

Pancontinental Oil & Gas NL PCL (\$0.19)

S&P/ASX 300 = 3452.4

SPECULATIVE BUY

Huge Leverage if WPL decides to play

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Pure Exploration Play

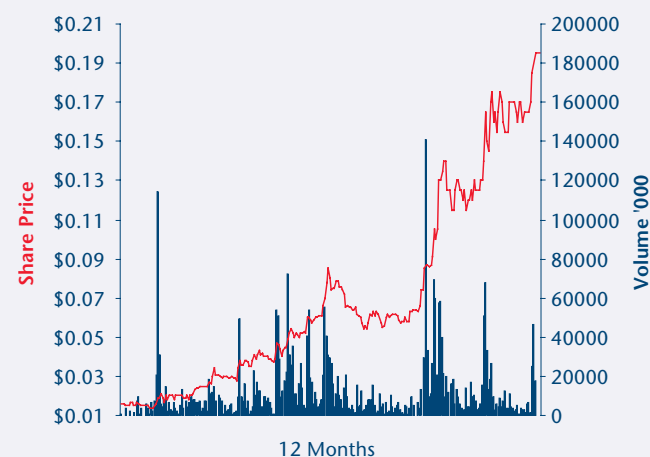
- ▲ Two small Australian companies now control all of the offshore Kenyan oil and gas permits. Woodside has farmed into both. Global Petroleum has a 20% interest in the 4 northern permits (L5, L7, L10, L11), while Pancontinental (PCL) has interests in 3 permits.
- ▲ PCL is a small, quite tightly held exploration company, whose principal asset is a 40% interest in three Production Sharing Contracts (PSC's), located offshore Kenya. The other participant is Afrex Limited.
- ▲ The three PSC's L6, L8 and L9 cover some 21,000 square kilometers, offshore Kenya. Water depth is modest, being between 300-1200m depth.
- ▲ Woodside has farmed into these permits, and has met the initial stage 1 of the farm-in, by shooting 2,000 km of 2-D seismic to earn a 50% interest. Woodside has the right to shoot additional seismic if it so chooses.

Not for Everyone!

- ▲ The terms of the farm-in with WPL are what has the potential to create huge leverage for PCL shareholders. However, the stock is quite tightly held, and is thus not particularly liquid.
- ▲ The farm-in is staged, therefore, PCL's future leverage (and hence share price movement) is dependant upon Woodside electing to drill a well in one of each of the PSC's. Given the limited data available, we suggest that Woodside will only choose to participate if it believes that the financial terms and the potential size of the target(s) warrant the risks of investing in a third world country.
- ▲ Thus far, PCL/WPL have identified leads, ranging in size from 50 – 1000m bbls in size. Clearly offshore Kenya is 'elephant' country. Kenya has only had a handful of oil exploration wells drilled to date, so while highly speculative, PCL offers extreme leverage to any success should Woodside decide to drill a well.

Company Statistics & Performance

Shares on Issue	154.8m	Daily Vol.	1,192,000
Market Cap.	\$27.9m	Debt	\$0.0m
52 Week Range	\$0.01 - \$0.185	Cash	\$0.7m



Investment Summary

Directors		
HD Kennedy		Chairman
AK Svalbe		CEO
PL Munachen		Executive Director
IR Cornelius		Non-Executive Director
LA Colless		Non-Executive Director
Top 5 Shareholders		
Rockfield Investments	26.70	17.2%
BL Williams	6.00	3.9%
L Cornelius	1.30	0.8%
M Kopcheff	1.00	0.6%
African Metals	1.00	0.6%
Top 20 Shareholders		51.80 33.5%
Reserves	Oil	Gas
not applicable	(mmb)	(bcf)
Resources	0.0	0.0
not applicable	0.0	0.0

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The Farm-In

- ▲ The terms of the farm-in with Woodside for the Kenyan acreage is as followings:
 - WPL must shoot at least 2,000 km of 2-D seismic to earn a 50% interest in PSC's L6, L8 & L9. Woodside has completed this earn in.
 - WPL must then elect in respect of each PSC to drill, and if warranted test, 1 well in the relevant PSC to increase its interest to 65% (or hand back the 50% stake to PCL and Afrex).
 - WPL has the further option in respect of each PSC to increase its interest to 75% by drilling, and if warranted testing, a second well in the relevant permit.
- ▲ Thus, PCL potentially has three bites of the cherry.
- ▲ The implicit value of the farm-in (assuming WPL decides to drill a total of 6 wells) is around US\$60m for 75%. Therefore PCL's diluted stake would be worth around US\$8m. We note that Woodside has also farmed into Global Petroleum's acreage offshore Kenya.
- ▲ There have only been around 20 wells drilled in total in Kenya, mostly in the early 1960's and early 1980's. Oil shows were common, and some wells recovered oil, suggesting an active petroleum system.

Risks

- ▲ Apart from the obvious geological risks, clearly, the largest risk is that Woodside decides not to drill any wells in PCL's acreage. We would expect PCL's share price to be highly leveraged to any news on Woodside's decision.
- ▲ This will be confirmed, should WPL decide to shoot additional seismic (i.e. WPL make a decision to shoot additional seismic in Global's acreage or PCL's acreage).
- ▲ Next, if WPL decide to drill a well (say in 2005), the potential target size will determine PCL's share price leverage.
- ▲ Assuming a 200m bbl target, the first well in each PSC offers the highest degree of leverage (as PCL's equity interest is diluted as WPL earns in). This size target would generate share price leverage (on the current issued capital of 178.7m shares, including options) of around 85 cps (or 435%).

Management

- ▲ Mr Andrew Svalbe is a well-respected geologist, and group Managing Director. The Chairman is Mr Henry Kennedy. Directors are Mr Inky Cornelius, and Mr Peter Munachen.
- ▲ They collectively own some 26.7m shares through Rockfield Investments.

Summary

- ▲ Should Woodside decide that Kenya is attractive (geologically/geo-politically and fiscally), then PCL and Global potentially offer extreme share price leverage to any exploration drilling.
- ▲ Obviously, this type of stock is not for everyone, and must be considered speculative, however, the potential upside is large (and would require additional capital). We rate the stock a SPEC BUY for those wanting leverage and cognizant of the risks.

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