

## Micro Cap Companies

### European Gas Starts to Flow

With Europe short of energy and dependent on Russian gas, a European gas story would seem to have a lot going for it - strong support from security and energy conscious governments, good infrastructure, a big import replacement opportunity, a cold winter, a large market, rising demand, and customers who can afford to pay. There are also the issues of climate change and European leadership in the transition to a low carbon future. And let's not forget the decisions by Germany and Switzerland to close all their nuclear plants over the next decade.

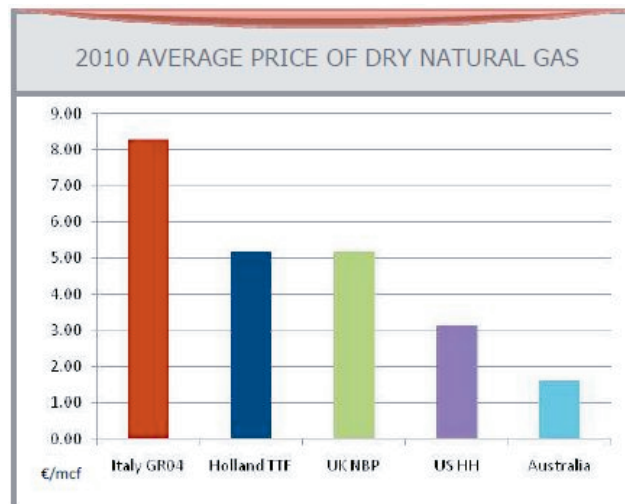
About the only thing missing is the gas.

All these factors combine to make Europe a huge importer of gas. In 2009 natural gas accounted for 24 per cent of the EU's primary energy consumption, but it was as high as 45 per cent in the Netherlands and over 35 per cent in five other countries. Of the total EU gas consumption of 18,904 petajoules (PJ), two thirds or 12,548 PJ came from outside the EU.

Western Europe has only about 2 per cent of the world's proven reserves of natural gas, and is also the least endowed continent for estimated reserves of unconventional gas such as coal seam gas, shale gas, and tight gas. So it is serious business in Europe to find new gas and make better use of the gas already found.

Among the many European gas explorers are two companies on the ASX, and both seem to be making progress.

Po Valley Energy and European Gas are micro caps with large exploration permits. Po Valley's focus is



natural gas, while European Gas' focus is mainly coal seam gas and coal mine methane. Another point of difference is geography, with Po Valley operating in Italy and European Gas in France, the Benelux countries and Italy.

#### Po Valley Energy

Po Valley is advanced enough to be making the transition to a gas producer and being cash flow positive.

The company has operated in Italy for the past 10 years. It has about a dozen licence areas covering 2,000 square kilometres, mostly in northern Italy but also southern Sicily. It has no shortage of assets with two producing gas fields, two development projects, five gas discoveries for appraisal, 11 gas exploration prospects and two exploration applications.

The production fields are Sillaro, its main one, and Castello. Sillaro has 1P gas reserves of 8.1 billion cubic feet (bcf) and 2P reserves of 8.8 bcf. Production commenced in May 2010 and is said to be stable at about 2.9 million cubic feet per day (mmcf/day) or 83,200 stan-

dard cubic metres per day (scm/day), which is inline with its contracted production.

Sillaro is only two kilometres from one of Po Valley's five appraisal projects, Fantuzza, which is expected to feed gas into the Sillaro plant. Drilling approval for Fantuzza is expected soon.

Production at Castello began in December 2009 and was disappointing when it became intermittent in May and June 2010 due to reduced pressure. Production is currently limited to 3,000 scm/day and the remaining reserves are being re-evaluated. The latest update is 1P reserves of 0.1 bcf and 2P reserves of 3.7 bcf.

Fortunately, approval has been received to drill a new well, Vitalba-1dirA, with spudding expected in August. Connection to the existing Castello plant and the recommencement of production is expected in the third or fourth quarter of 2011.

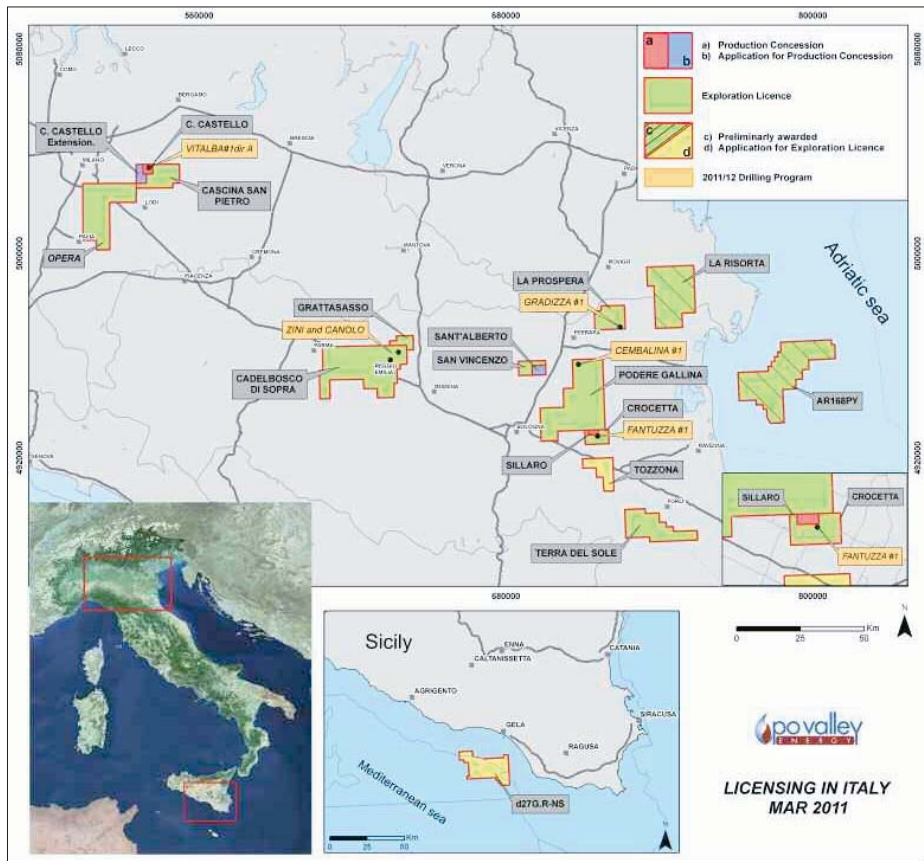
"If the new well is successful, we will significantly increase production at Castello as soon as we can. Since all the production plant at Castello is in place, this will generate an immediate increase in net cashflow," said chairman, Graham Bradley.

The two production licence applications are for the St Alberto and Bezzeca fields. Po Valley is aiming to achieve development approvals for these in the next 12 months.

The outlook for Po Valley is promising with steady gas production, early revenues, new production in the pipeline, and new fields being developed.

#### European Gas

The main assets of European Gas are several fields in eastern France, but it also has a project between Rome and Siena in Italy, and farm in and production sharing interests in northern France and the Benelux



### Po Valley Energy's assets.

countries. Despite a recent debt restructuring, its remaining assets are considerable.

The Lorraine field covers a long established coal mining region and has 988 square kilometres of permits mainly targeting coal seam gas. The contingent resource is at least 3,900 PJ.

The Jura (Lons le Saunier) permit area is 3,795 square kilometres with potential for coal seam gas and conventional gas, but also conventional oil.

Exploration options for the Lorraine and Jura fields

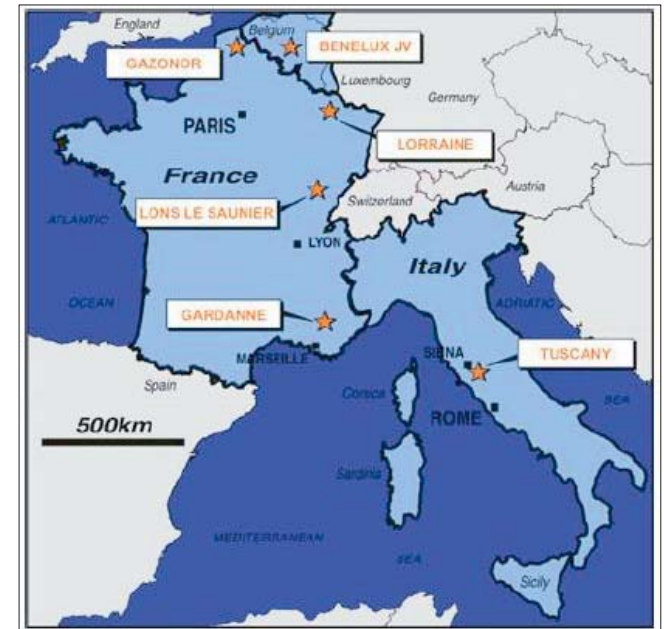
are being evaluated.

A third permit, Gardanne, is also part of an historical coal production area and covers 365 square kilometres. The coal is up to 300 metres thick with multiple seams, and the estimated gas is at least 105 PJ. European Gas has identified a place for an appraisal well to test the gas content, and baseline environmental studies commenced last year.

Since 2007 European Gas has had three permits covering 1,553 square kilometres in southern Tuscany in Italy. Each permit is for six years and gives exclusive rights to explore for and produce hydrocarbons. The company says all three areas are prospective for coal seam gas, and Environmental Impact Studies for each have been lodged.

Until recently European Gas owned other projects in northern France and Belgium, and together these and its remaining permits and application areas covered over 10,000 square kilometres. The company said these contained "the largest gas resources ever assembled in continental Western Europe". The contingent resources totaled 8,990 PJ.

However European Gas' asset portfolio changed dramatically recently with a restructure to end a convertible note held by its partner, Transcor Astra Group. Among other aspects this involved European Gas selling to Transcor its shares in Gazonor in northern France



European Gas' past and present assets.

and its 50 per cent equity interest in European Gas Benelux (EGB).

Gazonor has a large licence area covering 2,119 square kilometres and 2010 coal seam gas production was 1.2 PJ or 321 Gwh, while EGB is exploring for coal seam gas, coal mine methane and conventional oil and gas in Belgium, The Netherlands Lorraine and Luxembourg.

However, with Transcor now holding 11 per cent of European Gas, European Gas has remained in the Gazonor and EGB pictures. Transcor granted European Gas farm out and joint operating agreements with Gazonor for the Sud Midi and Valenciennois exploration permits, and a production sharing agreement with Gazonor for the Poissonniere and Désirée production permits. It also gave it a right of first refusal over any coal bed methane, tight or shale oil and gas projects sourced

by EGB in the Benelux area.

European Gas director Rod Bresnehan told Eco Investor the company is very happy with the Transcor/Gazonor deal as it can earn 70 per cent of any new 2P and 3P gas found. Gazonor is already a producer, so European Gas' focus will be on exploring for additional gas.

If all goes well the company could again be a producer by the first quarter of next year.

Executive chairman Julien Moulin said that with the convertible notes now restructured, the company has the capital structure to navigate the current market conditions and look to the future with confidence.

Overall, the company has considerable contingent gas reserves and these are likely to increase with further exploration across its many fields.

### The Environment

For some Australian investors Po Valley and European Gas may offer an alternative to the growing controversy around some local coal seam gas companies.

Like Australia, the use of fracking for extracting coal seam gas has become an issue in Europe. Reports have appeared in recent months of protests in France about fracking, and National Post has reported that the French government will back a proposed ban on its use. It quotes French Environment Minister Nathalie Kosciusko-Morizet as saying "I'm against hydraulic fracturing. We have seen the results in the US. There are risks for the water tables and these are risks we don't want to take." The legislation now being debated would cancel exploration permits granted last year to companies that plan to use fracking.

Po Valley is focused on natural gas, and Mr Bresnehan said the issue does not affect European Gas as it

uses lateral and vertical wells, not fracking, to release the gas. This technique does not apply pressure to crack the formation, but drills through the coal.

However, there is some question over how committed both companies are to being environmental, as Po Valley has two oil exploration opportunities, and European Gas has some hydrocarbon royalties in Western Australia's Canning Basin. However, at this stage both are very minor in each company's overall activities.

### Financials

On the financial side, Po Valley is in a good position. Its two producing wells delivered an initial 26.8 million cubic metres of gas in calendar 2010, 18.5 million from Sillaro and 8.3 million from Castello. Revenue was €7.1 million.

For the first quarter to March 31 this year, revenue was €2.2 million and, in line with its transition to becoming cash flow positive, net operating cash flow was €1.1 million. Cash at the end of the quarter was €1.6 million.

At both operating fields it has infrastructure in place and projects to increase production that could quickly add to revenue.

European Gas is not a stranger to revenue, which was €8.1 million in 2008-09, €5.3 million in 2009-10, and €4.6 million for the nine months to 31 March this year. Cash at the end of March was €2 million. But its ongoing revenue will be impacted by the restructure of its assets and the sale of Gazonor, which was the source of its gas sales. Its run of annual losses is unlikely to change in the short to medium term.

### Share Prices

On the share price front, it has been European Gas

that has been the standout performer. Last year it defied cleantech trends and rose strongly from a low last May of 9.2 cents to a high of 50 cents last November, just before its shares were voluntarily suspended.

The suspension was requested while the company renegotiated its convertible note with Transcor and other matters. The discharge of the convertible note was completed in early May, and in early June it finalized the conversion of an unsecured loan and a share issue. Its shares should recommence trading very soon.

The capital raising, via a placement, raised \$15 million at 45 cents per share, and under the convertible note restructure Transcor subscribed for its shares at 50 cents each, so the outlook for the shares when they relist is promising.

Meanwhile Po Valley's shares have declined significantly and recently hit an all time low of 19.5 cents. The all time high was \$2.25 in May 2008. Much of the decline occurred between January and May 2010 when problems emerged with production at Castello.

Mr Bradley recently told shareholders "Your directors share the disappointment of all shareholders in the poor performance of the Company's share price during 2010 and the setbacks underlying that performance. We believe, however, that our Company is now well placed to realise full value from the Company's assets."

One company has had its shares voluntarily suspended for over six months, the other's shares are at all time lows. It's not a pretty picture, yet there is a lot more happening below the surface and both companies are worth watching as they make the transition to producers and, hopefully, profitability. (ASX: PVE and EPG)