Progressive EQUITY RESEARCH

PETRO MATAD

OIL & GAS

9 August 2021

MATD.L

2.93p

Market Cap: £26.3m

SHARE PRICE (p)

12m high/low	8.3p/2.3p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	$10.0m *(PF at 05/08/21)*
Enterprise value	£19.2m
Index/market	AIM
Next news	Interims - Aug/Sept '21
Shares in Issue (m)	898.5
Chairman	Enkhmaa Davaanyam
Chief Executive	Mike Buck
Head of Finance	Tamir Battogtokh

COMPANY DESCRIPTION

Petro Matad is a UK listed exploration company which is focused on Mongolia

petromatadgroup.com

PETRO MATAD IS A RESEARCH CLIENT OF PROGRESSIVE

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Completed fundraise provides flexibility

Early development of Block XX to commence

Petro Matad has now completed its financing which has raised approximately US$10.5 million. This will give the company sufficient funds to start the initial development phase of the Heron field in Block XX in Mongolia where it currently has a 100% working interest. We believe that this fundraise leaves the company in a stronger position. Although the company is still looking for a partner, Petro Matad can now move ahead on its own regardless of whether or not an acceptable agreement is reached. While noting the improved financial position, we are reducing our RENAV to 22.5 p/share from 28.7 p/share to reflect the fundraising.

- Petro Matad has raised approximately US$10.5 million gross through a placing and an open offer. These two offers raised gross proceeds of US$10.5 million with the issue of 217.1 million shares at a price of 3.5 p/share. This enlarges the issued share in issue to 898.5 million – representing an increase of 31.9% increase

- The finances of the group have been dramatically improved with the completion of this fundraise. At the end of 2020, the company had net cash of approximately US$1 million. Following the financing, this will now have increased to a pro-forma level of approximately US$10 million, giving the company sufficient resources to fund the initial development of the Heron field

- The funds will initially be used to complete the Heron-1 well and install the well site production equipment required to start oil production in mid-2022. Management would then look to drill and complete two more wells to allow production to be further ramped up. The company is still looking for a partner to lessen its financial commitment. However, the funding gives the company the option of proceeding on its own should no acceptable farm-in offer be received.

- Should a partner be found, Petro Matad would look to drill three exploration targets that it would like to drill in the short term. Two of these are near-field exploration wells in the Block XX exploitation licence. The third well would be drilled in its other licence, Block V, on the Velociraptor prospect. Success at any of these wells could have a material impact on valuations.

- The implied valuation (RENAV) of the company will be reduced through this fund raising. This decrease is purely an arithmetical recalculation to reflect the fund raise. This leaves us to reduce the RENAV from a previous estimate of 28.7 p/share to 22.5 p/share. However, investors can take more confidence in the valuation given that the fund raise has given management to ability to start the development. Investors should view any valuation in the context of their own assessment of the relevant risks.

Moving Petro Matad forward

Financing

On 15 July, Petro Matad raised gross proceeds of US$10.4 million through the issue of approximately 214.9 million shares at a price of 3.5 p/share. Of this amount, 72.2% came from new and existing institutional shareholders, 21.1% from its major shareholder (Petrovis) and a director whilst the remainder was from retail shareholders. The company also had an open offer to allow shareholders that had not taken part in the placing to participate. Shares were offered on the basis of one new share for every 16 shares held. This was also at a price of 3.5 p/share. This has led to the issue of a further 2.17 million shares and raised approximately US$0.1 million. Overall, the number of shares has risen from 681.4 million to 898.5 million with gross proceeds of US$10.5 million.

This will give the company sufficient resources to start the Heron development. The initial move will be the completion of the Heron-1 well into a producing well and the purchase of the equipment required to start production. Management will also look to drill two additional production wells Heron-2 and Heron-3 . The capital expenditure on the wells, facilities and G&G is expected to cost US$9 million. This will then allow the company to start generating cash flow. This can then be utilised to fund further development of the field.

The pace of this development will depend on whether a partner can be brought in on terms that are attractive to Petro Matad. A new partner would leave Petro Matad with a reduced level of spending, with the funds raised allowing an increase in the pace of development. A partner is also likely to pay for past costs and potentially a premium for the historical works carried out by Petro Matad. This would give the company the funds to restart its exploration programme. Petro Matad's management team is eager to drill three wells which are not expected to be expensive given that they are relatively shallow onshore wells (see below). We believe that each well could cost approximately US$-2 million to drill.

The Heron development

We looked at the Heron development in detail in our initiation note (Petro Matad - The Hoards of Mongolia, 7 July 2021) and recap some key points here.

The initial development plan would be looking to deliver some limited early production to generate some cash flow to fund the future development. This will involve drilling a few wells and installing storage capacity. The crude is expected to be trucked to Block XIX for processing at PetroChina's facilities. The processed crude would then be exported by truck to China for refining. The funding will cover the first three wells on this field and the associated equipment required to get the crude produced to the adjacent processing facilities.

The next stage would be full field development which would involve the drilling of up to 32 production wells, water injection wells and the construction of its own processing capacity and water treatment facilities. The processed crude would be trucked to Block XIX where it would be put into the proposed pipeline and taken to the new Mongolian refinery. This should reduce the transportation costs when compared to the cost of trucking.

Heron – Base development

Management is looking at a base development which would look to exploit 33 mmbbl of recoverable oil reserves which assumes a 17% recovery of the oil in place. This would involve using fracked wells with water injection. It would be hoped that production could get to a peak of approximately 5,000 bbl/day.

Heron – Target development

However, management is aware that the recovery factor could be enhanced with more optimal drilling which is likely to include radial drilling and fishbone completions if this proved to be cost effective. Management believes that more optimal completions could improve well performance and ultimately achieve a recovery rate of approximately 30%. This could see the recoverable reserves increased to 58 mmbbl and allow production to nearly double from the base development and at the peak get close to 9,000 bb/day.

The field economics would be improved dramatically. Operating costs at 5,000 bbl/day are estimated to be US$10 million per annum whilst increasing the production up to 9,000 bbl/day would see operating costs increase to US$15 million. This equates to a 17% decline in unit operating costs. Unit capital expenditure costs would drop from approximately US$7.60/bbl to US$5.20/bbl – representing a 31% decline.

Exploration

The company has identified three exploration targets that it would like to drill in the short term. Two of these (Saiga and Gobi Bear) are the most impactful near-field exploration wells in the Block XX exploitation licence. Saiga comprises a relatively low risk, fault block trap immediately west of Heron and a well here will test if oil from Heron spills over to charge this prospect. Management believes that, if successful, this prospect could have P50 prospective recoverable resources of 14.3 mmbbl. Gobi Bear is a combination structural/stratigraphic trap in the south west of the exploitation licence. Through being a combination trap it is seen as higher risk than Saiga, although management believes that in this part of the block there could be better sands. This prospect, if successful, could contain P50 prospective recoverable resources of 55 mmbbl.

The third well is likely to be on the Velociraptor prospect in Block V. The company has identified four prospects in the 'Raptor Trend' (Tsagaanraptor, Velociraptor, Oviraptor and Utahraptor) which have multiple targets with a total potential recoverable prospective resources of approximately 600 mmbbl. Management is eager to drill one of these prospects in the short term with the most likely prospect to be drilled being Velociraptor. This is closer to the Snow Leopard well and is felt to have lower geological risk. Success here would significantly de-risk the other Raptor prospects.

Asset Valuation

Methodology

For valuing E & P companies we take the traditional approach of asset valuation that is used by the industry. Investors should therefore view any valuation in the context of their own assessments of the relevant risks. This valuation is derived through using a DCF (discounted cash flow) methodology to the known fields and discoveries of the company. The field production profiles, capital expenditure and operating costs are modelled under the appropriate fiscal regime to give a cash flow profile which is discounted to provide a net present value for each asset. We usually add an element of value for the risked exploration upside to give an indication of how this asset value may change over the next twelve months. The risk that we take is based on the play chances (reservoir, source and seal) coupled with the local chances (seal, migration and trap). Adding these together we can derive a RENAV (Risked Exploration Net Asset Value). We have assumed a flat oil price. In our base case, we use a Brent oil price of US$55/bbl. This is below the current level of approximately US$70/bbl but is the level that the forward futures curve tends to gravitate to over the next few years. The crude oil discovered at Heron is a light crude (API 43.7), low sulphur (0.03%) but has a high wax content. We are assuming that initially this crude is likely to trade at a 5% discount to the Brent crude marker.

The discount rate that we use in the valuation is the standard 10%. We have modelled the assets in US dollars and will translate this through at the current exchange rate to allow investors to see a sterling based valuation. Sterling is currently trading at a USD/GBP level of approximately 1.40. A stronger US Dollar would prove to be beneficial for UK shareholders. A more detailed explanation of the calculations and sensitivities can be found in our previous note.

Asset valuation

For the asset valuation we have taken the value of the Heron Base Development. With the Heron Target development there is still some uncertainty. Although the reserves are in place, there are questions over the ability to get the recovery rate higher. We have therefore assumed that there is a 50% chance of achieving this. As such we have added 50% of the incremental value of this development. We have also added the potential risked upside in the exploration. As a risking we have assumed the GCOS (Geological Chance of Success). As we mentioned earlier, the GCOS on the prospects is as follows: Saiga (57%), Gobi Bear (17%) and Velociraptor (20%). We have now adjusted for the balance sheet given that the company has effectively US$10 million of net cash.

The following table details the asset value we derive for the company. For the Heron base development, we derive a value of approximately 7.0 p/share which is reduced from our previous estimate of 9.3 p/share due to the share placing. The risked Heron Target development upside could produce a similar value of 7.1 p/share (down from 9.4 p/share) whilst the risked exploration could produce a value of 7.6 p/share (down from 10.1 p/share). The cash is valued at a level of 0.8 p/share. This will therefore give a RENAV of 22.5 p/share down from our previous valuation of 28.7 p/share.

Petro Matad RENAV (p/share)

	Risking %	NPV US$m	GBP	p/share
Fields				
Heron Base	100%	89.1	63.2	7.0
Exploitation upside				
Heron Target	50%	89.9	63.7	7.1
Exploration upside				
Gobi Bear	17%	34.2	24.3	2.7
Saiga	57%	33.3	23.6	2.6
Velociraptor	20%	29.2	20.7	2.3
Cash	100%	10.0	7.1	0.8
Total		285.6	202.6	22.5

Source: Progressive Research estimates

The above analysis is for information purposes only, and does not represent a valuation or target price. Investors should view any valuation in the context of their own assessments of the relevant risks

9 August 2021

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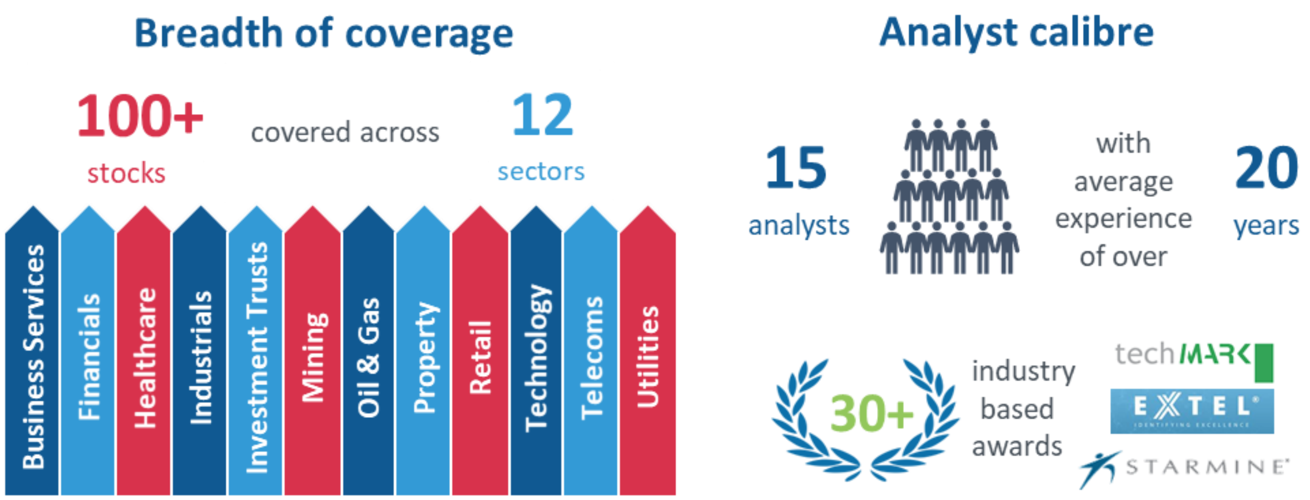

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