Gleneagle Asset Management Limited
Gleneagle Investment Trust (Equity Fund)

May 2023 Review

Summary

The ASX 200 sold off nearly -4% in May. Investing in early-stage illiquid companies isn't always smooth, our two main core holdings were under pressure, with another write-down in one of the unlisted investments. The result of -8.4% will no doubt be confronting to most, but we continue to hold these names and I'll outline the investment case for Helios and why we are so close.

We also had some excellent news with our Infinite Green investment; they are planning to IPO later this year at a much higher level than previously indicated. This should provide a huge positive boost for everyone's portfolio.

Helios

Helios's price is back down to where it was before the well update news in February. It is very clear that many traders/investors have lost faith and have been throwing in the towel. Again, we can be critical of the company's lack of communication causing these price setbacks, but the real question is **should we also be cutting this position and moving on?**

Let's just walk through the last 4 months again.

On the 9th February they announced strong oil and gas shows, flowback was 37% complete, 70-80 barrels of oil a day, 700K cubic feet of gas, and chlorides measurements indicated that the well had little water ("flowing back primarily frack water"). Most notably the last sentence of the announcement stated they would "keep the market informed". A welcome change and a great initial result. Unsurprising the stock started moving higher putting on 40% in the following month. Things were finally starting to happen after years of waiting.

Then the trail went cold.

We didn't get a flowback update from the company for 96 days. 96 days is a lifetime for a dying man, and even longer when you are expecting a flowback test result that could have been done in half that time. With no update, everyone logically assumed that the flowback testing must have failed, and the well was a dud. When a company doesn't inform the market, the only information is the price, and it was screaming "problems". Selling begets selling and price momentum goes negative.

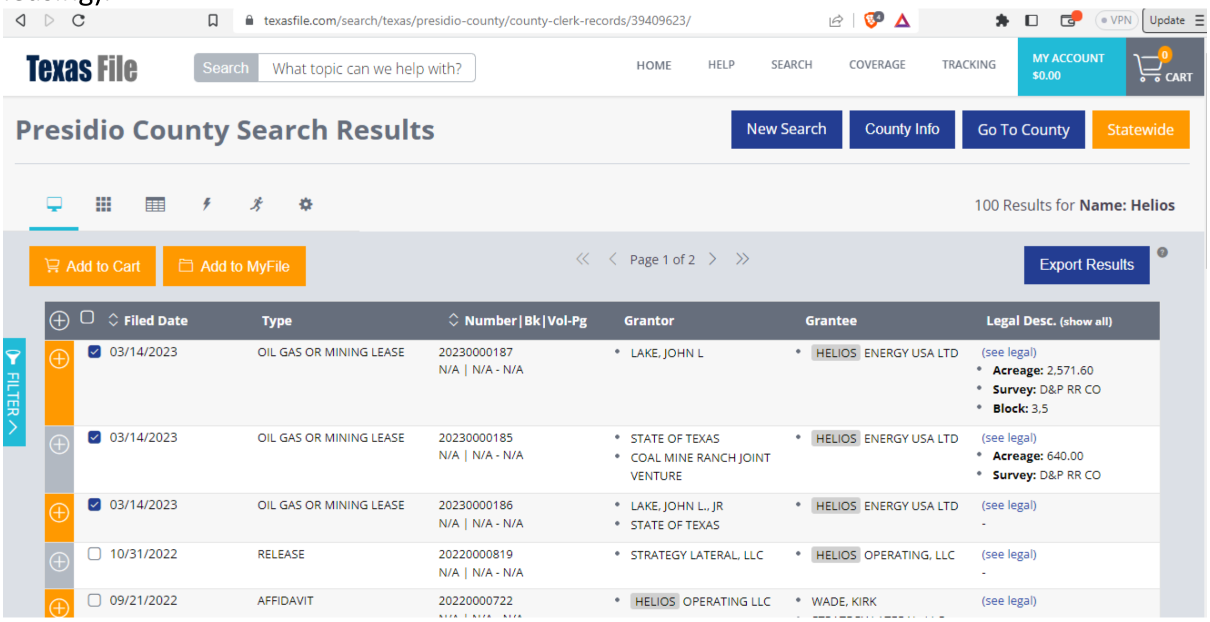
Before we go on, I do want to remind readers that I did point out a potential strategic reason for delaying the flow test results. Oil well flowback test results must be made public under Texas law. Landowners don't lease acres cheaply if they know what they are sitting on.

Last month they then announced the continuation of flowback testing. Wait, What? Continuation? They hadn't finished flowback testing and were just starting again? A 3-

month delay and all they mention is installation of production tubing and a compressor. Unsurprisingly, investor frustration was palpable. The following day we received a further well flowback progress report. Again, no explanation for the reasons for the extended delays. The good news was that **oil rate had increased** to over 100 BOPD, and the **gas rate had increased** to 1200K cubic feet/day, and this is with the **well still flowing back 750 barrels of frack water** – a great update and based on this we should expect higher oil and gas rates to come. But when investors are angry, fearful, or frustrated, they are not thinking rationally, so dump the stock and move on. And when a share price fails to rally after a seemingly good announcement – then the market message based off the price is 'something is wrong'.

So, let's look at what we know.

Helios is acquiring new land. Helios acquired 3 new lease acquisitions in March of which 2 have data, which is publicly available information on texasfile.com site. Expect these and potentially more acres to be announced to the ASX. I was surprised to find these leases under Helios's name, as often oil companies will obfuscate who's leasing by using seemingly unrelated entity names (recall you don't tip off the landowners about who is doing the leasing).



Well economics

Given that Helios has not provided any direct information, the follow section is worded general terms here based on 'rule of thumb' from discussions with people in the industry.

Oil well economics is a function of how much you make from the barrels of oils & gas per day vs cost of each well. For a good well, the cost payback time should be within 2-3 years.

You can put the number oil barrels, price of oil, transport costs etc into a model to determine how much revenue each well will generate, but again using the rules of thumb of industry experts - if they get 30 barrels of oil per stage, it should be considered a good result. 40 barrels a stage is excellent. 50+ is a bonanza. For a 4 stage well, this 120, 160 and 200 barrels/day respectively. We will get more flowback news (hopefully this month) – watch out for flow rates in terms of these numbers.

What is the average production rate of a well, and how does this rate differ between oil wells and natural gas wells?

In 2021, the average oil well produced 26 b/d (or roughly 33.5 BOE/d if including natural gas), and the average natural gas well produced about 181,647 cf/d (slightly more than 33.5 BOE/d of total oil and natural gas). The distribution by well size, however, is generally skewed. Many wells produce smaller volumes per day, and fewer wells produce very large volumes per day. In 2021, 77.9% of the more than 916,934 U.S. wells produced less than 15 BOE/d, and 6.4% of the wells produced more than 100 BOE/d.

Source: www.eia.gov/petroleum/wells/pdf/full_report.pdf

The gas rate is currently 1.2 MMCFPD (million cubic feet per day) and has been rising. There are several ways to work out what this is could be worth – using barrel of oil equivalent calculations but a better metric might be to use the Henry Hub gas contract price. The Henry Hub gas contract size is in MMBTu (Million Metric British Therman Units). This rate for 'clean gas' - there will be some losses after removing impurities such as moisture/co2 etc. There will also be transport costs – none of which I am privy to at this point, but we can get an indication on potential here.

> 1,000 cubic feet of natural gas = 1.037 MMBTU (Source: https://www.eia.gov/tools/faqs/faq.php?id=45&t=8)
>
> So 1.2 MMCFPD = 1244 MMBTU
>
> The Henry hub gas contract price is volatile - it hit $10 in 2022 and now ~$2.20 per MMBTU. The long-term average is around $3.00 which we shall use.
>
> At $3 per MMBTU, this is US$3733 per day before transport costs/wastage or US$1.36 million per year.

At ~US$3 million per well, the gas alone could go a long way to get under the 2-3 year payback window.

So, what are the catalysts in the short term?

- We should see the more flowback updates, and perhaps a final flowback rate.
- We should expect more land acres to be announced. We know they have acquired some.
- We could get an update on the economics of the gas.

Nothing about the investment thesis has deteriorated given the news flow. There have been delays, but there are always delays when investing and many of us have waited years for this. They are getting close. I like to say as an investor in Helios you'll also graduate with a PhD in patience.

I came across a tweet from @IanCassel which speaks to how to make big gains in small cap companies.

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The smaller the better
The more illiquid the better
The less institutionally owned the better
The more misunderstood the better
The less talked about the better
You make money by driving through the fears of other investors.

This describes our Helios and Elsight investment to a T.

Unlisted Investments

Most of these are small allocations (~1-2% of portfolio) and to date haven't been working. Unlisted investing is a bit hit and miss as a lot of early-stage companies fail. The basic strategy of unlisted investing (private equity) is that you invest in 10, 7-8 go terribly, 1-2 get your money back and the last one gets you 10x+ return. We had to write down another one in April (Red Piranha) which negatively impacted the month.

Fortunately, the Fund also has Infinite Green (renewable hydrogen play) which was given a much larger weighting than the other unlisted investments. Right now, it seems clear that renewable Hydrogen will be an essential part of the world's renewable future, and just last month the Australian government announced a $2 billion incentive for renewable hydrogen investment. **Infinite green is perfectly placed to benefit** and investors' appetite in this sector keeps growing. The company has great management and keeps going from strength to strength. We have learned that their current plan is to go public in October/November this year. **The price they are talking is currently ~4x** where we currently have it marked in the book. The main takeaway is this when they do finally list, it is shaping up to be a huge positive boost for everyone's portfolio and perhaps a great end to the calendar year.

If you have any questions or comments, please drop me a line at tim.muirhead@gleneagle.com.au

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