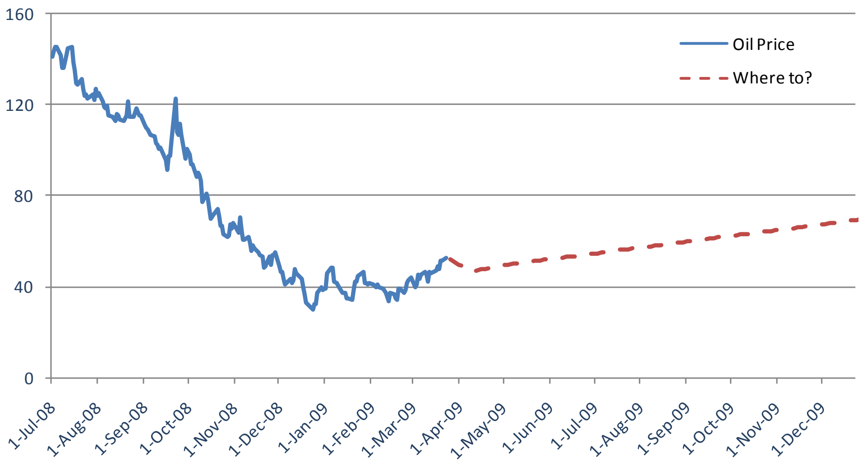
# Oil & Gas Book

## March 2009

David Wall

Oil and Gas Analyst

Where to Next?



Hartleys

# ESG.asx
## BUY

# EASTERN STAR GAS LTD

## Reserves Upgrade Expected

The Company is in the middle of a large reserves exploration and appraisal project at its Narrabri acreage (ESG 65%), located in NSW. ESG is targeting gross 2P reserves of 1,300 petajoules by the end of 2009. 7 core holes and 12 horizontal production pilots have been drilled to date as well as the first of four planned multi lateral production pilots. This drilling activity should result in a significant reserves upgrade later this year, and provide certainty around expected flow rates and the development concept. Conservatively valued, ESG's share of 1,300 petajoules would be worth ~117cps.

## Recent CSG Deals Re-Rate Sector

Recent deals in Queensland between Arrow/Shell, Santos/Petronas and BG/Pure Energy (to name a few) have valued CSG reserves at >$2.50 per gigajoule for 2P reserves and >$1 per gigajoule for 3P reserves. All of these deals were based on potential for a much larger resource and the gas being converted to LNG, which may trade at, or above, parity with oil in the future. These deals give an indication of what prices may be achieved for CSG acreage in NSW in 1-2 years once its infrastructure catches up to that of Queensland.

## MOUs in Place

ESG has MOUs in place for the sale of 1,300 petajoules of gas. It is no coincidence that this is also the 3P reserve number, as the reserve number is constrained by the MOUs. The establishment of the MOUs highlights the Company's approach to matching supply with demand and ensures a market for its gas.

## Contingent Resource 1,990 Petajoules

The Company has recently reported a resource prediction at its Narrabri CSG acreage, based on coals located outside of the current reserves area. Recent coreholes drilled at Dewhurst have achieved results well above expectations and have confirmed the geological model. The 2C contingent resource of 1,990 petajoules could be worth ~240cps to the Company.

## Massive Potential and Achieving Milestones

ESG is on the verge of proving up the development concept for its CSG acreage, via pilot production wells at Bohena and Bibblewindi, over the next few months. It is expected to announce a significant 2P reserve upgrade later this year. The Company has recently experienced a rally in its share price on the back of speculation of a takeover. We believe that the quality players in the CSG sector will continue to benefit from their future, strategic potential based on large resource positions. ESG has a quality management team with a solid business model. Success at its pilot production wells and reserve/resource upgrades are sure to result in further share price appreciation.

WA Oil & Gas: Developer / Explorer

24 Mar 2009

| | |
|---|---|
| **Share Price:** | $0.73 |
| **6mth Price Target:** | $1.06 |

**Brief Business Description:**
Coal seam gas developer with assets in New South Wales and South Australia

**Hartleys Brief Investment Conclusion**
Benefitting from coal seam gas activity in Queensland. Significant production testing in progress.

**Chairman & CEO:**
John Anderson (Chairman)
David Casey (Managing Director)

**Top Shareholders:**
Hillgrove Resources Limited (20.1%)
Merrill Lynch Nominees (5.1%)
TRU Energy Investments Pty Ltd (5.1%)

**Company Address:**
Level 7, 51 Pitt St
Sydney, NSW, 2000

| | |
|---|---|
| **Valuation:** | $1.06 |
| **Issued Capital:** | 816.2m |
| - fully diluted | 878.1m |
| **Market Cap:** | $591.8m |
| - fully diluted | $636.6m |
| **Cash (31 Mar '09):** | $78.7m |
| **Debt (31 Dec '08):** | $0.0m |

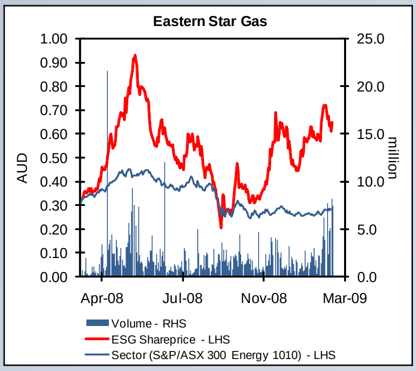
**Valuation Summary**

| Asset | Value $m | risked cps | unrisked cps |
|---|---|---|---|
| Narrabri | 838.9 | 96 | 360 |
| Other | 26.1 | 3 | 3 |
| Cash | 78.7 | 9 | 9 |
| Debt | - | - | - |
| O/heads | - 15.0 | - 2 | - 2 |
| **Total** | **928.7** | **106** | **370** |

| | FY08a |
|---|---|
| Chg in Cash* | $35.5m |
| Net Cash End | $37.5m |

| | |
|---|---|
| 2P Reserve (PJ gas) | 218 |
| EV / 2P Reserve ($/PJ gas) | $2.35 |

*includes share issue of $49m
Source: Hartleys Research





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# HIGHLIGHTS

## Overview

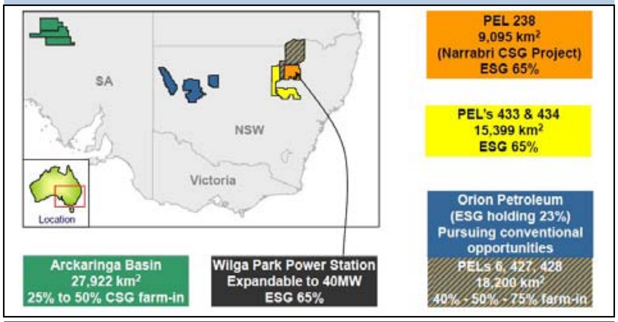
Eastern Star Gas Limited ("ESG", "Company") has recently embarked on the largest coal seam gas ("CSG") reserves exploration and appraisal project ever undertaken in New South Wales ("NSW"). ESG's 2P reserve at its Narrabri project is 218 petajoules, with an impressive gross 3P reserve of 845 petajoules. ESG is aiming to convert the 3P reserve to 2P by the end of 2009.

CSG activity in Australia has been primarily focused in Queensland; however, scope is expanding rapidly to include NSW and South Australia. ESG is well placed to advantage from this as it is fully funded and has secured MOUs, ensuring that it has a market for its product. This should provide a strong foundation from which to build possible LNG scale projects based on multi trillion cubic feet potential. The land grab for coal seam gas assets that has taken place in Queensland is likely to spill over into nearby acreage, such as that owned by Eastern Star.

The Company has recently completed a placement, raising $50m, predominantly to institutional investors. This placement gives the Company the necessary funds to progress, on a sole risk basis if required, its plans to prove up its massive resource potential.

We understand that Company's first dual lateral well is up and running, with another expected to be completed by the end of May. Peak flow rates will be achieved within 6-9 months; however, indicative flow rates may be estimated within 2 months. This means that ESG will have confirmation of flow rates by mid-year, which should result in a reserves upgrade at the same time.

*Fig. 42:ESG Asset Locations*




Source: Eastern Star Gas Ltd

Our valuation of Eastern Star Gas is 106cps, including asset, cash, investments and overheads. Our 6 month price target of 106cps fully reflects our valuation despite the negative sentiment in the broader market. We believe that coal seam gas companies on the east coast of Australia are immune to this sentiment and we would not be surprised if further speculation of a takeover for ESG resulted in a sharp increase in its share price in the short term.

*Fig. 43:Reserve / Resource Valuation*

| Prospect/Area | Location | Mean Net Recoverable Resource | NPV/GJ | POS# | Risked Value | Risked cps | Unrisked (High Case) cps |
|---|---|---|---|---|---|---|---|
| Narrabri 2P | New South Wales | 218 GJ | A$1.50 | 100% | A$327m | 40cps | 40cps |
| Narrabri 3P* | New South Wales | 627 GJ | A$1.00 | 80% | A$314m | 38cps | 77cps |
| Narrabri 2C | New South Wales | 1,990 GJ | A$1.00 | 10% | A$198m | 24cps | 243cps |
| **Total** | | | | | **A$839m** | **102cps** | **363cps** |

Source: Hartleys, ESG, *excludes 2P, #probability of success

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Hartleys has provided corporate advice within the past 12 months to Red Fork for which it has received fees.

Hartleys has completed capital raising in the past 12 months for Sun for which it received fees and expects to receive fees. Hartleys has also provided corporate advice within the past 12 months to Sun for which it expects to receive fees. Hartleys has a beneficial interest in 4,000,000 Sun options.

Hartleys has completed a capital raising in the past 12 months for First Australian Resources Limited (“FAR”), for which it received fees. Hartleys has also provided corporate advice within the past 12 months and continues to provide corporate advice to FAR, for which it has received and continues to receive fees. Hartleys has a beneficial interest in 2,000,000 FAR options.

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