, however, our valuation range remains intact at A\$0.015 – A\$0.018 after accounting for an increased share base. Key risks we see in BRK include: 1) retrieval in commodity prices; 2) partnership risk and 3) execution risk.

Share Price: A\$0.007

ASX: BRK

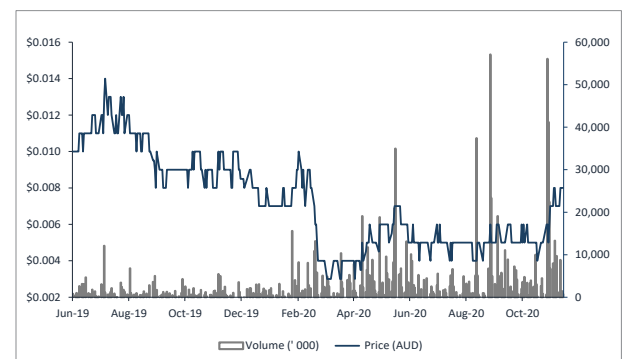
Sector: Oil and Gas Exploration

10 December 2020

Market Cap. (A\$ m)	10.3
# shares outstanding (m)	1,475.8
# share fully diluted (m)	2,048.4
Market Cap Ful. Dil. (A\$m)	14.3
Free Float	69.0%
12-months high/low (A\$)	0.010 / 0.002
Avg. 12M daily volume ('1000)	3,972.7
Website	<a href="http://brookside-energy.com.au">brookside-energy.com.au</a>

Source: Company, Pitt Street Research

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



Source: CommSec

<b>Valuation metrics</b>	
DCF fair valuation range (A\$)	0.015 – 0.018
WACC	10.0%
Assumed terminal growth rate	0.5%

Source: Pitt Street Research

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## Acquisition momentum continuing

### Thelma Well's acquisition expected to ramp up production and cashflows of the Orion Project

Following our previous research update released on 22 September 2020, the Orion Project JV has continued its acquisition momentum in the SCOOP Play of the Anadarko Basin in Oklahoma.

On 14 October 2020, the JV acquired its third producing asset, the Thelma 1-32 Well (Thelma Well), and its associated 40 Held by Production (HBP) acreage and expanded its footprint by establishing a new Area of Interest (AOI) in the SCOOP Play outside of the existing SWISH AOI. The Thelma Well, located in an area that can exhibit high oil production per unit with multiple discrete high porosity high permeability target zones, is a vertical well drilled in 1992 and has produced c.57K barrels of oil to date. Black Mesa, operator of the JV, has conducted tests on this well and based on their internal estimates is of the view that material oil and gas volumes could still be extracted from producing zones or behind pipe formations post a remedial workover activity. On 1 December 2020, BRK announced that the planned workover and restorative operations have been completed, with the Thelma Well set to kick off post a successful production test.

If the testing result turns out to be positive, it will expand the scale of the Orion Project by further adding untapped reservoirs to its forward production volumes. In our view, this resultant potential expansion in the overall production base of the Orion Project should in turn translate into increased cashflows for the JV through near to mid-term oil and gas sales. In addition, we think a successful production test should also improve acreage prices in the SCOOP Play of the Anadarko Basin, thereby providing BRK with embedded optionality from revalued acreage monetisation.

*Positive production test of the Thelma Well will largely expand the scale of the Orion Project by further adding untapped reservoirs to its overall production base*

### Gas sales commenced for Mitchell Well, oil to follow

Following the successful workover and installation of a gas meter in the Mitchell Well, BRK announced on 25 November 2020, the commencement of oil and gas production and sales for the Mitchell Well.

Management states that the Mitchell Well has now officially kicked off, with gas sales having already begun and the first load of oil expected to be sold in the current 4Q20. This update reflects management's successful acquisition and low-cost workover strategy carried over the Mitchell Well. Importantly, we view the successful restoration of commercial production in the Mitchell Well post workover as largely cash generative for the Orion Project JV due to near to mid-term oil and gas sales.

Moreover, the engineering team has continued to work on reducing the formation fluid levels in the Mitchell Well, the successful outcome of which will drive a steady uplift in the underlying production curves of both oil and gas, with production ultimately reaching their peak rates as fluid levels are fully contained. If this eventuates and assuming sales agreement in place, it will further drive up the forward cashflows and returns for the JV, the upsides of which should ultimately flow through to the BRK business, in our view.

*Continued reduction in formation fluid levels in the Mitchell Well could push oil and gas production rates further up the curve*



## Initial Prospective Resource estimate confirms high productivity of SWISH AOI

In 4Q20, BRK reported initial Prospective Resource estimate for its holdings in the SWISH AOI located in the SCOOP Play of the Anadarko Basin in Oklahoma (Figure 1). See Figure 2 for SWISH AOI's location within the SCOOP Play.

As Figure 1 shows, net barrels of oil equivalent (BOE) in the SWISH AOI amounts to 11,606,000, indicating the high potential and productivity of the SCOOP Play Acreage. This Prospective Resource estimate covers all three BRK's drilling space units (DSUs), namely Jewell, Flames and Rangers.

### Funding launched for Jewell Well development

On BRK's Jewell DSU, it is worth highlighting that the Jewell Well has been set up to target both the Sycamore and Woodford formations. In 4Q20, a funding initiative was launched to secure capital required for drilling and completion of the Jewell Well. It is supported by a leading accounting and business advisory firm Hall Chadwick and BRK's Orion Project JV partner, Stonehorse Energy. The deal involves the set-up of SABO Development Trust, a unit trust through which investors can subscribe for units in the trust. The subsequent capital raised will fund towards a working interest share of the operating costs for the Jewell Well. BRK expects to complete operations by 2Q21, with first sales expected in late 2Q21. The trust will receive its proportionate revenue share accordingly.

We think the successful operations of the Jewell Well will develop the large resource of the Sycamore-Woodford trend in the SWISH AOI and likely convert the stated Prospective Resource into Proven Undeveloped (PUD) Reserves. Furthermore, as the Prospective Resource is near developed and undeveloped reserves and in a proven oil and gas producing province, we view future drilling of the Jewell Well will likely generate sufficient volumes of oil and/or gas for a commercial development. On a separate note, we think this potential positive outcome will also likely drive up acreage prices in Anadarko Basin, therefore providing BRK with embedded optionality from revalued acreage monetisation.

**Figure 1: Net prospective resource attribute to BRK's SWISH AOI**

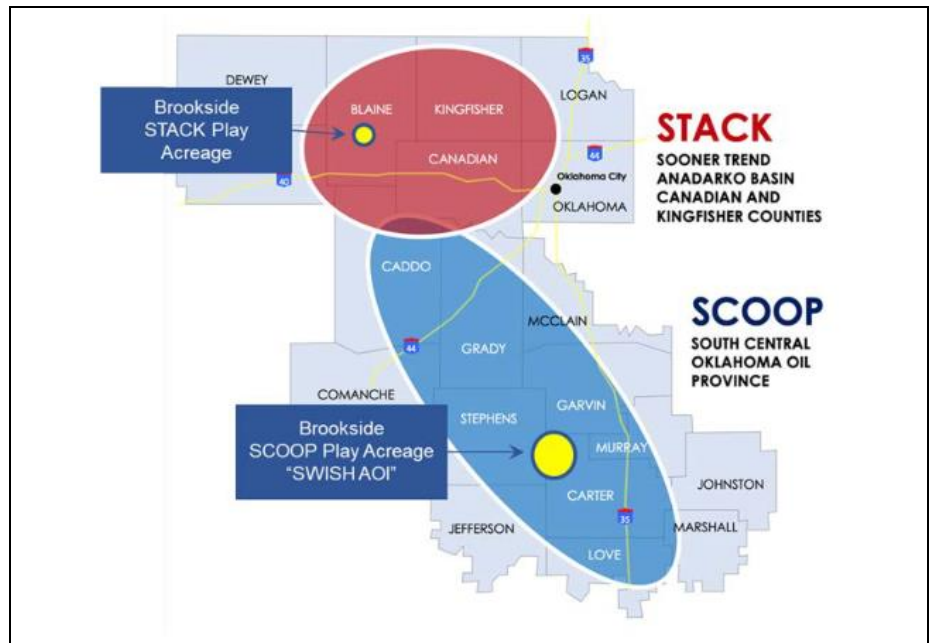
Resource (Net to Brookside)	Oil (MMbl)	Gas (Mcf)	Mboe
Prospective Resource (best estimate, unrisks)	3,839	46,602	11,606

Source: Company Report

*Increased acreage prices in Anadarko Basin provide BRK with embedded optionality from revalued acreage monetisation*



Figure 2: Locations of BRK's holdings in Anadarko Basin



Source: Company Report

## Oil price expected to continue its rally

Global oil prices have recovered significantly since their 2Q20 lows (Figure 3). This has enabled BRK to earn greater revenues for 3Q20 relative to 2Q20, even on a slightly reduced QoQ realised net volumes (Figure 4).

More recently, oil price rally has been further accelerated by the availability of a COVID vaccine, boosting hopes that international travel could resume in 2021, which is expected to drive a rebound in oil demand. As at 3 December 2020, oil Brent sits c.US\$48.7/bbl, while oil WTI hovers above US\$45.2/bbl<sup>1</sup>.

In terms of outlook for oil prices, Figure 3 shows consensus estimate for Brent crude to reach around US\$50/bbl by 4Q21. In our view, oil prices will likely continue to recover into 2021, and with some airline companies keen to resume international flights from July 2021 as well as the imminent rollout of COVID vaccines, we think near-term demand for crude oil will likely exceed consensus forecasts, and as such we believe oil prices could break US\$50/bbl sometime in 1Q21 as the market continues to reprice the commodity based on robust underlying demand drivers.

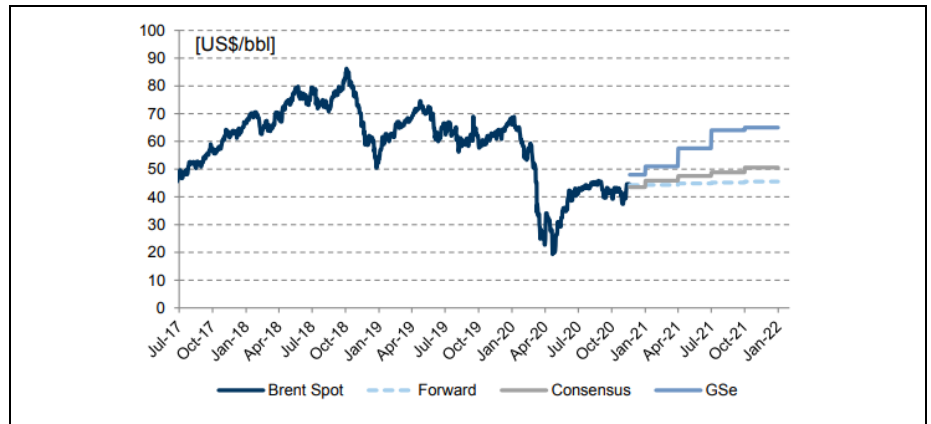
Accordingly, our fundamental view is that the continued expected rebound in oil prices will not only sustain investors' current strong sentiment towards energy stocks, but also translate positively into BRK's future financial and operational performance due to higher realised price points.

*We believe oil prices could break US\$50/bbl sometime in 1Q21 as the market continues to reprice the commodity based on robust underlying demand drivers*

<sup>1</sup> <https://www.afr.com/markets-data/commodities>

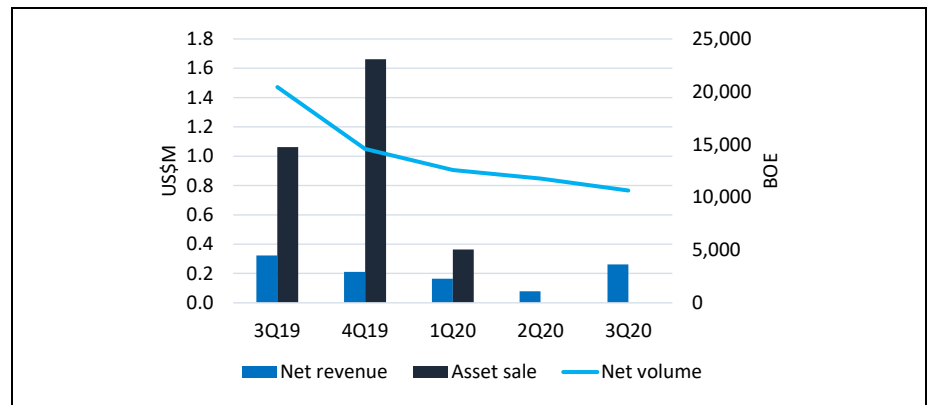


Figure 3: Oil vs. Forward & Consensus



Source: Goldman Sachs Global Investment Research

Figure 4: BRK's QoQ production volumes and revenues



Source: Company, Pitt Street Research

## Forecast changes and valuation

Based on the recent development of the Orion Project and renewed outlook for the oil and gas markets, we make the following two revisions to our model:

- We revise our revenue model to incorporate the JV's third acquisition of the Thelma Well and its associated future cashflows to be generated from forward oil and gas sales. Although management has not publicly provided guidance on the post workover production rates of the Thelma Well, we assume them to be similar to the post workover rates disclosed on the nearby Newberry Well, with which we utilise in our revenue modelling.
- In line with our reasoning on the outlook for the oil market, we increase our base case oil prices forecasts to US\$50/bbl for both FY21 and FY22, while our bull base assumes US\$55/bbl for FY22 and US\$60/bbl for FY22. On forward gas sales, we note that natural gas prices have mean reverted over the recent months, and as such we also adjust our gas prices forecasts to US\$2.9/Mcf base case and US\$3.1/Mcf bull case.

On a per share basis, however, our valuation range remains intact at A\$0.015 – A\$0.018 after accounting for an increased share base of c.1.5B. Our revised DCF valuation summary is shown in Figure 5. Figure 6 shows our sensitivity analysis on terminal growth rates and discount rates.



Figure 5: DCF valuation summary

Valuation (A\$M)	Base case	Bull case
Present value of FCF	20.9	23.4
Present value of terminal FCF	6.3	7.7
<b>Enterprise value</b>	<b>27.2</b>	<b>31.2</b>
Net debt (cash)	4.3	4.3
<b>Equity value (A\$M)</b>	<b>22.9</b>	<b>26.9</b>
Share outstanding (M)	1,476	1,476
<b>Implied price (A\$ cents)</b>	<b>1.55</b>	<b>1.82</b>
Current price (A\$ cents)	0.70	0.70
<i>Upside (%)</i>	<i>121.7%</i>	<i>160.0%</i>

Source: Pitt Street Research

Figure 6: Sensitivity analysis

Sensitivity Analysis									
WACC	10.00%								
Terminal Growth Rate	0.50%	Change in WACC							
Implied Price (A\$ cents)	1.55	9.25%	9.50%	9.75%	10.00%	10.25%	10.50%	10.75%	11.00%
Change in Terminal Growth Rate	0.20%	1.65	1.61	1.57	1.54	1.50	1.47	1.43	1.40
	0.30%	1.66	1.62	1.58	1.54	1.50	1.47	1.44	1.40
	0.40%	1.66	1.62	1.58	1.54	1.51	1.47	1.44	1.41
	0.50%	1.67	1.63	1.59	1.55	1.51	1.48	1.44	1.41
	0.60%	1.68	1.63	1.59	1.55	1.52	1.48	1.45	1.42
	0.70%	1.68	1.64	1.60	1.56	1.52	1.49	1.45	1.42
	0.80%	1.69	1.65	1.60	1.56	1.53	1.49	1.46	1.42

Source: Pitt Street Research

## Re-rating BRK

Despite the recent slight re-rate, BRK still currently trades at a large discount to our intrinsic value and we believe the undervaluation of BRK is due to a lack of investors awareness about the company's business model and their underappreciation of the high cash generative potential of the wells located in the Anadarko Basin.

However, we believe BRK will be re-rated by the market upon the occurrence of the following events:

- continued improving oil pricing outlook;
- funding secured for the Jewell Well development;
- production and sales updates from Jewell Well;
- production and sales updates from JV's acquired producing assets;
- further acquisitions of value enhancement producing properties;
- better-than-expected flow rates from existing wells; and
- higher acreage prices in the Anadarko Basin.



## Key risks

We see four main risks related to BRK's investment thesis.

- **Commodity price risk:** The potential retreat in commodity (oil and natural gas) prices can weigh on future drilling activity in the Anadarko Basin, negatively impacting BRK's prospects.
- **Execution risk:** BRK's transition to becoming an operator is in a nascent stage. There is a risk associated in bringing these wells online and establishing sustainable initial production rates at the operated units.
- **Geological risk:** Reserve figures attributable to STACK play holdings in the Anadarko Basin are estimates, and these estimates have both an associated risk of discovery and a risk of development.
- **Partnership risk:** BRK's operational success will depend on the continuation of the strong relationship with key exploration partners. In a scenario where a partner decides to pull out of the strategic alliance on short notice, BRK's growth prospects maybe hampered.

Please see <https://www.pittstreetresearch.com/> for our initiating coverage and previous updates on BRK.

## Appendix I – Analyst Qualifications

Cheng Ge, lead analyst on this report, is an equities research analyst at Pitt Street Research.

- Cheng obtained a B.Com in Finance and LL.B from University of New South Wales, in 2013, and has passed all three levels of the CFA Program.
- Prior to joining Pitt Street Research, he has worked for several financial services firms in Sydney, where his focus was on financial advice.
- He joined Pitt Street Research in January 2020.

Stuart Roberts 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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