



**ABN 49 002 796 974**

**FINANCIAL REPORT  
FOR THE HALF – YEAR ENDED  
31 DECEMBER 2006**

## CORPORATE DIRECTORY

### **Directors**

Ian P Middlemas - Chairman  
John D Begg – Managing Director  
Ronald L Miller  
Dougal J Ferguson

### **Solicitors**

Hardy Bowen, Lawyers

### **Auditor**

Ernst & Young

### **Company Secretary**

Dougal J Ferguson

### **Bankers**

Australia and New Zealand Banking  
Group Limited

### **Registered and Principal Office**

420 Roberts Road  
Subiaco WA 6008  
Australia

International: (61 8) 9380 2111

Facsimile: (61 8) 9380 2112

### **Stock Exchange Listing**

Salinas Energy Limited is listed on  
the Australian Stock Exchange  
(Symbol: SAE).

### **US Operations Office**

201 Bryant Street, Suite 2B  
Ojai, California, United States  
CA 93023

### **Share Register**

Computershare Investor Services Pty Ltd  
Level 2, Reserve Bank Building  
45 St Georges Terrace  
Perth WA 6000  
Australia

Telephone: 1300 557 010

Telephone: (61 8) 9323 2000

Facsimile: (61 8) 9323 2033

## DIRECTORS' REPORT

The Board of Directors of Salinas Energy Limited present their report on the consolidated entity of Salinas Energy Limited ("the Company" or "Salinas") and the entities it controlled during the half year ended 31 December 2006 ("Consolidated Entity" or "Group").

### Directors

The names of the Directors of Salinas Energy Limited in office during or since the end of the half-year until the date of this report are:

Ian P Middlemas - Chairman  
John D Begg – Managing Director  
Dougal J Ferguson (appointed 17 July 2006)  
Ronald L Miller  
Gregory J Dobson (resigned 22 November 2006)  
Mark L Pearce (resigned 17 July 2006)

Unless otherwise indicated, all directors held their position as a director throughout the entire half-year and up to the date of this report.

### Results

The loss of the Consolidated Entity for the half-year was \$3,896,274 (2005 profit: \$259,379) after income tax.

### Review of Operations

During the half year, the Company has continued to pursue its strategy of building its oil and gas business onshore Southern California. The Company achieved its short term objective of having first oil production in 2006, with completion of Lombardi 1-27 at the North San Ardo oil field as a production well. Initial oil sales were made in late 2006 and development of the North San Ardo oil field has continued to progress during the course of the half year.

As Operator, the Company successfully drilled two wells during the half year and has proven its credentials as a competent and safe Operator. The Company also successfully acquired as Operator a 3D seismic survey over the North San Ardo oil field.

The Company's plans will lead to a very active program of work including drilling of multiple wells in calendar 2007.

### Projects

#### North San Ardo Oil Project (Salinas 100%)

Phase 1 of the development of the North San Ardo Oil Project gained momentum during the half year with the drilling and completion of the Lombardi 1-27 appraisal well as an oil production well. The Lombardi 1-27 appraisal well, during trial production testing, produced oil consistently at over 100 bopd stimulated only by hot water injection. The well was drilled in August on the Southern lobe of the North San Ardo oil field, encountering an 80 foot oil column in excellent quality sandstone reservoir.

## SALINAS ENERGY LIMITED HALF-YEAR FINANCIAL REPORT

The Company sold its first cargo of crude in late December 2006 following the execution of a Crude Marketing Agreement with a local refinery. The agreement allows for the flexible supply of crude during the start-up phase which provides the Company with added flexibility with respect to the incremental development of the field, whilst providing cash flow to be generated from the wells that are on production.

During the half year, Salinas acquired a 3D seismic survey to assist in refining the mapping of the field and select locations for Phase 1 of the appraisal and development drilling program, expected to commence late February 2007. The Company is contracting a drilling rig for up to four wells, being two vertical appraisal wells and two horizontal production wells.

Following confirmation of the structure mapping from the two appraisal wells, the Company plans two horizontal wells in the field which will act as the main production wells in Phase 1 of the field development. Phase 1 of the drilling program is expected to take approximately two months to complete and the Company is targeting total field production rates in excess of 500 bopd by the end of the financial year.

The Company has committed to construction of first stage production facilities including a steam injection unit (in fabrication) which will be used to heat the heavy oil in the reservoir and stimulate oil flow rates. This is a common technique in use throughout the industry and specifically California.

### South Buena Vista (Salinas earning 25%)

All zones of interest in North Yowlumne 1-26 have been tested and the Company soon expects to be assigned its 25% earned interest in the project. Salinas considers the discovery of oil in North Yowlumne 1-26 a highly significant result and is planning further evaluation of the project, despite being unable to complete the initial well as a commercial producer.

The North Yowlumne 1-26 well discovered oil (32° and 36° API) in a trap with a strong stratigraphic element of closure and the initial exploration well may not have been drilled in the best part of the reservoir system. The Company estimates that the well flowed at rates up to 160 bopd during initial testing from interbedded sandstones between 12,470 feet and 13,020 feet. These rates were not replicated in a subsequent production testing program using hydraulic pumps which was initially hampered by a range of technical issues specific to this operation. It is not clear whether or not the well was damaged during the intervening period which would also have contributed towards the negative result when the well was put on pump.

The testing of North Yowlumne 1-26 has yet to prove commercial flows of oil however, evidence suggests that the well has encountered a potentially large oil resource and the Company is reviewing all the available data prior to making any decision on further appraisal drilling.

### Windgap (Salinas 42.50% and withdrawing)

The Company is in the process of withdrawing from the Windgap Project following completion of the production testing of the well. Windgap 42-36 failed to flow hydrocarbons at commercial quantities and Salinas does not consider a second well on the project is warranted, which would otherwise be required by the governing Acquisition Agreement.

Salinas previously lodged a performance bond of US\$1 million with respect to the operations of the well and is in the process of having the bond released.

Other San Joaquin Acreage (Salinas 100%)

A regional study of the San Joaquin Basin has been continuing during the half year with an extensive mapping program over the prospective areas of the Basin. The study is expected to be completed within the next few months. Upon completion of final mapping of the prospects, the Company will actively seek partners to fund a drilling program that is expected to commence in the second half of 2007.

Farmout Agreement with Statesman Resources

In accordance with the Company's strategy of managing exploration risk, Salinas has entered into a Farmout Agreement with Canadian (TSX listed) Statesman Resources whereby Statesman will contribute to an exploration and drilling program of up to four exploration wells in 2007 on leases held 100% by Salinas in the San Joaquin Basin.

Under the terms of the Farmout Agreement, Statesman will earn a 25% interest in the leases by funding 37.5% of the cost of the farmin wells in addition to paying 25% of the ongoing geosciences, engineering and administration work that Salinas will carry out to finalise the drilling targets. Statesman will also refund 25% of the past costs incurred for these leases, which totals approximately US\$400,000. Salinas will retain the operatorship of the leases and will operate the exploration program.

**Corporate and Financial**

During the half year, the Company sold non-core assets which, after conversion and selling costs, realised over \$4.5 million for the Company.

In addition to cash of \$6.2 million, the Company has two performance bonds in place totalling some \$2.6 million. It is expected that one of these bonds will be returned shortly following the Company's withdrawal from the Windgap project. The Company is also in the process of seeking proposals to partially debt finance its North San Ardo oil project.

**Auditor's Independence Declaration**

Section 307C of the Corporations Act 2001 requires our auditors, Ernst & Young, to provide the directors of Salinas Energy Limited with an Independence Declaration in relation to the review of the half-year financial report. This Independence Declaration is set out on the following page five.

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



**JOHN BEGG**  
Managing Director  
Perth, 23 February 2007



■ The Ernst & Young Building  
11 Mounts Bay Road  
Perth WA 6000  
Australia

■ Tel 61 8 9429 2222  
Fax 61 8 9429 2436

GPO Box M939  
Perth WA 6843

**Auditor's Independence Declaration to the Directors of Salinas Energy Limited**

In relation to our review of the financial report of Salinas Energy Limited for the half-year ended 31 December 2006, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

A handwritten signature in black ink that reads "Ernst + Young".

Ernst & Young

A handwritten signature in black ink that reads "Peter McIver".

Peter McIver  
Partner  
Perth  
23 February 2007

## DIRECTORS' DECLARATION

In accordance with a resolution of the directors of Salinas Energy Limited, I state that:

In the opinion of the directors:

- (a) the financial statements and notes of the consolidated entity are in accordance with the *Corporations Act 2001*, including:
  - (i) give a true and fair view of the financial position as at 31 December 2006 and the performance for the half-year ended on that date of the consolidated entity; and
  - (ii) comply with Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
- (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.

On behalf of the Board



**JOHN BEGG**  
Managing Director

**Perth, 23 February 2007**

## CONDENSED INCOME STATEMENT

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

	Notes	Consolidated	
		31 December 2006 \$	31 December 2005 \$
Revenue	3(i)	496,486	410,368
Cost of sales		(27,806)	-
<b>Gross Profit</b>		<b>468,680</b>	410,368
Other Income	3(ii)	28,400	475,000
Other Expenses	3(iii)	(4,393,354)	(625,989)
<b>Profit/(loss) before income tax expense</b>		<b>(3,896,274)</b>	259,379
Income tax expense		-	-
<b>Profit/(loss) after related income tax expense</b>		<b>(3,896,274)</b>	259,379
<b>Net profit/(loss) for the period attributable to members of Salinas Energy Limited</b>		<b>(3,896,274)</b>	259,379
Basic earnings per share for the period (cents per share)		(2.2)	0.2
Diluted earnings per share for the period (cents per share)		(2.2)	0.2

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

**CONDENSED BALANCE SHEET**

AS AT 31 DECEMBER 2006

		<b>Consolidated</b>	
	<b>Note</b>	<b>As at 31 December 2006 \$</b>	<b>As at 30 June 2006 \$</b>
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	5	6,194,357	9,369,318
Trade and other receivables		546,280	29,736
Inventories		197,912	150,000
Available for sale financial assets		7,500	12,500
Other financial assets		1,300,280	4,500,000
<b>Total current assets</b>		<b>8,246,329</b>	<b>14,061,554</b>
<b>Non-current assets</b>			
Other financial assets at fair value through profit or loss		1,339,045	2,812,464
Property, plant and equipment		330,670	215,931
Oil and gas properties in development	6	12,068,068	-
Exploration and evaluation assets	7	8,721,784	17,712,038
Receivables		22,976	-
<b>Total non-current assets</b>		<b>22,482,543</b>	<b>20,740,433</b>
<b>Total assets</b>		<b>30,728,872</b>	<b>34,801,987</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables		1,717,596	483,902
Provisions		33,030	19,888
<b>Total current liabilities</b>		<b>1,750,626</b>	<b>503,790</b>
<b>Total liabilities</b>		<b>1,750,626</b>	<b>503,790</b>
<b>Net assets</b>		<b>28,978,246</b>	<b>34,298,197</b>
<b>EQUITY</b>			
Contributed equity	9	76,782,321	76,755,321
Reserves		1,100,068	2,550,745
Accumulated losses		(48,904,143)	(45,007,869)
<b>Total equity</b>		<b>28,978,246</b>	<b>34,298,197</b>

The above Condensed Balance Sheet should be read in conjunction with the accompanying notes.

**CONDENSED STATEMENT OF CHANGES IN EQUITY**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

*Consolidated*

	<i>Issued Capital</i> \$	<i>Retained Earnings</i> \$	<i>Investments Available For Sale</i> \$	<i>Option Premium Reserve</i> \$	<i>Foreign Currency Translation Reserve</i> \$	<i>Total Equity</i> \$
<b>Balance at 1 July 2006</b>	<b>76,755,321</b>	<b>(45,007,869)</b>	<b>8,996</b>	<b>2,219,066</b>	<b>322,683</b>	<b>34,298,197</b>
Currency translation reserve	-	-	-	-	(1,653,177)	(1,653,177)
Net losses on available for sale financial assets	-	-	(5,000)	-	-	-
Total income and expense for the period recognised directly in equity	-	-	(5,000)	-	(1,653,177)	(1,658,177)
Loss for the period	-	(3,896,274)	-	-	-	(3,896,274)
Total income / (expense) for the period	-	(3,896,274)	(5,000)	-	(1,653,177)	(5,554,451)
Options Granted	-	-	-	212,000	-	212,000
Shares issued	27,000	-	-	(4,500)	-	22,500
<b>Balance at 31 December 2006</b>	<b>76,782,321</b>	<b>(48,904,143)</b>	<b>3,996</b>	<b>2,426,566</b>	<b>(1,330,494)</b>	<b>28,978,246</b>
<b>Balance at 1 July 2005</b>	<b>62,184,941</b>	<b>(46,050,250)</b>	<b>438,250</b>	-	-	<b>16,572,941</b>
Currency translation reserve	-	-	-	-	18,666	18,666
Net losses on available for sale financial assets	-	-	(205,000)	-	-	(205,000)
Total income and expense for the period recognised directly in equity	-	-	(205,000)	-	18,666	(186,334)
Profit for the period	-	259,379	-	-	-	259,379
Total income / expense for the period	-	259,379	-	-	-	259,379
Shares issued	-	-	-	-	-	-
<b>Balance at 31 December 2005</b>	<b>62,184,941</b>	<b>(45,790,871)</b>	<b>233,250</b>	-	<b>18,666</b>	<b>16,645,986</b>

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

## CONDENSED CASH FLOW STATEMENT

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

	<b>Consolidated</b>	
	<b>31 December 2006</b>	<b>31 December 2005</b>
	<b>\$</b>	<b>\$</b>
<b>Cash flows from operating activities</b>		
Receipts from customers	<b>74,064</b>	-
Payments to suppliers and employees	<b>(496,559)</b>	(725,300)
Interest received	<b>264,428</b>	410,368
<b>Net cash flows used in operating activities</b>	<b>(158,067)</b>	(314,932)
<b>Cash flows from investing activities</b>		
Payments for acquisition of plant and equipment	<b>(116,117)</b>	(14,560)
Payments for development of oil field assets	<b>(2,217,381)</b>	-
Payments for exploration and evaluation assets	<b>(4,863,084)</b>	(2,720,208)
Proceeds on sale of investments	<b>4,528,400</b>	-
<b>Net cash flows used in investing activities</b>	<b>(2,668,182)</b>	(2,734,768)
<b>Cash flows from financing activities</b>		
Proceeds from issue of shares	<b>22,500</b>	-
Loans to other entities	<b>(264,959)</b>	-
Other cash flows from financing activities	<b>(28,215)</b>	-
<b>Net cash flows from financing activities</b>	<b>(270,674)</b>	-
<b>Net decrease in cash and cash equivalents</b>	<b>(3,096,923)</b>	(3,049,700)
Net foreign exchange differences	<b>(78,038)</b>	-
Cash and cash equivalents at the beginning of the financial period	<b>9,369,318</b>	14,502,443
<b>Cash and cash equivalents at the end of the financial period</b>	<b>6,194,357</b>	11,452,743

The above Condensed Cash Flow Statement should be read in conjunction with the accompanying notes.

## NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

### 1. Corporate information

The financial report of Salinas Energy Limited (the Company) for the half-year ended 31 December 2006 was authorized for issue in accordance with a resolution of the directors on 23 February 2007. Salinas Energy Limited is a company incorporated in Australia and limited by shares which are publicly traded on the Australian Stock Exchange.

The nature of the operations and principal activities of the Group are described in note 4.

### 2. Summary of significant accounting policies

The half-year financial report does not include all notes of the type normally included within the annual financial report and therefore cannot be expected to provide as full an understanding of the financial performance, financial position and financing and investing activities of the consolidated entity as the full financial report.

The half-year financial report should be read in conjunction with the annual Financial Report of Salinas Energy Limited as at 30 June 2006.

It is recommended that the half-year financial report be considered together with any public announcements made by Salinas Energy Limited and its controlled entities during the half-year ended 31 December 2006 in accordance with the continuous disclosure obligations arising under the *Corporations Act 2001*.

#### (a) Basis of preparation

The half-year consolidated financial report is a general purpose financial report which has been prepared in accordance with the requirements of the *Corporations Act 2001*, applicable Accounting Standards, including AASB 134 Interim Financial Reporting and other mandatory professional reporting requirements.

The half-year financial report has also been prepared on a historical cost basis, except for available for sale investments and other financial assets, which have been measured at fair value.

The half-year financial report is presented in Australian dollars.

#### (b) Significant accounting policies

The half-year consolidated financial statements have been prepared using the same accounting policies as used in the annual financial statements for the year ended 30 June 2006, except for the adoption of amending standards mandatory for annual periods beginning on or after 1 July 2006, as described in Note 2(d).

#### (c) Basis of consolidation

The half-year consolidated financial statements comprise the financial statements of Salinas Energy Limited and its subsidiaries as at 31 December 2006 ('the Group').

#### (d) Changes in accounting policies

Australian Accounting Standards and UIG Interpretations that have recently been amended and are effective from 1 July 2006 are outlined in the table below:

**NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

<b>AASB Amendm ent</b>	<b>Affected Standard(s)</b>	<b>Nature of change to Accounting Policy</b>	<b>Application date for standard*</b>	<b>Application date for Group</b>
2005-1	<i>AASB 139: Financial Instruments: Recognition and Measurement</i>	No change to accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-4	<i>AASB 139: Financial Instruments: Recognition and Measurement, AASB 132: Financial Instruments: Disclosure and Presentation, AASB 1: First-time adoption of AIFRS, AASB 1023: General Insurance Contracts and AASB 1028: Life Insurance Contracts</i>	No change to accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-5	<i>AASB 1: First-time adoption of AIFRS, AASB 139: Financial Instruments: Recognition and Measurement</i>	No change to accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-6	<i>AASB 3: Business Combinations</i>	No change to accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2005-9	<i>AASB 4: Insurance Contracts, AASB 1023: General Insurance Contracts, AASB 139: Financial Instruments: Recognition and Measurement and AASB132: Financial Instruments: Disclosure and Presentation</i>	No change to accounting policy required. Therefore no impact.	1 January 2006	1 July 2006
2006-1	<i>AASB 121: The Effects of Changes in Foreign Exchange Rates</i>	No change to accounting policy required. Therefore no impact.	31 December 2006	1 July 2006
Revised Standard	<i>AASB 119: Employee Benefits</i>	No change to accounting policy required. Therefore no impact.	1 January 2006	1 July 2006

Application date is for the annual reporting periods beginning on or after the date shown in the above table with the exception of 2006-1 which is applicable for reporting periods ending on or after 31 December 2006.

**NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

The following amendments are not applicable to the Group and therefore have no impact:

<b>AASB Amendment</b>	<b>Affected Standard(s)</b>
2004-3	AASB 1: First time adoption of AIFRS, AASB 101: Presentation of Financial Statements, AASB 124: Related Party Disclosures
2005-3	AASB 119: Treatment of future taxes of defined benefits plan.
2006-3	AASB 1045: Land under Roads
New UIG	UIG 4: Determining whether an Arrangement contains a Lease
New UIG	UIG 5: Rights to Interests in Decommissioning, Restoration and Environmental Rehabilitation Funds
New UIG	UIG 6: Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
New UIG	UIG 7: Applying the Restatement Approach under AASB 129 Financial Reporting in Hyperinflationary Economies
New UIG	UIG 8: Scope of AASB 2
New UIG	UIG 9: Reassessment of Embedded Derivatives

**NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

	<b>Consolidated</b>	
	<b>31 December 2006</b>	<b>31 December 2005</b>
	<b>\$</b>	<b>\$</b>
<b>Note 3. Revenue, Income and Expenses</b>		
<b>i. Revenue</b>		
Oil Revenue	<b>10,370</b>	-
Finance Income	<b>343,981</b>	410,368
Management Fees	<b>142,135</b>	-
<b>Total revenue</b>	<b>469,486</b>	410,368
<b>ii. Other income</b>		
Gain on disposal of listed investment	<b>28,400</b>	-
Fair value gains on other financial assets at fair value through profit and loss	-	475,000
<b>Total other income</b>	<b>28,400</b>	475,000
<b>iii. Other expenses</b>		
Impairment of exploration and evaluation assets	3,210,499	-
Depreciation	57,844	74,512
Employee benefits	557,587	239,270
Business development	131,368	156,445
Foreign exchange losses	199,417	-
Sales and commercialisation (REL)	77,843	70,024
Impairment of receivables	-	85,738

**NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

**Note 4. Segment Information**

The Consolidated Entity operated in two business segments during the current half year and in two geographical segments, listed below:-

	<b>Segment Revenue</b>		<b>Segment Result</b>	
	<b>31 December 2006</b>	31 December 2005	<b>31 December 2006</b>	31 December 2005
<b>Geographical Segments</b>	\$	\$	\$	\$
Australia	-	-	<b>(624,254)</b>	396,391
United States	<b>152,505</b>	-	<b>(3,272,023)</b>	(137,012)
	<hr/>			
Consolidated	<b>152,505</b>	-	<b>(3,896,277)</b>	259,379
	<hr/>			
<b>Business Segments</b>				
Oil and Gas	<b>152,505</b>	-	<b>(3,272,023)</b>	(74,512)
Renewable Energy	-	-	<b>(77,843)</b>	(70,024)
Unallocated	-	-	<b>(546,411)</b>	403,915
	<hr/>			
Consolidated	<b>152,505</b>	-	<b>(3,896,277)</b>	259,379
	<hr/>			
			<b>Consolidated</b>	
			<b>31 December 2006</b>	31 December 2005
			\$	\$

**Note 5. Cash and cash equivalents**

For the purpose of the half-year condensed cash flow statement, cash and cash equivalents are comprised of the following:

Cash at bank and in hand	<b>457,792</b>	867,166
Short-term deposits	<b>5,736,565</b>	10,585,577
	<b>6,194,357</b>	11,452,743

**NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

	<b>Consolidated</b>	
	<b>31 December 2006</b>	<b>31 December 2005</b>
	<b>\$</b>	<b>\$</b>
<b>Note 6. Oil and gas properties in development</b>		
Opening Balance	-	-
Additions	<b>3,361,395</b>	-
Amortisation and Depreciation	-	-
Transfers from Exploration and Evaluation	<b>8,706,673</b>	-
<b>Total oil and gas properties in development</b>	<b>12,068,068</b>	-
<b>Note 7. Exploration and Evaluation assets</b>		
Opening Balance	<b>17,712,038</b>	-
Foreign Exchange on opening balance	<b>(1,369,868)</b>	-
Additions	<b>4,296,786</b>	2,873,162
Impairment of exploration and evaluation assets*	<b>(3,210,499)</b>	-
Transfer to oil and gas properties in development	<b>(8,706,673)</b>	-
<b>Total Exploration and Evaluation Expenditure</b>	<b>8,721,784</b>	2,873,162

\*On 17 January 2007, the Company withdrew from the Windgap project following failure of an appraisal well to produce a commercial flow of hydrocarbons. As a result, the carrying amount of the project has been written down to zero.

**Note 8. Share-based Payment Plans**

During the half year, 3.7 million share options were granted to Directors, employees and consultants. The fair value of the options granted is estimated as at the date of grant using a binomial model, taking into consideration the terms and conditions upon which the options were granted. The following table lists the details of the options and the inputs to the model used to determine the value of the share options for the half-year ended 31 December 2006:

	<b>Share Options issued in Half Year</b>			
	Directors		Employees and Consultants	
	24 November 2006		18 October 2006	
Grant Date				
Exercise Price	\$0.50	\$0.80	\$0.50	\$0.80
Number Granted	1,400,000	1,900,000	650,000	650,000
Expiry Date	31/12/07	31/12/08	31/12/07	31/12/08
Underlying Spot Price	\$0.335	\$0.335	\$0.39	\$0.39
Dividend yield (%)	-	-	-	-
Expected volatility (%)	55.00%	55.00%	55.00%	55.00%
Risk-free interest rate (%)	5.98%	5.98%	6.06%	6.06%
Expiration Period	1.126	2.126	1.202	2.204
Binomial Valuation	\$0.04	\$0.034	\$0.068	\$0.057

**NOTES TO THE HALF-YEAR FINANCIAL STATEMENTS**

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

**Note 9. Contributed Equity****(i) Ordinary Shares**

<b>Date</b>	<b>Details</b>	<b>Number</b>	<b>\$</b>
<b>1 July 2005</b>	<b>Opening balance</b>	<b>141,417,690</b>	<b>62,184,941</b>
31 January 2006	Issue of shares to Director	2,250,000	562,500
31 January 2006	Purchase of oil and gas assets	15,000,000	3,750,000
31 January 2006	Share issue expenses	-	(7,459)
31 January 2006	Issue of shares to consultants/advisors	3,250,000	812,500
31 January 2006	Share issue expenses	-	(11,842)
22 May 2006	Share placement at \$0.72 per share	12,500,000	9,000,000
22 May 2006	Share issue expenses	-	(737,829)
<b>30 June 2006</b>	<b>Closing balance</b>	<b>174,417,690</b>	<b>75,552,811</b>
26 July 2006	Conversion of Convertible Preference Shares	5,000,000	1,202,510
20 December 2006	Conversion of Employee Share Options	75,000	27,000
<b>31 December 2006</b>	<b>Closing balance</b>	<b>179,492,690</b>	<b>76,782,321</b>

**(ii) Convertible Preference Shares**

<b>Date</b>	<b>Details</b>	<b>Number</b>	<b>\$</b>
<b>1 July 2005</b>	<b>Opening balance</b>	-	-
31 January 2006	Purchase of oil and gas assets	1,000	1,202,510
<b>30 June 2006</b>	<b>Closing balance</b>	<b>1,000</b>	<b>1,202,510</b>
26 July 2006	Conversion of Convertible Preference Shares	(1,000)	(1,202,510)
<b>31 December 2006</b>	<b>Closing balance</b>	-	-

**Note 10. Contingent Assets and Liabilities**

Since the last annual reporting date, there has been no material change of any contingent assets or liabilities.

**Note 11. Dividends Paid and Proposed**

No dividend has been paid or proposed during the half year.

**Note 12. Events after Balance Date**

There were no events occurring after balance date that require disclosure.



■ The Ernst & Young Building  
11 Mounts Bay Road  
Perth WA 6000  
Australia

■ Tel 61 8 9429 2222  
Fax 61 8 9429 2436

GPO Box M939  
Perth WA 6843

To the members of Salinas Energy Limited

### **Report on the Condensed Half-Year Financial Report**

We have reviewed the accompanying half-year financial report of Salinas Energy Limited and the entities it controlled during the half-year, which comprises the condensed balance sheet as at 31 December 2006, and the condensed income statement, condensed statement of changes in equity and condensed cash flow statement for the half-year ended on that date, a statement of accounting policies, other selected explanatory notes and the directors' declaration.

#### *Directors' Responsibility for the half-year Financial Report*

The directors of the company are responsible for the preparation and fair presentation of the half-year financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations), the Corporations Act 2001. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the half-year financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### *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 consolidated entity's financial position as at 31 December 2006 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, other mandatory financial reporting requirements in Australia. As the auditor of Salinas Energy Limited and the entities it controlled during the half-year, 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. 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.

#### *Independence*

In conducting our review, we have complied with the independence requirements of the Corporations Act 2001. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the Directors' Report.



*Conclusion*

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the interim financial report of Salinas Energy Limited and the entities it controlled during the half-year, is not in accordance with:

- (a) the Corporations Act 2001, including:
  - (i) giving a true and fair view of the consolidated entity's financial position as at 31 December 2006 and of its performance for the half-year ended on that date; and
  - (ii) complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.

A handwritten signature in black ink that reads 'Ernst &amp; Young' in a cursive, stylized script.

Ernst & Young

A handwritten signature in black ink that reads 'Peter McIver' in a cursive, stylized script.

Peter McIver  
Partner  
Perth  
23 February 2007