

June 3, 2011

African Petroleum¹ (AOQ AO)

Last: A\$0.90

BUY

Target: A\$1.90↑

WHAT'S CHANGED

	NEW	OLD
Rating	nc	BUY
Target	A\$1.90	A\$1.80
Production 2010E (boe/d) 6:1	nc	0
Production 2011E (boe/d) 6:1	nc	0
CFPS 2010A (f.d.)	nc	(\$0.00)
CFPS 2011E (f.d.)	nc	(\$0.01)

SHARE DATA

Shares o/s (mm, basic/f.d.)		1597/1623
52-week high/low		A\$1.03/A\$0.60
Market capitalization (mm)		\$1,513
Enterprise value (mm)		\$1,374
Net debt (mm) – 2011E		(\$139)
Dividend yield		n/a
Projected Total Return		111%

FINANCIAL DATA

	2010A	2011E	2012E
Oil & NGLs (b/d)	0	0	0
Natural Gas (mmcf/d)	0	0	0
Total (boe/d) 6:1	0	0	0
Equivalent growth	0%	0%	0%
Brent (US\$/b)	74.65	105.00	105.00
UKNS Gas (US\$/mmbtu)	6.55	9.03	9.00
FX rate (USD/CAD)	0.9711	0.9700	1.000
EPS (f.d.)	(\$0.01)	(\$0.01)	(\$0.01)
CFPS (f.d.)	(\$0.00)	(\$0.01)	(\$0.01)
Net Debt (mm)	(\$2.1)	(\$45.6)	(\$17.6)
Debt/CF	nm	nm	nm
P/CF		nm	nm
P/CF (d'adj'd)		nm	nm

* (In US\$ unless otherwise stated)

Positioned to ramp up exploration campaign & expand footprint in West Africa

AOQ Closes A\$250 mm Placement

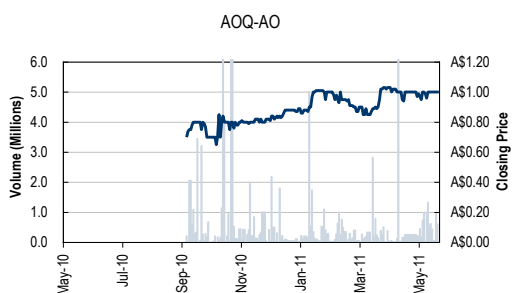
AOQ recently completed a A\$250 mm placement by issuing 250 mm shares at A\$1.00/sh to a broad range of blue chip institutional investors in Australia, Canada, the UK and the United States. The Placement took place in two tranches, with 193 mm shares being issued in April and 57 mm shares subsequently issued upon the receipt of shareholder approval in late May. AOQ intends to use the capital to drill up to four additional wells (increasing its drilling campaign to six wells), acquire further acreage in offshore West Africa and undertake additional 3D seismic (initially focusing on Block SL-03 offshore Sierra Leone).

Expanded Exploration Campaign - Funded for up to six wells

AOQ's capital raise provides Management with funding to pursue further exploration targets beyond its original drilling program and pick up additional assets in West Africa. Next to Liberia, the Company's Gambian block is the most progressed in terms of prospectivity, having already completed 3D seismic work. Over 20 exploration prospects have been identified, including the Alhamdulillah structure which has a potential resource range of 560-1,000 mmb. Additionally, the recently awarded SL-03 Sierra Leone block requires a 3D program before drilling, however we believe AOQ may wait for well results from its upcoming campaign in Liberia before finalizing its go-forward plans. Management have also indicated its interest to add additional acreage through various applications in West Africa.

Valuation & Recommendation

We are increasing our price target to A\$1.90/sh (from A\$1.80/sh) and reiterating our BUY recommendation following the recent A\$250 mm financing which expands AOQ's twelve month drilling campaign. Our target price now includes the risked upside from three exploration targets (two in Liberia and one in Gambia), as well our estimated Core NAV of A\$0.07/sh following the raise. We continue to expect AOQ's exploration program in Liberia to be the main driver for the share price over the next 12 months and look to the spudding of the first of two back-to-back wells in June/July. AOQ has transformed itself into the largest West African focused oil and gas company with an expansive acreage in Liberia, Gambia, Sierra Leone, Guinea, Senegal and Ghana. We believe Management will use the additional funding to further expand its presence in the region via various acreage applications and further accelerate its exploration program.





AOQ CLOSING A \$250 MM PLACEMENT

African Petroleum recently completed a \$250 mm placement by issuing 250 mm shares at \$1.00/sh to a broad range of blue chip institutional investors in Australia, Canada, the UK and the United States. The Placement took place in two tranches, with 193 mm shares being issued in April and 57 mm shares subsequently issued upon the receipt of shareholder approval in late May. Following completion of the Placement, AOQ has 1,597,002,598 shares on issue, and a market capitalization of ~\$ 1.6 bn.

Management intends to use the capital to drill up to four additional wells (increasing its drilling campaign to six wells), acquire further acreage in offshore West Africa and undertake additional 3D seismic (initially focusing on Block SL-03 offshore Sierra Leone).

ACCELERATED EXPLORATION CAMPAIGN - FUNDED FOR UP TO SIX WELLS

African Petroleum's capital raise provides Management with funding to pursue additional exploration targets beyond its original drilling program outlined in early 2011 as it is now funded for up to six wells. Next to Liberia, African Petroleum's Gambian block is the most progressed in terms of prospectivity. The Alhamdulillah Licence Block A1 and Licence Block A4 span a combined area of 2,668 sqkm (~660,000 acres) offshore, and we believe the acreage has significant exploration potential. More than 20 exploration prospects have been identified including the four way dip closed Alhamdulillah structure, which has an independently evaluated potential resource range of 560-1,000 mmb (estimates provided by Synergy). Prospect evaluation is underway, and Management was originally looking to potentially spud a well in Q4/11. We believe the additional funding will provide financial flexibility required to start securing a rig and aligning a drilling program within the next twelve months.

Additionally, the SL-03 Sierra Leone block requires a 3D program before drilling targets can be refined. The Company does intend to acquire 2D/3D seismic across Block SL-03 which was ratified by the Sierra Leonean Parliament in February 2011, however we believe it may wait for well results from its upcoming campaign in Liberia before finalizing its go-forward plans.

DRILLING IN LIBERIA SLIGHTLY DELAYED

African Petroleum's original spud date in Liberia has slipped slightly from May to June/July as Hess, which was drilling with the Maersk Deliverer rig, is reported to have made a big deep-water discovery resulting in the need to extend drilling. In an earnings call, Hess said that the "Paradise prospect" in the Deepwater Tano Cape Three Points Block in Ghana had so far hit 370 ft of net hydrocarbon pay in two separate intervals. Hess, who has 90% WI in license is carrying the state entity Ghana National Petroleum Corporation for the remaining 10% WI. Paradise was drilled in 6038 ft of water.

The results are preliminary and it is too early to speculate the resource size of the discovery as Hess still has ~ 1,100 ft to drill until reaching TD. During the call which was held at the end of April, Hess was drilling ahead at ~ 15,300 ft, and at that point estimated an additional two weeks of drilling and logging

before reaching target depth. The rig now moves to Ophir Energy (private), Far Limited (FAR AU) and Rocksource (RGT NO) who are expected to spud the Kora Prospect in the Profond block, AGC area, before routing onward to African Petroleum. Far and Rocksource said that they expected the rig to arrive in late May.

Consequently, African Petroleum is looking to start drilling in late June/July on Blocks LB-08 and LB-09 (100% WI, Operator). African Petroleum has identified over 50 prospects and leads which have potential unrisks reserves of 7-15 bnboe. Of these prospects, there are four key clusters in water depths of 800-2000m. The key clusters include one cluster to Block LB-08 (8-1 Horst Area), two clusters to Block LB-09 (Western Fan Area and Central Fan Area in Block LB-08), and the 9-1 Apalis Area cluster straddles both Blocks. Analysis is ongoing to appraise the additional prospects.

VALUATION & RECOMMENDATION

Since our last note, we have rolled forward our 2011 & 2012 estimates and increased our price forecasts. In light of a strong oil pricing environment, we increased our Brent oil price forecast to \$105.00/b in 2011 and 2012 and introduced a long-term forecast of \$100.00/b. Our price deck change has increased our estimate for the NPV per barrel figures in Liberia to \$19.80/b (from \$16.17/b). The net effect of this change does not affect our Core NAV as African Petroleum's drilling portfolio does not include any producing or undeveloped assets. Although we do not categorize any of African Petroleum's resources as undeveloped assets at this time, we believe its upcoming drilling program could quickly prove up both of the blocks potential value, shifting resources into the contingent from the prospective category. The increased per barrel value does increase our exploration targets as each prospect and consequently cluster are now more valuable. However, this increase is slightly diluted due to A\$250 mm raise. The A\$250 mm financing would have increased our cash component of our Core NAV, however, our higher capex assumptions mitigated the change, resulting in a cash value of A\$0.08/sh (previously published cash standing was A\$0.09/sh).

We are increasing our price target to A\$1.90/sh (from A\$1.80/sh) and reiterating our BUY recommendation following the recent A\$250 mm financing which expands AOQ's twelve month drilling campaign. Our target price now includes the risked upside from three exploration targets (two in Liberia and one in Gambia), as well our estimated Core NAV of A\$0.07/sh following the raise.

We assume the two wells in Liberia will target both the Apalis and Central Fan Area clusters. As a complete structure, we include 415 mmb for the Central Fan Area cluster (Block 9) and value it at A\$0.54/sh risked, A\$3.64/sh unrisks. The Apalis Cluster (straddling Block 8 & 9) includes 10 intervals which amount to 286 mmb, which we ascribe a risked value of A\$0.33/sh risked, A\$2.47/sh unrisks.

We believe it is possible that African Petroleum will drill the Alhamdulillah Structure on Block A1/A4 in Gambia later this year as it is now fully funded for up to six wells. We ascribe a value of A\$0.18/sh risked, A\$2.21/sh unrisks to the 560 mmb target.

We expect African Petroleum's exploration program in Liberia to be the main driver for the share price over the next 12 months. We also look to news flow from Ophir Energy, Anadarko and Chevron who are all drilling high impact wells in neighboring blocks as positive well results from any of the other deepwater players is expected to be positive for African Petroleum and help de-risk the basin as a whole. In a very short period of time, African Petroleum has transformed itself into the largest West African focused oil and gas company with acreage in Liberia, Gambia, Sierra Leone, Guinea, Senegal and Ghana. The additional funding will help accelerate activity as it is funded for up to six wells in West Africa and adequately positioned to further expand its presence in the region via various acreage applications.

African Petroleum's Net Asset Value

Net Asset Value Breakdown				
	MMBOE	US\$/BOE	US\$MM	A\$/sh
Production Assets	-	-	-	-
Cash/(Net Debt)			139.1	0.08
Undeveloped Assets	-	-	-	-
Other items incl G&A			(20.5)	(0.01)
Core NAV	-	\$ 0.00	119	A\$0.07
<i>Price to NAV (%)</i>				1297%
Option Proceeds			14.1	0.01
Risked Upside	588.6	11.61	6,832	4.00
Risked NAV	588.6	11.83	6,965	A\$4.08
<i>Price to Risked NAV (%)</i>				22%
			Current Stock Prices	A\$0.90
			2011 Risked	A\$4.08
			Unrisked	A\$63.78
Notes				
Reserves evaluated by ERC Equipoise Ltd as of Feb/2011.				
Long term Brent flat price is US\$100.00				
All asset values are NPV10 After Tax and in USD unless noted.				
Two years of G&A are deducted to ensure 'going concern' costs are captured.				

Source: African Petroleum, GMP Estimates



African Petroleum's Target Price

Target Price Calculation	
African Petroleum	A\$/sh
Production Assets	-
Cash/(Net Debt)	0.08
Undeveloped Assets	-
<u>Other Items incl G&A</u>	<u>(0.01)</u>
Core NAV	A\$ 0.07
Liberia - Block 8/9 (Apalis Cluster)	0.33
Liberia - Block 8/9 (Apalis Cluster) upside	0.36
Liberia - Block 9 Central Fan Cluster	0.54
Liberia - Block 9 Central Fan Cluster upside	0.40
Gambia - A1/A4 Alhamdulillah Structure	0.18
<u>Option Proceeds</u>	<u>0.01</u>
Sum of parts	A\$ 1.88
TARGET PRICE	A\$ 1.90
Share Price	A\$ 0.90
Expected Return	111%

Source: African Petroleum, GMP Estimates



African Petroleum's Risked Net Asset Value

African Petroleum Asset Breakdown													
Country	Property/Prospect	Gross Resource (mmboe)	Working Int. (%)	Costs (%)	Well Costs (US\$ mm)	Overall COS (%)	Spud (Year)	Value/BOE (US\$)	Net Risked Resources (mmboe)	Risked NAV (US\$ mm)	US\$/sh (FD)	Risked A\$/sh (FD)	Unrisked NAV (A\$/sh)
Producing Assets									0.0	0.0	0.00	0.0	0.0
Undeveloped assets									0.0	0.0	0.0	0.0	0.0
Exploration									0.0	0.0	0.0	0.0	0.0
Liberia - Block 8 (Horst Cluster)	APC8-1 Pg20-10	18.0	100%	100%	50.0	5%	2012	\$12.29	0.90	0.00	0.00	0.00	0.00
Liberia - Block 8 (Horst Cluster)	APC8-1 Horst UK90-70	37.0	100%	100%	0.0	15%	2012	\$12.29	5.55	68.23	0.04	0.04	0.30
Liberia - Block 8 (Horst Cluster)	APC8-1 UK60 Channel	46.0	100%	100%	0.0	8%	2012	\$12.29	3.68	45.24	0.03	0.03	0.37
Liberia - Block 8 (Horst Cluster)	APC8-1 Syn-rift	59.0	100%	100%	0.0	7%	2012	\$12.29	4.13	50.77	0.03	0.03	0.47
Liberia - Block 8 (Horst Cluster)	Upside	562.0	100%	100%	0.0	5%	2012	\$12.29	28.10	345.43	0.21	0.20	4.48
Liberia - Block 8 (8-2 North)	APC8-2 North Pg20-10	59.0	100%	100%	50.0	6%	2012	\$12.29	3.54	0.00	0.00	0.00	0.00
Liberia - Block 8 (8-2 North)	APC8-2 North UK70	24.0	100%	100%	0.0	13%	2012	\$12.29	3.12	38.35	0.02	0.02	0.19
Liberia - Block 8 (8-2 North)	APC8-2 North UK60	20.0	100%	100%	0.0	13%	2012	\$12.29	2.60	31.96	0.02	0.02	0.16
Liberia - Block 8 (8-2 North)	Upside	287.0	100%	100%	0.0	5%	2012	\$12.29	14.35	176.40	0.11	0.10	2.29
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 Pg20	4.0	100%	100%	50.0	5%	2011	\$13.52	0.20	0.00	0.00	0.00	0.00
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 Pg10	10.0	100%	100%	0.0	8%	2011	\$13.52	0.80	10.82	0.01	0.01	0.09
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 UK90	20.0	100%	100%	0.0	20%	2011	\$13.52	4.00	54.09	0.03	0.03	0.18
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 UK75	24.0	100%	100%	0.0	20%	2011	\$13.52	4.80	64.91	0.04	0.04	0.21
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 UK72	55.0	100%	100%	0.0	20%	2011	\$13.52	11.00	148.75	0.09	0.09	0.48
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 UK70	34.0	100%	100%	0.0	20%	2011	\$13.52	6.80	91.95	0.06	0.05	0.30
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 UK60	25.0	100%	100%	0.0	18%	2011	\$13.52	4.50	60.85	0.04	0.04	0.22
Liberia - Block 8/9 (Apalis Cluster)	APC_9_1 UK50	6.0	100%	100%	0.0	13%	2011	\$13.52	0.78	10.55	0.01	0.01	0.05
Liberia - Block 8/9 (Apalis Cluster)	APC-9_1 Synrift MCU	45.0	100%	100%	0.0	7%	2011	\$13.52	3.15	42.60	0.03	0.02	0.39
Liberia - Block 8/9 (Apalis Cluster)	APC9-2 UK60-70	63.0	100%	100%	0.0	9%	2011	\$13.52	5.67	76.67	0.05	0.04	0.55
Liberia - Block 8/9 (Apalis Cluster)	Upside	899.0	100%	100%	0.0	5%	2011	\$13.52	44.95	607.83	0.37	0.36	7.89
Liberia - Block 9	Central Fan Cluster	165.0	100%	100%	50.0	16%	2011	\$13.52	26.40	314.99	0.19	0.18	1.45
Liberia - Block 9	Central Fan Cluster	250.0	100%	100%	0.0	18%	2011	\$13.52	45.00	608.50	0.37	0.36	2.19
Liberia - Block 9	Central Fan Cluster Upside	1018.0	100%	100%	0.0	5%	2011	\$13.52	50.90	688.29	0.42	0.40	8.93
Liberia - Block 9	Western Fan Cluster	125.0	100%	100%	50.0	11%	2012	\$12.29	13.75	124.53	0.08	0.07	1.00
Liberia - Block 9	Western Fan Cluster	310.0	100%	100%	0.0	15%	2012	\$12.29	46.50	571.63	0.35	0.33	2.47
Liberia - Block 9	Western Fan Cluster Upside	1102.0	100%	100%	0.0	5%	2012	\$12.29	55.10	677.35	0.42	0.40	8.79
Liberia - Block 8/9 (South Fan Lead)	Turonian South TS-1	310.0	100%	100%	50.0	15%	2012	\$12.29	46.50	529.13	0.33	0.31	2.47
Gambia - A1/A4	Alhamdullillah Structure	560.0	60.0%	80%	50.0	10%	2012	\$10.16	33.60	305.36	0.19	0.18	2.21
Gambia - A1/A4	Alhamdullillah Structure Upside	440.0	60.0%	80%	0.0	5%	2012	\$10.16	13.20	134.11	0.08	0.08	1.74
Gambia - A1/A4	Additional Prospects	3500.0	60.0%	80%	150.0	5%	2012	\$10.16	105.00	952.75	0.59	0.56	13.84
Sierra Leone	SL-03												
Gross Resources Total									589	6,832	4.21	4.00	63.71
Fully Diluted Shares Outstanding (mm)		1,622.69											
AUD:USD Exchange Rate		0.95											
CAD:USD Exchange Rate		0.97											
Notes													
Estimates of Reserves and Resources are provided by management and GMP securities													
Overall COS = Chance of success after taking all risks into consideration including geological risk, political risk, etc													
Value/BOE is calculated from a field model in the specific fiscal regime of the host country after government take, all capex and costs have been removed, and the time value of money is applied													
Risked NAV is equivalent to Expected Monetary Value (EMV). Risked NAV = (Reward*C.o.S.) - [Capital at Risk*(1-C.o.S.)]													
Fully diluted shares outstanding = shares at period end + options + all dilutive securities													
Cost % = the difference (if any) in costs paid versus working interest. Of relevance when farm-outs or farm-ins occur													

Source: African Petroleum, GMP Estimates



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