

Mosaic Oil (MOS)

Bumping along the bottom – why?

The 2007 year was a successful one for MOS, with reserves up 5%, production up 10% and a record profit of A\$2.6m. Cash flow and the recent capital raising of A\$15.7m at 12c/MOS share will fund an accelerated exploration programme in 2008.

Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
EBITDA (A\$m)	2.21	3.81	10.9	17.6	17.5
Reported net profit (A\$m)	1.04	2.65	6.65	11.2	11.0
Normalised net profit (A\$m) ¹	1.04	2.65	6.65	11.2	11.0
Normalised EPS (c) ¹	0.22	0.55	1.14	1.93	1.89
Normalised EPS growth (%)	n/a	155.1	107.8	69.1	-2.11
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	48.7	19.1	9.18	5.43	5.55
EV/EBITDA (x)	24.8	15.0	8.43	6.89	8.65
Price/net oper. CF (x)	54.1	6.42	7.34	4.67	4.69
ROIC (%)	n/a	3.77	13.2	12.0	7.99

1. Pre-goodwill amortisation and exceptional items
Accounting Standard: IFRS
Source: Company data, ABN AMRO Morgans forecasts

year to Jun, fully diluted

Production and under-utilised infrastructure

Mosaic reported revenue of A\$4.6m for the December quarter, from sales of 99,125 boe produced through its under-utilised oil and gas infrastructure in the Western Surat-Bowen Basin with insured asset values above A\$55m. The 100%-owned Silver Springs gas-liquids processing facility is operating at 25% of its 15TJ/day capacity, the 50%-owned Wallumbilla LPG plant and pipeline (with 50%-owner and operator Santos) is operating at 50% of its current capacity of 25TJ/day, and the Churchie (MOS 49%) and Downlands (MOS 60.9%) pipelines are also operating well below capacity. It will support rapid commercialisation of exploration success in the Western Surat-Bowen Basin, and at high profit margins. MOS reported cash on hand of A\$17.4m at 31 December.

Picking the low-hanging fruit

The company's commercial drilling success rate in the region has ranged from 30% to 60% per year over the past five years, with over 60 high-quality near-field prospects and leads in its current inventory. These cover a range of play types for both oil and gas. MOS has 15 drillable prospects on productive trends in the Triassic Showgrounds/Rewan which host the structurally controlled Tinker-Taylor and SW Bainbilla fields. The Permian Tinowon Sandstone hosts the Churchie field, initially interpreted as a structural trap. A significant stratigraphic component is now confirmed, and Mosaic has defined three drill-ready Tinowon stratigraphic prospects.

Ten exploration wells to drill

In the past, MOS has funded its operations from cash flow, with EBITDA of A\$5.9m reported for 2006/07. With a drilling budget of A\$9.8m for the 2008 calendar year, MOS has raised A\$15.7m to fund this significantly stronger exploration drilling programme over the next two years. The initial drill programme will test 10 of the 30 drillable prospects. High profit margins on exploration success are available through the under-utilised production infrastructure. Drill success will provide a share price catalyst, and although carrying risk, we rate MOS a Buy.

Important disclosures regarding companies that are the subject of this report and an explanation of recommendations and volatility can be found at the end of this document.

Priced at close of business 5 February 2008.

Buy

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISOR TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

Absolute performance

n/a

Short term (0-60 days)

Oil, Gas & Consumable Fuels

Australia

Price

A\$0.105

Target price

A\$0.22

Market capitalisation

A\$61.05m (US\$55.00m)

Avg (12mth) daily turnover

A\$0.22m (US\$0.19m)

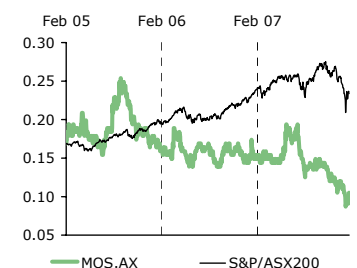
Reuters

MOS.AX

MOS80206

Price performance (1M) (3M) (12M)

Price (A\$)	0.1	0.1	0.2
Absolute %	-12.5	-24.5	-31.8
Rel market %	-4.7	-14.2	-31.5
Rel sector %	4.8	-6.7	-61.1



Stock borrowing: n/a

Volatility (30-day): 73.24%

Volatility (6-month trend): ↑

52-week range: 0.20-0.08

S&P/ASX200: 5792.90

BBG AP Oil & Gas: 727.48

Source: ABN AMRO, Bloomberg

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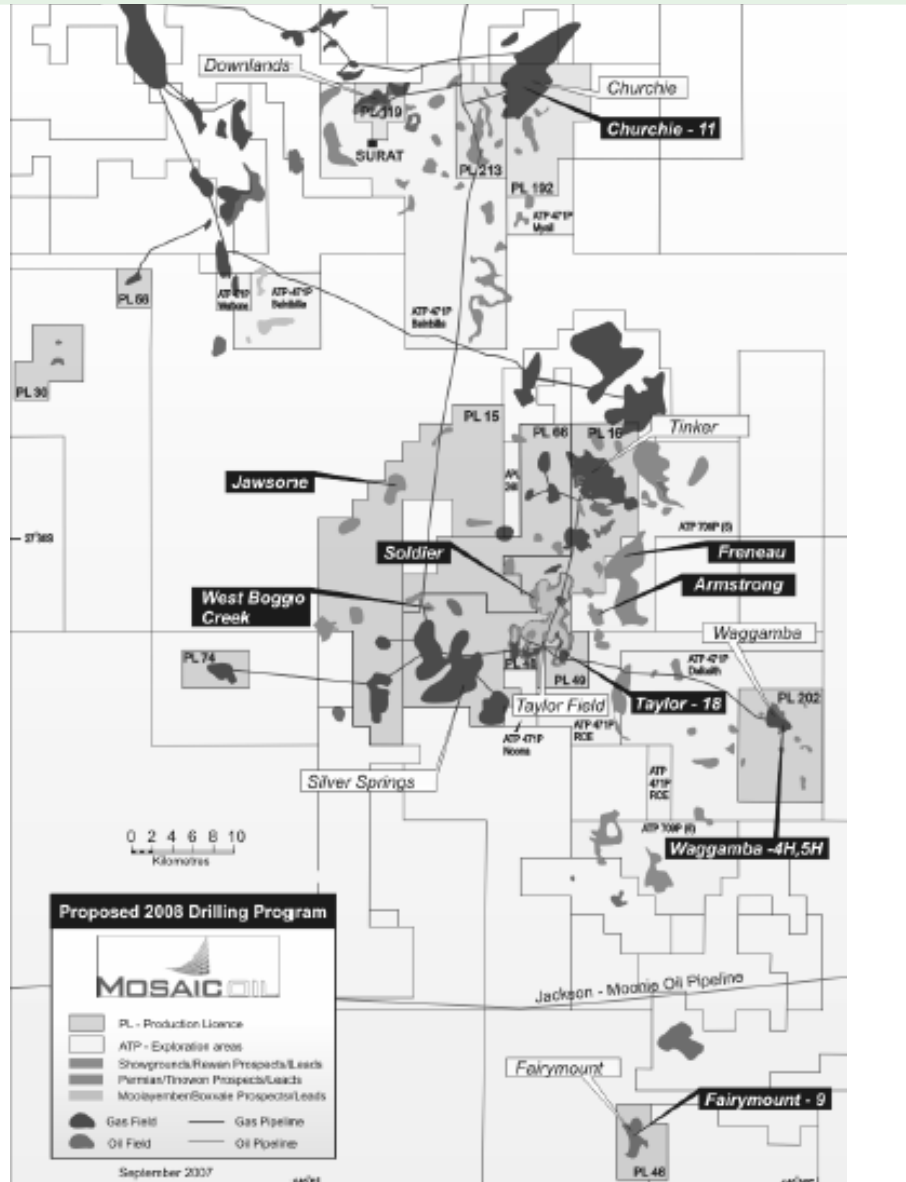
www.abnamromorgans.com.au

Company overview

Mosaic Oil NL (MOS) is an established junior oil and gas company with production, development and exploration in the Surat Basin in Queensland, and exploration in Papua New Guinea and the North-West Shelf of Western Australia. Production in the 06/07 year was 75,300 barrels of oil and condensate, 1.9PJ of gas and 3,700 tonnes of LPG. As at June 2007, Mosaic's 2P reserves were reported as 2.9mmbbls of oil, 52.3PJ of gas and 105,700t of LPG.

Mosaic's production interests are primarily located in the Surat/Bowen Basin in Queensland, with production licences cover the Churchie Gas Field (49%), Churchie West (83%), Silver Springs Area (100%, including North Boxleigh, Taylor-Tinker, Taylor and Roswin), the Waggamba Gas Field (100%), the Downslands Oil and Gas Field (including Downslands (83.333%), Downslands East (71.153%), and Spring Grove (77.5%)). Production is also sourced from Fairymount (100%), Riverslea (10%) and the Major Gas Field (16%).

Figure 1 : The Western Bowen-Surat Basin



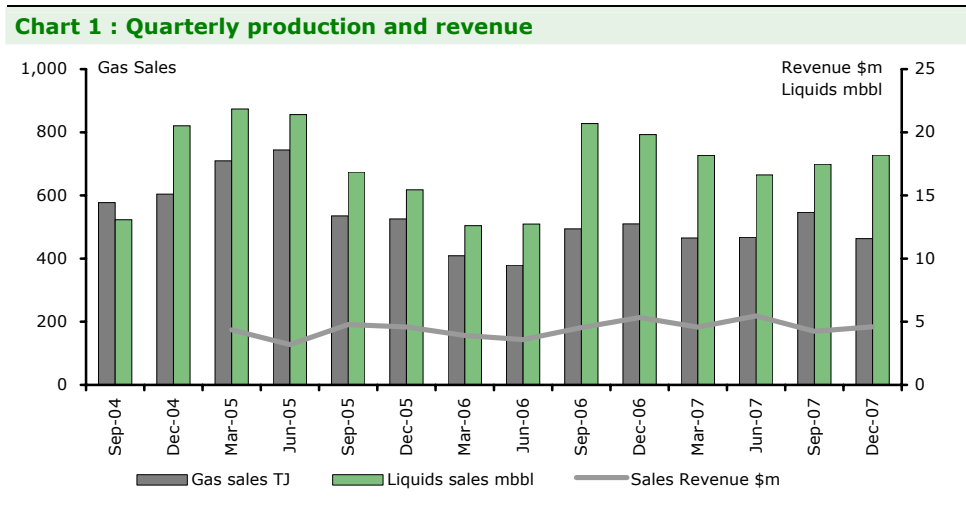
Source: Mosaic Oil

Mosaic operates the 100%-owned Silver Springs gas-liquids processing facility and has a 50% interest (with Santos 50% and operator) in the Wallumbilla LPG plant and pipeline, has a 49% interest in the Churchie pipeline and 60.9% in the Downlands pipeline. MOS is also listed on the Port Moresby stock exchange.

December 2007 quarter production

Mosaic produced 18,193 barrels of oil and condensate in the December 2007 quarter, and achieved an average price of A\$106.65/bbl (17,469 bbl @ A\$90.94 previously), generating revenue of A\$1.94m (A\$1.59m previously). It also produced 932 tonnes of LPG and 0.46PJ of gas (998t, 0.55PJ), generating a further A\$2.66m in revenue, taking total sales to A\$4.6m for the quarter (A\$4.3m previously). Gas production was below previous levels with the unplanned shutdown by one of Mosaic’s customers limiting offtake. Production and development expenses were A\$2.17m (A\$3.03m previously), and administration added a further A\$1.15m (A\$1.23m previously). These costs are in line with prior quarters. Of this sales revenue of A\$4.6m, A\$1.7m is due for payment in January 2008. Mosaic reported cash balances of A\$17.45m (A\$3.22m previously) at the end of the quarter, with a net A\$15.7m from a placement and rights issue at 12 cents per share, with one option attached to each 2 new shares.

Production levels are not high enough to generate the level of cash flow required to fund the proposed exploration and development drilling programme at the aggressive rate scheduled. Exploration and development success in the Western Surat Bowen could be rapidly connected to Mosaic’s existing infrastructure, and the higher utilisation rates would result in lower unit operating costs, improving profit margins across the board for Mosaic.



Source: Mosaic Oil

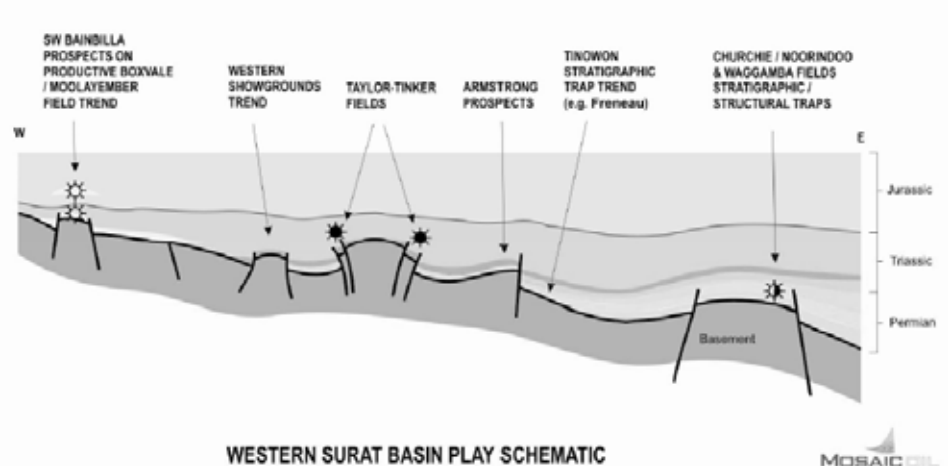
The exploration drilling programme

The Moonie oil field discovery in 1961 in the Surat Basin was the first commercial oil discovery in Australia, with production from the Jurassic Precipice Sandstone. In 1966 discoveries in the underlying Triassic Moolayember Formation, and subsequently the Silver Springs field discovery in 1974 in the underlying Triassic Showgrounds Sandstone confirmed the productivity of the Triassic sequence.

With the Downlands and subsequent discoveries, Mosaic Oil confirmed the potential of the older Permian Tinowon Formation, and the Churchie field is now the third largest field discovered in the Basin to date, behind Moonie (1961) and just behind Silver Springs (1974) in terms of size.

The Downlands, Waggamba and Churchie fields are currently in production from the Permian age Tinowon sandstone. Until recently, Churchie was considered to be a structural trap, like Downlands and Waggamba. Recent pressure data analysis and the results from wells drilled outside the structural closure have confirmed that there is a substantial component of stratigraphic control at Churchie. This interpretation has resulted in the definition of a number of prospects and leads.

Figure 2 : Play types in the Western Bowen-Surat Basin



Source: Mosaic Oil

The drill programme for 2008 is shown below. While a number of the wells are low-risk and are either development or aggressive development wells, there are two genuine exploration wells in the programme.

The Freneau gas-condensate prospect in the Tinowon sandstone is up-dip from the Rockhampton High #1 well, located immediately to the north. As is evident from the table below, success in Freneau has the potential to double the value of Mosaic.

The Armstrong prospect is a more traditional Surat play, targeting the Triassic Showgrounds and Rewan formations. It is potentially less significant than Freneau, but the play type is better constrained in the Surat, and is considered to be lower risk.

Table 1 : Proposed drill programme – 2008

PROSPECT/WELL	AREA	MOSAIC INTEREST	TARGETED RESERVES		Pc	NPV(10)	
			Mean	P10		Mean Case	P10 Case
GAS							
			BCF		A\$ Million		
Freneau	ATP709P(5)	100%	28.9	71.2	19%	\$71.0	\$176.0
Waggamba-4H	PL 202	100%	2.5	4.5	80%	\$10.4	\$16.9
Waggamba-5H	PL 202	100%	2.5	4.5	80%	\$10.4	\$16.9
Churchie 11	PL 192	49%	3.5	8.6	87%	\$8.7	\$19.4
Taylor 18	PL 16	100%	1.9	2.2	80%	\$6.7	\$6.9
Soldier 1 (Taylor 14 SW)	PL 16	100%	1.2	2.5	24%	\$5.0	\$9.3
OIL							
			MMBO		A\$ Million		
Armstrong	ATP709P(5)	100%	0.5	1.1	40%	\$6.9	\$14.8
Jawson	PL 15	50%	0.4	0.8	20%	\$4.3	\$10.1
West Boggo Creek	PL 16	100%	0.2	0.4	35%	\$4.2	\$7.8
Fairymount 9	PL 46	100%	0.1	0.2	80%	\$2.3	\$4.0

Dry Hole Capex: A\$12.6 MM

BCF: Billion cubic feet of gas

Assumptions: Oil price US\$70/bbl, Gas – existing contract price; A\$/US\$ 0.85

Source: Mosaic Oil

Valuation and risks

We have valued Mosaic Oil at A\$0.22 per share, with A\$0.15 attributable to Mosaic's production assets and 2P reserves in the Western Surat-Bowen Basin, and a further A\$0.03 for risked exploration upside. Mosaic's exploration tenements in Papua New Guinea and on the North West Shelf, offshore WA, together with net cash, and offset by an allowance for corporate overheads comprise the balance. Exploration success at Freneau or at a rate above 25% provide upside to our valuation, increasing the reserve base above our expectations. The oil and gas price, and the strength of the A\$/US\$ exchange rate are also risks to profitability and valuation. In particular a strengthening Queensland domestic gas price offers upside potential.

Table 2 : Valuation snapshot

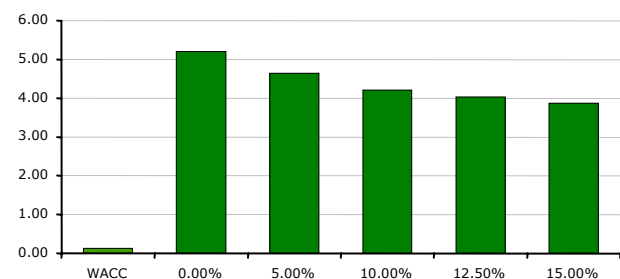
Fair value*	A\$0.22
Target price	A\$0.22
Current price	A\$0.11
Upside/downside	100%
* Methodology	Sum of the parts
Assumptions	
WACC	10.2%
Beta	1.57
Equity risk premium	4.5%
Risk-free rate	5.75%

Source: ABN AMRO Morgans estimates

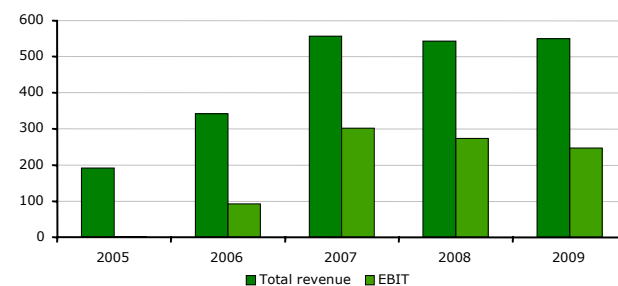
MOS – financial summary

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$)	0.11	Price target (A\$)	0.22	
Income statement						Valuation methodology	Sum of the Parts		Val'n (A\$) \$ 0.22	
Divisional sales	14.7	17.3	16.4	23.2	22.9	Valuation summary	A\$m	A\$ps	DCF valuation inputs	
Total revenue	14.8	17.3	20.6	28.4	29.1	Surat-Bowen 2P Reserves	85.4	0.15 Rf	5.75%	
EBITDA	2.2	3.8	10.9	17.6	17.5	Surat-Bowen Exploration	20.3	0.03 Rm-Rf	4.50%	
Depreciation & amortisation	-1.5	-1.4	-1.7	-1.8	-2.0	Production Assets	0.0	0.00 Beta	1.54	
EBIT	0.7	2.4	9.2	15.8	15.5	Other Exploration	20.3	0.03 CAPM (Rf+I)	12.7%	
Net interest expense	0.3	0.3	0.3	0.3	0.2	Net Cash	20.0	0.03 Tax rate (t)	30.0%	
Pre-tax profit	1.0	2.6	9.5	16.1	15.7	Corporate & Other	-20.0	-0.03 WACC	10.14%	
Income tax expense	0.0	0.0	-2.8	-4.8	-4.7	Total Value	126.0	0.22 Shares	581.4	
After-tax profit	1.0	2.6	6.6	11.2	11.0					
Minority interests	0.0	0.0	0.0	0.0	0.0					
NPAT	1.0	2.6	6.6	11.2	11.0	Production (Mt)	2006A	2007F	2008F	2009F
Significant items	0.0	0.0	0.0	0.0	0.0	Oil Sold - mbbbl	56.22	69.29	76.22	83.84
NPAT post abnormal	1.0	2.6	6.6	11.2	11.0	Gas sold - Tj	1848.98	1941.83	2136.01	2349.61
Growth ratios	2006A	2007A	2008F	2009F	2010F	Key assumptions	2006A	2007F	2008F	2009F
Sales growth	n/a	17%	-5%	41%	-1%	USD Exchange rate A\$	0.75	0.79	0.89	0.90
Operating cost growth	n/a	7%	-59%	1%	-2%	Oil Price Received (US\$/bbl)	65.20	63.50	66.54	55.00
						Gas Price Received (A\$/Gj)	3.50	3.50	3.50	3.50
Cash flow statement	2006A	2007A	2008F	2009F	2010F	Per share data	2007A	2008F	2009F	2010F
EBITDA	2.2	3.8	10.9	17.6	17.5	No. shares	481.3	581.4	581.4	581.4
Cash flow from ops (1)	0.9	7.9	8.3	13.1	13.0	EPS (cps)	0.6	1.1	1.9	1.9
Capex (2)	-4.4	-10.3	-40.0	-40.0	-40.0	EPS (normalised) (c)	0.6	1.1	1.9	1.9
Disposals/(acquisitions)	0.5	0.0	-5.0	-5.0	-5.0	Dividend per share (c)	0.0	0.0	0.0	0.0
Cash flow from invest (3)	-4.1	-10.4	-45.0	-45.0	-45.0	Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Incr/(decr) in equity	7.2	0.0	2.2	2.2	2.2	Dividend yield (%)	0.0	0.0	0.0	0.0
Incr/(decr) in debt	0.0	0.0	-30.0	0.0	0.0					
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Operating performance	2007A	2008F	2009F	2010F
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	EBIT growth	228%	290%	71%	-2%
Cash flow from fin (5)	7.2	0.0	-27.8	2.2	2.2	NPAT growth	155%	151%	69%	-2%
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Pre-goodwill NPAT growth	155%	151%	69%	-2%
Incr/(decr) cash (1+3+5+6)	4.0	-2.5	-64.5	-29.8	-29.8	Pre-goodwill EPS growth	155%	108%	69%	-2%
Equity FCF (1+2)	-3.5	-2.5	-31.7	-26.9	-27.0	Normalised EPS growth	155%	108%	69%	-2%
						Asset turnover (%)	7.4	8.2	12.5	9.6
Balance sheet	2006A	2007A	2008F	2009F	2010F	EBITDA margin (%)	15.0	22.1	66.5	76.1
Cash & deposits	6.2	3.7	-60.8	-90.6	-120.4	EBIT margin (%)	4.9	13.7	56.3	68.2
Trade debtors	2.5	2.3	2.3	2.3	2.3	Net profit margin (%)	7.0	15.3	40.6	48.5
Inventory	2.4	2.1	2.1	2.1	2.1	Return on net assets (%)	4.5	15.0	21.1	17.5
Investments	1.1	1.1	1.1	1.1	1.1	Net debt (A\$m)	-3.7	0.8	30.6	60.4
Other intangible assets	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-7.1	1.3	40.7	68.4
Fixed assets	33.0	39.0	82.4	125.6	168.6	Net interest/EBIT cover (x)	-8.4	-34.6	-62.4	-64.4
Other assets	11.2	12.4	12.4	12.4	12.4	ROIC (%)	3.8	13.2	12.0	8.0
Total assets	56.4	60.7	39.5	53.0	66.2					
Interest bearing debt	0.0	0.0	-30.0	-30.0	-30.0	Comparable multiples (x)	2007A	2008A	2009A	2010A
Trade payables	1.7	3.4	3.4	3.4	3.4	Mosaic Oil	EV/EBITDA	8.4	6.9	8.7
Long-term borrowings	0.0	0.0	-30.0	-30.0	-30.0	Year to 30 Jun	PE	9.2	5.4	5.6
Provisions	4.2	4.2	4.2	4.2	4.2					
Other liabilities	0.3	0.3	30.3	30.3	30.3	Tap Oil	EV/EBITDA	3.5	3.8	7.3
Total liabilities	6.3	7.9	-22.1	-22.1	-22.1	Year to 31 Dec 06	PE	32.0	28.7	n/a
Share capital	70.7	70.7	72.9	75.1	77.3					
Other reserves	0.0	0.0	0.0	0.0	0.0	Horizon Oil	EV/EBITDA	-85.4	-127.4	0.8
Retained earnings	-20.6	-17.9	-11.3	0.0	11.0	Year to 30 Jun 07	PE	n/a	n/a	2.4
Total equity	50.1	52.8	61.6	75.1	88.3					
Minority interest	0.0	0.0	0.0	0.0	0.0					
Total shareholders' equity	50.1	52.8	61.6	75.1	88.3					
Total liabilities & SE	56.4	60.7	39.5	53.0	66.2					

Valuation sensitivity to discount rate (A\$/share)



Total revenues and EBIT (A\$m)



Source: Company data, ABN AMRO Morgans forecasts

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Absolute performance, long-term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. The target price is the level the stock should currently trade at if the market accepted the analyst's view of the stock, provided the necessary catalysts are in place to effect the change in perception. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value the target price will differ from "fair" value. Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

For listed property trusts (LPTs) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more; a Hold 5-10%; and a Sell less than 5%.

Absolute performance, short-term (trading) recommendation: The Trading Buy/Sell recommendation implies upside/downside of 3% or more. The trading recommendation time horizon is 0-60 days.

Each stock has been assigned a Volatility Rating to assist in assessing the risk of the security. The rating measures the volatility of the security's daily closing price data over the previous year relative to other stocks included in either the S&P/ASX200 Index (large caps) or the Small Ordinaries Index (small caps) of which it is a member. This rating is a quantitative (objective) measure provided as an additional resource and is independent of the qualitative research process undertaken by our research analysts.

A rating of Low indicates very little movement in price over the previous year (Coefficient of Variation < 4 for small caps or < 5 for large caps). A Moderate rating implies average price movement over the previous year (Coefficient of Variation of 9 - 21 for small caps or 7.25 - 15 for large caps). A High rating implies significant price movement over the past year (Coefficient of Variation greater than 25 for small caps or 35 for large caps).

REGULATORY DISCLOSURES

Subject companies: MOS.AX

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