SUN resources NL

Company Insight
the intelligent market update

Sun Resources NL **Date of Lodgement: 20/9/12**

Title: "Company Insight – Woodbine Oil Play Developments Explained"

Highlights of Interview

- **Why the Woodbine oil play in East Texas is such an attractive focus for Sun Resources**
- **How the Delta,Amerril and Richland Oil Projects work together and the Company's overall strategic approach to creating value**
- **Net acreage position of more than 17,000 acres (and growing) is a critical mass**
- **Sun's acquisition of the Amerril Oil Project, including the introduction of Amerril Energy LLC as Sun's major shareholder**
- **The market for acreage in the Woodbine Oil Play, and how Sun aims to obtain value in this market**
- **Impact of the US$500 million Halcón purchase of producing leases (close to Sun's lease holdings)**
- **Beeler #1H well is first drilling in Sun's Woodbine development. Drilling results are expected this month with a further two wells committed**

Record of interview:
With Matthew Battrick Managing Director of Sun Resources NL (ASX: SUR).

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What characteristics of the Woodbine Oil Play attracted Sun Resources to the play?

Managing Director, Matthew Battrick
Sun considered a number of opportunities in early to mid-2011 to enter an unconventional oil play in East Texas where wells have typically been oil-rich, and the Woodbine fairway seemed to tick all the right boxes.

First, the Woodbine formation is a black oil play with some associated gas, unlike the gas-condensate play in the traditional Eagle Ford Shale (EFS) play of South Texas. Recent horizontal well production from the Woodbine has shown it to be 90 – 95% back oil, so gas is very much a by-product rather than a primary sale item.

Secondly, the Woodbine tight sandstone reservoir is able to store twice the oil volumes (twice the porosity) of the traditional, limestone-rich shale reservoirs. We have found from recent scout information that the decline curves from producing horizontal wells nearby are more modest than the typical shale oil and gas decline curves. Thus Woodbine oil wells with this production profile show enhanced profitability, probably due to enhanced permeability in the sandstone (up to ten times that in the traditional Eagle Ford Shale reservoir).

Third, traditional unconventional shale plays in the USA generally have only one (Bakken Shale) or two (EFS, South Texas) productive zones. By contrast, the Woodbine tight oil play in Leon County, East Texas, has three target zones within the Woodbine and up to four other geological targets, above and below the Woodbine.

Finally, we believe onshore oil in the USA is very attractive in a strategic sense, with the price of West Texas Intermediate (WTI) crude oil hovering between US$90-100 per barrel at the moment.

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What particular value does Sun Resources see in focusing on the Woodbine Oil Play?

Matthew Battrick
We see a number of value drivers.

First, the well economics are extremely attractive. In our area, Woodbine wells are typically 5,500-7,500 feet deep and normally pressured so well costs are around US$6-7 million; drilled, fracced and completed – plus or minus 10% - excluding lease operating costs.

So because of relatively cheap wells, black oil (rather than gas and condensate), and with the production rates which we are seeing nearby, we should be able to get a payback on our well costs within a matter of months. For example, if our Beeler well produces 600bpd on average, that would be 18,000 barrels of oil per month and about $1.7 million revenue per month, at US$95/bbl. That equals a payback in about 4 months after recovery of well operating costs (which are generally less than $15,000 per month), while lower flow rates should still produce rapid pay back by international standards.

Secondly, because we will produce oil rather than gas, our economics are not linked to poor domestic US gas prices; produced gas becomes an extra revenue item. And the risks of variable stratigraphy are mitigated by drilling a vertical pilot hole before selecting the zone to drill in to with the horizontal well section (the lateral).

Third, Sun has acquired its lease position at competitive rates. We were able to get in ahead of the intense industry interest of late, so we are in the right place at the right time.

Finally, and importantly, our asset position is extensive – about 17,010 net acres today - and we continue to increase our lease holding, providing Sun with critical mass in this play, a strong platform from which to build our Woodbine oil business. As we now hold a material lease position, we will be of interest to other parties seeking entry into this play. Moreover, having a large acreage position, a geographic focus and a high working interest means successful drilling will create significant value.

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The Company's entry into the Woodbine oil play was originally through the acquisition of the Delta Oil Project in August 2011. We have noticed that Sun appears to be aggressively moving to expand this position with the acquisition of the nearby Amerril Oil Project and Richland Oil Project announced in recent weeks. Why did the Delta Oil Project appeal to Sun Resources, and how do the Amerril and Richland Oil Projects fit in with the Company's original focus?

Matthew Battrick
The large working interest available to Sun in the Delta Oil Project and the contiguous nature of the leases for the most part gave us an excellent foundation on which to build our land bank in the Woodbine oil play, which we regard very favourably. Delta offered Sun a 100% working interest in 10,000 acres, which in turn gave us leverage and options on how we add value to the asset. We could choose to lay off some or all of the drilling costs to other parties through farmouts or drill at Sun's cost; in the event of success, both scenarios could deliver significant net reserves to Sun.

The only way to find oil and gas is to drill wells on leases you own so the strategic intent to improve our land position led us to the Amerril Oil Project; it fitted the bill. It allows us to build on Sun's Delta land position at a reasonable price in an oil fairway that is developing, expanding and attracting other operators. It is a perfect fit for the following reasons.

First because it's right next door to Delta and lies between Delta and an already proven producing area of the Woodbine play fairway; secondly, it is a strategic fit because it is in the core fairway, and thirdly, our partner Amerril Energy is funded through its sale of its interest in the PMO field to Halcón, and is keen to drill this acreage as soon as possible (we are now funded too through the recent $20 million placement). Putting it another way, the Amerril Oil Project delivered a material 50% working interest in substantial acreage and early drilling on the leases should add value to the 100%WI Delta leases we own right next door.

More recently, we have announced our farm-in to a third project in the Woodbine, the Richland Oil Project. Sun is earning a 13.54% working interest in the Beeler #1H well and a 16.67% interest in the remainder of the 1,360 acres. With our joint venture partners, we have recently announced we will drill a further 2 back-to-back wells after Beeler #1H.

This Richland deal is a fantastic one for Sun. It allows us to add value to our entire Woodbine portfolio through a very cheap and low-risk drilling programme adjacent to our lease positions in the Delta and Amerril Oil Projects.

Our acreage position is beginning to approach the size of Aurora Oil and Gas's ~19,300 net acres in the Sugarkane area of the EFS in Texas. Aurora has now drilled its leases and has booked significant reserves and created enormous shareholder value. But Sun is only just embarking on the first drilling of its acres, with the Beeler #1H well having been spudded on 18 August 2012.

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In early May, Sun agreed to acquire a 50% working interest and 37.5% net revenue interest in the Amerril Oil Project and the consideration was to be 1/3rd cash and 2/3rd shares. A small initial interest was purchased for cash but later Amerril Energy LLC agreed to swap the balance of the purchase price for shares in Sun Resources. What were Sun Resources' objectives and logic behind this change in the transaction?

Matthew Battrick
The thinking behind the Amerril transaction was strategic. By swapping cash consideration owed for the issue of shares to the vendor (Amerril), Sun would retain more of the working capital obtained from the recent placement. We can now deploy that capital more effectively in drilling our position across the three projects, or if we farmout drilling opportunities in Delta for example, we can use that working capital to buy more leases to replace any acres given up through farmout.

While the primary driver behind swapping the cash liability for shares was to retain as much working capital as possible to invest in growth, the Amerril transaction also brings in a major shareholder – one with experience in Leon County in particular and Texas in general, and one with a substantial balance sheet that can deliver the support we require for our projects and future growth.

Importantly, the transaction also shows that Amerril places value on the Delta Oil Project acres in agreeing to accept our shares in lieu of cash and thus becoming our largest shareholder.

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The Company recently raised $20 million via a placement. Is this enough to adequately develop the properties? What is the Company's thinking behind matching its cash resources with its acreage positions?

Matthew Battrick
The $20 million capital raising is sufficient to continue to strengthen our lease position and to fund our share of the 'proof-of-concept' drilling required to demonstrate the resource potential in the Delta, Amerril and Richland Oil Projects. As a consequence of the funding, we can increase value through a combination of drilling existing leases and further lease acquisitions.

The increased flexibility provided by this capital raising is already paying off, allowing Sun to participate in the expanded, 3-well drilling programme in the Richland Oil Project. To date, this has been very encouraging; with the first well having intersected 3 separate hydrocarbon pay zones.

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The market for acreage in many parts of US is quite dynamic. How does the market in the Woodbine work, and how does Sun Resources obtain value in this market?

Matthew Battrick
Sun's strategy is to acquire undrilled leases and then to create value by drilling up those leases, thereby converting resources to reserves and there are a number of ways of achieving this. The Woodbine is also one of the most attractive areas to hold properties: it is in the top two or three oil resource plays in the US.

There are also a large number of buyers in the US, with a lot of money and different investment appetites. This means there is a strong commercial market involving both private and public companies, and private equity funds. Buyers are often willing to sit back and wait for companies, such as Sun Resources, to de-risk oil plays via 'proof-of-concept' drilling and then buy-in once successful drilling has lessened the risk. So we have a great opportunity to monetise via commercial sale of the whole or part of our interests throughout the life-cycle of an asset because amongst the range of buyers there are many different risk profiles. Further, the US has an added attraction, once leases have been drilled and de-risked, in that there is very good access to relatively low-interest debt capital.

This all adds up to a deep and active market with many billion-dollar companies actively buying and selling acreage and production. For instance, there are 1500 rigs active in the USA (compared with less than 15 active rigs in Australia) and most of the active rigs in the US are being operated by private companies. The US has a lot of people with a lot of money who aim to participate at the next stages of development.

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What technical and commercial resources does the Company have, and how does the Company develop its own thinking independently of its major shareholders?

Matthew Battrick
There's a wealth of experience amongst Sun's Board and management. I have over 30 years of international oil and gas experience, as does Sun's exploration manager, Stewart Bayford. One of our non-executive directors, Dr Philip Linsley, has almost 40 years international oil and gas experience. With the acquisition of the Delta Oil Project last year, we also invited Damian Kestel, who has a stockbroking, institutional capital markets and asset management background and John Kenny, a lawyer with 18 years of experience in commercial matters, to join the Board. We have access to technical and business resources outside our Board, and have a very broad network in Perth. We also have experienced people who have worked with Aurora and Eureka, two companies that have been successful in the Eagle Ford Shale in Texas. Together we have the means to think independently about the business and execute successfully.

We have access to a team in Houston that we use, and have a number of relationship partners there too. For instance, the vendor of the Delta Oil Project (Carina Energy LLC) is incentivised to continue to provide technical and commercial advice and support, and was instrumental in delivering the Richland Oil Project. So we now have a very strong relationship with both Carina and Amerril. We also have independent legal and financial support in Houston and Denver, so while we don't presently have a fixed office in Houston with Sun Resources staff, we have a team with anything up to 20 people in Perth, Houston and Denver who are looking after our interests on behalf of all shareholders. This team has taken the company to where it is now, and grown the company in market capitalisation terms from $10 million to around $120 million.

While this is the right combination of expertise and cost-effectiveness at our stage of development, I suspect that with the growth in assets and value we will have to develop the team further and I am already working with our relationship partners in Houston to build a bigger, stronger team that remains as cost-effective as the one we've utilised to date.

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Halcón Resources has completed the acquisition of 100% of the nearby Petromax Woodbine oil production assets for US$500 million. Does this transaction have any valid parallels for Sun Resources, and if so, what implications can be drawn from the Halcón acquisition?

Matthew Battrick
The transaction does have valid parallels because the acreage is only a few miles from our Delta Oil Project acres and is immediately adjacent to our Amerril leases. It also sets a benchmark in this area for unit price of sale when 'proof-of-concept' and initial development drilling is successful. The Halcón price equates to about $30,000 per acre of value and compares with the US$1,500 and $2,500 per acre we paid for our leases, so Halcón has demonstrated a ten-fold increase in value as a consequence of successful drilling in the immediately adjacent area.

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Recent months have seen substantial activity at Sun Resources on both the acreage and fundraising fronts, and the development of considerable momentum. For the original investors in the Company, what guidance can you give them in terms of the Company's strategic direction, and what is necessary to build value in this area?

Matthew Battrick
The strategic direction we've taken is to improve the land position in a low-risk play, and try to decrease risk and increase value through exploration success. Previously the Company had worked in international exploration, perhaps drilling one well a year, and that is statistically a high-risk strategy to deliver success. So the strategic direction has changed to provide a lower-risk route to potentially strong operating cash flows from our Woodbine acres. We think we can deliver as much value through this play as, for example, a small interest in a much larger but riskier prospect offshore in the international arena.

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Overall, what do you see are the next steps in the Company's Woodbine development?

Matthew Battrick
Our broad purpose is to maintain through lease acquisitions around 15-20,000 net acres and progressively expand 'proof-of-concept' drilling across our leases. Drilling the Beeler #1H well in our latest asset acquisition, the Richland Oil Project, involves horizontal drilling into the Woodbine immediately adjacent to our Amerril and Delta leases. It is the first significant step in our Woodbine development. We hope soon to have three or five wells across our project areas to demonstrate proof-of-concept, and to start initial booking of reserves. Throughout, we aim to maintain our acreage position after any dilution through farm-outs, as we respond to opportunities on both the farm-out and acquisition fronts.

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Thank you Matthew.