

23 December 2008

## Elephant Hunting in the Browse

Analyst: Scott Simpson

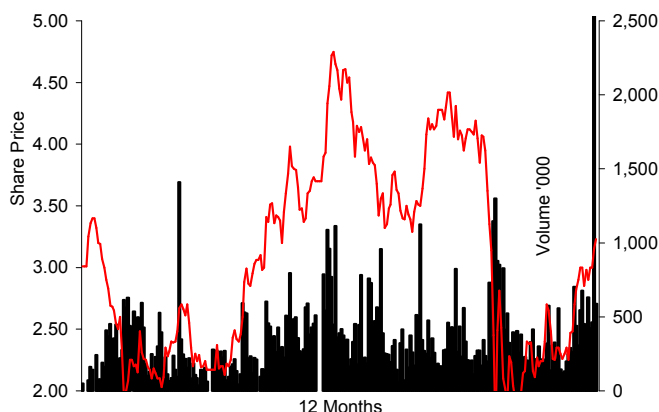
### OUR VIEW:

Karoon Gas Australia (KAR) is an Australian based explorer, offering a highly prospective asset portfolio across Australia, Brazil and Peru. KAR has achieved substantial appreciation of its share price over the past few years from its acquisition, work-up and farmout of its Browse Basin interests, plus acquisition of quality acreage in Brazil and Peru. The spotlight will be well and truly focussed on the company next month as it prepares to drill its first exploration well ever on the Poseidon prospect, targeting an estimated 7tcf of P50 prospective resource. KAR shares 3 permits in the Browse basin with JV partner ConocoPhillips (COP) with interests of 40%-49%. The Sedco-703 drilling rig is due on site in January 2009 and will drill one well in each of the three Browse Basin permits. KAR's in-house modelling of a potential 7tcf LNG development indicates a potential unrisks gross NPV of US\$5.0bn (~\$18/sh). Whilst it is important to note that KAR has no proven reserves to date, the drilling program will be testing an estimated 20tcf of unrisks prospective resource within its permits and if successful will provide massive upside. A recent independent report commissioned by KAR determined a mean estimated risks prospective resource across all of KAR's permits of 1,230mmboe. Based on these figures the company is one of the most highly leveraged exploration plays with ~8.25boe/share of risks exploration upside. The 200-day drilling program is the culmination of the KAR story and could create a substantial future oil and gas producer. Hence, we view this as a speculative and high risk BUY with a target price of \$4.41/sh.

- **Much anticipated Browse Basin drilling program.** KAR has identified a potential P50 resource of 23.7tcf of gas across its WA-314(49%), WA-315 (49%) and WA-398 (40%) permits from 4 drill-ready targets. Much of this potential will be tested from the drilling program with 3 wells to be drilled. Via its farmout of to ConocoPhillips, KAR's share of the US\$270m program is reduced to a cost of US\$72m. The first well to be drilled will be Poseidon-1, targeting a P50 estimate of 7tcf from the Poseidon prospect which straddles the WA-315 and WA-398 permits. Note that COP have the right to increase its stake in WA-314 and WA-315 in order to unitise its interests across the board. We currently value the prospect at \$140m (\$0.94/sh) based on \$0.5/mcf in place and 10% POS but highlight that the 7tcf resource is an estimate only and the chance of not encountering commercial hydrocarbons is a risk. However, by drilling a number of large scale prospects KAR have a good chance of unlocking substantial value. We also see funding of any large scale development, further dilution of ownership and timing to first gas as key considerations when looking at potential project valuations.
- **KAR hold a broad portfolio of quality exploration acreage.** KAR's strategy has been to acquire quality exploration acreage in highly prospective basins alongside known/producing fields. In addition to its Browse Basin interests the company holds a 66% stake in AC/P8 in the Bonaparte Basin (Australia), 100% interest in 5 blocks in the Santos Basin (Brazil) and earning up to 60% interest in Block Z38 in the Tumbes Basin (Peru). The forward plan includes seismic acquisition across AC/P8, Brazil and Peru with drilling forecast for 2010/2011.
- **Strong Balance sheet with limited exploration spend.** KAR has \$135m in cash and no debt and commitments for its current drilling program estimated at \$US72m. Hence the company is fully funded to complete this years exploration program across its assets but will need additional cash going forward. Note that KAR's internal model of a 7tcf LNG development requires additional net CAPEX of \$US3.2bn.

### Company Statistics & Performance

Shares on Issue	149.0m	Daily Vol.	340,917
Market Cap.	\$469m	Debt	\$0.0m
52 Week Range	\$1.67 - \$4.75	Cash	\$135.0m



### Directors & Substantial Shareholders

#### Directors

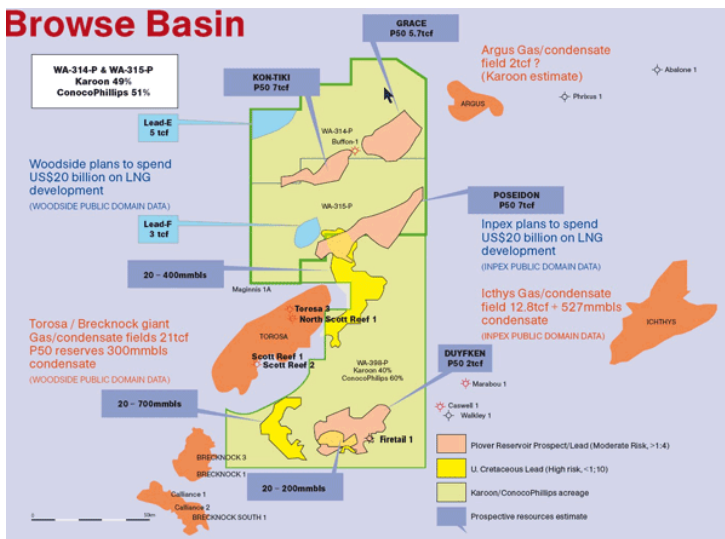
Name	Position
Robert Hosking	Executive Chariman
Mark Smith	Executive Director
Geoff Atkins	Director
Stephen Power	Director
Scott Hosking	Company Secretary

#### Substantial Shareholders

	Shares (m)	%
Talbot Group Investment Pty Ltd	22.9	15.6
Wellington Management Company	17.7	11.9
Robert Hosking	12.3	8.4

**OVERVIEW**

KAR in is an Australian based explorer with interests in four proven oil and gas basins in Australia, Brazil and Peru, targeting large commercial prospects within each area. Since the company was listed on the ASX in June 2004 at \$0.20, KAR has achieved a solid growth in share price through well executed acquisition, work-up and farm-out of highly prospective exploration acreage. The high level of interest in the KAR story stems from the multi-tcf targets located within its Browse Basin acreage and substantial upside should exploration prove positive. In 2006 KAR formed a strategic alliance with ConocoPhillips, farming out a 51% interest in its 2 x Browse Basin blocks (WA-314 and WA-315). In 2007 the JV acquired the adjoining WA-398 permit, split 60% COP, 40% KAR. The Sedco-703 has been contracted for 200-225 days to complete the Browse drilling program, consisting of 1 x well in each of the permits. The rig is expected to commence drilling next month and will continue through to Q3 2009. The first well will be the Poseidon target with potential for 7tcf of gas.



Source: KAR AGM Presentation - Nov 2008

**THE BROWSE BASIN (49% & 40%)**

KAR has interest in three permits in the Browse basin, WA-314-P (49%), WA-515-P (49%) and WA-398-P (40%) and has acquired extensive 3D seismic across all three. KAR's permits are on trend to Woodside's nearby Scott Reef (Torosa)/ Brecknock gas fields which has a proven P50 resource of 18tcf and 300mmbbl of condensate. The field is also alongside Inpex's Ichthys field with a P50 resource 12.8tcf and 300mmbbls. KAR has mapped 7 prospects across the permits with the first 3 mature prospects proposed for drilling.

**THE BONAPARTE BASIN (66.67%)**

KAR acquired its 66% interest in AC/P8 from Woodside in December 2007. The permit is situated in the Timor Sea and lies adjacent to the Laminaria and Corallina fields. The main prospect 'Jania' has potential for 20mmbbls of resource and is located within tie-back distance to the Laminaria/Corallina production facilities. A further 5 additional leads having also been identified. The JV is currently negotiating a proposed work programme for a 5-year extension of the permit.

**SANTOS BASIN / BRAZIL (100%)**

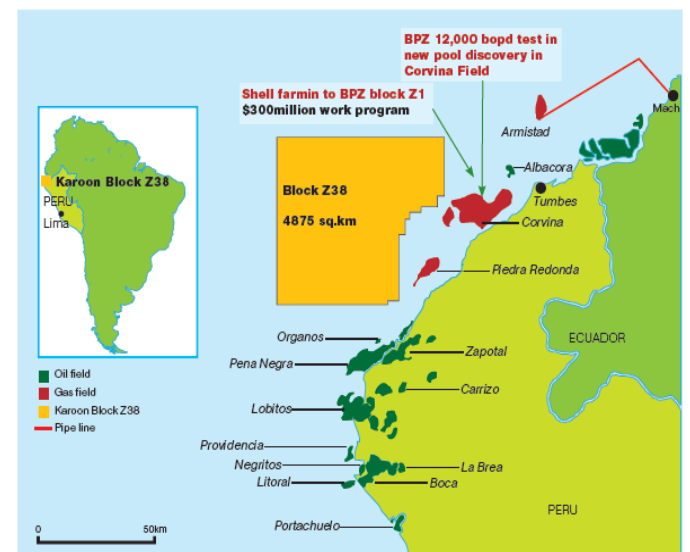
The Santos basin is located offshore the Santa Catrina region of Brazil which has been subject to multiple discoveries including the giant deep water Tupi field (Petrobras). In April 2008 Karoon Gas was awarded five blocks across 850 km<sup>2</sup> of prospective shallow water acreage on trend with existing Caravela/Merluza fields. KAR program includes interpretation of existing 2D data, acquisition of 3D seismic data in 2009 and potential drilling in 2011. 3 main leads have been identified with potential for 100-200mmbbls of oil and/or multi-tcf of prospective resource.



Source: KAR Announcement - Nov 2007

**TUMBES BASIN / PERU (20%)**

KAR's Tumbes Basin acreage is located in shallow water in close proximity to a number of producing fields, discovered in 1970-80's and close to markets and infrastructure onshore at the border city of Tumbes. The basin has produced over 1 billion bbls of oil to date and is host to a number of new developments including the Camisea LNG project and is in close proximity to the producing Amistad gas field. Two main leads have been identified with potential for 100-200mmbbls of oil and/or multi-tcf of prospective gas resource. KAR is earning up to 60% interest from funding of 2D and 3D seismic, scheduled for 2009, with drilling planned in 2010.



Source: KAR Investor Presentation - Nov 2008

## Research

Mark Simpson – Head of Research Phone: (+61 8) 9263 1678 Email: msimpson@psl.com.au  
Andrew Quin - Research Strategy Coordinator Phone: (+61 8) 9263 1152 Email: aquin@psl.com.au

## Resources

Andrew Harrington – Coal Analyst Phone: (+61 2) 8238 6214 Email: aharrington@psl.com.au  
Alex Passmore – Head of Metals & Mining Phone: (+61 8) 9263 1239 Email: apassmore@psl.com.au  
Scott Simpson – Oil & Gas Analyst Phone: (+61 8) 9263 1679 Email: ssimpson@psl.com.au  
Levi Spry – Resources Analyst Phone: (+61 8) 9263 1610 Email: lspry@psl.com.au  
Josh Welch – Resources Analyst Phone: (+61 8) 9263 1668 Email: jwelch@psl.com.au

## Industrials

Allan Franklin – Assistant Analyst Phone: (+61 8) 9263 1151 Email: afranklin@psl.com.au  
David Gibson – Industrial Analyst Phone: (+61 8) 9263 1664 Email: dgibson@psl.com.au  
Jonathan Kriska – Property Analyst Phone: (+61 2) 8238 6245 Email: jkriska@psl.com.au  
Russell Wright - Retail Analyst Phone: (+61 2) 8238 6219 Email: rwright@psl.com.au

## Institutional Dealing

Phil Schofield Phone: (+61 2) 8238 6223 Email: pschofield@psl.com.au  
Michael Brindal Phone: (+61 2) 8238 6274 Email: mbrindal@psl.com.au  
Dan Bahen Phone: (+61 2) 8238 6237 Email: dbahen@psl.com.au  
Paul Doherty Phone: (+61 3) 8803 0108 Email: pdoherty@psl.com.au  
Trent Foxe Phone: (+61 2) 8238 6265 Email: tfoxe@psl.com.au  
Andrew Frazer Phone: (+61 8) 9263 1241 Email: afrazer@psl.com.au  
Jason Lal Phone: (+61 2) 8238 6276 Email: jlal@psl.com.au  
Ben McIlvrde Phone: (+61 2) 8238 6253 Email: bmcilvrde@psl.com.au  
Jeremy Nugara Phone: (+61 3) 8803 0166 Email: jnugara@psl.com.au  
Trevor Pike Phone: (+61 3) 8803 0110 Email: tpike@psl.com.au  
Nicholas Whiteley Phone: (+61 2) 8238 6244 Email: nwhiteley@psl.com.au  
Sandy Wylie Phone: (+61 8) 9263 1232 Email: swylie@psl.com.au

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Securities & Derivatives Industry Association Principal Member  
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## Western Australia

Perth - Head Office: Level 23, Exchange Plaza, 2 The Esplanade, Perth, Western Australia 6000  
Ph: (+61 8) 9263 1111 Fax: (+61 8) 9325 6452 Email: patersons@psl.com.au

West Perth Office: Level 2, 34 Colin Street, West Perth Western Australia 6005  
Ph: (+61 8) 9482 0900 Fax: (+61 8) 9482 0999 Email: patersons@psl.com.au

Albany Office: Level 2, Middleton Centre, 184 Aberdeen Street, Albany, Western Australia 6330  
Ph: (+61 8) 9842 4700 Fax: (+61 8) 9841 4211 Email: albany@psl.com.au

Bunbury Office: Unit 3, 53 Victoria Street Bunbury, Western Australia 6230  
Ph: (+61 8) 707 2000 Fax: (+61 8) 9721 1840 Email: bunbury@psl.com.au

Busselton Office: Suite 1, 72 Duchess Street, Busselton Western Australia 6280  
Ph: (+61 8) 9754 0700 Fax: (+61 8) 9754 4333 Email: busselton@psl.com.au

Kalgoorlie Office: 63 Hannan Street, Kalgoorlie, Western Australia 6430  
Ph: (+61 8) 9021 1422 Fax: (+61 8) 9021 8133 Email: kalgoorlie@psl.com.au

## New South Wales

Sydney Office: Level 27, 264 George Street, Sydney New South Wales 2000  
Ph: (+61 2) 8238 6222 Fax: (+61 2) 8238 6266 Email: sydney@psl.com.au

## Victoria

Melbourne Office: Level 18, 90 Collins Street, Melbourne Victoria 3000  
Ph: (+61 3) 8803 0100 Fax: (+61 3) 8803 0199 Email: melbourne@psl.com.au

## Queensland

Brisbane Office: Level 37, 123 Eagle Street, Brisbane Queensland 4000  
Ph: (+61 7) 3737 8000 Fax: (+61 7) 3737 8100 Email: brisbane@psl.com.au

## ACT

Canberra Office: Level 4, 53 Blackall Street, Barton ACT 2600  
Ph: (+61 2) 6120 2222 Fax: (+61 2) 6273 3433 Email: canberra@psl.com.au