

# **EUROGAS INTERNATIONAL INC.**

**2009 THIRD QUARTER REPORT**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Eurogas International Inc. ("Eurogas International" or the "Corporation") is an independent oil and gas corporation, incorporated under the *Companies Act* (Barbados), engaged in exploration and drilling on its extensive landholdings offshore Tunisia, targeting large scale oil and natural gas reserves. The Corporation holds a 45% working interest, and is the non-operating partner, in the Sfax offshore permit (the "Sfax Permit") covering 908,425 acres located in the shallow Mediterranean waters in the Gulf of Gabes, offshore Tunisia and southeast of the city of Sfax. The Corporation's common shares are traded on the Canadian National Stock Exchange (CNSX) under the symbol EI.

This interim Management's Discussion and Analysis ("MD&A") is based on information at October 28, 2009 and provides an update on matters discussed in, and should be read in conjunction with the Corporation's unaudited financial statements as at and for the three and nine months ended September 30, 2009, the audited financial statements as at and for the year ended December 31, 2008 and the MD&A included in the Corporation's Canadian Non-Offering Preliminary Prospectus and U.S. Information Statement (the "Prospectus") dated March 24, 2009. 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, 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 this MD&A 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.

### Business Reorganization Completed in 2008

On July 10, 2008, Eurogas Corporation the Corporation's former parent, announced a restructuring plan that would allow for the distribution of its 100% interest in the Corporation as a dividend-in-kind to shareholders of Eurogas Corporation (the "Restructuring"), such that each shareholder of Eurogas Corporation received one newly issued common share of the Corporation for every five shares of Eurogas Corporation held. The Restructuring was completed on August 5, 2008 and the newly issued common shares of Eurogas International were placed in escrow for the benefit of shareholders of Eurogas Corporation, pending a public listing of the Corporation's common shares. The common shares of the Corporation began trading on the Canadian National Stock Exchange ("CNSX") on March 31, 2009.

Prior to completing the Restructuring, the Corporation issued common shares with a value of \$45.7 million in settlement of amounts owed to Eurogas Corporation. Eurogas Corporation subsequently exchanged its previous interest in the common shares of the Corporation for 32,150,000 newly issued Series A Preference Shares and 31,143,635 newly issued common shares of the Corporation. Eurogas Corporation plans to retain the Series A Preference Shares. As noted previously, the newly issued common shares were distributed to shareholders of Eurogas Corporation, at nominal value, as part of the Restructuring.

### *Series A Preference Shares*

The Series A Preference Shares rank in priority to the common shares of the Corporation as to the payment of dividends and the distribution of assets on dissolution, liquidation or winding-up of the Corporation and entitle Eurogas Corporation, as the holder thereof, to a fixed preferential cumulative dividend at the rate of 4% per annum. The Series A Preference Shares may be redeemed, at the option of either the Corporation or Eurogas Corporation, at any time, at a price equal to their face value of \$32.15 million. Eurogas Corporation has indicated that it does not intend to exercise its redemption entitlement until 2011.

In August 2009, Eurogas Corporation approved a request by Eurogas International to defer entitlement to payment of the cumulative 4% cash dividends payable on the Preferred Shares and entitlement to receive payment once such dividends are declared, until December 31, 2011. Eurogas Corporation may, if requested by Eurogas International, reinvest any such dividends received in cash into common shares of the Corporation, subject to regulatory approval.

### **Sfax Permit**

Eurogas International is currently conducting exploration programs for oil and natural gas offshore Tunisia in the Gulf of Gabes, where it holds an interest in the 1.0 million acre Sfax Permit. Eurogas International is a non-operating partner in the permit. All costs associated with the Sfax Permit are capitalized as part of the pre-production phase of operations.

The Sfax Permit lies within a hydrocarbon fairway that trends from offshore Libya, through the Gulf of Gabes, to onshore Tunisia and includes major oil and gas fields. The Sfax Permit is surrounded by producing oil and gas fields to the west, north and east, including the 330 million barrel Ashtart oil field that lies along the southeast boundary. Previous operators drilled and flow tested oil from three separate structures on the prospect at daily equivalent rates of 612, 1,200 and 1,800 barrels of oil per day. At that time, these structures were considered sub-economic to those operators and the wells were abandoned.

Following the granting of the Sfax Permit in 2004, the Corporation and its then sole joint venture and operating partner, Atlas Petroleum Exploration Worldwide Ltd. (“APEX”), acquired a new 3-D seismic program over 348 km<sup>2</sup> of the permit, which included the known Ras el Besh and Jawhara prospects that tested oil. The seismic provided an improved understanding of the geology.

During 2005, the Sfax Permit was converted to an exploration permit under the terms of a production sharing contract. The four year permit commenced December 9, 2005 and included a commitment to undertake seismic work, which has been completed, and to drill one exploration well prior to December 9, 2009. The REB-3 well (see “Ras El Besh”) was the commitment well for the Sfax Permit. On January 19, 2009, the Tunisian Hydrocarbon Committee approved a two-year extension to the Sfax Permit which will extend the primary term to December 8, 2011. The extension requires that one new exploration well be drilled during the extension period.

Eurogas International, on behalf of the joint venture, is overseeing the re-processing of all 3-dimensional seismic on the Sfax Permit. The 340 km<sup>2</sup> Sfax program over the Ras El Besh and Jawhara oil prospects are now complete and mapping has commenced. The 60 km<sup>2</sup> and 460 km<sup>2</sup> programs for Salloum and the Kerkennah Banks, respectively, will be reprocessed prior to the end of 2009. Selected 2-dimensional seismic lines will also be re-processed to re-map prospects and leads on the permit. Once this process is complete, Eurogas International, together with its joint venture partner, will re-map the prospects and leads, then seek a farmout partner to drill an exploration well to satisfy the one-well drilling obligation during the 2-year extension period.

### **Ras El Besh**

In December 2005, the Corporation and APEX applied for a development concession over the Ras el Besh prospect (the “REB Exploitation Concession”) within the Sfax Permit. The application was accepted by the Hydrocarbon Committee of the Tunisian government in July 2006 and the concession was gazetted on September 5, 2008 following commencement of drilling the REB-3 well on June 16, 2008. An exploitation concession is granted for a period of 30 years with a condition that concession development work starts within two years from the date of award. The REB-3 well is recognized by the Tunisian government as the commitment well under the initial term of the Sfax Permit ending December 9, 2009.

The REB-3 well reached total depth of 2,204 metres. Well logs and formation pressure tests identified the presence of oil in a high quality, 10-metre thick carbonate interval in the Reineche formation, which was subsequently confirmed by down-hole sampling. The well was plugged back and drilled horizontally to 3,284 metres. The sidetrack intercepted the top of the Reineche formation in a lower fault block approximately 1,000 metres to the northwest of the REB-3 well, then drilled horizontally through 400 metres of porous formation. The horizontal section was tested and produced over 1,000 barrels per day of fluid with a 10% cut of 27° API oil. Oil has now been tested at two locations 1,000 metres apart.

Upon completion of drilling and testing the REB-3 well, the joint venture partners requested and received approval from the Tunisian government to temporarily suspend the well and release the drilling rig, both of which were done. Agreement by the Tunisian government was subject to the re-interpretation and remapping of seismic data, after which the joint venture partners must decide to either re-enter or abandon the well. In the event of abandonment, the aggregate cost is estimated at between US\$6.5 million to US\$10 million. Actual costs will depend on factors such as the location of the rig and prevailing rates.

### Tunisian Asset Pool

During the three and nine months ended September 30, 2009, an aggregate of \$1.0 million and \$3.1 million, respectively (2008 - \$0.3 million and \$1.7 million, respectively) was capitalized to the Tunisian asset pool.

For the three and nine months ended September 30,		Three months		Nine months	
		2009	2008	2009	2008
Restoration of Ocean Patriot, net	\$	525,747	\$ -	\$ 1,382,878	\$ 571,825
Permit operator costs		11,376	21,493	35,406	352,676
Seismic activities		93,525	10,046	346,507	87,424
Ras-El-Besh well expenditures, net		183,046	-	747,663	117,406
Corporate general and administrative expenditures		141,564	263,000	456,584	473,000
Capitalized stock based compensation		-	28,683	-	118,508
Other expenditures		-	2,465	120,147	5,512
	\$	955,258	\$ 325,687	\$ 3,089,185	\$ 1,726,351

APEX, as operator under the Sfax joint venture has commenced arbitration proceedings against Seawolf Oilfield (Cyprus) Limited and Seawolf Oilfield Services Limited (collectively, "Seawolf") under the rules of the London Court of International Arbitration ("LCIA"). APEX has filed a statement of case seeking damages for misrepresentations and breach of a drilling contract as well as payment of indemnities under the contract. Seawolf responded to APEX's claims and filed a counterclaim. APEX is in the process of preparing for the LCIA hearing, which is scheduled for the second quarter of 2010. During the third quarter of 2009, APEX was successful in obtaining a default judgment against Seawolf in the state of Texas. The Company has not yet completed an assessment of the impact of this favourable ruling to the overall arbitration proceedings.

### Agreement with Delta Hydrocarbons B.V.

In April 2008, Eurogas International and APEX announced that they had entered into a series of agreements (the "Delta Agreements") with Amsterdam based Delta Hydrocarbons B.V. ("Delta"), whereby Delta acquired a 50% interest in the Sfax Permit and the Ras el Besh Concession (the "Joint Venture") and a 50% interest in Innovative Production Services, Ltd. ("IPS") in exchange for the expenditure by Delta of an aggregate of US\$125 million.

On May 22, 2009, Eurogas International announced that, together with APEX, it had reached an agreement with Delta with respect to Delta's previously expressed desire to exit from the Joint Venture and the related agreements. Under the agreement, Delta reassigned its 50% participating interest in the Sfax Permit and the REB-3 concession and transferred its shares in IPS to the remaining Joint Venture partners, including Eurogas International. In exchange, Delta is entitled to a portion of certain payments, when received by the Joint Venture, including a share, ranging from 20% to 34.7%, of the proceeds from the cost oil portion of any future production revenues and a share of the proceeds from any sale or lease of assets. Delta's rights to a share of proceeds is subject to a maximum of US\$20 million in aggregate, and in some

cases limited to a duration of 5 years. Delta remains committed to fund 50% of any costs associated with the abandonment of the REB-3 well until December 9, 2011.

During the term of the farmout agreement, capital expenditures in respect of the Tunisian asset pool were substantially funded by Delta pursuant to its US\$125 million spending commitment. On completion of the reassignment, Eurogas International's participating interest in the Sfax Permit, Ras-El-Besh concession and IPS reverted to 45% and APEX's participating interest reverted to 55%. Accordingly, the Corporation is responsible for 45% of ongoing capital expenditures related to these activities.

### **Work Program for 2009**

Following the results of the REB-3 well and the exit of Delta, the Joint Venture partners are now focused for the balance of 2009 on re-evaluating the Ras el Besh concession area and north of it covering both the Reineche and the El Garia formations. Initially, this entailed geological and geophysical studies and the re-processing of existing 3D seismic. The work program also includes geophysical evaluation of the satellite structures to the 330 million barrel Ashtart oil field adjacent to the eastern boundary of the Permit.

### **Salloum**

The work program for 2009 also includes feasibility studies to evaluate the Salloum oil prospect as a future drilling candidate on the Sfax Permit. An exploration well, (SAM 1) located 1.5 kilometres off the east coast of Tunisia, was drilled in 1991 by a previous operator and tested 1800 bpd of 42° API oil with no water from Bireno limestones. This structure is located in the northeast corner of the Sfax Permit in shallow waters adjacent to the city of Sfax and is adjacent to two producing oil fields that produce from the same targeted formation. In 2007, the Corporation and APEX arranged for 60 km<sup>2</sup> of shallow water 3-dimensional seismic to be shot and processed over this prospect. Revised mapping based on the 3-dimensional seismic program acquired in 2007 and older 2-dimensional seismic suggests the Salloum structure extends toward the shoreline and could be drilled from an onshore location, the viability of which will be an aspect of the feasibility study.

The estimated budget for the Sfax Permit and the Ras el Besh concession, including the Seawolf arbitration, for the remainder of 2009 is US\$1.6 million, of which Eurogas International is responsible for its net share (net US\$0.5 million).

### **IPS**

Eurogas International indirectly owns a 45% interest in a mobile production platform (“MOPU”) and two buoys through its equity ownership in IPS. The shareholders have agreed to monetize the MOPU and related equipment, either by way of sale or lease to another operator as soon as feasible. It is necessary to undertake some repairs and upgrades prior to the monetization of the MOPU, which the operating shareholder APEX is currently pursuing at a budgeted cost of US\$6 million. Delta paid US\$1.9 million of the repair costs through to the reassignment of the Delta Agreements. Eurogas International will pay its 45% share of the remaining US\$0.4 million (net US\$0.2 million) during the remainder of 2009. To September 30, 2009 Eurogas International has paid US\$1.2 million towards these repairs.

## **RESULTS OF OPERATIONS**

During the three and nine months ended September 30, 2009, the Corporation realized net losses of \$1,062,975 and \$2,664,764 respectively, (2008 - \$153,432 and \$422,160, respectively), including general and administrative expenses (“G&A”) and interest expense, net of interest and other miscellaneous revenues.

The Corporation's current energy projects are in the development stage and the Corporation has not generated operating revenues.

The Corporation earns interest income on cash and the deposit held with Eurogas Corporation. Interest revenue earned during the three and nine months ended September 30, 2009 was \$22,805 and \$119,270, respectively (2008 - \$76,008 and \$85,352, respectively). The amount of interest earned in each respective period reflects the variances in the balances of cash, investments, and the deposit with Eurogas Corporation held during those periods.

G&A totalled \$553,966 and \$1,230,109, respectively (2008 - \$85,608 and \$365,670, respectively) for the three and nine months ended September 30, 2009. G&A costs in the current year reflect costs associated with the public listing of the Corporation, including filing fees, corporate secretarial services, registrar and transfer agency fees and directors' fees. These costs aggregated \$63,963 and \$294,524 in the three and nine month periods ended September 30, 2009, respectively. Further G&A costs include legal costs with respect to the Seawolf litigation of \$441,653 and \$609,226 for the three and nine month periods ended September 30, 2009, respectively.

Included in expenses during the three and nine months ended September 30, 2009 is \$334,917 and \$965,585, respectively (2008 - \$199,190 and \$199,190 respectively) related to the Series A Preference Shares.

Costs associated with the asset retirement obligation in respect of the REB-3 well during the three and nine months ended September 30, 2009 include accretion costs of \$21,657 and \$64,970, respectively and depreciation costs of \$126,330 and \$378,990, respectively (2008 – Accretion costs of \$nil and depreciation costs of \$nil).

## LIQUIDITY AND CAPITAL RESOURCES

The partners in the Joint Venture are pursuing a significant evaluation and drilling program. The primary plan for the Sfax Permit is to evaluate and, if the evaluation results in economically viable reserves, to develop the three previously drilled prospects (Ras-El-Besh, Jawhara and Salloum). 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 \$4.7 million. At a 45% ownership interest, this amount would cover expenditures of \$10.4 million on the Sfax Permit and in respect of the IPS initiatives. 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 would be available to Eurogas International.

The remaining 2009 budget for the Sfax Permit and IPS projects is forecast to total US\$0.8 million, net to the Corporation. Current working capital amounts are sufficient to meet these immediate requirements. The Corporation is working with APEX to set the work programs anticipated for 2010. These work programs will encompass an assessment of available working capital.

### Outstanding Share Data

As at October 28, 2009, there were 31,143,635 common shares and 32,150,000 Series A Preference Shares outstanding.

## SELECTED QUARTERLY FINANCIAL INFORMATION

	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008
Interest income	\$ 22,805	\$ 47,893	\$ 48,572	\$ 55,211
Net loss from continuing operations	1,062,975	868,837	732,952	378,194
Capital expenditures	955,258	1,856,847	277,080	1,706,132

  

	September 30, 2008	June 30, 2008	March 31, 2008	December 31, 2007
Interest income	\$ 76,008	\$ 7,396	\$ 1,948	\$ 3,308
Net loss from continuing operations	153,432	208,845	59,883	8,097
Capital expenditures	325,687	93,067	1,307,597	1,030,124

## COMMITMENTS

There have been no substantive changes in the description and nature of commitments from those described in Note 9 to the audited consolidated financial statements of the Corporation as at and for the year ended December 31, 2008, and the associated MD&A.

## **RELATED PARTY TRANSACTIONS**

Other than as disclosed in the notes to the interim financial statements as at and for the three and nine months ended September 30, 2009, there have been no significant changes to the nature and scope of related party transactions described in Note 7 to the audited consolidated financial statements of the Corporation as at and for the year ended December 31, 2008 and the associated MD&A.

## **BUSINESS RISKS**

There are a number of inherent risks associated with the Corporation's two energy projects. Many of these risks are beyond the control of management. No changes have been identified to risk factors affecting our business and our approaches to managing these risks from those described in our MD&A as at and for the year ended December 31, 2008.

## **ACCOUNTING POLICIES AND ESTIMATES**

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. While management reviews its estimates regularly, new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. The interim financial statements follow the same accounting principles and methods of application as those described in Note 3 to the Corporation's audited financial statements as at and for the year ended December 31, 2008, except as described below under "Changes in accounting policies adopted in 2009". 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 MD&A as at and for the year ended December 31, 2008.

## **CHANGES IN ACCOUNTING POLICIES ADOPTED IN 2009**

### **Asset Recognition including Goodwill and Intangible Assets**

On January 1, 2009, the Corporation adopted the amendments to the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1000, "*Financial Statement Concepts*" and the new CICA Handbook Section 3064, "*Goodwill and Intangible Assets*", which replaced CICA Handbook Section 3062, "*Goodwill and Other Intangible Assets*". This guidance reinforces the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition. Under the amendments to CICA Handbook Section 1000, effective January 1, 2009, the deferral and matching of operating expenses over future revenues is no longer appropriate. The adoption of this new guidance had no impact on the reported results of the Corporation.

## **FUTURE ACCOUNTING CHANGES**

### **Financial Instruments – Disclosures**

In June 2009, the Canadian Accounting Standards Board ("AcSB") incorporated the recent amendments to International Financial Reporting Standards ("IFRS") 7, "*Financial Instruments: Disclosures*", into CICA Handbook Section 3862, "*Financial Instruments – Disclosures*". The amendments introduce a three level fair value disclosure hierarchy that distinguishes fair value measurements by the significance of the inputs used. In addition, the amendments require enhanced disclosures regarding the nature and extent of liquidity risk arising from financial instruments to which an entity is exposed. The amendments are applicable to the Corporation's annual financial statements beginning with fiscal 2009. Comparative information is not required in the year of adoption. The Corporation is currently evaluating the impact of the adoption of these amendments.

### **Business Combinations**

In January 2009, the CICA issued CICA Handbook Section 1582, "*Business Combinations*", Section 1601, "*Consolidations*", and Section 1602, "*Non-controlling Interests*". These sections replace the former CICA Handbook

Section 1581, “*Business Combinations*” and Section 1600, “*Consolidated Financial Statements*” and establish a new section for accounting for a non-controlling interest in a subsidiary.

CICA Handbook Section 1582 establishes standards for the accounting of a business combination. It provides the Canadian equivalent to IFRS 3, “*Business Combinations*” (January 2008). The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements. CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, “*Consolidated and Separate Financial Statements*” (January 2008).

CICA Handbook Section 1601 and Section 1602 apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. The Corporation is currently evaluating the impact of the adoption of these sections.

### **Impairment of Financial Assets**

In August 2009, the Canadian Accounting Standards Board (“AcSB”) amended CICA Handbook Section 3855, “*Financial Instruments – Recognition and Measurement*”, to achieve consistency with international standards on impairment of debt securities. The amendments changed the definition of a loan such that debt securities not quoted in an active market could be classified as a loan and measured at amortized cost. Impairment for debt securities classified as loans will be assessed and recorded using the incurred credit loss model of CICA Handbook Section 3025, “*Impaired Loans*”. Debt securities that are classified as available-for-sale securities continue to be written down to their fair value through earnings when the impairment is considered other-than-temporary. However, the impairment loss can be reversed if the fair value subsequently increases and the increase can be objectively related to an event occurring after the impairment loss was recognized. The amendments are applicable to the Corporation effective January 1, 2010. The Corporation is currently evaluating the impact of the adoption of these amendments.

### **International Financial Reporting Standards**

In February 2008, the CICA Accounting Standards Board confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS in calendar year 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there may be significant 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 financial statements beginning on January 1, 2011, including the restatement of comparative amounts for 2010. The Corporation, through active interaction with the IFRS implementation committee established by its parent, has initiated an assessment of the impact of IFRS adoption on its business activities, processes and accounting policies, after which it will implement a communication strategy, as appropriate, aimed at all stakeholders, including employees, rating agencies and shareholders, to assist in their understanding of its transition to IFRS.

## **CONTROL ENVIRONMENT**

### **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to the Corporation's management, as appropriate, to allow timely decisions regarding required disclosures. The Corporation's Chief Executive Officer and Chief Financial Officer, together with management, have concluded, based on their evaluation as of the end of the period covered by the filings, that the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer is made known to them by others within the Corporation.

### **Internal Control Over Financial Reporting**

Under the supervision of and with the participation of Eurogas International's management, including the Chief Executive Officer and the Chief Financial Officer, internal control over financial reporting has been designed and



maintained in order to provide reasonable assurance regarding the reliability of financial reporting, as of the end of the period covered by the filings. During the nine months ended September 30, 2009, there have been no material changes in internal control over financial reporting. In common with many small companies, segregation of duties is difficult, however, the Corporation has compensating controls in place, including key management authorizations and reviews.

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") at [www.sedar.com](http://www.sedar.com).

**EUROGAS INTERNATIONAL INC.**  
**Balance Sheets**  
**(Unaudited)**

As at	September 30, 2009	December 31, 2008
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 566,013	\$ 1,435,653
Accounts receivable	59,250	8,734
Prepays	14,357	-
Investments (Note 3)	4,500,690	-
Deposit with Eurogas Corporation (Note 9)	-	8,722,623
	5,140,310	10,167,010
Oil and natural gas properties (Note 4)	20,908,516	17,819,331
	\$ 26,048,826	\$ 27,986,341
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 355,145	\$ 122,355
Payable to Eurogas Corporation (Note 9)	28,455	886,223
	383,600	1,008,578
Asset retirement obligation (Note 5)	1,580,935	1,202,068
Accrued dividends on Series A Preference Shares (Note 6)	1,485,394	519,809
Series A Preference Shares (Note 6)	32,150,000	32,150,000
	35,599,929	34,880,455
<b>SHAREHOLDERS' DEFICIENCY</b>		
Share capital (Note 7)	1	1
Contributed Surplus (Note 7)	7,775	-
Deficit	(9,558,879)	(6,894,115)
	(9,551,103)	(6,894,114)
	\$ 26,048,826	\$ 27,986,341

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

**EUROGAS INTERNATIONAL INC.**  
**Statements of Operations and Comprehensive Loss**  
**(Unaudited)**

For the three and nine months ended September 30,

	Three months		Nine months	
	2009	2008	2009	2008
<b>REVENUE</b>				
Interest and other	\$ 22,805	\$ 76,008	\$ 119,270	\$ 85,352
<b>EXPENSES</b>				
General and administrative	553,966	85,608	1,230,109	365,670
Dividends on Series A Preference Shares (Note 6)	334,917	199,190	965,585	199,190
Depreciation and accretion	147,987	-	443,961	-
Interest expense	567	-	1,204	-
Foreign exchange loss (gain)	48,343	(55,358)	143,175	(57,348)
	1,085,780	229,440	2,784,034	507,512
<b>LOSS FROM OPERATIONS</b>	(1,062,975)	(153,432)	(2,664,764)	(422,160)
<b>NET AND COMPREHENSIVE LOSS FOR THE PERIOD</b>	\$ (1,062,975)	\$ (153,432)	\$ (2,664,764)	\$ (422,160)
<b>LOSS PER COMMON SHARE</b>				
Basic and diluted loss per share (Note 8)	\$ (0.03)	\$ -	\$ (0.09)	\$ (0.01)

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

**EUROGAS INTERNATIONAL INC.**  
**Statements of Changes in Shareholders' Deficiency**  
**(Unaudited)**

	Share Capital	Contributed Surplus	Deficit	Total
Balance, December 31, 2007	\$ 10,013,039	\$ -	\$ (29,613,634)	\$ (19,600,595)
Exchange of debt due to Eurogas Corporation	-	45,656,834	-	45,656,834
Reduction of stated capital	-	(23,519,873)	23,519,873	-
Exchange of common shares for				
Series A Preference Shares	(10,013,039)	(22,136,961)	-	(32,150,000)
Issuance of Common Shares	1	-	-	1
Net loss during the year ended December 31, 2008	-	-	(800,354)	(800,354)
Balance, December 31, 2008	1	-	(6,894,115)	(6,894,114)
Stock based compensation expense	-	7,775	-	7,775
Net loss during the nine months ended September 30, 2009	-	-	(2,664,764)	(2,664,764)
Balance, September 30, 2009	\$ 1	\$ 7,775	\$ (9,558,879)	\$ (9,551,103)

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

**EUROGAS INTERNATIONAL INC.**  
**Statements of Cash Flows**  
**(Unaudited)**

For the three and nine months ended September 30,

	Three months		Nine months	
	2009	2008	2009	2008
<b>OPERATING ACTIVITIES</b>				
Loss from operations	\$ (1,062,975)	\$ (153,432)	\$ (2,664,764)	\$ (422,160)
Non-cash items in operations				
Depreciation	126,330	-	378,991	-
Stock based compensation	1,512	-	7,775	-
Other	21,657	-	64,970	-
	(913,476)	(153,432)	(2,213,028)	(422,160)
Change in non-cash working capital:				
Accounts receivable	8,292	(7,621)	(50,516)	159,732
Prepaid and other	(14,357)	-	(14,357)	110,874
Accounts payable and accrued liabilities	(1,137,343)	(2,648)	234,620	(495,113)
	(2,056,884)	(163,701)	(2,043,281)	(646,667)
<b>FINANCING ACTIVITIES</b>				
Changes in amounts due to Eurogas Corporation	6,578,946	9,270,835	7,864,855	786,119
Deposit with Eurogas Corporation	-	(8,722,623)	-	(8,722,623)
Changes in accrued dividends payable	334,917	-	965,585	-
	6,913,863	548,212	8,830,440	(7,936,504)
<b>INVESTING ACTIVITIES</b>				
Proceeds from farmout of interest in oil and gas properties	-	-	-	11,161,266
Investment in guaranteed investment certificates	(4,500,690)	-	(4,500,690)	-
Investment in oil and natural gas properties	(1,081,588)	(297,004)	(3,156,109)	(1,607,843)
	(5,582,278)	(297,004)	(7,656,799)	9,553,423
<b>(DECREASE) INCREASE IN CASH</b>	(725,299)	87,507	(869,640)	970,252
<b>CASH, BEGINNING OF PERIOD</b>	1,291,312	1,277,377	1,435,653	394,632
<b>CASH, END OF PERIOD</b>	\$ 566,013	\$ 1,364,884	\$ 566,013	\$ 1,364,884

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

## **EUROGAS INTERNATIONAL INC.**

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

**As at and for the three and nine months ended September 30, 2009**

**(Unaudited)**

#### **1. NATURE AND CONTINUATION OF OPERATIONS**

Eurogas International Inc. (“Eurogas International” or the “Corporation”) is incorporated under the *Companies Act* (Barbados), and is an independent oil and gas company engaged in the exploration and drilling on its landholdings offshore Tunisia, targeting large-scale oil and natural gas reserves.

The Corporation is in the process of exploring, acquiring and developing its landholdings and has not yet determined whether the recoverability of resources is economically feasible. The recoverability of the amounts reported for oil and natural gas properties is dependent upon the discovery of economically recoverable reserves, obtaining exploitation concessions for those reserves identified, the ability to obtain necessary financing to complete development, and future profitable production or proceeds from disposition.

The Corporation’s ability to continue its operations and realize assets at their carrying values is dependent upon the continued support of its shareholders, obtaining additional financing, and generating revenues sufficient to cover its operating costs.

These interim financial statements have been prepared on the basis that the Corporation will be able to meet its commitments, continue operations, realize its assets and discharge its liabilities in the normal course of business. The ability to continue operations beyond the foreseeable future is dependent upon the Corporation achieving profitable operations, and/or securing additional financing.

#### **2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION**

These interim financial statements of Eurogas International have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Other than as described herein, these interim financial statements follow the same accounting principles and methods of application as those disclosed in Note 3 to the Corporation’s audited financial statements as at and for the year ended December 31, 2008 (“2008 Audited Financial Statements”). The Corporation’s interim financial statements do not include all disclosures required by Canadian GAAP for annual financial statements and accordingly, should be read in conjunction with the 2008 Audited Financial Statements.

The preparation of interim 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. All amounts are in Canadian dollars unless otherwise specified.

##### **Changes in Accounting Policies**

###### ***Asset Recognition including Goodwill and Intangible Assets***

On January 1, 2009, the Corporation adopted the amendments to the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1000, “*Financial Statement Concepts*” and the new CICA Handbook Section 3064, “*Goodwill and Intangible Assets*”, which replaced CICA Handbook Section

3062, “*Goodwill and Other Intangible Assets*”. This guidance reinforces the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition. Under the amendments to CICA Handbook Section 1000, effective January 1, 2009, the deferral and matching of operating expenses over future revenues is no longer appropriate. The adoption of this new guidance had no impact on the reported results of the Corporation.

### Comparative Figures

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

## 3. INVESTMENTS

	September 30, 2009	December 31, 2008
GICs	\$ 4,500,690	\$ -
	\$ 4,500,690	\$ -

In the third quarter of 2009, the Corporation acquired a guaranteed investment certificate (GIC) from a Canadian Schedule I Chartered Bank at a cost of \$4,500,000. This investment is designated as held-for-trading and accordingly, any change in its fair value is recorded in net earnings. During the third quarter of 2009, the Corporation recognized an unrealized appreciation in the fair value of this investment of \$690 (2008 – nil), which has been included in these financial statements as interest income.

## 4. OIL AND NATURAL GAS PROPERTIES

### *Sfax Permit*

During the three and nine months ended September 30, 2009, aggregate capital expenditures in respect of the Corporation’s exploration and development activities on its Tunisian oil and gas properties amounted to \$955,258 and \$3,089,185, respectively (September 30, 2008 - \$325,687 and \$1,726,351, respectively). The following table shows the components of such capital expenditures.

	For the three and nine months ended September 30,			
	Three months		Nine months	
	2009	2008	2009	2008
Restoration of Ocean Patriot, net	\$ 525,747	\$ -	\$ 1,382,878	\$ 571,825
Permit operator costs	11,376	21,493	35,406	352,676
Seismic activities	93,525	10,046	346,507	87,424
Ras-El-Besh well expenditures, net	183,046	-	747,663	117,406
Corporate general and administrative expenditures	141,564	263,000	456,584	473,000
Capitalized stock based compensation	-	28,683	-	118,508
Other expenditures	-	2,465	120,147	5,512
	\$ 955,258	\$ 325,687	\$ 3,089,185	\$ 1,726,351

On May 22, 2009, Eurogas International, together with its joint venture partner, Atlas Petroleum Exploration Worldwide Ltd. (“APEX”), reached an agreement with Delta Hydrocarbons B.V. (“Delta”) with respect to Delta's previously expressed desire to exit from the joint venture and the related agreements pertaining to the farmout of the Sfax Permit and the Ras-El-Besh (“REB-3”) concession in Tunisia. Under the original agreement, Delta had acquired a 50% interest in the Sfax joint venture and related contracts in exchange for expending US\$125 million. Capital expenditures were, during the period of the farmout agreement, substantially funded directly by Delta pursuant to its spending commitment.

Under the new agreement, Delta reassigned its 50% participating interest in the Sfax Permit and the REB-3 concession and transferred its shares in Innovative Production Services Limited (“IPS”) to the remaining joint venture partners, including Eurogas International. In exchange, Delta is entitled to a portion of certain payments, if and when received by the joint venture, including a share of the proceeds from the cost oil portion of any future production revenues and a share of the proceeds from any sale or lease of assets, to a maximum of US\$20 million. Delta remains committed to fund 50% of any costs associated with the abandonment of the REB-3 well until December 9, 2011.

Subsequent to the reassignment of Delta’s participating interest, Eurogas International's participating interest in the Sfax Permit, REB-3 concession and IPS was 45% and APEX's participating interest was 55%. Accordingly, Eurogas International is responsible for 45% of ongoing capital expenditures related to these activities.

## 5. ASSET RETIREMENT OBLIGATION

Upon completion of drilling and testing the REB-3 well pursuant to the Sfax Permit in Tunisia, the joint venture partners requested and received approval from the Tunisian government to temporarily suspend the well and release the drilling rig. The joint venture must either abandon or re-enter within certain timeframes. In the event of abandonment, the aggregate cost is estimated at between US\$6.5 million and US\$10 million. As a result, during 2008, Eurogas International recorded an asset retirement obligation in respect of its potential obligations in the event of abandonment of the well. A reconciliation of the asset retirement obligation is included in the following table.

	For the period ended September 30, 2009		
	Three Months	Nine Months	December 31, 2008
Balance, beginning of period	\$ 1,559,278	\$ 1,202,068	\$ -
Initial estimate of discounted cash flows	-	-	1,202,068
Revisions to estimated cash flows	-	313,897	-
Accretion	21,657	64,970	-
	\$ 1,580,935	\$ 1,580,935	\$ 1,202,068

The key assumptions on which the carrying amount of the asset retirement obligation was based included the following:

- Total undiscounted cash flow as at September 30, 2009 of \$1,790,978;
- Expected settlement in fiscal 2011; and
- Credit adjusted risk free rate at which the estimated payments have been discounted of 5.7%.

There were no liabilities incurred or settled during the three and nine months ended September 30, 2009.

## 6. PREFERENCE SHARES

During the three and nine months ended September 30, 2009, the Corporation recognized expenses of \$334,917 and \$965,585, respectively (September 30, 2008 - \$nil), representing the dividends accrued on the Series A Preference Shares.

Eurogas Corporation has indicated that it does not intend to exercise its redemption entitlement and it has agreed to accept the deferral of the payment of cumulative dividends thereon until 2011.



## 7. SHARE CAPITAL

At September 30, 2009, the Corporation had 31,143,635 common shares issued and outstanding. The Corporation is authorized to issue an unlimited number of common shares.

### Stock Based Compensation

On June 15, 2009, the Board of Directors of the Corporation approved the issuance of 600,000 stock options at an exercise price of \$0.05 per option, to directors of the Corporation. One third of the options vested immediately. The remaining options vest as to 50% each on the first and second anniversary date of the granting of the option award. The options expire on June 15, 2014.

The fair value of the options granted has been estimated at \$0.03 per share using the Black-Scholes option-pricing model. The following assumptions were used to determine the fair value of the options on the grant date:

Risk Free Interest Rate:	1.5%
Expected dividend yield:	-
Expected share price volatility:	100%
Option term:	3 years

The Corporation has recognized stock based compensation expense of \$7,775 in respect of these awards.

## 8. NET LOSS PER SHARE

For the three and nine months ended September 30,				
	Three months		Nine months	
	2009	2008	2009	2008
Net loss attributable to shareholders	\$ (1,062,975)	\$ (153,432)	\$ (2,664,764)	\$ (422,160)
Weighted average number of common shares outstanding	31,143,635	31,143,635	31,143,635	31,143,635
Basic and diluted net loss per share	\$ (0.03)	\$ -	\$ (0.09)	\$ (0.01)

In calculating the weighted average number of shares outstanding for purposes of determining the net loss per share in the three and nine month periods ended September 30, 2008, the Corporation assumed that the corporate reorganization of the Corporation as outlined in Note 2 to the 2008 Audited Financial Statements was completed on January 1, 2007.

## 9. RELATED PARTY TRANSACTIONS

The \$28,455 (2008 - \$886,223) payable to Eurogas Corporation is due on demand, is unsecured and is non-interest bearing.

During the third quarter of 2009, the Corporation redeemed its deposit with Eurogas Corporation for \$8,722,623 plus accrued and unpaid interest. Prior to redemption, the deposit with Eurogas Corporation earned interest at normal market rates. Interest earned on the deposit with Eurogas Corporation for the three and nine months ended September 30, 2009 was \$22,592 and \$118,840, respectively (September 30, 2008 - \$nil). The Corporation applied the proceeds from the redemption of the deposit with Eurogas Corporation

to repay amounts otherwise owing to Eurogas Corporation, with the residual balance used to purchase a GIC as described in Note 3.

During the first quarter of 2009, the Corporation entered into a services arrangement with Dundee Resources Limited, a wholly owned subsidiary of Dundee Corporation. Dundee Corporation is the principal shareholder of the Corporation. The services agreement with Dundee Resources Limited 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 nine months ended September 30, 2009, the Corporation incurred costs of \$33,360 and \$176,564, respectively (September 30, 2008 - \$nil), in respect of these arrangements.

## 10. COMMITMENTS

There have been no substantive changes to the description and nature of commitments from those described in Note 9 to the Corporation's 2008 Audited Financial Statements.

## 11. FINANCIAL INSTRUMENTS

The Corporation is exposed to financial risks due to the nature of its business and the financial assets and liabilities that it holds. Detailed disclosures on the Corporation's financial instruments are included in Note 8 to the 2008 Audited Financial Statements.

## 12. FUTURE ACCOUNTING CHANGES

### **Financial Instruments – Disclosures**

In June 2009, the Canadian Accounting Standards Board ("AcSB") incorporated the recent amendments to International Financial Reporting Standards ("IFRS") 7, "*Financial Instruments: Disclosures*", into CICA Handbook Section 3862, "*Financial Instruments – Disclosures*". The amendments introduce a three level fair value disclosure hierarchy that distinguishes fair value measurements by the significance of the inputs used. In addition, the amendments require enhanced disclosures regarding the nature and extent of liquidity risk arising from financial instruments to which an entity is exposed. The amendments are applicable to the Corporation's annual financial statements beginning with fiscal 2009. Comparative information is not required in the year of adoption. The Corporation is currently evaluating the impact of the adoption of these amendments.

### **Business Combinations**

In January 2009, the CICA issued CICA Handbook Section 1582, "*Business Combinations*", Section 1601, "*Consolidations*", and Section 1602, "*Non-controlling Interests*". These sections replace the former CICA Handbook Section 1581, "*Business Combinations*" and Section 1600, "*Consolidated Financial Statements*" and establish a new section for accounting for a non-controlling interest in a subsidiary.

CICA Handbook Section 1582 establishes standards for the accounting of a business combination. It provides the Canadian equivalent to IFRS 3, "*Business Combinations*" (January 2008). The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements. CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated

financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, “*Consolidated and Separate Financial Statements*” (January 2008).

CICA Handbook Section 1601 and Section 1602 apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. The Corporation is currently evaluating the impact of the adoption of these sections.

#### **Impairment of Financial Assets**

In August 2009, the AcSB amended CICA Handbook Section 3855, “*Financial Instruments – Recognition and Measurement*”, to achieve consistency with international standards on impairment of debt securities. The amendments changed the definition of a loan such that debt securities not quoted in an active market could be classified as a loan and measured at amortized cost. Impairment for debt securities classified as loans will be assessed and recorded using the incurred credit loss model of CICA Handbook Section 3025, “*Impaired Loans*”. Debt securities that are classified as available-for-sale securities continue to be written down to their fair value through earnings when the impairment is considered other-than-temporary. However, the impairment loss can be reversed if the fair value subsequently increases and the increase can be objectively related to an event occurring after the impairment loss was recognized. The amendments are applicable to the Corporation effective January 1, 2010. The Corporation is currently evaluating the impact of the adoption of these amendments.

#### **International Financial Reporting Standards**

In February 2008, the CICA Accounting Standards Board confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS in calendar year 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there may be significant differences on recognition, measurement and disclosure that may materially impact the Corporation’s financial statements.

The implementation of IFRS will apply to the Corporation's interim and annual financial statements beginning on January 1, 2011, including the restatement of comparative amounts for 2010. The Corporation, through active interaction with the IFRS implementation committee established by its parent, has initiated an assessment of the impact of IFRS adoption on its business activities, processes and accounting policies, after which it will implement a communication strategy, as appropriate, aimed at all stakeholders, including employees, rating agencies and shareholders, to assist in their understanding of its transition to IFRS.

## **Eurogas International Inc.**

### **Head Office**

Worthing Corporate Centre  
Worthing Main Road  
Christ Church BB15008  
Barbados

### **Registrar and Transfer Agent**

Computershare Investor Services Inc.  
100 University Avenue, 9<sup>th</sup> Floor  
Toronto, Ontario M5J 2Y1  
Toll Free: 1.800.564.6253  
Fax: 1.866.249.7775  
Email: [service@computershare.com](mailto:service@computershare.com)

### **Stock Exchange**

CNSX

### **Stock Symbol**

EI