RESEARCH

OIL AND GAS

7 February 2012

RECOMMENDATION
BUY

12 month price target	**$0.31**
12 month volume	122m
12 month share low	A$0.12
12 month share high	A$0.51

ISSUED CAPITAL

ASX	HOG
Share price	$0.15
Mkt cap[1]	$43m
Ordinary shares on issue	192m
Escrowed Shares	94m
Unlisted Options[2]	39.8m

1 Undiluted *Source: IRESS*
2 Various dates and strike prices

DIRECTORS

Paul Morgan	Exec Chairman
Michael Earle	Managing Director
John Hopkins	Non Exec Director
David Riekie	Non Exec Director

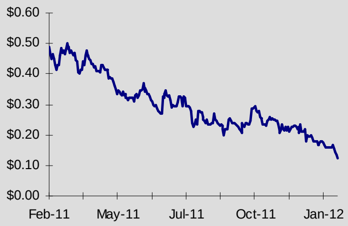
Source: HOG

MAJOR SHAREHOLDERS

Avenger Inv Holdings	9%
Acetone Ltd	9%
Paul Morgan	6.4%

Source: IRESS

12 MONTH PERFORMANCE



Source: IRESS

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Hawkley Oil and Gas Ltd (HOG)

Compelling Value at These Levels

HOG has been sold down heavily recently on the back of the disappointing Chernetska-1 well result. We believe at current share price levels ($0.15/sh), HOG offers compelling value and is currently trading at a substantial discount to our core valuation and an attractive discount to its peers on an EV/2P boe metric. We have therefore upgraded our recommendation to BUY (previously Speculative Buy).

Key Points:

- **Chernetska-1 results negative.** HOG announced the primary B20 target and the deeper B24/25 carbonate structures did not encounter commercial hydrocarbons. The B20 was found to be water bearing with correlation of the geology with adjacent wells confirming the B20 structure was different to the downdip discovery well (Slobidska 321) in that the B20 unit was comprised of two sandstone intervals and not one. Wireline logs over the deeper B24/25 carbonate section and a drill stem test indicated a tight interval with low permeability and no material hydrocarbons.

- **Overreaction to Chernetska result.** Given Chernetska-1 was the lowest risk target in the field, the result is disappointing and does create uncertainty towards the Chernetska forward drilling program. However, we believe the current selldown is overdone given only one well has been drilled in the field and the volumes being targeted in the primary B20 prospect were relatively small (1.47mmbbls oil). We expect the full potential of the Chernetska field to be known only after a number of wells have been drilled on the field.

- **Further asset diversification required.** The uncertainty caused by the Chernetska-1 well result does highlight that HOG needs to further diversify its asset base, in our view. We would like to see HOG secure an additional near producing/producing asset.

- **Compelling value at these levels.** Despite a reduction to our price target to $0.31/sh (previously $0.46/sh) to reflect the Chernetska-1 result and estimated equity dilution due to an increase in the 2012 activity program (an additional exploration well) we believe HOG offers compelling value at the current price level ($0.15/sh). Comparing HOG to its peers on an EV/2P metric, HOG is one of the cheapest companies on the ASX at ~$3.20/boe which is a significant discount to our sector average of ~$17/boe. In addition, we estimate HOG's core value (Sorochynska 2P reserves and cash) is $0.24/sh representing a 60% premium to HOG's current share price. **We have therefore upgraded our recommendation to BUY.**

- **Near term resource upgrade, increased production and further exploration.** HOG has a number of key catalysts which we believe will be value accretive to the share price. A resource upgrade for the Sorochynska field which will incorporate historical well data is expected in February. In addition a second development well (202) in Sorochynska is expected onstream in August which HOG expects to flow at ~7mmscf/d (Sorochynska-1 is currently producing ~6.8mmscf/d). Furthermore, HOG plans to drill another exploration well in Sorochynska or Chernetska by year end.

Compelling Value at These Levels

We believe HOG offers compelling value at these levels. HOG is currently trading at a significant EV/2P discount to its peers (Figure 1) and is trading well below its core value. Comparing HOG to its peers on an EV/2P metric, HOG is one of the cheapest companies on the ASX at ~$3.20/boe which is a significant discount to our sector average of ~$17/boe. In addition, we estimate HOG's core value (Sorochynska 2P reserves and cash) is $0.24/sh representing a 60% premium to HOG's current share price of $0.15/sh.

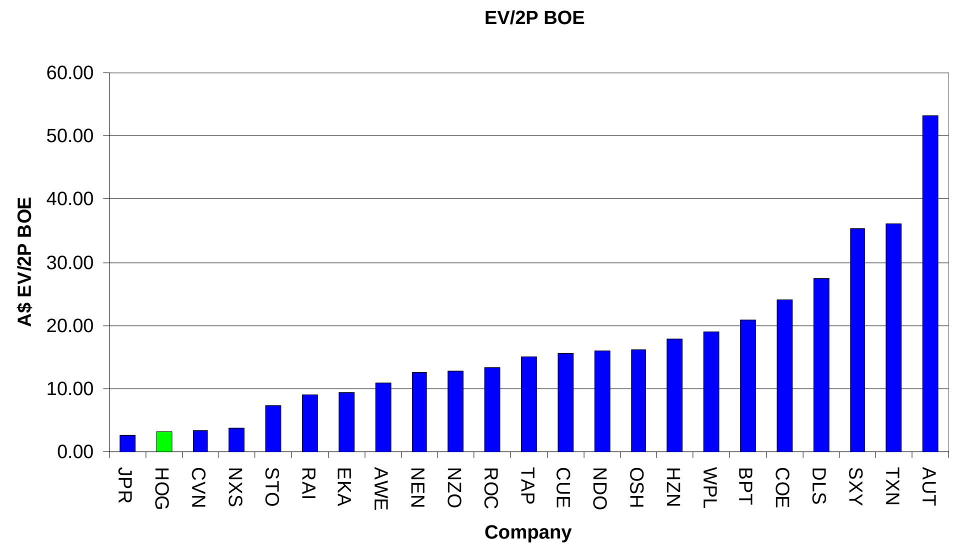

Figure 1: EV/2P Peer Comparison *Source: Company reports, DJC estimates*

Independent expert Moyes and Co estimates the Sorochynska-201 well NPV to be US$41m and up to US$219m if the 3P reserves (50.9bcf gas and 1.2mmboe condensate) are developed on the Sorochynska field (assumes five wells). These NPV's are before corporate tax (20% in Ukraine). The estimated NPV amounts to ~$34/boe which is significantly higher than our current assumption of ~$10/boe. We believe the valuation by Moyes and Co further highlights the upside in HOG's share price.

Valuation Component	NPV10 A$m	POS	Risked NPV A$m	A$/sh
Sorochynska 2P Reserves	76	100%	76	0.20
Sorochynska 3P Reserves	19	60%	11	0.03
Sorochynska Contingent Resources	44	40%	17	0.05
Exploration	98	10%	10	0.03
Corporate	(14)		-14	-0.04
Est. Cash	16		16	0.04
Est. Debt	0		0	0.00
Total	**238**		**116**	**0.31**

Figure 1: HOG Valuation *Source: DJC estimates*

Disclosure RCAN1025

This Research report, accurately expresses the personal view of the Author. All the information utilised in this report is accurate and current at the date stated on this report.

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The Author of this report made contact with **Hawkley Oil and Gas Ltd** for assistance with verification of facts, admittance to business sites, access to industry/company information. No inducements have been offered or accepted by the company.

The recommendation made in this report is valid for four weeks from the stated date of issue. If in the event another report has been constructed and released **Hawkley Oil and Gas Ltd**, the new recommendation supersedes this and therefore the recommendation in this report will become null and void.

Recommendation Definitions
SPECULATIVE BUY – 10% out-performance, but high risk
BUY – 10% or more out-performance
ACCUMUATE – 10% or more out-performance, buy on share price weakness
HOLD – 10% underperformance to 10% over performance
SELL – 10% or more underperformance
Period: During the forthcoming 12 months, at any time during that period and not necessarily just at the end of those 12 months.

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