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Australian Worldwide Exploration

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AWE 2.77 Core **HIGH** **B**

After a volatile past 12 months, the oil price is strengthening once again. Geopolitical tensions are the latest catalyst for the price rise and we anticipate further strength in the weeks ahead. The potential for conflict in the Middle East has been brewing for months, however with the recent capture of 15 British Navy personnel in the Persian Gulf, the world's attention is once again focussing on the troubled yet oil rich area.

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Tracking the oil price, energy related stocks are now beginning to stir after months of share price consolidation. Given our long-term bullish views on oil, we believe now is an opportune time to add another oil exposure to the Fat Prophets Portfolio.

AWE_d322.jpg

Last year we highlighted Santos as a potential opportunity. However, in our opinion, Australian Worldwide Exploration (AWE) offers far greater growth prospects. Last year, the company emerged as a significant energy producer and with another project due to come online in July this year, growth prospects for the company are strong.

As shown on the weekly chart, AWE has been a strong performer for many years. Between 1998 and the all-time high of June at $3.59, the stock rallied almost 20-fold. Following such extensive gains, it is hardly surprising that the upward trend has paused for consolidation.

In the near term, we anticipate further consolidation for AWE with support between $2.62 and $2.54 limiting downside risks, in our opinion. As shown on the daily chart, a modest lift during the past month has seen the stock challenging trendline resistance.

This barrier has contained prices for the past nine months and a sustained break above it would significantly strengthen the near term outlook for AWE. Such a move would bolster investor sentiment, initially targeting the region of $3.15 with a retest of the all-time high of $3.59 achievable in time.

AWE_w322.jpg

For those Members new to oil companies, the easiest way to understand their structure and prospects is to break the company's operations down into production, development and exploration.

Over the past few years, AWE has been developing numerous oil and gas projects. In the 2008 financial year, all these assets will be producing in tandem, leading to increased earnings and cash flows. Importantly, we believe the market has yet to recognise this potential.

Let's look at AWE's various production assets.

The Casino Gas Project, of which AWE has a 25 percent stake, is located off the Victorian Coast in the Otway Basin. Following a 16-month development phase, AWE successfully commissioned and brought the project into commercial production in February 2006. The project will deliver up to 420 Petajoules (PJ) of gas under the initial 12-year contract to TRUenergy, with initial production of around 35 PJ annually.

AWE has a 27.5 percent stake in the Cliff Head Oil Project, located offshore in the Perth Basin. Production from Cliff Head began in May 2006, soon after the Casino Project. Following a solid production performance in the initial stages, an electrical fault at the facility saw second quarter production levels fall. Despite this, the performance of the field reservoir has been good.

"... even looking out to 2009 numbers, AWE is attractive at current levels."

The third project to contribute to production is the BassGas Project, located in the Bass Basin, offshore Victoria. The project has suffered from significant delays, cost overruns and litigation issues with the engineering contractor, Clough. Project construction was finally completed in August 2006 and AWE began booking revenue from the sale of gas, LPG and condensate from September.

AWE has a 30 percent stake in the project, which comprises the Yolla, Trefoil and White Ibis fields, along with other exploration targets. The Yolla field is the target for initial development, but the company plans to tie-in production from the Trefoil and White Ibis fields in the future.

The Tui Project in New Zealand is the fourth core project in AWE's emerging production portfolio. Tui is located in the offshore Taranaki Basin on the western side of New Zealand's North Island.

In November 2005, the partners agreed to progress the project to the development stage and in February 2006, AWE increased its equity stake from 20 to 42.5 percent. In addition, the company moved to operator status. The Tui project is a significant one, with the company anticipating Tui delivering around 40 percent of total EBITDA (earnings before interest, tax, depreciation and amortisation) in the 2008 financial year.

Tui represents New Zealand's first stand-alone oil project. AWE anticipates first oil production around late June this year, so the project won't contribute to profitability until the 2008 financial year. The company expects the Tui crude oil to be highly sought, and anticipates it will be sold into the Australian East Coast refinery market.

The table below outlines the type of production and reserves base of each field. The company's EBITDA target assumes a US$50 per barrel oil price.

Project	Product	Reserves	EBITDA Target
Casino	Gas	17.3m barrels	$26m
Cliff Head	Oil	3.8m barrels	$65m
BassGas	Gas and Liquids	24.9m barrels	$32m
Tui Area	Oil	27.9m barrels	$187m

As well as the strong near term production profile, AWE has a few projects in the development phase.

Following discovery of gas at Henry-1 near the existing Casino field, development of the find is now underway with production expected in early 2009. In the Bass Basin, AWE plans to undertake development scoping studies on the previously discovered Trefoil and White Ibis fields.

AWE has a number of exploration activities planned over the next 12 months. Such activity is crucial for AWE and oil companies in general, as they need to keep replacing annual production. Given AWE is focussing exploration around existing fields, we remain confident of further discoveries.

So AWE's production, development and exploration activities all look positive, but what about the valuation? This is where we find the story even more attractive. Assuming the Tui development progresses as expected, we anticipate significant profit growth in 2008.

The following graph illustrates this profit growth potential. While we expect earnings to peak in 2008, earnings thereafter should still be significantly higher than current levels, and that assumption doesn't include higher oil price forecasts.

AWE_cash322.jpg

Based on consensus earnings estimates for the 2008 financial year, AWE looks very cheap. Given 2008 will be the peak year for production and profits, we acknowledge that the 2008 figures and therefore ratios are a little misleading. However, even looking out to 2009 numbers (see table) AWE is attractive at current levels.

Consensus Valuation Estimates

	2007	2008	2009
Price to earnings ratio	24.3	6.3	10.1
Net dividend yield	0%	0%	0
Price to book value	2.2	1.3	1.67
Return on Equity	10.9%	30.7%	15.1%

Source: Bloomberg

We also note that AWE remains exposed to oil prices, with less than 1.5 percent of total reserves hedged.

Financially, AWE remains in a solid position to fund development and exploration activity. As at 31 December, the company held around $140 million in cash on the balance sheet. The net debt position is zero.

Given the strength of the longer-term trend and recent signs of renewed investor support, we believe that current prices represent a good opportunity to gain exposure to this quality energy stock. Accordingly, **Fat Prophets recommend AWE as a buy to all Members around $2.76. AWE will now be included in the Fat Prophets Portfolio.**

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Snapshot AWE

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AWE's production assets include the Tui oil field offshore New Zealand, BassGas and the Casino gas developments offshore Victoria, and the Cliff Head oil project offshore Perth, WA. The company also holds exploration potential in these regions. The company recently expanded its interests with the successful takeover of ARC Energy. The company retains a very strong balance sheet position and has an aggressive 15-well drilling program planned over the next year.

Market Capitalisation: