

Oil Basins Limited (ASX: OBL)

Australia Junior Energy Exploration Company

Oil Basins Limited (ASX: OBL) is an Australia-based junior energy exploration company, focusing on two oil and gas exploration projects – one in the offshore Gippsland Basin (south-eastern Australia) and the other in onshore Canning Basin (Western Australia). The company has entered into separate farmin agreements to earn interests in both the properties. These properties are located in highly prospective areas with close proximity to existing oil fields and infrastructure. The Gippsland Basin is Australia's second largest oil producing basin, while the Canning Basin represents a largely unexplored area with significant resource potential. Given the current high price scenario and growing demand for energy (especially crude oil), both prospects are expected to offer significant leverage to the company as well as its shareholders.

- Oil Basins' properties represent excellent addresses. The offshore Vic/P41 Gippsland Basin permit contains three leads – Kipling, Oscar, and Cotton – that are considered mature to undergo drilling activity. Not only are the prospects located near to the existing oil and gas fields (Kipper and Basker), but are also closer to the Basker/Manta FPSO production and storage infrastructure. Taken together, the three prospects are estimated to contain prospective resources of 1,947 million barrels (MMbbls) of oil or 5,208 billion cubic feet (Bcf) of gas. Oil Basins is now looking forward to farmout options in order to commence the drilling of wells, which is scheduled to be complete by 2010.
- The company's other property, the Blina Back Reef Joint Venture Area, also holds great promise. The acreage covers an area of 354 sq km in the Canning Basin and is estimated to hold prospective resources of 270 MMbbls of oil. The Blina Back Reef JV includes some parts of the highly prospective Fitzroy trough and is near the Blina, Sundown and West terrace oil fields. This permit is also situated near an oil storage and transportation facility, the Blina oil hub, which may help the company reduce its transportation costs for this project. Another feather in the cap for Oil Basins is that ARC Energy Limited (ASX: ARQ) is in the process of taking over as the operator of the Blina Back Reef prospect. ARC's financial strength and experience is likely to expedite the development of the prospect. In fact, drilling is expected to commence in 2Q 2007.
- Both the properties offer significant leverage to the company as well as its shareholders. With regard to the 12.5% interest in the Vic/P41 permit, Oil Basins gets a net stake in the potential resource base of 243.4 MMbbls of oil or 651 Bcf of gas. For this, it is required to contribute a drilling cost of around A\$4.09 million based upon a gross farmin well cost of A\$13.0 million and thereafter costs are shared pro-rata. Likewise, with regard to the 35% assigned interest in the Blina Back Reef Play prospect, Oil Basins gets access to potential reserves of net 94.5 MMbbls of oil upon incurring well drilling cost of A\$1.05 million (A\$1.015 million still owing) based upon funding 70% of the future well cost capped at A\$1.5 million. Considering the current high demand and rising energy prices, the comparatively modest cost contribution only underlines the fact that Oil Basins is likely to strategically benefit from these agreements.
- A major positive with Oil Basins is the experience of its board members and management. While the company's Chairman, Mr Kim McGrath, is a renowned finance and investment banking executive, its Director, Mr Neil Doyle, brings to the table vast understanding in upstream oil and gas activities and over 13 years of experience in investment banking and corporate finance in the energy sector. Going forward, Oil Basins is likely to be a significant player in the upstream oil and gas field on account of the knowledge and business relationships of its management.



[http:// www.oilbasins.com.au](http://www.oilbasins.com.au)

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Initiation of Coverage

Equity Research

Analyst: Manish Tulsian
(212) 513-1203
research@khandaker.com
www.khandakerpartners.com

Price (A\$)	
05/02/2007	\$0.115
Price Target *	\$2.433
52 week high	\$0.140
52 week low	\$0.080

Shares Outstanding (millions)	
Basic Shares	33.91
Options & Warrants	33.72
Fully Diluted	67.63

Capitalization (A\$ millions)	
Current Market Cap	3.90
Target Market Cap *	164.54

Revenue (A\$)	
2003A	-
2004A	-
2005A	251,006
2006A	-

* Our target price and target market cap are aiming at a 12-18 months investment period. For details, please see financial forecasts and analysis.

Investment Summary

We are initiating coverage on Oil Basins Limited (ASX: OBL) with the expectation that the company's market cap could reach A\$164.54 million, with a corresponding target stock price of A\$2.433 over a 12–18 month horizon. Our bullish expectations are premised on the resource potential of the company's two properties and macro economic factors that indicate improving demand and energy pricing scenarios.

Both the permits of Oil Basins, the Vic/P41 permit in the Gippsland Basin, and the Blina Back Reef in the Canning Basin adorn excellent addresses. The offshore Gippsland Basin is Australia's second largest petroleum producing basin and hosts nearly 21 oil and gas fields. Structural interpretation of a 3D seismic shot in 2005 led to the identification of three leads on the Vic/P41 permit – Kipling, Oscar West, and Cotton. The three together host an estimated 1,947 MMbbls of oil or 5,208 Bcf of gas. The topography of the Kipling prospect is interpreted to be analogous to the nearby Kipper gas field. Kipper is in the process of being developed by its operator, Exxon Mobil Corporation (NYSE: XOM), and has an estimated 2P reserve of 600–700 Bcf of gas. The Oscar lead on the Vic/P41 permit is considered to bear resemblance to the Basker field situated to the west of Oscar. The Basker field, operated by Anzon Australia Limited (ASX: AZA), is nearing production and has the first FPSO infrastructure and oil & gas hub in the Gippsland Basin. The discovery of reserves nearby reduces the risks associated with the discovery of oil or gas, while the ready production infrastructure is expected to facilitate cost effective production from the Vic/P41 permit. The interpretations of the 3D seismic (currently underway) may lead to the identification of more prospects and give better clarity on the existing resource potential. Oil Basins, meanwhile, is busy looking out for farmout options to expedite drilling activity (scheduled to be complete by September 2010) in the area.

The company's Canning Basin prospect, known as the Blina Back Reef Play Joint Venture prospect, covers an area of 354 sq km and includes the highly prospective Fitzroy trough in the north. Like the Vic/P41 permit, the Back Reef prospect also lies close to existing oil fields – Blina, Sundown, and West Terrace – in the west that are currently producing at a modest rate of 50 barrels per day. The Back Reef prospect is a completely new, untested stratigraphic trap expected to host 270 MMbbls of oil. Moreover, it is in close proximity to the Blina oil hub, which has ready oil production and transportation facilities. This is likely to save the company and its joint venture parties any additional investments in oil storage and transportation, and thereby, bring down the project costs. However, ARC Energy Limited (ASX: ARQ), a well-known Australian energy company is in the process of acquiring the 30% stake of the operator, Golden Dynasty Resources Limited (TSX.V: GLY), in the Back Reef prospect. This marks an important milestone in the development of the prospect. Post acquisition, ARC is likely to become the operator of the project. ARC is a financially strong company with a market capitalization of nearly A\$300 million and has considerable experience in oil and gas exploration activities in the Canning Basin. Its entry into the joint venture is likely to fuel further development of the Back Reef prospect and maximize production. ARC is expected to deploy its drilling rig to commence the drilling of an oil well, Backreef-1, in the area by 2Q 2007.

Oil Basins' Gippsland/Canning Basin portfolio offers significant leverage to its shareholders. The nature of the farmin agreements is such that in respect of the 12.5% interest in the offshore Gippsland Basin Vic/P41 permit, the company gets stake of prospective 243.4 MMbbls of oil or 651 Bcf of gas. This will accrue only after Oil Basins contributes to the total well drilling cost of A\$4.087 million. Likewise, with regard to the 35% interest in the Blina Back Reef Play prospect, Oil Basins gets leverage to potential resource base of 94.5 MMbbls of oil upon incurring well drilling cost of A\$1.050 million. Therefore, by participating in exploration costs, Oil Basins will be able to command significant shares in both the projects. In fact, the company's stake in the Back Reef prospect could increase to as much as 50% if it chooses to exercise an option agreement with Backreef Oil Limited. Currently, the energy industry's macro economic factors are looking bright. Demand is expected to grow continuously following the strong economic growth in developing countries, mainly China and India. As a result, oil and gas prices are expected to stay at a high level, going forward.

Another factor contributing to the upbeat outlook for Oil Basins is its highly qualified and experienced board and management. The company's Chairman, Mr Kim McGrath, is a renowned finance and investment banking executive and has held various legal positions in leading multinationals such as Comalco, ICL, and Bank of America. Oil Basins' Director, Mr Neil Doyle, comes with considerable experience in upstream oil and gas activities, having worked with the likes of BHP Petroleum & Esso Exploration and Production Australia. He has over 13 years of experience in investment banking and corporate finance in the energy sector. The company has also appointed Mr Geoff Geary as geological consultant. Mr Geary has over 26 years of experience in seismic interpretation and analysis of stratigraphy. We believe the management's extensive knowledge and its business network would be beneficial to the company's future growth.

With three mature prospects ready for drilling in the Gippsland Basin and the expected commencement of drilling activity in the Canning Basin in 2Q2007, Oil Basins is well on track to achieve its objective of becoming a credible player in the fast growing oil and gas exploration sector.

Company Background & Business Strategy

Oil Basins Limited is a junior oil and gas exploration company, which has recently entered the industry. The company has undergone quite a few name changes since its incorporation as Amskan Limited on June 5, 1987. It adopted the name Saxon Group Investments Limited in October 2004 and was primarily into the business of manufacturing technological and information systems for industrial applications. However, looking at the vast opportunities in the energy sector, the management decided to shift its focus to the business of upstream oil and gas exploration. The company rechristened itself as Oil Basins Limited on June 13, 2006. The new company re-listed on the Australian Stock Exchange (ASX) on August 23, 2006, after a long suspension of 11 years.

Oil Basins is currently involved in two oil and gas exploration projects – one in the offshore Gippsland Basin in south-eastern Australia and the other on the onshore Canning Basin of Western Australia. The company has obtained rights to earn farmin interests in both the projects. These permits are considered highly prospective and are close to other existing oil and gas fields and infrastructure. The Gippsland Basin is the second largest oil producing basin in Australia and hosts some 21 oil and gas fields. Oil Basins has the right to earn 12.5% interest in the offshore Gippsland permit Vic/P41 in Bass Strait, which is currently held in a joint venture operated by Bass Strait Oil Company Limited (ASX: BAS). Oil Basins' Blina Back Reef Play Joint Venture covers a previously untested stratigraphic play, nearly 354 sq km in the Canning Basin and includes some parts of the highly prospective Fitzroy Trough. Oil Basins has 35% interest (and an option to earn additional 15%) in the joint venture project operated by Terratek Oil Tools Pty Ltd, which is currently in the process of being acquired by ARC Energy Limited (ASX: ARQ). Given ARC's financial strength, experience and strong presence in the Canning and Perth Basin, the acquisition is expected to provide a major boost to the development of the prospect. Oil Basins claims to attain very high leverage in the Back Reef Play prospect on a per share basis. At an estimated cost of A\$1.05 million for drilling an oil well, the company could benefit from its 35% interest in a prospect with a potential reserve of 270 MMbbls of oil.

Oil Basins' strategy is to initially identify and invest in energy exploration projects in Australia as well as outside and then expand to become a full-fledged property developer or operator. Since Oil Basins is a new entrant in this sector, the company's strategy falls in line with its pursuit of shareholder wealth maximization. Oil Basins intends to stay away from being an operator in the near term and instead farmin into projects that offer high leverage. Thus, by making a relatively small participation in exploration and development costs through joint ventures, the company keeps itself open to benefits arising from the growing market demand and prices of energy. In the near term, the company intends to sweat the assets by way of asset swaps, farmouts and simple straight forward cash trades in order to monetize its significant leverage to attractive assets.

Corporation Events and Actions

- January 18, 2007 – Oil Basins assigned 35% interest in Blina Back Reef Joint Venture (lodged with DoIR)
- January 16, 2007 – Department of Primary Industries (DPI) approves the OBL Farmins(s) on Gippsland Permit Vic/P41
- January 4, 2007 – OBL formally executed a formal Deed of Variation and Assignment Agreement with Golden Dynasty, Terratek and Backreef whereby Oil Basins (subject to regulatory approvals) is immediately assigned 35% of the Blina Back Reef Play JV Area subject to the terms of the earlier Oil Basins Farmin Agreement executed on May 29, 2006. Terratek consents to a partial assignment of 15% from Backreef’s remaining 35% participating interest in the Blina Back Reef Play JV Area to Oil Basins. The assignment is subject to Oil Basins exercising an option to acquire the 15% by no later than March 31, 2007.
- December 27, 2006 – Terratek provided Oil Basins and Backreef Oil with a ratification and clarification to the original farmin agreement signed in October 12, 2006
- December 6, 2006 – Arc Energy Limited announces its intention to acquire Terratek Oil Tools Pty Ltd from Golden Dynasty Resources Ltd
- October 12, 2006 – Back Reef farmin agreement is duly executed by Terratek and Backreef Oil Limited
- October 10, 2006 – Oil Basins acquires a further option for 15% of Blina Back Reef Play JV Area from Backreef Oil Limited
- September 29, 2006 – European Gas Limited transfers 100% of the issued capital in Terratek to Golden Dynasty
- August 23, 2006 – Oil Basins farmins for 12.5% of offshore Gippsland permit Vic/P41
- August 23, 2006 – Oil Basins requoted on ASX (after 11 years suspension)
- August 21, 2006 – Oil Basins exercises option with Moby for further 5% farmin interest in Vic/P41
- August 21, 2006 – Oil Basins Limited shares reinstatement to official quotation
- August 18, 2006 – Oil Basins signs formal farmin agreement with Eagle Bay
- July 27, 2006 – Oil Basins successfully completes public offer raising A\$2.5 million
- May 29, 2006 – Oil Basins farms in Blina Back Reef Joint Venture
- May 11, 2006 – Moby grants option to enter into farmin agreement for 5% Vic/P41
- April 10, 2006 – Oil Basins enters into conditional agreement with Eagle Bay for 7.5% of Vic/P41
- April 3, 2006 – Oil Basins enters into conditional agreement with Backreef Oil for 35% of Blina Back Reef Joint Venture

Management

Directors

Mr Kim W McGrath, Non-Executive Chairman

Mr McGrath is an internationally experienced resources finance and investment banking executive. He is the Chairman of Redbank Mines Limited (ASX: RBM) as well as the Managing Director of Delta Corporate Finance Pty Limited, a specialist advisory group (based in Sydney) with active business interests in Australia and the UK. His prior positions in Australia include legal roles with Comalco and ICL, General Counsel and Company Secretary of Bank of America Australia, and General Counsel with Bell Resources Ltd responsible for negotiating international lines of finance and business acquisitions. He was also the General Manager, Strategy and Planning, Industrial Equity Ltd.

Mr McGrath continues to hold full practicing certificates as a Solicitor in both England and Wales and in Victoria apart from holding Australian accounting qualifications as a CPA. He has also completed the Advanced Management Programme at the Oxford University and is a Fellow of the Australian Institute of Company Directors from where he successfully completed the Company Directors Course Diploma.

Mr Neil F Doyle, Non-Executive Director

Mr Neil Doyle is a qualified engineer with post-graduate qualifications in geomechanics (Monash University) and rich experience in upstream oil and gas activities and investment banking in the sector. He has knowledge in onshore and offshore upstream oil and gas activities, having worked with BHP Petroleum & Esso Exploration and Production Australia, and in the downstream refining products / LPG sector having worked with Shell Australia.

He comes with over 13 years experience in energy-related financial markets including investment banking and corporate finance. This covers all aspects of finance – equity capital raisings, M&A, project finance, resources deal structuring, international cross-border transactions and both initiating and advising on significant mergers and acquisitions – within the energy sector in Australia and New Zealand. In the later capacity, his last role prior to leaving JPMorgan in 2002, he was as Senior Vice President in the Energy Mergers and Acquisitions department and a member of their Global Energy Investment Banking Team. Mr Doyle also worked in Bell Resources Ltd where amongst other duties he served as General Manager of Weeks Petroleum during the Bass Strait Royalty Dispute and was operationally involved in over 35 wells, majority of them located offshore. Prior to joining Patersons Securities Limited in March 2004, as Director Corporate Finance, Mr Doyle has had ASX listed public company experience within the junior resources sector at Managing Director level.

Mr Graeme Menzies, Non-Executive Director

Mr Menzies is a solicitor practicing in the area of commercial law. He graduated from Melbourne University in 1971 and qualified for admission to the degree of Masters of Laws in 1975. He was admitted to practice in 1972. Since 1987, he has carried on practice as a sole practitioner under the name of Menzies & Partners. In the course of his legal practice, Mr Menzies has been involved in a wide range of activities, including takeovers, litigation in respect thereof, numerous capital raisings and corporate reconstructions. He has been involved in the listing or re-listing of a large number of public companies both industrial and mining. Mr Menzies has also been involved in the listing or re-listing of companies in the general industrial arena – manufacturing services and high technology services, more specifically biotechnology.

Mr Menzies holds directorships in Moby Oil & Gas Limited, Exoil Limited and a number of unlisted public companies.

Other Key Personnel

Ms Melanie J Leydin, Company Secretary

Ms Leydin is a Chartered Accountant and principal in a chartered accounting firm specializing in audit and company secretarial services. Ms Leydin has 14 years experience in the accounting profession and is a director and company secretary for a number of junior mining and exploration entities listed on the ASX.

Mr Geoff Geary, Geological Consultant

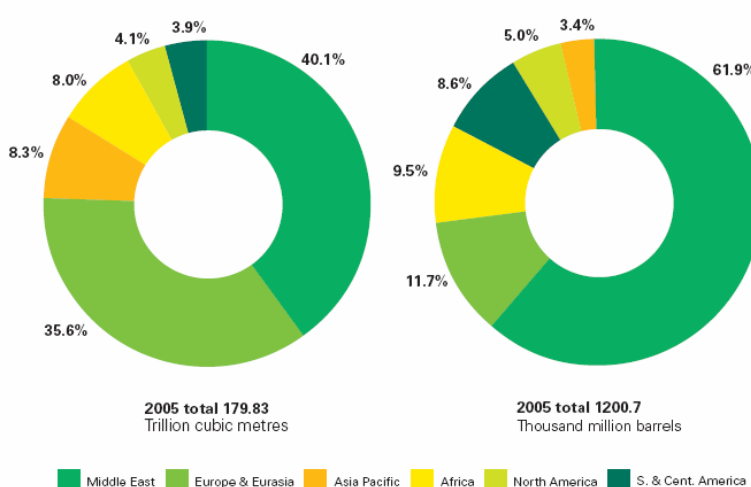
Mr Geoff Geary is a consultant petroleum geologist (formerly with Oil Company of Australia, Mobil Oil and regional explorationist with ExxonMobil Corp) of 26 years standing and has a Technical Services Agreement through his company, Focus on Australia Pty Ltd. He is also a Member of Petroleum Exploration Society of Australia. Mr Geary has significant experience in company mergers, acquisitions, acreage promotion and farmouts, having worked with smaller national companies and major multi-nationals. He has considerable knowledge in sedimentary basin analysis, sequence stratigraphy, structural geology, seismic interpretation, basin modeling, and oil and gas field evaluation and development.

Industry Overview

Petroleum or crude oil is a dark, sticky liquid found naturally in sedimentary rock formations in the earth. The hydrocarbon was formed from the remains of animals and plants that died millions of years ago. These remains were buried by thick layers of sand and silt and subjected to enormous pressure. The pressure along with the earth's heat transformed this organic mixture into crude oil. Natural gas, on the other hand, is a gaseous mixture of simple hydrocarbon compounds, formed in the same manner as petroleum and is usually found in oil fields, natural gas fields, and coal-beds. Natural gas is composed almost entirely of methane but does contain small amounts of other gases such as ethane, propane, butane and pentane. Petroleum and natural gas when burned form an excellent source of energy and are used extensively in residential, commercial and industrial applications.

According to BP Statistical Review 2006, proved world oil reserves are estimated to be about 1,200 billion barrels. Of these, nearly 62% are present in the Middle East. In terms of country-wise distribution, Saudi Arabia leads the pack followed by Iran, Iraq, and Kuwait.

Picture 1: Proved Oil and Gas Reserves by Country



Source: BP Statistical Review 2006

On the other hand, the world has around 6,360 Trillion cubic feet (Tcf) of proven gas reserves. Russia, the U.S., and Canada are the top three producers of natural gas accounting for 21.7%, 18.7%, and 6.7%, respectively, of the world's total production in 2005. If we rank countries on the basis of their proven reserves of natural gas, Russia retains the top spot; Iran and Qatar occupy the second and third positions.

Global Petroleum Trade

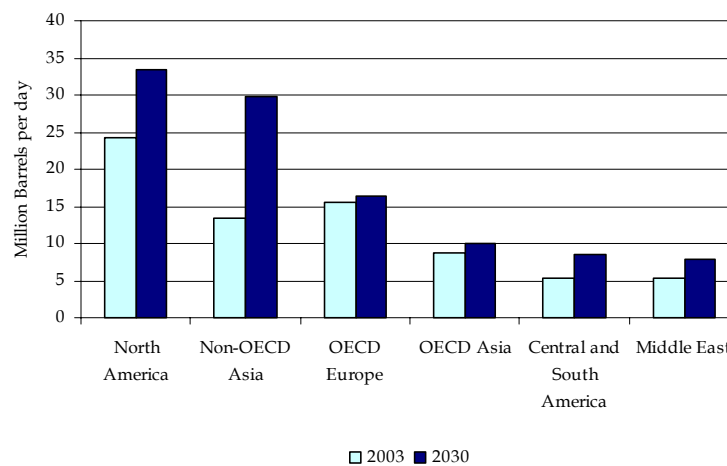
The Organization of Petroleum Exporting Countries (OPEC) countries are major exporters of oil with the developed Organization for Economic Co-operation & Development (OECD) countries in North America and Europe accounting for majority of the exports. The OECD is a unique forum where the governments of 30 market democracies work together to address the economic, social and governance challenges of globalization as well as to exploit opportunities. As per the Energy Information Administration (EIA), in 2003, OECD economies imported 17.9 MMbbls of oil per day from OPEC member countries. In other words, oil exports to OECD nations accounted for 57% of OPEC exports. On the other hand, OPEC exports to non-OECD countries stood at 13.8 MMb/d in 2003. However, by 2030, the non-OECD countries are likely to surpass OECD countries in terms of import of oil. Oil exports from OPEC to non-OECD are expected to touch 21.1 MMbbls per day, while the same to non-OECD countries is likely to reach 27.4 MMb/d.

Like most commodities, natural gas is also traded widely. Russia is the largest exporter, with net exports of 6.3 Tcf in 2003. Countries such as Indonesia, Malaysia, and Qatar with excess production of natural gas sell to countries such as Japan, South Korea, and Spain that face acute shortages. However, natural gas needs to be converted into LNG before being transported, which requires heavy investment. The ongoing expansion of international pipelines and increase in LNG shipments reflect the growth in gas trade in the global market.

Demand-Supply Scenario

The International Energy Agency (IEA) projects a 1.4% average annual growth in world oil demand from 80 MMbbls per day in 2003 to 118 MMbbls per day in 2030. As discussed earlier, roughly 43% of the increase in demand is expected to come from the non-OECD Asian countries, particularly China and India, due to robust economic growth. In fact, China's petroleum imports are expected to grow four times from 2003 to 2030. The transportation sector, followed by the industrial and residential sectors, is likely to account for much of the global oil consumption. To meet such a demand scenario, it is crucial for supply to increase by 38 MMbbls per day. However, investments by the oil-rich countries are likely to be less sufficient to meet the burgeoning demand and could lead to further spike in prices. In fact, most of the production is likely to come from the non-OPEC countries, mainly the U.S. and Canada. High fuel prices, technological advancements, and cost reduction activities are expected to boost supplies from these regions. The OPEC region is expected to produce 45.3 MMbbls per day of oil in 2030, while non-OPEC member nations would produce 72.6 MMbbls per day. Additionally, unconventional sources of energy such as biofuels (ethanol and bio diesel), coal-to-liquids and gas-to-liquids are likely to gain pace and according to the IEA, constitute nearly 10% of the petroleum supply in 2030.

Chart 1: World oil consumption by region



Source: Energy Information Administration

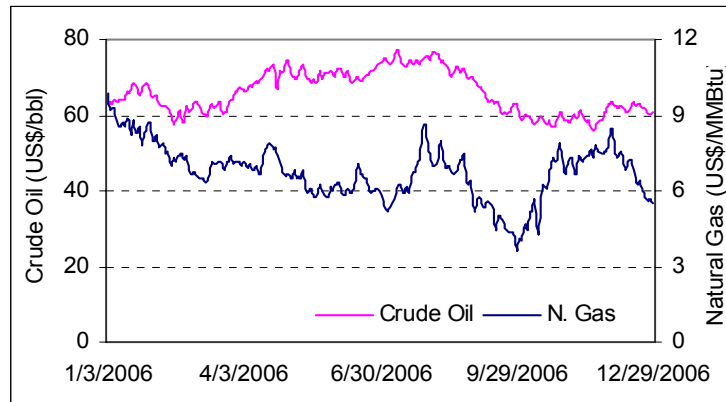
The worldwide consumption of natural gas, on the other hand, is likely to grow 2.4% annually and reach 182 Tcf by 2030. The growing demand for natural gas is largely attributable to its increasing usage in electricity generation and industrial sectors. In fact, these two sectors alone account for nearly 75% of the total demand for natural gas. Additionally, in recent years, the construction of homes using natural gas for heating as well as air conditioning has increased. In 2003, OECD countries accounted for over half of the global natural gas consumption of 95 Tcf. However, like oil, the consumption of natural gas in non-OECD countries is slated to exceed that in OECD countries by more than two times. The non-OECD Europe and Eurasia regions depend more on natural gas than any other region in the world. In non-OECD Asia, China and India are expected to lead the growth in demand. Natural gas consumption in these two countries is likely to increase by 6.8% and 5.9%, respectively, each year until 2030.

Pricing

The IEA anticipates oil prices to increase over the period 2003 to 2030. Demand is expected to significantly exceed investments in matching supply thereby causing prices to remain at a high level. Prices have been volatile historically and it is difficult to predict future trends. However, demand and supply forces are expected to eventually stabilize the prices.

Chart 2 (below) depicts the high volatility in crude oil prices in 2006. Prices peaked in early August of 2006 touching nearly US\$78 per barrel and gradually declined by year-end to nearly US\$60 per barrel due to ample inventories and fewer hurricane-related disruptions. Crude oil prices are likely to remain high following the continued growth in demand from China and India. Natural gas prices, which increased significantly in 2005—the commodity traded for as much as US\$15.8 per million British thermal units (MMBtu)—registered a decline for most part of 2006. Excess supply and higher gas inventories accounted for the decline in natural gas prices in the spot markets. The chart below represents the movement of world crude oil prices vis-à-vis that of natural gas.

Chart 2: Prices - Crude oil versus Natural Gas



Source: Bloomberg (In 2006, crude oil prices averaged US\$66.0 per barrel, while natural gas averaged US\$6.70 per MMBtu.)

Australian oil and gas industry

Australia's upstream petroleum industry is valued at approximately A\$17 billion contributing nearly 2% to the country's GDP and employing around 15,000 people. The industry also contributed an estimated A\$5 billion by way of taxes to the government. Petroleum accounts for over 50% of Australia's energy consumption. The consumption of natural gas is also expected to increase from 19% in 2004 to 24% by 2020.

According to BP Statistical Review 2006, Australia's proved oil reserves are estimated to be 4.045 billion barrels, while natural gas reserves stand at 88.956 Tcf. Historically, Australia has been a net exporter of petroleum; however, the country has reported trade deficit since 2003. Although the industry produced 123.82 MMbbls of crude oil in 2005, oil production has continuously declined since 2000, making the dependence on imports to meet the growing domestic demand inevitable. In fact, by 2015, demand is expected to reach 1,027 thousand barrels a day (kb/d), significantly higher than the likely supply of 237 kb/d. The country is well placed in the natural gas space. Australia has about 17% of total proven reserves in the Asia-Pacific region. It is currently the world's fifth-largest LNG exporter after Indonesia, Malaysia, Algeria, and Qatar. More than 85% of Australia's LNG exports find their way into just one country – Japan. Although other countries such as South Korea, Taiwan, India and Spain also receive LNG from Australia, they do account for a significant portion of the country's gas exports.

Most of Australia's oil and gas reserves are located in the country's north-west and south-east regions. Areas such as Bass Strait (offshore Victoria), the Cooper Basin (northern South Australia) and the Northwest Shelf (offshore Western Australia) are large producers of conventional natural gas. In recent years, new gas discoveries have been made in a number of basins such as the Otway, Carnarvon, Browse and Bonaparte Basins. Australia's largest single resource development is the North West Shelf project, located offshore near Karratha in Western Australia. It is operated by Woodside Petroleum Limited (ASX: WPL).

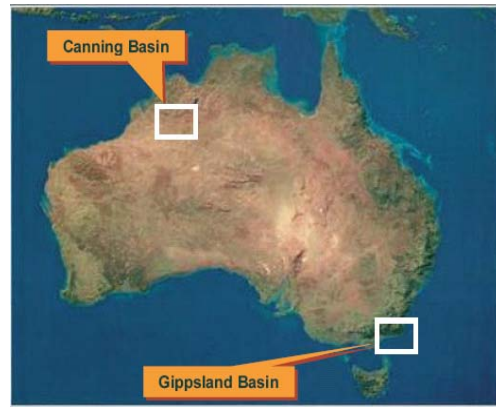
Issues Concerning the Industry

The oil and gas industry is fraught with risks, requires massive investment and is under tight regulations. The lead-time from discovery to production can extend from months to years, investment usually runs into billions of dollars and environmental issues are always hanging fire on the companies. Common costs associated with an oil and gas company include exploration expenses, development costs, and production costs. Of late, all the expenses (whether on geologists, equipment, labor or shipping) have gone up. In fact, exploration spending in Australia crossed the A\$1 billion mark in 2005; it was A\$922 million in 2004. High oil and gas prices are driving companies to produce more and gain from the favorable situation. However, good quality drilling prospects have become scarce and so have the availability of rigs and skilled people. In fact, despite higher spending on E&P activities, the frequency and size of major oil discoveries continue to decline and are likely to adversely affect future production. No wonder, many believe that world oil production is close to the peak (referring to the Hubbert's Peak) and no amount of exploration can alter the downward slope of production once the peak has been attained. However, since the demand for energy is likely to stay high due to the global economic uptrend, led mainly by China, India and other emerging economies, we believe these negatives do not hold much significance for Oil Basins.

Properties

Guided by its strategy to invest in oil and gas exploration opportunities, Oil Basins is currently focusing on two exploration projects, the offshore Gippsland Basin in south-eastern Australia and the onshore Canning Basin in Western Australia. The company has entered into formal agreements to earn interests in the two prospects. Both the permits are located in highly prospective areas and near to oil producing fields as well as ready infrastructure. Oil Basins expects the two projects to offer significant leverage to its shareholders by yielding returns much higher than the costs incurred.

Picture 2: Properties



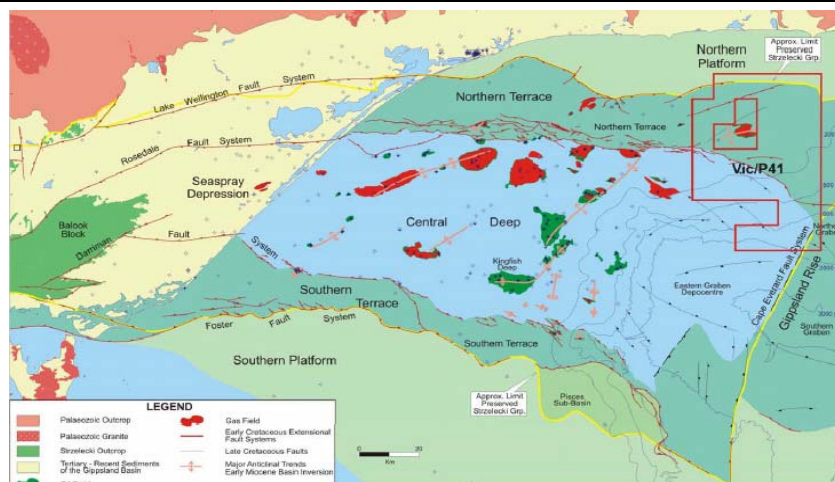
Source: Company

The Gippsland Basin

The Gippsland Basin lies offshore in the Eastern Bass Strait approximately 350 kilometers to the south-east of Melbourne, Victoria. The approximately 41,000 sq km basin is one of Australia’s most prolific hydrocarbon producing regions with about 4,073.5 MMbbls of proven and probable oil reserves and 9,617.6 Bcf of gas. The Gippsland Basin contains some 21 oil and gas fields that produced 25.4 MMbbls of oil in 2005, making it the second largest oil producing region in the country. A majority of the basin’s producing fields are located in shallow water less than 200 meters.

The Gippsland Basin trends east-west, comprising a deep central depression (the Central Deep) symmetrically bounded by faulted terraces and stable platforms on the north and south. Coarse-grained alluvial and fluvio-lacustrine facies as well as volcanogenic and non-marine sediments deposited during the Early Cretaceous period formed the lower Latrobe (Golden Beach Group), while the upper Latrobe is formed due to the marine and non-marine fluvio-deltaic/alluvial deposition in the Late Cretaceous-Palaeogene phase.

Picture 3: The Gippsland Basin



Source: Company

Oil Basins currently holds the right to earn 12.5% interest in offshore Gippsland Basin petroleum exploration permit, Vic/P41. The Vic/P41 permit area (also marked in Picture 3) is located to the northeast of the offshore Gippsland Basin and covers approximately 2,165 sq km in water depths ranging from 60 meters in the north to 2,000 meters in the south. However, following the renewal of license granted in September 2006 by the Department of Primary Industries (DPI), 50% of the area has been relinquished with the remainder subject to a work program as designated by the authority. Vic/P41 is currently held in a joint venture. With 45% interest, Bass Strait Oil Company Limited (ASX: BAS) is the operator of the project, while Moby Oil and Gas Ltd (ASX: MOG) and Eagle Bay Resources NL (ASX: EBR) hold rights to earn 25% and 17.5%, respectively. Oil Basins had secured the rights to earn 12.5% in the Vic/P41 permit by signing farmin agreements and making down payments of A\$500,000 and A\$333,333 to Eagle Bay and Moby Oil, respectively. These companies had farmed out 7.5% and 5.0% interest in the said permit to Oil Basins in August 2006. The DPI formally approved these rights to Oil Basins on January 16, 2007.

Under its agreement with Eagle Bay, Oil Basins will fund 18.75% of the cost of drilling a well up to a maximum limit of \$2,437,500 and pay pro rata 7.5% of the joint venture costs incurred during the period April 3, 2006, and the date of commitment to drill the well. Similarly, the agreement with Moby Oil entails funding 12.5% of the drilling costs subject to a cap of \$1,650,000 and 5% of joint venture costs incurred between May 1, 2006, and the date of commitment to drill the well. Accordingly, the potential impact of the conditional farmin agreements will be as follows:

Company	Equity Interest
Bass Strait Oil Company Ltd (Operator)	presently 45%
Moby Oil & Gas Limited	presently 30%; reducing to 25%
Eagle Bay Resources NL	presently 25%; reducing to 17.5%
Oil Basins	potentially 12.5%

By virtue of the agreements, Oil Basins' contribution towards well drilling costs amounts to A\$4.087 million; the total estimated costs are A\$13.0 million. However, considering the imminent increase in drilling expenditure due to high rig costs, any further rise in costs would have to be shared (pro-rata) by all the participants. Although, seems indifferent for Oil Basins, but, this in fact, could work out to be in favor of the company. Our reasoning for this is based on the fact that, Oil Basins gets the benefit of first move advantage, should the JV partners elect to farmout the project to another company. Another unique feature in the farmin agreement is that Oil Basins has the right to review any farmin proposal for 10 business days and can assign its interest(s) to a nominee or nominees. As such the company can choose to dilute the 7.5% and/or the 5% interest or elect to retain the 12.5% - leaving it enough options to enhance shareholder value.

The Vic/P41 permit is close to other oil and gas fields. As such some of the prospects identified on the Vic/P41 are considered to have topographic traits similar to those nearby, which indicates the area's potentiality. The Kipper gas field, operated by Exxon Mobil Corporation, and the Basker/Manta/Gummy oil gas fields, operated by Anzon Australia Limited, lie to the west of the permit. Furthermore, the resource potential of Gippsland Basin underlines the attractiveness of the Vic/P41 permit (the permit is free of any royalty charges) location. The Operator, Bass Strait Oil Company Limited is currently seeking more farmout agreements to fund the drilling of the well, which is unlikely to start in the near term due to the shortage of drilling rigs.

The joint venture completed the first 3D seismic activity for 575 sq km of the Vic/P41 permit area in 2005. The 3D survey and previous geophysical and geotechnical work underline the presence of significant resources of oil and gas in the region; particularly, plays adjacent to the Rosedale fault are considered to have high reserve potential. Furthermore, based on the survey, three leads namely, Kipling, Oscar, and Cotton/Benchley, were identified as being mature prospects ready for drilling. Together, the three prospects are estimated to contain resources of 1,947 MMbbls of oil or 5,208 Bcf of gas. Kipling, Benchley and Cotton, and several other smaller features, are identified as intra-Latrobe and Golden Beach plays.

The Kipling prospect

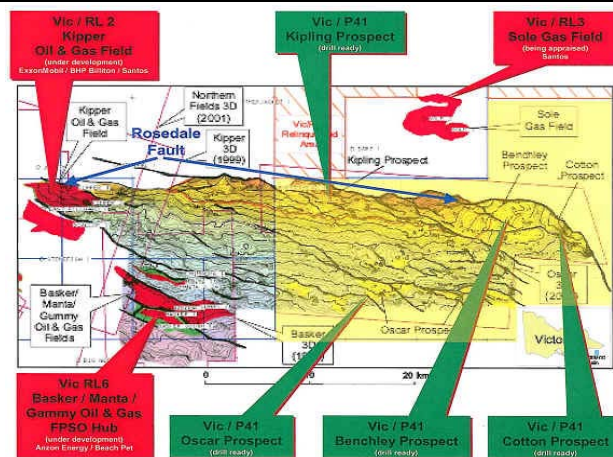
The Kipling prospect is a downthrown fault closure along the Rosedale fault. The top seal likely to be provided by volcanics is similar to the one found in the nearby Kipper oil and gas field. As such, the Kipling prospect is assumed to be analogous to Kipper. The Kipper gas field is situated immediately to the west of Kipling and is operated by Exxon Mobil. The Vic/L9 and RL2 permits on this field have estimated 2P reserves of 600–700 Bcf of gas and 40 MMbbls of condensate. Based on the 3D survey, the Kipling prospect is estimated to contain resources of 4,225 MMbbls of oil or 5,760 Bcf of gas. Furthermore, it is likely to be further segmented into subordinate structures.

The Oscar prospect

The Oscar prospect is assumed to be analogous to the nearby Basker field. 3D seismic indicates thick prospective reservoir at the intra-Latrobe and Golden Beach sections. Moreover, the presence of marine shale sequences signifies potential resources. The westernmost Oscar prospect is estimated to contain 115 MMbbls of oil or 494 Bcf of gas. Although less significant as

compared to other leads along the Rosedale fault, Oscar is considered to be a less risky prospect considering that the adjacent Basker field has estimated 2P reserves of 379 Bcf of gas and 39 MMbbls of oil and condensate. The presence of already established infrastructure would also make exploration in Oscar profitable.

Picture 4: The Vic/P41 permit



Source: Company

The Benchley and Cotton closures

The Benchley Latrobe closure and the Cotton Latrobe closure were identified in the 3D seismic shot along the downthrown side of the Rosedale fault. The Benchley Latrobe is further divided into two prospects at the Golden Beach and Kate Shale levels. The Cotton prospect is identified at the Top Kate Shale and the Top Golden Beach levels. It is estimated to contain reserves of 142 MMbbls of oil or 394 Bcf gas.

The Vic/P41 permit license was renewed beginning September 20, 2006 for additional five years. The DPI has assigned a new work program, which entails further geophysical and geological studies and the drilling of an oil well by September 20, 2010. Interpretation of the 575 sq km Oscar 3D seismic survey is currently underway and could hopefully indicate more prospects. In fact, the operator is re-appraising the permit to tap deeper Emperor formations known to hold gas columns as found in the Longtom permit (operated by Nexus Energy Limited (ASX: NSX)) situated to the northwest of Vic/P41. Oil Basins meanwhile is well on track with its funding obligations and has mostly met all pro-rata back-cost payments to both Eagle Bay and Moby Oil and the work program commitments.

The Canning Basin

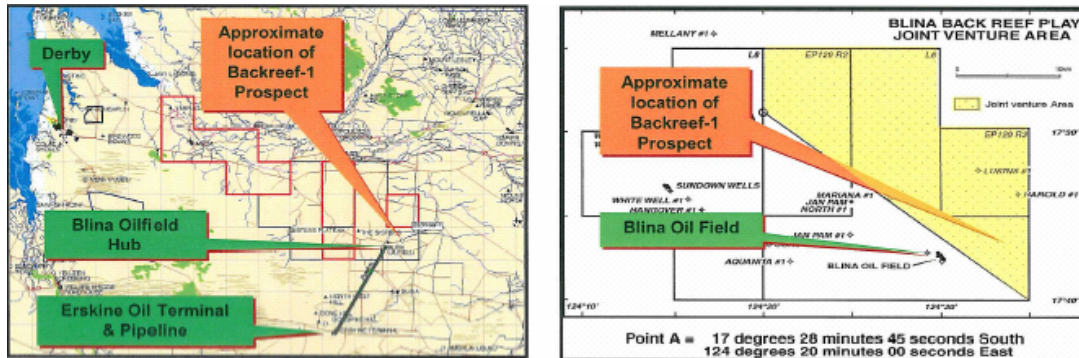
The Canning Basin is the largest sedimentary basin located in the central north of Western Australia and spans approximately 506,000 sq km of which approximately 400,000 sq km lies onshore. The basin is bound by the Precambrian Kimberley Block in the north and the Pilbara and Musgrave Blocks in the south; the Amadeus Basin lies to the east. It contains two northwesterly-trending depocentres – the Fitzroy Trough and the Gregory Sub-basin in the northern part and the Willara and Kidson Sub-basin complex in the southern part. Formed during the early Ordovician to early Cretaceous pericratonic phase, the basin has up to 15 kilometers of sedimentary formations (mainly Devonian and younger rocks) concentrated in the Fitzroy depocentre. The Fitzroy trough is considered to be the most prospective area in the basin. Petroleum exploration in the Canning Basin began in the early 1920s. Only 250 wells have been drilled so far and 78,000 kilometers of seismic shot in the largely unexplored region.

The Blina Back Reef Play Joint Venture Area is located on the Margaret Terrace and Lennard Shelf in the northeast of the Canning Basin. The acreage is contained within contiguous segments of Production Licence L6 and Exploration Permits EP 129, Parts R2 & R3. It covers nearly 354 sq km including some part of the Fitzroy Trough and lies close to the Blina, Sundown, and West Terrace oil fields.

The so-far untested Back Reef prospect is considered a high-risk and high-reward stratigraphic play potentially containing 270 MMbbls of oil circa 94 MMbbls. It is believed that oil may have been generated on the Lennard Shelf in a back reef environment as similar environments in the northern hemisphere are known to host large volumes of oil. The Back Reef prospect consists primarily of Devonian aged clastic turbidite formations. The area which contains the prospect namely Kimberley Downs Embayment is a half graben representing restricted marine embayment bounded by the Harold and Blina carbonate platform and reefal systems to the southwest and northeast respectively, opening to the ancient Devonian sea to the

southeast. The production license L6 was renewed on May 19, 2006, for 21 years. Due to this, once an oil well is drilled, production can be started almost immediately without having to wait for any environmental protection or native title issues. Moreover, the area is also close to the under-utilized Blina oil hub which is just 4 km away. The Blina oil hub has storage and transport infrastructure that helps transporting oil to the Erskine truck terminal on the Great Northern Highway via a pipeline. From the terminal, the oil is then trucked to ship loading facilities at Broome and then shipped to the Kwinana oil refinery in Western Australia. The pipeline is of much significance considering that the area witnesses heavy monsoon for five months during March to November.

Picture 5 – The Canning Basin interest



Source: Company

On October 12, 2006, Oil Basins through its wholly owned subsidiary, Oil Basins Expro Pty Ltd., executed a back-to-back farmin agreement with privately owned Backreef Oil Limited in respect of a 35% interest in the Blina Back Reef Play Joint Venture Area. Furthermore, the company entered into an option agreement for an additional 15% interest in the prospect. The option agreement gives the company the right but not the obligation to acquire a further 15% interest from Backreef Oil Limited. Under the agreement, Oil Basins would incur an estimated A\$1.05 million cost for drilling an oil well. The well will be drilled between the Blina and Harold Reefs to approximately 1,800 meters targeting the sands of the Clanmyer Formation. The Option agreement has been extended by Oil Basins until March 31, 2007 by paying A\$15,000. If Oil Basins exercises the option, it would be obligated to fund a further A\$450,000 towards the drilling of the prospect.

Interest at the Canning Basin area seems to be building up. On December 6, 2006, the Canadian operator Golden Dynasty Resources Limited (TSX.V: GLY) entered into an agreement to divest its entire stake (30%) in the Blina Back Reef JV Area. Golden Dynasty agreed to sell its wholly owned subsidiary, Terratek Drilling Tools Pty Limited to ARC Energy Limited for a consideration of A\$2.8 million and a 2% royalty. With the completion of the acquisition (subject to regulatory approval), ARC would most likely become the operator of the prospect. The current joint venture participants are:

Company	Equity Interest
Terratek Drilling Tools Pty Limited* (Operator)	presently 30%
Backreef Oil Limited	presently 35%; reducing to 20%
Oil Basins Limited	presently 35%; increasing to 50%

**Awaiting completion of acquisition by ARC Energy Limited subject to regulatory approval*

The acquisition of Terratek by ARC bears significant implications for the development of the prospect. ARC's financial strength and experience in oil and gas exploration activities would not only speed up drilling, but also help in maximizing production from the well. In fact, although there is an overall paucity of drilling rigs, work on the Backreef-1 well is now expected to commence by 2Q 2007 using ARC's Century-Rig 18 contracted for a two-year period. The drilling work had not been initiated until now due to cost overruns faced by Golden Dynasty on account of the non-availability of a suitable rig. Furthermore, Oil Basins intends to enter into back-to-back farmout agreements with third parties or enter into third party asset swaps in respect of its interests.

The Deed of Variation and Assignment Agreement with Golden Dynasty, Terratek and Backreef Oil regarding the farmin interests was formally lodged with the WA Department of Resources and Industry in early January 2007. Moreover, Oil Basins retains the right to farmout its stake to third party without having to obtain the operator's consent.

Picture 6 – Prospective Resources

PROSPECT	OPERATOR PRELIMINARY ESTIMATES Gross Prospective Resources		NET SHARE %	OIL BASINS SHARE Net Prospective Resources	
	Recoverable Oil *	Recoverable Gas *		Recoverable Oil *	Recoverable Gas *
	MMbbls	Bcf		MMbbls	Bcf
<u>GIPPSLAND</u>					
<u>VIC/P41</u>					
KIPLING ** <small>(single "mega-closure" case Vic/P41 only)</small>	1,690	<u>OR</u> 4,320	12.5	211.3	<u>OR</u> 540.0
OSCAR WEST	115	<u>OR</u> 494	12.5	14.4	<u>OR</u> 61.8
COTTON	142	<u>OR</u> 394	12.5	17.8	<u>OR</u> 49.3
Sub-Totals	1,947	5,208		243.4	651.0
<u>CANNING</u>					
<u>BACK REEF PLAY JV</u>					
BACKREEF	270	0	35	94.5	0.0
TOTALS	2,217	<u>OR</u> 5,208		337.9	<u>OR</u> 651.0

Source: Company

Ready storage and transporting infrastructure, presence of oil fields in the vicinity, and the nature of topography suggest that the acreage could be prospective and also quite profitable. Moreover, Oil Basins is expected to enjoy significant benefits as the company could potentially earn 50% interest in the prospect if it chooses to exercise the option. Oil Basins has clearly had a first move advantage in making this attractive investment.

Financial Forecast and Analysis

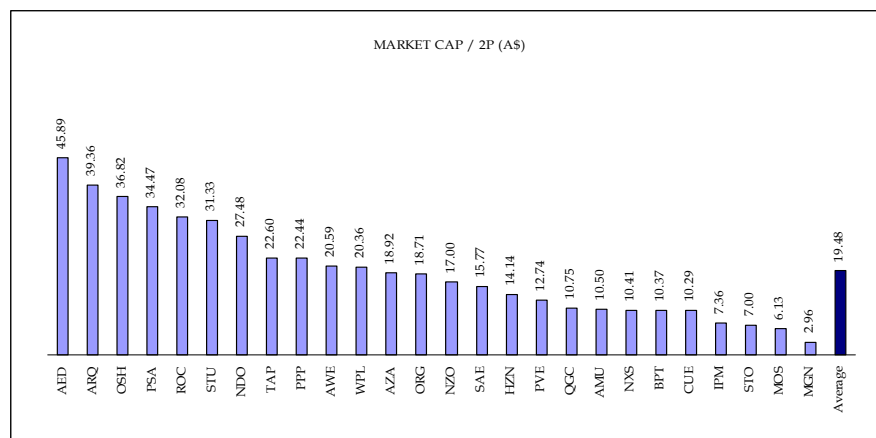
SUMMARY

We valued Oil Basins Limited using the Market-Cap approach. The method yielded a 12-18 month target price of A\$2.433, which is way above the stock's current market price of A\$0.115.

As per the method, we attempted to estimate the value of both the properties held by Oil Basins. For this, we jotted down the potential energy resources of both the properties, as mentioned by the company. This was adjusted for the equity stake held by Oil Basins. The company has rights to earn 12.5% in the Vic/P41 permit and 35.0% in the Blina Back Reef Play. Please note that the 575 sq km Vic/P41 permit area is likely to contain resources of 1,947 MMbbls of oil or 5,208 Bcf of gas. Moreover, the Blina Back Reef Play Joint Venture Area may hold 270 MMbbls of oil. However, Oil Basins' share in both these properties works out to 337.88 MMbbls of oil. In line with our conservative approach, we re-adjusted this resource base further and arrived at an estimated 2P reserve of 8.45 MMbbls. Some of the assumptions that helped us value the company are:

- Oil Basins would continue to hold 12.5% in Vic/P41 permit (Gippsland Basin)
- The company would not increase its equity interest, currently 35%, in the Blina Back Reef Play (Canning Basin)
- Only 10% of the potential target would move into the Contingent Resource category
- 2P reserves are likely to be 25.0% of the Contingent Resource
- All options/warrants would be exercised on time
- The Industry M-Cap/2P multiple stands at 19.48 (see the chart below)

Chart 3: Industry M-Cap/2P



Source: Bloomberg, Khandaker Research

Having calculated the industry multiple for the oil and gas companies, we simply multiplied it with the estimated 2P reserves of the properties held by Oil Basins. According to our analysis, Oil Basins is expected to command a fair value of A\$164.54 million, or A\$2.433 per share.

Conclusion

Although Oil Basins Limited (ASX: OBL) is a new player in the upstream oil and gas sector, we feel the company has made just the right kind of investments in two potentially resourceful areas. Both properties offer significant leverage to the company by giving it a high share in the reserves output for a comparatively smaller cost participation. With ARC Energy Limited coming in as the operator, drilling activity in the Canning Basin permit area is expected to commence at the earliest. The completion of interpretation of the 3D seismic may also lead to the identification of more prospects in the Vic/P41 permit and provide better clarity on existing resource base. Overall, the broad macro economic factors suggest continued growth in demand and high energy prices, going forward. Oil Basins' prospects appear bright in the light of these factors and we expect the company's stock price to reach a target of A\$2.433, at a corresponding market cap of A\$164.54 million over the next 12-18 months.

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