



Central Petroleum Limited

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Is Central Petroleum the best “bang-for-buck” oil play on the ASX?

By Andrew McCrea

Central Petroleum is an ASX listed junior exploration and production company, ticker (ASX: CTP) (PINK: CPTLF) which owns one of the largest packages of prospective oil and gas acreage in Australia.

Extensive Acreage & early mover advantage

In 1998, John Heugh, as the founding director of what was to be renamed Central Petroleum, began buying and pegging remote acreage in Central Australia that he calculated was prospective for oil and gas. Back then, oil was trading at only US\$10 per barrel and nobody wanted to know about oil.

Supply of acreage in Central Australia was plentiful, who would want to be buying oil acreage at a time when it was priced at sub-economic levels to develop? The acreage was arid and desert in any case, but Heugh – to coin maverick investor Peter Lynch’s phrase, “backed up the truck,” acquiring more and more acreage.

Central Australia is a relatively under-explored and underdeveloped petroleum province in Australia. Oil companies that drilled there in the 1960’s considered the acreage was too remote to port, too expensive to drill and just plain too hard. Central to Heugh’s strategy was that a rail link to port facilities at Darwin would change the economics.



As a result, Heugh and now Central Petroleum have secured a strategic acreage position in a classic piece of counter cyclical investing. Great fortunes are often made in this way.

Now these plays can be incredibly lucrative for investors backing them. Think of Paladin Resources’ John Borshoff acquiring uranium tenements when the uranium price was low and at sub-economic levels. Developing them, Paladin moved from a company with worth under five million dollars to current valuation north of \$2.9 billion. Investors in Paladin benefitted from a similar strategy to the one Heugh is employing at Central, riding the Paladin share price from 1-2 cents to over \$7.00 at its peak.

Has Central got the same stuff? Let’s see...

Date: Wednesday 12th May 2010
Price: \$0.068
Market Cap: \$61.9m

1 Year Share Price Graph



Share Information

Code: CTP
Listing: ASX
52 week High: \$0.23
52 week Low: \$0.07

Sector: Oil and Gas

Website: www.centralpetroleum.com.au

Company Synopsis:

Central Petroleum is an ASX listed junior exploration and production company operating what is regarded as the biggest package of prospective acreage in Australia at over 270,000 km². The acreage includes the majority of the Pedirka Basin in the Northern Territory and in South Australia, the majority of the Amadeus Basin in the Northern Territory, all of the known Lander Trough in the Northern Territory and approximately 25,000 km² of the Southern Georgina Basin.

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Heugh acquires so much acreage that Central now owns the largest exploration spread in Australia - over 270,000 km² or 60 to 70 million acres - across Central Australia, effectively putting its foot on a vastly under- explored region and one of the biggest package of prospective land acreage for an junior oil explorer in Australia. It surrounds two fields - the Mereenie and Palm Valley fields, in continuous production for over two decades - this interprets the Central ground as highly prospective.

No mean feat.

The acreage included the majority of the Pedirka Basin in the Northern Territory and in South Australia, the majority of the Amadeus Basin in the Northern Territory, all of the known Lander Trough in the Northern Territory and approximately 25,000 km² of the Southern Georgina Basin.

By 2004 the oil price saw a sustained level of above US\$30 per barrel - which is pretty close to break-even for oil exploration in Central Australia.

The oil price moved higher and allowed the company to raise more pre-float capital. In 2006, Central Petroleum listed on the Australian Stock Exchange.

Like all great stories, the journey for Heugh hasn't been without its trials and conflicts. But he has been able to raise funds and find investors to back his quest.

It's been said it's easier to raise funds for oil exploration in Australian than nearly anywhere else in the world. While a truism, funds have been there when needed by Heugh, a testament to his passion and the unswerving belief that if only Central could mount a significant drill program, there would be oil - lots of it.

Something else that enabled Central to get significant acreage was Heugh's and Central's ability to obtain native title, and get permits granted - something that many larger companies were not securing in 2005.

Heugh figured on paying the traditional landowners more in royalties to allow for rapid granting of permits because he could see the un-discovered, unlocked oil and gas potential of the acreage. As a maverick explorer, this was an important facet in gaining access and title to the large acreage position.

Much of Central's acreage is in the Simpson Desert that makes it hot, between 40 and 50 degrees centigrade, prone to sandstorms – and Central has to explore and drill in these conditions. Out there, it's either a lack of water or a deluge of water when cyclone season descends, causing rain squalls that don't give up and flooding on the roads that makes an oil explorer's work trickier.

2009

The company emerges from the Global Financial Crisis in a very strong position with a total of \$35.9 million in banked funds as at June 30th 2009. The company continues with various discussions and preliminary negotiations concerning additional farm-outs, strategic stabilising investment relationships, technology based joint ventures and capital raising avenues.

Heugh knows he needs to tap large reservoirs of cash and fast, if he is to get drill to hole and take the pressure off of shareholders and move fast to getting a return, any return from the large, yet, dormant acreage assets on the Central balance sheet.

Central's strategy to put together a range of joint venture partners to de-risk the company and get some help on the funding drilling. Drilling in the desert is expensive, around A\$5.5 million per well including rig mobilisation and road building, as well as being hot and thirsty work.

In 2008, Central brings Petroleum Exploration Australia in as a joint venture / farminee participant. In

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November 2009, Petroleum Exploration (PXA) is acquired by Queensland Gas Company and the acquisition of QGC by the BG Group immediately thereafter. This dealing allowed PXA to pay outstanding cash calls for some \$4.8 million owing to Central, and installed the BG Group as the new farminee and JV participant.

In January 2009, a further farm-out was concluded with Trident Energy Limited on terms similar to the previous PXA agreement whereby 20% of specified costs are to be paid to earn 10% equity in permit EP 115 in the Amadeus Basin. An extension of this agreement to include application area EPA 111 was concluded in February.

Subsequently in August 2009, a term sheet was agreed with Energy Infrastructure and Resources Limited (EIR) covering application area EPA 130.

Once granted, it is envisaged that EIR will contribute 60% to the cost of a specified work programme to earn 25% equity in the permit. The BG Group does not participate in this area, having previously transferred the PXA farm-in interest (20%) to Great Southern Gas Limited. When concluded, Central Petroleum's holding will reduce to 55%.

Central reviews its exploration plans for the remainder of 2009 and further to 2010 with its farm-in participants Petroleum Exploration Australia Limited, Trident Energy Limited, He Nuclear Limited and Rawson Resources Limited.

A significant exploration programme is planned subject to the agreement of various JV partners involved.

In the Pedirka Basin the drilling of Blamore and CBM-93001 in EP 93, and the drilling of Simpson 1 in the Simpson Prospect Block in EP97 which results in the discovery of thick sequences of coal and residual oil columns.

The release of independent reports as a result of the 2008 drilling campaign, demonstrating an exploration target potential of over 1 trillion tonnes of coal above a cut off depth of 1,000m and a Prospective Recoverable Resource of up to over a trillion barrels of synfuel being potentially available from Underground Coal Gasification and subsequent Liquefaction processes in the Pedirka Basin.

In 2009; sees Central successfully completing a rights issue in June. The issue is heavily over-subscribed, raises over \$30 million - together with the renewal of the rolling bond facility.

The substantial cash injection received, provides the company with the resources to enable it to carry out an expanded works program in Central Australia.

The programme proposed by Central Petroleum Ltd includes:

- 5 fully cored CSG wells (Pedirka Basin)
- 2D seismic survey - up to 1,350 line km (Amadeus and Pedirka basins) which is planned to run over into calendar year 2010;
- Gore™ geochemical surveys over the Johnstone, Surprise and Stuart prospects in EP 115.

The total cost of Phase One is estimated to be covered by joint venture funding and equity from shareholders. Central's share of costs is estimated at circa \$20.7 million if all joint venture participants contribute to the maximum contractual percentage.

Central reviews its general rationale for future operations and objectives in Central Australia.

Central decides its main goal is to discover and produce oil and helium, deciding this represents the fastest possible route to maximising shareholder returns by enhanced share value and potentially by dividend payments.

It aims to operate a central Australian petroleum hub connected to appropriate infrastructure to allow the export to domestic and overseas markets of both primary energy resources and value added petroleum and helium products.

The company plans to potentially capitalise on early cash flow from any oil discoveries but is seeking to build gas resources to a threshold point where value-adding processes such as LNG and or GTL for example, can be brought into play.

Helium production and sales are regarded as an intrinsic part of this overall strategy. Apart from conventional gas reservoir potential, the Company has had independent estimates of over 10,000 trillion cubic feet in UCG “syngas” prospective recoverable resources and as well has produced in-house estimates coupled with external independent reports of up to c.200 trillion cubic feet of gas in CSG and other unconventional reservoirs.

Along the way, three of Central's four joint venture partners: BG Group (QGC/PXA), He Nuclear and Red Sky Energy are in default according to Central, having not paid their cash calls. Funds are needed requiring Central to go to market to have any chance of monetising its huge acreage, to keep momentum and an exploration program moving ahead.

A rights issue is seen as the best way of allowing Central shareholders to participate in drilling success. A phase two program is planned from proceeds of the rights issue.

Heugh knows he has to keep moving to mount a full drill program in 2010.

Phase Two Exploration Program calendar year 2010

- Drilling of up to 4 conventional wells including Johnstone, Magee-2 and Ooraminna-2 prospects
- The Magee-2 gas, condensate, Helium, 0.5 BCFG, 15
- BCFG Helium UGIIP - this prospect has already flowed gas to surface in the Magee-1 well in 1992 and is a subsalt play;
- The Johnstone-1 oil 500 MMbbls UOIIP Ordovician (a Mereenie style of play);
- Optional Mt Kitty-1 gas, condensate, Helium 3 TCFG, 180 BCFG Helium UGIIP-430 km² in aerial closure, this prospect has not been drilled before and is a subsalt play type of enormous dimensions. This would be drilled subject to the success of Magee-2.
- The total cost of Phase Two is estimated to be up to circa \$57 million with CTP's share projected to be up to circa \$35 million if all joint venture participants contribute to the maximum contractual percentage.

Fast-forward to 2010

Exploration Upside (The blue sky – all in)

- Completing Coal Seam Gas wells - Four and Five that have already been started
- The first well, Ooraminna-2, could host up to 2 trillion cubic feet of gas in place at “high” estimate. Ooraminna-1 flowed gas to the surface on a poorly conducted test in 1963 as did Magee-1 in 1963.
- The second well, Johnstone-1 oil target could contain up to 500 MMbbls of oil in place at “high” estimate base, a large oil structure in the north west of the Amadeus Basin.



- The third well, Magee-2 well, is estimated to host up to 800 billion cubic feet of gas, 15 billion cubic feet of helium, a well in the southern part of the basin, that will target gas condensate and helium which is a very high priced commodity - in very short supply throughout the world.

With helium prices approaching \$130 USD/1,000 scfg in the US, helium production and sales are regarded as an intrinsic part of this overall strategy.

Central’s helium subsalt prospects have undergone previous drilling which flowed helium to the surface at six per cent. Intriguingly, Heugh calculated that with helium in such short supply throughout the world and the rising demand and prices today, these prospects are probably worth more than potential natural gas and condensate prospects at this point in time.

There is also substantial CSG/UCG potential in the Pedirka basin with an estimate of 34-70 TCFG of prospective CSG resource and exploration target resource respectively of 1 trillion tonnes of coal potentially available for UCG independently reported.

Coal value not recognised

A Central subsidiary, Merlin Coal Pty Ltd currently has around 20,000 km² of mineral act permits and applications, most granted, with an independent report citing over 500 billion tonnes of coal above 1,000m in a JORC viable “Exploration Target”. Coupled with recent advances in coal beneficiation, underground and open cut mining techniques and an established rail link to Port Darwin, Merlin Coal might have some major upside potential for Central.

Often forgotten, this 635 billion tonnes of coal in its tenements in the Pedirka basin take on a new significance in today’s energy-strapped world. While low grade, if the coal can be beneficiated into a mineable and exportable product – and there are a number of coal-hungry (Chinese?) potential partners that spring to mind - the value to Central, were these coal assets to be developed, would be significant.

Assuming the target resource of 635 billion tonnes of coal above 1000m is used as a base case and 25% is mineable at a value of \$1/tonne, using open cut and underground mining (long wall mining methods have improved recovery at lower cost) based on issued capital – the resultant value is significantly above current

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market capitalisation for Central.

In short, the coal assets, which have been a sleeper on the Central books, could ultimately be a company maker. One senses, all that would be needed is a small nudge from energy off-takers/buyers and this would change everything. Coal export may not be out of the question but intrinsically some value adding process such as coal gasification and GTL value adding in-situ prior to export might have more potential.

As a comparison, Gina Rhinehart's Hancock Coal Pty Ltd, which is spending an estimated \$5 billion to develop the Alpha Coal Project in Queensland, has a JORC compliant Measured, Indicated and Inferred resource of 3.9 billion tonnes - a trifle by comparison to Merlin and Central's 635 billion tonne independent coal resource target. Alpha will also require a new railway at a cost of \$2.2 billion to be built to move product to port, whereas Central can access the established rail link to Port Darwin,

Pulling the threads together

So John Heugh's mantra becomes "oil discovery and monetization." "Helium discovery and monetization." Either will do to get into production and get cash flows.

However, there is some significant intrinsic value quietly building within Central, not valued by the greater market – coal for one. For an experienced operator like Heugh, it would be surprising if he was not working hard on this thread as well.

Funding ticked

Central goes back to the well one more time with a deftly timed rights issue to existing shareholders. Along the way, Heugh picks up a lot of support and shareholders and an underwriter. Just how strong - is given the acid test in the renounceable rights issue.

Existing Central shareholders take up 59% of their entitlements under the rights issue. Existing shareholders then apply for a further 3,736,508 new shares of the 124,183,697 shortfall shares available. Getting one attaching, free option, exercisable at 16 cents on or before 31 March 2014, always plays well.

The issue raises A\$22.7 million before costs, as it's fully underwritten at 7.5 cents for each new share.

This will mean issuing a not, insubstantial 302,728,534 new shares in Central in the offer.

Central raises the necessary funds to drive its 2010 drilling and the underwriter places the shortfall shares. At 31 March 2010 quarter end, Central had cash reserves of \$24.9 million.

The issue is hugely critical to Central's and Heugh's objective of monetising assets and getting to cash flows to take pressure off of investors and to hopefully obtain results that will reward them and his team for years of toil. You can't put a drill to hole if the cash is not in the bank.

"The successful capital raising ensures Central now has the funding in place to complete the Phase One exploration programme, complete a minimum of three conventional wells during 2010," John Heugh says.

Central now has over 7,000 shareholders. Combined issued capital and listed options after the rights issue are not small at 907.3 million fully paid shares and 431.4 million options.

The Central Petroleum equation

The additional funding buys Central a 3 well drilling programme in EP82 and EP115:

The Phase Two 2010 commencement Q2 2010: 3+ conventional wells

- **Ooraminna-2** gas, 2 TCFG UGIIP - already flowed gas-to spud May 2010 target

Est. Start Date: 7th May. Finish Date: 2nd June

Target: 2 Trillion Cubic Feet Gas UGIIP

Has flowed gas to surface in Ooraminna 1 in 1963

- **Johnstone-1** (and/or Surprise, Stuart and NW Mereenie) oil up to 500 MMbbls UOIIP (shale gas/oil potential, will core the HVS)

Est. Start Date: 15th June. Finish Date: 15th July

Target: 500 million barrels of oil

Similar target to Mereenie Oilfield structure

- **Magee-2** gas, condensate, Helium 0.8 TCFG, 15 BCFG Helium UGIIP - previous flow

Est. Start Date: 1st August. Finish Date: 10th September

Target: 800 billion cubic feet of gas, 15 billion cubic feet of helium

Magee 1 drilled in 1992 flowed gas to surface with condensate and 6.2% helium, currently sells for >US\$100 per 1000 cubic feet.

Estimated cost of drilling is \$22 million covered by the recent rights issue.

The Probability / The odds

Oil and gas exploration plays are as much about figuring out probabilities and the odds (weighing up pluses versus minuses) of relative levels of success versus failure. With money in the bank to drill, minor delays from here for Central, are part and parcel of the game, raising sufficient money to stay in the game - is the key. This is done. Without funding, monetising the huge acreage assets, becomes a longer term strategy and a punt on investors' appetite for further delays.

Relatively low volumes of helium may be commercially extracted and sold from Central's interest areas in central Australia. Central's coal assets appear not to be valued at all by the market in today's market valuation, taking a line through recent transactions and demand from coal-hungry China.

But Central needs a score from upcoming wells, to put some spring into Heugh's step and to gee-up investors.

Prospective recoverable resources of oil in Central's acreage, painstakingly acquired by Heugh, are in the billion barrel range. And the prospects of finding oil must be rated above average to good, based on previous discoveries in the immediate areas, the seismic data interpretation and the geological formations.

Recently, Central advised that oil has been formally identified in samples from the well CBM 93003 in the Pedirka Basin in central Australia of a type that would seem to significantly enhance monetisation prospects and the prospectively of the region for Central Petroleum.

Commercialised volumes of gas also rate a better than even probability, both within the Perdika basin and in the Ooraminna 2, EP 82 prospect – a gas prospect which has flowed gas to surface before.

Using Central Petroleum’s own evaluation of the three prospects, investors can run their own numbers on the upside from the three wells and calculate probability of success.

It becomes apparent that in terms of drilling for oil and gas, in itself a high risk and high return play, the odds are attractive for Central with its three wells. Especially, when you throw in these factors: Central’s current market valuation; share price leverage to drilling success; time to drill and duration to receive flow rate results.

Clearly, stabilised flow rate flow rate results are critical but the market should get some idea as to success in each well before initial flow rate results are released.

Against that, this is an oil and gas exploration company, where despite best intentions - results can come up short. As well there are now a lot of shares in the market, new investors that came aboard during the rights issue may start trading their shares if the share price moves much above 8 cents in the lead up to drilling, stopping any momentum building in share price. The tincture of drilling success though, would change all that, bringing in a new raft of buyers.

Ooraminna-2 is considered a 40-50% chance of success. That’s attractive. It is being drilled right next to the old well that was drilled in 1963 and it was never tested properly.

For Johnstone-1, a 20-25% chance of success.

For Magee-2, a 25% chance of success.

Investors can impute an overall probability factor... Drilling down further, it is possible to derive a valuation for Central, using published Risked Mean probabilities and assuming: flow rates, porosity, oil and gas produced, transportation costs and oil price etc.

Assuming success for either of Ooraminna-2, Johnstone-1 and Magee-2 on a more conservative risked mean basis could impute an NPV value for Central of over 50 cents per share, pushed down by the weight of newly minted issued shares and options likely to be exercised. Discount that again, and a value of 35 cents is not untoward.

Given the 52 week share price range of Central of 7 cents to 23 cents, current or new investors in Central can be mollified they are buying near year lows - at the current share price of 6-7 cents.

Were Central to hit it big on all three wells, a valuation north of \$10 per share for Central is possible. It would be the oil equivalent of doing a Paladin Energy in oil and gas. A sniff of a commercial find on any of Central’s wells and the current stock price and market valuation - look very light.

Add-in a (discounted) value for coal assets – and this would literally catapult the valuation higher, in the process converting Central into an energy growth company category, rather than oil junior.

For now, Central gets to do what an oil junior should do, drill as many holes in the ground as possible, making discoveries and perhaps transform from explorer to producer. For investors, this is speculative – not for the faint of heart. However, there is a sense there is longer term story for Central Petroleum, yet to play out.

In the shorter term, is there a better risked, better positioned, and better primed oil/gas play - where early results will be known within months?

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