

Grand Gulf Energy (GGE)

Date: 20 July 2007

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Current Share Price	\$0.085
Valuation	\$0.165
Recommendation	SPECULATIVE BUY

Market Statistics

ASX Code	GGE
Sector	Energy
Ordinary Shares	297.9m
Capitalisation	\$25.3m
Cash (Argonaut estimate)	\$2.9m
Year High	9.5cps
Year Low	4.4cps

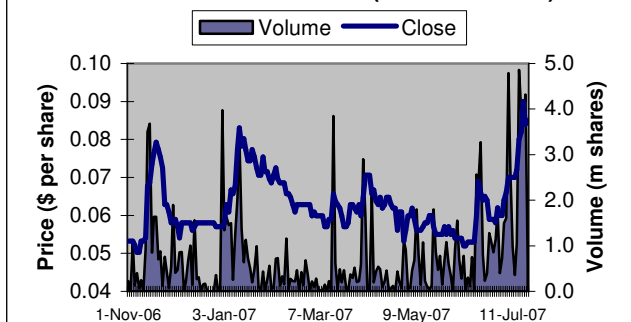
Directors

Charles Morgan	Chairman
James Trimble	CEO
Tony Grist	Non-Executive
Stephen Keenihan	Non-Executive
Allan Boss	Non-Executive

Major Shareholders

Directors & Management	16.2%
Macquarie Bank	11.0%
Argonaut	5.1%

GGE - Price and Volume (Nov 06 - Jul 07)



A GRAND START

- o Grand Gulf Energy has had a busy and successful 9 months since the decision was made to refocus on low risk, conventional projects in Oklahoma and Louisiana.
- o Oklahoma is an attractive location, with regulations that favour aggressive explorers, as well as having a prolific production history. In this state GGE has:
 - x Recently drilled two successful wells in the Foothills JV acreage, with 5 more planned over the next 6 months
 - x Completed, and is currently interpreting, 24 square miles of 3D seismic, which is expected to identify more locations
 - x Acquired the permanent fee mineral rights to (i.e. they own rather than lease) 4,000 acres surrounding the Foothills JV area
- o In Louisiana:
 - x One well has been drilled successfully in the Phase 3B programme, with 3 more expected to spud this quarter
 - x A 52 square mile 3D seismic survey was completed this month at the Napoleonville Salt Dome, where GGE has a substantial 25% interest
- o We are impressed with management's achievements to date, experience and relationships in the US. The latter points are critical in delivering not just the quantity, but importantly the quality, of deal flow.
- o GGE offers investors regular exposure to drilling activity, an expected steady growth in production and cashflow, and access to a significant prospect portfolio.
- o We are further encouraged by the solid financial support from major shareholders, and an initial valuation which provides a conservative value of **\$0.165 per share**.
- o Our positive view on management, assets and value (with upside potential) backs up our **Speculative Buy** recommendation.

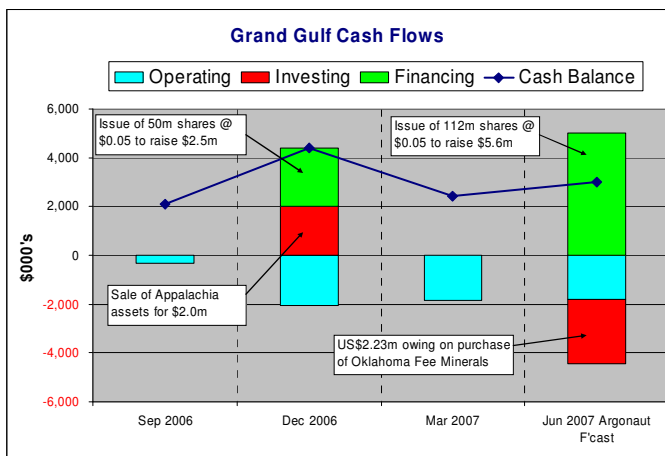
Important Disclosures

Argonaut underwrote the Entitlements Issue of 46.3m shares at \$0.05 per share in June 2007 and managed the placement of 50m shares at \$0.05 per share in December 2006. Argonaut received fees commensurate with these services. Argonaut has an interest in and / or controls 15,271,172 (5.1%) GGE shares and 1,342,385 GGE unlisted options. For further important disclosures, please see page 6.

SUMMARY OF RECENT EVENTS

- Grand Gulf Energy announced that it was changing its focus to low risk conventional projects in Oklahoma and Louisiana in September 2006.
- Since then, the Company has made substantial progress in advancing its US ambitions:

Figure 1: Cash Flows and Milestones Achieved



Significant Events:

Decision to divest Appalachian assets and focus on Louisiana and Oklahoma	Sale of majority of Appalachian assets	Foothills - 3D completed, two wells drilling outside seismic area	In Oklahoma, both wells successful (0.8 & 1.3mmcf/d), & Fee Minerals acquired
Jim Trimble appointed MD & CEO.	Agreement to acquire 12.5% interest in Foothills JV leases in Oklahoma	Napoleonville Salt Dome - 3D survey commenced	Phase 3B - well successful (flows 3.2mmcf/d on test)
Agreement to participate in Legend 3B drilling programme in Louisiana	Agreement to acquire 25% WI in 52sq.m. 3D & 30,000 lease acres Napoleonville Salt Dome	Phase 3B - one well drilling	Name change from Alto Energy to Grand Gulf Energy
	Raised \$2.5m by issue of 50m shares @ \$0.05	Arranged a \$4m working capital facility with Macquarie Bank	Raised \$5.6m by issue of 112m shares @ \$0.05 (entitlements & placement)

Source: GGE, Argonaut

INVESTMENT RATIONALE

- In June 2007 Argonaut met with GGE's senior management, associates, partners and other upstream oil and gas companies in Houston. We were very impressed with:
 - Management's experience and relationships in the US, ensuring the delivery of good quality deal flow
 - The focus on less risky, 3D supported conventional prospects of robust quality in highly prospective areas
- We believe that GGE will provide investors with:
 - Regular and near-term exposure to low-risk drilling activity
 - Steady growth in sales and cash flow
 - Access to further opportunities and a significant portfolio of attractive prospects

- On the latter point, we note that the recent acquisition in Oklahoma uniquely positions GGE (as an Australian listed Company) as owner, rather than lessee, of fee mineral rights in the US.
- We are further encouraged by the solid financial support from major shareholders, with directors and Macquarie Bank supporting the recent capital raising.
- We have placed an initial valuation on GGE of **\$0.165 per share**. We believe that we have been reasonably conservative in arriving at this number (see Valuation Section below), but note that it is still comfortably ahead of the current share price.
- Our positive view on management, assets and value leads us to maintain our **Speculative Buy** recommendation.

OVERVIEW OF ASSETS

- GGE's assets are all well positioned in active, proven and producing areas. Infrastructure is readily accessible in all areas, ensuring cheap, easy access, and a quick turnaround from drilling to cash flow.

Figure 2: Project Areas



Source: GGE

Foothills JV – Oklahoma

- Towards the end of last year, GGE acquired a 12.5% interest in the Foothills JV Project, which has gas production and development potential in LeFlore County. The JV has a gross lease position of more than 3,000 acres.
- The Foothills JV recently participated in a 24 square mile seismic survey. Interpretation is currently underway and is expected to result in the identification of up to 22 locations to be drilled over the next 3 years.
- In the last quarter, GGE participated in two successful wells which were drilled in the Foothills JV lease acreage, but outside of the 3D seismic area. Three immediate

follow up wells are planned, with one due to spud shortly (see Activity Section below).

Figure 3: Oklahoma Wells Drilled to Date

Oklahoma Drilling Results Summary				
Well	Interest	Location	Objective	Comments
Pate #5-18	25% (BP back in for 22% after 200% payout)	Le Flore County, Oklahoma	Spiro Formation	Turned into sales pipeline at a rate of 1.30mmcf/d
Reed #4-8	8%	Le Flore County, Oklahoma	Brazil Formation	Turned into sales pipeline at a rate of 0.75mmcf/d

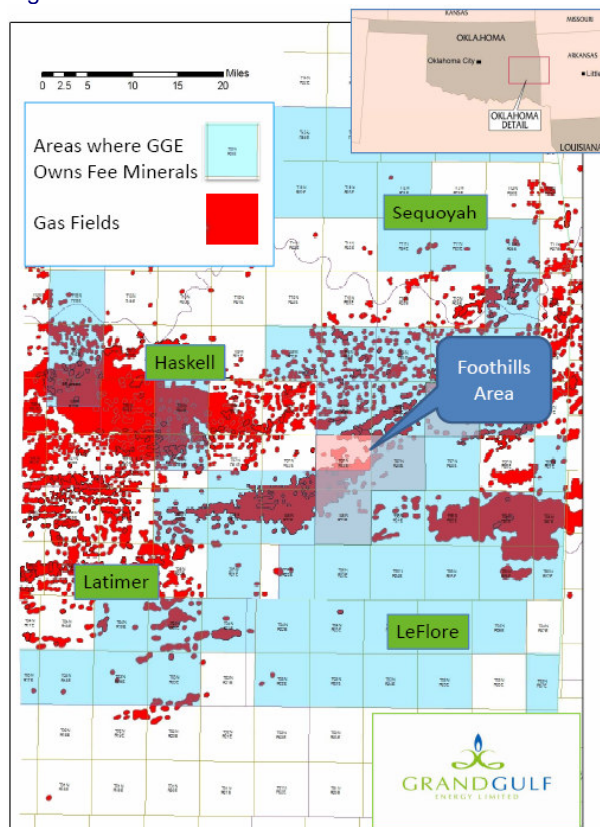
Source: GGE

At the time of the acquisition of the Foothills Project, the Independent Geologist provided a gross reserves estimate of 65bcf. This equates to 4.2bcf net to GGE (assuming an average 6.5% interest).

Fee Minerals Acreage – Oklahoma

- GGE recently signed an agreement to acquire the permanent fee mineral rights to 4,000 acres surrounding the Foothills JV acreage for US\$2.23m. The acquisition:
 - × Allows GGE to have 100% Net Revenue Interest in wells
 - × Enables GGE to receive lease payments and royalties where it elects to lease-out
- The acreage is amongst and on trend with many producing fields and much of it will soon be covered by 3D seismic. This should provide many well locations and production opportunities.

Figure 4: Oklahoma Detail



Source: GGE

This acquisition is noteworthy in that GGE have acquired the fee mineral rights as opposed to leasing them (the latter being the typical case for an Australian E&P Company in the US). Acquisition of **fee mineral rights** means that GGE:

- × Owns these rights in perpetuity
- × Can elect to participate in a well through equity contribution, but will not pay royalties on production (i.e. the Net Revenue Interest is the same as the Working Interest)
- × Can choose not to participate in a well, but if it is successful still enjoy the royalty payments (typically 25% of gross production revenue)
- × Receives lease payments from lessees
- In a recent presentation GGE provided a preliminary net reserve potential range of between 10bcf and 25bcf. This is broken down as follows:

Table 1: Fee Minerals Reserves Potential (net to GGE)

Fee Minerals	Preliminary Net Reserve Potential Range	
	From (bcf)	To (bcf)
Leased with 3D coverage	3.7	9.4
Leased without 3D coverage	0.2	0.6
Non-leased with 3D coverage	5.0	12.3
Non-leased, without 3D, on trend	1.2	2.9
Other areas	0.1	0.2
Total	10.2	25.4

Source: GGE

- The range in potential reserves in the table above is due to uncertainty over GGE's final participation in each well. This is because **forced pooling** arrangements in Oklahoma make it difficult to determine interests in specific wells in advance.
- While complicated, these arrangements are very attractive to junior companies wishing to encourage drilling activity, and work as follows:
 - × Each section (640 acres) is subject to forced pooling
 - × There may be a number of lease or fee minerals holders in each section
 - × Any of these holders can propose a well anywhere in the section
 - × All lease or fee mineral holders within the section are entitled to elect to participate (at a percentage based on their holding within the section)
 - × The Oklahoma Corporate Commission stands by to "force" timely decisions and arbitrate disagreements

Phase 3B Programme – Louisiana

- GGE is participating in a 4 well drilling programme called Phase 3B in southern Louisiana. The first well has been successfully drilled, tested at gross 3.2mmcf/d (to atmosphere), and will be tied into sales in early August. GGE has a 7.5% interest in this well.

Figure 5: Louisiana Wells Drilled to Date

Louisiana Drilling Results Summary				
Well	Interest	Location	Objective	Comments
ConocoPhillips #4	7.5% (AOI paying 10%)	Terrebonne Parish, Louisiana	Crescent Farm Sands	Flowed 3.2mmcf/d to atmosphere - to be turned into sales in early August

Source: GGE

- The prospects in Terrebonne and Vermillion parishes have been identified by Legend Petroleum, the principles of whom have extensive experience in the area, which is well known for its high well productivity.
- Two wells are expected to spud in August and September, targeting significant potential reserves (see Activity Section below).
- Based on Company announcements, we estimate net potential reserves from the 4 well programme to be 3.2bcf to GGE.

Napoleonville – Louisiana

- GGE has a 25% Working Interest in 28,000 gross lease option acres over the Napoleonville Salt Dome in Assumption Parish, Louisiana. It has already produced approximately 188bcf gas and 20mmbbls oil.
- The Napoleonville Salt Dome has not had 3D seismic previously applied and evidence from other salt domes in Louisiana is that 3D evaluation can improve reserves by 10% to 25%.
- A 52 square mile 3D seismic survey was completed this month, with interpretation commencing in August. GGE expects a drilling programme to commence in early 2008.
- The Company anticipates gross exposure of 13bcf and 8.4mmbbls, with an upside case of 350bcf and 15mmbbls. For valuation purposes we have assumed potential reserves of 3.3bcf and 2.1mmbbl to give 15.9bcfe net to GGE prior to further risking.

ACTIVITY

- In the coming months there will be considerable activity, and as a result GGE recently decided to introduce a Monthly Operations Report. This is to be applauded and will provide investors with an up to date summary of exploration, prospects, drilling and production.
- The Report for June 2007 presented the following detail:

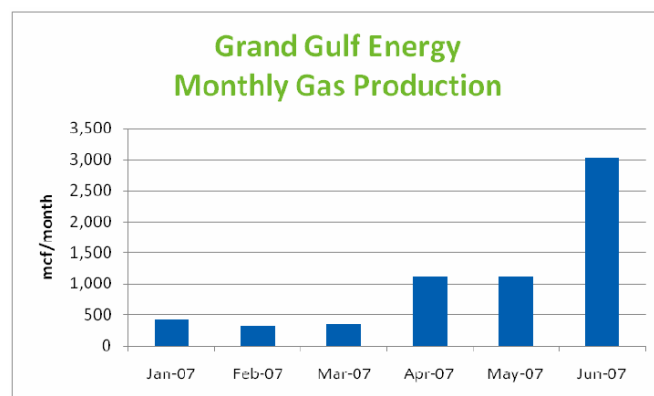
Figure 6: GGE June Monthly Operations Report

Prospects

Well	Working Interest	Location (County)	Spud Date (estimated)	Total Depth (estimated)	Target Initial Rate mcf/d	Target Reserves mmmcf gross
Oklahoma						
3D Seismic Spiro	10.0%	LeFlore	October	11,000 ft	1,500	3,000
3D Seismic Red Oak	10.0%	LeFlore	December	9,000 ft	1,000	1,000
Red Oak #2-17	8.0%	LeFlore	October	10,000 ft	750	1,000
Spiro #6-23	10.0%	LeFlore	November	12,000 ft	1,500	3,000
Louisiana						
Bastian Bay	25.0%	Plaquemine	September	2,000 ft	2,000	3,000

Drilling

Well	Working Interest	Net Revenue Interest	Location (County)	Spud Date (estimated)	Total Depth (est)	Current Depth	Target Initial Rate mcf/d	Target Reserves mmmcf gross
Oklahoma								
Nixon #1-8	8.0%	6.0%	LeFlore	Late July	9,700 ft	0	750	1,000
Louisiana								
Catapult #1	3.7%	2.8%	Vermilion	August	14,200 ft	0	5,000	30,000
Conoco Phillips #5	7.5%	5.6%	Terrebonne	September	12,500 ft	0	2,000	6,000



Source: GGE June Monthly Operations Report

- The June 2007 gas production figure includes the recently drilled Reed #4-8 well. Further growth in production is expected in the current quarter as the Pate #5-18 and the ConocoPhillips #4 well are turned into sales.
- This Report confirms our expectations of a steady:
 - × Generation of prospects for drilling
 - × Growth in production and cash flow
- Interpretation of 3D in the Foothills JV acreage in Oklahoma and the Napoleonville Salt Dome in Louisiana will significantly add to the prospect and drilling inventory.

VALUATION

- We value GGE based on an in-ground value of net risked expected reserves using the following assumptions:

- × Expected Reserves:

Table 2: GGE Net Expected Reserves for Valuation

	Net Expected Reserves (bcfe)	Comment
Oklahoma Foothills JV	4.2	As per Independent Expert Report (Nov 2006) – gross 65bcf x average 6.5% interest
Oklahoma Fee Minerals (3D, leased)	3.7	As per GGE Presentation (Jul 2007) – lower end of anticipated participation range
Oklahoma Fee Minerals (3D, not leased)	5.0	As above
Oklahoma Fee Minerals (other acreage)	1.4	As above
Louisiana Phase 3B	3.2	As per GGE Presentations (Jul 2007 and Nov 2006)
Louisiana Napoleonville	15.9	As per GGE Presentation (Nov 2006)

Source: Company Presentations, Independent Expert

- × In Ground Value of Gas:

Table 3: In-ground Value of Gas Assumptions

	In-ground Value of Gas (US\$/mcf)	Comment
Oklahoma – Leased	1.50	Based on internal calculations and US acquisition metrics
Oklahoma – Fee Minerals	2.50	As above, adjusted to remove royalty payments
Louisiana	2.00	Based on internal calculations and US acquisition metrics

Source: Argonaut

- An element of risk is already factored into the reserves figures shown in Table 2. We reduce these numbers further to take into account other risks associated with (amongst other things) the ability to successfully farm-out prospects, the interpretation of 3D seismic, technical risks, and timing issues.
- We believe this provides a reasonably conservative valuation for GGE. As drilling activity increases over the coming year the results, if successful, will provide confidence in, and upside to, the reserves numbers.

Table 4: GGE Project & Overall Valuation

Project	Net Expected Reserves (bcfe)	Risk Factor (%)	Net Risked Expected Reserves (bcfe)	In-ground Value of Gas (US\$/mcf)	Value (US\$m)	Value (A\$m)	Value (A\$/share)
Oklahoma Foothills JV	4.2	85%	3.6	1.50	5.4	6.3	0.020
Oklahoma Fee Minerals (3D, leased)	3.7	85%	3.2	2.50	7.9	9.4	0.029
Oklahoma Fee Minerals (3D, not leased)	5.0	50%	2.5	2.50	6.2	7.3	0.023
Oklahoma Fee Minerals (other acreage)	1.4	0%	-	-	-	-	-
Louisiana Phase 3B	3.2	65%	2.0	2.00	4.1	4.8	0.015
Louisiana Napoleonville	15.9	65%	10.3	2.00	20.7	24.3	0.077
Cash						2.9	0.009
Unpaid Capital						1.2	0.004
Corporate						-3.7	-0.012
Total						52.5	0.165

Source: Argonaut

- On the back of a number of company announcements in recent weeks, the run in the GGE share price has taken it up 47% since the end of June to \$0.085 per share.
- Our valuation of **\$0.165** per share is comfortably above this price, and would increase if the Company delivers consistent drilling success. This initial valuation provides backup for our **Speculative Buy** recommendation.

Disclosures & Disclaimer

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- The Argonaut Group has an interest in and / or controls 15,271,172 (5.1%) GGE fully paid Shares and 1,342,385 GGE unlisted options. The Argonaut Group's Managing Director & CEO, Edward Rigg, has an interest in 2,919,220 (1%) GGE fully paid shares.
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- This report was produced by Ian Christie, CFA and Director of Research, Argonaut Securities Pty Limited. Ian has an immaterial interest in GGE shares.

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