

4 Jun 2013

EMPIRE ENERGY GROUP LIMITED

Undervalued on Production

Empire Energy Group Limited ("Empire", "EEG", "Company") continues to produce profitable oil and gas, generating field EBITDAX for 1Q13 of US\$4.4m (group EBITDAX was US\$2.5m) on gross production of 67,567 barrels of oil and 603.9 mmcf of gas.

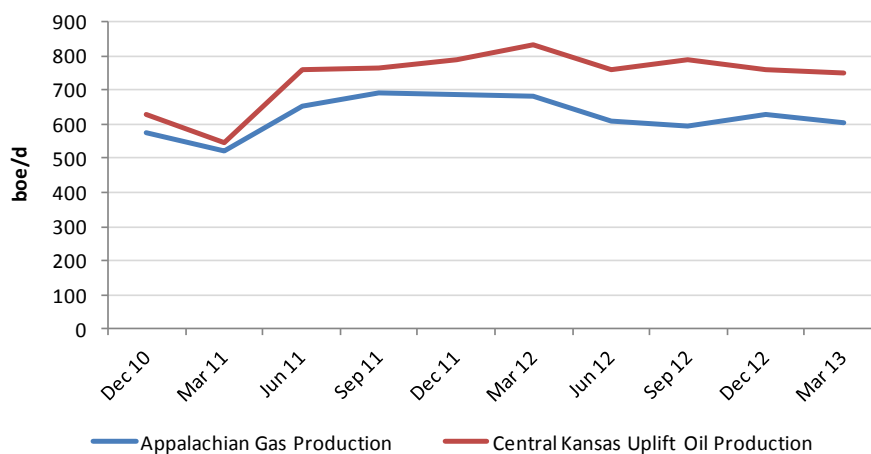
Cash on hand was US\$5.7m and debt was US\$47.8m (net debt of US\$42.1m).

Production steady at both assets

Production was steady (minimal decline) at both the Central Kansas Uplift and the Appalachian Basin. The minimal decline demonstrates the consistency of production available from the assets.

CAPEX for 1Q13 was just \$0.2m in the Central Kansas Uplift and \$0.1m in the Appalachian Basin.

Fig. 1: Production history



Source: Hartleys Research Estimates

Progress being made in the McArthur Basin

The Company continues to progress Native Title discussions and exploration planning over its 14.6 million acres in the McArthur Basin. Native Title approval for EPA 184 is expected to be complete by mid June 2013. Also, various other approvals have been received and plans advanced for seismic and geological studies across individual permits. This is an exciting value driver for Empire but we don't believe the market will respond to progress until well planning is underway.

Speculative Buy – low risk producer with exploration upside

We value Empire's combined production assets at \$92m but with US\$40m in net debt we see restrained upside in these assets. We believe the upside in Empire's shares will come from progress made in the unconventional assets. There are question marks surrounding the timing of when these assets can be better explored but we are already seeing progress made in the McArthur Basin. We maintain our Speculative Buy recommendation with a price target \$0.23.

Share Price:	\$0.100
12mth price target:	\$0.23

Brief Business Description:

Oil and gas production in the US with large unconventional upside

Hartleys Brief Investment Conclusion

Production provides a good base with upside to come from unconventional potential

Chairman & CEO:

B W McLeod

Company Address:

Level 7, Macquarie St
Sydney, NSW, 2000

Valuation:	\$0.452
Issued Capital:	304.9m
- fully diluted	304.9m
Market Cap:	\$33.5m
- fully diluted	\$30.5m
Net Cash (31 Mar '13):	-\$40.8m
EV	\$74.3m

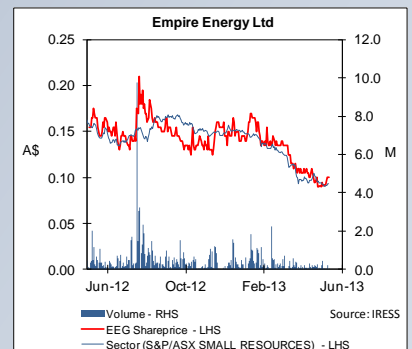
Valuation Summary

	\$m	\$/share
Appalachian Basin	\$41.8	\$0.137
Mid Continental USA	\$50.7	\$0.166
US Shale	\$65.3	\$0.214
Aus Shale	\$29.0	\$0.095
Net (Debt)/Cash	-\$40.8	-\$0.134
Corporate Overheads	-\$14.2	-\$0.046
Hedge	\$6.0	\$0.020
Total	\$137.9	\$0.452

Av daily turnover	\$0.1m
Yearly volume (shares)	115.2m

2P Reserve (mmboe)	11.28
EV/2P Reserve (\$/boe)	\$6.59

Source: Hartleys Research



Authors:

Peter Gray
Oil and Gas Analyst
Ph: +61 8 9268 2837
E: peter_gray@hartleys.com.au

KEY ASSUMPTIONS / RISKS

Our valuation methodology is based on a combination of DCF, risked value of resource potential using notional in ground valuation and conservative estimates for probability of success, and value per acre based on past transactions. This methodology results in value of 45cps.

Our price target is a discount to our valuation which considers the value of production and additional risked values of exploration assets. In EEG's case, this results in a price target of 23cps.

Fig. 1: Key assumptions and risks for valuation

Assumption	Risk of not realising assumption	Downside risk to valuation if assumption is incorrect	Comment
2P oil reserves are converted to 1P	Low	Moderate-High	We have included 1.3mmbbls of 2P reserves in our model. The development of these reserves will depend on improving recoveries, drilling more wells or working over existing wells. As such, there is no guarantee that these 2P reserves will be converted to 1P, however, we consider it likely because Empire has a great knowledge of the fields and the production history is very long.
Credit default risk	Low	High	If Empire's lender chose not to roll over the debt facility post February 2016, Empire would need to raise an estimated US\$25m either through the sale of assets, a capital raise or possibly alternative debt financing. A capital raise or an asset sale would be detrimental to the current share price.
Production risk	Low	Low-Moderate	Oil and gas production is inherently unpredictable but given the type and age of Empire's fields and the knowledge gained by Empire, we consider production risk to very low.
Long run oil price of \$90 and a long run gas price of \$5	Moderate	Moderate	Future commodity prices are influenced by many factors and are impossible to predict accurately. We base our long run commodity prices on consensus data. In addition, Empire implements a long term hedging policy.
Funding risk	Low	Low-Moderate	We do not believe that Empire has sufficient existing cash facilities (\$5.7m) or free cash flow to fund large scale development of its exploration assets. As such, it is likely that the Company will need to farmout a portion of its acreage or undertake a capital raising should it choose to develop and explore its shale acreage.
Exploration valuation risk	Low	Low-Moderate	We have estimate the value of Empire's exploration assets based on comparable metrics. No two assets are truly comparable and, as such, there is an inherent risk in a comparable valuation.

Conclusion

We believe the key risk to our valuation is exploration risk.

Source: Hartleys

HARTLEYS CORPORATE DIRECTORY

Research

Trent Barnett	Head of Research	+61 8 9268 3052
Mike Millikan	Resources Analyst	+61 8 9268 2805
Paul Cartwright	Oil & Gas Analyst	+61 8 9268 2826
Peter Gray	Oil & Gas Analyst	+61 8 9268 2837
Janine Bell	Research Assistant	+61 8 9268 2831

Corporate Finance

Grey Egerton-Warburton	Head of Corp Fin.	+61 8 9268 2851
Richard Simpson	Director –Corp. Fin.	+61 8 9268 2824
Paul Fryer	Director–Corp. Fin.	+61 8 9268 2819
Dale Bryan	Director–Corp. Fin.	+61 8 9268 2829
Ben Wale	Snr Mgr–Corp. Fin.	+61 8 9268 3055
Ben Crossing	Snr Mgr – Corp.Fin.	+61 8 9268 3047
Stephen Kite	Snr Mgr- Corp. Fin.	+61 8 9268 3050
Scott Weir	Mgr - Corp Fin.	+61 8 9268 2821

Registered Office

Level 6, 141 St Georges Tce Postal Address:

PerthWA 6000	GPO Box 2777
Australia	Perth WA 6001
PH:+61 8 9268 2888	FX: +61 8 9268 2800
www.hartleys.com.au	info@hartleys.com.au

Note: personal email addresses of company employees are structured in the following

manner:firstname_lastname@hartleys.com.au

Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a “Buy”. Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a “Buy”.
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

Institutional Sales

Carrick Ryan	+61 8 9268 2864
Justin Stewart	+61 8 9268 3062
Simon van den Berg	+61 8 9268 2867
Chris Chong	+61 8 9268 2817
Simon Andrew	+61 8 9268 3020
Veronika Tkacova	+61 8 9268 3053

Wealth Management

Nicola Bond	+61 8 9268 2840
Bradley Booth	+61 8 9268 2873
Adrian Brant	+61 8 9268 3065
Nathan Bray	+61 8 9268 2874
Sven Burrell	+61 8 9268 2847
Simon Casey	+61 8 9268 2875
Tony Chien	+61 8 9268 2850
Travis Clark	+61 8 9268 2876
Tim Cottee	+61 8 9268 3064
David Cross	+61 8 9268 2860
Nicholas Draper	+61 8 9268 2883
John Featherby	+61 8 9268 2811
Ben Fleay	+61 8 9268 2844
James Gatti	+61 8 9268 3025
John Georgiades	+61 8 9268 2887
John Goodlad	+61 8 9268 2890
Andrew Gribble	+61 8 9268 2842
David Hainsworth	+61 8 9268 3040
Neil Inglis	+61 8 9268 2894
Murray Jacob	+61 8 9268 2892
Bradley Knight	+61 8 9268 2823
Gavin Lehmann	+61 8 9268 2895
Shane Lehmann	+61 8 9268 2897
Steven Loxley	+61 8 9268 2857
Andrew Macnaughtan	+61 8 9268 2898
Scott Metcalf	+61 8 9268 2807
David Michael	+61 8 9268 2835
Damir Mikulic	+61 8 9268 3027
Jamie Moullin	+61 8 9268 2856
Chris Munro	+61 8 9268 2858
Michael Munro	+61 8 9268 2820
Ian Parker	+61 8 9268 2810
Charlie Ransom	+61 8 9268 2868
Brenton Reynolds	+61 8 9268 2866
Conlie Salvemini	+61 8 9268 2833
David Smyth	+61 8 9268 2839
Greg Soudure	+61 8 9268 2834
Sonya Soudure	+61 8 9268 2865
Dirk Vanderstruyf	+61 8 9268 2855
Jayne Walsh	+61 8 9268 2828
Samuel Williams	+61 8 9268 3041

Disclaimer/Disclosure

The author of this publication, Hartleys Limited ABN 33 104 195 057 (“Hartleys”), its Directors and their Associates from time to time may hold shares in the security/securities mentioned in this Research document and therefore may benefit from any increase in the price of those securities. Hartleys and its Advisers may earn brokerage, fees, commissions, other benefits or advantages as a result of a transaction arising from any advice mentioned in publications to clients.

The preparation of this report was subsidised by ASX in accordance with the ASX Equity Research Scheme. This report was prepared by Hartleys and not by ASX. The views expressed in this report do not necessarily reflect the views of ASX. No responsibility or liability is accepted by ASX in relation to this report.

Any financial product advice contained in this document is unsolicited general information only. Do not act on this advice without first consulting your investment adviser to determine whether the advice is appropriate for your investment objectives, financial situation and particular needs. Hartleys believes that any information or advice (including any financial product advice) contained in this document is accurate when issued. Hartleys however, does not warrant its accuracy or reliability. Hartleys, 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.