

Incremental Oil & Gas Ltd IOG

STRONG SILVERTIP GAS PRODUCTION BOOSTS OPERATING CASH FLOW

Capital Structure

ASX Code: IOG	
Shares	201.8 m.
Options	5.4 m.
Price	\$ 0.045
Market Cap	\$ 9.1 m.
Net debt (est)	\$ 9.3 m.
EV	\$ 18.4 m.
Diluted shares	207.2 m.

Board/Management ownership 28%

Board & Management

Mark Stowell	Non-Exec Chairman
John Whisler	Managing Director
Gerry McGann	Non-Exec Director
Matt McCann	Non-Exec Director
Simon Adams	CFO—Co Secretary

Valuation

Risky Valuation	Range			
	A\$ m.		\$ / Share	
Production assets	\$26.7	\$41.9	\$0.129	\$0.202
Net Debt	-\$9.3	-\$9.3	-\$0.045	-\$0.045
Share Options (NPV)	\$0.6	\$0.6	\$0.003	\$0.003
Risky Silvertip	\$3.0	\$6.1	\$0.015	\$0.029
Corporate	-\$3.8	-\$3.8	-\$0.019	-\$0.019
	\$17.2	\$35.4	\$0.083	\$0.171

Source: Strachan Corporate Ltd

Recommendation

The stock is a speculative buy.

An exceptional gas production result from an initial recompletion over a shallow target shows potential for strong operating cash flow support.

Further recompletion work into gas and oil targets at Silvertip hold substantial value upside for Incremental.

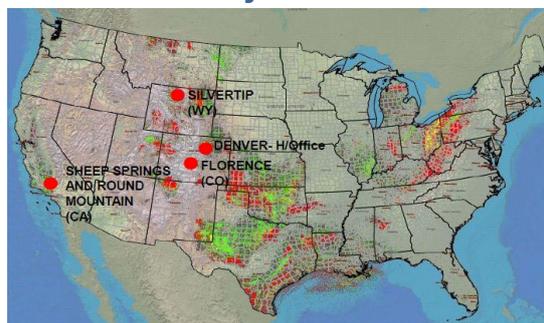
Peter Strachan



Investment Drivers

- ◆ **A SHALLOW MEETEETSE GAS TARGET FLOWS AT OVER 1.2 MMCUFT PER DAY:** Low cost recompletion of a shallow gas target from an existing well at the Silvertip field produced much stronger gas flow than expected. Strachan Corporate estimates that high pressure within the permeable Meeteetse sand reservoir holds potential for significant gas recovery of up to 0.6 Bcf from this well alone.
- ◆ **POSSIBLE BOOST TO ESTIMATED TOTAL GAS TARGET WITH MORE HIGH VALUE PROSPECTS BEING ASSESSED:** Incremental initially assessed a target of up to 3 Bcf of gas from a planned programme of 24 recompletions of existing wells over shallow gas sands at Silvertip. Flow from the most recent well represents an 8-fold increase in expected initial production (IP) of 150 to 200 Mcf per day to produce total recoverable gas of about 0.2 Bcf over the life of each well. Strachan Corporate estimates that results from this most recent well indicate potential for a much larger ultimate target, in excess of 4 Bcf.
- ◆ **STRONG CASH FLOW GENERATION TO SUPPORT GROWTH PROGRAMME BY INCREMENTAL OIL & GAS:** Projected financial return from this well alone indicates payback of original US\$35K CAPEX within two weeks and net revenue of over A\$500,000 over the first year of gas sales.
Strachan Corporate calculates that completion of the company's shallow gas development programme holds potential to lift IOG's operating cash flow by at least \$2 million pa.
- ◆ **EXPANDING PRODUCTION FROM ~600 BOEPD AT SILVERTIP:** In-house analysis of productive Paleozoic oil reservoirs below the main producing Frontier Formation, indicates Contingent Resources of between 2.1 and 3.6 mmbbls in the Phosphoria, Tensleep and Madison Formations. One recompletion of a well for oil, in the Madison Formation has been permitted for later this year.
- ◆ **WEAK PETROLEUM PRICES & DISTRESSED SELLERS OFFER OPPORTUNITY:** Strong deal flow and a supportive banking partner provide opportunity for Incremental, which has a track record of buying assets at below market value.
- ◆ **RISKED TARGET VALUE OF BETWEEN 8.3 AND 17.1 CPS:** Incremental is undervalued with respect to the value of its producing assets plus development potential. Field operating costs are typically less than US\$7.5/boe.

Incremental Oil & Gas - Project Locations



Source: Incremental

Introduction

Incremental Oil & Gas Ltd. has a low risk approach to its USA business model. The company has a track record of upgrading and expanding output at low capital cost from low priced asset acquisitions. As the oil price recovers, Incremental will have funded project development plus potential to uncover significant company growing development or exploration opportunities in known production regions.

Low cost oil & gas in the USA

A\$25.4 million discounted income estimated from 1P Reserves . . . supports current EV

A 24 well recompletion programme beginning H2 '16 targets up to >3 Bcf of gas

Reserves & production upgraded by >75% since acquisition mid 2015

Strachan Corporate estimates potential for up to 0.6 Bcf from latest recompleted gas zone.

Net Proved Reserves		Producing	Behind pipe	Total
Liquids	K bbls	780.8		780.8
Gas	mmcuft	3,835.8	1,856.4	5,692.2
BOE	K bbls	1,420.1	309.4	1,729.5

Source: Incremental Oil & Gas

An independent third party recently determined that Incremental's 1P Petroleum Reserves include 780.8 Kbbbls of oil plus 5.7 Bcf of gas behind pipe and in producing fields. Applying conservative forward commodity pricing from current cyclical low levels suggests future net income, discounted at 10% pa from these Reserves, of US\$19.3 million or A\$25 million, which compares favourably with IOG's current EV of A\$16.6 million.

The company has commenced a 24 well recompletion programme for a total estimated cost of less than US\$1 million. This work targets at least 3 Bcf of gas Reserves behind existing pipe and should boost gas production by over 2.5 mmcuft per day.

SILVERTIP

82.5% NRI

Incremental bought 100% WI in this multi-well oil and gas project in Wyoming during July 2015 for US\$6.3 million. The company's management was able to negotiate a very low purchase price compared with value, because of its knowledge of the U.S. oil & gas industry, supported by weak market conditions for petroleum assets.

IOG paid a multiple of US\$15,750 per flowing BOE for this asset, but a schedule of similar deals throughout the USA during 2015 by E-Spectrum concluded that the median multiple for oil weighted assets was US\$49,500 per BOEPD while gas assets worked out at US\$26,400 per BOEPD. Considering IOG's product mix, a multiple of ~US\$38,200 per BOEPD seems more appropriate to value the whole company.

Silvertip consists of 5,520 net mineral acres located in north-western Wyoming in the Big Horn Basin, over which the company holds about 14.6 square miles of 3D seismic data. The project includes substantial surface facilities, including an 18 mmcuft per day gas processing plant as well as compressors, three substantial oil storage batteries and offices, as well as a substantial and valuable inventory of well casing tubular steel and other down-hole equipment.

A recent IP of 1,200 Mcf per day, with a flowing casing pressure of over 400 PSI from a well recompletion over the Meeteetse Formation, indicates potential for much more gas than the upper limit of 3 Bcf that was originally estimated. While not all recompletions will perform as well as this most recent result, it is never the less very encouraging for both short to medium term operating earnings, as well as the outlook for expanding gas reserves.

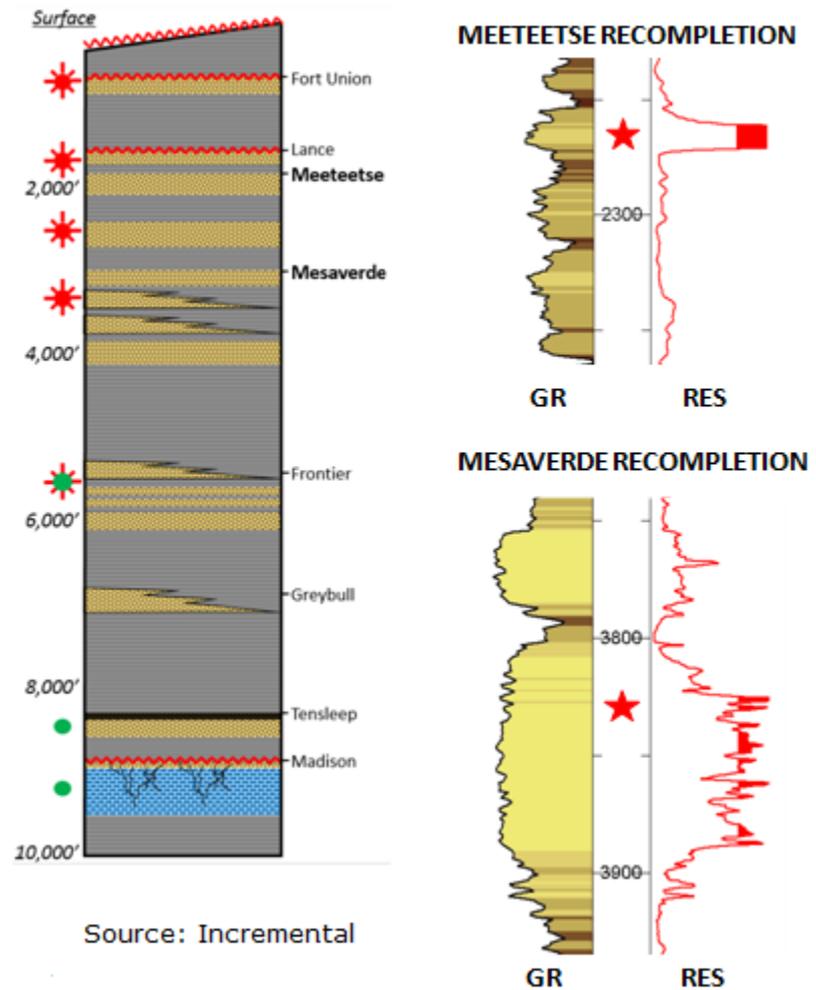
PDP Reserves at Silvertip currently amount to 3.7 Bcf of gas plus 0.347 mmbbls of oil, for a total of 0.96 mmbbls. Recent success with well recompletion should enable an upgrade to these Reserves.

Historically, the project has produced over 6.3 mmbbls of oil and 42 Bcf of gas, predominantly from the Frontier Formation at a depth of about 1,830 metres. The field contains multiple, stacked pay zones extending from shallow Upper Cretaceous gas zones below 500 metres to significant potential oil targets in the deeper Permian and Mississippian aged rocks below 2,600 metres depth.

Geological Column

PROVED DEVELOPED NON-PRODUCING SHALLOW GAS

20+ WELLS TARGETING 3 BCFG – LOW COST RECOMPLETIONS



Source: Incremental

During H2 2015, Incremental increased production at Silvertip from close to 400 to just below 700 BOEPD at an operating cost near US\$10/boe. The company undertook 25 well workovers and two new well completions in the shallow Meeteetse and Mesaverde sands, where porosities of around 20% support commercial flows from shallow depths.

Re-completion of gas sands adds >3 Bcf of gas

These two pilot recompletions indicate that similar zones can be produced economically from many of the existing 105 wellbores on the field. Independent technical analysis of this finding has outlined 1.81 Bcf of Proven, developed, non-producing (PDNP) Reserves and an in-house analysis lifts target gas to 3 Bcf, but the most recent flow rate of 1.2 mmmcuft per day at high reservoir pressure points to more production and reserve upside.

Tensleep reservoir has longer-term development potential in a higher oil price environment

Prior to 2005, the Pennsylvanian Tensleep Formation at a depth of about 2,620 metres produced sour oil plus methane mixed with H₂S gas, which was piped away for third party processing.

Further upside for development of the Madison Formation is under review

In-house analysis by the company now estimates that the Tensleep Formation holds 2.63 mmbbls of Contingent oil Resources in formations that will require water sweep to recover oil from low energy reservoirs. A low-cost test of the formation is possible by deepening a well from the shallower Frontier Formation.

Two historic wells in the deeper Madison Formation successfully produced light oil of 38° API but were never fully developed due to successful development in the shallower reservoirs. An in-house analysis estimates remaining Contingent Resources of 0.27 mmbbls of oil, but re-analysis of 3D seismic data will enable a better understanding of the Madison formation, including possible upside for future potential development.

Mature production profile at Florence

FLORENCE 100% WI

The Florence oilfield produces from fractured Pierre Shale between 914 and 1,128 metres. Production is following a shallow decline curve at around 50 BOPD, with only slight decline expected over coming years. The deeper Niobrara shale at the field has potential for additional production, but further work will await a stronger commodity price environment.

Sheep Springs decline is less than 2% pa

CALIFORNIA 100% WI

Production from the Sheep Springs and Round Mountain projects has stabilised at around 100 BOEPD. Both fields have further development potential that will await improved oil and gas pricing.

Californian Assets



Source: Incremental

Valuation

Incremental Oil & Gas trades with an enterprise value of ~US\$7.3/BOE of its 1P Reserves. Strachan Corporate calculates that, in the strong likelihood of adding 3 Bcf of 2P gas Reserves at Silvertip, the company's EV/BOE of 2P Reserves should be a modest US\$6.28/BOE, indicating room for significant capital appreciation as the oil & gas market recovers.

Incremental paid a rock bottom multiple of US\$15,750 per flowing barrel of oil equivalent when it purchased the Silvertip field. A multiple of US\$94,000 per flowing BOE was more common at higher oil and gas prices in 2013. Compilation of deals in the US\$10 to US\$2,000 million range during 2015 found that the median multiple for oil weighted deals was US\$49,500 per flowing BOEPD while gas weighted deals attracted a multiple of US\$4,400 per flowing MCF/d or US\$26,400 per flowing BOEPD. Applying a bargain basement multiple of US\$25,000 to the company's now ~800 BOEPD delivers a market price estimate of A\$26.7 million, but a more acceptable multiple of US\$38,200 per flowing BOEPD incorporating the oil and gas weighted outcomes during 2015, results in a target value for producing assets of A\$40.7 million or 24 cps.

Under these scenarios, estimated value for productive assets plus risked upside for development of gas and Paleozoic oil resides between 8.3 cents and 17.1 cents per share.

Assessed risked value between 8.3 & 17.1 cps

Risked Valuation	Range		\$/Share		Comments
	A\$m.				
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Net Debt	-\$9.3	-\$9.3	-\$0.045	-\$0.045	
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Risked Silvertip	\$3.0	\$6.1	\$0.015	\$0.029	
Corporate	-\$3.8	-\$3.8	\$0.019	-\$0.019	4 times non BD administration
	\$17.2	\$35.4	\$0.083	\$0.171	

Source: Strachan Corporate Ltd

Board & Management

Mark Stowell, Non-Executive Chairman

Mark has a history of work within the public company corporate sector for over 20 years including significant IPO and merger activities in the resource and energy sectors.

John Whisler, Managing Director

John has more than 25 years experience in the oil and gas industry. He has a broad range of skills including business development, project management, exploration, field production, drilling and completions. He was previously a Vice President of Operations at PetroGulf and then CEO of Delek Energy US.

Matthew McCann, Non-Executive Director

Matt has over 20 years of experience in the legal and energy sectors. He was Senior VP at Sandridge Energy and CEO for Transatlantic Petroleum which grew from a junior explorer to a significant international oil and gas producer in 2 years.

Gerry McGann, Non-Executive Director

Gerry has over 40 years experience in the upstream oil and gas industry as a petroleum geologist. He increased Occidental oil's production in Oman from 32K to 52K bopd in 3 years and was Managing Director at ASX listed Incremental Petroleum responsible for management of second largest oil production company in Turkey.

Simon Adams, CFO & Company Secretary

Simon has more than 20 years of experience with a number of ASX listed companies in various sectors including energy, agribusiness, resources and property.

Disclaimer

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