

Solving Europe's Gas Shortage

Date

22 August 2008

ASX Code

EPG

Share Price

60cps

Valuation

210cps

Market Cap (fully diluted)

\$119.5m (\$148.6m)

Issued Capital (fully diluted)

199.2m shares (247.7m)

Cash (as at 30 June 2008)

\$14.7m (€8.8m)

Management

Anthony McClure (Managing Director)
Alan John Flavelle (Exec Director)
Terence Willsted (Non Exec Dir.)

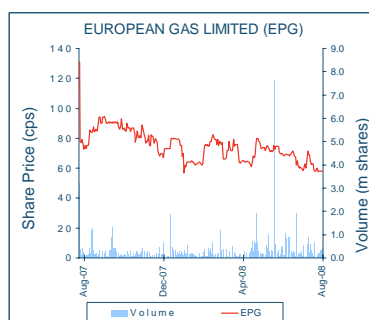
Top Two Shareholders

Ward Ferry Management (6.1%)
New City Investment Managers (5.4%)
Anglo Pacific Group (5.1%)
Henderson Global Investors (5.1%)

Resources Analyst

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Share Price Performance



Source: Iress

European Gas Limited (“EPG”, “Company”) entered into coal bed methane in France in 2004, prior to the re-rating of the sector and the large increase in European gas prices. The Company has not been re-rated along with its Australian peers and looks very cheap on an enterprise value to 2P reserve ratio, currently ~A\$1 per gigajoule. In addition to this, the Company is producing and selling gas at prices in excess of 3 times the price achieved on the east coast of Australia.

The Company has a distinct competitive advantage having secured title to almost the entirety of coal bed methane in France and is also active in Italy and the Benelux countries.

The majority of the Company’s current reserves and production are from coal mine methane (“CMM”) from an old coal mine at the 100% owned Gazonor project in northern France. The strategy of the Company is to expand on this production at Gazonor and to develop the substantial coal bed methane potential at the Gazonor and Lorraine projects.

The in-place resource potential for the Lorraine project has been previously estimated at 6 - 8 trillion cubic feet of gas, of which 2 trillion cubic feet should be economically viable. Gazonor has equally large potential. We rate **European Gas Limited** as a **Buy**.

Investment Highlights

- **Undervalued in Gas Starved Market** – Our high level risked valuation of EPG estimates that the Company is worth 186cps on a fully diluted basis, including the June cash balance of A\$14.7m. Recent peer transactions in Australia have averaged ~\$1.50 per gigajoule of 2P reserves. This ratio values EPG at \$210m or 85cps based on 140 petajoules of 2P reserves. With the current gas reliance in Europe on Russia, prices are forecast to increase from the already high levels of A\$12 per gigajoule to as high as A\$20 per gigajoule. Based on only the current 2P reserve number, EPG is well placed to take advantage of this situation.
- **Massive Potential at Lorraine** – The Company has recently drilled an appraisal well at its 100% owned Lorraine project, successfully completing two laterals and two sidetracks. The gas in place, based on 5% of the total acreage, is currently estimated at 992 billion cubic feet. The recent well encountered coal thicknesses 25-80% higher, and gas content values 15-25% higher, than those used to calculate the original resource. Previous calculations, based on 200 holes drilled, estimate that the gas in place at Lorraine is ~7 trillion cubic feet. EPG believe that 2 of the 7 trillion cubic feet is economically viable, with a recovery factor of 50%. Based on a conservative A\$1 value per mcf gas, this gives Lorraine a potential value of \$1b or 405cps.
- **Gazonor Resource, Production Set to Increase** – Production at the Company’s Gazonor project has averaged 2.7 billion cubic feet of gas per year, with 54% methane content. This equates to 1.5 petajoules per year, or 4,000 gigajoules per day. The Company is planning to increase this production to ~10,000 gigajoules per day by 2010. The coal bed methane potential at Gazonor is similar in size to that at Lorraine. Initial resource estimates are currently in progress.
- **10 Wells Scheduled for Next 12 Months** – EPG has scheduled up to 10 wells for the next 12 months. The wells will appraise potential at 6 of the Company’s projects located in France, Italy and the Low Countries. The program includes three additional wells at Lorraine and two at Gazonor. We expect that this drilling program will yield significant increases in resources and reserves over the coming months.

Valuation

Our valuation of EPG is based on its current and projected reserve / resource upgrades, discounted for risk. We have used a conservative \$1 per gigajoule, which is consistent with prices achieved in historical deals for CSG, but well below recent deals associated with LNG potential in Queensland.

The Company also has cash reserves of \$14.7m.

Table 1: Reserve / Resource Valuation

Prospect/Area	Location	Mean Net Recoverable Resource (GJ)	NPV/GJ	POS*	Risked Value	Risked cps	Unrisked cps
Gazonor 2P	France	138	\$1.00	100%	\$137.55	56	56
Gazonor 3P	France	237	\$1.00	50%	\$118.65	48	96
Gazonor Potential	France	863	\$1.00	5%	\$43.13	17	348
Lorraine - Saint Avold	France	218	\$1.00	40%	\$87.15	35	88
Lorraine - Alsting	France	302	\$1.00	20%	\$60.48	24	122
Lorraine Potential	France	1,050	\$1.00	5%	\$52.50	21	424
Gardanne	France	53	\$1.00	20%	\$10.50	4	21
St Etienne	France	-	\$1.00	10%	\$-	-	-
Tuscany	Italy	-	\$1.00	10%	\$-	-	-
Benelux	Pays-Bas	-	\$1.00	10%	\$-	-	-
Lons Le Saunier	France	-	\$1.00	20%	\$-	-	-
Total		2,860			\$ 509.96	206	1,155

Source: Hartleys Estimates, *Probability of Success

Valuation Summary

Table 2: Valuation Summary

Asset	Value (A\$m)	Value (cps)
Assets	\$510.0m	206cps
Cash	\$14.7m	6cps
Overheads	(\$5m)	(2cps)
Total	\$519.7m	210cps

Source: Hartleys Estimates

Conclusions

European Gas Limited negotiated its entry into the coal bed methane prior to the re-rating of the sector and is located in a mature gas market, with relatively high prices compared to those in Australia and extensive infrastructure in place. The Company has existing 2P reserves and production, both of which are expected to increase in the short term. Using very conservative valuation assumptions the Company appears undervalued compared to its peers, with an EV / 2P ratio of \$1 per gigajoule. This is around two thirds that of its peers in Australia, despite the disparity in pricing. European Gas has secured very large acreage positions across Europe and has significant upside, which should be unlocked by the current drilling campaign. We rate **European Gas Limited** as a **Buy**.

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Hartleys Recommendation Categories

Strong Buy	Significant share price appreciation anticipated
Buy	Share price appreciation anticipated
Speculative Buy	Share price appreciation anticipated but is considered high risk
Accumulate	Buy in periods of weakness
Hold	Take no action
Reduce	Sell in periods of strength
Sell	Significant price depreciation anticipated

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