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## QUARTERLY REPORT

*For the Quarter Ended 31 December 2009*

### HIGHLIGHTS

**OIL SALES PROVIDE POSITIVE CASH FLOW FOR COMPANY GOING INTO 2010 AND PREPARATIONS FOR DRILLING LIDSEY #2HZ WELL GATHER PACE AS DRILLING RIG AND SERVICES TENDER DOCUMENTATION ISSUED.**

#### **Southern England – Weald Basin - Onshore**

- **Oil Sales** – Approximately **AUD\$400,000** received by company from oil sales during first three months of ownership and operation.
- **Drilling Rig Tenders Issued** – Invitation to Tender documentation for suitable drilling rig to drill Lidsey #2Hz well issued.

**ITALIAN AUTHORITIES EDGE CLOSER TO ISSUING EXPLORATION PERMITS FOLLOWING WRITTEN CONFIRMATION FROM MINISTRY OF ECONOMICS THAT LEGAL COMPLIANCE HAS BEEN ACHIEVED.**

#### **Italy – Application Areas - Offshore**

- **Italian Permits** - Italian Authorities provide written confirmation of compliance with relevant Acts and Decrees. Application areas now to be converted to Exploration Permit status.

## PRODUCTION OPERATIONS

### UNITED KINGDOM

#### ONSHORE SOUTHERN ENGLAND - KEY PETROLEUM WEALD BASIN LTD

#### BROCKHAM OILFIELD (PL 235) AND LIDSEY OILFIELD (PL 241) (KEY 100%)

#### **SALES COMPARISON – LAST 3 MONTHS**

<b>MONTH</b>	<b>LIDSEY SALES BBLs</b>	<b>BROCKHAM SALES BBLs</b>	<b>TOTAL SALES BBLs</b>	<b>CUMULATIVE PRODUCTION SOLD</b>
DECEMBER 09	828	590	1418	<b>5047</b>
NOVEMBER 09	873	1507	2380	<b>3629</b>
OCTOBER 09	439	810	1249	<b>1249</b>

Approximately AUD\$400,000 has been achieved from oil sales during the quarter, despite very adverse operating conditions. This first quarter's results demonstrate that these oil fields are cash flow positive and this provides further incentive to continue to enhance field performance.

Since assuming ownership on 30<sup>th</sup> September 2009 and following a period of familiarization with the operations, the Company has commenced a programme to improve field operations and production efficiency. Throughout December 2009 and into January 2010 the worst winter weather in south east England for at least 30 years has impacted adversely on export road tanker movements in and out of the oil field sites. Oil flow through surface production facilities has also been impacted by numerous sub-zero temperature periods when severe well bore and surface flow line restrictions were created. Modifications to pipework, which commenced prior to the onset of poor weather, together with changes in chemical formulations used and the application of heat treatments, are all designed to optimise future production, eliminating these current issues.

All of these issues have impacted on oil sales and income during this first quarter of Key ownership but the Company has still managed to maintain sales of approximately AUD\$400,000. With the onset of warmer weather in the coming months, as well as the operational changes instigated by the Company, it is expected that improved production levels and sales will be seen. Prices received for oil sales have fluctuated during the quarter in line with world market prices for oil but remained in the healthy US\$70 to \$80 per barrel range.

#### **DRILLING OPERATIONS –**

Planning has continued during the quarter for the first development well drilling at the Lidsey oil field, which is currently scheduled to take place towards the end of the first quarter of 2010, subject to receiving relevant governmental and agency approvals.

Early in the December quarter, tenders were issued to select a suitable organisation within the United Kingdom to act as "Drilling Managers". Following this in-depth review of potential candidates, the oil and gas drilling consultants firm of Moorhouse Petroleum Limited has been awarded the contract to manage Key's drilling operations for the Lidsey well. This company specializes in onshore United Kingdom operations and has extensive experience in the sedimentary basin where the fields are located. Moorhouse Petroleum personnel will work closely with Key Petroleum's technical and managerial personnel, both in Australia and the United Kingdom, as preparations are made for the drilling of the Lidsey #2Hz well.

One of the first actions undertaken by the drilling team to kick start the drilling project has been the issuing of Invitation To Tender documentation to qualified drilling contractors. Site visits by potential contractors have been undertaken and various meetings held with individual tenderers to provide additional information required for well planning.

Final tender documentation was required by Key to be lodged early in January 2010. These tenders are now being reviewed by Key's drilling team.

During the December quarter a reservoir simulation study and a number of engineering studies were undertaken to model the potential well performance and the preferred completion design. This knowledge will be applied to the well path and a final well design.

A drilling programme has been prepared and discussions with the relevant authorities, environmental agency, and various drilling services providers have commenced.

## **EXPLORATION ACTIVITIES**

### **TANZANIA**

#### **OFFSHORE TANZANIA - FUNGUO PETROLEUM PTY LTD**

##### **NYUNI BLOCK (KEY 20%)**

##### **KILIWANI NORTH GAS DISCOVERY -**

The commercialisation process has continued slowly with further developments waiting on the Tanzanian government in relation to approval for Songas to expand gas processing facilities on Songo Songo Island and the environmental approval for the gas pipeline between the Kiliwani North #1 well and the Songo Songo gas plant. Other discussions on the commercialisation are being held between the Joint Venture Operator and Tanzanian parties, however progress has been slow and frustrating.

The Kiliwani North #1 well tested gas at a rate of 40 mscfd in June 2008 and since that time the Nyuni joint venture has, as part of its ongoing evaluation process, completed "in fill" seismic over Songo Songo Island during July 2009 to obtain a better understanding of the structure size. Processing of this seismic data is nearing completion and mapping of the discovery will commence shortly.

##### **NYUNI EXPLORATION PROSPECTS -**

Seismic reprocessing of legacy 2D data over a number of leads has highlighted the benefits and cost effectiveness of this programme. The reprocessing of an expanded suite of lines was continuing at the end of the quarter.

#### **OFFSHORE TANZANIA - FUNGUO PETROLEUM PTY LTD**

##### **WEST SONGO SONGO BLOCK (KEY 50%)**

##### **EXPLORATION PROSPECTS -**

The Joint Venture continues to review leads in the licence area which may mature to drillable status. The parties have agreed to reprocess the majority of the seismic recorded in the block

with the aim of improving the definition of the Chocha, Afisi and Miza leads. As well as enhancing the definition of these features, the new data may provide seismic attributes that upgrade the Late Cretaceous play at Afisi and Miza.

## **ITALY**

### **ONSHORE ITALY - PUMA PETROLEUM S.r.L.**

#### **BORSANO PERMIT (KEY 100%)**

The Borsano permit came to the end of its first term during November 2009. The Company's Italian subsidiary however, has lodged an application for an extension period with the relevant Ministry and further discussion will take place shortly with a view to expediting a determination on this application.

The Company continues working on its Borsano drilling preparation activities. However, the proposed drilling location lies in a built-up area and various potential environmental issues are causing the Company to review its plans for this well.

### **OFFSHORE ITALY - PUMA PETROLEUM S.r.L.**

#### **APPLICATION AREAS (KEY 100%)**

Key has four application areas as follows:

Lampedusa	d 342 C.R-.PU Application
Lampedusa	d 341 C.R-.PU Application
West Sardinia	d 90 E.R-.PU Application
Elba	d 91 E.R-.PU Application

Key's team has been working diligently on its Italian assets, within the bounds of the extensive legislative framework and protocols and attempting to meet the various obligations required in the application process. Key's Italian subsidiary, Puma Petroleum S.r.L, (Puma) has recently held a number of meetings with the Ministry of Economics in Rome to expedite the award of exploration permit status over these areas.

Following these recent meetings, the Ministry has now provided Puma with formal written confirmation that compliance with relevant legislation and protocols has been achieved for its offshore areas, d 341 C.R-.PU, d 342 C.R-.PU and d 90 E.R-.PU

The Company is now expecting official written notification in the coming weeks that the offshore areas have been granted exploration permit status, providing the necessary sanction for the Company to commence active exploration.

## **SURINAME**

### **ONSHORE SURINAME**

#### **UITKIJK AND CORONIE (KEY NET EQUITY 1.75% INDIRECT)**

#### **EXPLORATION PROSPECTS –**

As mentioned in the Company's previous quarterly report, Staatsolie Maatschappij Suriname N.V. (Staatsolie) in its 2009 half year report announced that the drilling undertaken in the Uitkijk block to the east of the 1 billion barrel Tambaredjo field had found significant oil reserves. These are currently estimated by Staatsolie to be 7 million barrels. Drilling is being undertaken in Suriname by Tullow Oil in conjunction with Paradise Oil, which is wholly-owned by Staatsolie. Key holds an indirect interest through an agreement with Hardman Oil and Gas Pty Ltd, now a wholly owned subsidiary of Tullow Oil plc and is not required to fund exploration under Tullow's farm-in programme at this time.

In its announcement, Staatsolie stated that a total of ten (10) wells had been drilled during this current drilling programme with all wells showing good oil indications.

The Staatsolie half year report also stated that the five (5) well drilling campaign in the Coronie block, was on track. Key was subsequently advised that the scheduled timing of drilling operations had slipped and were expected to commence during November 2009. This slippage was believed to be due to delays in receiving the drilling rig.

Key has now been informed that the drilling schedule has slipped once again and is now due to commence in March 2010.

## **CORPORATE ACTIVITY**

On 23rd November 2009 the Company held its Annual General Meeting in Perth. All resolutions put to shareholders were carried strongly on a show of hands and proxies lodged prior to the meeting.

The Company continues to evaluate asset acquisition opportunities in selected countries.

## **ENQUIRIES**

Please direct any queries to:

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**NOTE:** In accordance with ASX Listing Rules, any hydrocarbon reserves and/or drilling update information in this report has been reviewed and signed off by Mr. Ken Russell, Managing Director/CEO of Key Petroleum Ltd, who has at least 35 years experience in the sector. He consents to that information in the form and context in which it appears.