



# Eurogas Corporation

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

Eurogas Corporation ("Eurogas" or the "Corporation") is a Canadian-based company whose common shares trade on the TSX Venture Exchange ("TSXV") under the symbol EUG. Eurogas is focused on creating long-term value through the development of high-impact energy projects. The Corporation holds interests, both directly and indirectly, in the largest accumulation of producing oil and natural gas assets in Ontario, the development of an underground natural gas storage facility in Spain and through a preferred share interest in certain exploration and evaluation programs for oil and natural gas located offshore of Tunisia.

**This interim management's discussion and analysis has been prepared with an effective date of July 27, 2010, and provides an update on matters discussed in, and should be read in conjunction with the audited consolidated financial statements of the Corporation, including the notes thereto, as at and for the year ended December 31, 2009 (the "2009 Audited Consolidated Financial Statements") and the unaudited interim consolidated financial statements as at and for the three and six months ended June 30, 2010 (the "June 2010 Interim Consolidated Financial Statements"). All amounts are in Canadian dollars unless otherwise specified. Financial data has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), unless otherwise specified.**

### FORWARD-LOOKING STATEMENTS

Certain information set forth in this document, including management's assessment of the Corporation's future plans and operations, contains forward-looking statements. Forward-looking statements are statements that are predictive in nature, depend upon or refer to future events or conditions or include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates" or similar expressions. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Corporation's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management and labour and labour relations generally, health and safety risks, stock market volatility, the ability to access sufficient capital from internal and external sources, and other risk factors discussed or referred to in the section entitled "Business Risks" in the Corporation's management's discussion and analysis accompanying its 2009 Audited Consolidated Financial Statements, as updated herein and other documents filed from time to time with the securities administrators, all of which may be accessed at [www.sedar.com](http://www.sedar.com). Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. The Corporation's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what resulting benefits the Corporation will derive. The Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

### ACQUISITION OF ONTARIO OIL AND GAS ASSETS

On June 29, 2010, Dundee Energy Limited Partnership (the "Partnership"), a wholly-owned limited partnership of the Corporation, acquired a 95% working interest in onshore oil properties and a 65% working interest in offshore gas properties, all located in and around Lake Erie, Ontario (the "Acquisition"). As part of the Acquisition and through the ownership of the Partnership, the Corporation also acquired a 65% interest in certain other tangible assets, including drilling and completion vessels, gas plants and compressor stations and a 100% interest in oil storage tanks. The Acquisition also provides for ownership of certain seismic data. The Corporation paid \$133,048,280 to acquire the assets, subject to final closing adjustments estimated to be between \$2 million and \$4 million.

The initial acquisition price as announced in April 2010 was \$131 million. To this number we must add the expenses related to the Acquisition amounting to \$5,556,088. This amount includes interest of \$1,324,715, post closing costs of \$1,031,502 and legal and advisory costs of \$2,768,679.

During the period from March 1, 2010 to May 31, 2010 we earned, net of taxes \$3,507,808 and as such we have an adjusted the purchase price of \$133,048,280 and we have yet to receive the income to our account for the month of June 2010.

The allocation of the cash consideration to the various net assets acquired was based on a preliminary assessment of their underlying fair values and is summarized below:

<b>Net assets acquired</b>	
Oil and natural gas rights	\$ 113,424,767
Other tangible assets	27,373,096
Asset retirement obligation	(7,291,083)
Future income tax liability	(458,500)
	\$ 133,048,280

The assets, all located in and around Lake Erie in Ontario, include a 95% working interest in 65,000 acres of onshore oil properties as well as a 65% working interest in 902,000 acres of offshore gas properties. Current net production volumes from these assets include 706 barrels per day (“bpd”) of 42° API oil and condensate as well as 11.6 million cubic feet per day (MMcf/d) of natural gas. Combined, this represents net production volumes of 2,639 barrels of oil equivalent per day<sup>1</sup> (boed), generating an estimated approximate \$25 million of cash flows per annum, even at current low gas prices. The Acquisition provides the Corporation with a stable foundation of high netback production with significant low risk development potential.

Management, together with independent qualified reserves evaluators and engineers estimate proved reserves of 66 billion cubic feet of gas with a reserve life index<sup>2</sup> of 16.3 years as well as 2 million barrels of oil with a reserve life index of 6.9 years.

As part of the Acquisition, the Corporation acquired a 65% ownership interest in certain other assets including an offshore fleet of drilling and completion vessels, three gas plants and three compressor stations, all located onshore, and a 100% interest in four oil batteries. The Acquisition also provides for ownership or licensing of 14,680 km of 2-D seismic and 431 km<sup>2</sup> of 3-D seismic.

The Acquisition provides the Corporation with potential growth opportunities, including a significant number of development drilling locations, as well as opportunities for well re-completions and the optimization of the existing infrastructure system. Importantly, our quest to acquire these assets includes the potential for the development of gas storage reservoirs, the feasibility of which we are currently evaluating.

Part of the purchase price was funded using the Corporation’s cash and short term investments. The balance of the funding was provided by a bank loan revolving credit facility from a banking syndicate (see “Liquidity and Capital Resources”).

<sup>1</sup> Calculated at a barrel of oil (boe) conversion ratio of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf to 1 bbl), based on an energy equivalency conversion method which is primarily applicable at the burner tip and does not always represent a value equivalency at the wellhead.

<sup>2</sup> Reserve life index was determined by dividing proved reserves at the expected acquisition date by expected annual production. For greater certainty, the reserve life index included only proved reserves and does not include probable or possible reserves.

## **SPANISH UNDERGROUND GAS STORAGE PROJECT**

The Corporation's 73.7% owned subsidiary, Castor UGS Limited Partnership ("CLP"), holds a 33% interest in the Castor Exploration Permit through its investment in Escal UGS S.L. ("Escal"), providing the Corporation a 24.6% interest. The Castor Exploration Permit is owned directly by Escal and covers the abandoned Amposta oil field, which will be utilized by Escal for its Castor underground gas storage project ("Castor Project"). On June 15, 2008, the exploration permit was replaced by a development concession, which allows Escal to construct and utilize the Castor Project (the "Development Concession"). Upon completion, the Castor Project and facility will become a regulated utility forming a crucial element of Spain's energy infrastructure.

CLP has entered into agreements with ACS Servicios Comunicacions y Energia S.L. ("ACS") and Enagas, S.A. pursuant to which ACS acquired a 66.7% interest in Escal. In turn, Enagas S.A., the technical manager of the gas system and common carrier for the high pressure gas network in Spain, will acquire 50% of ACS's interest in Escal at commissioning and start-up of the Castor Project, subject to certain terms and conditions.

### **The Castor Underground Gas Storage Project**

The Castor Project and facility will provide Spain with urgently needed gas storage capacity by converting the abandoned Amposta oil field to gas storage operations. The project consists of an underground gas storage reservoir that lies at a depth of 1,800 metres, approximately 21 kilometres off the east coast of Spain in the Mediterranean Sea; two offshore platforms for 13 wells and processing facilities; an onshore compression and processing plant located in the municipality of Vinaroz and an adjoining 30-inch pipeline. The estimated cost of the Castor Project is €1.3 billion (Cdn\$1.7 billion). On July 22, 2010, Escal announced that it had entered into a project financing arrangement with a syndicate of banks to support the cost of the Castor Project (see "Liquidity and Capital Resources – Spain, Financing Status of the Castor Project"). Gas injection is scheduled to begin in 2012.

The Castor underground gas storage facility's anticipated working gas storage capacity of 1.3 billion cubic metres is expected to provide a reserve for seasonal and extraordinary peak demands, as well as the ability to respond to normal daily peak demands. The facility's anticipated high delivery rate of 25 million cubic metres per day will contribute strategic storage and reliability of supply to industrial and domestic customers in Spain.

### ***Regulator and Remuneration Regime***

Remuneration for underground gas storage includes three components: repayment of capital, return on investment and payment for operating and maintenance expenses. The capital cost of the project is returned in equal payments over the useful life of the asset, which is set at 10 years for all facilities except for the cushion gas, which is set at 20 years. A provisional remuneration regime may be implemented for the period between the granting of the Development Concession and the start-up of the facility, which would provide early cash flow. At the end of the useful life, the "cost of extension of useful life" payment commences at half the rate that was paid in the last year of the useful life and continues for the remaining period of the Development Concession (30 years plus two extensions of 10 years each).

Return on investment is based on the net investment multiplied by the remuneration rate. The remuneration rate is equal to the Spanish government's 10-year bond rate plus 3.5% and is set for the full useful life of the facility. As with repayment of capital, at the end of the useful life, the "cost of extension of useful life" payment will commence at half the rate that was paid in the last year of useful life and continues for the remaining period of the Development Concession. Payment for operating and maintenance includes both a fixed component and a variable component and is designed to cover actual operating and maintenance costs.

The Development Concession for the Castor Project, which was granted in 2008, was the primary regulatory approval needed to develop the Castor Project. Following receipt of the Development Concession, Escal applied for a series of secondary permits, all of which have now been received.

### ***Onshore Site***

The local authorities approved the site for the proposed onshore facilities in early 2008 and Escal has completed the procurement of land. The routing of the subsea pipeline from the shore to the site of the onshore facilities has been established and the necessary right of ways were granted. Earth works commenced mid-February of the current year.

### ***Engineering, Procurement, Construction (“EPC”)***

Escal has submitted its budget to the Ministry of Industry with planned spending of \$1.6 billion (€1.2 billion) which may be revised from time to time. As at June 30, 2010, \$611 million (€469 million) has been spent. The budget outlines spending for permitting, engineering, procurement and land acquisition. ACS, in its capacity as the overall EPC contractor, has awarded most of the major contracts, including the EPC and the transportation of the two offshore platforms, namely, the wellhead platform and the process platform, the drilling of 12 offshore wells, and the EPC of the onshore facilities. EPC contracts are pending for the installation of the onshore and offshore pipelines. The Corporation has no further expenditure obligations to maintain its 24.6% interest.

Detailed engineering for all facets of the project is underway. The tubulars required for the drilling of the wells have been procured and delivery is expected shortly.

Enagas S.A. has contracted and will pay for the construction of the pipeline needed to connect the Castor onshore facility to the national gas pipeline grid.

Construction is advancing, including construction of the process platform. Following completion of the process platform, which is expected in the third quarter of 2010, Escal will initiate a 12 well drilling program. Commencement of pipeline construction is scheduled for the fourth quarter of this year. The targeted completion date for the Castor Project is mid-2012.

### **PREFERRED SHARE INTEREST IN EUROGAS INTERNATIONAL INC.**

The Corporation holds a \$32,150,000 preferred share interest in Eurogas International Inc. (“Eurogas International”). Although the Corporation’s investment in Eurogas International is strictly limited to the preferred shares and the Corporation does not hold any common shares in Eurogas International, the nature of the Corporation’s preferred share investment requires the consolidation of the accounts of Eurogas International as it is considered a variable interest entity pursuant to Canadian GAAP. The nature of the preferred shares limits the value of the Corporation’s interest in Eurogas International to the face value of the preferred shares and any accrued interest thereon.

Eurogas International entered into a joint operating agreement with Atlas Petroleum Exploration Worldwide Ltd. (“APEX”), to undertake exploration, evaluation and extraction operations pursuant to the working interest awarded to them in the 1.0 million acre Sfax Offshore Exploration Permit (the “Sfax Permit”). APEX is the operating partner in the joint venture arrangement and owns 55%, while Eurogas International’s position is 45%.

During the three and six months ended June 30, 2010, an aggregate of \$0.8 million and \$2.0 million, respectively (three and six months ended June 30, 2009 - \$2.0 million and \$2.1 million, respectively) was capitalized to deferred exploration costs. The estimated budget for the Sfax Permit and the associated Ras-El-Besh Concession during the remainder of 2010, is US\$1.8 million, of which Eurogas International is responsible for its net share of US\$0.8 million.

During the second quarter of 2010, Eurogas International settled previously announced arbitration proceedings with Seawolf Oilfield (Cyprus) Limited and Seawolf Oilfield Services Limited for US\$12 million to be received by Eurogas International over an 18 month period. The settlement is secured by a bank guarantee from a recognized international bank. Eurogas International’s share of the proceeds will range from US\$2.7 million or 22.5% to

US\$5.4 million or 45%, subject to final determination under its joint venture agreement. Settlement proceeds, when received, will be recorded as a reduction in the carrying value of Eurogas International's interest in the deferred exploration costs.

Eurogas International completed the drilling of the Ras-El-Besh ("REB-3") well in 2008. Upon completion of drilling and testing, the joint venture partners obtained approval to temporarily suspend the well and release the drilling rig. Agreement by the Tunisian government was subject to the reinterpretation and remapping of seismic data, after which the joint venture partners must decide to either reenter or abandon the well. This assessment is currently being conducted. In the event of abandonment, the total cost to the joint venture is estimated to be between US\$6.5 million to US\$10 million. Actual costs will depend on factors such as the mobilization and demobilization cost of the rig and prevailing rates.

Additional information regarding Eurogas International may be accessed at [www.eurogasinternational.com](http://www.eurogasinternational.com).

## **CONSOLIDATED RESULTS OF OPERATIONS**

### **The six months ended June 30, 2010 compared with the six months ended June 30, 2009**

The Corporation and Eurogas International's current projects in both Spain and Tunisia are in the development, exploration and evaluation stage and therefore no operating revenues are currently generated from these activities. The Corporation's recent acquisition of oil and natural gas assets in Ontario legally closed on June 29, 2010, and is expected to generate operating revenues in the second half of 2010.

The Corporation incurred a net loss during the six months ended June 30, 2010 of \$2.3 million or approximately \$0.01 loss per share, compared with a net loss of \$1.5 million or approximately \$0.01 loss per share, incurred during the six months ended June 30, 2009.

During the six months ended June 30, 2010, the Corporation earned revenues of \$0.2 million (six months ended June 30, 2009 - \$1.0 million) which consisted primarily of interest revenue earned on the Corporation's cash and short term investments. The decrease in revenues reflects both lower levels of cash and short term investments as well as a decrease in the average interest rates earned thereon.

General and administrative expenses incurred during the six months ended June 30, 2010 were \$2.4 million, an increase of \$0.4 million over general and administrative expenses of \$2.0 million during the six months ended June 30, 2009. The increase reflects higher professional fees, including legal and consulting fees, incurred in the first six months of 2010 compared with the same period of 2009. Professional fees in the six months ended June 30, 2010, include \$0.6 million relating to Eurogas International's ongoing involvement in the Seawolf Litigation (see "Preferred Share Interest in Eurogas International Inc. - The Seawolf Litigation").

Depreciation and accretion expense during the six months ended June 30, 2010 was \$55,192 compared with \$307,419 incurred in the six months ended June 30, 2009, and included amounts related to the mobile offshore production unit and to the reclamation costs associated with the REB-3 well.

The Corporation accounts for its investment in Escal using the equity method. Accordingly, the Corporation is required to include in its net earnings and comprehensive income, an amount equal to its proportionate share of the results of operations and comprehensive income generated by Escal. During the six months ended June 30, 2010, the Corporation recognized equity earnings of \$4,958 (six months ended June 30, 2009 - loss of \$19,351). In addition, included in other comprehensive income for the six months ended June 30, 2010, is a foreign exchange loss of \$295,674 (six months ended June 30, 2009 - loss of \$41,971), representing the Corporation's share of foreign exchange adjustments incurred on the translation of Escal's operations to Canadian dollars, net of taxes.

## SELECTED QUARTERLY FINANCIAL INFORMATION

	Quarter ended:			
	30-Jun-10	31-Mar-10	31-Dec-09	30-Sep-09
Revenues	\$ 76,847	\$ 101,627	\$ 176,232	\$ 314,898
<b>Net loss</b>				
Operations	(1,384,827)	(1,035,761)	(962,344)	(793,506)
Equity participation	(893)	5,851	(3,887)	(1,641)
Non-controlling interest	63,484	65,628	45,019	38,768
	(1,322,236)	(964,282)	(921,212)	(756,379)
Funds used in (provided by) operations	1,250,968	(1,571,110)	(674,045)	(2,193,385)
Capital expenditures	806,629	1,225,008	261,332	951,484
Basic and fully diluted loss per share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ -

	Quarter ended:			
	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08
Revenues	\$ 494,463	\$ 535,264	\$ 584,938	\$ 537,588
<b>Net (loss) earnings</b>				
Operations	(967,850)	(591,984)	1,471,404	(1,897,397)
Equity participation	-	(19,351)	13,030	(10,543)
Non-controlling interest	66,733	32,067	(235,645)	343,995
	(901,117)	(579,268)	1,248,789	(1,563,945)
Funds used in (provided by) operations	445,270	(870,982)	(347,761)	160,225
Capital expenditures	1,853,121	267,880	1,704,905	325,687
Basic and fully diluted (loss) earnings per share	\$ (0.01)	\$ -	\$ 0.01	\$ (0.01)

## CONSOLIDATED RESULTS OF OPERATIONS

### The three months ended June 30, 2010 compared with the three months ended June 30, 2009

The Corporation incurred a net loss during the three months ended June 30, 2010 of \$1.3 million, or approximately \$0.01 loss per share compared with a net loss of \$0.9 million in the same period of the prior year, or approximately \$0.01 loss per share.

Interest revenue earned during the three months ended June 30, 2010 was \$0.1 million compared with \$0.5 million earned in the same period of the prior year. Consistent with the decrease in year-over-year interest revenues, this decrease reflects both lower levels of cash and short term investments as well as a decrease in the average interest rate earned on these funds.

General and administrative expenses incurred during the three months ended June 30, 2010 were \$1.3 million, an increase of \$0.1 million over general and administrative expenses of \$1.2 million incurred during the three months ended June 30, 2009. Increases in general and administrative costs reflect \$0.2 million of costs incurred during the second quarter of the current year pertaining to the Seawolf Litigation (see "Preferred Share Interest in Eurogas International Inc. - The Seawolf Litigation").

## LIQUIDITY AND CAPITAL RESOURCES

### **Cash Resources Availability**

At June 30, 2010, the Corporation had consolidated cash and short term investments aggregating \$3.4 million. Included in the Corporation's consolidated cash and short term balances is \$1.4 million held directly by Eurogas International.

On June 29, 2010, and in connection with the acquisition of the Ontario oil and natural gas assets, the Corporation's limited partnership established for the purpose of holding the Ontario oil and natural gas assets, arranged for the establishment of an \$80 million credit facility, including a \$20 million operating facility. The credit facility was placed with a banking syndicate of Canadian chartered banks. The credit facility is structured as a revolving demand loan, and is subject to a tiered interest rate structure that varies based on the net debt to cash flow ratio generated from the Ontario oil and natural gas assets. The interest rate is initially set at prime plus 3% for loans and letters of credit or, for bankers' acceptances, at the bankers' acceptance rate plus 4%.

At June 30, 2010, the Corporation had drawn \$63.9 million against the credit facility and, as required by statute, it had further issued a letter of credit for \$3.3 million in favour of the Ministry of Natural Resources in connection with future abandonment costs.

The Corporation anticipates that it will generate sufficient cashflow to support its ongoing working capital requirements.

### **Spain**

ACS is responsible for providing equity and arranging project financing for the Castor Project, including providing all guarantees that may be required, from the day it became a majority shareholder of Escal for all development and construction through to the inclusion of the underground storage facility into the Spanish gas system. After the system is operational, the Corporation will be responsible for its proportionate share of any new capital investments which we expect will be covered by the Corporation's revenue. Escal has submitted its budget to the Ministry of Industry with planned spending of \$1.6 billion (€1.2 billion) which may be revised from time to time. As at June 30, 2010, \$611 million (€469 million) has been spent.

#### *Financing Status of the Castor Project*

In 2009, Escal and its shareholders engaged a group of banks to lead a process to obtain project financing for the construction and commissioning of the Castor offshore and onshore facilities including pipelines, interest and guarantees during construction.

On July 22, 2010, the Corporation announced that Escal had completed a 10-year, €1.3 billion project financing with a syndicate of 19 banks. To provide security for the financing, CLP and the other shareholder of Escal have pledged their respective shares in Escal to the banking syndicate.

### **Tunisia**

At June 30, 2010, Eurogas International had cash and short term investments of \$1.4 million. The partners in the joint venture are pursuing a significant exploration, evaluation and drilling program. The primary plans for the Sfax Permit are to explore and evaluate and if the evaluation results in economically viable reserves, to develop the prospect and leads. In addition, if the results of the horizontal well at Ras-El-Besh indicate potential for development of the Reineche formation, additional Reineche structures within the Sfax Permit could be targeted for further evaluation.

Eurogas International currently has working capital of approximately \$0.6 million. At a 45% ownership interest, this amount would cover expenditures of \$1.4 million towards the remainder of the 2010 Work Program. In the event that the joint venture partners decide to abandon the REB-3 well, the 2010 Work Program will be adjusted

accordingly. Eurogas International believes that its working capital as well as expected proceeds from the settlement of the Seawolf litigation is sufficient to meet its current requirements. Any additional funding requirements would have to be accessed through debt or equity financings, farmout arrangements and/or bank borrowings. There can be no assurance that such funding or borrowing will be available to Eurogas International.

### **Outstanding Share Data**

As at July 27, 2010, the Corporation had 156,118,453 common shares outstanding. The Corporation has also issued 2,910,000 stock options to acquire common shares of the Corporation with a weighted average exercise price of \$1.16 as well as 355,000 deferred share units.

### **COMMITMENTS**

As part of the Tunisian Hydrocarbon Committee's approval of a two-year extension on the Sfax Permit, which extends the primary term to December 8, 2011, Eurogas International is committed to drilling one new exploration well during the extension period. Eurogas International has not completed its estimate of the costs to meet this commitment, as the costs are partially contingent on the selection of the prospect and location within the Sfax Permit.

### **RELATED PARTY TRANSACTIONS**

There have been no substantive changes in the nature and scope of related party transactions to those described in Note 14 to the 2009 Audited Consolidated Financial Statements and the accompanying management's discussion and analysis.

### **BUSINESS RISKS**

There are a number of inherent risks associated with the Corporation's activities. These risks were detailed in the section entitled "Business Risks" in the Corporation's management's discussion and analysis accompanying its 2009 Audited Consolidated Financial Statements. At June 30, 2010, the Corporation had not identified any material changes to the risk factors affecting our business and our approach to managing those risks, except as set out below.

The Corporation has initiated an assessment of the risks associated with the Acquisition (see "Acquisition of Ontario Oil and Gas Assets"). The Corporation is exposed to the following additional risks as a result of the Acquisition which are in addition to the risks identified in the 2009 management's discussion and analysis .

#### ***Volatility of Oil and Natural Gas Prices***

The Corporation's financial performance is highly sensitive to prevailing prices of oil and natural gas. Fluctuations in oil or natural gas prices could have a material adverse effect on the Corporation's operations and financial condition, the value of its reserves and its level of spending for oil and gas exploration and development. Prices for oil and natural gas fluctuate in response to changes in the supply of and demand for crude oil and natural gas, market uncertainty and a variety of additional factors that are largely beyond the Corporation's control. The volatility of oil and natural gas prices could have a material and adverse impact on the Corporation's financial performance.

#### ***Uncertainty of Reserve Estimates***

The process of estimating oil and gas reserves is complex and involves a significant number of assumptions in evaluating available geological, geophysical, engineering and economic data; therefore, reserves estimates are inherently uncertain. The Corporation relied on external evaluation of reserves in its evaluation of the Acquisition along with internally generated analysis. These estimates of proved reserves based on production history, results of exploration and development drilling, prevailing oil and gas prices and other factors, many of which are beyond the Corporation's control may be adjusted. In addition, there are numerous uncertainties in forecasting the amounts and timing of future production, costs, expenses and the results of exploration and development projects. All estimates are, to some degree, uncertain and classifications of reserves are only attempts to define the degree of uncertainty involved. For these reasons, estimates of the economically recoverable oil and natural gas reserves, the classification of such reserves based on risk of recovery and the measure of discounted future net cash flows, may vary

substantially. The Corporation's actual production, taxes and development and operating expenditures with respect to its reserves will likely vary from such estimates and such variances could be material.

### ***Health and Safety***

The Corporation's oil and gas production operations are subject to many risks, including the possibility of fire, explosions, mechanical failure, pipe failure, chemical spills, accidental flows of oil, natural gas or well fluids, sour gas releases, contamination of oil and gas, storms or other adverse weather conditions and other occurrences or incidents, which could result in personal injury or loss of life, damage or destruction of properties, environmental damages, cost of remedying such conditions or incidents, regulatory investigations and penalties and liability to third parties. The Corporation has a health, safety, security, environmental and operational integrity process to mitigate these risks. The Corporation also mitigates insurable risks to protect against significant losses by maintaining a comprehensive insurance program, while maintaining levels and amounts of risk within the Corporation that management believes to be acceptable. The Corporation believes its liability and property insurance is appropriate to its business and consistent with common industry practice, although such insurance will not provide coverage in all circumstances.

### ***Labour Costs and Labour Relations***

Labour costs constitute a significant portion of the operating costs. There can be no assurance that the Corporation will be able to maintain such costs at levels which do not negatively affect its business, results from operations and financial condition. To the extent that labour costs are subject to a collective bargaining agreement, there can be no assurance that future agreements with the employees' unions or the outcome of arbitrations will be on terms consistent with expectations or comparable to agreements entered into by competitors. Any future agreements or outcome of negotiations, mediations or arbitrations including in relation to wages or other labour costs or work rules may result in increased labour costs or other charges, which could have a material adverse effect on the Corporation's business results from operations and financial condition. A portion of the Corporation's employees are unionized and their long-term collective bargaining agreement expired on June 30, 2010. There can be no assurance that there will not be a labour conflict that could lead to an interruption or stoppage in operations.

### ***Tunisia***

In addition, Eurogas International capitalized all costs associated with the exploration and evaluation of its Tunisian activities. The recovery of these costs is contingent on the existence of economically recoverable reserves and future profitable production. The business and operations of Eurogas International may require substantial additional capital in order to execute any further exploration and development work.

## **ACCOUNTING POLICIES AND ESTIMATES**

Certain accounting policies are critical to understanding the Corporation's results of operations and financial condition. The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make judgements and estimates on matters that are uncertain. These estimates affect the reported amounts of assets and liabilities as well as revenues and expenses. Changes to these estimates may result in material changes to the Corporation's results of operations or financial condition. The June 2010 Interim Consolidated Financial Statements follow the same accounting principles and methods of application as those described in Note 1 to the Corporation's 2009 Audited Consolidated Financial Statements. A summary of the more significant judgements and estimates made by management is provided in the section entitled "Accounting Policies and Estimates" in the Corporation's management's discussion and analysis accompanying the 2009 Audited Consolidated Financial Statements.

## FUTURE ACCOUNTING DEVELOPMENTS

### **International Financial Reporting Standards (“IFRS”)**

In February 2008, the CICA Accounting Standards Board (the “Canadian AcSB”) confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS effective in calendar year 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there may be differences on recognition, measurement and disclosure that may materially impact the Corporation’s consolidated financial statements. The implementation of IFRS will apply to the Corporation’s interim and annual consolidated financial statements beginning on January 1, 2011, including the restatement of comparative amounts for 2010.

There have been no significant changes to the structure or timing of the Corporation’s IFRS conversion program, which was described in greater detail in the management’s discussion and analysis for the three months ended March 31, 2010 (“Q1 MD&A”). The following disclosure is a program progress update for the second quarter ending June 30, 2010.

### ***Analysis of IFRS Accounting Policies Affecting the Corporation***

#### ***IFRS 1: First-time Adoption of IFRS***

IFRS 1 provides the framework for the first-time adoption of IFRS and specifies that, in general, an entity shall apply the principles under IFRS retrospectively. IFRS 1 also specifies that the adjustments that arise on retrospective conversion to IFRS from Canadian GAAP should be directly recognized in retained earnings. Certain optional exemptions and mandatory exceptions to retrospective application are provided for under IFRS 1. While the Corporation continues to analyze the various accounting policy choices available under IFRS 1, certain tentative conclusions have been reached. The following is a preliminary assessment of transition exemptions expected to be relevant to the Corporation along with certain tentative conclusions:

- *Oil and Gas Properties* – IFRS 1 allows a first-time adopter using the full cost method of accounting under its previous GAAP to elect to measure oil and gas assets at the date of transition to IFRS on the following basis: (a) exploration and evaluation assets at the amount determined under previous GAAP and (b) assets in the development or production phases at the amount determined under previous GAAP, allocated to the underlying assets pro rata using reserve volumes or reserve values as of that date as more fully described in the Q1 MD&A. The Corporation expects to elect this exemption. A more complete assessment of the impact of IFRS on the Corporation’s oil and gas assets is expected by September 30, 2010.
- *Cumulative Translation Differences* – IFRS 1 permits cumulative translation gains and losses to be reset to zero at the transition date. This will result in the exclusion of translation differences that arose prior to the transition date from gains and losses on a subsequent disposal of a foreign operation. The Corporation expects to elect this exemption, which would reduce cumulative translation amounts of \$264,117 to zero at the transition date with a related increase to opening retained earnings.
- *Share-based Payments* – Under IFRS 1, a first-time adopter is not required to apply *IFRS 2: Share-based Payments* to equity instruments granted on or before November 7, 2002 or granted after November 7, 2002 but vested at the date of transition. The Corporation intends to elect this exemption and only apply IFRS 2 to those equity instruments that were not vested as at January 1, 2010.

#### ***IFRS 2: Share-based Payments***

Equity-settled share-based payments are measured at grant-date fair value under both IFRS and Canadian GAAP. However, there are differences related to the timing of expense recognition under the respective standards that impact the Corporation’s share-based payment programs. The Corporation has identified the specific differences in accounting for share-based payments under IFRS and is currently amending its share based payment models in order to quantify the impact upon transition. The Corporation has substantially

completed this quantitative exercise and does not expect the changes to have a significant impact on its consolidated financial statements upon transition to IFRS.

#### ***Next Steps***

The Corporation will continue to work on its assessment of the impact of IFRS adoption on the Corporation's accounting policies and related processes in the third quarter of 2010. Concurrent with this effort, the conversion committee will continue with its assessment of IFRS impacts on business activities and implement a communication strategy, as appropriate, aimed at all stakeholders, including employees, rating agencies, and shareholders, as may be appropriate to assist in their understanding of its transition to IFRS.

The Corporation will continue to monitor results from the existing conversion plan, as well as ongoing changes to IFRS, and adjust our transition and implementation plans accordingly. The Corporation's transition remains aligned to our implementation schedule and it is on track to meet the timelines essential to the changeover.

#### **CONTROLS AND PROCEDURES**

In accordance with the Canadian Securities Administrators' National Instrument 52-109, the Corporation has filed certificates signed by the Chief Executive Officer and Chief Financial Officer certifying that, among other things, the design of disclosure controls and procedures and the design of internal control over financial reporting are adequate. The financial disclosure controls and procedures provide reasonable assurance that material financial information has been duly disclosed by the Corporation. Furthermore, internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and its compliance with Canadian GAAP in its consolidated financial statements.

The Chief Executive Officer and Chief Financial Officer of the Corporation have also evaluated whether there were changes to the Corporation's internal control over financial reporting during the six months ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect the Corporation's internal control over financial reporting. No changes were identified during their evaluation.

It should be noted that while the Corporation's Chief Executive Officer and Chief Financial Officer believe that the Corporation's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system is met.

#### **ADDITIONAL INFORMATION**

Additional information relating to the Corporation may be accessed through the System for Electronic Document Analysis and Retrieval ("SEDAR") website at [www.sedar.com](http://www.sedar.com) and the Corporation's website at [www.eurogascorp.com](http://www.eurogascorp.com).

**EUROGAS CORPORATION**  
**Consolidated Balance Sheets**  
(Unaudited)

As at	June 30, 2010	December 31, 2009
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 2,044,076	\$ 263,328
Short term investments (Note 3)	1,324,456	74,459,138
Accounts receivable	676,117	531,510
Prepays	611,742	93,377
Loan receivable (Note 4)	547,882	660,302
Taxes recoverable	91,110	91,110
	<u>5,295,383</u>	<u>76,098,765</u>
Property, plant and equipment (Note 5)	140,872,005	79,083
Deferred exploration costs (Note 12)	23,207,534	21,175,897
Equity investment in Escal (Note 11)	3,927,834	4,260,789
Future income taxes	369,707	304,670
	<u>\$ 173,672,463</u>	<u>\$ 101,919,204</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Bank loan (Note 6)	\$ 63,887,988	\$ -
Accounts payable and accrued liabilities	4,585,985	1,367,109
	<u>68,473,973</u>	<u>1,367,109</u>
Asset retirement obligations (Notes 7 and 12)	8,939,462	1,602,591
Non-controlling interest (Note 8)	1,452,352	1,656,250
	<u>78,865,787</u>	<u>4,625,950</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 9)	97,746,065	97,746,065
Contributed surplus (Note 9)	5,137,968	5,120,116
Deficit	(8,123,562)	(5,837,044)
Accumulated other comprehensive income	46,205	264,117
	<u>94,806,676</u>	<u>97,293,254</u>
	<u>\$ 173,672,463</u>	<u>\$ 101,919,204</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

**EUROGAS CORPORATION**  
**Consolidated Statements of Operations**  
For the three and six months ended June 30, 2010 and 2009  
(Unaudited)

	Three months		Six months	
	2010	2009	2010	2009
<b>REVENUE</b>				
Interest and other	\$ 76,847	\$ 494,463	\$ 178,474	\$ 1,029,727
<b>EXPENSES</b>				
General and administrative	1,317,190	1,167,395	2,420,922	2,029,546
Interest	453,757	669	455,763	4,165
Depreciation and accretion	27,485	153,913	55,192	307,419
Foreign exchange loss	45,968	184,163	148,483	292,258
	1,844,400	1,506,140	3,080,360	2,633,388
<b>LOSS FROM OPERATIONS</b>	(1,767,553)	(1,011,677)	(2,901,886)	(1,603,661)
Share of earnings (losses) of equity accounted investee (Note 11)	(893)	-	4,958	(19,351)
<b>INCOME TAXES</b>				
Current tax provision	-	943	-	943
Future tax recovery	(382,726)	(44,770)	(481,298)	(44,770)
	(382,726)	(43,827)	(481,298)	(43,827)
<b>NET LOSS BEFORE NON-CONTROLLING INTEREST</b>	(1,385,720)	(967,850)	(2,415,630)	(1,579,185)
Non-controlling interest (Note 8)	63,484	66,733	129,112	98,800
<b>NET LOSS FOR THE PERIOD</b>	\$ (1,322,236)	\$ (901,117)	\$ (2,286,518)	\$ (1,480,385)
<b>BASIC AND DILUTED NET LOSS PER SHARE (Note 13)</b>	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)

*The accompanying notes are an integral part of these consolidated financial statements.*

**EUROGAS CORPORATION**  
**Consolidated Statements of Comprehensive Loss**  
For the three and six months ended June 30, 2010 and 2009  
(Unaudited)

	Three months		Six months	
	2010	2009	2010	2009
<b>NET LOSS FOR THE PERIOD</b>	\$ (1,322,236)	\$ (901,117)	\$ (2,286,518)	\$ (1,480,385)
Other comprehensive loss				
Net foreign currency loss on investment in self-sustaining operations, net of taxes of \$42,239 (2009 - \$17,143)	(191,560)	-	(295,674)	(41,971)
Non-controlling interest (Note 8)	50,380	-	77,762	11,038
<b>OTHER COMPREHENSIVE LOSS</b>	(141,180)	-	(217,912)	(30,933)
<b>COMPREHENSIVE LOSS FOR THE PERIOD</b>	\$ (1,463,416)	\$ (901,117)	\$ (2,504,430)	\$ (1,511,318)

*The accompanying notes are an integral part of these consolidated financial statements.*

**EUROGAS CORPORATION**  
**Consolidated Statements of Changes in Shareholders' Equity**  
(Unaudited)

	Share Capital	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2008	\$ 97,520,644	\$ 4,953,770	\$ (2,447,055)	\$ 416,684	\$ 100,444,043
Net loss	-	-	(3,157,976)	-	(3,157,976)
Stock based compensation	-	270,346	-	-	270,346
Other comprehensive loss	-	-	-	(152,567)	(152,567)
Issue costs	(6,579)	-	-	-	(6,579)
Costs of dividend-in-kind	-	-	(232,013)	-	(232,013)
Exercise of options	232,000	(104,000)	-	-	128,000
<b>Balance, December 31, 2009</b>	<b>97,746,065</b>	<b>5,120,116</b>	<b>(5,837,044)</b>	<b>264,117</b>	<b>97,293,254</b>
Net loss	-	-	(2,286,518)	-	(2,286,518)
Stock based compensation	-	17,852	-	-	17,852
Other comprehensive loss	-	-	-	(217,912)	(217,912)
<b>Balance, June 30, 2010</b>	<b>\$ 97,746,065</b>	<b>\$ 5,137,968</b>	<b>\$ (8,123,562)</b>	<b>\$ 46,205</b>	<b>\$ 94,806,676</b>

*The accompanying notes are an integral part of these consolidated financial statements.*

**EUROGAS CORPORATION**  
**Consolidated Statements of Cash Flows**  
For the three and six months ended June 30, 2010 and 2009  
(Unaudited)

	Three months		Six months	
	2010	2009	2010	2009
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	\$ (1,322,236)	\$ (901,117)	\$ (2,286,518)	\$ (1,480,385)
Non-cash items in operations				
Share of (earnings) losses from equity accounted investee	893	-	(4,958)	19,351
Depreciation and accretion	27,485	153,913	55,192	307,419
Gains on short term investments	(69,655)	(493,019)	(158,138)	(1,023,700)
Future income taxes	(382,726)	(44,770)	(481,298)	(44,770)
Non-controlling interest	(63,484)	(66,733)	(129,112)	(98,800)
Stock based compensation	10,472	159,818	20,828	312,236
Other	55,211	15,980	107,957	171,778
	(1,744,040)	(1,175,928)	(2,876,047)	(1,836,871)
Changes in non-cash working capital (Note 14)	2,995,007	1,621,198	2,555,904	1,411,159
	1,250,967	445,270	(320,143)	(425,712)
<b>FINANCING ACTIVITIES</b>				
Costs of dividend-in-kind	-	(157,896)	-	(310,399)
Issuance of shares, net of issue costs	-	-	-	116,367
Advanced from bank loan arrangements	63,887,988	-	63,887,988	-
Notes receivable	-	-	-	2,311,190
	63,887,988	(157,896)	63,887,988	2,117,158
<b>INVESTING ACTIVITIES</b>				
Redemptions of (investments in) short term investments, net	70,630,391	1,335,680	73,292,820	(664,320)
Acquisition of oil and gas properties	(133,048,280)	-	(133,048,280)	-
Deferred exploration costs	(806,629)	(1,983,178)	(2,031,637)	(2,074,521)
	(63,224,518)	(647,498)	(61,787,097)	(2,738,841)
<b>INCREASE (DECREASE) IN CASH</b>	1,914,437	(360,124)	1,780,748	(1,047,395)
<b>CASH, BEGINNING OF PERIOD</b>	129,639	1,702,342	263,328	2,389,613
<b>CASH, END OF PERIOD</b>	\$ 2,044,076	\$ 1,342,218	\$ 2,044,076	\$ 1,342,218

*The accompanying notes are an integral part of these consolidated financial statements.*

## **EUROGAS CORPORATION**

### **Notes to the Consolidated Financial Statements**

As at and for the three and six months ended June 30, 2010 and 2009

(Unaudited)

Eurogas Corporation (“Eurogas” or the “Corporation”) is an oil and natural gas company with a mandate to create long-term value through the exploration, development, production and marketing of oil and natural gas and other high impact energy projects.

#### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION**

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). All amounts are in Canadian dollars unless otherwise specified.

These interim consolidated financial statements follow the same accounting principles and methods of application as those disclosed in Note 1 to the Corporation’s audited consolidated financial statements as at and for the year ended December 31, 2009 (“2009 Audited Consolidated Financial Statements”), except as noted below. The Corporation’s interim consolidated financial statements do not include all disclosures required by Canadian GAAP for annual consolidated financial statements and accordingly, should be read in conjunction with the 2009 Audited Consolidated Financial Statements.

The preparation of interim consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities, the disclosure of contingencies as at the date of the interim consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are made based on information available as at the date of issuance of these interim consolidated financial statements. Actual results could differ from those estimates.

#### ***Comparative Figures***

Certain comparative figures have been reclassified to conform with current period consolidated financial statement presentation.

#### **2. ACQUISITION OF ONTARIO OIL AND GAS ASSETS**

On June 29, 2010, Dundee Energy Limited Partnership (“DELP”), a wholly-owned limited partnership of the Corporation, acquired a 95% working interest in onshore oil properties and a 65% working interest in offshore gas properties, all located in and around Lake Erie, Ontario. As part of the acquisition, DELP also acquired a 65% interest in certain other tangible assets, including drilling and completion vessels, gas plants and compressor stations and a 100% interest in oil storage tanks. The acquisition also provides for ownership of certain seismic data. The assets were acquired for aggregate cash consideration of \$133,048,280, including estimated transaction costs of \$2,768,679.

The allocation of the cash consideration to the various net assets acquired was based on a preliminary assessment of their underlying fair values and is summarized below:

<b>Net assets acquired</b>		
Oil and natural gas rights	\$	113,424,767
Other tangible assets		27,373,096
Asset retirement obligation		(7,291,083)
Future income tax liability		(458,500)
	\$	133,048,280
<b>Aggregate purchase price</b>		
Cash	\$	133,048,280
	\$	133,048,280

The allocation of the purchase price to the net assets acquired has not been finalized and will be subject to adjustment.

Acquired resource properties with proved reserves will be depleted over proved reserves using a unit of production method. For purposes of these calculations, production and reserves of natural gas are converted to barrels (bbls) on an energy equivalent basis at a ratio of 6,000 cubic feet (mcf) of natural gas for one barrel (bbl) of oil. Depletion rates will be updated annually unless there is a material change in circumstances, in which case they would be updated more frequently. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized.

### 3. SHORT TERM INVESTMENTS

As at	June 30, 2010	December 31, 2009
Fair value of investments	\$ 1,324,456	\$ 74,459,138
Weighted average interest rate	0.40%	0.51%
Weighted average days to maturity	78	310

During the three and six months ended June 30, 2010, the Corporation recognized interest income of \$69,655 and \$158,138, respectively (three and six months ended June 30, 2009 - \$493,019 and \$1,023,700, respectively), in respect of these investments.

### 4. LOAN RECEIVABLE

Amounts advanced to Escal UGS S.L. (“Escal”), for utilization by Escal for its underground gas storage project in Spain, are reflected in the Corporation’s consolidated financial statements as a loan receivable and are denominated in Euros.

	Canadian dollars	Euros
Balance, December 31, 2008	\$ 3,197,053	€ 1,875,545
Received during the year ended December 31, 2009	(2,311,190)	(1,435,343)
Foreign exchange loss	(225,561)	-
Balance, December 31, 2009	\$ 660,302	€ 440,202
Adjustment during the six months ended June 30, 2010	(25,539)	(19,886)
Foreign exchange loss	(86,881)	-
Balance, June 30, 2010	\$ 547,882	€ 420,316

## 5. PROPERTY, PLANT AND EQUIPMENT

As at	June 30, 2010	December 31, 2009
Oil and natural gas assets, Ontario	140,797,864	-
Other:		
Office equipment, furniture and fixtures	706,138	701,676
Accumulated depreciation	(631,997)	(622,593)
	\$ 140,872,005	\$ 79,083

Included in property, plant and equipment are recently acquired oil and natural gas properties in and around Lake Erie, Ontario, at their acquired cost of \$113,424,767 and other tangible assets at their acquired cost of \$27,373,096.

## 6. BANK LOAN

On June 29, 2010, DELP established a credit facility in the amount of \$80,000,000 with a syndicate comprised of certain Canadian chartered banks. The credit facility provides DELP with a revolving demand loan, subject to a tiered interest rate structure based on DELP's net debt to cash flow ratio, as defined in the credit facility. Based on DELP's current ratios, draws on the credit facility bear interest, at DELP's option, at either the bank's prime lending rate plus 3.0% for loans or letters of credit, or, for bankers' acceptances, at the bank's then prevailing bankers' acceptance rate plus 4.0%. DELP is subject to a standby fee of 0.55% on unused amounts under the credit facility.

In connection with the acquisition of oil and natural gas assets in Lake Erie, Ontario (Note 2), at June 30, 2010, DELP drew \$63,887,988 pursuant to the credit facility and it has further issued a letter of credit of \$3,270,000. Available credit under the credit facility at June 30, 2010 was \$12,842,012.

The credit facility is secured against all of the oil and natural gas assets owned by DELP. In addition, the Corporation has assigned a limited recourse guarantee of its units in DELP as further security pursuant to the credit facility. The credit facility is subject to certain covenants, including maintenance of minimum levels of working capital.

Interest expense relating to the credit facility since its establishment on June 29, 2010 was \$436,616, including arrangement fees and standby fee charges.

## 7. ASSET RETIREMENT OBLIGATIONS

In connection with the acquisition of the oil and natural gas assets in Ontario (Note 2), the Corporation recognized a liability representing the expected cash flows required to settle future asset retirement obligations. The undiscounted amount of these obligations were estimated as \$91,335,173, assuming a 2% annual inflation factor. The liability for the expected cash flows related to the obligations, as reflected in the consolidated financial statements, have been discounted at 6.65%

The costs attributed to the Ontario obligation are expected to be incurred over a period of 65 years, with approximately 2% being incurred within the next five years.

As is required by statute, the Corporation has provided the Ontario Ministry of Natural Resources with a letter of credit in respect of future abandonment costs. At June 30, 2010, the amount of the letter of credit was \$3,270,000 (Note 6).

## 8. NON-CONTROLLING INTEREST

	Six months ended 30-Jun-10		Year ended 31-Dec-09	
Opening balance	\$	1,656,250	\$	1,883,991
Non-controlling interest in results of subsidiaries		(129,112)		(182,587)
Non-controlling interest in comprehensive loss		(77,762)		(54,441)
Non-controlling interest in variable interest entities		2,976		9,287
Closing balance	\$	1,452,352	\$	1,656,250

## 9. SHARE CAPITAL

### *Issued and Outstanding*

	Number of shares		Amount	
Common shares outstanding, December 31, 2008	155,718,453	\$	97,520,644	
Exercise of stock options	400,000		232,000	
Issue costs	-		(6,579)	
Common shares outstanding, December 31, 2009 and June 30, 2010	156,118,453	\$	97,746,065	

### *Contributed Surplus*

	Six months ended 30-Jun-10		Year ended 31-Dec-09	
As at				
Balance, beginning of period	\$	5,120,116	\$	4,953,770
Amortization of stock based compensation - stock options		17,852		262,922
Amortization of stock based compensation - deferred share units		-		61,200
Exercise of stock options		-		(104,000)
Exercise of deferred share units		-		(53,776)
Balance, end of period	\$	5,137,968	\$	5,120,116

## 10. STOCK BASED COMPENSATION

The terms of the Corporation's stock based compensation plans are summarized in Note 9 to the 2009 Audited Consolidated Financial Statements.

### *Stock Option Plan*

During the three and six months ended June 30, 2010, the Corporation recognized stock based compensation expense of \$8,976 and \$17,852, respectively (three and six months ended June 30, 2009 - \$92,355 and \$244,773, respectively) in respect of outstanding stock options.

A summary of the status of the stock option plan as at June 30, 2010 and December 31, 2009 is as follows:

	June 30, 2010		December 31, 2009	
	Stock Options	Weighted Average Exercise Price	Stock Options	Weighted Average Exercise Price
Opening	3,985,000	\$ 1.26	5,205,000	\$ 1.21
Exercised	-	-	(400,000)	0.32
Forfeited	(1,075,000)	1.54	(820,000)	1.35
Closing	2,910,000	\$ 1.16	3,985,000	\$ 1.26

As at June 30, 2010, options to purchase common shares were exercisable as follows:

Option Price	Weighted Average Exercise Price	Options Outstanding	Options Exercisable	Contractual Life Remaining (Years)
At \$0.54	\$ 0.54	200,000	133,333	3.30
At \$1.12	\$ 1.12	2,250,000	2,250,000	1.88
At \$1.65	\$ 1.65	460,000	460,000	0.92

### *Deferred Share Unit Plan*

As at	June 30, 2010	December 31, 2009
Balance, beginning of period	355,000	315,000
Granted	-	120,000
Redemption	-	(80,000)
Balance, end of period	355,000	355,000

In the second quarter of the prior year, the Corporation granted deferred share units to certain directors and officers. Aggregate compensation expense in respect of the issuance was \$61,200. At June 30, 2010, there were 355,000 deferred share units outstanding.

### *Stock Based Compensation Expense in Variable Interest Entity*

During the second quarter of the prior year, Eurogas International Inc. (“Eurogas International”) awarded stock options to certain of its directors and executive officers to purchase common shares of Eurogas International. In the three and six months ended June 30, 2010, stock based compensation expense in respect of these stock option awards was \$1,496 and \$2,976, respectively (three and six months ended June 30, 2009 - \$6,263).

## **11. EQUITY ACCOUNTED INVESTMENT IN ESCAL**

The Corporation’s 73.7% owned subsidiary, Castor UGS Limited Partnership (“CLP”), holds an interest in the Castor Exploration Permit through its 33% interest in Escal. The Corporation accounts for its investment in Escal using the equity method.

For the three and six months ended June 30,	Three months		Six months		Year ended 31-Dec-09
	2010	2009	2010	2009	
Carrying value, beginning of period	\$ 4,147,652	\$ 4,443,783	\$ 4,260,789	\$ 4,522,248	\$ 4,522,248
Share of earnings (losses) of equity accounted investee	(893)	-	4,958	(19,351)	(24,879)
Share of other comprehensive loss from equity accounted investee	(218,925)	-	(337,913)	(59,114)	(236,580)
Carrying value, end of period	\$ 3,927,834	\$ 4,443,783	\$ 3,927,834	\$ 4,443,783	\$ 4,260,789

On July 22, 2010, the Corporation announced that Escal entered into a €1.3 billion financing arrangement with a banking syndicate for the construction and commission of the Castor underground gas storage project in Spain. To provide security for the financing, CLP and the other shareholder of Escal have pledged their respective shares in Escal to the banking syndicate.

## 12. INVESTMENT IN EUROGAS INTERNATIONAL INC.

The Corporation holds a \$32,150,000 preferred share interest in Eurogas International. While the Corporation's investment in Eurogas International is strictly limited to the preferred shares and the Corporation does not hold any common shares in Eurogas International, the nature of the Corporation's preferred share investment requires the consolidation of the accounts of Eurogas International as it is considered a variable interest entity pursuant to Canadian GAAP. The nature of the preferred shares limits the value of the Corporation's interest in Eurogas International to the face value of the preferred shares and any accrued interest thereon and outstanding payables to the Corporation.

The obligatory consolidation of Eurogas International has resulted in the following amounts being reflected in the Corporation's consolidated financial statements.

As at	June 30, 2010	December 31, 2009
Cash	\$ 33,453	\$ 185,901
Short term investments	1,324,456	4,005,040
Accounts receivable	130,092	57,461
Prepays	55,471	77,653
Deferred exploration costs	23,207,534	21,175,897
Accounts payable	(387,128)	(554,163)
Asset retirement obligation	(1,648,379)	(1,602,591)
Non-controlling interest	(12,263)	(9,287)
	<u>22,703,236</u>	<u>23,335,911</u>
Represented by:		
Preferred shares	32,150,000	32,150,000
Accrued interest	2,447,251	1,809,536
Payable to Eurogas Corporation	540,658	150,882
Accumulated deficit (Recognized by the Corporation)	(12,434,673)	(10,774,507)
	<u>\$ 22,703,236</u>	<u>\$ 23,335,911</u>

### *Deferred Exploration Costs*

During the three and six months ended June 30, 2010, aggregate capitalized costs related to the Tunisian oil and gas properties were \$806,629 and \$2,031,637, respectively (three and six months ended June 30, 2009 - \$1,856,847 and \$2,133,927, respectively).

Eurogas International has settled previously announced arbitration proceedings with Seawolf Oilfield (Cyprus) Limited and Seawolf Oilfield Services Limited for US\$12 million to be received by Eurogas International over an 18 month period. The settlement is secured by a bank guarantee from a recognized international bank. Eurogas International's share of the proceeds, will range from US\$2.7 million or 22.5% to US\$5.4 million or 45% subject to final determination under its joint venture agreement. Settlement proceeds, when received, will be recorded as a reduction in carrying value of Eurogas International's interest in the deferred exploration costs.

### *Asset Retirement Obligation*

Eurogas International, along with its joint venture partners, have estimated that the aggregate costs required in the event of abandonment of the Ras-El-Besh ("REB-3") well in Tunisia is between US\$6.5 million and US\$10 million. Eurogas International recorded an asset retirement obligation in respect of its share of the potential obligation in the event of abandonment of the REB-3 well.

The undiscounted amount of these obligations were estimated at \$1,790,978 (December 31, 2009 - \$1,790,978), assuming a 2% annual inflation factor. The liability for the expected cash flows related to these obligations, as reflected in the consolidated financial statements, have been discounted at 5.7%.

The costs attributed to the Tunisian obligation are expected to be incurred in fiscal 2011.

### 13. NET LOSS PER SHARE

For the three and six months ended June 30,	Three months		Six months	
	2010	2009	2010	2009
Net loss attributable to shareholders	\$ (1,322,236)	\$ (901,117)	\$ (2,286,518)	\$ (1,480,385)
Weighted average number of common shares outstanding	156,118,453	156,118,453	156,118,453	156,105,193
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)

### 14. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

#### *Changes in Non-cash Working Capital*

For the three and six months ended June 30,	Three months		Six months	
	2010	2009	2010	2009
Accounts receivable	\$ 58,991	\$ (67,355)	\$ (144,607)	\$ (18,429)
Accounts payable and accrued liabilities	3,423,008	1,554,283	3,218,876	1,362,328
Prepays	(486,992)	12,981	(518,365)	29,471
Taxes recoverable	-	121,289	-	37,789
Changes in non-cash working capital	\$ 2,995,007	\$ 1,621,198	\$ 2,555,904	\$ 1,411,159

During the three and six months ended June 30, 2010 and 2009, the Corporation made the following cash outlays in respect of interest expense and income taxes:

For the three and six months ended June 30,	Three months		Six months	
	2010	2009	2010	2009
Interest expense	\$ 453,757	\$ 670	\$ 455,763	\$ 4,166
Income taxes	\$ -	\$ 120,346	\$ -	\$ 36,846

### 15. RELATED PARTY TRANSACTIONS

Other than as disclosed below, there have been no substantive changes to the description and nature of the Corporation's related party transactions from those described in Note 14 to the 2009 Audited Consolidated Financial Statements.

#### *Services Arrangement with Dundee Resources Limited*

Dundee Resources Limited, a wholly owned subsidiary of the Corporation's parent, Dundee Corporation, provides the Corporation with administrative support services as well as geophysical, geological and engineering consultation with regard to the Corporation's activities. In the three and six month periods ended June 30, 2010, the Corporation incurred costs of \$214,845 and \$415,174, respectively (three and six months ended June 30, 2009 - \$149,109 and \$276,485, respectively) in respect of these arrangements.

#### *Accounts Payable and Accrued Liabilities*

Accounts payable and accrued liabilities include amounts due to Dundee Corporation and certain subsidiaries of Dundee Corporation. At June 30, 2010, these amounts were \$683,635.

## 16. COMMITMENTS

There have been no substantive changes to the description and nature of commitments from those described in Note 15 to the Corporation's 2009 Audited Consolidated Financial Statements.

## 17. FINANCIAL INSTRUMENTS

Detailed disclosures on the Corporation's financial instruments are included in Note 16 to the 2009 Audited Consolidated Financial Statements.

### *Fair Value of Financial Instruments*

At June 30, 2010, the Corporation's investments in GICs were the only financial instruments carried on the consolidated balance sheet at fair value. The investments are short term in nature and are accordingly valued at cost plus accrued interest, which approximates fair value. The valuation methodology used by the Corporation in its assessment of fair value includes an assessment of assets in quoted markets with similar interest rates and terms to maturity.

### *Risk Management*

The Corporation's financial instruments are exposed to financial risks due to the nature of the Corporation's business and the financial assets and liabilities that the Corporation holds. A detailed description of the nature of these risks is provided in Note 16 to the 2009 Audited Consolidated Financial Statements. In general, for every 50 basis point increase in market interest rates, net earnings before income taxes would increase by approximately \$159,800 and conversely, a 50 basis point decrease in market interest rates would decrease net earnings before income taxes by \$134,000.

As a result of the establishment of a credit facility (Note 6), the Corporation will also be exposed to interest rate risk on bank borrowings. As the credit facility was established on June 29, 2010, the impact of changes in interest rates to net earnings for the three and six months ended June 30, 2010 would be minimal.

## 18. FUTURE ACCOUNTING DEVELOPMENTS

### *Implementation of International Financial Reporting Standards ("IFRS")*

In February 2008, the AcSB affirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS effective in calendar year 2011. The implementation of IFRS will apply to the Corporation's interim and annual consolidated financial statements beginning on January 1, 2011, including the restatement of comparative amounts for 2010. As a result, the Corporation will publish its first financial statements, prepared in accordance with IFRS, for the quarter ended March 31, 2011.

While IFRS standards are premised on a conceptual framework similar to Canadian GAAP, there are differences in the areas of recognition, measurement and disclosure that may materially impact the Corporation's financial statements. The Corporation is participating in the IFRS implementation committee of its parent company and it has completed an assessment to identify the key accounting differences between Canadian GAAP and IFRS. The impact of these differences to the Corporation's financial results at the time of transition and on implementation is currently being assessed. Based on existing IFRS standards, significant differences to Canadian GAAP that may materially impact the Corporation's financial results include, but are not limited to, accounting for oil and gas assets and impairment of assets. The impact of IFRS to the Corporation at the transition will depend on the IFRS standards in effect at the time, accounting elections that have not yet been made, and the prevailing business and economic facts and circumstances.



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### **Stock Exchange**

TSX Venture Exchange

### **Stock Symbol**

EUG

[www.eurogascorp.com](http://www.eurogascorp.com)