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AUSTRALIAN FINANCIAL SERVICE
LICENCE 247431

BURRELL
stockbroking & superannuation

TELEPHONE: (07) 3006 7200
FACSIMILE: (07) 3839 6964
TOLL FREE: 1300 4 BURRELL

Internet: www.burrell.com.au
Email: info@burrell.com.au

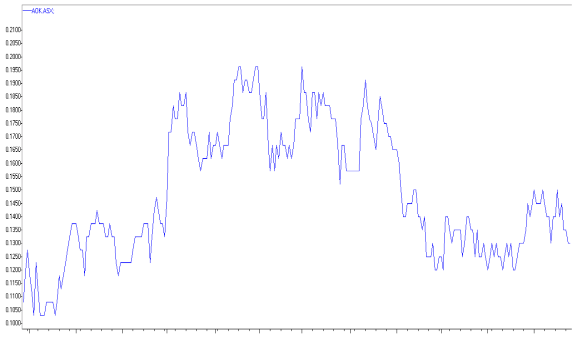
AUSTEX OIL (AOK)
(Impressive quarterly – set for growth)

24th August 2010

Recommendation:	BUY
Industry	Energy
ASX code:	AOK
Valuation:	**$0.32**
Current price:	$0.14
Upside to valuation:	129%

Key Statistics:	
Ordinary shares (m)	203.3
Market Cap (m)	$28.46
Debt (m)	Nil
Cash (m)	$4.0
Total reserves (2P) mboe	7.4
52 week range:	$0.10-$0.21

AOK 12 month share price performance



Source: IRESS

Robert Boyd (61-7) 3006 7233
Senior Analyst
rboyd@burrell.com.au

Event:

- Austex Oil (AOK) is an Australian listed oil and gas producer, focused on reworking and developing oil and gas leases in the USA. The operating focus is the US states of Oklahoma and Kansas.

- Recent positive discoveries from the Clark #1 & Clarke #5 in Kansas maintain our bright outlook for AOK and reinforce their position as being on track as a financially self sufficient oil and gas producer

Background:

- Austex Oil Ltd (ASX:AOK) was listed on the Australian Securities Exchange (ASX) in January 2008 raising A$20 million. The primary focus was initially re-working oil and gas leases in the USA, in particular in Oklahoma and Kansas. Since listing the company has expanded its lease interests from 1,000 acres to ~70,000 acres

- Oil and Gas leases in Kansas are held in partnership with Castle Resources Inc., the Kansas operator of the Radial Jet Enhancement Technology.

- At the present time AOK is producing oil and gas from leases in both Oklahoma and Kansas. International Energy Corporation (IEC), a wholly owned subsidiary of Austex, holds a 10 year marketing agreement for the State of Oklahoma for the patented Radial Jet Enhancement Technology.

Investment opinion:

- Austex offers investors the opportunity to own a well managed, debt-free business, with excellent growth potential in the full year 2011. The June quarterly demonstrated positive sales revenue, net of royalties and operating costs. The progressive ramp up of oil and gas production from Oklahoma will underpin the growth opportunities in Kansas and the pending acquisition in Kay County.

- Austex are incrementally building a cash flow business. Their experienced technical team is delivering impressive exploration results and they appear on track to increase production to approximately 1,000 bopd in the next 12 months. With a strong cash position and no debt, we have a positive outlook for AOK. Existing cash flows underpin the value proposition, while potential future discoveries garnish this investment with significant potential.

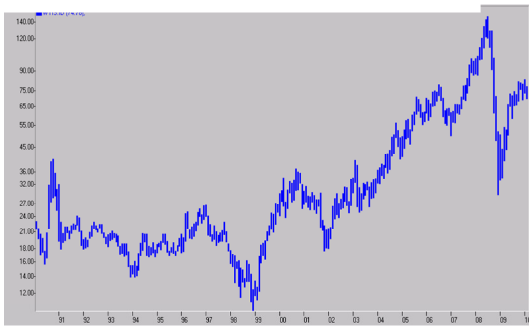
- **We maintain our BUY recommendation and have increased our DCF valuation to $0.32**

Profit and loss summary

Year end March (all figures A$ million)	2010	2011 (f)	2012 (f)
Revenue	1.5	6.2	10.2
EBITDA	**-3.0**	**3.1**	**7.0**
Depreciation and Amortisation	-0.6	-0.8	-1.2
EBIT	**-3.6**	**2.3**	**5.8**
Interest income (expense)	0.2	0.2	0.2
Pre-Tax Profit	**-3.4**	**2.5**	**6.0**
Tax Expense	0.0	0.0	-0.9
Net Profit (Loss)	**-3.4**	**2.5**	**5.1**
Abnormals	0.0	0.0	0.0

Cashflow Summary	**2010**	**2011 (f)**	**2012 (f)**
EBITDA	**-3.0**	**3.1**	**7.0**
Financial Income	0.2	0.2	0.2
Other operating items	0.2	0.1	0.2
Tax expense	0.0	0.0	-0.9
Changes in working capital	0.8	3.6	5.4
Operating cashflow	**-1.8**	**7.0**	**11.9**
Capex and investing activities	0.0	-4.0	-5.0
Net cashflows	**-1.8**	**3.0**	**6.9**
Acquisitions and Disposals	-5.1	-2.0	-2.5
Other investing items	0.0	0.0	0.0
Dividends	0.0	0.0	0.0
Net increase (decrease) in cash	**-6.9**	**1.0**	**4.4**

20 year crude oil spot price history



Source: IRESS

- For the past 12 months the crude oil price has traded around $70-$80 US per barrel. Even with an outlook for tepid US and European economic growth the crude price remains well above the levels from the GFC. We believe oil price risks are to the upside as economic demand gathers pace in 2011.
- AOK has strong valuation support from its current reserves showing 7.4 million barrels of 2P reserves. Table 1 highlights the inherent value in AOK purely from its oil and gas reserves. A new reserve report has been commissioned which will account for some of the more recent discoveries and is expected to be finalized in September 2010.

Table 1: Summary of AOK Oil and Gas reserves as at July 2010

Classification	**Oil (BO)**	**GAS (mcf)**	**BOE (BOE)**
1P (Proven)	**5,596,580**	**111,120**	**5,607,692**
2P (Proven + Probable)	**7,388,682**	**276,833**	**7,416,365**
3P (Proven + Probable + Possible)	**13,657,538**	**4,313,935**	**14,088,930**

Source: AOK

AOK - EV/2P share price sensitivity matrix

Enterprise value @ $0.14 ($million)			28.5
Share on Issue (m)			203.3
Total 2P reserves (mboe)			7.4
EV/2P	$3.85	$6.00	$9.00
Share Price	**$0.14**	**$0.22**	**$0.33**

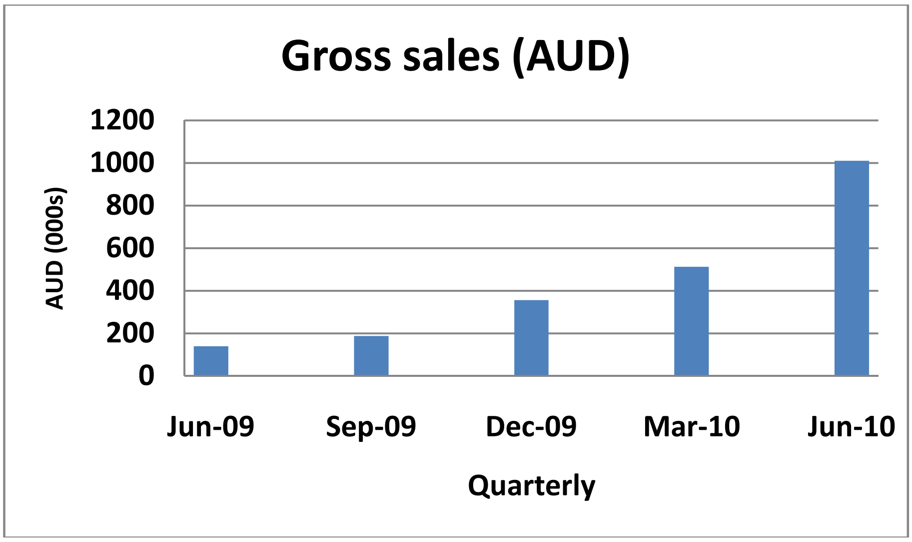
Source: IRESS and Burrell Research

A standard metric used to determine a base valuation for oil and gas stocks is to assess how much the investor is paying per barrel of oil (reasonable probability of being produced) in the ground. Based on the current 2P reserve assessment, investors are paying $3.85 per barrel of oil. At the current oil price of approximately $US75 per barrel, and costs of production of <$10, this is not demanding.

More acreage – Kay County

- Austex have entered into a conditional agreement to acquire 907 acres in Kay County, near the town of Tonkawa, Oklahoma. If the acquisition proceeds (Sept 30th 2010) AOK will hold a 100% working interest and an 81.25% Net Revenue Interest.
- At face value, this appears a positive acquisition for Austex. Kay Country is an area of aggressive development of oil projects by a number of operators, and there is reason to believe the ground AOK have acquired will be prospective. Additionally the acquisition price includes useful infrastructure and is to be funded from existing capital.
- We expect Austex can develop this prospect with existing staff and contractor relationships and assuming a successful deal completion will begin some well recompletions in the 4th quarter of calendar 2010.

A Strong June Quarterly

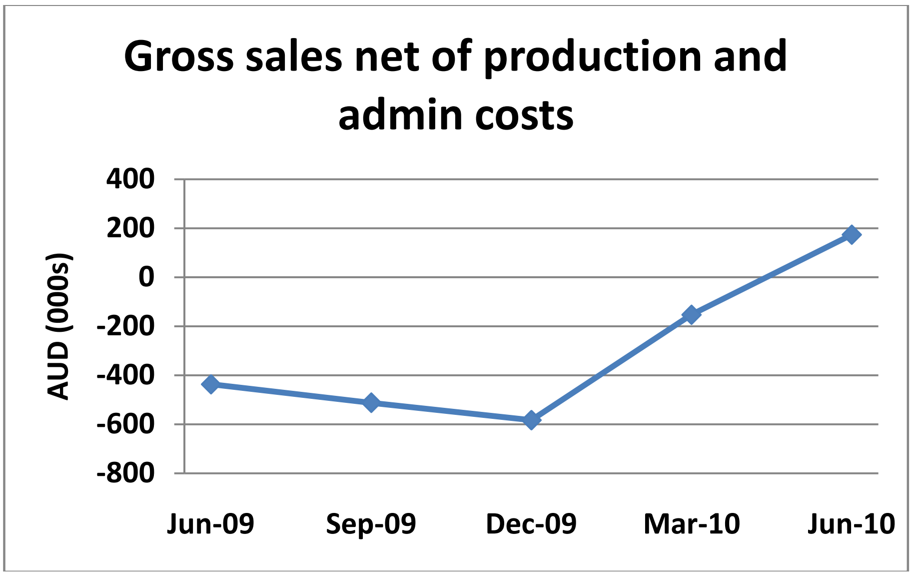


Source: IRESS and Burrell Research

Gross sales (net of Royalties) exceeded $1m for the June quarter 2010.

Over the past 12 months Austex have demonstrated their ability to convert a number of successful discoveries into production and gross revenue. They achieved a 97% increase in revenue, net of royalties from the March quarter to the June quarter 2010.

While we expect this growth trajectory to plateau somewhat in the September quarter, there is clear forward momentum in revenue.



Source: IRESS and Burrell Research

Austex achieved positive gross sales net of production and administration costs for the June quarter 2010. This is the first time they have achieved such a milestone in their listed history.

In essence, Austex were operationally cash flow positive and as further successful wells are brought into production we expect this trend to continue.

This achievement has been a stated management goal, and cash flow positive operations are a less common trait for micro cap stocks.

Oklahoma production:

AOK has three producing leases in Oklahoma, all within close proximity to the city of Tulsa. AOK's primary focus has been building a sustainable and meaningful cash flow from the Lancaster lease allowing the company to acquire and develop other ground amidst a background of reliable cash flow.

As is evident from table 2, drilling has been particularly successful on the Lancaster lease and the scope for additional infill drilling remains significant.

Source: AOK

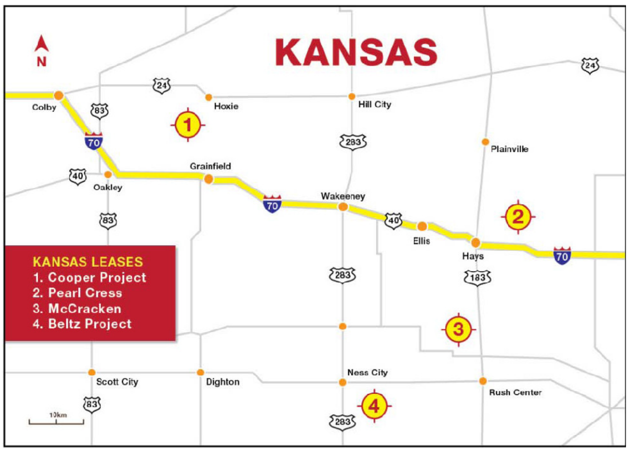
Table 2: Lancaster Lease Group

Well Name	Formation	Type	Status
Mayo Moore # 1	Red Fork	Oil / Gas	Producing
Mayo Moore # 2	Red Fork	Oil / Gas	Producing
Mayo Moore # 3	Red Fork	Injector	Operating
Mayo Moore # 4	Red Fork	Oil / Gas	Producing
Mayo Moore # 5	Red Fork	Oil / Gas	Producing
Mayo Moore # 6	Red Fork	Oil / Gas	Producing
Mayo Moore # 7	Big Lime	Oil / Gas	Producing
Mayo Moore # 8	Red Fork	Injector	Under completion
Baggett #1-33	Red Fork	Oil	Producing
Baggett #2-33	Red Fork	Oil / Gas	Producing
Baggett #3-33	Wilcox	Oil	Producing
Baggett #4-33	Red Fork	Oil / Gas	Drilling
Lancaster #5A	Red Fork	Oil / Gas	Under Completion
Hollie #1	Red Fork		Permitted
Hollie #2	Red Fork	Oil / Gas	Producing

Kansas production:

AOK operates in conjunction with Castle Resources Inc and geologist and owner Jerry Green on a number of projects in Kansas. Current production is approximately 100 bopd net to AOK. Since listing AOK have expanded their footprint beyond Oklahoma acquiring circa 67,000 acres in Kansas targeting conventional oil and gas.

Most work has been focused on the Cooper Lease with two successful wells to date. The Clarke #1 well produced at over 60 bopd in the June quarter while the Clark #5 well was drilled in June 2010 and intersected hydrocarbons in the Toronto and Lansing-Kansas City formations. A water disposal well was also completed in the June quarter 2010. With a number of additional prospects identified in the same region the Cooper Lease has the potential to deliver a number of 200 boepd wells as targets are drilled through to December 2010.



Source: AOK

History of oil and gas in Oklahoma & Kansas

- Both Oklahoma and Kansas have a rich history of oil and gas production. Oil seeps were recognised in Oklahoma well before the arrival of European settlers with the first international oil find occurring in 1889.[1] In the early 1900s Oklahoma was the largest oil producing entity in the world. Presently the business structural conditions are very favourable to small to medium sized companies that can apply economies of scale to multiple oil and gas lease arrangements.

- Mid continent USA is a politically stable environment to conduct business. There are multiple oil and gas leases available as historically a number of these leases have been held privately or as a side interest to agriculture.

Where does the opportunity lie?

- Austex have progressed substantially over the past 12 months. Building upon a steep learning curve in their early listed history, as at August 2010 the company has progressed from a small lease position to circa 70,000 acres with average production for the June quarter 2010 over 200 boe per day.

- The company is incrementally building a cash flow business which even now has a marketable value. As they progress further down this path, of production development and further exploration, the value of both reserves and future cash flows should be recognized in the market.

- Austex have a 12 month production target of circa 1,000 boe per day which suggests a pivotal year ahead for the company. It is probable there will be a level of share price correlation with production revenue, highlighting the potential future upside.

Valuation:

- Not withstanding the merit of valuing AOK based on its 2P reserves, we have used a DCF methodology and derive a valuation of $0.32.

- Some of the key assumptions involved in deriving this valuation include a WACC of 18.0%, comprised of a beta of 1.15, a risk free rate of 6.50%, an expected return on the market (Rm) of 9% and a sector risk premium of 8%.

- We assume a long-term mean oil price of US $75 per barrel and an AUD/USD of $0.85.

[1] Oklahoma Oil: Past Present and Future, Oklahoma Geological Survey

Burrell Stockbroking – Specialist Research and Advisory

Robert Boyd – Senior Analyst: rboyd@burrell.com.au
Peter Wright – Senior Resource Analyst: pwright@burrell.com.au
Bruce McLeary – Senior Analyst: bmcleary@burrell.com.au
Michael Mayrseidl – Property Analyst: mmayrseidl@burrell.com.au

Burrell Stockbroking Branches

Head Office: Brisbane

Level 4
24 Little Edward Street
Spring Hill Qld 4000
Tel: (07) 3006 7200
www.burrell.com.au

Bundaberg
76 Takalvan Street
Bundaberg QLD 4670
Tel: (07) 4153 4499

Ipswich
106 Brisbane Street
Ipswich QLD 4305
Tel: (07) 3884 5700

Gold Coast
6 Short Street
Southport QLD 4215
Tel: (07) 5583 7800

Toowoomba
6 Bell Street
Toowoomba QLD 4350
Tel: (07) 4699 4555

Recommendation Structure
The recommendation system rates stocks on a 12 month, absolute basis based on the total return (capital and dividends). BUY denotes an expectation of 30% or more total return; ADD within the range of 15 and 30%; NEUTRAL within the range of 0 and 15%; REDUCE within the range of 0 and -15%; SELL -15% or less. ACCEPT OFFER relates to a situation where there is a public offer for shares and our view is to accept that offer.

Analyst certification and disclosure of interest
The analyst certifies that the views expressed in this research accurately reflect their personal views about the subject securities.