

## This Week

### Single Best Idea (LIO)

StockAnalysis approaches 2007 with the view that finding value or even a speculative opportunity will be much more difficult than it was during 2006...

Page 1

### 2007 Outlook

Merger Mania  
Commodities  
US Housing  
Trends  
Australian Drought  
Caution

Page 1

### Market Moves

Otto & Incremental Hit Gas (OEL/IPM)  
Golden Gate Petroleum Drills Tight Target (GGP)  
Golden State Grinds Away (GDN)  
Roc Oil Breaks Down  
Australian Drought  
Caution

Page 3

### Australian Oil & Gas Sector

Over the past 18 months, the oil price rose from US\$60/bbl to a high of US\$78/bbl and then fell to US\$52/bbl...

Page 4

### Lessons from America A Blog!

Over the past century, the USA's economy has continually demonstrated dynamic growth...

Page 5

Indices & Prices	
All Ordinaries	5,649.00
Energy Index	11,956.10
Brent US\$/bbl	51.89
AUS\$/US\$	0.7826
As at Close January 15th	

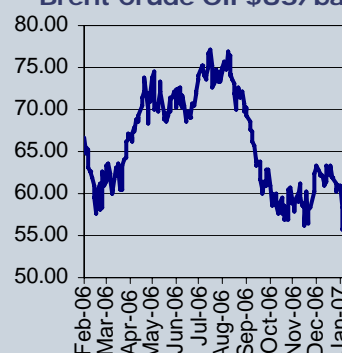
All Ordinaries



S&P ASX 200 Energy Index



Brent Crude Oil \$US/barrel



A\$/US\$



## Single Best Idea (LIO)

StockAnalysis approaches 2007 with the view that finding value or even a speculative opportunity will be much more difficult than it was during 2006.

In the last StockAnalysis edition of 2006, I outlined drilling being undertaken in the GOM by Lion Energy, Entek and GulfX. Following a share consolidation, Lion Energy is a very illiquid stock, trading between 35 and 40 cents. Subscribers may find difficulty buying stock at the current level, but StockAnalysis believes that more shares will appear on the market, should its price move towards the 45 cent level.

Lion has a 30% working interest in the wildcat well, OCS-G 27089 #1, which commenced drilling on the 8<sup>th</sup> of January in South Marsh Island Block 138. The well is programmed to drill to a depth of about 3,627 metres by mid February and has a target of about 6 mmbbls of oil plus 6 Bcf of gas, should hydrocarbons be present. Discovery would be worth 68 cps to Lion. This well will be followed by a wildcat in South Marsh Island Block 152, where discovery of 20 Bcf of gas would be worth an additional 29 cps.

**Lion Energy represents the best leveraged entrant into these exploration plays but is a purely speculative buy, with price support at 32 cents and a short term target of 60 cents.**

## 2007 Outlook

### Merger Mania

The first half of 2007 is likely to see continued corporate merger and takeover activity on the stock market, fuelled largely by an overdose of testosterone and piles of cash, resulting from strong cash flows emanating from oil, metal and coal miners. Ongoing weakness in the Australian east coast housing market during 2007 will direct a proportion of cash, which may otherwise have found its way into speculative housing ventures, towards the stock market, further increasing liquidity and boosting share prices. A growing private equity fad is also likely to boost stock market prices, at least until the first signs of a crack appear in this ultimately flawed business model. Alinta is the latest to feel the warm winds of private equity in the form of a proposed MBO, which confuses the roles of servant and master with employees acting like share owners prior to the fact. StockAnalysis has complained about this type of activity previously saying that it is just so much financial engineering, which does not actually create anything, nor does it build anything, but simply rearranges the pieces on the board, usually extracting fees for the promoters and leaving the underlying business in a less favourable state.

### Commodities

Gold is likely to be a star performer this year, despite currently trading at A\$800/oz, off its all time highs of A\$934/oz. Weakness in the US dollar during 2007 should ensure that the US\$ gold price rises, but the Aussie dollar is also likely to weaken later in the year under the dual influences of a poor balance of trade outlook as a result of the drought, and the prospect of weaker metal prices through 2007 and into 2008. A short term focus on stubborn US interest rates will ultimately be overcome by a more serious, underlying weakness of the US economy, though recent numbers belie this trend.

(Continued on page 2)

One positive influence is likely to be falling inflation. In Australia, lower energy input costs, stable or falling interest rates and a likely reduction of labour cost pressures, combined with lower banana prices, should reduce some inflationary concerns. The impact of the drought will however influence food prices higher as 2007 unfolds, lifting prices for flour and meat.

Rising stockpiles of base metals and oil, under the influence of falling demand out of the USA and Europe as a result of weaker economic activity and mild northern hemisphere winter weather, will see commodity prices take a breather early in 2007. Copper is likely to continue its fall from US\$4/lb reached last May, with short term support at US\$2.38/lb likely to provide little resistance, leading to a retreat to \$1.68/lb by mid year and possibly further falls to US\$1.50/\$1.38/lb longer term. The story is likely to be repeated elsewhere, with nickel falling from over US\$14/lb through support at US\$13.60/lb to US\$10/lb and potentially back to US\$7.65/lb by late 2007, despite its relatively tight supply demand position.

Oil has broken support levels around US\$55/bbl. However even with OPEC acting to shore up prices, further weakness to US\$50/bbl appears likely, but any fall below this level is likely to be short lived and provide plenty of buying opportunities for stocks in the sector, where takeovers are likely to be seen as a cheaper way to boost reserves than exploration. The oil price has fallen under multi-influences from producer forward selling, hedge funds reducing their long positions and traders covering previous forward positions at higher levels. The constant rivers of metal travelling up and down California's freeways, six lanes both ways, gives a clear understand that demand for oil is not going away any time soon. StockAnalysis expects that the oil price will move higher in the second half of 2007.

### *US Housing*

The US housing industry remains in a deep slump. House prices and activity will continue to fall through Q1 2007, though some sectoral respite is apparent. Many participants expect that the US housing market will bottom out during Q2 2007, but it may only form a plateau after a 12 month slump prior to resuming a downward trend as other economic influences, such as rising unemployment, begin to impact on housing demand. My contacts in the US floor covering industry, which provides a good late sector activity guide, indicate very weak trading conditions during Q4 2006, with some customers recording carpet sales at just 50% of levels seen a year ago.

### *Trends*

Worldwide, governments and corporations are working towards a workable carbon trading system, while global warming continues to take centre stage, both on political platforms as well as in corporate board rooms. Imposts arising from any new system to account for carbon may begin to play negatively on oil and coal companies as well as utilities and transport companies.

### *Australian Drought*

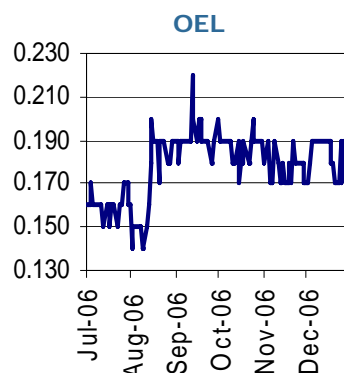
All eyes will turn to the Australian skies in April and May this year as farmers hope for a wet start to the cropping season. A second sequential failure of autumn rains would significantly undermine the ongoing and counter intuitive boom in the rural property markets of southeast Australia and the south of Western Australia.

### *Caution*

Investors may wish to begin to sit this dance out, preferring to shelter in the safe harbour afforded by well run, commercial, retail and industrial property trusts, where total returns of 8% to 12% pa have been achieved in the past. Continuation of any plan involving short term returns from backing the latest uranium or iron hopeful, where risks are several orders of magnitude higher, is fraught with danger.

Recent market wobbles in Asia and the USA show how rapidly the mood can change. After four years of strong growth, StockAnalysis believes that it is wise to protect your downside when considering investment in 2007.

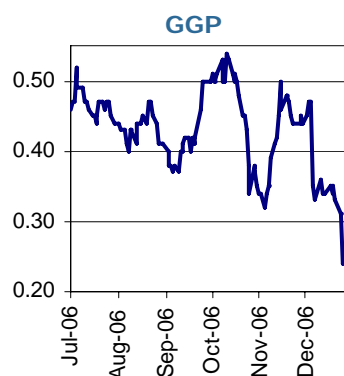
## Market Moves



### Otto & Incremental Hit Gas (OEL/IPM)

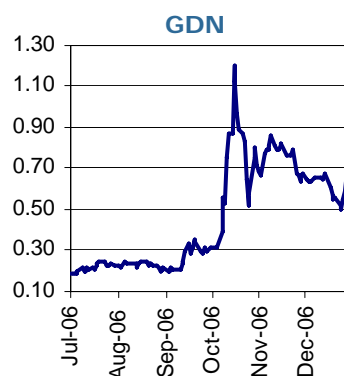
Drilling by Otto and Incremental Petroleum on their Thrace Basin permit has produced a 2 mmcuft/day gas flow from a 4 metre zone of interest at a depth of 327 metres. This zone is one of three zones of interest with an estimated net pay of 17.5 metres, at the Koyustu wildcat well. The main zone indicates a 10 metre reservoir section, which has been cased ahead of production. Pre-drill expectations for up to 5 Bcf of gas at Koyustu look likely to be conservative. Combining the Koyustu discovery with an estimated 1.5 Bcf of gas at the nearby Bati Umur discovery should provide sufficient gas to underwrite development.

StockAnalysis values Otto's 65% interest in this Turkish permit at over \$10 million or about 9 cps for Otto. **Otto is undervalued based on its 65% interest in the 6.4 mmbbl offshore Philippines Calait oilfield development, due for production in early 2008.**



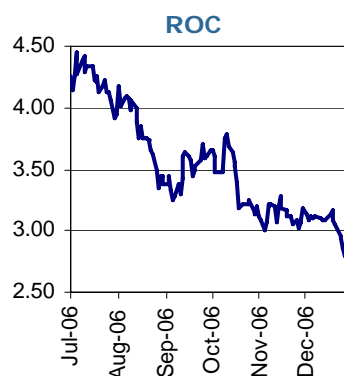
### Golden Gate Petroleum Drills Tight Target (GGP)

Golden Gate's Padre Island drilling programme is being re-evaluated following the intersection of poor reservoir units at its Plum Deep prospect. The big risk in GGP's projects at this location has been finding quality reservoirs, below known and productive gas fields. So far it looks like the deeper sands are tight and non-commercial and the company has re-focused on smaller, shallow prospects in the region, while it looks again at the geology to see if any of its deep structures deserve drill testing. **Caution is required.**



### Golden State Grinds Away (GDN)

Golden State's Paradox Basin well, now almost into its 8<sup>th</sup> month of drilling, is still trying to recover pipe, cemented into the hole by mistake. StockAnalysis hopes that recovery will enable the company to claim costs against its contractor, since funds must now be running low for what was initially billed as a 3-4 month programme. Interpretation of seismic data over the prospect has proven to be difficult, with deeper targets coming in very low to original prognosis. At the current rate of recovery, deepening the well may not get underway until the end of January, so we will have to wait until February to find out if there are hydrocarbons in the main Leadville Formation, just below the current base of operations. In the meantime, a gas discovery further out into the Paradox Basin in younger Jurassic sediments has excited the market, boosting GDN, even though this discovery has no influence over GDN's prospects from here.



### Roc Oil Breaks Down

Chartists will be looking with interest (horror) at Roc Oil's price chart, which has broken support at \$3 and now looks to be headed towards the next target at \$2.60, at which point StockAnalysis would be recommending purchase. Recent falls to \$2.80 were met with solid buying. **Buying the stock below \$3 per share may well prove to be the best investment opportunity of the year.** Roc holds price swaps over a total of 3.657 million barrels of oil with an average delivery price of US\$69.2/bbl and has put options over a further 193,333 barrels at US\$67/bbl, which should protect its revenue over the next two years. My valuation of \$3.40 per share is made up of \$2.80 per share for oil and gas assets plus \$0.60 per share for risk adjusted exploration value.

## Australian Oil & Gas Sector

In July 2005 I categorised 78 stocks in Australia's oil and gas sector. Stocks were selected as:

- A Producers with surplus operating cash flow
- B Funded emerging producers
- C Underfunded emerging producers & small producers needing additional funding
- D Exploration companies with cash and/or some development assets
- E Pure Exploration Companies

I also set aside an overlapping cohort of companies from within the above groupings who had interests in the USA as category F.

In today's StockAnalysis edition, I repeat this exercise as it helps to clear the head when you take a step back and look at the total playing field. Some new companies may be omitted. **Origin** is omitted as a diversified energy company and **Santos** is assumed to have divested its US interests.

So 18 months ago, I identified 78 companies in total, with 21 having interests in the USA. Today I tabulate 102 companies, of which 39 (excluding STO) have some US interests. Clearly, brokers have been busy floating new companies with a US focus, few of which have yet to kick any significant goals!

Over the past 18 months, the oil price rose from US\$60/bbl to a high of US\$78/bbl and then fell to US\$52/bbl. Two stocks, then in category A came back to the market for equity to support acquisitions and the development of new discoveries, namely **Amadeus** and **Petsec**. **Beach**, **Roc** and **QGC** are promoted while **Antares** is relegated following the sale of its Turkish gas fields.

My favoured stocks have generally performed poorly over the period but there were good opportunities to trade out. **Amadeus** moved from \$1 to \$1.40 before declining to \$0.95 under the weight of a weakening Australian Renewable Fuels, in which it holds a 28% interest. **Arc Energy** rose from \$1.80 to \$2.30 before falling to its current level around \$1.25. Arc now appears to be trading back towards value, with a strong operating cash flow to support its exploration and development in the Perth and Canning Basins as well as in Yemen.

**Australian Worldwide Exploration** has also been promoted. The company has a strong operating cash flow from Cliff Head, Casino and BassGas to support development of its Taranaki production and further development around Casino, along with its ongoing exploration appeal. **Roc Oil** will be re-rated this year as oil production from China, Mauritania, the UK Continental Shelf and Cliff Head combine to deliver a powerful cash flow which will support ongoing field developments on its two Chinese projects and also high impact exploration in Angola.

Amongst the developers, **Hardman** disappears from our market while **Nido**, **Otto**, **Po Valley** and **Pan Pacific** are promoted. My recommendations here did slightly better, with **Roc Oil** rising from \$2 to \$4.30 at one point prior to falling back to \$2.90. The stock has been burdened by a heavy new issue to fund a purchase of oil production in China, while the drill bit has been unkind to the company over the past couple of years. This could all change dramatically as the company gears up to drill 3 onshore prospects in Angola, starting in Q2 2007. Roc is now a significant producer by Australian standards and gets a gong for its cash flow, exposure to a long term rising oil price and its exploration appeal. The illiquid **NZOG** has done absolutely nothing on the market over the past 18 months, despite floating off its coal operations and moving towards production at Kupe and Tui. StockAnalysis sees long term value on NZOG.

(Continued on page 5)

Producers			Explorers		Aussies in the
A	B	C	D	E	USA
Amadeus Energy	AED Oil	<b>Adelphi Energy</b>	Austin Exploration	Advance Energy	Advance Energy
Anzon	Antares Energy	Aurora Energy	Carpathian	Alto Energy	Alto Energy
<b>Arc Energy</b>	<b>Horizon Oil</b>	Arrow Energy	Energy Investments	Audax	Amadeus Energy
<b>Australian Worldwide</b>	Magellan	Carnarvon	<b>Entek</b>	Australian Oil Co	Antares Energy
Beach Petroleum	Nido Petroleum	Cue Energy	Enterprise	Baraka Petroleum	Adelphi Energy
Cooper Energy	NZ Oil & Gas	Drillsearch	First Australian	Bass Strait Oil Co	Aurora Energy
Incremental Petroleum	<b>Otto Energy</b>	Eastern Star	Golden Gate	Bounty Oil & Gas	Austin Exploration
Oil Search	Pan Pacific	Elk Petroleum	Innamincka	Bow Energy	Comet Ridge
Petsec	Po Valley	European Gas	Livingston Petroleum	Caspian Oil	Elk Petroleum
Qld Gas Co	Samson O & G	Great Artesian	Molopo	Central Petroleum	Emerald Oil & Gas
<b>ROC Oil Corporation</b>	Stuart Pet	Impress	Nexus	Comet Ridge	Entek
Santos		Marion Energy	Nuenco	Eagle Bay	First Australian
Tap Oil Ltd		Metgasco	Pure Energy	Elixir Petroleum	Golden Gate
Woodside		Mosaic Oil	Planet Gas	Emerald Oil & Gas	Golden State
		Oilex	Roma Petroleum	Empire	GulfX
		Orchard Pet	Sun Resources	Essential Petroleum	Horizon Oil
		Pryme Energy	Sundance	Gas2Grid	K2 Energy
		Salinas	Sunshine Gas	Gippsland Offshore	Lakes Oil
		Strike	Tomahawk	Global Petroleum	Lion Energy
		Sydney Gas		Golden State	Livingston Petroleum
		VicPet		GulfX	Longreach
				Icon Energy	Marion Energy
				K2 Energy	Norwest Energy
				Karooon Gas	Nuenco
				Lakes Oil	Odyssey Energy
				<b>Lion Energy</b>	Orchard Pet
				Longreach	Pacrim Energy
				Moby Oil	Petsec
				Monitor Holdings	Planet Gas
				Norwest Energy	Pryme Energy
				Oil Basins	Salinas
				Odyssey Energy	Samson O & G
				Pacrim Energy	Strike
				Pancon	Sun Resources
				Rawson Resources	Sundance
				Target Energy	Target Energy
				Burleson	Tomahawk
					Burleson
					VicPet

**Preferred Stocks**

Source: Strachan Corp. Pty Ltd.

**Horizon Oil** has also jumped up my rankings. It was recommended 18 months ago at 10 cents, rose to 45 cents and then fell towards 30 cents. The company is moving towards production at its 10% held Maari project by mid-2008 and its Beibu Gulf interests are looking particularly promising following a 26 mmbbl discovery during 2006. HZN also has exploration or development interests in the USA and the Gulf of Thailand. Newcomer, **Otto Energy** debuts as a developer by virtue of its interest in the offshore Philippines, Calautit oilfield and recent Thrace basin gas discoveries. Otto needs to fund the drilling of a horizontal well at Calautit, but once done, cash flow should support further drilling, while its exploration is largely farmed out.

**First Australian** and **Samson** were recommended and both gave good trading opportunities with FAR rising from 10 to 25 cents while Samson rose from 30 to 55 cents. **Sun Resources** was a big disappointment, falling from 21 cents to 11 cents, but the company now has new management support.

StockAnalysis continues to like **Adelphi** following positive results from its Sugarloaf well and ongoing potential from its New Taiton project and interests in Yemen.

**Entek**, **GulfX** and **Lion Energy** are partners in a series of low risk exploration prospects in the Gulf of Mexico; however Entek has already made a significant gas discovery, which StockAnalysis believes should underpin its price at 22 cents. Lion offers the best leverage to exploration success and appears to be well backed by a new shareholder with significant influence in China.

Stocks in the exploration arena have generally shown more volatility, which might be expected. **Bow** rose from 15 cents to 30 and has since fallen to 17 cents. **Strike** rose from 15 cents to a high of 40 cents and has since weakened back to 30 cents while **Elixir** rose from 40 cents to \$1 and fell back to 39 cents and **Pancon** has traded around 6 to 8 cents.

Recent weakness in both oil and gas prices in the USA exposes weaknesses in investments in that market. Many new players are involved in high cost production from low volume, old fields or equally high cost production from unconventional reservoirs. This type of play relies on a gas price well over US\$6/Mcf and an oil price north of US\$60/bbl to make sense.

## Lessons from America A Blog!

Over the past century, the USA's economy has continually demonstrated dynamic growth, along with an astounding ability to adapt and encourage innovation. This is all the more surprising to an outside observer since, as a vast generalisation, I see that its society and economy appears to be governed under a "**Rule by Law**" rather than a more commonly accepted "Rule of Law".

So what makes America different and are there any aspects of the world's most successful economy ever, which render it vulnerable to change in the future?

The USA's laws appear to form an exoskeleton or framework surrounding and supporting society to protect the rights of individuals and organisations and to regulate commerce while enabling business to operate in an orderly fashion. Everything that takes place in America is governed under an umbrella of thick, black-letter law which ensures that lawyers proliferate. The USA has lawyers for everything including lawyers who specialise in defending other lawyers against malpractice suits. The USA has developed into an extremely litigious society. Bureaucracy is thick and decision making is slowed by procedural accountability with every stage of the process aware of the potential for litigation.

The USA has many anomalies to Australian eyes. While the speed limit on the nation's freeways is 65 mph, it appears to be acceptable to travel at 70-75 mph (everyone does), however "J" walking is strictly frowned upon and infringement attracts a fine of US\$140. Americans must be appalled at the undisciplined meanderings of pedestrians across Melbourne's Collins Street or Perth's St George's Terrace! On the positive side, littering is now taken seriously and attracts a fine of up to US\$1,000.

Belying its historic roots, the USA has become a highly military society. Naval, Army and Air Force facilities, schools, and personnel, are very visible and appear to be a much bigger part of that society than I have seen elsewhere in Europe or Australia.

The USA's rule by law is no better illustrated than by reference to its incarceration rate. The USA jails a huge percentage of its population, holding four times as many people in jail as the global average. At any one time, over 2 million US citizens are in its jails. The USA holds 738 people per 100,000 of its population in jail versus a global average of 140 per 100,000 of population. By comparison, Australia has a jail population of 126 per 100,000 while France holds 88 per 100,000 of its population. The number of US citizens in jail does not correlate with higher crime rates; they just incarcerate more of their citizens! In 12 States of the USA, between 10% and 15% of all Black men are in jail! Just as Australia's aboriginal community is over represented in its jail community, the USA's jail population is heavily weighted by Black and Hispanic people.

A rule of law, so often cited in the "old economies" of Europe and its colonies, such as Canada and Australia, works differently in my opinion. A rule of law involves the community adhering to a set of laws and customs developed and adapted over time, which are imbedded deep within the body of society, forming its internal skeleton. The rule of law supports commerce and protects property and civil rights from within its structure. In my opinion, rule by law is imposed on society, asserting the authority of government and the institutions, including the judiciary and the police force.

Rule of law is owned by society and thus is possibly more enduring and less fragile than a rule by law, effectively imposed on a community. Look at how New Orleans crumbles once the law broke down. A rule of law ensures that society's organs of authority function, while supported by a raft of laws which are a part of that society rather than imposed from above.

More on this topic!!

## Contact

Peter Strachan:  
Pex Publications:

[Peter@stockanalysis.com.au](mailto:Peter@stockanalysis.com.au)  
[oilinfo@pex.com.au](mailto:oilinfo@pex.com.au)

5/1 Almondbury Rd Mt Lawley, WA 6050

Tel: 08 9272 6555 Fax: 08 9272 5556

Website: [www.stockanalysis.com.au](http://www.stockanalysis.com.au)  
[www.pex.com.au](http://www.pex.com.au)

## Disclaimer

The information or advice (including any financial product advice) herein is believed to be reliable and accurate when issued however, Strachan Corporate Pty Ltd ABN 39 079 812 945; AFSL 259730 ("Strachan"), does not warrant its completeness, reliability or accuracy. Strachan, its Directors and their Associates from time to time may hold shares in the securities mentioned in this report and therefore may benefit from any increase in the price of those securities. Opinions and estimates constitute Strachan's judgment. The author certifies that the views expressed in this document accurately reflect the analyst's personal views about the subject company and are subject to change without notice. Strachan, its officers, agents and employees exclude all liability whatsoever, in negligence or otherwise, for any loss or damage relating to this document to the full extent permitted by law. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The investments and strategies discussed herein may not be suitable for all investors. The advice in StockAnalysis has been prepared without taking account of any particular person's investment objectives, financial situation or needs. Therefore, before acting on the advice, you should consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. There may be a product disclosure statement or other offer document for the securities and financial products we write about in StockAnalysis. You should obtain a copy of the product disclosure statement or offer document before making any decision about whether to acquire the security or product. If you have any doubts you should contact your investment advisor. The investments discussed may fluctuate in price and changes in commodity prices and exchange rates may have adverse effects on the value of investments. The author holds shares in OEL, EXS, CYL, ARQ, ADI, GDN, ROC, MGR, SUN, TAP, HGR, EXR, PCL, WSS, RCR, HZN, HAV & BRT.