



XSTATE RESOURCES LIMITED

ABN 96 009 217 154

INTERIM FINANCIAL REPORT

For the six months ended 30 June 2017

XSTATE RESOURCES LIMITED
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**XSTATE RESOURCES LIMITED
CORPORATE DIRECTORY**

CORPORATE DIRECTORY

Directors

Mr Cosimo Damiano
Mr Chris Hodge
Mr Ian Tchacos
Mr David McArthur

Secretary

Mr David McArthur

Registered and Principal Office

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Fremantle WA 6160

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Postal Address

PO Box 584
Fremantle WA 6959

Auditors

BDO
38 Station Street
Subiaco WA 6008

Bankers

ANZ Banking Group Limited
Level 6, 77 St Georges Terrace
Perth WA 6000

Share Registry

Advanced Share Registry Services
110 Stirling Highway
Nedlands WA 6009

ASX Code

Shares: XST

Country of Incorporation and Domicile

Australia

XSTATE RESOURCES LIMITED
DIRECTORS' REPORT
For the six months ended 30 June 2017

DIRECTORS' REPORT

The Directors present their report together with the financial statements of Xstate Resources Limited ("the Company") and of the Group, being the Company and its subsidiaries for the six months ended 30 June 2017 and the auditor's report thereon.

1. DIRECTORS

The Directors of the Company at any time during or since the end of the interim period are:

| Name | Period of directorship |
|--|-------------------------------|
| Executive | |
| Cosimo Damiano Managing Director | Appointed 27 October 2015 |
| Non-executive | |
| Chris Hodge <i>Member of the Audit & Risk Management Committee and Member of the Nominations & Remuneration Committee</i> | Appointed 12 November 2013 |
| David McArthur <i>Chair of the Audit & Risk Management Committee and Member of the Nominations & Remuneration Committee</i> | Appointed 3 September 2013 |
| Ian Tchacos <i>Chair of the Nominations & Remuneration Committee and Member of the Audit & Risk Management Committee</i> | Appointed 12 August 2014 |

Executive director and Non-executive director remuneration

At a general meeting on 31 January 2017 shareholders approved the issue of 5,000,000 fully paid shares to Mr Cosimo Damiano pursuant to him having achieved certain performance milestones under his contract.

On 3 February 2017, the Company issued 42,000,000 options to directors and consultants pursuant to the Employee Incentive Option Plan approved by shareholders on 31 January 2017. The 42,000,000 options are exercisable at 5 cents each on or before 31 December 2020.

XSTATE RESOURCES LIMITED
DIRECTORS' REPORT
For the six months ended 30 June 2017

2. OPERATING AND FINANCIAL REVIEW

Operational highlights for the period:

- In the Sacramento Basin, California, USA, Xstate, along with its joint venture partner, has pursued strategic production acquisitions that have delivered considerable production improvements in a short period of time and included strategic infrastructure that could fast track any exploration success.
- Production for the 6 months ending 30 June 2017 was 127,223 million cubic feet gross (14,895 million cubic feet net to Xstate). Production during the first half benefited from acquisitions and wells being brought online.
- Xstate is pursuing a range of growth opportunities focused on expanding the Company's asset base in its core Sacramento Basin region and acquiring conventional oil production onshore North America. The Board remains confident of closing a favourable transaction although timing is uncertain as commercial-in-confidence negotiations continue.
- Xstate is endeavouring to reach a resolution with the defaulting investors in respect of Xstate's claim for damages relating to the investors' breach of contract for the subscription for shares, which is a material event. The Company has commenced proceedings to pursue damages through the Australian and Singapore legal system should an amicable resolution for Xstate shareholders not be reached. Xstate will keep the market fully informed as this matter progresses.
- As at 30 June 2017 the Company held cash and cash equivalents of \$0.649m and no debt.
- At 30 June 2017, Xstate had 626,792,718 shares on issue and 1,528 shareholders. Its top 20 holders held 300,649,613 shares representing 48% of the Company's issued capital.

Further information may be found in the Company's reports for the March 2017 and June 2017 quarters, released to the ASX on 28 April 2017 and 31 July 2017, respectively.

XSTATE RESOURCES LIMITED
DIRECTORS' REPORT
For the six months ended 30 June 2017

2. OPERATING AND FINANCIAL REVIEW (continued)

| XSTATE RESOURCES LIMITED – SACRAMENTO BASIN NORTHERN CALIFORNIA TENEMENT LIST | | | |
|--|----------------------------------|------------------------------|---------------------------|
| Project name | Category | Working Interest (WI) | WI after Farm outs |
| Alvares Appraisal Well ¹ | Appraisal | 25% | 21% |
| Alvares Project ² | Exploration & Appraisal | 30% | 24% |
| Dempsey Prospect | Exploration & Appraisal | 10% | NA |
| Dempsey AMI ² | Active leasing 3 large prospects | 30% | 24% |
| Rancho Capay Field | Production | 10% | NA |
| Malton field | Production | 30% | NA |
| East Rice East Creek Field | Production | 10% | NA |
| Los Medanos Gas Field | Production | 10% | NA |
| Dutch Slough Field | Production | 30% | NA |
| Denverton Field | Production | 30% | NA |
| Northern California AMI | Active Prospect Generation | 30% | NA |
| ¹ Assumes sale of 4% WI to Bombora Natural Energy Pty Ltd ² Assumes sale of 6% WI to Bombora Natural Energy Pty Ltd NA – Not Applicable; no change to WI Projects are continuously reviewed for their strategic fit and are expected to be modified over time to reflect industry conditions. | | | |

Disclaimers

Exploration in the USA is conducted on leases granted by Mineral Right owners, in Xstate's case primarily private individuals or groups. Leases can vary in size from very small parcels (part of an acre) to large landholdings (covering a few square miles). Leases generally are for 5 years and rentals are paid annually. There are no work commitments associated with the leases. Some leases are 'Held By Production' and royalties, generally less than 20% of revenues, are paid to mineral right owners in lieu of rentals. Xstate has not listed all its leases as it is impractical and not meaningful for potential project value assessment in a conventional gas play. A detailed listing of leases may also lead to a loss of competitive advantage and consequently reduced value to Xstate shareholders.

XSTATE RESOURCES LIMITED
DIRECTORS' REPORT
For the six months ended 30 June 2017

3. DIVIDENDS

The Directors recommend that no dividend be provided for the six months ended 30 June 2017.

4. CORPORATE GOVERNANCE

In recognising the need for the highest standards of corporate behaviour and accountability, the Directors of Xstate Resources Limited support and have adhered to the principles of good corporate governance. The Group's corporate governance statement is contained within the 31 December 2016 Annual Report and can be viewed on the Company's website.

5. EVENTS SUBSEQUENT TO REPORTING DATE

Other than the matters disclosed in note 5.2 of the notes to the consolidated financial statements, there have been no matters or circumstances that have arisen since the end of the interim period that have significantly affected, or may significantly affect, the operations of the Group, the results of these operations, or the state of affairs of the Group in future financial years.

6. LEAD AUDITOR'S INDEPENDENCE DECLARATION

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is included in the Directors' Report.

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



DAVID MCARTHUR

Director

Dated at Perth, Western Australia this 8th day of September 2017.

DECLARATION OF INDEPENDENCE BY DEAN JUST TO THE DIRECTORS OF XSTATE RESOURCES LIMITED

As lead auditor for the review of Xstate Resources Limited for the half-year ended 30 June 2017, I declare that, to the best of my knowledge and belief, there have been:

1. No contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
2. No contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Xstate Resources Limited and the entities it controlled during the period.



Dean Just

Director

BDO Audit (WA) Pty Ltd

Perth, 8 September 2017

XSTATE RESOURCES LIMITED
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2017

| | Note | 30 June 2017 \$ | 31 December 2016 \$ |
|---|------|-----------------------|---------------------------|
| Assets | | | |
| Cash and cash equivalents | | 648,864 | 1,457,298 |
| Trade and other receivables | | 19,859 | 7,176 |
| Prepayments | | 106,986 | 32,768 |
| Total current assets | | 775,709 | 1,497,242 |
| Prepayment - oil and gas properties | 3.1 | - | 741,626 |
| Property, plant and equipment | | 838 | 1,041 |
| Trade and other receivables | | - | 11,708 |
| Deposits and bonds | | 1,980 | 15,855 |
| Total non-current assets | | 2,818 | 770,230 |
| Total assets | | 778,527 | 2,267,472 |
| Liabilities | | | |
| Trade and other payables | | (115,083) | (146,886) |
| Employee benefits | | - | (25,000) |
| Total current liabilities | | (115,083) | (171,886) |
| Site restoration provision | 3.2 | (272,857) | (58,653) |
| Total non-current liabilities | | (272,857) | (58,653) |
| Total liabilities | | (387,940) | (230,539) |
| Net assets | | 390,587 | 2,036,933 |
| Equity | | | |
| Share capital | 4.1 | 46,890,108 | 46,825,108 |
| Reserves | | 445,530 | 65,169 |
| Accumulated losses | | (46,945,051) | (44,853,344) |
| Total equity attributable to equity holders of the company | | 390,587 | 2,036,933 |

The accompanying notes are an integral part of these financial statements.

XSTATE RESOURCES LIMITED
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE SIX MONTHS ENDED 30 JUNE 2017

| | Note | 30 June 2017 \$ | 30 June 2016 \$ |
|---|------|-----------------------|-----------------------|
| Revenue from operating activities | | | |
| Finance income | | 2,992 | 4,722 |
| Other operating income | | 36,038 | 10,951 |
| Expenses | | | |
| Other operating expenses | | (58,064) | (36,926) |
| Exploration expenditure | | (45,990) | (128,178) |
| Site rehabilitation expenses | | (221,724) | - |
| Write-off investment in oil and gas properties | | (936,921) | - |
| Personnel expenses | | (545,066) | (129,251) |
| Share-based payment expense | 4.1 | (65,000) | - |
| General and administrative expenses | | (58,192) | (43,444) |
| Professional fees | | (191,080) | (162,323) |
| Finance expenses | | - | (13,958) |
| Marketing and business development expenses | | (5,068) | (532) |
| Depreciation | | (203) | (577) |
| Other (losses) and gains | | (1,308) | (3,131) |
| Results from operating activities | | (2,089,586) | (502,647) |
| Loss before income tax | | (2,089,586) | (502,647) |
| Income tax expense | | (2,121) | (1,090) |
| Loss for the period from continuing operations | | (2,091,707) | (503,737) |
| Loss for the period | | (2,091,707) | (503,737) |

The accompanying notes are an integral part of these financial statements.

XSTATE RESOURCES LIMITED
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE SIX MONTHS ENDED 30 JUNE 2017

| | 30 June 2017 \$ | 30 June 2016 \$ |
|---|--------------------------------|--------------------------------|
| Other comprehensive income | | |
| <i>Items that may be reclassified subsequently to profit or loss</i> | | |
| Foreign currency translation difference of foreign operations | 161 | 87 |
| Total items that may be reclassified subsequently to profit or loss | 161 | 87 |
| Total comprehensive loss for the period | (2,091,546) | (503,650) |
| Loss attributable to owners of the Company | (2,091,707) | (503,737) |
| Total comprehensive loss attributable to owners of the Company | (2,091,546) | (503,650) |
| Loss per share | | |
| Basic and diluted (cents per share) | (0.33) | (0.17) |

The accompanying notes are an integral part of these financial statements.

XSTATE RESOURCES LIMITED
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30 JUNE 2017

| | Attributable to equity holders of the Company | | | | | Total \$ |
|---|---|------------------------------|--------------------------|--|-----------------------------|-------------|
| | Share capital \$ | Translation reserve \$ | Options reserve \$ | Performance shares reserve \$ | Accumulated losses \$ | |
| Balance at 1 January 2017 | 46,825,108 | 169 | - | 65,000 | (44,853,344) | 2,036,933 |
| Total comprehensive expense for the period | | | | | | |
| Loss for the period | - | - | - | - | (2,091,707) | (2,091,707) |
| Other comprehensive income | | | | | | |
| Foreign exchange translation difference on foreign operations | - | 161 | - | - | - | 161 |
| Total comprehensive income | - | 161 | - | - | - | 161 |
| Total comprehensive loss for the period | - | 161 | - | - | (2,091,707) | (2,091,546) |
| Transactions with owners, recorded directly in equity: | | | | | | |
| Contributions by and distributions to owners | | | | | | |
| Issue of ordinary shares on conversion of performance rights | 65,000 | - | - | (65,000) | - | - |
| Share-based payment transactions | - | - | 445,200 | - | - | 445,200 |
| Total contributions by and distributions to owners | 65,000 | - | 445,200 | (65,000) | - | 445,200 |
| Total changes in ownership interests in subsidiaries | - | - | - | - | - | - |
| Total transactions with owners | 65,000 | - | 445,200 | (65,000) | - | 445,200 |
| Balance at 30 June 2017 | 46,890,108 | 330 | 445,200 | - | (46,945,051) | 390,587 |

The accompanying notes are an integral part of these financial statements.

XSTATE RESOURCES LIMITED
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30 JUNE 2016

| | Attributable to equity holders of the Company | | | | | Total \$ |
|---|---|------------------------------|--------------------------|--|-----------------------------|-------------|
| | Share capital \$ | Translation reserve \$ | Options reserve \$ | Performance shares reserve \$ | Accumulated losses \$ | |
| Balance at 1 January 2016 | 43,737,525 | 108 | 92,050 | - | (43,909,167) | (79,484) |
| Total comprehensive expense for the period | | | | | | |
| Loss for the period | - | - | - | - | (503,737) | (503,737) |
| Other comprehensive income | | | | | | |
| Foreign exchange translation difference on foreign operations | - | 87 | - | - | - | 87 |
| Total comprehensive income | - | 87 | - | - | - | 87 |
| Total comprehensive loss for the period | - | 87 | - | - | (503,737) | (503,650) |
| Transactions with owners, recorded directly in equity: | | | | | | |
| Contributions by and distributions to owners | | | | | | |
| Issue of ordinary shares | 3,418,655 | - | - | - | - | 3,418,655 |
| Transfer to accumulated losses on lapse of options | - | - | (43,550) | - | 43,550 | - |
| Share-based payment transactions | - | - | - | 14,662 | - | 14,662 |
| Capital raising costs | (328,935) | - | - | - | - | (328,935) |
| Total contributions by and distributions to owners | 3,089,720 | - | (43,550) | 14,662 | 43,550 | 3,104,382 |
| Total changes in ownership interests in subsidiaries | - | - | - | - | - | - |
| Total transactions with owners | 3,089,720 | - | (43,550) | 14,662 | 43,550 | 3,104,382 |
| Balance at 30 June 2016 | 46,827,245 | 195 | 48,500 | 14,662 | (44,369,354) | 2,521,248 |

The accompanying notes are an integral part of these financial statements.

XSTATE RESOURCES LIMITED
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED 30 JUNE 2017

| | 30 June 2017 \$ | 30 June 2016 \$ |
|---|--------------------------------|--------------------------------|
| Cash flow from operating activities | | |
| Cash paid to suppliers and employees | (402,241) | (360,761) |
| Payments for exploration, evaluation and development | (192,775) | (156,404) |
| Interest received | 2,992 | 2,855 |
| Income taxes paid | (2,121) | (1,090) |
| Net cash used in operating activities | (594,145) | (515,400) |
| Cash flows from investing activities | | |
| Payment of deposit for oil and gas properties | (195,295) | - |
| Net cash used in investing activities | (195,295) | - |
| Cash flow from financing activities | | |
| Proceeds from issue of share capital | - | 3,291,237 |
| Proceeds from issue of convertible notes | - | 125,000 |
| Proceeds from related party loans | - | 25,000 |
| Proceeds from settlement of loan to JV partner | - | 61,786 |
| Payment of capital raising costs | (13,423) | (326,462) |
| Payment of transaction costs related to loans | - | (8,750) |
| Repayment of loans from related party | - | (25,259) |
| Repayment of loans from / payment on behalf of JV partner | - | (46,566) |
| Repayment of premium funding facility | - | (17,798) |
| Net cash (used in) / from financing activities | (13,423) | 3,078,188 |
| Net decrease / (increase) in cash and cash equivalents | (802,863) | 2,562,788 |
| Cash and cash equivalents at 1 January | 1,457,298 | 38,039 |
| Effect of exchange rate fluctuations on cash held | (5,571) | (1,106) |
| Cash and cash equivalents at 30 June | 648,864 | 2,599,721 |

The accompanying notes are an integral part of these financial statements.

XSTATE RESOURCES LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED 30 JUNE 2017

SECTION 1 BASIS OF PREPARATION

Xstate Resources Limited (“the Company”) is a for-profit, listed company domiciled in Australia. The consolidated interim financial report of the Company as at and for the six months ended 30 June 2017 comprises the Company and its subsidiaries (together referred to as “the Group” and individually as “Group Entities”). The Group is primarily involved in oil and natural gas exploration in California, USA.

The interim financial report is intended to provide users with an update on the latest annual financial statements of the Group. As such it does not contain information that represents relatively insignificant changes occurring during the half year within the Group. The consolidated interim financial report does not include all of the information required for a full annual financial report, and should be read in conjunction with the consolidated annual financial report of the Group as at and for the year ended 31 December 2016, which is available upon request from the Company’s registered office at Level 1, 31 Cliff Street, Fremantle, Western Australia 6160 and on the Company’s website at www.xstate.com.au.

Selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Group’s financial position and performance since the last annual consolidated financial statements as at the year ended 31 December 2016.

1.1 Statement of Compliance

The consolidated interim financial report is a general purpose financial report prepared in accordance with AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001* and with IAS 34 *Interim Financial Reporting*.

The consolidated interim financial report was approved by the Board of Directors on 8 September 2017.

XSTATE RESOURCES LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SECTION 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Significant Accounting Policies

Except as described below, the accounting policies applied by the Group in the consolidated interim financial report are the same as those applied in its consolidated financial report as at and for the year ended 31 December 2016. The Group has adopted the following Amendments to Australian Accounting Standards with a date of initial application of 1 January 2017.

AASB 2016-1 – Recognition of Deferred Tax Assets for Unrealised Losses: Amends AASB 112 Income Taxes to clarify the requirements on recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value.

AASB 2016-2 – Disclosure Initiative Amendments to AASB 107: Amends AASB 107 Statement of Cash Flows to require entities preparing financial statements in accordance with Tier 1 reporting requirements to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

These changes do not impact the financial statements.

2.2 Judgements and Estimates

The preparation of interim financial reports requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

In preparing this consolidated interim financial report, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended 31 December 2016.

2.3 Foreign Currencies

The financial report is presented in Australian dollars, which is Xstate Limited's presentation currency and country of domicile.

In preparing the financial statements of the individual entities, transactions in foreign currencies are initially recorded in Australian dollars at the exchange rate on that day. Foreign currency monetary assets and liabilities are translated into Australian dollars at the yearend exchange rate. Where there is a movement in the exchange rate between the date of the transaction and the year end, a foreign exchange gain or loss may arise. Any such differences are recognised in the income statement. Non-monetary assets and liabilities measured at historical cost are translated into Australian dollars at the exchange rate on the date of the transaction.

2.4 Operating Segments

The Group has identified its operating segments on the internal reports that are reviewed and used by the Board of Directors (chief operating decision makers) in assessing performance and determining the allocation of resources.

The Group currently operates in one operating segment being oil and gas exploration and evaluation. Accordingly, under management's approach outlined, only one operating segment has been identified and no further disclosure is required in the financial statements.

XSTATE RESOURCES LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SECTION 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Going Concern

For the period ended 30 June 2017, the Group recorded a loss of \$2,091,707 and had net cash outflows from operating and investing activities of \$789,440. The ability of the Group to continue as a going concern is dependent on securing additional funding through settlement of the legal action described below or through debt or equity issues to continue to fund its operational activities.

These conditions indicate a material uncertainty that may cast a significant doubt about the Group's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

On 16 December 2016, the Company entered into binding letters of offer with four investors to raise A\$25 million. Formal subscription agreements were entered into with the four investors on 23 December 2016. There were no conditions precedent to the agreements, and all agreements were unconditional.

On 1 November 2016, the Company executed a letter of intent, subject to raising necessary funds, with Sunny Frog Oil to acquire a 24.5% interest in the Sansinena and East Los Angeles oil and gas fields in California, USA. Upon execution of the binding subscription agreement with the four investors, the Company entered into a formal acquisition agreement with Sunny Frog, and paid a \$670,980 (US\$500,000) non-refundable deposit pursuant to the terms of the Sunny Frog agreement. Due to delays in receipt of funds from the investors, on 3 January 2017 a further \$195,295 (US\$125,000) was paid by way of a non-refundable extension payment to extend the settlement date.

The four investors failed to meet the obligations of their subscription agreements, and on 17 April 2017 Sunny Frog terminated the sale agreement and retained the non-refundable payments.

Legal due diligence, project due diligence, travel, management time and the above non-refundable deposit and extension payment total approximately \$1.1 million.

A legal action has been commenced in the Supreme Court of Western Australia against the four defaulting investors seeking unspecified damages for breach of contract, including damages for loss of opportunity to be assessed by the Court.

On 23 August 2017, an application for Summary Judgement against all four defaulting investors was lodged by the Company with the supreme court.

The solicitors acting for the Company have advised that the clear breach of contract by the four investors not fulfilling their obligations under the subscription agreement has cost the company specifically identifiable and unspecified damages. Whilst the matter is yet to be heard by the Court, the Company and its solicitors are confident that the Court will rule in favour of the Company and that the finding by the Court will see a resolution to the legal action that will be financially beneficial to the Company. It is not possible at this stage to quantify the level of financial compensation.

In the absence of a satisfactory financial settlement of the above matter, the directors are aware that additional funds will need to be sourced for the Group to continue its business as budgeted, including meeting its exploration and development activities. The Group's cash flow forecast for the period to 31 December 2018 reflects that the Group will need to raise additional funds to enable it to meet its working capital requirements and its committed and planned development expenditure relating to its exploration and evaluation assets. The ability of the Group to continue as a going concern, and thereby be able to pay its debts as and when they fall due, is dependent on the Group successfully securing further working capital from one or more of the following alternatives:

XSTATE RESOURCES LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2.5 Going Concern (continued)

- Capital market raising such as:
 - Private placement
 - Entitlements issue
 - Share purchase plan
- Borrowings from related or third parties

The Directors have reviewed the Groups' financial position and forecast cash flows and reasonably expect that the Group will be able to raise additional funds to meet future costs and satisfy its business plans for at least the next 12 months. If necessary, the Group has the capacity to delay or cancel a number of expenses that are discretionary in nature, including administrative costs, exploration programmes and development expenditure that are not contractually committed. The timing of raising additional capital will depend on the investment markets, current and future planned exploration and development activities.

The directors are therefore of the opinion that the use of the going concern basis is appropriate in the circumstances. Notwithstanding this assessment there is significant uncertainty regarding the outcomes of the future funding alternatives.

Should the Group not be able to continue as a going concern, it may be required to realise its assets and discharge its liabilities other than in the ordinary course of business, and at amounts that may differ from those stated in the interim financial statements and that the interim financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or liabilities that might be necessary should the Group not continue as a going concern.

XSTATE RESOURCES LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SECTION 3 ASSETS AND LIABILITIES RELATING TO EXPLORATION AND EVALUATION

This section focuses on the assets and liabilities which form the core of the ongoing business, including those assets and liabilities which support ongoing exploration and evaluation as well as capital and other commitments existing at 30 June 2017.

Key estimates and assumptions in this section

Provisions

Provisions are determined by discounting the expected future cash flow at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance costs.

Site restoration

In accordance with the Group's published environment policy and applicable legal requirements, a provision for site restoration in respect of contaminated and disturbed land, and the related expense, is recognised when the land is contaminated or disturbed. Provisions for the costs of rehabilitation, decommissioning and restoration of the area disturbed during mining activities depends on the legal requirements at the date of decommissioning, the costs and timing of work and the discount rate to be applied.

At each reporting date, the site rehabilitation provision is re-measured to reflect any changes in discount rates and timing or amounts of the costs to be incurred. Such changes in the estimated liability are accounted for prospectively from the date of the change and re-added to, or deducted from, the related asset where it is possible that future economic benefits will flow to the entity.

3.1 Prepayment – Oil and Gas Properties

On 16 December 2016, the Company entered into binding letters of offer with four investors to raise A\$25 million. Formal subscription agreements were entered into with the four investors on 23 December 2016.

On 1 November 2016, the Company executed a letter of intent, subject to raising necessary funds, with Sunny Frog Oil to acquire a 24.5% interest in the Sansinena and East Los Angeles oil and gas fields in California, USA. Upon execution of the binding subscription agreements with the four investors, the Company entered into a formal acquisition agreement with Sunny Frog, and paid a \$670,980 (US\$500,000) non-refundable deposit pursuant to the terms of the Sunny Frog agreement. Due to delays in receipt of funds from the investors, on 3 January 2017 a further US\$125,000 was paid by way of a non-refundable extension payment to extend the settlement date.

The four investors failed to meet the obligations of their subscription agreements, and on 17 April 2017 Sunny Frog terminated the sale agreement and retained the non-refundable payments.

Legal action has commenced against the defaulting investors seeking unspecified damages for breach of contract.

| | 30 June 2017 | 31 December 2016 |
|---|-------------------------|-----------------------------|
| | \$ | \$ |
| Non-refundable deposit payment for 24.5% WI in Sansinena & East LA Basin oil and gas fields | - | 741,626 |
| Movement in carrying amounts | | |
| Opening balance | 741,626 | - |
| Non-refundable deposit | - | 670,980 |
| Establishment costs | - | 70,646 |
| Extension costs | 195,295 | - |
| Write-off | (936,921) | - |
| Closing balance | - | 741,626 |

XSTATE RESOURCES LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3.2 Provisions

The site restoration provision of \$272,857 (31 December 2016: \$58,653) is in respect of the Group's on-going obligation for the environmental rehabilitation of the Sacramento Basin onshore California area of interest. The timing of rehabilitation expenditure is dependent on the life of the oil field which may vary in the future. The nature of restoration activities includes restoration, reclamation and revegetation of affected areas. The Company continues to work with the Californian authorities with regards to the planning and timing of the rehabilitation.

| | 30 June 2017 | 31 December 2016 |
|-------------------------------------|-------------------------|-----------------------------|
| | \$ | \$ |
| Non-current | | |
| Site restoration provision | (272,857) | (58,653) |
| Movement in carrying amounts | | |
| Opening balance | (58,653) | (70,961) |
| Additional provisions recognised | (221,724) | - |
| Amounts utilised | - | 13,431 |
| Effects of foreign exchange | 7,520 | (1,123) |
| Closing balance | (272,857) | (58,653) |

XSTATE RESOURCES LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SECTION 4 EQUITY AND FUNDING

This section focuses on the share capital, options and debt funding available to the Group at period end.

4.1 Capital and Reserves

Share capital

| | Ordinary shares | | | |
|--|--------------------|--------------------|-------------------|-------------------|
| | Number of shares | | Amount in \$ | |
| | 30 June 2017 | 30 June 2016 | 30 June 2017 | 30 June 2016 |
| Movements in ordinary shares on issue: | | | | |
| On issue at 1 January | 621,792,718 | 238,061,695 | 46,825,108 | 43,737,525 |
| Shares issued and expensed during the period: | | | | |
| Private placement of shares at 0.5 cents each | - | 58,265,423 | - | 291,327 |
| Issue of shares at 1.0 cent each to raise working capital | - | 300,000,000 | - | 3,000,000 |
| Issue of shares at 0.5 cents each for conversion of Convertible Note | - | 25,465,600 | - | 127,328 |
| Issue of shares at 1.3 cents each converted from performance shares | 5,000,000 | - | 65,000 | - |
| Capital raising costs | - | - | - | (328,935) |
| On issue at 30 June | 626,792,718 | 621,792,718 | 46,890,108 | 46,827,245 |

The holders of ordinary shares are entitled to receive dividends as declared from time and are entitled to one vote per share at meetings of the Group. Option holders cannot participate in any new share issues by the Group without exercising their options.

In the event of a winding up of the Group, ordinary shareholders rank after all other shareholders and creditors and are fully entitled to any proceeds on liquidation.

All issued shares are fully paid.

Options

At the date of this report the Company has a total of 42,000,000 unissued ordinary shares under option with an exercise price of 5 cents and an expiry date of 31 December 2020. The key valuation assumptions made at valuation date are summarised below:

| | Number of options | Exercise price | Grant date | Expiry date | Life of options | Volatility | Risk free rate |
|-------------|-------------------|----------------|------------|-------------|-----------------|------------|----------------|
| Directors | 40,000,000 | 5 cents | 31-Jan-17 | 31-Dec-20 | 3.92 | 100% | 1.83% |
| Consultants | 2,000,000 | 5 cents | 03-Feb-17 | 31-Dec-20 | 3.91 | 100% | 1.83% |

These options do not entitle the holder to participate in any share issue of the Company.

During or since the end of the reporting period, no shares were issued as a result of the exercise of options.

During the reporting period, no options expired (30 June 2016: 19,500,000 expired).

XSTATE RESOURCES LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SECTION 5 OTHER DISCLOSURES

The disclosures in this section focus on share schemes in operation and financial risk management of the Group and other mandatory disclosures, such as related party transactions.

5.1 Subsidiaries

During the reporting period, the Company established the following USA subsidiaries:

| Name of entity | Date | Comments |
|-------------------|-----------------|--|
| CaIX SELA LLC | 10 January 2017 | Registered in California to hold the Los Angeles Basin assets to be acquired from Sunny Frog Oil LLC |
| Xstate (USA) Corp | 20 January 2017 | Incorporated in Delaware as a USA holding company |
| XGas LLC | 5 April 2017 | Registered in California to hold the exploration permits |

5.2 Subsequent Events

On 17 July 2017, the Company successfully completed a placement with sophisticated investors raising \$470,000 (before costs). Xstate issued 94,000,000 fully paid shares at 0.5 cents per share. The placement was made pursuant to Section 708 of the Corporations Act and Rule 7.1 of the ASX Listing Rules. Following the placement, the Company has 720,792,718 shares on issue.

Other than as disclosed in note 3.1 and above, there have been no matters or circumstances that have arisen since the end of the interim period that have significantly affected, or may significantly affect, the operations of the Group, the results of these operations, or the state of affairs of the Group in future financial years.

XSTATE RESOURCES LIMITED
DIRECTORS' DECLARATION

DIRECTORS' DECLARATION

In the opinion of the Directors of Xstate Resources Limited (the "Group"):

- (a) the consolidated financial statements and notes are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Group's financial position as at 30 June 2017 and of its performance for the six months ended on that date; and
 - (ii) complying with Australian 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.

Signed in accordance with a resolution of the Directors:

Dated at Perth this 8th day of September 2017



DAVID MCARTHUR
Director

INDEPENDENT AUDITOR'S REVIEW REPORT

To the members of Xstate Resources Limited

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Xstate Resources Limited, which comprises the consolidated statement of financial position as at 30 June 2017, the consolidated statement of profit or loss, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the half-year ended on that date, notes comprising a statement of accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the half-year's end or from time to time during the 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 and the *Corporations Act 2001* and for such internal 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 a 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 half-year 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 30 June 2017 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 Xstate Resources Limited, 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 confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Xstate Resources Limited, would be in the same terms if given to the directors as at the time of this auditor's review 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 half-year financial report of Xstate Resources Limited is not in accordance with the *Corporations Act 2001* including:

- (i) Giving a true and fair view of the consolidated entity's financial position as at 30 June 2017 and of its performance for the half-year ended on that date; and
- (ii) Complying with Accounting Standard AASB 134 *Interim Financial Reporting* and *Corporations Regulations 2001*.

Emphasis of matter - Material uncertainty relating to going concern

We draw attention to Note 2.5 in the financial report which describes the events and/or conditions which give rise to the existence of a material uncertainty that may cast significant doubt about the consolidated entity's ability to continue as a going concern and therefore the consolidated entity may be unable to realise its assets and discharge its liabilities in the normal course of business. Our conclusion is not modified in respect of this matter.

BDO Audit (WA) Pty Ltd



Dean Just

Director

Perth, 8 September 2017