

Investment Memo: 88 Energy (ASX:88E, AIM:88E)

Published: 21-Feb-2022

This memo was closed off due to Key Objective #1 failing. We have provided commentary on each of the memo items and it has been replaced by a new memo for 2022 - Update June 9 2022.

What does 88E do?

88 Energy Ltd (ASX: 88E | OTC: EEENF) is an oil and gas exploration company focussed on a portfolio of assets in the North Slope of Alaska, USA.

What is the macro theme behind 88E?

The world is moving into a period of oil and gas scarcity following multiple years of underinvestment.

The demand shock caused by COVID-19 and the subsequent oil price falls lead to a destruction in activity on the supply side. With demand now recovering, the supply-side hasn't responded, which we think will lead to oil price pressures to the upside in the medium-term.

[Update June 9th 2022 - Grade= A: We think that the macro theme is unchanged from when we first published this Investment Memo. With energy independence issues flaring up globally whilst in the background oil and gas prices continue to moving higher we think this thematic has only become stronger]

Why did we invest in 88E?

North Slope in Alaska: 88E is exploring for oil on the North Slope in Alaska - one of the "oiliest" places on the planet. This region is home to some of the largest oil fields in the US, including Prudhoe Bay - the largest onshore oil field in North America, having produced over 12 billion barrels of oil since discovery. 88E holds multiple assets with 3.4B+ barrels of oil equivalent discovery potential.

[Update June 9th 2022 - unchanged]

88E generally drills once a year in high risk / high reward events: 88E has drilled five wells in just over 6 years targeting large oil discoveries. We are invested in 88E because it provides exposure to a high-risk high-reward drilling program every year. The 88E share price tends to

perform well as 88E goes into a new drilling program. 88E is gearing up to drill the Merlin-2 Well in March 2022 targeting 652 million barrels of oil.

[Update June 9th 2022 - Grade= A: Despite the Merlin-2 drilling results returning no commercial discovery, 88E did manage to get its annual high risk high reward drilling event completed. We have therefore given it aN A for living up to one of the key reasons we held 88E in our portfolio]

Nearology to ConocoPhillips Willow Oil Field: 88E's 652 million barrel prospective resource at its Peregrine Project is analogous to the Willow Oil Field owned by ConocoPhillips, the #1 oil producer in Alaska. The Willow Oil Field has a resource between 400-750 million barrels of oil equivalent and is a planned 160k barrels/day over 30-years. 88E's exploration at the Peregrine Project is targeting a similar discovery.

[Update June 9th 2022 - Grade= C: This was one of the key reasons we were holding 88E in our portfolio leading up to the Merlin-2 drilling event. Unfortunately as is the case with most "nearology" exploration Investments, this reason failed to materialise. The Merlin-2 well failed to deliver a new discovery analogous to ConocoPhillips Willow field. We are still hoping in the future 88E re-visits Project Peregrine and tests the remaining independent prospects (Harrier/Harrier Deep)]

Oil out of favour: Fossil fuels are becoming increasingly shunned by investors and are leading to a lack of investment in oil and gas exploration. The transition to green energy is expected to take longer than the markets are expecting. Oil demand is expected to remain strong in the medium-term. COVID-19 demand shock shutdown a lot of barely profitable wells and as the demand-side of the equation recovers, supply is struggling to catch up.

[Memo Assessment - June 9th 2022] Grade= A: Over the course of the year, with the Russia/Ukraine conflict continuously escalating this reason for Investing has in fact strengthened. The oil price is up from ~US\$78/barrel when we launched our memo to now trade at ~US\$122/barrel]

What do we expect 88E to deliver in 2022?

THE Key Objective we want to see from 88E is to drill the Merlin-2 appraisal well at Project Peregrine.

88E will be drilling a 652 million barrels of oil equivalent target at the Merlin-2 Well in Q1-2022. The Merlin-1 well drilled in 2021 confirmed a petroleum system. Project Peregrine is analogous to ConocoPhillips Willow Oil field.

A discovery here would put 88E on the radar of the majors in the area. A lot is riding on the results of the Merlin-2 well, which is being drilled in March 2022 - the results of this well will determine what we want to see the company deliver for the rest of the year.

[Memo Assessment- June 9th 2022] Grade = F: The only key objective we set for 88E as part of this Investment Memo was for the company to try and make a discovery with the Merlin-2 well, unfortunately the drilling program returned no commercial discovery and our key objective failed to deliver what we expected]

What could go wrong?

Drilling Risk: 88E is still in the exploration stage so big drilling events can have binary outcomes, risk needs to be managed going into these large binary outcomes.

88E's upcoming Merlin-2 well is an appraisal well however. Whilst not an 'exploration' well it is still inherently high-risk. The purpose of an appraisal well is to test a previously discovered oil and gas show. There is a chance the appraisal well returns no oil and gas.

[Memo Assessment- June 9th 2022] Grade= F: This was the major risk ahead of the Merlin-2 drilling program. This risk materialised and the binary outcome went against us with no commercial oil & gas discovery being made]

Funding Risk: Oil and gas is a fossil fuel, with commitments from countries all over the world to decarbonise. ESG mandates for capital are forcing some investors to divest or move capital away from the space, 88E is still in the exploration stage and requires financing to get its assets commercialised.

[Memo Assessment- June 9th 2022] Grade= B: We think that 88E managed funding risk relatively well leading up to the drilling program. Ideally we would have liked to see 88E look to bring in a farm in partner who would have funded some of the drilling costs but the fact that 88E has managed to move away from the drilling program and still have some cash left over + some cash flow producing projects acquired, we think this risk was well managed by 88E]

Regulatory risk: Whilst this is not part of 88E's acreage, the Biden Administration suspended oil drilling licences in Alaska's Arctic National Wildlife Refuge earlier this year. ConocoPhillips are facing legal setbacks in bringing the Willow oil field project to production.

[Memo Assessment- June 9th 2022] Grade= A: 88E didn't have any regulatory risks pop up leading up to the Merlin-2 well, but it did face some time delays due to environmental concerns from local environmental lobbyists. The risk was well managed with the drilling program being done only a few weeks late]

What is our investment plan?

We have observed an increase in market speculation on the outcome of 88E drilling events every year.

We are anticipating a rise in the 88E share price either just before the drilling of Merlin-2, or going into the Merlin-2 drill results.

Our plan has been to invest early, months before drilling, and hold as momentum increases in the story.

We then seek to free carry and take some profit at drilling.

We hold a portion of our position going into the Merlin-2 results. This suits our investment strategy but may not suit yours.

Always seek professional advice when investing in speculative stocks like this one.

[Memo Assessment- June 9th 2022] Grade= B: In the lead up to the drill results we sold a portion of our Total Position in 88E in line with our Investment Plan enough to Free Carry. This de-risking before the drilling results limited our downside, whilst still providing enough upside exposure in the event that drilling was a success.

Note: this grade and assessment on the Investment plan is based on how well we stuck to our investment plan, not the outcome of the investment itself.

Disclosure: The authors of this article and owners of Next Investors, S3 Consortium Pty Ltd, and associated entities, own 6,610,000 88E shares at the time of writing this investment memo. S3 Consortium Pty Ltd has been engaged by 88E to share our commentary on the progress of our investment in 88E over time.