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Eastern Star Gas (ASX code: ESG) has announced that full-scale operation at the Bibblewindi Multi-Lateral Pilot on PEL238 at Narrabri, northern New South Wales has resumed. What does this mean for production development at the Pilot? What is your timeline toward establishing commercial gas flow rates at Bibblewindi?

Managing Director David Casey

The resumption of full-scale operation means we are, once again, successfully dewatering the laterals that comprise the pilot. When we originally brought the pilot on line, gas production was both immediate and ramping up quickly. After only one month of operation, gas production had reached 250,000 standard cubic feet per day. We expect we will be able to repeat, and in fact improve upon the past performance, given that we now also have the new shield wells in operation.

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Two shield wells were recently completed either side of the multi-lateral pilot well at Bibblewindi. To what extent do the shield wells de-risk the pilot? Is there a risk to the integrity of the formation? What cost does this add to the drilling programmes budget? Will it be necessary for every well planned?

Executive Director of Operations Peter Lansom

The Bibblewindi multi-lateral pilot initially comprised two side-by-side dual laterals, each of which incorporated three production wells. With this configuration the outer-most laterals were, in effect, operating as shield wells creating an area of greater drawdown in the middle of the pilot from which gas desorption and production would be greatest.

By adding the two new shield wells, one to each side of the pre-existing pilot, we aim to expand the area of greater drawdown. The new shield wells have not been installed to de-risk the pilot. They have been installed to expand it so as to better simulate a full-scale production development, providing further proof of concept. Full-scale production will involve many single laterals side-by-side.

Given the outstanding early performance of the multi-lateral pilot, in terms of connectivity with the coal fracturing system and communication between adjacent laterals, we have already determined that as we move to full-scale development it will be possible for adjacent laterals to be spaced around 1 kilometre apart. This will greatly reduce the number of wells required for, and hence the cost of, efficient and effective gas production.

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You have also completed a workover on four vertical producing wells. Has this been successful? Why was it necessary? How have you resolved this issue going forward?

Executive Director of Operations Peter Lansom

Workovers of the production wells was the fundamental thing we had to do to bring the multi-lateral pilot back onto full-scale operation. In fact, given the mechanical problems we have experienced, specifically a repeated series of mechanical failures of overseas-sourced pump drive rod couplings, the wells have actually been worked over several times over the last few months. Each time we have experienced a downhole mechanical failure a workover has been required. In the end, we decided to do a complete set of workovers using equipment from a different supplier and performing well clean-outs at the same time. Going forward, we will continue to monitor the performance and reliability of mechanical systems, fine-tuning design and equipment specification parameters as appropriate.

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Drilling has commenced at Dewhurst as part of a three-well lateral pilot programme. What are your expectations for additional commercial potential reserves at Dewhurst? When will you have first results? Are any shield wells planned?

Managing Director David Casey

The Dewhurst pilot will incorporate three single laterals, side-by-side. As with the multi-lateral and tri-lateral pilots, the Dewhurst laterals will be drilled perpendicular to the natural fracturing system of the target Bohena coal.

As with the Bibblewindi pilots, and noting that this is an isolated pilot rather than a full-scale development, the outer laterals actually perform the role of shield wells and the inner lateral simulates the performance that can be expected of full-scale development wells.

The Dewhurst pilot will be operated on a short term basis to demonstrate water and gas production profiles are consistent with those at Bibblewindi. Together with core and seismic data, it is planned this will allow the Bibblewindi and Dewhurst areas to be booked for reserves certification purposes.

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As at June 30 2009, CSG 2P reserves on PEL238 stood at 602 PJ (ESG share: 392PJ). What progress has the Joint Venture made toward its certification target during the September quarter? Are you confident the JV can still meet its 1300PJ (100%-basis) by the end of the current calendar year? What have been some of the challenges to date?

Managing Director David Casey

The key challenge to date has definitely been the series of pump drive rod coupling failures we experienced. It has set us back several months in terms of full-scale production history. On the bright side, while multi-lateral pilot operations have been scaled back, with only two pumps operating part-time, the performance of the pilot has continued to be in line with predictive modelling for the scaled-back, intermittent mode of operation.

At this stage, we remain confident that we will achieve our year-end reserves upgrade objective. Had it not been for the coupling failures, I think we were well-placed to comfortably exceed it.

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Once you have reached your reserve certification target, how will you approach development of this asset? What options have you considered? Why is the market valuing ESG on a forward 2P reserve multiple much lower than the average of recent transactions? How do you plan to close that value gap?

Managing Director David Casey

We have routinely pointed out that a successful gas business requires not just gas reserves, but also infrastructure and markets, and that these things are interactive. For example, you can't have certified reserves unless you have a market and, in turn, you need both in order to underwrite the costs of developing gas processing, compression and pipeline infrastructure.

Achievement of our present reserves target will see us achieve the critical mass that is required to move to full-scale development of coal seam gas production at Narrabri. It is my expectation that achievement of this step will not only close any perceived value gap, it will put ESG on the pathway to realising considerable upside as we move to realise the full long-term potential of the Narrabri project.

In terms of realising project potential we envisage, as we have previously discussed, a staged approach. After creating a regional gas market, as we are doing through expansion of the Wilga Park Power Station, we plan to commence supply of gas into the NSW gas market and then to realise market and project growth through supply of gas to new loads, particularly gas based electricity generation. Beyond that, we are investigating even larger opportunities, like methanol production, LNG and gas-to-liquids.

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Australian CSG industry is still relatively new but remains quite capital intensive. How are you managing cash flow during this certification period? Where do you see the opportunities for companies like ESG as the industry matures?

Managing Director David Casey

While cashflow management is for a small company never without challenge, we have planned carefully to ensure we have funding in place to take the company to the next level in terms of development. Our objective is to minimise overall dilution as we progress toward realising the full potential and value of the Narrabri project. For example, when we raised funds in March this year the placement was massively oversubscribed – we limited the amount raised to that required to deliver the present programme of work.

We envisage that achievement of the critical mass required to underwrite the transition to full-scale development will fundamentally change the funding opportunities available to us. With gas reserves certified, and commercial arrangements in place for their development, debt or project finance will become another option.

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You have indicated that approvals processes would be initiated soon, kicking off the process of putting in place permissions required for a full-scale gas project development. When can we expect that to become public?

Managing Director David Casey

At every step of our envisaged staged development, from drilling wells through to processing and pipelining gas, there will be an advance requirement for development approvals to be secured. Recognising the lead-time to secure such approvals, we consider it prudent that approvals processes be launched at an early opportunity.

We have, with specialist consultant assistance, prepared a Concept Plan to outline a vision for staged development of the Narrabri CSG project and associated downstream infrastructure. While we have held off submitting the Plan, while we brief relevant stakeholders on its content, we still anticipate it will be submitted, and become public, in the near future.

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Thank-you David & Peter.

For further information on Eastern Star Gas Limited visit www.easternstar.com.au or contact David Casey on 02 9251 5599 or office@easternstar.com.au

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