CLEVER ADVANCEMENT FOR ENERGY COMPANY

With interests in 36 wells, 25 of them producing, a Texas-focused energy player is doing what it said it would – successfully.

ADVANCE ENERGY HAS moved quickly from its incorporation three years ago, transforming itself from a holder of just one gas asset to a producer and trader of value-added petroleum property in two of the largest onshore basins in the United States.

Strategic alliances, local knowledge, well-established relationships and a passion for Texas are the keys to Advance's success as a project developer and trader.

Perth-based managing director Anthony Short is on the phone to key strategic partners in the Houston office and independent engineers in the Palo Pinto and Martin counties at least three times a day, ensuring all parties are up to date with production, asset evaluation and trading plays.

Everyone has access to the same data at the same time, enabling deals to be decided quickly, the most recent acquisition taking just five days.

Advance's key man in Texas is Embry Canterbury, a petroleum engineer and founder of Hibernia Resources LLC, the company with which Advance has converted a valuable and strategic alliance into a mutually satisfying joint operating agreement.

Short knows Texas well and has worked with Canterbury and Hibernia's principal finance man, former UBS Warburg executive Carl Carter III, for 11 years.

Hibernia is locally based, with substantial, long-term completion, workover and production experience. As such, Advance has been willing to negotiate a partnership whereby Hibernia oversees the sourcing, evaluation and day-to-day operations of all assets.

The structure of the alliance enables crucial cost containment, at the same time delivering Hibernia an incentive package including equity in wells on successful economic payback.

"We pay just $US3000 per month out of pocket, plus success fees, keeping total annual costs to between $US800,000 and $US900,000," Short told *RESOURCESTOCKS*.

"Importantly, we have a team we have worked with for a long time – good managers with experienced field people and consultants."

Historically prolific producers, the Fort Worth and Permian basins in the north and west of Texas nevertheless still offer significant opportunities.

Advance acquires its assets, not to realise their full potential, but with a view to value-adding, before onselling to the next tier of buyers.

Good contacts have ensured adequate financial backing in a region with enough quality ground to convince banks to back small operators.

Production also helps. Advance operates on a basis of $US80 per barrel (bbl) of oil and $US7 per thousand cubic feet (Mcf) of natural gas, but has been reaping in excess of these amounts for net daily output, which currently measures 819Mcf of gas and 84bbl of oil.

During the recent northern hemisphere summer, crude oil spiked at about $US145/bbl and gas touched $US13/Mcf.

Since early 2006, Advance has grown its oil production by 400% and gas by 300%, boosting revenue at least tenfold.

In addition, the company has ensured protection against substantial swings, hedging at $US95-105 an additional 1000bbl per month for two years from June 1, 2008. A call option at $US120 allows for upside and caps hedging costs at $US15/bbl.

These arrangements also ensure valuations against which the Sterling Bank of Texas can continue to offer finance.

From the outset, Advance made it clear to investors that it would be a trader, rather than hold assets for the long term.

In the next few months, it will provide tangible proof of its ability to stick with the game plan, selling two wholly owned Fort Worth Basin gas projects – Lone Camp and Possum Kingdom – to any one of a substantial list of prospective buyers.

Advance received 30 offers and holds three letters of intent for Lone Camp alone, a project it developed this year to its two most successful production quarters.

The company intentionally created two portfolios, one in the Palo Pinto County of the Fort Worth Basin, where it produces gas, and the other in the Martin County, near the town of Midland, an oil-producing zone.

Following the Lone Camp and Possum Kingdom sales, Advance intends to concentrate on oil in up to six Permian Basin counties surrounding Midland.

"We run a database on every operator and every well within these six counties," Short said.

In Martin County this year alone, Advance has successfully drilled and completed two development wells, confirmed new prospects and advanced preparations for the drilling of up to three additional wells by year's end.

With 3000 acres leased, 180,000 acres of 3D seismic, plenty of drilling capacity and already operating

20 wells, Advance remains on the lookout for additional ground, typically smaller leases that larger operators find unattractive or that ageing owners are ready to divest.

The company is running the ruler over 15 projects, six of them, totalling 6000 acres, already making the short list.

"This is an area where we have fantastic access to drilling people and equipment and where drill costs per well are just $US8000 to $US9000," Short said.

"In Motherlode III we have three leases, with 20 prospects and up to 80 potential wells, but there are 30 leases you would want there.

"Each well promises net production of between 300,000 and 500,000 barrels.

"The wells in this area are long-life, they produce for 30 to 40 years, and it's light crude."

Advance's list of criteria for considering new acquisitions is crystal clear – proximity to existing production, within the company's 3D seismic data profile, priced between $US6 million and $US12 million, and likely to deliver payback within three years.

"All our assets have paid out or are on track to pay out," Short added.

"Our last acquisition – a working interest in four wells – cost us $US700,000 from a bank advance and will pay out, on existing production, within 29 months.

"We take the view, if we were a buyer, what would be the best asset we would look for. A lot of the opportunities are so predictable and long-life."

An independent assessment commissioned by Sterling Bank earlier this year valued Advance's proven developed reserves, at a 10% discount, at $US15.59 million. Total reserves, including proven but not developed or non-producing, came in at $US32.37 million, equivalent to a net tangible assets backing of 17c per share.

The evaluation, by recognised conservative consultants WD Von Gonten & Co, does not include all of Advance's current interests. If it did, it would contain a further 100Mcf/day of gas production, from an additional 19 producing wells.

Short happily debunks the view that little oil remains to be found in Texas, pointing to a play analysis of major oil reserves in the Permian Basin conducted by the University of Texas.

The report describes the Permian Basin as the largest petroleum-producing basin in the US, containing an estimated 23% of proven US oil reserves.

Furthermore, it maintains the region holds the largest potential for additional US oil production, with 29% of estimated future oil reserves growth.

Infrastructure is well advanced throughout Texas, rendering completion costs comparatively miniscule to other regions, including Australia.

"Our last well completion cost less than $US200,000," Short said.

Advance is headquartered in Perth, Western Australia, has an office in Houston and plans to open another in Midland.

"Our core nucleus is here – we know the landowners and the smaller operators, and have done a lot of legwork, so we are staying to execute our game plan," Short said.

"In the next two years we will spend another $US40 million to realise between $US220 million and $US250 million in assets."

Funding will be a mix of $US20 million in bank debt, equity out of Australia and London, plus convertible notes, usually sourced in London.

Advance may not rank among the high-profile ASX energy listings of the past two years, its share price failing to reflect net tangible assets and contrasting with $US250,000 monthly cash flows.

"We recognise that the market and investing public may not fully understand our business model or strategic focus," Short explained.

"Accordingly we are making every effort to inform the market of our true asset position and of our evolving business model."

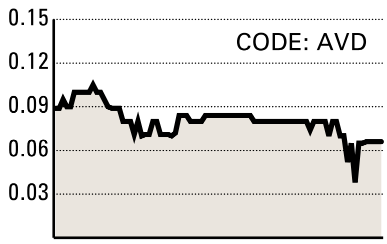
In 2008 alone, the company budgeted $US50 million to acquire additional producing assets and increase its existing working interests, to boost its prospects of attracting potential buyers.

For now, it remains content with a $40 million revolving line of credit with Sterling Bank, plus backing out of Europe, and accepts that global economic uncertainty currently renders other equity raisings a less likely option.

With finance costs at a comparatively cheap 6% – prime rate plus 1% – and with just $US7 million drawn on the bank facility, pending asset sales, plus $US3 million in convertible notes, the company has room to move. RS

Advance has completed two development wells in Martin County

ADVANCE ENERGY AT A GLANCE



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MARKET CAPITALISATION
$7.5 million (at press time)

MAJOR SHAREHOLDERS
Fay Holdings 11.34%
Sealblue Investments 5.79%
Bardev Pty Ltd 5.60%
Spartan Nominees 4.88%
Formaine Pty Ltd 4.86%
Accord Investment Corp 4.48%