

1 September 2023

Big Step Towards Development

NEED TO KNOW

- MOU with IDC (SA govt. agency) for LNG production
- Maiden reserve + increase to already large resource
- 100% drilling success rate continues

MOU with IDC for LNG production, major step towards development: The Industrial Development Corporation of South Africa (IDC), a wholly owned government subsidiary mandated to promote economic growth and industrial development in South Africa (SA), has signed a term sheet with KKO for the appraisal and production of LNG to deliver 60ktpa of LNG (50MW of electricity equivalent) growing to 600ktpa (500Mwe). This joins an existing agreement with the IDC for a proposed gas field of 30 wells to produce gas. Also, the IDC has a first right to participate in up to 45% of the next 60 wells developed by KKO.

Maiden reserve and significant increase to resource: KKO has a maiden reserve of 3.1 BCF (relating to KKO's 49%, 6.4 BCF gross) over a pilot gas production field underpinned by the IDC joint venture. The reserve relates to just 0.2% of KKO's acreage. Importantly, the success of the recent drilling campaigns has also been recognised with a 20% increase to contingent resources.

Drilling program at Mpumalanga Project has maintained 100% success rate: KKO's latest core hole established a sandstone gas pay zone of 153m, with the borehole situated just a few kilometres from SA's largest gas pipeline. Exploration drilling has now resumed in block ER270 to the south.

Investment Thesis

Prime location, long life, exploration upside: The Mpumalanga Project, ~200km south-east of Johannesburg, sits within existing infrastructure including power generation, gas pipelines, high-voltage transmission lines, road and rail. The project hosts a 2C contingent gas resource of 6.0 trillion cubic feet (TCF), found in shallow sandstone and coal formations, indicating a potential long-life gas development. This calculation was limited to drilled-out areas where sandstone gas and CBM has been discovered. A further ~5.8 TCF of 2U prospective resource was certified over the undrilled areas.

Near-term production, IDC agreements, government policy paves way: SA Government policy regarding power generation has opened the door for KKO to advance agreements such as the IDC partnership, from the small project in the vicinity of Amersfoort (the maiden reserve) to the larger scale of field development towards LNG production further south in the same block ER271.

Long-term production – SA energy crisis creates multiple options for gas sales for KKO: SA's ageing, underinvested power generation (predominantly coal) infrastructure, declining domestic offshore and imported onshore gas supply, as well as the existence of only one approved onshore gas producer, reflects the nation's significant energy crisis. KKO is enviably placed to be part of both a short and long-term, lower-carbon solution to SA's energy needs.

Valuation: A\$0.41 (Previous A\$0.27)

Our base-case valuation of A\$0.41/share values the development of LNG and gas at the Mpumalanga Project in addition to the contingent resource base. An alternative valuation of A\$1.76 is derived using average EV/Resource multiples. KKO has large potential as the project is developed, reserves are certified, and production is increased.

Risks

The key risks relate to development, reserves, conversion and funding.

Equities Research Australia

Energy

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Kinetiko Energy (KKO) is an Australian company that explores and develops advanced shallow conventional gas and coal bed methane opportunities in Southern Africa. Its flagship project is the Mpumalanga Gas Project in South Africa. The company has a 6 TCF 2C contingent resource and almost 7,000km² in granted rights and application areas. KKO's vision is to become a major player in South African onshore gas production.

<https://www.kinetiko.com.au/>

Valuation	A\$0.41 (prev. A\$0.27)
Current price	A\$0.12
Market cap	A\$94m
Cash on hand	A\$5.2m

Upcoming Catalysts and Newsflow

Period	
Ongoing	Continued drilling program
2HCY23	Finalisation of acquisition of 100% of project

Share Price (A\$)



Source: FactSet, MST Access.

Kinetiko Energy Ltd (ASX:KKO)

Share Price	A\$/sh	0.12
52 week high/low	A\$/sh	0.13 - 0.06
Valuation	A\$/sh	0.41
Market Cap (A\$m)	A\$m	94
Net Cash / (Debt) (A\$m)	A\$m	5
Enterprise Value (A\$m)	A\$m	88
Shares on Issue	m	781
Options/Performance shares	m	6
Potential Diluted Shares on Issue	m	787

Ratio Analysis	2022A	2023	2024	2025	2026	2027	2028
EPS (A¢)	(0.93)	(0.19)	0.13	0.48	1.28	3.09	3.72
P/E (x)	(7.1)	(45.6)	95.1	24.8	9.4	3.9	3.2
EPS Growth (%)		n/a	-166%	283%	165%	141%	20%
CFPS (A¢)	(0.58)	(0.20)	0.12	0.49	1.30	3.13	3.77
P/CF (x)	(11.3)	(43.8)	96.9	24.6	9.2	3.8	3.2
DPS (A¢)	-	-	-	-	-	-	-
Dividend Yield (%)	-	-	-	-	-	-	-
EV/ EBITDA (x)	-10.8	-58.6	89.1	21.8	7.7	2.5	1.6
EV / boe (x)	-	-	1,305.7	573.5	236.8	112.4	74.3
EV / PJe (x)	-	-	217.6	95.6	39.5	18.7	12.4
FCFPS							
FCF Yield (%)							

Assumptions (Yr end Jun)	2022A	2023	2024	2025	2026	2027	2028
Brent Oil Price (US\$/bbl)	53.65	88.38	86.70	80.6	82.2	83.9	82.8
Exchange Rate (A\$:1:US\$)	0.725	0.650	0.650	0.650	0.650	0.650	0.650
Gas Price (A\$/GJ)	4.81	7.00	16.08	16.41	16.73	17.07	17.41

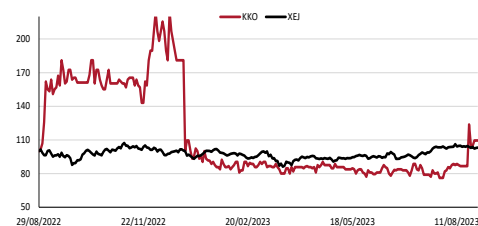
Production	2022A	2023	2024	2025	2026	2027	2028
Gas (TJ/d)	-	-	2	6	15	28.3	32.3
Gas (PJ)	-	-	0.7	2.3	5.6	10.3	11.8
LNG (Mt)	-	-	-	-	-	0.03	0.04
Oil / Condensate (mmbbl)	-	-	-	-	-	-	-
Total (mmboe)	-	-	0.12	0.38	0.94	1.72	1.97
Gas (mmboe)	-	-	0.12	0.38	0.94	1.72	1.97
LNG (mmboe)	-	-	-	-	-	-	-
Oil / Condensate (mmboe)	-	-	-	-	-	-	-
Year End Reserves 2P + 2C (mmbo)	-	350.1	349.9	349.6	348.6	346.9	344.9

Reserves and Resources	Working Interest	1P Gas (bcf)	2P Gas (bcf)	3P Gas (bcf)	1C Gas (bcf)	2C Gas (bcf)	3C Gas (bcf)
As at 1 July 2023							
ER 271 (Conventional Resources)	49.0%	1.93	3.15	4.92	512	853	1,322
ER 270 (Conventional Resources)	49.0%	-	-	-	417	705	1,094
ER 272 (Conventional Resources)	49.0%	-	-	-	403	536	697
Total		1.93	3.15	4.92	1,332	2,094	3,113

VALUATION	A\$m	Risking	A\$m	A\$ps
Mpumalanga Gas Project (~190 bcf)	157	90%	142	0.09
Onshore LNG Project (60 ktpa, ~80 bcf)	187	80%	150	0.10
Total Operations	345		291	0.19
Net Cash / (Debt)	11	100%	11	0.01
Admin / Corporate / Other	(33)	100%	(33)	(0.02)
Exploration (risk-adjusted)	16	50%	8	0.01
2C Conventional, risked (~420 bcf)	342	75%	256	0.17
2C CBM Unconventional, risked (~168 bcf)	137	75%	103	0.07
TOTAL VALUATION	818		637	0.41

Source MST Est, KKO.

KKO Relative to XEJ 12 months



Profit & Loss (A\$m)	2022A	2023	2024	2025	2026	2027	2028
Oil / Condensate Revenue	-	-	-	-	-	-	-
LPG Revenue	-	-	-	-	-	-	-
Gas Revenue	-	-	5	15	40	98	115
Total Sales	-	-	5	15	40	98	115
Operating Costs	-	-	(1)	(3)	(6)	(12)	(14)
Government Resource Taxes	-	-	(0)	(1)	(2)	(5)	(5)
Exploration & Development Expen	(2)	(1)	(1)	(1)	(1)	(2)	(2)
Other Net Income / Expense	(2)	(1)	(1)	(1)	(1)	(3)	(3)
EBITDA	(4)	(2)	2	10	29	77	91
EBITDAX	(2)	(1)	3	11	30	78	93
Depreciation & Amortisation	(0)	(0)	(0)	(0)	(0)	(0)	(0)
EBIT	(4)	(2)	2	10	29	76	90
Net Interest Expense	(2)	0	0	0	0	(5)	(5)
Pretax Profit	(6)	(2)	2	10	29	71	85
Tax Expense / Benefit	-	-	-	(3)	(8)	(20)	(24)
Net Attributable Profit	(6)	(2)	2	7	21	51	61
Reported Profit	(6)	(2)	2	7	21	51	61

Cash Flow (A\$m)	2022A	2023	2024	2025	2026	2027	2028
Pretax Profit	(6)	(2)	2	10	29	71	85
D&A & Other Non-Cash Items	2	0	(0)	0	0	1	1
Tax Paid	-	-	-	(3)	(8)	(20)	(24)
Cash from Operating Activities	(4)	(2)	2	7	21	52	62
Development Capex	(0)	(3)	(3)	(65)	(26)	(22)	(16)
Exploration Capex	(2)	(1)	(1)	(1)	(1)	(2)	(2)
Acquisitions/Other (Net of Sales)	-	-	-	-	-	-	-
Dividends Paid	-	-	-	-	-	-	-
Free Cash Flow	(5)	(5)	(1)	(57)	(4)	29	47
Cash Provided by Financing	6	8	8	67	17	(2)	(2)
Net Change in Cash	1	4	7	10	12	27	44

Balance Sheet (A\$m)	2022A	2023	2024	2025	2026	2027	2028
Cash & short term deposits	1	5	12	22	34	62	106
Receivables	0	0	1	5	15	40	70
Inventories	-	-	1	3	10	26	45
Property, Plant and Equipment	0	0	3	68	93	115	131
Capitalised exploration	-	-	-	-	-	-	-
Intangibles and Goodwill	-	-	-	-	-	-	-
Other assets	7	7	6	6	6	6	6
Total assets	10	13	25	106	161	251	359
Creditors	0	1	1	4	10	24	28
Borrowings	0	-	3	45	62	60	57
Other liabilities	-	(0)	(2)	2	13	40	85
Total liabilities	1	1	2	51	85	124	171
Shareholder equity	9	13	23	55	76	127	189
Shareholder Equity + Total Liabilities	10	13	25	106	161	251	359

MOU with IDC Sets Up KKO for Production

Overview of the new KKO–IDC agreement

Key points: staged development – starting small and working its way up

KKO has executed a non-binding Term Sheet with the Industrial Development Corporation of South Africa (IDC) to appraise and produce LNG at scale.

The project is staged as follows:

- it will deliver 60ktpa of LNG (50Mwe) initially
- it is planned to expand to 600ktpa of LNG (500Mwe) to become SA's largest onshore LNG project
- long term, IDC has the option to participate in further co-development to a cap of 1,800ktpa of LNG or 1,000MW LNG gas equivalent projects (1.5GWe), which will consume about 2 TCF of gas over two decades.

The starting operation is relatively small, representing a demonstration plant equivalent, but will allow KKO to ramp up and test the modular nature of the project. KKO expects that the 60ktpa LNG plant will be replicated to increase production.

IDC has a 60-day exclusivity period to finalise formal legal documentation.

Capital structure, financing and IDC participation for the first phase

The cost of the first phase of the project is estimated to be approximately A\$138m, which will be split between equity (A\$90m) and debt (A\$48m).

The IDC will invest approximately A\$52m for a 30% equity interest, and KKO will invest approximately A\$38m for a 70% JV interest. KKO has the option to introduce third-party investors for its 70% interest in the project.

The IDC will underwrite equity shortfalls on KKO's 70% portion for the 50MW-equivalent project, but is required by policy to not exceed a 49% stake in any project in which it invests.

The 60ktpa (50MW equivalent) LNG is expected to be developed over 2–3 years with 600ktpa (500MW equivalent) LNG to be developed over 9–10 years.

The importance of IDC involvement: demonstrates government buy-in to project

The IDC, a wholly owned subsidiary of the SA Government, is mandated to promote economic growth and industrial development in SA. It is allocated specific funding from the SA treasury in order to pursue this mandate.

The IDC's involvement in the project at an asset level is a key indicator that the government is confident in the project's viability and keen to seek alternative sources for power generation.

Recap of KKO's existing relationship with IDC: agreement to develop gas production field

KKO has an existing joint development agreement (JDA) with the IDC to co-develop a gas production field comprising up to 30 wells. The project is budgeted to cost approximately R155m (A\$12.2m), comprised of:

- 45% (R70m) contributed by the IDC – R16.3m already advanced
- 55% (R85m) by KKO – R20m already advanced.

The cash that has already been advanced by both parties will be used to drill a set of 5 approved appraisal wells to the west of Volksrust in the southern part of block ER271, and to begin development of well fields.

The IDC has the first right to participate for up to 45% equity relating to further gas production blocks, up to a total of 80 wells.

The backdrop: South Africa's energy situation – why new sources of electricity generation are needed

Energy in desperately short supply in SA

The SA energy market supply situation is dire, with new supply required in order to meet demand and replace high-carbon-emission power generation. Existing, primarily-coal-fired, power generation is old and has suffered from years of underinvestment, leading to regular power restrictions and blackouts. In addition, SA's gas supply is limited. It relies on imported supply from Sasol that is in imminent decline.

Domestic gas supplies are also limited with only one other gas production licence granted in the country, which has only recently begun production of LNG on a small scale.

Industry relies on LPG, and SA imports all of its diesel requirements to support one of the world's largest trucking fleets. The SA Government has been clear that the country requires domestic gas production, and that an identified part of its coal generator fleet will be converted to gas.

Economy and critical services are suffering

The energy crisis has had a devastating effect on the economy, with businesses closing, jobs lost and critical services such as healthcare and education affected. It has also discouraged much-needed investment in the country, which in turn has contributed to Eskom's lack of funding for new power stations to replace ageing infrastructure.

The problems from an ageing, carbon-intensive power generation system, declining offshore gas supply and only one licenced onshore gas producer (which has only just started production) need a solution.

Maiden Reserve and Resource Upgrade: Quality of Project Takes Another Step Up

Quality and potential of project demonstrated by independent reserves and resources assessment

Independent reserves and resource certifier Sproule has reviewed the Mpumalanga Gas Project. This review has confirmed KKO's growth potential, leading to:

- a maiden gas reserves assessment that confirms the project's positive economics
- increased contingent resources
- additional prospective resources.

We believe further exploration and development will unlock significant value for KKO and its shareholders.

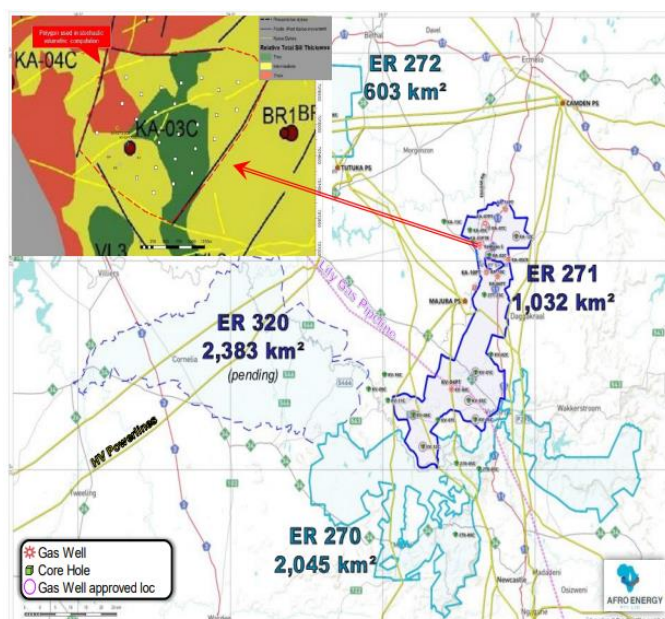
Maiden gas reserves assessed on 0.2% of acreage – upside potential strong

Sproule has assessed maiden gas reserves of 3.1 billion cubic feet (BCF) net to KKO (6.4 BCF gross) over a pilot gas production field. This field is part of the existing IDC joint venture (the IDC JV, agreed under the JDA discussed in the previous section) and has demonstrated positive economics. Importantly, as further commercial arrangements are confirmed, substantial growth in reserve certifications will follow.

Sproule's maiden gas reserve certification covers the planned 30-well pilot production cluster of the IDC JV project, with the area covering a mere 0.2% of the total exploration rights (6.8 km²).

The initial reserve is relatively small but demonstrates the commercial potential of KKO's exploration tenements.

Figure 1: Illustration of the 30 well cluster and small land area compared to total ER's



Source: KKO.

Contingent resource upgraded by 20% prompted by drilling success

Sproule's assessment of the project has prompted a 20% increase in the 2C contingent resource to 3.0 trillion cubic feet (TCF) net (6.0 TCF gross).

The increase is related to the continued success of KKO's drilling program (details in next section of this report) and is another indication of both the quality of the project and its huge potential.

This growth in resources is expected to continue, especially with the potential for substantial upgrades from an adjacent application exploration right (ER 320) once granted.

It is important to note that the new PRMS rules dictate that the contingent resource is calculated only over areas proven by drilling, so the areas as yet unexplored within the Rights Areas present another huge potential of 2U ~ 5.8 TCF which will convert to contingent as drilling continues.

Figure 2: Contingent Conventional resources: net (top) and gross (bottom)

Licencse	1C	2C	3C
ER271	512	853	1322
ER270	417	705	1094
ER272	403	536	697
Total	1332	2094	3113

Licencse	1C	2C	3C
ER271	1044	1741	2697
ER270	851	1439	2232
ER272	823	1093	1423
Total	2718	4273	6352

Source: KKO.

Figure 3: Contingent CBM resources: net (top) and gross (bottom)

Licencse	1C	2C	3C
ER270	38.5	503.8	3414.1
ER271	19.3	263.0	1573.2
ER272	5.4	73.6	440.5
Total	63.2	840.4	5427.8

Licencse	1C	2C	3C
ER270	78.6	1028.1	6967.5
ER271	39.4	536.8	3210.7
ER272	11.0	150.3	899.0
Total	129.0	1715.2	11077.2

Source: KKO.

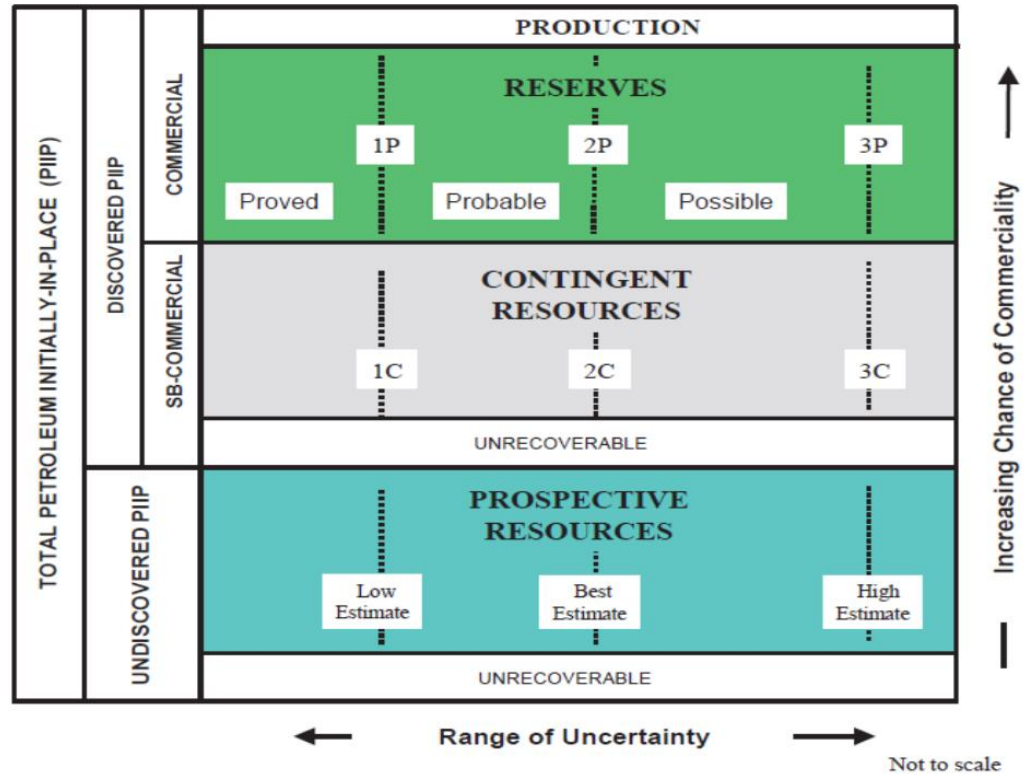
Prospective resource addition

Sproule has also calculated a concurrent prospective resource (2U) of 2.8 TCF net (5.8 TCF gross), which has the potential to be converted to contingent resource status through further exploration drilling.

A quick explainer on reserves and resources categories

Reserves and resources are classified according to a range of certainty and chance of commerciality. Figure 3 is a 'ready reckoner' that outlines the classification of reserves and resources.

Figure 4: Classifying resources and reserves



Source: Industry.

New Drilling Continues to Show Potential of a Huge Gas Province, Multiple Options for KKO

The Mpumalanga Project is ~200km from Johannesburg. The project, which covers ~7,000 km², sits within existing infrastructure (power generation, gas pipelines, high-voltage transmission lines, road, rail) and features a 2C contingent resource of 6 TCF.

KKO began a core exploration program for the Mpumalanga Project in September 2022. The first 6 holes in the program have continued the 100% drilling success rate (40 out of 40) and demonstrate the huge potential of the project. KKO plans another minimum 3 core holes in this program, which is designed to focus on identifying further gas-laden sandstones, coals and other carbonaceous structures and extend the continuity of potential gas fields in its new exploration tenement, northernmost block ER272.

Drill program: 40 gas strikes from 40 boreholes – 100% success rate continues

First core hole: success – gas in sandstone and coal for 247m

The first hole in the recently re-started program was strategically located near the Majuba Power Station, which has a 20MW gas generator awaiting a source of fuel.

Core hole 271-23C spudded in September 2022. The core hole represented an important milestone, marking KKO's return to exploration after the Korhaan well program was completed in June 2022.

The hole was completed and logged to a depth of 478m, with a thick, dolerite cap sill between 80 and 226m providing a vertical gas seal with gassy sandstone, coal and carbonaceous siltstones and mudstones below. Gas shows were nearly continuous below the dolerite during the drilling with gas-bearing geological sequences totalling 247m intersected, including 131.5m of sandstone pay.

In addition, desorption tests have been run on coal samples with measures of over 13m³ per tonne of coal – the highest reading to date at the project.

Second core hole: more success – 90 km south of first hole

The second core hole (270-06C), spudded in November 2022, is approximately 90km south of 271-23C. This hole was designed to test the potential of the southerly dipping basement structures and provide deeper, higher pressured gassy sands and coal sequences and open up an entirely new area for possible gas production.

Wireline logging results have established 147m of gassy sandstone pay in the vertical profile, being even greater than that reported in the previous Majuba core well (~131m).

Gas desorption testing from the core hole achieved gas content of nearly 7m³/t (and rising). Drilling of core hole 270-06C has intersected strong gassy sediments in targeted carbonaceous geology extending the potential contiguous gassy sandstone geology south from core well 271-23C by approximately 64km. This clearly demonstrates that there is another gas discovery, providing strong evidence that the deeper wells to the south would produce increased volumes for potential future production fields.

Third core hole: even better than the first two

The third core hole (270-03C), spudded in January 2023, is approximately 10km north of 270-06C and also designed to test the potential of the southerly dipping basement structures. This core hole provides deeper, higher-pressured gassy sands and coal sequences similar to those encountered in 270-06C. The well is strategically located approximately 2 km from SA's most significant gas pipeline, the Lilly Pipeline, and provides potential distribution infrastructure to major gas markets in SA's KwaZulu-Natal province.

Wireline logging results have established 153.5m (between 288m and 574m) of gassy sandstone pay in the vertical profile, being even greater than that reported in the 270-06C core well (~147m) as well as coal seams of 5.75m cumulative thickness. This is the first hole where KKO has seen reservoir quality sandstone in the glacial Dwyka Formation (below 561m).

Gas desorption testing from the core hole achieved gas content of over 10m³/t (and rising), which is also a better result than 270-06C.

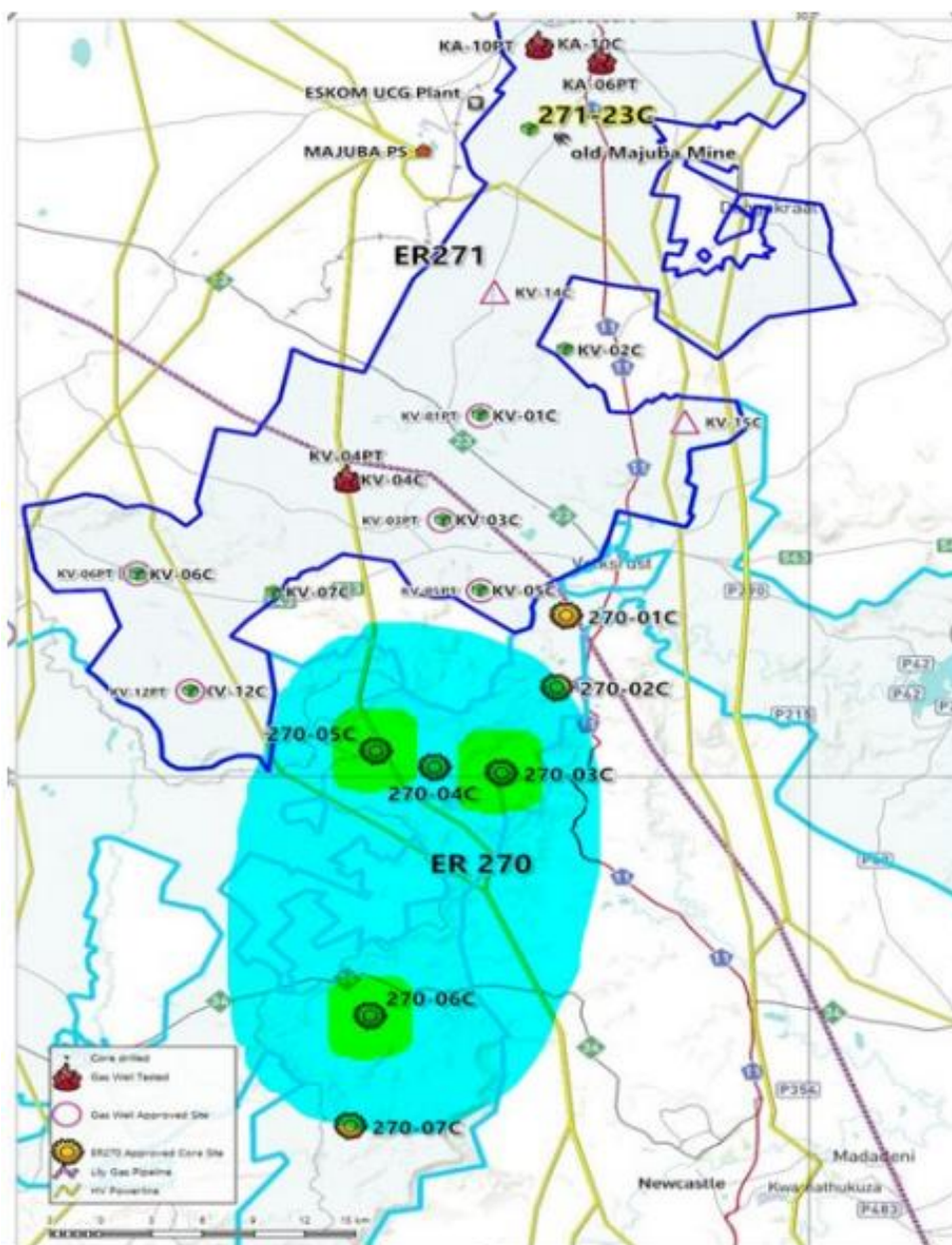
Fourth core hole: gas shows again

The fourth core hole (270-05C) spudded in March 2023. This hole is due north of 270-06C and north-west of 270-03C, approximately 7km from the Lilly Pipeline.

Wireline logging results have established 134.5m of sandstone pay zones, with coal seams of combined 4.19m thickness encountered.

The average depth of these sandstone reservoirs is 150m deeper than the Korhaan production wells to the north. This added depth should increase the pressure and volume of gas flow in a future production well in this new area, relative to the Korhaan area.

Figure 5: Locations of ER270 core holes: 270-06C (second), 270-03C (third), 270-05C (fourth)



Source: KKO.

Fifth and sixth core holes: moving to ER272 – with even more success; strategically located and at shallower depth

ER272 is some 120km northwest of the previous core holes in ER270. Core wells 272-01C and 272-02C spudded in early May. The strategic nature of these 2 holes is apparent with their location so close to the Secunda refinery, as well as to the Lilly pipeline. Sasol runs one of the world's biggest coal-to-liquids plants at Secunda and has stated its need to move toward a gas-to-liquids conversion as it works to reduce pollution while increasing output.

The terminal depth was shallower than what was encountered further south, due to the sloping nature of the Karoo basement structures.

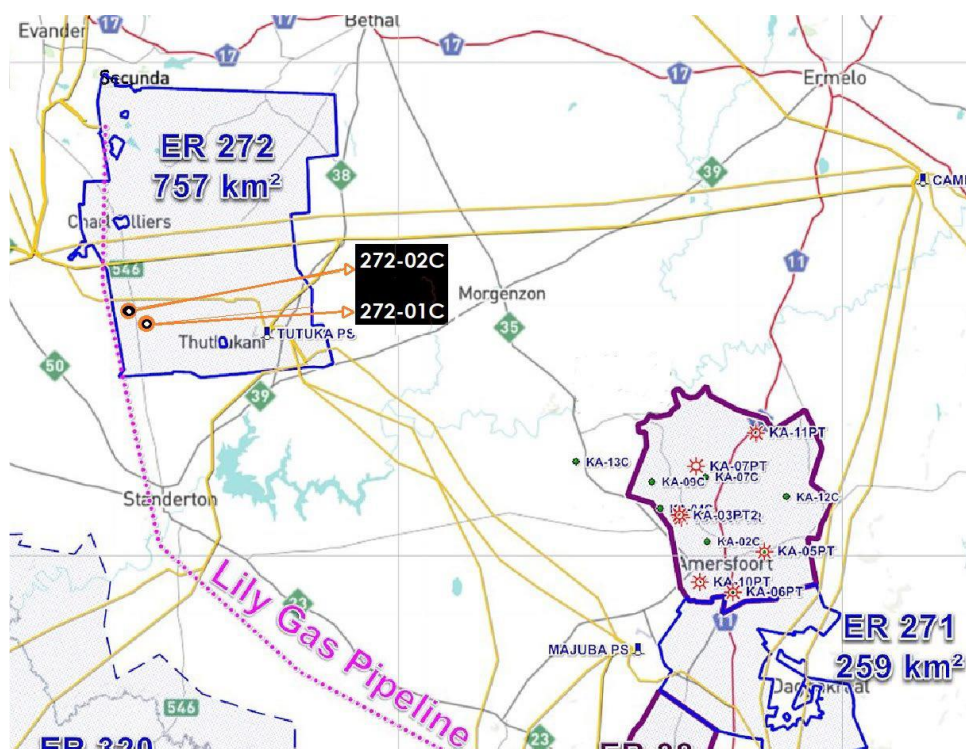
ER272-01C – 101m net gas pay: Core well 272-01C was the first gas exploration hole in Northern ER272, less than 100m from the Lilly Gas Pipeline. Results established a substantial sandstone gas interval of 101m. The gas shows began at depths of less than 70m.

ER272-02C – 117m net gas pay: The logging results from core well 272-02C established greater sandstone intervals compared to core well 272-01C of 117m, again from depths of less than 70m.

What's left? 2 more core holes spudded; total of 5 can be drilled in this program

Approval has been given for 5 core hole sites in tenement ER272, in addition to the 2 completed core holes. The 2 rigs have been moved and 2 further core holes spudded. Results from these holes are expected shortly.

Figure 6: Location of ER272 core holes



Source: KKO.

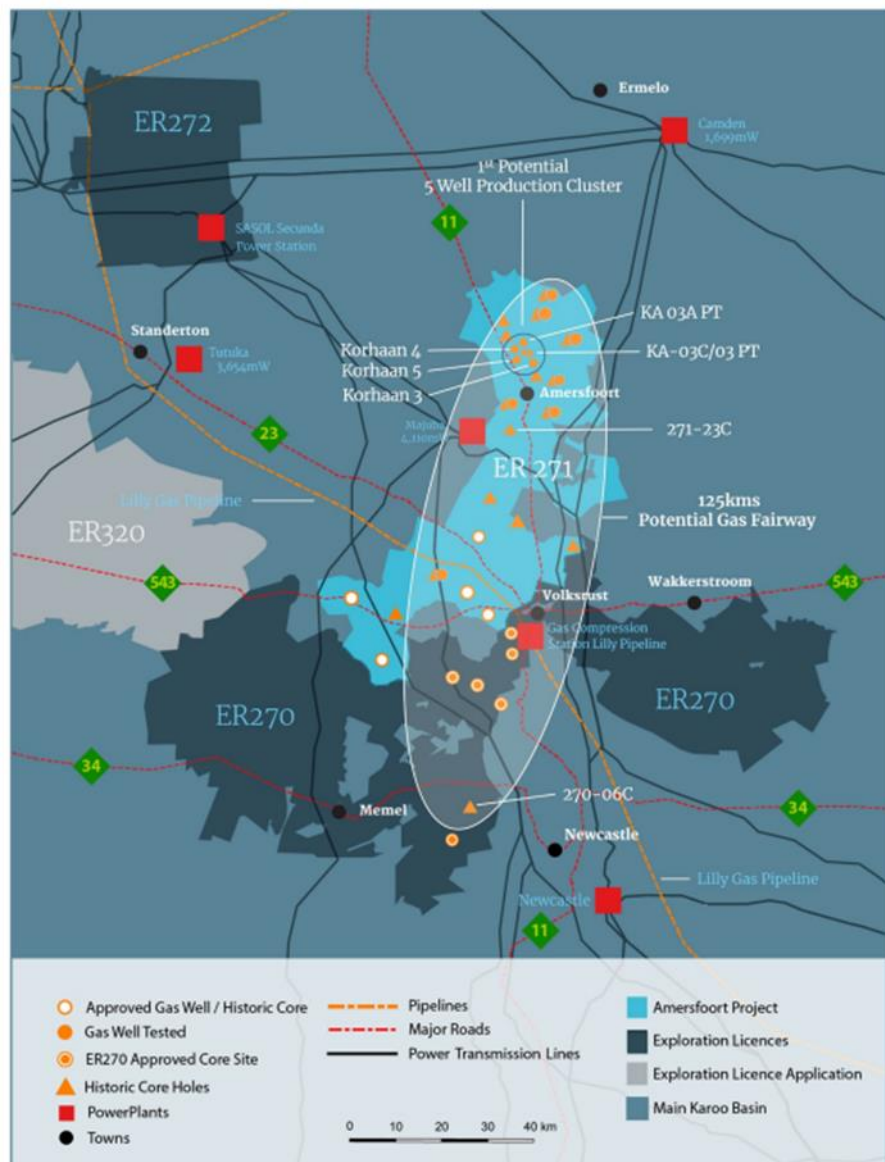
Recap of previous exploration success – focus on increasing resources

To date, only 20% of the total land package has been explored by aeromags surveys and drilling. The size of the exploration tenements presents KKO with multiple exploration options and an opportunity to increase the resource significantly.

Prior to the current drilling program, KKO's 100% success rate included:

- 23 core holes drilled in ER271, each intersecting gas
- 7 perm test wells successfully drilled, logged, tested and suspended for production
- first 5-well cluster (Beast and Korhaan wells) set for production (Figure 6: upper circled area)
- Korhaan Project holes (3.4 and 5) were percussion-drilled to intersect carbonaceous sandstone and coal geology at depths of 130–450m. The wells are conventional and have unsophisticated completions, as they are open holes that test the entire Lower Karoo section and have successfully flowed low-pressure gas. Gas exploration has focused on sandstones, coal and other carbonaceous structures at depths of 130–450m. The recent Korhaan 3-well drilling program confirmed geological lithological correlations with adjacent existing wells. Logs showed an average of over 100m of pay per well.

Figure 7: KKO's drilling success to date showing extent of potential gas fairway



Source: KKO.

IDC Is Not the Only Quality Partner: Potential Offtakers Line Up

KKO has identified potential offtakers for the gas it will produce, which is important for the potential growth of the company's gas reserves. KKO has executed a Letter of Intent (LOI) with Grüner Energy for a potential gas development and supply agreement and a Memorandum of Understanding (MOU) with FFS Refiners for a potential supply agreement. This represents continued strong third-party interest in the Mpumalanga Project and demonstrates its huge potential.

These two agreements highlight KKO's plans to develop multiple joint ventures with parties that have expertise in the provision of mid-stream infrastructure, focused on those who bring an existing market along with them in urgent need of high-quality gas.

Grüner Energy – LOI for gas development and supply

Grüner Energy has executed an LOI with KKO to conclude a gas development and supply agreement (gas supply agreement). Grüner develops, builds, owns and operates sustainable energy assets in emerging African markets, where it monetises regional gas resources using natural and biogas as a transitional fuel. KKO and Grüner intend to co-fund the development of a proof-of-concept gas production trial that, if successful, can be scaled.

The LOI has the purpose of ultimately negotiating and concluding within 6 months a formal, binding gas supply agreement between KKO and Grüner, whereby KKO agrees to explore, drill and extract natural gas within SA, and Grüner agrees to assist in developing production of natural gas and purchase such natural gas.

FFS Refiners – MOU for potential supply agreement

KKO has executed a non-binding MOU with FFS Refiners to finalise a gas supply agreement. FFS is a leading supplier of industrial heating fuels in SA and is seeking to supplement its industrial fuels business with the supply of LNG. KKO and FFS intend to develop a proof-of-concept gas production trial that, if successful, can be scaled into a long-term supply arrangement.

Near-Term Production: Gas to Power – IDC Term Sheet Reinforces Need for New Power Sources

Government policy urgently seeking additional generation capacity

The SA Government is working urgently to find solutions to the country's chronic power issues, and is looking to clear the way for alternative power generators in the short term, including gas-fired generation.

To this end, as part of its Energy Action Plan, the government is looking to:

- enable and accelerate private investment in generation capacity
- accelerate the procurement of new capacity from renewables, gas and battery storage
- fundamentally transform the electricity sector to achieve long-term energy security.

As part of the government's reform (which is favourable for KKO over the short and longer term), private power producers no longer need to obtain generation licences for electricity production of up to 100MW. This move aims to expedite the addition of crucial generation capacity.

Government initiatives are short- and long-term positive for KKO: paves the way for the company to generate its own power

These initiatives enable KKO to proceed with the installation of its own pilot genset at the project. Discussions have already advanced to procure equipment from a reputable global provider.

The SA Government's overarching policy is positive for KKO's business because it means that KKO and any of its JV partners can quickly engage gas generators within the project and tie them into the grid or supply to a remote customer via wheeling – potentially a strong short-term cash-generating option.

KKO's gas-to-power (GTP) program will entail using existing wells at Mpumalanga to produce gas to an in-field, containerised generator linked to the existing grid running through the farmlands.

KKO recently terminated a JV for power generation with Vutomi Energy in preference for an outcome more beneficial to its shareholders. The termination of this JV is a small negative, as it would have generated some cash in the shorter term, which will now be deferred until KKO acquires its own genset.

Long-Term Production – KKO in the Box Seat; SA Energy Crisis, Higher Demand Create Options

South Africa faces a serious energy problem

As mentioned previously in this report, and it bears repeating, the SA energy market supply situation is dire, with new supply required in order to meet demand and replace high-carbon-emission power generation. Industry relies on LPG, and SA imports all of its diesel requirements to support one of the world's largest trucking fleets. The problems caused by an ageing, carbon-intensive power generation system, declining offshore gas supply and only one licenced onshore gas producer (which has only just started production) require a solution. The SA Government has been clear that the country requires domestic gas production, and that an identified part of its coal generator fleet will be converted to gas.

KKO set to benefit long term from increased gas demand – four pillars of production

KKO is in a strong position to take advantage of SA's urgent need for alternative energy sources. KKO has indicated that it sees four key focus pillars for its business: gas to power, LNG, direct to pipeline and chemical derivatives.

(1) LNG for power and gas-to-power is a key focus of the business

The IDC MOU is a key to power generation and allows KKO to focus on continued drilling, adding to reserves and putting together a long-term growth profile.

In addition, purchase of generation sets is a short-term cash generation opportunity.

KKO's current core well program is adjacent to the Majuba power station, which includes a 20MW gas-fired unit that is currently static. KKO is the only potential supplier to that unit.

(2) LNG for transport converting from diesel and/or businesses converting from LPG

Enormous potential exists for supplying LNG into the transport business. SA has some 377,000 licensed heavy vehicles. Switching heavy truck and bus transport from diesel to LNG will realise increased efficiency and meaningful cost savings and reduce their carbon footprint. Renergen has recently begun production in its small-scale LNG plant at the Virginia gas project. The potential market for Renergen's heavy vehicle LNG product is 40,000–67,000 vehicles, showing the further potential for KKO to add to the supply in this market.

In addition, LNG can replace LPG. LPG in SA is generally of low quality, so customers would enjoy cost savings and increases in efficiency by converting to LNG.

(3) Direct to pipeline

The 600km Lilly 1 gas pipeline from Secunda to Durban runs through KKO's tenements. The pipe has a maximum diameter of 16". It has a capacity limited to 23 PJ/a. The present utilisation of Lilly-1 is 14PJ/a. The provision of gas to this pipeline is a simple, low-cost, high-return option for KKO.

(4) Chemical derivatives – urea and ammonia

The production of fertilisers requires natural gas. Russia's invasion of Ukraine has reduced the supply of urea and ammonia into the global market. The SA agriculture sector is desperately seeking lower-cost domestic supply.

Merger with Badimo Gas Goes Ahead; KKO to Own 100% of Mpumalanga

Shareholder approval was received in December 2022 for KKO to merge with Badimo Gas and to acquire the 51% of the Afro Energy Joint Venture it did not already own, thus acquiring 100% of the Mpumalanga Project. The upcoming completion of this transaction will represent a significant milestone for KKO, as its control of 100% of the project will enable streamlined decision making, comprehensive planning and capital deployment. This will also significantly improve KKO's ability to raise both debt and equity capital and to create further JV opportunities and involve strategic partners in its project or drilling programs.

Consideration

The consideration of the transaction was the issue of 567,704,812 shares in KKO to Badimo.

Badimo shareholders have voluntarily agreed to place the consideration shares they receive into escrow, which restricts the disposal of their KKO holdings for 12–27 months from issue. Two of the company's directors have also agreed to escrow a portion of their shares.

KKO is increasing ownership by 104% (from 49% to 100%) for an allocation of shares which represents an 82% increase of shares on issue, an accretive deal.

Transaction-related sale of KKO shares has been approved

In addition, to complete the merger, KKO was obligated within 4 months of 2 December 2022 to facilitate a A\$6.5m sale of Badimo consideration shares at a price between \$0.075 and \$0.15 per share. This corresponds to a minimum of 43,333,334 KKO shares (at a \$0.15 issue price) and a maximum of 86,666,667 (at a \$0.075 issue price). The purpose of the sale is to convert part of the consideration for the purchase of Afro Energy to cash for the shareholders of Badimo.

The number of shares issued by KKO as part of this sale will ultimately be deducted from the number of consideration shares to be issued to Badimo shareholders, so the total consideration shares to be issued will remain the same (567,704,812).

During the period, market conditions were poor and KKO was not able to complete the share sale within the required price range. KKO applied for a waiver to the ASX to extend the time to issue the Transaction Shares, but the ASX did not grant the waiver.

However, as a result of the waiver not being approved by the ASX, KKO reconvened a meeting of its shareholders to refresh the transaction approvals. The motions were passed on 23 June 2023.

KKO is progressing the transaction towards completion.

Valuation: Base Case of A\$0.41 (Previous \$A0.27) – Fully Diluted

Substantial implied upside under any scenario

We have looked at two different valuation methodologies (one as our base case, one as a cross-check) in order to arrive at what we view as a conservative risk-based valuation for KKO. Our base-case valuation of A\$0.41 (up from A\$0.27 previously) implies substantial upside from current levels and reflects the significant potential of this large resource.

We note some key strengths for KKO that support our positive view on the stock:

- KKO's assets have had a substantial amount of exploration and some appraisal performed on them over the last few years.
- The Mpumalanga Project has independently assessed reserves, contingent resources and prospective resources.
- KKO has recently signed a term sheet with IDC for the production of LNG which will be used for power generation and also has an agreement with the IDC for 30 production wells.
- KKO has many options for the commercialisation of its gas over the long term. These include LNG for power generation, gas to power, LNG for transport converting from diesel and/or businesses converting from LPG, direct to pipeline and chemical derivatives (urea and ammonia).

Valuation overview and methodology

Valuing exploration assets such as KKO's is quite a subjective process. A number of uncertainties are at play – significant test and appraisal works are yet to be completed, and financing is still uncertain. The key risks relate to development risks, reserves conversion and funding.

Scenario 1 (base-case valuation): IDC term sheet – development of LNG projects for power generation and gas project as per IDC JDA plus a risk based valuation of the 2C Contingent Resource – valuation A\$0.41 per share. Our base-case method uses a development NPV estimate of the IDC term sheet for the development of a 60ktpa of LNG project for delivery into power generation. We note that KKO will aim to develop up to 600ktpa of LNG, however we have not taken this into consideration due to the early stage of the agreement with the IDC. The growth option is significant and provides further potential upside to our valuation. We also include in this valuation the production JV with the IDC.

In addition, we value 20% of the independently assessed 2C Contingent Resources and place a value of A\$0.40 per bcf on that, and risk it at 75% (refer next section on EV/2C valuation where the market average value is A\$0.40 per bcf).

The valuation is calculated on a fully diluted share base assuming capital raises required for the LNG projects.

The valuation of this asset implies that a KKO shareholder obtains first stage of the LNG development project at a discount and gains exposure to the remainder of KKO's substantial gas resources and exploration potential for free.

Scenario 2 ('cross-check' valuation): EV/2P+2C Resources – valuation A\$1.76 per share. As a cross check, we look at the EV/Resource method, deriving a valuation of A\$1.76 using average market EV/Resource multiples. This method, a common valuation method in the equity market, assesses the value the market is attributing to combined 2P and 2C reserves and resources. This shows the potential upside to KKO as the project is developed, reserves are certified and production is increased.

Scenario 1 (base-case): development of asset – Mpumalanga Project: A\$0.41/share

We have modelled a development scenario to specifically focus on KKO's Mpumalanga Project and the recently announced IDC term sheet. We have valued a hypothetical, standalone Mpumalanga Project based on KKO's public filings, government data, internal estimates, industry benchmarks, and other CSG developments.

A preliminary, risk-adjusted, post-tax, NPV or a potential future Mpumalanga Project development is based on a conservative assumption that a small portion of currently booked substantial 2C contingent resource (~3.1 TCF) is monetised.

Figure 8: Base-case valuation for KKO

VALUATION	A\$m	Risking	A\$m	A\$ps
Mpumalanga Gas Project (~190 bcf)	157	90%	142	0.09
Onshore LNG Project (60 ktpa, ~80 bcf)	187	80%	150	0.10
Total Operations	345		291	0.19
Net Cash / (Debt)	11	100%	11	0.01
Admin / Corporate / Other	(33)	100%	(33)	(0.02)
Exploration (risk-adjusted)	16	50%	8	0.01
2C Conventional, risked (~420 bcf)	342	75%	256	0.17
2C CBM Unconventional, risked (~168 bcf)	137	75%	103	0.07
TOTAL VALUATION	818		637	0.41

Source: MST estimates.

Key assumptions in Scenario 1 (base-case valuation)

- We have used gas prices of the equivalent of A\$15/GJ
- We have developed an LNG production scenario based on a staged production to 60ktpa of LNG, producing for 20 years.
- Our valuation is based on modelled cash flows using DCF analysis and is subject to future refinement once more public information comes to light as the project is gradually de-risked.
- We base our well costs on a conservative assumption of ~A\$800k per well. We assume first gas in FY2024 for the IDC JDA and 2027 for LNG production.

Scenario 2 ('cross-check'):

EV/(2P+2C) – reserves and resources: A\$1.76/share (based on peer group average)

A commonly utilised valuation methodology is to compare the value attributed by the market to the reserves and resources in the ground, most often by analysing EV/(2P+2C). This methodology is commonly practised by investors.

The simplest and most effective way to do this is to look across KKO's peer group. Most of the peer group report a 2C figure but some do not have 2P. KKO's 2C resource is 5,988 BCF on a 100% basis.

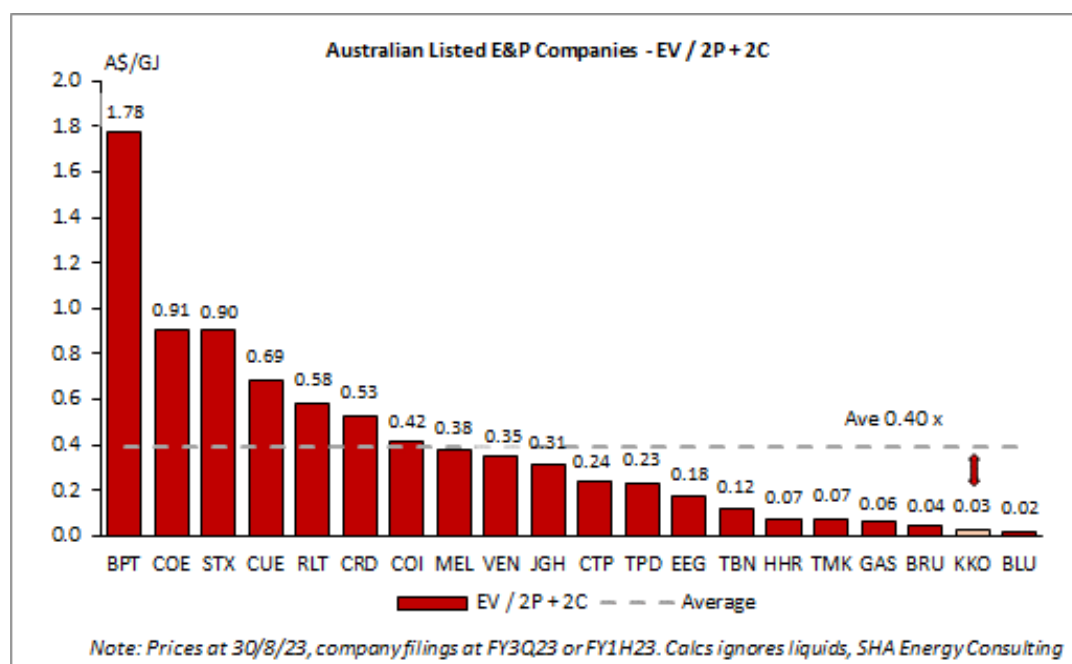
We have selected a group of small to mid-cap E&P companies at various life cycle stages, including producers. The median EV/(2P+2C) is \$0.40/GJ as shown in Figure 8, but with a very wide range of \$0.03–\$1.78/GJ. KKO's A\$0.03 EV/Resource the 2nd lowest of the group.

We see substantial opportunity for the equity market to rerate KKO's resources once investors become more confident of KKO's ability to execute.

If we apply a peer group median of A\$0.40/GJ to the entirety of KKO's 2C contingent resource booking, we achieve an implied valuation of A\$2,395m or A\$1.76 per share.

This is an unrisks number; however, it could also be considered that the market does apply a 'risk factor' to the multiples. We see the risk (discount) currently being applied to KKO as high given its early stage and position in SA. We believe that this is excessive and that over time the share price will likely rerate as KKO executes on its plans.

Figure 9: Average EV/2P+2C multiples – Australian-listed small energy companies



Source: SHA Energy Consulting, MST.

Positive catalysts for the share price and valuation

Further exploration success: KKO's current core program has delivered further gassy shows. Exploration success is a key catalyst to stock price performance.

Further reserves upgrades: Reserves are key to commercialisation of gas and for the company's ability to raise finance, and further upgrades will be a key near-term catalyst.

Further resource upgrades: Further testing and appraisal of these fields will be conducted. Conversion of prospective resources to contingent resources and contingent resources to reserves could be positive for the share price.

Further customer agreements: Gas sales agreements are key to cash generation and growth of the project.

Project financing: Obtaining project financing is key to the development of the assets into commercialisation.

Sell-down of assets: KKO's 100% ownership of assets is a key strategic advantage. Significant stakes in the assets can be sold down to JV partners/developers in order for KKO to fund and develop the project.

Early project delivery: The early commencement of any of the projects would mean cash flows were generated sooner and would reflect positively on management, which would likely boost the valuation.

Joint venture deals: Intelligent and innovative JV deals could add potential value to the portfolio of assets.

Gas price increases: Strong gas prices will be positive to commercialising the project. Once commercial, gas price increases would have a positive effect on the valuation and share price.

Government incentives: The SA Government has backed gas to help solve a genuine energy crisis. Further government incentives may accelerate and/or subsidise developments in the future and be a positive catalyst for KKO.

Risks to share price and valuation

Lack of exploration success: A key to the growth and development of the project, lack of exploration success would be a negative for the stock.

Reserves and resources disappointment: The expectation of further reserves growth means any disappointing results would pose a risk to the share price.

Project financing: Obtaining project financing is key to the development of the assets into commercialisation; delay to this is a key risk.

Inability to sell down assets: KKO's 100% ownership of assets is a key strategic advantage. Selldown of assets could provide funding for KKO. The inability to sell down assets may delay the project.

Gas price decreases: Upon commercialisation, price decreases of the underlying commodity would be a negative for the valuation. Gas prices represent the key sensitivity for the valuation.

Reversal of government backing of gas: The SA Government has backed gas to solve an energy crisis. Any change in the political climate would risk this backing being removed.

Community opposition: Any failure to adequately manage and meet community expectations with respect to issues such as compensation for land access, exploration activity, employment opportunities, and impact on local business may lead to local dissatisfaction, disruptions in the exploration program and potential losses to the company.

Delays to project delivery: Delays to any project delivery would negatively affect the valuation and may reflect negatively on management.

Black Economic Empowerment (BEE) risk: Compliance with BEE requirements is key to operating in SA. Any issues that arise with BEE can put projects at risk.

Financials: Development Funding Options and Potential Cash Flow

Current cash situation

KKO's cash balance as at 30 June 2023 was A\$5.2m, including A\$1.678m that relates to the amount placed into the Special Purpose Vehicle with the IDC.

Administrative costs are well controlled by KKO, with spend for the last quarter being around A\$0.3m. The cost-efficient nature of KKO's drilling was also highlighted this quarter with only A\$0.5m spent on exploration activities. We would assume that these costs will increase as the company both increases exploration activity and goes into production.

Historically, KKO has been reliant on equity capital, most of which has been spent on exploration and evaluation. KKO is also focused on converting its large resource base across to reserves and, recently, to commercialisation of gas, demonstrated by the IDC agreements.

Near-term cash commitments

KKO's key near-term cash commitments are:

- its current core drilling program
- funding its 55% share of the IDC agreement: R85m (A\$7.5m).

Longer-term funding

In order to move into commercial production, KKO will need to look at various funding options, which could include:

- **cash flow from operations:** We have assumed the commencement of the IDC JDA in FY2024. We have also forecast cash flow from the IDC joint venture
- **sell-down of acreage:** A sale for cash or farm-out could fund the development of the project. KKO's 100% ownership of the project via Afro Energy offers potential strategic partners to invest directly in the project
- **joint venture agreements:** As with the IDC agreement, KKO can develop innovative JV agreements over selected parts of the project
- **equity capital:** KKO has relied on equity capital to fund the portfolio to date. Development of that portfolio would logically include equity capital in the mix
- **debt:** Gas sale agreements may open up the option for KKO to be able to acquire debt finance or for forward sale agreements to be put in place.

Appendix 1: Overview of Flagship Mpumalanga Project – 100% KKO Control; Location, Location

Size and rights details

KKO's 100%-owned Mpumalanga Gas Project includes exploration rights:

- ER270, ER271 (into which ER38 and ER56 have been consolidated), and ER272
- ER320 (under application).

This flagship asset covers 6,065km², with 3,683km² of granted exploration rights and over 2,383km² under application. The reduction from previous acreage is due to the company being obliged by regulation to reduce its area during the rights renewal process, giving the operator the chance to divest itself of inoperable areas such as wetlands, townlands, mountains and canyons, and rather focus on the practical and operational geography under rights. This also minimises the annual licence fees payable to the regulator.

Ownership and operatorship – 100% KKO

KKO's operatorship and 100% equity interest in the project gives options for farm-downs to fund further exploration and development, reduce capital cost exposure and receive cash for resources prior to gas sales.

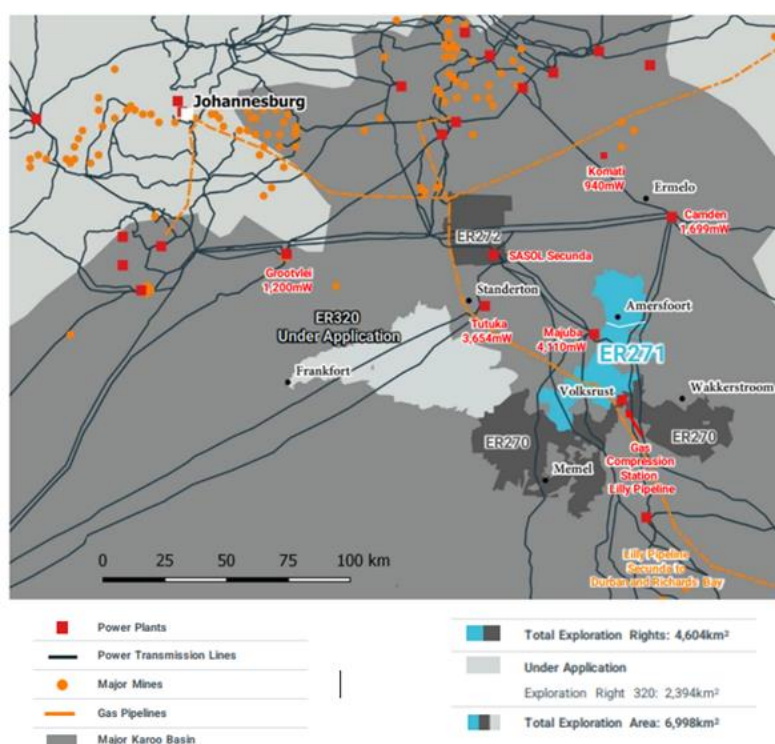
Afro Energy, the entity that holds 100% of the Mpumalanga Project, is owned 49% by KKO and 51% by Badimo Gas. KKO is in the process of acquiring 100% of Afro Energy by converting Badimo's 51% Afro Energy stake to a ~46% equity interest in KKO. This has been achieved by the issue of 567,704,812 shares in KKO to Badimo.

Location – proximity to infrastructure and potential customers

The Mpumalanga Project is located some 200km south-east of South Africa's largest metropolitan area, Johannesburg (see Figure 9). It is adjacent to and surrounded by key infrastructure including power stations, gas pipelines, high-voltage transmission lines, road and rail.

Potential users of gas are located nearby, including Majuba Power Station (4kW), which is capable of using gas to co-fire power generation and is only kilometres from planned drilling, and the Secunda refinery owned by Sasol (South Africa's largest gas consumer), situated on the northern boundary of ER272 where successful core drilling has been conducted.

Figure 10: Location of KKO's Mpumalanga Project and surrounding infrastructure



Source: KKO.

Geology

Proven and highly prospective Permian age fields; gas in both sandstone and coal formations

The Permian age sediments of the Northern Karoo Basin are extensively intruded by Jurassic age dolerites. The conventional sandstone reservoirs, in which gas is generated from the interbedded coals and coaly mudstones, are unconventionally trapped by younger volcanic dolerite intrusions. These honeycombed volcanic compartments with gas-filled sandstones are present over a large area with similar geology, as demonstrated by decades of previous coal exploration.

Every one of the exploration holes Afro drilled to date has found gas trapped in this way, in an area over 70km wide. The gas is 96–98% methane with a small component of nitrogen.

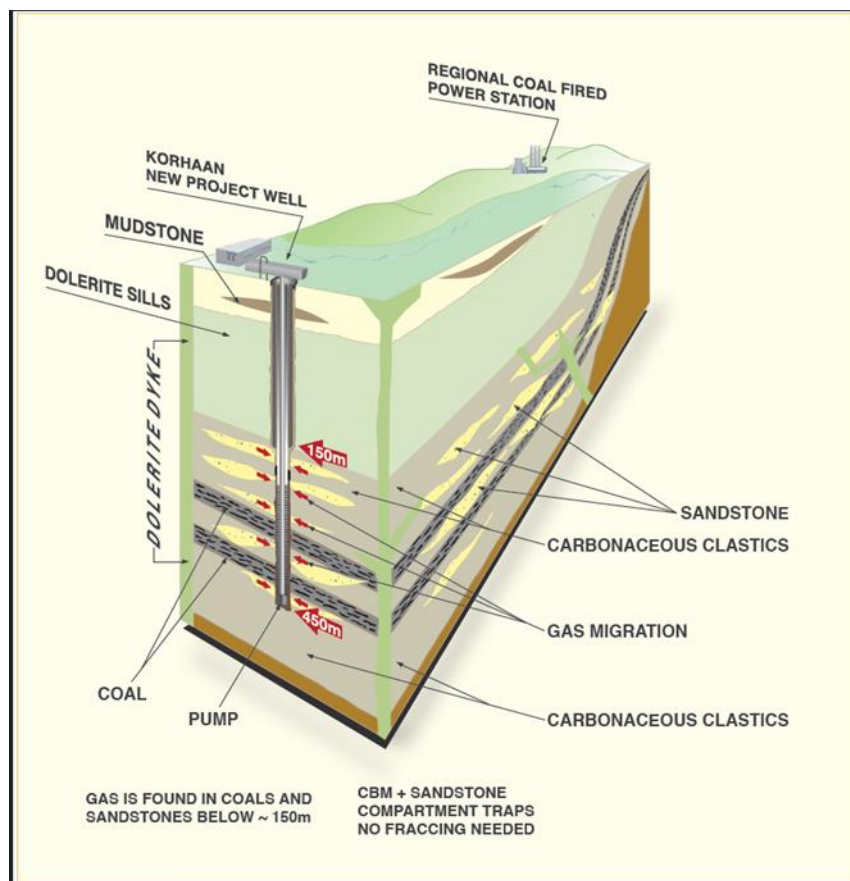
Potential for thousands of wells, with peak gas within days of dewatering

The gas zone depth ranges from 100m to 700m with simple vertical wells and no need for fracking. There is potential for thousands of wells across over KKO's licences containing multiple TCFs of gas.

Unlike a CSG well, which may require months of dewatering to reach peak production, these wells yield their peak gas rate within days of dewatering the sandstone layers, with much less water production than a CSG well. A handful of production test wells have proven the commercial nature of this play.

The next step is two-fold: to explore expanded areas for targeted markets and to add more producing wells to feed SA's transition away from coal and hydrocarbon imports.

Figure 11: Mpumalanga project geology



Source: KKO.

Methodology & Disclosures

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