

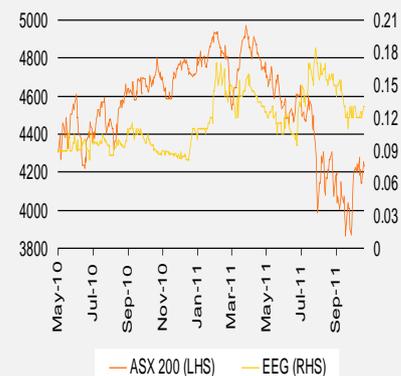
Empire Energy Group Limited

(Ticker: ASX:EEG; OTCQX:EEGNY)

November 4, 2011

RB MILESTONE GROUP 
EQUITY RESEARCH AND MARKET INTELLIGENCE

Price (A\$):	0.120
Target Price (A\$):	0.526
Beta:	1.04
Price/Book Ratio:	0.77
Debt/Equity Ratio:	1.68
Listed Exchange:	ASX
USA ADR's:	OTCQX



Recent News

27/10/2011: Empire Energy Group Limited announced that the Form 211 was filed by a US Market Maker and approved by FINRA, thereby allowing the market maker to commence making a market in the Company's ADR's on a 20:1 Basis.

14/10/2011: Empire Energy Group Limited announces that it will adopt USD as the presentation currency for financial reporting with effect from 1 July 2011.

07/10/2011: Empire Energy Group Limited announced that Driscoll#31-8, which is the 7th well of the proposed 10 development well drilling program in the Central Kansas Uplift will not be completed.

04/07/2011: Empire Energy Group Limited announced that the Moratorium on hydrofracking in New York State has been lifted and revised recommendations released.

Shares in Issue

278.19 M

Market Cap

(A\$M) 33.38

52 Week (High): A\$0.185

52 Week (Low): A\$0.081

A Low Risk Oil and Gas Company at Compelling Valuations

Empire Energy Group Limited (EEG) is an Australian company focused on oil & gas exploration and production in the US and Australia. EEG is currently producing from two fields in the US, namely Central Kansas Uplift (oil) and Appalachia Basin (gas), at 1,470 barrels of oil equivalent per day (boe/d). EEG has 2P Reserves of 16.8 MMBoe (36% Oil).

Empire Energy commenced a 10 development well drilling program in the Central Kansas Uplift in June 2011. 8 wells have been drilled and 7 wells were completed, while one well was plugged and abandoned between June 2011 and October 2011. The 9th well in the drilling program has been spudded. The drilling program in the Central Kansas Uplift has shown promising returns with production being commenced from 6 wells of the 10 well drilling program. In addition, the first 2 wells at the company's joint venture in the 17,000 acre Williston Basin, North Dakota project have been drilled with a completion rig contracted for completion of the first of the wells.

In July 2011, the New York State Department of Environmental Conservation's (DEC) de facto moratorium on hydrofracking ended, the DEC has issued revised recommendations on hydraulic fracturing which are now the subject of a 60 day public comment period which once finalized will enable Empire Energy Group to seek ways to monetize the Marcellus (220,000 acres) and Utica (190,000 acres) Shale acreage in New York State.

In addition the Company holds a 100% working interest in 14.6 million acres of prospective shale tenements under application in the McArthur Basin, Northern Territory, Australia. Major E&P companies, ConocoPhillips, Hess Mitsubishi, CNOOC and BG Group have recently farmed into frontier shale plays in Australia.

EEG has had a successful history of acquiring oil and gas assets that have yielded a positive effect on its earnings and cash flows. The company is planning to ramp-up production to greater than 2,500 Boe/d by 2012 and up to 10,000 Boe/d by 2015, of which 4,500 is planned through acquisitions. We believe that EEG's management has the required skills to achieve these targets.

We have valued EEG on the basis of peer EV/2P reserve multiple with a target price of A\$0.526/share, an upside of approximately 338.3% over the last traded price of A\$0.120.

Investment Arguments

- **Encouraging Results from the Well Drilling Program in the Central Kansas Uplift:** EEG commenced a 10 development well Drilling Program in the Central Kansas Uplift in June 2011. The well drilling program in the Central Kansas Uplift has shown promising returns with production being commenced from 6 of the 10 well drilling program. 8 wells have been drilled and 7 wells completed, with one well being plugged and abandoned. The 9th well in the drilling program has been spudded.
- **Opportunities to monetize the Marcellus and Utica Shale acreage in New York State:** The New York State Department of Environmental Conservation's (DEC) de facto moratorium on hydrofracking was lifted in July 2011. This enables Empire Energy Group to seek ways to monetize the Marcellus (220,000 acres gross) and Utica (190,000 acres gross) Shale acreage in New York State. Under the conditions set by the DEC, approximately 85% of the Marcellus Shale would become accessible for natural gas extractions. EEG owns assets in Pennsylvania & New York and lifting of the hydraulic fracturing moratorium could prove to be a trigger for EEG and enable it to increase its natural gas resources

- **Low Risk Profile with Approximately 75% Production Hedged at attractive prices:** EEG has hedged its oil and gas production at attractive prices for the next 4.5 years. The hedge reduces the risk profile of the company at a time when the volatility in the commodity market is very high. EEG has hedged approximately 75% of the oil production at US\$90/bbl and approximately 71% of the Gas production at an average of US\$5.90/mcf over the next 4.5 years. This hedge reduces the risk profile of EEG.
- **Impressive History of Acquisitions:** EEG has an impressive track record in acquiring oil & gas assets. After acquisitions in the Appalachian Basin and in Kansas, EEG's EPS rose from -0.1 cents in December 2009 to 2.68 cents in December 2010. By 2015, EEG intends to increase production by 4,500 boe/d through acquisitions. Its past acquisition record underscores our confidence in EEG's management and we believe that the company has the requisite skills to source and acquire value accretive assets.
- **Robust Oil and Gas Outlook:** The IEA expects the annual growth in oil demand to average 1.2 million barrels per day between June 2011 and 2016. In addition, natural gas demand could grow by around 500 billion cubic meters during the same time. EEG has plans to raise its production to over 2,500 boe/d by 2012 and up to 10,000 boe/d by 2015. EEG's increasing production and a strong exploration and development pipeline is expected to give a significant boost to the company's revenues and cash flows.
- **Attractively valued:** The company is trading at 4.8x based on EV/2P reserve against the industry average of 13.55x, a **steep** discount of 64%. In addition, after adjusting for oil/gas mix, the company's target EV/2P reserves ratio should be 11.5x. Hence we believe that EEG is considerably undervalued at this juncture.

Key Developments

New York State Hydraulic Fracturing Moratorium Ends

On July 1, 2011, the New York State Department of Environmental Conservation's (DEC) de facto moratorium on hydrofracking ended, thereby enabling Empire Energy Group to seek ways to monetize the Marcellus (220,000 acres gross) and Utica (190,000 acres gross) Shale acreage in New York State.

The New York State Department of Environmental Conservation also released the revised recommendations on mitigating the environmental impacts of hydraulic fracturing.

- High Volume fracturing would be prohibited in NYC and Syracuse Watersheds
- Surface drilling would be prohibited on state-owned land including parks, forest areas and wildlife management areas
- High Volume fracturing will be permitted on privately held lands under rigorous and effective controls
- DEC will issue regulations to codify the recommendations into state law.

Under these recommendations, approximately 85% of the Marcellus Shale would become accessible for natural gas extractions. EEG owns assets in Pennsylvania & New York, USA, which include the Marcellus and Utica shale. With the Hydraulic Fracturing Moratorium being lifted, subject to the issue of regulations noted above, EEG has an opportunity to monetize the Marcellus and Utica Shale acreage in the New York State.

Oil and Gas Production Hedged

EEG hedged approximately 75% of the oil production at US\$90/bbl and approximately 71% of the gas production at an average of US\$5.90/mcf over the next 4.5 years. The hedging reduces the risk profile of the company at a time when volatility in the commodity market is very high.

Commenced Drilling Program in the Central Kansas Uplift in June 2011

Empire Energy commenced a 10 development well Drilling Program in the Central Kansas Uplift in June 2011. Kansas, historically, has been very prolific oil and gas producing state, with the most prolific oil reservoirs being the Arbuckle (Ordovician) and Lansing – Kansas City (Pennsylvanian) formations. Arbuckle has been productive and almost 70% of the production has come from counties situated on the Central Kansas Uplift, where EEG operates.

EEG's initial focus in the Central Kansas was to drill low risk development wells. In addition, EEG is looking to delineate additional prospects and to convert probable reserves to reserve 1P category.

Development Well Drilling Updates - Production started from 6 wells

Production commenced from 6 of the 10 development well drilling program in the Central Kansas Uplift. Production has commenced from the Boxberger – Solomon #14, CL Newcomer #9, Kollman #15, Carmichael/Kollman West Unit #4, Esfeld #9, Krankenberg #5-19 wells.

The Driscoll #31-8 well, which was the 7th well of the proposed well drilling program, was not completed and the well is plugged. As expected formations were not encountered, the working interest owners decided not to proceed with the well.

The Helmers Unit #3, which is the 8th well of the proposed 10 development well drilling program in the Central Kansas Uplift, will be completed by the company and the Wokaty #7, the 9th well was spudded in October 2011.

Commenced 2 Well, Oil Drilling Program in the Williston Basin, North Dakota

The 2 oil well drilling program in Williston Basin, North Dakota commenced in September 2011. The first well in the drilling program is waiting on completion. On the second well, it has been decided to run production casing and complete the well targeting oil in both Bluell and Sherwood Formations. A completion rig has been contracted for completion of the first well.

Based on the production histories, EEG anticipates reserves of 179,000 barrels of oil, an initial rate of 100 boe/d, and a 10 month payout with a 10% discounted return on investment of 4.29x.

Change in Presentation Currency for Financial Reporting

EEG adopted the USD as the presentation currency for Financial Reporting. The group's first results in USD were for the quarter ended 30 September 2011.

The change was introduced due to the increasing contribution of the US operations and also the increasing interests from potential US based financiers. With the company's intention to list on the US securities exchange along with approximately 99% of the group revenues denominated in USD, the change to USD will provide shareholders a more accurate presentation of the company's performance.

The reporting change will have no impact on the underlying business and cash flows of the group.

Latest Financial Results

Exhibit 1 : Half Yearly Income Statements

Thousand Australian \$	Half Year June 30, 2010	Half Year June 30, 2011	YoY%
Revenue	9,463.6	15,638.3	65.2%
Cost of Sales	5,075.8	6,700.3	32.0%
Gross Profit	4,387.8	8,937.9	103.7%
Other Income	320.9	6.0	-98.1%
Gain on sale of acreage and mining tenement	26,256.1	1,057.5	-96.0%
Gain/ (loss) on sale of investments	(492.3)	30.5	-106.2%
Gain/ (loss) on foreign currency translation	3.7	(41.7)	-1236.0%
Impairment loss	(228.2)	(75.9)	-66.7%
Depreciation and Amortization	(3,787.7)	(2,778.8)	-26.6%
General and Administration Expense	(1,070.4)	(2,566.5)	139.8%
Profit/(Loss) Before Tax and Finance Costs	25,389.8	4,568.9	-82.0%
Finance Income	48.9	25.0	-48.8%
Finance Expense	(3,178.8)	(3,300.4)	3.8%
Profit/ (Loss) Before Income Tax	22,259.9	1,293.6	-94.2%
Income Tax Benefit/ (Expense)	(8,058.2)	(652.0)	-91.9%
Net Profit	14,201.7	641.6	-95.5%
Basic EPS (in cents)	8.13	0.26	-96.8%
Diluted EPS (in cents)	8.12	0.26	-96.8%

Source: Company Filings, RB Milestone

EEG reported a 65% YoY growth in revenues primarily because of massive increase in Net Oil Production as the company continued the consolidation of the Kansas Oil producing assets acquired in December 2010. The net daily production of 1,355 Boe/d for the six month ended June 30, 2011 was approximately 40% greater than the 965Boe/d production for the six month ended June 30, 2010. In addition, the average sales price per unit after hedging surged by 45% to \$54.43/Boe in 1HFY11.

Gross Margins for EEG improved significantly from approximately 46% in 1HFY10 to 57% in 1HFY11. As a result, EEG reported approximately 104% YoY growth in Gross Profit.

EEG's Profit before Tax and Financing Costs were impacted as the 1HFY10 included A\$ 25.98 million in profits from the sale of a portion of the company's Marcellus Shale acreage. In addition the company reported a foreign currency translation loss in 1HFY2011. As a result the company reported approximately 95% YoY decline in Net Profits for 1HFY11. However, this decline in Net Profits was primarily due to fact that the 1HFY10 included profits from the sale of acreage. After adjusting the gain on sale of acreage and tenement, EEG reported an exponential YoY growth in Profit before Taxes in 1HFY11.

Valuation & Investment View

We have valued EEG based on peer valuation using EV/Reserves as a comparable parameter. We have computed the EV/Reserves of the appropriate peer set for EEG. We have considered EEG's peers which are having only 2P reserves for computing a suitable valuation model. We have replaced Stuart Petroleum Limited, which was considered in the peer set at the time of Initiation of coverage, with Senex Energy Limited. Senex Energy Limited acquired Stuart Petroleum in May 2011 and is now a part of the peer group for EEG.

Exhibit 2 : Peer Valuation

Name	2P Reserves (in mmBoe)	EV (A\$ mn)	EV/2P Reserves
NZ Oil & Gas	12.0	126.2	10.5x
Petsec Energy	5.75	(9.54)	-1.7x
ROC Oil Company Ltd.	16.2	187.2	11.6x
Cooper Energy	2	67.6	33.8x
Horizon Oil	16.8	269.6	16.0x
New Standard Energy	10.9	59.9	5.5x
Senex Energy	20.1	383.6	19.1x
Carnarvon Petroleum*	20.4	77.8	3.8x
Industry Average	13.0	145.3	13.5x
Empire Energy Group Ltd	16.8	86.8	5.2x

Source: RB Milestone, Bloomberg, *Carnarvon Petroleum has not been considered in our valuation model as it has 3P reserves of 31.5 million boe.

From the table above, we notice that EEG's EV/2P reserves ratio at 4.8x is significantly lower than the average EV/2P reserves ratio of 13.55x for the selected peers. However, we believe that such a conclusion would be cursory in nature as it does not adjust for the impact of oil and gas mix in the 2P reserves. While valuing the company, we have removed the outliers, namely, Petsec Energy and Cooper Energy.

Oil prices have increased strongly over the past few months, in comparison with gas prices. Hence, companies with proportionately more oil reserves have seen an upgrade of their valuation reflecting higher values for their oil reserves.

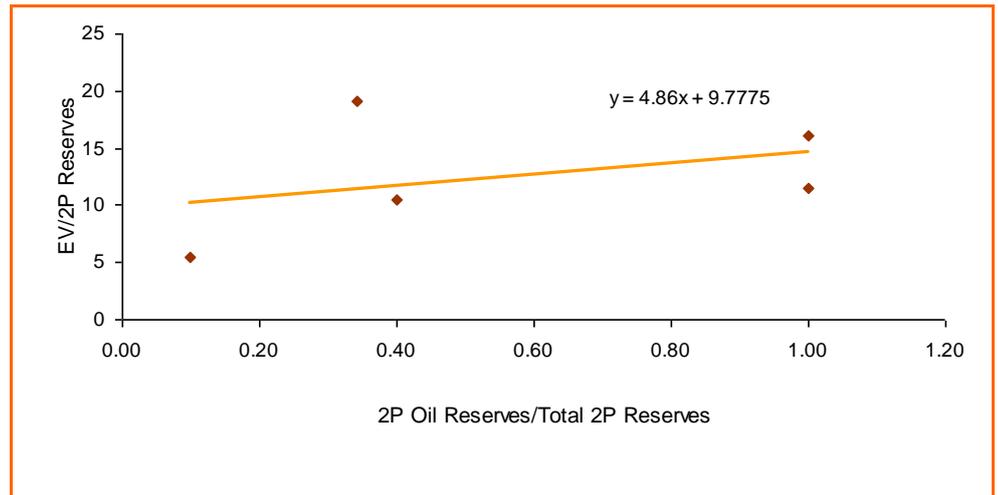
To account for this peculiarity, we have computed relation between EV/2P reserves and oil & gas mix, and got the following result:

Exhibit 3 : EV/2P Reserves and Oil/Gas Mix for Peers

Name	EV/2P Reserves	2P Oil Reserves/Total 2P Reserves
NZ Oil & Gas	10.5x	0.40
Petsec Energy	-1.7x	0.51
ROC Oil Company Ltd.	11.6x	1.00
Cooper Energy	33.8x	1.00
Horizon Oil	16.0x	1.00
New Standard Energy	5.5x	0.10
Senex Energy	19.1x	0.34
Carnarvon Petroleum	3.8x	1.00
Empire Energy Group Ltd	5.0x	0.36

Source: RB Milestone, Bloomberg

Exhibit 4 : Scatter Plot



Source: RB Milestone

This enabled us to estimate the EV/2P reserves for EEG given its current oil/gas reserve mix. Our revised target EV/2P reserve multiple is estimated at ~11x for EEG and the resultant target price is A\$0.526 per share. Our revised target reflects the strong development and exploratory pipeline along with the lifting of the moratorium on hydraulic Fracturing and the encouraging results from the Drilling Program in the Central Kansas Uplift. Oil constitutes 36% of the total 2P reserves of 16.8 MMBoe for EEG and hence warrants an attractive valuation. We believe that at current levels EEG appears undervalued as we have only included the current 2P reserves in our valuation and have not included any impact from the ongoing exploratory efforts, which can strongly uplift the company’s resource base.

Exhibit 5 : EEG Valuation

Valuation for EEG	in million \$
Enterprise Value (EV)	193.7
Adjustments	
Cash	10.7
Minority Interest	1.99
Total debt	56.16
Value of Equity	146.21
Number of Shares O/S*	278.19
Value Per Share	0.526
Current Market Price	0.120
Upside/(Downside)	338.3%

Source: RB Milestone, Bloomberg

*Number of outstanding shares includes 110 million shares issued through private placement and 4.74 million shares issued to existing shareholders through small placement

Disclaimer

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We strongly urge all investors to conduct their own research before making any investment decision.