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# Karoon Gas Australia (KAR)

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Active and exciting year ahead to potentially deliver immense value

**Recommendation**

**Spec Buy**

**Price**

**\$3.05**

**Target** (12 months)

**\$4.50**

**Expected Return**

Capital growth **48%**

Dividend yield **0**

Total expected return **48%**

**Company Data & Ratios**

Enterprise value **\$301m**

Market cap **\$454m**

Issued capital **148.8m**

Free float **70%**

12 month price range **\$1.65-4.90**

GICS sector **Energy**

KAR is a well funded, S&P/ASX 200 Index stock, with great potential upside from its exploration activities in the Browse Basin, Brazil and Peru. The eagerly awaited Browse drilling program is about to begin, which upon success could transform KAR into an LNG project participant with a share price multiples of the current price. As an oil and gas explorer, risks are high but so are the potential rewards. We maintain a Speculative Buy recommendation.

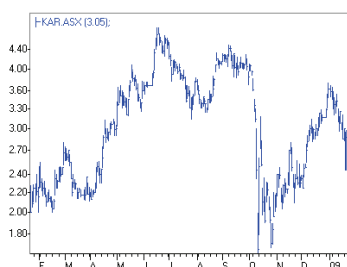
**Browse drilling soon to commence**

The first prospect to be drilled will be the large Poseidon feature, which spans the boundary of WA-315-P (KAR 49%) and WA-398-P (KAR 40%). Poseidon has an estimated P50 potential resource of 7TCF and lies close to WPL's Torosa field that has reserves of 18TCF and 300mb of condensate. This will mark the start of the long (7 months) and exciting drilling phase of the Browse exploration campaign with at least three very large prospects to be drilled by major partner and operator ConocoPhillips (COP).

**First prospect, Poseidon - potential value \$7.80ps**

SCE estimates an indicative value of success of Poseidon at around \$7.80 per KAR share on the basis of 7TCF and just US\$1.50/boe in place. Note that this is a very large target, equivalent to 1.3 billion boe. Our valuation of KAR's portfolio of prospects are summarised in the table below, which shows total risked value of \$11.35. Our price target further discounts the value of this quality portfolio, indicating the risk to our target price is clearly on the upside.

**Absolute Price**



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

**KAR Prospects Valuation Table**

Prospects	Gas	Liquids	Total Boe	KAR's share	NPV/boe	Unrisked Value		Risked Values		
	Tcf	MMbbl	MMboe	%	A\$/boe	A\$M	A\$/share	COS	MMboe	A\$/share
<b>Prospects</b>										
Unrisked P50 Reserve Potential										
Kon-Tiki	7		1280	40	2.27	1164	7.81	35%	179	2.73
Grace	5.7		1042	40	2.27	948	6.36	35%	146	2.23
Poseidon	7		1280	40	2.27	1164	7.81	35%	179	2.73
Duyfken	2		366	40	1.82	266	1.79	20%	29	0.36
<b>Total Browse</b>	<b>21.7</b>		<b>3968</b>			<b>23.76</b>			<b>534</b>	<b>8.05</b>
Tumbes Basin, Peru Z38	1	300	483	50	3.00	724	4.86	15%	36	0.73
Santos Basin, Brazil	2	400	766	50	5.00	1914	12.85	20%	77	2.57
<b>Total South America</b>		<b>700</b>	<b>1249</b>				<b>17.71</b>			<b>3.30</b>
<b>Total</b>							<b>41.47</b>			<b>11.35</b>

Notes: Brazil, Peru: assumes farm down to 50%

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

## Browse holds the key to an exciting future

**Poseidon to test 7TCF potential as start of 7 month program**

**At least three major prospects to be drilled.**

**Total of 22TCF potential.**

**LNG project NPV US\$5.0b or A\$20/sh (KAR's 40%)**

**Browse - has the gas to become a new LNG province**

The Sedco-703 drill rig is due to arrive on site late this month marking the start of the long (7 months) and exciting drilling phase of KAR's Browse exploration campaign. ConocoPhillips (COP) is operator and major equity partner in the permit. The first prospect to be drilled will be Poseidon, which spans the boundary of WA-315-P (KAR 49%) and WA-398-P (KAR 40%). Poseidon has a P50 estimated prospective resource of 7TCF, lying immediately to the north and east of WPL's giant Torosa/Brecknock field.

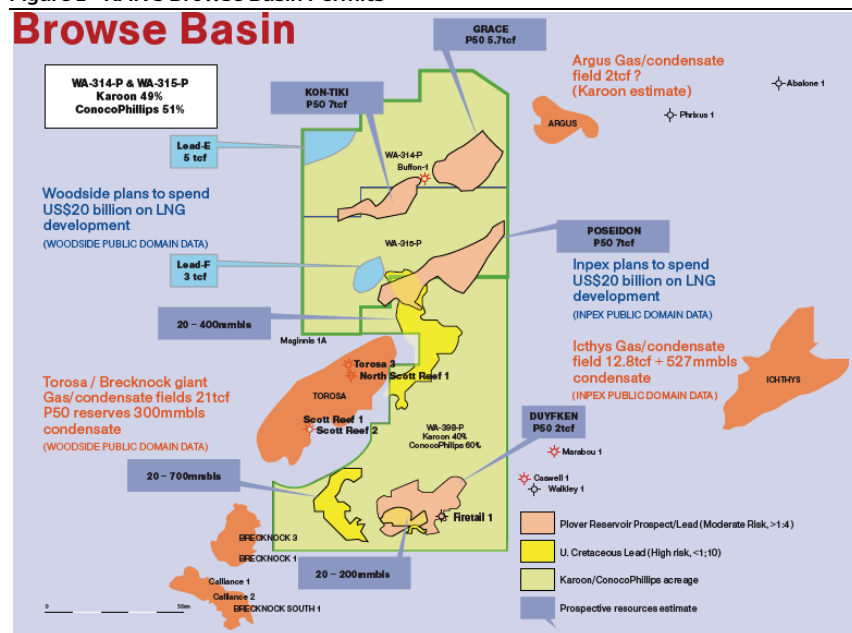
The rig is contracted for up to 225 days with at least three very large prospects to be drilled. As part of the WA-314-P and the WA-315-P farm in agreement, COP will fund 80% of this (third year) work program which requires one exploration well in each permit at an estimated cost of up to US\$80m each. COP has an option to acquire a further 9% interest in the permits by paying 80% of the next US\$125m of expenditure. The first stage work commitment for WA-398-P includes the drilling of one well.

KAR's technical team has identified four major prospects of Kon-Tiki, Grace, Poseidon and the smaller Duyfken, which have a combined P50 21.7TCF (Table 1). We place risked and unrisked value estimates on this total potential resource of \$23.76 and \$8.05 per share.

A gas discovery of the proportions envisaged would open the way for an LNG development, typical of others being planned in the basin. KAR's own indicative economics of a project based on 7TCF plus liquids is an NPV of US\$5.0b at an oil price of US\$50/b, of which KAR's 40% of the project equates to A\$20/share.

The Browse Basin is the centre of number of large resources looking to be developed by their owners. WPL's Torosa/Brecknock have a combined 21TCF and 300mb condensate and Inpex's 12.8TCF/530 mb lcthys field are the two largest and most advanced projects.

Figure 1 - KAR's Browse Basin Permits



- A 200-225 day drilling program is expected to start in December 2008, drilling at least one well each of the three permits.
- Total cost estimate US\$ 270 million. Karoon share US\$ 72 million.
- NB. With respect Karoon's Browsers Basin Joint Venture, the disclosures presented in this review do not necessarily reflect the views of ConocoPhillips.
- Karoon will amend prospective reserve estimates as work on the prospects is completed.

SOURCE: COMPANY DATA

## Opportunities in the Santos Basin, Brazil

**Early position in the Santos basin**

In November 2007 KAR was awarded 100% of five blocks covering 850 sq km in the offshore Santos basin in the state of Santa Catarina, Brazil, just south of Rio De Janeiro. The cost to KAR was a total of \$US25m in signature bonuses.

**Main leads are 100-200 mb, post salt**

The blocks are located in mid-range water depths of 300m, within 100km of a number of producing oil fields, Caravela/Merluza, and less than 50km from recent discoveries by Petrobras, estimated to be in the order of 150mb of oil.

**As well as large pre-salt targets**

Within KAR's acreage there are three main shallower leads at Eocene/Oligocene levels (as per the recent Petrobras discoveries) and Cretaceous levels with prospective resource target ranges of 100- 200mb.

**Giant Tupi and Carioca discoveries elevate values in the basin**

Additional potential has been recognised including sub-salt reservoirs of the type targeted by Petrobras in its new gas discovery (1-BRSA-617- SCS), 100km south.

At the time KAR was bidding for its blocks, the first wells in the Tupi work program (Petrobras) had been sunk and the field was later estimated to contain 5-8 Mb of recoverable oil. Tupi is located some 200km from KAR's permits in water depths of over 1,000m.

The subsequent Carioca discovery was identified as a potential giant oil discovery, with initial comments by a senior government official of a 33 Bb oil field. Consortium partners are Petrobras (45% - operator) and BG (30%).

These potential giant oil fields, discovered in deep water, have established the Santos basin as a new world class hydrocarbon province. Reservoir trap structures may vary across the basin, but the same source rocks are associated with Carioca, Tupi and the Caravela trend where KAR's permits are located.

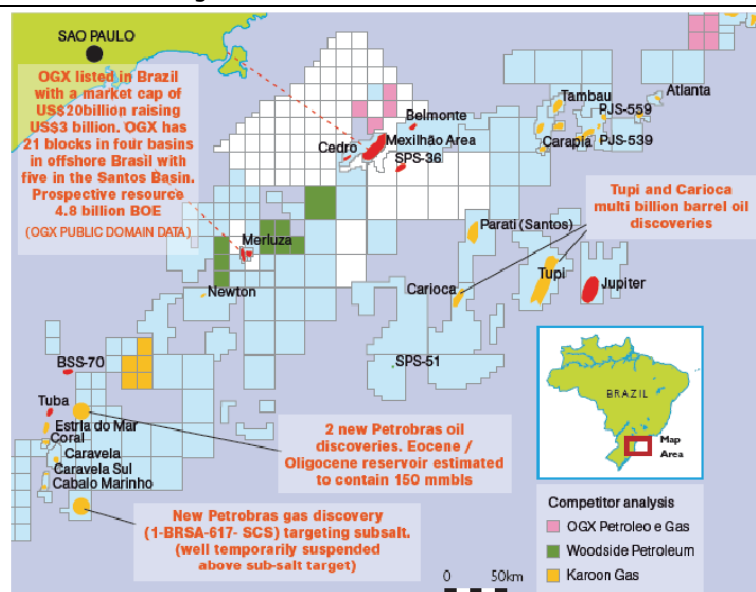
## Active 2009 ahead

**3D seismic coming up  
Drilling possibly 2011**

The 2009 work plan is to acquire 3D seismic, with drilling timed for 2011. Further drilling may follow in accordance with the optional two year second term of the work program, whereby one well is required to be drilled in each of the five blocks.

KAR has stated that all expenditure will be funded either through the use of KAR funds or possibly the equity restructuring or farm out of permits. There are opportunities for such farm outs to existing holders of other permits in the area.

Figure 2 - KAR's Brazilian acreage



SOURCE: COMPANY DATA

### Valuable prospects also in Peru

**Attractive proven oil and gas region**

In January 2008, KAR signed a Farmin Agreement with Vietnam American Exploration Company LLC (Vamex) for the exploration of Block Z38 located in the offshore Tumbes Basin in Northern Peru. Vamex is a 100% subsidiary of Pitkin Petroleum, a United States independent oil and gas company. This is an attractive region as evidenced by Shell’s recent US\$300m farm in to BPZ’s adjacent Z1 permit.

KAR will earn an initial 20% interest in the block by funding a new 2,000 km 2D seismic survey with the option of earning an additional 40% interest by acquiring 670 sq km of new 3D seismic data.

**Two advanced 100-200mb leads**

The block is prospective for both oil and gas with any offshore development facilitated by the close proximity of existing infrastructure. Two advanced leads have been identified with 100-200mb or multi TCF resource potential.

The prospectivity of the region has been established by the existence, between Block Z38 and the coastline, of a number of large oil and gas fields. The Corvina field, held by BPZ in adjoining Block Z1 contains 3P reserves of 4TCF gas.

### Bonaparte Basin has oil production potential

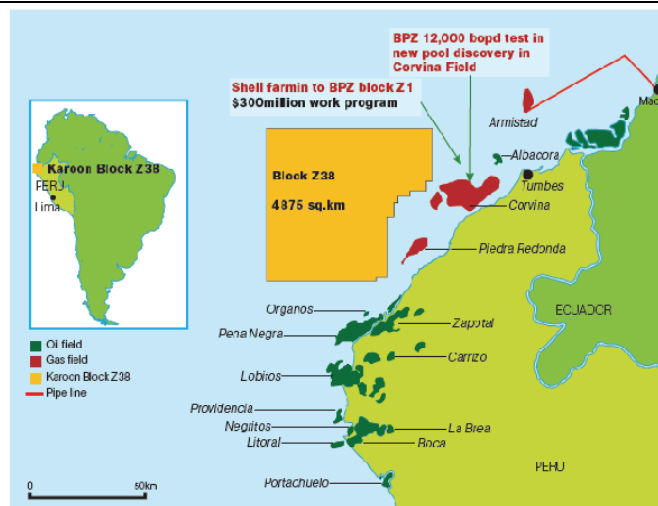
KAR has a 66% interest in AC/P8 in the offshore Bonaparte Basin. As it lies close to Laminaria/Corallina it has production tie in potential. The main prospect ‘Jania’ has up to 20mb potential prospective resource and there are 5 additional leads with similar size potential. Survey work is planned to precede possible drilling in 2012.

### Funding position

**Well funded with \$135m net cash**

The total cost of the upcoming Browse program, including seismic, has been estimated at US\$270m of which KAR’s share would be US\$72m. KAR has no debt and available cash of A\$135m. KAR has been able to manage its exploration outgoings through well constructed joint ventures (with COP) while maintaining significant interests in its permits. This is a model that stands to be applied successfully in other areas such as South America.

Figure 3 - Z38 in Peru’s Tumbes Basin



SOURCE: COMPANY DATA

**Recommendation structure**

Buy: Expect >15% total return on a 12 month view

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Fair Value: Expect total return between -15% and +15% on a 12 month view

Sell: Expect <-15% total return on a 12 month view

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Southern Cross Equities Ltd and its associates hold 909744 shares in KAR as at the date of this report. This position is subject to change without notice.



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