KAROON GAS AUSTRALIA LTD

INTERIM FINANCIAL REPORT
FOR THE FINANCIAL HALF-YEAR ENDED
31 DECEMBER 2010

ABN 53 107 001 338

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DIRECTORS' REPORT
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

The Board of Directors submits its Directors' Report on Karoon Gas Australia Ltd and its subsidiaries (the "Group") for the financial half-year ended 31 December 2010 (the "financial half-year").

Board of Directors

The names of the Directors of Karoon Gas Australia Ltd (the "Company") during the financial half-year and up to the date of this Directors Report are set out below:

Mr Robert M. Hosking – Executive Chairman;
Mr Mark A. Smith – Executive Director and Exploration Manager;
Mr Geoff Atkins – Independent Non-Executive Director;
Mr Stephen Power – Non-Executive Director; and
Mr Clark Davey – Independent Non-Executive Director.*

* Mr Davey was appointed as a Director of the Company on 1 October 2010 and has replaced Mr Robert Hosking on the Audit Committee.

Highlights - Company Operations

- A total of $268.2 million dollars in new funding was raised through a $186.4 million share placement to institutional and professional investors during September 2010, and $81.8 million through a share purchase plan completed during October 2010.
- 2,828 square kilometers of 3D seismic data over the greater Poseidon structure continued to be processed and interpreted providing better definition of the Poseidon Field and surrounding prospects.
- 750 square kilometers of wide azimuth 3D seismic data from the Santos Basin Brazil blocks continued to be processed with results expected for interpretation early in the second quarter 2011.
- 1,500 square kilometres of 3D seismic data acquired in the Tumbes Basin Z-38 Block, Peru was processed and is now in interpretation and early results indicate several new leads and prospects.
- Karoon Petróleo & Gás S.A., a wholly owned subsidiary of the Company, executed a Farm-in Agreement with Petróleo Brasileiro SA ("Petrobras") for two blocks in the Santos Basin, Brazil (subject to regulatory approvals in Brazil, including from the Brazilian Petroleum Agency).
- Petrobras made a discovery from the Maruja exploration well in Block S-M-1352 and achieved an equipment constrained production oil flow rate of 6,142 barrels of oil per day through a 5/8 inch choke during the clean up flow.
- Karoon agreed to increase its equity in WA-314-P from 40% to 90% subject to executing final documentation and obtaining regulatory approvals.
- During the financial half-year, Karoon planned a public offering on the BM&F BOVESPA in São Paulo, Brazil, of 31.9% of the common shares in its wholly owned subsidiary, Karoon Petróleo & Gás S.A., however, due to unfavourable financial market conditions Karoon decided not to proceed with the offering.

Financial Results

The consolidated loss for the financial half-year was $14,237,683 (2009: $11,475,748). The loss for the financial half-year was largely attributable to net foreign currency losses of $6,595,163 and costs of $5,507,440 associated with the public offering on the BM&FBOVESPA in São Paulo, Brazil.

DIRECTORS' REPORT (Continued)
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Review of Operations

Australia

Browse Basin permits WA-314-P, WA-315-P and WA-398-P

During the financial half-year, the interpretation of the 2,828 square kilometre 3D seismic data acquired over the greater Poseidon structure continued and the first full time cube has provided encouraging results. The interpretation from the seismic will be used in determining the location of future wells in the upcoming Poseidon drilling campaign.

Karoon's joint venture partner, ConocoPhillips have made preparations and submissions for a multi-well drilling program to begin in the second quarter 2011 subject to environmental approvals and to continue into 2012. Wells drilled as part of this multi-well exploration and appraisal program will define the size and deliverability of the Poseidon discovery. The data from these wells will form the basis of a potential future development decision.

At time of completing this report, the environmental approvals were still under consideration with additional information and workshops to be completed with the relevant Australian Government departments in the immediate term. Results from this work are expected in the near future. The joint venture has made preparations in readiness to begin the five to eight well drilling program in the shortest possible time after the approval is granted.

During November 2010, Karoon and ConocoPhilips executed a heads of agreement under which Karoon will acquire an additional 50% interest in the WA-314-P permit taking its total equity interest to 90%. Karoon has assessed seven leads and prospects in the WA-314-P block, including the Grace prospect, with a prospective resource potential size of 3.3 trillion cubic feet and 45 million barrels of condensate. A well will be drilled in WA-314-P as part of the upcoming Browse drilling campaign.

The offshore Browse Basin is located 350 km offshore from the North-Western Australian coastline.

Permit interests of the participants in, WA-314-P, WA-315-P and WA-398-P are:

Karoon Gas (Browse Basin) Pty Ltd	40.00%
ConocoPhillips (Browse Basin) Pty Ltd (Operator)	60.00%

Bonaparte Basin permit AC/P8

Karoon completed a Controlled Source Electro Magnetic ("CSEM") survey in July 2010 and commenced the processing and interpretation of the CSEM survey data set. The data from this survey will contribute to the understanding of the geology and prospectivity of potential drilling targets in AC/P8.

The AC/P8 permit contains two prospects and a number of leads which will need to be further defined by Karoon and its joint venture partner, Talisman Oil & Gas (Australia) Pty Limited.

Permit interests of the participants in AC/P8 are:

Karoon Energy International Ltd (Operator)	66.67%
Talisman Oil & Gas (Australia) Pty Limited	33.33%

DIRECTORS' REPORT (Continued)
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Review of Operations

South America

Brazil Blocks 1037, 1101, 1102, 1165 and 1166

The processing of a 750 square kilometre wide azimuth 3D seismic acquisition program over Karoon's 100% held Santos Basin blocks is continuing and will be followed by interpretation during the first half of 2011.

The objective of the wide azimuth seismic is to provide a uniform, high-quality, 3D seismic coverage with a focus on better depth imaging beneath and around salt structures allowing more accurate prospect delineation. This wide azimuth 3D seismic acquisition program is the first of its kind in Brazil.

The new seismic data will aid in the positioning of exploration wells expected to be drilled during late 2011, early 2012. Preparations for drilling are continuing with the ordering of long lead items and completion of negotiations for a shore base and drilling rig will continue throughout 2011.

The Santos Basin is offshore from the Santa Catarina region of Brazil, just south of Rio de Janeiro, which has recently yielded multiple oil discoveries. Recent discoveries in the Santos Basin include the Tupi and Carioca oil fields, the Newton oil discovery, the Caravela and Coral fields, the Merluza field and the Tiro, Sidon and Maruja discoveries.

Karoon has a 100% working interest and is the operator of its Santos Basin Blocks 1037, 1101, 1102, 1165 and 1166.

Blocks 1352 and 1354, 100% owned and operated by Petrobas

In August 2010, Karoon Petroleo & Gas S.A., a wholly owned subsidiary of the Company, executed a farm-in agreement with Petroleo Brasileiro S.A. ("Petrobras") to acquire a 20% interest in Blocks S-M-1352 and S-M-1354 located in the offshore Santos Basin, Brazil.

Under the farm-in agreement and subject to obtaining regulatory approvals from the Brazilian Petroleum Agency, Karoon Petroleo & Gas S.A. will earn a 20% equity interest by funding a proportion of the costs of drilling two exploration wells. Karoon Petroleo & Gas S.A. will then pay its equity share of continued work and reimburse Petrobras for sunk costs.

The first well, Quasi-1, was a high risk target which subsequently proved uncommercial.

The second well, Maruja-1, which commenced drilling in September 2010, made a discovery at 2,201-2,210 metres in the high porosity Oligocene sandstone reservoir. During production testing, the Maruja-1 well achieved an equipment constrained oil flow rate of 6,142 barrels of oil per day through a 5/8 inch choke during the clean up flow. This test was followed by a main flow period of 24 hours that achieved a stabilised flow rate of 4,675 barrels of oil per day and 0.8 mmscf/d of gas through a 1/2 inch choke, with a flowing wellhead pressure of 1,050 psia. An oil gravity of 38 API was also measured. Maruja-1 was drilled to a total depth 3,789 metres and following the production test was suspended. The well data from the Maruja-1 well will now be used for appraisal drill planning.

In February 2011, 'the Diamond Offshore Ocean Yorktown semisubmersible drilling rig' moved onto location and commenced drilling on the Maruja-2 appraisal well. The well's surface location is 4.8 km north east of the Maruja-1 exploration well.

DIRECTORS' REPORT (Continued)
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Review of Operations

Blocks 1352 and 1354, 100% owned and operated by Petrobas (continued)

The Maruja-2 well objectives are to test the extension of the Maruja-1 (1-SPS-76) reservoir over the north-east part of the closure. A vertical well will be cored to provide detailed reservoir evaluation and a sidetrack drilled to test reservoir continuity.

The official work program terms completed in December 2010, subsequently the farm-in area of S-M 1352 and S-M 1354 have been reduced to an area retained around the Maruja discovery. This reduction includes the full relinquishment of the Block BM-S 1354 and partial relinquishment of S-M 1352**.**

After completion of the farm-in work programs and regulatory approvals equity interest in BM-S-41/S-M-1352 will be:

Petroleo Brasiliero S.A. (Operator)	80%*
Karoon Petroleo e Gas S.A.	20%

*Equity interests stated are based on the completion of post farm-in obligations and are subject to regulatory approval from the Agencia Nacional do Petroleo, the Brazilian Petroleum Agency.

Peru Block Z-38

During financial half-year, the 1,500 square kilometre 3D seismic processing was completed and interpretation commenced. The objective of the seismic acquisition is to provide prospect delineation for a planned drilling campaign during 2012 and to gain a better understanding of previously underexplored areas within Block Z-38.

Early results from the 3D seismic are encouraging with several new leads and prospects being delineated. This data will now be used to high grade prospects for drilling early in 2012. Karoon has now commenced preparations for drilling and the process is expected to continue well into 2012.

Block Z-38 is located in the Tumbes Basin, offshore in the northwest of Peru. It is a region that is experiencing renewed activity after a series of successful exploration programs by the holder of the license area adjoining Block Z-38. The Talara Basin, to the south of the Tumbes Basin, has produced more than 1 billion barrels of oil. The Talara Basin is reported to be the location of the first oil production in South America in the late 1800's.

After completion of the farm-in work programs and regulatory approvals equity interests in Block Z-38 will be:

KEI (Peru Z38) Pty Ltd, Sucursal del Peru (Operator)	75%*
Vietnam American Exploration Company LLC	25%

*Equity interests stated are based on the post farm-in ownership. KEI (Peru Z-38) Pty Ltd, Sucursal del Peru is a subsidiary of Karoon.

Peru Block 144

Karoon continued its geotechnical, social and environmental work in the Block and continued interpretation of 1,000 kilometres of existing reprocessed 2D seismic data.

Karoon has a 100% working interest in Block 144.

DIRECTORS' REPORT (Continued)
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Future Plans, Development, Business Strategies and Prospects

Other than the matters included in this Directors' Report or elsewhere in the Interim Financial Report, future developments, business strategies and prospects of the Group and the expected results of those operations have not been disclosed as the Directors believe that the inclusion would most likely result in unreasonable prejudice to the Company and/or the Group.

External Auditor's Independence Declaration

A copy of the external Auditor's Independence Declaration for the financial half-year, as required under Section 307C of the *Corporations Act 2001*, is set out on page 7.

This Directors' Report is made in accordance with a resolution of the Board of Directors.

On behalf of the Directors:

Mr Robert Hosking
Executive Chairman

9 March 2011
Melbourne

AUDITORS' INDEPENDENCE DECLARATION
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

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Auditor's Independence Declaration

As lead auditor for the review of Karoon Gas Australia Ltd for the half year ended 31 December 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 review; and
b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Karoon Gas Australia Ltd and the entities it controlled during the period.

Charles Christie
Partner
PricewaterhouseCoopers

Melbourne
9 March 2011

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

	Note	Consolidated 31 Dec 2010 $	Consolidated 31 Dec 2009 $
Revenue		5,449,917	3,768,267
Other income		13,000	914
Total revenue and other income		5,462,917	3,769,181
Computer support		(299,030)	(180,717)
Consulting fees		(622,391)	(161,752)
Depreciation and amortisation expense		(205,396)	(211,756)
Employee benefits expense (net)		(3,796,571)	(3,421,338)
Exploration and evaluation expenditure expensed or written off		(299,004)	(68,966)
Finance costs		(85,897)	(72,534)
Legal fees		(173,684)	(276,912)
Net foreign currency losses	2	(6,595,163)	(9,281,522)
Property costs		(365,982)	(102,775)
Share registry and listing fees		(369,795)	(342,257)
Travel and accommodation expenses		(304,458)	(350,030)
Brazilian initial public offering expenses	2	(5,507,440)	-
Other expenses		(1,075,789)	(774,370)
Total expenses		(19,700,600)	(15,244,929)
Loss before income tax		(14,237,683)	(11,475,748)
Income tax		-	-
Loss for financial half-year	2	(14,237,683)	(11,475,748)
Other comprehensive loss:			
Exchange differences arising from the translation of financial statements of foreign subsidiaries		(8,238,018)	(245,350)
Income tax relating to components of other comprehensive loss		-	-
Other comprehensive loss for financial half-year, net of tax		(8,238,018)	(245,350)
Total comprehensive loss for financial half-year		**(22,475,701)**	**(11,721,098)**
Earnings per share for loss attributable to equity holders of the Company:			
Basic loss per ordinary share		(0.0723)	(0.0651)
Diluted loss per ordinary share *		(0.0723)	(0.0651)

* Diluted loss per ordinary share equates to basic loss per ordinary share because a loss per share is not considered dilutive for the purposes of calculating earnings per share pursuant to *AASB 133 'Earnings per Share'.*

The accompanying notes form an integral part of these condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2010

		Consolidated	
	Note	31 Dec 2010 $	30 June 2010 $
Current Assets			
Cash and cash equivalents		318,946,699	87,122,836
Trade and other receivables		4,039,557	4,873,578
Inventories		213,236	360,081
Security deposits		15,466,061	12,091,872
Other assets		744,589	710,376
Total current assets		339,410,142	105,158,743
Non-Current Assets			
Property, plant and equipment		1,304,277	607,552
Intangible assets		314,189	354,922
Exploration and evaluation expenditure carried forward		270,749,164	265,243,372
Security deposits		329,970	4,547,690
Total non-current assets		272,697,600	270,753,536
Total assets		612,107,742	375,912,279
Current Liabilities			
Trade and other payables		6,008,994	13,912,243
Income tax liability		-	235,727
Total current liabilities		6,008,994	14,147,970
Non-Current Liabilities			
Provisions		83,767	60,738
Total non-current liabilities		83,767	60,738
Total liabilities		6,092,761	14,208,708
Net Assets		**606,014,981**	**361,703,571**
Equity			
Issued capital	5	645,338,913	381,147,212
Accumulated losses		(48,948,123)	(34,710,440)
Share-based payments reserve		15,874,517	13,279,107
Foreign currency translation reserve		(6,250,326)	1,987,692
Total Equity		**606,014,981**	**361,703,571**

The accompanying notes form an integral part of these condensed consolidated financial statements.

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010**

Consolidated	Issued capital	Accumulated losses	Share-based payments reserve	Foreign currency translation reserve	Total Equity
	$	$	$	$	$
Balance as at 1 July 2009	347,331,271	(19,816,601)	7,990,060	(845,891)	334,658,839
Loss for financial half-year	-	(11,475,748)	-	-	(11,475,748)
Exchange differences arising from the translation of financial statements of foreign subsidiaries	-	-	-	(245,350)	(245,350)
Total comprehensive loss for financial half-year	-	(11,475,748)	-	(245,350)	(11,721,098)
Transactions with owners in their capacity as owners:					
Ordinary shares issued	32,468,259	-	-	-	32,468,259
Transaction costs arising on shares issued	(288,318)	-	-	-	(288,318)
Share-based payments expense	-	-	2,617,342	-	2,617,342
	32,179,941	-	2,617,342	-	34,797,283
Balance as at 31 December 2009	**379,511,212**	**(31,292,349)**	**10,607,402**	**(1,091,241)**	**357,735,024**
Balance as at 1 July 2010	381,147,212	(34,710,440)	13,279,107	1,987,692	361,703,571
Loss for financial half-year	-	(14,237,683)	-	-	(14,237,683)
Exchange differences arising from the translation of financial statements of foreign subsidiaries	-	-	-	(8,238,018)	(8,238,018)
Total comprehensive loss for financial half-year	-	(14,237,683)	-	(8,238,018)	(22,475,701)
Transactions with owners in their capacity as owners:					
Ordinary shares issued	272,836,747	-	-	-	272,836,747
Transaction costs arising on shares issued	(8,645,046)	-	-	-	(8,645,046)
Share-based payments expense	-	-	2,595,410	-	2,595,410
	264,191,701	-	2,595,410	-	266,787,111
Balance as at 31 December 2010	**645,338,913**	**(48,948,123)**	**15,874,517**	**(6,250,326)**	**606,014,981**

The accompanying notes form an integral part of these condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

	Consolidated	
	31 Dec 2010 $	31 Dec 2009 $
Cash Flows From Operating Activities		
Receipts from customers (inclusive of GST refunds)	1,098,911	359,629
Payments to suppliers and employees (inclusive of GST)	(11,393,538)	(3,416,787)
Payments for exploration and evaluation expenditure expensed	(299,004)	(68,966)
Interest received	3,847,697	3,094,609
Interest and other costs of finance paid	(85,897)	(72,534)
Income taxes paid	(220,227)	-
Net cash flows used in operating activities	(7,052,058)	(104,049)
Cash Flows From Investing Activities		
Purchase of plant and equipment and computer software	(848,208)	(409,068)
Payments for exploration and evaluation expenditure	(17,549,743)	(48,372,027)
Payment of security deposits (net)	(304,358)	-
Net cash flows used in investing activities	(18,702,309)	(48,781,095)
Cash Flows From Financing Activities		
Proceeds from issue of ordinary shares	272,836,747	27,956,031
Payments for transaction costs arising on ordinary shares issued	(8,645,046)	(800,819)
Net cash flows provided by financing activities	264,191,701	27,155,212
Net increase (decrease) in cash and cash equivalents held	238,437,334	(21,729,932)
Cash and cash equivalents as at the beginning of financial half-year	87,122,836	228,238,280
Effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies	(6,613,471)	(9,456,049)
Cash and cash equivalents at the end of financial half-year	**318,946,699**	**197,052,299**

The accompanying notes form an integral part of these condensed consolidated financial statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 1. Basis Of Preparation Of Condensed Consolidated Financial Statements

The condensed consolidated financial statements are general-purpose financial statements, which have been prepared in accordance with Australian Accounting Standard *AASB 134 'Interim Financial Reporting'* and the *Corporations Act 2001*.

The condensed consolidated financial statements do not include all the notes of the type normally included in an Annual Report.

It is recommended that the condensed consolidated financial statements be read in conjunction with the Annual Report for the financial year ended 30 June 2010 and any public announcements made by Karoon Gas Australia Ltd during the financial half-year ended 31 December 2010 in accordance with the continuous disclosure requirements of the *Corporations Act 2001* and ASX Listing Rules.

Apart from the change in accounting policy noted below, the condensed consolidated financial statements have been prepared using the same accounting policies and methods of computation as used in the corresponding interim financial half-year and Annual Report for the financial year ended 30 June 2010.

Where necessary, comparative information has been reclassified to achieve consistency in disclosure with financial half-year amounts and other disclosures.

Change in accounting policy

The Group has applied revised Australian Accounting Standard *AASB 107 'Statement of Cash Flows'* issued by the AASB, which was mandatory to apply to the current reporting period.

Under the revised accounting standard, only exploration and evaluation expenditure that is capitalised may be presented as cash flows from investing activities. Under the Group's previous accounting policy, all cash flows associated with exploration and evaluation expenditure (comprising both amounts expensed and capitalised) were classified as cash flows from investing activities. The change in accounting policy increased net cash outflows from operating activities and decreased net cash outflows from investing activities in the previous financial half-year by $68,966.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 1. Basis Of Preparation Of Condensed Consolidated Financial Statements (continued)

Going concern

On the basis of the present level of operations and after consideration of the Group's ability to:

i. farm-out its interests in exploration permits/Blocks in order to fund future exploration expenditure commitments;

ii. raise capital through the issue of new ordinary shares in the Company to meet working capital requirements and/or shortfalls in exploration expenditure commitments; and

iii. manage its existing cash and future cash flows to meet its current obligations and future plans,

the Directors are of the opinion that for the next 12 month period from the date of signing the Directors' Declaration, the Group and Company will have sufficient liquidity to meet their existing commitments and accordingly present these condensed consolidated financial statements on a going concern basis.

Note 2. Results For Financial Half-Year

	Consolidated	
	31 Dec 2010 $	**31 Dec 2009 $**
The results for the financial half-year include the following revenue and expense items which are unusual because of their nature, size or incidence:		
Net foreign currency losses	(6,595,163)	(9,281,522)
Brazilian initial public offering expenses	(5,507,440)	-

Note 3. Dividends

There were no ordinary dividends declared or paid during the financial half-year by the Company (31 December 2009: $Nil).

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 4. Segment Information

(a) Description of segments

The Group has identified its operating segments based on the internal reports that are reviewed and used by the Executive Chairman and Executive Director/Exploration Manager (identified as the "chief operating decision maker") in assessing performance and in determining the allocation of resources.

The operating segments identified are based on the Group's equity interest in each individual exploration permit. Discrete financial information (including expenditure on exploration and evaluation assets) is provided to the chief operating decision maker on a regular basis. In certain circumstances, individual exploration permits are aggregated into a single operating segment where the economic characteristics and long term planning and operational considerations of the individual exploration permits are such that they are considered interdependent.

The Group has identified three operating segments:

- Australia exploration – the Group is currently involved in the exploration and evaluation of hydrocarbons in four offshore permit areas within the Browse Basin, Australia: WA-314-P, WA-315-P, WA-398-P and AC/P8;
- Brazil exploration – the Group is currently involved in the exploration and evaluation of hydrocarbons in five offshore Blocks within the Santos Basin, Brazil: Block 1037, Block 1101, Block 1102, Block 1165, Block 1166;
- Peru exploration – the Group is currently involved in the exploration and evaluation of hydrocarbons in two Blocks in Peru: Block 144 (onshore) and Block Z-38 (offshore).

'All other segments' include amounts of a corporate nature not specifically attributable to an operating segment.

The following items and associated assets and liabilities are not allocated to operating segments as they are not considered part of the core operations of any segment but are reviewed by the chief operating decision maker on a monthly basis:

- interest income;
- net foreign currency gains (losses);
- finance costs;
- employee benefits expense (including non-cash share-based payments expense);
- administration and other operating expenses;
- depreciation and amortisation expense;
- property costs; and
- income tax expense.

Employee benefits expense and other operating expenses, that are associated with the exploration for and evaluation of the resources and specifically relate to an area of interest, are allocated to the area of interest and are capitalised as exploration and evaluation assets.

Segment revenues and results do not include transfers between segments as intercompany balances are eliminated on consolidation.

The amounts provided to the chief operating decision maker with respect to total assets are measured in a manner consistent with that of the consolidated financial statements. Reportable segment assets are equal to consolidated total assets.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 4. Segment Information (continued)

(b) Operating segments

Segment performance	Australia $	Brazil $	Peru $	All Other Segments $	Consolidated $
Revenue for financial half-year 31 December 2010					
Segment revenue	-	-	-	13,000	13,000
Interest income from unrelated entities					5,449,917
Total revenue					5,462,917
Result for financial half-year 31 December 2010					
Exploration and evaluation expenditure expensed or written off	(223,286)	(26,260)	(16,640)	(32,818)	(299,004)
Interest income from unrelated entities					5,449,917
Net foreign currency losses					(6,595,163)
Finance costs					(85,897)
Employee benefits expense (net)					(3,796,571)
Administration and other operating expenses					(8,352,587)
Depreciation and amortisation expense					(205,396)
Property costs					(365,982)
Loss before income tax					(14,237,683)
Income tax					-
Loss for financial half-year					(14,237,683)
Revenue for financial half-year 31 December 2009					
Segment revenue	-	-	-	-	-
Interest income from unrelated entities					3,768,267
Total revenue					3,768,267
Result for financial half-year 31 December 2009					
Exploration and evaluation expenditure expensed or written off	(21,443)	(5,136)	(2,839)	(38,634)	(68,052)
Interest income from unrelated entities					3,768,267
Net foreign currency losses					(9,281,522)
Finance costs					(72,534)
Employee benefits expense (net)					(3,421,338)
Administration and other operating expenses					(2,086,038)
Depreciation and amortisation expense					(211,756)
Property costs					(102,775)
Loss before income tax					(11,475,748)
Income tax					-
Loss for financial half-year					(11,475,748)

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010**

Note 4. Segment Information (continued)

(b) Operating segments (continued)

Segment assets	Australia $	Brazil $	Peru $	All Other Segments $	Consolidated $
As at 31 December 2010					
Segment asset information					
Cash and cash equivalents	676,630	438,468	455,134	317,376,467	318,946,699
Exploration and evaluation expenditure carried forward	194,020,403	54,990,112	21,738,649	-	270,749,164
Security deposits	-	11,321,862	4,038,269	435,900	15,796,031
Inventories	213,236	-	-	-	213,236
Other	598,509	55,009	2,241,627	3,507,467	6,402,612
Segment assets	195,508,778	66,805,451	28,473,679	321,319,834	612,107,742
As at 30 June 2010					
Segment asset information					
Cash and cash equivalents	10,230,163	1,965,638	223,434	74,703,601	87,122,836
Exploration and evaluation expenditure carried forward	190,077,406	52,024,240	23,141,726	-	265,243,372
Security deposits	35,115	11,723,326	4,810,814	70,307	16,639,562
Inventories	360,081	-	-	-	360,081
Other	1,339,515	28,487	3,343,996	1,834,430	6,546,428
Segment assets	202,042,280	65,741,691	31,519,970	76,608,338	375,912,279

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 5. Issued Capital

	31 Dec 2010	30 June 2010
(a) Share capital	$	$
Ordinary shares, fully paid	645,338,913	381,147,212

(b) Movement in ordinary shares

Date	Details	Number of ordinary shares	$
1 July 2009	Opening balance in previous financial year	171,301,831	347,331,271
	Share purchase plan	3,514,367	23,546,259
	Exercise of other share options	1,250,000	5,000,000
	Exercise of ESOP options	1,480,000	5,558,000
	Less: Transaction costs arising on ordinary shares issued during previous financial year		(288,318)
30 June 2010	Balance as at end of previous financial year	177,546,198	381,147,212
	Share placement	26,631,929	186,423,503
	Share purchase plan	11,692,642	81,848,494
	Exercise of other share options	1,000,000	2,950,000
	Exercise of ESOP options	425,000	1,614,750
	Less: Transaction costs arising on ordinary shares issued during financial half-year		(8,645,046)
31 December 2010	Balance as at end of financial half-year	**217,295,769**	**645,338,913**

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 6. Commitments

	Consolidated	
	31 Dec 2010 $	**30 June 2010 $**
(a) Capital expenditure commitments		
Contracts for capital expenditure in relation to assets not provided for in the condensed consolidated financial statements:		
(i) Drilling operations		
Not later than 1 year	13,253,289	-
Total capital expenditure commitments	13,253,289	-
(b) Exploration expenditure commitments		
Some subsidiaries within the Group have commitments for exploration expenditure arising from commitments to governments, to perform minimum exploration and evaluation work and expend minimum amounts of money pursuant to the award of exploration permits WA-314-P, WA-315-P, WA-398-P, Block 1037, Block 1101, Block 1102, Block 1165, Block 1166, Block Z-38, Block 144 and AC/P8 not provided for in the condensed consolidated financial statements. Included in exploration expenditure commitments are $178,448,515 (30 June 2010: $175,918,961) of commitments that relate to the non-guaranteed work commitments:		
Not later than 1 year	101,859,524	40,061,235
Later than 1 year but not later than 5 years	178,448,515	215,123,116
Total exploration expenditure commitments	280,308,039	255,184,351

Estimates for future exploration expenditure commitments to government are based on estimated well and seismic costs, which will change as actual drilling locations and seismic surveys are organised, and are determined in current dollars on an undiscounted basis. The exploration and evaluation obligations may vary significantly as a result of renegotiations with relevant parties.

The commitments may also be reduced by the Group entering into farm-out agreements, which are typical of the normal operating activities of the Group.

Where exploration and evaluation expenditure included in this category relates to an existing contract for expenditure, the amount will be included in both categories (a) and (b) above.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

Note 7. Contingent Liabilities

On 23rd August 2010, Karoon Petroleo & Gas S.A., a wholly owned subsidiary of the Company, executed a farm-in agreement with Petroleo Brasileiro S.A. ("Petrobras") to acquire a 20% interest in Blocks S-M-1352 and S-M-1354 located in the offshore Santos Basin, Brazil.

Under the farm-in agreement and subject to obtaining regulatory approvals from the Brazilian Petroleum Agency, Karoon Petroleo & Gas S.A. will earn a 20% equity interest by funding a proportion of the costs of drilling two exploration wells. Karoon Petroleo & Gas S.A. will then pay its equity share of continued work and reimburse Petrobras for sunk costs.

The two well drilling program included drilling of the Quasi Prospect in Block S-M-1354, which was subsequently plugged and abandoned in September 2010. The second well, the Maruja-1 exploration well in Block S-M-1352 commenced drilling in September 2010 and was suspended following a completion of a production test in January 2011. Block S-M-1354 expired in November 2010 and was formally relinquished by Petrobras in January 2011. Subsequently the farmin area of S-M 1352 and S-M 1354 have been reduced to an area retained around the Maruja discovery. This reduction also includes the and partial relinquishment of S-M 1352**.**

Under the agreement, Karoon's share of the costs incurred on both blocks as at 31 December 2010 that are payable upon obtaining regulatory approval was $33,182,215.

Note 8. Subsequent Events

Since 31 December 2010, the following material events have occurred:

(a) Maruja Field Appraisal

In February 2011, 'the Diamond Offshore Ocean Yorktown semisubmersible drilling rig' moved onto location and commenced drilling on the Maruja-2 appraisal well. The well's surface location is 4.8 km north east of the Maruja-1 exploration well.

The Maruja-2 well objectives are to test the extension of the Maruja-1 (1-SPS-76) reservoir over the north-east part of the closure. A vertical well will be cored to provide detailed reservoir evaluation and a sidetrack drilled to test reservoir continuity.

DIRECTORS' DECLARATION
FOR THE FINANCIAL HALF-YEAR ENDED 31 DECEMBER 2010

In the Directors' opinion:

1. the condensed consolidated financial statements and notes, set out on pages 8 to 19, are in accordance with the *Corporations Act 2001,* including:

   a) complying with Australian Accounting Standard *AASB 134 'Interim Financial Reporting'* and the *Corporations Regulations 2001*; and
   b) giving a true and fair view of the Group's financial position as at 31 December 2010 and of its performance for the financial half-year ended on that date; and

2. there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Board of Directors.

On behalf of the Directors:

Mr Robert Hosking
Executive Chairman

9 March 2011
Melbourne

PRICEWATERHOUSECOOPERS

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Independent auditor's review report to the members of Karoon Gas Australia Ltd

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Karoon Gas Australia Ltd, which comprises the condensed consolidated statement of financial position as at 31 December 2010, the condensed consolidated statement of comprehensive income, condensed consolidated statement of changes in equity and condensed consolidated statement of cash flows for the half-year ended on that date, selected explanatory notes and the directors' declaration for the Karoon Gas Australia Ltd Group (the "Group"). The Group comprises both Karoon Gas Australia Ltd (the "Company") and the entities it controlled during that half-year.

Directors' responsibility for the half-year financial report

The directors of the Company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001* and for such control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of an Interim Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Group's financial position as at 31 December 2010 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Karoon Gas Australia Ltd, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. It also includes reading the other information included with the financial report to determine whether it contains any material inconsistencies with the financial report. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

PRICEWATERHOUSECOOPERS

Independent auditor's review report to the members of Karoon Gas Australia Ltd (continued)

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

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

Matters relating to the electronic presentation of the reviewed financial report

This review report relates to the financial report of the Group for the half-year ended 31 December 2010 included on Karoon Gas Australia Ltd's web site. The Company's directors are responsible for the integrity of the Karoon Gas Australia Ltd's web site. We have not been engaged to report on the integrity of this web site. The review report refers only to the statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these statements. If users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the reviewed financial report to confirm the information included in the reviewed financial report presented on this web site.

Independence

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

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Karoon Gas Australia Ltd is not in accordance with the *Corporations Act 2001* including:

(a) giving a true and fair view of the Group's financial position as at 31 December 2010 and of its performance for the half-year ended on that date; and

(b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and *Corporations Regulations 2001.*

PricewaterhouseCoopers

PricewaterhouseCoopers

Charles Christie
Partner

Melbourne
9 March 2011

GLOSSARY

Term	Definition
2D seismic	Two-dimensional seismic.
3D seismic	Three-dimensional seismic.
$ or cents	Units of Australian currency.
AASB	Australian Accounting Standards Board.
ASX	Australian Securities Exchange or ASX Limited (ABN: 98 008 624 691).
Block	A licence or concession area. It may be almost any size or shape, although usually part of a grid pattern.
boe	Barrel of oil equivalent. The factor used to convert gas to oil equivalent is based upon an approximate energy value of 6,000 standard cubic feet per barrel and not price equivalence at the time.
condensate	Hydrocarbons which are predominantly pentane and heavier compounds which are in a gas phase in the reservoir and which separate out from natural gas at the well head and condense to liquid at lower pressures and temperatures.
ConocoPhillips	ConocoPhillips (Browse Basin) Pty Ltd.
contingent resources	Quantities of hydrocarbons which are estimated, on a given date, to be potentially recoverable from known accumulations, but which are not yet currently considered to be commercially recoverable for lack of market or suitable price.
CSEM	Controlled Source Electro Magnetic (survey).
Director	A Director of Karoon Gas Australia Ltd.
Discovery well	The first successful well on a new prospect.
DST	Drill stem test.
ESOP	The Karoon Gas Australia Employee Share Option Plan.
exploration	The process of identifying, discovering and testing prospective hydrocarbon regions and structures, mainly by interpreting regional and specific geochemical, geological, geophysical survey data and drilling.
farm-in and farm-out	A commercial agreement in which an incoming joint venture participant (the “farmee”) earns an interest in an exploration permit by funding a proportion of exploration and evaluation expenditures, while the participant owning the interest in the permit (the “farmor”) pays a reduced contribution. The interest received by a farmee is a farm-in while the interest transferred by the farmor is a farm-out.
financial half-year	Financial half-year ended 31 December 2010.
Group	Karoon Gas Australia Ltd and its subsidiaries.
GST	Goods and Services Tax in Australia.
hydrocarbon	A compound of the elements hydrogen and carbon, in either liquid or gaseous form. Natural gas and petroleum are mixtures of hydrocarbons.
Karoon or Group	Karoon Gas Australia Ltd and its subsidiaries.
km	Kilometre.
lead	A potential hydrocarbon target which has been identified but requires further evaluation before it is drill ready, at which point it becomes a prospect.
LNG	Liquefied natural gas.

GLOSSARY (Continued)

Term	Definition
m	Metres.
mmscf/d	Millions of standard cubic feet per day; equivalent to 28,317 cubic metres per day.
Monte Carlo simulation	Where there is uncertainty in the variables used in the calculation of economically recoverable reserves, the ranges of possible values of each variable can be incorporated in a Monte Carlo simulation calculation to produce a range of probabilistic outcomes that reflect that uncertainty. The "mean" is the expected outcome. The P10 (probability greater than 10%) is often used as the maximum case, the P50 (probability of 50%) the mid case and the P90 (probability greater than 90%) the minimum case.
mRT	Metres rotary table.
operator	One joint venture participant that has been appointed to carry out all operations on behalf of all the joint venture participants.
ordinary shares	The ordinary shares in the capital of Karoon Gas Australia Ltd.
permit	A hydrocarbon tenement, lease, licence, concession or Block.
Petrobras	Petróleo Brasileiro SA.
play	A trend within a prospective basin that has common geologic elements containing one or more fields, prospects or leads with common characteristics.
prospect	A geological or geophysical anomaly that has been surveyed and defined, usually by seismic data, to the degree that its configuration is fairly well established, and on which further exploration such as drilling can be recommended.
prospective resource	The term used to describe undiscovered volumes in an exploration prospect yet to be drilled.
psia	Pounds per square inch absolute
reservoir	A porous and permeable rock formation to store and transmit fluids such as hydrocarbons and water.
risk	Prospect risk or geologic risk is the assessed chance that the drilling of the prospect will be successful in finding significant volumes of hydrocarbons. The risk is calculated by multiplying the chance of success of each of the petroleum system elements involved in the prospect.
seismic survey	A type of geophysical survey where the travel times of artificially created seismic waves are measured as they are reflected in a near vertical plane back to the surface from subsurface boundaries. This data is typically used to determine the depths to form of stratigraphic units and in making subsurface structural contour maps and ultimately in delineating prospective structures.
spud	To start drilling a new well.
Talisman	Talisman Oil & Gas (Australia) Pty Limited.
TCF	Trillion cubic feet (1,000,000,000,000 cubic feet).
unrisked	A risk value has not been applied to an estimate of hydrocarbon volume either in place or recoverable.
USD	United States dollars.

For further information please see the Karoon website or contact:

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