



Morning Note

13 December 2012

Markets

The Dow industrials faded at the last gasp after being up 65 points near the end of the session to finish 3 points weaker. Optimism related to new asset purchases of \$45b per month by the Fed, in addition to the \$40b of mortgage backed securities it already purchases, was offset by the fiscal cliff deadlock in Washington.

Base metals were stronger across the board, with the exception of nickel (aluminium +1.5%, tin +0.7% and copper +0.4%), gold was flat at \$1,711.6/oz, and crude up 1.1% to \$86.77/bbl.

Pancontinental (PCL) – Is it too Obvious?

Sometimes we cannot see the forest for the trees. In the case of PCL, we believe that the market has focussed too much on the detail (or lack thereof) in relation to the Mbawa discovery well drilled a few months ago. The available detail being a small gas discovery at one of several prospective horizons when the expectation was large oil. The bigger picture that has been missed, in our view, is:

- This is a first up discovery in virgin territory and the first ever discovery offshore Kenya
- Reservoir quality is excellent
- Type II kerogen source rock mature for generation of gas **and oil**. This means that oil has been generated in the system and now the Apache led joint venture is tasked with determining where it is.
- The deeper horizon was not intersected meaning that prospectivity at this level remains.

The upshot of all of this is that a worst case scenario will be discovery of significant quantities of gas offshore Kenya over the next two years, with an upside case that includes oil. Majors and internationally renowned explorers such as Apache, Tullow, BG and Anadarko all believe in the oil story based on interpretation of likely differences in maturity of the source rock offshore Kenya vs that offshore Tanzania and Mozambique where large gas discoveries have been made with stunning success in recent years.

Given that drilling is about to commence again offshore Kenya we would expect that once this news penetrates the market, the share price should start to appreciate. Anadarko has announced, via the Kenyan Ministry of Energy, that it will be drilling two wells in blocks adjacent to PCL's interests offshore Kenya, commencing in December. BG and Apache also have plans to drill multiple wells in 2013, for which PCL will have direct exposure through its ownership in blocks L8, L10A and L10B. A farm-out of PCL's L6 block could also provide a catalyst.

Additionally, HRT will be drilling a well in a permit adjacent to PCL's acreage offshore Namibia, where analysis has detected a strong incidence of surface seeps. This well is scheduled for spud in February 2013. Recent drilling offshore Namibia has not yielded commercial results; however, this well will be the first in the Walvis Basin, where the source rock is thought to be in the oil window in present day.

It is also likely that we will see an independent certified update on prospective resources across all or part of the portfolio. This has been an effective value creator for many other junior explorers.

PCL has cash at bank of A\$39m so is fully funded for the forward work program and with an Enterprise Value of A\$55m, it is comparatively cheap to other explorers that do not have proof through drilling of an active petroleum system, seal and reservoir. Risk has been decreased (but is still present – this is exploration after all), the upside remains intact and the share price has declined. This, in our view, defines the opportunity.

We do not officially cover PCL so there is no recommendation or price target but we would be surprised if the share price did not double over the next few months on speculation alone. Given that we believe that additional discoveries are likely offshore Kenya, we also can see a strong likelihood of a sharply higher share price by this time next year.

World Markets		+ / -	%
Dow Jones	13,245	-3	-0.0
NASDAQ	3,014	-8	-0.3
S & P 500	1,428	1	0.0
FTSE 100	5,946	21	0.4
Nikkei 225	9,581	56	0.6
Hang Seng	22,503	179	0.8
ASX All Ords	4,592	11	0.2

Currencies		+ / -	%
\$A/\$US	1.055	-0.00	-0.04
\$US/Yen	83.250	-0.01	-0.01
GBP/\$A	1.531	0.00	0.03
Euro/\$US	1.307	-0.00	-0.01

Energy		+ / -	%
WTI (US\$/bbl)	86.77	0.98	1.1
Henry Hub (US\$/mcf)	3.33	-0.06	-1.8
UxC Uranium (US\$/lb)	43.50	1.00	2.4

Bulks		+ / -	%
Fines -62% CFR (US\$/t)	125.00	0.10	0.1
Freight (US\$/t)	7.30	-1.10	-13.1
Thermal Coal FOB (US\$/t)	90.65	3.55	4.1

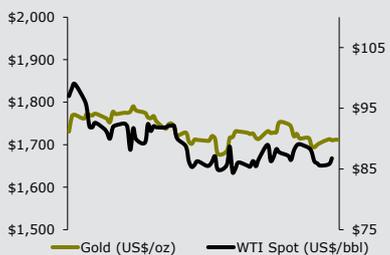
Precious Metals (Bloomberg)		+ / -	%
Gold (US\$/oz)	1,711.6	1.2	0.1
Platinum (US\$/oz)	1,635.8	0.3	0.0
Silver (US\$/oz)	33.5	-0.0	-0.0

LME, Cash		+ / -	%
Aluminium (US\$/t)	2,141	31.3	1.5
Copper (US\$/t)	8,105	30.8	0.4
Lead (US\$/t)	2,305	24.0	1.1
Nickel (US\$/t)	17,632	-102.0	-0.6
Tin (US\$/t)	23,152	163.0	0.7
Zinc (US\$/t)	2,071	16.0	0.8

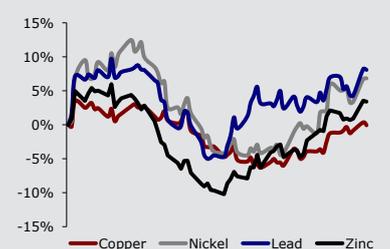
International Markets (3 Month)



Gold v Oil (3 Month)



Base Metals (Rebased) (3 Month)



**Contact Details****Research:****Ian Christie**

Director, Industrial Research
+61 8 9224 6872

Troy Irvin

Director, Metals & Mining Research
+61 8 9224 6871

Adam Miethke

Director, Metals & Mining Research
+61 8 9224 6806

Dave Wall

Director, Energy Research
+61 8 9224 6864

Emily Reilly

Analyst, Industrial Research
+61 8 9224 6809

Matthew Keane

Analyst, Metals & Mining Research
+61 8 9224 6869

Patrick Chang

Analyst, Metals & Mining Research
+61 8 9224 6835

Chris Jiang

Analyst, Metals & Mining Research
+852 3557 4804

Institutional Sales - Perth:**Chris Wippl**

Head of Sales & Research
+61 8 9224 6875

John Santul

Consultant, Sales & Research
+61 8 9224 6859

Damian Rooney

Senior Institutional Dealer
+61 8 9224 6862

Ben Willoughby

Institutional Dealer
+61 8 9224 6876

Bryan Johnson

Institutional Dealer
+61 8 9224 6834

Alex Wallis

Institutional Dealer
+61 8 9224 6805

Institutional Sales - Hong Kong:**Travis Smithson**

Managing Director - Asia
+852 9832 0852

Angus McGeoch

Institutional Research Sales
+852 6623 8935

Corporate and Private Client Sales:**Glen Colgan**

Executive Director, Desk Manager
+61 8 9224 6874

Kevin Johnson

Executive Director, Corporate Stockbroking
+61 8 9224 6880

James McGlew

Executive Director, Corporate Stockbroking
+61 8 9224 6866

Simon Lyons

Director, Private Clients
+61 8 9224 6881

Geoff Barnesby-Johnson

Senior Dealer, Corporate Stockbroking
+61 8 9224 6854

Andrew Venn

Senior Dealer, Corporate Stockbroking
+61 8 9224 6865

Cameron Fraser

Dealer, Private Clients
+61 8 9224 6851

Rob Healy

Dealer, Private Clients
+61 8 9224 6873

Ben Rattigan

Dealer, Private Clients
+61 8 9224 6824

Luke Levis

Dealer, Private Clients
+61 8 9224 6852

Important Disclosure

The analyst has a beneficial interest in the shares of PCL.

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