WHIreland

16 October 2007

UK EQUITY RESEARCH

NATURAL RESOURCES

BUY **158½p**

Market Cap	£53m
Index	AIM
Shares in Issue	33.6m
Fully Diluted	49.4m
Net Cash	£16m

Performance	**AIM**
1 month:	-4%
3 months:	+10%
12 months:	-16%
High/Low	
12 months:	197 -125

Last Results	Prelims - 15 Oct 07
Next Results	Interim - March 08
Reuters/BBG	MOG.L / MOG LN
Change in Recommendation	N/A

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*WH Ireland acts as nomad and Broker to Mediterranean Oil & Gas plc.

WH Ireland's staff, connected parties and discretionary clients have a 0.1% shareholding and hold options in Mediterranean Oil & Gas.

Any research on this company should not be relied on as objective or impartial. This note is intended for institutional investors only and is not for distribution to private clients.

Mediterranean Oil & Gas*

Development updates – significant progress expected

Mediterranean Oil & Gas (MOG) is an established Italian gas explorer and producer. The company has Italian oil and gas development projects and also has exploration prospects in the Mediterranean region, including Italy, Malta, France and Tunisia.

After a couple of years of preparation, fully funded drilling in four key projects is expected to start in the next few months. The resulting newsflow should help the market better assess the company's prospects. In our view, the current market value of the company overly discounts the chances of success in any one of its prospects.

The company is likely to become a medium sized oil producer if the January 2008 appraisal and development well at its 100% owned Ombrina Mare oilfield is successful. Production is planned to start the same year.

MOG has 22.9% in the exciting Monte Grosso prospect (Serra San Bernardo permit), which is close to and on trend with Europe's biggest onshore oilfields. On a mean basis, the prospective oil in place is 1.25bn barrels – the high case estimate is 2.1bn barrels. The first well is set to spud in December.

The first well on the company's attractive Tunisian block (25%) is due to spud soon. A rig has been contracted for the fourth quarter for the 107mb Teboursouk prospect.

In addition, appraisal drilling at the French heavy oil field of Grenade (MOG 11.1%) is due to start before year end. The successful farm-out of the Maltese acreage and the recently announced offering by the NOC (Libya) of acreage immediately adjoining the Southern border of MOG's Maltese blocks is very likely to facilitate the early drilling of one of the massive structures identified there. The share price performance has been lacklustre for some time because there has been a lengthy period of drilling inactivity. But there should be a profusion of announcements in the next few months, drawing serious attention to the company for the first time. A lot has happened behind the scenes – and many of MOG's prospects have grown as interpretation of seismic and other data has clarified matters. We would suggest that there will be considerable excitement once the Monte Grosso well has spudded. Many of the majors are very interested in this structure and it is no accident that ENI and Total are among the partners. But even the relatively mundane and low risk Ombrina Mare appraisal well has the potential to yield significant upside for shareholders.

Overview

Mediterranean's share price has been in the doldrums for some time as operational activity has been limited to essential preparatory work. This "dumb" phase is inevitable when companies are readying drilling campaigns. However, all the pieces are in place for several of MOG's projects and from now on there will be a steady stream of potentially high impact activity which seems bound to draw attention to the company. We expect both fundamental and speculative buying to develop in the near future. We consider that many of the shares (maybe 70%) are in long term safe hands - cornerstone investors include Stark Investments, Transcontinental Group, Enso, Goldman Sachs, Tectonic Fund, JP Morgan, LR Global, and Majedie. The consequently limited free float may well mean that such buying could bring about a significant movement in the share price.

In our view, there is an excellent mix of projects, ranging all the way from low risk cash generators to potentially massive, but high risk plays. This mix should ensure that the company can be profitable while retaining significant speculative upside, a good combination for many investors. MOG has sufficient cash to fund its near-term drilling program, ongoing cashflow from Italian gas production (Italian gas prices are strong at around \$10/mcf) and supportive cornerstone shareholders. Its management team is strong and well-connected. This is demonstrated by its success in contracting an ENI jack-up rig for Ombrina Mare and the ENI specialized high performance rig for Monte Grosso. This was achieved in a climate of acute rig shortages in Italy.

This note is intended to focus on key developments and how they are set to move forward in the near future.

Monte Grosso (MOG 22.9% and operator)

The Monte Grosso prospect lies in the Serra San Bernardo Permit and the Monte Grosso 2 well is expected to spud in December. The company's partners include ENI, with whom there is a drilling service agreement, and Total, which illustrates both the company's credibility and the prospectivity of the license. Indeed, the prospect is described by the company itself as "world class" and assigns the overall geological chance of success at 21.4%, which is high for an exploration well.

The prospect is large - the CPR estimated 710mb in place in the IPO document as their most likely case and 2.1bn barrels in their high case. The present estimates suggest, on a mean basis, 1.25bn barrels in place and prospective oil resources of 280mb (64mb net to MOG). The high case figure is still put at 2.1 bn barrels in place (109mb net). These figures are exciting and success would transform MOG at a stroke. The well will be very deep – it is expected to reach 6900 metres and could take as long as a year to drill. In consequence, it will be expensive with a preliminary estimate of Euro 50m.

There have been a rash of commercial discoveries in the region with many of the majors involved. Total's Tempa Rossa field, currently being developed as one of Europe's largest onshore oilfields, is close as is the Monte Alpi/Cerra Falcone field, owned by ENI and Shell, which is now producing over 100,000b/d. It is interesting that Shell, with interests in all three of these fields, has successfully applied for substantial amounts of acreage nearby, including some bordering on Serra San Bernardo.

British Gas drilled MG1 some ten years ago. The well failed technically due to the fact that it went off the true vertical as it got deeper. Today's technical expertise is significantly better and this problem is unlikely to recur. Whilst MOG is the operator of the permit, the highly specialised rig which will be employed on this job is provided by way of a full service contract with ENI, who will therefore be actually operating the rig. ENI have now successfully drilled over 50 wells in excess of 5000 metres. Cerra Falcone, Monte Alpi and Tempa Rossa have all had similar wells. However, the data from MG1 has provided a very substantial volume of technical information on the 5000 metres of ground it penetrated.

Ombrina Mare (100% MOG)

Ombrina Mare is currently MOG's primary development focus. It is significant for the company because of its 100% stake. The field is estimated to hold (Best Estimate basis) 166mb of oil in place, leading to contingent reserves of 27.5mb with a high case of 64mb. This is sharply higher than the 89.5mb oil in place and 19.5mb contingent reserves estimated by the CPR at the time of the company's AIM listing in 2005. It appears that this substantial upgrade, due to interpretation of 3D seismic carried out subsequent to the CPR, has been overlooked by the market. The field was discovered in 1987 by Elf and is located 7 km from the Italian east coast in a mere 20 metres of water. The discovery well flowed 428b/d of 18 degree API crude oil and 6.8mcf/d of gas on extended test. The reservoir depth is a modest 2100m. At the time of discovery, oil prices were very low and the field was uneconomic. With the advent of horizontal drilling techniques (and sharply higher oil prices), likely flow rates are now much greater than hitherto, transforming the attractiveness of the find. Horizontal drilling at heavy oil fields such as this gives sharply higher production rates than traditional vertical wells – sometimes 10-15 times as much.

MOG has booked a rig to start drilling a horizontal appraisal/development well in January 2008 and if this is successful the development will be fast-tracked so that production could start early in 2009. The development is close to other production (such as ENI's recently discovered Miglionico field) and can be tied in to ENI's oil processing plant onshore to the northwest with relatively short pipelines. On the Best Estimate basis, production will peak at 8200b/d, providing an 18 month payback. On the High Estimate, peak production will hit 13,650b/d and generate a 12 month payback period. In either case, MOG would be catapulted into the middle rank of oil and gas producers.

The Ombrina Mare well can certainly be regarded as an appraisal. The chances of success of finding gas are put higher than 90% while the oil has at least a 50% chance of coming in.

Close to the main field are two satellite oil prospects (Ombrina South and Ombrina Southeast), which have significant oil potential, with potential oil in place estimates of 32mb and 68mb. If exploratory drilling proves up these possible reserves, they could be developed in conjunction with the main field, which would be very cost-effective. In addition, there are three potential gas satellites, two of which (estimated at a combined 12bcf) could be developed easily and quickly as they partly overlie the oilfield. The third potential gasfield is some 12 km away. Gas was produced in Ombrina Mare 1 – this offers the possibility of gas lift to aid production of oil.

The apparently similar Rospo Mare field, which has been in production for almost 20 years, lies nearby to the southeast. However, while Rospo Mare oil is heavy with an API gravity of 10, Ombrina Mare tested substantially lighter 18 API crude.

It is quite possible that Ombrina Mare is bigger than the current figures suggest. It appears that the lowest closing contour covers an area two and a half times as big as that discovered by the original well. This may or may not contain oil-bearing strata but there seems to be a good case for drilling deeper to find out if there are further intervals.

Guendalina (MOG 20%)

The Guendalina gas field development, recently approved by partners and government, is MOG's biggest gas project. ENI is the operator of the field and has the other 80%. Guendalina, in water depths of 20m some 25km from shore, is going to be tied back into ENI's Tea development, 12 km to the south, as this is the most economic way of producing the field.

ENI's latest development plan has indicated proven reserves of 22.3bcf, with proven and probable reserves set at 27.9bcf. At the time of MOG's AIM listing, the reserves were put at only 16bcf, so the field has become more significant, doubling the company's P & P reserves.

Production is due to start in 2009, but when full output is reached the following year, ENI has indicated a likely output level of 5bcf, MOG's share of which would more than double its Italian gas production. The company is projecting a 12 month payback on the investment.

The Medjerda Block - Tunisia (25%)

MOG's first entry into Mediterranean Africa took place last year with the acquisition of 25% of this Tunisian permit. It is a large onshore Block (4956 sq km) in a relatively unexplored part of the country. A number of prospects and leads have been identified and a rig has been contracted for the first well (on Teboursouk), scheduled for late this year. Since 1995, significant amounts of seismic and geological work have been carried out and the acreage has been matured enough for drilling to be justified. There are several different geological domains on the block and an assortment of potential targets, with significant oil seeps giving further grounds for optimism.

MOG acquired its stake from Carthago Oil, which retains a 10% interest, free carried by MOG and capped at $1m. The operator is Range Petroleum, which has a 65% interest in the block.

Potential recoverable reserves on Teboursouk have been assessed at a significant 107 million barrels in two horizons (26.8mb net) with a high case 381mb (95.2mb net). Risks are high as the area is only lightly explored but exploration costs are modest. Furthermore, any fields discovered would have low development and production costs due to the location – and the Bizerta refinery is close by, which will also vastly aid the economics. The block contract is a Production Sharing Contract and the fiscal terms are described as favourable.

Grenade – France (11.15% MOG)

Grenade is an undeveloped heavy oil field (10deg API) in the Aquitaine Basin. It was discovered by Elf in 1975 and has a Best Estimate oil in place figure of 300mb, although it could be three times that size. Low recoverability means that these figures equate to 1.3mb net to MOG on a best case basis and 6.3mb high case. The challenge is to get a commercial flow rate.

Drilling of an appraisal/development well is planned for late 2007 as part of a pilot production scheme. Development will probably involve a vertical well deviated to become a horizontal one. This allows much higher flow rates of the heavy oil. One of the partners, Nautical Petroleum, is a heavy oil specialist and it is likely that their carbon dioxide technology will be used to optimise production, allowing the light fractions of the oil to be separated and sold. Modern enhanced oil recovery methods, including horizontal drilling, offer good chances of success, although it is not clear what flow rates are liable to occur.

Malta

MOG has 80% of Blocks 4 to 7 in Malta's offshore Area 4. This covers more than 5000 sq km and water depths range from 250 to 800 metres. The oil and gas potential is massive and is based on analogues of large Tunisian and Libyan fields. The structures are clearly world-class and it is unusual to find a small company with such a big stake in such enormous prospects. The company farmed out an initial 20% stake in the Blocks to Leni Gas & Oil (LGO) earlier this year. LGO acquired its interest by funding 2D and 3D infill seismic surveys, solely funding $5m of work. It can increase its interest to 50% in Area 4 by paying 80% of the cost of the first exploration well. LGO is controlled by MOG's former Chairman, David Lenigas.

Malta is an EU member state, the political climate is stable and the fiscal terms are attractive.

The farm-out has allowed progress to be made on Malta and the agreed seismic program was shot in May and June this year. Processing of the new seismic is being conducted by CggVeritas and will be followed by interpretation of the results in November. The idea is to identify a drilling site in Spring 2008 for a possible spud later that year.

As this well is not imminent, we will summarise this acreage for now. MOG has announced Best Estimate prospective oil in place figure (independently assessed by RPS) of 5.71bn barrels, leading to a prospective resource of 1.3bn barrels net to MOG. The high estimate prospective resource is as much as 3.6bn barrels. Nine structures have been identified so far. The largest is Luzzu, but Tarxien, on Block 7, was found much earlier and much more work, including 3D seismic, has been done on it. In consequence, we would expect Tarxien to be the first prospect to be drilled.

Mediterranean's Italian Gas Portfolio

The company has interests in 18 production concessions (10 operated) covering 1707 sq. km. and 10 exploration permits totalling 2152 sq. km.. Seven other applications (342 sq. km.) are pending. Most of these interests are onshore with a few in shallow water offshore. They are scattered throughout Italy. Proven and probable reserves total some 6bcf. The company also has interests in various gas treatment facilities.

Although production is modest at around 0.7bcf/year, it is stable and the high price of gas in Italy means that the revenue generated covers overheads and the cost of onshore operations. Further investments in low-risk projects are planned, which is expected to increase production over and above the doubling represented by Guendalina

It is worth noting that the company has 15% interests in a number of gas discoveries in the North Adriatic. These are currently "frozen" for environmental reasons. In due course, four are expected to be released, adding maybe 39bcf to MOG's reserves.

Management

There have been several additions to the management team in recent months as the company has grown. The Board has been increased by two while the number of operational personnel has risen by twenty to around thirty. Giovanni Catalano has moved from being CEO to a non-executive officer with a new consultant role. MOG has been fortunate to recruit 52 year old Sergio Morandi as its new CEO. Mr Morandi has a great deal of experience in the Italian upstream sector, most recently as Shell's Head of Exploration in Italy. He is well-connected and has published papers on seismology and petroleum geology. In addition, while working at Elf Italia and Enterprise Oil, he was involved in both the discovery of Ombrina Mare and the evaluation of Monte Grosso.

In June, the company added a Chief Financial Officer, Fabio Bortolotti, who is based in London. Mr Bortolotti comes well qualified for the job and this appointment was timely, given the step-up in the company's activities

Finances

The company appears to have enough cash for its current exploration program, with capital spending expected to reach some Euro24m in the next year. MOG has net cash at present (holding steady at Euro15m at 30/6/07). A further £5.4m (Euro 8.1m) of options is likely to be taken up in November, which should add to cash reserves. Its positive cashflow (Euro2.75m last year) also makes a small contribution to the capital and exploratory spend. If Ombrina Mare proceeds to the development phase in the wake of the appraisal well, it is planned to utilise project financing.

The company's Euro 7m convertible notes were restructured in July. They are now interest-free and can be converted at 50p per share until March 2009. The proceeds will be used to retire the debt raised at their issue.

It is likely that Ombrina Mare will be producing in 2009, which could increase cashflow significantly. We expect that any development projects will be project financed without much difficulty. The major expense of the Monte Grosso well has been budgeted, while the farm-out of Malta probably allows for the first well to be funded without the need to call on shareholders for additional funds. Thereafter, the company may need to raise more capital, possibly including further farm-outs. How it does this will no doubt be decided by how the current program pans out. It is worth remembering that MOG is ambitious and we would not rule out it making further acquisitions of promising acreage and/or development prospects.

Valuation and Appraisal

As ever with Mediterranean Oil & Gas, any risk-discounted valuation comes up with a "fair" value a country mile in excess of the share price. This is hardly surprising. The market capitalisation of around £78m fully diluted is far from generous. The cash, coupled with the projected cash element of the convertible note and the options, is worth around £15m, leaving only £63m assigned by the market for the operations. The relatively low risk Ombrina Mare field alone may contain 27.5mb of oil on a Best Estimate basis. With each barrel worth maybe Euro18-20, any valuation of the company is likely to yield far more than this. So Ombrina Mare's oil, with the chance of success at over 50%, is on a risk discounted basis worth more than the company's present market capitalisation.

The table overleaf provides some illustrative values for MOG on a risk-discounted basis. We would caution that all such numbers are to be treated with caution and should be used for providing an order of magnitude, not giving an accurate or absolute assessment. Note that the oil and gas values used are WHI estimates for undeveloped reserves. It is assumed that any cash that the company has is used up in the exploration. In the case of Malta, it is extremely unlikely that the company would retain 50% in the event of a discovery. We are using the fully diluted number of shares.

In our view, the market in its wisdom has decided that oil companies should be valued at way below their underlying worth. This undervaluation is likely to be corrected in due course. The recent approaches for Burren at up to £11 per share against the £7.50 at which the shares were trading before takeover murmurs began are a case in point. Burren had no difficulty rejecting the £11 offers as a long way short of the underlying value. We are not surprised. Were it not for the fact that the oil majors have been busy buying back their own shares rather than seeking undervalued assets on the market, we feel that this sectors undervaluation anomaly would have been corrected a long time ago.

MOG is likely, in our view, to be revalued as its key wells are going down. If this does not happen, it would hardly be a surprise if a fairer value were to be attained by bid approaches, just like Burren.

Mediterranean Oil and Gas - risked valuations

Key Inputs

	Euro	$
Italian Gas Value/mcf	10	14.03
Low Cost Oil Value/bbl	7.5	10.52
High Cost Oil Value/bbl	5.5	7.72
$/Euro	1.403	
Euro/£	1.445	
£/$	2.028	
35.3 cub feet = 1 cub metre		

	Size (recov)		Owned	Euro/mcf or bbl	Value (mEuro)	COS WHI est	Value (mEuro)
Ombrina Mare	28	mb	100	6.75	186	50%	93
Ombrina Mare South	8	mb	100	6.75	54	25%	14
Ombrina Mare Southeast	17	mb	100	6.75	115	25%	29
Ombrina Mare gas leads	7	bcf	100	10	12	70%	8
Ombrina Mare - gas lead	3	bcf	100	10	5	15%	1
Guendalina	28	bcf	20	10	9	95%	9
Monte Grosso	280	mb	22.9	7.5	481	15%	72
Other gas fields (net)	6	bcf	100	10	10	95%	10
Tebersouk	107	mb	25	7.5	201	15%	30
Grenade	12	mb	11.15	5.25	7	80%	6

BASIC VALUE — €270 p/share

Speculative Plays

Malta (9 prospects)	1471	mb	50	5.5	4045	7.5%	303
Frozen assets	22	bcf	100	7.5	166	10%	17

SPECULATIVE EXTRA — €320 p/share

TOTAL VALUE — **€590 p/share**

Disclosures

WH Ireland Recommendation Definitions

Buy
Expected to outperform the FTSE All Share by 15% or more over the next 12 months.

Outperform
Expected to outperform the FTSE All Share by 5/15% over the next 12 months.

Market Perform
Expected to perform in line with the FTSE All Share over the next 12 months.

Underperform
Expected to underperform the FTSE All Share by 5/15% or more over the next 12 months.

Sell
Expected to underperform the FTSE All Share by 15% or more over the next 12 months.

Speculative Buy
The stock has considerable level of upside but there is a higher than average degree of risk.

Share Price Target

The share price target is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon.

Stock Rating Distribution

As at the quarter ending 30th September 2007 the distribution of all our published recommendations is as follows:

Recommendation	Total Stocks	Percentage
Buy	18	22%
Speculative Buy	6	7%
Outperform	30	37%
Market Perform	22	27%
Underperform	4	5%
Sell	1	1%
Total	81	100%

This table demonstrates the distribution of WH Ireland recommendations. The first column illustrates the distribution in absolute terms with the second showing the percentages.

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This research is classified as being "non-objective" as defined by the FSA's Conduct of Business Rule 7.16.5. Please refer to www.wh-ireland.co.uk for a summary of our conflict of interest policy.

Analyst Certification

The research analyst or analysts attest that the views expressed in this research report accurately reflect his or her personal views about the subject security and issuer. Furthermore, no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendation or views expressed in this research report.

Companies Mentioned

N/A

Share Price Date/Time

Company Name	Recommendation	Price	Price Date/Time
Mediterranean Oil and Gas	BUY	158½p	16/10/07 09.00

Source: WH Ireland

Summary of Company Notes

N/A

Date	Event	Recommendation	Price (p)
07 March 06	Interims	BUY	146p
05 June 06	update	BUY	216p
16 October 07	Update & Prelims	BUY	158½p

Summary of Security Recommendations

N/A

*Current Analyst (CA), Previous Analyst (PA)

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