Biannual Report – Nona Mills Project

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LETTER FROM THE DIRECTOR

It's been an interesting six months in the global oil market and the start of 2015 was challenging across all performance measures. The historic highs in barrel pricing that peaked from 2010 to mid-2014 are yet to be seen again and the ongoing growth in US supply has had a world-wide effect, along with other international factors that impacted the industry.

As we weather through this period of uncertainty in supply and demand, production levels for the Nona Mills Project are at the lower end. It is hoped that prices will re-establish closer to the US $70barrel mark and then the implementation to convert the field to gas lift and jet pump can be progressed. Once this occurs, the Nona Mills Project will no doubt be delivering encouraging results.

Given the current economic climate it's important to note the Nona Mills Project is not a short term consideration. While some major oil companies have been forced to close and many jobs are lost, it's heartening to know we're at the beginning of an exciting venture and we look optimistically towards a positive oil futures market.

The report provides a short update on global trends including factors shaping the market, price movements and a comprehensive six-month global summary as well as expectations for the six months moving forward.

As previously noted, payment details are received three to four months in arrears and the net investor revenue has taken into account the freight, taxes, royalties and operating costs for each month.

I know you share my enthusiasm and I thank you for being a part of the Nona Mills Project.

Yours sincerely

W. Blazejczyk

Wayne Blazejczyk
DIRECTOR

OIL MARKET HIGHLIGHTS

Crude Oil Price Movements: Six-month summary

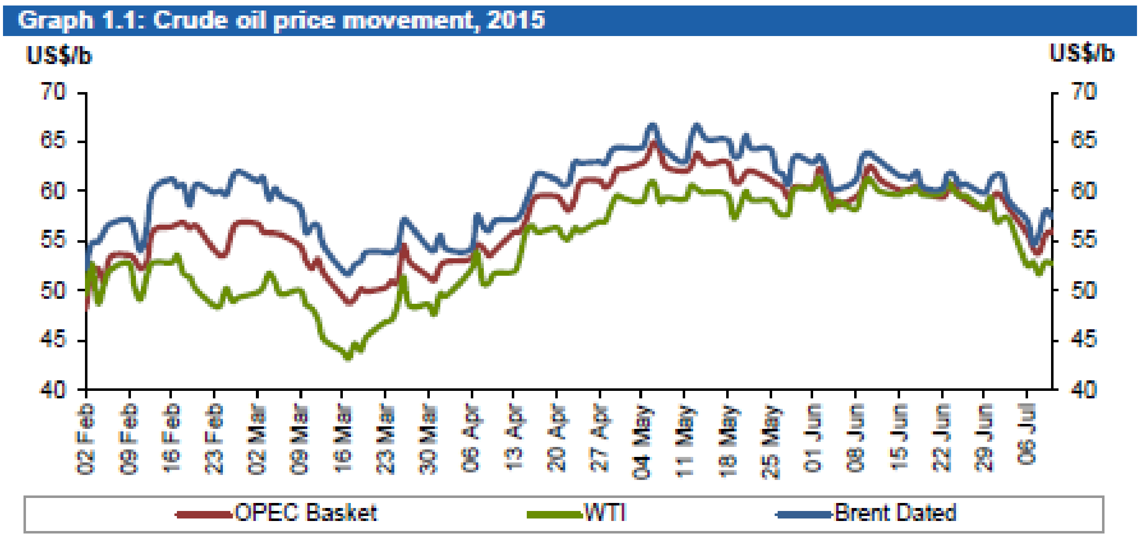
The OPEC Reference Basket (ORB) plunged $23.06 or 31% in 1Q15 from $73.36/b in 4Q14 and remained markedly lower than the previous quarter and year. Although support came late in March from the depreciation of the US dollar and geopolitics, oil futures ended lower amid a growing oil glut, storage constraints in the US and the rising US dollar earlier on. Compared to a year ago, the year-to-date ORB value was approximately 52% lower at $50.27/b from $104.73/b.

The second quarter heralded a significant 19% increase to stand at $60.21/b, the highest growth in more than three years.

In oil futures both ICE Brent and Nymex WTI were down in 1Q15 with ICE Brent dipping from $63.27/b in December to $56.94/b in March and Nymex WTI dropping from $59.29/b to $47.85/b. A narrowing of the Brent-WTI spread in January to $2.43/b was offset by later increases and by the end of 1Q15 the spread moved sharply to above $9/b.

2Q15 signalled new highs with ICE Brent moving into mid $60/b before falling to $63.75/b in June, although this was still above 4Q14. The Nymex WTI shot up $11.97 ending at $59.83/b but both contracts were down for the year. US crude stockpiles eased and US demand picked up to narrow the transatlantic spread to end 2Q15 significantly lower at around $3.92/b.

By the end of the period, National Australia Bank had reviewed its forecast model and expects oil to remain below US $70 barrel throughout 2015 and 2016.



Graph Reference: OPEC Monthly Oil Market Report – July 2015

World Economy

World economic growth for 2015 is forecast at 3.2%, which is slightly lower than the 2016 forecast of 3.5%. The OECD economies are anticipating to expand by 2.0% in the current year, increasing to 2.1% in 2016. China is expected to reach 6.5% this year, down from the earlier proposed 6.9% and continuing at 6.5% for 2016, while India is forecasting 7.5% with growth to 7.7% in 2016. On a positive note, both Russia and Brazil are forecast to move out of recession.

World Oil Demand

World oil demand is expected to grow 1.28 mb/d in 2015, following an upward revision of 0.10 mb/d in June. In 2016, oil demand is forecast to pick up 1.34 mb/d hitting record world consumption of 94.04 mb/d. OECD demand is likely to register positive growth of 0.18 mb/d, while non-OECD consumption is projected to grow by 1.16 mb/d. Almost two thirds of 2015 oil demand growth is seen coming from China, other Asia and the Middle East.

World Oil Supply

Non-OPEC oil supply growth for the year has been revised up by 0.18 mb/d from June to 0.86 mb/d, mainly driven by OECD Americas, Latin America and the FSU. In 2016, non-OPEC oil supply is projected to grow by 0.30 mb/d to average 57.69 mb/d. OPEC NGLs are expected to increase by 0.17 mb/d in 2016, down from 0.19 mb/d in the current year.

Product Markets and Refining Operations

Product markets in the Atlantic Basin were generally strong in the first six months of the year. The US driving season pushed up gasoline demand to around 9.5 mb/d in June, a level not seen in years, providing support to the gasoline crack spreads. This partially offset the weakness in the middle and bottom of the barrel, allowing refinery margins to remain healthy in the region. Asian margins maintained its strength this year with regional demand and a heavy maintenance season lending support to the Asian market.

Tanker Market

Average spot freight rates for dirty tankers varied considerably this year based on changes in the Aframax, VLCC and Suezmax market rates as well as weather conditions and port delays. A further factor was the high tonnage availability and low tonnage demand due to the refinery maintenance season in the East of Suez. Clean tanker freight rates were high in the East but the average declined as freight rates on the West of Suez were weak.

Stock Movements

OECD commercial oil stocks rose substantially throughout the year to stand at 2,858 mb. At this level, inventories are 153 mb higher than the latest five-year average. The US Energy Information Administration advises that global oil inventory builds in 2Q15 hit 2.0 million b/d, which was the highest level of inventory builds since 4Q08. The pace of inventory builds is expected to slow in 4Q15 to roughly 1.2 million b/d. 2016 inventories are expected to slow to an average of 0.4 million b/d as global liquids output is expected to be unchanged from 2015.

Balance of Supply and Demand

Demand for OPEC crude is estimated at 29.2 mb/d in 2015 and represents a gain of 0.2 mb/d over the previous year. OPEC crude demand for 2016 is projected at 30.1 mb/d, up by 0.9 mb/d over the estimated level for the current year.

Crude Oil Price Movements: Month by month review

The OPEC Reference Basket (ORB) ended **January** down $15.08 or 25% to average $44.38/b, reaching its lowest value in six years as excess supply and weak demand continued to weigh on the crude oil market. ICE Brent ended at $49.76/b, down $13.51 from December 2014. Nymex WTI lost $11.96 to stand at $47.33/b. The Brent-WTI spread narrowed to $2.43/b.

In **February**, the ORB averaged $54.06/b, representing a gain of $9.68 or nearly 22% amid a pickup in prompt demand from Europe and Asia and optimism that oil prices may have reached bottom. ICE Brent rose $9.04 to $58.80/b, while Nymex WTI gained $3.40 to stand at $50.72/b. The Brent-WTI spread widened to above $8/b.

The market refocused on the oversupply situation and the ORB retreated in **March** by $1.60 to $52.46/b as demand remained subdued. ICE Brent and Nymex WTI futures contracts also fell $1.86 and $2.87 to average $56.94/b and $47.85/b, respectively, for the month. The Brent-WTI spread widened to around $9/b.

The ORB rose in **April** to its highest value this year supported by various bullish factors. The Basket increased $4.84 to $57.30/b, although remained considerably lower y-o-y. ICE Brent rose $4.20 to $61.14/b and Nymex WTI jumped $6.77 to $54.63/b.

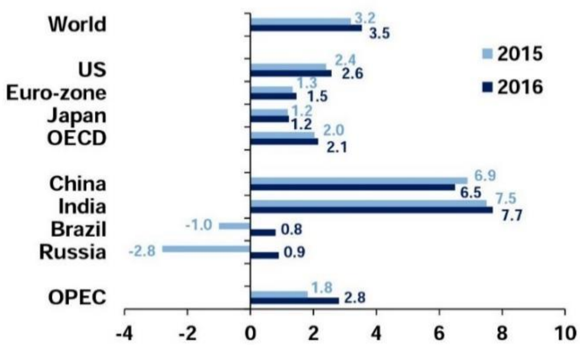
May brought about a new ORB high of the year, averaging $62.16/b and a gain of $4.86/b. The ICE Brent contract was up $4.47 m-o-m at $65.61/b, while the Nymex WTI contract shot up $4.74 to $59.37/b. An increase in crude oil demand, firm refined product markets and inventories drawdowns were key elements supporting the market.

June saw the ORB decline $1.95 to average $60.21/b. Crude oil futures prices had mixed movement with ICE Brent falling by $1.86 to average $63.75/b, while Nymex WTI gained 46¢ to reach $59.83/b, causing the Brent-WTI spread to narrow to around $3.90/b. Money managers further reduced net-long positions in the futures markets.

GLOBAL MARKET GROWTH

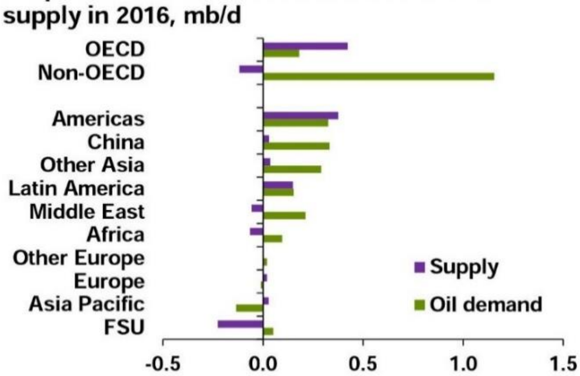
The global GDP growth forecast for 2015 has been revised down to 3.2% from 3.3%. This assumes a higher growth rate in the second half, particularly after a weak 1Q15. In 2016, GDP growth is forecast to be higher at 3.5% (***Graph 1***). The OECD is forecast to expand by 2.1%, an increase from this year's 2.0%. China is expected to slow to 6.5% from 6.9% this year, while India is forecast to reach higher growth at 7.7%, compared to 7.5% in 2015.

Graph 1: GDP growth rate in 2016, %



Source: OPEC Secretariat.

Graph 2: Growth in oil demand and non-OPEC supply in 2016, mb/d



Source: OPEC Secretariat.

While current oil prices will continue to support the world economy to some extent, numerous challenges are likely to offset this positive effect, preventing higher growth;

- High debt levels across the OECD.
- Continuing high unemployment in the Euro-zone in combination with the uncertainties in Greece.
- Expectations of rising interest rates in the US.
- Overcapacity amid a slowing economy in China.
- On-going geopolitical issues.

The improvement in global economic activities in 2016 is projected to translate into higher oil consumption. As a result, 1.34mb/d of oil demand is forecast with total consumption reaching 93.94 mb/d. OECD demand is expected to increase by 0.18 mb/d, with growth in the OECD Americas rising firmly, while OECD Europe and Asia Pacific are expected to decline (***Graph 2, previous page)***.

In the non-OECD, oil demand growth is expected to be around 1.16 mb/d. The highest contribution is seen coming from China, although growth is forecast to be lower than in the current year. Looking at the oil product mix, diesel oil and gasoline will continue to drive growth to supply the expanding transportation sector. At the same time, the demand forecast for next year is subject to some uncertainty factors, including;

- The scope of economic growth.
- Industrial production developments.
- Oil price trends.
- Weather conditions.
- Changing oil intensity in different regions.
- Policy changes including fuel substitution.

Non-OPEC supply growth in 2015 has slowed compared to last year, although expectations have been revised up since the beginning of July to average 0.86 mb/d. For 2016, non-OPEC supply growth is projected to slow further, increasing by 0.30 mb/d to average 57.7 mb/d. This prediction is based on a bottom-up approach, looking at field-by-field developments and the latest information regarding project ramp-ups and startups. Total US liquids production is expected to increase by 0.33mb/d, just one third of the 0.93mb/d expected this year. The main growth contributors are seen to be the US, Brazil, Canada, Australia, Norway and China, which will be partially offset by declines in Russia, Mexico, Azerbaijan, Kazakhstan, and Yemen. OPEC NGLs and non-conventional liquids are expected to rise by 0.17 mb/d to average 6.18 mb/d in 2016.

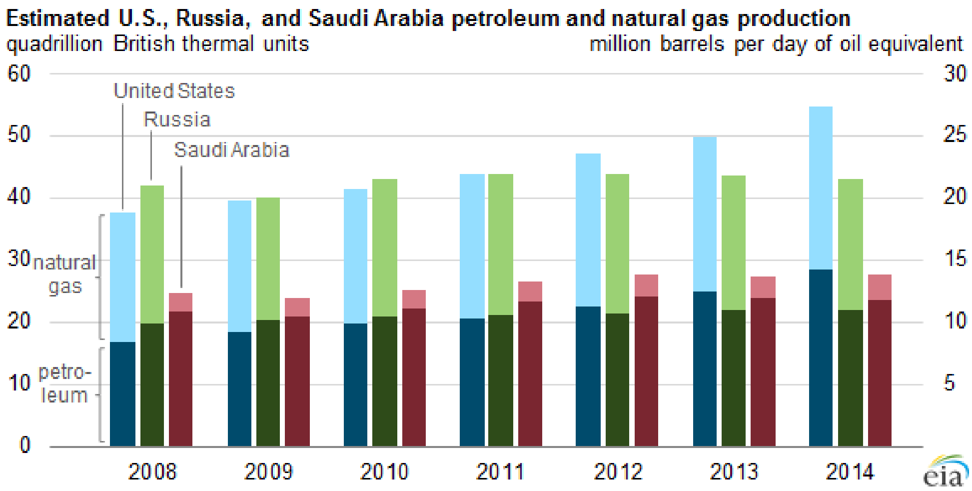
Based on the above forecasts, incremental world oil demand will outpace projected non-OPEC supply and OPEC NGLs, resulting in 2016 OPEC crude demand of 30.1 mb/d. This represents a projected increase of 0.9 mb/d over the current year and follows an expected rise of 0.2 mb in 2015. This would imply an improvement towards a more balanced market. Better-than-expected momentum in the global economy, especially in the emerging markets, would contribute further to oil demand growth in the coming year.

GLOBAL MARKET CONDITIONS

OPEC's share of the global oil market has fallen over the years as non-OPEC countries such as the US and Canada increased their output. High oil prices from 2010 to 2013 drove non-OPEC countries to develop new technologies and land techniques such as horizontal drilling and hydraulic fracturing.

The top ten oil-producing countries comprising the big three of Russia, Saudi Arabia and the US hold approximately 64% of world production. By the end of December 2014, the US was producing 9.127 million barrels of crude oil a day, up approximately 15% from the previous year. Increased US oil production saw it overtake Russia to emerge as the largest producer in the world (***see graph below***).

As domestic production increased, the US imported less oil. In 4Q14, crude oil imports from Saudi Arabia dropped to 850,000 barrels a day and the Arab nation lost half its US customer base. In order to regain market share, OPEC maintained output, which sent prices falling.



According to National Australia Bank, crude oil prices are likely to be stable around current depressed levels for the next six months, with an upturn only likely in the December quarter after US production from shale finally starts to decline. NAB noted the "unrelenting" growth in US crude supplies was only partly offset by some improvements in demand by a number of key consumers including the US, China and India.

Oil prices historically increase during winter in northern countries as oil demand surges for heating. However, the oversupply of oil in the market negated the seasonality factor.

Key factors to 2015 global market conditions include:

- A sharp correction in Chinese equity markets.
- Greece's high-profile political wrangling with the Troika over its debt crisis.
- The lead-up to the conclusion of a nuclear deal between Iran and the world's powers.
- A heavy seasonal maintenance cycle.
- Continued growth in US shale oil production and inventory, to record levels.
- Quick appreciation of the US dollar, which is viewed as negative for crude oil producers.

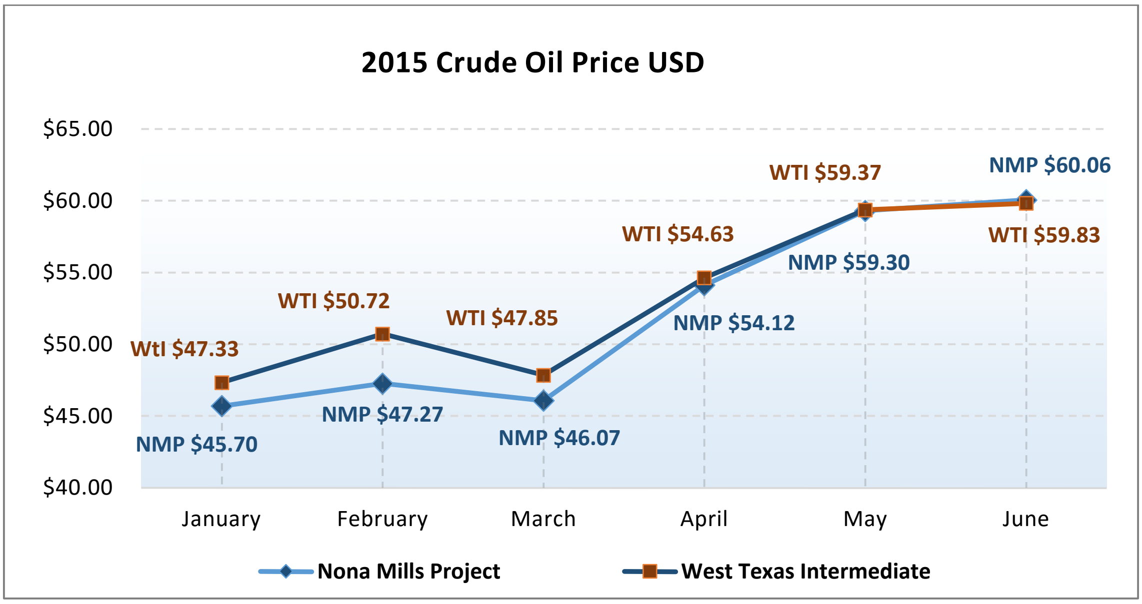
References: OPEC Monthly Oil Market Reports, US Energy Information Administration, National Australia Bank Oil Market Update July 2015.

NONA MILLS PROJECT MOVING FORWARD

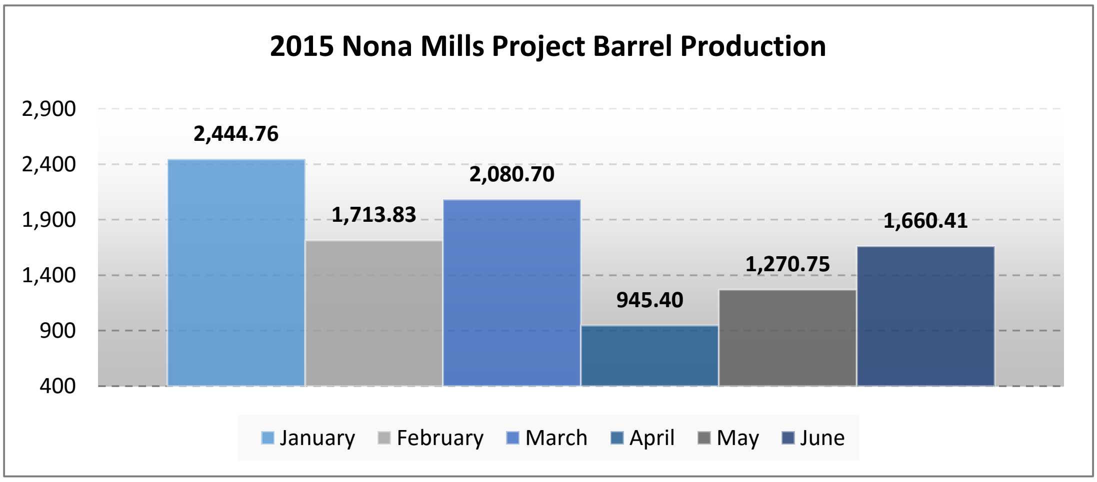
The first phase of the Nona Mills Project is the secondary recovery of 10 wells within section B of the field and the redevelopment plan is to workover all 10 wells. While Electronic Submersible Pumps (ESP's) were implemented as the primary method to artificially lift the wells, it was since determined that gas lift and jet pump are ideal lifting methods to combat the excessive sanding experienced in the Nona Mills formations.

Several ESP's are continuing to assist production across the field however, when the mechanical lifecycle expires in the coming year they will be replaced with either a gas lift or jet pump as there are no downhole moving parts and sand can be filtered at the surface without causing damage to the equipment.

The full implementation to convert the field will progress when a higher barrel price is established, which is proposed at approximately $US70. Analysts advise an upward motion in the value of oil is possible for 4Q15, so the transition will be on hold until then.



The extended periods of high oil prices of past years have provided a global incentive to invest in exploration and expansion, which leads to an increase in supply and in turn puts downward pressure on prices. Now that oil prices are low, the opportunity to invest in infrastructure and machinery is weakened until pressures on demand increase prices.

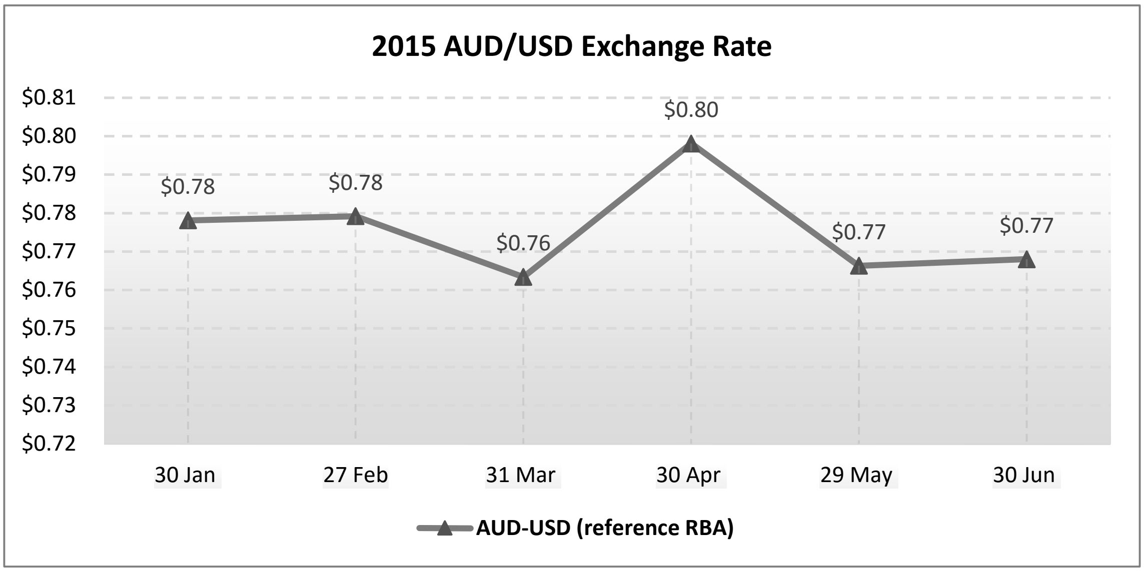


NONA MILLS PROJECT REPORT UPDATE

The net investor revenue of the NMP has taken into account the freight, taxes, royalties and operating costs each month. Please note that payment details are received three to four months in arrears. Given the current economic climate it is important to be reminded that the Nona Mills Project is not a short term consideration.

Of interest, some US oil exploration and production companies such as ConocoPhillips announced a spending cut of $3 billion for 2015 and Apache Corporation plans to reduce its capital expenditure by 26% in 2015 compared to 2014.

While strength in the USD is an economic growth factor, the falling value of the AUD against the USD provides a positive conversion of NMP income from USD into AUD.



SUMMARY NOTES FROM PRIMROSE RESOURCES

The year started with a cold winter in Texas that saw frequent downtime throughout the field due to the wet gas freezing in the lines. An ESP well was fitted to gas lift and a larger dehydration unit was installed to assist in the gas lift volumes. Further testing and research in Jet Pump technology is proving to be positive however all non-essential work including maintenance is halted to minimise costs, until the current market environment improves.

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