

Date of issue

05.01.09

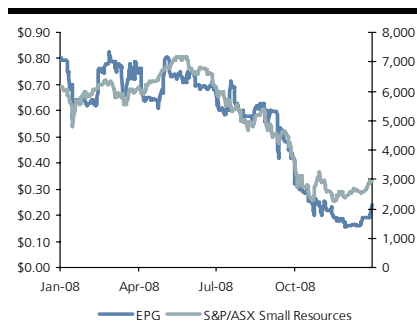
Company Update

INVESTMENT DATA

Share Price	\$0.23
Issued Capital	
Ordinary Shares	199.2m
Options/Other	65.1m
Fully Diluted	264.3m
Market Cap (undiluted)	\$60.8m
52 Week Low/High	\$0.15 / \$0.84
Price Target (12 months)	\$0.78

Top 20 shareholders as at 30 September 2008 held 67% of total shares on issue

	Year end Jun 08a	09f	10f	11f
Revenue	€m 3.7	10.5	25.5	46.8
EBITDA	€m -0.8	2.8	10.2	21.1
EBIT	€m -4.5	-7.5	-2.1	6.7
NPAT (A\$)	\$m -5.3	-9.0	-2.9	5.5
EPS (A\$)	¢ -2.1	-3.0	-0.8	1.6
EPS growth	% N/A	N/A	N/A	N/A
DPS (A\$)	¢ 0.0	0.0	0.0	0.0
Yield	% N/A	N/A	N/A	N/A
P/E	x N/A	N/A	N/A	14.4x
EV/EBITDA	x N/A	27.2x	9.7x	4.7x



European Gas (EPG)

Buy

Company Update

European Gas (ASX code: EPG) issued a comprehensive update on its Coal Mine Methane (CMM) operations and other activities in France on 23 December 2008.

Highlights:

- December Quarter production averaged over 5,000GJ per day, or 0.45PJ for the period. Winter gas prices have been strong at €8/GJ (equivalent to A\$16.45/GJ), generating revenues of €0.9m per month. However, lower energy prices will have an impact in the March 2009 quarter, with EPG expecting to receive an average of €6.25/GJ (A\$12.75).
- The company stated that it "has no intention or requirement for sourcing additional funding". With only €3.4m of cash at the end of September, EPG is implementing a cost reduction program. Operating costs at the Gazonor site will be 25% lower than experienced in calendar 2008, with a 15% cost reduction already achieved. Although gas sales are relatively modest, they are "highly profitable". Administration costs are also expected to be 20% lower in 2009.
- Pre-feasibility studies to expand gas production at Gazonor, and electricity generation are progressing. It has been determined that the reservoir at the Avion site can extract gas at levels 66% higher than the current rate, without suffering natural decline for the next 10 years. EPG is seeking to optimise such expansion potential while minimizing capex through leasing of power generation units, or other options.
- Regarding the exploration projects, the company has commenced discussions with several substantial groups for the joint evaluation of one or more of its exploration areas. Any move to accelerate exploration work with a credible partner will be welcome, particularly at the Lorraine project where the cost of drilling is high. The only disappointing aspect of the company's market release, was that no update was provided regarding the status of the Folschviller-1 well at Lorraine.
- The board is planning to appoint two additional non-executive directors early in 2009 to strengthen its European representation.

Taking a much more conservative view, EPG is still undervalued

Bell Potter has reduced its valuation of EPG to \$0.78 from \$1.10, primarily by reducing our gas price assumptions to €5/GJ from €7/GJ, in light of much lower oil prices and a more negative outlook for the European economies. We have also reduced sales volumes for the FY09 year by 15%. The core valuation of Gazonor has declined to \$0.30 a share from \$0.61, which is still well above the current share price of \$0.23. The remainder of the valuation is for the resource potential, which is substantial.

Bell Potter maintains a Buy recommendation

We continue to regard EPG as a very interesting opportunity to invest in a Coal Seam Gas company, operating in the attractive European gas market. Bell Potter believes there is good scope for a re-rating if the company can not only maintain operations but increase its production, and get a partner to fund the evaluation of one or two of its exploration projects, without the need for an equity issue.

However, as a small cap company with limited financial resources, it represents a higher risk investment in the current market environment.

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European Gas Ltd (EPG)						Share price: \$0.230					
As at 5/01/2009						Market cap: \$60.8m					
€m reporting						Recommendation: Buy					
Income Statement						Valuation Data					
Year end June 30 (€m)	2007A	2008A	2009F	2010F	2011F	Year end June 30	2007A	2008A	2009F	2010F	2011F
Revenue	1.4	3.7	10.5	25.5	46.8	Adjusted NPAT (A\$)	-1.3	-5.3	-9.0	-2.9	5.5
EBITDA	-1.4	-0.8	2.8	10.2	21.1	Adjusted EPS (A\$)	-0.7c	-2.1c	-3.0c	-0.8c	1.6c
DD&A	0.0	-1.4	-2.7	-4.8	-6.2	EPS growth	N/A	N/A	43%	N/A	N/A
Exploration write-off (50%)	-0.1	-2.3	-7.5	-7.5	-8.3	P/E ratio	N/A	N/A	N/A	-28.8x	14.4x
EBIT	-1.5	-4.5	-7.5	-2.1	6.7	OpCFPS (A\$)	-0.8c	-0.7c	0.9c	4.9c	8.6c
Net interest	0.3	-0.3	-0.6	-0.5	-1.7	Price/OpCFPS	N/A	N/A	26.9x	4.7x	2.7x
Abnormals	0.0	0.0	0.0	0.0	0.0	DPS (A\$)	0.0c	0.0c	0.0c	0.0c	0.0c
Pre-tax profit	-1.2	-4.8	-8.1	-2.6	4.9	Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Tax	0.0	0.0	0.0	-1.6	-4.4	EV/EBITDA	N/A	N/A	27.2x	9.7x	4.7x
Minority interests	0.0	0.0	0.0	0.0	0.0	Profitability Ratios					
Reported net profit	-1.2	-4.8	-8.1	-4.2	0.5	Year end June 30	2007A	2008A	2009F	2010F	2011F
Adjusted net profit	-0.8	-3.2	-5.4	-1.7	3.3	EBITDA/sales	N/A	N/A	26%	40%	45%
(adjusted net profit = pre-tax profit before abnormals minus tax at marginal rate)						EBIT/sales	N/A	N/A	N/A	N/A	14%
Cashflow						Return on assets (avg.)	-4%	-10%	-12%	-3%	4%
Year end June 30 (€m)	2007A	2008A	2009F	2010F	2011F	Return on equity (avg.)	-5%	-15%	-18%	-4%	9%
Reconciliation						Dividend cover	N/A	N/A	N/A	N/A	N/A
Net profit	-1.2	-4.8	-8.1	-4.2	0.5	Effective tax rate	0%	0%	0%	-63%	89%
Exploration write-off (50%)	0.1	2.3	7.5	7.5	8.3	Liquidity & Leverage					
Depreciation	0.0	1.4	2.7	4.8	6.2	Year end June 30	2007A	2008A	2009F	2010F	2011F
Change in working capital	1.4	0.4	-0.6	2.1	2.9	Net debt	-3.2	-6.6	-8.6	15.7	16.0
Other	-1.1	0.0	0.0	0.0	0.0	Net debt/equity	-13%	-35%	-21%	43%	43%
Net operating cashflow	-0.8	-0.8	1.5	10.2	17.8	Interest cover	4.2x	-2.6x	4.3x	20.6x	12.2x
Investing cashflow						Assumptions					
Capex on PPE	-0.2	-1.1	-14.5	-19.8	-1.6	Year end June 30	2007A	2008F	2009F	2010F	2011F
Exploration	-4.7	-4.5	-15.0	-15.0	-16.5	Gazonor Electricity (GW/h)	0	0	0	28	56
Divestments (Acquisitions)	0.6	-26.6	0.0	0.0	0.0	Gazonor CMM (PJ)	1.5	1.5	1.5	2.3	2.3
Net investing cash flow	-4.3	-32.2	-29.5	-34.8	-18.1	Gazonor CBM (PJ)	0.0	0.0	0.0	2.0	5.0
Financing activities						Lorraine CBM (PJ)	0.0	0.0	0.0	0.0	0.0
Issue of shares	0.4	0.0	30.0	0.2	0.0	Total Production (PJe)	1.5	1.5	1.5	4.5	7.9
Buy backs	0.0	0.0	0.0	0.0	0.0	Net daily production (TJ/day)	4.1	4.1	4.1	12.4	21.5
Dividends paid	0.0	0.0	0.0	0.0	0.0	Gas price (€/MWh)	€ 18.00	€ 17.64	€ 25.20	€ 18.72	€ 19.47
Debt	0.0	0.0	0.0	20.7	0.4	Gas price equivalent (A\$/GJ)	8.31	8.10	11.67	8.67	9.01
Convertible notes	0.0	36.4	0.0	0.0	0.0	Exchange rate (A\$/Euro)	0.602	0.605	0.600	0.600	0.600
Net financing cash flow	0.4	36.4	30.0	20.9	0.4	Valuation					
FX impact	0.0	0.0	0.0	0.0	0.0	Existing project @10% DR	PJ	€m	\$m	\$/GJ	\$/share
Net change in cash held	-4.7	3.4	2.0	-3.6	0.1	Gazonor CMM (20 years)	31	23	39	\$1.24	\$0.11
Balance Sheet						Development assets @15% DR					
Year end June 30 (€m)	2007A	2008A	2009F	2010F	2011F	Gazonor Power (20 years)	21	21	34	\$1.68	\$0.09
Assets						Gazonor CBM (20 years)	72	22	36	\$0.51	\$0.10
Cash assets	3.2	6.6	8.6	5.0	5.1	Sub-total	123	66	110	\$0.89	\$0.30
Receivables	0.3	0.3	0.2	0.6	1.5	Exploration assets @ €0.05/GJ					
Inventories	0.0	0.0	0.0	0.0	0.0	Gazonor CBM upside	1000	50	83	\$0.08	\$0.23
Other	0.0	0.0	0.0	0.1	0.1	Lorraine CBM potential	1000	50	83	\$0.08	\$0.23
Total current assets	3.5	6.9	8.8	5.6	6.8	Other exploration	400	20	33	\$0.08	\$0.09
PP&E + Development	2.0	2.5	14.3	29.2	24.7	Cash / (Net debt)		3	6		\$0.02
Investment	0.0	0.0	0.0	0.0	0.0	DCF of corporate costs €2m pa		-19	-31		-\$0.09
Exploration assets	21.1	23.4	30.9	38.4	46.6	TOTAL		170	284		\$0.78
Deferred tax assets	0.0	0.0	0.0	0.0	0.0	Valuation sensitivities					
Other	1.6	1.6	1.6	1.6	1.6	Gas volumes				A\$m	\$/share
Total non-current assets	24.7	27.5	46.7	69.2	72.9	Base case (Gazonor incl. CBM)		8PJpa		284	\$0.78
Total assets	28.3	34.4	55.6	74.8	79.7	Downside (Gazonor CMM & Power only)		3PJpa		248	\$0.68
Liabilities						Upside (Gazonor + Lorraine)		8+10PJpa		324	\$0.89
Debt	0.0	0.0	0.0	20.7	21.1	Gas price					
Payables	2.0	1.0	1.1	2.4	4.4	Base case		€5.00/GJ		284	\$0.78
Deferred revenue	0.0	0.0	0.0	0.0	0.0	Downside		€4.00/GJ		228	\$0.63
Current tax liabilities	0.0	0.0	0.0	0.5	1.4	Upside		€8.00/GJ		444	\$1.22
Provisions	0.0	1.3	0.5	1.2	2.2	Gas flow per well at Gazonor					
Total current liabilities	2.0	2.3	1.6	24.9	29.2	Base case		0.5mmcf/d		284	\$0.78
Debt	0.0	0.0	0.0	0.0	0.0	Downside		0.3mmcf/d		252	\$0.69
Other	1.7	13.0	13.0	13.0	13.0	Upside		1.0mmcf/d		328	\$0.90
Provisions	0.0	0.0	0.0	0.0	0.0	Discount rates +/- 2.5%					
Total non-current liabilities	1.7	13.0	13.0	13.0	13.0	Base case		10% & 15%		284	\$0.78
Total liabilities	3.7	15.4	14.6	37.9	42.2	Downside		12.5% & 17.5%		224	\$0.61
Net assets	24.6	19.1	40.9	36.9	37.5	Upside		10% & 12.5%		330	\$0.91
Equity						Peer group reserves comparison					
Contributed equity	30.1	29.4	59.4	59.6	59.6		EV	2P	3P	EV/2P	EV/3P
Reserves & outside equity	0.3	0.3	0.3	0.3	0.3		\$m	PJ	PJ	\$/GJ	\$/GJ
Retained earnings	-5.8	-10.6	-18.7	-22.9	-22.4	AOE	1,049	1,001	2,189	\$1.05	\$0.48
Total equity	24.6	19.1	40.9	36.9	37.5	ESG	507	336	1,300	\$1.51	\$0.39
Diluted shares on issue	198.2	246.7	346.7	347.7	347.7	MEL	68	298	1,538	\$0.23	\$0.04
Weighted ave diluted shares	161.5	198.2	300.8	346.7	347.7	MPO	143	213	467	\$0.67	\$0.31
						PES	609	394	1,241	\$1.55	\$0.49
						Peer group average				\$1.00	\$0.34
						EPG	55	140	380	\$0.39	\$0.15

Note: EPG reserves for Gazonor only & gas prices 3-5x higher in Europe

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