



**KRATOS ENERGY LIMITED**

**ABN 28 125 901 868**

**ANNUAL REPORT  
FOR THE YEAR ENDED  
30 JUNE 2011**

## Contents

Corporate Directory.....	3
Letter to Shareholders .....	4
Directors' Report .....	5
Auditor's Independence Declaration .....	12
Statement of Comprehensive Income.....	13
Statement of Financial Position .....	14
Statement of Changes in Equity .....	15
Statement of Cash Flows .....	16
Notes to the Financial Statements .....	17
Directors' Declaration.....	39
Independent Auditor's Report .....	40
Shareholder Information .....	41

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## Corporate Directory

This Annual Report covers Kratos Energy Limited as an individual entity. The Company's functional and presentation currency is AUD (\$).

A description of the Company's operations and principal activity is included in the review of operations and activities in the Directors' report on pages 5 to 11. The Directors' Report is not part of the Financial Report.

### Directors

Mr Robert E. T. Towner  
Mr Matthew R. Sheldrick  
Mr Michael B Lowry

### Auditors

BDO Audit (WA) Pty Ltd  
38 Station Street  
Subiaco WA 6008

### Company Secretary

Mr Michael Andruszkiw

### Bankers

National Australia Bank  
1232 Hay Street  
West Perth WA 6005

### Registered Office

Unit 18  
589 Stirling Highway  
Cottesloe WA 6011  
T: +61 8 9286 2828  
F: +61 8 9286 2211

### Solicitors

Price Sierakowski  
Level 24 St Martins Tower  
44 St Georges Terrace  
Perth WA 6000

### Share Registry

Security Transfer Registrars Pty Ltd  
770 Canning Highway  
Applecross WA 6153  
T: +61 8 9315 0933  
F: +61 8 9315 2233

### Website

[www.kratosenergy.com](http://www.kratosenergy.com)

## Letter to Shareholders

Dear Shareholder

On behalf of the Board of Directors of Kratos Energy Limited ("Kratos" or "Company"), we present the Annual Report for the year ended 30 June 2011.

Shareholders will be aware that in November 2010, Kratos participated in a 25% interest in the drilling of the Radway Prospect, approximately 130kms north east of Edmonton in Calgary, Canada. This prospect had been generated by US based South Bay Resources, using 3D seismic and was considered to be a risky but high impact target.

Drilling of the Radway Prospect encountered various hydrocarbon indications, the most promising being in the Mannville Channel Cretaceous zone between 734m and 742m in depth. However, subsequent analysis of this zone determined that the gas response obtained during drilling was actually heavy oil with no likelihood of achieving commercial production. Accordingly, the well was subsequently plugged and abandoned.

The drilling disappointment at Radway came not long after the Company's participation in the drilling of the Big Bend Prospect during June 2010, which was also plugged and abandoned. The net effect of the participation in each of these dry exploration wells was that the Company's cash reserves were substantially depleted. As a result of this, in February 2011, the Directors agreed to personally lend the Company up to \$100,000 on commercial terms, in order that it could continue to operate, albeit on a substantially reduced scale. As at 30 June 2011 the Company had drawn down \$60,000 of these funds.

During the Financial Year, the Directors also sought shareholder approval to consolidate the Company's existing share capital on a 1 for 3 basis. In April 2011, shareholders approved this consolidation and consequently, the Company's issued share capital was reduced from 36,230,002 to 12,076,711 shares.

At the completion of the Company's participation in the Radway well, Kratos had effectively satisfied all its farm-in obligations to South Bay Resources. At that time a decision was taken to discontinue the relationship with South Bay and to commence the review and identification of other energy projects worldwide.

In this regard, the Director's are pleased to advise that since year end, Kratos has engaged the services of Mr Michael Lowry as Managing Director. Mr Lowry has significant experience in the resources industry over a 40 year period, including an executive role with Cliffs Western Australian Mining (the managing company of the Cliffs Robe River Iron Associates project in the Pilbara region); CEO and Director of The Griffin Coal Mining Company; CEO and Director of Phoenix Energy Pty Ltd and President of Phoenix Energy Inc. that had oil and gas exploration interests in Utah.

On behalf of Kratos, Mr Lowry has commenced the review and assessment of various potential thermal coal acquisitions in Indonesia and the Directors are particularly pleased with the progress to date. The Company will keep shareholders up to date as due diligence on these potential acquisitions progress.

In conjunction with Mr Lowry's appointment to the Board, the Company has also received the resignations of Messrs Chris Moyes and Dee Patterson from the Board. The Company wishes to thank Messrs Moyes and Patterson for their contributions to Kratos since inception.

Finally, the Board would like to acknowledge the patience of shareholders during what has been a particularly difficult time. We hope to update shareholders with some better news during the course of the 2011/12 financial year.

Yours faithfully

**Robert Towner**  
Chairman

## Directors' Report

Your Directors present their report on the Company for the financial year ended 30 June 2011.

### Directors

The names of the Directors in office during the year and until the date of this report are as follows. All Directors were in office for the entire period unless otherwise stated.

**Mr Robert Towner**  
**Chairman**  
**Appointed 15 June 2007**

Mr Towner is the founder and Managing Director of Cornerstone Corporate Pty Ltd, an Australian Financial Services Licencee. Mr Towner has 20 years experience in the financial services industry and during this time has successfully facilitated capital raisings and provided corporate advisory services to a large number of small to medium sized companies in the resources, energy and industrial sectors.

Mr Towner founded bioMD Limited, a bio-medical company that has been listed on the Australian Stock Exchange since 2004. As founder and Executive Director of bioMD Ltd, Mr Towner was instrumental in the company's recent merger with Allied Medical Group to form ASX listed company Allied Healthcare Group Limited (ASX Code: AHZ). Mr Towner continues to act as Non-Executive Director of the merged company with particular responsibility for maintaining Board awareness of financial markets, corporate governance, capital structuring and working capital requirements.

An interest of 4,057,003 ordinary shares of Kratos Energy Limited is held.

**Mr Matthew Sheldrick**  
**Executive Director**  
**Appointed 7 August 2007**

Matthew Sheldrick holds a Bachelor of Commerce from the University of Western Australia and is a Chartered Accountant. Mr Sheldrick spent 10 years in the securities industry advising both domestic and international institutional clients on Australian resource equities. He has founded a number of listed companies in the energy and resources sectors, including Eureka Energy Ltd, Gawler Resources Ltd and Black Fire Minerals Ltd and has been involved in the growth of these companies by way of mergers and acquisitions. He is currently a non-executive director of WAG Ltd and Apex Minerals Ltd and is the non-executive chairman of unlisted Cohiba Minerals Ltd.

An interest of 1,183,334 ordinary shares of Kratos Energy Limited is held.

**Mr Michael Lowry**  
**Managing Director**  
**Appointed 15 September 2011**

Mr Lowry has significant experience in the resources industry over a 40 year period, including an executive role with Cliffs Western Australian Mining (the managing company of the Cliffs Robe River Iron Associates project in the Pilbara region); CEO and Director of The Griffin Coal Mining Company; CEO and Director of Phoenix Energy Pty Ltd and President of Phoenix Energy Inc. that had oil and gas exploration interests in Utah.

## **Directors' Report (continued)**

Over the past 19 years Mike has worked in all aspects of thermal coal mining. He has led new coal mine developments in Western Australia and undertaken extensive due diligence assignments researching and reporting on potential acquisitions of overseas coal assets.

Mike has served as an Executive Councillor on the board of the WA Chamber of Minerals and Energy and was a Member of the WA Coal Industry Council delegation that was commissioned to review modern coal mining practices in the United States, Germany and Britain and ascertain their applicable and or suitability for the WA Coal Mining Industry.

Michael does not hold an interest in the ordinary shares of Kratos Energy Limited.

### **Mr Christopher Moyes**

**Director**

**Appointed 15 June 2007 – Resigned 15 September 2011**

Christopher (Chris) Moyes holds a Bachelor of Science (1968) in Geology and Biology from Western Australia and earned a MSc in petroleum engineering from the Royal School of Mines, Imperial College, London University in 1974.

Chris has advised and managed the placement of funds in exploration and production ventures in the U.S. and internationally, and the evaluation of production in properties for acquisition and investment opportunities. He advises on new company issues, including support in the international markets for capital and identified and acquired assets for these companies, and developed technical and contractual aspects of public documents.

For 24 years, Chris has managed the ongoing development of a group of companies under Moyes & Co. Inc. which includes comprehensive analysis on industry activity, purchase, sale and merger transactions, financial commitments, exploration, farm-outs and relinquishment of obligations. The database is integral to the Company's core business in the identification of opportunities and provision of Fair Market Values and financing.

Chris has 40 years experience in the energy sector and has published a number of papers on petroleum legislation, exploration and project financing, and provides advice and management of client and joint venture operations, investment programs, technical and business aspects of exploration and production contracts, joint venture and farm-in arrangements.

He is a current member of the SPE for which group he was the founding Singapore member, the AAPG and the Association of International Petroleum Negotiators.

Chris is an SPE Distinguished Lecturer on International Petroleum Finance, 1996-1997 and has made presentations in several countries addressing International Petroleum Finance, the source and cost of capital.

An interest of 360,252 ordinary shares of Kratos Energy Limited is held.

### **Mr Paul Dee Patterson**

**Director**

**Appointed 21 February 2008 – Resigned 14 September 2011**

Dee Patterson has over 25 years experience in the oil and gas industry and holds a Bachelor of Science in Engineering (1981) from the University of Texas at Arlington and an MBA in Corporate Finance (1994) from the University of Dallas and is a registered Professional Engineer.

## Directors' Report (continued)

Dee joined Moyes & Co. in 2000 as Managing Director, where he has been an integral part of Moyes & Co. Prior to joining Moyes & Co. he spent 18 years with ARCO Oil and Gas, Vastar Resources and ARCO International where he had responsibilities as a Reservoir and Operations Engineer, was involved in M&A, exploration prospect evaluation and was advisor on the Tangguh LNG project and held positions of increasing responsibility in their commercial and finance organisations.

He is an active member in SPE, the Society of Petroleum Evaluation Engineers (SPEE) and the Association of International Petroleum Negotiators. He has made numerous presentations and has authored papers on commercial and finance issues on the oil and gas industry.

An interest of 171,667 ordinary shares of Kratos Energy Limited is held.

### Company Secretary

The following person held the position of Company Secretary at the end of the financial year:

**Mr Michael Andruszkiw**  
**Company Secretary**

Michael was appointed company secretary on 29 March 2011. Michael holds a Bachelor of Business majoring in Accounting and Finance, a Graduate Diploma (ICAA) and a Graduate Diploma in Applied Corporate Governance. Michael is a member of the Institute of Chartered Accountants in Australia and Chartered Secretaries Australia.

The following person held the position of Company Secretary during the financial year:

**Ms Narelle Warren**  
**Company Secretary**

Ms Warren qualified as a Chartered Accountant with a Bachelor of Laws and Bachelor of Commerce. Ms Warren has over 9 years experience as a Company Secretary and Financial Officer of both private and publicly listed companies.

Ms Warren also works as a consultant on a project basis specialising in the co-ordination and management of capital raisings, associated due diligence procedures as well as the provision of company secretarial and financial management services.

Prior to working as a self-employed consultant, Ms Warren was employed by a corporate advisory group in Perth, HSBC in London and KPMG Perth.

Ms Warren resigned as company secretary on 31 March 2011.

### Principal Activity

The principal activity of the economic entity during the year was the identification of investment opportunities in the resources sector and the completion of the Company's participation in a drilling programme in Alberta, Canada.

## Directors' Report (continued)

### Operating Results

The result of the Company for the year ended 30 June 2011 was a loss of \$712,730 (2010: \$972,718). The net loss of the Company predominantly related to recognising the Company's share of drilling costs in Alberta, Canada, travel to review the project and the administration and compliance costs of running a public company.

### Dividends Paid or Recommended

No dividend has been paid or recommended by the Directors since the commencement of the year.

### Review of Operations

During the financial year the Company participated (for a 25% interest) in the drilling of the Radway Prospect, approximately 130kms north east of Edmonton in Calgary, Canada. This prospect had been generated by US based South Bay Resources, using 3D seismic and was considered to be a risky but high impact target.

Drilling of the Radway Prospect encountered various hydrocarbon indications, the most promising being in the Mannville Channel Cretaceous zone between 734m and 742m in depth. However, subsequent analysis of this zone determined that the gas response obtained during drilling was actually heavy oil with no likelihood of achieving commercial production. Accordingly, the well was subsequently plugged and abandoned.

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During the Financial Year, the Directors also sought shareholder approval to consolidate the Company's existing share capital on a 1 for 3 basis. In April 2011, shareholders approved this consolidation and consequently, the Company's issued share capital was reduced from 36,230,002 to 12,076,711 shares.

At the completion of the Company's participation in the Radway well, Kratos had effectively satisfied all its farm-in obligations to South Bay Resources. At that time a decision was taken to discontinue the relationship with South Bay and to commence the review and identification of other energy projects worldwide.

In this regard, since year end, Kratos has engaged the services of Mr Michael Lowry as Managing Director. Mr Lowry has significant experience in the resources industry over a 40 year period, including an executive role with Cliffs Western Australian Mining (the managing company of the Cliffs Robe River Iron Associates project in the Pilbara region); CEO and Director of The Griffin Coal Mining Company; CEO and Director of Phoenix Energy Pty Ltd and President of Phoenix Energy Inc. that had oil and gas exploration interests in Utah.

On behalf of Kratos, Mr Lowry has commenced the review and assessment of various potential thermal coal acquisitions in Indonesia and the Directors are particularly pleased with the progress to date.

In conjunction with Mr Lowry's appointment to the Board, the Company has also received the resignations of Messrs Chris Moyes and Dee Patterson from the Board. The Company wishes to thank Messrs Moyes and Patterson for their contributions to Kratos since inception.

## **Directors' Report (continued)**

### **Financial Position**

#### Liquidity and Capital Resources

The cash flow statement shows that cash and cash equivalents as at 30 June 2011 was \$12,574.

This movement in cash reserves is mainly due to the following:

- Drilling expenses of approximately \$388,000
- Raising capital of \$60,000 through the issue of 100,000 shares at \$0.10 and the conversion of 1,000,000 options with an exercise price of \$0.05 per option.
- Costs of approximately \$110,000 associated with an IPO that did not proceed.

#### Share Consolidation During the Year

The Directors continually monitor the appropriateness of the capital structure of the company.

The Directors called a general meeting on 28 April 2011 to put forward to members a resolution to conduct a share consolidation on a one for three basis. This was done to ensure that the capital structure was appropriate and equitable for potential new investors.

This resolution was passed on a show of hands and the company reduced its shares on issue from 36,230,002 to 12,076,711.

### **Significant Changes in State Of Affairs**

No other significant changes in the economic entity's state of affairs occurred during the year.

### **Matters Subsequent to the end of the Financial Year**

On 15 September 2011 Mr Mike Lowry was appointed to the board in the position of Managing Director.

In conjunction with Mr Lowry's appointment, Messers Moyes and Patterson resigned as directors of the company.

Mr Lowry has commenced the review and assessment of various potential thermal coal acquisitions in Indonesia.

### **Business Strategy, Future Developments and Prospects**

Kratos' strategy is to identify and selectively acquire coal assets and services in Indonesia using the experience and expertise of its management team in resource projects generally and in the Indonesian coal sector specifically. To support this strategy, Kratos is targeting projects with near term production to take advantage of strengthening coal prices and to generate profits and free cash flow in the short to medium term.

## Directors' Report (continued)

### Environmental Issues

The Directors are mindful of the regulatory regime in relation to the impact of the organisational activities on the environment.

There have been no known breaches by the Company during the financial year.

The National Greenhouse and Energy Reporting Act 2007 require the Company to report its annual greenhouse gas emissions and energy use. The Company have considered the requirements and they are not required to report at this stage. The Company will reassess this going forward.

### Meetings of Directors

During the year, 6 meetings of Directors were held. Attendances by each Director during the year were as follows:

Director	Board Meetings	
	Number eligible to attend	Number attended
Mr Robert Towner	6	6
Mr Matthew Sheldrick	6	6
Mr Chris Moyes	6	6
Mr Paul Dee Patterson	6	6

### Shares under Option

There are no shares under option at the date of this report.

### Proceedings on Behalf of Company

No person has applied for Leave of Court to bring proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of those proceedings.

The Company was not a party to any such proceedings during the year.

### Indemnity of Officers and Auditors

During the financial year, the Company agreed to indemnify the Directors and officers of the Company against any liability incurred by the directors and officers and paid a premium in respect of a contract insuring the Directors and officers of the Company against a liability incurred by such Directors and officers to the extent permitted by the Corporations Act 2001. The Company has not, during or since the end of the year, indemnified or agreed to indemnify the auditor of the company, against a liability incurred by the auditor.

The Company, since the end of the year, did not renew the policy insuring the Directors and officers against any liability incurred by the Directors and officers to the extent permitted by the Corporations Act 2001.

## Directors' Report (continued)

### Auditor's Independence Declaration

Signed in accordance with a resolution of the Board of Directors.

A handwritten signature in black ink, appearing to read 'Robert Towner', with a stylized flourish at the end.

**Robert Towner**  
Chairman

Perth, Western Australia,

## **Auditor's Independence Declaration**

## Statement of Comprehensive Income For the financial year ended 30 June 2011

	Note	2011 \$	2010 \$
Revenue from continuing operations		-	-
Other income	4	9,005	44,013
Exploration and evaluation expenditure		(388,827)	(761,604)
Employment expenses		(116,264)	(96,903)
Adviser option expense		-	(46,784)
Foreign exchange loss		-	(181)
Travel costs		(19,821)	(28,909)
Other expenses		(87,533)	(82,350)
Costs associated with unsuccessful IPO		(109,290)	-
<b>Loss before income tax</b>		<b>(712,730)</b>	<b>(972,718)</b>
Income tax expense	5	-	-
<b>Loss after tax from continuing operations</b>		<b>(712,730)</b>	<b>(972,718)</b>
Profit from discontinued operations		-	-
<b>Net loss for the year</b>		<b>(712,730)</b>	<b>(972,718)</b>
<b>Other comprehensive income for the year, net of tax</b>		<b>-</b>	<b>-</b>
<b>Total comprehensive income for the year attributable to members of the company</b>		<b>(712,730)</b>	<b>(972,718)</b>

The above Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

## Statement of Financial Position As at 30 June 2011

	Note	2011 \$	2010 \$
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents	8	12,574	552,203
Other receivables	9	620	58,051
Other assets	10	1,833	53,015
<b>Total Current Assets</b>		<b>15,027</b>	<b>663,269</b>
<b>Non-Current Assets</b>			
Property, Plant & Equipment	11	906	-
<b>Total Non-Current Assets</b>		<b>906</b>	<b>-</b>
<b>TOTAL ASSETS</b>		<b>15,933</b>	<b>663,269</b>
<b>LIABILITIES</b>			
<b>Current Liabilities</b>			
Trade and other payables	12	12,527	69,106
Loans	13	61,973	-
<b>Total Current Liabilities</b>		<b>74,500</b>	<b>69,106</b>
<b>TOTAL LIABILITIES</b>		<b>74,500</b>	<b>69,106</b>
<b>NET (DEFICIENCY) IN ASSETS</b>		<b>(58,567)</b>	<b>594,163</b>
<b>EQUITY</b>			
Contributed equity	14	1,605,206	1,545,206
Option reserve	15	84,489	84,489
Accumulated losses	15	(1,748,262)	(1,035,532)
<b>TOTAL (DEFICIENCY) IN EQUITY</b>		<b>(58,567)</b>	<b>594,163</b>

The above Statement of Financial Position should be read in conjunction with the accompanying notes.

## Statement of Changes in Equity For the Financial Year ended 30 June 2011

	Contributed Equity	Accumulated Losses	Option Reserve	Total Equity
	\$	\$	\$	\$
<b>At 30 June 2010</b>	1,545,206	(1,035,532)	84,489	594,163
Other comprehensive income for the year	-	-	-	-
Loss for the year	-	(712,730)	-	(712,730)
Total comprehensive income	-	(712,730)	-	(712,730)
<i>Transactions with owners in their capacity as owners</i>				
Issue of share capital, net of transaction costs	60,000	-	-	(60,000)
<b>At 30 June 2011</b>	1,605,206	(1,748,262)	84,489	(58,567)

	Contributed Equity	Accumulated Losses	Option Reserve	Total Equity
	\$	\$	\$	\$
<b>At 30 June 2009</b>	1,417,653	(62,814)	37,705	1,392,544
Other comprehensive income for the year	-	-	-	-
Loss for the year	-	(972,718)	-	(972,718)
Total comprehensive income	-	(972,718)	-	(972,718)
<i>Transactions with owners in their capacity as owners</i>				
Issue of share capital, net of transaction costs	127,553	-	-	127,553
Option expense	-	-	46,784	46,784
<b>At 30 June 2010</b>	1,545,206	(1,035,532)	84,489	594,163

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

## Statement of Cash Flows

### For the Financial Year ended 30 June 2011

	Note	2011 \$	2010 \$
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Payments to suppliers and employees		(226,520)	(176,788)
Payments for exploration and evaluation expenditure		(388,827)	(814,236)
Interest received		8,704	44,013
Other (GST paid and recoverable)		4,799	-
Net cash inflow /(outflow) from operating activities	8	(601,844)	(947,011)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Payment for purchases of office equipment		(1,510)	-
		(1,510)	-
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from issue of shares		113,015	198,000
Selective share buy-back		-	(50,000)
Payment of share buy-back costs		-	(12,197)
Payment of unallocated capital raising costs		-	(44,908)
Proceeds from Director Loans		60,000	-
IPO Costs		(109,290)	-
Net cash inflow from financing activities		63,725	90,895
Net increase in cash and cash equivalents held		(539,629)	(856,116)
Cash and cash equivalents at beginning of the period		552,203	1,408,319
Cash and cash equivalents at end of financial year	8	12,574	552,203

The above Statement of Cash Flows should be read in conjunction with the accompanying notes.

## Notes to the Financial Statements

### 1. Corporate Information

The financial statements of Kratos Energy Limited for the financial year ended 30 June 2011 was authorised for issue in accordance with a resolution of the Directors on 31 October 2011. The financial statements include the financial statements and notes of Kratos Energy Limited.

Kratos Energy Limited is a company limited by shares incorporated in Australia.

### 2. Statement of Significant Accounting Policies

#### (a) Basis of Preparation

The financial statements are general purpose financial statements, which have been prepared in accordance with Australian Accounting Standards, the requirements of the Corporations Act 2001, Australian Accounting Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board.

The financial statements are presented in Australian dollars which is the functional and presentation currency of the Company.

#### *Compliance with IFRS*

The financial statements of Kratos Energy Limited, an individual entity, comply with Australian Accounting Standards, which includes Australian equivalents to International Financial Reporting Standards (AIFRS), in their entirety. Compliance with AIFRS ensures that the financial statements also comply with International Financial Reporting Standards (IFRS) in their entirety.

#### *Historical cost convention*

The financial statements have been prepared on an accruals basis and are based on historical costs.

#### (b) Going concern

The company incurred a net loss of \$712,730 (2010: \$972,718) for the year and operating cash outflows of \$601,844 (2010: \$947,011).

The financial report has been prepared on a going concern basis, which contemplates the continuity of normal business activity and the realisation of assets and the settlement of liabilities in the normal course of business.

The ability of the Company to continue as a going concern is dependent on the Company being able to identify a suitable project and the continued support of its shareholders and related parties to raise additional funds as required to meet ongoing commitments and for working capital.

Following the appointment of Mr Lowry subsequent to year end, the Company has commenced the review and assessment of various potential thermal coal acquisitions in Indonesia. Once an appropriate project has been identified and the necessary due diligence completed it is the director's intention that additional equity will be raised to fund the project.

Based upon the expectation of sourcing a suitable a project, continued support of shareholders and related parties, the Directors consider it appropriate for the financial report be prepared on a going concern basis. Should the Company be unsuccessful in finding an appropriate project to undertake additional raisings, the entity may not be able to continue as a going concern and realise their assets and extinguish their liabilities in the normal course of operations. No adjustments have been made relating to the recoverability and classification of liabilities that might be necessary should the Company not continue as a going concern.

## Notes to the Financial Statements (continued)

### 2. Statement of Significant Accounting Policies (continued)

(c) Basis of Consolidation

*Joint venture operations*

The proportionate share of the Group's interests in the assets, liabilities, income and expenses of joint venture operations have been incorporated in the financial statements under the appropriate headings. Details of joint venture operations are set out in Note 17.

(d) Trade and Other Receivables

Trade receivables, which generally have 30-90 day terms, are recognised initially at fair value and carried at original invoice amount less an allowance for any uncollectible amounts.

An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

(e) Cash and Cash Equivalents

Cash and short-term deposits in the Statement of Financial Position comprise cash at bank and on hand and short-term deposits with an original maturity of three months or less.

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

(f) Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

*Interest*

Revenue is recognised as the interest accrues (using the effective interest method, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net carrying amount of the financial asset.

(g) Exploration and Evaluation assets

The Company has adopted the policy of expensing all exploration and evaluation expenditure in relation to its oil and gas leases as incurred. Where the Directors decide to progress the development in an area of interest all further expenditure incurred relating to the area will be capitalised. Projects are advanced to development status and classified as oil and gas properties when it is expected that further expenditure can be recouped through sale or successful development and exploitation of the area of interest. Such expenditure is carried forward up to commencement of production at which time it is amortised over the life of the economically recoverable reserves.

## Notes to the Financial Statements (continued)

### 2. Statement of Significant Accounting Policies (continued)

#### (h) Segment Reporting

Segment information is presented using a 'management approach', i.e. segment information is provided on the same basis as information used for internal reporting purposes by the Managing Director.

An operating segment's operating results are reviewed regularly by the Managing Director to make decisions about resources to be allocated to the segment and assess its performance.

#### (i) Income Tax

The income tax expense for the period is the tax payable on the current period's taxable income based on the national income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax base of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Deferred tax assets and liabilities are recognised for all temporary differences, between carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases, at the tax rates expected to apply when the assets are recovered or liabilities settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction. Exceptions are made for certain temporary differences arising on initial recognition of an asset or a liability if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit.

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

Deferred tax assets and liabilities are not recognised for temporary differences between the carrying amount and tax bases of investments in subsidiaries, associates and interests in joint ventures 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.

Current and deferred tax balances relating to amounts recognised directly in other comprehensive income are also recognised directly in other comprehensive income.

#### (j) Other Taxes

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

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

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

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

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

## Notes to the Financial Statements (continued)

### 2. Statement of Significant Accounting Policies (continued)

#### (k) Trade and Other Payables

Trade and other payables represent liabilities for goods and services provided to the Company prior to the year end and which are unpaid. These amounts are unsecured and have 30-60 day payment terms.

#### (l) Contributed Equity

Ordinary shares are classified as equity.

Costs directly attributable to the issue of new shares or options are shown as a deduction from the equity proceeds, net of any income tax benefit. Costs directly attributable to the issue of new shares are included as part of the purchase consideration.

#### (m) Fair Value

Fair values may be used for financial asset and liability measurement as well as for sundry disclosures.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to their short-term nature. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

#### (n) Share-based Payment Transactions

The Company may provide compensation to advisers of the Company in the form of share-based payment transactions, whereby advisers render services in exchange for shares or rights over shares ('equity-settled transactions').

The cost of these equity-settled transactions with advisers is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an external valuer using a Black-Scholes model, and further details are given in note 21.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Kratos Energy Limited (market conditions).

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

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

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

## Notes to the Financial Statements (continued)

### 2. Statement of Significant Accounting Policies (continued)

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

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

#### (o) Critical Accounting Estimates and Judgements Required

The Directors evaluate estimates and judgments incorporated into the financial statements based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the Company.

##### *Share-based payment transactions*

The Company measures the cost of equity-settled transactions with employees and directors by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined using the Black-Scholes model. Should the assumptions used in these calculations differ, the amounts recognised could significantly change. Details of estimates used can be found in Note 21.

##### *Exploration Expenditure*

The Company has elected to expense exploration expenditure until such time an economically viable project is identified.

## Notes to the Financial Statements (continued)

### 2. Statement of Significant Accounting Policies (continued)

(p) Accounting Standards Issued Not Yet Effective

Certain new accounting standards have been published that are not mandatory for 30 June 2011 reporting periods. The Company has not applied any of the following in preparing this financial report:

Affected Standard	Title of Affected Standard	Nature of Change	Application Date *	Impact on Initial Application
AASB 9  AASB 2009-11	Financial Instruments  Amendments to Australian Accounting Standards arising from AASB 9	AASB 9 addresses the classification and measurement of financial assets and is likely to affect the company's accounting for its financial assets.	1 January 2013 but is available for early adoption	The company is yet to assess its full impact and has not yet decided when to adopt AASB 9.
AASB 101	<i>Presentation of Financial Statements</i>	A detailed reconciliation of each time of other comprehensive income may be included in the statement of changes in equity or in the notes to the financial statements.	Periods commencing on or after 1 January 2011	There will be no impact on initial adoption of this amendment as a detailed reconciliation of each item of other comprehensive income has always been included in the statement of changes in equity.
IFRS 11	<i>Joint Arrangements</i>	Joint arrangements will be classified as either 'joint operations' (where parties with joint control have rights to asset and obligations for liabilities) or 'joint ventures' (where parties with joint control have rights to the net assets of the arrangement).  Joint arrangements structured as a separate vehicle will generally be treated as joint ventures and accounted for using the equity method (proportionate consolidation no longer allowed).	Periods commencing on or after 1 January 2013	When the standard is first adopted for the year ended 30 June 2014, there will be no impact on transactions and balances recognised in the financial statements because the entity has not entered into any joint ceased its only joint arrangement in the current reporting period.

IFRS 13	<i>Fair Value Movements</i>	Currently, fair value measurement requirements are included in several Accounting Standards. IFRS 13 establishes a single framework for measuring fair value of financial and non-financial items recognised at fair value in the statement of financial position or disclosed in the notes in the financial statements.	Periods commencing on or after 1 January 2013	Due to recent release the entity has yet to conduct a detailed analysis of the differences between the current fair valuation methodologies used and those required by IFRS 13. However, when this standard is adopted for the first time for the year ended 30 June 2014, there will be no impact on the financial statements because the revised fair value measurement requirements apply prospectively from 1 July 2013.
IFRS 13	<i>Fair Value Measurement</i>	Additional disclosures required for items measured at fair value in the statement of financial position, as well as items merely disclosed at fair value in the notes to the financial statements. Extensive additional disclosure requirements for items measured at fair value that are 'level 3' valuations in the fair value hierarchy that are not financial instruments, e.g. land and buildings, investment properties etc.	Periods commencing on or after 1 January 2013	When this standard is adopted for the first time on 1 July 2012, additional disclosures will be required about fair values.

<p>Amendment to IAS 1</p>	<p>Presentation of Items of Other Comprehensive Income</p>	<p>Amendments to align the presentation of items of other comprehensive income (OCI) with US GAAP. Various name changes as follows:</p> <ul style="list-style-type: none"> <li>• Statement of comprehensive income – to be referred to as a ‘statement of profit or loss and other comprehensive income’</li> <li>• Statements – to be referred to as ‘statement of profit or loss’ and ‘statement of comprehensive income’.</li> </ul> <p>OCI items must be grouped together into two sections: those that could subsequently be reclassified into profit or loss and those that cannot.</p>	<p>Periods commencing on or after 1 January 2013.</p>	<p>As this is a disclosure standard only, there will be no impact on amounts recognised in the financial statements.</p>
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IAS 19	<i>Employee Benefits</i>	<p>Main changes include:</p> <ul style="list-style-type: none"> <li>• Elimination of the 'corridor' approach for deferring gains/losses for defined benefit plans</li> <li>• Actuarial gains/losses on remeasuring the defined benefit plan obligation/asset to be recognised in OCI rather than in profit or loss, and cannot be reclassified in subsequent periods.</li> <li>• Subtle amendment to timing for recognition of liabilities for termination benefits.</li> <li>• Employee benefits expected to be settled (as opposed to due to settled under current standard) within 12 months after the end of the reporting period are short-term benefits, and therefore not discounted when calculating leave liabilities. Annual leave not expected to be used within 12 months of the end of reporting period will in future be discounted when calculating leave liability.</li> </ul>	Periods commencing on or after 1 January 2013	Due to the recent release of these amendments and that adoption is only mandatory for the 30 June 2014 year end, the entity has not yet made an assessment of the impact of these amendments.
AASB 1054	Australian Additional Disclosures	<p>Moves additional Australian specific disclosure requirements for for-profit entities from various Australian Accounting Standards into this Standard as a result of the Trans-Tasman Convergence Project. Removes the requirement to disclose each class of capital commitment and expenditure commitment contracted for at the end of the reporting period (other than commitments for the supply of inventories).</p>	Periods commencing on or after 1 July 2011	When this Standard is adopted for the first time for the year ended 30 June 2012, the financial statements will no longer include disclosures about capital and other expenditure commitments, including finance and operating lease commitments, as these are no longer required by AASB 1054.

## Notes to the Financial Statements (continued)

### 3. Segment Information

#### (a) Description of Segments

Management has determined that there is one identifiable reportable segment, being exploration for oil and gas in Alberta, Canada.

#### (b) Segment information

	Canada \$	Total \$
<b>Year ended 30 June 2011</b>		
<b>Revenue</b>		
Sales to external customers	-	-
Segment revenue	-	-
Segment loss	(388,827)	(388,827)
<b>Other segment information</b>		
Segment assets	-	-
Segment liabilities	-	-

	Canada \$	Total \$
<b>Year ended 30 June 2010</b>		
<b>Revenue</b>		
Sales to external customers	-	-
Segment revenue	-	-
Segment loss	(761,604)	(761,604)
<b>Other segment information</b>		
Segment assets	52,632	52,632
Segment liabilities	-	-

#### (c) Other segment information

##### (i) Segment result

The reconciliation of segment information to loss before income tax from continuing operations is as follows:

	2011 \$	2010
<b>Segment loss</b>	(388,827)	(761,604)
Corporate costs	(323,903)	(211,114)
<b>Loss before income tax from continuing operations</b>	(712,730)	(972,718)

## Notes to the Financial Statements (continued)

### 3. Segment Information (continued)

#### (ii) Segment assets and liabilities

Segment assets and liabilities are those that are directly attributable to a segment and the relevant portion that can be allocated to the segment on a reasonable basis.

Segment assets include all assets used by the segment and consist primarily of operating cash, receivables, property, plant and equipment and other intangible assets.

Segment liabilities consist primarily of creditors, employee benefits and borrowings.

Reportable segment assets reconciled to total assets as follows:

	2011 \$	2010 \$
<b>Segment assets</b>	-	52,632
Unallocated:		
Cash and cash equivalents	12,574	552,203
Other receivables	620	58,434
Other assets	1,833	-
Property, Plant & Equipment	906	-
<b>Total assets per the statement of financial position</b>	<b>15,933</b>	<b>663,269</b>

### 4 Revenue and Expenses

	2011 \$	2010 \$
(a) <b>Other income</b>		
Revenue	8,704	44,013
Foreign exchange gain	301	-
<b>Total other income</b>	<b>9,005</b>	<b>44,013</b>

## Notes to the Financial Statements (continued)

### 5. Income Tax

#### Income tax expense

	2011	2010
	\$	\$
Accounting loss before income tax	(712,730)	(972,718)
At the statutory income tax rate of 30% (2010: 30%)	(213,819)	(291,815)
Share issue expenses	19,434	(6,796)
Temporary differences not recognised	(2,730)	(3,839)
Permanent differences	117,583	250,725
Deferred tax asset not recognised	79,532	51,725
Income tax expense	-	-
At effective income tax rate of 30%		

#### Deferred Income Tax

Deferred income tax at 30 June not recognised relates to the following:

	2011	2010
	\$	\$
<i>Deferred income tax assets</i>		
Accruals temporary difference	2,708	5,100
Share issue expenses	43,045	10,367
Tax losses	138,523	58,990
Deferred tax asset not recognised	529,405	74,457

The Company has tax losses arising in Australia of \$461,742 (2010: \$196,635) that are available indefinitely for offset against future taxable profits of the companies in which the losses arose, subject to the Company satisfying the necessary loss recoupment tests.

### 6. Key Management Personnel

There are no other key management personnel other than the Directors of the Company.

#### a) Remuneration of Directors

	2011	2010
	\$	\$
Short-term employee benefits	105,000	87,500
Post employment benefits	9,450	7,875
Share-based payment	-	-
Total	114,450	93,375

## Notes to the Financial Statements (continued)

### 6. Key Management Personnel (continued)

At a board meeting on 3 May 2011 remuneration paid to directors was suspended indefinitely effective 31 March 2011.

b) Option holdings

No Options have been issued to Directors since incorporation.

c) Shareholdings

The number of shares in the Company held during the financial period by each Director of Kratos Energy Limited, including their personally related parties, is set out below.

#### Ordinary Shares

	Balance at Start of Period	Granted During Period as Compensation	Received During Period on Exercise of Options	Other Changes During the Period	Balance at End of Period
<b>2011</b>					
<b>Directors</b>	<b>01-07-2010</b>				<b>30-06-2011</b>
Mr Robert Towner	4,200,001	-	-	(2,799,998)	1,400,003
Mr Matthew Sheldrick	3,550,000	-	-	(2,366,666)	1,183,334
Mr Christopher Moyes	4,371,751	-	-	(2,914,499)	1,457,252
Mr Paul Dee Patterson	2,075,000	-	-	(1,383,333)	691,667
<b>TOTAL</b>	<b>14,196,752</b>	<b>-</b>	<b>-</b>	<b>(9,464,496)</b>	<b>4,732,256</b>

	Balance at Start of Period	Granted During Period as Compensation	Received During Period on Exercise of Options	Other Changes During the Period	Balance at End of Period
<b>2010</b>					
<b>Directors</b>	<b>01-07-2009</b>				<b>30-06-2010</b>
Mr Robert Towner	6,700,001	-	-	(2,500,000)	4,200,001
Mr Christopher Moyes	13,371,751	-	-	(9,000,000)	4,371,751
Mr Paul Dee Patterson	2,075,000	-	-	-	2,075,000
Mr Matthew Sheldrick	2,050,000	-	-	1,500,000	3,550,000
<b>TOTAL</b>	<b>24,196,752</b>	<b>-</b>	<b>-</b>	<b>(10,000,000)</b>	<b>14,196,752</b>

All equity transactions with Directors other than those arising from the exercise of remuneration options have been entered into under terms and conditions no more favourable than those the entity would have adopted if dealing at arm's length.

## Notes to the Financial Statements (continued)

### 6. Key Management Personnel (continued)

#### d) Other transactions with Directors

At 30 June 2011 there were no amounts payable to Directors or director-related entities for the reimbursement of expenses.

During the year ended 30 June 2011 Kratos paid pursuant to an agreement with BioMD Ltd, a company of which Robert Towner is a Director, \$6,000 for the provision for office services and related services. This agreement expired on the 30 September 2010.

During the year ended 30 June 2011 Kratos paid pursuant to an agreement with Cornerstone Corporate Pty Ltd, a company of which Robert Towner is a Director, \$10,740 for the provision for office and related services.

At a board meeting on 3 May 2011, the director's resolved that where possible it would suspend indefinitely the current contracts of the company effective 31 March 2011. The agreement with Cornerstone has been suspended indefinitely.

During the year ended 30 June 2011 Kratos entered into an agreement with Cornerstone Corporate Pty Ltd, a company of which Robert Towner is a Director to provide company secretarial services. No payments were made to Cornerstone Corporate during the financial year ended 30 June 2011 in relation to this agreement in line with the board resolution on 3 May 2011.

At 30 June 2010 the following amounts were payable to Directors or director-related entities for reimbursement of expenses.

Director	Entity	\$	Purpose
Chris Moyes	Moyes & Co	5,891	Travel reimbursements on review of projects
Robert Towner	BioMD Ltd	2,200	Provision of office facilities and services
Robert Towner	Cornerstone Corporate Pty Ltd	1,120	Telephone and overhead expense reimbursement

On the 31 January 2011 Kratos entered into loan agreements with each of the directors to provide an unsecured revolving credit facility of \$25,000 each. The term was for 6 months with an interest rate of 8%p.a payable monthly in arrears.

At 30 June 2011, the directors have each provided \$15,000 (total \$60,000) under this facility with interest accrued but not yet paid of \$1973 in total. (see Note 13 below).

## Notes to the Financial Statements (continued)

### 7. Auditor's Remuneration

	2011 \$	2010 \$
Audit and other assurance services		
BDO Audit (WA) Pty Ltd		
Audit or review of the financial statements of the entity	12,000	17,000
Other services		
BDO Corporate Finance (WA) Pty Ltd		
Independent expert's report	-	7,000
Investigative accountant's report	-	8,000
	<u>12,000</u>	<u>27,000</u>

### 8. Cash and Cash Equivalents

	2011 \$	2010 \$
Cash at bank and in hand	636	29,342
Short-term bank deposits	11,938	522,861
	<u>12,574</u>	<u>552,203</u>

The effective interest rate on short-term bank deposits are made for varying periods of between one day and one month depending on immediate cash requirements of the Company, and earn interest at the respective short-term deposit rates between 0.01% and 4.5%. Refer to note 18 for financial risk management disclosures.

#### Reconciliation of cash

Cash at the end of the financial period as shown in the Statement of cash flows is reconciled to items in the Statement of Financial Position as follows:-

Cash at bank and in hand	636	29,342
Short term deposits	11,938	522,861
	<u>12,574</u>	<u>552,203</u>

#### Reconciliation from the net loss after tax to the net cash flows used in operations

Net loss	(712,730)	(972,718)
Non-cash transactions in loss		
Option expense	2,577	46,784
Financing costs in net loss	109,290	-
Change in assets and liabilities		
(Increase)/decrease in GST receivables	4,799	(3,623)
(Increase)/decrease in other assets	50,799	(52,632)
Increase/(decrease) in other payables	(56,579)	35,178
	<u>(601,844)</u>	<u>(947,011)</u>

## Notes to the Financial Statements (continued)

### 9. Other Receivables

	2011 \$	2010 \$
<b>CURRENT</b>		
Other receivables	-	52,632
GST receivable	620	5,419
	<u>620</u>	<u>58,051</u>

### 10. Other Assets

	2011 \$	2010 \$
<b>CURRENT</b>		
Deferred capital raising costs	-	53,105
Prepayments	1,833	-
	<u>1,833</u>	<u>53,105</u>

### 11. Property, Plant & Equipment

	2011 \$	2010 \$
Opening net book value	-	-
Additions	1,510	-
Depreciation charge for the year	(604)	-
Closing net book value	<u>906</u>	-
Cost or fair value	1,510	-
Accumulated depreciation	(604)	-
Net book amount	<u>906</u>	-

### 12. Trade and Other Payables

	2011 \$	2010 \$
<b>CURRENT</b>		
Trade payables	3,502	30,231
Other payables	9,025	38,875
	<u>12,527</u>	<u>69,106</u>

## Notes to the Financial Statements (continued)

### 13. Loans

	2011 \$	2010 \$
<b>CURRENT</b>		
Loans to related parties	61,973	-

An unsecured revolving credit facility was established with each of the directors on 31 January 2011. Under the agreement the director's would provide up to \$25,000 each for a period of 6 months at an interest rate of 8%. The balance at the reporting date represents a drawdown on this facility of \$60,000 (\$15,000 per director) and unpaid interest as at the reporting date.

### 14. Contributed Equity

	2011 No.	2011 \$	2010 No.	2010 \$
Ordinary Shares Issued and fully paid	12,076,711	1,495,916	35,130,002	1,545,206
<b>Ordinary Shares</b>				
At the beginning of reporting period	35,130,002	1,545,206	43,150,002	1,417,653
- Shares cancelled pursuant to buy-back during the period			(10,000,000)	(50,000)
- Payment of share buy-back costs			-	(12,197)
- Ordinary shares issued on 30-06-2010 pursuant to Placement			1,980,000	198,000
- Payment of capital raising costs				(8,250)
- Ordinary shares issued on 22-07-2010 pursuant to Placement	100,000	10,000		
- Options exercised @ \$0.05 on 04-08-2010	1,000,000	50,000		
- 1:3 share consolidation approved at General Meeting of Members on 28-04-2010	(24,153,291)	-		
Balance	12,076,711	1,605,206	35,130,002	1,545,206

i. Ordinary shares entitle the holder to participate in dividends and the proposed winding up of the Company in proportion to the number and amount paid on the share hold.

ii. Capital Management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Given the stage of the Company's development there are no formal targets set for return on capital. There were no changes to the Company's approach to capital management during the period. The Company is not subject to externally imposed capital requirements.

## Notes to the Financial Statements (continued)

### 15. Option Reserve and Accumulated Losses

	2011 \$	2010 \$
Share based payments	84,489	84,489
Accumulated losses	(1,748,262)	(1,035,532)
<b>Option reserve</b>		
At the beginning of the financial period	84,489	37,705
Share-based payments	-	46,784
As at 30 June	84,489	84,489
<b>Accumulated losses</b>		
At the beginning of the financial period	(1,035,532)	(62,814)
Loss for the period	(712,730)	(972,718)
As at 30 June	(1,748,262)	(1,035,532)

#### Option Reserve

The option reserve is used to record the value of equity benefits which may be provided to advisers and consultants as payments for services.

### 16. Contingent Liabilities and Contingent Assets

The Directors are not aware of any contingent liabilities or contingent assets which require disclosure as at 30 June 2011.

### 17. Joint Venture Operations

Kratos Energy previously entered into various farm-in agreements with South Bay Resources to pay up to 33.33% of costs to drill advanced oil & gas prospects. Kratos Energy would earn up to a 25% interest in the prospect and would be entitled to 25% of any future revenue after payment of applicable taxes and royalties. The Company's interests in the assets employed in the joint venture are included in the statement of financial position in accordance with the accounting policy described in note 2c, under the following classifications:

	2011 \$	2010 \$
Other receivables	-	52,632
Share of assets employed in joint venture	-	52,632

All exploration expenditure relates to joint venture operations being \$388,827 (2010: \$761,604)

Kratos has satisfied all of its farm-in obligations with South Bay Resources and a decision was made to discontinue its relationship with South Bay Resources.

## Notes to the Financial Statements (continued)

### 18. Financial Risk Management

The Company's principal financial instruments comprise cash and short-term deposits. The main purpose of these financial instruments is to raise finance for the Company's operations.

The Company has various other financial instruments such as trade creditors, which arise directly from its operations.

It is, and has been throughout the period under review, the Company's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Company's financial instruments are interest rate risk, liquidity risk and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

#### (i) Interest rate risk

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's cash at bank held with variable interest rates.

The Company does not rely on the generation of interest on cash at bank to provide working capital and as a result does not consider this to be material to the Company and have therefore not undertaken any further analysis of exposure.

The following table sets out the carrying amount of the financial instruments that are exposed to interest rate risk:

Year ended 30 June 2011	Balance \$	Weighted Average Interest Rate %
<i>Floating Rate</i>		
Financial Assets		
Cash and cash equivalents	12,574	4.5
<i>Fixed Rate</i>		
Financial Liabilities		
Loans	61,972	8
<b>Year ended 30 June 2010</b>		
<i>Floating Rate</i>		
Financial Assets		
Cash and cash equivalents	552,503	3.5
<i>Fixed Rate</i>		
Financial Liabilities		
Loans	-	N/A

## Notes to the Financial Statements (continued)

### 18. Financial Risk Management (continued)

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until maturity of the instrument.

The other financial instruments of the Company that are not included in the above tables are non-interest bearing and are therefore not subject to interest rate risk.

#### Cash flow sensitivity analysis for variable rate instruments

As at 30 June 2011 and 30 June 2010 a sensitivity analysis has not been disclosed in the current year in relation to the floating interest deposits for the Company, as the results are immaterial to the Statement of Comprehensive Income.

#### (ii) Credit risk

Credit risk is the risk of financial loss to the Company if a counter party to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash at bank. The carrying amount of financial assets represents the maximum credit exposure.

Financial assets that are neither past due and not impaired are as follows:

	2011	2010
	\$	\$
Cash and cash equivalents		
'AA' S&P rating	12,574	552,203

The credit risk on liquid funds is limited because the counter party is a bank with a high credit rating. Credit risk on liquid funds is managed by only holding cash balances with financial institutions with a high credit rating.

#### (iii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial liabilities as and when they fall due. The Company manages liquidity risk by continually monitoring cash reserves and cashflow forecasts to ensure that financial commitments can be met as and when they fall due.

The Company's objective is to maintain a balance between continuity of funding and flexibility through the use of equity funding.

#### Maturities of financial liabilities

The table below analyses the entity's financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

## Notes to the Financial Statements (continued)

### 19. Financial Instruments

	Less than 6 months \$	Carrying amount \$
<b>2011</b>		
Trade and other payables	12,527	12,527
Loans	61,973	61,973
	74,500	74,500
<b>2010</b>		
Trade and other payables	69,106	69,106

#### Fair values

The carrying value of trade receivables and payables are assumed to approximate their fair values due to their short-term nature.

### 20. Related Party Disclosure

(a) Key management personnel

Disclosures relating to key management personnel are set out in note 6.

(b) Transactions with related parties

There are no transactions with related parties other than what is disclosed in note 6.

### 21. Share-based Payments

No options have been issued during the 2011 year.

No options have been issued during the 2010 year.

The 1,000,000 adviser options that were issued on 28 October 2008 were exercised on the 4 August 2010.

### 22. Events after Reporting Date

In conjunction with Messrs Moyes' and Patterson's resignation from the board, the board received notice in respect of their revolving credit facilities. The facilities have been extended to 31 March 2012, with the facility capped at its current drawn down value of \$15,000 (each) on the same terms with no requirement to provide the additional \$10,000 if called.

### 23. Commitments

At year end, Kratos has no outstanding commitments pursuant to its farm-in agreements with South Bay Resources.

### 24. Dividends

There are no dividends paid or payable at year-end.

## Notes to the Financial Statements (continued)

### 25. Company Details

The registered office and principal place of business of the Company is:

Unit 18, 589 Stirling Highway  
Cottesloe Western Australia 6011  
Tel: +61 8 9286 2828  
Fax: +61 8 9286 2211

## Directors' Declaration

In accordance with a resolution of the Directors of Kratos Energy Limited, I state that:

In the opinion of the Directors:

- (a) The financial statements and notes as set out on pages 13 to 38 of the Company are in accordance with the Corporations Act 2001, including:
  - (i) giving a true and fair view of the Company's financial position as at 30 June 2011 and of its performance for the year ended on that date; and
  - (ii) complying with Accounting Standards and Corporations Regulations 2001.
- (b) There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- (c) The Company has included in the notes to the financial statement an explicit and unreserved statement of compliance with International Financial Reporting Standards.

On behalf of the Board



**Robert Towner**  
Chairman

Perth, Western Australia

## **Independent Audit Report**

## Shareholder Information

### Twenty Largest Shareholders as at 26 October 2011

Name	No. ordinary shares held	% of issued capital held
Cornerstone Corporate Pty Ltd	2,657,000	22.00%
Matthew R Sheldrick	1,183,334	9.80%
Austin 4 Pty Ltd	1,000,000	8.28%
Ayman Hariri	1,000,000	8.28%
David M Cross	416,668	3.45%
Sally Towner	366,668	3.04%
Ucan Nominees Pty Ltd	333,334	2.76%
Michael Arnett	250,000	2.07%
Foxmore Holdings Pty Ltd	250,000	2.07%
Christopher P Moyes	181,460	1.50%
Francoise C Moyes	178,792	1.48%
Paul D Patterson	171,667	1.42%
Rupsojoa Pty Ltd	166,667	1.38%
Chatelle Pty Ltd	166,667	1.38%
Paul R Hearne	166,667	1.38%
Concept Biotech Pty Ltd	166,667	1.38%
Linton Investments Pty Ltd	166,667	1.38%
Ian M Cross	150,000	1.24%
Chris R K Moore	130,000	1.08%