# ANNUAL REPORT 2009

## THE **ENERGY** TO **SUCCEED**

EasternStar GAS


# Eastern Star Gas Limited
# **2009 Annual Report**

ABN – 29 094 269 780

# EASTERN STAR GAS

## Company Outline

### the JOURNEY

Over the year Eastern Star has certified additional CSG reserves in the Gunnedah Basin and certified a resource in excess of 6,000 PJs. The integrated geological and engineering model continues to step out across the basin after drilling 10 successful coreholes and completing two multi-lateral pilots during the period.

### the METHOD

Eastern Star has built an extensive exploration portfolio, an expert management team, and continue an aggressive exploration & appraisal programme.

### the FUTURE

Key near-term objectives now being pursued:

- Completion of a further eight multi-lateral pilot wells in 2009
- Continued dewatering and reserve certification from new and existing pilots
- Certification of 2P gas reserves of 1,300 PJ by end 2009
- Continue farm-ins on portfolio of 70,616 km$^2$
- Secure high-value market opportunities to support full-scale project development
- Further expansion of the Wilga Park Power Station
- Commence concept approval process for full-scale project development

# THE YEAR IN BRIEF

## Key Achievements

## CORPORATE

- Successful $50 million capital raising, to fund drilling, infrastructure and farm-in activities
- Santos' acquisition of 35% stake in the Narrabri CSG Project strengthens the joint venture with partner already committed to development of coal seam gas in NSW
- Admission to the ASX 200
- Commencement of trading on the International OTCQX

## GAS RESERVES

- Independently certified 2P gas reserves increased from 185 PJ to 602 P (100% project case).
- First Independently Certified Contingent Resource of 6,128PJ (100% project case) announced

## EXPLORATION

- Corehole appraisal programme confirms further potential in the north of PEL 238 and also areas close to existing facilities at Coonarah
- First stage of farm-in to Orion Petroleum leases almost complete

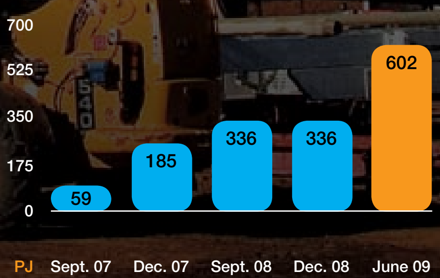
## MARKETING

- Continuation of Eastern Star's phased marketing strategy which is naturally aligned with project development.
- First stage of Wilga Park Power Station Upgrade complete with commissioning of first new 3MW generator.
- Independent report commissioned to examine suitability of the Port of Newcastle for a gas liquefication and export (LNG) project

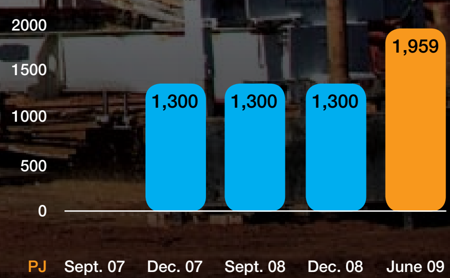
## EXPLORATION & PRODUCTION

- Major success of the lateral drilling programme, with the Bibblewindi Multi-lateral and Bibblewindi Tri-lateral Pilots complete
- Strong gas and water flow rates confirm high coal seam permeability and laterals as best completion technology to optimise reservoir connectivity and production
- Flowline completed to link Wilga Park with the Bohena and Bibblewindi pilots

### 2P GAS RESERVES




### 3P GAS RESERVES



# CHAIRMAN'S LETTER

## Eastern Star Gas Annual Report 2009

Completion of a gas flowline from the Bibblewindi production pilots to Wilga Park Power Station, coupled with the completion of the first stage of Wilga Park's upgrade, has brought us a step closer to full-scale commercialisation. Wilga Park's first new 3 MW generator was commissioned in July 2009.

Dear Shareholder

2009 has been an extremely productive year for Eastern Star Gas. We have made much progress in achieving the goals we outlined in our last Annual Report, in particular, our goal to become NSW's largest supplier of natural gas.

The success of the multi-lateral drilling programme will help unlock the enormous potential of PEL 238. In particular, the technology will allow even fewer wells than anticipated to be drilled, minimising both cost and surface disturbance, thereby lowering future production costs. The success of the drilling programme and the innovative technology employed, is a testament to the skill and insight of our technical team.

A certified reserves upgrade for PEL238 announced in August this year has seen a 79% 2P reserves uplift from 336PJ to 602PJ. A similar uplift was recorded for 3P reserves up 51% from 1,300PJ to 1,959PJ. Eastern Star is confident results from the field this year will support a further reserves upgrade and see the target of 1300PJ of 2P reserves achieved by the end of 2009.

Our corehole exploration programme, which has stepped out into less explored areas of our leases, has had encouraging results, with thick permeable seams located in almost all of our coreholes. This also bodes well for further reserves upgrades.

Completion of a gas flowline from the Bibblewindi production pilots to Wilga Park Power Station, coupled with the completion of the first stage of Wilga Park's upgrade, has brought us a step closer to increased commercialisation. Wilga Park's first new 3 MW generator was commissioned in July, and capacity will be further expanded as gas production increases.

Progress has not been limited to the field. Eastern Star commenced trading on the International OTCQX in January and two months later broke into the ASX 200. Confidence in the company was illustrated when a $50 million capital raising in March was heavily over-subscribed despite a cautious market. This funding has secured our ongoing drilling programme.

In July, Eastern Star welcomed a new joint venture partner in Santos Limited. Santos, which shares a similar vision for commercialisation of CSG in the Gunnedah Basin, acquired Gastar's 35% stake in the Narrabri CSG Project and a 19.99% share in Eastern Star through the purchase of Hillgrove Resources shares. Eastern Star anticipates a partnership between the two main explorers in the area will be of enormous benefit, particularly as Eastern Star transitions to being a major supplier of gas and investigates markets outside NSW, including longer-term high-yield options such as LNG.

Progress is being made on the more immediate goal of getting Narrabri CSG to the NSW market. Work towards gaining Part 3A approval for a pipeline connecting Eastern Star's CSG prospects to APA's Central Ranges Pipeline is well under way. Preliminary enquiries into the suitability of Newcastle for the construction of LNG facilities have also been undertaken.

Eastern Star takes particular pride in its community relations in and around Narrabri, NSW. We have maintained our high standards during our expanded corehole and production pilot activities over the last year and remain committed to this stance as we step out over our tenements.

Our goal to become NSW's largest supplier of natural gas coincides with the recognition that NSW needs a comprehensive broad-based energy policy. With large reserves of indigenous gas, Eastern Star is well placed to play a key role in that strategy.

Overall, it has been a year of great consolidation for the company and we have proven beyond doubt that the operational path chosen was the right one. With gas production expected to ramp up exponentially in the coming months, Eastern Star will not only be the operators of the largest acreage in the State, but well on the way to realising our vision to be NSW's leading supplier of natural gas.

In closing I would like to note that it has again been a privilege to work with a committed, harmonious board and executive team over the past 18 months.

**The Hon. John Anderson**
**Chairman**

10 September 2009


**Lucas Rig 26 on 24 hour operations**

# REVIEW OF OPERATIONS
## GAS RESERVES AND PRODUCTION


Adjusting separator pressure at Bibblewindi Lateral Pilot

With in excess of 6,000 PJs of Contingent Gas Resource over and above 1,959 PJs of 3P gas reserves now certified, the potential of the Narrabri Coal Seam Gas Project is beyond doubt.

With the performance of the multi-lateral production pilots exceeding expectations, Eastern Star Gas remains on track to realise that potential.

## GAS RESERVES

The Narrabri Coal Seam Gas Project is owned by Eastern Star Gas Ltd (65%) in joint venture with Santos Limited (35%). Santos acquired Gastar Exploration Ltd's interest in the Project effective 1 July 2009, along with Gastar's 35% interest in Petroleum Exploration Licences 433 and 434.

The Narrabri Coal Seam Gas Project comprises the Coal Seam Gas resource of Petroleum Exploration Licence ('PEL') 238, Petroleum Assessment Lease ('PAL2') 2 and Petroleum Production Licence ('PPL') 3. During 2008/09, the Narrabri Coal Seam Gas Project continued to be the prime focus of the Company's attention.

In December 2008, following an assessment of results from just four coreholes then completed in the Dewhurst area, the independently certified gas reserves of the Narrabri Coal Seam Gas Project were substantially increased. Netherland Sewell and Associates Inc ('NSAI'), appointed by the Company to carry out independent gas reserves assessments, upgraded 2P (proven plus probable) gas reserves to 336 PJ, an 80% increase from the level certified less than one year earlier. Independently certified 3P (proven plus probable plus possible) gas reserves remained unchanged at 1,300 PJ, reflecting the level of gas market then demonstrated to exist.

In February 2009, the Narrabri Coal Seam Gas Project realised its first Independently Certified Contingent Resource certification. Focussing principally on the Bohena Seam, NSAI certified 6,128 PJ of Contingent Resource over and above the existing Gas Reserves. It is envisaged that with ongoing market development these resources will be progressively converted to reserves when prospective markets for gas are identified.

In August 2009, NSAI increased their assessment of 2P (proved plus probable) gas reserves to 602 PJ ( Eastern Star interest 392 PJ). Importantly, albeit only modest at this time, NSAI has attributed reserves to the Namoi seam in the Upper Maules Creek Formation for the first time, recognising the encouraging results beginning
to emerge from the Bibblewindi West lateral pilot.

The reserves and resource certification outcomes achieved during 2008/09 were in line with the Company's expectations and timeframe, and point to the massive potential of the Narrabri Coal Seam Gas Project.

The Company is confident that exploration and appraisal activity will see the stated target of achieving independently certified 2P gas reserves of 1300PJ (ESG interest 845 PJ) realised by the end of 2009.

| | Effective Date | | |
|---|---|---|---|
| | 31 December 2007 | 31 December 2008 | 30 June 2009 |
| 1P (proven) | 13.7 PJ | 13.7 PJ | 21 PJ |
| 2P (proven + probable) | | 120.3 PJ | 218.4 PJ |
| 391 PJ | | | |
| 3P (proven + probable + possible) | 845.0 PJ | 845.0 PJ | 1,273 PJ |
| 1C | – | 776 PJ | Not reviewed |
| 2C | – | 1,984 PJ | Not reviewed |
| 3C | – | 3,983 PJ | Not reviewed |

**Eastern Star Gas' share of the independently certified Gas Reserves and Resources of the Narrabri Coal Seam Gas Project is summarised in the table above.**

## MULTI-LATERAL PRODUCTION PILOTS

In December 2008, following mobilisation of the newly-built Schramm TXD drilling rig, Eastern Star commenced its PEL 238 lateral drilling programme. The purpose of this programme was to address the unique challenges represented by the distinctive fracture architecture of the coals being targeted.

Unlike more typical coal, the coals being targeted by the Narrabri Coal Seam Gas Project are predominantly vertically-fractured, so lateral wells drilled perpendicular to this natural fracture system are ideal to maximise communication within the coal and, in turn gas production potential. Consequently, Eastern Star expects the multi-lateral wells to have a gas production capability significantly greater than that achievable with conventional vertical wells.

The first production pilot to incorporate lateral wells is the Bibblewindi Multi-lateral pilot, 4 kilometres to the south of Eastern Star's existing Bibblewindi 9-spot (vertical) production pilot. The Bibblewindi Multi-lateral pilot incorporates two adjacent but separate dual-lateral or horizontal completion wells intersecting a total of six production wells.

# REVIEW OF OPERATIONS

## GAS RESERVES AND PRODUCTION (continued)

**Narrabri Coal Seam Gas Project Production Pilots**

| Pilot | Description | Target Coal Seam | Production Commenced |
|---|---|---|---|
| Bohena | 3 vertical, fracture-stimulated wells, in line | Bohena | November 2004 |
| Bibblewindi 9-spot | 9 vertical, fracture-stimulated wells in diamond formation | Bohena | December 2006 |
| Bibblewindi Multi-lateral | 2 adjacent, twin-lateral wells intersecting 6 vertical production wells | Bohena | March-May 2009 |
| Bibblewindi Tri-lateral | Tri-lateral well-set, intersecting 4 vertical production wells | Namoi | n/a |

The decision to utilise lateral technology, and subsequent expectations with respect to gas production potential, appear justified based on early results from this production pilot. By early June 2009, after commencement of dewatering activity in early May, gas production had reached an initial 250,000 standard cubic feet per day with water production of 3,500-4,000 barrels per day.

Shortly after reaching this gas production rate, however, the wells experienced a series of repeated failures of pump drive shaft couplings. The failures appear to be attributable to poor material quality of the couplings and following work-overs to replace failed equipment, dewatering re-commenced, with gas production increasing once again.

Notwithstanding these temporary issues the Bibblewindi Multi-lateral has nonetheless confirmed:

- the suitability of the steering and intersection technology adopted by Eastern Star as an Australian first, with vertical well intersections (1 kilometre deep and 1 kilometre away) consistently and reliably achieved;
- the ability to stay within the target coal seam while drilling laterally and;
- a favourably high level of interference indicating good fracture communication between adjacent wells;
- from a full-field development perspective, this interference will allow spacing between laterals to be significantly increased from the 400 metres adopted for the Multi-lateral pilot to around 1 kilometre in future pilots.

Following success of the Bibblewindi Multi-lateral pilot, the Bibblewindi Tri-lateral pilot was drilled about 4 kilometres to the west of Eastern Star's existing Bibblewindi 9-spot (vertical) production pilot.

The Tri-lateral pilot, which is a variation to, and optimisation of, the initial Multi-lateral design, represents yet another level of technical challenge in that:

- it involved drilling of three laterals from a single location (intersecting a total of four vertical production wells): and
- the laterals were drilled in an area of thinner coal development (around 4 metres), confirming the applicability of the steering technology and techniques adopted.

Unlike previous production pilots, the Bibblewindi Tri-lateral pilot targeted the Early Permian Namoi coal seam approximately 50 metres above the Bohena seam. Although the Namoi coal seam is prevalent over large areas of PEL 238 it had not previously been production tested or taken into account in past gas reserve or resource assessments.

Drilling of the Tri-lateral has established the Namoi coal seam as having considerable additional reserves potential and confirmed the lateral technology as well-suited for accessing and producing from thinner coal seams.

Work is now underway on the Dewhurst Triple-lateral production pilot. This pilot comprises three separate, parallel laterals at a relatively close-spacing of around 200 metres, but only intersecting a single vertical well each. The laterals are close-spaced to increase interference between them to accelerate dewatering and, consequently, ramp up gas production to assist in early reserve determination. In the longer term, when full-scale development drilling is underway, it is anticipated the spacing between laterals will be similarly increased to around 1 kilometre increasing the cost-effectiveness of this and future pilots.

### PILOT PROGRAMME

**Narrabri Coal Seam Gas Project – Production Pilots**
**PEL 238, PAL 2 and PPL 3**
**Gunnedah Basin, New South Wales**
**ESG 65% Santos 35%**

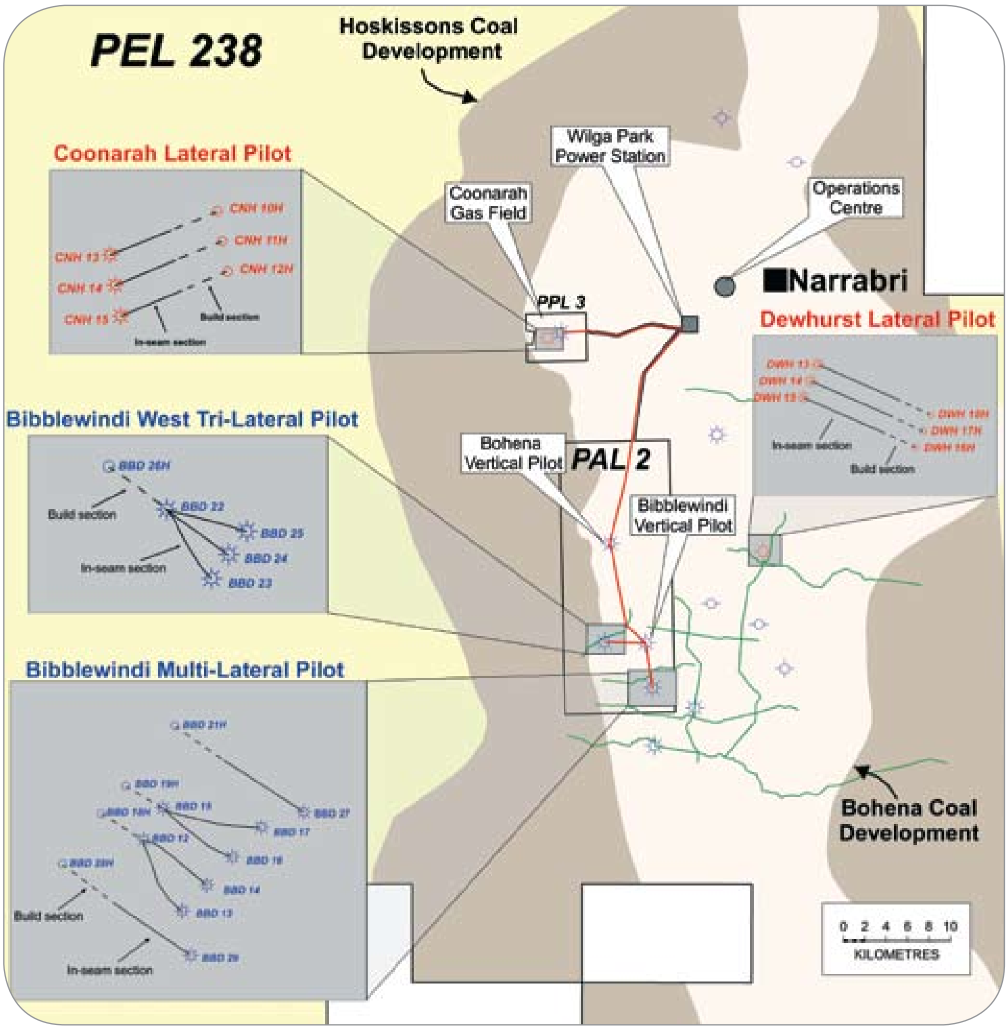
In addition to the recently drilled Lateral Production Pilots, the Narrabri Coal Seam gas project includes two vertical CSG production pilots within PAL 2.

The Bohena pilot consists of three vertical, fracture-stimulated wells (Bohena 3, 7 & 9). The wells run south-west to north-east and target the Bohena and Narrabri coal seams. The first pilot well (Bohena-3) was drilled in 1998, the current pilot production operation commenced in May 2006.

Gas production rates from the Bohena pilot continue to slowly increase, an observation consistent with structure of the target coal and the limited extent to which the well configuration can achieve effective dewatering of the coal.

The Bibblewindi 9-spot pilot vertical production pilot is located in the southern part of PAL 2. It consists of nine vertical, fracture-stimulated wells in a north-south oriented diamond pattern with a well spacing of 40 acres, producing from the Bohena coal seam. The close spacing of the wells maximises the impact of interference, whereby adjacent wells assist each other with dewatering of the target coal seam in order to reduce the time taken to achieve commercial rates of gas production.

A tenth well, located to the north of the main pilot on a nominal 160 acre spacing, is used for pressure monitoring purposes. The Bibblewindi pilot commenced production in December 2006. Gas production rates from the Bibblewindi 9-spot pilot remained steady during 2008/09.




**Location and design of lateral Pilots**

- Petroleum Exploration Licence
- Petroleum Lease
- Hoskissons Coal Development
- Bohena Coal Development
- 2008 Seismic Survey
- Eastern Star Pipelines
- Recent Drilling
- Proposed Lateral Pilot Wells

## Coonarah Gas Field
## PPL 3
## Gunnedah Basin, New South Wales

The Coonarah gas field is a sandstone reservoir within the Early Permian Maules Creek Formation. The gas field is operated pursuant to Petroleum Production Licence 3 ('PPL 3') which was issued to the Company in December 2003. Commercial gas production from the field first commenced in 2004 and the field is now well in decline, having failed to meet performance expectations held at the time of its development.

The quantity of conventional gas produced from the Coonarah gas field during 2008/09 was 30 TJ, all of which was used to generate electricity at the Wilga Park Power Station.

## GAS AND WATER HANDLING

Gas and water produced from all production pilots in the Bibblewindi area is transported through low pressure polyethylene pipelines to facilities at the southern perimeter of the Bibblewindi 9-spot pilot. From there, gas is transported through a fibreglass pipeline for use at the Wilga Park Power Station, while water is processed in a reverse osmosis water treatment plant.

Raw water produced from the pilot production wells contains up to 1% total dissolved solids, the bulk of which is sodium bicarbonate (commonly known as baking soda). In excess of 70% of the raw water is turned into drinking-quality water, while the balance, into which solids are concentrated, is evaporated in a fully-lined evaporation pond. The evaporation pond is fitted with an enhanced evaporation system to speed up the evaporation process.

Fresh water from the reverse osmosis plant is currently used by the Company in field and drilling operations.

# REVIEW OF OPERATIONS

## EXPLORATION AND APPRAISAL

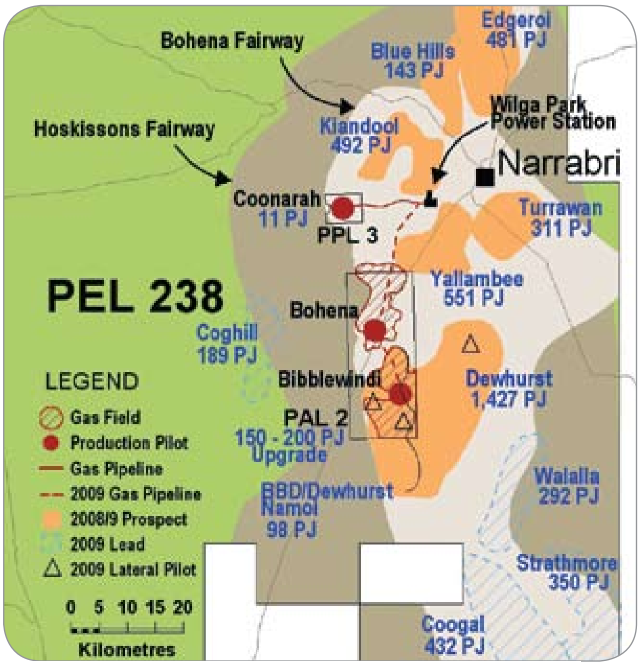
Laying out drill collars on Lucas Rig 26

The ultimate objective of the Company's ongoing CSG exploration and appraisal programme is to increase certified gas reserves to a level that will not only support full-scale CSG production, but will also be the foundation for development in NSW of a new gas-based value adding industry.

## Narrabri Coal Seam Gas Project
## PEL 238, PAL 2 and PPL 3
## Gunnedah Basin, New South Wales
## ESG 65% Santos 35%

The majority of exploration and appraisal activities conducted by the Company during 2008/09 were focussed on the Narrabri Coal Seam Gas Project, building upon work carried out in previous years. The continuing objectives of exploration and appraisal activity are to:

- assess CSG prospectivity across PEL 238;
- provide data to support an ongoing gas reserves upgrade, with a near-term target of at least 1,300 PJ of independently certified 2P gas reserves by the end of 2009; and
- support an early transition to full-scale project development and supply of gas into east coast gas markets.




**Prospective recoverable resources to be assessed during 2008/9 programme.**

Activities conducted over the past year within the Narrabri Coal Seam Gas Project included seismic acquisition and processing, corehole drilling and development of CSG production pilots. Data from these activities was utilised in ongoing development and refinement of CSG reservoir and production models, as well as for the purpose of in-house and independent gas reserves assessments.

### *Seismic Acquisition and Processing*

170 kilometres of new seismic was acquired, principally in the Dewhust area, during September 2008. Data from the 2008 seismic survey was processed and, in addition, 603 kilometres of existing seismic data was reprocessed using modern techniques with a focus on coal formations rather than geological structuring. Integration of the newly processed data into the geological model is continuing, and has been an important input to selection of locations for step out wells to support reserves assessment activities.

### *Corehole Drilling*

The corehole appraisal programme, commenced during 2007/08 with drilling of three coreholes in the Dewhurst area, continued during 2008/09. A total of 10 coreholes have now been drilled.

Coreholes drilled in the Dewhurst area, east of Bibblewindi, have all intersected between 34.5 and 43.1 metres of coal, of which between 16.4 and 21.7 metres has been within the Bohena seam. Data from the first 4 coreholes completed in the Dewhurst area combined with data from the Dewhurst Seismic Survey formed the basis for the December 2008 increase of independently certified 2P gas reserves to 336 PJ.

The sixth corehole was drilled in the Edgeroi area, north of Narrabri and 43 km north of the Dewhurst area. The corehole ('Edgeroi 1') intersected over 23 metres of coal, including 10 metres in the Bohena seam, providing positive confirmation of the lateral extent of the thick, highly permeable and gas-saturated Bohena seam in a trough that extends to the northern boundary of PEL 238.

The seventh corehole, Blue Hills 1, was located to evaluate the Black Jack and Maules Creek formations, on the shelf area on the western flank of the trough tested by Edgeroi 1. The corehole, 17km north north-west of Narrabri, intersected 10.34m of coal including a 9.94m thick Hoskissons seam. With initial test results indicating both good gas content and high permeability, the CSG prospectivity of the northern extent of PEL 238 has been confirmed by these two wildcat coreholes.

Coonarah 9, the eighth corehole, was designed to investigate the encouraging potential of the Hoskissons coal seam identified after reviewing the results of Coonarah 2 which was drilled in 1995. The Coonarah 9 corehole intersected 7.5m of Hoskissons coal, confirming the lateral extent of that seam. A CSG production pilot is now being planned for the Coonarah area, targeting the Hoskissons coal seam. An advantage of a production pilot in the Coonarah area will be the ability to utilise existing gas flowlines to transport pilot production gas for use at the Wilga Park Power Station. While the Bohena coal seam was not intersected by the Coonarah 9 corehole, seismic data indicates the seam is well developed to the east and a follow-up corehole, Tintsfield 1, the tenth of the current programme, is underway to confirm this prognosis.

The ninth corehole completed as part of the present campaign was at Yallambee. It was designed to test both the Hoskissons and Bohena seams at a location about 14 kilometres north of the Bohena Field.

In summary, coreholes completed to date have confirmed:

- the easterly extension of the thick Bohena coal seam;
- the CSG potential of the northern portion of PEL 238; and
- the viability of a CSG production pilot to be located close to existing facilities in the Coonarah area.

### *Step-out Production Wells*

As part of reserves upgrade activity carried out during 2008/09, Eastern Star drilled four step-out reserve addition wells in the Dewhurst area (Dewhurst 6, 8, 9 and Dewhurst 10) and one in the Bibblewindi area (Bibblewindi 20), in locations where gas content was adequately defined and additional specialised corehole data was not required. These wells provided similar data to coreholes on coal thickness and permeability sufficient for reserve determination, but have the added advantage that, unlike coreholes, they can be utilised in the future as production wells rather than abandoned. This will reduce the overall cost of ongoing development.

### PEL 433 and PEL 434
### Gunnedah Basin, New South Wales
### ESG 65% Santos 35%

No field exploration or appraisal activity was undertaken within PELs 433 or 434 during the past year. Analysis of core samples acquired during 2007 on the eastern side of PEL 433 indicated low gas content in the target Hoskissons seam. Subsequently, exploration efforts were focussed on locations in the Tooraweenah Trough, to the west of the PEL 433, and in the southern portion of PEL 434 where the Hoskissons seam is deeper and where previous drilling activity has identified Maules Creek coals. Planning of a seismic survey to target the Maules Creek coals is underway for recording in late 2009 with locations for testing the Hoskissons seam in late 2009 and early 2010 being finalised.

### PEL 6, PEL 427 and PEL 428
### Bowen, Surat and northern Gunnedah Basins, New South Wales

In August 2008, Eastern Star reached agreement with Orion Petroleum Ltd on arrangements to farm-in to the CSG rights of Petroleum Exploration Licences 6427 and 428 in the Bowen, Surat and northern Gunnedah Basins.

PELs 6, 427 and 428 together cover in excess of 18,000 square kilometres to the north and west of the Company's existing primary exploration acreage (PEL 238). Target coals within the farm-in areas are generally younger than those within PEL 238 and, notably, include areas of Walloon coal development. An internal estimate prepared by the Company indicates that the prospects to be investigated as part of the first stage of the farm-in, could contain a high-side prospective gas resource of 3,500 Bcf.

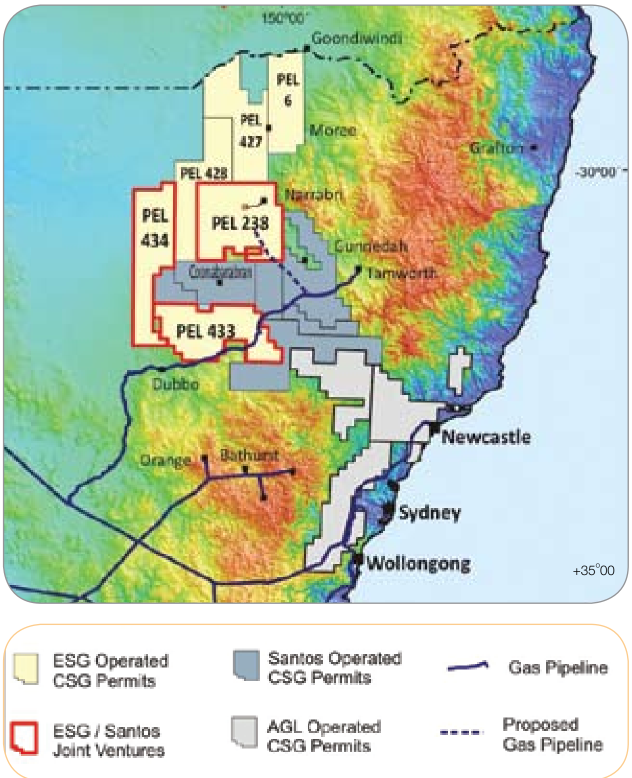
To earn the relevant interests, Eastern Star is required to complete the entire farm-in work programme detailed in the table on p13 and also has an option, by completing a second corehole in PEL 6, to earn a 75% interest in the CSG rights of PEL 6.

Performance of the farm-in work programme began in February 2009 with commencement of the Moree North Seismic Survey. The survey involved the acquisition of 100 line kilometres of seismic within Petroleum Exploration Licence 6.

Subsequently, coreholes were drilled within PELs 427 and 428. The Moree-4 corehole, 20 kilometres north-northwest of Moree within PEL 427, tested the CSG potential of the Cretaceous Coreena Member. The corehole intersected approximately 4.9 metres of gassy coal.


| Area | CSG Interests Earned | Farm-in Programme |
|---|---|---|
| PEL 6 | 50% (option to 75%) | 100 kilometre seismic; 1 corehole (option includes 1 additional corehole) |
| PEL 427 | 50% | 1 corehole |
| PEL 428 | 40% | 1 corehole |

**Summary of Farm-in Arrangements**




**Eastern Star Gas NSW assets**

The Kurrabooma 1 corehole, situated 70 kilometres west of Moree within PEL 428, also targeted coals in the Cretaceous Member. It intersected around 4.6 metres of gassy coal.

Following a review of the data from the Moree North Seismic Survey, Eastern Star has identified a number of attractive drilling locations in PEL 6 to target the previously untested Triassic Moolayember Formation coals at depths of around 500 to 800 metres. As this is an extensive play, the company plans to drill two coreholes in this target in late 2009, thus completing both stages of the farm-in to the Orion Petroleum licences. The seismic data also indicates the possible presence of Early Permian Maules Creek Formation Coals, similar to those on test in PEL 238, at depths which are prospective for coal seam gas. As a result, at least one well will be deepened to test this zone. Completion of both these coreholes will take the Company's PEL 6 CSG interest to 75%.

### PEL 117, PEL 121 and PEL 122
### Arckaringa Basin, South Australia

Commencement of a two stage farm-in to Petroleum Exploration Licences 117, 121 and 122 in the Arckaringa Basin region of South Australia has been delayed following the acquisition of SAPEX, party to the original farm-in agreement, by Linc Energy Ltd. Arrangements for coordination of the farm-in work programme with the activities of Linc, which is focused on underground coal gasification opportunities, have yet to be finalised.

The exploration permits over which Eastern Star Gas has farm-in rights cover in excess of 27,000 square kilometres. A two stage farm-in arrangement has been agreed. The first stage of the farm-in involves drilling of three coreholes, one in each of the three PELs, for which the Company will earn a 25% interest in coal seam gas rights of the exploration licences.

The second stage of the farm-in will, if the Company elects to proceed, involve drilling and testing of a notional five-well production pilot, for which the Company will earn a further 25% interest in coal seam gas rights of the exploration licences.

The Arckaringa Basin region has significant potential for coal seam gas. The extent and development of target coals are well understood due to previous coal exploration drilling. Target coals within the farm-in areas are sub-bituminous and lie within the Early Permian Mt Toondina Formation. Typically, the aggregate coal thickness is 20 to 35 metres, comprising five to nine seams with individual thicknesses up to 7.3 metres.

### EL 4507, EL 4510
### Otway Basin, Victoria

Sale of the Company's interests in PELs 4507 and 4510 to Western Victoria Energy Pty Ltd was completed on 8 August 2008. Western Victoria Energy has since elected to take over responsibility for the Oak Park pilot project within PEL 4507. Eastern Star Gas now has no ongoing obligations in respect of PELs 4507 and 4510.

The company has a 2.5% overriding royalty on the value of any petroleum produced from ELs 4507 and 4510 and a 3% overriding royalty on the value of any gold or precious stones produced.

# REVIEW OF OPERATIONS

## SUMMARY OF LICENCE INTERESTS

**Summary of Licence Interests**

| Basin | Description | Licence | Area (km²) | Interest | Comment |
|---|---|---|---|---|---|
| Arckaringa Basin | South Australia | PEL 117 | 9,547 | Earning 25% CSG Rights | Potential to earn further 25% CSG Rights |
| | | PEL 121 | 9,848 | | |
| | | PEL 122 | 8,572 | | |
| Gunnedah Basin | New South Wales | PPL 3 | 26 | 65% Petroleum Rights | Subject to 0.855% CSG ORRI and 0.555% Conventional ORRI |
| | | PAL 2 | 267 | 100% Conventional Rights; 65% CSG Rights | Subject to 0.855% CSG ORRI and 0.555% Conventional ORRI |
| | | PEL 238 | 8,802 | | Subject to 0.855% CSG ORRI and 0.555% Conventional ORRI |
| | | PEL 433 | 7,663 | | |
| | | PEL 434 | 7,736 | | |
| Bowen/Surat and NorthernGunnedah Basins | New South Wales | PEL 6 | 5,165 | Earning 50% CSG Rights | Subject to 3.5% ORRI. Potential to earn further 25% CSG Rights |
| | | PEL 427 | 7,014 | Earning 50% CSG Rights | |
| | | PEL 428 | 6,021 | Earning 40% CSG Rights | |
| | | TOTAL | 70,616 | | |

# REVIEW OF OPERATIONS

## ELECTRICITY PRODUCTION

Wilga Park Power Station

### WILGA PARK POWER STATION

Until recently the Wilga Park Power Station has been operated intermittently owing to limited availability of gas from the Coonarah gasfield. However, with installation of a new gas flowline completed and expansion of the power station underway, the power station will once again be operated on a full-time basis.

Part 3A planning approval for installation of the new flowline and for expansion of the power station was received in December 2008. The new fibreglass flowline, can deliver coal seam gas to the power station from production wells in the Bohena and Bibblewindi areas, including the Multi-lateral and Tri-lateral pilots. Fibreglass was selected for construction of the flowline as it has a pressure rating capability that provides capacity upside to supply other possible regional loads or, alternatively, there is scope for the pipeline to be used for other purposes, such as water transfer, should the need arise.

Expansion of the Wilga Park Power Station is being undertaken on a progressive basis, to make use of growing quantities of coal seam gas produced by each of the pilots.

The first stage of the expansion was completed at the end of July 2009 when the first new 3 MW Jenbacher gas engine driven generator was commissioned, bringing the total installed generating capacity at Wilga Park to 7 MW.

Approvals are in place for the total installed capacity at Wilga Park to be increased to 40 MW, at which point it will utilise around 11 terrajoules per day of gas. The power station will ultimately comprise two separate stations – the original Wilga Park Power Station (Wilga Park ‘A’) with a capacity of nominally 10 MW and an adjoining nominal 30 MW ‘B’ Station.

All electricity generated at Wilga Park continues to be sold to Country Energy under a 10 year Power Purchase Agreement (PPA), now in its sixth year. In generating electricity, the gas-fuelled Wilga Park Power Station produces significantly lower greenhouse gas emissions than are produced from coal fired generators. The power station therefore contributes to achievement of the NSW Government’s greenhouse gas reduction initiative and receives NSW Greenhouse Gas Abatement Certificates (NGACs’). The NGAC’s are also sold to Country Energy under the terms of the PPA.

The value of electricity and NGACs suppied to Country Energy during 2008/09 was $158,000.

**Gas fired generator at Wilga Park Power Station**

# REVIEW OF OPERATIONS
## COMMERCIAL AND MARKETING

Opportunities for coordinated development of gas reserves, gas markets and downstream infrastructure are closely monitored with a view to achieving an early transition to full-scale gas production.

Of particular interest are emerging, high-value market opportunities that would not be possible in NSW without the benefit of the truly world-scale Narrabri gas resource, and which need to be secured to realise the full value of that resource.

Over the past year, Eastern Star has maintained its proactive approach to business development with the fundamental gas business requirements – reserves, markets and infrastructure – being addressed in a parallel but potentially staged manner.

The first market development stage is now well under way. It involves creation by Eastern Star of a new regional gas market through use of pilot production gas at the Wilga Park Power Station. The power station will be progressively expanded as pilot production gas quantities rise. Arrangements are in place with Clarke Energy for acquisition of additional generating units, as required. In preparation for continued expansion of the power station, key facilities (such as fuel gas system and control room) installed in association with the first new 3 MW generator have been sized to accommodate planned growth.

Future gas marketing stages are, for convenience, in order of potential size:

**Stage 2** supply of gas into the existing NSW and east coast gas markets.

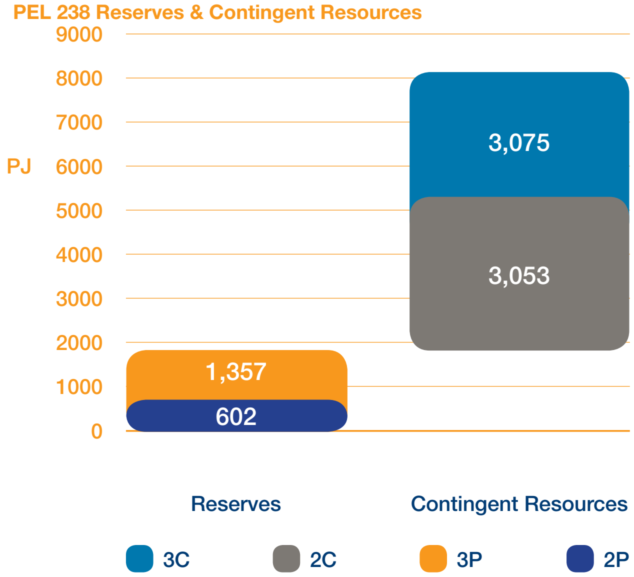
**Stage 3** supply of gas to meet new greenfields growth of domestic gas markets, most likely to be associated with environmentally friendly use of gas to generate electricity.

**Stage 4** supply of gas for use in major new value-adding initiatives that would not, without significant quantities of gas being available, be possible in NSW or, for that matter, on the Australian eastern seaboard.

It is important to note that the marketing stages outlined above need not be implemented consecutively. Indeed, given the potential of the Narrabri CSG Project, Eastern Star has over the past year maintained a keen focus on pursuit of the Stage 4 initiative.

The gas reserves potential of the Project is so large relative to domestic gas market opportunities that early implementation of a Stage 4 initiative will greatly assist in maximising net returns to shareholders.

PEL 238 Reserves & Contingent Resources




### KEY COMMERCIAL AND MARKETING ACTIVITIES

Discussions have been initiated with a number of prospective Stage 2 (ie existing) gas users. Arrangements for sale of gas to major users are dependent not only upon the timely availability of gas reserves and infrastructure but also, among other things, upon the term of the users' pre-existing gas supply arrangements. Opportunities to secure loads to underwrite market entry are being monitored.

In parallel with the above, discussions are ongoing with the APA Group, owner and operator of the Central Ranges, Central West and Moomba to Sydney Pipelines.

Eastern Star is also monitoring gas-fuelled power station development proposals. While Eastern Star already has Memoranda of Understanding in place with Macquarie Generation and Babcock & Brown for supply of around 70 PJ/a of gas, several other parties are also pursuing Northern NSW and the Hunter Valley-based power station development initiatives.

# REVIEW OF OPERATIONS

## CORPORATE

Eastern Star considers the Narrabri CSG Project is particularly well placed to competitively supply gas for use in such projects. While the NSW Government's electricity industry privatisation initiatives appear to have introduced an element of uncertainty and delay into power station planning and decision making, there is nonetheless a compelling requirement that new generating capacity be developed to come on line by around 2013-14.

Eastern Star is also involved in preliminary discussions regarding Stage 4 initiatives, such as LNG or methanol production for export via Newcastle. Eastern Star commissioned an independent report to examine the potential for development of a Newcastle-based gas liquefaction and export project (ie an LNG project). LNG (ie, natural gas that has been cooled to become a liquid) is a non-explosive, environmentally friendly fuel. The report concluded that an LNG project could be developed at Newcastle in compliance with environmental and safety requirements.

Recognising the benefits to shareholders and stakeholders of such initiatives, Eastern Star has formulated a Development Plan for the Narrabri CSG Project, incorporating Stage 4 type initiatives, that will shortly be submitted for consideration in accordance with NSW planning processes.

### CAPITAL RAISINGS

On 12 March 2009, the company successfully completed an equity capital raising with the issue of 90.1m new fully paid shares through Patersons Securities Limited raising $50 million.

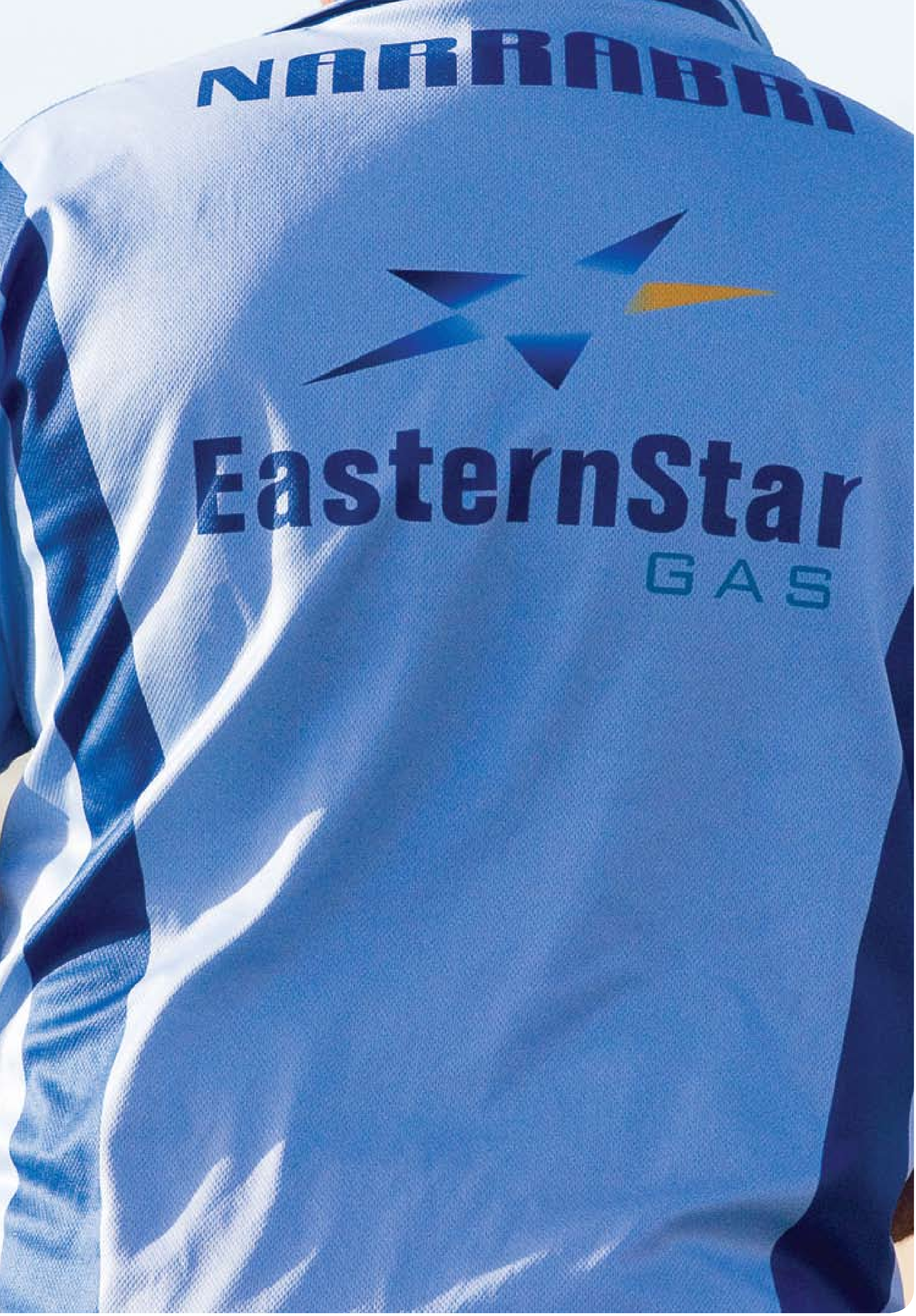
### RETIREMENT OF DIRECTOR

Mr Doug Battersby, a Founding Director of the Company, retired at the Annual General Meeting on 19 November 2008. At that meeting the Chairman and Board thanked Mr Battersby for his contribution to the Company. As one of its founders and a major shareholder since the Company's listing in 2001, he has greatly increased shareholders' wealth and positioned the Company for further growth.

### RESIGNATION OF DIRECTOR

Mr David Archer resigned as Director on August 27. Mr Archer was appointed as a Director in October 2006 when Hillgrove Resources Limited vended its 32.5% interest in PEL 238 into Eastern Star, for an interest in the Company. He served as Chairman of the Audit Committee and the Remuneration and Nomination Committee. The Board thanked Mr Archer for his invaluable contribution on a wide range of transactions and issues during his 3 years as a non-executive Director.

**Wilga Park Power Station prepared for future expansion**




Narrabri Bowling Club proudly sponsored by Eastern Star Gas

# Eastern Star Gas Limited
# **2009 Financial Report**

ABN – 29 094 269 780

# DIRECTORS' REPORT

Eastern Star Gas Annual Report 2009

The Hon. John Anderson

Mr David Casey

Dr David King

Mr David Archer

The Directors present their report on the Group consisting of Eastern Star Gas Limited (Parent Entity) and the entities it controlled at the end of, or during, the year ended 30 June 2009.

## DIRECTORS

The following persons have been Directors of Eastern Star Gas Limited during the year up and to the date of this report.

### The Hon. John Anderson

*Non-Executive Chairman*

Appointed on 15 October 2007

Former Member of Federal Parliament; Deputy Prime Minister for six years 1999 to 2005. He holds a Master of Arts (Sydney) and is a farmer in Northern NSW. In government he drove policy initiatives as diverse as the National Water Initiative, Auslink (national transport plan) and Regional Development; he served on the National Security Committee for six years and was on the Economic Review Committee which reconstructed the Federal Budgets in the earlier years of the Howard government. He retains a deep interest in regional development and the sustainable use of natural resources.

### Mr David Casey

*Managing Director*

Appointed Executive Director - Operations on 5 July 2006 and Managing Director on 31 October 2007

David Casey graduated with an Honours degree in Geology from the University of Sydney in 1991 and in the same year joined specialist coal seam gas company In Situ (Australia) Pty Ltd. In 1996, he formed his own coal seam gas consultancy business, and subsequently was a founder of Multiphase Technologies Pty Ltd., a provider of coal seam testing services. David has more than 15 years' experience in the management and evaluation of all aspects of CSG exploration and appraisal, from initial reservoir characterisation and fairway identification through to drilling, testing and production operations. He joined Eastern Star Gas Limited in September 2005 as Chief Operating Officer, and was previously a Director of Molopo Australia Limited between April 2001 and October 2005.

### Dr David King

*Non-Executive Director*

First appointed on 25 August 2000

Chairman of the Remuneration and Nomination Committee and Member of the Audit and Risk Committee. Dr King graduated with a First Class Honours degree in Physics/Mathematics from the University of East Anglia in 1969, a Masters degree in Geophysics from Imperial College, University of London in 1970, and a PhD in Seismology from the Australian National University in 1974. After an early academic research career, he held executive positions at Offshore Oil NL and Hartogen Energy Limited before an appointment as Managing Director of gold producer North Flinders Mines Ltd. In 1991, he joined Beach Petroleum/Claremont Petroleum as Chief Executive Officer, a position he held until 1995. He is a Founding Director of Eastern Star Gas, a Director of Baron Partners Limited (since 1990), Medical Therapies Limited and Ausmon Resources Limited (since January 2006).

### Mr David Archer

*Non-Executive Director*

Appointed on 30 October 2006 and resigned 27 August 2009

Chairman of the Audit and Risk Committee and member of the Remuneration and Nomination Committee up until his resignation. David Archer has a Bachelor of Economics degree, he also holds a Law Diploma and is



Mr Douglas Battersby Mr Alex Sundich Mr Peter Lansom

a barrister (non-practising) of the Supreme Court of New South Wales. He is a Fellow of the Australasian Institute of Mining & Metallurgy and has been actively involved in the Australian resources industry for over 25 years. He has held executive and non-executive roles in a number of Australian companies. He was also previously a Director of Hostworks Group Limited and Medivac Limited. He has been the Managing Director of Hillgrove Resources Limited since 2003. He is also currently a Director of Crusader Holdings NL and InterMet Resources Limited.

**Mr Douglas Battersby**
*Non-Executive Director*

First appointed on 25 August 2000 and resigned 19 November 2008

Member of the Remuneration and Nomination Committee up until his resignation. Doug Battersby graduated with a Bachelor of Science (Geology) in 1965 and a Master of Science in Petroleum Geochemistry in 1969 from the University of Melbourne. He has over 30 years technical and managerial experience in the oil and gas industry, working in Australia and internationally for companies including Delhi, Exxon, Hartogen and PetSec.

**Mr Alex Sundich**
*Non-Executive Director*

Appointed on 20 September 2007

Chairman of the Audit and Risk Committee and member of the Remuneration Committee and Nomination Committee. Alex has over 20 years' experience in the financial services industry and is a Fellow of the Financial Services Institute of Australia, a Member of the Institute of Chartered Accountants in Australia and a Member of the Australian Institute of Company Directors. Alex is an Executive Director of Harvest Capital Partners, an investment firm that he co-founded in 2008. From 2003 to 2008, Alex held senior management positions within the funds management industry. Prior to that, Alex was an investment banker providing advice to corporate clients on merger and acquisition transactions and debt and equity capital raisings, with a particular focus on the oil, gas and mining industries. Alex worked with Goldman Sachs and Credit Suisse First Boston during this period which included six years working in New York. Alex is also a Non-Executive Director of Ellex Medical Lasers Limited, an ASX listed manufacturer of medical equipment.

**Mr Peter Lansom**
*Executive Director Operations*

Appointed on 16 November 2007 as an alternate Executive Director for Dr King and appointed as an Executive Director Operations on 14 October 2008

Mr Lansom holds a Bachelor of Petroleum Engineering (Honours) degree from the University of NSW and has over 20 years' experience in conventional and coal seam gas exploration and development, working with Origin Energy Limited (Origin) and also with Santos Limited. He has significant expertise in well intervention and stimulation, reservoir modelling, field development planning and optimisation and asset valuations in both conventional hydrocarbon and CSG. In his past role at Origin, in the key management position of Chief Petroleum Engineer, he had responsibility for delivering the corporate year end petroleum reserves report and ensuring that consistently high standards in sub-surface engineering were maintained across that company's assets.

# DIRECTORS' REPORT

(continued)

## COMPANY SECRETARY

The Company Secretary of the Parent Entity as at the end of the financial year and at the date of this report is:

**Ian Kirkham**

Appointed on 28 January 2008

Ian is a Member of the Institute of Chartered Accountants in Australia with a Bachelor of Economics degree. He started his career in accountancy in Sydney with Coopers & Lybrand where he worked for five years before being seconded to Coopers & Lybrand Toronto for two years. On his return to Sydney Ian worked for several ASX listed exploration/mining companies as Chief Financial Officer and Company Secretary assisting the companies through exploration, evaluation, financing, development and production phases. From 2004 to 2007 he was Chief Financial Officer and Company Secretary for Hillgrove Resources Limited where he participated in the PEL 238 Narrabri Coal Seam Gas Joint Venture through Hillgrove's then 32.5% joint venture stake. Ian joined the Company in December 2007 as Chief Financial Officer and was appointed Company Secretary on 28 January 2008.

## PRINCIPAL ACTIVITIES

The principal activities of the Group during the financial year consisted of exploration for oil and gas, development and production of natural gas and production of electricity from a gas fired power station. The Parent Entity, a public listed company, and the subsidiaries, all being proprietary companies, were incorporated in Australia as limited liability companies and are domiciled in Australia.

## OPERATING RESULTS

Total revenue decreased to $2,365,000 (2008 – $2,510,000) primarily due to a decrease in interest income. Sales of electricity at the Wilga Park Power Station reduced to $158,000 (2008 – $266,000) as a result of low gas production from the Coonarah Gas Field. The net loss of the Group after income tax for the financial year was $2,519,000 (2008 – $4,181,000). Deferred exploration expenditure that was expensed during the period amounted to $109,000 (2008 – $189,000).

## FINANCIAL POSITION

Total assets increased by $51,876,000 and total liabilities increased by $3,619,000 resulting in the increase of net assets by $48,257,000 at 30 June 2009. The increase in net assets arose predominantly from the issue of new shares for cash. During the year, the Company issued 90,909,091 ordinary shares at 55 cents per share for cash proceeds of $50 million. These funds will be primarily applied to the development and evaluation of the Narrabri Coal Seam Gas Project and independent certification of gas reserves to underpin future gas sales contracts and general operation costs.

## DIVIDENDS

No dividends have been paid or declared since the end of the previous financial period.

## STATE OF AFFAIRS

The state of affairs of the Group was not affected by any significant changes during the financial year other than the following:

1. The issued capital of the Parent Entity increased by the issue of 92,059,091 new fully paid ordinary shares as follows:
   (a) For cash 90,909,091 shares by placement at 50 cents per share raising $50.0 million
   (b) Under the Employee Incentive Plan: 1,150,000 shares at an average of 45 cents per share against total loan of $517,500 advanced to the participants.

## SHARE OPTIONS

At the date of this report the Parent Entity has 25,000 (2008 – 25,000,000) unquoted options over unissued ordinary shares, each option exercisable at 15 cents per share on or before 30 October 2009. The terms of the options do not permit an option holder to participate in any other share issue of the Parent Entity or related entity.

## MATTERS SUBSEQUENT TO THE END OF THE FINANCIAL YEAR

There has not arisen in the interval since 30 June 2009 and up to the date of this report, any matter that, in the opinion of the Directors, has significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group in future financial years other than the following:

(a) On 2 July 2009, Santos acquired Gastar Exploration Limited's 35% interest in PEL 238 (Narrabri CSG Project), PEL 433, PEL 434 and the Wilga Park Power Station. Santos also acquired a 19.99% interest in the company from Hillgrove Resources Limited. There is no financial effect of this transaction on the Group.

## REVIEW OF OPERATIONS AND LIKELY DEVELOPMENTS

A detailed review of the operations for the financial year together with future developments are set out on pages 6 to19. The Group continued producing gas from the Coonarah Gas Field to fuel the Wilga Park Power Station which generates electricity that is sold to Country Energy under a Power Purchase Agreement. The Group also continued to explore for gas with a focus on coal seam gas production pilots. During the financial year two in-seam multi-lateral production pilots were completed at Bibblewindi. A gas gathering system was also installed linking the expanded power station to all Bibblewindi and Bohena pilots. Except as described elsewhere in this Annual Report the likely results of the exploration activities and development are unknown at the date of this report.

## ENVIRONMENTAL REGULATIONS

The Group's operations are subject to significant environmental and other regulations. The Group has a policy of engaging appropriately experienced contractors and consultants to advise on and ensure compliance with environmental regulations in respect of its exploration, development and production activities. During the year, the Parent Entity employed a full time Environmental Officer to oversee practices in environmental management of the Group's activities. There have been no reports of breaches of environmental regulations in the financial year and at the date of this report.

## INDEMNIFICATION OF OFFICERS AND AUDITORS

The Parent Entity has entered into a Deed of Access, Indemnity and Insurance with each of the Directors of the Company. Subject to the Corporations Act 2001, the Deed provides an indemnity in respect of liability each of the Directors may incur in relation to the conduct of the business or affairs of the Parent Entity, Acts or Omission of the Directors in relation to the business or affairs of the Parent Entity or the performance, manner of performance or failure to perform the Directors responsibilities in relation to the business or affairs of the Parent Entity, in each case in the period during which each Director (respectively) holds office. The Parent Entity has not otherwise, during or since the end of the financial year, indemnified or agreed to indemnify an auditor of the Company or of any related body corporate against a liability incurred by such an auditor.

## MEETINGS OF DIRECTORS

The following table sets out the number of meetings held by the Directors of the Parent Entity during the year ended 30 June 2009 and the number of meetings attended by each Director:

| | Number of meetings attended | Number of meetings held while in office |
|---|---|---|
| John Anderson | 16 | 16 |
| David Casey | 16 | 16 |
| David Archer | 13 | 16 |
| David King | 16 | 16 |
| Alex Sundich | 13 | 16 |
| Peter Lansom | 15 | 16 |
| Doug Battersby | 3 | 4 |

*The Audit and Risk Committee met three times during the year ended 30 June 2009.*

## REMUNERATION REPORT

### (a) Directors and Executives

The names and positions held of Parent Entity Directors and Executives in office during the financial year and the previous financial year are:

#### MANAGING DIRECTOR

David Casey (appointed 31 October 2007)

#### NON-EXECUTIVE DIRECTORS

John Anderson – Chairman (appointed 15 October 2007)
David Archer (appointed 30 October 2006 & resigned 27 August 2009)
Doug Battersby (retired 19 November 2008)
David King (appointed 25 August 2000)
Alex Sundich (appointed 20 September 2007)

#### EXECUTIVE DIRECTOR

Peter Lansom – Executive Director Operations (appointed 14 October 2008)

#### EXECUTIVES

Ashley Edgar – General Manager Exploration and New Ventures
Roland Sleeman – General Manager Commercial
Ian Kirkham – Chief Financial Officer and Company Secretary

### (b) Remuneration Policy and Practices

The Board, assisted by the Remuneration Committee, establishes appropriate remuneration for Directors and remuneration levels and incentive structures for key management personnel.

Key management personnel are those who have authority and responsibility for planning, directing and controlling the activities of the Company and the Group and this category includes both the Executive Directors of the Company and Executives of the Company and the Group.

The Group's policy for determining the nature and amount of emoluments of Board members and specified Executives is as follows:

### (i) Non-Executive Directors

The Board's policy is to remunerate Non-Executive Directors at market rates for comparable companies for time, commitment and responsibilities. The Board determines payments to the Non-Executive Directors and reviews their remuneration annually, based on market practices.

The base fee of each Non-Executive Director for all Board activities is $40,000 (2008 – $40,000) per year and the fee for the Chairman is $100,000 (2008 – $100,000). Where applicable superannuation contributions equal to 9% of the fees are paid to each Non-Executive Director's personal retirement plan.

### (ii) Executives

The remuneration structure for Executives, including Executive Directors, is based on a number of factors, including qualifications, particular experience and general past performance of the individual concerned, overall performance of the Group and general human resources market pricing. The contracts for service between the Parent Entity and the Executives are on a continuing basis. Upon retirement Executive Directors and Executives are paid employee benefit entitlements accrued, in accordance with applicable legislation, to the date of retirement.

A short term incentive (STI) is applicable for Senior Executives with defined percentages of eligible base salary to be paid upon achievement of specified performance criteria. The overall effect of the Company's remuneration policies is to retain capable and energetic Directors and to attract and retain Executives who have reasonable additional incentive for superior performance.

Executives are able to participate in the Eastern Star Gas Employee Incentive Plan (EIP) at the invitation of the Board where securities offered under the plan may be subject to predetermined performance conditions. Directors may participate in the Eastern Star Gas Employee Incentive Plan subject to approval of shareholders.

(c) **Details of Remuneration**

| | Short-term | | | | Long-term | |
|---|---|---|---|---|---|---|
| | Salary and fees $ | STI $ | Non-cash $ | EIP $ | Super-annuation $ | Total $ |
| **2009** | | | | | | |
| **Parent Entity Directors** | | | | | | |
| John Anderson | 100,000 | – | – | 43,699 | 9,000 | 152,699 |
| David Casey | 436,404 | 166,560 | 20,011 | 102,170 | 39,276 | 764,421 |
| Peter Lansom | 385,321 | 112,767 | 15,658 | 652,092 | 34,678 | 1,200,516 |
| David Archer | 40,000 | – | – | – | 2,700 | 42,700 |
| Doug Battersby | 16,667 | – | – | – | 1,500 | 18,167 |
| David King | 40,000 | – | – | – | 3,600 | 43,600 |
| Alex Sundich | 40,000 | – | – | – | 3,600 | 43,600 |
| | **1,058,392** | **279,327** | **35,669** | **797,961** | **94,354** | **2,265,703** |
| **Executives** | | | | | | |
| Ashley Edgar | 330,275 | 101,260 | 13,105 | 734,794 | 29,725 | 1,209,159 |
| Ian Kirkham | 300,000 | 62,115 | 5,250 | 140,913 | 27,000 | 535,278 |
| Roland Sleeman | 300,000 | 72,268 | 13,394 | 630,986 | 27,000 | 1,043,648 |
| | **930,275** | **235,643** | **31,749** | **1,506,693** | **83,725** | **2,788,085** |
| **2008** | | | | | | |
| **Parent Entity Directors** | | | | | | |
| John Anderson | 71,324 | – | – | – | 6,419 | 77,743 |
| Dennis Morton | 152,392 | – | 1,177 | – | 9,000 | 162,569 |
| David Casey | 340,000 | – | 13,418 | 202,840 | 30,600 | 586,858 |
| David Archer | 33,750 | – | – | – | – | 33,750 |
| Doug Battersby | 33,750 | – | – | – | 3,038 | 36,788 |
| David King | 38,115 | – | 2,326 | – | 3,430 | 43,871 |
| Chris Ryan | 12,500 | – | – | – | 1,125 | 13,625 |
| Alex Sundich | 31,205 | – | – | – | 2,808 | 34,013 |
| | **713,036** | **–** | **16,921** | **202,840** | **56,420** | **989,217** |
| **Executives** | | | | | | |
| Ashley Edgar | 233,128 | – | 9,238 | 1,139,143 | 20,982 | 1,402,491 |
| Ian Kirkham | 143,493 | – | – | 239,087 | 12,914 | 395,494 |
| Peter Lansom | 259,300 | – | 15,474 | 1,101,618 | 23,337 | 1,399,729 |
| Roland Sleeman | 166,667 | – | – | 699,114 | 15,000 | 880,781 |
| Patrick Sam Yue | 189,809 | – | – | – | 14,777 | 204,586 |
| | **992,397** | **–** | **24,712** | **3,178,962** | **87,010** | **4,283,081** |

All EIP incentives relate to issued shares. There were no options granted over unissued shares during or since the end of the financial year by the Parent Entity or a subsidiary to Directors or any Executive as part of their remuneration.

## REMUNERATION REPORT

### (c) Details of Remuneration (continued)

The relative proportions of remuneration that are linked to performance that are fixed are as follows:

| | Fixed Remuneration | | At risk – STI | | At risk – LT | |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** | **2009** | **2008** |
| **Parent Entity Directors** | | | | | | |
| John Anderson | 71% | 100% | – | – | 29% | – |
| David Casey | 65% | 63% | 22% | – | 13% | 37% |
| Dennis Morton | – | 100% | – | – | – | – |
| Peter Lansom | 36% | – | 9% | – | 55% | – |
| David Archer | 100% | 100% | – | – | – | – |
| Doug Battersby | 100% | 100% | – | – | – | – |
| David King | 100% | 100% | – | – | – | – |
| Alex Sundich | 100% | 100% | – | – | – | – |
| Chris Ryan | – | 100% | – | – | – | – |
| **Executives** | | | | | | |
| Ashley Edgar | 31% | 18% | 8% | – | 61% | 82% |
| Ian Kirkham | 62% | 40% | 12% | – | 26% | 60% |
| Peter Lansom | – | 20% | – | – | – | 80% |
| Roland Sleeman | 33% | 21% | 7% | – | 60% | 79% |
| Patrick Sam Yue | – | 100% | – | – | – | – |

### d) Compensation of Key Management Personnel

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $** | 2008 $ | **2009 $** | 2008 $ |
| Short-term employee benefits | **2,571,055** | 1,746,066 | **2,571,055** | 1,746,066 |
| Post-employment benefits | **178,079** | 143,430 | **178,079** | 143,430 |
| Share-based payment | **2,304,654** | 3,381,792 | **2,304,654** | 3,381,792 |
| | **5,053,788** | 5,271,288 | **5,053,788** | 5,271,288 |

Remuneration and other terms of employment for the Managing Director and other key management personnel are formalised in employment agreements reviewed by the Remuneration Committee. Each of these agreements is based on Total Fixed Remuneration (TFR) plus Short Term Incentives (STI) and participation in the company's Employee Incentive Plan (EIP). The major provisions of the employment agreements relating to remuneration are set out below:

**David Casey, Managing Director**

- Term: 3 year contract from 4 July 2009
- TFR of $738,500, STI $325,000 and LTI $150,000.
- Employee Incentive Plan (EIP) participation
    - Tranche 1: 625,000 shares at $0.45 each vest if 400 PJs of 2P gas reserves are certified by 31 January 2009. (vested 19 August 2009**)
    - Tranche 2: 625,000 shares at $0.45 each vest if a total of 600 PJs of 2P gas reserves are certified by 31 December 2009. (vested 19 August 2009)

    **Directors have used their discretion under the Plan Rules to vest Tranche 1 shares on the basis that the Tranche 1 vesting requirements were substantially met (with 83% of reserves target achieved), the ultimate Tranche 2 target was met and the significant contribution of the Managing Director to the strong performance of the Company during the period.

**Peter Lansom**
**Executive Director – Chief Operating Officer**

- Term: 3 year contract from 10 September 2007.
- TFR of $420,000 and STI $192,661.
- Employee Incentive Plan (EIP) participation
    - Tranche 1: 1,500,000 shares at $0.45 each vest after 6 months of employment. (vested 10 March 2008)
    - Tranche 2: 3,000,000 shares at $0.54 each vest within 24 months if:
        - 50 PJs of 2P gas reserves are certified outside the 2006/2007 programme; or
        - after 12 months employment Company shares trade above $1.05. (vested 19 August 2009)
    - Tranche 3: 3,000,000 shares at $0.54 each vest within 24 months if:
        - 200 PJs of 2P gas reserves are certified on a new licence; or
        - 400 PJs of 2P gas reserves are certified on an existing licence; or
        - after 12 months employment Company shares trade above $1.50. (vested 19 August 2009)

**Ashley Edgar**
**General Manager Exploration New Ventures**

- Term: 3 year contract from 27 August 2007.
- TFR of $360,000 and STI $165,138.
- Employee Incentive Plan (EIP) participation
    - Tranche 1: 1,000,000 shares at $0.45 each vest after 6 months of employment. (vested 27 February 2008)
    - Tranche 2: 3,000,000 shares at $0.54 each vest within 24 months if:
        - 50 PJs of 2P gas reserves are certified outside the 2006/2007 programme; or
        - after 12 months employment Company shares trade above $1.05. (vested 19 August 2009)
    - Tranche 3: 3,000,000 shares at $0.54 each vest within 24 months if:
        - 200 PJs of 2P gas reserves are certified on a new licence; or
        - 400 PJs of 2P gas reserves are certified on an existing licence; or
        - after 12 months employment Company shares trade above $1.50. (vested 19 August 2009)

**Roland Sleeman, General Manager Commercial**

- Term: 3 year contract from 1 November 2007.
- TFR of $327,000 and STI $150,000.
- Employee Incentive Plan (EIP) participation
    - Tranche 1: 750,000 shares at $0.45 each vest after 9 months of employment. (vested 1 August 2008)
    - Tranche 2: 2,625,000 shares at $0.45 each vest if a 500 PJ gas sales agreement is entered into.
    - Tranche 3: 2,625,000 shares at $0.45 each vest if a further 500 PJ gas sales agreement is entered into or downstream commercial arrangements have been finalised for the 500 PJ gas sales agreement.

**Ian Kirkham**
**Chief Financial Officer & Company Secretary**

- Term: 3 year contract from 5 December 2007.
- TFR of $327,000 and STI $150,000.
- Employee Incentive Plan (EIP) participation
    - Tranche 1: 1,000,000 shares at $0.45 each vest after 9 months of employment. (vested 5 September 2008)
    - Tranche 2: 1,000,000 shares at $0.45 each vest after 18 months of employment. (vested 5 June 2009)

## REMUNERATION REPORT (continued)

### (e) Shareholdings of Key Management Personnel

| | Beginning of Year Number | Acquired Under Overriding Royalty | Acquired Under Employee Incentive Plan Number | Net Change Other Number | End of Year Number |
|---|---|---|---|---|---|
| **2009** | | | | | |
| John Anderson | 40,000 | – | 500,000* | – | 540,000 |
| David Casey | 8,000,000 | – | – | – | 8,000,000 |
| David Archer | – | – | – | – | – |
| Doug Battersby – Retired** | 30,055,462 | – | – | – | 30,055,462 |
| David King | 20,456,558 | – | – | – | 20,456,558 |
| Alex Sundich | 11,041,124 | – | – | (1,100,000) | 9,941,124 |
| Ashley Edgar | 7,000,000 | – | – | – | 7,000,000 |
| Ian Kirkham | 2,100,000 | – | – | – | 2,100,000 |
| Peter Lansom | 7,500,000 | – | – | – | 7,500,000 |
| Roland Sleeman | 6,684,474 | – | – | – | 6,684,474 |
| | **92,877,618** | **–** | **500,000** | **(1,100,000)** | **92,277,618** |
| **2008** | | | | | |
| John Anderson | – | – | – | 40,000 | 40,000 |
| David Casey | 6,750,000 | – | 1,250,000* | – | 8,000,000 |
| Dennis Morton – Retired** | 19,053,333 | 11,030,988 | – | – | 30,084,321 |
| David Archer | – | – | – | – | – |
| Doug Battersby | 21,000,000 | 11,030,988 | – | (1,975,526) | 30,055,462 |
| David King | 12,413,333 | 11,030,988 | – | (2,987,763) | 20,456,558 |
| Chris Ryan – Resigned** | 7,615,456 | – | – | (3,975,526) | 3,639,930 |
| Alex Sundich | 11,028,887 | – | _ | 12,237 | 11,041,124 |
| Ashley Edgar | – | – | 7,000,000* | – | 7,000,000 |
| Ian Kirkham | 100,000 | – | 2,000,000* | – | 2,100,000 |
| Peter Lansom | – | – | 7,500,000* | – | 7,500,000 |
| Roland Sleeman | 422,237 | – | 6,250,000* | 12,237 | 6,684,474 |
| Patrick Sam Yue – Resigned** | 4,940,299 | – | – | 158,168 | 5,098,467 |
| | **83,323,545** | **33,092,964** | **24,000,000** | **(8,716,173)** | **131,700,336** |

** Shares issued under Employee Incentive Plan are subject to satisfaction to the conditions as described in (d) above.*

*** Share holdings are as at the date of resignation.*

### (f) Loans to Key Management Personnel

| | Beginning of Year $ | Addition $ | Repayment $ | End of Year $ | Maturity Date |
|---|---|---|---|---|---|
| **2009** | | | | | |
| John Anderson | – | 90,000 | – | 90,000 | 30 November 2013* |
| David Casey | 101,250 | – | – | 101,250 | 30 November 2010 |
| | 900,000 | – | – | 900,000 | 15 June 2011 |
| | 562,500 | – | – | 562,500 | 26 March 2013* |
| | **1,563,750** | **–** | **–** | **1,563,750** | |
| Peter Lansom | 3,915,000 | – | – | 3,915,000 | 10 September 2012* |
| Ashley Edgar | 3,690,000 | – | – | 3,690,000 | 27 August 2012* |
| Roland Sleeman | 2,700,000 | – | – | 2,700,000 | 31 October 2012* |
| Ian Kirkham | 900,000 | – | – | 900,000 | 5 December 2012 |
| **2008** | | | | | |
| David Casey | 101,250 | – | – | 101,250 | 30 November 2010 |
| | 900,000 | – | – | 900,000 | 15 June 2011 |
| | – | 562,500 | – | 562,500 | 26 March 2013* |
| | **1,001,250** | **562,500** | **–** | **1,563,750** | |
| Peter Lansom | – | 3,915,000 | – | 3,915,000 | 31 July 2012* |
| Ashley Edgar | – | 3,690,000 | – | 3,690,000 | 30 July 2012* |
| Roland Sleeman | – | 2,700,000 | – | 2,700,000 | 1 November 2012* |
| Ian Kirkham | – | 900,000 | – | 900,000 | 5 December 2012* |
| Patrick Sam Yue | 30,000 | – | (30,000) | – | 30 June 2009 |
| | 67,500 | – | (67,500) | – | 30 November 2010 |
| | **97,500** | **–** | **(97,500)** | **–** | |

*The loans were made to key management personnel under the Eastern Star Gas Employee Incentive Plan to subscribe for fully paid ordinary shares in the Parent Entity. The loans are interest free and mature 5 years from the date that they were provided. The issued shares may not be dealt with by the key management personnel until the loan has been repaid. The repayment of the loan is limited to the loan value or proceeds on eventual disposal of the shares.*

* *The loans are not due and payable if the entitlement conditions to the related issued shares are not satisfied, those conditions as described in (d) above.*

# DIRECTORS' REPORT
(continued)

## AUDIT AND NON-AUDIT SERVICES

Details of amounts paid or payable to the auditors, PKF, for the audit and non-audit services provided during the year are set out below:

| | Consolidated | |
|---|---|---|
| | **2009 $** | 2008 $ |
| **Audit services** | | |
| PKF – Audit and review of financial reports | 159,860 | 97,750 |
| **Non-audit services** | | |
| PKF – General matters | – | – |
| **Total** | 159,860 | 97,750 |

The Board of Directors has considered the position and is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors are satisfied that the provision of non-audit services by the auditors, set out below, did not compromise the auditors' independence requirements of the Corporations Act 2001 for the following reasons:

- All non-audit services have been reviewed by the Audit Committee to ensure they do not impact the impartiality and objectivity of the auditors
- None of the services undermine the general principles relating to auditors independence as set out in APES 110 Code of Ethics for Professional Accountants

## AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration as required under section 307c of the Corporations Act 2001 is set out on page 33.

## INDEMNIFICATION OF OFFICERS

The Group has provided for and paid premiums during the year for Directors' and officers' liability and legal expenses' insurance contracts.

The insurance premiums relate to:

- Costs and expenses incurred by the relevant officers in defending proceedings, whether civil or criminal and whatever their outcome;
- Other liabilities that may arise from their position, with the exception of conduct involving a wilful breach of duty or improper use of information or position to gain a personal advantage.

The Directors have not included details of the nature of the liabilities covered or the amount of the premium paid with respect to the Directors' and Officers' liability and legal expenses' insurance contract, as such disclosure is prohibited under the terms of the contract.

## ROUNDING OF AMOUNTS

Amounts in the financial report and Directors' report have been rounded to the nearest thousand dollars in accordance with the Australian Securities and Investments Commission Class Order 98/100.

This report is made in accordance with a resolution of Directors.

Dated 10 September 2009

**David Casey**
Managing Director

# LEAD AUDITORS' INDEPENDENCE DECLARATION

## Under section 307C of the Corporations Act 2001

PKF

Chartered Accountants
& Business Advisers

**Auditor's Independence Declaration**

As lead auditor for the audit of Eastern Star Gas Limited for the year ended 30 June 2009, I declare that to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

(b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Eastern Star Gas Limited and the entities it controlled during the year.

**PKF**

**Bruce Gordon**
Partner

10 September 2009
Sydney

Tel: 61 2 9251 4100 I Fax: 61 2 9240 9821 I www.pkf.com.au
PKF I ABN 83 236 985 726
Level 10, 1 Margaret Street I Sydney I New South Wales 2000 I Australia
DX 10173 I Sydney Stock Exchange I New South Wales

# CORPORATE GOVERNANCE STATEMENT

## CORPORATE GOVERNANCE

Eastern Star Gas Limited and the Board are committed to protecting and enhancing shareholder value and conducting Eastern Star Gas Limited's business ethically and in accordance with the highest standards of corporate governance.

The Board is committed to following the corporate governance guidelines and recommendations set out by the *ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations* (ASX Guidelines).

As at the date of this report and during the 2008 financial year, the Company complied with the requirements in the ASX Guidelines. This Corporate Governance Statement outlines the key aspects and mechanisms of the Company's governance framework, which was established, and is continually reviewed, by the Board.

Eastern Star Gas Limited's main corporate governance policies which can be found in full at the Company's official website www.easternstar.com.au are set out below:

- Board Charter
- Audit and Risk Committee Charter
- Remuneration and Nomination Committee Charter
- Directors Code of Conduct
- Shareholder Communication Policy
- Continuous Disclosure Policy
- Share Trading Policy
- Code of Business Conduct
- Remuneration Policy
- Privacy Policy

## BOARD OF DIRECTORS

### *Role of the Board/Directors*

The Board is elected by shareholders to represent all shareholders – its primary role being the protection and enhancement of long-term shareholder value.

To fulfil this role, the Board is responsible for the overall corporate governance of the Group entity including its strategic direction, establishing goals for management and monitoring the achievement of these goals and defining policies and monitoring the business of the subsidiary, to ensure it is conducted appropriately and in the best interests of shareholders.

In respect of all decisions concerning the Company's affairs, it is the responsibility of each Director to conscientiously consider the interests of shareholders in light of the circumstances and to take into account the effects of such decisions on the interests of all shareholders.

### *Composition of the Board*

The names of the Directors of the Company in office at the date of this statement are set out in the Directors' Report of the annual report.

The number of Directors is specified in Clause 45 of the Company's Constitution as a minimum of three up to a maximum of 10. The Chairman may be either an Executive or Non-Executive Director.

Retirement and rotation of Directors is governed by the Corporations Act 2001 and Clause 47 of the Company's Constitution. Each year one third of the Directors retire and may offer themselves for re-election.

When a Board vacancy exists or where it is considered that a Director with particular skills or experience is required, the Board would make an appointment of a candidate with the appropriate skills, qualifications and experience.

### *Relationship of Board with Management*

Management of the day to day business of the Company is to be conducted by or under the supervision of the Board and by such other officers and employees to whom the management function is properly delegated by the Board.

As the Company grows, the Board will adopt appropriate structures and procedures to ensure that the Board functions independently of management.

Information is formally presented to the Board at regular board meetings by way of reports to the Board and review of performance to date.

### *Conflict of interest*

In accordance with the Corporations Act 2001 and the Company's Constitution, Directors must keep the Board advised, on an ongoing basis, of any interest that could potentially conflict with those of the Company. Details of Director related entity transactions with the Company and Group entity are set out in Note 30.

### *Director dealings in Company shares*

Directors and senior management may acquire shares in the Company, but are prohibited from dealing in Company securities:

- in the month preceding the release of the Company's half-year and annual results to the Australian Stock Exchange ('ASX');
- whilst in possession of price sensitive information.

Directors must advise the Chairman of the Board and senior management must advise the Company Secretary before they sell or buy shares in the Company and confirm they are not in possession of any unpublished price-sensitive information. Directors must advise the ASX of any transactions conducted by them in shares in the Company.

*Related party transactions*

Directors and senior management will convey to all stakeholders the message that integrity and effective control cannot be compromised when dealing with any supplier, particularly if a supplier is a related party.

A Director or an entity over which a Director has control or significant influence, who enters into a transaction with the Company must make full disclosure of all material elements of the transaction to the Chairman or, if the Director involved is the Chairman, to the Board.

*Constitution*

The Directors must adhere to, and the Board must conduct itself in accordance with, the Constitution of the Company.

*Independent professional advice and access to Company information*

Each Director has the right of access to all relevant Company information and to the Company's Executives and, subject to prior consultation with the Chairman, may seek independent professional advice at the Group entity's expense. A copy of advice received by the Director is made available to all other members of the Board.

*The role of shareholders*

The Board aims to ensure that shareholders are informed of all major developments affecting the Group entity's state of affairs as follows.

- The full annual financial report is available to all shareholders, including relevant information about the operations of the Group entity during the year, changes in the state of affairs and details of future developments, in addition to the other disclosures required by the Corporations Act 2001.
- The half-yearly report contains summarised financial information and a review of the operations of the Group entity during the period. The half-year financial report is lodged with the Australian Securities and Investments Commission and the ASX, and sent to any shareholder who requests it.
- Proposed major changes in the Group entity which may impact on share ownership rights are submitted to a vote of shareholders.

All documents that are released publicly are available on the ASX internet web site at www.asx.com.au and the Group entity internet web site at www.easternstar.com.

The Board encourages full participation of shareholders at the Annual General Meeting to ensure a high level of accountability and identification with the Group entity's strategy and goals. Important issues are presented to the shareholders as single resolutions. The shareholders are requested to vote on the appointment and aggregate remuneration of Directors, the granting of options and shares to Directors and changes to the Constitution.

Copies of the Constitution are available to any shareholder who requests it.

*Audit and Risk Committee*

The members of the Audit and Risk Committee during the year were all independent Non-Executive directors and comprised David Archer (Chairman), Douglas Battersby, David King and Alex Sundich. The Audit and Risk Committee has responsibility for making recommendations to the Board on the appointment, evaluation and retention or removal of the external auditor, setting fees for audit and non-audit services (if any) and ensuring that the auditor reports to the Committee and the Board as representatives of the shareholders. PKF has been the auditor since 2000 financial year. As part of the independence process, the Audit and Risk Committee will require the rotation of the audit signing partner and the independent review partner every five years.

The lead audit partner of PKF will attend the annual general meeting and will be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.

Eastern Star, with the approval of the Audit and Risk Committee, may decide to employ the auditor on assignments additional to their statutory and audit duties where the auditor's expertise and experience with Eastern Star are important, and where these services will not impair the external auditor's independence.

Details of the amounts paid or payable to the auditor and its related practices for audit and non-audit services provided during the year are set out in the Directors' Report on page 32.

*Remuneration and Nomination Committee*

The members of the Remuneration and Nomination Committee during the year were all independent Non-Executive Directors and comprised David Archer (Chairman), Douglas Battersby, David King and Alex Sundich. Details of the qualifications of the Remuneration and Nomination Committee members are included in the Directors' Report.

This Committee's Charter provides for it to assist the Board in the effective discharge of its responsibilities in relation to remuneration of Executives and Non-Executive Directors, and in determining the composition and performance of the Board. In meeting this purpose the Committee's duties include (among others):

- regularly reviewing the executive remuneration policy of Eastern Star Gas Limited to ensure that it is clearly linked to the performance of Eastern Star

Gas Limited and it motivates senior Executives to pursue both short term deliverables and long-term growth;

- reviewing all aspects of the remuneration (including base pay, incentive payments, equity awards, retirement rights and service contracts) and any proposed change to the terms of employment of the CEO and his or her direct reports;
- developing and reviewing appropriate succession plans for key Executives;
- reviewing the recruitment, retention and termination policies and procedures for senior Executives;
- reviewing the policy and any proposed changes regarding the remuneration of Non-Executive Directors;
- developing and implementing a policy for the selection and appointment of new Directors to the Board and overseeing any process regarding the search for a new Chief Executive Officer or Non-Executive Director;
- developing, implementing and disclosing procedures for evaluating the performance of the Board, its committees and individual Directors; and
- developing and implementing an induction procedure for new Directors.

The Committee also considers, and advises the Board on, matters such as succession and senior Executive compensation policies, including short and long term incentive plans and Eastern Star Gas Limited's recruitment, retention and termination policies.

The Committee has available to it the services of independent professional advisers to assist in the search for high-calibre people at all levels and to ensure that the terms and conditions offered by Eastern Star Gas Limited are competitive with those offered by comparable companies.

## INTERNAL CONTROL FRAMEWORK

The Board acknowledges that it is responsible for the overall internal control framework, but recognises that no cost effective internal control system will preclude all errors and irregularities. The Board examines the adequacy of the nature, extent and effectiveness of the internal control processes of the Group entity on an ongoing basis and has instigated a control framework that can be described as follows.

- Financial reporting – the Company reports to ASX yearly and half-yearly.
- Continuous disclosure – procedures are in place to ensure that all price sensitive information is reported to ASX in accordance with the continuous disclosure requirements of the Corporations Act 2001 and ASX Listing Rules.
- Investment appraisal – the risks involved in a diversified resources exploration, development and production company and the specific uncertainties for the Company are regularly monitored and reviewed. All proposals reviewed by the Board include a consciousconsideration of the issues and risks of the proposal.

## ETHICAL STANDARDS

All Directors, managers and employees of the Company are expected to act with the utmost integrity and objectivity, striving at all times to enhance the performance of the Group entity.

In maintaining its ethical standards, the Company:

- behaves with integrity in all its dealings with customers, shareholders, employees, government, suppliers and the community;
- ensures that its actions comply with applicable laws and regulations;
- maintains harmonious relations with communities located near company operations;
- maintains and implements policies that enable the employees of the Company to avoid situations where conflicts of interest could arise;
- does not engage in any activity that could be construed to involve an improper inducement; and
- achieves a working environment where:
  - equal opportunity is practised,
  - harassment and other offensive behaviour is not tolerated,
  - the confidentiality of commercially sensitive information is protected, and
  - employees are encouraged to discuss concerns about ethical behaviour arising from their employment with their supervisor.

## CONTINUOUS REVIEW OF COUNCIL GUIDELINES

Company's activities develop in size, nature and scope, the Board and management will continuously review the Company's policies and procedures in light of the Council's guidelines and recommendations regarding corporate governance and best practice. The Board is committed to identifying enhancements to the Company's policies and procedures (including the implementation of any formal corporate governance committees) to ensure continued investor confidence in the operations of the Company.

# INCOME STATEMENTS

| | Note | Consolidated 2009 $'000 | Consolidated 2008 $'000 | Parent Entity 2009 $'000 | Parent Entity 2008 $'000 |
|---|---|---|---|---|---|
| **Continuing operations** | | | | | |
| **Revenue** | 3 | **2,365** | 2,510 | **2,426** | 2,268 |
| **Other Income** | 4 | **2,401** | – | **–** | – |
| **Expenses:** | | | | | |
| Raw materials and consumables used | | **(263)** | (759) | **–** | – |
| Lease payments | | **–** | (136) | **–** | – |
| Exploration and evaluation expenditure written off | | **(109)** | (189) | **(109)** | (189) |
| Fixed assets written off | | **–** | (23) | **–** | (9) |
| Well equipment written off | | **(184)** | – | **(44)** | – |
| Depreciation and amortisation expenses | 5 | **(416)** | (311) | **(301)** | (127) |
| Movement in provision for impairment of amount receivable from subsidiary | | **–** | – | **2,566** | (858) |
| Finance costs | | **–** | (3) | **–** | (1) |
| Share of loss of associate accounted for using the equity method | | **–** | (4) | **–** | (4) |
| Other | 6 | **(6,313)** | (5,266) | **(6,307)** | (5,129) |
| **Total expenses** | | **(7,285)** | (6,691) | **(4,195)** | (6,317) |
| **Loss before income tax expense** | | **(2,519)** | (4,181) | **(1,769)** | (4,049) |
| Income tax expense | 8 | **–** | – | **–** | – |
| **Net loss attributable to members of the Parent entity** | | **(2,519)** | (4,181) | **(1,769)** | (4,049) |
| **Basic/diluted loss per share (cents per share)** | 7 | **(0.34)** | (0.62) | | |

*The above Income Statements should be read in conjunction with the accompanying notes.*

# BALANCE SHEETS

as at 30 June 2009

| | Note | Consolidated 2009 $'000 | Consolidated 2008 $'000 | Parent Entity 2009 $'000 | Parent Entity 2008 $'000 |
|---|---|---|---|---|---|
| **Current assets** | | | | | |
| Cash and cash equivalents | 22(a) | **59,568** | 37,536 | **56,882** | 35,090 |
| Trade and other receivables | 9 | **2,171** | 2,045 | **71,656** | 44,658 |
| Other financial assets | 10 | **–** | 285 | **–** | 285 |
| Well equipment | | **1,569** | 484 | **104** | 147 |
| **Total current assets** | | **63,308** | 40,350 | **128,642** | 80,180 |
| **Non-current assets** | | | | | |
| Other financial assets | 10 | **2,169** | 1,591 | **32,126** | 31,556 |
| Property, plant and equipment | 11 | **8,609** | 7,921 | **528** | 761 |
| Exploration and evaluation expenditure | 12 | **76,318** | 48,707 | **1,374** | 42 |
| Intangible assets | 13 | **9,610** | 9,569 | **251** | 210 |
| **Total non-current assets** | | **96,706** | 67,788 | **34,279** | 32,569 |
| **Total assets** | | **160,014** | 108,138 | **162,921** | 112,749 |
| **Current liabilities** | | | | | |
| Trade and other payables | 14 | **4,470** | 1,587 | **1,818** | 863 |
| Provisions | 15 | **393** | 232 | **393** | 232 |
| **Total current liabilities** | | **4,863** | 1,819 | **2,211** | 1,095 |
| **Non-current liabilities** | | | | | |
| Provisions | 15 | **1,398** | 823 | **89** | 40 |
| **Total non-current liabilities** | | **1,398** | 823 | **89** | 40 |
| **Total liabilities** | | **6,261** | 2,642 | **2,300** | 1,135 |
| **Net assets** | | **153,753** | 105,496 | **160,621** | 111,614 |
| **Equity** | | | | | |
| Contributed equity | 16 | **190,706** | 142,662 | **190,706** | 142,662 |
| Reserves | 17 | **9,691** | 6,959 | **9,691** | 6,959 |
| Accumulated losses | 18 | **(46,644)** | (44,125) | **(39,776)** | (38,007) |
| **Total equity** | | **153,753** | 105,496 | **160,621** | 111,614 |

*The above Balance Sheets should be read in conjunction with the accompanying notes.*

# STATEMENTS OF CHANGES IN EQUITY

for the year ended 30 June 2009

| | Issued Capital $'000 | Converting Notes $'000 | Reserves $'000 | Accumulated Losses $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Consolidated** | | | | | |
| **Balance at 1 July 2008** | 142,662 | – | 6,959 | (44,125) | 105,496 |
| Loss attributable to members of the Parent Entity | – | – | – | (2,519) | (2,519) |
| Total recognised income and expense attributable to the members of the Parent Entity | – | – | – | (2,519) | (2,519) |
| Issue of shares | 50,000 | – | – | – | 50,000 |
| Issue of shares under Employee Incentive Plan | 45 | – | (16) | – | 29 |
| Option grants under Employee Incentive Plan | – | – | 2,838 | – | 2,838 |
| Exercise of options | 202 | – | (90) | – | 112 |
| Capital raising costs | (2,203) | – | – | – | (2,203) |
| **Balance at 30 June 2009** | 190,706 | – | 9,691 | (46,644) | 153,753 |
| **Balance at 1 July 2007** | 78,755 | 6,353 | 3,338 | (39,944) | 48,502 |
| Loss attributable to members of the Parent entity | – | – | – | (4,181) | (4,181) |
| Total recognised income and expense attributable to the members of the Parent entity | – | – | – | (4,181) | (4,181) |
| Issue of shares | 58,912 | – | – | – | 58,912 |
| Issue of shares under Employee Incentive Plan | 450 | – | (161) | – | 289 |
| Option grants under Employee Incentive Plan | – | – | 3,782 | – | 3,782 |
| Conversion of converting notes | 6,353 | (6,353) | – | – | – |
| Capital raising costs | (1,808) | – | – | – | (1,808) |
| **Balance at 30 June 2008** | 142,662 | – | 6,959 | (44,125) | 105,496 |

*The above Statements of Changes in Equity should be read in conjunction with the accompanying notes.*

# STATEMENTS OF CHANGES IN EQUITY

## for the year ended 30 June 2009 (continued)

| | Issued Capital $'000 | Converting Notes $'000 | Reserves $'000 | Accumulated Losses $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Parent entity** | | | | | |
| **Balance at 1 July 2008** | 142,662 | – | 6,959 | (38,007) | 111,614 |
| Loss attributable to members of the Parent Entity | – | – | – | (1,769) | (1,769) |
| Total recognised income and expense attributable to the members of the Parent Entity | – | – | – | (1,769) | (1,769) |
| Issue of shares | 50,000 | – | – | – | 50,000 |
| Issue of shares under Employee Incentive Plan | 45 | – | (16) | – | 29 |
| Option grants under Employee Incentive Plan | – | – | 2,838 | – | 2,838 |
| Exercise of options | 202 | – | (90) | – | 112 |
| Capital raising costs | (2,203) | – | – | – | (2,203) |
| **Balance at 30 June 2009** | 190,706 | – | 9,691 | (39,776) | 160,621 |
| **Balance at 1 July 2007** | 78,755 | 6,353 | 3,338 | (33,958) | 54,488 |
| Loss attributable to members of the Parent Entity | – | – | – | (4,049) | (4,049) |
| Total recognised income and expense attributable to the members of the Parent Entity | – | – | – | (4,049) | (4,049) |
| Issue of shares | 58,912 | – | – | – | 58,912 |
| Issue of shares under Employee Incentive Plan | 450 | – | (161) | – | 289 |
| Option grants under Employee Incentive Plan | – | – | 3,782 | – | 3,782 |
| Conversion of converting notes | 6,353 | (6,353) | – | – | – |
| Capital raising costs | (1,808) | – | – | – | (1,808) |
| **Balance at 30 June 2008** | 142,662 | – | 6,959 | (38,007) | 111,614 |

*The above Statements of Changes in Equity should be read in conjunction with the accompanying notes.*

# CASH FLOW STATEMENTS

## for the year ended 30 June 2009

| | Note | Consolidated | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Cash Flows from Operating Activities** | | | | | |
| Receipts from customers | | **201** | 284 | **–** | – |
| Payments to suppliers and employees | | **(5,490)** | (5,243) | **(6,153)** | (4,291) |
| Interest received | | **1,749** | 2,033 | **1,550** | 1,943 |
| Interest paid | | **–** | (2) | **–** | (1) |
| Sundry receipts | | **419** | 68 | **1,774** | 216 |
| **Net Cash Outflow from Operating Activities** | 21(b) | **(3,121)** | (2,860) | **(2,829)** | (2,133) |
| **Cash Flows from Investing Activities** | | | | | |
| Payments for property, plant and equipment | | **(3,490)** | (2,400) | **(285)** | (696) |
| Payments for exploration and evaluation | | **(25,040)** | (5,794) | **(1,225)** | (324) |
| Payments for intangible assets | | **–** | (3,808) | **–** | (3,808) |
| Payments for security deposits | | **(552)** | (352) | **(552)** | (352) |
| Payments for investment in associate | | **–** | (4) | **–** | (4) |
| Payments to subsidiaries | | **–** | – | **(22,870)** | (10,094) |
| Receipts for security deposits refunded | | **326** | – | **326** | – |
| Proceeds from Farm-in Contribution | | **87** | 675 | **87** | 675 |
| Payments for Farm-in exploration costs | | **(130)** | (490) | **(130)** | (490) |
| Proceeds from sale of non-current assets | | **4,682** | – | **–** | – |
| Proceeds from Joint Venturer's share of intangible assets acquired | | **1,332** | 3,700 | **1,332** | 3,700 |
| **Net cash outflow from investing activities** | | **(22,785)** | (8,473) | **(23,317)** | (11,393) |
| **Cash Flows from Financing Activities** | | | | | |
| Proceeds from issue of shares | | **50,141** | 48,619 | **50,141** | 48,619 |
| Capital raising costs | | **(2,203)** | (1,808) | **(2,203)** | (1,808) |
| **Net Cash Inflow from Financing Activities** | | **47,938** | 46,811 | **47,938** | 46,811 |
| **Net Increase (Decrease) in cash and cash equivalents** | | **22,032** | 35,478 | **21,792** | 33,285 |
| Cash and cash equivalents at the beginning of the financial year | | **37,536** | 2,058 | **35,090** | 1,805 |
| **Cash and cash equivalents at the End of the Financial Year** | 21(a) | **59,568** | 37,536 | **56,882** | 35,090 |

*The above Cash Flow Statements should be read in conjunction with the accompanying notes.*

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2009

## NOTE 1 – BASIS OF PREPARATION

The financial report is a general purpose financial report which has been drawn up in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board (including the Australian Interpretations) and the Corporations Act 2001.

The financial report includes financial statements for Eastern Star Gas Limited as an individual Parent Entity and the Group consisting of Eastern Star Gas Limited and its subsidiaries.

A summary of the significant accounting policies are stated in Note 2 below. These policies have been consistency applied to all years presented, unless otherwise stated.

### (a) Basis of measurement

The financial report has been prepared on the historical cost basis except that certain assets have been measured at fair value. Cost is based on the fair values of the consideration given in exchange for assets.

### (b) Compliance with IFRS

The financial report also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

### (c) Comparative figures

Where required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

### (d) Critical estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are:

#### (i) Exploration and evaluation

The Group's policy for exploration and evaluation expenditure is discussed in Note 2(xii). The application of this policy requires management to make certain estimates and assumptions as to future events and circumstances, particularly in relation to the assessment of whether economic quantities of reserves have been found. Any such estimates and assumptions may change as new information becomes available. If, after having capitalised exploration and evaluation expenditure, management concludes that the capitalised expenditure is unlikely to be recovered by future exploitation or sale, then the relevant capitalised amount will be written off to the income statement.

The carrying amount of exploration and evaluation assets is disclosed in Note 12.

#### (ii) Provision for restoration

The Group estimates the future removal and restoration costs of gas, wells, pipelines and related assets at the time of installation of the assets. In most instances the removal of these assets will occur many years in the future. The estimate of future removal costs therefore requires management to make judgements regarding the removal date, future environmental legislation, the extent of restoration activities required and future removal technologies.
The carrying amount of the provision for restoration is disclosed in Note 15.

#### (iii) Impairment of oil and gas assets

The Group assesses whether gas assets are impaired on a semi annual basis. This requires an estimation of the recoverable amount of the cash generating unit to which the assets belong. The carrying amount of oil and gas assets and the assumptions used in the estimation of recoverable amount are discussed in Notes 2(ix).

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (i) Principles of consolidation

**Subsidiaries**

The consolidated accounts have been prepared by combining the financial statements of all the entities that comprise the Group, being Eastern Star Gas Limited (Parent Entity) and its subsidiaries as defined in Accounting Standard AASB127 'Consolidated and Separate Financial Statements'. A list of subsidiaries appears in Note 20. Consistent accounting policies have been applied in the preparation and presentation of the consolidated accounts.

Subsidiaries are all those entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

The consolidated accounts include the information and results of each subsidiary from the date on which the Parent Entity obtains control and until such time as the Parent Entity ceases to control such entity.

In preparing the consolidated accounts, all inter-company balances and transactions, and unrealised profits arising within the Group, are eliminated in full.

Investments in subsidiaries are accounted for at cost in the Parent Entity.

**Jointly controlled assets**

Interests in jointly controlled assets are reported in the financial statements by including the Group entity's share of assets employed in the joint ventures, the share of liabilities incurred in relation to the joint ventures and the share of any expenses incurred in relation to the joint ventures in their respective classification categories.

**Investment in associates**

Associates are all entities over which the Group has significant influence but not control or joint control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

The Group's investment in its associates is accounted for using the equity method of accounting in the consolidated financial statements. The associates are entities over which the Group has significant influence and that are neither subsidiaries nor joint ventures.

The investment in the associates are carried out in the consolidated balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associates, less any impairment recognition. Goodwill relating to its associates is included in the carrying amount of the investment and is not amortisable.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

If the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group ceases to recognise its share of further losses, unless it has incurred obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of the profits only after the share of losses not recognised.

The annual reporting dates of the associates and the Group are identical and the associates' accounting policies conform to those used by the Group for like transactions and events in similar circumstances.

### (ii) Operating cycle

An operating cycle of 12 months has been used as the basis for identifying current assets and current liabilities in the Balance Sheet.

### (iii) Revenue recognition

*Sale of products*

Revenue from the sale of products is recognised when control of the products has passed to the buyer, the amount of revenue can be measured reliably and it is probable that it will be received by the Group.

*Interest revenue*

Interest revenue is recognised on a time proportion basis that takes into account the effective yield on the financial asset.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (iv) Borrowing costs

Borrowing costs include interest on short-term and long-term borrowings, ancillary costs incurred in connection with the arrangement of borrowings and finance lease charges. Borrowing costs are recognised as expenses in the period in which they are incurred except where they are included in the cost of projects under development.

### (v) Foreign currency translations

Foreign currency transactions during the year are translated to Australian currency at the rates of exchange applicable at the dates of the transactions. Amounts receivable and payable in foreign currencies at balance date are converted at the rates of exchange current at that date. The gains and losses from translation of assets and liabilities, whether realised or unrealised, are included in profit or loss from ordinary activities as they arise.

### (vi) Income tax

AIFRS Accounting Standard AASB 112 has been applied by the Group for the year. However, the Standard permits the Group to not recognise the net benefit of tax losses and temporary differences in the accounts as assets after liabilities until there is sufficient probability that the Parent and the Subsidiaries will derive sufficient income in the forseeable future on a sustainable basis. For the current year the deferred tax assets at 30 June 2009 are recognised only to the extent of the quantum of deferred tax liabilities.

The following policy is intended to be fully applied when the Directors are satisfied with that expectancy of sufficient income.

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction in which the Group operates (Australia) adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in subsidiaries where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority (Australian Taxation Office). Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

### Australian Tax Consolidation Legislation

Eastern Star Gas Limited and its wholly-owned Australian subsidiaries have implemented the tax consolidation legislation.

The head entity, Eastern Star Gas Limited, and the subsidiaries in the tax consolidated group account for their own current and deferred tax amounts. These tax amounts are measured as if each entity in the tax consolidated group continues to be a stand alone taxpayer in its own right.

In addition to its own current and deferred tax amounts, Eastern Star Gas Limited also recognises the current tax liabilities (or assets) and the deferred tax assets arising from unused tax losses and unused tax credits assumed from subsidiaries in the tax consolidated group.

Assets or liabilities arising with the tax consolidated entities are recognised as amounts receivable from or payable to other entities in the Group.

### Petroleum Resource Rent Tax

The Group's operations are conducted in parts of Australia which are not exposed to PRRT. There will be no current PRRT payable or deferred PRRT liabilities booked as a result.

### (vii) Cash and cash equivalents

For the purposes of the Balance Sheet and the Statement of Cash Flows, cash and cash equivalent includes deposits at call which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value.

### (viii) Trade and other receivables

Trade and other receivables represent the principal amounts due at balance date plus accrued interest and less, where applicable, any unearned income and provisions for doubtful accounts.

### (ix) Impairment of assets

At each reporting date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at each reporting date and whenever there is an indication that the asset may be impaired. Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Oil and gas assets, plant and equipment are assessed for impairment on a cash generating unit ('CGU') basis. A cash generating unit is the smallest grouping of assets that generates independent cash flows, and generally represents an individual oil or gas field. Impairment losses recognised in respect of cash generating units are allocated to reduce the carrying amount of the assets in the unit on a pro-rata basis. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior year. A reversal of an impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

### (x) Well equipment

Tubing, pipes and other parts acquired for use on wells are stated at cost. When installed in exploration wells these parts will be included as tangible assets as part of deferred exploration and evaluation expenditure, and when installed in development wells they will be included in plant and equipment.

### (xi) Property, plant and equipment

Property, plant and equipment is stated at cost. On disposal of an item of property, plant and equipment, the difference between the sales proceeds and the carrying amount of the asset is recognised as a gain or loss. All items of property, plant and equipment, except for land, are depreciated using the straight line method over their expected useful lives to the Group. The expected useful lives are as follows:

| | |
|---|---|
| Office furniture | 10 years |
| Computer equipment | 3 years |
| Other office equipment | 5 years |
| Field plant and equipment | 5 years |
| Motor vehicles | 5 years |
| Leasehold improvements | 3 years |
| Buildings | 25 years |

The power plant and the pipeline are depreciated on a unit of production basis over the useful life of the gas fields that supply the power plant and use the pipeline, determined by reference to estimated proved and probable reserves.

The carrying amount of plant and equipment is reviewed to ensure it is not in excess of the recoverable amount from those assets. The recoverable amount is assessed on the basis of the expected net cash flows which will be received from the assets' employment and subsequent disposal. The expected net cash flows are discounted to their present values at a rate of 12% in determining recoverable amounts.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (xii) Exploration and evaluation expenditure

Exploration and evaluation expenditure incurred is accumulated in respect of each identifiable area of interest, and carried forward in the Balance Sheet where:

(a) rights to tenure of the area of interest are current; and

(b) one of the following conditions is met:

(i) such costs are expected to be recouped through successful development and exploitation of the area of interest or alternatively, by its sale; or

(ii) exploration and/or evaluation activities in the area of interest have not at balance date yet reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the areas are continuing.

Exploration and evaluation expenditure is classified as tangible and intangible according to the nature of the assets acquired and the expenditure. Tangible assets include well equipment.

Tangible assets are depreciated using the straight line method over its useful life ranging 3 to 20 years, and this depreciation is recognised as part of the cost of exploration intangible assets.

Indirect costs relating to exploration and evaluation in areas of interest are capitalised in the year they are incurred. A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest. At such regular review the indirect costs arising during the early stages of a project are written off when deemed inappropriate to continue to be carried forward. Accumulated expenditure on areas which have been abandoned, or are considered to be of no value, is written off in the year in which such a decision is made.

### (xiii) Development and producing expenditure

Development and producing expenditure incurred is accumulated in respect of each identifiable area of interest, and carried forward in the Balance Sheet where rights to tenure of the area of interest are current, and such costs are expected to be recouped through successful development of the area of interest or alternatively, by its sale.

Indirect costs relating to development and producing areas are capitalised in the year they are incurred. Development expenditure relating to an area of interest in the pre-production stage is carried forward to the extent that such expenditure is expected to be recouped. A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

The carrying amount of development and producing expenditure is reviewed to ensure it is not in excess of the recoverable amount from those assets. The recoverable amount is assessed on the basis of the expected net cash flows which will be received from the assets' employment and subsequent disposal. The expected net cash flows are discounted to their present values at a rate of 10% in determining recoverable amounts.

On the commencement of production in an area of interest, accumulated development costs for that area are amortised on a unit of production basis over the useful life of the field determined by reference to the estimated proved and probable reserves.

Development and producing expenditure is classified as tangible and intangible according to the nature of the assets acquired and the item of expenditure. Tangible assets include well equipment. Intangible assets are disclosed as development and producing expenditure and tangible assets are included in property, plant and equipment in the Balance Sheet.

### (xiv) Restoration and rehabilitation obligations

A provision for restoration and rehabilitation obligations is recognised on a gradual basis over the life of the exploration and production licences. The amount recognised includes costs of reclamation and site rehabilitation after taking into account restoration works which are carried out during exploration or development. The provision for restoration costs is determined from an estimate of future costs and is capitalised as exploration expenditure.

If the effect of time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

### (xv) Trade and other payables

Trade payables represent the principal amounts outstanding at balance date plus, where applicable, any accrued interest. The carrying amounts of accounts payable approximate net fair values.

### (xvi) Financial instruments

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

*Impairment of financial assets*

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the loss is recognised in profit or loss.

*Financial liabilities*

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

### (xvii) Convertible notes

Convertible notes, issued by the Parent Entity, are compound financial instruments that contain both a financial liability and an equity element. The financial liability is a contractual obligation to deliver cash at the maturity date and under certain circumstances prior to maturity date if the notes have not been converted and the equity element is a call option granting the holder the right, from the date of issue until the maturity date, to convert the notes into fully paid ordinary shares at a predetermined price per share. On issue of the notes, the value of the liability component, being the present value of the contractually determined stream of future cash flows discounted at the applicable market rate of interest, is included as a liability in the Balance Sheet. The difference between the total value of the liability component and the proceeds of the notes issue is recognised as the value of the equity component and credited to issued capital.

### (xviii) Converting notes

Converting notes issued by the Parent Entity, that convert at maturity date to a predetermined number of fully paid ordinary shares with no option exercisable by the Parent Entity or the holder for the redemption of the converting notes for cash or another financial asset, are classified as equity in the Balance Sheet.

### (xix) Earnings per share

*Basic earnings per share*

Basic earnings per share is determined by dividing the operating loss after income tax attributable to members of the Parent Entity by the weighted average number of ordinary shares outstanding during the financial year.

*Diluted earnings per share*

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account:

- the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares, and
- the weighted average number of additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

### (xx) Employee benefits

*Wages, salaries and annual leave*

The following liabilities arising in respect of employee benefits are measured at their nominal amounts:

- salaries and annual leave regardless whether they are expected to be settled within 12 months of the reporting date; and
- other employee benefits expected to be settled within 12 months of the reporting date.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

*Long service leave*

Long service leave is recognised in the provision for employee benefits and measured at the present value of expected future payments to be made in respect of services provided by employees at the reporting date using the projected unit credit method by taking into account the expected rates of salary increases. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity that match closest to the estimated future cash outflows.

### (xxi) Leases

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods in which they are incurred.

### (xxii) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the Balance Sheet are shown inclusive of GST.

### (xxiii) Rounding of amounts

The Parent Entity and Group have applied the relief available under Australian Securities and Investments Commission Class Order 98/100 and accordingly, amounts in the financial report and Directors' Report have been rounded to the nearest thousand dollars.

### (xxiv) Business combinations

The purchase method of accounting is used to account for all business combinations. Assets given, shares issued or liabilities incurred are measured at their fair value. When equity instruments are issued in a business combination, the fair value of the instruments is their published market price at the date of the settlement. The excess of the cost of the business combination over the net fair value of the identifiable net assets acquired is recognised as goodwill.

### (xxv) Share-based payment transactions

The Group provides benefits to its employees (including Directors) in the form of share-based payments via the Eastern Star Gas Limited Employee Incentive and Contractors Plan (EIP) under equity-settled transactions in which the employees and contractors render services in exchange for shares or rights over shares. Shares are granted as an incentive to the employees and contractors to remain in the Group's employ or continue to provide services or to reward them for their efforts in improving the Group's performance.

The cost of these equity-settled transactions with employees and contractors is measured by reference to the fair value of the equity instruments at the date at which they are granted and is recognised over the vesting period of the equity instruments. The fair value is determined using a Black Scholes model that takes into account the exercise price, the vesting term, the impact of dilution, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk free interest rate for the term of the equity instruments.

The fair value of equity-settled transactions is recognised as an expense with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled (the vesting period) and based on the best available estimate of the number of equity instruments expected to vest. Estimates are subsequently revised at each balance sheet date if there is any information indicating that the number of equity instruments expected to vest differs from previous estimates.

The cumulative expense to the income statement is the result of (i) the fair value at grant date of the equity instruments; (ii) the current best estimate of the number of equity instruments that will vest; and (iii) the expired portion of the vesting period.

The charge to the income statement for the period is the cumulative amount as calculated above less the amounts already charged in previous periods. There is a corresponding credit to equity. The Group offers interest free loans to employees and contractors (including Directors) for terms of up to five years under the EIP for subscription of shares and under such loans the Parent Entity holds a lien over the issued shares.

In accordance with the interpretation, the issue of shares using the proceeds of the loan under the EIP to employees and contractors (including Directors) have been treated as an option grant.

In accordance with AASB 2 *Share based payments* as clarified by the International Financial Reporting Interpretations Council (IFRIC) in their rejection statement, and subsequently confirmed by the Australian Accounting Standards Board, the issue of shares using the proceeds of the loan under the EIP has been treated as an option grant.

### (xxvi) Intangible assets

Intangible assets are recognised only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

Intangible assets acquired separately or in a business combination are initially measured at cost and the cost is its fair value at the acquisition date. Subsequent to initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful life and tested for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with finite useful life is reviewed at least at each annual reporting period. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. Intangible assets with indefinite useful lives will not be amortised and their useful lives are reviewed at each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. Intangible assets with indefinite useful lives are tested for impairment annually.

The amortisation expense on intangible assets with finite lives for each period will be charged to profit or loss.

### (xxvii) Segment reporting

A business segment is identified for a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other business segments. A geographical segment is identified when products or services are provided within a particular economic environment subject to risks and returns that are different from those of segments operating in other economic environments.

### (xxviii) New Australian Accounting Standards

The following Australian Accounting Standards and Interpretation have been issued or amended and are applicable to the Parent Entity and Group but are not yet effective. They have not been adopted in preparation of the financial statements at the reporting date.

| **Australian Accounting Standards and Interpretation** | **Effective for annual reporting periods beginning on or after** |
|---|---|
| *AASB 8 Operating Segments* | *1 January 2009* |
| *AASB 101 Presentation of financial statements (Amended)* | *1 January 2009* |
| *AASB 3 Business Combinations (Amended)* | *1 July 2009* |
| *AASB 127 Consolidated and Separate Financial Statements (Amended)* | *1 July 2009* |

AASB 8 will result in a change in segment disclosures presented in the financial report such that the segments presented will not be based on primary and secondary segments but reflect those segments and amounts regularly reviewed by the entity's chief operating decision maker. While the amounts presented in the financial statements will not change the amounts presented in the segment reporting note may differ to those currently presented as a result of AASB 8 requiring the amounts presented to be based on those seen by the entity's chief operating decision maker.

AASB 101 (Amended) changes how an entity presents changes in equity and especially how it reports changes in equity that arise from transactions with owners in their capacity as owners. The amended standard also changes presentation and terminology of the primary financial statements. The new rules do not change the recognition, measurement or disclosure of specific transactions and other events.

The introduction of AASB 101 (Amended) will not have a material impact on the amounts presented within the financial statement but it likely to result in a substantial change in the presentation and terminology of the primary financial statements.

Adoption of AASB 3 (Amended) is likely to result in substantial changes in the way in which the entity accounts for business combinations. The entity has been unable to assess (as at authorisation of this financial report) the financial impact of this change on the entity's financial report in the period of initial application.

Adoption in revised AASB 127 is likely to result in changes in the way in which the entity accounts for changes in Consolidated and Separate Financial Statements. The entity has been unable to assess (as at authorisation of this financial report) the financial impact of this change on the entity's financial report in the period of initial application.

These Standards and Interpretation will be first applied in the financial report of the Group that relates to the annual reporting period beginning after the effective date of each pronouncement.

## NOTE 3 – REVENUE

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Sales revenue | **158** | 266 | **–** | – |
| Interest from other persons | **1,857** | 2,135 | **1,657** | 2,029 |
| Other | **350** | 109 | **769** | 239 |
| | **2,365** | 2,510 | **2,426** | 2,268 |

## NOTE 4 – OTHER INCOME

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Net gain on sale of assets | **2,401** | – | **–** | – |
| | **2,401** | – | **–** | – |

**Details of the sale of 35% interest in Wilga Park Power Stations, PPL3 assets and related business**

On 30 June 2008, the Company's subsidiary Narrabri Power Limited entered into a sale agreement to sell a 35% interest in the Wilga Park Power Station business and Petroleum Production Licence 3 (PPL3) assets to Gastar Exploration Ltd ('Gastar'). Gastar agreed to pay the Company US$3.00m for a 35% interest in the Wilga Park Power Station and PPL3 with a further US$0.25m payment after successful expansion of the power station. Conditions precedent were satisfied on 8 December 2008 and the US$3.00m (A$ 4.68m) payment was received on 19 February 2009. Net gain on disposal of the assets amounted to $2.4m.

Details of the sale are as follows:

| | Consolidated |
|---|---|
| | **2009 $'000** |
| **Consideration received or receivable:** | |
| Cash | **4,682** |
| Carrying amount of net assets sold | **(2,281)** |
| **Gain on sale of assets before income tax** | **2,401** |

Upon successful expansion of the power station (and certain performance criteria thereof), additional cash consideration of US$0.25m may be receivable. This amount has not been recognised in the consideration receivable and the gain on sale of assets as the amount cannot be reliably determined at this stage.

## NOTE 5 – DEPRECIATION AND AMORTISATION

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Depreciation | **416** | 201 | **301** | 127 |
| Amortisation of development expenditure | **–** | 110* | **–** | – |
| | **416** | 311 | **301** | 127 |

** Development expenditure has been fully amortised at 30 June 2008. There was no development expenditure incurred in this financial year.*

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2009 (continued)

## NOTE 6 – OTHER EXPENSES

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Loss before income tax includes the following specific expenses:** | | | | |
| Rental on operating leases | **571** | 396 | **571** | 396 |
| Employees costs | **2,209** | 2,369 | **2,209** | 2,365 |
| Provision for employee entitlements | **210** | (26) | **210** | (26) |
| Audit fees | **160** | 98 | **160** | 98 |
| Corporate services | **1,088** | 765 | **1,088** | 634 |
| Members' services | **415** | 274 | **415** | 274 |
| Directors' Fees | **237** | 221 | **237** | 221 |
| IT Services | **167** | 151 | **167** | 151 |
| Travel Costs | **317** | 219 | **317** | 219 |
| Communication Costs | **137** | 101 | **137** | 101 |
| Software Maintenance Costs | **147** | 112 | **147** | 112 |
| Office Supplies | **140** | 125 | **140** | 125 |
| Other | **515** | 461 | **509** | 459 |
| | **6,313** | 5,266 | **6,307** | 5,129 |

## NOTE 7 – BASIC/DILUTED LOSS PER SHARE

| | Consolidated | |
|---|---|---|
| | **2009** | 2008 |
| Operating loss after income tax used in the calculation of basic loss per share | **(2,519)** | (4,181) |
| Weighted average number of ordinary shares outstanding during the year used in the calculation of basic loss per share* | **751,235,988** | 671,916,785 |
| Basic/diluted loss per share (cents per share) | **(0.34)** | (0.62) |

*37,525,000 (2008: 36,525,000) options granted under the Eastern Star Gas Limited Employee Incentive Plan are not included in the calculation of diluted earnings per share because they are antidilutive for the year ended 30 June 2009. These options could potentially dilute basic earnings per share in the future.

## NOTE 8 – INCOME TAX

The Group became a tax consolidated group on 1 July 2003. There are presently no tax sharing or funding agreements in place. The Parent Entity and each of the subsidiaries are in tax loss position for the year and have substantial tax losses carried forward.

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **(a) Income tax expense** | | | | |
| Current tax | | | | |
| Current income tax charged | **–** | – | **–** | – |
| Deferred tax | | | | |
| Deferred income tax benefit / (expense) included in income tax expense comprises: | | | | |
| - (Increase) in deferred tax assets* | **(16,300)** | – | **(300)** | – |
| - Decrease in deferred tax liabilities* | **16,300** | – | **300** | – |
| Income Tax expense reported in the income statement | **–** | – | **–** | – |

*see note (c)

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **b) Numerical reconciliation of income tax expense to prima facie tax payable is as follows:** | | | | |
| Loss from operations before income tax | **(2,519)** | (4,181) | **(1,769)** | (4,049) |
| Tax at Australian tax rate of 30% (2008: 30%) | **(756)** | (1,255) | **(531)** | (1,215) |
| Tax effect of non-temporary differences | | | | |
| Entertainment expenses non deductible | **7** | 5 | **7** | 5 |
| Employee share option plan costs non deductible | **299** | 380 | **299** | 380 |
| Reversal of provisions and equity accounting losses | **–** | 258 | **(770)** | 258 |
| Legal expenses non deductible | **–** | 33 | **–** | 33 |
| Tax effect of equity raising costs debited to equity | **(345)** | (216) | **(345)** | (216) |
| Tax effect of tax losses and temporary differences not recognised | **795** | 795 | **1,340** | 755 |
| Income tax expense | **–** | **–** | **–** | – |

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2009 (continued)

## NOTE 8 – INCOME TAX (continued)

### (c) Deferred tax assets and liabilities

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **(i) Deferred tax assets** | | | | |
| The balance comprises temporary differences attributable to: | | | | |
| Provisions for rehabilitation | **1,308** | 781 | **–** | – |
| Accrual of costs not yet incurred | **70** | 54 | **70** | 54 |
| Provisions for employee leave entitlements | **482** | 272 | **482** | 272 |
| Legal costs | **100** | – | **100** | – |
| Overriding royalties | **114** | 1,487 | **114** | 168 |
| Tax losses carried forward | **99,691** | 81,656 | **27,580** | 22,318 |
| Share issue costs | **3,227** | 2,172 | **3,227** | 2,172 |
| Gross deferred tax assets | **104,992** | 86,422 | **31,573** | 24,984 |
| Total potential tax benefit at 30% | **31,498** | 25,927 | **9,472** | 7,495 |
| Amounts recognised during the year and set-off of deferred tax liabilities pursuant to set-off provisions (note c (ii)) | **(16,300)** | – | **(373)** | – |
| Net potential deferred tax assets* | **15,198** | 25,927 | **9,099** | 7,495 |
| **(ii) Deferred tax liabilities** | | | | |
| The balance comprises temporary differences attributable to: | | | | |
| Consumables | **1,569** | 484 | **104** | 147 |
| Prepayments | **62** | 95 | **62** | – |
| Interest receivable | **164** | – | **164** | 91 |
| Borrowing costs | **436** | 436 | **–** | – |
| Black hole costs | **1,328** | 1,872 | **–** | – |
| Exploration and development expenditures | | | | |
| - accelerated deductions | **50,775** | 39,848 | **914** | 42 |
| Others | **–** | – | **–** | (3) |
| Gross deferred tax liabilities | **54,334** | 42,735 | **1,244** | 277 |
| Total potential tax liability at 30% | **16,300** | 12,821 | **373** | 83 |
| Amounts recognised during the year and set-off of deferred tax assets pursuant to set-off provisions (note c (i)) | **(16,300)** | – | **(373)** | – |
| Net potential deferred tax liabilities* | **–** | 12,821 | **–** | 83 |

* The net potential deferred tax asset in respect of unused losses and temporary differences of $50,658,000 (2008: $43,687,000) has not been recognised.

## NOTE 9 – TRADE AND OTHER RECEIVABLES (CURRENT)

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Trade receivables | **566** | 210 | **1,598** | 586 |
| Interest receivable | **164** | 98 | **164** | 91 |
| Other receivables | **1,249** | 1,638 | **76** | 1,508 |
| Prepayments | **192** | 99 | **97** | 28 |
| | **2,171** | 2,045 | **1,935** | 2,213 |
| Amounts receivable from subsidiaries | **–** | – | **79,882** | 55,172 |
| Less: Provision for impairment | **–** | – | **(10,161)** | (12,727) |
| | **–** | – | **69,721** | 42,445 |
| | **2,171** | 2,045 | **71,656** | 44,658 |

### (a) Impaired receivables

The amount receivable from subsidiaries is dependent on the successful development and exploitation of the areas of interest or alternatively, by their sale. The provision for impairment made by the Parent Entity relates to the amount receivable from Narrabri Power Pty Ltd and provided such that the amounts receivable are equal to the net asset value of that subsidiary.

| **Movement in provision for impairment for the year** | | | | |
|---|---|---|---|---|
| At beginning of year | **–** | – | **12,727** | 11,869 |
| Impaired receivable (recovered)/provided for during the year | **–** | – | **(2,566)** | 858 |
| At end of year | **–** | – | **10,161** | 12,727 |

## NOTE 10 – OTHER FINANCIAL ASSETS

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | 2009 $'000 | 2008 $'000 | 2009 $'000 | 2008 $'000 |
| **Current** | | | | |
| Performance bonds (indemnity guarantees) | – | 285 | – | 285 |
| **Non Current** | | | | |
| Shares in subsidiaries (Note 19) | – | – | 30,105 | 30,105 |
| Shares in associates (Note 29) | – | – | 4 | 4 |
| Performance bonds (indemnity guarantees) | 2,169 | 1,591 | 2,017 | 1,447 |
| | 2,169 | 1,591 | 32,126 | 31,556 |

These financial assets are carried at cost. Performance bonds are secured by term deposits with financial institutions in favour of the Department of Mineral Resources. During the year performance bonds of $240,000 were refunded for PEL 6, 8, 422, 424, 427, 428 and 455 which transferred to Orion Petroleum Limited, an associate of the Group.

## NOTE 11 – PROPERTY, PLANT AND EQUIPMENT

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | 2009 $'000 | 2008 $'000 | 2009 $'000 | 2008 $'000 |
| Leasehold improvements | 339 | 422 | 339 | 422 |
| Accumulated amortisation | (108) | – | (108) | – |
| | 231 | 422 | 231 | 422 |
| Buildings | 516 | 199 | – | – |
| Accumulated depreciation | (2) | – | – | – |
| | 514 | 199 | – | – |
| Power station expansion under construction | 2,666 | – | – | – |
| Land at cost | 230 | 230 | – | – |
| Disposal (1) | (81) | – | – | – |
| | 149 | 230 | – | – |
| Plant, equipment and motor vehicles at cost | 1,930 | 1,508 | 1,001 | 901 |
| Disposal (1) | (13) | – | – | – |
| Write off | – | (21) | – | (9) |
| Accumulated depreciation | (927) | (663) | (704) | (553) |
| | 990 | 824 | 297 | 339 |
| Power plant | 5,910 | 5,910 | – | – |
| Disposal (1) | (1,719) | – | – | – |
| Accumulated depreciation | (1,000) | (1,000) | – | – |
| | 3,191 | 4,910 | – | – |
| Pipeline | 1,926 | 1,926 | – | – |
| Disposal (1) | (468) | – | – | – |
| Accumulated depreciation | (590) | (590) | – | – |
| | 868 | 1,336 | – | – |
| | 8,609 | 7,921 | 528 | 761 |

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Movements during the year:** | | | | |
| **Leasehold improvement** | | | | |
| At beginning of year | **422** | – | **422** | – |
| Additions at cost | **(83)** | 422 | **(83)** | 422 |
| Amortisation expense | **(108)** | – | **(108)** | – |
| At end of year | **231** | 422 | **231** | 422 |
| **Buildings** | | | | |
| At beginning of year | **199** | – | **–** | – |
| Additions at cost | **317** | 199 | **–** | – |
| Depreciation expense | **(2)** | – | **–** | – |
| At end of year | **514** | 199 | **–** | – |
| **Power station expansion under construction** | | | | |
| At beginning of year | **–** | – | **–** | – |
| Additions at cost | **2,666** | – | **–** | – |
| At end of year | **2,666** | – | **–** | – |
| **Land** | | | | |
| At beginning of year | **230** | 210 | **–** | – |
| Additions at cost | **–** | 20 | **–** | – |
| Disposal (1) | **(81)** | – | **–** | – |
| At end of year | **149** | 230 | **–** | – |
| **Plant and equipment and motor vehicles** | | | | |
| At beginning of year | **824** | 425 | **339** | 204 |
| Additions at cost | **443** | 610 | **109** | 260 |
| Disposal (1) | **(13)** | – | **–** | – |
| Write off | **–** | (21) | **–** | (9) |
| Depreciation expense | **(264)** | (190) | **(151)** | (116) |
| At end of year | **990** | 824 | **297** | 339 |
| **Power plant** | | | | |
| At beginning of year | **4,910** | 2,227 | **–** | – |
| Additions at cost | **–** | 2,683 | **–** | – |
| Disposal (1) | **(1,719)** | – | **–** | – |
| At end of year | **3,191** | 4,910 | **–** | – |
| **Pipeline** | | | | |
| At beginning of year | **1,336** | 1,336 | **–** | – |
| Disposal (1) | **(468)** | – | **–** | – |
| At end of year | **868** | 1,336 | **–** | – |

## NOTE 11 – PROPERTY, PLANT AND EQUIPMENT (continued)

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Total** | | | | |
| At beginning of year | **7,921** | 4,198 | **761** | 204 |
| Additions at cost | **3,343** | 3,934 | **26** | 682 |
| Disposal [1] | **(2,281)** | – | **–** | – |
| Write off | **–** | (21) | **–** | (9) |
| Depreciation expense | **(374)** | (190) | **(259)** | (116) |
| | **8,609** | 7,921 | **528** | 761 |

[1] *Disposal of Property, plant and equipment amounting to $2,281,000 (2008: $nil) related to sale of a 35% interest in the Wilga Park Power station assets and Petroleum Production Licence 3 assets. See Note 4 for further details.*

Ultimate recoupment of the carrying value of plant and equipment is dependent on successful development and exploitation, or sale of the exploration and evaluation areas of interest that will utilise the plant and equipment.

## NOTE 12 – EXPLORATION AND EVALUATION EXPENDITURE

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Tangible | **5,922** | 3,019 | **–** | – |
| Intangible | **70,396** | 45,688 | **1,374** | 42 |
| | **76,318** | 48,707 | **1,374** | 42 |
| **Movements during the year:** | | | | |
| **Tangible** | | | | |
| At beginning of year | **3,019** | 2,838 | **–** | – |
| Additions at cost | **3,145** | 181 | **–** | – |
| Depreciation charge | **(242)** | – | **–** | – |
| At end of year | **5,922** | 3,019 | **–** | – |
| **Intangible** | | | | |
| At beginning of year | **45,688** | 37,973 | **42** | – |
| Additions at cost | **24,817** | 7,934 | **1,441** | 261 |
| Amount written off during the year | **(109)** | (219) | **(109)** | (219) |
| At end of year | **70,396** | 45,688 | **1,374** | 42 |

Ultimate recoupment of the carrying value of the exploration and evaluation areas is dependent on successful development and commercial exploitation, or alternatively sale of the respective areas of interest.

## NOTE 13 – INTANGIBLE ASSETS

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Royalty interests | **9,359** | 9,359 | **–** | – |
| Software | **304** | 221 | **304** | 221 |
| Amortisation | **(53)** | (11) | **(53)** | (11) |
| At end of year | **251** | 210 | **251** | 210 |
| Total | **9,610** | 9,569 | **251** | 210 |

The overriding royalty interests were capitalised once 185 PJ of Proved and Probable (2P) reserves were certified in PEL 238. The remaining overriding royalty at 30 June 2009 is 0.855%. Amortisation will be charged once production of gas commences from PEL 238.

Software is amortised at 14.28% p.a.

## NOTE 14 – TRADE AND OTHER PAYABLES (CURRENT)

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Trade payables | **2,533** | 1,017 | **429** | 458 |
| Accruals | **732** | 328 | **218** | 163 |
| Other payables | **1,205** | 242 | **1,171** | 242 |
| | **4,470** | 1,587 | **1,818** | 863 |

### (a) Ageing Analysis of trade Payables

The ageing analysis of trade payables that are past due as at 30 June 2009 but not impaired is as follows:

| | 0 – 30 days $'000 | 31 – 60 days $'000 | 61 – 90 days $'000 | + 90 days $'000 | Total $'000 |
|---|---|---|---|---|---|
| **2009** | | | | | |
| Consolidated | 2,336 | 165 | 32 | – | 2,533 |
| Parent | 391 | 7 | 31 | – | 429 |
| **2008** | | | | | |
| Consolidated | 973 | – | 44 | – | 1,017 |
| Parent | 458 | – | – | – | 458 |

## NOTE 15 – PROVISIONS

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Provisions (Current)** | | | | |
| Employee entitlements | **393** | 232 | **393** | 232 |
| **Provisions (Non-current)** | | | | |
| Employee entitlements | **89** | 40 | **89** | 40 |
| Restoration and rehabilitation | **1,309** | 783 | **–** | – |
| | **1,398** | 823 | **89** | 40 |
| **Employee entitlements** | | | | |
| At beginning of year | **40** | 32 | **40** | 32 |
| Arising during the year | **49** | 69 | **49** | 69 |
| Utilised during the year | **–** | (61) | **–** | (61) |
| At end of year | **89** | 40 | **89** | 40 |
| **Provision for restoration and rehabilitation** | | | | |
| At beginning of year | **783** | 551 | **–** | – |
| Arising during the year | **526** | 232 | **–** | – |
| At end of year | **1,309** | 783 | **–** | – |

There were 38 (2008 – 34) employees during the year.

## NOTE 16 – CONTRIBUTED EQUITY

| | Consolidated 2009 $'000 | Consolidated 2008 $'000 | Parent Entity 2009 $'000 | Parent Entity 2008 $'000 |
|---|---|---|---|---|
| **(a) Issued capital** | | | | |
| **Balance at beginning of year:** | | | | |
| 724,575,702 fully paid ordinary shares (2008 – 540,353,566) | **142,662** | 78,755 | **142,662** | 78,755 |
| Fully paid ordinary shares issued during the year: | | | | |
| Issue of 750,000 shares in November 2008 | | | | |
| – 750,000 shares at 15 cents each | **112** | - | **112** | - |
| – Option reserve relating to the issue | **90** | - | **90** | - |
| 150,000 shares under employee incentive plan in January 2009 | | | | |
| – 100,000 shares at 13.5 cents | **13** | – | **16** | – |
| – 50,000 shares at 32 cents | **16** | – | **13** | – |
| – exercise of option grant on share-based payments | **16** | – | **16** | – |
| 90,909,091 shares at 55 cents each by private placement in March 2009 | **50,000** | – | **50,000** | – |
| 33,435,569 shares at 19 cents each on conversion of converting notes by Hillgrove Energy Limited in July/September 2007 and March 2008 | **–** | 6,353 | **–** | 6,353 |
| 1,870,000 shares under employee incentive plan in July/August 2007 and February/March/April and May 2008 | | | | |
| – 650,000 shares at 12 cents each | **–** | 78 | **–** | 78 |
| – 970,000 shares at 13.5 cents each | **–** | 131 | **–** | 131 |
| – 250,000 shares at 32 cents each | **–** | 80 | **–** | 80 |
| – exercise of option grant on share-based payments | **–** | 161 | **–** | 161 |
| 33,092,964 shares at 32 cents each for cancellation of overriding royalty interest in PEL 238 | **–** | 10,589 | **–** | 10,589 |
| 60,823,530 shares at 42.5 cents each by private placement in September 2007 | **–** | 25,850 | **–** | 25,850 |
| 55,000,073 shares at 40.86 each under the share purchase plan in December 2007 | **–** | 22,473 | **–** | 22,473 |
| | **192,909** | 144,470 | **192,909** | 144,470 |
| Less: Transaction costs arising on share issues | **(2,203)** | (1,808) | **(2,203)** | (1,808) |
| Balance on issue at end of year: | | | | |
| 816,384,793 fully paid ordinary shares (2008 – 724,575,702) | **190,706** | 142,662 | **190,706** | 142,662 |

The Parent Entity does not have authorised capital nor par value in respect of its issued shares. Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the Company in proportion to the number of shares held. Every ordinary shareholder present at a meeting of the Company in person or by proxy, is entitled to one vote, and upon a poll each ordinary share is entitled to one vote.

## NOTE 17 – RESERVES

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Options reserve** | | | | |
| At beginning of year | **3,000** | 3,000 | **3,000** | 3000 |
| Exercise of options | **(90)** | – | **(90)** | – |
| At end of year | **2,910** | 3,000 | **2,910** | 3,000 |
| **Share-based payments reserve** | | | | |
| At beginning of year | **3,959** | 338 | **3,959** | 338 |
| Issue of shares under Employee Incentive Plan | **(16)** | (161) | **(16)** | (161) |
| Option grants under the Employee Incentive Plan | **2,838** | 3,782 | **2,838** | 3,782 |
| At end of year | **6,781** | 3,959 | **6,781** | 3,959 |
| **Total reserves** | | | | |
| At beginning of year | **6,959** | 3,338 | **6,959** | 3,338 |
| Exercise of options | **(90)** | – | **(90)** | – |
| Issue of shares under Employee Incentive Plan | **(16)** | (161) | **(16)** | (161) |
| Option grants under the Employee Incentive Plan | **2,838** | 3,782 | **2,838** | 3,782 |
| At end of year | **9,691** | 6,959 | **9,691** | 6,959 |

**(a) Options**

At the end of the financial year, the Parent Entity had the following options over un-issued ordinary shares, each option exercisable for one ordinary share:

| Expiry Date | Exercise Price $ | **2009 Number** | 2008 Number |
|---|---|---|---|
| 30 October 2009 [1] | 0.15 | **24,250,000** | 25,000,000 |
| | | **24,250,000** | 25,000,000 |

[1] *In October 2006, the Parent Entity issued 25,000,000 options at 15 cents each in addition to cash, shares and converting notes for acquiring of Hillgrove Energy Pty Limited, each option exercisable for one share on or before 30 October 2009. During the year 750,000 (2008: nil) options were exercised at 15 cents each.*

## NOTE 18 – ACCUMULATED LOSSES

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Accumulated losses at beginning of financial year | **44,125** | 39,944 | **38,007** | 33,958 |
| Net loss attributable to members of the Parent Entity | **2,519** | 4,181 | **1,769** | 4,049 |
| Accumulated losses at end of financial year | **46,644** | 44,125 | **39,776** | 38,007 |

## NOTE 19 – SUBSIDIARIES

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in Note 2 (i).

| | **Percentage Owned 2009 %** | 2008 % |
|---|---|---|
| The Subsidiaries are as follows: | | |
| Narrabri Energy Limited | **100** | 100 |
| Eastern Energy Australia Pty Limited. | **100** | 100 |
| Tooncomet Pty Limited | **100** | 100 |
| Sulu Resources Pty Limited | **100** | 100 |
| Narrabri Power Limited | **100** | 100 |
| Hillgrove Energy Pty Limited | **100** | 100 |
| Eastern Star Gas Operations Pty Limited. | **100** | – |
| Betel Gas Pty Limited. | **100** | – |

The Parent Entity and Subsidiaries are incorporated and domiciled in Australia. The shares held in the Subsidiaries are ordinary shares.

## NOTE 20 – REMUNERATION OF AUDITORS

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Audit and review of financial reports | **159,860** | 97,750 | **159,860** | 97,750 |
| | **159,860** | 97,750 | **159,860** | 97,750 |

## NOTE 21 – FINANCIAL RISK MANAGEMENT

The Group is exposed to changes in foreign exchange rates, commodity prices and interest rates in its activities.

The material financial instruments to which the Group has exposure include:

- Cash and short term deposits;
- Receivables; and
- Accounts payable.

### (a) Cashflow and fair value interest rate risk

All of the Group's financial instruments are either non-interest bearing or bear interest at commercial interest rates. The weighted average interest rate on cash and short-term deposits at 30 June 2009 was 3.11% (2008: 7.49%). The weighted average interest rate on other financial assets at 30 June 2009 was 3.85% (2008: 7.64%). All receivables and payables are non-interest bearing. The Group's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market, interest rates and the effective weighted average interest rates on those financial assets, is set out below:

| | Average Interest Rate % | Variable Interest Rate $'000 | Fixed Interest Rate Maturing Within 1 Year $'000 | Fixed Interest Rate Maturing 1 to 5 Years $'000 | Non-Interest Bearing $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Consolidated** | | | | | | |
| 2009 | | | | | | |
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 3.11 | 9,299 | 50,269 | – | – | 59,568 |
| Trade and other receivables | – | – | – | – | 1,979 | 1,979 |
| Other financial assets | 3.85 | – | 2,133 | – | 36 | 2,169 |
| | | **9,299** | **52,402** | **–** | **2,015** | **63,716** |
| **Financial liabilities** | | | | | | |
| Trade and other payables | – | – | – | – | 4,470 | 4,470 |
| | | **–** | **–** | **–** | **4,470** | **4,470** |
| 2008 | | | | | | |
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 7.49 | 1,259 | 36,277 | – | – | 37,536 |
| Trade and other receivables | – | – | – | – | 1,946 | 1,946 |
| Other financial assets | 7.64 | – | 1,840 | – | 36 | 1,876 |
| | | **1,259** | **38,117** | **–** | **1,982** | **41,358** |
| **Financial liabilities** | | | | | | |
| Trade and other payables | – | – | – | – | 1,587 | 1,587 |
| | | **–** | **–** | **–** | **1,587** | **1,587** |

| | Average Interest Rate % | Variable Interest Rate $'000 | Fixed Interest Rate Maturing Within 1 Year $'000 | Fixed Interest Rate Maturing 1 to 5 Years $'000 | Non-Interest Bearing $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Parent Entity** | | | | | | |
| 2009 | | | | | | |
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 3.21 | 6,543 | 50,339 | – | – | 56,882 |
| Trade and other receivables | – | – | – | – | 71,559 | 71,559 |
| Other financial assets | 3.9 | – | 1,981 | – | 36 | 2,017 |
| | | **6,543** | **52,320** | **–** | **71,595** | **130,458** |
| **Financial liabilities** | | | | | | |
| Trade and other payables | – | – | – | – | 1,818 | 1,818 |
| | | **–** | **–** | **–** | **1,818** | **1,818** |

| | Average Interest Rate % | Variable Interest Rate $'000 | Fixed Interest Rate Maturing Within 1 Year $'000 | Fixed Interest Rate Maturing 1 to 5 Years $'000 | Non-Interest Bearing $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Parent Entity** | | | | | | |
| 2008 | | | | | | |
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 7.53 | 722 | 34,368 | – | – | 35,090 |
| Trade and other receivables | – | – | – | – | 44,630 | 44,630 |
| Other financial assets | 7.64 | – | 1,696 | – | 36 | 1,732 |
| | | **722** | **36,064** | **–** | **44,666** | **81,452** |
| **Financial liabilities** | | | | | | |
| Trade and other payables | – | – | – | – | 863 | 863 |
| | | **–** | **–** | **–** | **863** | **863** |

## NOTE 21 – FINANCIAL RISK MANAGEMENT (continued)

### (b) Sensitivity analysis

The Group analyses its interest rate exposure using sensitivity analysis. Based upon the average balance of interest bearing assets during the year, if interest rates changed by +/- 1%, with all other variables held constant, the estimated impact on post-tax profit and equity would have been:

| | Post Tax Loss Lower/(Higher) | | Equity Lower/(Higher) | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Consolidated** | | | | |
| Interest base rate + 1% | **416** | 307 | **416** | 307 |
| Interest base rate - 1% | **(416)** | (307) | **(416)** | (307) |
| **Parent** | | | | |
| Interest base rate + 1% | **342** | 262 | **342** | 262 |
| Interest base rate - 1% | **(342)** | (262) | **(342)** | (262) |

### (c) Credit risk

Financial instruments, which potentially subject the Group to credit risk, consist primarily of cash and short term deposits and trade debtors. Credit risk on cash, short term deposits and trade debtors is largely minimised by dealing with companies with acceptable credit ratings. The Group has no reason to believe credit losses will arise from any of the above financial instruments. However, the maximum amount of loss, which may possibly be realised, is the carrying amount of the financial instrument.

### (d) Net fair value of financial instruments

The carrying amounts of cash and short term deposits, receivables, security deposits, accounts payable and provision for employee entitlements approximate fair value due to the short maturity of these instruments. Adequate provision is made in respect of trade debtors.

### (e) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. The Group manages liquidity risk by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. Surplus funds are only invested in instruments that are tradeable in liquid markets.

The Group monitors its cash flow on a monthly basis to ensure adequate funds in place for exploration and development activities.

The Group's principle financial instruments comprise of receivables, payables, cash and cash equivalent. The Group's exposure to credit risk arises from potential default of the counter party. The level of risk default within the Group is minimal and bad debts are not significant due to the Group delivering and selling all electricity output to Country Energy under a 10 year Power Purchase Agreement.

The risk implied from the cash outflows from Trade and Other Payables arise from payments for property, plant and equipment and for exploration and development. The Group has established Cash Flow Projections to monitor its future work Programmes to ensure the outflow from the work Programmes will not exceed the Cash Flow Projections.

The risk implied from the financial instrument values associated with cash inflows and outflows as at year ended 30 June 2009 are set out in the table overleaf.

| | ≤ 6 Months $'000 | 6 – 12 Months $'000 | 1 – 5 Years $'000 | > 5 Years $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Consolidated** | | | | | |
| 2009 | | | | | |
| **Financial assets** | | | | | |
| Cash and cash equivalents | 42,568 | 17,000 | – | – | 59,568 |
| Trade and other receivables | 1,979 | – | – | – | 1,979 |
| Other financial assets | – | – | – | 2,169 | 2,169 |
| | **44,547** | **17,000** | **–** | **2,169** | **63,716** |
| **Financial liabilities** | | | | | |
| Trade and other payables | 4,470 | – | – | – | 4,470 |
| | **4,470** | **–** | **–** | **–** | **4,470** |
| 2008 | | | | | |
| **Financial assets** | | | | | |
| Cash and cash equivalents | 37,536 | – | – | – | 37,536 |
| Trade and other receivables | 1,946 | – | – | – | 1,946 |
| Other financial assets | 285 | – | – | 1,591 | 1,876 |
| | **39,767** | **–** | **–** | **1,591** | **41,358** |
| **Financial liabilities** | | | | | |
| Trade and other payables | 1,587 | – | – | – | 1,587 |
| | **1,587** | **–** | **–** | **–** | **1,587** |
| **Parent** | | | | | |
| 2009 | | | | | |
| **Financial assets** | | | | | |
| Cash and cash equivalents | 39,882 | 17,000 | – | – | 56,882 |
| Trade and other receivables | 1,838 | 69,721 | – | – | 71,559 |
| Other financial assets | – | – | – | 2,017 | 2,017 |
| | **41,720** | **86,721** | **–** | **2,017** | **130,458** |
| **Financial liabilities** | | | | | |
| Trade and other payables | 1,818 | – | – | – | 1,818 |
| | **1,818** | **–** | **–** | **–** | **1,818** |

NOTE 21 – FINANCIAL RISK MANAGEMENT (CONTINUED)

| | ≤ 6 Months $'000 | 6 – 12 Months $'000 | 1 – 5 Years $'000 | > 5 Years $'000 | Total $'000 |
|---|---|---|---|---|---|
| 2008 | | | | | |
| **Financial assets** | | | | | |
| Cash and cash equivalents | 35,090 | – | – | – | 35,090 |
| Trade and other receivables | 2,185 | 42,445 | – | – | 44,630 |
| Other financial assets | 285 | – | – | 1,447 | 1,732 |
| | **37,560** | **42,445** | **–** | **1,447** | **81,452** |
| **Financial liabilities** | | | | | |
| Trade and other payables | 863 | – | – | – | 863 |
| | **863** | **–** | **–** | **–** | **863** |

**(f) Net fair values**

Methods and assumptions used in determining net fair value

For assets and other liabilities, the net fair value approximates their carrying values. No financial assets and financial liabilities are readily traded on organised markets in standardised form. The Group has no financial assets where the carrying amount exceeds net fair values at balance date. The aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the Balance Sheet and in the notes to and forming part of the financial statements.

**(g) Capital risk management**

The Group manages its capital to ensure that it will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from last year.

## NOTE 22 – NOTES TO THE STATEMENTS OF CASH FLOWS

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **(a) Reconciliation of cash** | | | | |
| Cash at bank and on hand | **9,299** | 1,259 | **6,543** | 722 |
| Deposits | **50,269** | 36,277 | **50,339** | 34,368 |
| | **59,568** | 37,536 | **56,882** | 35,090 |
| **(b) Reconciliation of loss from ordinary activities after income tax to net cash outflow from operating activities** | | | | |
| Loss from operating activities after income tax | **(2,519)** | (4,181) | **(1,769)** | (4,049) |
| Add non cash items in operating activities: | | | | |
| Depreciation and amortisation | **416** | 311 | **301** | 127 |
| Provision for employee entitlements | **210** | (26) | **210** | (26) |
| Movement in provision for impairment of amount receivable from subsidiary | **–** | – | **(2,566)** | 858 |
| Exploration and evaluation expenditure written off | **109** | 189 | **109** | 189 |
| Assets written off | **–** | 23 | **–** | 9 |
| Gain on sale of assets | **(2,401)** | – | **–** | – |
| Well equipment written off | **184** | – | **44** | – |
| Share-based payments | **998** | 1,270 | **998** | 1,270 |
| Share of loss of an associate | **–** | 4 | **–** | 4 |
| Changes in operating assets and liabilities: | | | | |
| (Decrease) Increase in trade and other payables | **(48)** | (268) | **965** | 174 |
| (Decrease) Increase in borrowings | **–** | (69) | **–** | (17) |
| (Increase) Decrease in receivables | **65** | (23) | **(955)** | (610) |
| (Increase) Decrease in prepayments | **(27)** | 12 | **(60)** | 24 |
| Increase in interest receivable | **(108)** | (102) | **(106)** | (86) |
| Net Cash outflow from Operating Activities | **(3,121)** | (2,860) | **(2,829)** | (2,133) |
| **(c) Non-cash financing or investing activities** | | | | |
| Issue of securities as consideration for: | | | | |
| Cancellation of overriding royalty interests in PEL 238 | **–** | 6,781 | **–** | 6,781 |
| | **–** | 6,781 | **–** | 6,781 |

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2009 (continued)

## NOTE 23 – SEGMENT INFORMATION

The Group operates in Australia and in the energy, oil and gas industry.

## NOTE 24 – SUPERANNUATION

The Group makes contributions based on each employee's salary, to superannuation plans that provide employees with benefits on retirement in accordance with the requirements of the superannuation guarantee legislation.

## NOTE 25 – COMMITMENTS FOR EXPENDITURE

The Group is required to outlay lease rentals, capital expenditure and to meet minimum committed expenditure requirements to maintain current rights of tenure to exploration tenements. These obligations may be subject to renegotiation or farmed out or the tenements may be relinquished. The expenditure commitments have not been provided for in the financial statements and are due as follows:

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| **Exploration and evaluation expenditure** | | | | |
| Within 1 year | **3,380** | 2,795 | **780** | 845 |
| Later than 1 year and not later than 5 years | **2,730** | – | **780** | – |
| | **6,110** | 2,795 | **1,560** | 845 |
| **Property, plant and equipment** | | | | |
| Contractual obligations to purchase Plant and Equipment and expected to settle: | | | | |
| Within 1 year | **1,145** | 5,221 | **–** | – |
| | **1,145** | 5,221 | **–** | – |
| **Operating contracts** | | | | |
| Minimum payments under non-cancellable contracts according to the time expected to elapse to the expected date of payment: | | | | |
| Within 1 year | **879** | 451 | **879** | 451 |
| Later than 1 year and not later than 5 years | **3,488** | 2,134 | **3,488** | 2,134 |
| Later than 5 years | **1,008** | – | **1,008** | – |
| | **5,375** | 2,585 | **5,375** | 2,585 |

## NOTE 26 – EMPLOYEE INCENTIVE PLAN

The Parent Entity has established the Eastern Star Gas Limited Employee Incentive Plan (EIP) under which the Directors may offer options and ordinary shares in the Parent Entity to eligible persons following an annual performance review. The shares may not be subscribed for less than the market value of the shares at the time an offer is made under the plan. The Directors may also offer interest free loans for terms of up to five years under the plan for subscription of shares and under such loans the Parent Entity holds a lien over the issued shares. Options are issued, if any, free at grant. The exercise price of the options cannot be less than 20 cents per share or the market value of a share at the time of offer of the shares. The maximum total number of options and shares that may be offered or issued under the plan may not exceed 5% of the issued capital of the Parent Entity.

The shares issued under the plan rank pari passu with other issued ordinary shares and are not listed while there are loans outstanding on the subscription of the shares. Any loan extended for the subscription of shares to a participant has limited recourse to the proceeds on disposal of the shares.

At 30 June 2009 the Parent Entity has interest free loans and ordinary shares issued in current and prior years under the EIP as follows:

| Loan Grant Date | Loan Maturity Date | Issue Price per Share $ | Number of Shares | Loan Balance $ |
|---|---|---|---|---|
| 1 July 2004 | 30 June 2009 | 0.12 | 300,000 | 36,000 |
| 1 December 2005 | 30 November 2010 | 0.135 | 1,600,000 | 216,000 |
| 16 June 2006 | 15 June 2011 | 0.15 | 3,000,000[a](1) | 450,000 |
| 16 June 2006 | 15 June 2011 | 0.15 | 3,000,000[a](2) | 450,000 |
| 5 March 2007 | 4 March 2012 | 0.32 | 1,125,000[b] | 360,000 |
| 31 July 2007 | 30 July 2012 | 0.45 | 1,000,000[c] | 450,000 |
| 31 July 2007 | 30 July 2012 | 0.54 | 3,000,000[d] | 1,620,000 |
| 31 Jul 2007 | 30 July 2012 | 0.54 | 3,000,000[e] | 1,620,000 |
| 1 August 2007 | 31 July 2012 | 0.45 | 1,500,000[c] | 675,000 |
| 1 August 2007 | 31 July 2012 | 0.54 | 3,000,000[d] | 1,620,000 |
| 1 August 2007 | 31 July 2012 | 0.54 | 3,000,000[e] | 1,620,000 |
| 1 August 2007 | 31 July 2012 | 0.45 | 200,000[c] | 90,000 |
| 1 August 2007 | 31 July 2012 | 0.54 | 450,000[d] | 243,000 |
| 1 August 2007 | 31 July 2012 | 0.54 | 450,000[d] | 243,000 |
| 1 November 2007 | 31 October 2012 | 0.45 | 750,000[c] | 337,500 |
| 1 November 2007 | 31 October 2012 | 0.45 | 2,625,000[f](1) | 1,181,250 |
| 1 November 2007 | 31 October 2012 | 0.45 | 2,625,000[f](2) | 1,181,250 |
| 8 November 2007 | 7 November 2012 | 0.45 | 100,000[c] | 45,000 |
| 8 November 2007 | 7 November 2012 | 0.54 | 200,000[g] | 108,000 |
| 8 November 20077 | 7 November 2012 | 0.54 | 200,000[h] | 108,000 |
| 5 December 2007 | 4 December 2012 | 0.45 | 2,000,000[c] | 900,000 |
| 27 March 2008 | 26 March 2013 | 0.45 | 625,000[i](1) | 281,250 |
| 27 March 2008 | 26 March 2013 | 0.45 | 625,000[i](2) | 281,250 |
| 2 April 2008 | 1 April 2013 | 0.35 | 2,000,000[c] | 700,000 |
| 21 August 2008 | 20 August 2013 | 0.45 | 650,000[j] | 292,500 |
| 19 November 2008 | 18 November 2013 | 0.45 | 500,000[c] | 225,000 |
| | | | **37,525,000** | **15,334,000** |

NOTE 26 – EMPLOYEE INCENTIVE PLAN (continued)

[a] *Shares issued and loans granted subject to satisfaction of vesting conditions which is the independent certification of proved and probable gas reserves (2P) within the coal seam gas Bohena Project Area of PEL 238 as follows:*

[1] *50 petajoules by 30 September 2007*

[2] *200 petajoules by 31 December 2007*

[b] *Shares issued and loans granted subject to satisfaction of vesting conditions of which 50% of the shares vest after 12 months and the balance after 24 months of the date of grant.*

[c] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of period of employment.*

[d] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of independent certification of proved and probable gas reserves (2P) of the new licence or existing licences or after 12 months employment Company shares trade above $1.05.*

[e] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of independent certification of proved and probable gas reserves (2P) of the new licence or existing licences or after 12 months employment Company shares trade above $1.50.*

[f] *Shares issued and loans granted subject to satisfaction of vesting conditions as follows:*

[1] *500 petajoules gas sales agreement is entered.*

[2] *Further 500 petajoules gas sales agreement is entered into or downstream commercial arrangements have been finalised for the 500 petajoules gas sales agreement.*

[g] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of completion of an integrated geoscience database and geological model for the Gunnedah Basin.*

[h] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of securing equity in new coal seam gas licences.*

[i] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of independent certification of proved and probable gas reserves (2P) of the new licence or existing licences as follows:*

[1] *400 petajoules are certified by 31 January 2009*

[2] *600 petajoules are certified by 31 December 2009*

[j] *Shares issued and loans granted subject to satisfaction of vesting conditions on the basis of drilling rig and safety operations targets.*

**(a) Recognised share based payments**

The Parent Entity has recognised share based payments of $2,838,858 (2008 – $3,781,749) under the plan of which $1,840,830 (2008: $2,571,842) is included as additions to intangible exploration and evaluation expenditure and $998,028 (2008: $1,269,907) expensed as employee costs.

**(b) Summary of option grants under Employee Incentive Plan**

| | **2009 Number** | **2009 Weighted Average Exercise Price $** | 2008 Number | 2008 Weighted Average Exercise Price $ | 2007 Number | 2007 Weighted Average Exercise Price $ |
|---|---|---|---|---|---|---|
| Outstanding at the beginning of the year | **36,525,000** | **0.20** | 11,045,000 | 0.07 | 10,725,000 | 0.06 |
| Granted during the year | **1,150,000** | **0.18** | 27,350,000 | 0.25 | 1,425,000 | 0.15 |
| Exercised during the year | **(150,000)** | **0.10** | (1,870,000) | 0.09 | (1,105,000) | 0.09 |
| Outstanding at the end of the year | **37,525,000** | **0.20** | 36,525,000 | 0.20 | 11,045,000 | 0.07 |

**(c) Weighted average remaining contractual life**

The weighted average remaining contractual life for the option grants outstanding is 2.95 years (2008 – 3.89 years).

**(d) Weighted average fair value**

The weighted average fair value of option grants during the year was $ 0.18 (2008 – $0.25).

## NOTE 27 – CONTINGENT LIABILITIES

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $'000** | 2008 $'000 | **2009 $'000** | 2008 $'000 |
| Bankers' guarantees issued for fulfillment of obligations under exploration licences and operating contracts secured by a charge over term deposits lodged with the bankers. | **2,035** | 1,541 | **1,906** | 1,412 |
| Termination benefits payable in certain circumstances in accordance with employment agreements. | **984** | 822 | **984** | 822 |
| | **3,019** | 2,363 | **2,890** | 2,234 |

The Parent Entity has entered into a Deed of Access, Indemnity and Insurance with each of the Directors of the Company. Subject to the Corporations Act 2001, the Deed provides an indemnity in respect of liability that each of the Directors may incur in relation to the conduct of the business or affairs of the Parent Entity, acts or omission of the Directors in relation to the business or affairs of the Parent Entity or the performance, manner of performance or failure to perform the Directors' responsibilities in relation to the business or affairs of the Parent Entity, in each case in the period during which the Director held office as a Director of the Parent Entity.

## NOTE 28 – INTERESTS IN JOINT VENTURES

The Group has the following participating interests in joint ventures with principal activities of oil and gas exploration. The joint ventures are not separate legal entities and are contractual arrangements between the participants for the sharing of costs and output.

| | Consolidated | |
|---|---|---|
| | **2009 %** | 2008 % |
| PEL 238 Narrabri Coal Seam Gas Joint Venture, Gunnedah Basin, NSW | **65** | 65 |
| Wilga Park Power Station Joint Venture | **65** | – |

**(a) PEL 238 Gunnedah Coal Seam Gas Joint Venture**

The Group has a 65% participating interest in PEL 238 Gunnedah Coal Seam Gas Joint Venture which includes Petroleum Production Licence 3. The Group's net assets and net profits employed in the joint venture are included in the Consolidated Balance Sheet and Income Statement are as follows:

## NOTE 28 – INTERESTS IN JOINT VENTURES (continued)

| | Consolidated 2009 $'000 | Consolidated 2008 $'000 |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | **844** | 2,355 |
| Trade and other receivables | **1,176** | 86 |
| Other current assets | **–** | 21 |
| Well equipment | **1,456** | 174 |
| **Total current assets** | **3,476** | 2,636 |
| **Non-current assets** | | |
| Property, plant and equipment | **2,052** | 738 |
| Exploration and evaluation expenditure | **52,818** | 25,655 |
| **Total non-current assets** | **54,870** | 26,393 |
| **Total assets** | **58,346** | 29,029 |
| **Current liabilities** | | |
| Trade and other payables | **3,636** | 1,024 |
| **Net assets** | **54,710** | 28,005 |
| **Revenue** | **187** | 94 |
| **Expenses** | | |
| Depreciation and amortisation | **(108)** | (64) |
| Fixed assets written off | **–** | (12) |
| **Profit before income tax expense** | **79** | 18 |
| Income tax expense | **–** | – |
| Net profit attributable to members of the Parent Entity after income tax expense | **79** | 18 |

### (b) Wilga park power station joint venture

The Group has a 65% participating interest in Wilga Park Power Station. The Group's net assets and net losses employed in the joint venture are included in the Consolidated Balance Sheet and Income Statement as follows:

| | 2009 $'000 | 2008 $'000 |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | **660** | – |
| Trade and other receivables | **98** | – |
| **Total current assets** | **758** | – |
| **Non-current assets** | | |
| Property, plant and equipment | **6,025** | – |
| **Total non-current assets** | **6,025** | – |
| **Total assets** | **6,783** | – |
| **Current liabilities** | | |
| Trade and other payables | **25** | – |
| **Net assets** | **6,758** | – |

| | Consolidated 2009 $'000 | 2008 $'000 |
|---|---|---|
| **Revenue** | 71 | |
| **Expenses** | | |
| Raw materials and consumables used | (320) | – |
| Depreciation and amortisation | (7) | – |
| **Total expenses** | (327) | – |
| **Loss before income tax expense** | (256) | – |
| Income tax expense | – | – |
| Net loss attributable to members of the Parent entity after income tax expense | (256) | – |

## NOTE 29 – INVESTMENT IN ASSOCIATE

| | Consolidated 2009 $'000 | 2008 $'000 |
|---|---|---|
| **(a) Investment details** | | |
| Orion Petroleum Limited (listed) | – | – |

The Group has a 23.1% ownership interest in Orion Petroleum Limited (30 June 2008: 23.1%), a company involved in the exploration and evaluation of oil and gas.

The associate is incorporated and domiciled in Australia.

| **(b) Movements in the carrying amount of the investment in associate** | | |
|---|---|---|
| At 1 July 2008 | – | – |
| Investment during the year | – | 4 |
| Share of loss during the year | – | (4) |
| At 30 June 2009 | – | – |

**(c) Fair value of listed investment in associate**

The market value of the Group's investment in associate is $3,003,000 (2008: $4,647,500)

**(d) Summarised financial information**

| **Extract from the associate's balance sheet:*** | | |
|---|---|---|
| Current assets | 13,092 | 19,689 |
| Non-current assets | 1,857 | 1,057 |
| | 14,949 | 20,746 |
| Current liabilities | (203) | (1,337) |
| Net assets | 14,746 | 19,409 |
| **Extract from the associate's income statement:*** | | |
| Revenue | 891 | 865 |
| Expenses | (5,622) | (2,739) |
| Net loss | (4,731) | (1,874) |

** Based on Management Accounts at 30 June 2009.*

## NOTE 29 – INVESTMENT IN ASSOCIATE (continued)

| | Consolidated | |
|---|---|---|
| | **2009 $'000** | 2008 $'000 |
| **(e) Group's share of associate's profits accounted for using the equity method:** | | |
| Loss before income tax | **–** | (4) |
| Income tax expense | **–** | – |
| Loss after income tax | **–** | (4) |

The total unrecognised share of losses of the associate for the period was $1,093,000 (2008: $429,000) and cumulatively was $1,522,000 (2008: $429,000)

## NOTE 30 – KEY MANAGEMENT PERSONNEL DISCLOSURES

### (a) Details of Key Management Personnel

**Directors**

| | |
|---|---|
| John Anderson | Chairman (non-executive) |
| David Casey | Managing Director |
| Peter Lansom | Executive Director – Appointed 14 October 2008 |
| David Archer | Director (non-executive) – Resigned 27 August 2009 |
| Douglas Battersby | Director (non-executive) – Resigned 30 November 2008 |
| David King | Director (non-executive) |
| Alex Sundich | Director (non-executive) |

**Executives**

| | |
|---|---|
| Ashley Edgar | General Manager Exploration & New Ventures |
| Ian Kirkham | Chief Financial Officer & Company Secretary |
| Roland Sleeman | General Manager Commercial |

### (b) Compensation of Key Management Personnel

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2009 $** | 2008 $ | **2009 $** | 2008 $ |
| Short-term employee benefits | **2,571,055** | 1,746,066 | **2,571,055** | 1,746,066 |
| Post-employment benefits | **178,079** | 143,430 | **178,079** | 143,430 |
| Share-based payment | **2,304,654** | 3,381,792 | **2,304,654** | 3,381,792 |
| | **5,053,788** | 5,271,288 | **5,053,788** | 5,271,288 |

### (c) Shareholdings of Key Management Personnel

| | Under Beginning of Year | Acquired Employee Overriding Royalty | Acquired Under Employee Incentive Plan | Net Change Other | End of Year |
|---|---|---|---|---|---|
| | Number | | Number | Number | Number |
| **2009** | | | | | |
| John Anderson | 40,000 | – | 500,000 | – | 540,000 |
| David Casey | 8,000,000 | – | – | – | 8,000,000 |
| David Archer | – | – | – | – | – |
| Douglas Battersby – Retired** | 30,055,462 | – | – | – | 30,055,462 |
| David King | 20,456,558 | – | – | – | 20,456,558 |
| Alex Sundich | 11,041,124 | – | – | (1,100,000) | 9,941,124 |
| Ashley Edgar | 7,000,000 | – | – | – | 7,000,000 |
| Ian Kirkham | 2,100,000 | – | – | – | 2,100,000 |
| Peter Lansom | 7,500,000 | – | – | – | 7,500,000 |
| Roland Sleeman | 6,684,474 | – | – | – | 6,684,474 |
| | **92,877,618** | **–** | **500,000** | **(1,100,000)** | **92,277,618** |
| **2008** | | | | | |
| John Anderson | – | – | – | 40,000 | 40,000 |
| David Casey | 6,750,000 | – | 1,250,000* | – | 8,000,000 |
| Dennis Morton – Retired** | 19,053,333 | 11,030,988 | – | – | 30,084,321 |
| David Archer | – | – | – | – | – |
| Douglas Battersby | 21,000,000 | 11,030,988 | – | (1,975,526) | 30,055,462 |
| David King | 12,413,333 | 11,030,988 | – | (2,987,763) | 20,456,558 |
| Christopher Ryan – Resigned** | 7,615,456 | – | – | (3,975,526) | 3,639,930 |
| Alex Sundich | 11,028,887 | – | – | 12,237 | 11,041,124 |
| Ashley Edgar | – | – | 7,000,000* | – | 7,000,000 |
| Ian Kirkham | 100,000 | – | 2,000,000* | – | 2,100,000 |
| Peter Lansom | – | – | 7,500,000* | – | 7,500,000 |
| Roland Sleeman | 422,237 | – | 6,250,000* | 12,237 | 6,684,474 |
| Patrick Sam Yue – Resigned** | 4,940,299 | – | – | 158,168 | 5,098,467 |
| | **83,323,545** | **33,092,964** | **24,000,000** | **(8,716,173)** | **131,700,336** |

** Shares issued under Employee Incentive Plan are subject to satisfaction to the conditions as described in Note 26 and in the Remuneration Report on page 26.*

*** Share holdings are as at the date of resignation.*

## NOTE 30 – KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)

### (d) Loans to Key Management Personnel

| 2009 | Beginning of Year $ | Interest Paid or Payable For The Year $ | Interest Not Charged $ | Addition $ | Repayment $ | End of Year $ | Maturity Date |
|---|---|---|---|---|---|---|---|
| John Anderson | – | – | – | 90,000 | – | 90,000 | 30 November 2013* |
| David Casey | 101,250 | – | – | – | – | 101,250 | 30 November 2010 |
| | 900,000 | – | – | – | – | 900,000 | 15 June 2011 |
| | 562,500 | – | – | – | – | 562,500 | 26 March 2013* |
| | **1,563,750** | **–** | **–** | **–** | **–** | **1,563,750** | |
| Peter Lansom | 3,915,000 | – | – | – | – | 3,915,000 | 10 September 2012* |
| Ashley Edgar | 3,690,000 | – | – | – | – | 3,690,000 | 27 August 2012* |
| Roland Sleeman | 2,700,000 | – | – | – | – | 2,700,000 | 31 October 2012* |
| Ian Kirkham | 900,000 | – | – | – | – | 900,000 | 5 December 2012 |
| **2008** | | | | | | | |
| David Casey | 101,250 | – | – | – | – | 101,250 | 30 November 2010 |
| | 900,000 | – | – | – | – | 900,000 | 15 June 2011 |
| | – | – | – | 562,500 | – | 562,500 | 26 March 2013* |
| | **1,001,250** | **–** | **–** | **562,500** | **–** | **1,563,750** | |
| Peter Lansom | – | – | – | 3,915,000 | – | 3,915,000 | 31 July 2012* |
| Ashley Edgar | – | – | – | 3,690,000 | – | 3,690,000 | 30 July 2012* |
| Roland Sleeman | – | – | – | 2,700,000 | – | 2,700,000 | 1 November 2012* |
| Ian Kirkham | – | – | – | 900,000 | – | 900,000 | 5 December 2012* |
| Patrick Sam Yue | 30,000 | – | – | – | (30,000) | – | 30 June 2009 |
| | 67,500 | – | – | – | (67,500) | – | 30 November 2010 |
| | **97,500** | **–** | **–** | **–** | **(97,500)** | **–** | |

The loans were made to key management personnel under the Eastern Star Gas Employee Incentive Plan to subscribe for fully paid ordinary shares in the Parent Entity. The loans are interest free and mature on 5 years from the date that they were provided. The issued shares may not be dealt with by the key management personnel until the loan has been repaid. The repayment of the loan is limited to the proceeds on eventual disposal of the shares.

** The loans are not due and payable if the entitlement to the related issued shares are not satisfied those conditions as described in Note 26 and in the Remuneration Report on page 26.*

## NOTE 31 – EVENTS OCCURRING AFTER REPORTING DATE

There has not arisen in the interval since 30 June 2009 and up to the date of this report, any matter that, in the opinion of the Directors, has significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group in future financial years other than the following:

**(a)** On 2 July 2009, Santos acquired Gastar Exploration's 35% interest in PEL238 (Narrabri CSG Project), PEL433, PEL434 and the Wilga Park Power Station. Santos also acquired a 19.99% interest in Eastern Star Gas Limited from Hillgrove Resources Limited. There is no financial effect of this transaction on the Group.

## NOTE 32 – RELATED PARTY DISCLOSURE

**(a)** On 30 June 2008 the company's subsidiary Narrabri Power Limited entered into sale agreement to sell 32.5% of the PPL3 Pipeline infrastructure for the consideration amount of USD403,758.00 to each company Eastern Energy Australia Pty Ltd and Hillgrove Energy Pty Limited. Payments were settled through the Parent Entity as disclosed in note 32(b).

**(b)** **Loan to Subsidiary**

During the financial year the Parent Entity made interest free loans with no specified repayment date or any present obligation to repay the loan to its subsidiaries as follows:

| | **Balance at 30 June 2009 $'000** | Balance at 30 June 2008 $'000 |
|---|---|---|
| Narrabri Power Pty Ltd – Operations | **18,228** | 19,661 |
| Eastern Energy Australia Pty Ltd<br>Contribution to the Narrabri Coal Seam Gas Joint Venture, costs for cancellation of overriding royalty interests, share-based payment costs in PEL 238 and acquisition of pipeline | **35,136** | 22,165 |
| Hillgrove Energy Pty Limited – Contribution to the Narrabri Basin Coal Seam Gas Project, costs for cancellation of overriding royalty interests, share-based payment costs in PEL 238 and acquisition of pipeline | **26,518** | 13,344 |
| | **79,882** | 55,170 |

The loans are expected to be recoverable within 12 months.

## NOTE 33 – CORPORATE INFORMATION

The financial report of Eastern Star Gas Limited for the year ended 30 June 2009 was authorised for issuel in accordance with a resolution of the Directors on 7 September 2009.

Eastern Star Gas Limited is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Securities Exchange.

# DIRECTORS' DECLARATION

for the year ended 30 June 2009

## THE DIRECTORS OF EASTERN STAR GAS LIMITED DECLARE THAT:

(a) in the directors' opinion, the financial statements and notes on pages 37 to 79, and the remuneration disclosures that are contained in the Remuneration report in the Directors' report, set out on pages 26 to 31, are accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the company's and the consolidated entity's financial Position as at 30 June 2009 and of their performance, for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 1(b)

(c) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

The directors have been given the declarations by the chief executive officer and chief financial officer for the financial year ended 30 June 2009, required by Section 295A of the Corporations Act 2001.

Signed in accordance with a resolution of the Directors.

Dated 10 September 2009

**David Casey**
Director

# INDEPENDENT AUDIT REPORT

## to the members of Eastern Star Gas Limited

PKF
Chartered Accountants
& Business Advisers

**INDEPENDENT AUDITOR'S REPORT**

To the members of Eastern Star Gas Limited

**Report on the Financial Report**

We have audited the accompanying financial report of Eastern Star Gas Limited, which comprises the balance sheet as at 30 June 2009, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration for both Eastern Star Gas Limited (the company) and the consolidated entity. The consolidated entity comprises the company and the entities it controlled at the year's end and from time to time during the financial year.

*Directors' Responsibility for the Financial Report*

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1(b), the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that compliance with Australian Equivalents to International Financial Reporting Standards ensures that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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PKF | ABN 83 236 985 726
Level 10, 1 Margaret Street | Sydney | New South Wales 2000 | Australia
DX 10173 | Sydney Stock Exchange | New South Wales

# INDEPENDENT AUDIT REPORT

to the members of Eastern Star Gas Limited (continued)

PKF

Chartered Accountants
& Business Advisers

*Independence*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

*Auditor's Opinion*

In our opinion:

(a) the financial report of Eastern Star Gas Limited is in accordance with the *Corporations Act 2001*, including:

  (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2009 and of their performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards (including Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and

(b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1(b).

**Report on the Remuneration Report**

We have audited the Remuneration Report included in pages 26 to 31 of the directors' report for the year ended 30 June 2009. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

*Auditor's Opinion*

In our opinion the Remuneration Report of Eastern Star Gas Limited for the year ended 30 June 2009 complies with section 300A of the *Corporations Act 2001*.

PKF

**PKF**

Bruce Gordon.

**Bruce Gordon**
Partner

10 September 2009
Sydney

# ADDITIONAL INFORMATION

## 1. SHAREHOLDINGS

### (a) Distribution of Shareholders as at 28 August 2009

| Size of Holding | Number of Holders | Ordinary Shares Held | % |
|---|---|---|---|
| 1 – 1,000 | 773 | 579,490 | 0.07% |
| 1,001 – 5,000 | 3,106 | 9,924,282 | 1.18% |
| 5,001 – 10,000 | 2,114 | 17,918,212 | 2.13% |
| 10,001 – 100,000 | 3,723 | 125,389,067 | 14.81% |
| 100,001 – over | 576 | 724,323,742 | 81.81% |
| | **10,292** | **878,134,793** | **100.00%** |

34 shareholders held less than a marketable parcel of shares.

### (b) Top Twenty Shareholders as at 28 August 2009

| Shareholder | Number of Ordinary Shares | % Held |
|---|---|---|
| Santos Limited | 175,519,143 | 19.99% |
| National Nominees Limited | 55,525,791 | 6.32% |
| Truenergy Investments Pty Ltd | 38,546,256 | 4.39% |
| J P Morgan Nominees Aust. Limited | 36,804,844 | 4.19% |
| HSBC Custody Nominees (Aust.) Limited | 31,253,415 | 3.56% |
| Merrill Lynch (Aust.) Nominees Pty Limited | 27,402,290 | 3.12% |
| Veruse Pty Limited | 23,043,225 | 2.62% |
| Seistend Pty Ltd | 18,500,000 | 2.11% |
| Mr Dennis James Morton | 14,683,333 | 1.67% |
| ANZ Nominees Limited | 9,074,496 | 1.03% |
| Citicorp Nominees Pty Limited | 9,010,881 | 1.03% |
| Mr David Casey | 8,000,000 | 0.91% |
| Mr Peter Lansom | 7,500,000 | 0.85% |
| Budside Pty Ltd | 7,030,988 | 0.80% |
| Mr Douglas Geoffrey Battersby | 7,012,237 | 0.80% |
| Mr Ashley Edgar | 7,000,000 | 0.80% |
| Pine Street Pty Ltd | 6,426,190 | 0.73% |
| Mr Roland Sleeman | 6,250,000 | 0.71% |
| Diemar & Associates Pty Ltd | 4,873,987 | 0.56% |
| Baron Nominees Pty Limited | 4,195,000 | 0.48% |
| | **497,652,076** | **56.67%** |
| Employee Fully Paid Ordinary Shares | 37,275,000 | 4.24% |
| ASX Listed Fully Paid Ordinary Shares | 840,859,793 | 95.76% |
| **Total Fully Paid Ordinary Shares** | **878,134,793** | **100.00%** |

## 2. OPTIONHOLDINGS

Distribution of Optionholders as at 28 August 2009
Options 15 cents expiring on 30 October 2011

| Size of Holding<br>% | Number of Holders | Ordinary Shares Held |
|---|---|---|
| 10,001 – 100,000<br>100.00% | 1 | 25,000 |

**Holder of 20% or more:** Santos Limited – 25,000

## 3. VOTING RIGHTS

(a) at meetings of members each member entitled to vote may vote in person or by proxy or attorney or,
in the case of a member which is a body corporate, by representative duly authorised;

(b) on a show of hands every member entitled to vote and be present in person or by proxy or attorney
or representative duly authorised shall have one (1) vote; and

(c) on a poll every member entitled to vote and be present in person or by proxy or attorney or representative duly authorised shall have one (1) vote for each fully paid share of which he is a holder.

## 4. AUDIT AND RISK COMMITTEE

As at the date of this report the Group has an Audit and Risk Committee, a subcommittee of the Board of Directors.

## 5. SUBSTANTIAL SHAREHOLDERS

The securities held by substantial shareholders are as follows:

| Name | Number of Shares |
|---|---|
| Santos Limited | 175,519,143 |
| TRUenergy Investments Pty Ltd | 38,546,256 |

# CORPORATE DIRECTORY

**Eastern Star Gas Limited – ABN 29 094 269 780**

## Directors

| | |
|---|---|
| The Hon. John Anderson | (Chairman) |
| David Casey | (Managing Director) |
| Dr David King | (Non- Executive) |
| Alex Sundich | (Non-Executive) |
| Peter Lansom | (Executive Director – Operations) |

## Company Secretary

Ian Kirkham

## Registered Office

Level 7, 51 Pitt Street
SYDNEY NSW 2000
Tel: (02) 9251 5599
Fax: (02) 9251 2299
email: office@easternstar.com.au

## Website

www.easternstar.com.au

## Share Registry

Registries Limited
Level 7, 207 Kent Street
SYDNEY NSW 2000
Tel: (02) 9290 9600
Fax: (02) 9279 0664

## Auditors

PKF
Level 10, 1 Margaret Street
SYDNEY NSW 2000

## Home Stock Exchange

Australian Stock Exchange Limited
4 Bridge Street
SYDNEY NSW 2000

**ASX code:** ESG