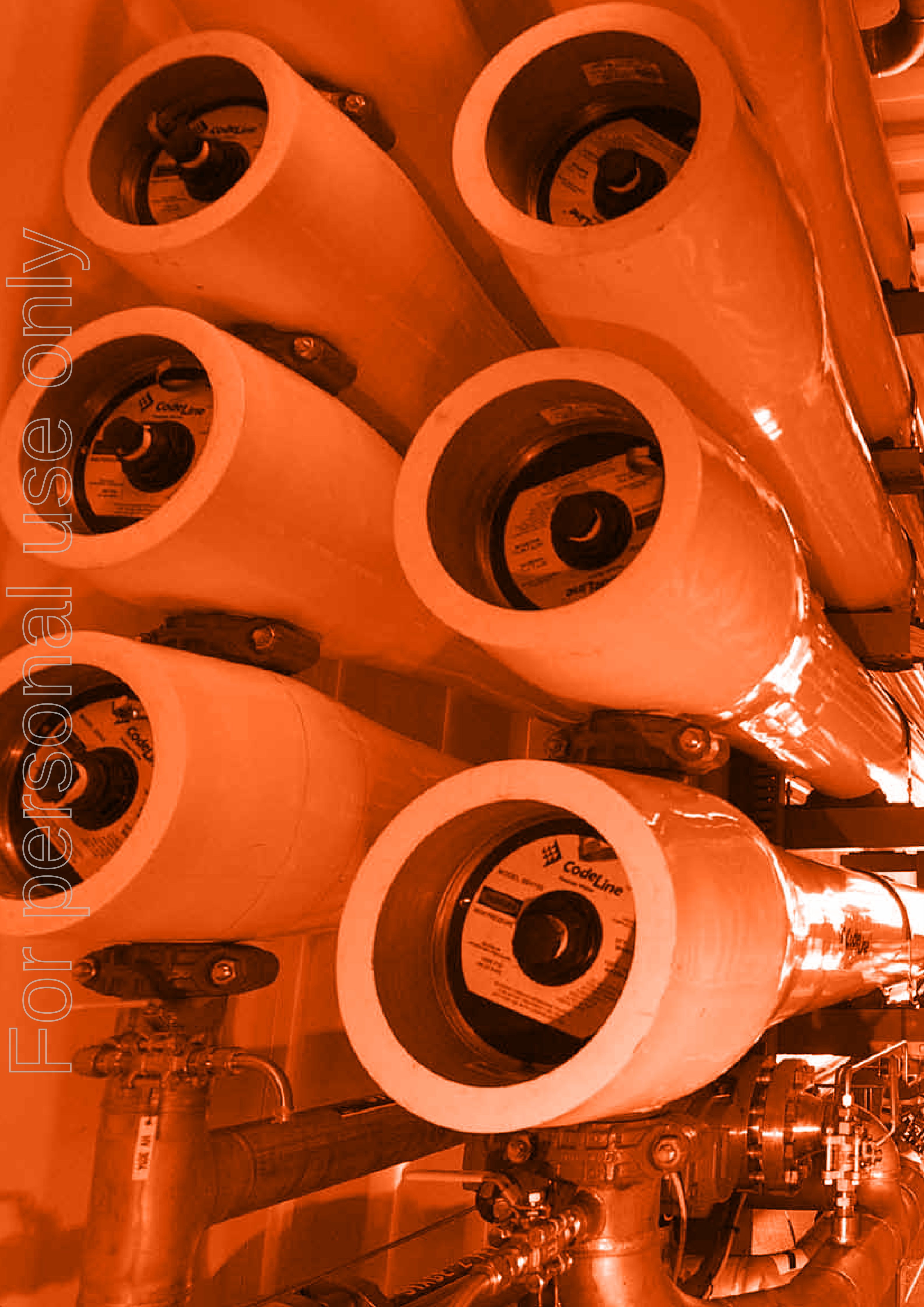
ENERGY

TO SUCCEED

EasternStar GAS

2010 ANNUAL REPORT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Contents

EASTERN STAR GAS LIMITED 2010 ANNUAL REPORT 1

VISION

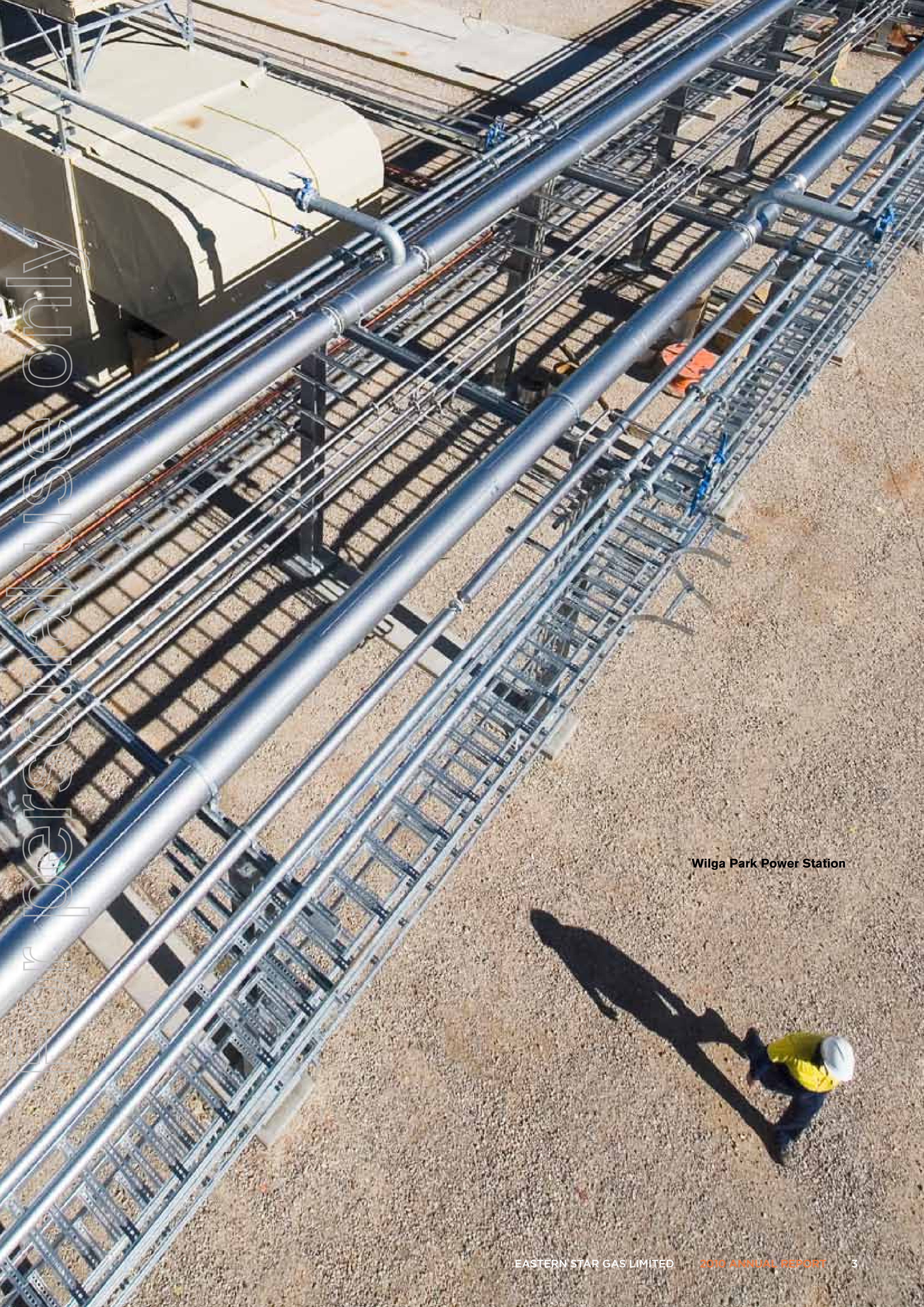
EASTERN STAR GAS AIMS TO BE NEW SOUTH WALES' LEADING SUPPLIER OF NATURAL GAS.

STRATEGY

EASTERN STAR GAS OPERATES AUSTRALIA'S BIGGEST PORTFOLIO OF HIGH-QUALITY COAL SEAM GAS ACREAGE.

BASED UPON THIS ACREAGE, EASTERN STAR IS PUTTING IN PLACE THE FUNDAMENTALS FOR A SUCCESSFUL GAS BUSINESS: GAS RESERVES; GAS MARKETS; AND INFRASTRUCTURE.

OUR HIGHLY SKILLED TECHNICAL, COMMERCIAL AND FINANCIAL TEAMS ARE EMPLOYING INDUSTRY BEST PRACTICES AND STATE-OF-THE-ART TECHNOLOGIES TO REALISE THE COMPANY'S VISION.



Wilga Park Power Station


EasternStar GAS
EasternStar GAS

PROGRESS

THROUGH 2009/10

Eastern Star Gas has had an enormously successful year with key achievements in all facets of Company Operations.

EXPLORATION

- Farm-in to northern NSW acreage (PELs 6, 427 and 428) complete
- Corehole appraisal programme confirms northward extension of Dewhurst gasfield

COMMERCIAL

- Development approvals processes underway with Preliminary Environmental Reports submitted for gas field and processing development, pipelines to Wellington and Newcastle, and LNG Project at Newcastle
- Memorandum of Understanding signed with ERM Power for supply of 20 PJ/a of gas to a 600 MW power station approved for development at Wellington
- Feasibility Study under way for development of an LNG export project at Newcastle. Study partners are Hitachi Corporation and Toyo Engineering Corporation
- 24 hectare site acquired on Kooragang Island (Newcastle) for proposed LNG Project
- Significant milestones realised through ongoing proactive approach to business development

ELECTRICITY PRODUCTION

- Commitment made to installation of a further three 3 Megawatt gas engine driven generators
- Wilga Park Power Station now operating continuously using coal seam gas

CORPORATE

- Share purchase plan completed in November 2009, raising $20.6million
- Successful $100 million capital raising in August 2010, to fund land purchase, exploration, project development activities and front end engineering and design activities (FEED)

GAS RESERVES & PRODUCTION

- Independently certified 2P gas reserves increased from 602 PJ to 1,520 PJ (100% project case)
- Independently certified Contingent Resource of 6,215 PJ (100% project case) announced
- Lateral pilots now operational
- Reverse Osmosis water handling capacity significantly expanded
- Outstanding performance of Bibblewindi West pilot further confirms suitability of lateral well design and provides indication of likely future performance of the Bibblewindi Multi-lateral pilot

2010

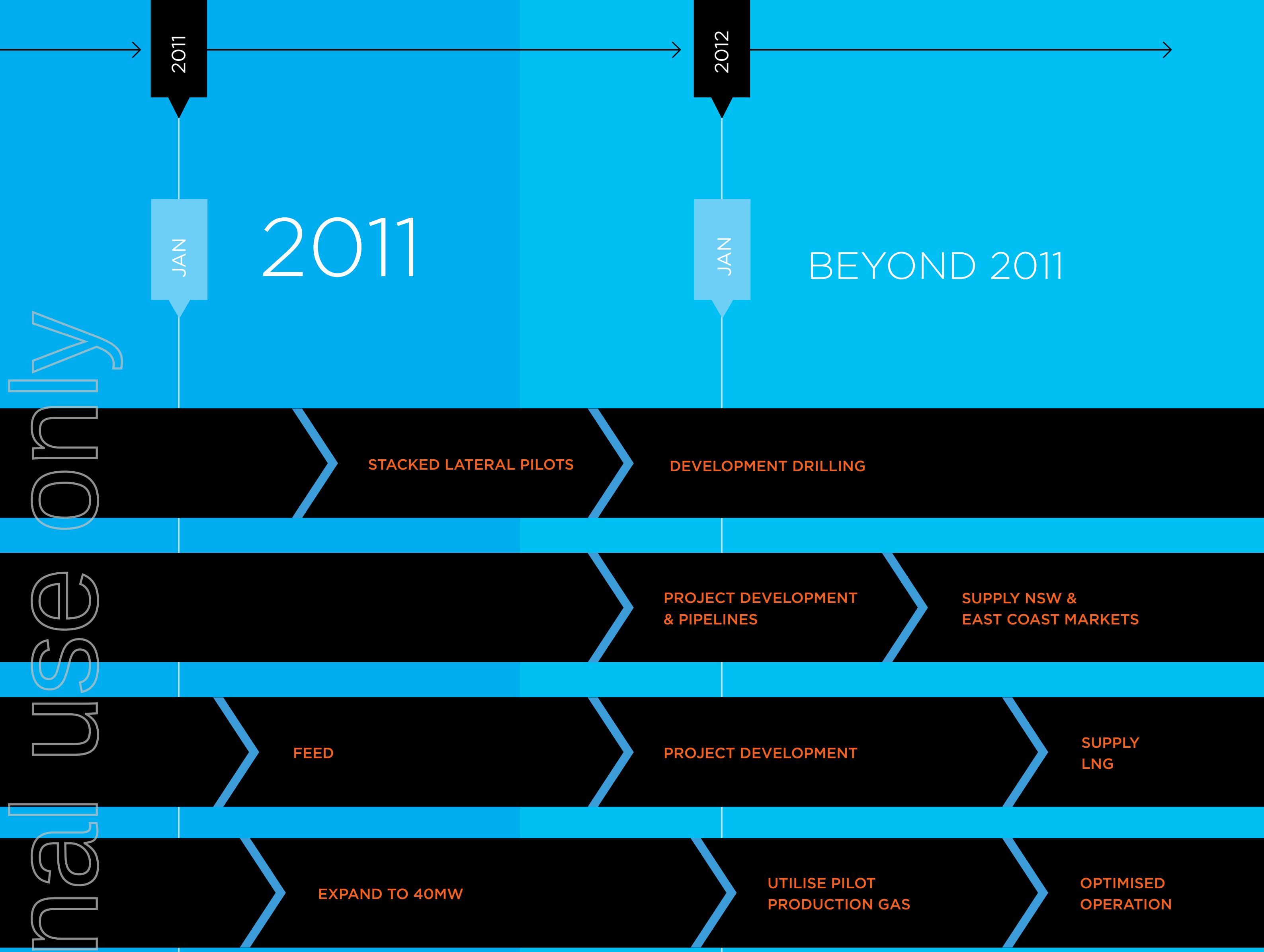
JULY

2010

GAS PRODUCTION	RAMP UP EXISTING PILOTS
COMMERCIALISATION: DOMESTIC	FINALISE AGREEMENTS
COMMERCIALISATION: LNG NEWCASTLE	FEASIBILITY STUDY, APPROVALS
WILGA PARK POWER STATION	EXPAND TO 16MW

THE FUTURE

Eastern Star Gas has committed to a long-term, staged development plan that will maximise the potential of the Narrabri Coal Seam Gas Project and deliver optimal results. In the coming year, the Company intends to reach a number of major milestones.



NEXT STEPS

- Secure approvals for and develop pilot projects to demonstrate the next generation production well design – a stacked lateral configuration to efficiently produce gas from multiple coal seams
- Ramp up gas production from existing and new pilots to support ongoing gas reserves upgrades and, in turn, underwrite financial close on gas sales agreements and project development
- Finalise arrangements for sale of gas in quantities to support project development, potentially including as feed gas for the proposed LNG project at Newcastle
- Secure land access, approvals and finance for development of the Narrabri Coal Seam Gas Project, including pipeline infrastructure

CHAIRMAN'S LETTER

EASTERN STAR GAS ANNUAL REPORT 2010

Dear Shareholder

IT IS WITH GREAT PLEASURE THAT I PRESENT MY CHAIRMAN'S REPORT FOR 2010, AND IN SO DOING REFLECT ON VERY SUBSTANTIAL PROGRESS AS ESG WORKS TOWARD NOT ONLY CEMENTING ITS PLACE AS NSW'S LARGEST SUPPLIER OF NATURAL GAS, BUT AS A MAJOR EXPORTER AS WELL.

Australia, we now know, is extremely well endowed with natural gas. There has been a great deal of attention paid to coal seam gas in eastern Australia in recent times, and it is worth reminding ourselves of the great value of the timely discovery and development of this major resource.

We live in an energy-hungry world, which faces the very real prospect of demand for oil challenging the global capacity to pump it over the next decade. The Chinese, for example, are aware that their rapidly-growing economy – including an extra one million cars on their roads every month – may itself trigger supply shortfalls. In response, they are taking concrete actions to substitute gas for oil, one example being the purchasing of 50,000 gas powered buses for Beijing.

Coming from the land, I am extremely conscious that we are utterly dependent upon oil for global food production and that both farmers and consumers are very vulnerable to oil price or supply shocks. Any substitution of gas for oil, including gas-to-liquids (GTL) technologies, in the global chain will extend our window of opportunity for developing a food supply capacity that is less dependent upon oil.

At a national level here in Australia, our supplies of crude oil are being rapidly depleted, and the impact on our balance of payments, already hefty, will grow very rapidly in coming years. ESG's exciting plans for exporting LNG from Newcastle will help address that ballooning imbalance.

At the NSW state level, the lack of capital investment in electricity generation capacity in recent years threatens both power outages and much higher power costs over the next decades unless urgent action is taken. By far the quickest, cleanest and cheapest solution lies in gas co-generation and new gas-fired power stations, especially for meeting peak demand periods. The new power station to be built at Wellington by ERM Power, to which we propose under the MoU with that company to provide 20 PJ of gas per annum over twenty years, is a classic example of the best way forward.

At the local level, ESG is providing real regional development already, with much more to come. We invest around $15m per year into the Narrabri economy, for example, and already employ (both directly and indirectly) some 60 people locally.

We place great importance in our community relationships. ESG recognises the need to ensure people have confidence in our commitment to sound environmental management, and we strive to be transparent and available to listen to and talk with local communities.

You will read more of our activities in the rest of the Annual Report, but I would like to highlight a few points.

Since my last report we have seen a 152 percent increase in the independently certified Proven and Probable (2P) gas reserves of the Narrabri Coal Seam Gas Project. The Contingent Resource now stands at 6,215 PJ and indeed, the now recognised size and quality of the resource, coupled with the technical and corporate capabilities of the ESG team, have underpinned a number of very significant advances for the Company in recent months.

I have already referred to the MoU with ERM Power, and touched on the prospect of LNG exports from Newcastle Significantly on the 24th of May 2010, ESG announced that it had entered into an MoU with Hitachi Limited and Toyo Engineering in Japan to investigate a potential LNG export project at Newcastle. Since that announcement we advised the market we had purchased 24ha of land at Kooragang Island in Newcastle. This provides us with a site for an LNG plant, initially of 1 million tonnes per year, with a potential of up to 4 million tonnes per year.

These developments plainly represent solid progress towards commercialisation of the Narrabri resource. The land purchase in particular provides the certainty needed to confidently proceed with project planning, approvals and commercial activities for the proposed plant.

During the year we raised significant funds, a $20.6 million Share Purchase Plan in December 2009 and a $100 million institutional placement in August this year, ensuring a strong capital position to progress our many activities. These include the corehole appraisal programme which confirmed the northward extension of the Dewhurst gasfield, feasibility studies and progressing Front-End Engineering and Design (FEED) regarding the Narrabri field development, ongoing exploration, evaluation and development and the expansion of the Wilga Park Power Station.

I am grateful for the hard work and support of the ESG Board and senior management team. I would particularly like to mention that Chris Sadler has proven an excellent addition to the Board, and that David Casey's leadership has been energetic, forward-looking and a great example to the rest of the team.

With a world-class management and technical team and a clear commercialisation strategy, Eastern Star is well positioned to achieve our vision of being NSW's leading supplier of natural gas.

The Hon. John Anderson
Chairman

16 September 2010

REVIEW OF OPERATIONS

COMPANY BACKGROUND

HISTORY

Eastern Star Gas floated in 2001 with a focus, at that time, on conventional oil and gas exploration in the Gunnedah Basin region of New South Wales. The Company enjoyed early success with the Coonarah Gasfield, brought on line in 2004, supplying natural gas to the purpose-built Wilga Park Power Station, located to the west of Narrabri.

While the early success was somewhat short lived, with the Coonarah Gasfield failing to meet performance expectations, the Company's extensive NSW exploration acreage was the basis for a newfound and material source of wealth as the coal seam gas (CSG) industry raced toward maturity on the Australian East Coast.

Building upon early CSG exploration activity, that confirmed beyond doubt the CSG resource potential of Eastern Star Gas' acreage, 2007 was a watershed year for the Company. Exploration attention was refocused specifically on coal seam gas, conventional exploration activities were floated into Orion Petroleum and the Company's technical, commercial and financial management was strengthened to address gas business fundamentals from reservoir to market.

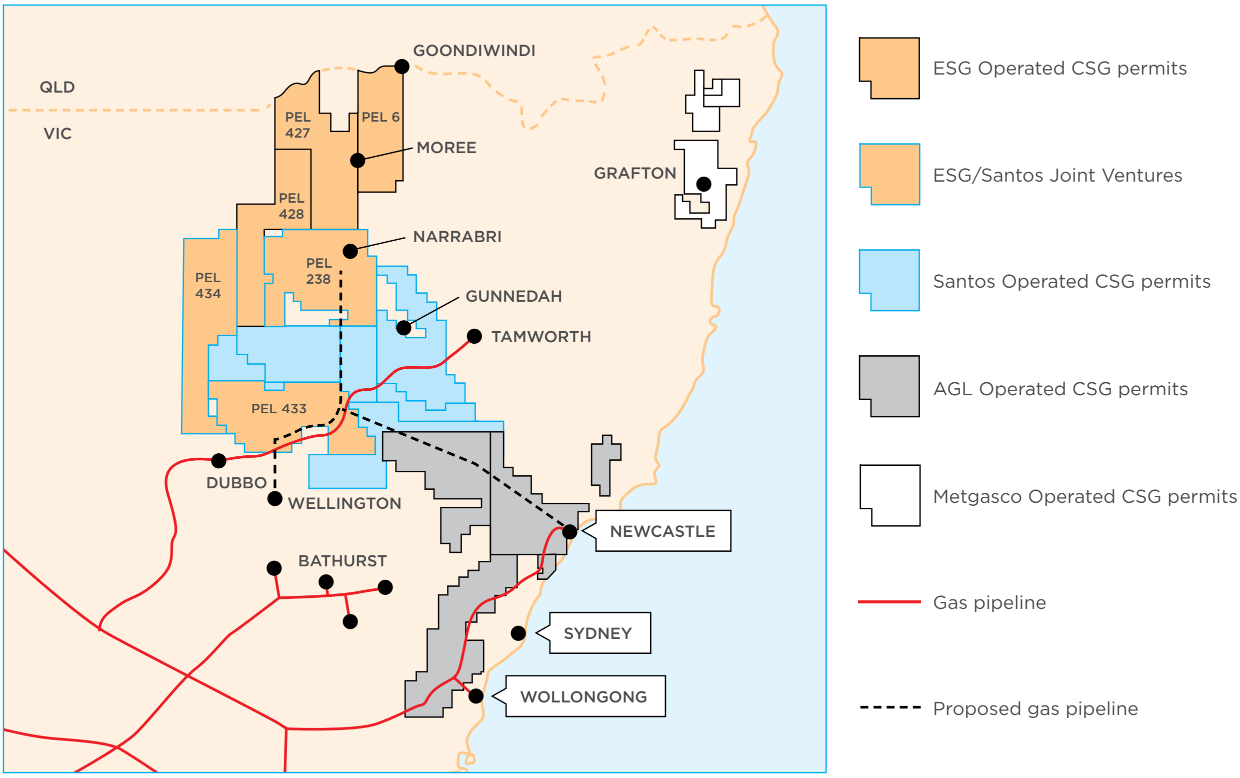
SINCE 2007, EASTERN STAR GAS HAS BY ANY MEASURE ACHIEVED EXPONENTIAL GROWTH. THE COMPANY NOW HAS AUSTRALIA'S LARGEST OPERATED PORTFOLIO OF CSG EXPLORATION ACREAGE AND IS METHODICALLY ADVANCING PLANS FOR COMMERCIALISATION OF THE NARRABRI CSG PROJECT.

PRESENT POSITION

Today, Eastern Star Gas operates 8 CSG licence areas, covering 41,827 square kilometres of the Gunnedah and southern Bowen Basins and including the Narrabri CSG Project. In addition, the Company operates the Wilga Park Power Station, which utilises pilot production gas from the Narrabri CSG Project, and is involved as operator for a farm-in to 27,922 square kilometres of CSG exploration acreage in the Arckaringa Basin region of South Australia.

EASTERN STAR GAS LICENCE INTERESTS

Basin(s)	State	Licence	Area (km²)	ESG Interest	Comment
Gunnedah	New South Wales	PPL 3	26	65% all Petroleum Rights	Narrabri CSG Project
		PAL 2	267	100% Conventional Rights; 65% CSG Rights	Over-riding royalties: CSG – 0.855% Conventional – 0.555%
		PEL 238	7920		
Gunnedah	New South Wales	PEL 433	7,678	65% all Petroleum Rights	
		PEL 434	7,736		
Bowen/Surat and Northern Gunnedah	New South Wales	PEL 6	5,165	75% CSG Rights	Over-riding royalty 3.5%
		PEL 427	7,014	50% CSG Rights	
		PEL 428	6,021	40% CSG Rights	
Arckaringa Basin	South Australia	PEL 117	9,547	Earning 25% CSG Rights	Potential to earn further 25% CSG Rights
		PEL 121	9,848		
		PEL 122	8,527		
		Total	69,749		



NSW CSG Exploration Acreage and Gas Pipelines

Wilga Park Power Station

REVIEW OF OPERATIONS

EXPLORATION AND APPRAISAL

THE UNDERLYING PURPOSE OF EXPLORATION AND APPRAISAL ACTIVITY IS TO IDENTIFY AND THEN PROVE UP GAS RESERVES – A KEY DRIVER OF COMPANY VALUE. EASTERN STAR GAS ENSURES THERE IS A BALANCE BETWEEN ONGOING UPGRADING OF KNOWN GAS RESERVES AND RESOURCES, AND WILDCAT EXPLORATION OF NEW AREAS TO IDENTIFY NEW RESOURCE POTENTIAL.

Exploration and appraisal activities have been widespread during the past year, albeit with a focus upon the Narrabri CSG Project where the aim has been upgrading of gas reserves to underwrite project development.

NARRABRI COAL SEAM GAS PROJECT

PPL 3, PAL 2 AND PEL 238
Gunnedah Basin, New South Wales

The objectives of exploration and appraisal activity undertaken during the past year within licence areas comprising the Narrabri CSG Project were:

» provision of geological data to support continued gas reserves upgrades; and

» ongoing assessment of CSG prospectivity across under-explored areas of PEL 238.

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

Schramm Drilling Rig, Operations Room

SEISMIC ACQUISITION AND PROCESSING

80 kilometres of new seismic was acquired in three separate back-to-back surveys carried out at Edgeroi, Coghill and Dewhurst South during April 2010. Data from the seismic surveys was processed and integrated into geological modelling that is routinely utilised in planning of exploration, appraisal and development drilling activities.

COREHOLE DRILLING

Eastern Star Gas continued an active drilling programme in the PEL 238 / PAL 2 / PPL 3 Narrabri Coal Seam Gas Project area and mobilised a second coring rig in October 2009 to accelerate operations.

Coreholes drilled within PEL 238, some of which have stepped out toward the edge of prospective acreage in order to confirm the extent of coal deposition, have intersected material quantities of coal.

Data from the coreholes is used in development of the geological model of the Narrabri CSG Project and, in turn, in planning of future pilot production and development wells.

Key outcomes of corehole drilling and seismic surveys within PEL 238 during the year include:

» extension of Bohena seam development west of the previous interpreted limit;

» extension of known southern limit of Dewhurst field with at least three new appraisal well locations delineated; and

» location identified for a Hoskissons seam pilot at Tintsfield.

OTHER PERMIT AREAS

PEL 433 AND PEL 434

Gunnedah Basin, New South Wales

Within PEL 433 the 40 km Cobbora Seismic Survey was completed during March 2010. The objective of the survey was to assess early Permian coal development in a depositional trough below the drilled depth of historic coal exploration holes. Preliminary interpretation suggests coal seams may exist in two separate trough areas.

Within PEL 434, the Baradine Creek 1 corehole was completed. The corehole was designed and located to evaluate the coal seam gas potential of both the Early Cretaceous Bungil Formation coals and deeper sediments within the northern Pilliga Trough. The corehole reached a total depth of 805 metres, intersecting 4.5 metres of coal in the Bungil Formation.

Approvals for drilling of two coreholes within PEL 433, namely Dilly 1 and Ellendale 1, were secured during the year.

PEL 6, PEL 427 AND PEL 428

Bowen, Surat and northern Gunnedah Basins, New South Wales

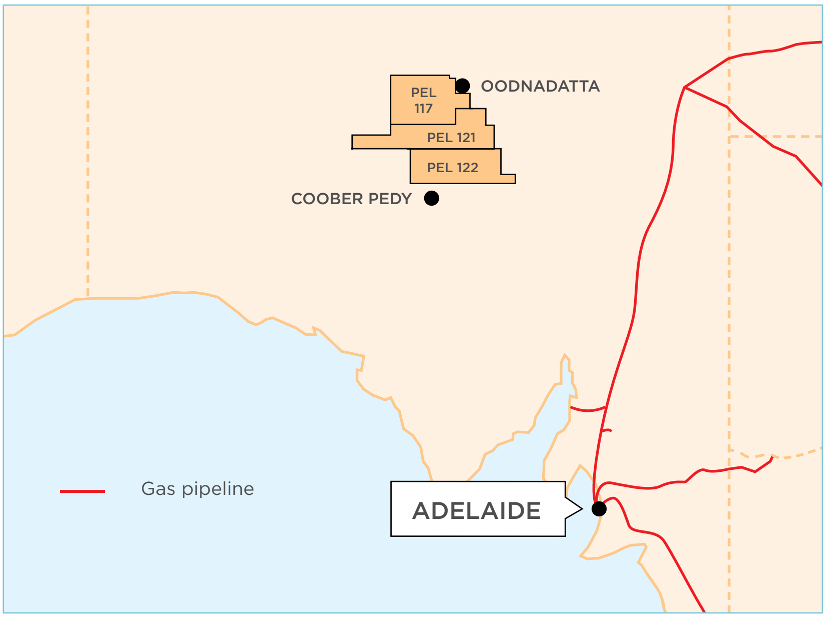
Together these PELs cover in excess of 18,000 square kilometres to the north and west of the Narrabri CSG Project.

Following completion of farm-in arrangements, Eastern Star Gas is operator of and has a 75% interest in the CSG rights of PEL 6, a 50% interest in the CSG rights of PEL 427 and a 40% interest in the CSG rights of PEL 428.

To satisfy the final requirements of the farm-in to these licence areas, three coreholes were drilled in PEL 6 during the course of the year. The coreholes were designed to assess the CSG potential of the Moolayember Formation, were:

» Gwydir 1, which intersected 4.0 metres of coal;
» Milguy 1, which intersected approximately 6 metres of net coal; and
» Camurra 2, which intersected 6.8 metres of net coal.

The result of exploration activity carried out to date in these licence areas will be taken into account in mapping of resource potential and planning further exploration activity.



South Australian Exploration Acreage Farm-in

PEL 117, PEL 121 AND PEL 122

Arckaringa Basin, South Australia

Eastern Star Gas has two-stage farm-in rights over PELs 117, 121 and 122 in the Arckaringa Basin region of South Australia. The first stage of the farm-in involves drilling of three coreholes, one in each of the PELs, for which the Company will earn a 25% interest in the coal seam gas rights of the exploration licences. The second, optional stage of the farm-in is intended to involve drilling and testing of a notional five-well production pilot, in return for which the Company will earn a further 25% interest in coal seam gas rights of the exploration licences.

Completion of the farm-in work programme was initially delayed pending development of arrangements for coordination of CSG activities and other conventional and underground coal gasification activities. This was necessary following acquisition of SAPEX, party to the original farm-in agreement, by Linc Energy Ltd, which is focused on underground coal gasification opportunities.

Subsequently, a four corehole programme that overlapped components of the envisaged farm-in work programme and collected information of use in evaluation of the CSG potential of target coals was completed. Data from that corehole programme has been shared with Eastern Star Gas and work is underway to identify and agree optimal arrangements for ongoing evaluation and development of the Arckaringa Basin exploration licences.

REVIEW OF OPERATIONS

GAS RESERVES AND PRODUCTION

GAS RESERVES

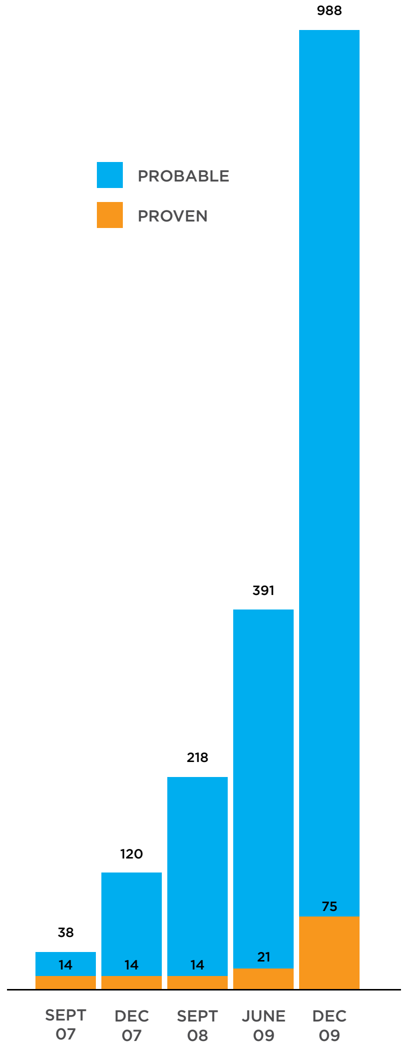
EASTERN STAR GAS HAS A 65% OWNERSHIP INTEREST IN THE GAS RESERVES AND RESOURCES OF THE NARRABRI CSG PROJECT. THIS COMPRISES THE CSG RIGHTS OF PETROLEUM EXPLORATION LICENCE ('PEL') 238, PETROLEUM ASSESSMENT LEASE ('PAL') 2 AND PETROLEUM PRODUCTION LICENCE ('PPL') 3. THE NARRABRI CSG PROJECT IS OPERATED BY THE COMPANY AND, AS IN PREVIOUS YEARS, IS THE PRIME FOCUS OF THE COMPANY'S ATTENTION.

The Narrabri CSG Project achieved its first independent gas reserves certification in December 2007, following which upgrades were achieved in December 2008 and June 2009. A further, 152% upgrade in certified Proven and Probable (2P) gas reserves was achieved during the year, with 2P project reserves increased to 1,520 PJ at an effective date of 31 December 2009. With effect on the same date an upgrade of independently certified gas resources was also achieved.

Eastern Star Gas' share of the independently certified gas reserves and resources of the Narrabri CSG Project is tabulated below.

The gas reserves and resource estimates tabulated below were determined by Mr John Hattner of Netherland Sewell and Associates Inc ('NSAI'), Dallas, Texas, USA, in accordance with Petroleum Resource Management System guidelines. Mr Hattner is a full-time employee of NSAI, is a qualified person as defined under ASX Listing Rule 5.11 and has consented to the use of the reserves and resource figures as tabulated.

The reserves and resource certification upgrades achieved during the year reflect the ongoing success of the Company's exploration, appraisal and pilot production programmes. The upgrades were in line with the Company's expectations and reaffirm the massive potential of the Narrabri CSG Project.



Eastern Star Gas Interest in certified gas reserves. Units: Petajoules (PJ)

ESG INTEREST IN NARRABRI CSG PROJECT GAS RESERVES AND RESOURCES

Reserves / Resources Category	Previous 30 June 2009	Current 31 December 2009
1P (Proven)	21 PJ	75 PJ
2P (Proven + Probable)	391 PJ	988 PJ
3P (Proven Probable + Possible)	1,273 PJ	1.818 PJ
1C	776 PJ	808 PJ
2C	1,984 PJ	2,285 PJ
3C	3,983 PJ	4,040 PJ

Drilling Production Pilot Wells

REVIEW OF OPERATIONS

GAS RESERVES AND PRODUCTION (CONT'D)

COAL SEAM GAS PILOT PROGRAMME

EASTERN STAR GAS, AS OPERATOR OF THE NARRABRI CSG PROJECT, IS CONDUCTING COAL SEAM GAS PILOT PRODUCTION ACTIVITIES AT MULTIPLE LOCATIONS, AS OUTLINED IN THE TABLE BELOW.

While early production pilots, involving vertical fracture-stimulated wells, served to demonstrate commerciality of gas production, they did not achieve rates of gas production consistent with the high measured permeability (up to 130 millidarcies) and high gas content of the target coal seams.

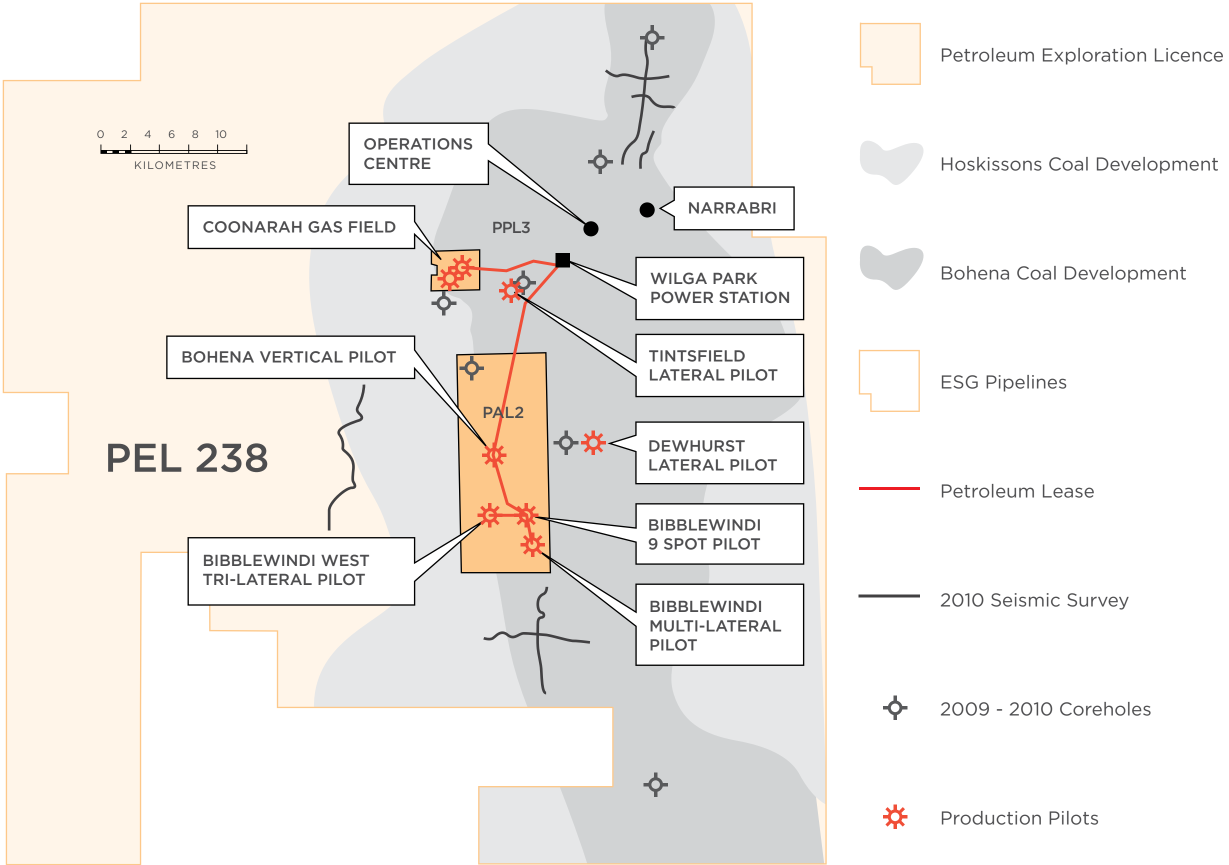
This was due to the unique, vertically fractured architecture of the target coals. In December 2008, following a comprehensive review to identify and secure drilling technologies and expertise specifically suited to the target coals, the Company embarked upon a programme involving lateral or horizontal wells, drilled in a direction perpendicular to the natural fracturing system of the coal.

The success of the lateral well design was apparent even during drilling of the first Bibblewindi multi-lateral pilot. Water flow rates, a necessary precursor to good gas flow rates, were more than an order of magnitude better than historically achieved from vertical fracture-stimulated wells. Further, it was quickly apparent that the directional fracture system of the target coals is itself so well developed that, from an ongoing development perspective, a spacing of around 1 kilometre between adjacent lateral wells can be comfortably adopted. This is especially important as, the larger the drainage area of each individual well, the lower the unit cost of gas production.

Building upon experience with the Bibblewindi multi-lateral pilot Eastern Star Gas then completed the Bibblewindi West lateral pilot, operation of which commenced in November 2009.

NARRABRI CSG PROJECT – PILOT PRODUCTION ACTIVITIES

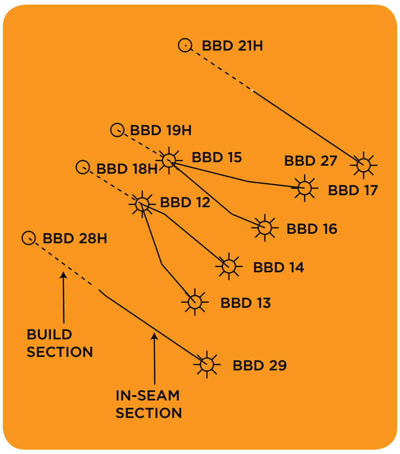
Pilot	Configuration	Commenced Operation	Observations
Bohena	3 vertical wells in straight line on 40 acre spacing	November 2004 originally; May 2006 in present configuration	Demonstrate commerciality but do not take advantage of unique architecture of target coals
Bibblewindi 9-spot	9 vertical, fracture-stimulated wells in diamond pattern on 40 acre spacing, primarily targeting Bohena coal seam	December 2006 – January 2007	
Bibblewindi Multi-lateral	Two adjacent bi-lateral wells a plus two single-lateral shield wells and a total of 8 vertical production wells, targeting Bohena coal seam	March – May 2009 with shield wells online September 2009	Confirms suitability of lateral well design
Bibblewindi West	Tri-lateral well set with 4 vertical production wells, targeting Namoi coal seam	November 2009	Establishes Namoi coal seam as a significant gas resource
Tintsfield	Three parallel lateral wells with three vertical production wells, targeting Hoskissons coal seam	Scheduled for October 2010	Targets the Hoskissons coal seam which has yet to be included in reserve estimates
Dewhurst	Three parallel lateral wells with three vertical production wells, targeting Bohena coal seam	Scheduled for October 2010	Will be operated on a short term basis to confirm performance



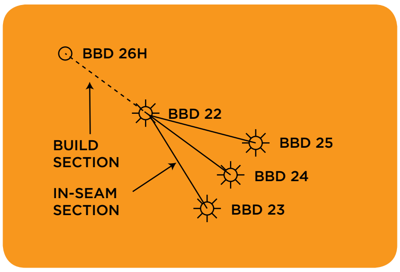
Pilot Production Activities

Gas Production well site

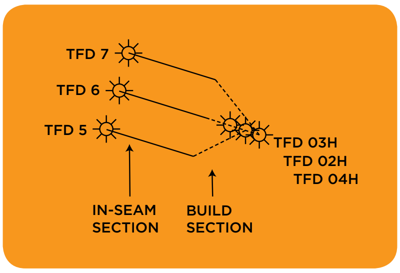
BIBBLEWINDI MULTI-LATERAL PILOT



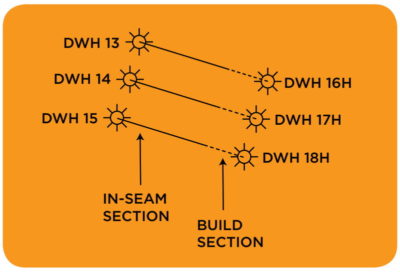
BIBBLEWINDI WEST TRI-LATERAL PILOT



TINTSFIELD LATERAL PILOT



DEWHURST LATERAL PILOT



The Bibblewindi West pilot was a further, outstanding success for multiple reasons:

» Within one month of commencement of dewatering, the pilot flowed gas at a rate in excess of 2.0 MMscfd. This demonstrated not only the potential of the previously untested Namoi coal seam, but also the potential of the slightly deeper but much thicker Bohena coal seam that is targeted by the Bibblewindi multi-lateral pilot. On the basis of the performance of the Bibblewindi West pilot, the Namoi coal seam was for the first time included in certified gas reserves estimates as at December 2009.

» Immediately after achieving the 2.0 MMscfd gas flow rate the Bibblewindi West pilot was shut in to allow a refit of surface facilities to handle the exceptional flow rates. Subsequently, extreme wet weather, followed by a series of water processing problems (associated with installation and commissioning of new reverse osmosis equipment), meant that operation of the Bibblewindi West pilot was, until July 2010, intermittent. While intermittent operation of a coal seam gas production pilot is normally avoided, in the case of Bibblewindi West it has demonstrated that production operations can be interrupted without compromising overall performance. Each time the Bibblewindi West pilot was brought on line gas production quickly and reliably ramped up to around 1.0 MMscfd as the head of water on the coal seam was pumped down to 500 metres, thereby providing valuable data for calibration and refinement of reservoir models.

» Following a resumption of continuous operation in late July 2010, gas production from the Bibblewindi West pilot climbed quickly through 1.0 MMscfd to in excess of 2.0 MMscfd, replicating previous performance.

Drilling of pilots at Tintsfield and Dewhurst was then commenced. Both these production pilots involve three separate but parallel lateral wells each intersecting a vertical production well. This well configuration approximates the layout planned for future development drilling save that the spacing of development wells will be significantly greater than is necessarily adopted for pilot production purposes (to accelerate dewatering) and, as outlined below, development wells are likely to access multiple coal seams. For present gas reserves certification purposes, gas production pilots access only one coal seam at a time in order to demonstrate beyond doubt the water and gas production characteristics of that particular seam.

Operation of the Tintsfield and Dewhurst production pilots is scheduled to commence in Oct 2010. The Company expects performance results from these pilots will make an important contribution to gas reserves upgrades during the coming year. Importantly, the Tintsfield pilot, which has been connected to allow pilot production gas to be utilised at the Wilga Park Power Station, is targeting the Hoskissons coal seam – a seam that, despite being both areally extensive and thick, has not been taken into account in previous gas reserves estimates.

The Dewhurst pilot, which serves to confirm the geographic extent of the thick, highly saturated Bohena coal seam, will be operated on a short term basis only, due to the fact it is not connected to current gas-processing facilities. It is expected that short term operation will be sufficient to demonstrate (to the satisfaction of independent gas reserves certifiers) that water and gas production characteristics at Dewhurst are comparable with those at other locations.

Eastern Star Gas is now planning, and has funding in place to complete, a series of stacked lateral wells. The stacked lateral design will allow gas to be produced from multiple coal seam sequences (for example, the Hoskissons, Namoi and Bohena seams) by means of a single vertical production well intersected by multiple lateral wells, all drilled from a common location but each accessing a separate coal seam. The Company is confident that this well configuration will see it become one of, if not the, lowest cost Australian producer of coal seam gas.

REVIEW OF OPERATIONS

GAS RESERVES AND PRODUCTION (CONT'D)

CONVENTIONAL NATURAL GAS PRODUCTION

Gas production from the Coonarah Gasfield, located within PPL 3, ceased during the year.

The Coonarah gas field was originally brought on line in 2004, supplying gas to the Wilga Park Power Station. The field failed to meet gas production expectations to the extent that operation of the Wilga Park Power Station was compromised. Following installation of pipeline infrastructure to allow the power station to be fuelled with coal seam gas from the Company's production pilots, ongoing operation of the Coonarah Gasfield was no longer financially viable.

The quantity of conventional gas produced from the Coonarah gas field during 2009/10, prior to cessation of gas production operations, was 16 TJ.

GAS AND WATER HANDLING

With the exception of the Dewhurst pilot, which is being operated on a temporary basis only:

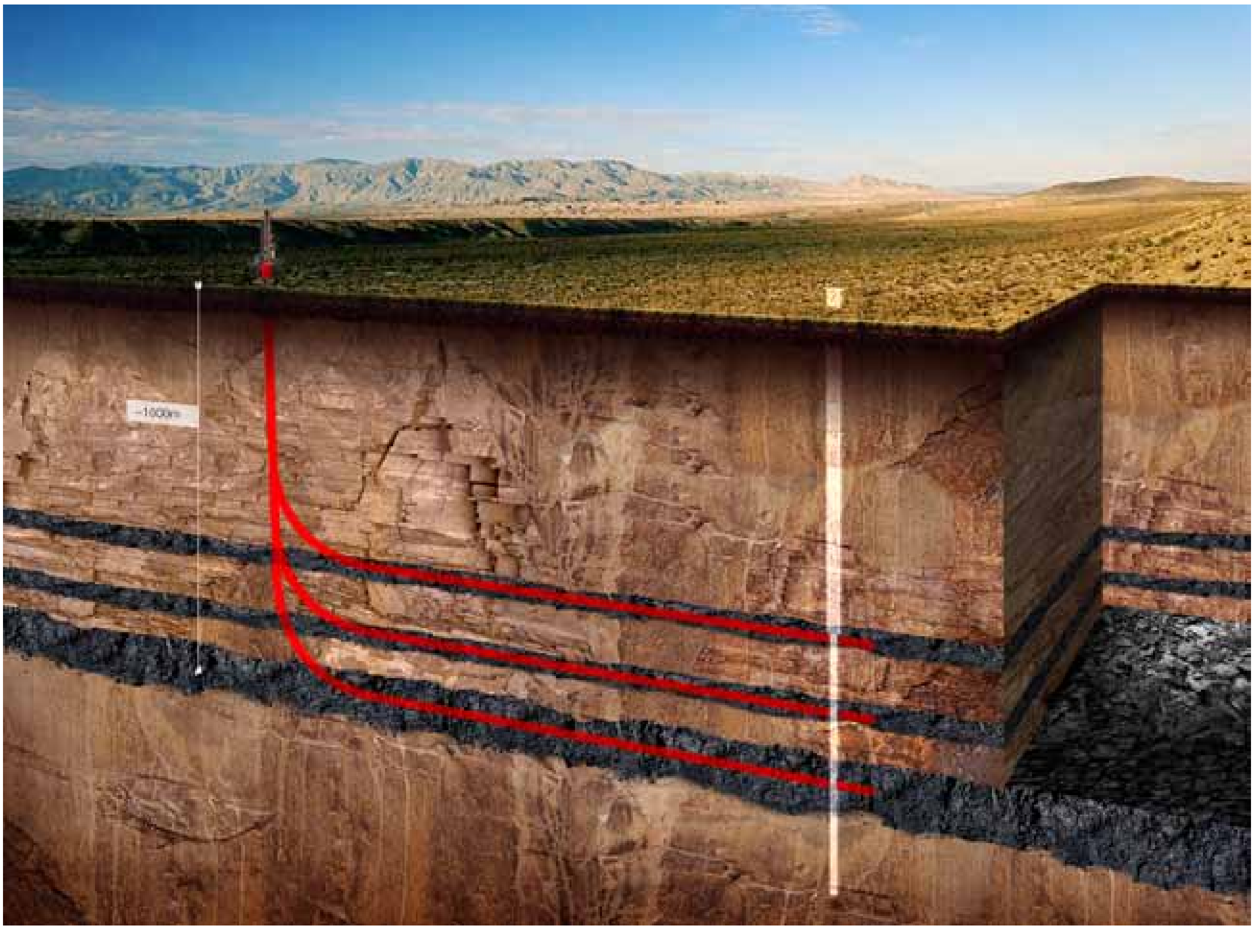
» Gas produced from the Company's production pilots is transported through low pressure flowlines to the Wilga Park Power Station where it is used to generate electricity.

» Water produced from the Company's production pilots is processed by reverse osmosis to produce a high-quality fresh water steam and a residual stream into which dissolved solids (primarily sodium bicarbonate, or baking soda) are concentrated. The residual stream is evaporated in fully-lined evaporation ponds.

During the year, the Company commissioned several new Reverse Osmosis water treatment units. The Company's water treatment capability now totals 3.2 Megalitres per day (or more than 20,000 barrels of water per day). 53% of this capacity is owned by the Narrabri CSG Joint Venture, the balance is rented.

An important geological feature of the Narrabri CSG Project is that the target coals are structurally isolated from the much shallower sandstones from which groundwater is pumped for agricultural and domestic purposes.

Unlike CSG production operations in some other locations (where the coal seam may be connected to or itself used as a source of water) CSG production activities at the Narrabri CSG project will not have an impact on the surface or groundwater resources of the community.



Stacked Lateral Well

REVIEW OF OPERATIONS

ELECTRICITY PRODUCTION

WILGA PARK POWER STATION

EASTERN STAR GAS OPERATES, AND OWNS 65% OF, THE WILGA PARK POWER STATION.

The presently installed electricity generating capacity at Wilga Park, in what is referred to as the 'A' Station, is 7 MW (comprising one 3 MW generator and four 1 MW generators, all of which are gas engine driven). The Wilga Park 'A' station is operating on a continuous basis using coal seam gas from production pilots in the Bibblewindi area and soon at Tintsfield. The Coonarah gas field, from which gas was historically sourced for operation of the power station, was shut-in during the year following continued decline of production from the field and ramp-up of coal seam gas pilot production.

In May 2010 Eastern Star Gas committed to installation at Wilga Park of a further three 3 MW Jenbacher gas engine driven generators. The new units will be available for operation during the first quarter of 2011.

The first of these new units will see the installed capacity of the 'A' Station increased to 10 MW, which is the maximum capacity of the interconnection between the 'A' Station and Country Energy's electricity transmission system.

The second and third of the new units will be installed as part of a new 'B' station which, when fully operational, will take total site capacity to 40 MW and utilise around 3.5 Petajoules per annum of gas. It is the Company's expectation that the strong ramp-up of coal seam gas production, from both existing and new pilots, will continue during 2010/11 and that the 'B' station will therefore be fully utilised.

All electricity generated at Wilga Park is presently sold to Country Energy under a 10 year Power Purchase Agreement (PPA), now in its seventh year. In addition, NSW Greenhouse Gas Abatement Certificates (NGACs'), created by virtue of the power station's high efficiency and low carbon dioxide emissions, are also sold to Country Energy under the terms of the PPA.

The value of electricity supplied to Country Energy during 2009/10 was $966,582.

Wilga Park Power Station

Gas Production Wellhead

REVIEW OF OPERATIONS
COMMERCIAL AND MARKETING

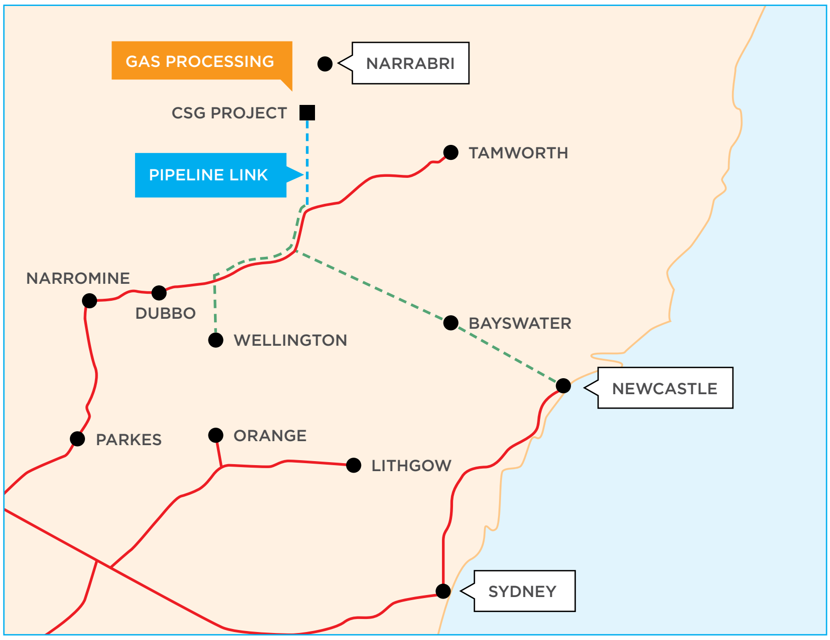
WITH CERTIFIED PROJECT GAS RESERVES AND CONTINGENT RESOURCES NOW EXCEEDING 9,000 PJ (9 TRILLION CUBIC FEET), OF WHICH 1,520 PJ IS IN THE PROVEN AND PROBABLE RESERVES CATEGORY, EASTERN STAR GAS HAS ACHIEVED THE CRITICAL MASS REQUIRED TO SUPPORT PROJECT AND DOWNSTREAM INFRASTRUCTURE DEVELOPMENT.

Over the past year, Eastern Star Gas continued its proactive approach to business development, achieving outstanding success along the way. Together, these successes reflect the wisdom of the staged marketing approach that has been diligently pursued by the Company over recent years, and also pave the way for continued progress toward profitable development of the Narrabri CSG Project.

MEMORANDUM OF UNDERSTANDING WITH ERM POWER

In May 2010, Eastern Star Gas entered into a Memorandum of Understanding (MoU) with ERM Power for supply of gas to a 600 MW power station approved for development at Wellington, some 300 kilometres south of Narrabri.

The MoU provides for supply of 20 Petajoules of gas per year over a 20 year period commencing mid 2013. Gas pricing arrangements, although yet to be finalised, are to be dependent upon wholesale electricity prices. Having regard for industry predictions of future wholesale electricity prices, the Company estimates revenue from the proposed gas supply arrangement will exceed $1.6 billion.



Project Location and Proposed Pipelines

The opportunity to supply gas to the Wellington Power Station is considered important for multiple reasons, including:

» ERM Power's Wellington site is fully approved for development. This is important in NSW where the need for development of new electricity generation infrastructure is becoming pressing; and

» ERM Power has a sound track record, having successfully developed a number of gas fuelled power stations around Australia including the Braemar Power Station, itself fuelled by coal seam gas.

Planning and approvals processes for development of gasfield and pipeline infrastructure to produce and deliver gas to the Wellington Power Station were well advanced by year end.

LNG NEWCASTLE PROJECT FEASIBILITY STUDY

In May 2010, Eastern Star Gas entered into a Memorandum of Understanding with Hitachi Ltd, Industrial & Social Infrastructure Systems Company and Toyo Engineering Corporation pursuant to which the feasibility of developing a liquefied natural gas (LNG) export project at Newcastle is being investigated. A key component of the Feasibility Study is the proposed use of mid-scale, electric motor driven liquefaction technology.

This technology offers a number of compelling advantages including:

» high efficiency and low environmental impact;

» high reliability, owing to the essentially maintenance-free nature of the electric motor drives, and flexibility of operation;

» small footprint and low noise emissions, both of which are important for the Newcastle location; and

» internationally competitive capital cost and construction time.

The Feasibility Study is planned for completion by the end of 2010. Subject to favourable Feasibility Study outcomes, front end engineering and design activities (FEED) will then be progressed.

Eastern Star Gas envisages the LNG Newcastle Project will be developed initially as a 1 million tonne per annum (Mtpa) facility with early expansion to at least 2 Mtpa. Like larger LNG projects proposed for other Australian locations, significant economies will be achievable as the LNG Newcastle Project is expanded. Unlike other projects however, the LNG Newcastle Project will not suffer ramp-gas management challenges – the electric motor driven LNG trains can be comfortably and efficiently operated at part load and each 0.5 Mtpa increment of capacity requires just 25 PJ/a of gas.

REVIEW OF OPERATIONS

COMMERCIAL AND MARKETING

NEWCASTLE LNG PROJECT SITE

In August 2010 Eastern Star Gas purchased a 24 hectare parcel of land on the eastern end of Kooragang Island, Newcastle. Acquisition of the land was a further important step toward realisation of the LNG Newcastle Project. In securing the land, the Company has removed a key obstacle to timely pursuit of the LNG Newcastle Project. Approvals processes and, in turn, LNG offtake and Project equity discussions can now proceed unhindered.

The purchase cost of the Kooragang Island site was $25 million, of which $2.5 million was payable immediately with the balance to be paid in February 2011. Eastern Star Gas has an option (exercisable in January 2011) to not proceed with the purchase in the event specified approvals are not forthcoming. Eastern Star Gas is confident that the approvals will be secured.

PROJECT APPROVALS PROCESSES

A Concept Plan outlining a vision for staged development of the Narrabri CSG Project was originally lodged with the NSW Department of Planning in early November 2009. The development vision commenced with drilling of gas production wells and installation of infrastructure to service the NSW gas market, then provided for ongoing expansion to support new power station and downstream processing initiatives including the LNG Newcastle Project.

Eastern star Gas has recently submitted Preliminary Environmental Assessment (PEA) documentation required to secure Part 3A consent for development of gas production and processing facilities at Narrabri, construction of gas transmission pipelines to Wellington and Newcastle, and development of the LNG Newcastle Project. In addition, land access discussions were initiated for the proposed gas pipelines.

Eastern Star Gas aims to progress approvals and licencing processes with the objective of being able to finalise gas sales arrangements and make project development commitments by the second half of 2011.

OTHER GAS MARKETING ACTIVITIES

Discussions are ongoing with a number of existing domestic and prospective greenfields gas users. In parallel with these discussions the Company continues to work with the APA Group in investigating arrangements for delivery of gas to customers, regardless of their location. The APA Group is the owner and operator of the Central Ranges, Central West and Moomba to Sydney Pipelines as well as the Victorian Principal Transmission System and gas pipelines servicing Mt Isa and Brisbane.

Since gas pipeline infrastructure exhibits significant economies of scale, with pipeline tariffs falling exponentially as throughputs increase, an important facet of Eastern Star Gas' marketing strategy is to pursue gas markets of size and location to ensure unit costs of gas delivery are minimised, and gas netback prices maximised.

ESG's Kooragang Island Site

REVIEW OF OPERATIONS

CORPORATE

CAPITAL RAISINGS

On 9 August 2010 the Company successfully completed a $100 million equity capital raising with the issue of 119.1 million new fully paid shares at an issue price of $0.84. This represents an 8.2% discount from the previous closing price and a 5.4% discount to the volume weighted average price (VWAP). The shares were issued to new institutional and sophisticated investors and to existing shareholders through a placement underwritten and managed jointly by Credit Suisse (Australia) Limited and RBS Morgans Corporate Limited. The capital raising provided funding for key activities including purchase of land on Kooragang Island (Newcastle), completion of project front end engineering and design activities, and ongoing pilot and development well drilling.

APPOINTMENT OF DIRECTOR

Mr Chris Sadler was appointed as a Non-Executive Director on 15 October 2009. The Directors consider Mr Sadler's appointment ideal as his wealth of experience, both in Australia and overseas, will be invaluable as major expansion and development opportunities are considered in the near term.

Mr Sadler is an experienced company director. He is currently a director of Mitre 10 Australia Limited, Deputy Chairman of Austock Group Limited and has a strong involvement with not-for-profit organisations, being the Deputy Chairman of Opportunity International Australia and sitting on the board of Alpha International in London. Mr Sadler has had extensive professional experience in the investment banking industry, working in senior roles in New York, London and Melbourne for companies such as JP Morgan, Citigroup and Deutsche Bank.

FINANCIAL REPORT

EASTERN STAR GAS ANNUAL REPORT 2010

DIRECTORS' REPORT

EASTERN STAR GAS ANNUAL REPORT 2010

THE DIRECTORS PRESENT THEIR REPORT ON THE GROUP CONSISTING OF EASTERN STAR GAS LIMITED (PARENT ENTITY) AND THE ENTITIES IT CONTROLLED AT THE END OF, OR DURING, THE YEAR ENDED 30 JUNE 2010.

DIRECTORS

THE PERSONS BELOW HAVE BEEN DIRECTORS OF EASTERN STAR GAS LIMITED DURING THE YEAR UP AND TO THE DATE OF THIS REPORT.

THE HON. JOHN ANDERSON

Non-Executive Chairman

Appointed on 15 October 2007

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

MR DAVID CASEY

Managing Director

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

David Casey graduated with an Honours degree in Geology from the University of Sydney in 1991 and in the same year joined specialist coal seam gas company in Situ (Australia) Pty Ltd. In 1996, he formed his own coal seam gas consultancy business, and subsequently was a founder of Multiphase Technologies Pty Ltd., a provider of coal seam testing services. David has almost 20 years' experience in the management and evaluation of all aspects of CSG exploration and appraisal, from initial reservoir characterisation and fairway identification through to drilling, testing and production operations. He joined Eastern Star Gas Limited in September 2005 as Chief Operating Officer, and was previously a Director of Molopo Australia Limited between April 2001 and October 2005.

DR DAVID KING

Non-Executive Director

First appointed on 25 August 2000

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

MR CHRIS SADLER

Non-Executive Chairman

Appointed on 15 October 2009

Member of the Audit and Risk Committee and the Remuneration Committee and Nomination Committee. Mr Sadler is currently Deputy Chairman of Austock Group Limited. Previous director roles include Gloucester Coal Limited and Mitre 10 Australia Limited. He has a strong involvement with not-for-profit organisations and is Deputy Chairman of Opportunity International Australia and sits on the board of Alpha International in London. He has extensive professional experience in the investment banking industry, working in senior roles in New York, London and Melbourne for companies such as JP Morgan, Citigroup and Deutsche Bank.

MR ALEX SUNDICH

Non-Executive Chairman

Appointed on 20 September 2007

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

MR PETER LANSOM

Executive Director – Operations

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

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

MR DAVID ARCHER

Non-Executive Director

Appointed on 30 October 2006 and resigned 27 August 2009

Chairman of the Audit and Risk Committee and member of the Remuneration and Nomination Committee up until his resignation. David Archer has a Bachelor of Economics degree, he also holds a Law Diploma and is a barrister (non-practising) of the Supreme Court of New South Wales. He is a Fellow of the Australasian Institute of Mining & Metallurgy and has been actively involved in the Australian resources industry for over 25 years. He has held executive and non-executive roles in a number of Australian companies. He was also previously a Director of Hostworks Group Limited and Medivac Limited. He has been the Managing Director of Hillgrove Resources Limited since 2003. He is also currently a Director of Crusader Holdings NL and InterMet Resources Limited.

PRINCIPAL ACTIVITIES

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

OPERATING RESULTS

Total revenue increased to $3,282,000 (2009 – $2,365,000) primarily due to a sales of electricity at the Wilga Park Power Station which increased to $628,000 (2009 – $158,000). During the year a new 3MW gas engine was installed the gas supply was switched from the conventional Coonarah Gas Field to the CSG Fields at Bibblewindi and Bohena. Other income decreased to $25,000 from $2,401,000 in the prior year. In 2009 the sale of 35% interest in Wilga Park Power Stations, PPL3 assets and related business netted a $2,401,000 gain, this was not repeated in 2010. The net loss of the Group after income tax for the financial year was $6,547,000 (2009 – $2,519,000). Deferred exploration expenditure that was expensed during the period amounted to $183,000 (2009 – $109,000).

FINANCIAL POSITION

Total assets increased by $20,569,000 and total liabilities increased by $822,000 resulting in the increase of net assets by $19,947,000 at 30 June 2010. The increase in net assets arose predominantly from the issue of new shares for cash. During the year, the Company issued ordinary shares for the Share Purchase Plan and exercise of options for cash proceeds of $20,561,000 and $3,638,000 respectively. These funds have been applied to the development and evaluation of the Narrabri Coal Seam Gas Project and independent certification of gas reserves to underpin future gas sales contracts and general operation costs.

DIVIDENDS

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

STATE OF AFFAIRS

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

- The Parent Entity issued of 50,789,629 new fully paid ordinary shares as follows:
  - Share Purchase Plan was completed on 17 November 2009 with the issue of 24,189,629 new fully paid shares to existing shareholders raising $20,561,000.
  - Unquoted options over unissued ordinary shares totalling 24,250,000 were exercised at 15 cents per share on 9 July, 26 August and 26 November 2009 before they expired on 30 October 2009. Total cash proceeds from the exercise options were $3,638,000.
  - Under the Employee Incentive Plan: 2,350,000 shares were issued at an average price of 90 cents per share with a total loan of $2,105,000 advanced to the participants.

MATTERS SUBSEQUENT TO THE END OF THE FINANCIAL YEAR

There has not arisen in the interval since 30 June 2010 and up to the date of this report, any matter that, in the opinion of the Directors, has significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group in future financial years other than the following:

- On 10 August 2010, the company successfully completed a fully underwritten institutional placement of 119,047,619 new fully paid shares raising $100 million (net $96.8 million).
- On 9 August 2010, the company entered into an agreement to acquire a 24 hectare parcel of land on Kooragang Island, Newcastle for $25 million, as a site for the proposed Liquefied Natural Gas Newcastle ("LNGN") export project. The company has paid a non-refundable 10% deposit upfront with the remainder payable in February 2011. If the company does not receive the necessary approvals for the purchase to proceed under the acquisition agreement, the Company has the option to terminate the agreement until 14 January 2011.

REVIEW OF OPERATIONS AND LIKELY DEVELOPMENTS

A detailed review of the operations for the financial year together with future developments are set out on pages 10 to 24. Over the year Eastern Star has certified additional CSG reserves in the Gunnedah Basin and certified a resource in excess of 6,000 PJs. The integrated geological and engineering model continues to step out across the basin after drilling 10 successful coreholes and completing two multi-lateral pilots during the period. The Group increased its generation capacity at the Wilga Park Power Station and switched its gas supply from the conventional Coonarah Gas Field to the CSG Fields at Bibblewindi and Bohena. A further expansion of the powers station up to 16MW is currently underway. Except as described elsewhere in this Annual Report the results of the exploration activities and development are unknown at the date of this report.

ENVIRONMENTAL REGULATIONS

The Group's operations are subject to significant environmental and other regulations. The Group has a policy of engaging appropriately experienced contractors and consultants to advise on and ensure compliance with environmental regulations in respect of its exploration, development and production activities. During the year, the Parent Entity expanded its environmental department to oversee a larger portfolio of environmental management and compliance as a result of increasing exploration, drilling and production activities.

During the financial year, the group did not receive any fines and was not subject to prosecution or other enforcement action in respect of applicable environmental regulations or environmental protection legislation, except as set out below:

In February 2010, the Company reported an incident had occurred near the site of the Tintsfield CSG pilot in PEL238. This resulted in the Company being fined $2500 by the NSW Industry and Investment for breach of the Permit conditions. Investigations ascertained that a sub-contractor servicing the Tintsfield 1 core hole incorrectly disposed of drilling fluids. Rehabilitation of the site was undertaken with 48 hours of the incident and the successful rectification of damage has been verified by independent assessment.

INDEMNIFICATION OF OFFICERS AND AUDITORS

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

MEETINGS OF DIRECTORS

The following table sets out the number of meetings held by the Directors of the Parent Entity during the year ended 30 June 2010 and the number of meetings attended by each Director:

	No. of Meetings Attended	No. of Meetings Held While in Office
John Anderson	13	13
David Casey	13	13
Peter Lansom	13	13
David Archer	2	3
David King	12	13
Chris Sadler	10	10
Alex Sundich	13	13

The Audit and Risk Committee met three times during the year ended 30 June 2010.

REMUNERATION REPORT

(a) Directors and Executives

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

MANAGING DIRECTOR

David Casey (appointed 31 October 2007)

NON-EXECUTIVE DIRECTORS

John Anderson – Chairman (appointed 15 October 2007)

David King (appointed 25 August 2000)

Alex Sundich (appointed 20 September 2007)

Chris Sadler (appointed 15 October 2009)

David Archer (appointed 30 October 2006 & resigned 27 August 2009)

EXECUTIVE DIRECTOR

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

EXECUTIVES

Ashley Edgar – General Manager Exploration and New Ventures

Roland Sleeman – Chief Commercial Officer

Ian Kirkham – Chief Financial Officer and Company Secretary

(b) Remuneration Policy and Practices

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

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

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

(i) Non-Executive Directors

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

The base fee of each Non-Executive Director for all Board activities is $60,000 (2009 – $40,000) per year and the fee for the Chairman is $115,000 (2009 – $100,000). Where applicable superannuation contributions equal to 9% of the fees are paid to each Non-Executive Director's personal retirement plan.

(ii) Executives

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

A short term incentive (STI) is applicable for Senior Executives with defined percentages of eligible base salary to be paid upon achievement of specified performance criteria. Performance criteria include job specific efficiency measures as well as macro issues such reserve generation, production, commercialisation and finance objectives. The overall effect of the Company's remuneration policies is to retain capable and energetic Directors and to attract and retain Executives who have reasonable additional incentive for superior performance.

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

DIRECTORS' REPORT

(CONTINUED)

(c) Details of Remuneration

	Salary and fees $	Short-term STI $	Non-cash $	EIP $	Long-term Super-annuation $	Total $
2010						
Parent Entity Directors						
John Anderson	106,250	–	–	23,781	9,563	139,594
David Casey	650,000	337,380	26,346	25,000	58,500	1,097,226
Peter Lansom	443,113	157,500	9,252	181,291	39,800	830,956
David Archer	10,000	–	–	–	900	10,900
David King	48,333	–	–	–	4,350	52,683
Chris Sadler	36,863	–	–	–	–	36,863
Alex Sundich	48,333	–	–	–	4,350	52,683
	1,342,892	**494,880**	**35,598**	**230,072**	**117,463**	**2,220,905**
Executives						
Ashley Edgar	368,304	126,000	8,419	206,063	16,896	725,682
Ian Kirkham	321,000	98,100	6,940	-	28,890	454,930
Roland Sleeman	351,000	122,625	14,078	158,650	31,590	677,943
	1,040,304	**346,725**	**29,437**	**364,713**	**77,376**	**1,858,555**
2009						
Parent Entity Directors						
John Anderson	100,000	–	–	43,699	9,000	152,699
David Casey	436,404	166,560	20,011	102,170	39,276	764,421
Peter Lansom	385,321	112,767	15,658	652,092	34,678	1,200,516
David Archer	40,000	–	–	–	2,700	42,700
Doug Battersby	16,667	–	–	–	1,500	18,167
David King	40,000	–	–	–	3,600	43,600
Alex Sundich	40,000	–	–	–	3,600	43,600
	1,058,392	**279,327**	**35,669**	**797,961**	**94,354**	**2,265,703**
Executives						
Ashley Edgar	330,275	101,260	13,105	734,794	29,725	1,209,159
Ian Kirkham	300,000	62,115	5,250	140,913	27,000	535,278
Roland Sleeman	300,000	72,268	13,394	630,986	27,000	1,043,648
	930,275	**235,643**	**31,749**	**1,506,693**	**83,725**	**2,788,085**

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

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

	Fixed Remuneration		At risk - STI		At risk - LT	
	2010	2009	2010	2009	2010	2009
Parent Entity Directors						
John Anderson	83%	71%	–	–	17%	29%
David Casey	67%	65%	31%	22%	2%	13%
Peter Lansom	59%	36%	19%	9%	22%	55%
David Archer	100%	100%	–	–	–	–
Doug Battersby	100%	100%	–	–	–	–
David King	100%	100%	–	–	–	–
Chris Sadler	100%	–	–	–	–	–
Alex Sundich	100%	100%	–	–	–	–
Executives						
Ashley Edgar	37%	31%	17%	8%	45%	61%
Ian Kirkham	78%	62%	22%	12%	–	26%
Roland Sleeman	73%	33%	18%	7%	9%	60%

(d) Compensation of Key Management Personnel

	Consolidated	
	2010 $	2009 $
Short-term employee benefits	3,289,836	2,571,055
Post-employment benefits	194,839	178,079
Share-based payment	594,785	2,304,654
	4,079,460	**5,053,788**

DIRECTORS' REPORT

(CONTINUED)

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

David Casey, Managing Director

- Term: Contracted until 4 July 2012
- TFR of $970,000 STI up to $485,000.
- Employee Incentive Plan (EIP) participation
  - Tranche 1: 625,000 shares at $0.45 each vest if 400 PJs of 2P gas reserves are certified by 31 January 2009. (vested 19 August 2009**)
  - Tranche 2: 625,000 shares at $0.45 each vest if a total of 600 PJs of 2P gas reserves are certified by 31 December 2009. (vested 19 August 2009)

  ** Directors have used their discretion under the Plan Rules to vest Tranche 1 shares on the basis that the Tranche 1 vesting requirements were substantially met (with 83% of reserves target achieved), the ultimate Tranche 2 target was met and the significant contribution of the Managing Director to the strong performance of the Company during the period. After discussion with the ASX Directors have determined to seek ratification by shareholders of the issue of shares to Mr Casey. That ratification will be sought at the 2010 AGM. If ratification does not occur the shares will be cancelled and an alternative comparable form of remuneration agreed with Mr Casey.

Peter Lansom, Executive Director — Operations

- Term: Contracted until 10 September 2013.
- TFR of $631,000 and STI up to $266,000.
- Employee Incentive Plan (EIP) participation
  - Tranche 1: 1,500,000 shares at $0.45 each vest after 6 months of employment. (vested 10 March 2008)
  - Tranche 2: 3,000,000 shares at $0.54 each vest within 24 months if:
    - 50 PJs of 2P gas reserves are certified outside the 2006/2007 programme; or
    - after 12 months employment Company shares trade above $1.05. (vested 19 August 2009)
  - Tranche 3: 3,000,000 shares at $0.54 each vest within 24 months if:
    - 200 PJs of 2P gas reserves are certified on a new licence; or
    - 400 PJs of 2P gas reserves are certified on an existing licence; or
    - after 12 months employment Company shares trade above $1.50. (vested 19 August 2009)

Ashley Edgar, General Manager Exploration New Ventures

- Term: Contracted until 27 August 2013.
- TFR of $404,000 and STI up to $202,000.
- Employee Incentive Plan (EIP) participation
  - Tranche 1: 1,000,000 shares at $0.45 each vest after 6 months of employment. (vested 27 February 2008)
  - Tranche 2: 3,000,000 shares at $0.54 each vest within 24 months if:
    - 50 PJs of 2P gas reserves are certified outside the 2006/2007 programme; or
    - after 12 months employment Company shares trade above $1.05. (vested 19 August 2009)
  - Tranche 3: 3,000,000 shares at $0.54 each vest within 24 months if:
    - 200 PJs of 2P gas reserves are certified on a new licence; or
    - 400 PJs of 2P gas reserves are certified on an existing licence; or
    - after 12 months employment Company shares trade above $1.50. (vested 19 August 2009)

Roland Sleeman, Chief Commercial Officer

- Term: Contracted until 1 November 2013.
- TFR of $420,000 and STI up to $210,000.
- Employee Incentive Plan (EIP) participation
  - Tranche 1: 750,000 shares at $0.45 each vest after 9 months of employment. (vested 1 August 2008)
  - Tranche 2: 2,625,000 shares at $0.45 each vest if a gas sales agreement is entered into that delivers shareholder value equivalent to the Macquarie Generation MoU.
  - Tranche 3: 2,625,000 shares at $0.45 each vest if further gas sales are made to approximately double the level of gas sales from the first gas sales agreement or downstream commercial / infrastructure arrangements are made to allow gas deliveries under the first gas sales agreement.

Ian Kirkham, Chief Financial Officer & Company Secretary

- Term: Contracted until 5 December 2013.
- TFR of $367,000 and STI up to $183,000.
- Employee Incentive Plan (EIP) participation
  - Tranche 1: 1,000,000 shares at $0.45 each vest after 9 months of employment. (vested 5 September 2008)
  - Tranche 2: 1,000,000 shares at $0.45 each vest after 18 months of employment. (vested 5 June 2009)

(e) Share holdings of Key Management Personnel

	Beginning of Year Number	Acquired Under Employee Incentive Plan Number	Net Change Other Number	End of Year Number
2010				
John Anderson	540,000	–	–	540,000
David Casey	8,000,000	–	48,898	8,048,898
David Archer – Resigned**	–	–	–	–
David King	20,456,558	–	17,648	20,474,206
Chris Sadler	–	–	–	–
Alex Sundich	9,941,124	–	35,296	9,976,420
Ashley Edgar	7,000,000	–	67,648	7,067,648
Ian Kirkham	2,100,000	–	100,000	2,200,000
Peter Lansom	7,500,000	–	29,648	7,529,648
Roland Sleeman	6,684,474	–	–	6,684,474
	62,222,156	**–**	**299,138**	**62,521,294**
2009				
John Anderson	40,000	500,000*	–	540,000
David Casey	8,000,000	–	–	8,000,000
David Archer	–	–	–	–
Doug Battersby – Retired**	30,055,462	–	–	30,055,462
David King	20,456,558	–	–	20,456,558
Alex Sundich	11,041,124	–	(1,100,000)	9,941,124
Ashley Edgar	7,000,000	–	–	7,000,000
Ian Kirkham	2,100,000	–	–	2,100,000
Peter Lansom	7,500,000	–	–	7,500,000
Roland Sleeman	6,684,474	–	–	6,684,474
	92,877,618	**500,000**	**(1,100,000)**	**92,277,618**

* *Shares issued under Employee Incentive Plan are subject to satisfaction to the conditions as described in (d) above.*
** *Share holdings are as at the date of resignation.*

AUDIT AND NON-AUDIT SERVICES

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

	Consolidated 2010 $	2009 $
Audit services		
PKF – Audit and review of financial statements	98,730	159,860
Non-audit services		
PKF – General matters	-	-
Total	**98,730**	**159,860**

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

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

AUDITOR'S INDEPENDENCE DECLARATION

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

INDEMNIFICATION OF OFFICERS

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

The insurance premiums relate to:

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

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

ROUNDING OF AMOUNTS

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

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

Dated 16 September 2010

David Casey
Managing Director

LEAD AUDITORS’ INDEPENDENCE DECLARATION

UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

PKF

Chartered Accountants
& Business Advisers

Auditors’ Independence Declaration

As lead auditor for the audit of Eastern Star Gas Limited for the year ended 30 June 2010, I declare that to the best of my knowledge and belief there have been:

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

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

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

PKF

PKF

Bruce Gordon

Bruce Gordon
Partner

16 September 2010

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Level 10, 1 Margaret Street | Sydney | New South Wales 2000 | Australia
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CORPORATE GOVERNANCE STATEMENT

CORPORATE GOVERNANCE

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

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

As at the date of this report and during the 2010 financial year, the Company complied with the requirements in the ASX Guidelines. This Corporate Governance Statement outlines the key aspects and mechanisms of the Company's governance framework, which was established, and is continually reviewed, by the Board.

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

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

BOARD OF DIRECTORS

Role of the Board/Directors

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

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

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

Composition of the Board

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

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

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

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

Relationship of Board with Management

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

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

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

Conflict of interest

In accordance with the Corporations Act 2001 and the Company's Constitution, Directors must keep the Board advised, on an ongoing basis, of any interest that could potentially conflict with those of the Company. Details of Director related entity transactions with the Company and Group entity are set out in Note 33.

Director dealings in Company shares

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

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

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

Related party transactions

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

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

Constitution

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

Independent professional advice and access to Company information

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

The role of shareholders

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

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

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

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

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

Audit and Risk Committee

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

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

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

Details of the amounts paid or payable to the auditor and its related practices for audit and non-audit services provided during the year are set out in the Directors' Report on page 34.

Remuneration and Nomination Committee

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

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

- regularly reviewing the executive remuneration policy of Eastern Star Gas Limited to ensure that it is clearly linked to the performance of Eastern Star Gas Limited and it motivates senior Executives to pursue both short term deliverables and long-term growth;
- reviewing all aspects of the remuneration (including base pay, incentive payments, equity awards, retirement rights and service contracts) and any proposed change to the terms of employment of the CEO and his or her direct reports;
- developing and reviewing appropriate succession plans for key Executives;
- reviewing the recruitment, retention and termination policies and procedures for senior Executives;
- reviewing the policy and any proposed changes regarding the remuneration of Non-Executive Directors;
- developing and implementing a policy for the selection and appointment of new Directors to the Board and overseeing any process regarding the search for a new Chief Executive Officer or Non-Executive Director;
- developing, implementing and disclosing procedures for evaluating the performance of the Board, its committees and individual Directors; and
- developing and implementing an induction procedure for new Directors.

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

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

INTERNAL CONTROL FRAMEWORK

The Board acknowledges that it is responsible for the overall internal control framework, but recognises that no cost effective internal control system will preclude all errors and

CORPORATE GOVERNANCE STATEMENT

(CONTINUED)

irregularities. The Board examines the adequacy of the nature, extent and effectiveness of the internal control processes of the Group entity on an ongoing basis and has instigated a control framework that can be described as follows.

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

ETHICAL STANDARDS

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

In maintaining its ethical standards, the Company:

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

CONTINUOUS REVIEW OF COUNCIL GUIDELINES

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

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 30 JUNE 2010

	Note	Consolidated 2010 $'000	2009 $'000
Continuing operations			
Revenue	4	3,282	2,365
Other Income	5	25	2,401
Expenses:			
Raw materials and consumables used		(488)	(263)
Exploration and evaluation expenditure written off		(183)	(109)
Well equipment written off		(24)	(184)
Depreciation and amortisation	6	(918)	(416)
Other	7	(8,241)	(6,313)
Total expenses		**(9,854)**	**(7,285)**
Loss before income tax expense		**(6,547)**	**(2,519)**
Income tax expense	8	–	–
Loss from continuing operations		(6,547)	(2,519)
Other comprehensive income		–	–
Total comprehensive loss attributable to members of the Parent entity		**(6,547)**	**(2,519)**
Basic/diluted loss per share (cents per share)	9	**(0.77)**	**(0.34)**

The above statements of comprehensive income should be read in conjunction with the accompanying notes.

BALANCE SHEETS

AS AT 30 JUNE 2010

	Note	Consolidated 2010 $'000	2009 $'000
Current assets			
Cash and cash equivalents	25(a)	31,586	59,568
Trade and other receivables	10	3,777	2,171
Well equipment		1,339	1,569
Total current assets		**36,702**	**63,308**
Non-current assets			
Other financial assets	11	2,649	2,169
Property, plant and equipment	12	9,044	8,609
Exploration and evaluation expenditure	13	122,597	76,318
Intangible assets	14	9,591	9,610
Total non-current assets		**143,881**	**96,706**
Total assets		**180,583**	**160,014**
Current liabilites			
Trade and other payables	15	4,293	4,470
Provisions	16	537	393
Total current liabilities		**4,830**	**4,863**
Non-current liabilities			
Trade and other payables	15	377	-
Provisions	16	1,876	1,398
Total non-current liabilities		**2,253**	**1,398**
Total liabilities		**7,083**	**6,261**
Net assets		**173,500**	**153,753**
Contributed equity	17	219,160	190,706
Reserves	18	7,531	9,691
Accumulated losses	19	(53,191)	(46,644)
Total equity		**173,500**	**153,753**

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

STATEMENTS OF CHANGES IN EQUITY

FOR THE YEAR ENDED 30 JUNE 2010

	Issued Capital $'000	Reserves $'000	Accumulated Losses $'000	Total $'000
Consolidated				
Balance at 1 July 2009	**190,706**	**9,691**	**(46,644)**	**153,753**
Total comprehensive loss attributable to members of the Parent Entity	–	–	(6,547)	(6,547)
Transactions with owners in their capacity as owners:				
Issue of shares	20,561	–	–	20,561
Issue of shares under Employee Incentive Plan	1,406	(312)	–	1,094
Option grants under Employee Incentive Plan	–	1,062	–	1,062
Exercise of options	6,548	(2,910)	–	3,638
Capital raising costs	(61)	–	–	(61)
Balance at 30 June 2010	**219,160**	**7,531**	**(53,191)**	**173,500**
Balance at 1 July 2008	**142,662**	**6,959**	**(44,125)**	**105,496**
Total comprehensive loss attributable to members of the Parent Entity	–	–	(2,519)	(2,519)
Transactions with owners in their capacity as owners:				
Issue of shares	50,000	–	–	50,000
Issue of shares under Employee Incentive Plan	45	(16)	–	29
Option grants under Employee Incentive Plan	–	2,838	–	2,838
Exercise of options	202	(90)	–	112
Capital raising costs	(2,203)	–	–	(2,203)
Balance at 30 June 2009	**190,706**	**9,691**	**(46,644)**	**153,753**

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

STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2010

	Note	Consolidated 2010 $'000	2009 $'000
Cash Flows from Operating Activities			
Receipts from customers		661	201
Payments to suppliers and employees		(9,402)	(5,490)
Interest received		1,870	1,749
Sundry receipts		663	419
Net Cash Outflow from Operating Activities	**25(b)**	**(6,208)**	**(3,121)**
Cash Flows from Investing Activities			
Payments for property, plant and equipment		(1,403)	(3,490)
Payments for exploration and evaluation		(43,896)	(25,040)
Payments for security deposits		(675)	(552)
Receipts for security deposits refunded		205	326
Lease incentive – proceeds received for incentive fit out		529	–
Loan to related Party		(1,764)	–
Proceeds from Farm-in Contribution		39	87
Payments for Farm-in exploration costs		(70)	(130)
Proceeds from sale of non-current assets		30	4,682
Proceeds from Joint Venturer's share of intangible assets acquired		–	1,332
Net cash outflow from investing activities		**(47,005)**	**(22,785)**
Cash Flows from Financing Activities			
Proceeds from issue of shares		25,292	50,141
Capital raising costs		(61)	(2,203)
Net Cash Inflow from Financing Activities		**25,231**	**47,938**
Net Increase (Decrease) in cash and cash equivalents		**(27,982)**	**22,032**
Cash and cash equivalents at the beginning of the financial year		59,568	37,536
Cash and cash equivalents at the end of the Financial Year	**25(a)**	**31,586**	**59,568**

The above statements of cash flows should be read in conjunction with the accompanying notes.

NOTE 1 — BASIS OF PREPARATION

These general purpose financial statements have been drawn up in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board (including the Australian Interpretations) and the Corporations Act 2001.

The financial statements include financial statements for Eastern Star Gas Limited consisting of Eastern Star Gas Limited and its subsidiaries.

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

(a) Basis of measurement

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

(b) Compliance with IFRS

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

(c) New Accounting Standards and Interpretations

(i) The Group has adopted the new accounting standards coming into effect in the financial year.

AASB 8 Operating Segments effective 1 January 2009.

AASB 101 Presentation of Financial Statements (Amended) effective 1 January 2009

AASB 3 Business Combinations(Amended) effective 1 January 2009

AASB 127 Consolidated and Separate Financial Statements (Amended) effective 1 January 2009

AASB 2008 –1 Amendments to Australian Accounting Standards – Share-based Payments: Vesting Conditions and Cancellations effective 1 January 2009

AASB 2008 –7 Amendments to Australian Accounting Standards – Cost of an Investment in a subsidiary, Jointly Controlled Entity or Associate effective 1 January 2009

When the adoption of the Standard or Interpretation is deemed to have an impact on the financial statements or performance of the Group, its impact is described below:

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

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

The introduction of AASB 101 (amended) did not have a material impact on the amounts presented within the financial statements but it resulted in a substantial change in the presentation and terminology of the primary financial statements.

AASB 2008 -1 clarifies that vesting conditions comprise service conditions and performance conditions only and that other features of a share-based payment transaction are not vesting conditions. It also specify that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

Adoption of the revised AASB 2008 –1 did not result in a change in accounting policy for the entity as AASB 2008 –1 only clarifies an existing treatment the entity had already complied with.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010 (CONTINUED)

NOTE 1 — BASIS OF PREPARATION (continued)

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

Australian Accounting Standards and Interpretation	Effective for annual reporting periods beginning on or after
AASB 9 Financial Instruments	*1 Jan 2013*
AASB 1053 Application of Tiers of Australian Accounting Standards	*1 Jul 2013*
2009 – 5 Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 5, 8, 101, 107, 117, 118, 136 & 139]	*1 Jan 2010*
2009 – 8 Amendments to Australian Accounting Standards – Group Cash-settled Share-based Payment Transactions [AASB 2]	*1 Jan 2010*
2009 – 10 Amendments to Australian Accounting Standards – Classification of Rights Issues [AASB 132]	*1 Feb 2010*
2009 – 12 Amendments to Australian Accounting Standards [AASBs 5, 8, 108, 110, 112, 119, 133, 137, 139, 1023 & 1031 and Interpretations 2, 4, 16, 1039 & 1052]	*1 Jan 2011*
2010 – 2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements	*1 Jul 2013*
2010 – 3 Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 3, AASB 7, AASB 121, AASB 128, AASB 131, AASB 132 & AASB 139]	*1 Jul 2010*
2010 – 4 Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 1, AASB 7, AASB 101 & AASB 134 and Interpretation 13]	*1 Jul 2011*

AASB 9 Financial Instruments

AASB 9 includes requirements for the classification and measurement of financial assets resulting from the first part of Phase 1 of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement (AASB 139 Financial Instruments: Recognition and Measurement). These requirements improve and simplify the approach for classification and measurement of financial assets compared with the requirements of AASB 139. The IASB plans to complete its work on financial liabilities during 2010 and will issue requirements for financial liabilities that will be included in AASB 9 in due course.

The main changes from AASB 139 are described below.

(a) Financial assets are classified based on (a) the objective of the entity's business model for managing the financial assets; and (b) the characteristics of the contractual cash flows. This replaces the numerous categories of financial assets in AASB 139, each of which had its own classification criteria. Application guidance has been included in AASB 9 on how to apply the conditions necessary for amortised cost measurement.

(b) AASB 9 allows an irrevocable election on initial recognition to present gains and losses on investments in equity instruments that are not held for trading in other comprehensive income. Dividends in respect of these investments that are a return on investment can be recognised in profit or loss and there is no impairment or recycling on disposal of the instrument.

(c) Financial assets can be designated and measured at fair value through profit or loss at initial recognition if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases.

(d) Hybrid contracts with financial asset hosts are classified and measured in their entirety in accordance with the classification criteria. Embedded derivative assets that are separated from financial liability or non-financial hosts in accordance with AASB 139 are to be accounted for in accordance with AASB 9.

(e) Investments in unquoted equity instruments (and contracts on those investments that must be settled by delivery of the unquoted equity instrument) must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value.

(f) Investments in contractually linked instruments that create concentrations of credit risk (tranches) are classified and measured using a 'look through' approach. Such an approach looks to the underlying assets generating cash flows and assesses the cash flows against the classification criteria (discussed in (a) above) to determine whether the investment is measured at fair value or amortised cost.

(g) Financial assets are reclassified when there is a relevant change in the entity's business model changes.

AASB 1053 Application of Tiers of Australian Accounting Standards

This Standard establishes a differential financial reporting framework consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

(a) Tier 1: Australian Accounting Standards; and

(b) Tier 2: Australian Accounting Standards – Reduced Disclosure

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

The following entities apply Tier 1 requirements in preparing general purpose financial statements:

(a) for-profit entities in the private sector that have public accountability (as defined in this Standard); and

(b) the Australian Government and State, Territory and Local Governments.

The following entities apply either Tier 2 or Tier 1 requirements in preparing general purpose financial statements:

(a) for-profit private sector entities that do not have public accountability;

(b) all not-for-profit private sector entities; and

(c) public sector entities other than the Australian Government and State, Territory and Local Governments.

Public accountability means accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs. A for-profit private sector entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

AASB 2009-5 Amendments Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 5, 8, 101, 107, 117, 118, 136 & 139]

AASB 2009-5 results from the International Accounting Standards Board's annual improvements project. The annual improvements project provides a vehicle for making non-urgent but necessary amendments to accounting standards.

The amendments to some Standards result in accounting changes for presentation, recognition or measurement purposes, while some amendments that relate to terminology and editorial changes are expected to have no or minimal effect on accounting. The subjects of the principal amendments to the Standards are set out in the preface to the standard.

AASB 2009-8 Amendments to Australian Accounting Standards – Group Cash-settled Share-based Payment Transactions [AASB 2]

AASB 2009-8 clarifies the scope of AASB 2 by requiring an entity that receives goods or services in a share-based payment arrangement to account for those goods or services no matter which entity in the group settles the transaction, and no matter whether the transaction is settled in shares or cash.

The amendments incorporate the requirements previously included in Interpretation 8 and Interpretation 11 and as a consequence these two Interpretations are superseded by the amendments.

AASB 2009-10 Amendments to Australian Accounting Standards – Classification of Rights Issues [AASB 132]

The amendments clarify that rights, options or warrants to acquire a fixed number of an entity's own equity instruments for a fixed amount in any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all existing owners of the same class of its own non-derivative equity instruments.

AASB 2009-12 Amendments to Australian Accounting Standards [AASBs 5, 8, 108, 110, 112, 119, 133, 137, 139, 1023 & 1031 and Interpretations 2, 4, 16, 1039 & 1052]

The amendment to AASB 8 requires an entity to exercise judgement in assessing whether a government and entities known to be under the control of that government are considered a single customer for the purposes of certain operating segment disclosures.

This Standard also makes numerous editorial amendments to a range of Australian Accounting Standards and Interpretations, including amendments to reflect changes made to the text of IFRSs by the IASB.

These amendments have no major impact on the requirements of the amended pronouncements.

AASB 2010-2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements

This Standard gives effect to Australian Accounting Standards – Reduced Disclosure Requirements. AASB 1053 provides further information regarding the differential reporting framework and the two tiers of reporting requirements for preparing general purpose financial statements.

AASB 2010-3 Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 3, AASB 7, AASB 121, AASB 128, AASB 131, AASB 132 & AASB 139]

The subjects of the principal amendments to the Standards are set out below:

AASB 3 Business Combinations

- Measurement of non-controlling interests
- Unreplaced and voluntarily replaced share-based payment awards
- Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised AASB 3 (2008)

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010 (CONTINUED)

NOTE 1 — BASIS OF PREPARATION (continued)

AASB 2010-4 Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 1, AASB 7, AASB 101 & AASB 134 and Interpretation 13]

The subjects of the principal amendments to the Standards are set out below:

AASB 1 First-time Adoption of Australian Accounting Standards

- Accounting policy changes in the year of adoption
- Revaluation basis as deemed cost
- Use of deemed cost for operations subject to rate regulation

AASB 7 Financial Instruments: Disclosures

- Clarification of disclosures

AASB 101 Presentation of Financial Statements

- Clarification of statements of changes in equity

AASB 134 Interim Financial Reporting

- Significant events and transactions

Interpretation 13 Customer Loyalty Programmes

- Fair value of award credits

(d) Comparative figures

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

(e) Financial Statements Presentation

The Group has applied the revised AASB101 Presentation of Financial Statements which became effective on 1 January 2009. The revised standard requires the separate presentation of a statements of comprehensive income and a statements of changes in equity. All non owner changes in equity must now be presented in the statements of comprehensive income. As a consequence, the company has had to change the presentation of its financial statements.

(f) Critical estimates and judgements

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

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

(i) Exploration and evaluation

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

The carrying amount of exploration and evaluation expenditure is disclosed in Note 13.

(ii) Provision for restoration

The Group estimates the future removal and restoration costs of gas, wells, pipelines and related assets at the time of installation of the assets. In most instances the removal of these assets will occur many years in the future. The estimate of future removal costs therefore requires management to make judgements regarding the removal date, future environmental legislation, the extent of restoration activities required and future removal technologies. The carrying amount of the provision for restoration is disclosed in Note 16.

(iii) Impairment of oil and gas assets

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

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(i) Principles of consolidation

Subsidiaries

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

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

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

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

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

Jointly controlled assets

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

Investment in associates

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

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

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

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

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

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

(ii) Operating cycle

An operating cycle of 12 months has been used as the basis for identifying current assets and current liabilities in the balance sheets

(iii) Revenue recognition

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

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

(iv) Borrowing costs

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

(v) Foreign currency translations

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

(vi) Income tax

AIFRS Accounting Standard AASB 112 has been applied by the Group for the year. However, the Standard permits the Group to not recognise the net benefit of tax losses and temporary differences in the accounts as assets after liabilities until there is sufficient probability that the Parent and the Subsidiaries will derive sufficient income in the forseeable future on a sustainable basis. For the current year the deferred tax assets at 30 June 2010 are recognised only to the extent of the quantum of deferred tax liabilities.

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

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

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

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

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

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

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Australian Tax Consolidation Legislation

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

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

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

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

Petroleum Resource Rent Tax

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

(vii) Cash and cash equivalents

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

(viii)Trade and other receivables

Trade and other receivables represent the principal amounts due at balance date plus accrued interest and less, where applicable, any unearned income and provisions for doubtful accounts. Trade receivables are normally collectible within 30 days.

(ix) Impairment of assets

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

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

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

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

(x) Well equipment

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

(xi) Property, plant and equipment

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

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

The power plant and the pipeline are depreciated on a unit of production basis over the useful life (12 – 15 years) of the gas fields that supply the power plant and use the pipeline, determined by reference to estimated proved and probable reserves.

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

For personal use only

(xii) Exploration and evaluation expenditure

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

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

(b) one of the following conditions is met:

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

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

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

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

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

(xiii) Development and producing expenditure

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

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

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

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

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

(xiv) Restoration and rehabilitation obligations

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

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

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

(xv) Trade and other payables

Trade payables represent the principal amounts outstanding at balance date plus, where applicable, any accrued interest. The carrying amounts of accounts payable approximate net fair values. The amounts are unsecured and are usually paid within 30 days of recognition.

(xvi) Financial instruments

Loans and receivables

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

Impairment of financial assets

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

Financial liabilities

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

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(xvii) Convertible notes

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

(xviii) Converting notes

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

(xix) Earnings per share

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

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

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

(xx) Employee benefits

Wages, salaries and annual leave

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

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

Long service leave

Long service leave is recognised in the provision for employee benefits and measured at the present value of expected future payments to be made in respect of services provided by employees at the reporting date using the projected unit credit method by taking into account the expected rates of salary increases.

Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity that match closest to the estimated future cash outflows.

(xxi) Leases

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

(xxii) Goods and Services Tax (GST)

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

(xxiii) Rounding of amounts

The Company and Group is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that class order all financial information in the financial report has been rounded to the nearest one thousand dollars unless otherwise stated.

(xxiv) Business combinations

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

(xxv) Share-based payment transactions

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

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

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

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

The charge to the statements of comprehensive income for the period is the cumulative amount as calculated above less the amounts already charged in previous periods. There is a corresponding credit to equity. The Group offers interest free loans to employees and contractors (including Directors) for terms of up to five years under the EIP for subscription of shares and under such loans the Parent Entity holds a lien over the issued shares. The employee has no obligation to pay for the outstanding loan. The shares issued under the plan rank pari passu with other issued ordinary shares and are not listed while there are loans outstanding on the subscription of the shares.

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

(xxvi) Intangible assets

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

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

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

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

(xxvii) Segment reporting

The Group has applied the revised AASB 8 Operating Segments from 1 July 2009. AASB 8 disclosures are shown in Note 3. AASB 8 requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes. This has resulted in a change of reportable segments presented. The information reported for each segment has also changed and comparative amounts are now reported on a consistent basis with the current period.

Operating segments are now reported in a manner that is more consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker has been identified as the board of directors, Chief Executive Officer and Chief Financial Officer that collectively make strategic decisions.

Description of Segments

Business segments

The Group undertakes the activities of exploration, development and production of coal seam gas and the sale of electricity generated form that gas. The Board has therefore identified the following reportable segments:

Coal Seam Gas

Consists of exploration, development and production of coal seam gas within Australia. The Board monitors capital expenditure and operating costs in Australia and has assessed the risks associated with operations and the economic characteristics to be similar across state borders and as such all coal seam gas operations within Australia are considered to be one segment.

Electricity Generation

Generation and distribution of electricity produced at Wilga Park Power Station using Pilot gas and sold under a long term contract.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010 (CONTINUED)

NOTE 3 — OPERATING SEGMENTS

(a) Description of segments

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

Management has determined the operating segments based on the reports reviewed by the board of directors that are used to make strategic decisions. Management has identified two reportable segments consisting of Coal Seam Gas and Electricity Generation.

(b) Segment information provided to the board of directors

The segment information provided to the board of directors for the reportable segments for the year ended 30 June 2010 is as follows:

	Coal Seam Gas $'000	Electricity Generation $'000	Other Unallocated/ Eliminations $'000	Total $'000
2010				
Revenue				
Sales to external customers	–	628	–	628
Other revenue from external customers	2	–	2	4
Unallocated revenue	–	–	2,300	2,300
Total segment revenue	**2**	**628**	**2,302**	**2,932**
Adjusted EBITDA	**–**	**100**	**(7,638)**	**(7,538)**
Depreciation and amortisation	(166)	(275)	(477)	(918)
Total segment assets	**13,670**	**(6,806)**	**173,719**	**180,583**
Total assets includes:				
Investments in associates and joint venture partnership	411	3,365	(3,776)	–
Addition to:				
– Property, plant and equipment	157	491	666	1,314
– Exploration and evaluation expenditure	44,344	–	2,663	47,007
Total segment liabilities	**5,410**	**134**	**1,539**	**7,083**

	Coal Seam Gas $'000	Electricity Generation $'000	Other Unallocated/ Eliminations $'000	Total $'000
2009				
Revenue				
Sales to external customers	–	158	–	158
Other revenue from external customers	–	–	124	124
Unallocated revenue	–	–	645	645
Total segment revenue	**–**	**158**	**769**	**927**
Adjusted EBITDA	**–**	**(251)**	**(5,229)**	**(5,480)**
Depreciation and amortisation	(108)	(7)	(301)	(416)
Segment assets	**11,540**	**(6,736)**	**155,210**	**160,014**
Total assets includes:				
Investments in associates and joint venture partnership	411	3,365	(3,776)	–
Addition to:				
– Property, plant and equipment	1,903	1,414	26	3,343
– Exploration and evaluation expenditure	26,521	–	1,441	27,962
Segment liabilities	**4,291**	**60**	**1,910**	**6,261**

(i) Segment revenue reconciliation to the statements of comprehensive income

Segment revenue reconciles to total revenue from continuing operations as follows:

	Consolidated 2010 $'000	2009 $'000
Total segment revenue	2,932	927
Intersegment revenue elimination	(1,494)	(419)
Other revenue from continuing activities	1,844	1,857
Total revenue from continuing operations	**3,282**	**2,365**

(ii) Segment assets reconciliation to the balance sheets

Reportable segments' assets are reconciled to total assets as follows:

	Consolidated 2010 $'000	2009 $'000
Segment operating assets	188,270	165,488
Intersegment eliminations	(7,687)	(5,474)
Total assets per balance sheets	**180,583**	**160,014**

NOTE 3 — OPERATING SEGMENTS (continued)

(iii) Segment liabilities reconciliation to the balance sheets

Reportable segments' liabilities are reconciled to total liabilities as follows:

	Consolidated 2010 $'000	Consolidated 2009 $'000
Segment operating liabilities	5,693	5,514
Intersegment eliminations	(1,023)	(1,044)
Provisions	2,413	1,791
Total liabilities per balance sheets	**7,083**	**6,261**

(iv) Adjusted EBITDA

A reconciliation of adjusted EBITDA to operating loss before income tax is provided as follows:

	Consolidated 2010 $'000	Consolidated 2009 $'000
Adjusted EBITDA	(7,538)	(5,480)
Intersegment eliminations	(1,332)	(830)
Interest revenue	1,844	1,857
Legal expenses	(657)	(234)
Share-based payments	(275)	(998)
Depreciation	(918)	(416)
Other	2,329	3,582
Loss before income tax from continuing operations	**(6,547)**	**(2,519)**

NOTE 4 — REVENUE

	Consolidated 2010 $'000	Consolidated 2009 $'000
Sales revenue	628	158
Interest from other persons	1,844	1,857
Other	810	350
	3,282	**2,365**

NOTE 5 — OTHER INCOME

	Consolidated 2010 $'000	Consolidated 2009 $'000
Net gain on sale of assets	25	2,401
	25	**2,401**

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

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

Details of the sale are as follows:

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

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

NOTE 6 – DEPRECIATION AND AMORTISATION

	Consolidated	
	2010 $'000	2009 $'000
Depreciation	873	375
Amortisation of intangible assets	45	41
	918	**416**

NOTE 7 – OTHER EXPENSES

	Consolidated	
	2010 $'000	2009 $'000
Loss before income tax includes the following specific expenses:		
Rental on operating leases	1,211	571
Employees costs	2,468	2,209
Provision for employee entitlements	201	210
Audit fees	99	160
Corporate services	1,802	1,088
Members' services	335	415
Directors' Fees	250	237
IT Services	182	167
Travel Costs	573	317
Communication Costs	201	137
Software Maintenance Costs	72	147
Office Supplies	169	140
Other	678	515
	8,241	**6,313**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010 (CONTINUED)

NOTE 8 — INCOME TAX

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

	Consolidated	
	2010 $'000	2009 $'000
(a) Income tax expense		
Current tax		
Current income tax charged	–	–
– (Increase) in deferred tax assets*	(26,174)	(16,300)
– Decrease in deferred tax liabilities*	26,174	16,300
Income Tax expense reported in the statements of comprehensive income	**–**	**–**

* *see note (c)*

(b) Numerical reconciliation of income tax expense to prima facie tax payable is as follows:

	2010 $'000	2009 $'000
Loss from operations before income tax	(6,547)	(2,519)
Tax at Australian tax rate of 30% (2009: 30%)	(1,964)	(756)
Entertainment expenses non deductible	3	7
Employee share option plan costs non deductible	83	299
Reversal of provisions and equity accounting losses	–	–
Legal expenses non deductible	4	–
Tax effect of equity raising costs debited to equity	(326)	(345)
Tax effect of tax losses and temporary differences not recognised	2,200	795
Income tax expense	**–**	**–**

(c) Deferred tax assets and liabilities

	Consolidated 2010 $'000	2009 $'000
(i) Deferred tax assets		
The balance comprises temporary differences attributable to:		
Provisions for rehabilitation	1,730	1,308
Accrual of costs not yet incurred	100	70
Provisions for employee leave entitlements	683	482
Legal costs	114	100
Overriding royalties	–	114
Tax losses carried forward	140,160	99,691
Share issue costs	2,204	3,227
Gross deferred tax assets	**144,991**	**104,992**
Total potential tax benefit at 30%	**43,497**	**31,498**
Amounts recognised during the year and set-off of deferred tax liabilities pursuant to set-off provisions (note c (ii))	(26,174)	(16,300)
Net potential deferred tax assets*	17,323	15,198
(ii) Deferred tax liabilities		
The balance comprises temporary differences attributable to:		
Consumables	1,339	1,569
Prepayments	15	62
Interest receivable	121	164
Borrowing costs	436	436
Black hole costs	4,350	1,328
– accelerated deductions	80,987	50,775
Others	–	–
Gross deferred tax liabilities	87,248	54,334
Total potential tax liability at 30%	**26,174**	**16,300**
Amounts recognised during the year and set-off of deferred tax assets pursuant to set-off provisions (note c (i))	(26,174)	(16,300)
Net potential deferred tax liabilities*	–	–

* *The net potential deferred tax asset in respect of unused losses and temporary differences of $57,743,000 (2009: $50,658,000) has not been recognised.*

NOTE 9 — BASIC/DILUTED LOSS PER SHARE

	Consolidated 2010	Consolidated 2009
Operating loss after income tax used in the calculation of basic loss per share	(6,478)	(2,519)
Weighted average number of ordinary shares outstanding during the year used in the calculation of basic loss per share*	855,289,138	751,235,988
Basic/diluted loss per share (cents per share)	(0.77)	(0.34)

* *32,475,000 (2009: 37,525,000) options granted under the Eastern Star Gas Limited Employee Incentive Plan are not included in the calculation of diluted earnings per share because they are antidilutive for the year ended 30 June 2010. These options could potentially dilute basic earnings per share in the future.*

NOTE 10 — TRADE AND OTHER RECEIVABLES (CURRENT)

	Consolidated 2010 $'000	Consolidated 2009 $'000
Trade receivables	515	566
Interest receivable	128	164
Other receivables	2,927	1,249
Prepayments	207	192
	3,777	**2,171**

NOTE 11 — OTHER FINANCIAL ASSETS

	Consolidated 2010 $'000	Consolidated 2009 $'000
Performance bonds (indemnity guarantees)	2,649	2,169
	2,649	**2,169**

NOTE 12 — PROPERTY, PLANT AND EQUIPMENT

	Consolidated 2010 $'000	2009 $'000
Leasehold improvements	809	339
Accumulated amortisation	(398)	(108)
	411	231
Buildings	539	516
Accumulated depreciation	(23)	(2)
	516	514
Power plant expansion under construction	–	2,666
Land at cost	149	230
Disposal	–	(1)(81)
	149	149
Plant, equipment and motor vehicles at cost	2,272	1,930
Disposal	(6)	(1)(13)
Accumulated depreciation	(1,220)	(927)
	1,046	990
Power plant	6,969	5,910
Disposal	–	(1)(1,719)
Accumulated depreciation	(915)	(1,000)
	6,054	3,191
Pipeline	1,252	1,926
Disposal	–	(1)(468)
Accumulated depreciation	(384)	(590)
	868	868
	9,044	**8,609**
Movements during the year:		
Leasehold improvement		
At beginning of year	231	422
Additions at cost	470	(83)
Amortisation expense	(290)	(108)
At end of year	411	231
Buildings		
At beginning of year	514	199
Additions at cost	23	317
Depreciation expense	(21)	(2)
At end of year	516	514

NOTE 12 — PROPERTY, PLANT AND EQUIPMENT (continued)

	Consolidated 2010 $'000	2009 $'000
Power plant expansion under construction		
At beginning of year	2,666	–
Transfer to Power Plant	(2,666)	2,666
At end of year	**–**	**2,666**
Land		
At beginning of year	**149**	**230**
Additions at cost	–	–
Disposal	–	[1](81)
At end of year	**149**	**149**
Plant and equipment and motor vehicles		
At beginning of year	990	824
Additions at cost	360	443
Disposal	(6)	(13)
Depreciation expense	(298)	[1](264)
At end of year	**1,046**	**990**
Power Plant		
At beginning of year	3,191	4,910
Transfer from Power Plant under construction	2,666	–
Additions at cost	461	–
Disposal	–	[1](1,719)
Depreciation expense	(264)	–
At end of year	**6,054**	**3,191**
Pipeline		
At beginning of year	868	1,336
Disposal	–	[1](468)
At end of year	**868**	**868**
Total		
At beginning of year	8,609	7,921
Additions at cost	1,314	3,343
Disposal	(6)	[1](2,281)
Depreciation and amortisation expense	(873)	(374)
	9,044	**8,609**

[1] *Disposal of Property, plant and equipment amounting $2,281,000 related to sale of a 35% interest in the Wilga Park Power station assets and Petroleum Production Licence 3 assets. See Note 5 for further details.*

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NOTE 13 — EXPLORATION AND EVALUATION EXPENDITURE

	Consolidated 2010 $'000	2009 $'000
Tangible	9,412	5,922
Intangible	113,185	70,396
	122,597	76,318
Movements during the year:		
Tangible		
At beginning of year	5,922	3,019
Additions at cost	4,035	3,145
Depreciation charge	(545)	(242)
At end of year	**9,412**	**5,922**
Intangible		
At beginning of year	70,396	45,688
Additions at cost	42,972	24,817
Amount written off during the year	(183)	(109)
At end of year	**113,185**	**70,396**

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

NOTE 14 — INTANGIBLE ASSETS

	Consolidated 2010 $'000	2009 $'000
Royalty interests	9,359	9,359
Software	330	304
Amortisation	(98)	(53)
At end of year	232	251
Total	**9,591**	**9,610**
Software		
At beginning of year	251	210
Additions at cost	26	83
Amortisation	(45)	(42)
At end of year	**232**	**251**

The overriding royalty interests were capitalised once 185 PJ of Proved and Probable (2P) reserves were certified in PEL 238. The remaining overriding royalty at 30 June 2010 is 0.855%. Amortisation will be charged once production of gas commences from PEL 238.

Software is amortised at 14.28% p.a.

NOTE 15 — TRADE AND OTHER PAYABLES

	Consolidated 2010 $'000	Consolidated 2009 $'000
Trade payables	2,399	2,533
Accruals	1,814	732
Other payables	80	1,205
	4,293	4,470
Non-current		
Other payables	377	–
	377	**–**

(a) Ageing Analysis of Trade Payables

The ageing analysis of trade payables that are past due as at 30 June 2010 but not impaired is as follows:

	0 - 30 days $'000	31 - 60 days $'000	61 - 90 days $'000	+ 90 days $'000	Total $'000
2010					
Consolidated	2,395	37	(3)	(30)	2,399
2009					
Consolidated	2,336	165	32	–	2,533

NOTE 16 — PROVISIONS

	Consolidated 2010 $'000	Consolidated 2009 $'000
Provisions (Current)		
Employee entitlements	537	393
Provisions (Non-current)		
Employee entitlements	146	89
Restoration and rehabilitation	1,730	1,309
	1,876	1,398
Employee entitlements		
At beginning of year	89	40
Arising during the year	57	49
Utilised during the year	–	–
At end of year	146	89
Provision for restoration and rehabilitation		
At beginning of year	1,309	783
Arising during the year	421	526
At end of year	**1,730**	**1,309**

There were 52 (2009 – 38) employees during the year.

These provisions have been provided in accordance with the accounting policies described in 2 (xiv) and (x).

NOTE 17 — CONTRIBUTED EQUITY

	Consolidated 2010 $'000	2009 $'000
(a) Issued capital		
Balance at beginning of year:		
816,384,793 listed fully paid ordinary shares (2008 – 724,575,702)	190,706	142,662
Exercise 24,250,000 options at 15 cents each		
– 23,695,614 shares in July 2009	3,554	–
– 529,386 shares in August 2009	80	–
– 25,000 shares in September 2009	4	–
– Option reserve relating to the issue	2,910	–
Loan repayment for 7,400,000 shares under employee incentive plan in August, September 2009 and April 2010		
– 300,000 shares at 12 cents	36	–
– 1,050,000 shares at 13.5 cents	142	–
– 6,000,000 shares at 15 cents	900	–
– 50,000 shares at 32 cents	16	–
– Exercise of option grant on share-based payments	312	–
Issue of 24,189,629 shares at 85 cents each under share purchase plan	20,561	–
Issue of 750,000 shares in November 2008		
– 750,000 shares at 15 cents each	–	112
– Option reserve relating to the issue	–	90
150,000 shares under employee incentive plan in January 2009		
– 100,000 shares at 13.5 cents	–	13
– 50,000 shares at 32 cents	–	16
– exercise of option grant on share-based payments	–	16
90,909,091 shares at 55 cents each by private placement in March 2009	–	50,000
Less: Transaction costs arising on share issues	(61)	(2,203)
872,224,422 listed fully paid ordinary shares (2009 – 816,384,793)	**219,160**	**190,706**

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

NOTE 18 — RESERVES

	Consolidated 2010 $'000	2009 $'000
Options reserve		
At beginning of year	2,910	3,000
Exercise of options	(2,910)	(90)
At end of year	–	2,910
Share-based payments reserve		
At beginning of year	6,781	3,959
Issue of shares under Employee Incentive Plan	(312)	(16)
Option grants under the Employee Incentive Plan	1,062	2,838
At end of year	7,531	6,781
Total reserves		
At beginning of year	9,691	6,959
Exercise of options	(2,910)	(90)
Issue of shares under Employee Incentive Plan	(312)	(16)
Option grants under the Employee Incentive Plan	1,062	2,838
At end of year	7,531	9,691

(a) Options

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

Expiry Date	Exercise Price $	2010 Number	2009 Number
30 October 2009 (1)	0.15	–	24,250,000
		–	**24,250,000**

(1) In October 2006, the Parent Entity issued 25,000,000 options at 15 cents each in addition to cash, shares and converting notes for acquiring of Hillgrove Energy Pty Limited, each option exercisable for one share on or before 30 October 2009. During the year 24,250,000 (2009: 750,000) options were exercised at 15 cents each.

NOTE 19 — ACCUMULATED LOSSES

	Consolidated 2010 $'000	2009 $'000
Accumulated losses at beginning of financial year	46,644	44,125
Net loss attributable to members of the Parent Entity	6,547	2,519
Accumulated losses at end of financial year	**53,191**	**46,644**

NOTE 20 — SUBSIDIARIES

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

	Percentage Owned 2010 %	Percentage Owned 2009 %
The Subsidiaries are as follows:		
Narrabri Energy Limited	100	100
Eastern Energy Australia Pty Limited	100	100
Tooncomet Pty Limited	100	100
Sulu Resources Pty Limited	100	100
Narrabri Power Limited	100	100
Hillgrove Energy Pty Limited	100	100
Eastern Star Gas Operations Pty Limited	100	100
Betel Gas Pty Limited	100	100

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

NOTE 21 — INTERESTS IN JOINT VENTURES

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

	Eastern Star Gas Share 2010 %	Eastern Star Gas Share 2009 %
PEL 238 Narrabri Coal Seam Gas Joint Venture, Gunnedah Basin, NSW	65	65
Wilga Park Power Station Joint Venture	65	65
PELs 433 and 434 Coal Seam Gas Joint Venture, Gunnedah Basin, NSW	65	100
PEL 6 Coal Seam Gas Joint Venture, Bowen/Surat Basin, NSW	75	–

NOTE 21 — INTERESTS IN JOINT VENTURES (continued)

The Group's net assets and net profits employed in the joint venture are included in the Consolidated Balance Sheets and Statements of Comprehensive Income are as follows:

	PEL 238 Narrabri Coal Seam Gas Joint Venture, Gunnedah Basin, NSW $'000	Wilga Park Power Station Joint Venture $'000	PELs 433 and 434 Coal Seam Gas Joint Venture, Gunnedah Basin, NSW $'000	PEL 6 Coal Seam Gas Joint Venture, Bowen/Surat Basin, NSW $'000	Total $'000
2010					
Current assets					
Cash and cash equivalents	3,650	904	599	–	5,153
Trade and other receivables	670	82	40	7	799
Well equipment	1,218	–	41	–	1,259
Total current assets	**5,538**	**986**	**680**	**7**	**7,211**
Non-current assets					
Property, plant and equipment	2,036	6,252	–	–	8,288
Exploration and evaluation expenditure	92,961	–	704	426	94,091
Total non-current assets	**94,997**	**6,252**	**704**	**426**	**102,379**
Total assets	**100,535**	**7,238**	**1,384**	**433**	**109,590**
Current liabilities					
Trade and other payables	3,620	100	491	433	4,644
Net assets	**96,915**	**7,138**	**893**	**–**	**104,946**
Revenue	**262**	**637**	**4**	**–**	**903**
Other income	**8**	**–**	**–**	**–**	**8**
	270	**637**	**4**	**–**	**911**
Expenses					
Raw materials and consumables used	–	(507)	–	–	(507)
Depreciation and amortisation	(166)	(275)	–	–	(441)
Total expenses	**(166)**	**(782)**	**–**	**–**	**(948)**
Profit/(loss) before income tax expense	**104**	**(145)**	**4**	**–**	**(37)**
Income tax expense	–	–	–	–	–
Net loss attributable to members of the Parent entity after income tax expense	104	(145)	4	–	(37)

	PEL 238 Narrabri Coal Seam Gas Joint Venture, Gunnedah Basin, NSW $’000	Wilga Park Power Station Joint Venture $’000	PELs 433 and 434 Coal Seam Gas Joint Venture, Gunnedah Basin, NSW $’000	PEL 6 Coal Seam Gas Joint Venture, Bowen/Surat Basin, NSW $’000	Total $’000
2009					
Current assets					
Cash and cash equivalents	844	660	–	–	1,504
Trade and other receivables	1,176	98	–	–	1,274
Well equipment	1,456	-	–	–	1,456
Total current assets	**3,476**	**758**	**–**	**–**	**4,234**
Property, plant and equipment	2,052	6,025	–	–	8,077
Exploration and evaluation expenditure	52,818	–	–	–	52,818
Total non-current assets	**54,870**	**6,025**	**–**	**–**	**60,895**
Total assets	**58,346**	**6,783**	**–**	**–**	**65,129**
Trade and other payables	3,636	25	–	–	3,661
Net assets	**54,710**	**6,758**	**–**	**–**	**61,468**
Revenue	**187**	**71**	**–**	**–**	**258**
Expenses					
Raw materials and consumables used	–	(320)	–	–	(320)
Depreciation and amortisation	(108)	(7)	–	–	(115)
Total expenses	**(108)**	**(327)**	**–**	**–**	**(435)**
Profit/(loss) before income tax expense	**79**	**(256)**	**–**	**–**	**(177)**
Income tax expense	–	–	–	–	–
Net loss attributable to members of the Parent entity after income tax expense	79	(256)	–	–	(177)

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010 (CONTINUED)

NOTE 22 — INVESTMENT IN ASSOCIATE

(a) Investment details

The Group has a 23.1% ownership interest in Orion Petroleum Limited (2009: 23.1%), a company involved in the exploration and evaluation of oil and gas.

The associate is incorporated and domiciled in Australia.

(b) Fair value of listed investment in associate

The market value of the Group's investment in associate is $1,680,250 (2009: $3,003,000)

(c) Summarised financial information

Extract from the associate's balance sheets:*

	Consolidated 2010 $'000	Consolidated 2009 $'000
Current assets	10,448	13,092
Non-current assets	1,704	1,857
	12,152	14,949
Current liabilities	(1,997)	(203)
Net assets	10,155	14,746
Extract from the associate's statements of comprehensive income:*		
Revenue	533	891
Expenses	(5,165)	(5,622)
Net loss	(4,632)	(4,731)

* *Based on unaudited Management Accounts at 30 June 2010.*

(d) Group's share of associate's profits accounted for using the equity method:

	2010	2009
Loss before income tax	–	–
Income tax expense	–	–
Loss after income tax	–	–

The total unrecognised share of losses of the associate for the period was $1,069,000 (2009: $1,093,000) and cumulatively was $2,592,000(2009: $1,522,000).

NOTE 23 — REMUNERATION OF AUDITORS

	Consolidated 2010 $'000	Consolidated 2009 $'000
Audit and review of financial statements	98,730	159,860
	98,730	**159,860**

NOTE 24 — FINANCIAL RISK MANAGEMENT

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

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

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

(a) Cashflow and fair value interest rate risk

All of the Group's financial instruments are either non-interest bearing or bear interest at commercial interest rates. The weighted average interest rate on cash and short-term deposits at 30 June 2010 was 4.16% (2009: 3.11%). The weighted average interest rate on other financial assets at 30 June 2010 was 4.93% (2009: 3.85%). All receivables and payables are non-interest bearing. The Group's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market, interest rates and the effective weighted average interest rates on those financial assets, is set out below:

	Average Interest Rate %	Variable Interest Rate $'000	Fixed Interest Rate Maturing Within 1 Year $'000	Fixed Interest Rate Maturing 1 to 5 Years $'000	Non-Interest Bearing $'000	Total $'000
Consolidated						
2010						
Financial assets						
Cash and cash equivalents	4.16	4,882	26,704	–	–	31,586
Trade and other receivables	–	–	–	–	3,570	3,570
Other financial assets	4.93	–	2,613	–	36	2,649
	–	**4,882**	**29,317**	**–**	**3,606**	**37,805**
Financial liabilities						
Trade and other payables	–	–	–	–	4,670	4,670
	–	**–**	**–**	**–**	**4,670**	**4,670**
2009						
Financial assets						
Cash and cash equivalents	3.11	9,299	50,269	–	–	59,568
Trade and other receivables	–	–	–	–	1,979	1,979
Other financial assets	3.85	–	2,133	–	36	2,169
	–	**9,299**	**52,402**	**–**	**2,015**	**63,716**
Financial liabilities						
Trade and other payables	–	–	–	–	4,470	4,470
	–	**–**	**–**	**–**	**4,470**	**4,470**

NOTE 24 — FINANCIAL RISK MANAGEMENT (continued)

(b) Sensitivity analysis

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

	Post Tax Loss Lower/(Higher)		Equity Lower/(Higher)	
	2010 $'000	2009 $'000	2010 $'000	2009 $'000
Consolidated				
Interest base rate + 1%	468	416	468	416
Interest base rate − 1%	(468)	(416)	(468)	(416)

(c) Credit risk

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

(d) Net fair value of financial instruments

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

(e) Liquidity risk

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

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

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

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

The risk implied from the financial instrument values associated with cash inflows and outflows as at year ended 30 June 2010 are set out in the table overleaf.

	= 6 Months $'000	6 – 12 Months $'000	1 – 5 Years $'000	> 5 Years $'000	Total $'000
Consolidated					
2010					
Financial assets					
Cash and cash equivalents	25,000	6,586	–	–	31,586
Trade and other receivables	3,570	–	–	–	3,570
Other financial assets	–	–	–	2,649	2,649
	28,570	**6,586**	**–**	**2,649**	**37,805**
Financial liabilities					
Trade and other payables	4,670	–	–	–	4,670
	4,670	**–**	**–**	**–**	**4,670**
2009					
Financial assets					
Cash and cash equivalents	42,568	17,000	–	–	59,568
Trade and other receivables	1,979	–	–	–	1,979
Other financial assets	–	–	–	2,169	2,169
	44,547	**17,000**	**–**	**2,169**	**63,716**
Financial liabilities					
Trade and other payables	4,470	–	–	–	4,470
	4,470	**–**	**–**	**–**	**4,470**

(f) Net fair values

Methods and assumptions used in determining net fair value

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

(g) Capital risk management

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

NOTE 25 — NOTES TO THE STATEMENTS OF CASH FLOWS

	Consolidated 2010 $'000	2009 $'000
(a) Reconciliation cash		
Cash at bank and on hand	4,882	9,299
Deposits	26,704	50,269
	31,586	**59,568**
(b) Reconciliation of loss from ordinary activities after income tax to net cash outflow from operating activities		
Loss from operating activities after income tax	(6,547)	(2,519)
Depreciation and amortisation	918	416
Provision for employee entitlements	201	210
Exploration and evaluation expenditure written off	183	109
Gain on sale of assets	(25)	(2,401)
Well equipment written off	24	184
Share-based payments	275	998
(Decrease) Increase in trade and other payables	90	(48)
Decrease (Increase) in receivables	(1,414)	65
Decrease (Increase) in prepayments	97	(27)
(Decrease) Increase in interest receivable	(10)	(108)
Net Cash outflow from Operating Activities	**(6,208)**	**(3,121)**

NOTE 26 — SUPERANNUATION

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

NOTE 27 — COMMITMENTS FOR EXPENDITURE

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

	Consolidated	
	2010 $'000	2009 $'000
Within 1 year	4,867	3,380
Later than 1 year and not later than 5 years	718	2,730
	5,585	**6,110**
Contractual obligations to purchase Plant and Equipment and expected to settle:		
Within 1 year	3,968	1,145
	3,968	**1,145**
Operating contracts		
Minimum payments under non-cancellable contracts according to the time expected to elapse to the expected date of payment:		
Within 1 year	747	879
Later than 1 year and not later than 5 years	2,497	3,488
Later than 5 years	504	1,008
	3,748	**5,375**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010 (CONTINUED)

NOTE 28 — EMPLOYEE INCENTIVE PLAN

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

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

At 30 June 2010 the Parent Entity has interest free loans and ordinary shares issued in current and prior years under the EIP as follows:

Loan Grant Date	Loan Maturity Date	Issue Price per Share $	Number of Shares	Loan Balance $
1 December 2005	30 November 2010	0.135	550,000	74,250
5 March 2007	4 March 2012	0.32	1,075,000[b]	344,000
31 July 2007	30 July 2012	0.45	1,000,000[c]	450,000
31 July 2007	30 July 2012	0.54	3,000,000[d]	1,620,000
31 July 2007	30 July 2012	0.54	3,000,000[e]	1,620,000
1 August 2007	31 July 2012	0.45	1,500,000[c]	675,000
1 August 2007	31 July 2012	0.54	3,000,000[d]	1,620,000
1 August 2007	31 July 2012	0.54	3,000,000[e]	1,620,000
1 August 2007	31 July 2012	0.45	200,000[c]	90,000
1 August 2007	31 July 2012	0.54	450,000[d]	243,000
1 August 2007	31 July 2012	0.54	450,000[d]	243,000
1 November 2007	31 October 2012	0.45	750,000[c]	337,500
1 November 2007	31 October 2012	0.45	2,625,000[f][1]	1,181,250
1 November 2007	31 October 2012	0.45	2,625,000[f][2]	1,181,250
8 November 2007	7 November 2012	0.45	100,000[c]	45,000
8 November 2007	7 November 2012	0.54	200,000[g]	108,000
8 November 2007	7 November 2012	0.54	200,000[h]	108,000
5 December 2007	4 December 2012	0.45	2,000,000[c]	900,000
27 March 2008	26 March 2013	0.45	625,000[i][1]	281,250
27 March 2008	26 March 2013	0.45	625,000[i][2]	281,250
2 April 2008	1 April 2013	0.35	2,000,000[c]	700,000
21 August 2008	20 August 2013	0.45	650,000[j]	292,500
19 November 2008	18 November 2013	0.45	500,000[c]	225,000
22 September 2009	21 September 2014	1.05	500,000[c]	525,000
2 February 2010	1 February 2015	0.80	1,150,000[c]	920,000
17 March 2010	16 March 2015	0.84	250,000[a]	210,000

Loan Grant Date	Loan Maturity Date	Issue Price per Share $	Number of Shares	Loan Balance $
13 April 2010	12 April 2015	1.00	250,000[(k)]	250,000
19 April 2010	18 April 2015	1.00	200,000[(c)]	200,000
			32,475,000	**16,345,250**

[(a)] *Shares issued and loans granted subject to satisfaction of vesting conditions of which 50% of the shares vest after execution of gas sales agreement and the balance after securing development approvals.*

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

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

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

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

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

- [(1)] *500 petajoules gas sales agreement is entered.*
- [(2)] *Further 500 petajoules gas sales agreement is entered into or downstream commercial arrangements have been finalised for the 500 petajoules gas sales agreement.*

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

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

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

- [(1)] *400 petajoules are certified by 31 January 2009*
- [(2)] *600 petajoules are certified by 31 December 2009*

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

[(k)] *Shares issued and loans granted subject to satisfaction of vesting conditions of which 50% of the shares vest after commencement of FEED for an LNG project and the balance after finalisation of pipeline arrangements.*

(a) Recognised share based payments

The Parent Entity has recognised share based payments of $1,061,955 (2009 – $2,838,858) under the plan of which $786,798(2009: $1,840,830) is included as additions to intangible exploration and evaluation expenditure and $275,157 (2009: $998,028) expensed as employee costs.

(b) Summary of option grants under Employee Incentive Plan

	2010 Number	2010 Weighted Average Exercise Price $	2009 Number	2009 Weighted Average Exercise Price $	2008 Number	2008 Weighted Average Exercise Price $
Outstanding at the beginning of the year	37,525,000	0.20	36,525,000	0.20	11,045,000	0.07
Granted during the year	2,350,000	0.56	1,150,000	0.18	27,350,000	0.25
Exercised during the year	(7,400,000)	0.05	(150,000)	0.10	(1,870,000)	0.09
Outstanding at the end of the year	**32,475,000**	**0.26**	**37,525,000**	**0.20**	**36,525,000**	**0.20**

(c) Weighted average remaining contractual life

The weighted average remaining contractual life for the option grants outstanding is 2.40 years (2009 – 2.95 years).

(d) Weighted average fair value

The weighted average fair value of option grants during the year was $ 0.56 (2009 – $0.18).

NOTE 29 — CONTINGENT LIABILITIES

	Consolidated 2010 $'000	2009 $'000
Bankers' guarantees issued for fulfilment of obligations under exploration licences and operating contracts secured by a charge over term deposits lodged with the bankers.	2,505	2,035
Termination benefits payable in certain circumstances in accordance with employment agreements.	1,201	984
Production payments payable to Gastar Exploration Limited when sustainable production of sales gas produced from PEL238 reaches certain milestones as follows:		
• US$ 5 million when production reaches 25 million cfd	5,839	-
• US$ 5 million when production reaches 40 million cfd	5,839	-
	15,384	**3,019**

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

NOTE 30 — PARENT ENTITY DISCLOSURES

	Consolidated 2010 $'000	2009 $'000
Information relating to Eastern Star Gas Limited		
Current assets	145,544	128,642
Total assets	183,859	162,921
Current liabilities	1,976	2,211
Total liabilities	2,122	2,300
Net assets	**181,737**	**160,621**
Equity		
Contributed equity	219,160	190,706
Reserves	7,531	9,691
Accumulated losses	(44,954)	(39,776)
	181,737	**160,621**
Loss of the parent entity	(5,178)	(1,769)
Total comprehensive income of the parent entity	–	–
Contingent liabilities		
Bankers' guarantees issued for fulfilment of obligations under exploration licences and operating contracts secured by a charge over term deposits lodged with the bankers.	2,505	1,906
Termination benefits payable in certain circumstances in accordance with employment agreements	1,201	984
	3,706	**2,890**

NOTE 31 — KEY MANAGEMENT PERSONNEL DISCLOSURES

(a) Details of Key Management Personnel

Directors	
John Anderson	Chairman (non-executive)
David Casey	Managing Director
Peter Lansom	Executive Director — Operations
David King	Director (non-executive)
Chris Sadler	Director (non-executive) – Appointed 15 October 2009
Alex Sundich	Director (non-executive)
Executives	
Ashley Edgar	General Manager Exploration & New Ventures
Roland Sleeman	Chief Commercial Officer
Ian Kirkham	Chief Financial Officer & Company Secretary

(b) Compensation of Key Management Personnel

	Consolidated	
	2010 $'000	2009 $'000
Short-term employee benefits	3,289,836	2,571,055
Post-employment benefits	194,839	178,079
Share-based payment	594,785	2,304,654
	4,079,460	**5,053,788**

NOTE 31 — KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)

(c) Share holdings of Key Management Personnel

	Beginning of Year Number	Acquired Under Employee Incentive Plan Number	Net Change Other Number	End of Year Number
2010				
John Anderson	540,000	–	–	540,000
David Casey	8,000,000	–	48,898	8,048,898
David Archer – Resigned	–	–	–	–
David King	20,456,558	–	17,648	20,474,206
Chris Sadler	–	–	–	–
Alex Sundich	9,941,124	–	35,296	9,976,420
Ashley Edgar	7,000,000	–	67,648	7,067,648
Ian Kirkham	2,100,000	–	100,000	2,200,000
Peter Lansom	7,500,000	–	29,648	7,529,648
Roland Sleeman	6,684,474	–	–	6,684,474
	62,222,156	**–**	**299,138**	**62,521,294**
2009				
John Anderson	40,000	500,000	–	540,000
David Casey	8,000,000	–	–	8,000,000
David Archer	–	–	–	–
Douglas Battersby – Retired**	30,055,462	–	–	30,055,462
David King	20,456,558	–	–	20,456,558
Alex Sundich	11,041,124	–	(1,100,000)	9,941,124
Ashley Edgar	7,000,000	–	–	7,000,000
Ian Kirkham	2,100,000	–	–	2,100,000
Peter Lansom	7,500,000	–	–	7,500,000
Roland Sleeman	6,684,474	–	–	6,684,474
	92,877,618	**500,000**	**(1,100,000)**	**92,277,618**

* *Shares issued under Employee Incentive Plan are subject to satisfaction to the conditions as described in Note 28 and in the Remuneration Report on page 29.*

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

NOTE 32 — EVENTS OCCURRING AFTER REPORTING DATE

There has not arisen in the interval since 30 June 2010 and up to the date of this report, any matter that, in the opinion of the Directors, has significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group in future financial years other than the following:

(a) On 10 August 2010, the company successfully completed a fully underwritten institutional placement of 119,047,619 new fully paid shares raising $100 million (net 96.8 million).

(b) On 9 August 2010, the company entered into an agreement to acquire a 24 hectare parcel of land on Kooragang Island, Newcastle for A$25 million, as a site for the proposed Liquefied Natural Gas Newcastle ("LNGN") export project. The company has paid a non-refundable 10% deposit upfront with the remainder payable in February 2011. If the company does not receive the necessary approvals for the purchase to proceed under the acquisition agreement, the Company has the option to terminate the agreement until 14 January 2011.

NOTE 33 — RELATED PARTY DISCLOSURE

(a) Loan to Subsidiary

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

	Balance at 30 June 2010 $'000	Balance at 30 June 2009 $'000
Narrabri Power Pty Ltd. – Operations	20,169	18,228
Eastern Energy Australia Pty Ltd. Contribution to the Narrabri Coal Seam Gas Joint Venture, costs for cancellation of overriding royalty interests, share-based payment costs in PEL 238 and acquisition of pipeline	57,963	35,136
Hillgrove Energy Pty Limited Contribution to the Narrabri Basin Coal Seam Gas Project, costs for cancellation of overriding royalty interests, share-based payment costs in PEL 238 and acquisition of pipeline	49,344	26,518
Betel Gas Pty Ltd Contribution share-based payment costs in PEL 6	2	–
	127,478	**79,882**

The loans are expected to be recoverable within 12 months.

NOTE 34 — CORPORATE INFORMATION

The financial statements of Eastern Star Gas Limited for the year ended 30 June 2010 was authorised for issue in accordance with a resolution of the Directors on 15 September 2010.

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

DIRECTORS' DECLARATION

FOR THE YEAR ENDED 30 JUNE 2010

THE DIRECTORS OF EASTERN STAR GAS LIMITED DECLARE THAT:

(a) in the directors' opinion, the financial statements and notes on pages 39 to 79, and the Remuneration report in the Directors' report, set out on pages 26 to 34, are accordance with the Corporations Act 2001, including:

  (i) giving a true and fair view of the company's and the Group's financial Position as at 30 June 2010 and of their performance, for the financial year ended on that date; and

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

(b) the financial statements also complies with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) as disclosed in note 1(b).

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

The directors have been given the declarations by the chief executive officer and chief financial officer for the financial year ended 30 June 2010, required by Section 295A of the Corporations Act 2001.

Signed in accordance with a resolution of the Directors.

Dated 16 September 2010

David Casey
Director

INDEPENDENT AUDIT REPORT

TO THE MEMBERS OF EASTERN STAR GAS LIMITED

PKF
Chartered Accountants
& Business Advisers

INDEPENDENT AUDITORS' REPORT

To the members of Eastern Star Gas Limited

Report on the Financial Report

We have audited the accompanying financial report of Eastern Star Gas Limited, which comprises the balance sheet as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year ended on that date selected explanatory notes and the directors' declaration of Eastern Star Gas Limited (the consolidated entity). The consolidated entity comprises the entity and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

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

Auditor's Responsibility

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

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

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

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INDEPENDENT AUDIT REPORT (CONT'D)

TO THE MEMBERS OF EASTERN STAR GAS LIMITED

PKF
Chartered Accountants
& Business Advisers

Independence

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

Auditors' Opinion

In our opinion:

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

 (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date; and

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

(b) the consolidated financial statements also comply with International Financial Reporting Standards as disclosed in Note 1.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 29 to 33 of the directors' report for the year ended 30 June 2010. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditors' Opinion

In our opinion the Remuneration Report of Eastern Star Gas Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Acts 2001*.

PKF

Bruce Gordon
Partner

16 September 2010

ADDITIONAL INFORMATION

FOR THE YEAR ENDED 30 JUNE 2010

1. SHARE HOLDINGS

(a) Distribution of Shareholders as at 3 September 2010

Size of Holiding	Number of Holders	Ordinary Shares Held	%
1 – 1,000	1,040	722,644	0.07%
1,001 – 5,000	3,566	11,204,383	1.09%
5,001 – 10,000	2,685	22,063,839	2.16%
10,001 – 100,000	5,040	159,800,429	15.61%
100,001 – over	693	829,955,746	81.07%
	13,024	**1,023,747,041**	**100.00%**

34 shareholders held less than a marketable parcel of shares.

(b) Top Twenty Shareholders as at 3 September 2010

Shareholder	Number of Ordinary Shares	% Held
Santos Limited	204,647,033	19.99%
J P Morgan Nominees Australia Limited	64,893,196	6.34%
HSBC Custody Nominees (Australia) Limited	46,861,334	4.58%
National Nominees Limited	46,043,080	4.50%
Truenergy Investments Pty Ltd	38,546,256	3.77%
Mr Douglas Geoffrey Battersby	30,090,758	2.94%
Merrill Lynch (Australia) Nominees Pty Limited	23,943,575	2.34%
Mr Dennis James Morton	17,276,985	1.69%
Australian Foundation Investment Company Limited	14,700,000	1.44%
Citicorp Nominees Pty Limited	13,189,158	1.29%
Mr Alexander Sundich	9,456,420	0.92%
ANZ Nominees Limited	8,447,495	0.83%
Morgan Stanley Australia Securities (Nominee) Pty Limited	8,258,000	0.81%
Brispot Nominees Pty Ltd	7,736,815	0.76%
Mr Peter Barry Lansom	7,529,648	0.74%
Mr Ashley Vincent Edgar	7,017,648	0.69%
UBS Nominees Pty Ltd	6,766,911	0.66%
Mr Roland Sleeman	6,262,237	0.61%
Budside Pty Ltd	6,050,280	0.59%
Australian Reward Investment Alliance	5,257,763	0.51%
	572,974,592	55.97%
Employee Fully Paid Ordinary Shares	32,445,000	3.17%
ASX Listed Fully Paid Ordinary Shares	991,302,041	96.83%
Total Fully Paid Ordinary Shares	**1,023,747,041**	**100.00%**

ADDITIONAL INFORMATION (CONT'D)

FOR THE YEAR ENDED 30 JUNE 2010

2. VOTING RIGHTS

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

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

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

3. AUDIT AND RISK COMMITTEE

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

4. SUBSTANTIAL SHAREHOLDERS

The securities held by substantial shareholders are as follows:

Name	Number of Shares
Santos Limited	204,647,033

CORPORATE DIRECTORY

DIRECTORS

The Hon. John Anderson	(Chairman)
David Casey	(Managing Director)
Dr David King	(Non-Executive)
Chris Sadler	(Non-Executive)
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