

Hillgrove Resources Limited and it's Controlled Entities

Half Year Financial Report
31 July 2006

Hillgrove Resources Limited and its Controlled Entities

ACN 004 297 116

Contents

Directors Report	1
Auditors' Independence Declaration	5
Consolidated Income Statement	6
Consolidated Balance Sheet	7
Consolidated Statement of Changes in Equity	8
Consolidated Cash Flow Statement	9
Notes to the Financial Statements	10
Directors' Declaration	12
Independent Review Report	13

Directors' Report

The directors present their report together with the financial report of the consolidated entity, being the Company and its controlled entities, for the half-year ended 31 July 2006.

Directors

The directors of the Company at any time during the half year or since the end of the half year are:

Name and qualifications	Age	Experience and special responsibilities
David Stuart Archer	50	Chairman/Managing Director
Qualifications		B.Ec., Dip. Law (BAB), F.Aus.I.M.M.
Experience		David has held executive and non-executive roles in a number of Australian companies and has been actively involved in the Australian resources industry for over 25 years. He is a barrister (non-practising) of the Supreme Court of New South Wales and was the founder and former executive chairman of PowerTel Limited and Savage Resources Limited and has an extensive range of business interests. Appointed 11 November 2002
Ronald David Belz	51	Director
Qualifications		B.Bus., CPA
Experience		Ron has been a member of CPA Australia since 1982 and a Certified Practising Accountant since 1987, and operates his own practice in Edgecliff, Sydney. Ron has extensive knowledge and experience in accounting and taxation law in Australia. Appointed 11 November 2002
The Hon. Dean Craig Brown	63	Director
Qualifications		B Rur. Sc., Grad. Dip Bus. Admin, M. Rur. Sc.
Experience		Former Premier and Minister of the South Australian Government, Member of the South Australian Parliament 1973-1985 and 1992-2006. Has held various portfolios including health, aboriginal affairs, public works, industrial relations, and information technology. Also Deputy Premier and Leader of the Opposition. Currently a Member of the National Youth Mental Health Advisory Board, Director of Foodbank SA and a member of several advisory boards. Previously a Director of AACM International Pty Ltd (1986-92) and a Senior Agricultural Scientist, SA Government. Appointed: 1 September 2006

Name and qualifications	Age	Experience and special responsibilities
John Andrew Quirke	56	Director
Qualifications		B.A & Dip. Ed. Adelaide University
Experience		Starting his career as a secondary school teacher, he became a Private Secretary to a Federal Senator before being elected the Member for Playford in 1989. In 1997 he became a Federal Senator and then Deputy Chief Whip before resigning in 2000. John gained extensive State and Federal committee experience which included competition policy, public works, social development, economics and finance, and since has been an active member of numerous legislative committees specialising in mining and economics, a Trustee to the Australia/ Cambodia Foundation and Board Member of Operation Flinders. Appointed 19 April 2005
Pearce Macarthur Bowman	57	Director
Qualifications		B.Eng., M.Eng.Sc., MBA (AGSB)
Experience		Pearce was CEO of Generation Victoria from 1993-94 playing a key role in the transition of the State Electricity Commission to corporatised Generation Victoria. From 1994-2000 he served as Executive GM Copper/Uranium for WMC Limited, responsible for expansion of Olympic Dam and Nifty Copper operations. From 2001-02 Pearce was CEO Elect of Australian Power and Energy Ltd. He is Executive Chairman of PMI Ventures Ltd., a Canadian based gold exploration company with extensive assets in Ghana. Appointed 20 April 2005 Resigned 31 July 2006

Principal activities

The activities of the consolidated entity have been focused on identifying resources opportunities that can either be brought into production readily or those where there is a defined value adding route within a clearly understood risk environment. Commodities that are of particular interest include copper, gold, garnet, natural gas, silver, lead and zinc.

There were no significant changes in the nature of the consolidated entity's principal activities during the half-year.

Directors Report

Review and results of operations

The loss of the consolidated entity for the half-year was \$956,947 (half year to 31 July 2005 loss: \$470,022).

Exploration & Feasibility Study

During the period the consolidated entity continued exploration on its two primary projects:

- Roche Mining continued the pre-feasibility assessment of the Kanmantoo Copper/Gold Mine to evaluate the potential re-development of the mine.
- During May an updated resource assessment of 25.375MT at 1.0% copper and 0.2 g/t gold was announced, which included drilling results through to March 2006. Results have continued to highlight a number of extensions to the North East, South East and Eastern Zones.
- A nine well drilling programme was completed at the Gunnedah Basin Coal Seam Gas Joint Venture (PEL238) at Bibblewindi and awaits dewatering.

Capital Raising

The following funds were raised during the period:

- On 14 March 2006 the Company placed 7.5 million ordinary shares and 3.75 million options with Maple Leaf Capital raising \$1,500,000.
- On 14 March 2006 the Company placed 7.5 million ordinary shares and 3.75 million options with Anglo Pacific group raising \$1,500,000.

Debt Funding

During the period the company borrowed a second \$2,000,000 under the Sempra Convertible Note Facility. Interest under the facility totalling \$124,770 has been expensed for the period and will be paid through the issue of Company shares.

InterMet IPO

During the period the Company floated its subsidiary InterMet Resources Limited (InterMet) on the Australian Stock Exchange. As part of the listing process 18% of the shares were disposed of at a loss of \$53,300. The remaining shares held at 31 July 2006 had a book value of \$246,702 and a market value of approximately \$2.1 million. The share of InterMet's net losses accounted for using the equity method was \$25,614.

Dividends

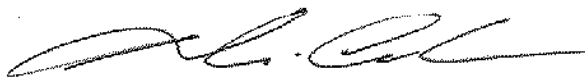
No dividends have been paid or declared by the Company since the end of the previous financial year.

Auditors independence declaration

A copy of the auditors' independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 5.

Signed in accordance with a resolution of the directors:

Dated at Sydney this 10th day of October 2006.



D S Archer
Director



R D Belz
Director

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Auditors' Independence Declaration

As lead auditor for the review of Hillgrove Resources Limited for the half-year ended 31 July 2006, 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 review; and
- (b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect to Hillgrove Resources Limited and the entities it controlled during this period.


John Campion
Partner
PricewaterhouseCoopers

Newcastle
10 October 2006

Consolidated Income Statement

For the half year ended 31 July 2006

	Note	Half Year	
		July 2006	July 2005
		\$	\$
Revenue from continuing operations		125,356	70,000
Other Income		144,406	164,309
Accounting, ASIC & Audit		(59,762)	(28,447)
Bank Interest & Charges		(128,087)	(1,261)
Computing & Communications		(31,028)	(19,204)
Consultants Fees		(73,488)	(24,855)
Depreciation		(41,064)	(30,687)
Directors Fees		(45,000)	(38,750)
Entertainment		(291)	(466)
Insurance		(24,025)	(1,349)
Public Co. Expenses		(67,944)	(51,504)
Rent		(84,138)	(84,732)
Employee benefits expense		(387,580)	(257,397)
Travel		(75,653)	(89,045)
Promotion		(71,614)	(62,029)
Rehabilitation expenditure		(17,763)	-
Loss on sale of shares		(53,300)	-
Other Expenses		(21,185)	(14,607)
Share of net profits of associates accounted for using the equity method		(56,414)	-
Loss before income tax		(968,574)	(470,022)
Income tax expense		-	-
Net Loss attributable to members of the Hillgrove Resources Limited		(968,574)	(470,022)
Earnings per share for loss attributable to the ordinary equity holders of the company:			
Basic earnings per share		(0.005)	(0.003)
Diluted earnings per share		(0.005)	(0.003)

The consolidated income statement above should be read in conjunction with the accompanying notes.

Consolidated Balance Sheet

	Note	Consolidated 31 July 2006 \$	Consolidated 31 January 2006 \$
Current assets			
Cash and cash equivalents		2,983,191	5,125,486
Receivables		738,586	521,280
Available-for-sale financial assets		902,404	131,680
Total current assets		<u>4,624,181</u>	<u>5,778,446</u>
Non current assets			
Investments accounted for using the equity method		190,288	-
Property, plant and equipment		475,325	254,435
Exploration & evaluation expenditure		18,333,622	12,505,628
Total non current assets		<u>18,999,235</u>	<u>12,760,063</u>
Total assets		<u>23,623,415</u>	<u>18,538,509</u>
Current liabilities			
Payables		1,493,954	527,142
Provisions		23,174	12,996
Other		22,837	22,837
Total current liabilities		<u>1,539,965</u>	<u>562,975</u>
Non current liabilities			
Interest bearing liabilities		4,000,000	2,000,000
Provisions		150,000	150,000
Other		41,869	53,288
Total Non current liabilities		<u>4,191,869</u>	<u>2,203,288</u>
Total liabilities		<u>5,731,834</u>	<u>2,766,263</u>
Net Assets		<u>17,891,581</u>	<u>15,772,246</u>
Equity			
Contributed equity		25,680,530	22,696,758
Reserves		252,776	121,293
Accumulated losses		(8,041,724)	(7,073,151)
Parent entity interest		17,891,581	15,744,900
Minority interest		-	27,346
Total equity		<u>17,891,581</u>	<u>15,772,246</u>

The consolidated balance sheet above should be read in conjunction with the accompanying notes.

Consolidated Statement of Changes In Equity

For The Half Year Ended 31 July 2006

	Half Year	
	July 2006	July 2005
Total equity at the beginning of the half year	15,772,246	11,848,979
Employee share options	131,483	41,507
Adjustments on adoption of AASB132 and AASB139	-	5,563
Net income recognised directly in equity	131,483	47,070
Loss for the half year	(968,574)	(475,582)
Total recognised income and expense for the half year	(837,091)	(428,512)
Transactions with equity holders in their capacity as equity holders:		
Contributions of equity, net of transaction costs	2,983,772	2,907,500
Minority interest on disposal of subsidiary	(27,346)	-
Total equity at the end of the half year	17,891,581	14,327,967

The consolidated statement of changes in equity above should be read in conjunction with the accompanying notes.

Consolidated Cash Flows Statement

For The Half Year Ended 31 July 2006

	Half Year	
	July 2006	July 2005
	\$	\$
Cash Flows From Operating Activities		
Receipts from customers (inclusive of GST)	69,397	70,000
Payments to suppliers and employees (inclusive of GST)	(482,353)	(1,263,067)
Interest received	120,773	121,345
Net cash outflow from operating activities	(292,183)	(1,071,722)
Cash Flows From Investing Activities		
Exploration /mine development	(5,827,994)	(2,436,240)
Payments for plant and equipment	(261,953)	(38,830)
Proceeds on sale of investments	61,659	17,868
Payments for investment	(725,114)	(164,458)
Net cash outflow from investing activities	(6,753,402)	(2,621,661)
Cash Flows From Financing Activities		
Proceeds from issue of shares	3,005,717	3,000,000
Transaction costs arising from issue of shares	(102,427)	(92,500)
Proceeds from issue of convertible notes	2,000,000	-
Net cash inflow from financing activities	4,903,290	2,907,500
Net increase in cash and cash equivalents	(2,142,295)	(785,883)
Cash and cash equivalents at the beginning of the financial period	5,125,486	4,469,830
Cash and cash equivalents at the end of the financial period	2,983,191	3,683,947

The consolidated cash flows statement above should be read in conjunction with the accompanying notes.

Notes to the Financial Statements

For The Half Year Ended 31 July 2006

1. Statement of significant accounting policies

This general purpose financial report for the interim half year reporting period ended 31 July 2006 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*.

This interim financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 31 January 2006 and any public announcements made by Hillgrove Resources Limited during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*.

The accounting policies adopted in the preparation of the financial report are consistent with those of the previous financial year and corresponding interim reporting periods.

	Note	July 2006 \$	July 2005 \$
2. Contributed equity			
Issued and paid-up capital			
181,410,637 ordinary shares, fully paid			
(2005 – 158,089,015 ordinary shares, fully paid)	3 (a)	<u>25,680,530</u>	<u>20,729,281</u>

3. Ordinary shares

Movements During the half year

Balance as at beginning of half year	22,696,758	17,821,781
Shares Issued		
- 15,000,000 for cash pursuant to a placement	-	3,000,000
- 7,500,000 for cash pursuant to a placement	1,500,000	-
- 293,035 Convertible Note Interest	80,482	-
- 7,500,000 for cash pursuant to a placement	1,500,000	-
- 25,587 for cash to exercise options	5,117	-
- 3,000 for cash to exercise options	600	-
- transaction costs arising from share issues	<u>(102,427)</u>	<u>(92,500)</u>
Balance at end of half-year	<u>25,680,530</u>	<u>20,729,281</u>

Notes to the Financial Statements
For The Half Year Ended 31 July 2006

4. Dividends

The company has not paid or declared a dividend since the end of the previous financial year.

5. Segment reporting

The consolidated entity operates predominantly in the mineral exploration business in Australia.

6. Events subsequent to reporting date

In the opinion of the directors, no items, transactions or events of a material and unusual nature have arisen in the interval between the end of the financial year and the date of this report which have significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in subsequent financial years, apart from the following:

Sale of Gunnedah Coal Seam Gas Joint Venture

On 28 August 2006 the company announced that it would sell its wholly owned subsidiary, Hillgrove Energy Pty. Limited, which holds 32.5% interest in the Gunnedah Basin Gas Project (Coal Seam Gas Joint Venture) in return for shares and options in Eastern Star Gas Limited (Eastern Star), which also has a 32.5% interest in the Coal Seem Gas Joint Venture. The transaction is subject to the approval of Eastern Star's shareholders. Consideration consists of 92.36 million Eastern Star ordinary shares, 47.64 million zero coupon converting notes and 25 million three year Eastern Star options exercisable at 15 cents each. The securities will be the subject of a restriction agreement for 12 months under the Listing Rules of the ASX.

Directors' Declaration

In the opinion of the directors of Hillgrove Resources Limited ("the Company"):

- (a) the financial statements and notes, set out on pages 6 to 11, are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the consolidated entity as at 31 July 2006 and of its performance, as represented by the results of its operations and its cash flows, for the half year ended on that date; and
 - (ii) complying with Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements.
- (b) There are reasonable grounds to believe that the company will be able to pay it's debts as and when they become due and payable.

Dated at Sydney this 10th day of October 2006.

Signed in accordance with a resolution of the directors:



D S Archer
Director



R D Belz
Director

Independent Review Report

To the members of Hillgrove Resources Limited

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the financial report of Hillgrove Resources Limited:

- does not give a true and fair view, as required by the *Corporations Act 2001* in Australia, of the financial position of the Hillgrove Resources Group (defined below) as at 31 July 2006 and of its performance for the half-year ended on that date, and
- is not presented in accordance with the *Corporations Act 2001*, Accounting Standard AASB 134: *Interim Financial Reporting* and other mandatory financial reporting requirements in Australia, and the *Corporations Regulations 2001*.

This statement must be read in conjunction with the rest of our review report.

Scope

The financial report and directors' responsibility

The financial report comprises the balance sheet, income statement, statement of changes in equity, cash flow statement, accompanying notes to the financial statements, and the directors' declaration for the Hillgrove Resources Group (the consolidated entity), for the half-year ended 31 July 2006. The consolidated entity comprises both Hillgrove Resources Limited (the company) and the entities it controlled during that half-year.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Review approach

We conducted an independent review in order for the company to lodge the financial report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements. For further explanation of a review, visit our website <http://www.pwc.com/au/financialstatementaudit>.

We performed procedures in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report does not present fairly, in accordance with the *Corporations Act 2001*, Accounting Standard AASB 134: *Interim Financial Reporting* and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the consolidated entity's financial position, and its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which included:

- inquiries of company personnel/the responsible entity's personnel, and
- analytical procedures applied to financial data.

Our procedures include reading the other information included with the financial report to determine whether it contains any material inconsistencies with the financial report.

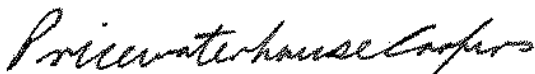
These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than that given in an audit. We have not performed an audit, and accordingly, we do not express an audit opinion.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

Our review did not involve an analysis of the prudence of business decisions made by directors or management.

Independence

In conducting our review, we followed applicable independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*.



PricewaterhouseCoopers



John Campion
Partner

Newcastle
10 October 2006