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Advance Energy Limited
(ACN 111 823 762)

Appendix 4E
Preliminary final report

Financial year ended 31 December 2006

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1. RESULTS FOR ANNOUNCEMENT TO THE MARKET

	Year ended 31 December	14 Months ended 31 December	Change	Up/Down	Percentage change
	<u>2006</u> <u>A\$'000</u>	<u>2005</u> <u>A\$'000</u>			
Revenues from continuing operations	1,118	408	710	UP	174%
Loss from continuing operations after tax attributable to members	(3,508)	(1,327)	(2,181)	DOWN	164%
Net loss for the period attributable to ordinary shareholders	(3,508)	(1,327)	(2,181)	DOWN	164%
Net tangible assets	5,443	881	4,562	UP	518%
Net tangible assets per security	\$0.0798	\$0.0266	\$0.0532	UP	200%

No dividends were paid or are proposed for the current or corresponding period.

The comparative period was the 14 months ended 31 December 2005. 31 December 2005 was the company's first period ended since incorporation.

2. COMMENTARY

2.1. Corporate overview and strategy

Advance Energy Ltd ("AEL") was established in 2004 to acquire and develop oil and gas producing assets in the United States of America. The Company listed on the ASX on the 2 June 2006.

AEL aims to acquire, develop and trade producing properties to maximize returns on funds invested. The Company has pursued a strategy of acquiring energy projects in the USA that contain existing proven production, proved behind pipe reserves and step out/in fill drilling potential located within close proximity of existing infrastructure. It is intended to rework the assets to reduce operating costs, increase production and optimize profitability. Drilling will be undertaken on defined exploration targets to add new reserves and increase production. Once fully developed, the strategy is to divest properties that have paid back capital and reinvest the proceeds into new properties which can provide a superior return.

The acquisition and development activities will be funded by a combination of equity, debt, the reinvestment of cash flow and the proceeds from the periodic divestment of properties. The Company has established a \$20 million revolving line of credit with Sterling Bank in the USA which had been drawn down to \$6.4 million by the end of December 2006.

AEL's US operations are managed by North American Energy Inc ("NAE"), an experienced oil and gas exploration and production manager based in Houston Texas. NAE provides identification, assessment and management of exploration and production projects for AEL. NAE also provides professional and administrative services to AEL. To help ensure that NAE's interests are aligned with AEL, NAE will join AEL as a participant in acquired projects by receiving 10% of the Working Interest (WI) acquired by AEL at the time of acquisition and a further 7.5% of the Working Interest at Economic Payout. NAE also has an equity position in AEL.

2.2. Investment Philosophy

Advance Energy has developed an investment philosophy based on strict investment parameters which ensure that the Company is focused on cash returns on producing assets. These returns are to be leveraged through the use of bank debt and new technologies. The type of asset the Company seeks to acquire is one with current production, which the Company believes it can increase through work-overs and low-risk development drilling. The Company has also adopted a trading discipline with its assets to ensure that the Company is continually trading its properties as they reach maturity and moving on to better quality assets, which reflect increased development potential.

2.3. Operations Overview and prospects

Martin County – Mother Lode Project

AEL's Mother Lode 3-D Project is located just north of Midland, Texas, in the north-central portion of the Midland Basin. The project covers 250 square miles of contiguous 3-D seismic data located in the northern part of Midland County, the central portion of Martin County, and the southern part of Dawson County.

After acquiring this data, it was reprocessed and to it added subsurface geological control from over 1,000 wells to enhance the prospecting methodology. To date, there have been 15 wells drilled on prospects generated from this project and 14 have been completed as producers for a success rate of 93%. AEL has participated in two phases of this project as described below.

- Phase I

In May of 2005, the Company acquired a 22.5% average Working Interest (17% average NRI) in five wells producing from the Strawn Limestone. The properties are in the central portion of Martin County approximately 20 miles northeast of the city of Midland, Texas.

The five producing wells resulted from the drilling of two prospects (Homestake and RKE, see Figure 1 below) that were generated by utilizing the prior mentioned 3-D seismic data. Subsequent to the acquisition, AEL participated in two hydraulic fracture stimulation treatments that resulted in an average six-fold increase of production for the two wells. In addition, AEL is currently participating in the completion of a successfully drilled development well that offsets one of the five originally acquired wells. Future development plans for these assets include an additional stimulation treatment on one well and the drilling of up to three more development wells.

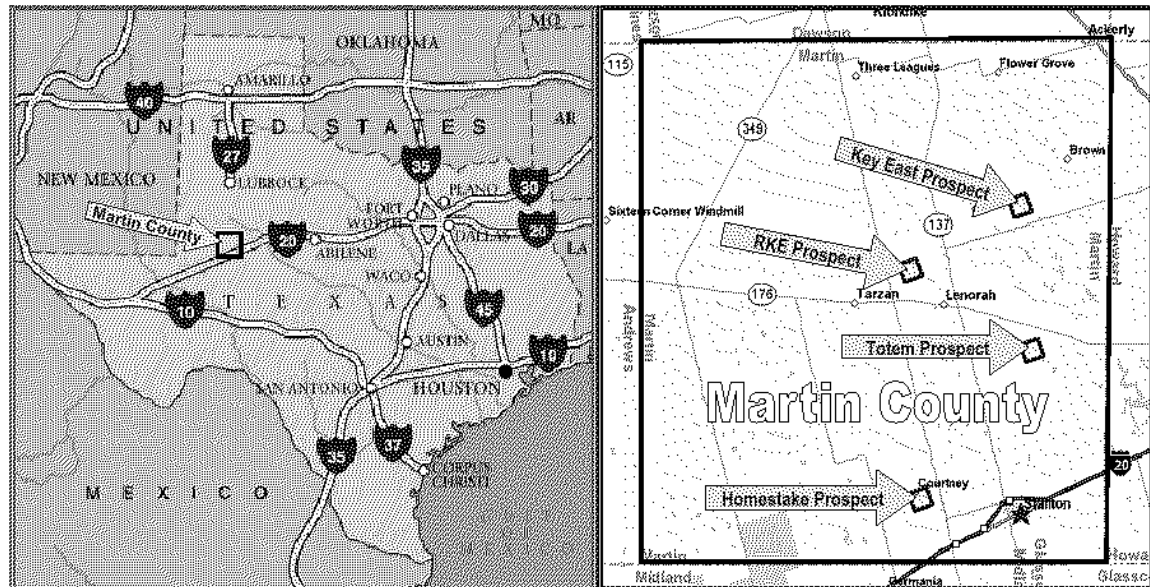
The five producing wells acquired by the Company are currently producing at a cumulative rate of 110 boepd and have cumulative production in excess of 257,000 BOE from May 2001 to October of 2006. It should be noted that the wells were producing 75 boepd at the time of acquisition

- Phase II

Since listing, AEL participated in the development drilling of the Totem Prospect. This prospect, generated from the above mentioned 3-D seismic, consists of 640 acres. In July of 2006, AEL acquired a 12.5% Working Interest in the discovery well and the rights to participate in the drilling of up to seven additional wells. There are currently two wells producing at a combined rate of 175 boepd. At the time of this report, a third well has been successfully drilled and is awaiting completion. AEL

expects to participate in the drilling of five more wells on this prospect over the next 12 months. AEL also participated in the drilling and successful completion of a well on the Key East prospect. This well began producing in December of 2006 at a rate of 80 BOEPD.

Figure 1: General Location of The Martin County Projects



Palo Pinto County - Lone Camp Project

AEL has acquired a 71.5% average Working Interest (53.625% average NRI) in nine producing oil and natural gas wells, one salt water disposal well and a 67.5% interest in an eight kilometer natural gas transmission line. The project is located in the eastern portion of Palo Pinto County, Texas approximately 50 miles west of Fort Worth, Texas.

The project area covers approximately 1,279 acres and affords easy access and contains no adverse environmental conditions.

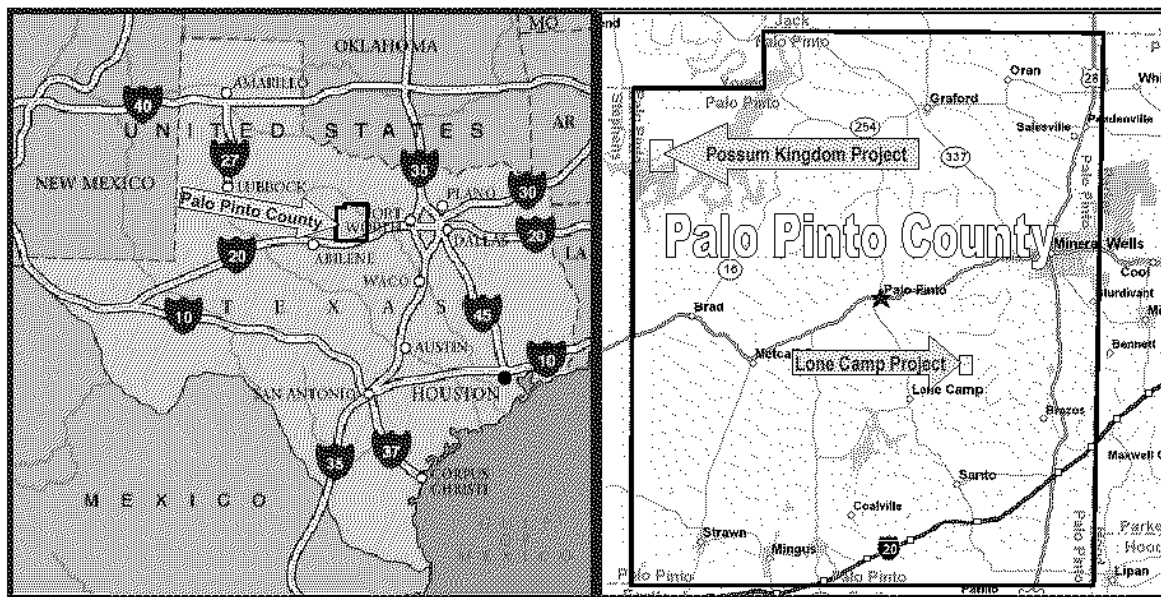
The nine wells are currently producing at a rate of 250 mcfepd natural gas from four hydrocarbon zones. The development plan scheduled for 2007 includes drilling two developmental wells and performing two work-overs. This development plan is anticipated to add up to an additional 1,000 mcfepd to the existing production. In total, these wells have produced in excess of 3,300 mmcf of natural gas from July, 1985 to October, 2006.

Palo Pinto County - Possum Kingdom Project

In December 2006 AEL purchased an average working interest of 90% in the Possum Kingdom project located in Palo Pinto County Texas for US\$9,675,000 (excluding post completion adjustments). In summary the project comprises:

- Nine producing wells currently averaging 2,300 Mcfepd
- Average per well LOE of \$1,250 per month
- Approximately 1,015 net acres held by production and lease
- Three stimulation and one mechanical (PDP Enhancement) candidates
- Five Proved Developed Non-Producing (PDNP or Behind Pipe) candidates
- Three Proved Undeveloped (PUD) locations
- Total Proved Net Reserves in excess of 5.25 Bcfe
- Eastern acreage being leased by large Barnett Shale operators

Figure 2: General Location of Palo Pinto County Projects



The existing wells produce from various Bend Conglomerate reservoirs at an average depth of 4,100 ft. and have produced in excess of 1,100,000 Mcfe in two and a half years of production. Several of the wells have recently been drilled and completed. An extensive development and work-over program is planned for this project during 2007.

Palo Pinto County - Barnett Shale History and Overview

As a part of these acquisitions, Advance has gained rights to the Barnett Shale Field. The Barnett Shale is geological formation with excellent economic possibilities. It consists of Mississippian sedimentary rocks in the state of Texas. The formation is estimated to stretch from the city of Dallas west, covering 5,000 square miles and at least 17 counties.

Some experts have suggested the Barnett Shale may be the largest onshore natural gas field in the United States. The field is proven to have 2.1 trillion cubic feet of natural gas, and is widely estimated to contain as much as 30 trillion cubic feet of natural gas resources. Oil has also been found in lesser quantities, but sufficient (with recent high oil prices) to be commercially viable.

Operators, such as EOG Resources and Devon Energy, have stated in public reports as recently as Mid-2005 that they estimate that 1/3 to 1/2 of the land in these counties, including "hot" counties like Johnson and Tarrant, will get wells (It would logically flow that the rest of the land will either get pooled in a unit that will have wells, or get nothing at all if the land is in an especially complex area). There have been few dry holes drilled; and because technology like 3D Seismic allows operators to predict faulting and karsting before they drill this bad acreage can be avoided. Therefore, it is safe to conclude that these rights Advance holds on this Barnett Shale field could be of great economic significance. One realistic possibility is that Advance could choose to sell the rights to one of the companies which are actively involved in developing the field currently.

2.4 Results

The company was initially listed on ASX on the 2 June 2006. This gave the company the access to capital it required to acquire assets which would fall within the stated investment philosophy (see above). As is evident from the discussion above, this also allowed the company to plan and begin executing an extensive drilling and work-over plan which is designed to enhance the value of properties acquired. Both the current and prior periods therefore reflected the costs of growth of the asset base, rather than reflecting significant revenue growth. Revenue is however, expected to reflect the benefit of the increased asset base during 2007.

Significant changes in the state of affairs of the group during the year included (AUD \$ 000):

a) An increase in:	
- issued share capital	7,072
- issue of options at various prices	1,634
b) An increase in the debt structure as follows	
- Issue of convertible notes	4,274
- Bank finance	8,062
c) Acquisition of assets and development costs in Texas, USA net of depletions and depreciation	14,826

The above movements reflect clearly the growth and acquisition phase of the company to date. During February 2006, the Company entered into a revolving line of credit with Stirling bank in the U.S. Generally, the borrowing base of the line of credit as determined by the bank approximates the company's investment in oil and gas properties, up to a maximum of US\$ 20 million.

2.5. Prospects

At the date of this report, the directors are resolved to continue with the consideration of appropriate additional property transactions in line with the company's stated objectives. Directors intend to continue to seek additional cash and finance facilities to facilitate growth of its property portfolio. The directors are of the opinion that this will provide the momentum required in the industry and achieve overall company objectives resulting in increased returns to shareholders.

2.6. Environmental Issues

The Group's operations are subject to various environmental regulations under the Federal and State Laws of the United States of America. The majority of the company's activities involve low level disturbance associated with its production facilities and exploration drilling programs. As at the date of this report the group complies fully with all such regulations.

**3. CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006**

		Group	
	Note	2006 \$'000	14 Months ended 31 December 2005 \$'000
Revenue from continuing operations	7.3	1,118	408
Cost of Oil & Gas sold		(297)	(79)
Gross profit		821	329
Other revenue		55	43
Depreciation	7.4, 7.10	(106)	(13)
Depletion of oil and gas properties	7.4, 7.9	(156)	(104)
Foreign exchange gains/(losses)		(23)	52
Staff costs	7.4	(1,369)	(714)
Administrative expenses	7.4	(1,674)	(557)
Operating result before interest and tax		(2,452)	(964)
Net finance costs		(1,119)	(362)
Finance charges earned		99	5
Finance costs	7.4	(1,218)	(367)
Loss before tax		(3,571)	(1,326)
Income tax benefit/(expense)	7.5	63	(1)
Net loss for the year attributable to the ordinary shareholders of the Company		(3,508)	(1,327)
Earnings per share			
Basic	7.17	(0.066)	(0.093)

The Income Statement should be read in conjunction with the accompanying notes to the financial statements.

**4. CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2006**

	Note	Group	
		2006 \$'000	2005 \$'000
Current Assets			
Cash and cash equivalents	7.6	1,727	1,109
Receivables	7.7	465	178
Total current assets		2,192	1,287
Non current Assets			
Property, plant and equipment	7.10	1,427	82
Oil and gas properties	7.9	14,269	788
Deferred tax assets	7.19	110	11
Exploration and evaluation costs	7.8	292	292
Total non current assets		16,098	1,173
Total Assets		18,290	2,460
Current Liabilities			
Payables	7.11	382	308
Provisions	7.12	44	13
Interest bearing liabilities	7.13	-	1,210
Total current liabilities		426	1,531
Non current liabilities			
Deferred tax liability	7.20	85	48
Interest bearing liabilities	7.13	12,336	-
Total non current liabilities		12,421	48
Total Liabilities		12,847	1,579
Net Assets		5,443	881
Equity			
Issued share capital	7.14	8,764	1,692
Reserves	7.15	1,514	516
Accumulated losses	7.16	(4,835)	(1,327)
Total Equity		5,443	881

The Balance Sheet should be read in conjunction with the accompanying notes to the financial statements.

**5. CONSOLIDATED CASH FLOW STATEMENT
AS AT 31 DECEMBER 2006**

	Note	Group	
		2006 \$'000	14 Months ended 31 December 2005 \$'000
Cash flows from operating activities			
Receipts from customers		896	282
Payments to suppliers and staff		(2,446)	(592)
Interest received		99	5
Interest and borrowing costs		(269)	(85)
Other income		20	43
Net cash (used in) operating activities	7.18	(1,700)	(347)
Cash flows from investing activities			
Purchase of oil and gas properties		(13,795)	(891)
Purchase of plant and equipment		(1,511)	(95)
Payment for bonds		-	(13)
Exploration expenditure		-	(292)
Net cash (used in) investing activities		(15,306)	(1,291)
Cash flows from financing activities			
Proceeds from issues of shares		7,162	870
Capital raising costs		(485)	(119)
Proceeds from borrowings		13,612	1,996
Repayments of borrowings		(2,665)	-
Net cash flows provided by financing activities		17,624	2,747
Net increase in cash held		618	1,109
Cash and cash equivalents at the beginning of the financial period		1,109	-
Cash and cash equivalents at the end of the financial period		1,727	1,109

The statement of Cash Flows should be read in conjunction with the accompanying notes to the financial statements.

6. CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

14 Months ended 31 December 2005	Issued Capital	Equity Reserve	Option Reserve	Foreign Currency Translated Reserve	Accumulated losses	TOTAL
\$'000						
Balance at beginning of period	-	-	-	-	-	-
Issues of share capital, net of capital raising costs	1,692	-	-	-	-	1,692
Cost of share based payments	-	335	144	-	-	479
Value of conversion rights – convertible note	-	83	-	-	-	83
Currency translation difference	-	-	-	(46)	-	(46)
Loss for period	-	-	-	-	(1,327)	(1,327)
	1,692	418	144	(46)	(1,327)	881

Year ended 31 December 2006	Issued Capital	Equity Reserve	Option Reserve	Foreign Currency Translated Reserve	Accumulated losses	TOTAL
\$'000						
Balance at beginning of period	1,692	418	144	(46)	(1,327)	881
Issues of share capital, net of capital raising costs	7,072	(750)	-	-	-	6,322
Cost of share based payments	-	-	1,634	-	-	1,634
Value of conversion rights – convertible note	-	482	-	-	-	482
Currency translation difference	-	-	-	(368)	-	(368)
Loss for period	-	-	-	-	(3,508)	(3,508)
	8,764	150	1,778	(414)	(4,835)	5,443

The above Consolidated Statement of Changes in Equity should be read in conjunction with the accompanying notes to the financial statements

7. NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

7.1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial report includes separate financial statements for Advance Energy Limited as an individual entity and the consolidated entity consisting of Advance Energy Limited and its subsidiaries.

(a) Basis of Preparation

This general purpose financial report has been prepared in accordance with Australian equivalents to International Financial Reporting Standards (AIFRSs), other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations and the Corporations Act 2001.

i) Compliance with IFRSs

Australian Accounting Standards include AIFRSs. Compliance with AIFRSs ensures that the consolidated financial statements and notes of value AIFRS comply with International Financial Reporting Standards (IFRSs). The parent entity financial statements and notes also comply with IFRSs.

ii) Early adoption of standards

The Group has elected to apply the following pronouncements to the annual reporting period beginning 1 January 2006.

- UIG 8 Scope of AASB 2 (issued March 2006), application date periods commencing 1 May 2006
- UIG 9 Reassessment of Embedded Derivatives (issued April 2006), application date periods commencing 1 June 2006
- UIG 10 Interim Financial Reporting and Impairment (issued September 2006), application date periods commencing 1 November 2006

This includes applying the pronouncements to the comparatives in accordance with AASB 108 Accounting Policies, changes in Accounting Estimates and Errors. No adjustments were required for any of the above interpretations.

iii) Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities (including derivative instruments at fair value through profit or loss, certain classes of property, plant and equipment and investment property.

iv) Critical accounting estimates

The preparation of financial statements in conformity with AIFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

v) Comparative Figures

As the 2005 was the company's first reporting period, all comparative figures relate to the 14 months ended 31 December 2005.

(b) Principles of Consolidation

Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Advance Energy Limited (“company” or “parent entity”) as at 31 December 2006 and the results of all subsidiaries for the year then ended. Advance Energy Limited and its subsidiaries together are referred to in this financial report as the Group or the consolidated entity.

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.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Investments in subsidiaries are accounted for at cost in the individual financial statements of Advance Energy Limited.

(c) Segment reporting

A business segment is 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 engaged in providing products or services within a particular economic environment and is subject to risks and returns that are different from those of segments operating in other economic environments.

(d) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The consolidated financial statements are presented in Australian dollars, which is Advance Energy Limited’s functional and presentation currency. The functional currency of the overseas subsidiaries is in US\$.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale financial assets are included in the fair value reserve in equity.

(iii) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each income statement are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transactions); and
- All resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other financial instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences are recognised in the income statement as part of the gain or loss on sale where applicable.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entities and translated at the closing rate.

(e) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured.

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, trade allowances and amounts collected on behalf of third parties. Revenue is recognised as follows:

(i) Interest income

Interest income is recognised on a time proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income.

(ii) Oil and Gas revenue

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Cash flows are included in the Cash Flow Statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(f) Inventories

Oil stocks and field consumables are stated at the lower of cost and net realisable value. Cost includes all expenditure incurred in acquiring and bringing the inventories to their existing condition and location.

(g) Trade and other receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost, less provision for doubtful debts. Trade receivables are due for settlement between thirty (30) and ninety (90) days from the date of recognition.

Collectibility of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. A provision for doubtful receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. The amount of the provision is recognised in the income statement.

(h) Property, Plant and Equipment

i) Plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated losses impairment.

ii) Depreciation

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset which is estimated to vary between 5 and 15 years

iii) Impairment

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

If any indication of impairment exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount.

The recoverable amount of plant and equipment is the greater 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.

Impairment losses are recognised separately in the income statement.

Any item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

i) Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments.

Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are recognised as an expense in the income statement on a straight line basis over the lease term.

(j) Investments and other financial assets

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and, in the case of assets classified as held-to-maturity, re-evaluates this designation at each reporting date.

(i) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading which are acquired principally for the purpose of selling in the short term with the intention of making a profit. Derivatives are also categorised as held for trading unless they are designated as hedges.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of selling the receivable. They are included in current assets, except for those with maturities greater than 12 months after the balance sheet date which are classified as non-current assets. Loans and receivables are included in receivables in the balance sheet (note 7.7).

(iii) Available-for-sale financial assets

Available-for-sale financial assets, comprising principally marketable equity securities, are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within twelve (12) months of the balance sheet date.

Regular purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expenses in the income statement. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit and loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains or losses arising from changes in the fair value of the ‘financial assets at fair value through profit or loss’ category, including interest and dividend income, are presented in the income statement within other income or other expenses in the period in which they arise.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in profit or loss and other changes in carrying amount are recognised in equity. Changes in the fair value of other monetary and non-monetary securities classified as available-for-sale are recognised in equity.

When securities classified as available-for sale or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities.

The Group assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of a security below its cost is considered in determining whether the security is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss- measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit and loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments classified as available-for-sale are not reversed through the income statement.

(k) Exploration, evaluation and development expenditure

Exploration, evaluation and development expenditure incurred is either written off as incurred or accumulated in respect of each identifiable area of interest. Costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves.

Accumulated costs in relation to an abandoned area are written off in full against profit in the period in which the decision to abandon the area is made.

When production commences, the accumulated costs for the relevant area of interest are amortised over the life of the area according to the rate of depletion of the economically recoverable reserves.

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.

Restoration, rehabilitation and environmental costs necessitated by exploration and evaluation activities are expensed as incurred and treated as exploration and evaluation expenditure.

(l) Oil and gas properties

Following commencement of production activities all acquisition, exploration, evaluation and development expenditure in relation to an area of interest is accumulated into and oil and gas property.

When further development expenditure is incurred in respect of a property after the commencement of production, such expenditure is carried forward as part of the cost of that property only when substantial economic benefits are established, otherwise such expenditure is classified as part of the cost of production.

Amortisation of the cost of oil and gas properties is provided on the unit-of-production basis over the proved developed reserves of the field concerned with separate calculations being made for each resource. The unit-of-production basis results in an amortisation charge proportional to the depletion of the economically recoverable reserves. Amortisation is charged from the commencement of production.

The net carrying value of each property is reviewed regularly for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If the asset does not generate largely independent cash flows, the recoverable amount is determined for the cash generating unit to which the asset belongs. If such indication exists and where the carrying value exceeds the estimated recoverable amount, the assets are written down to their recoverable amount.

The recoverable amount is the greater of fair-value less costs to sell and value in use. In assessing value in use, the estimated cash flows are discounted to their present value using the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the assets

(m) Fair Value estimation

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount the asset is considered impaired and is written down to its recoverable amount.

The fair value of financial assets and financial liabilities must be estimated for recognition and measured or for disclosure purposes.

The fair value of financial instruments traded in active markets (such as publicly traded derivatives, and trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

The fair value of financial instruments that are not traded in an active market (for example convertible notes) is determined using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt instruments held.

Other techniques such as estimated discounted cash flows, are used to determine fair value for remaining financial instruments.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

(n) Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the income statement over the period of the borrowings using the effective interest method.

The fair value of the liability portion of a convertible note is determined using a market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the notes. The remainder of the proceeds is allocated to the conversion option. This is recognised and included in shareholder's equity, net of income tax effects.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(o) Trade and other payables

These amounts represent liabilities for goods and services provided to the group prior to the end of the financial year, which remain unpaid at year end. The amounts are unsecured and are usually paid within 60 days of recognition.

(p) Provisions

Provision is made for employee entitlement benefits as a result of employees rendering services up to balance date. These benefits include salary and wages, annual leave and long service leave. Liabilities in respect of salary and wages and annual leave expected to be settled within 12 months of the reporting date are measured at their nominal value. The liability for long service leave is measured at the present value of expected future outflows to be made in respect of services provided by employees up to the reporting date.

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

If the effect of the 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 assessments 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 recognized as a finance cost.

(q) Employee benefits

(i) Wages and salaries, annual leave and sick leave

Liabilities for wages and salaries, including non-monetary benefits, annual leave and accumulating sick leave expected to be settled within 12 months of the reporting date are recognised in other payables in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Long service leave

The liability for long service leave is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

(r) Share Based Payments

The Group provides benefits to employees (including directors) of the Group in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions').

The cost of these equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an external valuer using the Black & Scholes method.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than those specified in the Terms and Conditions of the Convertible Preference Shares.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('vesting date').

The cumulative expense recognized for equity-settled transactions at each reporting date until vesting date reflects (i) the extent to which the vesting period has expired and (ii) the number of awards that, in the opinion of the directors of the Group, will ultimately vest. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognized as if the terms had not been modified. In addition, an expense is recognized for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new award are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings per share.

(s) Borrowing Costs

Borrowing costs are recognised as an expense when incurred except if costs were incurred for the construction of any qualifying asset, where the costs are capitalised over the period that is required to complete and prepare the asset for its intended use or sale.

(t) Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less.

For the purposes of the Cash Flow Statement cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(u) Income Tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is provided on all temporary differences at the balance sheet date between the tax bases or assets and liabilities are recognised for all taxable temporary differences:

- Except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised:

- Except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future extent that it is probable that the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in the income statement.

(v) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except;

- Where the GST incurred on a purchase of goods and services is not recoverable from the taxation authorities, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense item as applicable; and
- Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Cash flows are included the Cash Flow Statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(w) Contributed Equity

Issued and paid up capital is recognised at the fair value of the consideration received by the company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction, net of tax, of the share proceeds received.

(x) Earnings per share

(i) Basic earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

(ii) 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 share and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

(y) Rounding of amounts

The Company is of a kind referred to in Class order 98/0100, issued by the Australian Securities and Investments Commission, relating to the “rounding off” of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

(z) **New accounting standards and interpretations**

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2006 reporting periods. The Group's assessment of the impact of these new standards and interpretations is set out below.

(i) *AASB 7 Financial Instruments: Disclosures and AASB 2005-10 Amendments to Australian Standards (AASB 132, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 & AASB 1038)*

AASB7 and AASB 2005-10 are applicable to annual reporting periods beginning on or after 1 January 2007. The Group has not adopted the standards early. Application of the standards will not affect any of the amounts recognised in the financial statements, but will impact the type of information disclosed in relation to the Group's financial instruments.

7.2 SEGMENT REPORTING

Business Segment

The consolidated entity operates solely in the exploration and development of properties for the development of oil and gas. Therefore only geographical segment information is provided.

Geographical Segments

All operational activities are located in Texas in the USA. The head office is based in Perth, Australia.

14 Months ended 31 December 2005	USA	Australia	Eliminations	Consolidated
Geographical segment	\$'000	\$'000	\$'000	\$'000
Revenues from continuing operations	408	-	-	408
Segment result (loss)	78	(1,405)	-	(1,327)
Segment assets	1,377	2,363	(1,280)	2,460
Segment liabilities	1,343	1,514	(1,278)	1,579
Acquisition of plant & equipment, exploration & evaluation and other non-current assets	1,279	-	-	1,279
Depreciation and amortisation	117	-	-	117

2006	USA	Australia	Eliminations	Consolidated
Geographical segment	\$'000	\$'000	\$'000	\$'000
Revenues from continuing operations	1,118	-	-	1,118
Segment result (loss)	(80)	(3,842)	414	(3,508)
Segment assets	16,625	9,905	(8,240)	18,290
Segment liabilities	16,626	4,460	(8,239)	12,847
Acquisition of plant & equipment, exploration & evaluation and other non-current assets	15,139	167	-	15,306
Depreciation and amortisation	232	30	-	262

7.3. REVENUE FROM CONTINUING OPERATIONS

GROUP	
2006 \$'000	14 Months ended 31 December 2005 \$'000
Oil and gas sales	1,118 408

7.4. EXPENSES

GROUP	
2006 \$'000	14 Months ended 31 December 2005 \$'000
Loss from continuing operations before income tax has been determined after	
(a) Depreciation and depletion	
Depreciation of plant and equipment	106 13
Depletion of oil and gas properties	156 104
Total depreciation and depletion	262 117
(b) Lease payments	
Minimum lease payments	
- operating lease	61 55
(c) Employee benefit expense	
Directors expense	767 409
Expense of share base payments	316 305
(d) Finance costs	
Interest on borrowings	293 62
Borrowing costs	925 305
	1,218 367

7.5. INCOME TAX

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
a) Income tax (benefit)/expense		
Current income tax charge	-	-
Deferred income tax relating to origination of temporary differences	(63)	1
Income tax (benefit)/expense reported in the Income Statement	(63)	1
b) Deferred income tax (benefit)/expense		
Decrease/(increase) in deferred tax asset	(106)	(11)
(Decrease)/increase in deferred tax liability	43	12
	(63)	1
c) Amounts recognised directly in equity		
Net deferred tax debited directly to equity	-	36
d) Numerical reconciliation of income tax expense to prima facie tax payable		
Accounting loss before tax	(3,571)	(1,327)
At statutory income tax rate of 30%	(1,072)	(399)
Expenditure not allowable for tax purposes	492	121
Unrecognised tax losses	536	316
Other	(19)	(37)
Income tax (benefit)/expense	(63)	1
e) Unrecognised timing differences and tax losses:		
Parent tax loss for the year	431	316
<i>Australian timing differences:</i>		
Depreciable assets	4	-
Accrued expenses	35	-
Borrowing costs	63	-
Unrealised forex losses	-	-
Accrued interest	8	-
Non-deductible employee entitlements	4	-
Superannuation	1	-
Deductible employee entitlements	(4)	-
Accrued expenses opening balance	(6)	-
Total unrecognised	536	316

Net deferred assets for the parent company have not been brought into account as it is not probable within the immediate future profits will be available against which deductible temporary differences and tax losses can be utilised.

7.6. CASH AND CASH EQUIVALENTS

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Cash at bank	1,727	1,109

Cash at bank earns interest of floating interest rates of between 6.5% and 8.5% (2005: 5.4%).

7.7. TRADE AND OTHER RECEIVABLES

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Current		
Trade receivables	414	126
Other receivables	51	52
	465	178

7.8. EXPLORATION & EVALUATION COSTS

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Non-Current		
Exploration, evaluation and development costs carried forward in respect of areas of interest in exploration and evaluation phases	292	292
Reconciled as follows:		
Opening balance	292	-
Exploration assets acquired during the period	-	292
Closing Balance	292	292

The ultimate recoupment of these costs is dependent on successful development and commercial exploitation, or alternatively, the sale of the respective areas.

7.9. OIL AND GAS PROPERTIES

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Oil and gas properties – cost	14,517	892
Less accumulated depletion	(248)	(104)
	14,269	788
Reconciled as follows:		
Opening balance	788	-
Acquired during period	13,795	892
Depletion charge	(156)	(104)
Foreign exchange difference	(158)	-
	14,269	788

7.10. PROPERTY, PLANT AND EQUIPMENT

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Plant and equipment – cost	1,541	95
Less accumulated depreciation	(114)	(13)
	1,427	82

Movements in carrying amounts

Movement in the carrying amounts for property, plant and equipment between the beginning and the end of the current financial period:

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Group		
Balance at the beginning of period	82	-
Additions	1,511	95
Disposals	-	-
Depreciation expense	(106)	(13)
Foreign exchange difference	(60)	-
	1,427	82

7.11. TRADE AND OTHER PAYABLES

	GROUP	
	2006 \$'000	2005 \$'000
Trade creditors	24	45
Accruals	358	263
	382	308

7.12. PROVISIONS

	GROUP	
	2006 \$'000	2005 \$'000
Employee benefits	44	13
Number of employees at year end	2	3

7.13. INTEREST BEARING LOANS AND BORROWINGS

	GROUP	
	2006 \$'000	2005 \$'000
Current		
Convertible Note – unsecured	-	1,210
Comprising:		
Face value of the note	-	1,329
Other equity securities – value of conversion rights	-	(119)
	-	1,210
Non-current		
Convertible Notes – unsecured ¹		
Face value of the note	4,250	-
Interest accrued	24	-
	4,274	-
Bank loan – secured ²	8,062	-
	12,336	-

- 1) During November and December 2006 the Company issued five new convertible notes with a face value totalling \$4,250,000. In aggregate these convertible notes may be converted into a maximum of 6,250,000 shares at the option of the holder before the repayment dates. The term of the note is eighteen (18) months with a coupon of 11% per annum. \$3,000,000 of these notes may be converted into a fixed 3,750,000 shares. The balance of \$1,250,000 may be converted at the higher of 50 cents or 80% of the market value prevalent at the time of conversion.
- 2) During February 2006, the Company entered into a revolving line of credit with a Stirling bank in the U.S. Generally, the borrowing base of the line of credit as determined by the bank approximates the company's investment in oil and gas properties, up to a maximum of US\$ 20 million. The loan bears interest at US prime plu 1.5% and is secured against the company's oil and gas properties. This loan is repayable on 10 February 2008, and the intention is to renegotiate in the normal course of business.

7.14. ISSUED CAPITAL

7.14.1 Ordinary shares

68,199,099 fully paid ordinary shares (2005: 33,137,766)

Movements in shares on issue

Beginning of period

Shares issued during the period

7 ordinary shares issued @ \$1.00

10,000,000 ordinary shares issued @ \$0.0001¢

16,318,156 ordinary shares issued @ \$0.08¢

6,819,603 ordinary shares issued @ \$0.10¢

1,728,000 shares issued @ \$0.10¢

333,333 @ \$0.15¢

27,000,000 @ \$0.25¢

Converting 5 Preference Shares into 5,000,000 ordinary shares

1,000,000 Options exercised @ \$0.25¢

Less capital raising costs

End of period

GROUP	
2006	2005
\$'000	\$'000
8,764	1,692
1,988	-
-	1
-	1,305
-	682
173	-
50	-
6,750	-
750	-
250	-
9,961	1,988
(1,197)	(296)
8,764	1,692

- (a) Effective 1 July 1998 the Corporations Legislation in place abolished the concepts of authorised capital and par value of shares. Accordingly the Parent does not have authorised capital or par value in respect of issued shares.
- (b) Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held.
- (c) At shareholders meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

7.14.2 Options

The movements in options over ordinary shares during the year were as follows:

2006					
Expiry Date	Exercise Price	Number at beginning of period	Issued	Exercised	Number at end of period
31 December 2010	\$0.25	10,000,000	4,850,000	(1,000,000)	13,850,000
15 December 2009	\$0.60	-	5,000,000	-	5,000,000
29 December 2009	\$0.65	-	250,000	-	250,000
		10,000,000	10,100,000	(1,000,000)	19,100,000

14 Months ended 31 December 2005					
Expiry Date	Exercise Price	Number at beginning of period	Issued	Exercised	Number at end of period
31 December 2010	\$0.25	-	10,000,000	-	10,000,000

No options have expired or have been cancelled since incorporation.

7.14.3 Converting Preference Shares

All convertible preference shares were issued during the period ended 31 December 2005.

The movement in Converting Preference Shares during the year were as follows:

2006 Class	No. at beginning of period	Issued	Converted into ords	No. at end of period
CPS - A	5	-	(5)	-
CPS - B	5	-	-	5
CPS - C	2	-	-	2
CPS - D	2	-	-	2
	14	-	(5)	9

Each Converting Preference Share (CPS) convert into 1,000,000 ordinary shares as follows:

CPS-A – upon the Company's shares being listed on the main board of the ASX, these were converted into ordinary shares on date of listing, being 2 June 2006.

CPS-B – upon the Company achieving production of 500 BOPD

CPS-C – upon the Company achieving production of 1000 BOPD

CPS-D – upon the Company achieving production of 1500 BOPD

7.15. RESERVES

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Option reserve ⁽¹⁾	1,778	144
Foreign currency translation reserve ⁽²⁾	(414)	(46)
Equity reserve ⁽³⁾	150	418
	1,514	516
⁽¹⁾ Option reserve		
Opening balance	144	-
Issue of options during period	1,634	144
	1,778	144
⁽²⁾ Foreign currency translation		
Opening balance	(46)	-
Currency translation differences arising during the year	(368)	(46)
	(414)	(46)
⁽³⁾ Equity reserve		
Opening balance	418	-
Issue of CPS	601	335
Conversion into ordinary shares	(750)	-
Value of conversion right convertible note	(119)	119
Deferred tax component	-	(36)
	150	418

Nature and purpose of reserves

⁽¹⁾ Option reserve

The option reserve is used to recognise the fair value of options issued but not exercised.

Fair value of options granted

The assessed fair value at grant date of options granted during the period is between 12.8¢ and 23.3¢ (2005:\$0.0138) cents per option. The fair value at grant date is independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, 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 option.

The model inputs for options granted during the period included:

- (a) options are granted for no consideration
- (b) expected price volatility of the company's shares: between 27.0% and 50.0%
- (c) expected dividend yield: 0%
- (d) risk-free interest rate: between 5.7% and 5.9%

The expected price volatility is based on the historic volatility of an average of comparable companies.

⁽²⁾ **Foreign currency translation reserve**

Exchange differences arising on translation of the foreign controlled entity are taken to the foreign currency translation reserve as described in note 7.1(d). The reserve is recognised in profit and loss when the net investment is disposed of.

⁽³⁾ **Equity reserve**

The equity reserve is used to recognise the amortised portion of the fair value of CPS's issued and the equity component of the convertible note issued during the period.

Fair Value of CPS granted

The assessed fair value at grant date of CPS's granted during the period was:

-	CPS A	\$149,000 per CPS
-	CPS B	\$ 89,300 per CPS
-	CPS C	\$ 29,800 per CPS
-	CPS D	\$ 3,000 per CPS

The fair value at grant date is independently determined using a Black-Scholes pricing model that takes into account the exercise price, the term of the CPS, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the CPS, 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 option.

The amount disclosed as contributed entity during the period ended 31 December 2005 represents the amount paid per CPS of \$0.0001 each plus the amortised value as prescribed by AASB139. The following assumptions were utilised in calculating fair value of the shares.

- (a) underlying security spot price at grant: \$0.15
- (b) expected price volatility of the company's shares: 50.23%
- (c) expected dividend yield: 0%
- (d) risk-free interest rate: 5.70%

The expected price volatility is based on the historic volatility of an average of comparable companies.

The total value of the CPS were calculated at \$1,258,100. The total value is being amortised to the income statement in line with production. At the end of the year \$936,720 (2005: \$454,000) had been reflected through the income statement.

7.16. ACCUMULATED LOSSES

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Accumulated losses at the beginning of the year	(1,327)	-
Net loss attributable to the members of the parent entity	(3,508)	(1,327)
Accumulated losses at the end of the financial year	(4,835)	(1,327)

7.17 LOSS PER SHARE

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Reconciliation of earnings to net loss		
Net loss	(3,508)	(1,327)
Earnings/(loss) used in the calculation of basic and dilutive EPS	(3,508)	(1,327)
Weighted average number of ordinary shares outstanding during the period used in calculation of basic and dilutive EPS	Number 53,207,976	Number 14,314,199

Dilutive EPS is not reflected as it would result in the reduction of the loss per share.

7.18. CASH FLOW INFORMATION

Reconciliation of cash flow from operations with loss from continuing operations after income tax.

	GROUP	
	2006 \$'000	14 Months ended 31 December 2005 \$'000
Loss from ordinary activities after income tax	(3,508)	(1,327)
Non cash flows in loss from continuing operations		
Depreciation	106	13
Depletion	156	104
Increase/decrease in provisions	32	13
CPS costs amortised	517	-
Equities issued in lieu of payment	1,248	761
Income not received	(287)	(126)
Interest accrued not paid	24	-
Foreign exchange difference	(109)	(55)
Reversal of deferred tax liability	-	(36)
Changes in assets and liabilities		
Increase in trade creditors and accruals	154	307
Increase in other debtors	29	(39)
Increase in deferred tax assets	(99)	(11)
Increase in deferred tax liabilities	37	49
Cash flows from (used in) operations	(1,700)	(347)

7.19. DEFERRED TAX ASSETS

The balance comprises temporary differences attributable to:

GROUP	
2006 \$'000	14 Months ended 31 December 2005 \$'000
Organisation costs	4
Book depletion	1
Net operating loss	6
Net deferred tax asset	11
Movements:	
Opening balance	-
Amount brought to account	11
Foreign exchange difference	-
Closing balance	11
7.20. DEFERRED TAX LIABILITIES	
The balance comprises temporary differences attributable to:	
Intangible drilling costs	48
Movements:	
Opening balance	-
Amount brought to account	48
Foreign exchange difference	-
Closing balance	48

7.21. SUBSIDIARIES

The Company has the following Subsidiaries

Name of Subsidiary	Place of Incorporation	Percentage held 2006	Percentage held 2005
Advance Exploration and Production, Inc	Texas USA	100%	100%
AEPI Midstream, Inc	Texas USA	100%	-

Advance Exploration and Production, Inc was incorporated on 1 July 2005 with initial issued capital of US\$1,000 (A\$1,282).

AEPI Midstream was incorporated on 20 September 2006 to hold the Group's midstream assets, with initial issued capital of US\$1,000. (A\$1,282).

7.22. EVENTS SUBSEQUENT TO BALANCE SHEET DATE

Subsequent to the year end, the company has raised an additional \$1,275,000 through the issue of additional convertible notes. These are on similar conditions as those outstanding at the end of the financial year as per note 17. In aggregate these convertible notes may be converted into a maximum of 1,800,000 shares at the option of the holder before the repayment dates. The term of the notes is eighteen (18) months with a coupon of 11% per annum. \$275,000 of these notes may be converted at the higher of 50 cents or 80% of the market value prevalent at the time of conversion. The balance of \$1,000,000 is convertible into a fixed 1,250,000 shares.

The company also repaid a convertible note to the value of \$750,000, which was convertible into a maximum of 1,500,000 shares.

Other than the matters mentioned above, up to the date of this report, there have been no other materially significant events.

7.23. CONTINGENCIES

There were no known contingencies at year end.

8. COMPLIANCE STATEMENT

8.1 This report is based on accounts which are currently subject to audit.



Lance Camacho
Company Secretary

Date: 28 February 2007