25th August 2010

AUSTRALIAN EQUITY RESEARCH

AUSTEX OIL LIMITED - UPDATE

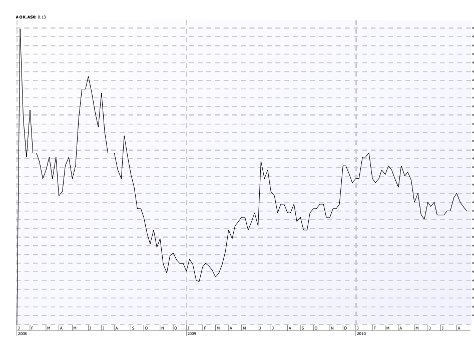
Introduction

AusTex Oil (AOK) is an Australian based company engaged in the exploration and development of oil leases in Oklahoma and Kansas in the US. Low risk development of the Lancaster and Sweet Leases in Oklahoma provide the company with a solid production base; while the Cooper project in Kansas is an early stage discovery that could provide substantial upside. The yet to be completed Tonkawa East acquisition in Oklahoma, also promises substantial upside through the application of new horizontal well technology. With operational cashflows strengthening and attractive large scale but relatively low risk targets we believe AOK is a low-risk oil junior with a clear growth path (aspirational target of 1,000 BOEPD), company changing exploration and operating in an attractive region. We rate AOK as a Spec Buy with a 33c price target.

Recommendation	
Industry	Energy
12 month rating	Spec Buy
12 month price target	$0.33
Forecast price appreciation	128%
Price (AOK)	$0.145

Trading Data (AUD)	
52 wk range	$0.06 - $0.22
Market cap	$28.4m
Shares	203m
Cash/Liquids	$5.4m
Debt	Nil
Enterprise value	$23.0m

Performance (A$)



IRESS

Significant Events Since Last Report

- Accelerated development of the Lancaster Lease has seen the number of producing wells increase to 10, with 2 injectors and another 2 under completion as at end July. AOK are targeting 15 wells by the end of September and full development by the end of the next fiscal year which should stabilize production at 20-30 BOEPD per well.
- In Kansas, Clarke # 1 is producing, Clarke # 5 intersected oil but mechanical problems have delayed completion and production and Clarke # 7 is ready to go.
- Letter of Intent to acquire Tonkawa East project, nearby wells producing 300-500 BOEPD.
- June quarter cashflow report showed 100% revenue growth to $1.3m.

Kansas – Exploration Delivering

AOK received permission to dispose of water from Clarke # 1 and has been producing from the Lansing-Kansas Formation (photos below show Clarke pump and tank battery). Although Clarke # 1 intersected two producing formations, the Lansing-Kansas City (with initial production at 230 BOEPD) and the Toronto Formation (with initial production at 250 BOEPD), production is currently only from the Lansing-Kansas City Formation as there were issues with water compatibility between the formations.

Clarke # 5 has also intersected oil and should be brought into production shortly. Clarke # 7 is ready for drilling. AOK plans to drill one Clarke well per quarter.

Being a virgin discovery, the Kansas project is at early stages with the company still working to define the structures. Although AOK will produce from these wells, the optimal production rate will not be achieved for some time.

Clarke # 1 is now a producer:

Source: AOK

Map showing location of Cooper project:

Source: AOK

AOK's Kansas projects are in JV with private company Castle Resources, which is the operator. AOK holds a 53% working interest and a 43% net revenue interest.

The Kansas project is exciting for AOK as much of it is virgin territory and the flow rates tend to be higher than its Oklahoma wells. AOK has identified 20+ targets on the Cooper Lease following the structure. It would not take a high success rate to have a substantial impact on valuation.

Oklahoma – Low Risk Development Play

AOK anticipates achieving 18 wells at Lancaster during the December quarter; however some work will be diverted to the new acquisition, once completed. Although ten wells are producing now, the optimal rates won't be achieved until the lease is fully developed including water injectors to maintain pressure. AOK is targeting average well production of 20-30 BOEPD, which would give >300 BOEPD assuming some wells are injectors. Once fully developed with water injectors, the wells should be relatively long life 15-20 years with production decline of around 10%, similar to other Red Fork formation producers.

After Lancaster, AOK will start developing Sweet Lease, which is a similar low risk reworking to Lancaster.

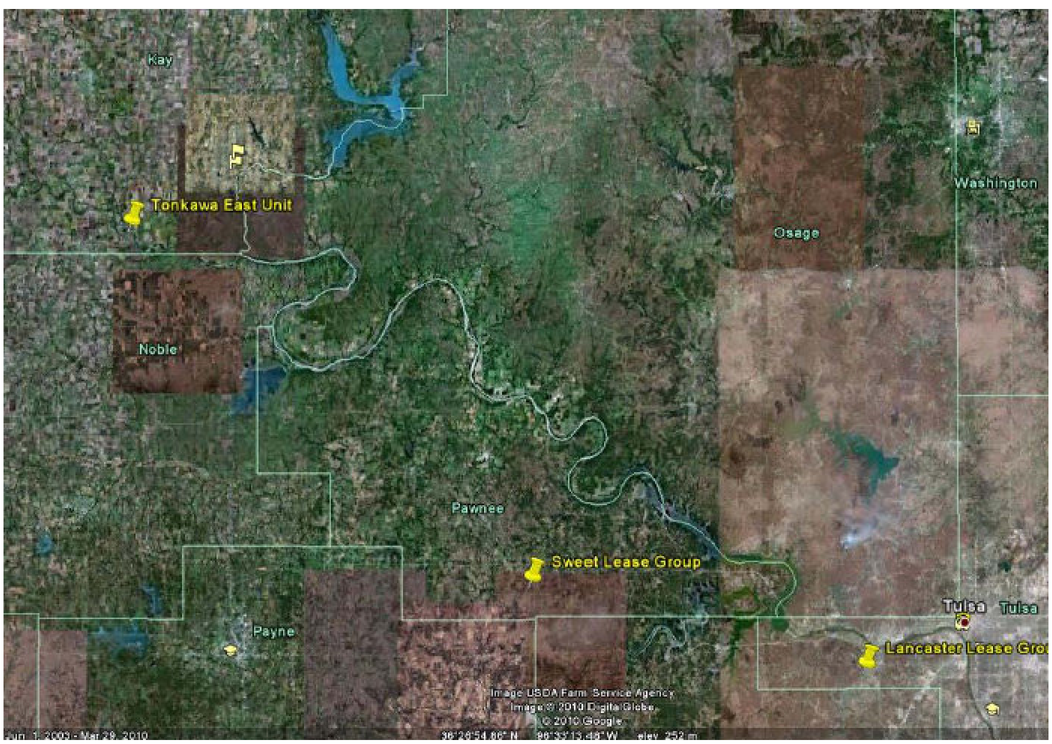
Tonkawa East

Tonkawa East is an exciting new type of project that is looking to access known reservoirs with new technology that can improve the economics. AOK is following the model pioneered by NYSE listed Range Resources which is achieving production of 300-500 BOEPD through horizontal well technology. AOK will look to re-work existing wells but the key upside is horizontal well technology that increases yield from vertically fractured formations.

The Tonkawa East deal is yet to complete and as yet AOK hasn't disclosed the cost or conditions. However, AOK has stated it would have an NRI of 81.25% and expects the deal completed by the end of September.

AOK may consider drilling a vertical well before the end of the year to enhance the science, given the success of neighboring plays. This project will be three-pronged with reworks, recompletions and new drilling while seeking to obtain other acreage in the area.

The map below shows Tonkawa East's location relative to AOK's other Oklahoma leases:



Source: AOK

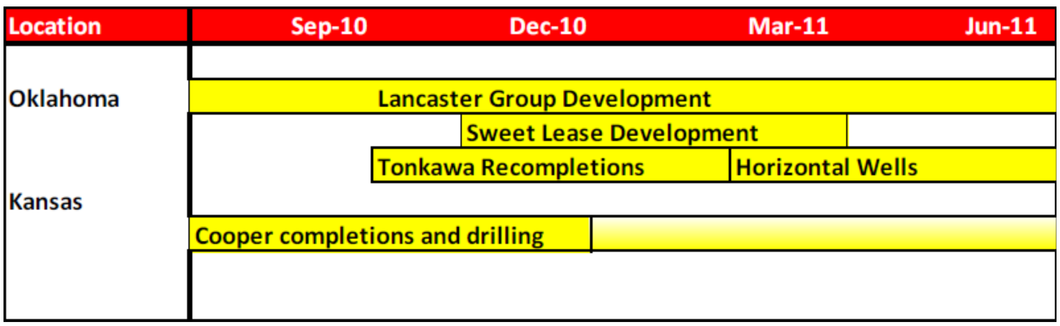
Upcoming Developments

Reserve update to include new wells

AOK has commissioned an independent report to update the reserves – the last update was in March 2009 with a 2P oil reserve of 7.4 MBOE. Since then AOK has discovered significant oil intersections at the Cooper Project, and developed the Lancaster project. Further reserves could be added with the acquisition of Tonkawa East.

Rapid development continues

The timeline below shows AOK's plans for its leases.

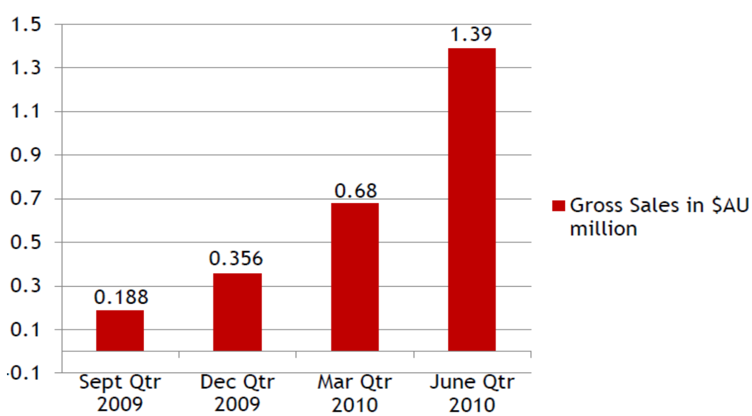


Cashflows – Strong Revenue Growth Continues

Revenues received during the June quarter increased to $1,390,000 from $680,000 in the March quarter, continuing the positive growth trend (see chart below). Costs rose in line with increased production but administrative and financing costs also rose due to end-of-year accounting and the fees for the raising. We would expect these corporate costs to reduce next quarter.

AOK finished the quarter with $5.4m in cash. During the June quarter the producing wells generated operational free cash flow of $174k. Development spend of $1.013m was the highest it has been and should see the positive growth trend continue. This should enable self-funding of growth although AOK may look to other sources of funding to accelerate development.

AOK's quarterly revenues are growing strongly:



Current and Future Production

We believe that with the latest drilling AOK has demonstrated strong growth potential. On current discoveries we believe that AOK is approaching over 400 BOEPD. This is shown in the table below.

Project	**Current Production**	**Near Term Estimate**
Lancaster	8 wells x 15 BOEPD = 120 BOEPD	14 wells x 25 BOEPD = 350 BOEPD
Sweet	2 wells held by production	Development after Lancaster
Clarke # 1	50 BOEPD	80 BOEPD with mechanical improvements
Clarke # 5	Under completion	Approximately 80 BOEPD
Clarke # 7	Drilling	Approximately 80 BOEPD
Tonkawa East		Approximately 300 BOEPD
Totals	170 BOEPD	**Relatively certain 430 BOEPD with Lancaster and Clarke #1** Potentially 890 BOEPD if currently planned wells come in

Valuation and Recommendation – Upgrade Target to $0.33

Current production is around 150 BOEPD although this may have risen with the development done during the June quarter. This level covers production and admin costs and leaves a small amount of cashflow for development. However AOK will likely use cash reserves and outside sources to rapidly develop in accord with the timeline above. With this schedule AOK **has demonstrated near term growth potential of over 400 BOEPD which should fund a high rate of self sustaining growth.**

We base our valuation on a 12 month target production of 600 BOEPD, which assumes full development of the Lancaster Lease, development of the Sweet Lease, and some production from Clarke. We also acknowledge the large upside that could come from the Tonkawa East lease, which could see AOK demonstrate potential for ~900 BOEPD by year end.

Our price target of $0.33 is a slight reduction to the previous target of $0.35 due to the rights issue and lower spot oil prices. The target is derived from the average of the 2 EV/EBITDA scenarios below.

Valuing Cashflows – What is 600 BOEPD Worth?

We see that AOK could quite conceivably reach production of over 600 BOEPD within a year. At this point what would the company be worth?

The tables below show the EV/EBITDA and Free Cash Flows of AOK at different production rates and oil prices:

1. 170 BOEPD which is roughly what AOK produced in the June quarter
2. 200 BOEPD which is where they could be currently
3. 430 BOEPD which appears achievable in the short term
4. 600 BOEPD which we believe is a reasonable target for AOK within the next twelve months considering planned exploration wells and depletion of existing wells

The table uses company guidance of $200,000/month for general and administrative costs and US$20/bbl for lifting and royalty costs. The Enterprise Value is calculated using the share price at time of writing which was $0.145ps.

Firstly, assuming an oil price of US$70/bbl and AUD of 90c…

Barrels of Oil Equivalent per day	170	200	430	600
Revenue ($m)	4.8	5.7	12.2	17.0
G&A ($m)	2.4	2.4	2.4	2.4
Lifting and Royalty cost ($m)	1.4	1.6	3.5	4.7
Operating Cashflow ($m)	1.0	1.7	6.3	9.8
Development Cost ($m, at $400k/month	4.8	4.8	4.8	4.8
Free Cash Flow ($m)	-3.8	-3.1	1.5	5.0
EV/EBITDA	22.0	13.9	3.6	2.4

Secondly using spot oil of US$75/bbl and AUD of 90c…

Barrels of Oil Equivalent per day	170	200	400	800
Revenue ($m)	5.2	6.1	13.1	18.3
G&A ($m)	2.4	2.4	2.4	2.4
Lifting and Royalty cost ($m)	1.4	1.6	3.5	4.9
Operating Cashflow ($m)	1.4	2.1	7.2	11
Development Cost ($m, at $400k/month	4.8	4.8	4.8	4.8
Free Cash Flow ($m)	-3.4	-2.7	2.4	6.2
EV/EBITDA	16.5	11.2	3.2	2.1

Putting AOK on an EV/EBITDA multiple of 6x, given it is a oil junior with strong self sustaining growth, **12 month target of $0.31 for the $70/bbl oil price scenario, and $0.35 for the $75/bbl scenario.**

Risks

- AOK's valuation and cashflows are subject to the volatility of the oil and AUD price.
- AOK's growth relies on continued exploration success which is not guaranteed.
- Regulations affecting the business could change, although the on-shore US is a relatively stable regime.
- The usual operational and safety risks associated with any extractive industry.

Contacts

Tony Gordon +61 2 8252 5577

Kristian Blaszczynski +61 2 8252 5575

Ratings

BUY – anticipated stock return is greater than 10%

SELL – anticipated stock return is less than -10%

HOLD – anticipated stock return is between -10% and +10%

SPECULATIVE – high risk with stock price likely to fluctuate by 50% or more

---

Disclosure of interest
HPW Parties may receive or may have received fees, commissions and brokerage by acting as corporate adviser or agent for companies described in this document, and may hold directorships or other offices with such companies. HPW Parties may hold an interest in securities or financial products described in this document, may benefit from an increase in the price or value of them, and may effect or participate in transactions which are inconsistent with any statement made in this document.

Intended use of this Document
This report is intended for clients of Hanuman Private wealth ONLY and any recommendation or comments made need to be considered in the context of your investment strategy. This document is not intended to be used as a sales document but as information for Hanuman Private Wealth staff and clients.

Disclaimer
The information contained in this document is general information only and is not financial or investment advice, and does not take into account your specific financial situation, particular needs and investment objectives. This document has been prepared from sources which Hanuman Investments Pty Ltd, trading as Hanuman Private Wealth ("HPW") believes to be reliable, but none of HPW, its directors, employees and associates (HPW Parties) give or make any representation or warranty that any such information is accurate, complete, reliable or up-to-date, and Hanumans disclaims all liability for loss or damage, direct or indirect, suffered by any person arising from any use of or reliance on such information. HPW recommends that you consult your financial adviser before making any financial or investment decision. HPW does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect any of the information contained in this document.

Hanuman Private Wealth is the trading name of Hanuman Investments Pty Ltd (ABN 33 120 258 540, AFSL No. 313416).

Hanuman Investments Pty Limited trading as Hanuman Private Wealth ABN 33 120 258 540 I AFSL No. 313 416
Street Address Level 9, 65 York Street, Sydney NSW 2000
Mailing Address GPO Box 7088, Sydney NSW 2001
Phone (02) 8252 55 88 I Fax (02) 8252 5599 I Email service@hanumans.com.au
ww.hanumans.com.au