

This Week

Pancontinental Oil & Gas Cranks Up the Action

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Following completion of an equity raising and assuming a merger with exploration partner Afrex is approved on 5 August; Pancon will have 333.5 million shares on issue with the potential to move to 352.9 million shares once its permits in Kenya and Morocco move to the next stage of development. Pancon will have cash of ~\$2.5m to fund operations over the coming two years. Within the next 6 months, Pancon will spend about \$0.8m on drilling in New Zealand and acquisition of seismic data in the Carnarvon Basin, but will most likely farmout further drilling activity to conserve cash.

Later in the September quarter, Pancon is scheduled to participate in drilling a well into the 4-5MMbbl Oru prospect in the **Taranaki Basin**. Discovery here would be worth up to \$15m to the company, which holds a 9.4% interest in the permit. If Oru is a success, the partners in the permit may seek to drill the nearby Punkehawa prospect. Any discovery in this location could be rapidly brought on line using nearby processing plant and pipeline transport facilities.

In the **Carnarvon Basin**, Pancon and its partner Strike Oil are acquiring seismic over prospects in EP-424 and EP-110. EP-424 holds the Hastings prospect, which is thought to be analogous to the nearby Roller and Skate oil fields, operated by Chevron. Pancon holds 25% of the permit and may look to farm down to fund drilling of this 20-60MMbbl prospect early in 2006. If Pancon retains 12.5% in EP-110, discovery would be worth over 12 cps. Meanwhile, Pancon has a 33.33% interest in WA-312-P, located to the east of the Stag oil field. Any success with the upcoming drilling at the Gats and Hestia prospects to the west of Stag would increase interest in this nearby permit, which has several small but ready-to-drill prospects waiting for a farmin partner to fund drilling.

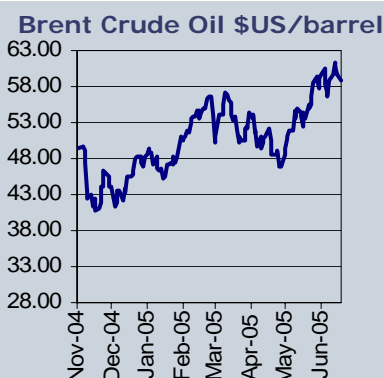
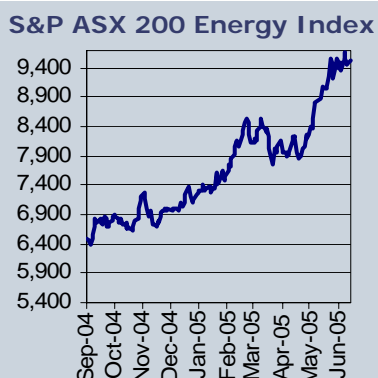
In **Malta**, US based independent energy company, Anadarko recently farmed in to earn an interest of up to 75% in Pancon's Blocks, leaving Pancon free carried with 20% through the shooting of a large 2D seismic programme and drilling of two wells. Anadarko has committed a minimum of US\$14m to the programme and could spend up to US\$32m on Pancon's behalf, if the programme goes well. Wells in this area are estimated to cost US\$11m on a dry hole basis, with testing adding \$2-3m to the cost per well. The reservoirs in this basin tend to be carbonate so 3D seismic is largely ineffective in providing additional information on the location of hydrocarbons, making 2D seismic the tool of preference. Ahead of any results, StockAnalysis calculates that this programme alone provides a value of about A\$8m to Pancon's diluted interest.

The Maltese permits totalling 14,800km², are well located with respect to surrounding large oil and gas accumulations in Tunisian and Libyan waters. Existing seismic data has outlined a number of leads with potential to hold between 100 and 1,000MMbbls of recoverable oil. Anadarko will be keen to drill a well by the end of 2006 and has already gone out to tender for a seismic vessel to conduct additional data acquisition.

In **Kenya**, Pancon is negotiating final terms with potential farmin partners who will have access to 2D seismic data to guide the acquisition of additional 3D seismic and the drilling of at least two wells. Pancon's permit areas cover 21,253km² or about one third of this offshore basin, which has many similarities to Australia's North West Shelf area, showing multiple play types in at least three separate age strata.

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Indices & Prices	
All Ordinaries	4225.10
Energy Index	9540.80
Brent US\$/bbl	58.93
AUS\$/US\$	0.7559
As at Close July 12th	

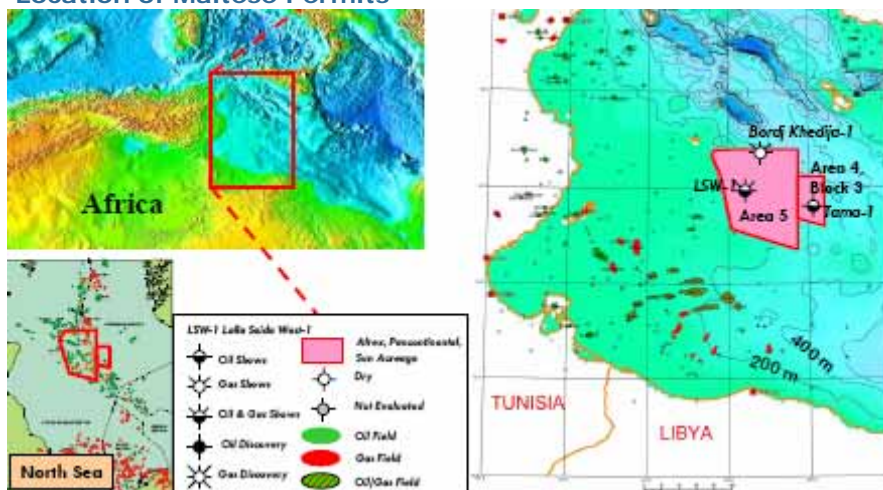




Pancontinental	
ASX Code	PCL
Current Price	0.07
Number Shares (mil)	351.0
Market Cap (mil)	24.57

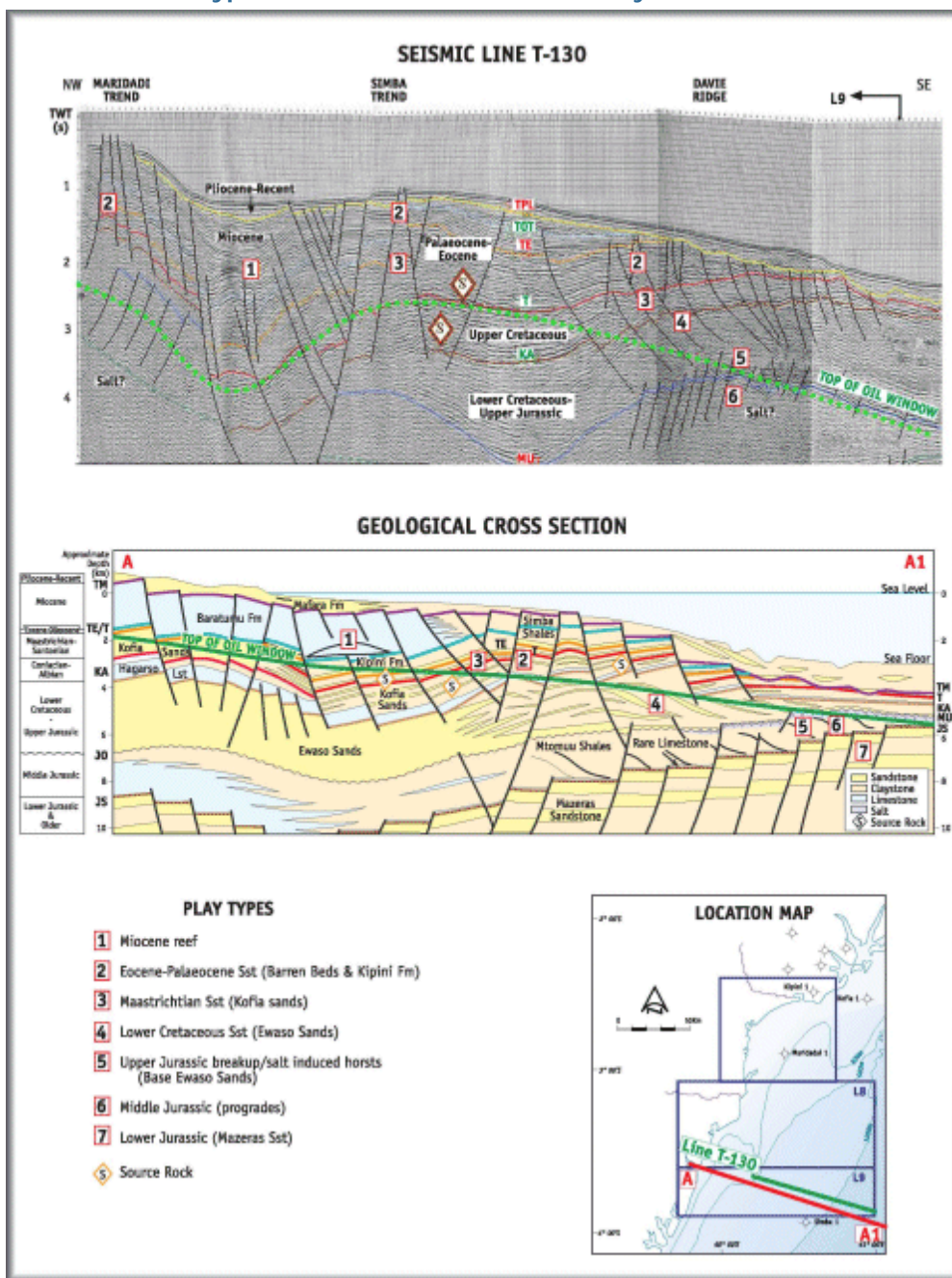
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Location of Maltese Permits



Source: Pancontinental Oil & Gas NL

Location and Typical Structure of Pancon's Kenyan Permits



This basin is real frontier territory for Pancon and covers a huge area equal to 200km by about 106 km, which will not be fully tested by just 2 wells. While targets offshore Kenya are large and deep, advances in deep sea drilling and production techniques bring this area firmly into focus for energy hungry regions such as India and China.

Fiscal terms in both Malta and Kenya allow rapid cost recovery out of initial cash flow and result in an estimated after tax return to the contractor in the range of 35% to 40%, comparable with terms in Australia and far better than those on offer in Indonesia, where the contractors share of profit oil is just 15%, prior to corporate taxation.

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Source: Pancontinental Oil & Gas NL

Valuation

Valuing small exploration companies is as much an art as an exact science.

1. Market Price

A crude way to assess a company is to look at its market price. Markets are good at determining price but bad at indicating value. If shares in all companies were always fair value, then no-one would want to buy them! For instance, last financial year Woodside's shares rose 74% so they were either undervalued at the beginning of the year or they are over valued today. Similarly, StockAnalysis recommended Tap Oil late in April at \$1.81, saying that the company had value of over \$3 per share and the stock has since risen to over \$2.50 per share. Clearly the price of a share is not a good gauge of its value and so **StockAnalysis will ignore Pancon's current price of around 7.5 cents for the sake of valuation.**

2. Price relative to another Stock

Theory has it that the more a company is studied by investors and analysts, the more likely is its share price to reflect true value. Since smaller companies are less analysed, this theory goes a long way towards explaining why smaller companies are often cheaper than larger companies, even though there are separate and higher business risks associated with smaller companies.

The same caveats apply to this method as to the pure share price method. However, in Pancon's case, exploration company **Global Petroleum**, has a remarkably similar portfolio of interests. Global has exploration interests adjacent to Pancon in both Malta and Kenya, a 14% holding in the Falklands Island Oil Company plus other high risk exploration interests. One significant difference is that Global holds about \$6.2m of cash, whereas Pancon is less securely funded with just \$2.5m, increasing the risk that it will dilute existing shareholders with further equity issues in the medium term. Global has come under quite a lot of investor scrutiny since it listed on London's AIM and so its price may be considered to more accurately reflect its true value than does the price of Pancon.

Global has 169.3m shares and a market capitalisation of \$90m while Pancon has a market cap of just \$27m. **On this basis, Pancon could be considered to be one third of its fair value and its shares should therefore be priced at about 22 cents.**

3. Price for a willing buyer or Farmin Programme

US independent, Anadarko has recently farmed in to earn 75% of Pancon's Maltese Permits by spending an estimated US\$30m on drilling and seismic. The fact that Anadarko is willing to spend this money must mean that it thinks that there is a good chance the permits will be worth much more. On the basis of this farmin, Pancon's 20% carried interest could be valued at US\$8m. In a nearby deal, Woodside and its partner Occidental Petroleum recently agreed a US\$100m work programme for 3 permits in Libyan waters, adjacent to Pancon's blocks. This equates to roughly A\$45m per permit, valuing 20% at A\$9m, which is in line with the Maltese farmin valuation. Assuming a similar metric for the Kenyan permits, where drilling costs could be as high as US\$30m per well, "values" Pancon's interest at about \$25m.

If Anadarko's programme is unsuccessful, the permits may be downgraded, however these permits cover a huge area equal to 200km by 74km. Such a chunk of ground is equivalent in size to a portion of the Carnarvon Basin stretching from Exmouth to just north of Barrow Island. To think that two wells and some seismic is all that it takes to assess an area of this size is a mistake.

4. Risk adjusted value.

Oil exploration is a probability game. Tools like seismic or information about reservoir quality and the quality of sealing shales from nearby wells reduce the risks in this game. In Malta, Pancon has identified 8 leads from gravity and seismic data. The highest grade prospect, Chianti is defined by at least three seismic lines and is estimated to have potential to hold up to 450MMbbls of recoverable oil. Let's assume that Anadarko's additional seismic has a 45% chance of confirming the target and a 55% chance of knocking it out of contention. Then, if we look at the drilling stats for this part of the Mediterranean when targeting a seismically well defined prospect, we might find that wells have a 1:8 chance of success (12.5%). Multiplying these probabilities gives Chianti a 5.6% chance of success. In this case we take a severely negative view and discount all other prospects spread over the rest of this huge permit! This is like saying there is an oil field at Barrow Island but nothing else to find nearby! If we then value this oil at just A\$6/bbl (when A\$12 might be more appropriate) and apply the risk adjustment, StockAnalysis values Pancon's 20% interest in this permit at \$30m.

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StockAnalysis provides a valuation for Pancon of 24 cps based on a risk adjusted assessment of its permits. Given the risk that the company will need to expand its capital base to fund further exploration and development, a short term price target of 18 cents is considered reasonable. Any success at Oru in the Taranaki Basin would significantly reduce Pancon's funding risk, providing either a rapid cash flow to support corporate activity or an asset which could be sold to fund additional projects. Early farmout for drilling of the Hastings prospect could see this target tested in H1 2006, providing significant upside to Pancon.

Valuation of Pancon

Asset	Value \$m	\$ per Share	Comment
Cash	\$ 2.5	0.01	
Exploration	\$ 87	0.25	\$36m on farmin terms
Other	-\$ 4	-0.01	Corporate
		<u>0.24</u>	

Well	Equity	Target Pj	Target MMbbl	Risk %	NPV \$m	Discovery Value \$/share	Risked NPV \$m	PCL cost to drill \$m	Risked NPV \$m
Oru	9.4%	2	5	10%	103	0.03	10	0.5	0.5
Hastings EP 424	12.5%		30	7%	330	0.12	23	0.2	2.7
EP 104(R4) Stokes Bay	11.0%	50	10	12%	128	0.04	15	0.3	1.4
Malta	20.0%		450	5.6%	2700	1.53	151	-	30.2
Kenya Global	25.0%	3000	1000	3.0%	6600	4.68	198	-	49.5

Source: Strachan Corp. Pty Ltd.

Conclusion

Pancon has huge leverage to exploration success in high risk-high reward permits in the Mediterranean and offshore Kenya. StockAnalysis sees funding as the major risk, as is the case for all junior oil exploration companies however, the company is now funded for at least 18 months of operation. Finalisation of its merger with Afrex in early August plus a planned AIM listing will focus market attention on Pancon's undoubted exploration potential. StockAnalysis places a strong speculative buy recommendation on the stock.

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