

Empire Energy Group Limited

(Ticker: ASX:EEG)

June 8, 2011

RB MILESTONE GROUP 
EQUITY RESEARCH AND MARKET INTELLIGENCE

Price (A\$):	0.110
Target Price (A\$):	0.275
Beta:	0.93
Price/Book Ratio:	0.55
Debt/Equity Ratio:	2.21
Listed Exchange:	ASX



Recent News

06.06.2011: Empire Energy Group Limited spuds first well in the current drilling program in the Central Kansas Uplift.

03.06.2011: Empire Energy Group Limited increases the Company's issued capital by 4,740,429 following the closure of a Share Purchase Plan.

03/06/2011: Empire Energy Group's Directors has increased their direct and indirect interest in the Company through participation in the Company Share Purchase Plan.

26/05/2011: Empire Energy Group Limited has secured a drilling rig for commencement of its initial drilling program in the Central Kansas Uplift

Shares in Issue

278.19 M

Market Cap

(A\$M) 30.6

52 Week (High): A\$0.185

52 Week (Low): A\$0.081

A Low Risk Oil & Gas Company with Strong Upside Potential

Empire Energy Group Limited (EEG) is an Australian company focused on oil & gas exploration and production in the USA and Australia. EEG is currently producing from two of its regions in the US, namely Central Kansas Uplift (oil) and Appalachia Basin (gas), at 1,520 barrels of oil equivalent per day (boe/d). Central Kansas Uplift properties have proven and probable (2P) reserves of 4.8 million barrels, while Appalachia Basin has 2P reserves of 73.3 billion cubic feet. With one exception EEG operates all its own properties.

EEG also has four exploration-stage projects in the US and Australia. (i) The company is planning to drill two wells in 2011 on one of its oil exploration projects in the US, namely the Williston Basin, North Dakota, with target reserves of 170,000 barrels from each. (ii) EEG has commenced a development drilling program in Kansas where it is seeking to drill at least 10 wells in 2011. (iii) Holding over 300,000 acres in New York and Pennsylvania EEG has two shale prospects in the US, the Marcellus and Utica. The Marcellus holds both shale oil and gas while Utica holds shale gas. (iv) A very large frontier shale play in Australia is at a very early stage as the company is still negotiating landholder agreements.

EEG has had a successful history of acquiring oil and gas assets that have yielded a positive effect on its earnings and cash flows. The company is planning to ramp-up production to 10,000 boe/d by 2015, of which 4,500 is planned through acquisitions. We believe that EEG's management has the required skills to achieve these targets.

We have valued EEG on the basis of peer EV/2P reserve multiple with a target price of A\$0.275/share, an upside of 150.1% over the last traded price of A\$0.110.

Investment Arguments

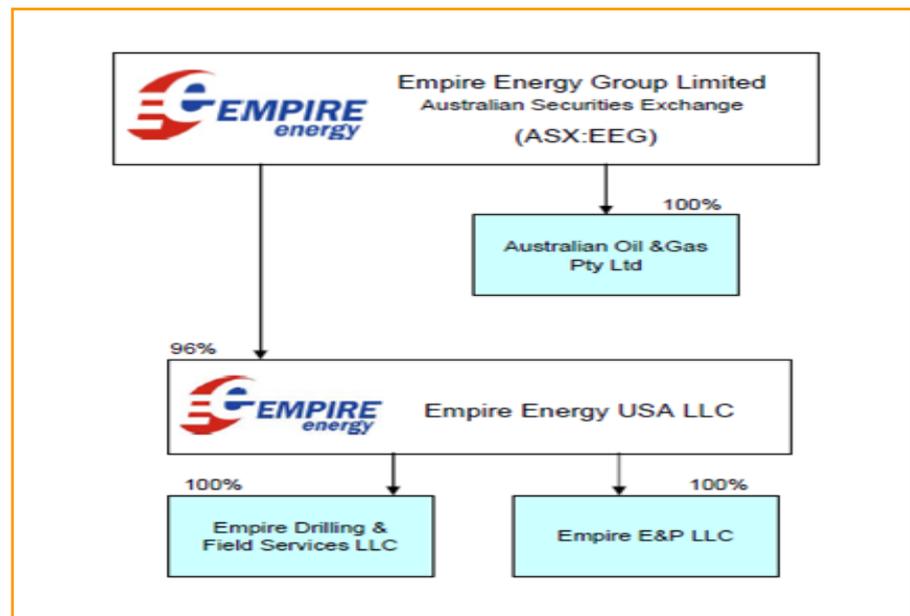
- **Opportunities in Appalachia and Australia are Positive:** EEG owns assets in Pennsylvania & New York, USA, which include the Marcellus and Utica shales. Certified petroleum engineers from Ralph E. Davis Associates expect Marcellus to contain potential shale oil resource of 70 million barrels and Utica to hold gas resources of over 5 tcf of unrisked gas in place. EEG has also identified opportunities for sourcing shale oil and gas from two basins in the Northern Territory, Australia.
- **Acquisitions to be EPS Accretive:** EEG has an impressive track record in acquiring oil & gas assets. After acquisitions in the Appalachian Basin and in Kansas, EEG's EPS rose from -0.1 cents in December 2009 to 2.68 cents in December 2010. By 2015, EEG intends to increase production by 4,500 boe/d through acquisitions. Its past acquisition record underscores our confidence in EEG's management and we believe that the company has the requisite skills to source and acquire value accretive assets
- **Robust Price Outlook for Oil & Gas:** EEG has plans to raise its production from current levels of 1,520 boe/d to 2,500 boe/d by end of 2012. The U.S. Energy Information Administration (EIA) has forecasted an average price of US\$103 and US\$107 per barrel for WTI crude in 2011 and 2012, respectively, whereas for natural gas the EIA is expecting an average price of US\$4.24 per MMBtu in 2011 and US\$4.65 per MMBtu in 2012. EEG's rise in production, coupled with the firm crude oil prices in 2011 and 2012, will give a significant boost to the company's revenues and cash flows
- **Attractively Valued:** The company is trading at 5.6x based on EV/2P reserve basis against the industry average of 22.56x, a steep discount of 75%. Even after adjusting for oil/gas mix, the company's target EV/2P reserves ratio should be 7.8x. Hence we believe that EEG is considerably undervalued at this juncture

Company Overview

Introduction

Empire Energy Group Limited (EEG) is an Australian company engaged in the acquisition, development, exploration, production and sale of oil and natural gas. The Sydney-based company is focused on low-risk, long-life onshore oil and gas fields in the US. In March 2011, the company acquired a new name from its primary US subsidiary, Empire Energy USA LLC (96% stake), to better represent its business. It was previously known as Imperial Corporation Limited. EEG’s other main wholly-owned subsidiary is Imperial Oil & Gas Pty Limited, with operations in Australia.

Exhibit 1 : Corporate Structure



Source: Company Reports

EEG caters to domestic pipeline and refinery owners primarily in the US states districts of Pennsylvania, New York and Kansas. It trades on the ASX under the symbol “EEG”. It also has a NYSE OTC listing, IMPGY, but does not trade. EEG is looking to activate its listing on the NYSE via merger or acquisition opportunities.

In 2006, EEG entered the US oil and gas industry through a natural gas joint venture (JV) in the Appalachian Basin of North East USA. In four years, the company has expanded its business by way of three major acquisitions worth around US\$103 million.

Exhibit 2 : Key Acquisitions

Key Milestones	
2006	Entry into USA through a JV in the Appalachian Basin
December 2006	Acquisition of 160 gas wells in Hawthorne, Pennsylvania for \$8.85 million
December 2009	Acquisition of 1800 gas wells in Mayville, Pennsylvania/New York for \$38 million
December 2010	Acquisition of 245 oil wells in Kansas and 18000 acres in North Dakota for \$56.25 million

Source: RB Milestone, Company Reports

The company's distinct business strategy has been to identify and acquire new upstream assets to boost its oil and gas production. EEG has two operational fields in the US – Central Kansas Uplift and Appalachia (New York (Mayville) and Pennsylvania (Hawthorne)), The company has commenced an oil drilling program in Kansas, the first phase of which includes drilling of three development wells. EEG has 2P (proved + probable) reserves of 16.8 mn barrels of oil equivalent (boe) and 3P (proved + probable + possible) reserves of 18 mn boe. The current average equivalent production for EEG stands at 1,520 barrels of oil equivalent per day (Boe/d), of which 36% is oil and the rest is natural gas.

In addition to the upstream activities in USA, EEG has identified opportunities for sourcing shale oil and gas from two basins in Australia. It has 14.6mm acres under exploration license application in McArthur Basin in The Northern Territory. For permits to be granted and exploration work to start agreements are being negotiated with Traditional Land Owners. This process has commenced.

EEG has completed oil and gas transactions worth US\$80.8 million in 2010, including the sale of a portion of its non-core Marcellus shale assets in Pennsylvania at \$4,250/acre raising US\$24.6 million. It has secured a credit facility of US\$150 million from Macquarie Bank, from which it currently has drawn US\$65 million at an average interest rate of LIBOR + 4.2%. In April 2011, EEG raised A\$13.2 million in capital through a private placement of 110 million shares at a price of A\$0.12 per share. It also raised A\$0.57 million from existing shareholders through the issue of 4.7 million shares at a price of A\$0.12 per share. EEG intends to use these funds to pay for capital raising costs, meet its production targets during 2012-15; undertake development drilling at oil wells in Kansas; perform exploration drilling in potential shale gas resources at Appalachian and Williston Basins; repay debt; and meet its working capital needs.

Key Operations

(i) Central Kansas Uplift – Oil Production

EEG acquired oil-producing assets in the Central Kansas Uplift (CKU) region for US\$56.2 million in December 2010. The project spans over 16 Central Kansas counties and has a total area of 18,000 gross acres. CKU project is the mainstay of EEG's oil business, accounting for 99% of its oil production. EEG has 245 operating wells currently producing approximately 550 boe/d. In keeping with its fast-growth strategy, the company is targeting low-risk development wells in the region. It will also try to delineate additional prospects and convert probable reserves to reserve 1P category.

CKU region is of economic importance for EEG for the following reasons:

- It includes one of the most prolific oil reservoirs – the Arbuckle formation
- The total well reserve potential for the region is more than 100,000 boe
- Well depths are in the range of 3000-3500 feet, which means lower drilling costs
- Presence of stratigraphic features within reservoirs, like natural structural traps created by uplift, can help in trapping of oil and gas
- Water-driven reservoirs leading to high recovery of oil

Arbuckle Formation

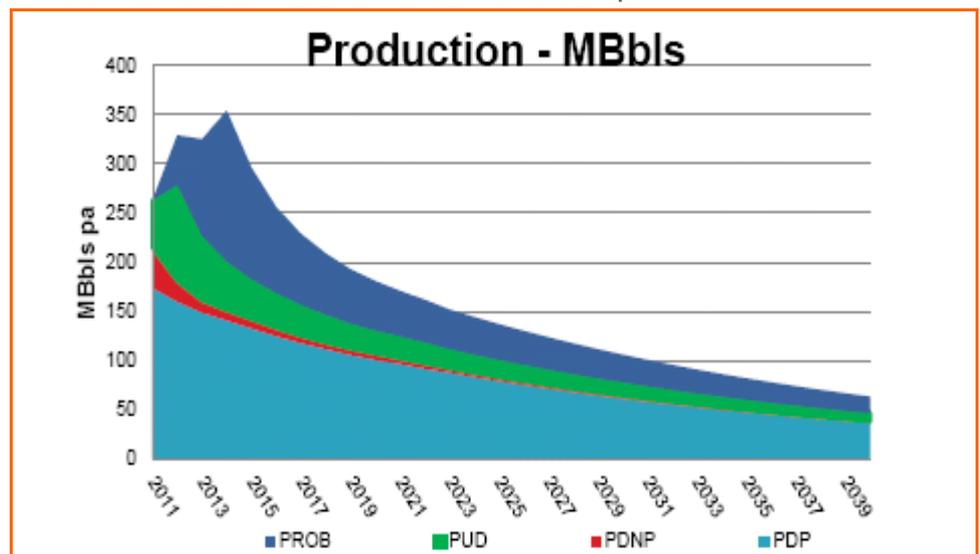
The Arbuckle is the largest producing formations in CKU, more than 1.6 billion barrels of oil since the late 1920's. A typical well in the region, after initial production which can be up to 100 barrels of oil per day, will go on to produce an average of 3.5 barrels of oil per day for many years. There are 158 reservoirs in the region with an average depth of about

3,600 feet and average thickness of 15 feet. These carbonate reservoirs are made up of shallow-shelf dolomites. Dolomite rocks have low porosity and permeability but in some Arbuckle reservoirs they exhibit good porosity and permeability due to karst-derived solution-collapse brecciation. Karst is a landscape formed by dissolution of carbonate rocks such as dolomite. It is replete with features like bedding plane spaces; fractures and faults; vugs; or small open spaces.

CKU Production

EEG's landholding in CKU is estimated to have 1P (proved) reserves of 3.6 million barrels (71% of which is proved, developed and producing) and 2P (proved + probable) reserves of 4.8 million barrels. The company acquired these oil-producing assets at an attractive 1P reserve multiple of US\$15.50/boe, significantly below the US\$25/boe reserve multiple up to which acquisitions are recorded in USA.

Exhibit 3 : Estimated Oil Production from Central Kansas Uplift



Source: Company Reports

EEG operates 99% of the acquired properties that are HBP (held by production) with proven offset drilling locations identified. There are 17 PDNP (proved, developed and non-producing) wells to be re-worked, 31 PUD (proved and undeveloped) locations and 56 probable locations. The Working Interest (WI) and Net Revenue Interest (NRI) for EEG in CKU is 74.5% and 63%, respectively. The estimated 1P PV10 value (present value of estimated future oil and gas reserves, net of estimated direct expenses, discounted at an annual discount rate of 10%) and 2P PV10 value at acquisition date stand at US\$90.8 million and US\$115.5 million, respectively. The company has hedged 75% of its oil production at US\$90 per barrel.

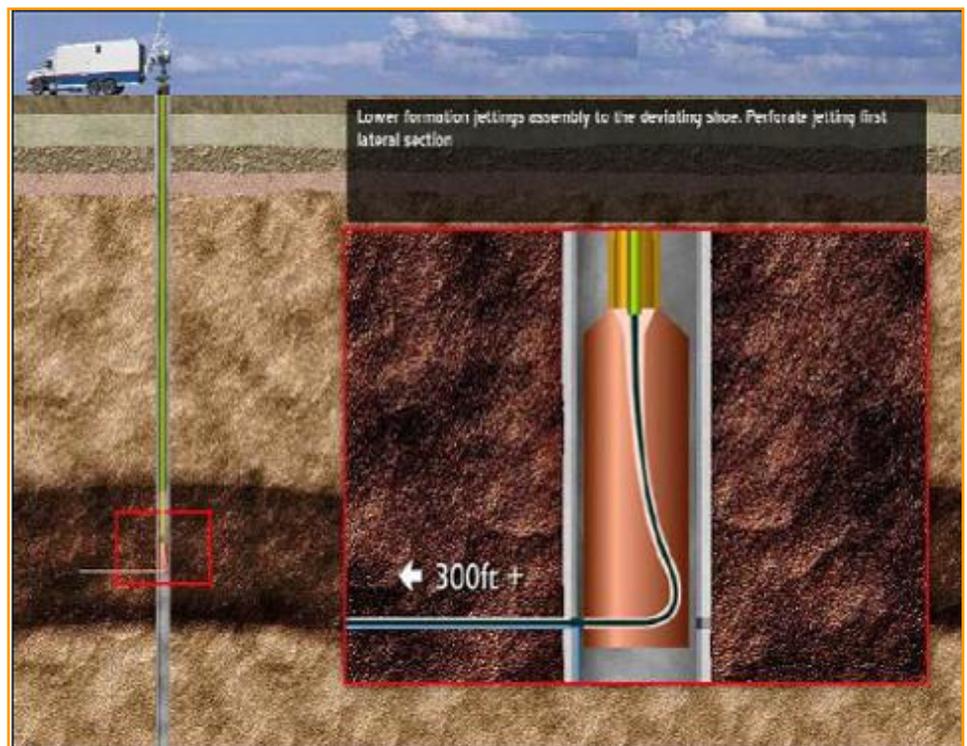
Production in CKU has come down over the years but according to the Kansas Geological Survey estimate, 60% of its recoverable reserves remain still untapped. EEG could very well possibly exploit these reserves with the identification of more than 80 potential drill locations. The company has secured a drilling rig in Russell County and will soon undertake an initial drilling program which includes drilling of 10 development wells with a target depth of up to 3,750 feet. Three wells – the Boxberger #14, the Newcomer #9 and the Driscoll #31-8 – will be drilled in the first phase and the remaining seven are in the planning stage. The estimated completion costs per well is approx. US\$410,000. EEG holds up to ~70% Working Interests (WI) in the wells. The company is also likely to use the following techniques to boost its oil production:

- **Ongoing Polymer Treatment.** This technique involves the use of gelled polymers to increase production in oil and gas wells that are impacted by excessive water

production. Gelled polymers selectively reduce produced water volumes while retaining the oil volume. They are created by mixing of dry polymers with water and crosslinking them with a metal ion. These polymers are then pumped on the wellbore. The gel seals in high permeability fractures that connect the wellbore to the aquifer. The wellbore is flushed, usually with clean lease crude, after the pumping of optimum treatment volume. It is then shut for 5 to 10 days to allow the polymer to develop maximum gel strength before returning to production. This leads to a change in the drainage pattern to a wellbore, thereby improving oil and gas extraction. Polymer treatment is expensive but beneficial in the long run

- **Water Flooding Opportunities.** Through this method, a reservoir is flooded with water to displace residual oil. The force of water increases reservoir pressure, thereby sweeping the oil into adjacent production wells
- **Down Hole Radial Water Jetting.** This technique is used when oil reserves cannot be recovered using conventional technologies. In this method, a deflector shoe along with high pressure water jetting is employed. The shoe, which is located downhole, laterally deflects high-pressure water entering boring holes up to a depth of 300 feet. This is an efficient and economic technique to extract oil reserves

Exhibit 4 : Water Jetting



Source: Company Reports

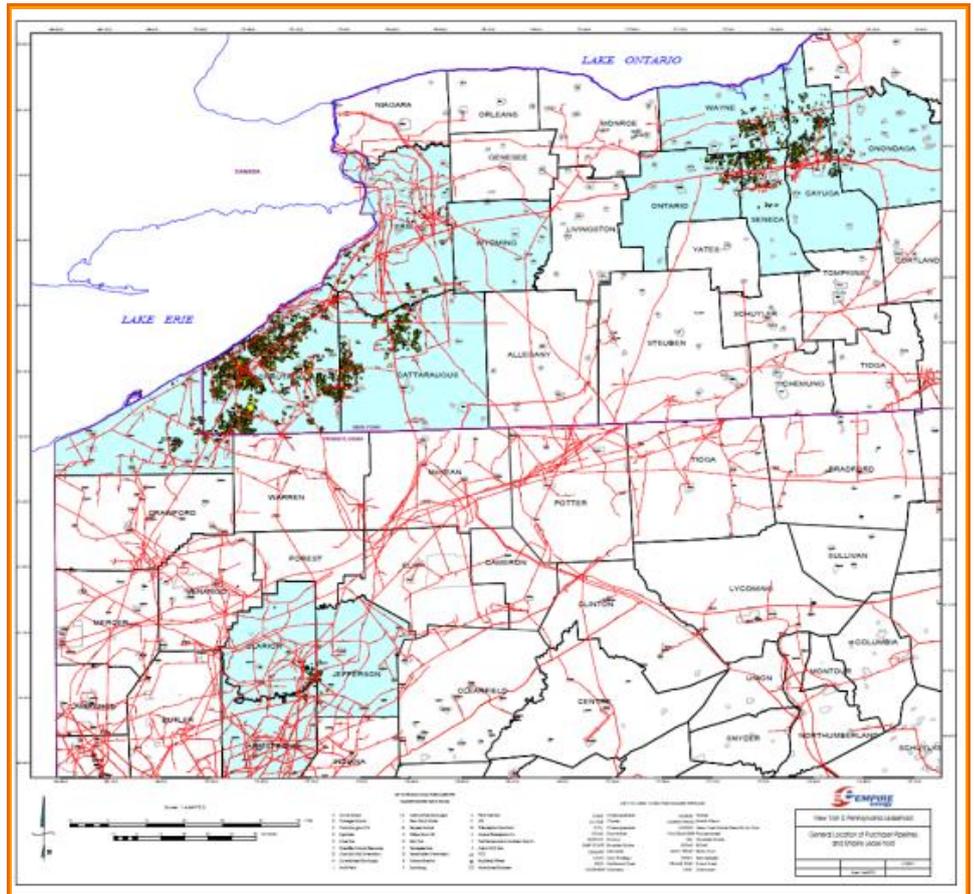
- **High Volume Submersible Pumps.** This technique employs submersible pumps to provide a form of artificial lift. The lift is employed for increasing the flow of liquids to the surface of a production well. By decreasing the pressure at the bottom of the well (by lowering bottomhole flowing pressure, or increasing drawdown), significantly more oil can be produced from the well as compared with natural production

(ii) Appalachia – Gas Production

EEG acquired 303,000 acres of land with 1,805 natural gas wells in the Appalachian Basin for US\$38 million in December 2009. The project is spread over nine counties in New York and one county in Pennsylvania, US. In addition EEG already had gas operations on an additional three Counties in Pennsylvania. EEG acquired these assets at a valuation of

US\$0.57 per Mcf of 1P reserves. The acquisition gives the company access to a large reserve for oil & gas resource, including shallow Marcellus and Utica Shales.

Exhibit 5 : Appalachia Operations

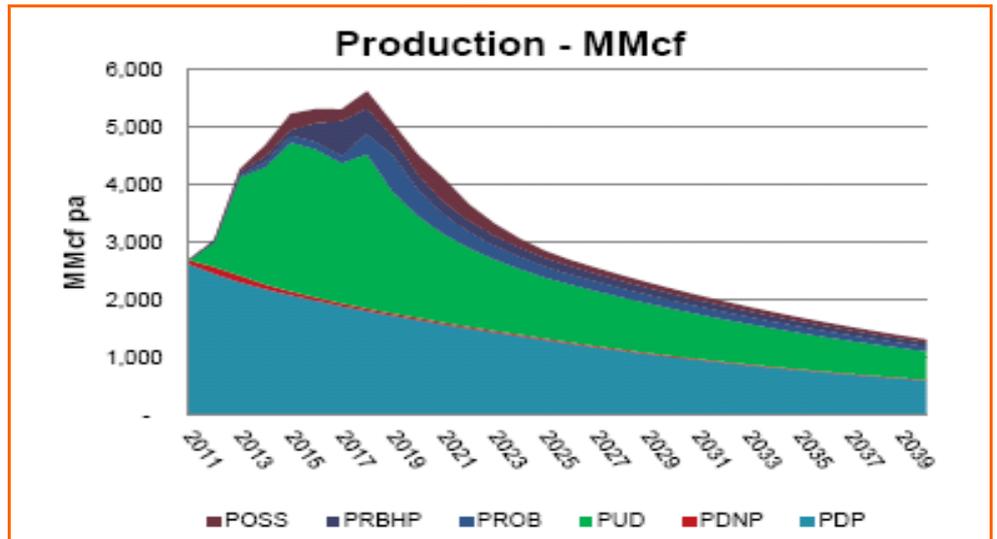


Source:Company Reports

The Appalachian Basin has an important place in the US’s history of oil and gas production as the discovery of the first US oil well took place in this area. Appalachian Basin is also the most active drilling area in the country, comprising one-third of the total US wells drilled in a year. The basin contains a large number of potentially-productive formations which gives it a very high success rate of 97% for gas well drilling. The first discovery of oil in the basin took place in 1859 in the Drake Titusville well in north-western Pennsylvania. Current gas production from Appalachia stands at 5,800 thousands cubic feet per day (Mcf/d).

EEG operates 98% of its Appalachian properties, 75% of which are HBP (held by production). EEG’s landholding contains hundreds of PUD well locations favorable for low-cost, tight sandstone drilling. EEG has a Working Interest (WI) of 96.5% and Net Revenue Interest of 76.5% in its Appalachia properties. The region is estimated to have 1P (proved) reserves of 65.0 billion cubic feet (60% of which is proved, developed and producing), 2P (proved + probable) reserves of 73.3 billion cubic feet and 3P (proved + probable + possible) reserves of 79.6 billion cubic feet. The estimated 1P PV10 and 2P PV10 values at acquisition date stand at US\$58.9 million and US\$65.4 million, respectively. EEG has hedged 80% of its gas production at US\$5.85 Mcf/d.

Exhibit 6 : Estimated Gas Production from Appalachia



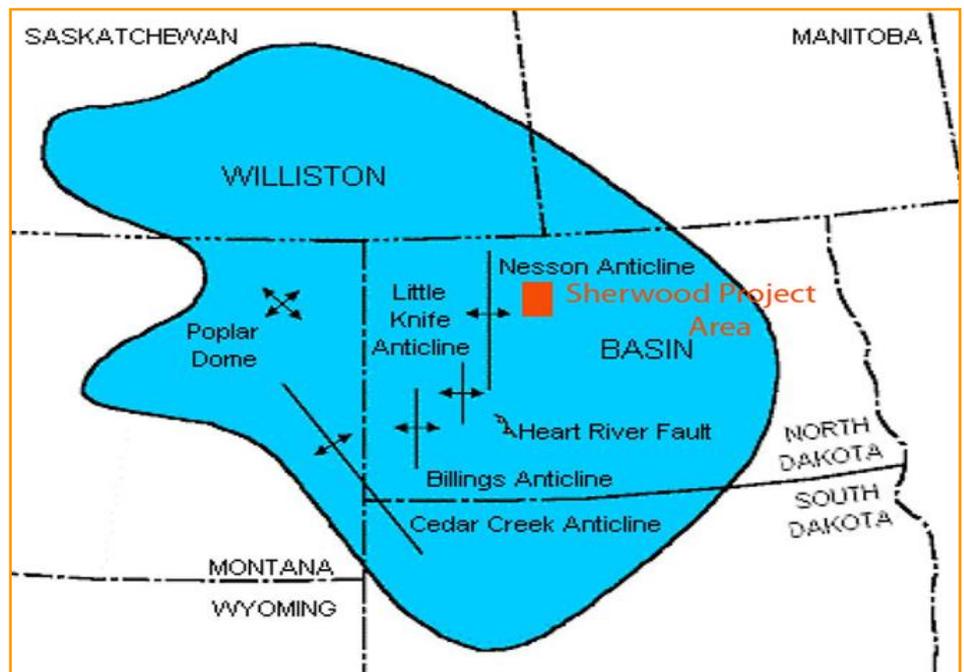
Source:Company Reports

Subject to natural gas prices, EEG can drill hundreds of its proved, undeveloped (PUD) locations in the Basin. EEG has plans to acquire more gas production. The current pipeline network consists of 650 miles of pipelines carrying natural gas from Appalachian Basin. The company intends to acquire an additional 200 miles of pipeline, which can be merged into the existing pipeline network to enable enhanced operational management.

(iii) Williston Basin –Oil Potential

Through the Sherwood Shoreline JV, EEG has an interest (27% NRI) in a 17,000 acre exploration project in the Williston Basin, North Dakota. The Williston Basin spreads from Saskatchewan, Canada to the North Dakota and Montana districts of the US.

Exhibit 7 : Williston Basin

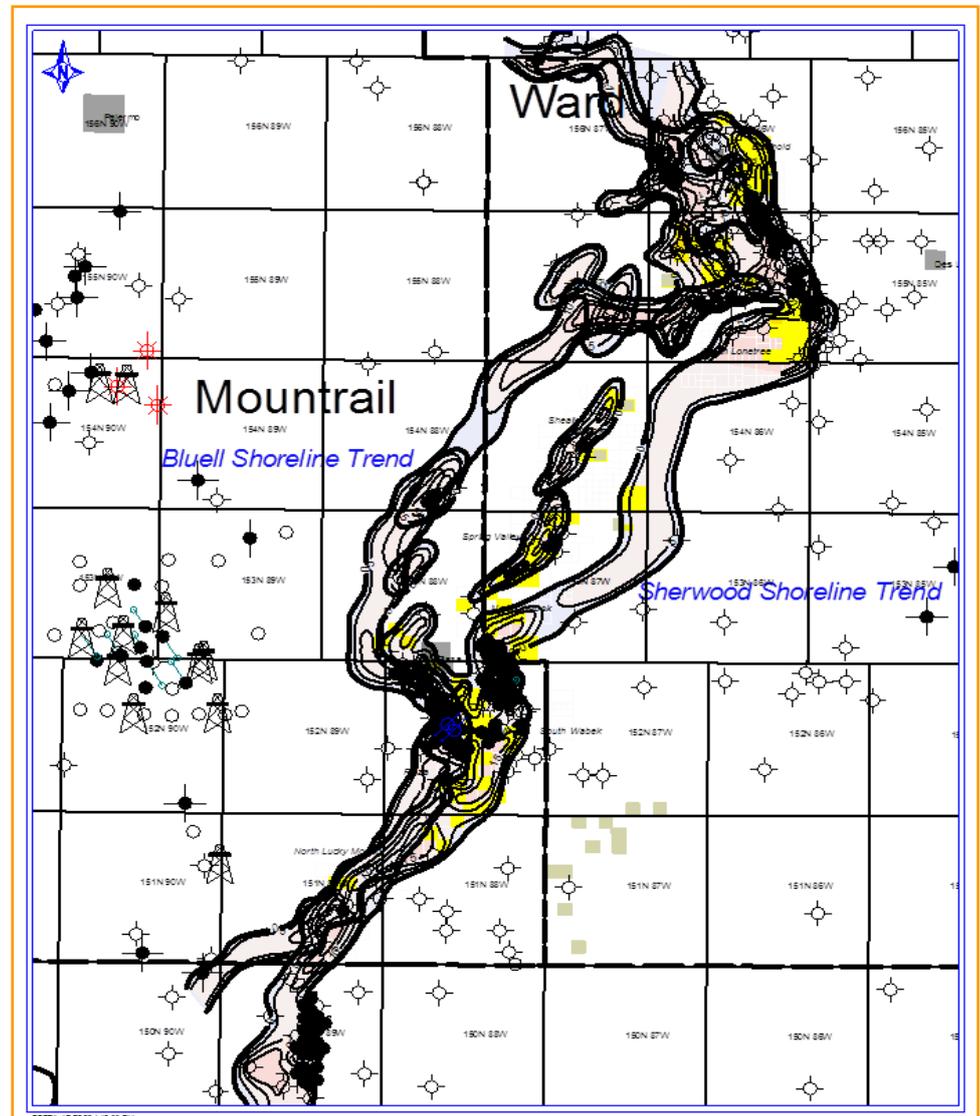


Source:Company Reports

The Sherwood Shoreline JV is targeting a stratigraphic trap with updip pinch-outs of impermeable dolomitized carbonate that line the low-energy shoreline from north to south. Updip pinch-outs provide natural traps and help laterally seal dipping reservoirs. The JV is being operated by Vecta Oil and Gas Limited. The project region consists of a number

of producing wells, with an average depth of 7,000-7,500 ft. EEG has allocated US\$1.40 million to conduct exploration drilling for its share in the first two wells targeting the Bluell and Sherwood reservoirs. The drilling of the wells is expected to start in July 2011. The company is targeting a production of +170,000 Bbl/well based on the existing production in the analogous fields of Plaza (107 MBbl/well) in the Bluell sub-unit, and Wabek (182 MBbl/well) and Lone Tree (107 MBbl/well) in the Sherwood sub-unit. EEG's Working Interest (WI) for the Williston Basin is 35% while Net Revenue Interest (NRI) is 27%.

Exhibit 8 : Sherwood Shoreline JV, Mountrail and Ward Counties, North Dakota

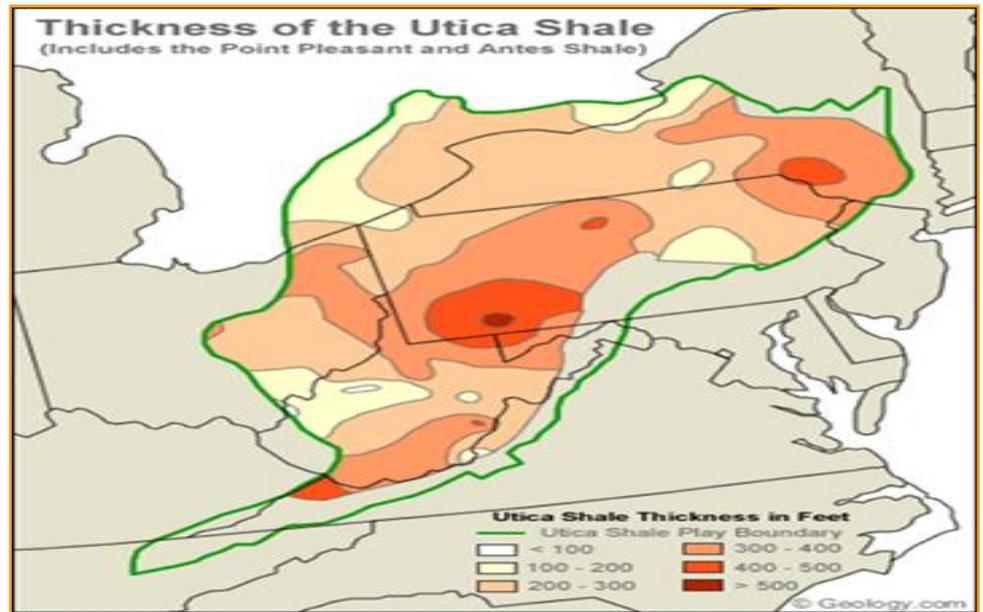


Source: Company Reports

(iv) Mayville - Marcellus/Utica Shale Potential

EEG acquired oil and gas assets with a total land area of ~300,000 acres in Mayville, New York State in December 2009. These assets include Marcellus and Utica shales, the organic-rich black shales in the northern Appalachian Basin. In April 2010, EEG appointed Ralph E Davis Associates Petroleum Engineers to undertake a resource report based on this landholding. Ralph Engineers used deterministic and probabilistic techniques like Monte Carlo stimulation to establish continuous distributions of gas in place (GIP) and recoverable gas in the region. Marcellus is estimated to have a shale oil potential resource of 70 million Bbls with a recovery factor (RF) of 3%, while Utica has a gas potential resource of more than 5 Tcf of gas in place (GIP), (unrisked), excluding additional land area. In addition, Marcellus has 262 Tcf of technically-recoverable natural gas resources according to the April 2009 US Dept of Energy Report.

Exhibit 11 : Utica Shale



Source: Company Reports, RB Milestone

For EEG, Utica shale is attractive considering the following factors:

- Utica formation is extensively deposited in the Appalachian Basin
- Gas reserves have low H₂S and CO₂. Carbonate reservoirs often have high H₂S and CO₂ content, whose corrosive mechanism makes exploitation of gas reservoirs risky
- An extensive pipeline structure is in place, which leads to lower processing costs

Exhibit 12 : Shale Gas Potential Resources

Formation	Reserve Type	Type of asset	Category	GIP (Bcf)	Calculated Acres	Acres held (net)
Utica	4P	Shale (Gas)	Resource	4,638.0	18,571	186,240

Source: Company Reports, RB Milestone

NY State has imposed a statewide moratorium on hydro-fracturing until July 1, 2011.

Development Program

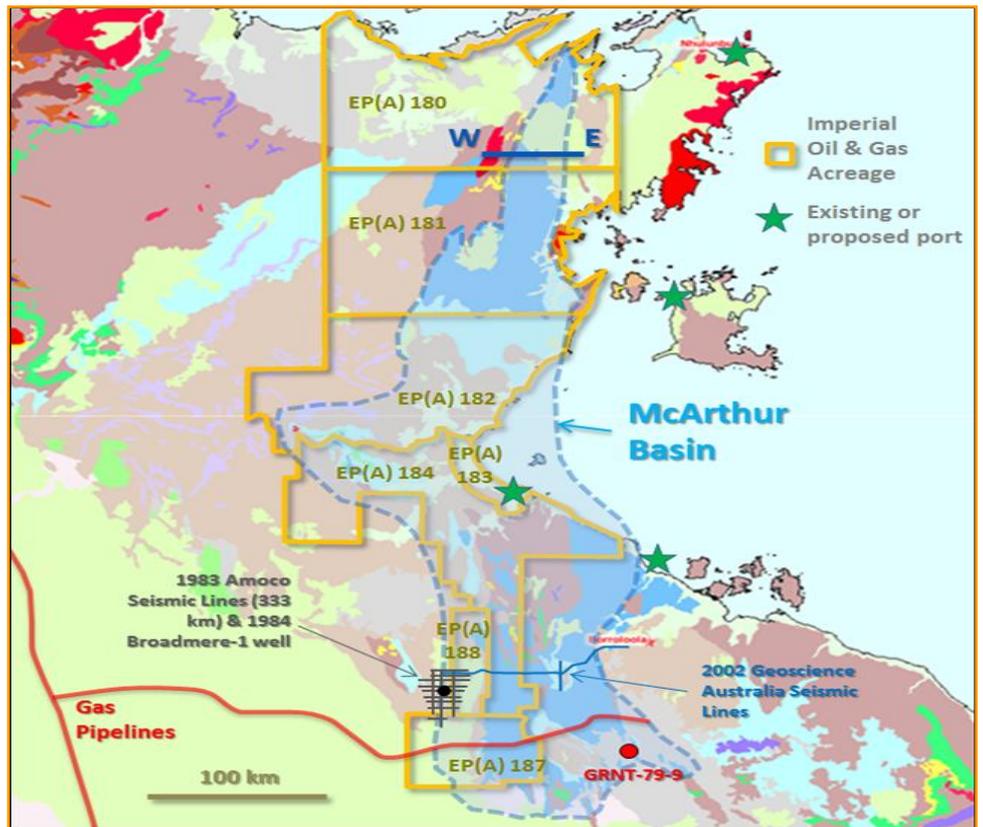
At a time of low natural gas prices, EEG is planning to undertake the following development measures to enhance its natural gas production:

- Reworking ~625 miles of its gathering and pipeline networks which prior to acquisition remained neglected for years
- Acquisition of ~200 miles of pipeline from regional utility to gain control of more gas production

(v) Australia – Shale Potential

In 2010, EEG through its subsidiary Imperial Oil & Gas Pty Limited started screening for shale gas exploration opportunities in Australia. The company has received permits to explore large-scale shale gas on 14.6 million acres of land in the Northern Territory. The permits are in the high risk/ high return zone because of very low historic exploration maturity in the region. The geological data have confirmed the presence of gas in the region. Currently, the company is in negotiations with landholders for permission to acquire permits to begin exploration work and will revisit the opportunities in Australia using expertise and technologies gained from operations in the US.

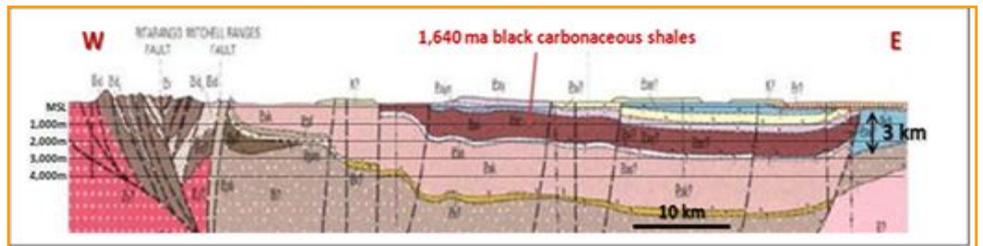
Exhibit 13 : Northern Territory, Australia



Source: Company Reports

The target gas resource is in 1,640 million year old Palaeo-Proterozoic organic-rich black shales of the Barney Creek Formation and equivalents, proven gas-prone in the South McArthur Basin. In particular the 1979 mineral core hole GRNT-79-9 ignited and sustained a 6m high yellow smoky gas flare for approximately 6 months producing an estimated 0.5 Bcf at 6mmscfd. Gas analysis revealed C1-C7. In addition oil bleeds are common in cores and hence shale oil offers secondary potential.

Exhibit 14 : Northern Territory, Australia



Source: Company Reports

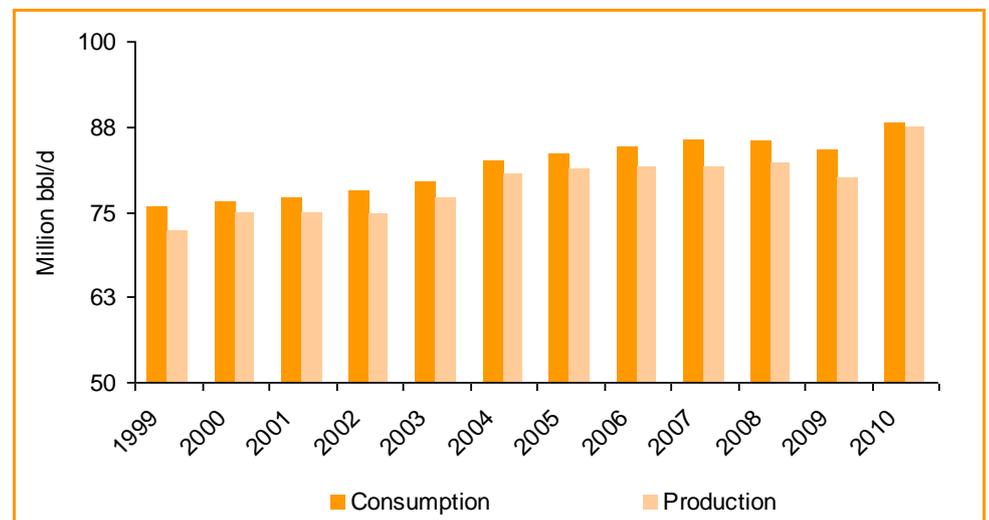
Industry Overview

Introduction

Oil and gas are the most important primary energy sources in the present era of industrialization. Post the global economic crisis (GEC), world energy demand increased by 2% in 2010. The global significance of the oil and gas industry could be gauged from the fact that 58% of the global energy demand was met by the oil and gas industry during 2010.

- Oil Demand.** Demand for oil is expected to be robust in 2011 and 2012. According to the US Energy Information Administration (EIA) estimates, global consumption of liquid fuels is expected to increase by 1.4 million bbl/d to 88.1 million bbl/d in 2011 and by an additional 1.6 million bbl/d to 89.7 million bbl/d in 2012, led by emerging economies such as China, India, Brazil and the Middle East
- Oil Supply.** Supply of crude is expected to remain tight in 2011 and 2012. According to the EIA, crude oil production is likely to register an increase of 1.0 million bbl/d to 87.8 million bbl/d in 2011 and 1.5 million bbl/d to 89.3 million bbl/d in 2012, with major contributions from China, Brazil, Canada and former Soviet Union countries. EIA projections suggest that OPEC's surplus capacity will decrease from 3.9 million bbl/d in December 2010 to 3.6 million bbl/d by the end of 2011, and to 3.1 million bbl/d by the end of 2012

Exhibit 15 : Global Oil Consumption and Production



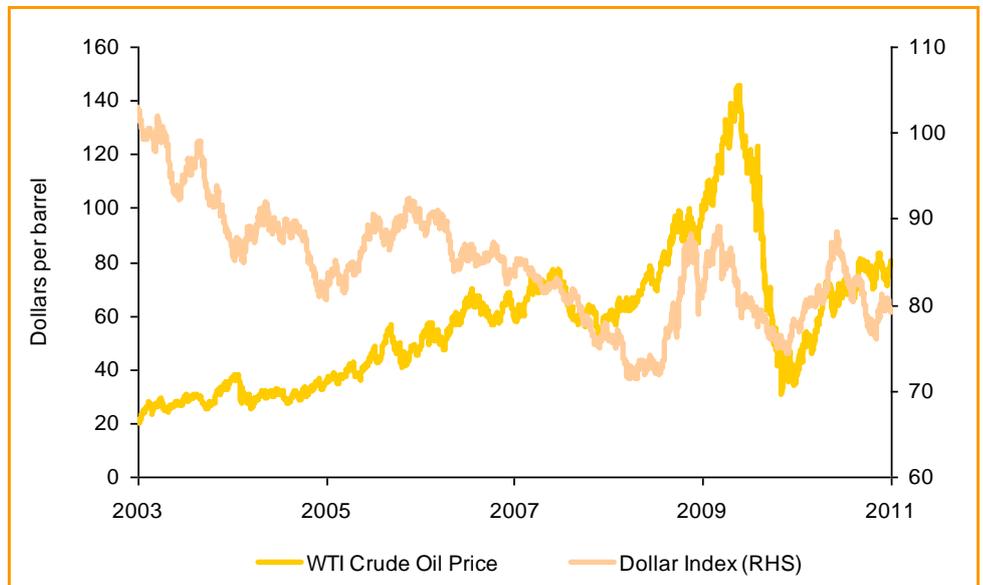
Source: EIA, RB Milestone

Demand Factors for Oil

- World Economy.** The global economy recovered from the GFC in 2010, leading to GDP growth in developed and developing markets. The US economy and Euro zone grew by 2.8% and 1.7%, respectively, in 2010. Emerging economies like Brazil, Russia, India and China also recovered from falling growth rates, which were witnessed in 2009. According to IMF, global GDP is expected to register a growth of 4.4% in 2011, with US GDP and Euro zone GDP forecasted to grow at 2.8% and 1.6% respectively in 2011, indicating that the global economic recovery has commenced
- Quantitative Easing: QE1 and QE2.** The Federal Reserve announced the first of two monetary easing programs on November 25, 2008. The first program (QE1) began Treasury purchases on January 1, 2009 with an authorized total of US\$600 billion. This amount was later increased to US\$1.725 trillion. With QE1, the newly printed

dollars of the Fed were used to purchase illiquid assets such as mortgage backed securities from the large commercial banks. Under QE2, US\$600 billion was authorized for new Treasury purchases to last through June 30, 2011. These initiatives have helped to jumpstart economic recovery in the country, which is the largest consumer of crude in the world

Exhibit 16 : WTI Crude Oil Price Vs Dollar Index

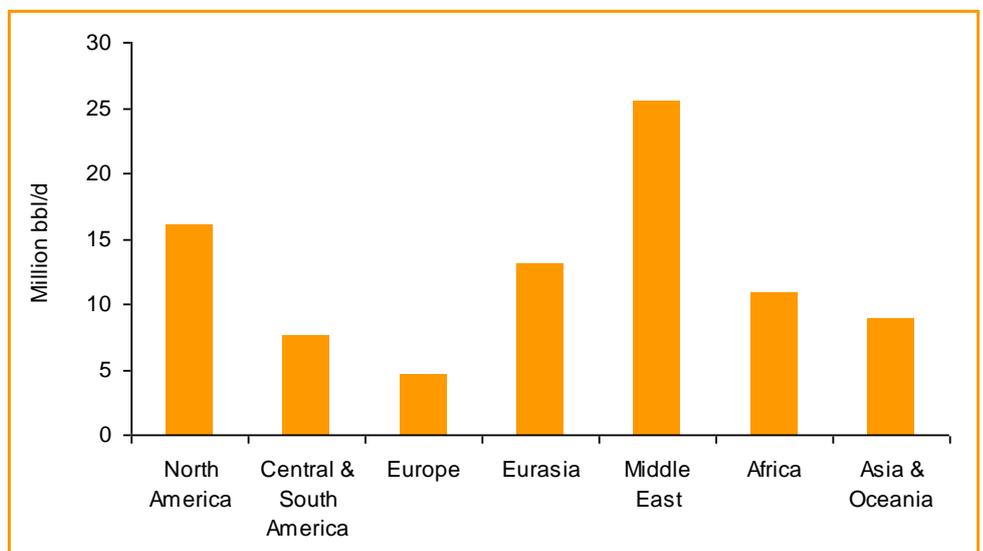


Source: EIA, RB Milestone

Supply Factors for Oil

- OPEC Policy.** The OPEC (Organization of Petroleum Exporting Countries) influences oil prices by assigning production quotas to its member nations with the objective of controlling global supply of crude. The OPEC continues to exert considerable influence in the petroleum market as buyers and sellers await decisions taken at OPEC meetings and closely monitor the institution’s behavior. The ability of OPEC members to influence oil prices could be gauged from the fact that during 1996, a flood of Saudi crude oil came to the market and drove down prices

Exhibit 17 : Oil Supply by Region



Source: EIA, RB Milestone

- Political Uncertainty in Oil Producing Countries.** The Middle-East crisis has been one of the major factors behind the recent spike in prices of Brent Crude and WTI

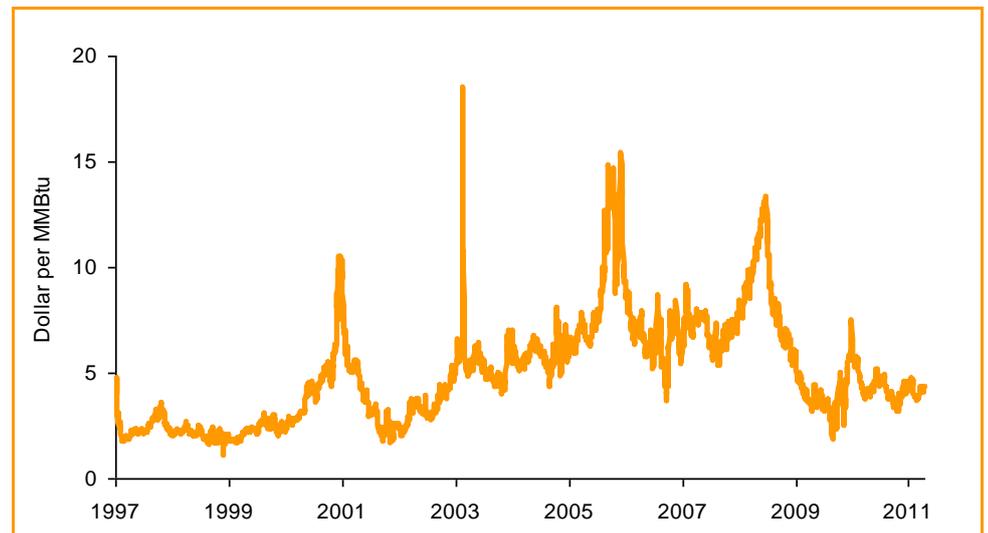
Crude. The crisis which began in Egypt in February 2011 soon engulfed other oil producers such as Bahrain, Oman, Libya, Syria and Yemen leading to a strong upward momentum in oil prices. Market concerns that the crisis could spill over to Saudi Arabia, the largest global producer of crude, further pushed oil prices due to fears of supply disruptions

Oil Price Outlook

Although WTI crude oil spot prices traded at an average of US\$79 per barrel in 2010, the ongoing crisis in the Middle-east coupled with future demand-supply scenario has prompted EIA to forecast an average price of US\$103 and US\$107 per barrel for WTI crude in 2011 and 2012, respectively. EIA also expects oil markets to remain tight on the back of increasing demand for liquid fuels from emerging economies such as China and India coupled with slowing growth in non-OPEC supply, which would maintain an upward pressure on oil prices.

On May 24, 2011 Goldman Sachs boosted its 12-month price forecast for Brent crude to US\$130 per barrel, from US\$107 earlier. and for end-2012 to US\$140 per barrel, from US\$120 previously, citing stronger global economic growth and tightness in OPEC's spare capacity. In line with Goldman, Morgan Stanley also revised its Brent crude forecast for 2011 to US\$120 per barrel, from US\$100 earlier, and also raised its 2012 forecast to US\$130 per barrel, from US\$105 previously, stating that the loss of ~1.5m barrels per day from Libya coupled with solid demand from emerging economies will lead to tighter inventories going forward.

Exhibit 18 : WTI Spot Price



Source: EIA, RB Milestone

Natural Gas

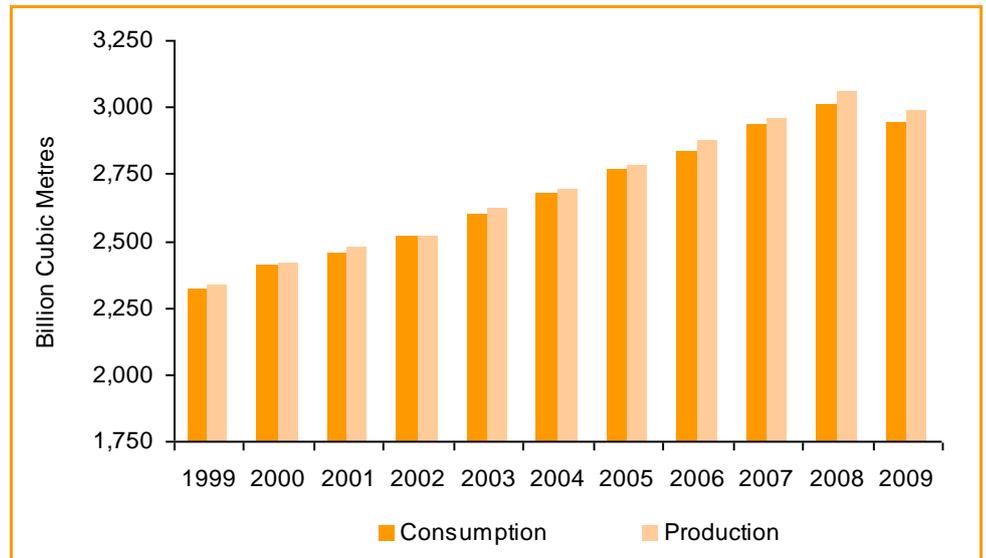
- **Natural Gas Demand:** In 2010, natural gas consumption in the US recorded a growth of 5.1% to 66.1 billion cubic feet per day (Bcf/d). According to EIA, natural gas consumption is expected to edge up by 0.5% y-o-y to 66.7 Bcf/d in 2011 on the back of a 1.9% growth in industrial consumption to 18.4 Bcf/d

In 2012, EIA expects natural gas consumption to grow 0.7% to 67.0 Bcf/d. The growth will be primarily driven by industrial and electric power sectors which is expected to more than offset the projected fall in residential and commercial consumption.

- **Natural Gas Supply:** US natural gas production grew 4.5% to 61.8 Bcf/d in 2010. According to EIA, total natural gas marketed production is expected to grow by 2.4% to 63.3 Bcf/d in 2011 and by 0.8% to 63.8 Bcf/d in 2012. The decline in the growth

rate would be caused by “freeze-offs” during cold weather which forces some producers to halt part of their production

Exhibit 19 : Global Natural Gas Production and Consumption



Source: EIA, RB Milestone

- Natural Gas Inventory:** US natural gas inventory levels stood at 1,757 Bcf as of April 29, 2011. Large drawdowns of inventory took place in January and February 2011 because of the cold temperatures and production freeze offs. EIA expects the inventory levels, although low in the first half of the year, to remain strong on the back of higher forecast production right through the 2011 injection season

Demand and Supply factors for Natural Gas

- Growth in Industrial Output.** Industrial demand constitutes ~37.6% of natural gas demand, which is the highest of any sector. EIA expects industrial energy demand to rise at an average annual rate of 1.2% till 2025. Further growth in industrial production could lead to increased demand for natural gas
- Role of Fuel Switching.** Large-volume gas consumers, primarily industrial consumers and electricity generators, can switch between natural gas and oil, depending on the prices of each. This fuel switching leads to an increase/decrease in the demand for natural gas, leading to fluctuations in its price
- Inventory Levels.** Natural gas inventory levels can have a significant impact on its price. Inventory levels have an inverse relationship with natural gas price. When the inventory levels are low, a signal is being sent to the market indicating a smaller supply cushion, leading to higher prices. On the other hand, when inventory levels are high, this sends a signal that there is greater supply flexibility, leading to lower prices
- Impact of Weather Changes.** Weather conditions can have a major impact on natural gas demand and supply. Demand from residential and commercial users, which consume natural gas for heating, surge during winters. Extreme weather conditions like freeze-offs during very cold weather could also force some natural gas producers to temporarily shut down some production
- Pipeline Infrastructure.** The availability of natural gas supplies at the market place are impacted by the ability to transport natural gas from producing regions to consumption regions. The interstate and intrastate pipeline infrastructure can only transport a specific amount of natural gas at any given time and, in essence, provides the upper limit for the amount of natural gas that can reach the market. Currently, the pipeline infrastructure has a daily delivery capacity of 148 Bcf, as per the EIA

Natural Gas Price Outlook

The Henry Hub spot price averaged US\$4.25 per MMBtu in April 2011. EIA expects the Henry Hub price to average US\$4.24 per MMBtu in 2011, a reduction of 15 cents from the average price recorded in 2010, as it believes that uncertainty over future prices is lesser in 2011 as compared to last year at this time. However, EIA forecasts the Henry Hub price to average at US\$4.65 per MMBtu in 2012 due to the expected decline in production from current levels which would lead to tightening of the domestic market next year. Further, the earthquake in Japan, the largest importer of LNG in the world, and ensuing disruptions in the country's generation of nuclear power is expected to boost Japan's demand for LNG as a replacement for generating electricity, all of which will contribute towards higher global LNG prices.

Exhibit 20 : Henry Hub Natural Gas Spot Price



Source: EIA, RB Milestone

Growth Drivers

History of Successful Acquisitions

EEG has been quite active in terms of acquiring oil & gas assets, especially in the US. Below are the details of EEG's acquisition track record:

Exhibit 21 : Acquisition History for EEG

Date	Place	Number of Wells/Number of Acres	Acquisition Price	Acquisition Multiple	1P Reserves
11/12/2006	Hawthorne, Pennsylvania	160 natural gas wells and 5,800 acres in PA	US\$8.85 million	US\$0.74/Mcf of 1P Reserves	11.3 Bcf
09/12/2009	Mayville, Pennsylvania/New York	1,805 natural gas wells and 303,000 gross acres in NY and PA	US\$38 million	US\$0.57/Mcf of 1P Reserves	56 Bcf
23/12/2010	Kansas and North Dakota	245 oil wells and 18,000 gross acres in Kansas and 17,000 gross acres in North Dakota	US\$56.25 million	US\$15.6/Boe of 1P Reserves	3.75 mmBoe

Source: Company Filings, RB Milestone

In December 2009, EEG acquired 1,800 gas wells in Mayville, Pennsylvania/New York for US\$38 million. Subsequently, EEG's natural gas reserves increased by about six times

and the company also turned EPS positive, from a loss of A\$0.01/share in December 2009 before the acquisition, to A\$0.027 per share in December 2010. EEG's share price rallied 16.7% following the news of the acquisition in Mayville.

Later in December 2010, EEG acquired oil producing assets in Central Kansas Uplift region for US\$56.2 million. The acquisition increased the production capacity by 550 barrels of oil equivalent per day (boe/d) to 1,520 boe/d. According to management, the acquisition's 2P reserves of 4.4 million boe will boost oil production in the coming years. EEG's share price rose 25% following the news of the acquisition in Kansas.

We believe that EEG has the capability to evaluate and invest in value accretive projects and companies going forward. The company has set production targets of 2,500 boe/d by 2012 and 10,000 boe/d by 2015, while its current production is 1,520 boe/d. The management has planned to meet the ~8,500 boe/d shortfall through its development of current projects as well as through acquisitions. The company aims to increase production by 4000 boe/d through drilling and the remaining 4,500 boe/d through acquisitions.

Its past acquisition record underscores our confidence in EEG's management and we believe that the company has the requisite skills to source and acquire value accretive assets.

Mayville Can Boost Resource Base

EEG's Appalachian Basin assets comprise resource rich Marcellus and Utica shales. According to certified petroleum engineers, Ralph E Davis Associates, wells within the defined Marcellus oil resource zone are estimated to contain prospective resource of more than 70 million barrels of oil, based on a recovery factor of 3%. On the other hand, Utica shale is expected to hold 5 trillion cu. feet of gas. The estimate for Utica includes wells that have been drilled during exploration and there could be further upside as exploration activities progress and more wells are drilled.

Encouraging Prospects of Shale Assets in Australia

EEG's subsidiary, Imperial Oil & Gas Pty Limited, has identified potential shale gas resource in the MacArthur Basin in Northern Territory, Australia. The company is seeking exploration permits for 14.6 million acres and the exploration target is for shale oil & gas in organic rich black shale. The shale has shown presence of gas with mineral exploration well GRNT-79-9 igniting and producing a six meter flare for six months, burning ~0.5 billion cubic feet of gas in the process. We believe that the MacArthur Basin has the potential to establish presence of a significant gas resource in the near future.

Exhibit 22 : Flare in GRNT 79-9 Well



Source: Company Reports

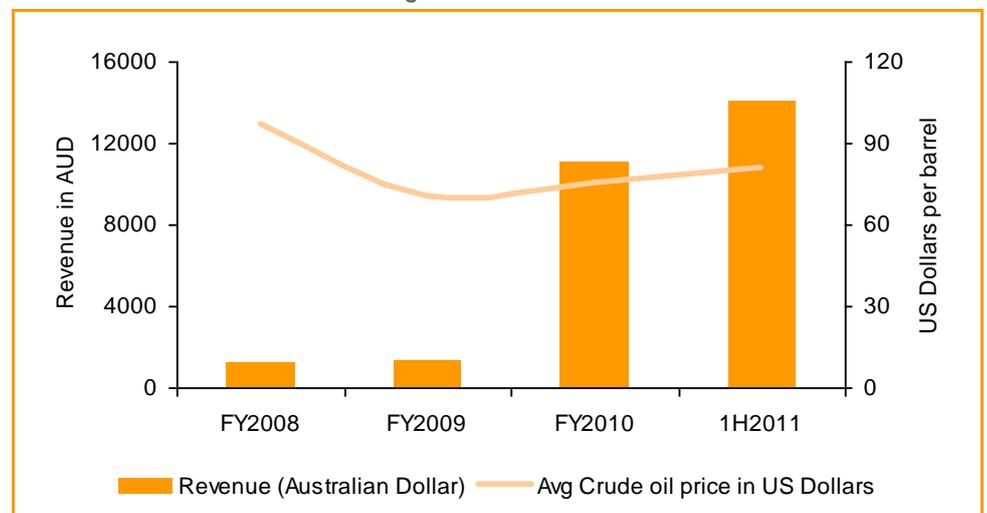
Robust Price Outlook for Oil & Gas

EEG has 2P reserves of 16.8 million Boe, of which 36% is oil and the rest is natural gas. EEG has targeted a daily production of 2,500 Boe/d by 2012 through organic and inorganic growth. EEG's increase in production for coming years and robust prices of crude oil & natural gas in the international market will significantly increase the revenues and bottom line of the company.

Oil & Gas prices are driven by demand factors and supply factors. According to World Bank data, world GDP growth is expected to grow by 4.4% in 2011. The economic recovery of the world economy would cause an upward pressure on demand for oil & gas. The strength of the dollar is impacted by Federal policy and Quantitative easing measures taken by the Fed. With QE2 coming to an end on June 30, 2011, stocks and commodities could face a downward trend. There is a possibility that QE3 will be announced to lower long term interest rates in US. The US dollar has fallen post the announcements of QE1 and QE2. We could expect that trend to continue in case of announcement of QE3. Growth in industrial output and electricity generation plays a major role in demand for natural gas. According to EIA estimates, Industrial energy demand is expected to rise at an average rate of 1.2% per year until 2025. EIA expects US electricity power sector generation to fall by 0.2% in 2011 and increase by 2.4% in 2012.

According to EIA estimates, West Texas Intermediate (WTI) Crude Oil is expected to trade at an average price of US\$103 and US\$107 per barrel for WTI crude in 2011 and 2012, respectively, whereas natural gas is expected to trade at an average of \$4.24 per MMBtu in 2011 and \$4.65 per MMBtu in 2012. Further, Goldman Sachs recently boosted its 12-month price forecast for Brent crude to US\$130 per barrel, from US\$107 earlier, and for end-2012 to US\$140 per barrel, from US\$120 previously, while Morgan Stanley lifted its forecast for 2011 to US\$120 per barrel, from US\$100 earlier, and for 2012 to US\$130 per barrel, from US\$105 previously. The companies cited strong demand from emerging economies; tightness in OPEC's spare capacity; and the ongoing crisis in Libya as the major reasons for the revised forecast. EEG's revenues are closely linked to the international crude oil and natural gas prices. Revenues and net profit of the company could increase on back of the rise in price of the international crude oil and natural gas prices.

Exhibit 23 : EEG's Revenue and Average Crude Oil Price



Source: Company Reports, RB Milestone

Technological Innovation Gives Cost Advantage

Technological innovation in E&P has played a vital role in meeting the rising industry demand for oil & gas. Technological advancement has enabled companies in the oil & gas sector to operate in a profitable manner. The use of latest technology has made E&P operations more efficient, safe and environmentally friendly. EEG plans to use the following technologies for exploration and drilling:

- EEG plans to use 3D Seismology to pinpoint structural closures in the drilling program in Central Kansas Uplift. 3D seismology uses traditional seismic imaging techniques, in combination with powerful computers and processors to create a three dimensional model of the subsurface layers. This technology would help oil & gas explorers to identify prospects more easily; effectively place wells; reduce the number of holes drilled; decrease drilling costs; and save time. 3D seismic imaging provides the company with economic and environmental benefits
- Empire Drilling & Field Services LLC, a subsidiary of EEG, is using the horizontal drilling technique in Marcellus Shale development program. The company has derived many cost benefits by using horizontal drilling. The drilling is a type of directional drilling, in which a 90 degree turn is taken in the well within a few feet. Horizontal drilling is effective in extracting non-thick productive formations, which extend over a large lateral area. Before directional drilling was invented, such formations were either economically infeasible or required multiple wells to recover the hydrocarbons
- Innovations in drilling technology and techniques, multidimensional seismology and use of hydro fracturing method have made it possible to tap into Marcellus shale in the Appalachian Basin. Hydro fracturing uses a mixture of millions of gallons of water, sand and chemicals which is injected at high pressure into the horizontally drilled wells. This high pressure causes the shale rock formations to crack and release the trapped gas

SWOT

Strengths

- The acquisition of oil assets in Central Kansas Uplift has been positive as it has provided the company with daily oil production of 550 barrels of oil
- The 2P reserves of the company (16.8 million boe) will fetch significant cash flows for the company in the near future especially as oil prices have climbed significantly in recent times
- The company has access to funds of US\$13.9 million, raised in May 2011, which mitigates funding risk to a great extent
- EEG has a US\$150 million credit facility with Macquarie Bank Limited currently drawn to around \$65 million
- The company is protected against fluctuations in oil & gas prices as it has hedged 75% of oil production till 2015 at US\$90 per barrel and 75% of natural gas production at US\$5.85 per Mcf. EEG is also protected against interest rate risk as it has entered into interest rate swap agreement for a notional amount of US\$7.94 million

Weaknesses

- Current international gas prices makes tight sandstone gas wells in New York and Pennsylvania economically infeasible for the company
- The current fracking moratorium in New York State does not allow the Company to develop its large (+300,000 acres) Marcellus and Utica Shale landholdings
- The company's oil production is concentrated in Central Kansas Uplift, which exposes the company to risks against any operational failure in the unit. However, production is from a number of wells offsetting any catastrophic risk

Opportunity

- Accretive acquisitions in both Kansas and the north eastern USA is conducive for oil & gas development and exploration

Threat

- Although at marginal cost, the company's future operations in MacArthur Basin, Australia could receive a major setback for the Company's long term reserve building program if landholder negotiations are prolonged

Latest Financial Results

Exhibit 24 : Half Yearly Income Statements

Thousand Australian \$	Half Year Dec 31, 2009	Half Year Dec 31, 2010	YoY%
Revenue	1,601	14,041	776.8%
Cost of Sales	736	7,037	856.1%
Gross Profit	865	7,004	709.4%
Other Income	199	160	-19.6%
Profit on Sale of Investment	688	123	-82.1%
Net Gain/ (loss) on Foreign Currency	(243)	(9)	-96.4%
Impairment Loss on Available For Sale Assets	-	(62)	
Depreciation and Amortization	(515)	(3,261)	533.6%
Share of Profit/(Loss) on Equity Accounted Investments	(22)	-	
Administration Expense	(1,472)	(3,263)	121.6%
Fair Value Adjustment to Non-Controlling Interest on Consolidation	(127)	-	
Profit/(Loss) Before Tax and Finance Costs	(626)	694	-210.8%
Finance Income	70	40	-71.0%
Finance Expense	(1,212)	(1,858)	53.3%
Profit/ (Loss) Before Income Tax	(1,769)	(1,124)	-36.4%
Income Tax Benefit/ (Expense)	(18)	6,054	-33,721.9%
Net Profit	(1,787)	4,929	-375.9%
Basic EPS (in cents)	(0.10)	2.68	-3,230.4%
Diluted EPS (in cents)	(0.08)	2.68	-3,756.2%

Source: Company Filings, RB Milestone

EEG did not have significant oil & gas assets in 2009 and thus could only report revenue of ~A\$1.6 million for half year ending December 31, 2009. In 2010, EEG acquired various assets, including the acquisition of oil wells in Kansas, which resulted in revenue of ~A\$14 million. Income tax benefit of A\$6.1 million enabled EEG to post profit of A\$4.9 million for half year ending December 31, 2010.

Valuation & Investment View

We have valued EEG based on peer valuation using EV/Reserves as a comparable parameter. We have computed the EV/Reserves of the appropriate peer set for EEG. We have considered EEG's peers which are having only 2P reserves for computing a suitable valuation model.

Exhibit 25 : Peer Valuation

Name	2P Reserves (in mmBoe)	EV (A\$ mn)	EV/2P Reserves
NZ Oil & Gas	12.4	237.6	19.2x
Petsec Energy	5.75	49.4	8.6x
ROC Oil Company Ltd.	16.2	251.1	15.5x
Cooper Energy	2	84.38	42.2x
Horizon Oil	12	425.8	35.5x
New Standard Energy	10.9	22.9	2.1x
Stuart Petroleum	1.94	67.7	34.9x
Carnarvon Petroleum*	20.4	133.1	6.5x
Empire Energy Group Ltd	16.8	94.7	5.6x

Source: RB Milestone, Bloomberg, *Carnarvon Petroleum has not been considered in our valuation model as it has 3P reserves of 31.5 million boe.

From the table above we notice that EEG's EV/2P reserves ratio at 5.6x is significantly lower than the average EV/2P reserves ratio of 22.56x for the selected peers. However,

we believe that such a conclusion would be cursory in nature as it does not adjust for the impact of oil and gas mix in the 2P reserves.

While oil prices have increased strongly over the past few months, gas prices have appreciated just 2% in the last 12 months. Hence, companies with proportionately more oil reserves have seen an upgrade of their valuation reflecting higher values for their oil reserves.

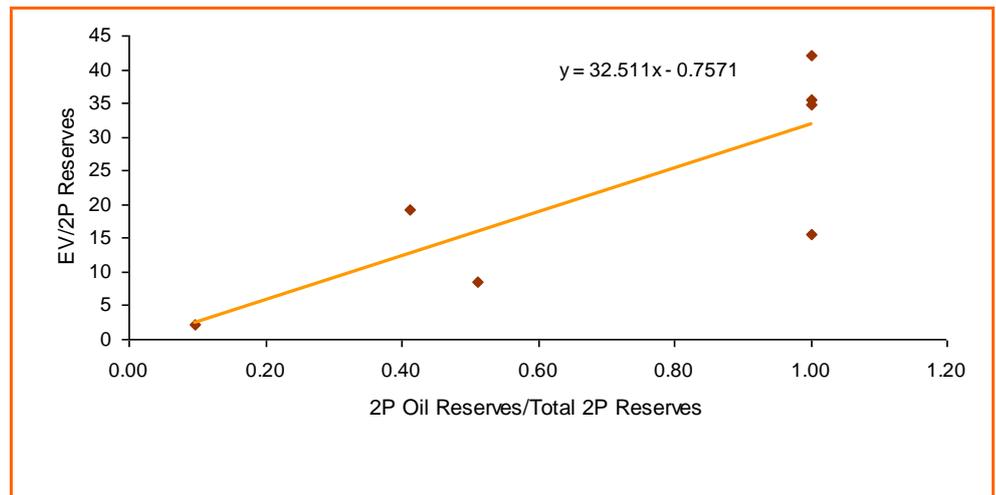
To account for this peculiarity, we have computed relation between EV/2P reserves and oil & gas mix, and got the following result:

Exhibit 26 : EV/2P Reserves and Oil/Gas Mix for Peers

Name	EV/2P Reserves	2P Oil Reserves/Total 2P Reserves
NZ Oil & Gas	19.2x	0.41
Petsec Energy	8.6x	0.51
ROC Oil Company Ltd.	15.5x	1.00
Cooper Energy	42.2x	1.00
Horizon Oil	35.5x	1.00
New Standard Energy	2.1x	0.10
Stuart Petroleum	34.9x	1.00
Carnarvon Petroleum	6.5x	1.00
Empire Energy Group Ltd	5.6x	0.26

Source: RB Milestone, Bloomberg

Exhibit 27 : Scatter Plot



Source: RB Milestone

This enabled us to estimate the EV/2P reserves for EEG given its current oil/gas reserve mix. Our target EV/2P reserves multiple is estimated at ~8x for EEG and the resultant target price is A\$0.275 per share. We believe that at current levels EEG appears undervalued as we have only included the current 2P reserves in our valuation and have not included any impact from the ongoing exploratory efforts, which can strongly uplift the company's resource base.

Exhibit 28 : EEG Valuation

Valuation for EEG	in million \$
Enterprise Value (EV)	130.32
Adjustments	
Cash*	16.4
Minority Interest	2.61
Total debt	67.58
Value of Equity	76.54
Number of Shares O/S**	278.19
Value Per Share	0.275
Current Market Price	0.110
Upside/(Downside)	150.1%

Source: RB Milestone, Bloomberg

*Cash includes A\$13.2 million received from private placement of 110 million shares in April 2011 and A\$568,860 raised through a small placement to existing shareholders

**Number of outstanding shares includes 110 million shares issued through private placement and 4.74 million shares issued to existing shareholders through small placement

Key Risk Factors

- **Forex Risk.** EEG is exposed to forex risk as its revenues and expenditures are recorded in US dollar. Balance Sheet of the company could be significantly impacted by the movement in US\$/A\$ exchange rate. Forex risk can be minimized by borrowing in US\$ for US\$ operations and keep a minimum cash balance in Australia
- **Commodity Price Risk.** EEG's revenues and cash flows are exposed to the movement in the price of oil and gas in the international market, but the Company has around 75% of its oil and gas production hedged, with no requirement for margin calls if the commodity price moves to the detriment of the hedges
- **Interest Rate Risk.** EEG is vulnerable against the fluctuations in interest rates in the US, where it has major interest bearing liabilities. The company tries to optimize its interest expense by using a mix of fixed rate and floating rate debt instruments. The company also enters into interest rate swaps to minimize the interest rate risk. The company is very sensitive to changes in interest rate as one percent increase in interest rate can reduce the company's post-tax profit by A\$650,000
- **Credit Risk.** EEG is exposed to credit risk in case of default of the counter party. Credit risk arises when counter party fails to meet its financial obligation. The company has been trying to minimize the credit risk by trading only with recognized and credit worthy third parties
- **Regulatory Risk.** EEG's entire oil & gas production is from the US. Any unfavourable change in policies for onshore oil & gas exploration by the US government could impact the company's E&P activities
- **Natural Calamity Risk.** EEG is vulnerable to risk from natural calamities like earthquakes, adverse weather conditions, etc, which could disrupt the exploration activities of the company and hamper its oil and gas production. However EEG has undertaken a strategy where production is generated from a large number of efficiently run oil and gas wells, which have a very long life, and as such slow decline, offsetting any calamity that may arise in a specific region
- **Operational Risk.** EEG faces operational risk if it is unable to continue exploration activities due to operational difficulties such as absence of skilled labor; non-availability of tools and equipments required for exploration; industrial and environment accidents; and industrial disputes

EEG Management and Board of Directors

Bruce William McLeod, Executive Chairman and CEO

Mr. McLeod has been EEG's Director since May 21, 1996. Prior to joining EEG, Mr. McLeod was involved in raising debt and equity capital for a number of property projects and companies, as well as the takeover and rationalization of listed and unlisted companies. Previously he spent six years with the Bank of America's subsidiary, BA Australia Limited. While there, he served as the Executive Director, responsible for its financial and capital markets operations. Mr. McLeod is also Chairman of Mayan Iron Corporation Limited

David Henty Sutton, Non-Executive Director

Mr. Sutton became EEG's Non-Executive Director on January 17, 1997. Mr. Sutton has many years of experience as a Director of companies involved with share broking and investment banking. Mr. Sutton currently owns and manages Dayton Way Financial Pty Ltd., a boutique financial services company focusing on the global resource sector. Mr. Sutton is also a director of Sinovus Mining Limited. Prior to Mr. Sutton's current role, he was a partner and director of several securities exchange member firms

Kevin Anthony Torpey, Non-Executive Director

Mr. Torpey was appointed as Non-Executive Director on November 26, 1992. Mr. Torpey is a Chartered Professional Engineer. Over the last 40 years, Mr. Torpey has been involved in the development of many diverse major projects involving oil; iron ore; aluminum; nickel; lead/zinc; uranium; magnesite; coal; and gold located in Australia, Ireland and Indonesia. Mr. Torpey is currently a Director of Latrobe Magnesium Limited and Camberwell Coal Pty Limited

David Hughes, Joint Company Secretary

Mr. David Hughes joined EEG as Company Secretary on November 11, 1992. Prior to joining EEG, Mr. Hughes held similar positions with other listed companies for over 20 years. Mr. Hughes is currently acting as Company Secretary or Joint Company Secretary for a number of other Australian listed public companies

Rachel Ryan, General Manager Finance and Joint Company Secretary

Ms. Ryan has been employed in the Company's corporate finances division since 2006 and now serves as General Manager Finance. Ms. Ryan was appointed as Joint Company Secretary on July 21, 2010

Dr David Kahn

Dr Kahn's qualification includes Bachelors in Engineering from McGill University and Masters in Chemical and Petroleum Engineering as well as a PhD in the same discipline, from Ecole Nationale Supérieure du Pétrole et des Moteurs (Paris). Dr. Kahn is currently a director of Gale Force Inc., Sonic Technology Inc. and WHL Energy Limited. During the past seven years, Dr. Kahn has been a principal in companies focused on developing strategies for exploiting unconventional oil and gas assets

Dr John Warburton, Consultant and Director, CEO Imperial Oil & Gas Pty Limited

Dr Warburton was also appointed as a director and Chief Executive Officer of EEG's wholly owned subsidiary, Imperial Oil and Gas Pty Ltd., on March 18, 2011. Dr. Warburton has 27 years of technical and leadership experience in International Petroleum E&P, including 11 years with BP and 4 years as General Manager Exploration & New Business for LASMO-ENI in Pakistan. Dr. Warburton is the Director of Sydney-based Petroleum Exploration Business Consultancy Insight Exploration and he maintains a strong global executive network

USA Management

Al Boyer, SVP & Chief Operations Officer

Mr Boyer has been involved in the natural gas business for over 40 years. Mr Boyer currently operates over 40 privately owned wells. In the early 2000's he was involved in a well drilling program of 200 wells over a 20 month period for Somerset Oil & Gas Inc as well as the consolidation of their field operations until its takeover by EOG Resources. Mr Boyer has drilled 1,000's of wells in western PA, NY, OH and WV

Tony Crisafio, Chief Financial Officer

Mr Crisafio serves as Contract Chief Financial Officer. He is an independent business consultant, providing financial and operational advice to 8 businesses. Prior, he was the Chief Operating Officer to Cinema World, Inc. and a Partner with Ernst & Young. Mr Crisafio is also a Director and Chairman of the Audit Committee of Petroleum Development Corporation Inc, an oil and gas company with operations in the Appalachians, Michigan and the Rocky Mountain Region

Rob Kramer, VP - Mid Con Operations

Mr Kramer is responsible for the Company's Mid-Con operations in Kansas and North Dakota. Prior to joining Empire Energy he was a Completions and Production Engineer for Anshutz Exploraton Corp, a large private company with extensive operations in the USA E&P industry. Prior to that he played a key role in the establishment of Sanjel (USA) Inc in the Mid Con region where he was Lead Engineer for well design including cementing, fracturing, acidizing as well as coil tubing operations. Mr Kramer began his E&P engineering career with Schlumberger where he was a Field Engineer for their Well Stimulation Services

Tim Hull, VP - Appalachia Operations

Mr Hull is responsible for the Company's Appalachia operations in New York and Pennsylvania. He was regional field manager for Range Resources Inc in New York State prior to its acquisition by Empire Energy in late 2009. Mr Hull has had extensive experience in natural gas production and operations, currently managing around 1,800 wells and 300 miles of pipeline

Bob Gustafson, Financial Controller

Mr Gustafson is responsible for Empire Energy's financial operations working with a team of 6 staff at the Company's Headquarters outside Pittsburgh PA. He has had extensive experience in both the financial sector and the oil and gas sector. Previously Mr Gustafson was manager of Financial Accounting for Severstal-Wheeling Inc, one of Pennsylvania's major steel plants. Prior to that, for a period of over 20 years he has had various financial responsibilities for E&P companies which include TW Phillips Gas & Oil Co., Columbia Energy Services, Equitable Resources Energy Co and Gulf Oil Corporation

Susan Gasper, Accountant

Ms Gasper has been with the Company since early 2009 and has been responsible for developing the Company's accounting, IT and Financial Management systems

Disclaimer

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