

# Australian Oil Company Ltd

## California oil & gas focus

- AOC is an oil and gas exploration company focused onshore in California's prolific hydrocarbon basins.
- The company has recently secured a substantial package of highly prospective oil and gas brown fields to green fields targets.
- Despite a long history of production the onshore basins of California continue to show discovery upside as confirmed by the 250mmbbl Occidental San Joaquin oil field.
- The state also has some of the best infrastructure allowing for fast track production from initial discovery success.
- AOC directors and management have extensive experience in discovery and field development.

## Near term drill bit and production upside

### Hood-Franklin Project

- An appraisal well to spud in SQ11 targeting a mid-case recoverable reserve of 14Bcf.
- Excellent upscale opportunities with success case.
- Additional upside with the high case potential of 46Bcf which covers the full seismic anomaly at Hood-Franklin.

### Los Alamos Project

- Monterey oil play up dip of a previous exploration well. Planned to spud in DQ12.
- Significant company making upside with success case which we estimate may equate to net recoverable reserves to AOC of +5mmbo.

## Price target

- We have placed a price target on AOC of A\$0.32 per share which assumes success at the fully funded Hood-Franklin well in SQ11.
- We see success at the Los Alamos project in DQ11 as providing significant leverage to the share price towards \$0.60 to \$1.00 per share.

## Recommendation

- We recommend a SPECULATIVE BUY based on the high impacting nature of planned drilling over the next 6 months and the company making potential of the Los Alamos project.

AOC.ASX

Spec. BUY

25 July 2011

Share Price \$0.17  
6 month Price target \$0.32

GICS sector Materials

Market capitalisation\* \$m 12  
Shares on Issue\* m 69  
Cash on hand \$m 2.5  
Enterprise value \$m 9  
Previous rating Initiation  
\* Undiluted

### Directors & Management

Non-Exec. Chairman Andrew Childs  
Managing Director Grant Jagelman  
Non-Exec. Director Keith Martens  
Non-Exec. Director Ian Tchacos

### Major Shareholders

Grant Jagelman 10.0%  
Andrew Childs 5.4%  
Harris Super Fund 5.4%  
Humbolt Capital 5.1%

### AOC Vs Energy Index (XEK)



Piers Reynolds  
(03) 8601 1196  
preynolds@veritassecurities.com.au

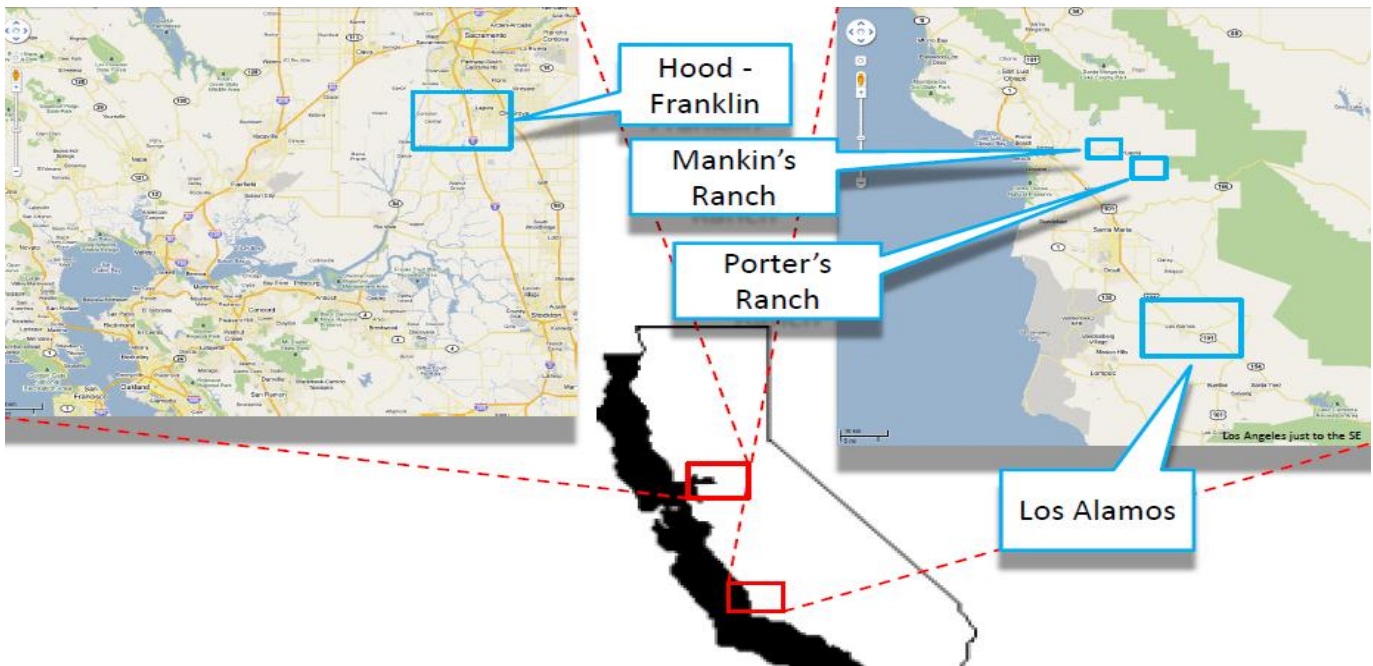
## Company background and overview

The Australian Oil Company (AOC) listed on the ASX in October 2005 to explore for oil and gas in Australia and overseas. Up to 2007, AOC focused on its Australian assets. In 2006, it acquired an interest in 440 acres of oil leases at Huasna Valley, Mankins Ranch in the St Luis Obispo County, USA. Since this acquisition, the Company has shifted its focus to the USA, increasing the number of oil leases at Mankins Ranch (AOC 35%) and acquiring 3 additional projects in the USA. These additional projects include the right to earn a 75% interest in the Hood-Franklin Gas Field in Sacramento, a 45% interest in 9,051 acres of oil leases to the south east of Mankins Ranch at Porter Ranch and in May 2011, the right to earn a 56.25% in 3,100 acres in Los Alamos, St Barbara County.

**AOC started a USA onshore focus in 2007**

The next 12 months are significant for AOC, as success at any of its 4 onshore USA projects could result in a company making the transition from explorer to producer status.

**Figure 1: AOC onshore California Projects**



Source: Company reports

## California – infrastructure rich

California has a long history of oil and gas production dating back to the 1500s when Spanish explorers observed native Indians gathering asphaltum from natural oil seeps. The cumulative average daily production of all oil and gas bearing basins in California is currently circa 680,000 boepd. California has arguably some of the best oil and gas infrastructure of any region in the world, courtesy of its long history of production. Pipelines are numerous in all established regions of production and oil and gas can easily be sold into the domestic market. Consequently, the time and cost involved in completing a development well and linking into local infrastructure is minimal.

**Average cumulative production from all basins is 680,000 boepd**

**Large discoveries are still being made up to 250mmboe**

Despite widespread exploitation, there remains considerable scope for further significant discoveries, such as the recent Occidental San Joaquin 150-250MMboe discovery.

## Prolific Basins

**The Santa Maria and Sacramento Basins have been prolific producers**

The Huasna Basin relative to the surrounding Ventura, Santa Maria, and San Joaquin Basins has been relatively under exploited, despite historical drilling and a number of commercial oil discoveries, indicating a common presence of hydrocarbons. The Basin is located to the north east of the prolific Santa Maria Basin. The reservoir source and seal are from the Miocene age Monterey formation, which is typically oil prone as evidenced in the nearby Huasna Oil Field. The Monterey formation contains thick sections of potential reservoir rocks that are highly laminated. The sediments comprise dolostone, diatomite, porcellanite, siliceous shale, and chert. The Miocene sediments of the Huasna Basin have a higher sand content which may positively influence primary reservoir characteristics. As in the nearby Santa Maria Basin, establishing secondary fracture porosity and permeability is of significance.

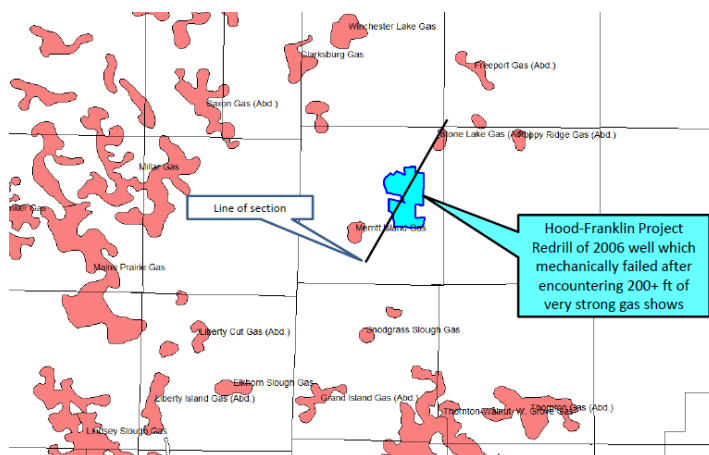
The onshore Sacramento Basin is primarily gas bearing with production from in excess of 70 gas fields and 2 oil fields. The Basin covers an area of 18,900km<sup>2</sup> extending approximately 335km from Redding in the north to south of Sacramento city and is approximately 95km in width. Major gas discoveries include Rio Vista (3.5TCF) and Grimes (885BCF).

## Hood-Franklin Gas Field (earning 55%, operator)

The Hood-Franklin gas project is located 12 miles south of the city of Sacramento in the Sacramento Basin. The project is a Deep Forbes style play targeting gas. AOC are funding 100% of well costs and completion (~\$1,050K) toward a sidetrack well to earn a 75% interest. Of this 75%, AOC have indicated that a subsidiary (to be sold for \$350K) holding a 20% interest will pay 40% of the well costs. Hence AOC will be paying \$630K to earn their net working interest of 55% in the permit.

**History:** The appraisal well to be drilled by AOC in 3Q 2011 is a sidetrack to the Archer-Whitney #F1 well. After strong gas shows over a net pay zone of 200ft+ from approximately 10,000ft depth, mechanical control of the well was lost.

**Figure 2: Hood-Franklin Gas Field location**

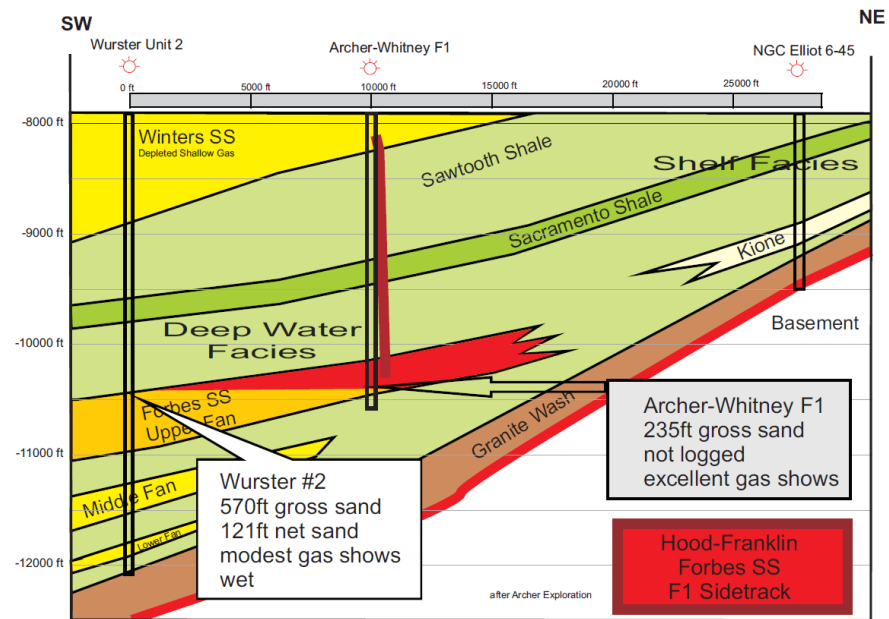


Source: Company Reports

**Conceptual Development:** The Whitney sidetrack is targeting mid case gas reserves of 14Bcf. A success case scenario would result in a gas flow rate of up to 5MMcf/day with net

revenue of US\$3-3.5 per Mcf. AOC will receive 80% of net revenue until payback for well costs is achieved, resulting in payback within 3 months. Thereafter, AOC will revert to its 55% net working interest, with potential revenue from a success case of up to ~US\$2.4m per year for each well. It is envisaged that an additional 5 to 8 wells would be drilled should the Whitney sidetrack prove commercial at a cost of \$2.2m each, to be funded out of cashflow.

**Figure 3: Hood-Franklin Project redrill schematic section**



Source: Company Reports

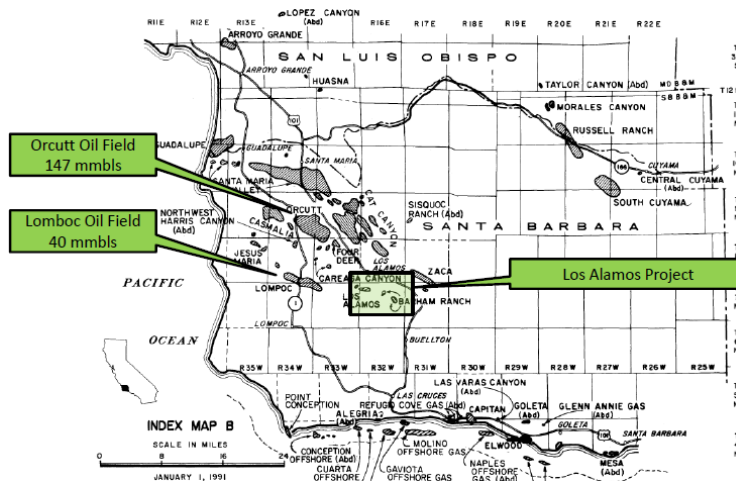
## Los Alamos (56.25% WI)

**Los Alamos is a high impacting oil play**

The Los Alamos project is an onshore, Monterey shale oil play located in Santa Barbara County, California to the southwest of the company’s Mankin’s Ranch and Porter Ranch projects. AOC are funding 75% of the costs of an appraisal well (\$3m in total, \$2.2m net to AOC) to earn a net working interest of 56.25%. It is envisaged that the appraisal well will be completed in 4Q 2011. AOC have indicated that they may farm-out 20% of their 56.25% WI prior to drilling at a minimum 2-for-1 promotion deal. This would offset the net drilling costs for AOC by a further \$850K+.

**History:** During the early 1980s, Sunoco Inc (formerly Sun Oil Co) completed a work programme on the project culminating in the drilling of 2 exploration wells Sun Blair 1 (1984) and Sun Blair 5 (1986). Sun Blair 5 intersected a deeper Monterey shale target recovering 30-34 API oil. Further work on Los Alamos since then has been limited.

Figure 4: Los Alamos location along trend of significant oil fields



The project is located along trend of large onshore oil fields

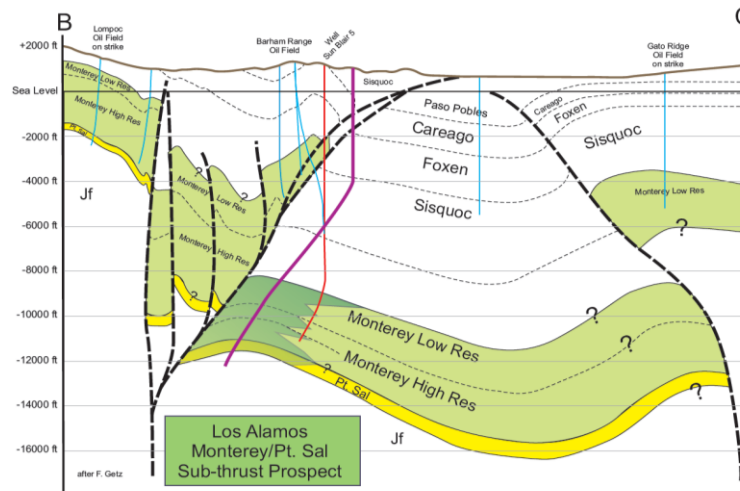
Success may lead to high impacting company making cash flow scenarios

Source: Company reports

**Conceptual Development:** On a success case scenario, AOC will receive back 75% of revenue until well costs have been recovered with expected payback in approximately 4 months. Thereafter, it reverts to its 56.25% working interest. Should the well prove successful, it is targeted to produce between 400bbl to 600bbl per day, linking into local infrastructure, with the oil attracting a small premium to WTI. After a 20% royalty and operating costs, AOC would receive ~US\$60 in net revenue per bbl at current oil prices. Should this scenario unfold, AOC have indicated they would look to drill in the order of 15 to 25 additional wells to be funded out of cashflow.

The value upside that would result from a discovery we regard as highly significant. A scenario of 15 wells producing 300 bopd (approx. 1.6MMbbls per annum) and net revenue of US\$60 per barrel would equate to cash flow of \$6.5m per well or approximately \$55m net to AOC at 56.25% WI.

Figure 5: Los Alamos cross-section with potential oil bearing zones



Cross section of the large target Monterey shale

Source: Company reports

## Mankins Ranch (35% and fully funded)

The Mankins Ranch project is a 1,400 acre onshore Monterey shale oil play located in St Louis County, California. AOC holds a 35% working interest and are currently being fully funded by Excelaron LLC (spending \$2.6m to earn 65%). Permitting is pending with the earliest expected approval to occur in 3Q 2011.

Once approvals have been received, 2 wells are planned to twin historical wells and test potential oil recoverability for which historical data has been deemed to be inaccurate. As a result of the lengthy permitting process it is anticipated that drilling at Mankins Ranch will occur in 1Qtr 2012. For this reason we have excluded Mankins Ranch from our price target for AOC.

## Porter's Ranch Project (45% after CALOG sale & operator)

Porter's Ranch comprises approximately 9,000 acres of tenure located to the south west of Mankins Ranch targeting a similar style of Monterey oil shale play. During 1980 Phillip's Petroleum Co. completed extensive work acquiring seismic, installing road infrastructure and preparing 2 well sites.

In 1981, it drilled an exploration well, Porter D-2, which intersected oil at 700ft, 2,500ft, 4,600ft, and 7,000ft before control of the well was lost. Due to the low oil prices at the time Phillip's pulled out of the project despite the encouraging results from Porter D-2, with no major exploration work completed since then.

Leasing for Porter's Ranch was recently finalized in May 2011 and reprocessing of historical 2D seismic has commenced. It is unlikely that AOC will be able to drill at Porter's Ranch until CY2012 and hence we have excluded this from our price target for AOC until more clarity surrounding the drilling of an exploration well is announced to the market.

## Other Assets

**Cooper Basin:** AOC have recently looked to exit from PEL 182 in the Cooper Basin via the partial farm-out of its interest to Dome Petroleum (7.5%) and the intended sale of its residual interest (5%) to Strategic Energy Resources.

**Exmouth Sub-Basin:** AOC retain a 17% interest in EP 435 with no further work intended to be completed until results from the Bee-Eater 1 well are interpreted. To date, the timeframe for drilling this well has not been set.

**Timor Oil:** AOC holds a 50% interest in Timor Oil which retains the 100% right to explore for oil and gas onshore in East Timor. As no legislation exists in East Timor governing onshore oil and gas exploration, it would currently be illegal for AOC to complete any exploration.

## Financials

**Cash:** Post the recent rights issue, the company has approximately \$2.5m in cash to fund drilling of a side-track well at the Hood-Franklin Gas Project in 3Q 2011 and to apply to working capital.

First drilling may occur in late 2011 at the earliest

**Tax:** The fiscal regime in California is very favourable with contractors receiving between 50% and 60% of income post the government's cut and taxes.

## Directors

**Andrew Childs, Chairman** – Managing Director Petroleum Ventures Pty Ltd, chairman of Bombora Energy Pty Ltd, Director of Orion Energy Pty Ltd and ADX Energy Ltd.

**Grant Jagelman, Managing Director** – Non practicing lawyer, previously Chief Executive Officer or Chairman of a number of public and private oil and gas exploration and producing companies over a period of 35 years.

**Ian Tchacos, Non-Executive Director** – An energy professional with over 25 years experience in international oil and gas exploration, development and production. Ian is currently Chairman of ADX Energy Ltd, Instinct Energy Ltd and formerly Managing Director of Nexus Energy.

**Keith Martens, Non-Executive Director** – An explorationist with 35 years experience in Australia and North America. Formally, exploration manager of Tap Oil, then Bow Energy and currently lead explorationist to Senex Energy, Jupiter Energy and Australian Oil Company.

Sales

Tony Bonello +61 2 8252 3230  
 Robert Scappatura +61 2 8252 3240  
 Andrew McCauley +61 2 8252 3260  
 Patrick Ford +61 2 82523211  
 Sam Streeter +61 2 8252 3235  
 Clay Melbourn +61 2 8252 3220  
 Bryce Reynolds +61 2 8252 3215  
 Stephen Murphy +61 8 9380 8351

Research

Resources  
 Piers Reynolds +61 3 8601 1196

Industrials  
 Brent Mitchell +61 3 8605 4830  
 Levi Hawker +61 3 8601 1180

RATING

BUY – anticipated stock return is greater than 10%  
 SELL – anticipated stock return is less than -10%  
 HOLD – anticipated stock return is between -10% and +10%  
 SPECULATIVE – High risk with stock price likely to fluctuate by 50% or more

This report has been issued by Veritas Securities Limited A.B.N. 94 117 124 535, Australian Financial Services Licence Number 297043.

Disclaimer. The information contained in this document is general information only and is not financial or investment advice, and does not take into account your specific financial situation, particular needs and investment objectives. This document has been prepared from sources which Veritas Securities Limited ("Veritas") believes to be reliable, but none of Veritas, its directors, employees and associates ("Veritas Parties") give or make any representation or warranty that any such information is accurate, complete, reliable or up-to-date, and Veritas disclaims all liability for loss or damage, direct or indirect, suffered by any person arising from any use of or reliance on such information. Veritas recommends that you consult your financial adviser before making any financial or investment decision. Veritas does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect any of the information contained in this document.

Disclosure of interest. Veritas Parties may receive or may have received fees, commissions and brokerage by acting as corporate adviser or broker for companies described in this document, and may hold directorships or other offices with such companies. Veritas Parties may hold an interest in securities or financial products described in this document, may benefit from an increase in the price or value of them, and may effect or participate in transactions which are inconsistent with any statement made in this document.

Veritas Securities Limited A.B.N. 94 117 124 535 AFSL No. 297 043 GPO Box 4877, Sydney, NSW, 2001 www.veritassecurities.com.au	Sydney Level 4, 175 Macquarie Street Sydney, NSW, 2000 Tel: (02) 8252 3200 Fax: (02) 8252 3299	Melbourne Level 8, 350 Collins Street Melbourne, VIC, 3000 Tel: (03) 8601 1196 Fax: (03) 8601 1180	Perth Suite 5, 531 Hay Street Subiaco, WA, 6008 Tel: (08) 9380 8351 Fax: (08) 9380 8300
--	--	--	---