

## Eastern Star Gas (ESG)

### **Namoi Seam provides exciting early flow rate**

★ Eastern Star Gas has announced that the Bibblewindi West tri-lateral production pilot – based on the hitherto unexplored Namoi coal seam – is producing gas at a rate of more than two million cubic feet per day. As the wells are still undergoing de-watering, a significantly higher initial peak production rate – possible as much as 3.5 mmscf/day - may be achieved within the next 3-4 weeks.

★ The high flow rates are being achieved off a relative short total lateral seam length of around 2,250 metres net, indicative of high productivity rates and returns on in-field capital. Even at low gas prices, double-digit pre-tax returns can be achieved off low cost lateral wells such as those used in the pilot program.

★ The achievement of very high initial flow rates from the untested Namoi seam is exciting as it suggests that development and operating costs for the Narrabri coal seam gas joint venture – owned by Eastern Star and Santos – will be significantly lower than we had previously thought. The Namoi seam is stacked very close to the main Bohena coal seam, which to date has been the main focus for production testing, with the close proximity of the seams allowing production to occur from both seams through a single well head.

★ The Namoi coal seam is thin but continuous across most of ESG's main Narrabri exploration permit – PEL 238 – and has relatively high gas content as 12-13 M3/tonne. Achievement of a high flow rate indicates that ESG will achieve a significant increase in reserves from this permit in 2010.

★ Gas produced from the production pilot will be burned at the Wilga Park gas-fired power station, currently undergoing expansion to 40 Mw of capacity. At the expanded capacity, Wilga Park will be able to consume 5.7 million cubic feet per day of gas and generate earnings before interest, tax, depreciation and amortisation of around \$9 million a year.

★ Gas production from the nearby Bibblewindi multi-lateral production pilot, based on the thicker Bohena seam, continues to ramp up after a series of pump failures. Production has now climbed to more than 700,000 scf/day and is likely to peak at close to 2.2 mmscf/day.

★ The achievement of good commercial flow rates from both the Bohena and Namoi seams now means that all of the technical bogeys that have dogged the Narrabri project to date have now been laid to rest and there are no substantial technical or financial barriers to converting the project into a major gas producer. The challenge for ESG and Santos now is to develop markets for the gas other than base load electricity, with LNG being the most likely candidate.

★ As a result of the de-risking achieved as a result of the pilot program, and the likely impact on reserves, we have upgraded our ESG valuation to \$1.47 per share. We are lifting our price target from 95 cents to \$1.25.

★ Recommendation. Eastern Star Gas offers investors highly leveraged exposure to the development of the Narrabri coal seam gas project in Northern New South Wales. While the gas market is in temporary over-supply, we believe that the development export markets in Asia for east coast gas will lead to a significant re-rating of the value of coal seam gas resources over the next 4-5 years. As the major technical risks associated with the Narrabri project have now been overcome, we upgrade ESG to a BUY recommendation (medium risk) for both short and long term investors.

## Eastern Star Gar - Exploration Permits

	Permit Interest	Permit Area	1P	2P	3P	GIP
PEL 238	65%	8802	21.5	392	1273	3983
PEL 434	65%	7663		1609		
PEL 433	65%	7736		1625		
PEL 6	50%	5165		1085		
PEL 427	50%	7014		1473		
PEL 428	50%	6021		1264		

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21.5	392	1273	11039
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### Valuation Range

<b>Low</b>	<b>\$/Gj</b>	1.8	1.2	0.75	0.12
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<b>High</b>	<b>\$/Gj</b>	2.2	1.4	0.95	0.22
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<b>Low</b>	<b>\$m</b>	39	470	955	1325
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<b>High</b>	<b>\$m</b>	47	549	1209	2429
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<b>Low</b>	<b>\$/share</b>	0.04	0.52	1.06	1.47
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<b>High</b>	<b>\$/share</b>	0.05	0.61	1.34	2.69
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(Disclosure: The author of this report owns no ESG shares).