State Gas Limited
(ACN 617 322 488)
GPO Box 10348
BRISBANE QLD 4001

ASX RELEASE
(**ASX: GAS**)

16 April 2020

Letter to Shareholders

Dear Fellow Shareholders,

Target 2021 – Gas-to-Market Plan

We are living in unprecedented times, and I am writing to you to provide an update on our Company's position within this dynamic environment. As an overarching observation, we are very fortunate to be operating from a position of 100% ownership of a well-located gas field in Central Queensland in the advanced stages of appraisal.

As you are aware, your Company has embarked on a project aimed at placing the Company in a position to produce Sales Gas by the end of calendar year 2021. To this end State Gas Limited ("State Gas" or "the Company") successfully drilled Aldinga East-1A, placed Nyanda-4 on production test (with very encouraging results so far), and commenced the process of production testing Serocold-1[1].

Your Company has assessed its situation in the current context and is tightly focussing its near term activities on those most likely to build reserves and hence company value, while at the same time moving the Company towards achieving gas to market as soon as possible. In addition, we have restructured Board and management remuneration and, where possible, negotiated reductions from suppliers.

Our program is focussed on obtaining the production data from the field which is vital to determination of the parameters of the commercial project (eg gas and water production profiles) through production testing of the Nyanda-4 and Serocold-1 wells. The production testing we commenced late last year was interrupted by extensive flooding at the Project site during the previous Quarter, however we have recently re-gained access. With weather forecasts now promising the site access road has been repaired and a rig is currently on site replacing the pumping mechanisms on the wells. Both Nyanda-4 and Serocold-1 are expected to be dewatering again by the end of this month, and we are looking forward to the continuation of the encouraging production testing results we received earlier this year.

Your Board is very positive about your Company's prospects. While external conditions are currently challenging, your Board believes that a number of those challenges create opportunities that State Gas is well placed to exploit. Recent events have impacted our plan to achieve First Gas, now delayed to 2022, but your Board believes this new timing will place the Company in a "sweet spot" for gas deliveries into the East Coast market.

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[1] ASX Announcement 12 February 2020

This is because of the interaction of the following dynamics:

1. Future Eastern Seaboard gas production;
2. The Asian LNG market prognosis;
3. The impact of the Asian LNG market on the domestic market; and
4. The general impact of low oil prices.

Future Australian Gas Production

The recently released Australian Energy Market Operator's ("AEMO") report *Gas Statement of Opportunities 2020*[2] has confirmed the decline in gas production from Bass Strait to which I alluded last year in one of my first presentations as Executive Chairman of State Gas[3].

AEMO's 2020 forecast of gas supply and demand over the next 35 years is shown in the chart below. However, this supply forecast was made prior to recent announcements by major domestic gas players deferring or curtailing exploration, appraisal and development projects. The impact of these decisions will not be felt until calendar year 2022. The yellow wedge in the graph below is therefore at risk.

The AEMO 2020 forecast also precedes the current "hibernation" brought on in response to the Coronavirus crisis, and this will undoubtedly affect gas demand. However Australian gas demand will return, perhaps not fully for some time, but in the view of your Board demand will return more quickly than the "lost" supply will be made up. Your Board believes that by 2022 the demand reduction will likely be less than the decrease in supply, and thus by late 2022 there will be an urgent need for new east coast gas supplies.

The Asian LNG Market Prognosis

In 2019, according to the recently released Shell LNG Outlook 2020[4], global LNG demand grew by a whopping 12.5%. In the same period the International Energy Agency ("IEA") records a less than 4% increase in global oil demand on a total of 99.1 million barrels[5]. In other words, LNG demand grew during 2019 more than three times as fast as oil demand. Further disparity in growth seems likely in this Coronavirus impacted world, with oil demand much more impacted by declines in non-essential transport. Yet long-term LNG pricing remains tied to oil pricing - ignoring market reality. How long can gas pricing remain dependent on oil prices?

LNG demand in our region is primarily driven by the industrial output of four major economies: China, Japan, South Korea and Taiwan. All of these countries appear to have managed the Coronavirus pandemic either earlier, or better, than Western economies. Whilst the timing of the recovery of industrial output in those countries will not be simultaneous, it will most likely be sooner rather than later.

It is also relevant that the economic shock occasioned by the COVID-19 virus was not preceded by an industrial inventory build-up as has been commonly the case in past recessions, but rather, has been accompanied by supply chain shortages. The result may be that these supply chain shortages help a quicker recovery in industrial output when health issues allow. This would result in a commensurate recovery in LNG demand and pricing.

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[2] https://aemo.com.au/-/media/files/gas/national_planning_and_forecasting/gsoo/2020/2020-gas-statement-of-opportunities.pdf?la=en

[3] QUPEX 8 October 2019

[4] https://www.shell.com/energy-and-innovation/natural-gas/liquefied-natural-gas-lng/lng-outlook-2020.html#iframe=L3dlYmFwcHMvTE5HX291dGxvb2sv

[5] https://www.iea.org/

At the end of 2019 there was a record number of new LNG projects either reaching or approaching FID for supply in the back half of the 2020s, however in the last few weeks several of these have been cancelled or deferred. The *Australian Financial Review* noted last week[6] that over $80 billion worth of LNG projects in Australia and PNG alone have been so affected. This further suggests a tightening of Asian LNG markets as this decade progresses.

LNG Impact on the Domestic Gas Market

It is a fact that that the Australian East Coast domestic gas market is linked to the LNG market, and this was apparent in the redirection of Queensland gas from the spot LNG market to the domestic market early this year, as the COVID-19 pandemic slowed Asian industrial demand. Naturally, the converse should apply when the demand growth I refer to above causes the Asian LNG spot market price to increase. Growing LNG export demand may well coincide with gas shortages at home.

World-wide Impact of Lower Oil Prices

Oil prices are now at historic lows, and while the Easter weekend has seen Russia and the Saudis agree to cut production, it must surely be unlikely that prices will regain the 65% drop since the beginning of this year. The consequence may well be a long-term impact on oil shale production in the USA, as oil shale needs sustaining capital investment. Testimony to the short-term impact is the 40% decline over 12 months in the number of operating rigs in North America[7], as well as companies such as Whiting Petroleum (a major US oil services supplier) filing for Chapter 11 insolvency protection earlier this month[8]. A substantial proportion of US gas production is a by-product of the production of oil shale, and a continued decline in oil shale will impact US gas supplies. A reduction in US gas exports can be expected, as can the deferral or cancellation of US LNG projects that had been slated for FID[9]. Will this be an end to the Henry Hub / LNG spot arbitrage as we know it?

The economic impact of this dynamic may be currently masked by the Coronavirus-related decline in industrial output. However your Board believes that while oil prices will improve from the early April lows, they will remain at a level that could impact US production for longer than any downturn caused by the Coronavirus**.**

Conclusion

It will be apparent that in the view of your Board the combination of:

1. a decrease of Bass Strait gas production, together with the curtailment of capital on the appraisal and development of new sources of domestic gas supply; and
2. the rebound in industrial output in China, Japan, South Korea and Taiwan, combined with reduced US LNG exports,

should result in market conditions for domestic gas in late 2022 that are very different from those existing now. And serendipitously, by continued progression of our Project, your

[6] AFR 9 April 2020

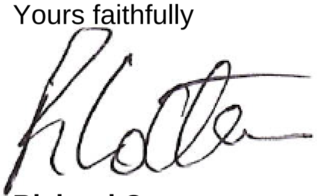
[7] Baker Hughes North America Rig Count: https://rigcount.bakerhughes.com/na-rig-count

[8] http://whiting.com/investor-relations/press-releases/

[9] World Oil News March 15 2020: https://www.worldoil.com/news/2020/3/13/oil-s-crash-is-both-a-help-and-a-hazard-for-lng-export-projects

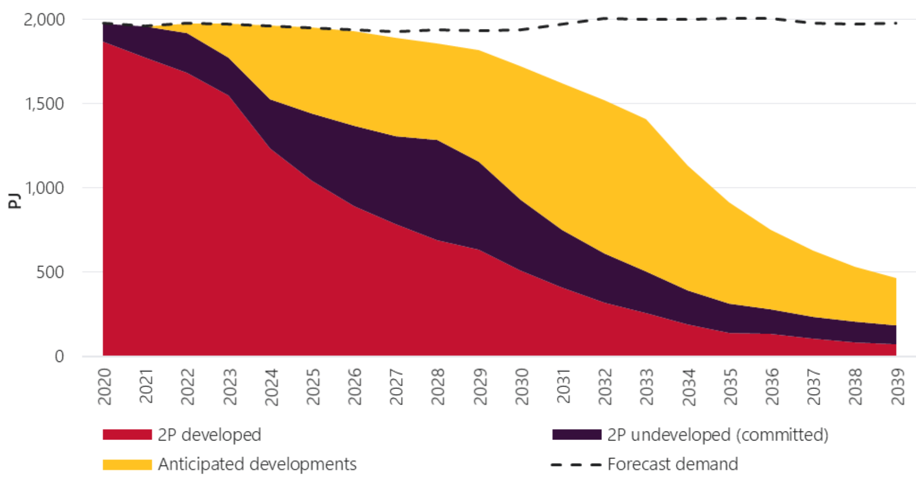
Company anticipates being positioned to deliver Reid's Dome gas into that market at just that time. We look forward to the opportunity!

Yours faithfully



Richard Cottee
Executive Chairman
STATE GAS LIMITED

Projected eastern and south-eastern Australia gas production (existing projects, and committed and anticipated developments, Central scenario, 2020-39



Source: Australian Energy Market Operator Gas Statement of Opportunities 2020

This announcement was approved for release by Richard Cottee, Executive Chairman.

ENDS

FOR FURTHER INFORMATION

Richard Cottee
Executive Chairman
P: 0458 517 850
E: richard@stategas.com

Lucy Snelling
Chief Executive Officer
P: 0439 608 241
E: lucy@stategas.com

www.stategas.com