Breakaway Research

Target Energy (TEX)

Ramping up activity in the prolific Permian Basin

Recommendation: Speculative Buy

Company Update

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Company Information

ASX Code	TEX
Share Price	A$0.056
Shares + con notes	448.0m
Options	41.2m
Market Cap	**A$29.5m**
Cash (June 30)	A$1.5m
Debt	A$1.8m
Enterprise Value	**A$25.7m**

Directors

Non- Exec Chairman	Chris Rowe
Managing Director	Laurence Roe
Non- Exec Director	Stephen Mann
Chairman (TELA USA)	Ralph Kehle

Substantial Shareholders

Investmet Ltd	29%
Graham Riley	5%
Little Breton S/F	3%
Michael Fotios	2%
Annabel Glover	2%

Company Details

Address	6 Richardson St, Suite 5 West Perth, 6005, WA
Phone	+618 9476 9000
Web	www.targetenergy.com.au

1 Year Price Chart

Source: Bloomberg

Key Points

- ***Target Energy is pursuing a low risk growth strategy focussed on the prolific Permian Basin***
- ***Current production averaging ~250 boepd, with a target of doubling production over the coming year***
- ***2 successful recent wells are awaiting completion for production (Darwin #3 at Fairway and Pine Pasture #3 at East Chalkley)***
- ***3 Permian Basin exploration wells scheduled in the next few months***

Target Energy is a rapidly growing oil and gas producer focussed on the prolific Permian Basin in West Texas. The company has increased its 2P reserves by 887% to 1.2 mmboe (and total reserves and resources by 280% to 2.8 mmboe) during the past year and has achieved a 235% gain in net production over the past two quarters. An active exploration program is in progress and should drive further strong uplift in production. Target Energy is dual listed trading on the US OTCQX and the ASX.

Investment Thesis

Target Energy (ASX: TEX) is a US based oil & gas producer and explorer that has established meaningful acreage positions in proven major hydrocarbon producing areas in the Permian Basin and Gulf Coast regions. From modest beginnings, production and exploration activity is now gathering momentum and creating a robust, sustainable corporate platform.

2P reserves rose strongly to 1.2 mmboe as at 30th June, largely driven by drilling successes at Darwin #1 and #2 (in 2012) and Sydney #1 (in 2013). Similarly, these wells have helped boost net production by more than 200% in the last few quarters. In turn this is driving improved cash flow which is being directed at accelerating growth activities.

Opportunity exists for significant production increases during Q3 and Q4 2013 with five wells either awaiting completion (Darwin #3 and Pine Pasture #3) or about to be drilled (Sydney #2, Darwin #4 and Sydney #3). In addition, production rates will be boosted by a proposed waterflood of the East Chalkley oil-field.

In the near term Target Energy will continue to expand in a relatively low risk, low cost manner via multiple completions based on conventional carbonate reservoirs in vertical wells. In the longer term there is potential to exploit large scale resources via fracture stimulation of shale and tight oil plays in both vertical and lateral wells.

Company Update

2P Reserves increase 887%

Target Energy recently released the annual Reserve and Resource estimate for its combined Texas and Louisiana based projects. Encouragingly, **Proved and Probable Reserves jumped 887%** to ~1.2 million barrels of oil equivalent, with the oil component making up ~80% of reserves.

2P Reserves of ~1.2 million barrels of oil equivalent

Total Reserves and Resources as at June 30, 2013 (net to Target Energy's interest)

Category	Net Reserves & Resources		BO equiv.
	Oil (Mbbls)	Gas (MMscf)	(Mboe)
Proved Developed Producing (PDP)	109.1	200.6	142.5
Proved Developed Not Producing (PDNP)	36.4	85.7	50.7
Proved Undeveloped (PUD)	331.6	517.6	417.9
Total Proved Reserves (1P)	**477.1**	**803.9**	**611.1**
Probable	455.7	670.3	567.4
Total Proved & Probable Reserves (2P)	**932.8**	**1,474.2**	**1,178.5**
Possible	683.9	970.9	845.8
Total Proved, Probable & Possible Reserves (3P)	**1,616.80**	**2,445.10**	**2,024.30**

Source: Target Energy

The bulk of the reserve estimate is made up from four producing Fairway Project wells; namely BOA 12 #1, Sydney #1 and Darwin #1 and Darwin #2 (which have combined total 3P Reserve of 1.7 Mboe).

The table below summarises the current production status of the producing wells, as well as the indicative time line for upcoming drilling and well completion activity.

2 wells set to add to production

3 more wells to be drilled in 2013

Target Energy - Total Current Production Summary and Upcoming Wells

Well	Interest (%)	Average daily gas production (mcfgd)	Average daily oil production (bopd)
BOA 12 #1	60%	0	20
Darwin #1 & #2	60%	120	120
Sydney #1	60%	200	150
Darwin #3*	60%	Producing	Imminent
Sydney #2*	60%	Q4 2013	Q4 2013
Darwin #4*	60%	Q4 2013	Q4 2013
Sydney #3*	60%	Q1 2014	Q1 2014
Pine Pasture #2	35%	nmf	40
Pine Pasture #3*	35%	nmf	Imminent
Section 28	25%	825	20
Merta	25%	200	nmf
Total		1145	352
Total net to TEX		**840**	**194**

**Wells to be drilled or completed for production in 2013*
Source: Target Energy and Breakaway estimates

Fairway Project

Target Energy 60%, Trilogy Operating (operator) 30%, Avalon Oil 10%

The Company's flagship Fairway Project is located in the highly productive West Texas Permian Basin, which is the largest onshore hydrocarbon basin in the US, covering 52 counties and over 75,000 square miles. Total daily production from the basin is ~1.3 million barrels of oil and ~4 billion cubic feet of gas. This equates to approximately 3 times Australia's total daily hydrocarbon output.

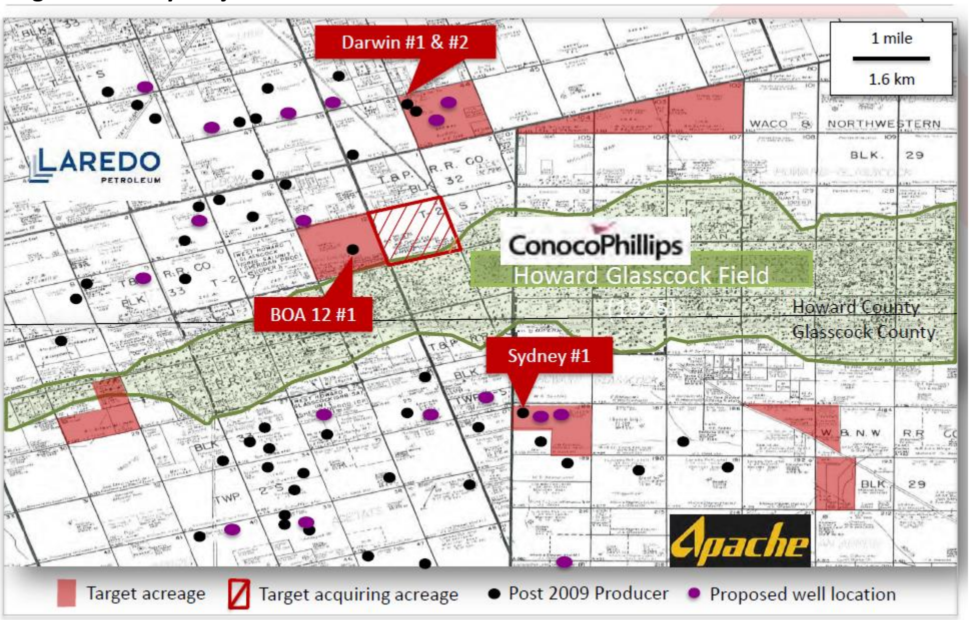
Located in a highly productive basin

The Permian Basin remains at the cutting edge of activity in the U.S. because it provides low risk, oil-rich, stacked reservoir zones that can be fully exploited by modern technology, and it is well serviced by infrastructure and services companies.

Blocks surrounded by producing wells

Target Energy has established a series of lease holding 'blocks' in the Basin, straddling the Howard and Glasscock county border. This field was discovered in 1925, has produced over 410 Mbbls of oil and remains highly productive. Target continues to expand its portfolio in the region.

Target's Fairway Project in the Midland Basin



Source: Target Energy

The plan above outlines Target Energy's existing holdings in the region, and the large number of recent successful wells and proposed new wells serves to illustrate the value of these holdings.

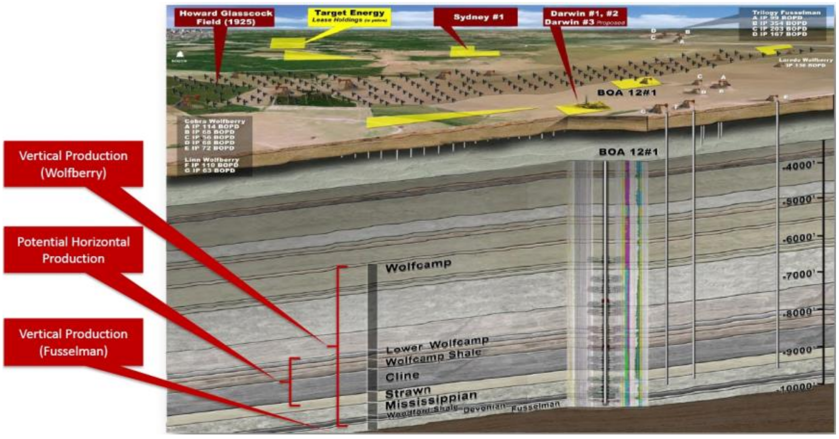
Proven Strategy

Within the Permian Basin, the Spraberry formation hosts the largest oil and gas reserves and is ranked third in the US by total proved reserves and seventh in total production. The Wolfcamp formation lies below the Spraberry and is also a major hydrocarbon producer within the Basin. The Wolfcamp trend is however, also well known for its low permeability.

Fusselman and Wolfberry wells achieve robust economics

Advancements in completion technology have made it possible to combine production from the Spraberry and Wolfcamp zones (known as 'Wolfberry') in areas that were previously considered uneconomic on a standalone basis, but are now achieving robust economic results. Drilling depths of typical 'Wolfberry' wells are between 2,500 and 3,500m (7,000-10,500ft) and typically include 8-12 fracture stimulations beginning at the bottommost formation.

Fairway Project – Permian Basin Fusselman, Wolfberry and Cline targets



Source: Target Energy

Target's Development Strategy

Target has a multiple completion strategy for its Fairway Project wells, with up to 110 locations identified. Phase 1 drilling is targeting conventional carbonate reservoirs in the Fusselman formation in vertical wells supporting strong production for 5-6 years. Phase 2 involves fracture stimulation of shale and tight oil plays – initially via vertical wells in the Wolfberry section and then potentially via laterals in the Cline Shale. These would represent long life assets. Indicative well economics are outlined below.

Fusselman represents a conventional low risk, low cost initial target

Indicative Fusselman Single Well Economics

	Assumptions			
Well Capex	US$m.	$1.8		
Oil Cut	%	86		
	High Case - EUR 430MBOE			
WTI	**US$/bbl**	**80**	**90**	**100**
IRR	%	423	506	596
NPV (10%)	US$m.	$7.0	$8.0	$9.0
	Mid Case - EUR 240MBOE			
WTI	**US$/bbl**	**80**	**90**	**100**
IRR	%	165	198	233
NPV (10%)	US$m.	$3.3	$3.9	$4.4
	Low Case - EUR 110MBOE			
WTI	**US$/bbl**	**80**	**90**	**100**
IRR	%	41	51	62
NPV (10%)	US$m.	$0.8	$1.1	$1.3

Fracture stimulation of the 'Wolfberry' is a potential second production phase

Indicative Wolfberry Single Well Economics

	Assumptions			
Well Capex	US$m.	$2.1		
Oil Cut	%	80		
	High Case – estimated ultimate recovery (EUR) 185MBOE			
WTI	**US$/bbl**	**80**	**90**	**100**
IRR	%	90	107	124
NPV (10%)	US$m.	$2.3	$2.7	$3.2
	Mid Case - EUR 150MBOE			
WTI	**US$/bbl**	**80**	**90**	**100**
IRR	%	64	77	89
NPV (10%)	US$m.	$1.6	$1.9	$2.3
	Low Case - EUR 115MBOE			
WTI	**US$/bbl**	**80**	**90**	**100**
IRR	%	40	50	59
NPV (10%)	US$m.	$0.9	$1.2	$1.4

Longer term opportunities exist for lateral drilling of the Cline Shale

Source: Target Energy *NB EUR = estimated ultimate recoverable resources*

Current Producing Wells – Fairway Project

BOA 12 #1

BOA 12 #1 Target's initial producing well

The BOA 12 #1 well was drilled in late 2011 and primarily targeted the 'Wolfberry' interval. The well was fracture stimulated in 11 separate zones over a 1,100m interval of the Wolfberry. Initial attempts at oil production were inhibited by water flow problems. Subsequently a down-hole jet pump was installed, enabling oil production of around 20 bopd.

Darwin #1 and Darwin #2

Darwin #1 was drilled to a total depth of 3,070m and encountered strong hydrocarbon shows throughout the Wolfberry section and in the deeper Fusselman formation. The nearby Darwin #2 well was originally drilled in 1983 - however it was plugged and abandoned as 'uneconomic' at that time. Following the strong oil and wet gas shows from the Darwin #1 well, the JV decided to re-enter the historical well to test the Wolfberry section (which had not been historically tested) as well as the Fusselman and Ellenburger.

Darwin #1 and Darwin #2 confirm Fusselman and Wolfberry strategy

The completion of the Darwin #1 and Darwin #2 wells are a significant step forward for the Company as it confirms the potential which exists within the deeper Fusselman formation.

Pressure testing of the Fusselman reservoir at Darwin indicates that the hydrocarbon accumulation is independent from any other Fusselman accumulations in the area and, as such, it is considered to be a **new field discovery**. **The positive result from these wells paves the way for a roll out of this strategy across numerous sites within the Company's lease holdings.**

Sydney #1 and Darwin #3

Sydney #1 to be producing shortly

The Sydney #1 well is located ~10km south of the Darwin wells and close to other successful Wolfberry and Fusselman wells. The well was brought into production from the Fusselman formation and, in keeping with best practise, testing of the Wolfberry section is deferred while the Fusselman remains productive. The Darwin #3 well is the latest well to be drilled within the Fairway project area and is located ~460m east of Darwin #1 and #2 wells. Darwin #3 encountered high levels of oil and gas shows while drilling, and is awaiting completion.

Increasing Licence Area

Target now has a possible 110 well locations

Target recently increased its Fairway Project area interests from 3,492 acres to 4,528 acres, representing a 22% increase. Assuming 40 acre spacing between well locations, Target now has up to 110 possible well locations within its holdings. With its existing wells supporting 3P reserves of ~1.75 Mboe, **significant exploration upside could be realised as targets with 'similar characteristics' to existing producing wells are tested**.

There is scope to double the number of possible wells to 220 within the lease holdings should the Texas regulator agree to change the minimum spacing from 40 to 20 acres (operator consensus within the Permian Basin suggests the reservoirs are inefficiently drained under 40 acre spacing and thus should be changed to a 20 acre minimum). This would further enhance the exploitation potential and the overall value attributable to the project.

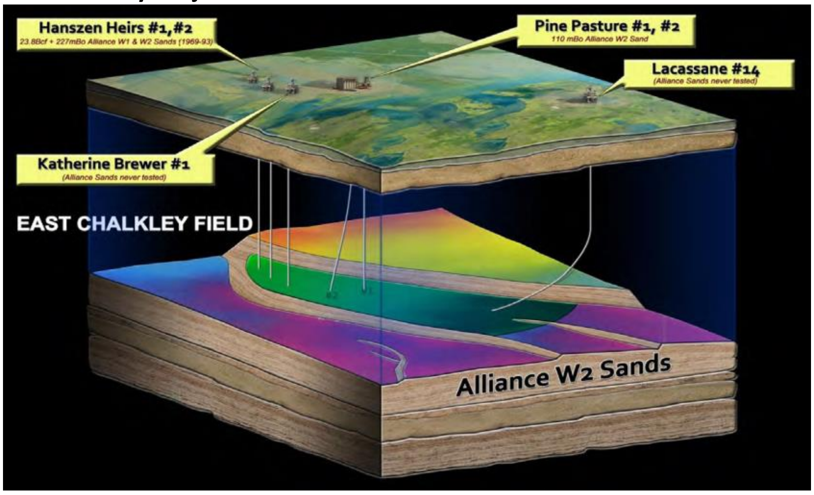
East Chalkley

Target Energy – 35% working interest (Louisiana, USA)

Potential now to drill additional producing wells

Target Energy initially achieved success in this area by participating in the drilling of Pine Pasture #2 in 2008. More recently the Pine Pasture #3 development well was drilled and it is currently being completed as an oil producer. The operator is also considering a waterflood to enhance field production. This is a secondary recovery method that involves water being injected into the reservoir formation to displace residual oil to adjacent production wells.

East Chalkley Project – Pine Pasture wells



Source: Target Energy

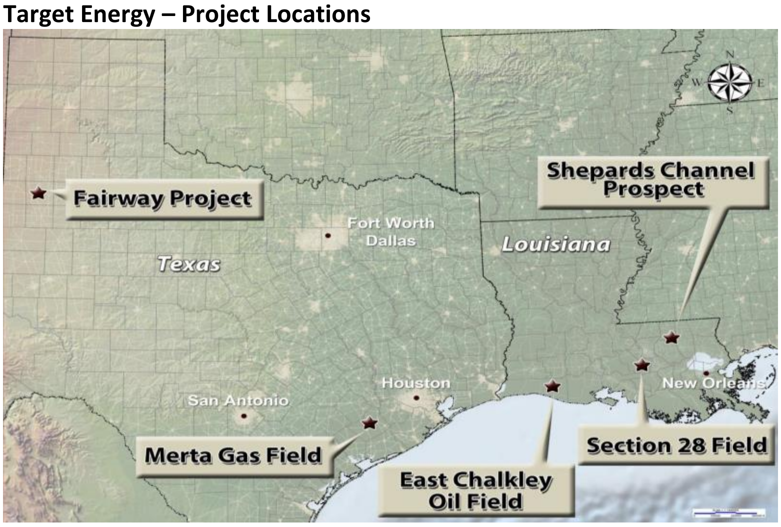
Multiple bypassed pay zones at Section 28

Additional Gulf Coast Assets

Target Energy also has an interest 25% interest in two producing Gulf Coast assets, namely the 'Section 28' field and the 'Merta' gas field.

Minimal additional capital investment required

Target Energy – Project Locations



Source: Target Energy

Attractive value proposition for investors

Breakaway's View

Breakaway is encouraged by the momentum that Target Energy is achieving in the Permian Basin. It is rapidly gaining the critical mass necessary to de-risk this style of investment, and its improving cash flow is supporting acceleration of assessment activities. Breakaway believes Target Energy represents an attractive 'value' proposition with low risk, well-funded growth attributes.

Analyst Verification

We, Grant Craighead and Geoff Reed, as the Research Analysts, hereby certify that the views expressed in this research accurately reflect our personal views about the subject securities or issuers and no part of analyst compensation is directly or indirectly related to the inclusion of specific recommendations or views in this research.

Disclosure

Breakaway Investment Group (AFSL 290093) may receive corporate advisory fees, consultancy fees and commissions on sale and purchase of the shares of Target Energy and may hold direct and indirect shares in the company. It has also received a commission on the preparation of this research note.

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