



# ReconAfrica Ltd.

(RECO-V, RECAF-OTCQX, OXD – Frankfurt)

SECTOR: Energy

STOCK PRICE \$1.85  
 RATING **BUY**  
 TARGET PRICE ↓ \$8.00  
 Previous \$14.00

## COMPANY UPDATE

### Not a Dry Hole, but Not a Commercial Discovery; Market Focusing on the Latter

**OUR TAKE:** Yesterday, ReconAfrica provided an update on operations including results of the Makandina 8-2 well, spud date of the Wisdom 5-1 well, and first look at fresh seismic results. In our view, this was a very technical update with most investors likely discounting information and perhaps ‘missing the forest for the trees’ and instead keying in on the results of the Makandina 8-2 well, that while being deemed a technical/geological success (hydrocarbons were encountered) was not judged to be a commercial hole, which has resulted in a significant negative impact on the stock.

Keep in mind, the exploration and evaluation of this resource is still at a very early stage and will require substantial capital and drilling to delineate and prove commerciality. Also remember the 8-2 well was the first well that was drilled and controlled on one seismic line. With a current cash position of ~\$40 MM, the Company plans to continue to appraise the same rift play as the 8-2 well with the Wisdom 5-1 well. Additionally, interpretation of the Company’s phase 2 seismic program is now complete and internally has already identified additional leads which has increased the prospect portfolio, while also identifying targets in a new play type, the “Damara Fold Belt” which is believed to be an extensive area southwest of the Karoo Rift Basin.

Of course we would have liked to see a good reservoir development and a commercial well, but the data from the 8-2 well is very important to the overall exploration effort, which will continue with additional seismic and an active drilling campaign through 1Q23.

#### KEY HIGHLIGHTS

- ◆ **A technical success but not economic.** The Makandina 8-2 well is the third well that has been drilled in the Kavango Basin by the Company. The well encountered flowable hydrocarbons (primarily c1-c5, wet gas) from both the Karoo Rift and below and once again encountered all the components of a working petroleum system (source rock, reservoir rock, and closures/traps). The challenge has been finding all in the same place in commercial accumulation with current sparse seismic coverage (the 8-2 well was tied to just 1 seismic line).
- ◆ **Next up – the Wisdom 5-1 well.** Following up on the technical success of the 8-2 well, the Company has selected the next location. The objective of the well is to test stacked plays in a different part of the Karoo Rift Basin, with an additional objective of penetrating deeper reservoirs in the Pre-Karoo. Same geologic zones targeted/encountered in the Makandina. The location is controlled by 3 lines of seismic which coupled with the drilling of the 8-2 well should reduce drilling risk. The well is expected to be spud by mid-November, placing the next drilling catalyst in mid 1Q23.
- ◆ **Drilling and shooting simultaneously.** An additional 1,500 km of 2D seismic has received environmental approval. Mobilization of crews is currently underway and data acquisition is expected to begin later this month and run concurrently with drilling of the 5-1 well.
- ◆ **JV process ongoing.** The JV process as announced on September 8<sup>th</sup> is ongoing with good interest from a variety of companies. We suspect interest will pick up following new seismic data in combination with results of the 8-2 well. A strong partner would also be seen as endorsing the technical work ReconAfrica has done to date.

#### RECOMMENDED ACTION

**RECO equates to a high risk/high reward opportunity with well-defined near-term catalysts**

- ◆ **We maintain our Buy rating but reduce our Target Price on ReconAfrica from \$14 to \$8 to reflect more conservative assumptions in our NAV estimate.** Specifically we extended our forecasted date of initial cash flow to 2026 from 2024; increased our discount rate to 15% (from 12.5%); and reduced our estimate for chance of commerciality (reduced from 36% to 24%) which is a function of risk of commercial success (reduced from 55% to 40%) and risk of development (reduced from 65% to 60%).

PROJECTED RETURN **332%**

RISK FACTOR **Very High**

#### SCENARIO ANALYSIS

Downside Scenario	Current Price	Price Target
\$0.00	\$1.85	\$8.00
↓100%		↑332%

#### KEY STATISTICS AND METRICS

52-Week High/Low	\$7.47 / \$3.25
YTD Performance	-71%
Dividend Yield	N/A
Shares O/S	236.6 MM (f.d.)
Market Capitalization	\$438 MM
Net Debt (Q2/22)	-\$41.3 MM
Enterprise Value	\$397 MM
Daily Volume (3 mos.)	256,000
Currency	C\$ unless noted

#### HAYWOOD ESTIMATES (CAD)

	2021A	2022E	2023E
Production (boe/d)	1,157	1,200	1,200
% Oil	27%	30%	30%
CAPEX - E&D (MM)	\$35.6	\$60.0	\$50.0
Cash Flow (MM)	nm	nm	\$3.1
CFPS (fd)	nm	nm	\$0.01
D/CF	nm	nm	nm
EV/DACF	nm	nm	nm
EV/BOE/D	nm	nm	nm

#### VALUATION

**RECO trades at ~0.2x our heavily risked NAV of \$8.00/sh.**

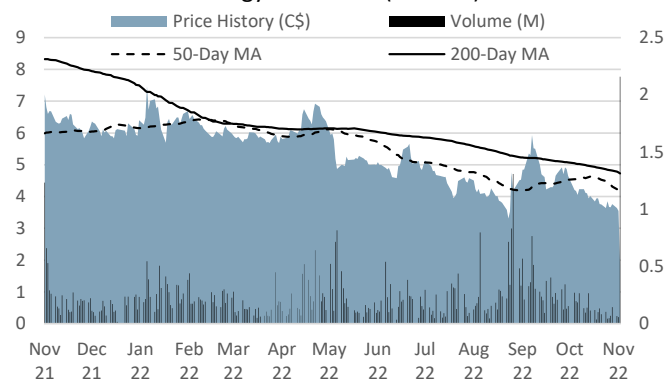
## INVESTMENT THESIS

Our investment drivers are as follows:

- ◆ **The Kavango Basin – This Could Be Big:** RECO holds a 95% interest (NAMCOR holds 5% assuming closing of RECO/NAMCOR WI purchase) in 6.3MM acres in northeast Namibia and 100% in an additional 2.22MM acres in adjacent Botswana. An NI 51-101 compliant resource report prepared by NSAI (dated April 27/22) underlined the potential of the Kavango Basin in NE Namibia which shows a total net unrisked best-estimate prospective resource of 854.1 MMbbls of oil. In our view, the team is positioning themselves as leaders of understanding the basin, and on success, given the scale of the Kavango Basin, we believe RECO could have plenty of opportunities to enter strategic joint-ventures (farm-outs) which could sanction further de-risking of the basin without dilution to existing shareholders.
- ◆ **Upcoming catalysts.** JV potential in 2022/23; Seismic phase 2 extension (+1,500 kms of 2D) approved and expected to run through April 2023 with multiple updates along the way; Wisdom 5-1 well, key to eventual commercialization.

## SCENARIO ANALYSIS

### Reconnaissance Energy Africa Ltd. (RECO-V)



Source: Capital IQ, and Haywood Securities

### TARGET PRICE

ReconAfrica is an early-stage resource exploration resource play. As such, we focus on our total risked NAV, which includes our upside estimate of the best prospective resource potential in the Kavango Basin. In arriving at our 12-month target price of \$8.00/share, we have risked this upside potential by an ~24% chance of commercialization.

### DOWNSIDE CASE

Should exploration drilling be unsuccessful, we estimate the downside to the stock could be nil (\$0.00/share) as a negative outcome would make securing or finding a JV partner to carry further appraisal drilling challenging. Should the team, however, be successful in proving the presence of oil and economic viability of its resource, we think that the stock could be worth multiples of its current valuation.

*Our downside scenario price is a theoretical case based on notional valuation metrics and market assumptions. The downside price is solely intended for demonstrative purposes and is not to be regarded as a reflection of all market possibilities. It is not a guarantee that this company's share price will not drop below this price level and hence should not be taken as such.*

### KEY RISKS

- **Exploration/Commerciality risk.** A sole driver of our resource value is attributable to the prospective resource potential of the Company's newly discovered Kavango Basin. The exploration and appraisal of this resource is at an early stage and will require substantial amounts of capital and resources to develop and move to commercialization. Failure to prove the presence of hydrocarbons or commerciality could very likely result in significant share price deterioration.
- **Environmental opposition to hydrocarbon development and public acceptance.** ReconAfrica primary's activities involve the exploration and potential extraction of fossil fuels in Namibia and Botswana. As such, public opposition may obstruct the Company's ability to deliver on its planned activities which could negatively affect the share price. Examples of opposition include but are not limited to environmental and social group opposed to petroleum extraction, and land and water use issues.

### Company Profile

**ReconAfrica Ltd.** is a Canadian-based oil and gas company working collaboratively with national governments to explore oil and gas potential in Northeast Namibia and Northwest Botswana – the Kavango Basin

### Company Website

[www.ReconAfrica.com](http://www.ReconAfrica.com)

Scot Evans – CEO

Carlos Escribano – CFO

Nick Steinsberger – SVP, Drilling & Completions

Diana McQueen – SCP, Corporate Communications & Relations



## Valuation: Material Upside as Kavango Play is De-risked

ReconAfrica is an early-stage resource exploration resource play. As a result, we focus on our total risked NAV for RECO, which includes full value for the prospective recoverable resource potential in the Kavango Basin in NE Namibia as reported by a NI 51-101 compliant resource report prepared by NSAI, which shows a total net un-risked mean prospective resource of 854.1 MMbbl of conventional oil and 1,216 Bcf of conventional natural gas. The estimate of prospective resource was dated as of December 31, 2021, and includes 35 leads with multiple potential target zones located in PEL 73.

In arriving at our 12-month target price of \$8/share, we have applied a risk factor to this upside potential of 24%.

Figure 1: RECO Net Asset Value

	Field Interest	Prospective Recoverable Resource (P50)			Risk Factor CoC % <sup>3</sup>	Risk Factor	Risk Factor
		Net Reserves mmbae <sup>1</sup>	Unrisked US\$/boe	Unrisked US\$MM <sup>2</sup>		US\$MM	C\$/share <sup>4</sup>
<b>Exploration Assets</b>							
Kavango Basin							
	Namibia - aggregate working interest	95%	998				
	<b>Total net mmbae</b>		<b>998</b>	<b>\$5.70</b>	<b>\$5,682</b>	<b>24%</b>	<b>\$1,364</b>
							<b>\$8.00</b>

(1) Based on net unrisked prospective resource potential from a prospective resource report prepared by NSAI

(2) PV15% on long-term Brent price of US\$65/bbl

(3) Chance of commerciality is a product of the risk of a successful commercial discovery and risk of development; CoC = CoSD\*CoD, or 40%\*60%=24%

(4) Calculated on a fully diluted share count of 236.6 MM shares and USD/CAD exchange rate of \$0.74

Source: Haywood Securities Inc.

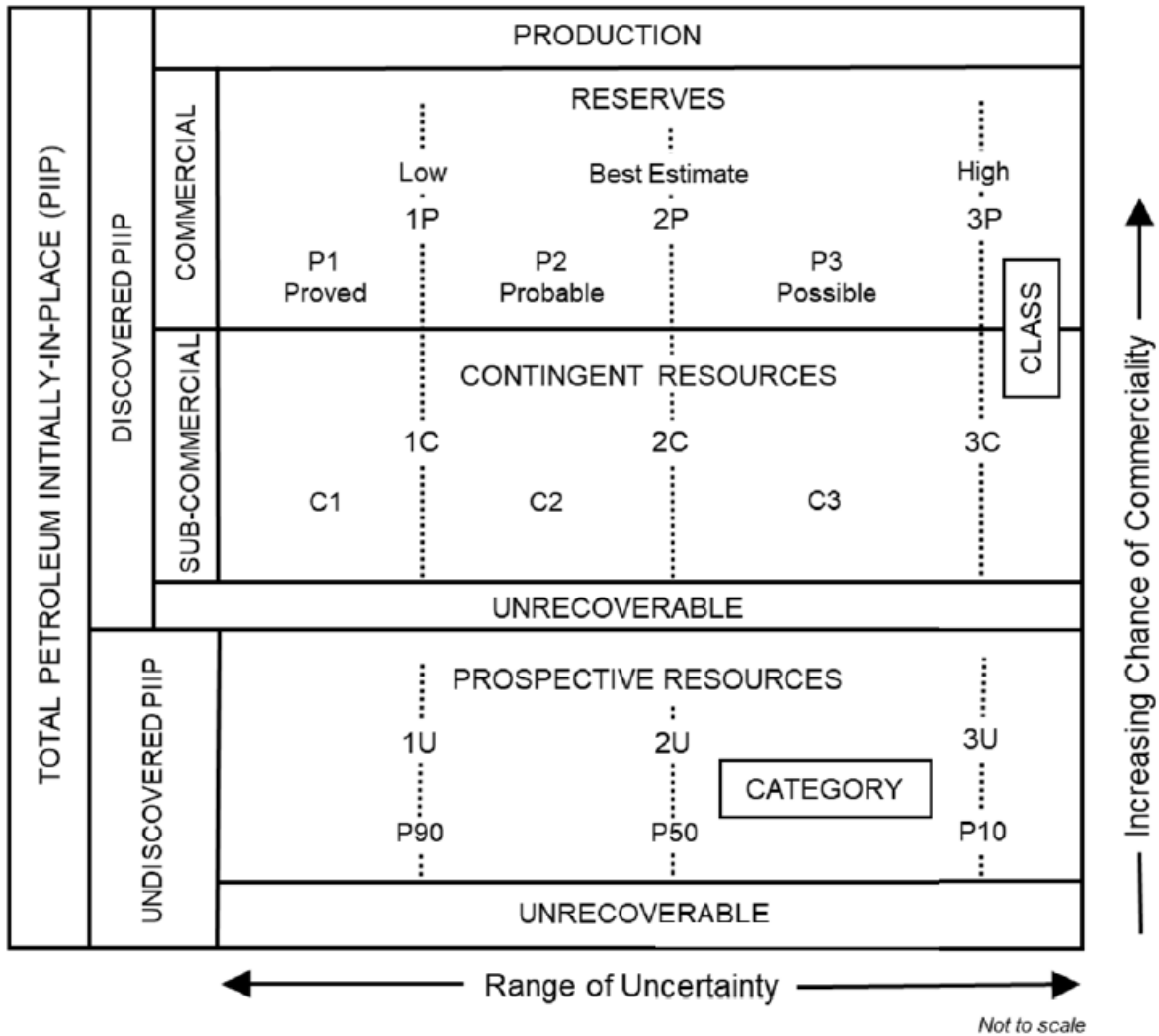


## Appendix: Background Information on Reserve Classifications

The reporting of reserves for Canadian producers is governed by NI 51-101 *Standards of Disclosure for Oil & Gas Activities*, which uses reserve and resource definitions derived from the COGEH.

The COGEH uses the resource classification system depicted in Figure 4. Total Petroleum Initially in Place (PIIP), which is the quantity of petroleum estimated to exist originally in naturally occurring formations, is divided into Undiscovered and Discovered PIIP. Discovered PIIP is further divided into four categories: Unrecoverable, Contingent Resources, Reserves, and Production. Contingent resources are classified as quantities of petroleum estimated to be recoverable from known accumulations, but which are not currently considered commercially recoverable due to one or more contingencies (such as economic, legal, environmental, or regulatory matters). Projects in an early stage of evaluation may also be classified as contingent resource.

Figure 4: Resource classification system



Source: SPE-PRMS Resource Classification System



## Investment Risks

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While this is not an exhaustive list, we view the following risks as being noteworthy to investors in ReconAfrica Ltd.

**Liquidity risk.** Early-stage companies face liquidity challenges in maintaining sufficient capital to meet working capital and government commitment obligations and may require outside capital (debt/equity) to meet any shortfall. The Company has significantly mitigated this risk with the recent financing and exercise of warrants.

**Commerciality risk.** A sole driver of our resource value is attributable to the prospective resource potential of the Company's newly discovered Kavango Basin. The exploration and appraisal of this resource is at an early stage and will require substantial amounts of capital and resources to develop and move to commercialization. Failure to prove commerciality could very likely result in significant share price deterioration.

**Delays.** Any delay or cost increases at the upcoming appraisal drilling campaign would be considered to be negative by investors and may cause concerns about the Company's funding.

**Environmental opposition to hydrocarbon development and public acceptance.** ReconAfrica's primary activities involve the exploration and potential extraction of fossil fuels in Namibia and Botswana. As such, public opposition may obstruct the Company's ability to deliver on its planned activities which could negatively affect the share price. Examples of opposition include but are not limited to environmental and social groups opposed to petroleum extraction, and land and water use issues.



## Important Information and Legal Disclosures

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### Analyst Certification

I, Christopher Jones, hereby certify that the views expressed in this report (which includes the rating assigned to the issuer's shares as well as the analytical substance and tone of the report) accurately reflect my/our personal views about the subject securities and the issuer. No part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations.

### Important Disclosures

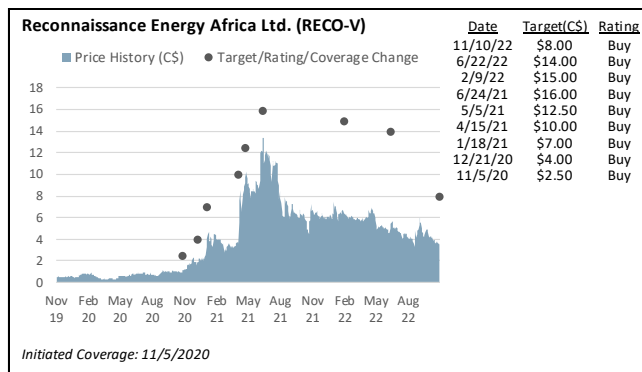
Of the companies included in the report the following Important Disclosures apply:

- ◆ The Analyst(s) preparing this report (or a member of the Analysts' households) have a financial interest in ReconAfrica (RECO-V).
- ◆ Haywood Securities, Inc. has reviewed lead projects of ReconAfrica (RECO-V) and a portion of the expenses for this travel may have been reimbursed by the issuer.
- ◆ Haywood Securities Inc. or one of its subsidiaries has managed or co-managed or participated as selling group in a public offering of securities for ReconAfrica (RECO-V) in the last 12 months.

### Distribution of Ratings (as of November 10, 2022)

	%	#	IB Clients (TTM)
<b>Buy</b>	77.0%	77	73.7%
<b>Hold</b>	10.0%	10	10.5%
<b>Sell</b>	0.0%	0	0.0%
<b>Tender</b>	1.0%	1	5.3%
<b>UR (Buy)</b>	0.0%	0	0.0%
<b>UR (Hold)</b>	0.0%	0	0.0%
<b>UR (Sell)</b>	0.0%	0	0.0%
<b>Dropped (TTM)</b>	12.0%	12	10.5%

### Price Chart, Rating and Target Price History (as of November 10, 2022)



B: Buy; H: Hold; S: Sell; T: Tender; UR: Under Review  
Source: Capital IQ and Haywood Securities

**Link to Research Policy:** <http://haywood.com/what-we-offer/research/research-policy>

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