Update

4 August 2010

Tower Resources

Year End	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/08	0.0	(0.93)	(0.2)	0.0	N/A	N/A
12/09	0.0	(0.71)	(0.1)	0.0	N/A	N/A
12/10e	0.0	(1.50)	(0.2)	0.0	N/A	N/A
12/11e	0.0	(1.50)	(0.2)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Investment summary: Bullish Namibia CPR

The focus of Tower's exploration activity has shifted to Namibia following the disappointing drilling results in Uganda in 2009 and early 2010. The recently released CPR points to the bullish potential of the offshore Namibia project. Tower is one of the leading plays on what is possibly an emerging major new hydrocarbon province in the South Atlantic. We believe an exploration well offshore Nambia remains a possibility during the early 2012 weather window.

Namibia project: Tower free carried initially

Tower has a 15% working interest in Licence 0010 located between about 50km and 200km west of the Namibian coast. The operator is Arcadia Petroleum, a privately held oil trading company with oil exploration interests, including in the Falklands in conjunction with Desire Petroleum. Importantly, Tower is free carried during the seismic gathering phase and for the first exploration well.

Geological prospectivity: South Atlantic rift system

Simplistically the theory behind offshore Namibia's prospectivity as a hydrocarbons province is that it is part of the South Atlantic rift system and has analogous characteristics to other petroleum provinces in the basin. Significantly, large sedimentary basins offshore Namibia contain broadly similar Mid Cretaceous source rocks to those in the prolific Brazilian offshore oilfields.

Resource base: Supergiant potential

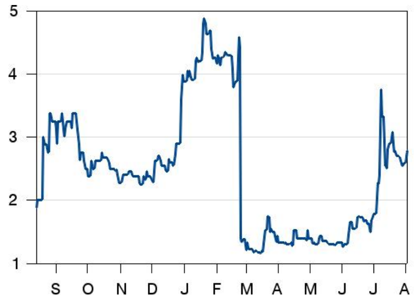
According to Oilfield International's CPR, Licence 0010 has gross prospective resources at the 50% probability level of 9.6bnboe in the event of light oil bearing structures. This is similar in scale to the supergiant Tupi discovery offshore Brazil. Net to Tower, prospective resources on the same basis are put at 1.38bnboe.

Valuation: Namibia EMV of 45p/share

At this stage any valuations are necessarily tentative. Oil International's EMV for Tower's 15% working interest in Namibia Licence 0010 is $696m or 45p/share. This is based on net risk adjusted resources of 170mmboe and implies $4.1/boe. We believe this is a plausible valuation basis in the event that drilling points to gross recoverable resources of over 1bnboe with a heavy weighting towards crude oil.

Price	2.78p
Market Cap	£28m

Share price graph



Share details

Code	TRP
Listing	AIM
Sector	Oil & Gas
Shares in issue	1,007.2m

Price

52 week	High	Low
	4.88p	1.15p

Balance Sheet as at 31 December 2009

Debt/Equity (%)	N/A
NAV per share (c)	2.7
Net cash ($m)*	2.0

Estimated end July 2010.

Business

Tower Resources is a frontier oil and gas exploration company focused on Africa. There are two projects in Uganda's Albertine Basin and offshore Namibia.

Valuation

	2009	2010e	2011e
P/E relative	N/A	N/A	N/A
P/CF	N/A	N/A	N/A
EV/Sales	N/A	N/A	N/A
ROE	N/A	N/A	N/A

Geography based on revenues (2009)

UK	Europe	US	Other
0%	0%	0%	0%

Analysts

Peter J Dupont 020 3077 5741

Neil Shah 020 3077 5715

oilandgas@edisoninvestmentresearch.co.uk

Tower Resources is a research client of Edison Investment Research Limited

South-west Africa margin geological background

The offshore margin of south-west Africa contains four large sedimentary basins which, running from north to south, are called Namibe, Walvis, Luderitz and Orange. Their existence is believed to reflect thermal subsidence following a period of rifting preceding the formation of the South Atlantic in the Mid Jurassic period approximately 150m years ago. Sediments were subsequently deposited during the Cretaceous and into the Paleocene period. Initially the sediments were of continental lacustrine origin and included Mid Cretaceous organic rich shales and clays. These provided the source rock for the emerging petroleum system and are broadly similar in age and type to those found offshore Brazil. In the Upper Cretaceous period, possibly aided by marine incursions, sandstone and carbonate sequences were deposited which provided the foundation for potentially high quality hydrocarbon reservoirs. Shales deposited during the Upper Cretaceous and the Paleocene periods are thought likely to provide the seal to the petroleum system. This contrasts with the offshore Brazilian fields where deep layers of salt perform this function. Maturation of the source rock was aided during the Cretaceous period by deepening sedimentation and water incursion.

During both the rifting and post rifting phase the south-west African margin was subject to heavy faulting. This has provided an effective mechanism for the efficient migration and trapping of hydrocarbons. In common with elsewhere in the South Atlantic basin, it is the combination of tectonic activity and sedimentation that makes the south-west African margin prospective for hydrocarbons.

South-west Africa margin exploration activity

The south-west Africa margin covers a very large area that is comparable in size to the North Sea. Exploration activity in the region is very much in its infancy with only nine wells drilled so far according to Chariot Oil, a junior with the second largest acreage in the region. Five of these wells have been drilled in Tullow's Kudu gas field, about 170km west of the Namibian coast in the Orange basin. Resources here are put at 1.3tcf but development has yet to be sanctioned. In the northern Namibe basin a consortium led by Russian E&P concern Sintezneftgaz announced an apparently large gas discovery in July 2009 at the Kunene-1 well, about 60km offshore. According to Namibian government sources, Kunene may have resources of up to 14tcf, but there has not been any independent confirmation and the status of Kunene is unclear at this time.

Norsk Hydro drilled two wells in 1994 and 1995 on Block 1911 in what is now the Arcadia/Tower Licence 0010 located in the Walvis and Namibe basins. Both wells were abandoned as dry holes, but the drilling revealed three potential source rock horizons along with a number of good quality reservoirs and residual oil saturations.

Chariot is arguably further down the exploration trail than most of the players with acreage in the south-west African margin. It has undertaken an extensive 2-D and 3-D seismic gathering exercise which has resulted in one prospect and 25 leads so far. Gross un-risked resources across Chariot's acreage are put at 8.5bn barrels which is clearly in supergiant field territory. Significantly, in Block 2714A in the Orange basin Chariot has farmed out a 50% working interest to Petrobras.

So far, Petrobras is the only major to have exposure to the south-west Africa offshore margin. Chariot is actively seeking farm-in partners to speed drilling activity. We believe the south-west Africa margin could attract growing exploration interest in the near term, particularly if there are further discoveries in Falklands' waters.

Namibia offshore project: Licence 0010

Project profile

Tower has a 15% working interest in Licence 0010 which contains blocks 1910A, 1911 and 2011 and covers 23,277sq km. Arcadia Petroleum owns the other 85% and is the operator, having farmed-in in September 2007. A 50% relinquishment of the less prospective eastern acreage was made in August 2009. Geologically the Licence is located at the northern end of the Walvis Basin and the southern end of the Namibe basin on the southern flank of the Walvis Ridge, the high point between Angola and South Africa. It lies between 50km and 200km west of the north Namibian Skeleton Coast and approximately 450km north-west of Walvis Bay, the nearest deepwater port. The water depth across the Licence area ranges from a not particularly deep 150m to a very deep 3,000m. Importantly, Tower is free carried financially for the 3-D seismic survey and for the first exploration well.

2-D seismic surveys were shot on Licence 0010 in 2006 and 2007 and further seismic data was acquired. The results were very encouraging with four large structures identified running south-east to north-west over a distance of about 200km towards the western extremity of the Licence area. Running from north to south the structures are called Beta, Alpha, Gamma and Delta. Beta lies about 200km south-west of the Kuene gas find. The structural highs appear to have been uplifted to their present positions due to tectonic activity in relatively recent Middle Miocene or even Pliocene times. The Delta structure appears the most promising for hydrocarbons based on the seismic and AVO analysis. Indeed, it is the location of the only prospect identified so far which means that it is theoretically suitable for drilling without further information. To improve understanding and minimise drilling risk, a 3-D seismic survey is presently being shot over the Delta prospect. This commenced in early July and should be completed towards the end of August. Analysis and interpretation is expected to take until early 2011.

The Delta prospect, 54km south-west of the Norsk Hydro 1911-15 well, refers to a Maastricht (Upper Cretaceous) sandstone horizon target. The evidence from 2-D seismic points to a well defined closure, while confidence is high in terms of the presence of a seal in the form of shale. Confidence however is somewhat lower in terms of hydrocarbons migration and particular the presence and quality of the reservoir. Overall, Oil International has assigned a 26% geological chance of success to the Delta prospect, which is relatively high for this early stage of exploration. In addition to the Delta prospect, Licence 0010 contains three leads as follows: Delta Palaeocene, Alpha Palaeocene and Gamma Palaeocene. These are all high risk targets at this stage and require further information to raise confidence to the prospect level. Geological chances of success for the three leads have been assessed by Oil International at 8%, 20% and 12% respectively.

Drilling plan

The current plan is to drill an exploration well on the Delta prospect in the weather window between October 2011 and April 2012, with the 3-D seismic assisting in identifying the precise location. Given the time constraints related to Arcadia needing to farm-out before contracting a rig and the lead time for well planning, it now seems unlikely that drilling will occur before early 2012. Assuming a commercial discovery is made an appraisal drilling programme might then be undertaken, followed possibly by another exploration well before the expiry of the current exploration licence period in August 2013. Production is theoretically possible by end 2015 using a FPSO facility. A large scale appraisal and development programme would however probably take until 2020.

Given the location and nature of the planned exploration well drilling will be costly. The average depth of water over Delta is relatively deep at 1,115m, while the supply line from Walvis Bay is long. The well will also be relatively deep if it is in line with the approximately 4,500m of the earlier Norsk Hydro wells. All told, we believe the cost of the planned exploration well will be in the region of $50m. Heavy exploration spending suggests that Arcadia/Tower will in all likelihood have to seek farm-in partners in the coming months. It should also be noted that due to heavy exploration and development expenditure, hydrocarbon reserves will need to be substantial to justify development. Much, of course, will depend on price developments over the next two or three years and whether discoveries are orientated to gas or oil. Assuming oil, we believe that to achieve critical-mass recoverable reserves of at least 200 or 300mm barrels will be required at today's economics to justify development.

Resources

Oil International has derived its estimates of resources based on three different assumptions for the fluid type. These are that the reservoirs are predominantly light oil, gas condensate and dry gas bearing. For the Delta structure, Oil International assigned probabilities to these outcomes of 50%, 40% and 10% respectively, while the other structures were rated 45%, 44% and 11% respectively. The odds of discovering gas are believed to be greater in the more northerly structures where the source rocks are deeper.

Oil International's estimates of prospective resources based on the alternative fluid type assumptions are as follows:

- In the event of light oil, gross recoverable resources of 7.55bn barrels and 12.4tcf of natural gas or 9.6bnboe. Tower's share would be 1.08bn barrels and 1.8tcf or 1.38bnboe.
- In the event of gas condensate, gross recoverable resources of 765mm barrels and 28.5tcf of natural gas or 5.52bnboe. Net to Tower this would be equivalent to 109mm barrels and 4.1tcf or 792mmboe.
- In the event of dry gas, gross recoverable resources of 67mm barrels and 27.8tcf of natural gas or 4.70bnboe. Net to Tower this would be equivalent to 10mm barrels and 3.9tcf or 660mmboe.

Clearly, the first outcome would suggest a supergiant oil and gas discovery similar to those, such as Tupi, made in recent years in the Santos Basin, offshore Brazil. Given the scale of the oil resources and the potential for light oil, project economics would probably also look highly attractive despite the relatively remote location and fairly deep water. The gas intensive outcomes also point to substantial resources but the economics of a gas development project would be considerably less attractive than for one based predominantly on light oil.

Uganda

Drilling results revisited

Tower's drilling programme in Uganda's Block 5, the most northerly concession in the Albertine Basin, has so far proved disappointing. The Iti-1 well drilled in May/June 2009 and the Avivi-1 well drilled in February 2010 both proved dry or perhaps more accurately the results were ambiguous. As is usually the case with drilling programmes, Tower's knowledge of Block 5 was greatly enhanced by the drilling programme and it remains confident in the prospectivity of the zone.

Significantly in the case of Iti-1, subsequent analysis of the drilling results has proved more encouraging than the initial interpretation. Independent analyses confirmed the presence of clean reservoir sands with good porosity. Permeability, however, was found to be low. Studies of the fluid samples have revealed traces of oil, while small quantities of oil were extracted from the rock samples. The conclusion perhaps is that Iti-1 was an oil find in a poor quality reservoir.

The Avivi-1 well, located 20km south of Iti-1, also encountered traces of oil in the fluid samples similar to those encountered in Iti-1 and from surface samples. Again, reservoir quality appeared to be of poor quality. Importantly, the Avivi-1 well encountered thick sequences of organic rich clays which point to high quality source rocks in the deeper areas of the basin. Overall, Tower believes that it has significantly de-risked the issues of oil generation and migration towards the southern extremity of Block 5. According to Tower, the challenge now is to identify structures in the deeper part of the basin where reservoir quality is considerably better than that encountered up to now. This will involve obtaining substantially more seismic coverage in the areas of interest.

Status of the licence and work programme

At the end of April Tower announced that it had been granted a renewal of the licence covering Block 5 by the Ugandan Ministry of Energy and Mineral Development. The licence will now continue until 27 March 2012. Following the discussions with the ministry, the area of the licence has been cut from 6,040sq km to 2,941sq km. Australian junior Global Petroleum financed the bulk of the Iti-1 well and 25% of the Avivi-1 well. An agreement was recently reached between Tower and Global such that the latter will have a continuing option to take a 25% working interest in Block 5, while having no obligation to contribute to expenditure.

Tower has recently completed an 8,412km aero gravity gradiometry survey. The results should be known by end August and will provide vital information for a planned 500km 2-D seismic shoot. This in turn will be used in selecting the next drilling target. The seismic survey will cost a substantial $12m and will require third party financing. Tower has indicated that it is sounding out farm-in interest regarding the seismic survey and a new Block 5 exploration well. Probably the earliest that a well could be drilled is the second quarter of 2011. Based on the experience with Avivi-1, an exploration well is likely to cost about $7.5m with another $1m for testing.

Compared with the deepwater offshore Namibia play, the minimum resources required for commercial development in Uganda Block 5 would be decidedly modest. In all probability 25mm barrels would be sufficient at current prices and assuming light oil. Initially oil from an oilfield towards the southern end of Block 5 could be trucked to the gathering and processing facility planned for the large fields discovered in Bocks 1 and 2, 60 to 100km to the south. Subsequently a pipeline link could probably be added cost effectively. By 2015, it should be noted, an export pipeline is expected to be in operation linking the Lake Albert gathering and processing facility with the Indian Ocean port and refinery of Mombasa.

Exploration and development news

The recent exploration news from other players in Uganda has been mixed. On the positive front Tullow has just announced another discovery at its Nsoga -5 appraisal well in the Butiaba region at the northern end of Block 2. Ten metres of net oil pay were encountered at the relatively shallow depth of 587m in the high quality stacked fluvial reservoirs that characterise the Victoria-Nile delta zone. By contrast, Dominion Petroleum recently announced that its Ngaji-1well in Block 4B on the eastern shore of Lake Edward failed to encounter hydrocarbons. This was its first well in the Albertine/Lake Edward Basin. Their plan now is to obtain more seismic in preparation for a new drilling programme in 2011.

Tullow has also recently announced the conclusion of its purchase of Heritage Oil's assets in the Albertine Basin. This paves the way for the commercial development of the large oilfields discovered in recent years in Blocks 1, 2 and 3 in conjunction with Tullow's new joint venture partners, CNOOC and Total. The first commercial production is expected in Q4 2011 from the Kasamene oil and Nzizi gas fields. Initially, the production and processing facilities will have a capacity of 10,000b/d. Gas will be supplied to a new regional power station at Hoima. By 2015 Tullow expects oil production in the Albertine Basin to be running at over 200,000b/d.

Financials

Tower ended 2009 with a very comfortable cash position of $8.6m. Demands on cash, however, in 2010 have been heavy. Following the Avivi-1 well at the end of February the cash balance was down to $3.5m and in the subsequent five months there has been an outflow of an estimated $2.8m comprising $1.8m for the Namibia CPR and gravity survey plus $1m for corporate and general overhead. With the cash balance now down to about $0.7m it is likely that a fund-raising will be required in the coming months to finance the latter. In 2011 any capital spending on the Ugandan and Namibian projects will be largely or wholly undertaken by farm-in partners.

It should be noted that the overhead burden has recently been significantly reduced due to the directors agreeing to waive $84,000 in fees between May 2010 and April 2011in exchange for 6,339,622 warrants. These are exercisable at 1.325p between 28 May 2011 and 28 May 2013.

Valuation

Oil International has concluded that the EMV (expected monetary value) of Tower's 15% working interest in Namibia Licence 0010 is $696m or 45p/share. This, it should be noted, is based on net risk adjusted resources of 170mmboe and a 2020 start-up for commercial production. The valuation basis is an implied $4.1/boe. For perspective, Tower Resources' current market capitalisation is about $44m (£28m at $1.56/£) or 2.8p/share.

However, any valuation based on discounted cash flow calculations for offshore Namibia should be considered highly tentative even when, as in this case, there is a risked assessment of resources. Given the frontier nature of the Namibia project, the long lead time to commercial production and the need to secure a farm-in partner or partners to drill the first well, the level of uncertainty surrounding the project at this stage is particularly high.

As Oil International has intimated, 45p/share should not be considered as the market value of the 15% stake in Licence 0010. Rather, in our view, it should be considered as the potential value if, after drilling, it appears that gross recoverable resources of significantly over 1bnboe are on the cards. In these circumstances we believe a price/boe of $4 to $5 would be plausible subject to the caveat that the resource base is heavily orientated towards light oil. A gas find, in our view, would sell for well under this valuation basis, given considerably less favourable economics. On a positive note, if resources really are as large as the un-risked estimates made by Oil International the potential valuation is far higher than 45p/share.

Finally there is the question of the valuation of the Ugandan play. In the past, Tower has suggested that Block 1 has the potential to yield discoveries with recoverable resources of up to 100mm barrels. If correct and assuming a chance of success of 20%, a working interest of 30% and a price/barrel of $5, it could be argued that Uganda is potentially worth $30m currently. This would be equivalent to 2p/share.

The key issue now concerning Tower is what might drive the stock over the coming six or so months. Over this time frame we believe the most influential items of news will potentially be as follows:

- Farm-in partners for the Namibian offshore project possibly combined with greater visibility on a drilling target and date.
- Results of the Namibian 3-D seismic survey which should be known early in 2011.
- Results of the aero gravity programme in Uganda
- Farm-in partners and work programme in Uganda.

As for other exploration plays, news concerning drilling will be particularly influential.

Exhibit 1: Financials

$'000s	2008	2009	2010	2011
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	0	0	0	0
Cost of Sales	0	0	0	0
Gross Profit	0	0	0	0
EBITDA	(949)	(715)	(1,465)	(1,465)
Operating Profit (before GW and except.)	(984)	(750)	(1,500)	(1,500)
Intangible Amortisation	0	0	0	0
Exceptionals	(311)	(336)	0	0
Other	0	0	0	0
Operating Profit	(1,295)	(1,086)	(1,500)	(1,500)
Net Interest	51	40	3	0
Profit Before Tax (norm)	(933)	(710)	(1,497)	(1,500)
Profit Before Tax (FRS 3)	(1,244)	(1,046)	(1,497)	(1,500)
Tax	0	0	0	0
Profit After Tax (norm)	(933)	(710)	(1,497)	(1,500)
Profit After Tax (FRS 3)	(1,244)	(1,046)	(1,497)	(1,500)
Average Number of Shares Outstanding (m)	542.71	683.1	1007.16	1007.16
EPS - normalised (c)	(0.17)	(0.10)	(0.15)	(0.15)
EPS - FRS 3 (c)	(0.23)	(0.15)	(0.15)	(0.15)
Dividend per share (c)	0	0	0	0
Gross Margin (%)	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A
BALANCE SHEET				
Fixed Assets	15,294	18,329	25,695	27,727
Intangible Assets	15,140	18,187	25,587	27,587
Tangible Assets	154	142	108	140
Investments	0	0	0	0
Current Assets	1,146	9,605	1,024	1,024
Stocks	0	0	0	0
Debtors	419	1,024	1,024	1,024
Cash	727	8,581	0	0
Current Liabilities	(1,715)	(579)	(860)	(4,325)
Creditors	(1,715)	(579)	(579)	(579)
Short term borrowings	0	0	(281)	(3,746)
Long Term Liabilities	0	0	0	0
Long term borrowings	0	0	0	0
Other long term liabilities	0	0	0	0
Net Assets	14,725	27,355	25,859	24,426
CASH FLOW				
Operating Cash Flow	(771)	(2,590)	(1,465)	(1,465)
Net Interest	51	40	3	0
Tax	0	0	0	0
Capex	(5,563)	(2,937)	(7,400)	(2,000)
Acquisitions/disposals	(94)	0	0	0
Financing	1,568	13,341	0	0
Dividends	0	0	0	0
Net Cash Flow	(4,809)	7,854	(8,862)	(3,465)
Opening net debt/(cash)	(5,536)	(727)	(8,581)	281
HP finance leases initiated	0	0	0	0
Other	0	0	0	0
Closing net debt/(cash)	(727)	(8,581)	281	3,746

Source: Company accounts/Edison Investment Research