

# BGF Equities Company Research

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## Metgasco Limited

MEL

Initiating Coverage

Through 'conventional' thinking, could we see a gas major emerge?

Share Price	\$0.42	-85% Discount to valuation
Valuation	\$3.06	Based on \$0.60/GJ 2P, \$0.30/GJ 3P
12 Month Hi - Lo	\$0.42 - \$0.93	
Market Cap'n	\$105m	
Issued Capital	249.0	mill. fully paid
Options	9.5	mill.
Cash balance	\$24m	
Debt	\$0m	
Major S'holders	David Johnson 6.51%	
	Glenda McLoughlin 3.38%	
	Magnim Pty Ltd 2.49%	
	ANZ Nominees Limited 2.46%	



### Recommendation: SPECULATIVE BUY

**Investment Perspective:** With the conventional gas discovery in the Clarence-Moreton Basin in November last year, Metgasco have come to attention in a way their very good coal seam gas (CSG) story had failed to do. Kingfisher was a sensational natural gas discovery with flows of 3 mcf, the largest gas discovery ever recorded in NSW.

However, it is the certified 3P reserve of 2239PJ of CSG which, for now, provides the solid ground upon which the proposed power and gas reticulation businesses will take shape. Compared to their peers, MEL is a standout in value and location, with the embryonic natural gas story still to unfold over the next several years.

We can think of no other gas play which has 100% ownership and operatorship of its assets, and access to effectively the whole of a highly prospective geological basin in a single jurisdiction, with both coal seam gas and conventional oil and gas prospectivity in close proximity to the largest and fastest growing gas market in the country. The company has been 'flying under the radar', concentrating on building the asset base and failing to offer

investors obvious pathways to commercialisation. The power and pipeline projects in gestation should change all of that. The scaleable Richmond Valley Power Station, the Lions Way gas pipeline and the broader eastern seaboard market, possibly including participation in the LNG business, are all in the project pipeline.

We expect strong upside from here. There are reasonable expectations that the coal seam gas resource base will continue to grow with possible participation in LNG projects after 2014, while incremental power plant expansions will allow the ramp up of gas production over the next few years.

Metgasco is finally emerging, with a strong reserve base, conventional gas exploration blue sky and with some off-take options now apparent. The management team has shown rigour and a strong technical bent, and is now turning their gaze to the commercial aspects and are positioning the company to achieve a higher profile and to get in the game. The way should now be clear for positive news-flow on projects and resources to lead to greater market recognition and a strong re-rating of the share price.

## Primary Points

<b>Resources</b> <i>2TCF with extensive upside</i>	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> 100% interest in the most prospective areas of the Clarence-Moreton Basin in NSW</li> <li><input checked="" type="checkbox"/> Prospective for both conventional and coal seam gas close to major markets</li> <li><input checked="" type="checkbox"/> Reserves - CSG: 2239 GJ 3P with large acreage untested</li> </ul>
<b>2010 Exploration Program (Mar-Oct)</b>	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> The Bowerbird E2 CSG pilot well intersected 42m of gassy coal with oil shows (March).</li> <li><input checked="" type="checkbox"/> An additional 2-4 pilot wells to be drilled, plus a core drilling program to add reserves</li> <li><input checked="" type="checkbox"/> 200km of 2D seismic surveys and two deep convention wells testing two prime targets</li> </ul>
<b>Commercialisation</b> <i>Power projects and pipeline the key</i>	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> Introduce a project partner through sell-down of PEL 16 assets</li> <li><input checked="" type="checkbox"/> Richmond Valley 30MW power station to be developed in stages</li> <li><input checked="" type="checkbox"/> Larger scale 200MW Northern Rivers Power Station proposal</li> <li><input checked="" type="checkbox"/> Lions Way Pipeline to allow access to Eastern States and LNG Projects</li> </ul>
<b>Management</b> <i>Conservative, technical and systematic</i>	<ul style="list-style-type: none"> <li><input checked="" type="checkbox"/> Conservative approach has kept the stock a complete secret</li> <li><input checked="" type="checkbox"/> Capable management team with high integrity, technical know-how, but low profile</li> <li><input checked="" type="checkbox"/> Continues to grow resources and is positioning the company for take-off</li> </ul>

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## Valuation Metrics

### Resources-based Methodology & Peer Comparison

Using an EV/Resource metric, we value MEL at **A\$0.26/GJ** of 2P CSG reserve and **A\$0.05/GJ** of 3P CSG reserve. These values compare favourably with MEL's CSG peers, as illustrated by the figures below:

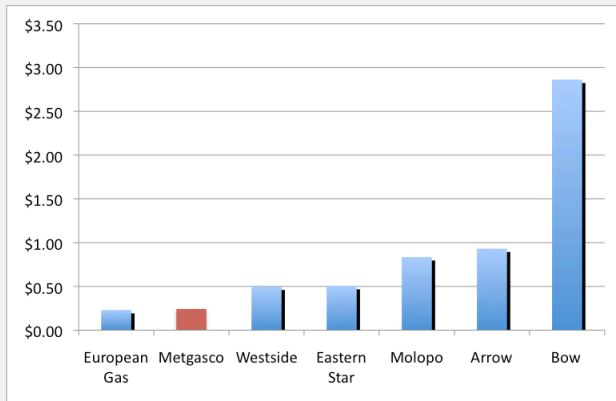


Figure 1 - \$EV/2P G.J. Source: BGF Equities

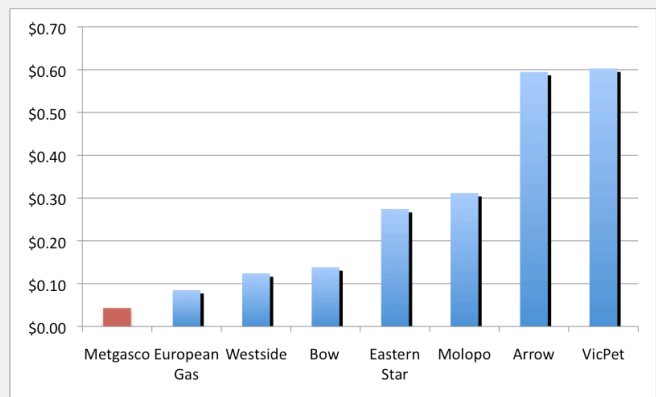


Figure 2 - \$EV/3P G.J. Source: BGF Equities

### Asset-based Methodology & Peer Comparison

Using an resource metric (Fig.3), we value MEL at **A\$3.03/share** bases on certified CSG reserves only. These values compare favourably with MEL's CSG peers, as illustrated by figure 3 below. This excludes the upside potential of the conventional gas assets, which has no certified reserve to date.

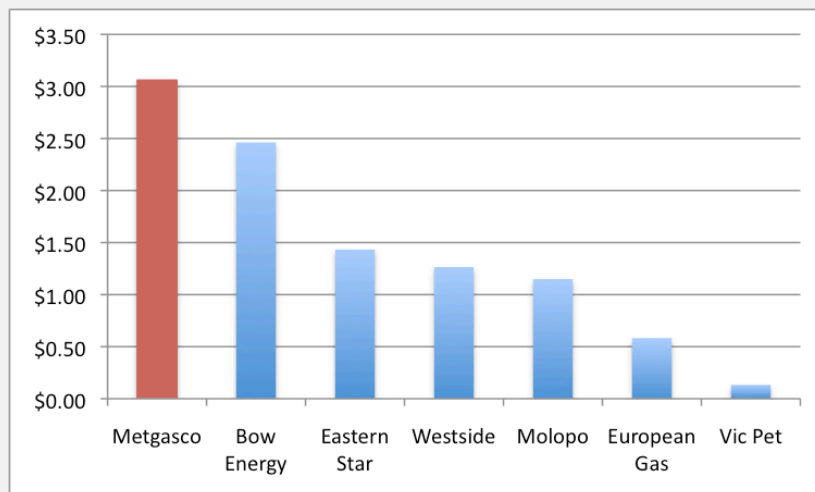


Figure 3 - 1P, 2P, 3P Reserve Value per Share. Source: BGF Equities

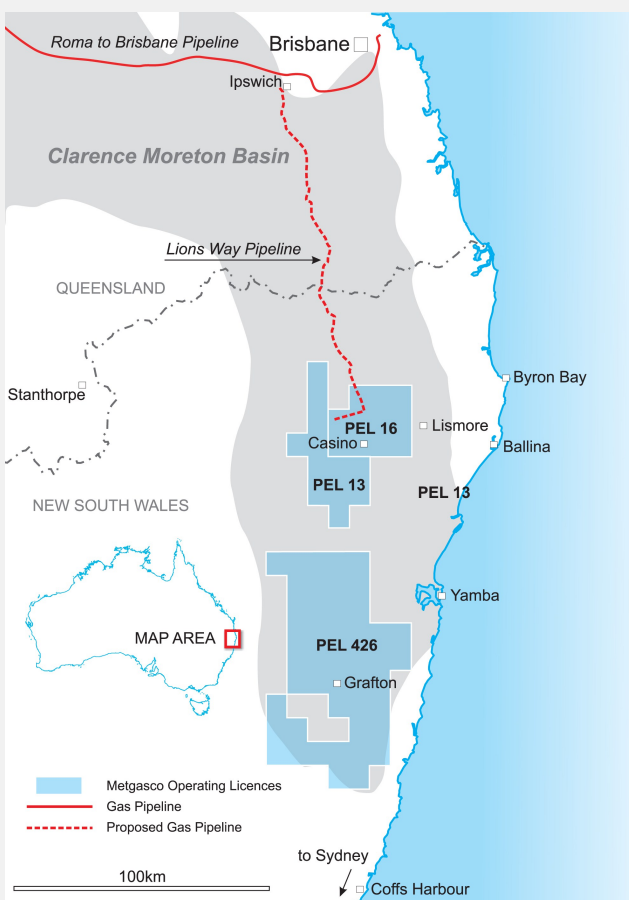
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## Clarence Moreton Basin, NSW

### Background

Metgasco was incorporated in 1999, converted to a public company in 2002 and ASX listed in 2004 with a single 833 km<sup>2</sup> permit, PEL 16, in the Clarence-Moreton Basin in northern NSW.

In 2005, MEL completed five production test wells on PEL16 leading to certification of initial gas reserves in 2006 as well as earning and interest into the adjacent permit, PEL13. In 2007, a farm-in into PEL 426 provided a 5739 km<sup>2</sup> exploration footprint. The company has since purchased the minority interests in the permits and has 100% interest in the project.

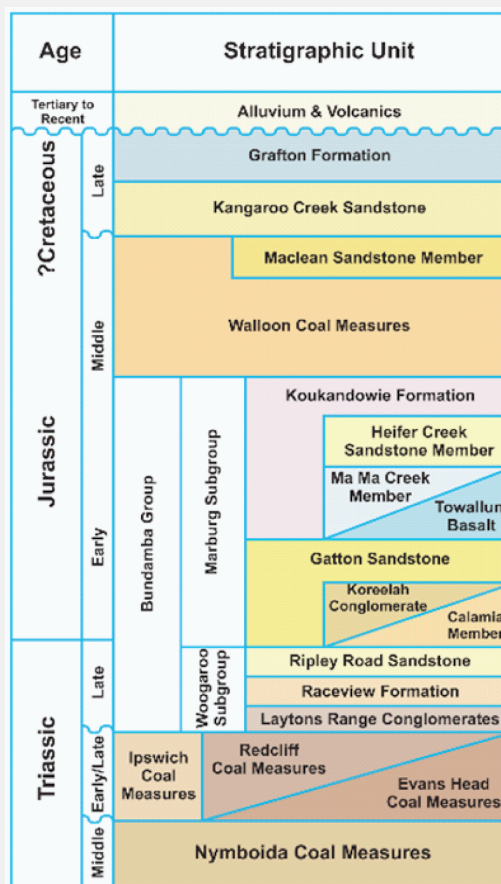


Project Location Map (Source: MEL)

The Clarence-Moreton Basin covers about 16,000 km<sup>2</sup> of NSW and has only been lightly explored for conventional oil and gas with about 10 wells drilled between 1965 and 1985. The early exploration wells were drilled with an oil focus using the less advanced drilling technology of the day and where the use of heavy drilling muds is thought to have masked gas shows in the wells.

The Basin has hosted only very limited coal mining in the past 150 years and has been actively explored for coal seam gas since 2005. Some of the Metgasco permits are overlain with geothermal exploration permits and the basement rocks (>3500m) are considered prospective for geothermal energy.

The primary exploration focus for CSG to date has been the Middle Jurassic Walloon Coal Measures (WCM) found on



Clarence-Moreton Basin Stratigraphy (Source: MEL)

PEL13 and PEL16. These coal measures are extensive throughout the Surat basin in Queensland and provide a significant proportion of Queensland CSG production. The Clarence-Moreton Basin, in New South Wales, contains the southern extension of these coals.

The coal seams of the WCM occur at a depth of between 200-800m, have high gas content, tend to be over-saturated with gas, with seam thickness varying between 2m to 9m.

Eleven coal seams have been identified within PEL16, the primary focus of exploration to date. Gas composition analysis shows a very pure natural gas with approximately 98% methane (CH<sub>4</sub>) content and negligible carbon dioxide (CO<sub>2</sub>).

The conventional oil and gas hydrocarbons are in the structural and stratigraphic traps within the Triassic-Jurassic Bundamba Group sandstones.

There is as yet untested CSG potential in the deeper Triassic units in the Ipswich and Nymboida Coal Measures.

### Coal Seam Gas Exploration

Exploration drilling started in 2005 with 18,347m completed to 2007. Initial gas reserves were certified in 2006, with additional reserves added every year. The initial 1P (proven) reserves was announced in 2009 from the Corella P11 well.

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This well has provided flows of 220,000 cfd with dewatering still underway. Water flows have been low, typically <60bpd.

A reinterpretation of all seismic data in 2009 allowed two further discovery wells, Wyan E1 (PEL13) and Orara E1 (PEL426). Both wells flowed gas without water which is encouraging as water flows adds significantly to the cost of production. Water is not expected to be such an issue in the Clarence - Moreton Basin as in the Surat and Bowen Basins in Queensland.

The drilling to date, indicates typically low permeability reservoirs producing mainly dry natural gas.

The 2010 CSG program commenced in March with the spudding of the Bowerbird E-2 core well in PEL 13.

The objective of Bowerbird E-2 is to assist in the delineation of an interpreted coal seam gas fairway in the Walloon Coal Measures from the Corella CP11 trial production well in PEL 16, extending approximately 20 kilometres north west into PEL 13. The target depth of the well is 700 metres to test the Richmond and I/J/K coal seam gas reservoirs.

The core well will provide data on gas content, gas composition, coal quality and thickness and reservoir permeability. The data collected will assist in planning additional trial production activities ahead of any potential field development.

Field development production ramp up would be in line with developing off-take projects.

### Conventional Gas Exploration

The potential lies in the sandstone formations lying deep beneath the coal seams.

For Metgasco the conventional gas resource development program during 2007, involved processing all of the 800km of pre-existing 2D seismic data plus more recent data from the DPI. The first conventional well, Riflebird E14, drilled in March 2008, showed significant gas flows, and provided some insight into the conventional potential of the basin.

The Kingfisher E1 was the first conventional gas appraisal well in PEL 16. The well was drilled in November 2009 to appraise the deeper sandstones including the Ripley Road sandstones, which are analogous to a known hydrocarbon reservoir, the Precipice Sandstone in the Surat Basin.

The well was drilled to 2,090m in late 2009 identifying 138m of possible gas bearing sands with 30m of net pay identified. A 3.7m zone (Ripley Road) at 1,043.7m depth was tested in January 2010 and flowed at 2.97 mcf through a 1" choke. The well was flowing gas at total depth indicating further potential from the deeper formations. Other zones are now being tested to determine the best completion method for production drilling.

Metgasco's initial analysis is that the field has a contingent resource estimate of 77 BCF (P50) which is the largest conventional gas discovery in New South Wales oil and gas exploration. Data to date indicates medium to highly porous reservoirs with sufficient permeability to allow gas flow to the well.

Further wells are planned for 2010, after further studies to determine reservoir structure. Two new prospects - Mackellar and Mackellar North, are expected to be drilled to 2,100m later in 2010. It is expected to drill back-to-back

wells because of the high mobilisation costs experienced to date.

### Resources/Reserves

MEL have developed over 2 TCF of gas reserves since drilling commenced in 2005 (Fig. 4) adding additional reserves every year and with major upgrades in 2006 and 2010. (Fig. 5)

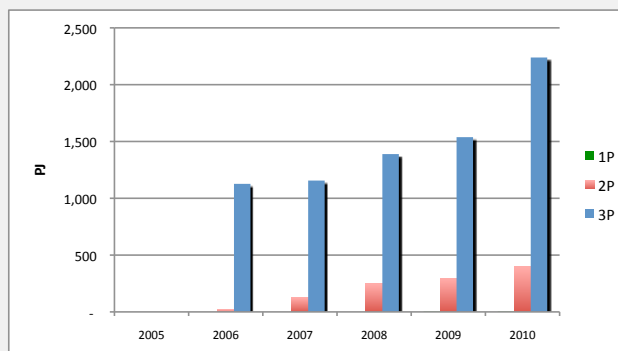


Fig. 4 - Total Reserves Growth (Source: MEL, BGF Equities)

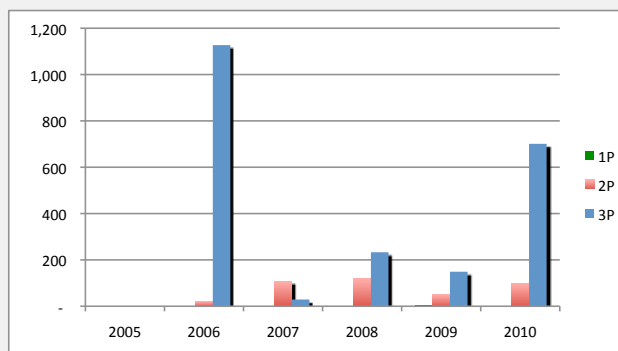


Fig. 5 - Annual Additions to CSG Reserves (Source: MEL, BGF Equities)

The company has also quoted additional contingent resources and Gas-In-Place estimates for the conventional gas project (Table 1).

Coal Seam Gas	PEL 16 Total (PJ)	Bcf
1P	2.7	2.6
2P	397	381
3P	2239	2153
2C	1177	1131
Conventional Gas	PEL 16 Total (PJ)	Bcf
1C (P90)	-	-
2C (P50)	80	77
3C (P10)	295	284

Table 1 - MEL Estimates- Dec 2010 (Source: MEL)

An initial contingent resource estimate of 77 BCF for the newly discovered Kingfisher Gas Field provides ample opportunity for establishing a reserve.

### Development Strategy

The company as now indicated its intention to pursue multiple pathways to commercialise its reserves while allowing the exploration program to provide additional reserves. Infrastructure is the key, and Metgasco are proposing power and pipeline projects to allow timely integration into the emerging Eastern States gas and power markets and the LNG business. The current strategy is to introduce a project partner through a sell down of the PEL16 assets.

#### Richmond Valley Power Station (RVPS)

The power station will deliver electrical power into Country Energy's local grid providing a locally generated source of electricity within the Richmond Valley region. A 30MW RVPS has received NSW development approval and FID. The proposal is for 10x3MW reciprocating gas engines to be constructed in total or in three stages of approximately 10MW per stage depending upon contracted loads.

Staging of the RVPS would enable the power station development to progress in line with the gas field development. MEL have exercised their option on a land purchase for the RVPS.

The larger 200MW Northern Rivers Power Station is at the concept stage and would consist of much larger 50+MW generator units and would require a significant off-take of up to 15PJ/y of gas.

*Comment: The RVPS project was stalled for some time due to the NSW Government permitting authorities requiring confirmation of a sufficient gas reserves margin to support the project. This has now been rectified and the project has full development application status. At full 30MW capacity, the plant is expected to consume 2.5 PJ/y sourced from the Casino Gas Project on PEL 16, and generate perhaps \$6-8m in revenue.*

#### Lions Way Gas Pipeline (LWGP)

Metgasco is proposing to construct a gas transmission pipeline from Casino in northern NSW to deliver gas to Ipswich in south-east Queensland and provide access to the broader eastern Australian gas market via a connection to the Roma-Brisbane pipeline. The 140 km pipeline will supply gas to Metgasco's off-take partner, CS Energy at its Swanbank Power station and have a nominal capacity of up to 60PJ/y, subject to an assessment of final demand.

Metgasco will now prepare easement agreements under relevant New South Wales and Queensland legislation. Route studies and environmental studies have been completed. Construction of the pipeline is expected to commence in 2012.

*Comment: The NSW Planning Department has extended the application to 31st December 2010 with the issue of the Director-Generals requirements, for the Environmental Assessment. The capital cost is expected to be around \$110m. The involvement of a pipeline developer and a project partner will be necessary to develop this project.*

#### Wholesale Gas Market

The wholesale gas market has many strands and could include gas for power projects or to LNG projects. Participation in the LNG business and to non-captive power stations is dependent on pipeline access to the Queensland pipeline network. The Lions Way Project has the potential to provide this link. The growth of micro LNG and CNG projects producing transport fuels, is another pathway to commercialisation.

MEL are now at the stage of identifying project partners for up to 50% interest in the PEL 16 Casino Gas Project and the downstream power and pipeline projects. It is unlikely that commercial gas production would start before 2014.

*Comment: With both CSG and conventional gas resources, Mel are likely to emerge as one of the lowest cost producers of gas capable of supplying into the burgeoning LNG market.*

### Corporate and Finances

#### Board and Management

Management and Board of Directors currently comprises:

Dr Peter Power (Non Exec. Chairman, Director)

Mr David Johnson (Managing Director)

Ms Glenda McLoughlin (Director, CFO)

Mr Nicholas Heath (Non Exec. Director)

Mr Steven Koroknay (Non Exec. Director, Independent Director)

Mr Peter Stanmore (General Manager, Exploration)

Michael O'Brien - (General Manager, Development)

#### Finances

MEL currently has \$24m in cash and no debt.

Current cash will allow the company to continue its conventional and CSG drilling programs throughout 2010. The proposed two deep conventional wells of around 2100m depth will cost in the order of \$8 million.

Disclosure: BGF Equities Pty Ltd have not been paid fees by MEL. The author does not own shares in MEL.

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