

QUARTERLY REPORT 31 DECEMBER 2010

HIGHLIGHTS

Gazonor, France

- Gas sales of 83,272 MWh (299,783 GJ) for the quarter.
- Gas prices (ave.) for the quarter of €15.92 per MWh (€4.42 per GJ), (AU\$20.82 per MWh; AU\$5.78 per GJ respectively).

Exploration, Lorraine

- MHA Petroleum Consultants (“MHA”) of Denver have reviewed part of EGL’s

eastern France (“Lorraine”) exploration area, and the study confirms the exciting prospectivity of this region, with Contingent Resources of C1 (40BCF), C2 (2.35 TCF) and C3 (7.91 TCF) assessed for the study area.

- MHA also reviewed the previous well tests on EGL’s Folschviller #2 exploration well, which EGL plans to place on production test during the first half of 2011.

Corporate

- EGL requested voluntary suspension from trading in its shares during the quarter as it undertakes negotiations with the Convertible Note holder Transcor Astra Group (“Transcor”).

Company Information

Board of Directors

Julien Moulin (Chairman)
Peter Cockcroft (Managing Director)
Rod Bresnehan (Non Executive Director)
Sebastian Hempel (Non Executive Director)

Company Secretary

Mark E Pitts

ASX Code: EPG
Shares on Issue: 238,944,359
Conv. Notes¹: 55,100,000
Options: 16,500,000

¹ 24,250 notes converting to approximately 55,100,000 fully paid ordinary shares subject to customary adjustment provisions.



Figure 1: Projects Location Map

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GAZONOR

Northern France

European Gas holds a 100% interest in the Gazonor project in Northern France. The Gazonor assets include the gas exploitation rights over the Poissonnière and Désirée permits, comprising a total area of 767 square kilometres (km²) including the Poissonnière extension (granted January 2009).

The Valenciennois exploration permit, comprising an area of 432 square kilometres (km²), was granted in October 2009.

The Sud Midi exploration permit was granted on July 26th, 2010 and is adjacent to EGL's Gazonor Production Concession. The permit area covers 929 km².

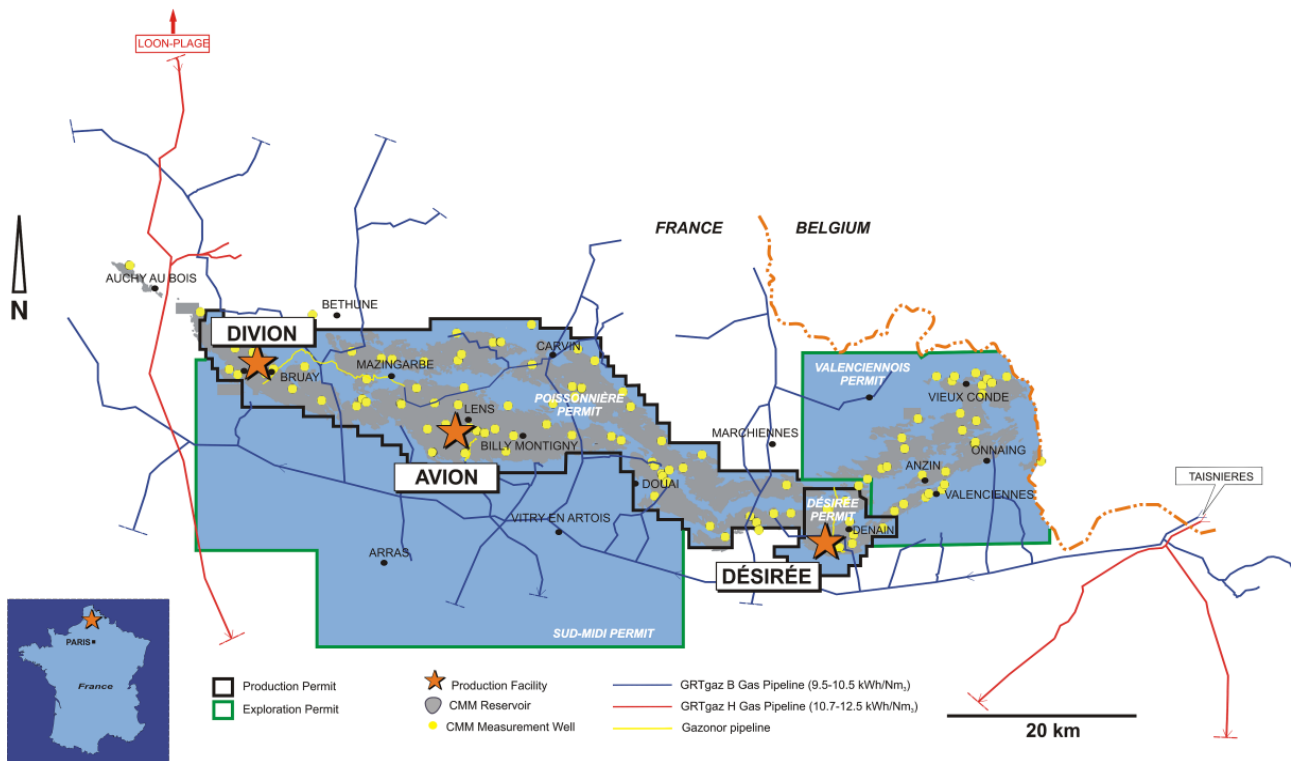


Figure 2: Gazonor Project Location Map

Gas Sales

Detail of gas sales for the quarter are summarised in the following table.

Sales		Average Price Received	
MWh	GJ	€/MWh	€/GJ
83,272	299,783	15.92	4.42

Gas sales of 83,273 MWh (299,783 GJ) for the quarter

Gas sales increased compared to the third quarter 2010, due to more demand in the grid (autumn/winter versus summer).

Revenues for the quarter totalled €1.325 million (A\$ 1.691 million).

Exploration Programme

Evaluation of the Coal Mine Methane (CMM) resources present in the Valenciennois exploration permit, including the identification of isolated resources not in communication with existing production facilities at Avion or Désirée, was completed by the Company during the period. In conjunction with this work the CBM potential in adjacent coals, expected to be unaffected by mining, was evaluated.

An update of CMM reserves estimates by DMT of Essen was initiated during the period under review. DMT is expected to issue an independent report, detailing the results of the reserves study and stating reserves in PRMS terminology, in the first quarter of 2011.

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LORRAINE

Eastern France

European Gas holds a 100% interest in two permits, covering a major part of the Lorraine Basin. In addition, the Company has recently submitted an application for an additional 360 km² (Lorraine Nord). (see Figure 3.)

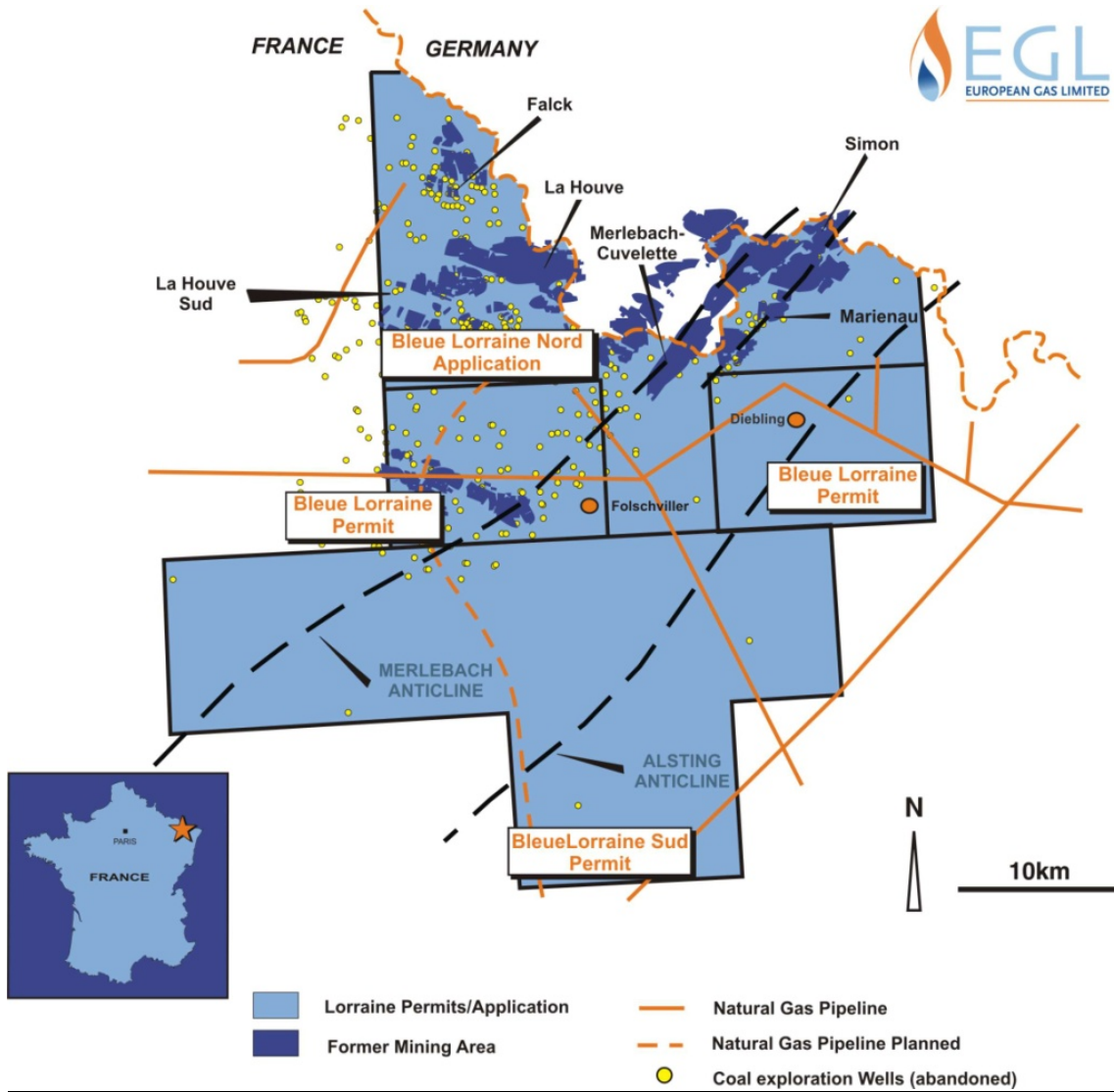


Figure 3: Lorraine Project Location Map

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Exploration Program

During the quarter an independent resource study by MHA Petroleum Consultants on the Alsting Anticline and an independent evaluation of the test results from the Folschviller 2 well was commenced. The scope of work for the study includes a review of the geological model derived from re-processed seismic and use of the model, together with coal thickness and gas content information, to prepare resource estimates. Company exploration personnel continued with the incorporation of previous mine drilling and mapping information to support the independent evaluation of the Alsting structure as well as with the identification of additional targets. The MHA resource study, which covers an area of approximately 110 square kilometres within the 788 square kilometre permit, is scheduled to be completed in the first quarter of 2011.

Well Test Program

MHA was retained by the Company to independently interpret the data from the testing carried out at the Folschviller 2 well. Data from testing the upper lateral in isolation and from the testing of both laterals was reviewed. MHA's analysis of the production test of the upper lateral is encouraging. Interpretation of the buildup portion of the test was complicated by long lasting wellbore storage effects which persisted until shortly before the derivative trace was influenced by the boundaries. Analysis of the very short pseudo-radial flow period between the end of wellbore storage and the onset of boundary influences gave a horizontal permeability of 1.7 mD. As this test was conducted above desorption pressure and produced only water, no gas, the reported permeability of 1.7 mD is absolute horizontal permeability of the coal. Test data was not sufficiently clear to resolve the estimated blended permeability into directional permeabilities. The coals are slightly underpressured with a gradient of 8.86 kPa/m (0.392 psi/ft).

The MHA analysis increases the Company's confidence in previous estimates of the potential performance of horizontal wells in the Lorraine coals. These estimates have been used as the basis for future testing and production plans and are to be reflected in the 2011-2013 budget for continued work in Lorraine.

JURA (LONS-LE-SAUNIER)

Central France

European Gas holds a 100% interest in the Jura (Lons-le-Saunier) permit.

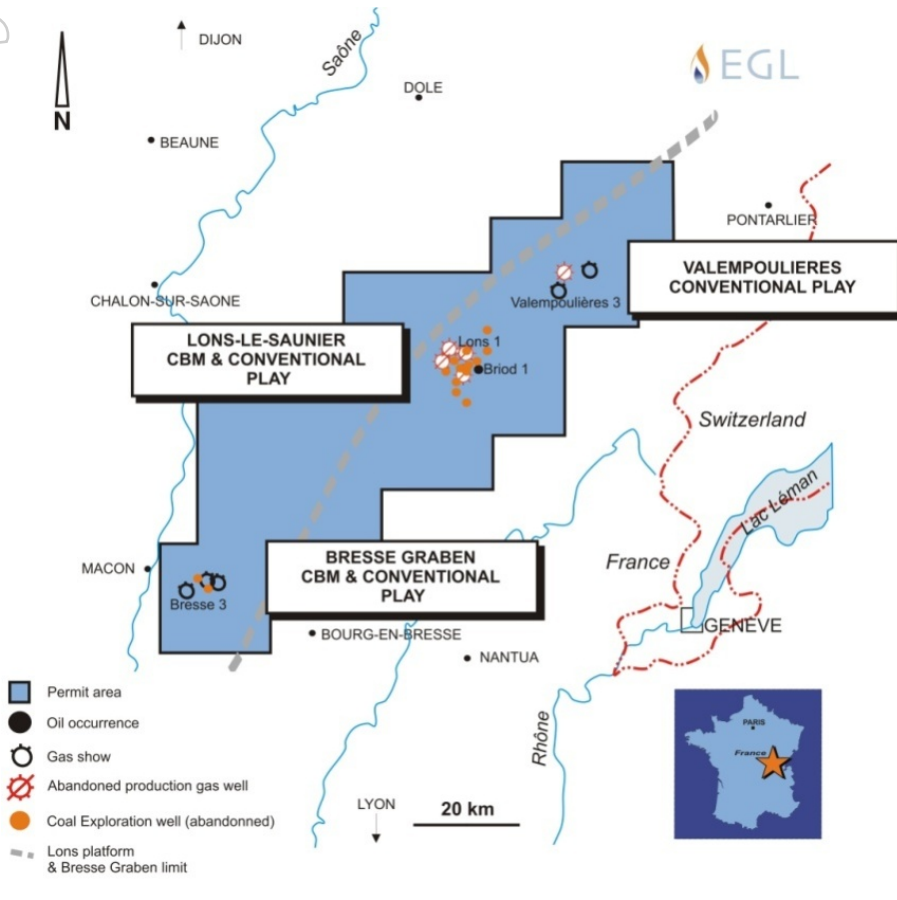


Figure 4: Jura (Lons-le-Saunier) Project Location Map

Exploration Program

The 3,795km² Jura (Lons-le-Saunier) permit contains an undeveloped coalfield with CBM potential, two historically produced conventional natural gas fields, several other conventional gas shows and unconventional oil and gas potential in the Bresse Graben (see Figure 4.). Re-evaluation of seismic and other data indicates potential for additional conventional gas accumulations as well as potential for gas resources within the previously exploited areas.

During the quarter under review the geology model developed in 2009 was improved with more detailed formation tops picked from seismic and analyses of additional well logs. The planned work included evaluation of the remaining resources in the known gas accumulations and identification of potential oil accumulations. The quality of available historical well data did not allow significant improvement in the understanding of the previously produced fields. These targets remain an exploration priority, and planning for new seismic acquisition and for drilling will commence in the first quarter of 2011.

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The potential source and reservoir rocks in the deeper Bresse Graben have been mapped in the parts of the structure covered by re-processed seismic. Formations of interest and structural traps thought to be favourable for both unconventional gas (shale gas) and conventional natural gas are present. The Company is encouraged by the results of the study so far and plans to propose a seismic program covering parts of the Bresse Graben in the near future.

In the area around Lons le Saunier the Stephanian coals are known from previous mining exploration drilling. These coals are identified on re-processed seismic which also shows that there may be coal present outside the drilled area. Plans for 2011 include identification of a location for a well to test the coals and the conventional reservoir potential in conjunction with the seismic program discussed above.

GARDANNE

Southern France

European Gas holds a 100% interest in the “Gaz de Gardanne” permit. The area is within a larger unconventional resource target area which has been the subject of significant permitting interest in the last year.

Exploration Program

A drilling location has been selected to test the coals in an area of the basin where the effects of flooded mine workings will be minimized. Site evaluation and environmental studies for the location were completed during the quarter. A well design and an application for drilling are planned for the first quarter 2011.

BENELUX JOINT VENTURE

Belgium

European Gas holds a 50% interest in a joint venture company created for the purposes of securing title, exploring, developing, extraction and marketing of hydrocarbons including CBM, CMM and conventional oil and gas within Belgium, the Netherlands and Luxembourg (“European Gas Benelux S.A.”).

European Gas Benelux S.A. has applied to the Wallonia Government for a hydrocarbon permit “Hainaut” covering 443 km². The application covers the immediate southern extension of the Wallonia Coal Basin and historical coal mining region. The Basin is the eastern extension of the Nord Pas de Calais Basin in France in which the Company’s Gazonor project is situated. A production permit application has also been submitted for “Anderlues et Perennes” which covers 40 km².

The target for European Gas Benelux S.A. is both CBM and CMM.

SOUTHERN TUSCANY

Italy

Three permit areas covering a total of 1,553 km² have been granted and preliminary environmental impact studies have been submitted to the Regione Toscana. Initial work will commence upon formal notification that the reports have been accepted.

No work was conducted during the quarter.

CANNING BASIN

Western Australia

European Gas holds a Net Well Head Royalty (2% to 3%) over 30,171 km² in the Canning Basin, Western Australia.

CORPORATE

Convertible Notes

During the quarter the Company announced that it had executed an amendment agreement (“the Agreement”) with Transcor Astra Group (“Transcor”), the holder of the Convertible Notes (“the Notes”) issued in 2007. The effect of the Agreement was to extend the maturity of the Notes to the 31st of January 2011.

The Managing Director, Peter Cockcroft noted that “the Agreement was a positive sign and allows the Company to work together with Transcor to reach a favorable arrangement that will allow the Company to continue to grow in the exciting European unconventional gas sector”.

Suspension from Trading

On 24 November 2010 the Company asked that ASX suspend trading in its shares pending resolution of the negotiation with the note holder Transcor. The Company believes that the suspension is in the best interests of shareholders whilst some uncertainty exists. The timeframe for the suspension is dependent upon the outcome of negotiations.

FINANCIALS APPENDIX 5B

At 31 December 2010, the Company had available funds of approximately €1.98 million (AU\$2.61 million).

The attached Appendix 5B highlights the quarter’s cash activities and other relevant financial information.

Outlook

The first quarter in calendar 2011 will be important in the future of the Company as the Board moves to properly fund its exploration program in Europe and capitalise on its extensive and prospective portfolio.

It will require the completion of the current negotiation on refinancing the Convertible Notes.

This Quarterly Activities Report has been compiled for the three months ending 31 December 2010, events subsequent to the end of the quarter which have already been announced by the Company have not been included.

ABOUT EUROPEAN GAS LIMITED

European Gas Limited (ABN 75 075 760 655) is a hydrocarbon explorer/developer with projects in western Europe. The strategy of the Company is to develop Coal Bed Methane and Coal Mine Methane projects, in particular, in France where the Company with major holdings under licence holds a significant competitive advantage.

The western European natural gas market is substantial with advanced infrastructure, including extensive pipeline networks and a free and open market.

The Company also holds hydrocarbon royalties in the Canning Basin of Western Australia.

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Appendix 5B

Mining exploration entity quarterly report

Introduced 1/7/96. Origin: Appendix 8. Amended 1/7/97, 1/7/98, 30/9/2001.

Name of entity

EUROPEAN GAS LIMITED

ABN

75 075 760 655

Quarter ended ("current quarter")

31 December 2010

Consolidated statement of cash flows

Cash flows related to operating activities		Current quarter 3 months €'000	Year to date 6 months €'000
1.1	Receipts from product sales and related debtors	1,557	3,438
1.2	Payments for		
	(a) exploration and evaluation	-	-
	(b) development	-	-
	(c) production	(1,000)	(2,951)
	(d) administration	(960)	(1,454)
1.3	Dividends received	-	-
1.4	Interest and other items of a similar nature received	21	24
1.5	Interest and other costs of finance paid	(87)	(604)
1.6	Taxes paid	(14)	(34)
1.7	Other	-	-
	Net Operating Cash Flows	(483)	(1,581)
Cash flows related to investing activities			
1.8	Payment for purchases of:		
	(a) prospects	-	-
	(b) equity investments	-	-
	(c) other fixed assets	-	-
1.9	Proceeds from sale of:		
	(a)prospects	-	-
	(b)equity investments	15	15
	(c)other fixed assets	-	-
1.10	Loans to other entities	-	-
1.11	Cash assets acquired	-	-
1.12	Other	-	-
	Net investing cash flows	15	15
1.13	Total operating and investing cash flows (carried forward)	(468)	(1,566)

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Appendix 5B
Mining exploration entity quarterly report

1.13	Total operating and investing cash flows (brought forward)	(468)	(1,566)
	Cash flows related to financing activities		
1.14	Proceeds from issues of shares, options, etc.	-	2,100
1.15	Proceeds from sale of forfeited shares	-	-
1.16	Proceeds from borrowings	-	-
1.17	Repayment of borrowings	-	-
1.18	Dividends paid	-	-
1.19	Convertible notes (refer Note 6)	-	-
1.20	Other	-	-
	Net financing cash flows	-	2,100
	Net increase (decrease) in cash held	(468)	534
1.21	Cash at beginning of quarter/year to date	2,584	1,549
1.22	Exchange rate adjustments to item 1.21	(137)	(104)
1.23	Cash at end of quarter	1,979	1,979

Payments to directors of the entity and associates of the directors

Payments to related entities of the entity and associates of the related entities

		Current quarter €'000
1.24	Aggregate amount of payments to the parties included in item 1.2	80
1.25	Aggregate amount of loans to the parties included in item 1.10	

1.26	Explanation necessary for an understanding of the transactions
	Directors remuneration

Non-cash financing and investing activities

2.1	
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2.2	
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+ See chapter 19 for defined terms.

Financing facilities available

Add notes as necessary for an understanding of the position. ⁽¹⁾

		Amount available €'000	Amount used €'000
3.1	Loan facilities Yorkville Advisors LLC – Equity Funding Facility (Limit of AUD\$10m undrawn at 31 March 2010)	7,121	-
	High Net Worth Private Investor - AUD\$2.5m <i>(Note this short term loan is repayable on 31 March 2011 and at present the Financier has indicated its support for the Company and will consider refinancing options)</i>	-	1,701
3.2	Credit standby arrangements	-	-

Estimated cash outflows for next quarter

		€'000
4.1	Exploration and evaluation	-
4.2	Development	-
4.3	Production	1,200
4.4	Administration	1,350
	Total <i>(refer Note 7.)</i>	2,550

Reconciliation of cash

Reconciliation of cash at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts is as follows.		Current quarter €'000	Previous quarter €'000
5.1	Cash on hand and at bank	1,979	2,584
5.2	Deposits at call	-	-
5.3	Bank overdraft	-	-
5.4	Other (provide details)	-	-
Total: cash at end of quarter (item 1.22)		1,979	2,584

Changes in interests in mining tenements

		Tenement reference	Nature of interest (note 2)	Interest at beginning of quarter	Interest at end of quarter
6.1	Interests in mining tenements relinquished, reduced or lapsed				
6.2	Interests in mining tenements acquired or increased				

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Appendix 5B
Mining exploration entity quarterly report

Issued and quoted securities at end of current quarter

Description includes rate of interest and any redemption or conversion rights together with prices and dates.

		Total number on issue	Total Number quoted	Issue price per security (see note 3) (AU\$)	Amount paid up per security (see note 3) (AU\$)
7.1	Preference *securities <i>(description)</i>				
7.2	Changes during quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs, redemptions				
7.3	*Ordinary securities	238,944,359	238,944,359	-	-
7.4	Changes during quarter (a) Increases through issues Ordinary shares				
7.5	*Convertible debt securities Tranche A Tranche B <i>(refer to note 6)</i>	14,500 notes 9,750 notes			
7.6	Changes during quarter (a) Increases through issues (b) Decreases through securities matured, converted				
7.7	Unquoted options Contractor options CEO Options	<u>Number</u> 2,000,000 1,500,000 3,000,000 10,000,000	<u>Quoted</u> Nil Nil Nil Nil	<u>Exercise price</u> \$2.50 \$0.35 \$0.50 \$0.70	<u>Expiry date</u> 15/04/2012 31/12/2011 31/12/2012 31/12/2012
7.8	Issued during quarter CEO Options	<u>Number</u> 1,500,000 3,000,000 10,000,000	<u>Quoted</u> Nil Nil Nil	<u>Exercise price</u> \$0.35 \$0.50 \$0.70	<u>Expiry date</u> 31/12/2011 31/12/2012 31/12/2012
7.9	Exercised during quarter	<u>Number</u>	<u>Quoted</u>	<u>Exercise price</u>	<u>Expiry date</u>
7.10	Lapsed during quarter Employee / Contractor options	<u>Number</u>	<u>Quoted</u>	<u>Exercise price</u>	<u>Expiry date</u>
7.11	Debentures <i>(totals only)</i>				
7.12	Unsecured notes <i>(totals only)</i>				

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Compliance statement

- 1 This statement has been prepared under accounting policies which comply with accounting standards as defined in the Corporations Act or other standards acceptable to ASX (see note 4).
- 2 This statement does give a true and fair view of the matters disclosed.



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Mark Pitts
(Company Secretary)

Date 7 February 2011

Notes

- 1 The quarterly report provides a basis for informing the market how the entity's activities have been financed for the past quarter and the effect on its cash position. An entity wanting to disclose additional information is encouraged to do so, in a note or notes attached to this report.
- 2 The "Nature of interest" (items 6.1 and 6.2) includes options in respect of interests in mining tenements acquired, exercised or lapsed during the reporting period. If the entity is involved in a joint venture agreement and there are conditions precedent which will change its percentage interest in a mining tenement, it should disclose the change of percentage interest and conditions precedent in the list required for items 6.1 and 6.2.
- 3 **Issued and quoted securities** The issue price and amount paid up is not required in items 7.1 and 7.3 for fully paid securities.
- 4 The definitions in, and provisions of, *AASB6 Exploration for and Evaluation of Mineral Resources* and *AASB107: Cash Flow Statements* apply to this report.
- 5 **Accounting Standards** ASX will accept, for example, the use of International Accounting Standards for foreign entities. If the standards used do not address a topic, the Australian standard on that topic (if any) must be complied with.
- 6 **Convertible Notes** – The Convertible Notes are secured with a face value of €1,500, and at the end of the Quarter had an agreed extended maturity date of 31 January 2011. The notes carry a coupon rate of 5% up until 31 December 2010 and then 7% until the maturity date. Upon conversion, Tranche A and Tranche B would convert to approximately 55 million fully paid ordinary shares in the Company subject to customary adjustment provisions.
- 7 The estimated cash outflows shown at (4.1 – 4.4) exceed available cash at the end of the quarter (1.23) however this does not account for the cash to be generated from gas sales (1.1)

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