RENERGEN LIMITED

Initiation of coverage

2nd September 2019
Supplying Markets in Need

Renergen is an emerging producer of natural gas and helium. Renergen’s 90% owned Virginia Gas Project (the project) is South Africa’s first and only onshore petroleum right and currently supplies local bus companies with compressed natural gas (CNG). The planned expansion of the project will supply Liquified Natural Gas (LNG) to heavy vehicle operators and industrial gas users in South Africa, offering a lower cost, cleaner and more efficient energy option while its helium is a high-value, irreplaceable element supplying a global market seeking new suppliers.

A Gas Project with a Difference

Renergen’s major asset is a 90% shareholding in Tetra4, the 100% owner of the project, located 250 km south-west of Johannesburg in Free State, South Africa. The relatively high level of Helium within Tetra 4’s low impurity gas reserves is its key difference, creating significant value. All approvals have been obtained and Stage One production is planned to commence in 2021 to produce 50 tons of LNG and 350kg of helium per day. We estimate Stage Two expansion will produce an additional 185 tons of LNG and 1200kg of helium a day.

Stage One Fully Funded

Renergen has secured a loan of $US40 million from the United States Government’s development finance institution, the Overseas Private Investment Corporation (OPIC), recognising the growing strategic importance of Renergen’s helium production. The recent listing on the ASX raised $A10 million. The company is fully funded for Stage One of the project and planned exploration spend.

Valuation

Our base case NPV valuation for Renergen is $A1.80 / ZAR 18.00. Stage Two of the project development is the main component of the valuation. Key deliverables are conversion of heavy vehicles and industrial users to LNG, securing of helium offtake and construction of the project on time and on budget.
Investment thesis: Targeting South African Natural Gas and Global Helium – Markets in Need

Renergen is an emerging natural gas and helium producer listed on both the Johannesburg Stock Exchange (JSE) and the Australian Securities Exchange (ASX). Its key asset is the 90% owned Tetra4, owner of the Virginia Gas Project, located 250 km south-west of Johannesburg in Free State, South Africa. The project has large reserves of low-impurity methane gas with a high concentration of helium, a scarce and strategically valuable asset. Renergen is strongly positioned to be a new supplier into markets in need. The project’s liquefied natural gas (LNG) will target South Africa’s heavy transport industry as a substitute for diesel, and its wholesale gas markets as a substitute for liquefied petroleum gas (LPG) and for other industrial uses including power generation. Helium will be supplied into a tight market seeking new suppliers. Stage One of the project is targeting first production in 2021.

Recent Events

- 21 August 2019 OPIC US$40 million loan officially signed and funded.
- 7 August 2019: EPCM Holdings appointed contractor for Stage One gas gathering equipment construction.
- 6 June 2019: Renergen lists on the ASX and raises A$10 million of new capital in a fully subscribed offering.
- 14 February 2019: Black Knight Logistics signs a contract to take LNG for 100 trucks from the project.
- 30 November 2018: ZAR125 million rights issue.
- 21 May 2018: SA Breweries signs a contract to take compressed natural gas (CNG) and LNG from the project.
- 3 May 2016: Linde, a major, global helium company, commits to a “take or pay” agreement to purchase 80% of the production of Stage One of the project.

Potential Near-Term Catalysts

- Further LNG and / or helium supply contract signings
- Drill results from the exploration of the high-concentration helium sandstone play
- Successful development drilling, including incline well success
- Announcement of contracts for the construction of Stage One Liquefaction Plants
- Commencement of construction of Stage One

Valuation – NPV A$1.80 / ZAR 18.00

Our base case valuation is based on a two-stage development of the Virginia Gas Project, with production out to 2042 (the life of the production licence). Independently verified 2P (proven and probable) gas reserves of 138.8 billion cubic feet (bcf) of gas and 3.3 bcf of helium are sufficient to run the project out to 2070.

Risks and Sensitivities

Key risks to our valuation are lower-than-expected take-up of LNG by the South African heavy vehicle industry, lower-than-expected drilling success rates, delays in construction and increased capital costs.

The key pricing sensitivity is LNG. We see the risk of competition from imported LNG and regional gas supplies as low in the short-to-medium term, and do not expect the pricing of Renergen’s LNG to be influenced by the global LNG markets.

Our pricing of helium is conservative. If the current tight supply conditions continue over the medium term and expected new supplies from mega gas projects are delayed further than expected, there is significant upside to helium pricing in our valuation.

Successful drilling and confirmation of high-concentration helium in the sandstone play represents a potential significant increase to our valuation.

Financials

The US Government has viewed the project as strategically important, providing a US$40 million loan via OPIC with favourable terms and conditions. Along with existing cash reserves from the ASX initial public offering and equity raised in 2018, Stage One of the project and all sandstone play drilling is fully funded.
Renergen’s Markets – SA Natural Gas and Global Helium – Supply Needed

Renergen’s strategy to develop the Virginia Gas Project into a producer of LNG and Helium is based on monetising a significant reserve base. South Africa’s energy market is tight and in need of new supply. The global helium market supply is also constrained. The company has an opportunity to create significant value by timely delivery into these markets.

SA Gas Market: Short in Supply

South Africa’s energy costs have been rising significantly (see Figure 1). Rising coal costs and the SA Government’s decision to promote renewable energy have been the key drivers of this increase. Although not as significant a rise, diesel prices have risen as well. Natural gas provides a competitive alternative for customers.

Figure 1 – South African Diesel Price and Electricity Price History

The SA gas market is undersupplied. Outside Renergen’s project, the gas market is unlikely to see any further expansion and development until alternative gas supplies become available through imported LNG or local or regional gas supplies.

There are currently only two sources of gas available for supply to the market: synthetic gas from coal to liquids and imported gas from Mozambique. Both sources are controlled / operated by the vertically integrated gas company Sasol and are significantly constrained. Since the first commercial supply of gas was brought in from Mozambique 15 years ago, the availability of gas supply and related infrastructure has remained static.

LNG is seen as part of the solution to South Africa’s energy issues, to be used by heavy vehicles as transport fuel, by industrial users and for power generation.

Imported LNG requires an anchor power project and large capital investments for port facilities and regasification plants. Regasification, as planned by the SA Government, would constrain natural gas to the pipeline or around the port of entry, as liquefying the gas again would be prohibitively expensive. Government efforts to introduce new gas sources through imported LNG to power projects have suffered repeated delays which remain largely unsolved.

There has been recent exploration success in offshore South Africa, with the Brulpadda well discovering gas. A substantial amount of work is to be completed on this discovery and a final development decision is some years away. There is no indication of whether the gas from this discovery will be sold domestically or into the international LNG market.

Renergen’s domestically produced LNG faces minimal barriers to entry, has first mover advantage, and possesses capacity to supply the heavy vehicle industry, industrial users and power projects.

The SA natural gas market presents multiple opportunities for Renergen.
Global Helium Market – Tight Supply and Steady Demand

The global helium market is opaque, with limited information on pricing, demand and supply. What can be determined is that supply is constrained, deficits are likely, and demand is steady. A positive pricing environment over the short-to-medium term should be expected.

Demand

Helium is a critical ingredient in magnetic resonance imaging (MRI), lifting, balloons, welding, rocketry and other high-level sciences (see Figure 3). Due to helium’s low boiling point and light weight, for many of its uses there is no substitute.

Global demand for helium is around 6 bcf pa and is expected to increase at 2% per annum. The strongest growth is expected to occur in China and South Korea (4% per annum) driven largely by increased electronic manufacturing and MRI usage in those markets. Helium demand is driven by its “no-substitute” characteristic and rising global demand for advanced medical imaging.

The chief risk to demand is the potential for technological developments that bypass the need for helium in current quantities. The irreplaceable qualities of helium and its expense have encouraged users to develop technologies that reduce the amount of helium required in key machines, such as helium recycling in MRI scanners.

Figure 2 – World Consumption of Helium by Region

Source IHS Markit

Figure 3 – Uses of Helium

Source USGS / Renergen
Supply
With demand steadily growing at around 2%pa, the key to helium market is the changing nature of supply. The supply story is driven by the US Bureau of Land Management (BLM). In the 1920s, the US Government began to stockpile large quantities of helium, identifying it as a future critical resource. The stockpile grew significantly through the 20th century until 1996 when the BLM announced that it would reverse its policy and sell off its surplus reserves to the market at a steady rate over 20–25 years. The BLM surplus accounts for 20% of the global supply of helium. The BLM will exit the market completely by 2021 as its strategic reserve is depleted.

Closing 20% of the global supply will squeeze an already tight market. New sources of supply are limited and will not offset this decrease for some time. Much of helium’s supply stems from being a by-product of gas production. Mega gas projects can extract helium commercially from levels as low as 0.1%. Qatar’s Helium III due in 2020 and Russia’s Amur due 2021 represent new supply but have significant risk of delay. Global LNG economics has led to the postponement of other large gas projects, removing potential supply from the helium market.

Around 20 Liquefaction plants supply the entire global helium market, a number of these are in areas of political instability accompanied by instances of disruption to supply (e.g. the 2017 Qatar blockade where multiple Arab states cut ties with Qatar disrupting helium production and supply for several weeks).

Helium has been added to the critical minerals list in both the USA and the EU, giving governing agencies more authority over strategies to ensure the secure and reliable supply of this critical element.

“It’s pretty safe to say that at least 2019 is going to be vulnerable to upset and it could be ugly for a while. It’s not going to get better tomorrow, it’s not going to fix itself right away, but when everything is running right and all the plants are running, there could be times when things feel a little better”

Phil Kornbluth, Kornbluth Helium Consulting, Gasworld Global Helium Summit 2018

Figure 4 – World Production of Helium by Region

Source USGS

Pricing
Helium is traditionally traded on long-term confidential contracts, which keeps pricing opaque. The large-scale, well-publicised and reliable sell-off of BLM reserves has arguably kept pricing of helium artificially low over the past decade, with private prices materially above BLM pricing. For reference, however, BLM prices have risen substantially in the past few years, from US$110/mcf (thousand cubic feet) in 2016 to US$280/mcf in August 2018. Seventy per cent of that increase occurred in the final BLM auction as buyers sought to accumulate inventory, possibly foreseeing a tightening of supply or a future rise in price.

Uncertainty and tightening in supply coupled with steady demand, will provide continued support for pricing and may support marked increases.

Renergen’s helium reserves represent a strategically important part of global supply.
Renergen’s Market Position and Reserves – Strong on Both Fronts

Renergen and the SA Gas Market

Renergen is in the unique position of being the only producer of onshore natural gas to emerge in South Africa since the 1970s. The onshore petroleum production rights are valid until 2042, and there are additional exploration rights in Evander prospect to the north-west of the Virginia Gas Project. Renergen plans to commence exploration in Evander once the project is operational. There are immediate plans to explore in the sandstone play within the project in order to confirm high-concentration helium (initial testing has shown levels of 11% helium).

Renergen’s gas fields are situated in an energy scarce area, with high customer density and limited competition. The targeted markets for LNG are all domestic and include heavy vehicles, industrial users and potentially power generation. Renergen has a significant first mover advantage from its access to independently proven natural gas reserves. Pricing for Renergen’s LNG should not be directly influenced by the global LNG market.

Figure 5 outlines the company’s path to production through 2019 and beyond.

Figure 5 – The Path to Production

Source: Renergen

Primary LNG Market – SA Heavy Vehicles

Renergen is targeting around 70% of its LNG production from Stage One to supply the SA heavy transport industry. SA has some 377,000 licensed heavy vehicles. Renergen’s current compressed natural gas (CNG) plant supplies several transport customers. The LNG will be distributed via modular mobile refuelling facilities located on vacant land on established trucking routes.

Switching Renergen’s customers from diesel to LNG will realise increased efficiency, meaningful cost savings and reduce their carbon tax (anticipated to be introduced in 2019). Truck manufacturers may see LNG as a differentiator providing significant marketing value for their brand and, as a result, Renergen will work with willing manufacturers to approach their existing customers proposing a switch over from diesel to LNG when the trucks reach their end of warranty period.

The potential market for Renergen’s heavy vehicle LNG product is between 40,000 and 67,000 vehicles. These vehicles are in the provinces of Gauteng, Free State, KwaZulu-Natal, Mpumalanga and Western Cape.

Renergen expects to supply up to 3,300 heavy-duty trucks when it is producing LNG at maximum capacity. This translates to between 4.9% and 8.2% of the potential market opportunity. This is less than 1% of the total number of heavy haulage trucks registered on SA roads.

To attract customers to its product, Renergen is pricing its LNG at a relative discount to the SA diesel price. The diesel price is regulated in SA and is highly correlated to the price of Brent Crude (see figure 6) The LNG price will be based on a discount of 25% of the SA wholesale diesel price, the same pricing that Renergen offers its current CNG customers. A critical advantage of LNG over CNG is that, since LNG is cooled to a liquid form, it has a higher energy density compared to CNG and takes up only one-third of the volume, enabling far greater distances on each tank.
Renergen has agreements for the supply of natural gas generated by the new plant, once it is in operation, with Megabus, South African Breweries and Black Knight Logistics. The number of prospective customers in the heavy vehicle industry exceeds the current production capacity of Stage One, and Renergen expects to award allocations on a first-come, first-served basis.

Despite having established relationships with heavy vehicle operators, there is a risk that Renergen will not be able to sell its planned percentage of production due to lack of conversion. Renergen will have to be able to meet customer demand in terms of quality, price, volume and functional requirements. The SA market is unfamiliar with LNG and lacks awareness of its benefits and safety aspects. This may delay wide-scale conversion.

**Other SA LNG Markets – LPG Replacement, Industrial Users and Power Generation**

Renergen is targeting around 30% of its LNG production from Stage One to supply industrial users.

The primary focus will be to replace LPG with LNG. Currently, LPG is priced at a premium to Renergen’s targeted LNG price. LPG in South Africa is generally of low quality, so customers would enjoy cost savings and increases in efficiency by converting to LNG. Renergen will price its LNG to wholesale customers at a “bulk rate”.

There are prospective customers in the wholesale market relating to power and steam, cookers and paint shops. As described above, allocation will be on a first-come, first-served basis.

If LNG conversion to trucks lags behind Renergen’s expectations, an alternative short-term strategy would be to sell a greater percentage of the LNG to industrial users. As industrial users pay a lower price than transport users, there would be a decrease in revenue.

Due to the continuing issues in the SA power industry – particularly regarding high costs and reliability, power generators may become strategically important to Renergen’s mix of sales over time, and may offer a higher returning option.

The price achieved for LNG is on a weighted basis between the heavy vehicle markets and wholesale customers (70/30).
Renergen and the Global Helium Market

Renergen will sell the majority of its helium from Stage One of the project under an offtake agreement with Linde. The “take or pay” firm agreement is for up to 80% (a maximum of 24,000mcf pa) of the helium produced from Stage One of the project. The term is for 10 years from the start of production, with a 10-year option to extend by Linde. The pricing for the first 10 years is US$200/mcf (US$42/kg) plus US CPI.

Helium pricing is opaque and difficult to determine. However, recent sales in the market have risen to US$380/kg. We do not expect pricing to be near that level over the medium-to-long term; however, it demonstrates the tightness of the current market and indicates the need of some market participants.

All helium contracts will be denominated in US Dollars. The remainder of production from Stage One can be sold to other participants in the market. Renergen aims to sell this at around US$65–US$75/kg (US$306–US$353/mcf). There is significant interest from buyers.

The Linde contract represents a sound underpinning of Stage One of the project, despite the relatively low pricing. As a new entrant in the market, it is important that Renergen demonstrate its reliability as a supplier, and the Linde contract provides the opportunity to do that. The contract provides certainty of offtake and payment, reducing risk.

Stage Two, with around 1,200 kg per day of additional production, presents an opportunity to expand the customer base and achieve higher prices. The 2P reserves comfortably cover Stage Two production for the remainder of the production licence.

Renergen’s geographic position is a competitive advantage. A key aspect of helium is that its useful life from time of production is only 44 days. As an example, transport of helium from Qatar to the key growth market of China takes around 44 days, leaving no margin for error. Renergen’s helium can reach the same market in 35 days.

Given the current supply uncertainty, and despite mega projects in Qatar and Russia expected to be brought into production over the next few years, we expect the helium market to remain relatively tight. Renergen’s entry to the market is well timed and, with its geographic advantage, the Stage One production available to the market and Stage Two production should be well sought after. We expect prices for Stage Two production to be higher than the prices achieved under the Linde contract.

Renergen’s Reserves – Strong Position to Deliver

MHA Petroleum Consultants have conducted an independent review of the reserve and resource position of Tetra4’s Virginia Gas Field, in which Renergen has a 90% interest, as of March 2019. The previous independent reviews of reserves were conducted by MHA in 2018, and Deloitte in 2016 and 2015. Helium reserves were first recognised by MHA in the 2018 review. 1P (proven), 2P (proven and probable) and 3P (proven, probable and possible) reserves have increased with each review. MHA first recognised the contingent resources in 2018 and reduced its assessment of contingent resources in 2019.

The location of the Virginia Gas Field is shown in Figure 7.
Gas emitting boreholes have been identified from mineral exploration activities. Several of these boreholes are flowing gas at high production rates with high concentrations of helium and have been doing so for decades. Renergen (via its 90% shareholding in Tetra4) owns 100% of the working interest in 188,427 hectares. There are currently 12 existing economically viable wells in the project.

The geology of the project overlies the Witwatersrand Supergroup of meta-sediments that host the Welkom Goldfield (see Figure 8). The source of the methane gas is primarily microbial in origin from deep within the Witwatersrand Supergroup, with groundwater circulating through the large faults and contacting bacteria living in the crust. The helium is derived from deep within the earth or from radioactive minerals within the crust. It then moves through faults and mixes with the microbial methane in the subsurface.

Figure 8 – Project Geology

Source: Shango Solutions / Renergen

The low-pressure nature of the project has allowed for relatively simple drilling techniques. Wells that target gas have historically met with varying results. The success of the vertical wells drilled, with a target depth of 400m to 750m, has depended on their intersecting the gas-bearing faults. We have assumed a success rate of 60% for any additional new wells. Renergen is planning to drill wells inclined at 55 degrees to optimise the intersection of the gas-bearing faults. These wells come at a higher cost than vertical wells, however they increase the likelihood of intersecting gas.

There is some evidence that the biogenic nature of the resource makes it a continuing and renewable resource. There are wells in the project that have been producing gas for 40 years without discernible pressure drop. Currently, no quantitative studies exist to prove the renewable nature of the resource; consequently, we have assumed a 5% annual decline rate of the producing wells in the project.

We have forecast production commencing in FY2022 until the end of the petroleum rights for the project (in 2042). We have commenced Stage Two production in FY2026. Under this scenario, approximately 50% of 2P reserves are consumed.

MHA have also estimated a contingent resource. We have not considered this resource in our valuation, but it does indicate the potential that exists within the project.

The independently verified net reserves as at March 2019 are set out in Tables 1 and 2.
Table 1 - Project Reserves

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Helium

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Source MHA

Table 2 - Project Contingent Resources

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Source MHA

LNG Pricing is key to the valuation. We have assumed that 70% of LNG is sold to the heavy vehicle industry and 30% to industrial users for the life of the project.

Heavy vehicle LNG is priced at 25% discount to the SA diesel price. The SA diesel price is regulated by the government and is highly correlated to the SA Brent crude price. The price has been inflated in line with MST’s Brent crude price at 2.5% pa. We see risk of competition from imported LNG and regional supplies as low on the short-medium term, and do not expect the pricing of Renergen’s LNG to be influenced by global LNG markets.

Renergen will price its LNG to industrial users at a “bulk rate”. The price achieved for LNG is on a weighted basis between heavy vehicle markets and industrial users.
Valuation – Stage Two the Key Driver

Valuation

We value Renergen at an NPV of A$1.80 / ZAR18.00. We have applied a relatively high 12.5% discount rate, and a 23-year life for the project (the remaining life of the production licence until 2042). Approximately 50% of the 2P reserve base is consumed over the term of the production licence. Utilising the full 2P Reserve base extends the life of the project to 2070 and adds approximately A$0.40 / ZAR4.00 to our valuation.

We have applied a commercial and development risk factor of 95% on Stage One and 85% on Stage 2. We have assumed a 60% success rate of drilling vertical wells. The inclined well drilling programme planned by Renergen has the potential to increase the success rate of the wells and flow rates.

The key driver of the valuation is the successful construction and implementation of the Stage Two expansion. Our valuation including only Stage One of the project is A$0.52 / ZAR5.20. The current share price implies partial valuation of the Stage Two expansion.

Key Assumptions

Figure 9 – LNG Pricing Assumptions

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Heavy vehicle LNG is priced at 25% discount to the SA diesel price. The SA diesel price is regulated by the government and is highly correlated to the SA Brent crude price. The price has been inflated in line with MST’s Brent crude price at 2.5%pa. We see risk of competition from imported LNG and regional supplies as low on the short-medium term, and do not expect the pricing of Renergen’s LNG to be influenced by global LNG markets.

Renergen will price its LNG to industrial users at a “bulk rate”. The price achieved for LNG is on a weighted basis between heavy vehicle markets and industrial users.
We have assumed that 80% of Stage One’s helium is sold under the Linde contract at US$200mcf and inflated at 2.5% as per the contract. The remaining 20% is priced at “market” rates which we have assumed to be US$305mcf as per management guidance.

Stage Two pricing, beginning in FY2026 is assumed to be fully contracted, with pricing of the contract being US$250mcf and inflated at 2.5% per annum. This price is at a premium to the equivalent Linde contract pricing at the time reflecting a continuing tight market. Any further delays to mega gas projects in Qatar and Russia will further tighten the market and present upside risk to the price.

We have assumed a 5% decline rate on the production wells. There is a possibility that the wells are a continuing and renewable resource without discernible pressure drop; however, this is yet to be proven.

Given a large capital spend, Stage Two of the project will require funding exceeding that of the cashflow of the company at the time. In our valuation, the project is funded by debt (see Financials section).
Key Sensitivities

The valuation’s key sensitivity is the pricing of LNG, followed by helium pricing. Table 5 shows the effect that +/– 10% pricing changes have on the valuation. The valuation is also sensitive to increases in capital and operating costs. Table 6 shows the effect that +/– 10% cost changes have on the valuation.

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Sandstone Play – High-Concentration Helium – Virginia Gas Project

The sandstone play, covering some 120sqkm of the project has had some promising indications, revealing up to 11% helium in the gas. The company has decided to use some of the proceeds of the ASX listing capital raising to investigate this deposit and conduct horizontal drilling.

We have allowed for the expenditure of ZAR34.5 million in FY2020 for three horizontal exploration wells, and ZAR21.5 million for a pre-feasibility study into the deposit.

If the sandstone play drilling is successful and defines a new high-concentration helium reserve, Renergen will accelerate the feasibility study of the deposit to determine whether it is to be used for Stage Two expansion instead of the existing reserves. With the significantly higher levels of helium, early development of this project has the potential to double the valuation. Capital costs would be higher than for the current Stage Two of the project due to the higher cost of drilling horizontal wells. Pipeline and liquefaction capital would be similar.

Due to its early stage, the successful development of the sandstone deposit has not been included in financials or valuation.
Positive Catalysts for the Share Price
Although we see some of the value of Stage Two being reflected in the current share price, there are several catalysts that will drive the share price towards our valuation.

Drilling and Confirmation of Flow Rates of Wells for Initial Production
Successful drilling of production wells, particularly by using incline drilling, and confirmation of flow rates will increase the market’s confidence in the delivery of gas to the project. Target second half of CY2020.

Commencement of Construction of Stage One
The commencement of construction of Stage One will be an important milestone for the company as the project turns from planning to execution. Target second half of CY2019.

Successful Drilling of Sandstone Wells
Successful exploration results in the sandstone play will open the possibility of a Stage Two development based on 11% helium as opposed to the current reserve grade of 2.4%. Significant valuation upside is generated by higher grade helium. Target second half CY2019.

Signing of Customer Contracts
Signing of further customer contracts will increase the market’s confidence in take-up of LNG in South Africa as a transport fuel or industrial energy source. Several are currently under negotiation.

On-time Construction of Stage One
Delivery of the project on time and to budget will demonstrate the company’s ability to deliver to expectations. Target March 2021.

Consistent Performance of Liquefaction Plants / Positive Cash Flow
Consistent performance of the liquefaction plants will prove the project, begin to create positive cash flow and increase confidence in Stage Two.

Price Increases in Helium and LNG above our Estimates
The valuation is sensitive to price increases in both products (see table 5 and 6)

Feasibility Study Sandstone Play
If drilling is successful in the sandstone play, completion of the feasibility studies will boost market confidence in higher grade helium being delivered to the project. Geological results expected second half 2019.

Approval of Stage Two Plant
This will be a major milestone for the company and its development (Funding planned for first half CY2020)

Risks to the Share Price and Valuation

Lower than expected conversion to LNG – Heavy Vehicle and Wholesale Markets
Renergen’s strategy relies on the SA heavy vehicle and wholesale markets market adopting LNG. Slower-than-expected rates of conversion will be unfavourable to the share price and valuation.
Disappointing Drill Results, Lower Strike Rates and Flow Rates than Expected

Disappointing drill results and flow rates will be detrimental to the share price and decrease confidence in Stage Two. Disappointment in sandstone drilling results will also lower the expectations of high-grade helium being available to the market. Reservoir performance is a key to the project’s success.

Increased Costs (Drilling, Construction), Delays to Construction of LNG and Helium Plants

In development stages, increases in costs and/or delays to construction impact valuation and reduce market confidence.

Competition from Other Gas Sources

Imported LNG is seen as an alternative energy source for South Africa and, despite delays in implementation to date, may be competitive with Stage Two’s LNG. This may impact pricing and lead to closer alignment with global LNG prices.

Inability to Sign Additional Helium Customers

As a key value driver, any issues with signing helium customers will be negative.

Decreased Prices for Products

The valuation is sensitive to price decreases in both helium and LNG (see Table 5 and 6).

Political Risk / Fiscal Changes in South Africa

Energy policy has followed a difficult path in South Africa. Renergen has all approvals in place; however, there does remain a risk that policy and fiscal regime change will detrimentally affect the company. Changes in fuel tax effecting LNG will reduce its competitiveness with diesel and may require a change in strategy.

Delays and Increased Cost Stage Two

As the key driver of long-term value in Renergen, any delays or increases in cost for Stage Two would be viewed negatively by the market and will decrease valuation (see Table 6).

Poor Performance of Plant and Equipment

Reliable output from the liquefaction plants is a key driver of value for Renergen.

Renergen Market Factors

Renergen has several market factors that may affect the share price:

- **“South Africa effect”**
  The broader market tends to take a negative view on businesses based in South Africa. A view that South Africa presents a higher-than-average risk prevails. The view focuses on risks to ownership and tenure, BEE requirements, political and fiscal stability, workforce reliability and general safety.

- **Liquidity**
  Renergen has 112,635,000 shares on issue. Five shareholders own approximately 65% of the issued capital and the top 20 owns approximately 80%. Renergen is an illiquid stock and will not trade freely. The result can be either long periods of very little movement and trading in the stock, or large movements in the price as small parcels of shares are traded.

- **Micro-cap**
  In addition to the issue of liquidity, Renergen is a “micro-cap” stock, which limits its investment appeal for certain investors.

- **Lack of awareness – Australian Market**
  The market in Australia is not well educated about the stock and Renergen’s business. This can be improved with increased research and company presence.
Financials – Stage One Fully Funded

Stage One of the Virginia Gas Project

Renergen is at a crucial stage in its development. Having acquired the asset, proven its reserves, identified markets, obtained funding and gained all government and environmental approvals, the project has progressed to the development stage. The targeted date of first LNG and helium production is March 2021.

Renergen has raised equity capital through its JSE listing over the years. Most recently, it completed a capital raising in Australia and obtained an ASX listing. As at 28 February 2019, Renergen had ZAR97.9 million of cash, with debt sitting at ZAR49.7 million (ZAR39.9 million of debt is an interest-free loan not due until 2022).

Renergen has a US$40 million loan from OPIC to fund Stage One of the project. This loan was signed and completed on 21 August 2019.

Renergen is approaching the most challenging and high-risk phase of its development. Capital overruns and/or time delays in the construction process are viewed negatively by investors and can place downward pressure on the share price. Our assessment of Renergen’s project is that it is relatively simple, mainly “off the shelf” and has a skilled labour force available to it. We believe that the likelihood of delays and cost overruns are at the lower end of the scale but do exist. We have Stage One commencing in June 2021, three-months later than Renergen’s current estimates.

While the project is under construction, small amounts of revenue will be generated from CNG sales; however, Renergen will be cash flow negative for that period and drawing on the financial reserves of the company.

The OPIC loan is at favourable terms for Renergen. The US$40 million facility is for a period of 12 years and we have assumed a rate of 4% above OPIC’s funding rate (US Treasury rates). A 30-month grace period for principal repayments is in place.

Renergen will have negative operating cashflow in FY2020. It will require ZAR494 million to fund Stage One of the project and to explore the sandstone section of the deposit. Upon commencement of the project in FY2022, the company will become cash flow positive.

The company is adequately funded to construct Stage One of the project (see Table 7).

Table 7 – Funding of Stage One

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>ZAR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash less debt at February 2019</td>
<td>48</td>
</tr>
<tr>
<td>Australian Listing Capital Raising</td>
<td>95</td>
</tr>
<tr>
<td>Funds available from OPIC loan</td>
<td>588</td>
</tr>
<tr>
<td>Estimated Funds available for project</td>
<td>731</td>
</tr>
<tr>
<td>Estimated Capital Cost Stage One</td>
<td>(438)</td>
</tr>
<tr>
<td>Estimated Sandstone Drilling cost and feasibility</td>
<td>(56)</td>
</tr>
<tr>
<td>Estimated excess Funding Stage One</td>
<td>237</td>
</tr>
</tbody>
</table>

Source: MST Est

Stage Two of the Virginia Gas Project

The project’s 2P reserves allow for the company to expand the project well beyond its Stage One capacity of 2,700 GJ per day of LNG and 350 kg per day of helium.

Management estimates that they will expand the project to produce an additional 10,000 GJ per day of LNG and 1,200 kg per day of helium.

To achieve this goal, the company will need to construct another LNG and helium plant, drill, complete and tie in significant additional wells, and add pipeline capacity.
Table 8 – Funding of Stage Two

<table>
<thead>
<tr>
<th>Capital Requirements</th>
<th>Year</th>
<th>ZAR Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Well Drilling and Completion Capex</td>
<td>FY2024</td>
<td>276</td>
</tr>
<tr>
<td>Pipeline and Liquification Plant Capex</td>
<td>FY2025</td>
<td>709</td>
</tr>
<tr>
<td>Pipeline and Liquification Plant Capex</td>
<td>FY2026</td>
<td>709</td>
</tr>
<tr>
<td>Cost of Stage Two Expansion</td>
<td></td>
<td>1,694</td>
</tr>
<tr>
<td>Estimated Funding Required (net of cashflow)</td>
<td></td>
<td>823</td>
</tr>
</tbody>
</table>

Source: MST Est

Financial Statements

Renergen is currently a loss-making enterprise (see Table 10). As an early-stage company with a small amount of revenue and large set-up costs, it is not expected that Renergen will become profitable until FY2022 when Stage One of the LNG and helium plant has begun production.

Table 9 – Summary Financial Statements

<table>
<thead>
<tr>
<th>Financial Summary (ZAR'000s)</th>
<th>FY19</th>
<th>FY20e</th>
<th>FY21e</th>
<th>FY22e</th>
<th>FY23e</th>
<th>FY24e</th>
</tr>
</thead>
<tbody>
<tr>
<td>28-Feb PROFIT &amp; LOSS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>2,987</td>
<td>8,630</td>
<td>4,574</td>
<td>157,330</td>
<td>323,191</td>
<td>331,989</td>
</tr>
<tr>
<td>Operating Costs</td>
<td>44,227</td>
<td>44,358</td>
<td>48,353</td>
<td>95,357</td>
<td>148,385</td>
<td>157,807</td>
</tr>
<tr>
<td>EBIT</td>
<td>-46,014</td>
<td>-44,990</td>
<td>-53,571</td>
<td>52,458</td>
<td>97,499</td>
<td>82,718</td>
</tr>
<tr>
<td>Tax</td>
<td>3,572</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>NPAT (Reported)</td>
<td>-44,976</td>
<td>-42,030</td>
<td>-51,632</td>
<td>39,534</td>
<td>97,499</td>
<td>82,718</td>
</tr>
<tr>
<td>Minority Interest</td>
<td>-4,116</td>
<td>-4,670</td>
<td>-5,737</td>
<td>4,393</td>
<td>10,833</td>
<td>9,191</td>
</tr>
<tr>
<td>Average Number of Shares Outstanding</td>
<td>100,135</td>
<td>112,635</td>
<td>112,635</td>
<td>112,635</td>
<td>112,635</td>
<td>112,635</td>
</tr>
<tr>
<td>EPS (Underlying) ZAR</td>
<td>-0.50</td>
<td>-0.40</td>
<td>-0.46</td>
<td>0.35</td>
<td>0.87</td>
<td>0.73</td>
</tr>
<tr>
<td>EPS (Underlying) AUD</td>
<td>-0.05</td>
<td>-0.04</td>
<td>-0.05</td>
<td>0.04</td>
<td>0.09</td>
<td>0.07</td>
</tr>
<tr>
<td>P/E ZAR</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>22.8</td>
<td>9.2</td>
<td>10.9</td>
</tr>
<tr>
<td>P/E AUD</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>0.6</td>
<td>0.7</td>
<td>1.1</td>
</tr>
</tbody>
</table>

BALANCE SHEET

| Current Assets                | 102,438| 125,501| 50,473| 66,257 | 83,396 | 84,306 |
| Cash                         | 97,956 | 121,019| 21,109| 68,147 | 87,464 | 88,640 |
| Receivables                  | 4,482  | 4,482  | 381   | 13,111 | 26,933 | 27,666 |
| Non-Current Assets           | 122,672| 214,909| 594,979| 592,867| 565,427| 437,382|
| Intangibles                  | 70,494 | 115,893| 124,991| 118,090| 125,439| 350,063|
| Current Liabilities          | 11,193 | 11,193 | 376   | 1,849  | 3,031  | 3,105  |
| Long Term Debt               | 39,647 | 106,647| 479,875| 448,347| 328,332| 473,698|
| Provisions                   | 9,829  | 9,829  | 9,829 | 9,829  | 9,829  | 9,829  |
| Net Assets                   | 164,233| 221,533| 155,164| 199,091| 307,423| 399,332|
| Share Capital                | 301,277| 396,277| 396,277| 396,277| 396,277| 396,277|
| Reserves                     | 448    | 448    | 448   | 448    | 448    | 448    |
| Retained Earnings            | -121,091|-163,121|-214,753|-175,249|-77,720  | 4,998   |
| Minority Interests           | 10,141 | -21,071|-26,808 | -22,415|-11,582 | -2,391 |
| Total Equity                 | 164,233| 221,533| 155,164| 199,091| 307,423| 399,332|

CASH FLOW

| Working Capital Change       | 2,335  | 0      | 6,716  | 11,457 | 12,440 | 660    |
| Maintenance Capex            | 0      | 0      | -7,403 | -7,403 | -7,736 | -8,084 |
| Expansion Capex              | -9,587 | -101,500| -382,460| 0     | -20,000| -295,500|
| Acquisitions                 | -3,756 | 0      | 0      | 0      | 0      | 0      |
| Investing Cash Flow          | -13,343| -101,500| -389,863| -7,403 | -27,736| -303,584|
| Equity Issued                | 140,212| 95,000 | 0      | 0      | 0      | 0      |
| Debt Issued                  | 5,149  | 67,000 | 373,228| -31,528| -120,015| 145,365|
| Financing Cash Flow          | 145,310| 62,000 | 373,228| -31,528| -120,015| 145,365|
| Change in Cash Balance       | 94,919 | 23,063 | -70,927| 3,055  | 3,317  | 176    |

Source: MST Est
Environmental, Social and Governance (ESG)

ESG factors play an integral role in many investors' decision processes.

Environmental

The assessment of Renergen's environmental credentials falls into two categories:

- environmental assessment of the Virginia Gas Project
- environmental assessment of Renergen’s key products, LNG and helium.

Environmental Impact of the Virginia Gas Project

All extractive industries have an impact on the environment. The project will involve the drilling and completion of production wells and the construction of gas-gathering equipment, pipeline infrastructure and the associated LNG and helium plants. Renergen will also be providing mobile filling stations along major transport routes for LNG customers.

The major environmental impact from the project will be the well footprint. An average well can produce around 120,000 standard cubic feet (scf) of gas per day. Stage One will require approximately 20 working wells to achieve the required production rates. Depending on success rates of drilling, the wells may be spread over a wide area and will have associated pipework to the central gas processing facility. Each individual well’s footprint is not large by oil and gas industry standards, and on abandonment leaves minimal damage (see Figure 11).

Under Renergen’s licensing conditions, the company is required to provide in the accounts ZAR200,000 per well as a remediation provision, and to deposit ZAR20,000 per well as a bond, which is classified as “Restricted Cash” in the balance sheet.

Figure 11 – Well Footprint

Source: Renergen

As noted earlier, there is some evidence that the biogenic nature of the resource makes it a continuing and renewable resource. There are wells in the project that have been producing gas for 40 years without discernible pressure drop. Currently, no quantitative studies exist to prove the renewable nature of the resource. If future studies prove the resources to be continuing and renewable, it will be considered more environmentally advantageous than other gas projects.
Environmental Impact of Renergen’s Products

LNG

Renergen’s LNG markets will have significant environmental benefits, providing a less carbon intensive substitute for SA’s existing transport fuel, thermal fuel and power.

Seventy per cent of Renergen’s LNG will be sold as replacement for diesel in the heavy vehicle market. The life cycle emissions from LNG are 30% less than diesel when run on dual fuel and 60% when run exclusively on gas. In addition, a truck running on LNG has a 13% reduction in fuel consumption. Higher energy density LNG has less volume than diesel and trucks travel greater distances on LNG. The overall cost savings for operators have been shown to be greater than 26%.

Thirty per cent of Renergen’s LNG will either replace LPG or be used in power projects. LNG has far less impurities than LPG, creates less emissions and has greater efficiency. LNG customers will pay less for the LNG than they currently pay for LPG, further enhancing LNG’s appeal. LNG-fired power stations generate less emissions than coal-powered generators and are more efficient in converting energy.

Helium

Helium is a non-renewable resource, and in most cases a by-product of gas production. Helium has many properties that make it both valuable and environmentally friendly. It is inert and does not react chemically with other elements, is non-toxic, colourless, odourless and tasteless. Helium is crucial to industry, research and medicine. It is the only substance with no viscosity in liquid form, making it critical for use in high-energy physics.

Social

The social aspects of Renergen’s business are key to operating successfully in South Africa. The company:

• is 100% compliant with its Black Economic Empowerment requirements. Tetra 4 has 10% BEE ownership.
• had zero injuries or fatalities in FY2019
• employs predominantly local staff and engages local contractors for most of its work
• places 62% of its procurement spend with local firms
• has spent ZAR190,000 on further education for staff
• awarded six educational scholarships in FY2019
• has donated time and funds to charitable organisations
• accesses farmers’ land for wells and infrastructure and pays ZAR18,000 per hectare per annum.

The construction and continuing operations of the Virginia Gas Project will provide economic stimulation in an area in need of economic stimulus, will reduce the country’s reliance on fuel imports and increase the country’s exports.

Helium is used in high-end science and medical industries, particularly in the use of MRI machines, significantly benefitting the community.

Governance

Renergen’s governance policies are well documented and are in line with accepted principles. The company:

• adopts the “King IV” principles and practices as set out by the Institute of Directors in South Africa
• has a large board for its size, with nine members, five of whom are non-executive independent directors. There are three subcommittees (Audit, Risk and IT; Governance, Ethics Transformation and Compensation; and Nominations). The executive committee is made up of the CEO, COO and CFO
• recognises the benefits of a diverse board and has adopted a policy for the promotion of gender and race diversity and inclusion at board level
• ensures that the board’s qualifications are appropriate for the business
• has remuneration policies that are clearly set out and in line with market practices
• has no litigation matters outstanding
Management – Experienced and Capable

We have assessed Renergen’s senior management team as having the appropriate qualifications and experience to take the company through exploration and production drilling, construction and into production. The management is considered capable of delivering to company targets. We also consider the management competent to manage Renergen’s day-to-day affairs and to deal with the market.

Key Management

Mr Stefano Marani, Chief Executive Officer
Marani was instrumental in acquiring the Tetra4 property and has been involved in the management of Renergen since 2013. He has a financial background and qualifications in actuarial studies.

Mr Nick Mitchell, Chief Operating Officer
Mitchell was also instrumental in the acquisition of Tetra4 and has worked as COO since that time. He has worked closely with Marani in establishing Renergen. Mitchell has an operations, sales and IT background.

Ms Fulu Ravele, Chief Financial Officer
Ravele is a qualified Chartered Accountant with experience in audit, financial accounting and management accounting. She has been with Tetra4 since 2015.

Mr Johann Weidmann, Project Manager
Weidmann has 30 years of experience in managing multi-disciplinary engineering teams on projects including power, oil and gas and infrastructure. He has also worked on pipeline projects.

Mrs Nompumelelo Msimang, Engineering Process Manager
A Process Engineer with extensive experience in the SA fuel industry, Msimang has worked with Sasol and BP Southern Africa.

Mr Robert Katzke, Operations Manager
Katzke is responsible for the daily operations of the plant and staff. He has extensive experience in various types of plants and mine management.

Key Person Risk

We consider that Renergen has some key person risk. Given the deep involvement of Stefano Marani and Nick Mitchell since the beginning of the venture, we believe their loss would be detrimental to the company and have a detrimental effect on the share price. We do, however, view the likelihood of either of these senior managers departing Renergen as low.
Appendices

Appendix 1 – Revenue

Figure 12 – Revenue by Product by Year (ZAR million)

![Graph showing revenue by product by year.](image)

Source MST Est

Figure 13 - Percentage Revenue Share by Product by Year

![Graph showing percentage revenue share by product by year.](image)

Source MST Est

Figure 14 – Production Share by Product by Year (ZAR million)

![Graph showing production share by product by year.](image)

Source MST Est

Appendix 2 – Major Shareholders

Table 10 – Major Shareholders

<table>
<thead>
<tr>
<th>Beneficial Shareholder</th>
<th>Number of Shares</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tamryn Investments</td>
<td>34,461,220</td>
<td>30.60</td>
</tr>
<tr>
<td>Govt Employees Pension Fund</td>
<td>14,302,901</td>
<td>12.70</td>
</tr>
<tr>
<td>MATC Investments</td>
<td>8,708,806</td>
<td>7.73</td>
</tr>
<tr>
<td>CRT Investments</td>
<td>8,597,139</td>
<td>7.63</td>
</tr>
<tr>
<td>Notable Pioneer Limited</td>
<td>7,950,000</td>
<td>7.06</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>74,020,066</strong></td>
<td><strong>65.72</strong></td>
</tr>
</tbody>
</table>

Source Renergen
Appendix 3 – References

1 Lungiswa Energy – The Natural Gas Market in South Africa – Renergen Prospectus 2019
2 Renergen Prospectus 2019, Independent Helium Industry Report
3 MHA Update on Reserves Virginia Gas Project – Renergen Prospectus 2019
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