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QUARTERLY ACTIVITIES REPORT FOURTH QUARTER ENDED 30 JUNE 2012

Throughout the second quarter of 2012 the NSW Government continued to work on updating policies that regulate the coal seam gas industry in the state. While this work remains incomplete the Government has not renewed exploration leases or granted production licences to the industry, including Metgasco. This has led to delays in key elements of Metgasco's forward work program.

While awaiting the issue of new government permits, Metgasco:

- continued to prepare for the planned drilling program;
- pursued plans and environmental approvals for our production facilities;
- progressed local, interstate and export gas sales opportunities; and
- continued to champion the benefits of the CSG industry in the Northern Rivers Region.

The market for natural gas remains very strong, as indicated by numerous speakers at the annual APPEA conference in May who highlighted the critical role gas will play in international and Asian energy supplies over the next 20 years. In Australia there is open recognition that the Queensland LNG export projects will have less gas reserves than desired and operators will look to source gas from outside their operating areas. There is also widely held concern about gas supplies in NSW, particularly from 2014 when major tranches of contracted supply begin to taper off. With its established reserves, Metgasco is well positioned.

Review of Exploration and Development Activities

Conventional Exploration and Appraisal Program

Wet weather continued to delay completion of the seismic program planned in PEL 16, frustrating our efforts to appraise the structure updip from the Kingfisher well. Acquisition of this seismic information remains a highly desirable part of confirming a location for the proposed Rosella-E01 well to test the Greater Mackellar structure. The seismic will be conducted as soon as ground conditions become suitable for deployment of the recording equipment. Based on current weather conditions and forecast trends the timing of

acquisition is expected in the third quarter, with the well now scheduled to be drilled in the last quarter of 2012 or, in the first half of 2013, depending on rig availability.

Metgasco has held discussions with several parties who have shown an interest in farming into the conventional potential in PEL 16.

During the quarter, regional geological studies were completed on the prospectivity of the conventional targets in the licence areas and to better define the character of the shallow overburden rocks. Studies included a review of reservoir properties and the strata overlying the Walloon Coal Measures. As an additional benefit, the studies increased our understanding of water production issues within the Walloon coal measures and showed no connectivity to aquifers close to the surface.

Proposed Kangaroo Creek Sandstone Test in MSC06

A decision to test two zones in the basal Kangaroo Creek Sandstone of the South Casino 6 (MSC06) well was deferred until more clarity is available from a competitor's drilling program in an adjacent exploration permit. Farm-in activity during the quarter in the adjacent permit has served to demonstrate continued interest in the Clarence Moreton basin and reflects very favourably on the value of Metgasco's holdings.

Certified Reserves

The Company recognises the following gas reserves and resources in its tenement areas.

Independently certified gas reserves – Petajoules (PJ) All reserves are 100% owned by Metgasco			
Reserve Category	PEL 13	PEL 16	Total
1P (Proven)		2.7	2.7
2P (Proven + Probable)	31	397	428
3P (Proven + Probable + Possible)	303	2,239	2,542
2C Contingent Resource	1,334	1,177	2,511

The estimates of gas reserves have been prepared by Mr Tim Hower, and staff under his supervision, of MHA Petroleum Consultants (Denver). Mr Hower is chairman of MHA and has over 25 years of petroleum engineering experience and is a qualified person as defined under the ASX listing rule 5.11. Reserves have been developed within the guidelines of the SPE. MHA has consented to the use of this information.

2011/2012 drilling program

Preparations for the 2012 drilling program remain well advanced. The drilling program consists of 3 core wells, 2 to 3 lateral pilot production wells and the conventional well, Rosella-E01. All long lead items have been delivered.

Commitment to a drilling rig contract has been delayed until the NSW Government's new policies are announced and exploration licence renewals and all approvals are in place. On the assumption that the conditions above will be satisfied shortly, Metgasco hopes to commence drilling by the fourth quarter of 2012.

Water handling

Holding Ponds and Water Management Plan

As part of its exploration activities, Metgasco has in the past had approval to store produced water (water produced from the coal seams during well testing) and drilling fluid in five holding ponds. It is also building a 6th pond.

During 2011 and 2012, with the approval of the local authorities, Metgasco disposed of some of the stored water to the local sewage treatment plant (STP). In the second quarter 2012 the council identified that its EPA licence needed to be amended to allow for the treatment of produced water. Water transfers ceased as a consequence while new approvals were obtained. Following a new approval limited transfers of water have once again been directed to the STP. EPA correspondence states that there is no environmental harm associated with the use of the STP.

Metgasco is working with government agencies to update its water management plan, originally submitted in 2008. Metgasco will now be required to commit to specific beneficial uses for the water during the exploration phase whereas before this was required only during the production phase. Our new water management plan is expected to be completed in third quarter 2012.

BioAssay Testing

Following on from the successful bioassay tests of produced water using selected freshwater species conducted by Aquatic Bioassay and Consulting Laboratories in California, Metgasco forwarded two additional samples of "saltier" fluids for further testing. These fluids were representative of spent drilling fluids and some produced water. Aquatic Bioassay and Consulting has been a leader in California for toxicity testing and aquatic biological monitoring for over 30 years.

Although Metgasco is still awaiting the final reports, preliminary results again indicate the absence of anything in these waters that is toxic to the freshwater species tested. The higher salinity spent drilling fluid was required to be diluted to 10% to achieve satisfactory results while the produced water, which had a higher salinity than previously tested, required a dilution to around 25%.

These are very positive results, indicating that with appropriate treatment, even potentially as simple as dilution, produced water can be managed safely.

Release of water analysis data

In response to community interest Metgasco released a set of detailed fluid analyses. This data is included on our website. Metgasco is currently developing the long term disposal options for our spent drilling fluid which seeks to capitalise on its potential benefit as a source of potassium for some of the potassium deficient soils in the Northern Rivers area.

Review of Commercial Developments

Gas commercialisation strategy

Metgasco remains focussed on:

- (1) developing a local industrial market of up to 10PJ/pa in the Northern Rivers region; and
- (2) gas sales of 30-90PJ/pa for LNG export and supplementing other existing domestic gas supplies that will be contracted in future for overseas buyers.

Metgasco has confirmed the potential for early local CNG sales within a 200km radius of Casino followed by micro LNG sales in the medium term. These opportunities, supplemented by targeted pipelines to key customers in the region such as Richmond Dairies, offer the prospect of displacing more expensive imported fuels used by local industry.

The other key local development project, the Richmond Valley Power Station, remains on hold, pending final government approval. Metgasco holds a Part 3A approval for the development. While waiting for approval, Metgasco has been examining the optimal generating mode and has been exploring ways to reduce development costs.

Metgasco also commenced discussions with industrial and agricultural consumers regarding potential natural gas, electricity and water sales in other areas of the Northern Rivers, including Lismore.

Longer term sales are expected to be delivered via the Lions Way Pipeline to the existing national pipeline grid near Ipswich or to export markets via a floating LNG facility in NSW. The floating LNG facility remains a credible and potentially more profitable alternative to the Lions Way Pipeline. Metgasco is reviewing these and other pipeline route options in order to balance the needs of local community, environmental impact as well as technical complexity and commercial profitability. Metgasco is in discussion with potential pipeline owners regarding opportunities to fast track the pipeline(s) design and construction.

Metgasco will be continuing work on its field development plan and will consult with government to facilitate approvals so that its appraisal and commercial projects can proceed as soon as possible.

There is wide market recognition of an imminent gas supply problem on the eastern coast of Australia from 2014 onwards. NSW in particular faces a difficult situation with prices expected to increase significantly.

Review of Corporate Developments

Community and Government Engagement

The NSW Government continues to indicate its support for the industry, recognising the value that it can add. Unfortunately, the completion of these policy initiatives has been delayed. As a consequence, renewal of exploration licences and approval of production licences have been delayed. This is a concern for the CSG industry as a whole, including Metgasco.

As far as the government's initiatives are concerned Metgasco understands that:

- drafts of the Strategic Regional Land Use Policy, the Aquifer Interference Policy and Code of Practice were issued for community comment in early May and are close to completion;
- a new Land and Water Commissioner, reporting to the Director General of the Department of Trade and Investment, is to be appointed to oversee the industry, particularly on behalf of landholders;
- a standardised land access agreement will be developed; and
- the royalty holiday for CSG producers will end.

Metgasco has argued that many of the new policies are unnecessary and are not good examples of regulation or risk management. Metgasco opposes the end to the royalty holiday. Metgasco believes the royalty holiday is a sensible policy and is also the basis of the exploration funds Metgasco has already committed.

During the quarter Metgasco released its submission to the NSW Government's Regional Action Plan 2020. Metgasco's submission highlighted the potential role that the development of the CSG industry would play in strengthening local businesses and growing job opportunities in the Northern Rivers area, which is acknowledged as having twice the national unemployment level.

Metgasco released *Economic Impact of Proposed Natural Gas Operations in Northern Rivers* prepared by Lawrence Consulting which stated the potential economic benefit to the regional economy from a full developed business model to be:

- \$1.4 billion of direct expenditure over 20 years;
- \$2.1 billion of total expenditure over 20 years;
- 400 full time equivalent (FTE) direct construction jobs;
- 270 FTE direct operations jobs;
- 1,000 FTE total construction jobs; and
- 950 FTE total operations jobs.

Metgasco continues to meet with members of the Northern Rivers community to further affirm that the industry is safe and environmentally acceptable, uses established techniques, is highly regulated by the NSW Government and can co-exist with other land uses.

Personnel

Metgasco announced the appointment of Dr Simon Hann to the position of Drilling and Production Manager. Dr Hann is currently the Drilling and Completions Manager for Santos/GLNG in Queensland and brings extensive drilling and coal seam gas experience to Metgasco. Given that drilling and production performance is one of the keys to Metgasco's success, this is a particularly important appointment. Dr Hann starts work with Metgasco in late August, in time to participate in the planning of our near term wells.

In another change, Mr Michael O'Brien, the Chief Operating Officer, has decided to retire after nearly five years with Metgasco. Mr O'Brien has made a major contribution to Metgasco, managing its drilling, reservoir, operations and development work. His drilling, reservoir and operations duties will be assumed by Dr Hann and his development responsibilities by our Business Development Manager, Mr Robert Petersen.

Cash Position

The Company ended the quarter with a cash position of \$12.2 million.

Shareholder Base

At 30 June Metgasco had 337,414,140 shares on issue and 5,580,624 options outstanding.

Outlook - Planned Forward Work Program Next Quarter

Metgasco understands that the NSW Government's regulatory review will be completed in the near future and that the Government will show its support of the CSG industry through the renewal of exploration licences and approval of production licences.

Metgasco's focus over the next quarter will be to:

- complete government approvals, allowing its core and lateral well program to commence;
- submit its environmental assessment for the pipelines and production / appraisal licences required for the Richmond Dairies sale gas supply;
- complete the seismic program, facilitating the drilling of its conventional exploration prospect;
- further market development, both local and interstate / export LNG;
- continue discussions with potential farmin partners; and
- continue promoting the benefits and safety of the industry to the Northern Rivers Region.

Background on Metgasco

www.metgasco.com.au

Metgasco has a 100% interest in PEL 16, 13 and 426 in the Clarence Moreton Basin in NSW where it operates the largest acreage position in the basin. Metgasco currently has 2P gas reserves of 428 Petajoules and 3P gas reserves of 2,542 Petajoules. The Company is exploring for conventional and unconventional gas. Metgasco is currently progressing its gas commercialisation agenda which includes gas and electricity supply to NSW and gas supply to Queensland. With gas in place resources likely to exceed the domestic markets requirements and sufficient to supply export scale projects, Metgasco is currently investigating LNG project development options.

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