Enclosed is an article from the August issue of the ‘Oil & Gas Gazette’, which gives a good summary of where Lakes Oil is currently at.

At present we are awaiting availability of a Rig to drill Wombat - 4, together with the results of an Engineering Study we are having done to assess the potential reserves of the Wombat Structure.

Shareholders will be kept informed on both these matters. We are receiving many enquiries about our proposed merger with Cape Energy. Due diligence is continuing and a full information document will be sent to Shareholders at the appropriate time. At this stage we are unable to provide any further information.

ROBERT J. ANNELLS
Chairman
Lakes Oil

Lakes to crank up tight gas test

By Haydn Black

THE 62-YEAR-OLD LAKES Oil is a maverick in two ways.

Not only is it the only company seriously interested in drilling in the onshore Gippsland Basin, but it is also a vociferous proponent of the potential for tight oil and gas accumulations in Australia.

The feisty junior has been rattling the tin and drilling wells for more than 10 years on the doorstep of Australia’s only supergiant oil province and host to the entrenched market power of the Gippsland Basin Joint Venture (ExxonMobil 50%, BHP Billiton 50%).

Philosophy

Australia is possibly the toughest market in which to attempt commercialisation of tight gas.

Despite that perception, after burning through more than $40 million without a commercial outcome, Lakes chairman Rob Annells remains as passionate about his discoveries – and their potential – as ever.

“That’s the shame of the whole industry in Australia,” he told Oil & Gas Gazette.

“Apart from the Cooper Basin, and now Queensland for coal seam methane, and maybe the Perth Basin, nobody is really interested in anything, which is a pity because there are plenty of prospects in the Northern Territory and Queensland, South Australia and Victoria that are crying to be drilled.”

Lakes is attacking that problem with a well defined, if not always well understood, wildcat drilling philosophy.

In addition to its Gippsland and Otway Basin permits, the Melbourne-based explorer has assembled the underlying geothermal acreage as part of spin-out company Greenearth Energy, pegged some acreage in New Zealand’s East Coast Basin, and recently secured a large frontier permit EP 142 within the NT that has oil potential as evidenced by the Poeppe’s Corner-1 and Thomas-1 wells.

Cornerstone

Lakes’ cornerstone Victorian projects have occupied most of its time, energy and funds for the past 10 years, and there’s still a lot of time and money required to tease any production from the subsurface reservoirs.

It’s for that reason that Lakes has converted PEP 157 and PEP 155 into 10-year retention leases (PRL 2 and PRL 3) and raised another $9 million over the past 12 months to help shoot the first ever 3D seismic over the Wombat structure.

Annells cited those two actions as “the signal to get going again” after being delayed by several years.

He said that following the fracture stimulation work at Wombat and Trifon in 2004/05 it was clear the task ahead would require a new understanding with the Victorian Government – a new approach that would allow leaseholders time to properly assess their ground.

“Three of our leases came to the end of their terms, and we took quite some time to negotiate a retention lease with the department here,” Annells said.

“What’s not generally well appreciated, and the department didn’t understand at the time, is that tight gas is not structurally bound. It can be in a syncline as easily as an anticline, and it takes a bit of time for traditional geologists to be able to accept that.”

Wombat

Lakes has collected the first onshore 3D seismic in Victoria over the Wombat structure and, with that knowledge, recently raised another $5.2 million from shareholders to help progress its post-seismic drilling plans.

The 3D seismic indicated that Wombat-4 could be drilled updip from Wombat-3.

“Although the gas is not structurally bound we want to go to the top of the structure because obviously that will be more weathered than in the synclines, and we are hoping that Wombat-4 may not need to be fracc’d in the top level,” he said.

The best well drilled into the field so far was Wombat-2, which flowed at 680,000 cubic feet per day.

There is more than 1,000 metres of syncline identified in the Wombat field, and Lakes hopes that the upper parts of the structure may be capable of producing enough gas to have the field declared commercial.

With cashflow from the upper Wombat structure, Lakes would then be able to bank the deeper resource for future development, Annells explained.

Based on previous drilling the field has an in-place resource of 535.4 billion cubic feet, however that could be increased with additional drilling.

Funding

Cashed up from the recent raising, and with a stake in takeover target Roma Petroleum worth some $5 million, Lakes is in the best fiscal position of its long life.

That position helps offset the 4.26 billion shares now on issue.

“Every time you raise money you water your shareholders down, and we have a lot of shares out there, but our shareholder base has been the lifeblood of the company and I am not about to burn them,” he said.

“When you are supported by your shareholder base – after all they do own the company – you have got to be very conscious of it. A lot of people forget that.

“There are plenty of people who want to throw stones at us for what we are doing, but the life of onshore explorers is very difficult, particularly in Victoria.

“You can raise $2 million here and $3 million here, but you will never be like the offshore boys who have $50 million because you can’t raise that sort of money.

“You have to crawl along and fight the fight, and it takes a long time.”

Annells said the funds from the last raising would be used to fund the Gellibrand-1 commitment well within the Otway Basin permit PEP 164 targeting lower Cretaceous tight gas potential.

Lakes is also preparing for the next unfunded Wombat-4 well, and he raised the idea that Lakes could liquidate its shareholding in Roma to fund the next Wombat well.

Uphill battle

Annells knows that to develop the Wombat and Trifon discoveries he’s facing an uphill battle.

He is convinced the recovery of 39.58° API gravity oil in 2004 within Wombat-3 was significant
“It was the same oil as the offshore oil,” he said.

“It was easy for people to write us off, to say we had fluked some fluvial channel, but since we were at 2,200m, about 1,000m into the strzelecki, well that’s impossible.

“How did it get down there? The obvious answer is that the oil down there has gone up into the offshore areas. That fact is out there but everyone has chosen to ignore it.”

The strzelecki formation sits underneath the Latrobe coals and is considered the economic basement offshore.

Lakes’ deeper wells, being cheaper, can be drilled more readily and Annells said more wells would be drilled into the formation in the future, although it is a difficult formation to image on even 3D seismic as the latrobe formation coals are so thick they sap most of the energy seen is that when we drill a well we get the maximum amount of information out of the well before we walk away,” Annells claimed.

“A lot of people drill into their target, find nothing, and then they try to bury the body as quickly as possible. We have a completely different approach. That’s why our three Wombat wells and the Trifon wells lakes has drilled have never been tested.

“We are in no hurry to get up there because we believe Wombat is going to be the quickest and most fruitful in the short-term,” Annells said.

Lakes may also re-enter the recent Alberton-1 and Napier High-1 wells.

“We have applied for a retention lease there, and until we have that granted we don’t want to say too much about what we have seen there.”

**Historic approach**

The company is also keen to re-enter the Lakes Entrance oil field.

The Lakes Entrance field was discovered in 1924 oil shaft was sunk by the Commonwealth Government during World War II in an attempt to access the area’s oil reserves.

Lakes Oil was originally listed in 1946 to explore the Lakes Entrance field. It was delisted in 1959 after exhausting its funds.

The company then became a controlled entity of Woodside Petroleum but was restructured and relisted by Annells in 1985.

After focusing on the US and Papua New Guinea, and then the Otway Basin, Lakes started examining the gippsland Basin potential in the late 1990s and has become synonymous with Victoria since.

One of its first projects was a test of the historic Lakes Entrance oil field that has not produced since 1951.

Lakes drilled the Hunters Lane-1 well in 1997 when oil was at US$12/bbl and as such the field was not sufficiently commercial, however today even a modest 20 barrels of oil per day flow would be worthwhile, according to Annells.

Several thousand barrels have been produced, and Lakes suggests new centrifuge technology to separate oil from water could prove a new economic discovery.

As Oil&Gas Gazette was preparing to go to press Lakes emerged from a trading halt, announcing that it had signed a non-binding terms sheet with unlisted Cape Energy in respect of a potential business combination of the two companies.

The result would bring Cape’s sole asset, the Golden Beach offshore gas development project in the medium term into the fold, to complement Lake’s onshore longer-term tight gas plays.

The preliminary, non binding terms sheet contemplates implementing the merger by way of a share and cash transaction whilst retaining Lakes as a listed entity.

Golden Beach was discovered by the Burmah Oil Company of Australia in 1967. It is located just 4km from the Gippsland coast, close to Lakes’ Wombat and Trifon fields.

Lakes and Cape plan to negotiate in good faith with a view to completion of a definitive agreement by the middle of September 2008.