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## **QUARTERLY REPORT**

***For the Quarter Ended 31 March 2010***

### **HIGHLIGHTS**

#### **UNITED KINGDOM:**

**PRODUCTION OPTIMISATION PROGRAMME CONTINUES WITH WORKOVER OF ONE WELL.**

**PREPARATIONS FOR DRILLING LIDSEY #2HZ WELL CONTINUE.**

**KEY's OIL PRODUCTION AFFECTED BY SEVERE WEATHER IN UK.**

#### **TANZANIA:**

**TANZANIAN DIVESTMENT PLANNED.**

#### **ITALY:**

**EXPLORATION LICENCE STATUS GRANTED (POST-END QUARTER)**

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

- **Oil Sales** – Approximately **AUD\$184,000** received by the Company from sales with production being materially affected by severe weather condition, workover operations and piping modifications. Compares with revenue of some AUD\$400,000 for the December Quarter
- **Drilling – Regulatory Approvals Being Sought** – Tender documentation for suitable drilling rig and services to drill Lidsey #2Hz well issued.

#### **Tanzanian Planned Divestment**

During the previous quarter Key received an approach from the UAE based, Ras Al Khaimah Gas Commission ("RAK Gas"), a participant in the Nyuni block joint venture, to acquire Key's interests in both the Nyuni and West Songo Songo PSCs. Following much discussion between

the parties, a sale price was agreed. RAK Gas however, has now disputed the basis of the agreement reached with Key and this has thwarted the exchange of formal sale contracts.

In light of RAK Gas repudiating the proposed sale and purchase of the Interests, Key has decided to embark upon a programme to implement a sale of the Interests in the near future, conditional upon a reasonable price being attained. The Company has engaged external consultants experienced in these matters to assist it with this effort. This divestment decision has not been taken lightly but it has been influenced by a number of factors, predominantly a strategic change in focus for the Company from Africa to Europe where it sees greater near-term potential upside for a company of its size and a frustratingly slow pace of commercialization of the Kiliwani North #1 gas discovery. Key's positioning in the UK and its ongoing involvement in Italy where its offshore permits show considerable promise, provides it with the opportunity to become involved in a number of projects that have potential to provide near term growth for the Company.

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

- **Italian Permits** - Italian Authorities issued a Decree for exploration in the West Sardinia licence area (E.R.54.PU), effective 21 April 2010. This is the first award of four that are expected to ensue from current licence applications. The Lampedusa permits change to exploration status were to be issued at the same time as the West Sardinia award however changes to block coordinates by the Ministry of Economics, that do not materially affect the prospectivity of the areas, are to be changed and formal notification of exploration status will be issued shortly.

#### **UNITED KINGDOM**

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

##### **Brockham Oilfield (PL 235) and Lidsey Oilfield (PL 241) (Key 100%)**

#### **PRODUCTION OPERATIONS –**

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

| MONTH        | LIDSEY<br>SALES<br>BBLs | BROCKHAM<br>SALES<br>BBLs | TOTAL<br>SALES<br>BBLs | CUMULATIVE<br>PRODUCTION<br>SOLD |
|--------------|-------------------------|---------------------------|------------------------|----------------------------------|
| MARCH '10    | 871                     | 635                       | 1506                   | 7946                             |
| FEBRUARY '10 | 1176                    | 217                       | 1393                   | 6440                             |
| JANUARY '10  | -                       | -                         | -                      | 5047                             |

Approximately AUD\$184,000 has been achieved from oil sales during the quarter, in the face of very adverse operating conditions. Through December 2009 and January 2010, the worst winter weather in south east England for at least 30 years adversely impacted movements of export road tankers and other production-related activities. The low temperatures have also affected wellbore deliverability through restrictions in surface flowlines and near surface equipment.

Sales volumes were also impacted by the Company's decision to take the highest producing well, Brockham 2Y, offline to conduct a workover to modify the well bore completion string. This was felt necessary as part of the field optimisation plan and allowed installation of down hole chemical injection lines which it is felt will improve production operations going forward and should reduce the impact of colder weather in the future. Although the actual workover should not have been a long operation the delayed approval by the regulatory authority to conduct the workover and the late delivery of a number of critical equipment components needed to

complete the workover impacted on the time to complete the work. The latter two issues were items that Key had no control over.

The Company has continued a programme to improve field operations and production efficiency. In addition to the workover, modifications to pipework, changes in injected chemical formulations and the application of heat treatments, have all been introduced to optimise future production.

Positively, the quarter has seen a general firming of world oil prices in the range of US\$70 to \$87 per barrel, with prices for Key oil sales rising accordingly with industry and financial pundits expecting prices to remain in this band or slightly higher as the year unfolds.

## **DRILLING OPERATIONS –**

Preparations continued for the first development well drilling at the Lidsey oil field, which is currently scheduled to take place in mid-2010, subject to receiving relevant governmental and agency approvals.

Tenders documentation was issued and the Company has received bids for the selection of drilling equipment and services for the drilling of Lidsey #2Hz. The majority of winning tenders have now been selected and an application has been submitted to the Environmental Agency, seeking permission for the drilling operation to be undertaken from the Company's production facilities location.

Engineering design work for the drilling of the well was being finalized at the end of the quarter with the final process being a recommended means of artificial lift for fluids produced from Lidsey #2Hz.

## **EXPLORATION ACTIVITIES**

### **OFFSHORE TANZANIA**

#### **Nyuni Block (Key 20.0%)**

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

On 7 April, the Company announced the results of an independent assessment that estimated a mean, contingent in-place gas resource of 40 BCF at Kiliwani North. The gas discovery has a potential in-place upside of 60 BCF and is expected to have a high recovery factor.

The Kiliwani North #1 well tested gas at a rate of 40 MMcfd in June 2008 and since that time the discovery has been appraised by the recording of "in fill" seismic over, and adjacent to, Songo Songo Island during July 2009.

Market analysis and negotiations for the commercialisation of Kiliwani North have continued during the period.

### **NYUNI EXPLORATION PROSPECTS -**

Mapping of recently reprocessed seismic 2D data over lead areas in the licence has indicated that the Nyuni Anticline is the largest and least risky exploration prospect in the licence area.

The Operator has proposed this structure as the location for the drilling of a deviated well from an onshore drillsite in late 2010.

The Nyuni Anticline was drilled in 2003/4 by Nyuni #1A which penetrated the Lower Cretaceous objectives some 200m below the structural crest. Despite being offstructure, the well encountered a 15m thick Aptian-Albian sandstone section that is interpreted to be gas bearing and was not tested for operational reasons. The underlying Top Neocomian sandstones were water-bearing in that well but encouraging oil and gas shows were recorded deeper in the well.

## **OFFSHORE TANZANIA**

### **West Songo Songo Block (Key 50.0% via its subsidiary Funguo Petroleum Pty Ltd)**

#### **EXPLORATION PROSPECTS -**

The Joint Venture continues to review leads in the licence area which may mature to drillable status. During the June quarter, the parties will commence the reprocessing of 389km 2D seismic recorded in the block and adjacent waters 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.

The prospectivity of the east African margin was highlighted during the quarter by spectacular drilling results from Anadarko's first offshore well in the region. Their Windjammer well, located just south of the Tanzania-Mozambique border, penetrated a gas bearing section over 365m thick and with 169m of net gas-bearing sandstones. Anadarko plan to drill another three deepwater exploration wells under the same programme. Key believes that an export LNG industry will eventually develop in east Africa and that further drilling will lead to significant hydrocarbon liquids discoveries in the region.

## **ITALY**

### **ONSHORE ITALY**

#### **Borsano Permit (Key 100%)**

The Borsano permit came to the end of its first term during November 2009. The Company's Italian subsidiary has lodged an application for an extension period with the relevant Ministry and this has been gazetted by the Minister. 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**

### **Application Areas (Key 100%)**

The status of Key's application for four licence areas in Italian waters is now as follows:

|               |                                                                     |
|---------------|---------------------------------------------------------------------|
| Lampedusa     | d 341 C.R-.PU Application – Pending announcement of new designation |
| Lampedusa     | d 342 C.R-.PU Application – Pending announcement of new designation |
| West Sardinia | d 90 E.R-.PU Exploration - Awarded as E.R.54.PU on 21 April 2010    |
| Elba          | d 91 E.R-.PU Application                                            |

Following 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 and d 342 C.R-.PU and that these are expected to be issued in a similar

manner as the successful West Sardinia application. The two Lampedusa areas have not been actively explored for over 20 years and lie on the Pelagian Shelf, with similar prospectivity to areas in the Tunisian and Libyan sectors of the Mediterranean. The Italian fiscal regime is however more attractive than those in adjoining national regimes.

Further documentation was also submitted to Italian Government Authorities in support of Key's application for an exploration licence over the Elba application area.

### **SURINAME (Onshore)**

**Uitkijk and Coronie (Key net equity 1.75% indirect)**

### **EXPLORATION PROSPECTS –**

Drilling is being undertaken in Suriname by Tullow Oil in conjunction with Paradise Oil, which is wholly-owned by Staatsolie. The Company 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.

Due to rig availability, the five well drilling campaign in the Coronie block has been delayed to the June Quarter. Key is not required to contribute drilling costs for those wells.

### **CORPORATE ACTIVITY**

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.*