

AFSL: 247 404

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Monday, 30 June 2008

RISK ASSESSMENT

Recommendation	Spec Buy
Stock Price	A\$0.12
1 Yr Target Price	A\$0.34
Market Risk	Medium
Liquidity Risk	High
Project Risk	High

Source: MPS Research

CAPITAL STRUCTURE

ASX Code	KTE
Share price	A\$0.12
Market cap*	A\$22.4M
Ordinary shares	138.9m
Tradeable Options	41.4m
Unlisted Options	6.5m

*Fully diluted basis

Source: KTE

DIRECTORS

Non-Exec Chairman	Sam Gazal
Managing Director	Peter Moore
Non-Exec Director	Ken Gaunt
Non-Exec Director	John Thompson
Non-Exec Director	Michael Reed
Non-Exec Director	Bob Rosenthal

Source: KTE

TOP 3 SHAREHOLDERS

Edwards Meadows Pty Limited	8.5%
Golden Words Pty Limited	8.2%
Metro Energy Group Inc	2.9%

Source: KTE

REGISTERED OFFICE

Address:	Level 2 Kyle House 27 Macquarie Place Sydney NSW 2000
Telephone:	02 9251 3311
Facsimile:	02 9251 6550
Website:	www.k2energy.com.au

Source: KTE

SHARE PRICE CHART



K2 Energy Ltd (KTE)

New Gas Shale Play – Horizontal Drilling in Oklahoma

KEY POINTS

- Production growth and exploration potential in US gas market.
- Focus on unconventional oil and gas targets in the Caney and Woodford shales.
- 47Bcfe – 81Bcfe of un-risked contingent gas potential (net to KTE).
- The Woodford Shale is a new high-growth shale gas region.
- Three 10-12 week horizontal wells planned for H2 2008 by KTE and its partners.
- First horizontal appraisal well test results expected in mid-August.

KTE is engaged in oil and gas exploration and production in the United States. Under its Bad Creek Project, KTE holds 5,500 net acres prospective for conventional oil and gas, and prolific unconventional gas in the Caney and the underlying Woodford Shales in the Hughes, Okfuskee and Okmulgee counties in Oklahoma.

The Project has producing conventional oil and gas wells and a range of potential targets. The main focus, however, is placed on the unconventional gas and condensate targets in the Caney and Woodford shales, located in the Arkoma Basin.

An estimated 550 horizontal wells have been drilled in the Arkoma basin. Production from the Woodford Shale, by large US oil and gas corporations, aggregates to more than 270MMcf/day (98Bcf/year) at a typical well rate of 1.5MMcf/day.

An assessment from Netherland, Sewell & Associates, an independent energy consultant, estimated an un-risked contingent gas resource for the Caney and Woodford shales of between 17Bcfe and 81Bcfe (net to KTE).

MPS' peer comparison valuation between KTE and the selected US corporations is based on working interests in the Woodford shale play. MPS values KTE at \$0.34/share on the basis of its net acreage holding and \$0.63/share on the basis of KTE's potential gas-resource ratio. Based on a gas price of US\$10.85/Mcf (currently US\$13.20/Mcf) MPS has derived a NPV of US\$6/Mcf. This gives a valuation for KTE of \$0.55/share, for a gas resource 17Bcfe.

KTE and Peer Comparisons on the Woodford Shale Interest

Public Listed Company	K2 Energy*	PetroQuest	Newfield	St.Mary	Continental
Exchange Ticker	KTE	PQ	NFX	SM	CLR
Woodford Shale Interest					
net holding (acres)	5,500	31,000	165,000	40,000	45,000
Reserves 1P (Bcfe)	47**	48	453	19	61
Potential Resource (Bcfe)	81**	738	-	562	1,260
Production (MMcf/day)	1.0-5.0*	22.0	200.0	23.6	3.1
No. Production wells	1-5*	12	183	20	3
Ave. Prod/well (MMcf/day)	0.5-1.0*	1.8	1.1	1.2	1.0
Ave. Cost/well (US\$m)	2.0-3.0*	4.2-4.7	6.7	4.0-4.4	5.0
Recoverable gas/well (Bcfe)	1.0-3.0*	2.5-3.5	> 4.5	2.7	2.4
Ave. Exploration Cost/Mcf	1.0-2.0*	1.7	1.5	1.5	2.1
Woodford Exploration 2008					
Budget (US\$m)	0.7 [#]	125	460	155	130
No. Hzt Wells	2-3	25	100	16	23
No. Drilling Rigs	1	5	12	3	6

*MPS estimates, **NSA estimates, [#]KTE interests

Source: Company data & MPS

K2 Energy – IN PROFILE

K2 Energy Ltd (KTE) is an ASX-listed company engaged in oil and gas exploration and production in the United States. The company has established oil and gas production from multiple projects located in Texas and Oklahoma. Its key focus is in onshore conventional oil and gas with prospective unconventional oil and gas targets at the Caney and Woodford shale prospects at the Bad Creek Project in Oklahoma.

KTE was merged with Tomahawk Energy in May 2007. KTE combined its operational expertise with Tomahawk's tenements and unconventional gas focus. The combined entity has interests in four main project areas in Texas and Oklahoma, USA.

State	Project	Targets	KTE Interest
Oklahoma	Bad Creek	Conventional oil and gas	11-30%
		Unconventional oil and gas - Caney and Woodford Shale	11-30%
Texas	Hidden Lake	Conventional oil and gas	9%
	Shary	Conventional oil and gas	12%

KTE's focus is the unconventional oil and gas targets of the Caney and Woodford prospects at the Bad Creek Project. The project also contains conventional oil and gas producing wells and additional targets.

KTE's major and project partner is the Metro Energy Group, a private US oil and gas company, a specialist in conventional and unconventional oil and gas shale operations. Irvine Energy Plc, an AIM listed company that has acquired a working interest in the leases of Metro Energy Group in Oklahoma has secured funding for the drilling programs currently underway.

KTE and its partners have in the past year concentrated on drilling uncomplicated targets from conventional reservoirs and have spudded 5 wells for 4 discoveries in the Bad Creek Project area. KTE holds 5,500 acres prospective for conventional oil and gas as well as the prolific unconventional gas bearing Caney and the underlying Woodford Shales. (US listed companies give a current value of such land acreage worth between US\$4,000 and US\$6,000 per acre).

Following the independent assessment by Schlumberger Limited of the 3D seismic survey on the Bad Creek Project, an initial 16 prospective targets were identified to be tested by a horizontal drilling program. An assessment from the independent energy consultant Netherland, Sewell & Associates, estimated an un-risked contingent gas resource for the Caney and Woodford shales between 17Bcfe to 81Bcfe net to KTE.

In the 2008 March quarter, gas production, including condensates, from the existing 17 wells aggregated to 28.2MMcfe (net to KTE). Exploration successes, combined with the development of new wells are expected to increase gas production.

KTE Production Profile

Quarterly	Sep-07	Dec-07	Mar-08	Jun-08E*
Gross Production				
Total Gas Equiv (MMcfe)	153.3	189.1	167.5	200.0
KTE Net Production				
Total Gas Equiv (MMcfe)	28.3	32.1	28.2	31.0
Total Half-Yearly Revenue (A\$'000)	321.6		473.6*	

*MPS Estimate

Source: KTE

KTE Financial History

Year End 30 June (A\$'000)	2004	2005	2006	2007	Dec 07*
Total Revenue	4	1,323	2,351	1,222	321
Total Operating Expense	(4)	(1,097)	(1,792)	(25,913)	(2,473)
EBIT	0	(1,074)	(1,434)	(28,041)	(2,586)
NPAT	(39)	(1,074)	(1,434)	(28,041)	(2,453)
Total Assets	4,013	16,727	29,144	12,373	9,894
Total Liabilities	183	2,072	1,192	285	123
Total Shareholders Equity	3,830	14,655	27,952	12,088	9,771
Total Shares Outstanding (m)	36.6	52.4	75.5	116.9	118.9

*Jun-Dec 2007

Source: KTE

KTE Project Map



Source: KTE

KTE Management Team

Sam Gazal – Non-Executive Chairman

Mr Gazal has over 35 years of experience directing public and private companies; including Gazal Industries Ltd, Winthrop Investments Ltd and Country Television Services Ltd.

Peter Moore – Managing Director

Mr Moore was formerly a commercial lawyer and has worked in the resource exploration industry for 21 years. He has commercial experience in oil and gas exploration industry in Australia and the United States.

Ken Gaunt – Non-Executive Director

Mr Gaunt founded Electronic Banking Solutions Pty Ltd in 1998, and continued to develop the business until its merger with Cash Card Australia Ltd in 2003.

John Thompson – Non-Executive Director

Mr Thompson is currently a director of several private and public companies involved in oil and mineral services. He also has experience in the general management of resource and scientific companies.

Michael Reed – Non-Executive Director

Mr Reed graduated with honours in geology in 1982 and is a Certified Petroleum Geologist with the American Association of Petroleum Geologists. He has 24 years of experience in oil and gas exploration and investment.

Bob Rosenthal – Non-Executive Director

Mr Rosenthal graduated in 1974 with a B. Sc in Geology from the University of Southern California. He has 30 years experience in the oil and gas industry and has worked on projects in the Gulf of Mexico and Alaska.

Top 10 Shareholders

Shareholders	Shares	% Total
1 Edwards Meadows Pty Limited	11,100,000	8.5
2 Golden Words Pty Limited	10,771,703	8.2
3 Metro Energy Group Inc	3,800,000	2.9
4 Blazed Pty Limited	2,550,000	2.0
5 Ryan M. Moynagh	2,193,068	1.7
6 National Nominees Limited	2,039,300	1.6
7 Golden Eggs Super Fund	2,000,000	1.5
8 Aspen Energy Pty Limited	1,800,000	1.4
9 Balander Pty Limited	1,770,000	1.4
10 Merrill Lynch (Aus) Nominees	1,669,701	1.3
Top 10 % Issued Capital	39,693,772	30.3

Source: KTE (19/6/08)

Investment Review

In the United States (US) in 2007 total gas consumption was 23Tcf; natural gas is the fastest growing primary energy source. In 2006 gas made up 24.7% of total energy consumption by fuel type, and in 2007 it accounted for 25.2%. In 2008 the price of natural gas in the US has already increased by 60.8% to >US\$12.6/MMBtu (US\$12.9/Mcf). Furthermore, it is estimated that 17% of the total US domestic gas supply comes from coal seam methane and gas shales; the EIA predicts that by 2030 unconventional natural gas production will account for close to half of domestic supply.

Shale gas deposits are considered to be a form of unconventional gas, and it is one of America's fastest growing onshore energy developments. Shale gas deposits are contained in low-permeability rocks and the methane is stored in systems of natural fractures. The application of horizontal drilling technology has enabled the development of multiple hydraulic fracturing, allowing more modern efficient controls, improved placement of wells, higher exploration success rates and higher production rates of up to 4MMcf/day. The major productive gas shale areas in the US are the Barnett Shale in the Fort Worth Basin, Ohio Shale in the Appalachian Basin, Antrim Shale in the Michigan Basin and the newly developed Caney and Woodford shale deposits in the Arkoma Basin.

KTE's unconventional gas targets are in the Caney and Woodford shale plays, located in the Arkoma Basin southeast of Oklahoma. The Caney and Woodford shale is now a proven gas province, with the Woodford formation characterised by longer duration natural gas production through the implementation of horizontal well drilling technology. Major oil and gas companies have budgeted for large exploration drilling programs (>150 wells for 2008) in the Caney and Woodford area after very successful results to date. An estimated 550 horizontal wells have been drilled with aggregate production from the Woodford Shale at more than 270MMcf/day (98Bcf/year), with typical flows of 1.5MMcf/day per well.

KTE currently has working interests in two vertical wells, the Snell 3-19 and Wise 1-20, in the Caney Shale, and has working interests in two vertical wells the Snell 2-19 and Snell 4-18 producing from the Woodford Shale. The Farrow well, recently completed in Woodford, is expected to be producing in the June quarter. KTE and its JV partners plan to drill and complete 3 new horizontal wells in the June and Sept quarters 2008. The company hopes to prove up its estimated 17-81Bcfe gas resource in the Caney and Woodford Shales. Additionally, KTE and its partners have secured finance and working capital for the current and future drilling/development program.

KTE and Peer Comparisons on the Woodford Shale Interest

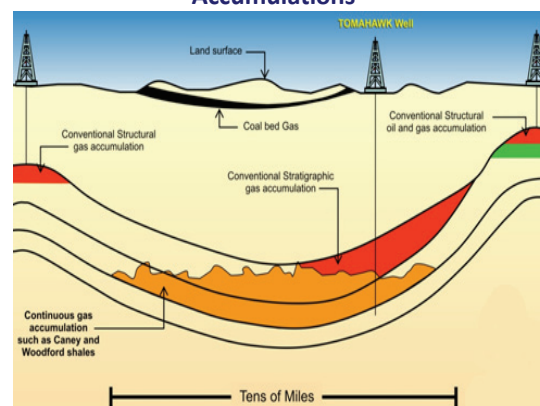
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*MPS estimates, **NSA estimates, ⁿKTE in interests

Source: Company data & MPS

KTE's Woodford Shale project costs and reserve estimates are comparable to the reserve profile of the largest companies currently producing and exploring in the Woodford Shale region. KTE's initial budget of US\$1.2m is to cover its share of three horizontal wells, up to end of this year (Jones #1, 25%, Sears #1, 11% and Holt #1, 30.5%), with a total cost of between US\$2-3m per well. KTE's costs are half the average cost of its competitors due to the shallow shale depth of about 3,500ft, compared to its competitors' depth of 4,000-8,000ft. The level of activity of US listed corporations in the Woodford shale gives a helpful peer valuation and comparison.

Conventional and Non-Conventional Gas Accumulations

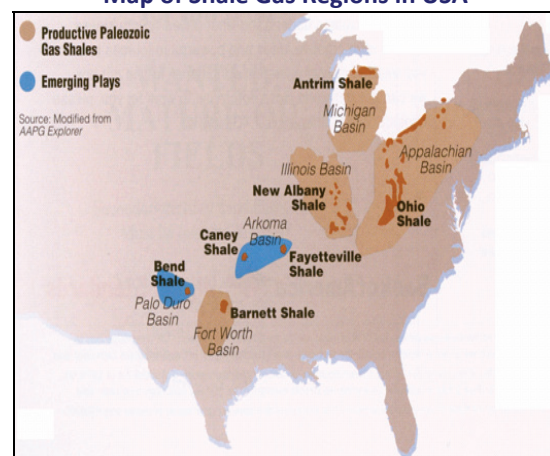


Source: KTE

Conventional gas targets originally formed in layers of porous rock like sandstone and limestone. Gas from source rocks has seeped upwards until having trapped by seals of impervious geological strata or geologic faults or folds. In the diagram above, conventional gas structures are coloured red, and unconventional in orange.

Unconventional shale gas, however, is quite different and requires complex drilling and extraction techniques. Shale gas deposits are generally composed of low-permeability strata, and the gas is trapped natural fractures, which provide the permeability for the reservoir. Shale encountered in the US has been found to be hundreds of metres thick and can cover many millions of acres.

Map of Shale Gas Regions in USA



Source: KTE

The Woodford and Caney Shale region is now one of the fastest developing unconventional gas exploration targets in the USA.

Project Review

KTE's current focus is the Bad Creek Project, where the company holds a net interest of 5,500 acres within 52 leases located in the Hughes, Okfuskee and Okmulgee counties. The project contains producing conventional oil and gas wells and a number of potential targets; however the main focus is currently on the unconventional oil and gas targets of the Caney and Woodford shale prospects located in the Arkoma Basin. The Caney shale averages 160ft in thickness a depth of 3,800ft, while the Woodford shale is about 40ft in thickness and averages a depth of 4,100ft.

KTE produced 24MMcf net pay of gas in the March 08 quarter, with the main wells Patriot #1 and Snell 2-19 producing at a steady rate of 200Mcf/day. KTE currently has 17 conventional producing wells on the Bad Creek Project. The company has identified a further 20+ conventional oil and gas targets from the recently completed 3D seismic from Schlumberger Limited.

Horizontal drilling of the unconventional shale deposits, combined with fracture stimulation technology, provides a more economical development than simple vertical wells and fracturing. An estimated 550 horizontal wells have been drilled and some 100 horizontal wells are being tested each quarter in the Woodford shale play, according to the Newfield Exploration Company. Currently, more than 46 industry drilling rigs are actively testing the Woodford shale area.

The advantage of horizontal drilling is to expose significantly more reservoir rock to the well bore surface than a conventional vertical well. A vertical well might get 40 feet (12m) of pay in the Woodford, whereas a horizontal well might get 8-10x the pay zone and may achieve much higher flow rates and higher recoveries. The technology allows an increased intersection of multiple fracture systems, allowing higher efficiencies and better recovery and production rates.

KTE and its JV partners are looking to test an initial 3 horizontal drilling targets out of the 16 prospects showing high density fracture zones within the shale structures identified from the 3D seismic data. The first 10-12 week horizontal Woodford appraisal well was spudded on 2nd June 08 and should be drilled, completed and production tested by mid to late August 2008.

KTE holds a 25% interest in the Jones #1 well, an 11% interest in the Sears #1 Woodford well, plus a 30.5% interest in the Holt #1 well, which is testing the Caney shale. KTE's existing producing vertical Woodford well (Snell #2-19) was drilled in October 2004 and has since consistently produced at 200+Mcf/day. The proposed horizontal wells are expected to produce at significantly higher rates.

The assessment by the independent consultant, Netherland, Sewell and Associates Inc. (NSAI), estimated an un-risked contingent gas resource for KTE's Caney and Woodford Shale acreage of between 17Bcf and 81Bcf (net to KTE).

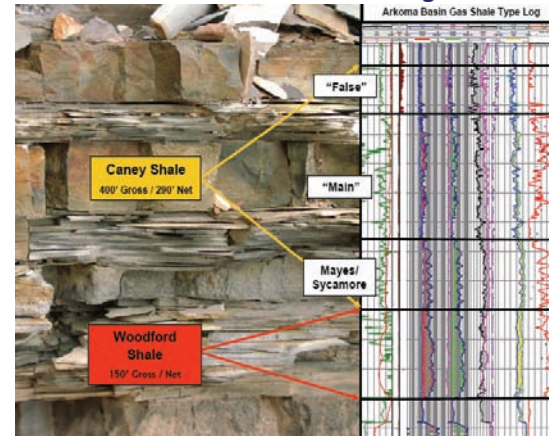
The estimates were based on a review of technical data, information provided by the companies involved, industry data on productive shale plays, independent petrophysical analysis of log records and an industrial standard estimate.

Netherland Sewell – Un-risked Contingent Gas Resource (Bcf)

	Low	Best	High
Caney Shale	10	28	49
Woodford Shale	7	19	32
Total	17	47	81

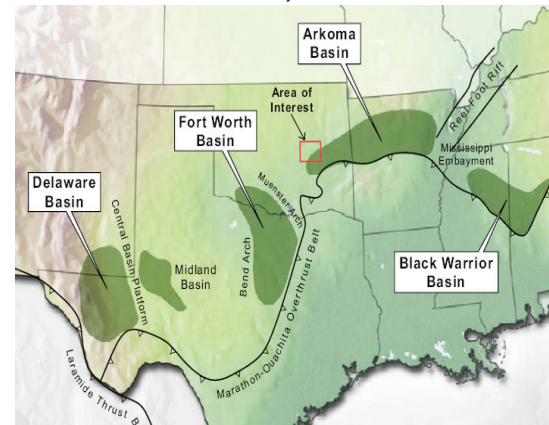
Source: Netherland, Sewell & Associates Inc

Arkoma Basin Gas Shale Log



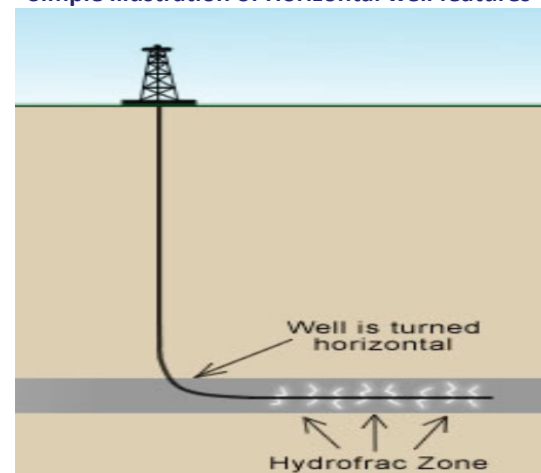
Source: Newfield Exploration

KTE Area of Interest in the Caney and Woodford Shale, Arkoma Basin



Source: Netherland, Sewell & Associates Inc

Simple illustration of Horizontal well features



Source: Geology.Com

Project Valuation

MPS has assessed the value of KTE's assets using three different methods.

In the first valuation method, MPS calculated KTE's peer company enterprise values (EV) for the Woodford shales. This was done by applying the proportion of the Woodford shale 1P gas reserves over the total 1P gas reserves to the EV. Averaging this over the 5 companies and applying it to KTE net holding of 5,550 acres the value is US\$61m, equal to A\$0.34 per KTE share on fully diluted basis.

MPS Valuation Method 1

Valuation	PQ	NFX	SM	CLR	XTO	Average
1. EV per Acres (US\$/acres)						
Woodford % of EV ¹ (US\$m)	406	1,479	60	890	1,462	
Net Woodford acres	31,000	165,000	40,000	45,000	120,000	
EV per Acres (US\$/acres)	13,103	8,964	1,498	19,768	12,181	11,103
KTE's acreage value (US\$m)	72	49	8	109	67	61
KTE value per Share (A\$)	0.41	0.28	0.05	0.61	0.38	0.34

¹Based on 1P reserves, *Fully diluted (186.8m shares) & FXA\$/US\$ = 0.95

MPS Research

MPS' second valuation method is based on the peer company ratio of the Woodford Shale proportion of EV, divided by their total 1P reserves. This ratio was then multiplied by 17Bcfe from Netherland's lowest (highest probability) reserve estimates. The value of KTE's potential gas reserves of 17Bcf is US\$112m, equal to A\$0.63 per share on fully diluted basis.

MPS Valuation Method 2

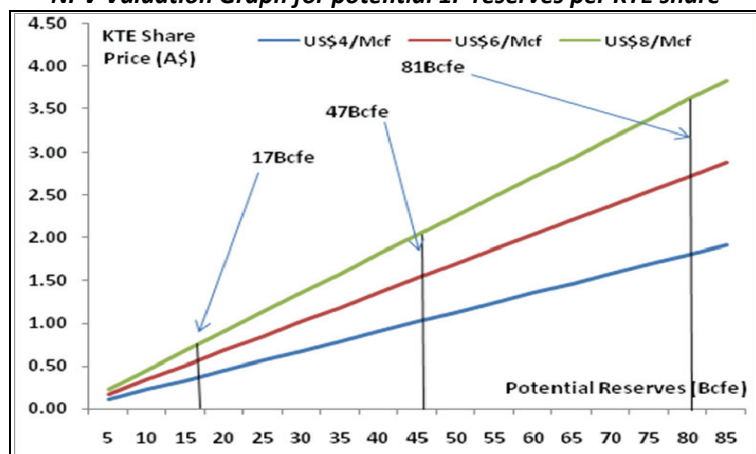
Valuation	PQ	NFX	SM	CLR	XTO	Average
2. Woodford % EV per Bcfe						
Woodford % EV per Bcfe	8.4	3.3	3.2	14.5	3.5	6.6
KTE value @ 17Bcfe (US\$m)	144	56	54	246	60	112
KTE value per Share (A\$)	0.81	0.31	0.30	1.39	0.34	0.63

MPS Research

For the third valuation method, MPS has simulated gas production over 7 years (with a 10% production decline) to give a range of NPV/Mcf (8% discount rate) for a series of realised net book gas prices (shown above on the RHS).

The results shown in the below graph use an estimated NPV values of US\$4, 6 and 8 Mcf for KTE's potential reserves of 17 to 81Bcf, as indicated by the report by Netherland, Sewell & Associates. The chart indicates a valuation for KTE's share of A\$0.35 to A\$0.68 for 17Bcfe, A\$1.00 to A\$2.05 for 47Bcfe and A\$1.80-A\$3.60 for 81Bcfe potential.

NPV Valuation Graph for potential 1P reserves per KTE share



Source: MPS Research

KTE Potential Gas Resource (Bcf)

Woodford Shale	Caney Shale		
	Low	Med	High
Low	17	35	56
Med	29	47	68
High	42	60	81

Source: NSA

NPV Valuation per KTE Potential Resource (A\$/share @ US\$6/Mcf)

Woodford Shale	Caney Shale		
	Low	Med	High
Low	0.55	1.12	1.80
Med	0.93	1.51	2.18
High	1.35	1.93	2.60

Source: MPS Research

MPS Valuation Method 3: Production Scenario per Well

	2009	2010	2011	2012	2013	2014	2015
Production							
Mcf/day	500	500	450	405	365	328	295
MMcf/year	183	183	164	148	133	120	108
<hr/>							
Total Prod. (MMcf)	1,038						
Assume US\$3/Mcf operating costs							

	Realised Gas Price (US\$/Mcf)						
	8.0	10.0	12.0	14.0	16.0	18	20
NPV \$ per Mcf Reserve	3.8	5.4	6.9	8.4	9.9	11.5	13.0

Source: MPS Research

MPS expects NPV of US\$3.8 – 8.4 per Mcf gas reserves over a range of US\$8-14per Mcf gas price.

KTE Other Projects

The Hidden Lake Prospect

- The Gayle #1 discovery well in Brazoria County, Texas was successfully drilled in the September quarter of 2007.
- The well was put on production in October 2007 averaging production of 200Mcf/day and 80 barrels of oil per day.
- Prospect has potential for 2 additional wells

Shary Prospect (Hidalgo County, Texas)

- Based on 3D mapping, it is believed that this prospect has several gas-bearing sand formations, and that the total potential reserves range from 2 to 9Bcf.
- The Kaler #1 Shary well was drilled and an initial flow rate of 1MMcf/day was achieved, currently the well is producing at 80Mcf/day

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Analyst Verification

I, Wen Jie He, as the Research Analyst, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities or issuers and no part of analyst compensation is directly or indirectly related to the inclusion of specific recommendations or views in this research. The analyst principally responsible for the preparation of this research have received compensation based on overall revenues, including investment banking revenues, of Martin Place Securities Pty Ltd and we have taken reasonable care to achieve and maintain independence and unbiased objectivity in making any recommendations.

Disclosure

Martin Place Securities Pty Ltd and its associates declare that as Monday, 30 June 2008 they may have a relevant interest in the securities recommended herein, in particular:

- Martin Place Securities Pty Ltd has conducted a placement capital raising for K2 Energy Ltd and earned commissions on this raising. MPS has been commissioned to do a further capital raising.
- The author of this document **does not** have a relevant interest in KTE securities. This position can change at any time.
- The directors and associates of Martin Place Securities Pty Ltd may hold shares in KTE securities. This position can change at any time.

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