LAKES OIL N.L.

ABN 62 004 247 214

Company Update
July 2006

Drilling Loy Yang -2 well

CORPORATE INFORMATION

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July 2006

Dear Shareholder,

Lakes Oil enjoys the support of a wide range of shareholders who share our vision of creating a successful exploration and production company centred on the onshore portions of the Gippsland and Otway Basins.

This booklet explains in some detail our activities, as well as the challenges and potential rewards which we are working towards.

It should also answer a number of questions which shareholders put to us from time to time.

By way of overview, many may not appreciate that we have spent in excess of $30 million in PEP 157 alone, on our "tight gas project". This has required considerable financial support from shareholders, and has also affected the price of our stock listed on the Australian Stock Exchange.

Lakes Oil initiated, and continues to "pioneer", the "tight gas" technology in Australia. Although fracture stimulation of tight gas (and oil) sands is widely used and appreciated in North America and elsewhere, there is relatively little understanding, even within the oil industry, in this country.

In-depth discussions with successful overseas producers of tight gas have re-affirmed our confidence in both the technology and the potential resources within our permits. More-over, the work we have carried out, and our results to date, are now attracting interest from a number of potential partners.

One example is the recent visit to Melbourne by a nine-member delegation from Sinopec, China's largest oil and gas company, which resulted in a non-binding Memorandum of Understanding aimed at introducing both technology and capital into our projects. Sinopec is currently undertaking due diligence with a view to further negotiations being held in July/August this year.

If successfully completed, the negotiations would greatly reduce the need for capital contributions from shareholders, and indeed this is also our strategy in dealing with approaches that have been received from US interests seeking to join with us in our tight gas projects.

Over the last few years shareholders have been invited to participate in a number of capital raisings, primarily to fund development of our projects to the point at which we could successfully introduce suitable partners. Lakes' believes we are now in a position to do so, and to make physical estimates of gas in place, and expected recovery rates. This in turns permits the modelling of daily gas flows based on computer-generated production estimates, assuming gas is generated from a number of "sands" within each well.

The commerciality of these models is based on the fact that all of our wells within the Strzelecki Formation have encountered gas in multiple zones, and the data which we now possess provides potential partners with the ability to assess and value our projects.

Should these estimates prove to be correct, the current market value of Lakes Oil (approximately $35 million) would appear conservative.

I remind you that the figures presented in the booklet are estimated only, and although based on factual information, may not be achieved. However, if they are in the "ball park", then using these estimates would mean our projects are potentially commercial, and could be up and running, and generating a cash flow in a relatively short period.

We believe that Lakes Oil projects could constitute an important new **Victorian Energy Asset,** and that this explains the interest we are receiving from overseas companies who understand the full potential of our resource base.

The next big spend for Lakes Oil will require an estimated $15 - $20 million of pre-feasibility capital, and this is clearly beyond our reach at this time. It would be spent on drilling, fracture-stimulating and testing two more wells in the Wombat location (using all the knowledge we have acquired on our earlier wells) and another well on the Baragwanath anticline. This would be followed by a full feasibility study to determine the economics of going into commercial production.

Accordingly, our discussions with potential partners are aimed at procuring the required financing (whilst retaining the maximum equity possible in our projects) to carry Lakes Oil through to commerciality.

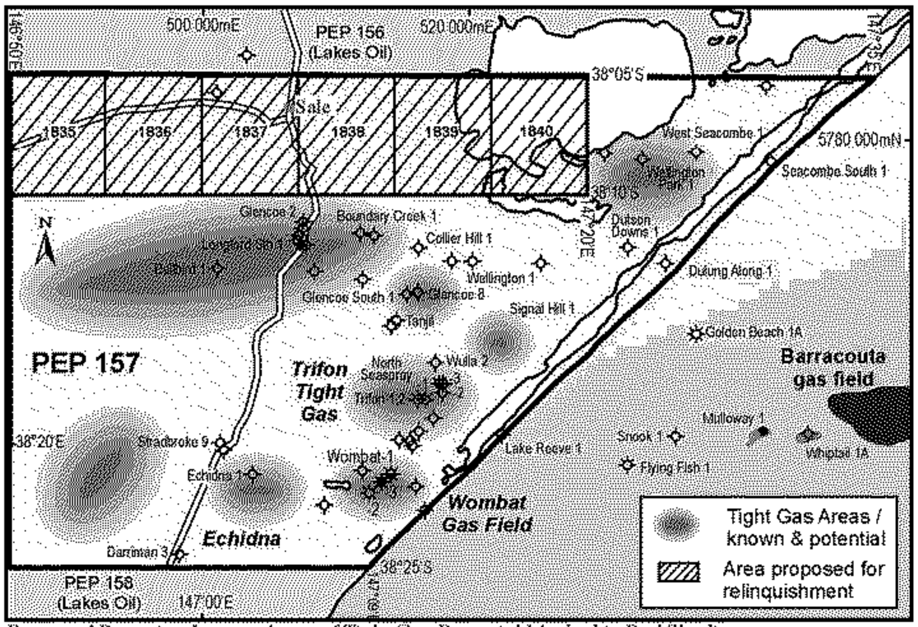
Yours sincerely
LAKES OIL N.L.

ROBERT J. ANNELLS
Chairman

SUMMARY OF RECENT ACTIVITIES

- **Retention Lease Application for PEP 157**

  Lakes Oil has submitted a Retention Lease Application over about 75% of PEP 157 for a 15 year period in order to identify and explore for further tight gas prospects in the lease and to bring the Wombat - Trifon-Gangell Gas Fields to commerciality.



Proposed Retention Lease - Areas of Tight Gas Potential Marked in Red Shading

- **Sinopec discussions with Lakes Oil**

A nine member delegation from China's largest oil and gas company, Sinopec, visited Lakes Oil recently to examine our technical data in the Gippsland and Otway Basins. The group visited our field operations during their stay and have indicated their interest in our tight gas objectives. Extended discussions with Sinopec resulted in the signing of a non-binding Memorandum of Understanding between Lakes Oil and Sinopec with the intention of further negotiations.


Sinopec delegation visit to the Wombat Gas Field


Lakes Oil Chairman Mr Rob Annells and Sinopec's Mr Zhoy Liqing signing Memorandum of Understanding in Melbourne

- **Integrated Reservoir Study**

Lakes Oil commissioned a USA oilfield consulting group to conduct an independent feasibility study of the Wombat, Gangell and Trifon tight gas fields. Results from Phase I of this "Integrated Reservoir Study" indicate that the production prospectivity of the three tight gas fields prospects under review is clearly positive and the consultants recommend going ahead with Phase II of the pre-feasibility study - hydraulic fracturing design and production drilling.

Estimated Volumes
Wombat, Trifon and Gangell Fields*

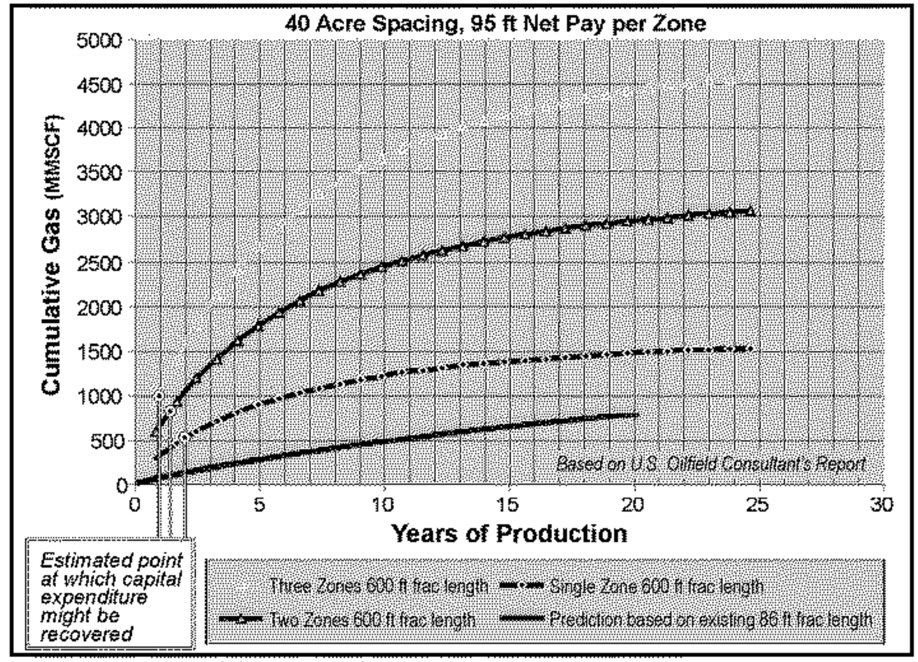
- **Wombat structure** appears to have the best porosity and has estimated gas-in-place volume of 535.4 bcf
- **Gangell structure** is smaller with an estimated gas-in-place volume of 375.4 bcf
- **Trifon structure** has an estimated gas-in-place volume of 32.0 bcf based on limited, shallow DST data. However, post-frac gas flowed to surface from the deeper 2350m reservoir sand in Trifon 2 and could enlarge the gas-in-place volume to 559.5 bcf.

A recovery factor of 50% - 60% is given for these fields

** Source: Report prepared by U.S. Oilfield Consultant*

Lakes Oil wishes to emphasize that the report's references to these potential gas flows are based on a large number of assumptions, are subject to a large number of risks and there is a large degree of uncertainty associated with them. The potential gas flows should not be assumed to represent future reserves, which will depend on a variety of factors including the need to confirm their existence and characteristics and the ability to extract them in a commercial and cost effective manner.

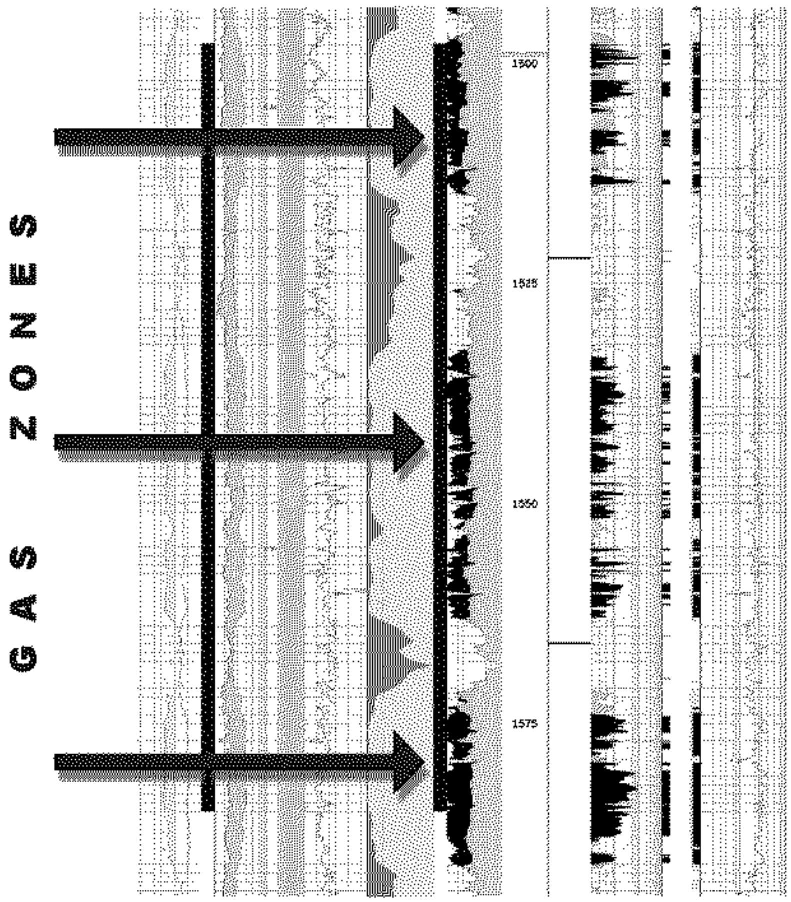
- **Production Estimates for Wombat Field**



Forecast of Potential Cumulative Gas Production - Wombat Field

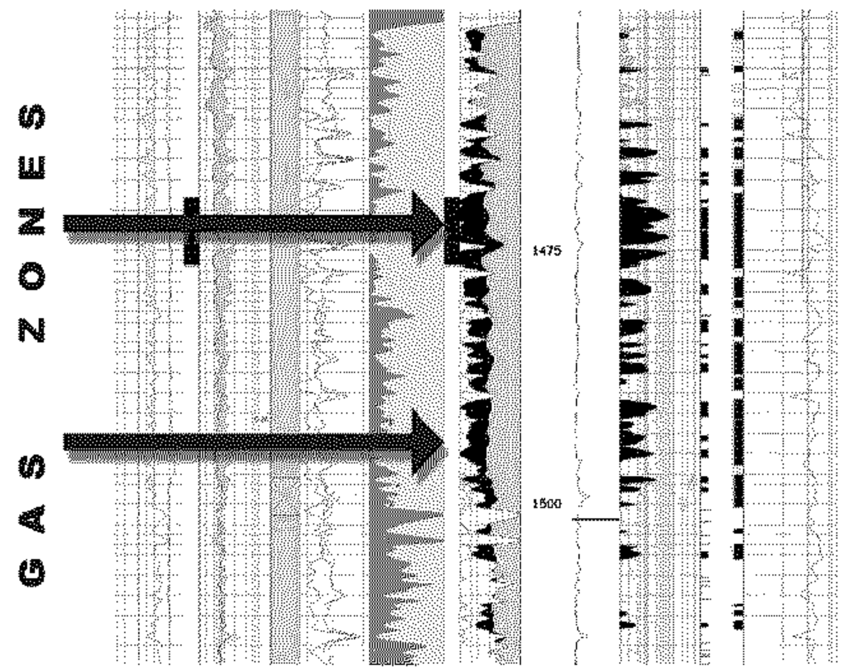
This chart shows a forecast of cumulative gas production volumes for three fracture zone scenarios in a single producing well based on known and probable flow rates and reservoir thicknesses in the Wombat Field. The chart also shows the time it takes to reach estimated capital cost recovery for the three scenarios given.

WOMBAT - 1



- 1st Strzelecki gas flow
- Highest Strzelecki gas flows 2mmcfd (max)
- 500m gross gas column

WOMBAT - 2

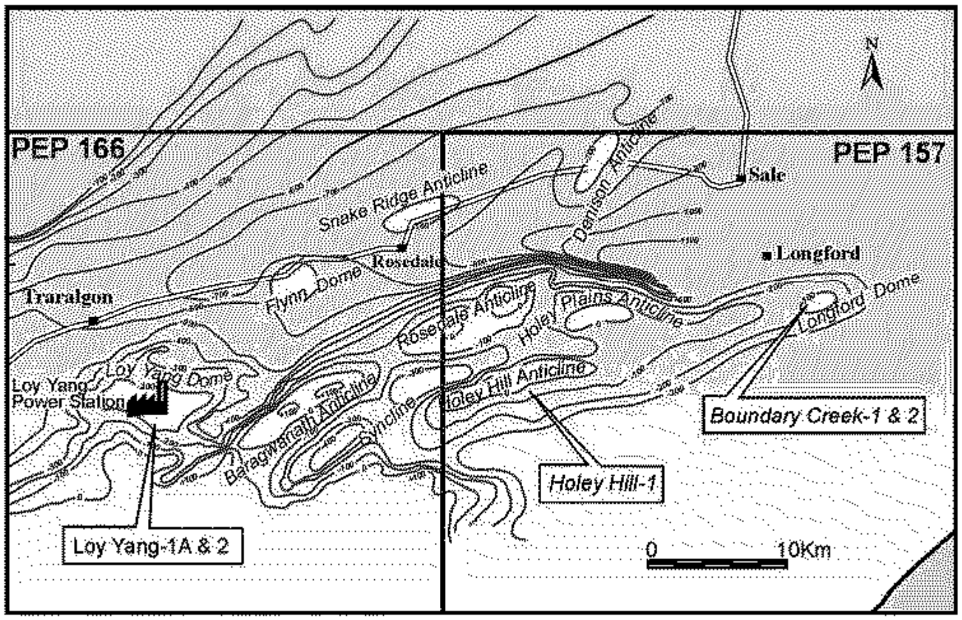


- Sustained gas rate of 680 mcfd from 1 fracture-stimulated zone
- Better zone yet to be fracture stimulated
- Other zones expected from deeper drilling

PEP 166

- **Anticlinal Structures in the Latrobe Valley Region**

The map below shows that several anticlinal structures occur along the length of the greater Baragwanath Anticline. The Latrobe Valley power stations are all located on shallow structural highs where Tertiary coals are close to the surface and legitimate Strzelecki targets are probably present at depth. Lakes' recently - drilled Loy Yang 2 well was located on the Loy Yang dome which is under the Loy Yang A Power Station. Future successful drilling of other Strzelecki structures are therefore placed in a strategically strong position in relation to existing infra-structure and markets in the Latrobe Valley.



Structures of the Latrobe Valley Region

RECENT DRILLING AND SEISMIC SURVEY

Lakes has maintained vigorous drilling programs in several permits which include:

- **Boundary Creek-2**

The Boundary Creek-2 tight gas discovery well, drilled in October 2005 on the Longford dome on the eastern extension of the Baragwanath Anticline The well was cased to about 1,100 metres and suspended for fracture stimulation at a later date in the upper prospective gas zones encountered. We are currently waiting on a time slot for equipment availability in order to hydraulically fracture the tight gas reservoirs identified in the upper Strzelecki Group, which we believe have excellent potential for tight gas productivity.

- **Loy Yang-2** (cover photo)

Loy Yang 2 was drilled in March, 2006 to a total depth of 1,443 metres on the Loy Yang Dome in the Latrobe Valley to test for Strzelecki tight gas reservoirs. The well is strategically located next to the largest coal fired power station in Australia (incorporating a gas peaking unit). Structural mapping indicates that the crest of the Loy Yang Dome forms a closure at the top of the Strzelecki Group and is located up dip from the Loy Yang 2 well. Loy Yang 2 well has been cased and will be hydraulically fractured in the near future.

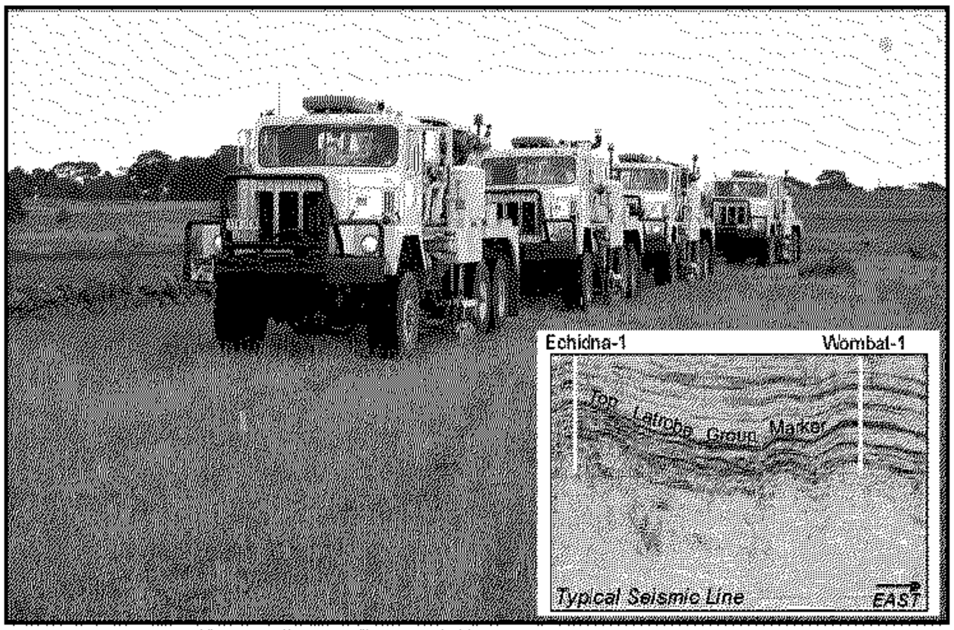
Loy Yang-2 drilling results are significant because they:

* Confirmed the presence of tight gas reservoirs throughout the Strzelecki Group in this well;
* Discovered the presence of free oil in the Strzelecki Group (oil shows also observed over approximately 600 metre interval)
* Showed that both oil and gas shows continued to total depth, inferring that further oil and gas may be present at deeper levels, based on correlation with the Loy Yang 1A well, drilled 40 metres away;

- Upgraded the potential of the Strzelecki Group tight gas model throughout all of our Gippsland Basin permits;
- Extended the prospectivity of the Strzelecki Group across the Baragwanath Anticline from Boundary Creek-2, located 70 km to the east of this well.

- **Seismic Survey in PEP's 163, 164**

A 55 kilometre vibroseis seismic survey was conducted on the Bellarine Peninsula and around Colac. This survey was conducted in the first week of June and is now awaiting processing and results. When the final processed data is available, it will be interpreted with a view to identifying potential drilling targets in the Lower Cretaceous Eumeralla Group



Recent Activities - Vibroseis Seismic Survey , PEP 163,164

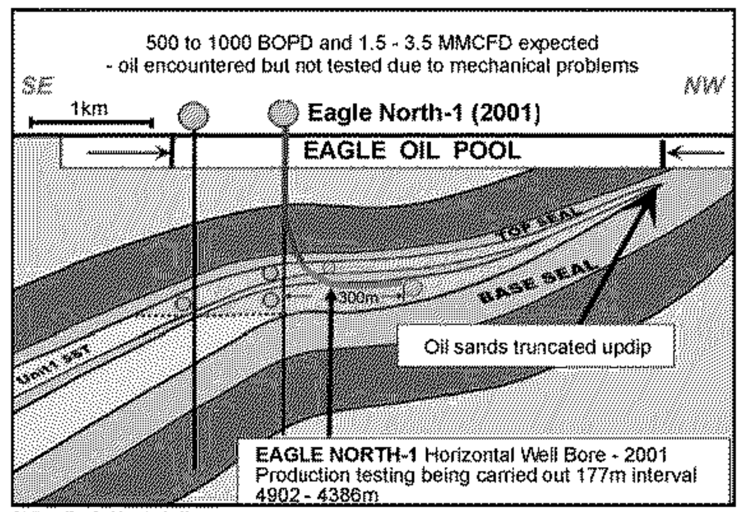
CURRENT PROJECTS

- **USA - Drilling of Eagle North-1 well continues**

In California, Lakes Oil is participating in the drilling of the Eagle North-1 well, which was spudded in January 2006. This well is an appraisal well on the Eagle Oil Pool, discovered in 1986 by the Mary Bellocchi-1 well located 366 metres to the south east in which Lakes also participated. The current well was drilled to 4,386 metres from a vertical hole and upon reaching the target oil-bearing Gatchell Sandstone, a horizontal lateral was drilled for about 177 metres.

Regrettably, the well encountered operational difficulties relating to the nature of the unconsolidated oil reservoir sequence encountered in the horizontal hole. In order to reduce the costs and to carry out the testing of this well in a more efficient manner a completion rig and coiled tubing unit have been secured. This has enabled the operator, Victoria Petroleum NL, to release the more costly large drilling rig which has been on site for several months.

Although the cost of this well has "blown out" significantly the operator is hopeful that flow rates of up to 1,000 barrels of oil per day could be possible. Lakes Oil holds 15% interest in this well and with the oil price currently at approximately $70 a barrel we would re-coup our cost reasonably quickly if the well should flow as anticipated.

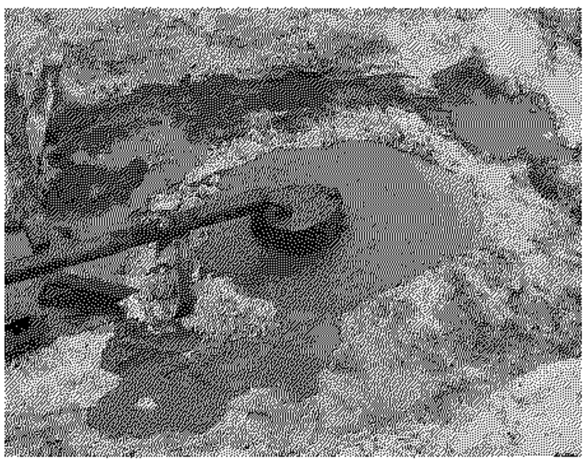


U.S.A. Eagle North drilling

- **The *Riddle* of our onshore oil occurrences**

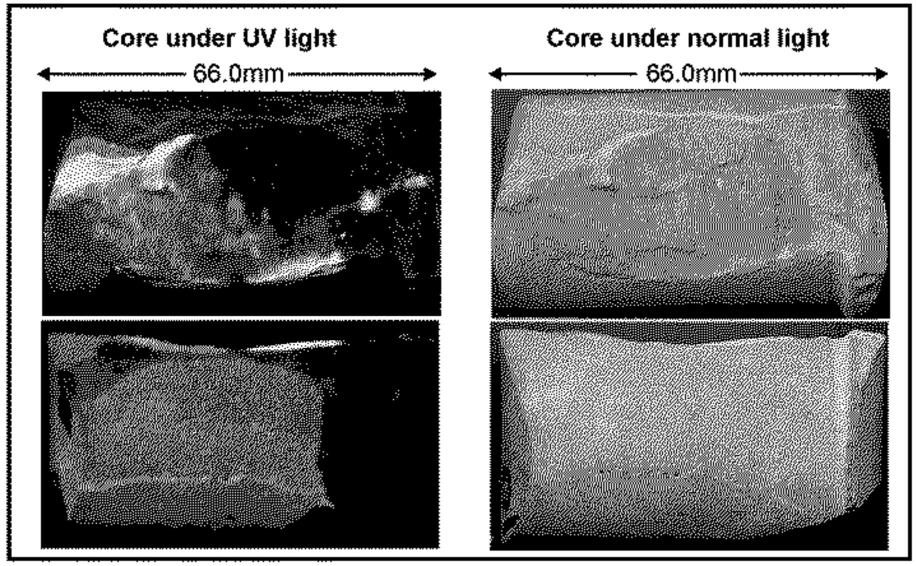
Lakes Oil is continuing research into the origin and nature of widespread oil occurrences in our onshore Gippsland Basin areas. This ongoing study includes examination of both new and old well data . We believe that the oils in the Lower Cretaceous Strzelecki Group throughout the entire length onshore Gippsland Basin are very probably derived from the same type of non-marine source and that it was generated from within the Strzelecki Group. Migration of the oil from the source into reservoir rocks is believed to be mostly localised and not regional. We believe that the Strzelecki Group therefore provides a source, seal and reservoir package.

The nature of these onshore oils is very similar to those in the overlying Tertiary Latrobe Group reservoirs found in the big offshore fields in Bass Strait. We believe, therefore, that the offshore oils are, at least in part, sourced from the underlying Strzelecki Group.



- 1st oil flow from Strzelecki Group
- 8 barrels oil recovered at surface
- 39.81° API oil
- Good waxy oil, not biodegraded

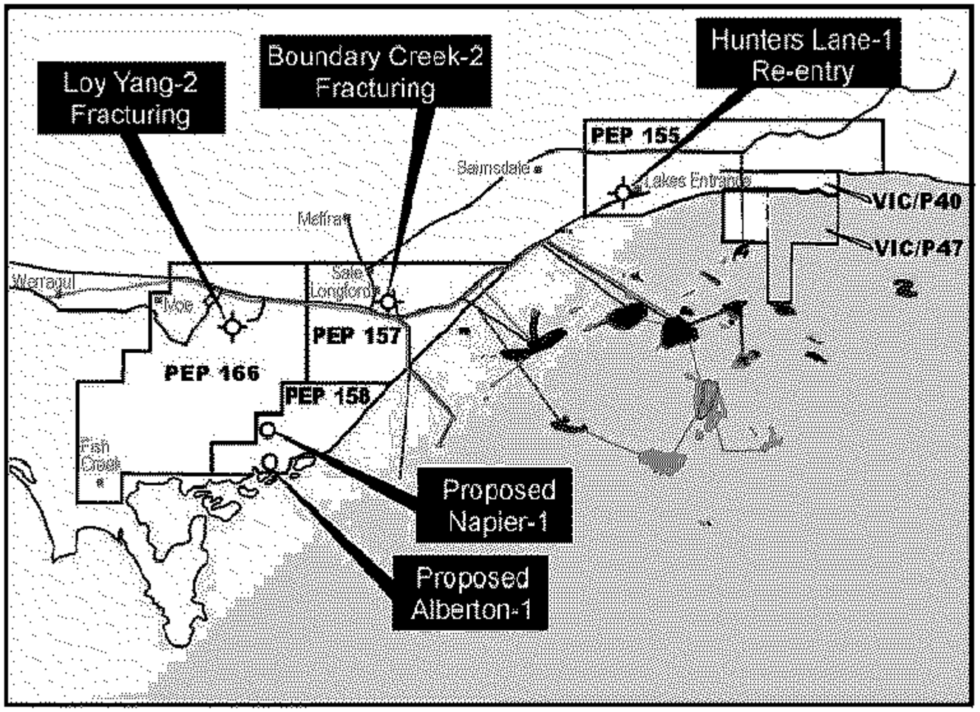
Wombat-3 Oil



Oil Fluorescence in Loy Yang-2

Accordingly, we see the deeper Strzelecki oil occurrences as a whole new play and we have engaged a USA consultant to assess the prospectivity of potential deep oil plays that may be present towards the base of the Strzelecki Group in our permits and to assist us in finding a farmin partner to develop this concept.

PROPOSED ACTIVITIES



Summary of Proposed Activities

- **PEP 158 - Drill Napier 1 and Alberton 1**

  These two wells are planned as Strzelecki tight gas targets on the south-eastern edge of the Baragwanath Anticline and drilling operations are planned to begin in the last quarter of 2006.

- **PEP 157 and PEP 166 - Fracturing of Boundary Creek 2 and Loy Yang 2**

  Fracture stimulation of several prospective gas zones in Loy Yang 2 and Boundary Creek 2 is planned for the next six months depending on availability of equipment.

- **PEP 155 - Lakes Entrance Oil Field re-entry and examination of oil in Hunters Lanes 1**

  The company is pursuing alternative methods of onsite extraction from Hunters Lane well. Planning is underway to open up this well in the near future to test the reservoir and formation fluid conditions *in situ* because the well has been shut-in for a number of years. If the separation process can be successfully achieved, the current oil price could make this project economically viable.

PEP 155 - Lakes Entrance Oil Field - Hunters Lane 1 re-entry and work-over