

Annual Report 2017



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Karoon Gas Australia Ltd is a global oil and gas exploration company headquartered in Melbourne, Australia, with country offices in Brazil and Peru.



CHAIRMAN AND MANAGING DIRECTOR'S REVIEW

The world oil market during the 2017 financial year has experienced continuing over supply and weaker demand. The recovery in the oil and gas market experienced from the early part of 2016 has not continued through to 2017, with oil industry analysts now appearing to have abandoned hope of a rapid oil price recovery and shifted expectations to materially lower short to medium term oil prices. This change in sentiment came in spite of OPEC and Russia's coordinated efforts to normalise high oil inventories through active market management. Instead the oil price outlook has been shaped by the resilience and speed of recovery in United States onshore oil production along with increased supply from Libya, Nigeria, Iraq and Iran.

As shale reaches its peak and the sweet spots are drilled out, it will be necessary to increase world oil supply over the medium to longer term. The current continued lack of investment, outside of United States shale oil, is expected to result in accelerating decline rates in non-OPEC supply from 2020 requiring new conventional offshore oil supply growth. This lack of investment, along with rising United States onshore cost inflation, and geopolitical uncertainty are all reasons to remain optimistic on a recovery in oil prices over the medium to longer term.

Karoon has accepted the reality that a significant recovery in oil prices may still be some way off and has responded by looking beyond its established exploration led business strategy and has resolved to continue to concentrate on procuring cash positive development and production opportunities to provide base cash flow in the medium term. A subdued oil and gas price environment can provide opportunities for well-positioned companies. Karoon has an established technical, geological and geophysical, and financial team to identify and evaluate development and production assets. Karoon also has a robust balance sheet, placing the Company in an enviable position to take advantage of selected acquisition opportunities that come up for sale.

“Karoon has a competitive advantage in evaluating opportunities in Brazil, with a significant geological and geophysical knowledge base and an operational track record in the Santos Basin.”

During the course of the financial year, Karoon was the successful tenderer for the potential purchase of the Baúna and Tartaruga oil fields offshore Brazil, offered for competitive sale process by Petróleo Brasileiro SA ('Petróbras'). While Karoon was genuinely committed to the sales process, external political and industry factors in Brazil required Petróbras to withdraw the assets from the market and the sale was unable to proceed. Karoon's experience gained from the bidding and due diligence process can be applied to a new process and/or to other assets.

Oil and gas development and production assets continue to be offered for sale throughout the world, as large oil and gas companies rationalise their portfolios in the continuing subdued oil price environment. Over the past year, Karoon has continued to look

at the purchase of select oil and gas opportunities in many parts of the world and has honed its skills in appraising and carrying out due diligence. Karoon continues to be in a position to expeditiously complete a value accretive acquisition, when the right opportunity is identified.

Brazil

Echidna Innovative Development Concept, Santos Basin

The principal focus for Karoon during 2017 continued to be to further advance appraisal and pre-development planning of the Echidna and Kangaroo light oil discoveries in the Santos Basin, Brazil. The aim has been to produce a design that is economically robust and is realistic in the current oil price environment.

As a result of 18 months of extensive subsurface evaluation, during July 2017 the Board of Directors approved an innovative development concept for Echidna that will progress the project to the next phase, being Front End Engineering and Design ('FEED').

The Echidna development concept utilises a leased floating production, storage and off-loading ('FPSO') facility, producing from 2 extended horizontal production wells and 1 gas injection well. Expected peak oil production is approximately 28,000 barrels per day.

The FEED phase is expected to take approximately 8 months and cost approximately \$10 million, with completion planned during the March 2018 quarter. A final investment decision ('FID') is targeted for the June 2018 quarter.

As part of the FEED process, Karoon will issue a Request for Tender to select suppliers with the intention of contracting an Engineering Procurement Construction and Installation work package for the Echidna development.

The dramatic global oil industry downturn over the past three years has led to lower vessel utilisation rates and higher equipment inventory levels, globally and in Brazil. The present cyclical downturn has presented a window of opportunity in which Karoon expects to receive development tenders that provide significant funding flexibility. Based on recent supplier discussions, Karoon expects to receive tenders that substantially reduce upfront capital commitments including deferred payment structures, equipment financing solutions, subsurface risk reward sharing and/or equity ownership.



New Opportunities

The Brazilian oil and gas regulator Agência Nacional do Petróleo, Gás Natural e Biocombustíveis ('ANP') has announced new acreage opportunities in Brazil with the launch of several new exploratory block bid rounds. Key regulatory changes have been implemented (with others pending) to boost the attractiveness of these bid rounds, which include lowering and improving minimum local content requirements and ending Petróbras' mandatory operatorship of pre-salt acreage.

Karoon has a competitive advantage in evaluating opportunities in Brazil, with a significant geological and geophysical knowledge base and an operational track record in the Santos Basin. Depending on the number of blocks considered to be attractive and the size of the commitment necessary to win them, Karoon will look at a joint bidding process with major international oil companies to maximise potential opportunities.

Peru

Z-38, Tumbes Basin

Karoon identified additional prospectivity in shallower sequences in its Z-38 Block during the financial year, adding prospective resources to what is already a long list of good targets in the Block. Karoon has now largely completed this current phase of work and as such has reduced its workload in-country to allow for partnering opportunities before progressing to the drilling phase.

Following on from the positive seismic quantitative interpretation over the previous two years, Karoon has received renewed farm-in interest from international companies. The Peruvian authorities are also supportive of progressing to the drilling phase and have extended current approvals to facilitate drilling in the near term.

Karoon is encouraged by the interest from potential partners and hopes that a successful farm-out of the Block will yield a pathway to drilling in the next year or so.

Australia

EPP46, Ceduna Sub-basin, Great Australian Bight

During the financial year, Karoon strengthened its exploration portfolio with the acquisition of a significant Australian exploration asset, namely exploration permit EPP46 in the Ceduna Sub-basin of the Great Australian Bight ('GAB'). The permit covers an area of 17,649 square kilometres ('sq km') in a prospective exploration area, with prospective resources for the whole GAB area potentially matching those delivered in Bass Strait over the past 40 years.

Karoon has a firm exploration commitment over three years to obtain 5,000 kilometres of 2D and 2,500 sq km of 3D marine seismic data, processed to pre-stack depth migration, with 550 kilometres of 2D seismic reprocessing and gravity and magnetics surveying tied with these seismic acquisition surveys. The initial seismic survey will be conducted in the first half of calendar 2018, at a time to optimise safety and minimise environment risks.

Karoon is very aware of the environmental sensitivities in the GAB and has taken steps to ensure seismic contractors conduct stakeholder consultation and environmental assessments with due care. Karoon has had a long and successful history, since it listed during June 2004, in operating seismic acquisition programs. Karoon has operated successful seismic and other geophysical surveys in Australia in the Browse and Bonaparte Basins, in Peru with large 2D and 3D seismic surveys through some of the largest fishing grounds in the world, and in Brazil with 3D seismic surveys.

For Karoon, the idea of success in operated surveys encompasses both the technical results of the activity and, importantly, the successful engagement of all stakeholders in the areas involved. Stakeholder groups include government regulatory authorities, local fishing and other industry groups, local Indigenous groups and adjoining permit holders among others. This engagement is characterised by multiple meetings and workshops with the diverse groups, identifying areas of concern and managing issues for the mutual benefit of all stakeholders. The key objective in stakeholder engagement for Karoon is to maximise transparency throughout the process. To date, this has resulted in excellent outcomes for all stakeholders, including shareholders, for all of Karoon's operated seismic activities.

Looking to the Future

In addition to advancing Karoon's organic growth ambitions, the Company remains committed to its acquisition strategy and capitalising on current market conditions to acquire development and/or production assets, along with opportunities that are consistent with the Company's exploration led growth strategy.

Exploration Opportunities

Karoon has a well-developed approach to exploration. The Company looks to acquire high-equity interests in offshore acreage that has the potential to deliver world-class assets. Karoon recognises that while exploration is a high-risk activity, it can potentially deliver high reward on success. Success does not come easily and, on an individual opportunity basis, cannot be guaranteed. However, by having a diversified portfolio of prospects and by ranking individual prospects one against the other, and against new opportunities, the portfolio can be upgraded and the chance of success improved.



The present cyclical downturn in worldwide oil and gas exploration provides an ideal opportunity to upgrade Karoon's exploration portfolio. Karoon is therefore also continuing to appraise exploration prospects to improve the chance of success.

Strategic Partnerships

During July 2017, Karoon entered into agreements with DEA Deutsche Erdoel AG ('DEA') to review and evaluate and, if thought appropriate, jointly bid for oil and gas assets in selected areas offshore Brazil. These arrangements include an exclusive option granted to DEA for the acquisition of a non-operated interest of up to 50% in Karoon's five Santos Basin offshore exploration blocks, including the Echidna and Kangaroo light oil discoveries, subject to satisfactory due diligence and agreement of terms.

A partnership with DEA would significantly assist Karoon toward achieving its goal of realising meaningful oil production from Karoon's Santos Basin assets.



Prudent Management

Karoon has responded to the subdued oil price environment by adapting its business strategy to take advantage of the potential opportunities arising from the industry cyclical downturn. In particular, Karoon is seeking to complement its exploration portfolio with a development and/or production asset and to upgrade its exploration portfolio as those opportunities become available.

In order to achieve success in such a challenging market, Karoon has taken difficult yet prudent management decisions to reduce costs. Operationally, significant effort has been put into achieving a capital efficient design for the development of the Echidna light oil discovery by optimising both well configuration and design and by working with service providers to utilise idle infrastructure for mutual benefit. Administratively, Karoon has reduced employee and contractor numbers in both Australia and South America and also sought to consolidate information technology and technical resources across jurisdictions to improve efficiencies. Karoon is continuing its work on reducing administrative costs, without compromising safety or its ability to review opportunities and progress the most valuable prospects in its portfolio.

Karoon will continue its ongoing review and reduction of both operational and administrative costs, as well as looking for further efficiency gains.

These are challenging times for companies in the oil and gas industry. The Board of Directors would like to thank its shareholders for their continued support. The Board of Directors would also like to thank our dedicated employees and contractors for their continuing efforts over the past year, to advance Karoon towards the Company's long-term goals.

A handwritten signature in black ink, appearing to read 'DKg'.

Dr David Klingner
Independent Non-Executive
Chairman

A handwritten signature in black ink, appearing to read 'RH'.

Mr Robert Hosking
Managing Director

21 September 2017

HIGHLIGHTS FOR 2016–2017

➤ **Acquisition** of Pacific's 35% equity interest in the jointly held Santos Basin Blocks including the Echidna, Kangaroo and Bilby oil discoveries for up to US\$20.5 million.

➤ **Pre-FEED** was completed for the Echidna light oil discovery progressing the project to the next phase in the development pathway, being FEED.

The Echidna development concept selected was designed to deliver a capital efficient, risk-weighted concept that is economically robust in the current oil price environment.

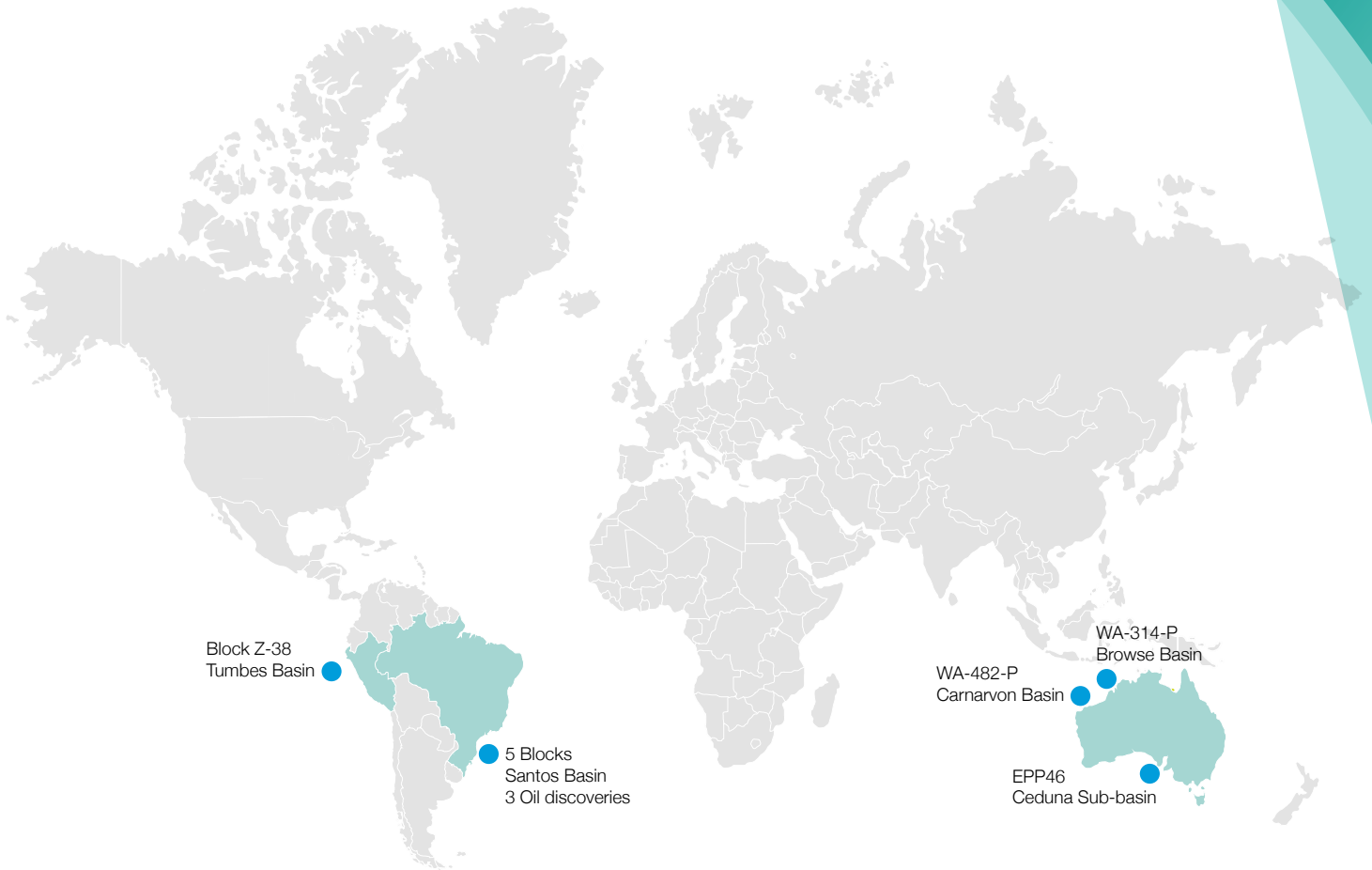
➤ **The exploration** portfolio was strengthened with the acquisition of permit EPP46 in the offshore Ceduna Sub-basin, Australia.

➤ **During July 2017** Karoon formed a strategic alliance with a high-quality, well capitalised global oil and gas E&P company, DEA, via agreements to review and evaluate and, if thought appropriate, jointly bid for oil and gas opportunities in selected areas in offshore Brazil.

These agreements also include the granting of an exclusive option for the potential farm-out of up to a 50% equity interest in Karoon's five Santos Basin Blocks, including the Echidna and Kangaroo light oil discoveries.



WHERE WE OPERATE



| Exploration Permit/Block | Basin | Equity Interest (%) | Gross Acreage (sq km) | Water Depth (m) | Type | Status |
|----------------------------------|--------------------------|---------------------|-----------------------|-----------------|-------------|--------------------------------|
| WA-314-P | Browse | 100* | 998 | 500 (average) | Oil | Exploration |
| WA-482-P | Northern Carnarvon | 50 | 13,539 | 400-2,000 | Oil | Exploration |
| EPP46 | Bight (Ceduna Sub-basin) | 100* | 17,649 | 1,300 (average) | Oil and Gas | Exploration |
| S-M-1037, 1101, 1102, 1165, 1166 | Santos | 100* | 549 | 400 (average) | Oil | Discovery appraisal (pre-FEED) |
| Z-38 | Tumbes | 75*^ | 4,750 | 300-3,000 | Oil | Exploration |

* Denotes Karoon's operatorship of the exploration permit/Block.

^ Karoon's 75% equity interest is subject to completion of farm-in obligations.

During the financial year, exploration Block 144 (Marañón Basin, Peru) was relinquished without penalty.

STRATEGY, STRENGTHS AND RISKS

Corporate Strategy

Karoon is a global independent oil and gas company seeking to utilise its geotechnical skillset to identify and acquire assets where it identifies substantial prospectivity, then add value by applying its regional experience. Karoon also looks to capitalise on cyclical downturns to acquire development or production opportunities where it can add value.

The Company looks to acquire high-equity interests in offshore acreage which have the potential to deliver significant hydrocarbon projects. The acreage is typically acquired through either bid rounds or farm-ins in underexplored early stage exploration opportunities within proven petroleum systems.

Value is created through the geotechnical work-up of the acreage, leveraging the high equity interests through farm-outs to assist in funding the capital-intensive exploration and appraisal drilling phase to achieve commercialisation.

While the Company's core strategy is identifying offshore early stage exploration opportunities, Karoon's medium to longer term strategy is to evolve into a development company with operated production assets.

Strengths

- / Extensive petroleum industry and management experience.
- / Significant acreage position in proven and prospective petroleum systems.
- / Globally diversified portfolio of prospects.
- / Proven track record of managing equity interests to fund exploration and appraisal work programs.
- / Proven track record of drilling success with a 62% exploration and appraisal drilling success rate over the life of the Company.
- / Track record of successfully operating 2 exploration and appraisal drilling campaigns in Brazil, drilling a total of 6 wells plus 2 side-tracks, with a Total Recordable Incident Rate ('TRIR') of less than 1 per 200,000 man hours.
- / Proven track record of monetising exploration and appraisal assets.
- / Application of leading seismic techniques and leading edge exploration and analysis technology.
- / Ability to attract and retain highly qualified and experienced personnel in preparation for transition into a production company.
- / Demonstrated ability to create and develop strategic partnerships with industry participants.
- / Robust balance sheet to fund organic and non-organic growth opportunities.

Specific Risks

- / Petroleum exploration and evaluation rely on the interpretation of complex and uncertain data, which might not lead to a successful outcome.
- / Operating risks, such as adverse weather conditions, mechanical failures, equipment and personnel availability and permitting delays, can have adverse financial implications.
- / Insurance coverage may be insufficient to cover all risks associated with oil and gas exploration and evaluation.
- / Volatile market conditions for oil and gas may affect the ability to obtain funding on acceptable terms.
- / The business requires substantial capital investment and maintenance expenditures, which may be financially onerous.
- / The outcome of farm-out discussions and processes are uncertain.
- / Exchange rate fluctuations in United States dollars and Brazilian REALS.
- / Social, political and geographical risks associated with multinational operations.
- / Environmental damage associated with field operations.

RESOURCE SUMMARY

Karoon is currently in the process of reviewing its contingent and prospective resources as disclosed in Karoon's ASX announcements 'Contingent Resource Volume Update: Santos Basin Brazil' and 'Independently Certified Net Un-risked Prospective Resource, Australia and Peru, Best Case Net to Karoon 4.5 tcf Wet Gas and 4.2 bn bbls Oil' on 17 September 2015 and 30 April 2014 respectively. This process is expected to be completed in the coming months.



OPERATIONS REVIEW

For the Financial Year Ended 30 June 2017

Santos Basin, Brazil



Santos Basin Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166

During March 2008, Karoon was awarded 100% participation in 5 offshore exploration blocks in the Santos Basin, located in the State of Sao Paulo approximately 200 km off the coast of Brazil. The blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166 (the 'Blocks') have an average water depth of approximately 400 metres.

During September 2012, Karoon farmed out a 35% interest in the Blocks to Pacific Exploration and Production Corp. ('Pacific'), formerly Pacific Rubiales Energy Corp. As a result of persistently low oil prices and high levels of debt, Pacific entered insolvency protection during April 2016 following which Karoon repurchased Pacific's interest in the Blocks during September 2016 for US\$15.5 million plus an additional US\$5 million deferred contingent payable on a production threshold of 1 million barrels of oil equivalent being reached from the Blocks.

Since 2013, Karoon has successfully operated two drilling campaigns making 3 oil discoveries: Kangaroo, Bilby, and Echidna. A total of 6 exploration and appraisal wells have been drilled, including 2 side-tracks, with a TRIR of less than 1 per 200,000 man hours. Importantly, production tests in the Echidna-1 and Kangaroo-2 well locations have proven deliverability from both light oil discoveries.

Due to strong production test results and lower reservoir complexity, the Echidna light oil discovery is the immediate focus going forward.

Echidna Development Concept

During the financial year, the geotechnical evaluation of the Echidna light oil discovery was completed. The subsurface evaluation included reservoir modelling, production scenario analysis and well construction feasibility studies along with development optimisation work. The optimisation work was focused on delivering a capital efficient, risk-weighted development concept for the Echidna light

oil discovery that is economically robust in the current oil price environment.

Following the completion of the pre-FEED work, the Board approved an Echidna development concept progressing the project to the next phase in the development, being FEED.

The proposed Echidna development concept consists of:

- a leased floating production, storage, and off-loading facility;
- 2 extended horizontal production wells and 1 gas injection well; and
- expected peak oil production of approximately 28,000 bbl/day (14,000 bbl/day per well).

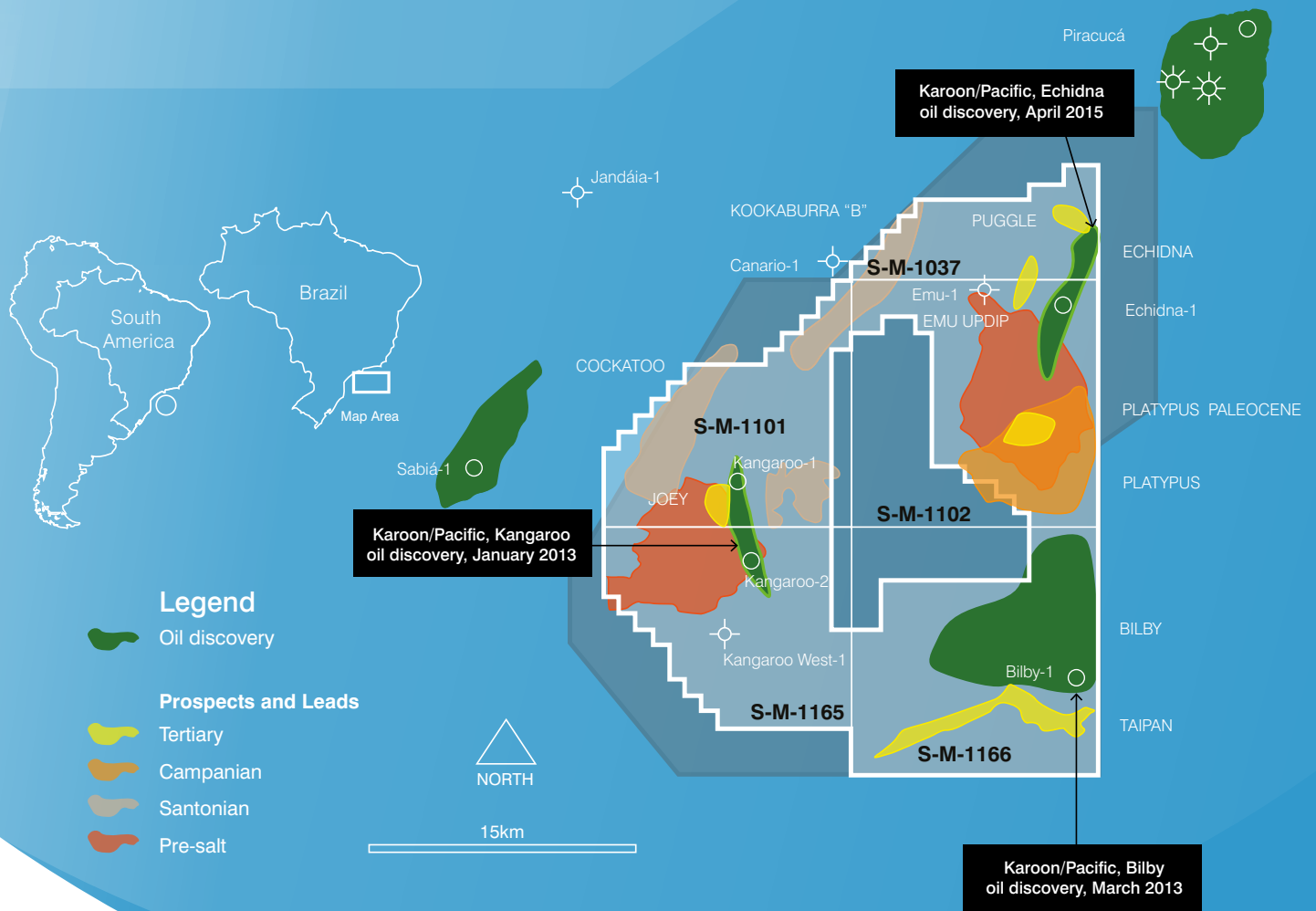
Forward Work Program

The current work program, approved by the Brazilian oil and gas regulator ANP during 2015, includes two firm wells in the Echidna/Emu area, the acquisition and processing of a new 3D seismic survey, pre-stack depth migration of data at 2 millisecond ('ms') sampling and further processing of 2 ms data to increase resolution. All firm commitments under the plan are to be completed by 31 December 2018.

Following Pacific entering insolvency protection, the Echidna appraisal campaign planned for the 2016 financial year was deferred. Positive progress made on the Echidna light oil discovery development concept during the financial year, along with the decision to progress to FEED, resulted in the decision to release the Olinda Star semi-submersible drilling rig during the financial year. The Olinda Star had been contracted prior to Pacific applying for insolvency protection and exiting the Santos Basin Blocks. Exploration and evaluation expenditure associated with drilling rig mobilisation costs during the financial year were expensed, and mobilisation costs capitalised as at 30 June 2016 were written-off.

Key Statistics

| | |
|-------------------------|--|
| Blocks: | S-M-1037, S-M-1101, S-M-1102, S-M-1165, S-M-1166 |
| Equity Interest: | 100% |
| Operator: | Karoon |
| Gross Acreage: | 549 sq km |
| Water Depth: | 400 metres (average) |
| Type: | Oil |
| Status: | Discovery appraisal phase (pre-FEED) |



Given the decision to progress the Echidna light oil discovery to FEED, it is Karoon's intention to 'Declare Commerciality' on the Echidna and Kangaroo oil discoveries, targeting a FID during the June 2018 quarter. Upon making a Declaration of Commerciality, the Blocks will move into the 'production development phase'.

FEED is expected to take approximately 8 months and cost approximately \$10 million, with completion planned during the March 2018 quarter.

The current cyclical downturn in the oil and gas industry has led to lower vessel utilisation rates and higher inventory levels. These conditions have presented a window of opportunity in which Karoon expects to receive tenders that provide significant funding flexibility and that will likely reduce upfront capital commitments. Based on recent supplier discussions, this funding flexibility is expected to include deferred payment structures, equipment financing solutions, subsurface risk reward sharing, and/or equity ownership.

Karoon remains committed to farming down equity in its 100% owned Santos Basin Blocks prior to FID.

Equity Interest

Equity interest of Karoon in the Santos Basin Blocks is:

| | |
|---------------------------------------|------|
| Karoon Petróleo & Gas Ltda (Operator) | 100% |
|---------------------------------------|------|

“Since 2013, Karoon has successfully operated two drilling campaigns making 3 oil discoveries: Kangaroo, Bilby, and Echidna.”

Browse Basin, Australia



Browse Basin Exploration Permit WA-314-P

From 2004 to 2014, the Browse Basin formed the cornerstone of Karoon's exploration efforts. Karoon farmed out a 60% interest (including operatorship) in its original exploration permits to ConocoPhillips during 2006, with the joint operation making the multi-tcf Poseidon gas discovery during 2009. During June 2014, Karoon sold its 40% interest in Poseidon (exploration permits WA-315-P and WA-398-P) for up to US\$800 million. As at the end of the financial year, a contingent milestone consideration of up to US\$200 million remained outstanding.

Karoon has retained a 100% interest in exploration permit WA-314-P (acquired during 2004), located approximately 350 km offshore from the northern part of the Western Australian coast.

WA-314-P contains a significant target, the Elvie prospect. Following interpretation of the initial Kraken 3D marine seismic survey data and thermal maturation modelling, evidence of hydrocarbons generating from a source kitchen to the northwest of the Elvie structure, suggesting an oil prone source.

Geological and Geophysical Work Program

During the financial year the Kraken 3D seismic data was reprocessed. The reprocessing was undertaken due to challenging metocean conditions of the seabed, including extreme rugosity of the seafloor, variation in water depths and variable seabed sediments.

The final reprocessed data is expected to be received during the September 2017 quarter. This work is expected to provide better definition of plays identified and together with amplitude versus offset ('AVO')/ Quantitative Inversion analysis will allow re-risking of the Elvie prospect.

Forward Work Program

The current work program consists of low-cost geological and geophysical ('G&G') studies. Any decision to commit to drilling a further exploration well in the permit will be made at the earlier of a farm-out or a decision to proceed into the optional fourth year of the current exploration licence. The current three-year exploration period expires during October 2018.

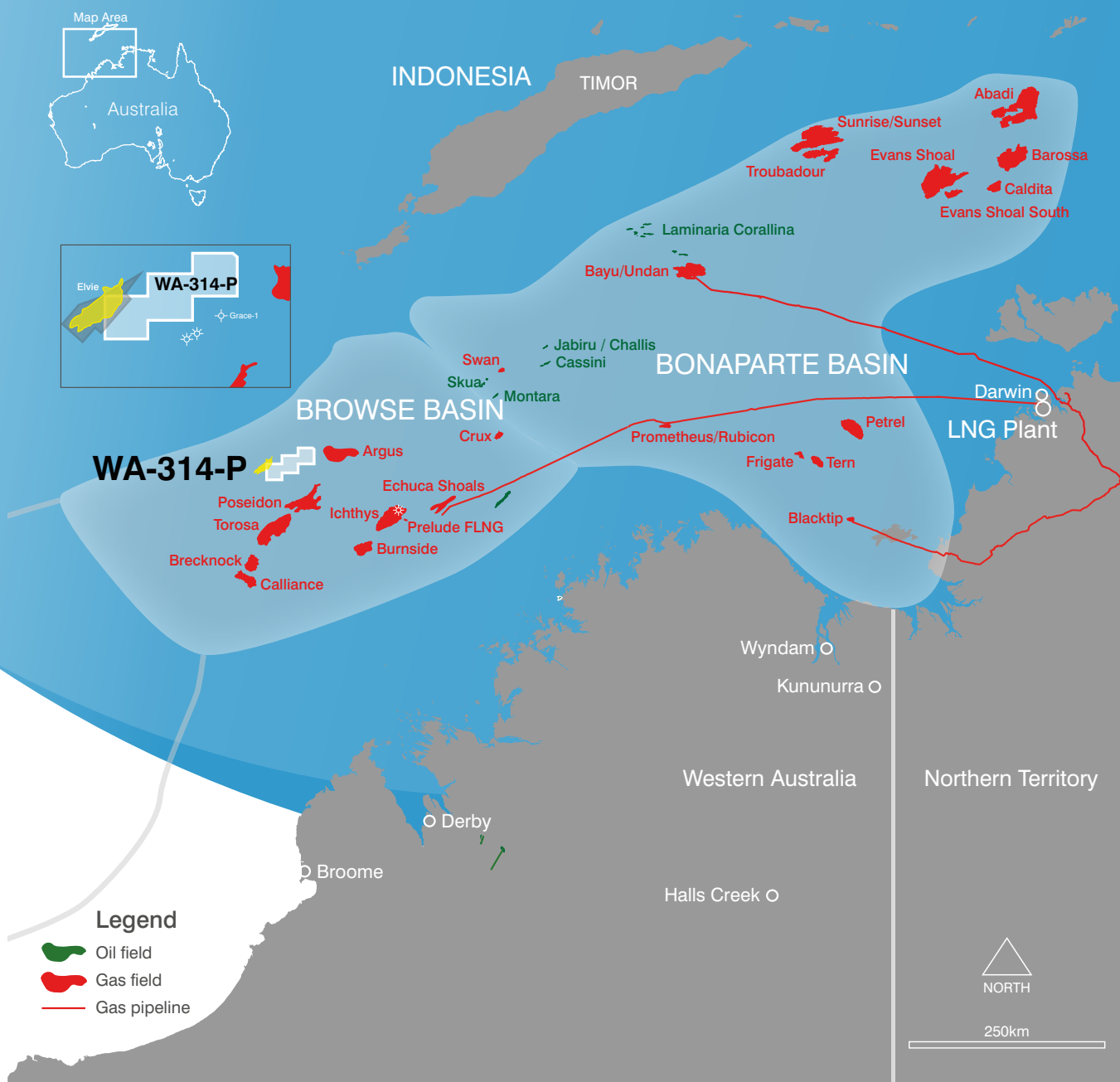
Equity Interest

Equity interest of Karoon in WA-314-P is:

| | |
|--|------|
| Karoon Gas Browse Basin Pty Ltd (Operator) | 100% |
|--|------|

Key Statistics

| | |
|-------------------------|----------------------|
| Permit: | WA-314-P |
| Equity Interest: | 100% |
| Operator: | Karoon |
| Gross Acreage: | 998 sq km |
| Water Depth: | 500 metres (average) |
| Type: | Oil |
| Status: | Exploration phase |



Northern Carnarvon Basin, Australia



Northern Carnarvon Basin Exploration Permit WA-482-P

During September 2012, Karoon acquired a 100% interest in exploration permit WA-482-P in the Northern Carnarvon Basin. The permit is located approximately 300 km offshore, from the north Western Australian Coast in water depths ranging from 400 to 2,000 metres. The exploration permit covers a large area of 13,539 sq km.

Karoon farmed out a 50% interest and operatorship in WA-482-P to Apache Northwest Pty Ltd, now part of Quadrant Energy Australia Limited, during May 2014. Following the farm-out, the Levitt-1 exploration well was drilled and discovered water bearing reservoirs.

While the exploration permit is in a relatively underexplored part of the Basin, the Carnarvon Basin is one of Australia's largest and most prolific oil and gas regions. The permit covers a very large area and a successful exploration result could open new exploration plays in the Basin.

The joint operation has high-quality 3D seismic data covering over 75% of the entire permit.

Geological and Geophysical Work Program

During the financial year, charge modelling studies over the permit were completed. The purpose of this work was to better understand the risks associated with effective hydrocarbon charge for the mapped structures.

The charge modelling results, along with the ongoing analysis of the extensive high-quality 3D seismic data set and the Levitt-1 well results were integrated into the geological model.

Forward Work Program

Subsequent to the end of the financial year, the Operator was granted a variation of the Year 6 work program.

Following completion of the charge modelling studies, further geotechnical work is required to better understand, risk, and rank the prospects. The variation of conditions to the Year 6 work program replaced the current well commitment with PSDM seismic reprocessing and G&G studies.

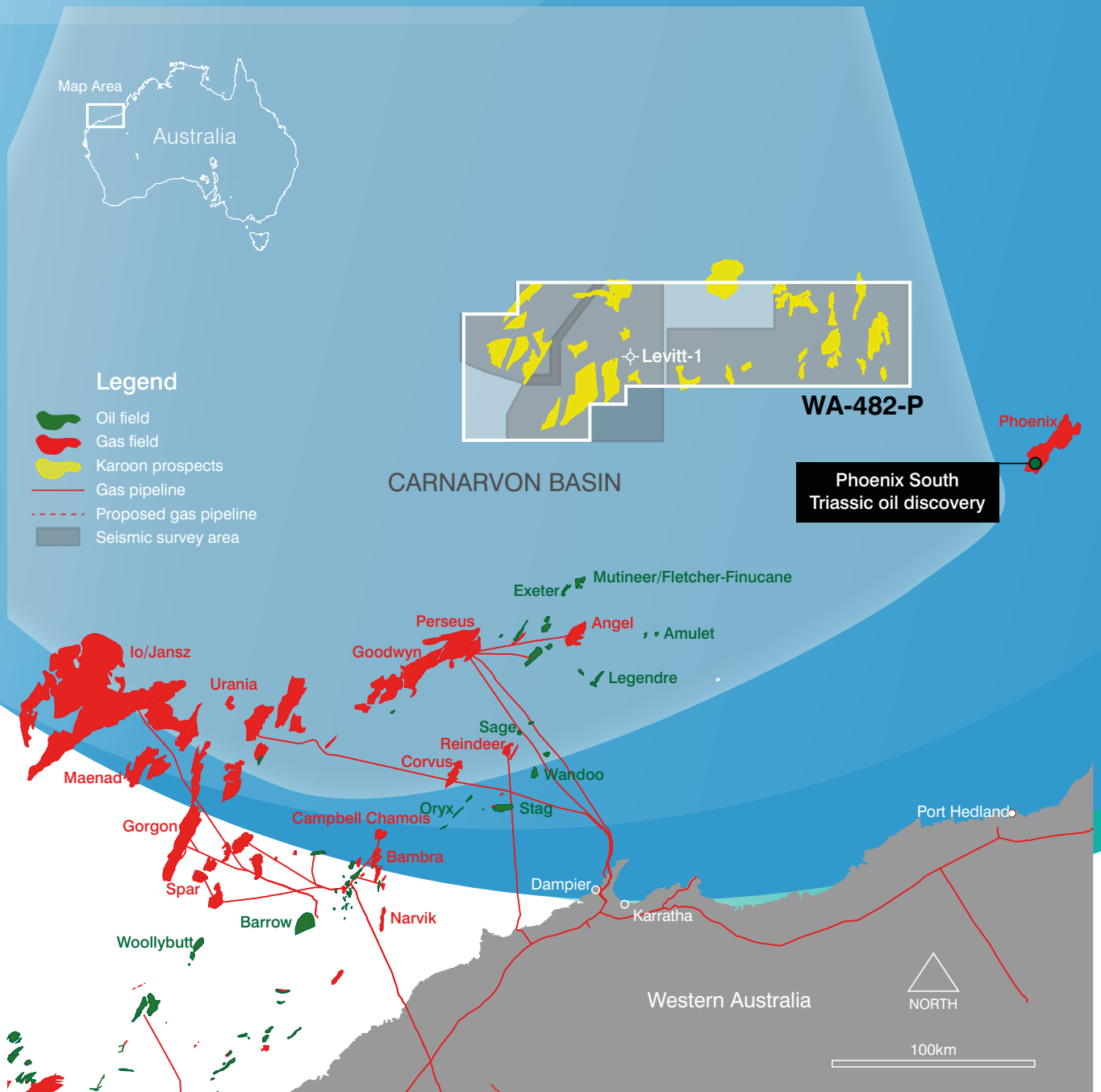
Equity Interests

Equity interests of the participants in WA-482-P are:

| | |
|---------------------------------------|-----|
| Karoon Gas (FPSO) Pty Ltd | 50% |
| Quadrant Northwest Pty Ltd (Operator) | 50% |

Key Statistics

| | |
|-------------------------|---|
| Permit: | WA-482-P |
| Equity Interest: | 50% |
| Operator: | Quadrant Northwest Pty Ltd (50% interest) |
| Gross Acreage: | 13,539 sq km |
| Water Depth: | 400 to 2,000 metres |
| Type: | Oil |
| Status: | Exploration phase |



“While the exploration permit is in a relatively underexplored part of the Basin, the Carnarvon Basin is one of Australia’s largest and most prolific oil and gas regions. The permit covers a very large area and a successful exploration result could open new exploration plays in the Basin.”

Ceduna Sub-basin, Great Australian Bight, Australia



Ceduna Sub-basin Exploration Permit EPP46

Karooon was awarded exploration permit EPP46 during October 2016. The permit covers 17,649 sq km in one of Australia's most active and prospective frontier oil exploration provinces, the Ceduna Sub-basin, offshore South Australia.

The geology, potential target size and surrounding exploration activity make it an exciting high impact opportunity broadening Karooon's exploration portfolio.

The Ceduna Sub-basin is part of the GAB and hosts one of the world's last underexplored Cretaceous basins. The Sub-basin is the major depocentre of the GAB and hosts a massive Cretaceous delta system, analogous to some of the great petroleum provinces around the world. There is a thick sedimentary succession with multiple structural and stratigraphic stacked play types. The sediments thicken in the central to outer areas of the Sub-basin, which remain largely untested.

Historically, 4 wells have been drilled across the Ceduna Sub-basin (12 in the GAB) based on 2D seismic data, predominantly targeting the shallower, flanking depocentres in shallow waters near the Sub-basin margin. These wells were drilled without causing harm to the local social or natural environments. The deeper part of the GAB remains largely untested and is the main industry focus for the current exploration programs.

The latest GAB exploration cycle commenced during 2011, with a total of 10 exploration permits released to date. The initial three-year

work programs committed to the acquisition of over 40,000 sq km of 3D seismic and the drilling of 9 exploration wells for an estimated \$1.2 billion. Several large oil and gas industry participants have identified the GAB as an exciting opportunity and a significant amount of drilling activity is expected in the GAB over the coming 24 months. Chevron remains committed to a 4 well exploration program, while Statoil has a 1 well exploration drilling commitment.

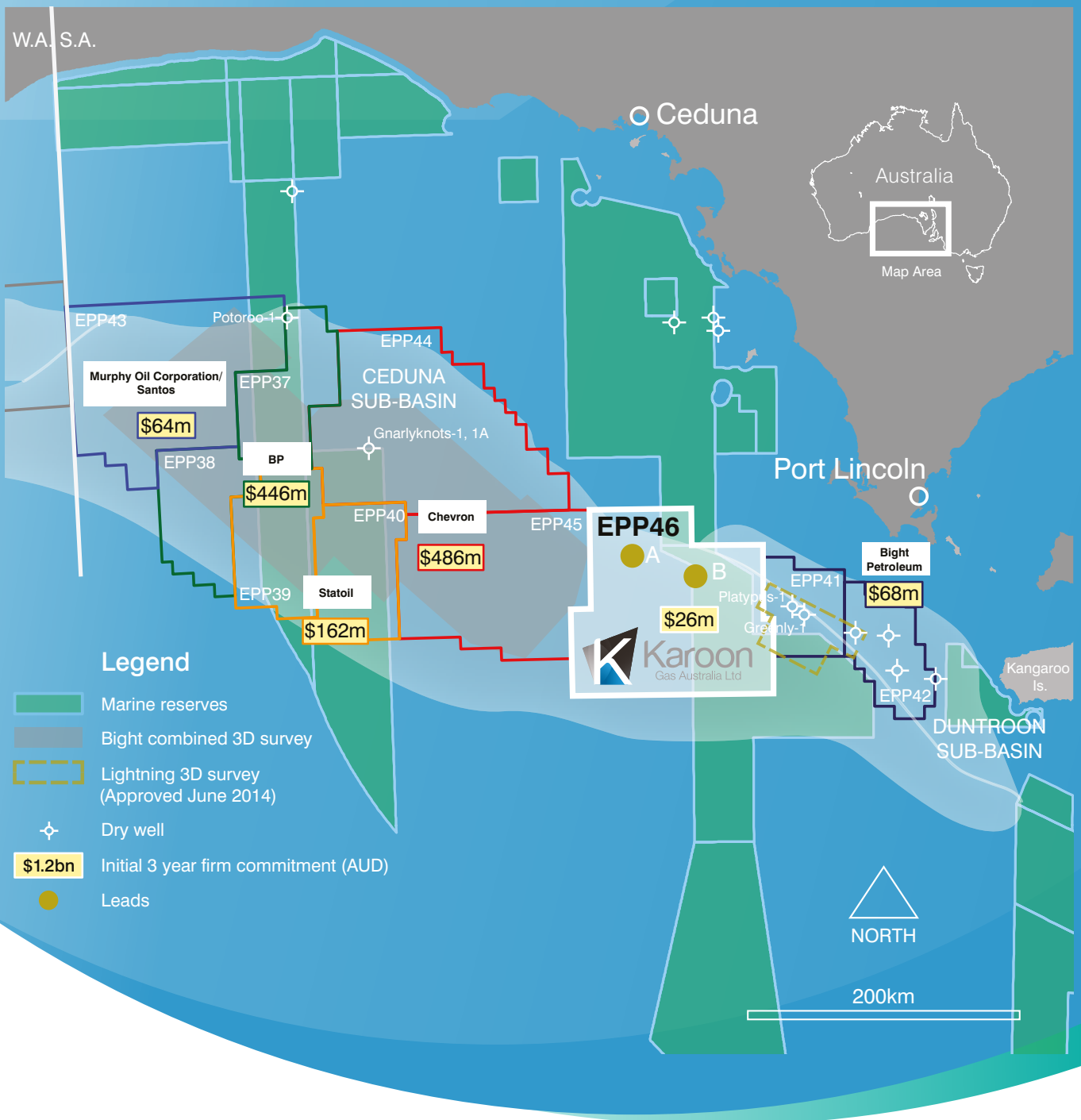
Drilling success in the surrounding exploration permits would likely be transformational to prospectivity in Karooon's exploration permit.

Historical geoscience studies, seismic surveys and exploration drilling support the presence of a working petroleum system over the Ceduna Sub-basin, supported by the following:

- organic rich Turonian source rocks were recovered from samples off the seafloor;
- historical 2D seismic shows potential for structuration likely to result in large trapping geometries including tilted fault blocks and anticlines;
- historical 2D seismic provides encouraging seismic amplitude support in a number of plays;
- natural oil and gas seeps; and
- Greenly-1 exploration well had oil and gas shows, as well as intersecting good quality sandstone reservoirs.

Key Statistics

| | |
|-------------------------|------------------------|
| Permit: | EPP46 |
| Equity Interest: | 100% |
| Operator: | Karooon |
| Gross Acreage: | 17,649 sq km |
| Water Depth: | 1,300 metres (average) |
| Type: | Oil and gas |
| Status: | Exploration phase |



Forward Work Program

Karoon’s initial three-year firm commitment term consists of the acquisition of 2D and 3D marine seismic surveys and G&G studies.

The seismic surveys include obtaining 5,000 km of 2D and 2,500 sq km of 3D marine seismic data, processed to pre-stack depth migration, with 550 km of 2D seismic reprocessing and gravity and magnetics surveying tied with these seismic acquisition surveys.

Karoon is planning to acquire 2D marine seismic data via a multi-client 2D seismic survey over the permit during the first half of calendar year 2018. The timing of this acquisition will be to optimise safety and minimise environment risks. Survey tenders have been received and are currently being evaluated.

Equity Interest

Equity interest of Karoon in EPP46 is:

| | |
|--|------|
| Karoon Gas Browse Basin Pty Ltd (Operator) | 100% |
|--|------|

“The geology, potential target size and surrounding exploration activity make it an exciting high impact opportunity broadening Karoon’s exploration portfolio.”

Tumbes Basin, Peru



Tumbes Basin Block Z-38

During January 2008, Karoon signed a farm-in agreement to acquire a 20% participating interest in offshore Block Z-38, located in the Tumbes Basin, 10 km off the northwest coast of Peru. The Block covers an area of 4,750 sq km. Karoon was approved as Operator during October 2009 and has subsequently increased its equity interest to 75%, subject to completion of farm-in obligations.

The Tumbes Basin is located north of and adjacent to the Talara Basin, a prolific oil and gas basin discovered in the late 1800s, which has produced over 1.7 billion barrels of oil to date. Historically, there has been very little exploration in the offshore portion of the Talara or Tumbes Basins, particularly in water depths over 120 metres.

To date, Karoon has conducted several geologic studies across the Block. These include a drop core survey recovering sea floor samples to surface, the acquisition of a 1,500 sq km 3D seismic survey (during 2011), and quantitative inversion analysis of seismic. Numerous large prospects have been identified and amplitude anomalies observed which support the potential presence of trapped hydrocarbons.

Hydrocarbons recovered from seabed drop core surveys contain biomarkers which match the marine source rock (Oligocene Heath Formation) for the Tumbes Basin edge fields and the giant onshore oil fields of the Talara Basin. This evidence suggests the prospects in Karoon's Block are accessing these same source rocks.

Studies to date characterise the geological setting as an active Oligocene-Miocene pull-apart system which is similar in dimension, process and age to the prolific San Joaquin Basin, California which has produced over 12 billion barrels of oil and 3.5 tcf gas to date. The Oligocene Heath is similar in setting and characteristics to the San Joaquin Miocene Monterey Formation source rock.

Karoon's prospects lie in the undrilled Block Z-38 Tumbes Basin centre block, approximately 40 km from the Tumbes Basin edge fields. As in the San Joaquin Basin, it is believed reservoir quality will improve with an increase in sediment transport distance. Recent quantitative interpretation of seismic data is encouraging and supports a large number of prospects and leads.

During June 2013, Karoon secured regulatory approval for the proposed Tumbes Basin drilling campaign. Environmental Impact Assessment ('EIA') has been completed and approved.

During July 2014, the Block was placed into force majeure with an effective date of 1 September 2013. The third period term has approximately 22 months remaining once force majeure is lifted.

Geological and Geophysical Work Program

During the financial year advanced geophysical and AVO studies commenced using existing 3D seismic data. The results of this new seismic attribute and AVO analysis are very encouraging and indicate a clear distinction between water, oil and gas signatures in reservoirs over the 1,500 sq km 3D seismic area.

New seismic analysis has also identified several additional younger and shallower prospects, which have good quality seismic attributes, some aligning to depth contours. This may indicate oil water contacts.

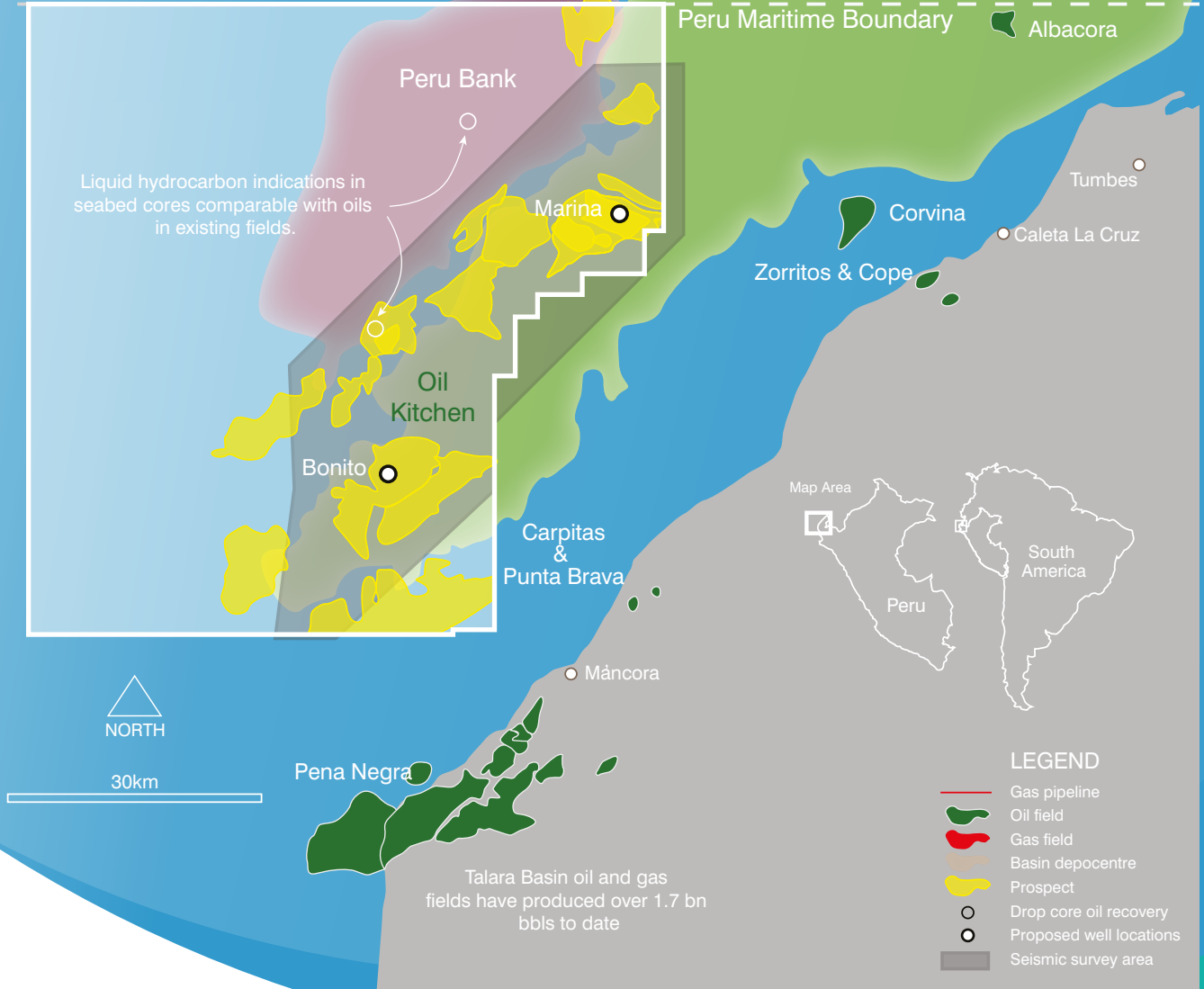
On completion of this work, Karoon expects the prospects in these younger shallower zones could add prospective resource volumes to the previously disclosed prospective resource volumes.

Key Statistics

| | |
|-------------------------|---|
| Block: | Z-38 |
| Equity Interest: | 75%* |
| Operator: | Karoon |
| Gross Acreage: | 4,750 sq km |
| Water Depth: | 300 to 3,000 metres |
| Type: | Oil |
| Status: | Exploration phase, currently in force majeure |

* Karoon's 75% equity interest is subject to completion of farm-in obligations.

Block Z-38



Forward Work Program

The current plan is to drill up to two exploration wells. Approvals and long lead items are in place for the drilling program and the preliminary well locations have been selected for the Marina and Bonito prospects.

During the financial year, the Marina-1 exploration well location was reviewed and the well path amended to incorporate additional younger reservoir targets into the well plan identified in the seismic attribute analysis.

Equity Interests

Equity interests of the participants in Block Z-38 are:

| | |
|--|------|
| KEI (Peru Z38) Pty Ltd, Sucursal del Peru (Operator) | 75%* |
| Pitkin Petroleum Peru Z-38 SRL | 25% |

* Karoon's 75% equity interest remains subject to completion of farm-in obligations.

CORPORATE SUSTAINABILITY REPORT

For the Financial Year Ended 30 June 2017

Karoon has continued to look for opportunities to foster and advance a culture of sustainability within the Group during the 2017 financial year. Karoon has encouraged environmental, social and governance ('ESG') principles in decision making at all levels of the organisation.

Highlights of the financial year included:

- continuing preparation of documentation for Karoon's new Operating Management System ('OMS');
- the ongoing commitment to social and environmental projects in South America and Australia;
- internal environmental education programs to inform employees and contractors, and provide tools to help them reduce their carbon footprint; and
- adapting Karoon's strategic planning and risk management to optimise performance and efficiencies in a prolonged lower oil price environment.

A summary of Karoon's sustainability approach and achievements in the key areas of Health, Safety, Security and Environment ('HSSE'), Respect for Communities, Climate Change, and People and Culture is provided below. Further details regarding these areas and others are contained in Karoon's new Sustainability Report, available on the Karoon website.

Philosophy and Management

Karoon's approach to sustainability and ESG principles is developed and implemented through its broader risk management framework, overseen by the Risk and Governance Committee of the Board of Directors.



Karoon's Risk Management Team maintains a Corporate Risk Register, which assists strategic decision making and helps focus Karoon's sustainability efforts. Karoon updates its Corporate Risk Register regularly throughout the financial year to ensure its risk mitigation strategies are appropriate. The Risk and Governance Committee reviews the Register at least annually to ensure risks have been appropriately assessed, they adequately reflect the Board's risk appetite and adequate controls have been identified.

Health, Safety, Security and Environment

Regardless of the economic climate, Karoon's first priority is always the health and safety of its people and those in the local communities where it operates.

As there were no drilling programs during the 2017 financial year, the HSSE metrics for the financial year were all zero.

The HSSE Team has been able to use the non-operational time to prepare OMS documentation. When implemented, the OMS will replace the current Health, Safety, Security and Environment Management System, which is tailored to Karoon's exploration activities. The OMS is applicable across a range of activities from exploration, development and production and also incorporates

other Karoon policies and procedures including those related to Human Resources and Finance. The Karoon OMS has been adopted from OGP Report number 510 and applies across all Karoon offices worldwide.

Respect for Communities

Karoon recognises the importance of operating responsibly to protect the health and safety of its people and those in the communities where it operates. For several years, Karoon's Social and Environmental Team has been actively working to ensure local communities have been kept well informed of Karoon's activities and are provided with opportunities to advance education and health care in those communities where it is most needed.

Karoon has previously reported on a number of different social and environmental programs it has been proud to sponsor. These programs have been successfully implemented over a number of years and continue to be ongoing. They have provided tangible long-term benefits in healthcare, education, environmental stewardship and economic independence.

During the 2017 financial year, Karoon continued to support communities in locations where it operates through:

- donations of supplies for local communities affected by El Niño in Peru;
- development of 'The Pleasure in Reading Project' in Brazil;
- donations of school materials, food supplies, cleaning products and hygiene products to children's shelters and care centres in Brazil; and
- sponsorship of the Great Australian Bight Right Whale Study in Australia ('GABRWS').

Karoon is proud to be able to sponsor these and other programs. Further details of Karoon's social and environmental projects in Brazil and Peru are available at the Karoon Brazil website www.karoon.com.br. Details of the GABRWS can be found at www.gabrightwhales.com.

Climate Change

Historically, Karoon has reported on climate change in its Annual Report and through the Carbon Disclosure Project. This financial year Karoon has reviewed disclosures in light of the Task Force on Climate-related Financial Disclosures ('TCFD') Report and decided to increase the level of disclosure in the 2017 Annual Report to align to the four core elements of disclosure recommended in the TCFD Report, namely: governance, strategy, risk management, and metrics and targets. This will replace Karoon's CDP reporting, so all disclosures are made through its mainstream reporting.

Governance

The highest level of responsibility for climate change within Karoon is delegated by the Board of Directors to the Risk and Governance Committee. The Risk and Governance Committee is comprised of members of the Board of Directors, and is responsible for a range of risk and governance matters, including identifying material exposures to economic, environmental and social sustainability risks. This Committee is supported by the Risk Management Team, which involves senior management from across different areas of the organisation, including the Sustainability Manager.



CORPORATE SUSTAINABILITY REPORT (continued)

For the Financial Year Ended 30 June 2017



Strategy

Karoon views energy as being important for economic and social development and acknowledges that an energy transition to low carbon fuels is underway to reduce the impacts of climate change. Being in the oil and gas industry, successfully identifying and managing these challenges is paramount and necessary for the long-term success and sustainability of Karoon's business.

Karoon is committed to investing in world-class assets which it assesses through a rigorous due diligence process. This process incorporates an awareness of the future low carbon economy and how to manage resources to join this economy in the short to medium term. Karoon understands the increasing need for a transitional fuel that will be less emission intensive than fuels such as coal and oil. As gas is a recognised transition fuel Karoon will increase its focus on gas assets when looking to purchase either exploration, development and/or production assets in the short to medium term, however, a final purchase will also be influenced by the market availability of gas assets.

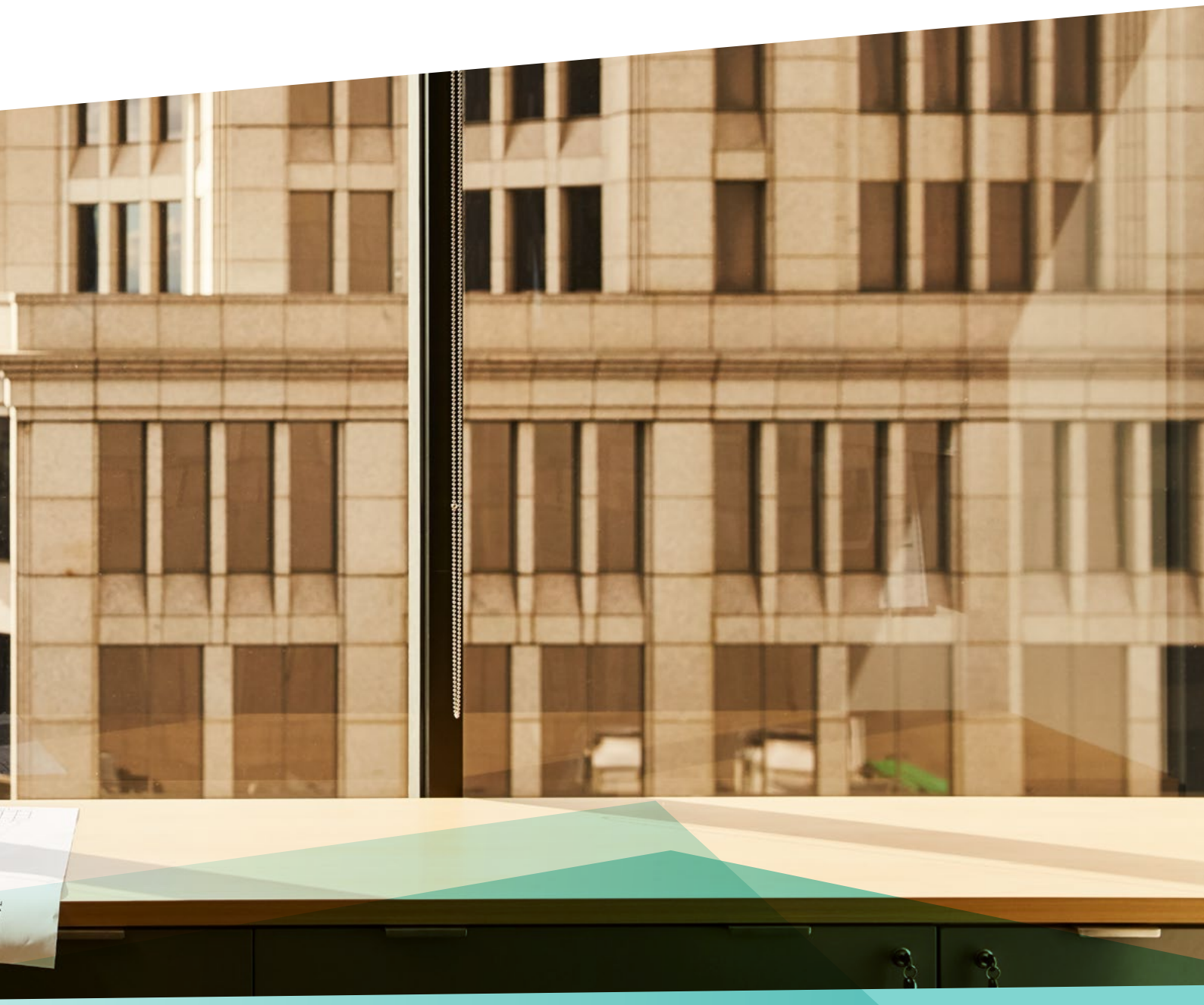
Risk Management

High level climate-related risks are identified and assessed using Karoon's Corporate Risk Matrix, which includes several measures of consequence relating to environmental, safety, financial and reputational impacts.

More detailed operational risks (including those relating to operational climate change impacts) are assessed using the Karoon HSSE Risk Matrix, and each operated activity must be addressed and meet an acceptable level of risk before operations commence.

Metrics and Targets

Karoon's Scope 1 emissions for the 2017 financial year were 52 tonnes of carbon dioxide equivalent and Scope 2 were 175 tonnes of carbon dioxide equivalent. Scope 1 emissions were from transport fuels used by fleet cars, while Scope 2 emissions were from electricity consumed at Karoon's office locations. Karoon did not have any emissions from exploration activities during the 2017 financial year.



Karoon has reduced its operational emissions through low carbon energy purchases to its Australian offices, using GreenPower for a portion of electricity.

Karoon will continue to monitor its emissions. Given the majority of its emissions are from exploration activities, Karoon will investigate an appropriate basis for an emissions target once it commences exploration, development and/or other operational activities. Karoon's administration emissions have decreased by 10% since 2014, however, given the scale of these emissions compared to exploration/development/operation emissions, Karoon does not believe setting a target over administration activities alone is sufficiently meaningful.

People and Culture

Staff Engagement and Education

Karoon's Social and Environmental Team, based in South America, sought to educate and encourage Karoon employees and contractors to actively consider ways to change their behaviour, both in the workplace and at home, to be more environmentally sustainable.

Members of the Karoon Sustainability Team provided employees and contractors in all offices with information for World Environment Day, which Karoon celebrates each year as part of Karoon Environment Week. Employees and contractors were provided with tools to help them calculate their carbon footprint in day-to-day activities. Resources were also provided for employees and contractors to share with their families and friends so that the learning could continue at home.

Diversity

Karoon was pleased to announce the appointment of its first female Director, Ms Luciana Rachid, during August 2016. Ms Rachid brings a wealth of experience to the Karoon Board of Directors from her previous work in the Brazilian oil and gas industry. Karoon has a robust Diversity Policy, applicable across all its offices and in all jurisdictions, and is committed to promoting a culture of diversity and acceptance. Karoon has been reporting regularly on gender diversity through its Corporate Governance Statement, which has consistently shown that female employees make up more than 40% of all employees across all Karoon offices and that more than 20% of senior executives are female across the Group.

DIRECTORS' REPORT

The Board of Directors submits its Directors' Report on Karoon Gas Australia Ltd (the 'Company') and its subsidiaries (the 'Group') for the financial year ended 30 June 2017 (the 'financial year').

Board of Directors

Under the Company's Constitution, the minimum number of Directors that may comprise the Board of Directors is currently 3 and the maximum number of Directors is 10. Directors are elected and re-elected at Annual General Meetings of the Company.

The names of the Directors of the Company during the financial year and up to the date of this Directors' Report are set out below:



Dr David Klingner

BSc. (Hons), PhD, FAusIMM

Independent Non-Executive Chairman

Appointed 19 December 2014.

David has over a decade of Australian and international boardroom experience and has worked in the natural resources industry for 50 years. David spent his career working for Rio Tinto and its affiliated companies, holding many senior executive positions including Head of Exploration, Group Executive Coal and Gold, Managing Director Kaltim Prima Coal. David's various other commercial and technical roles included Group Geologist Petroleum Exploration. Since 2004, David has been an active company chairman and corporate director.

David brings considerable global project development and stakeholder management expertise to the Board of Directors of Karoon across the resources industry. He has experience in navigating complex and difficult social and fiscal environments as well as chairing several companies through the modern governance landscape both in Australia and North America. In addition, David has significant exploration experience worldwide, including South America.

David has a Bachelor of Science degree in Geology (Hons) from the University of Queensland and a PhD from the University of Melbourne. He is a fellow of the Australian Institute of Mining and Metallurgy and a member of the Prospectors and Developers Association of Canada and the Institute of Corporate Directors.

Current and past directorships of other listed companies include: former Chairman of Turquoise Hill Resources Ltd (formerly Ivanhoe Mines Ltd TSE: IVN), a TSX and NYSE listed company (TRQ: TSX, NYSE and NASDAQ. Resigned 1 January 2015), former Chairman of Codan Limited (ASX: CDA. Resigned 18 February 2015) and former Chairman of Energy Resources of Australia Ltd (ASX: ERA. Resigned 8 February 2013).

Member of the Remuneration Committee, Risk and Governance Committee.



Mr Robert Hosking

Managing Director

Appointed 11 November 2003.

Robert is the founding Director of the Company and has more than 35 years of commercial experience in the management of several companies. Robert has been involved in the oil and gas industry for 20 years and was a founding director/shareholder of Nexus Energy Limited.

Robert also has a background of more than 18 years' commercial experience in the steel industry. He jointly owned and managed businesses involved in the trans global sourcing, shipping and distribution of steel-related products, with particular expertise gained in Europe and the Asia/Pacific Rim.



Mr Mark Smith

Dip. App. Geol, Bsc. (Geology)

Executive Director and Exploration Director

Appointed 20 November 2003.

Mark has more than 30 years' experience as a geologist and exploration manager in petroleum exploration and development in Australia, South East Asia, North and South America. His early experience was gained while working with BHP Petroleum. Mark has been directly involved with 16 economic oil and gas discoveries.

Mark has geoscience skills in regional basin and tectonic studies, petroleum systems fairway assessments, prospect evaluations, risking and volumetrics, fault seal prediction and well site operations. His management skills cover general and human resources management, acreage evaluation and acquisition projects, farm-ins/farm-outs, well site operations management and management of onshore and offshore drilling operations.



Ms Luciana Bastos de Freitas Rachid

B Chem Eng. Post Grad Degree Corporate Finance

Independent Non-Executive Director

Appointed 26 August 2016.

Luciana has over 35 years' experience in the oil and gas industry in both technical and senior leadership roles in Brazil, including 20 years in the Exploration and Production Division of Petróbras. During this time she worked in senior management roles, starting as a process engineer and completing her time in the corporate management team.

Luciana also has a number of years' experience serving on Boards in Brazil. She has represented Petróbras as Chairperson of Transportadora Brasileira Gasoduto Bolívia-Brasil SA, and Gás Brasileiro Distribuidora SA as well as a Director of Transportadora Associada de Gás, Companhia de Gás de Minas Gerais and Companhia Paranaense de Gás.

Luciana's technical experience covers a variety of project evaluation, development and management roles including Marlim Leste Asset Manager, the design of the first offshore platforms in the Campos Basin, the production, handling and processing of natural gas onshore and offshore, the coordination of the Petróbras E&P Deepwater Strategic Project and a variety technical and economic feasibility studies on major projects including participation in the first Petróbras project finance deals.

Luciana has also held positions in the Petróbras financial team including Executive Manager of Investor Relations, Executive Manager of Financial Planning and Risk Management in the Gas and Energy Division and General Manager of Marketing and Trading, Executive Manager of Corporate Affairs, Executive Manager for Logistics and Investments in Natural Gas and Chief Executive Officer of Transportadora Brasileira Gasoduto Bolívia-Brasil SA and most recently Chief Executive Officer of Transportadora Associada de Gas SA.

Member of the Nomination Committee, Risk and Governance Committee.



Mr Geoff Atkins

FIE Aust. CP Eng.

Independent Non-Executive Director

Appointed 22 February 2005.

Geoff has over 45 years' experience in investigation, planning, design, documentation and project management of numerous significant port, harbour and maritime projects. These include container terminals, LNG jetties, oil and gas wharves, heavy lift facilities, cement, coal, bauxite, iron ore and other bulk terminals, shipping logistics and naval bases.

Geoff has gained substantial overseas experience completing marine projects in Indonesia, Malaysia, Thailand, Vietnam, Sri Lanka, India, South Africa, Namibia, New Zealand and the United Kingdom. LNG, oil, gas, bulk ports and other large maritime infrastructure projects that Geoff has been involved in have included the design of Woodside Petroleum Limited's LNG jetty, tender design of ConocoPhillips' Darwin LNG jetty and concept designs for the Sunrise LNG jetty. Geoff has also been involved in investigations of proposed LNG marine terminals in Taiwan, Iran and Israel for BHP Petroleum and the West Kingfish and Cobia oil drilling platforms for ESSO/BHP in Bass Strait.

Chairman of the Nomination Committee.

Member of the Audit Committee.



Mr Clark Davey

B. Commerce, FTIA, MAICD

Independent Non-Executive Director

Appointed 1 October 2010.

Clark has over 30 years' experience in the Australian natural resources industry as a taxation consultant to oil and gas and mining companies. Clark was a partner at Price Waterhouse and PricewaterhouseCoopers specialising in the natural resources industry. For a number of years he held resource industry leadership roles within both firms. Clark is a member of the Taxation Institute of Australia and the Australian Institute of Company Directors.

Clark provides a wealth of taxation and business advisory knowledge and experience to the Company, including experience with company income tax, petroleum resource rent taxation in Australia and assisting with accounting and capital management. He has assisted many Australian companies with tax management of their joint venture interests and has had considerable experience with merger and acquisition transactions. He has also assisted companies expand their resource industry interests internationally.

Current directorships of other listed companies include Redflex Holdings Limited (appointed 6 January 2015).

Chairman of the Audit Committee.

Member of the Nomination Committee, Remuneration Committee, Risk and Governance Committee.



Mr Peter Turnbull

B. Commerce, LLB, FGIA, FAICD

Independent Non-Executive Director

Appointed 6 June 2014.

Peter is an experienced independent Non-Executive Director with significant exposure to the global mining, energy and technology sectors.

Peter's experience has enabled the development of global perspectives and the development of significant expertise in relation to the development and commercialisation of disruptive technologies.

Peter has significant regulatory and public policy experience from prior executive roles including as a Director of the Securities and Futures Commission of Hong Kong. Currently, Peter is an executive committee member of several global organisations which promote good governance, and is a regular contributor and speaker in Australia and overseas on corporate governance issues and is a former President of the Governance Institute of Australia.

Peter's senior executive roles over 30 years involved significant experience in very large publicly listed organisations where operations spanned many different countries, particularly South East Asia, Europe and the United States. Peter's executive experience included over a decade in energy markets and the resources sector including as Company Secretary of Newcrest Mining Limited, Company Secretary and General Counsel of BTR Nylex Limited and General Manager, Legal and Corporate Affairs with Energex Limited.

Current directorships of other listed companies include: Metallica Minerals Limited (appointed Chairman on 12 December 2016).

Chairman of the Remuneration Committee.

Chairman of the Risk and Governance Committee.

Member of the Audit Committee and Nomination Committee.



Mr Jose Coutinho Barbosa

Bsc. (Geology), Msc. (Geophysics)

Non-Executive Director

Appointed 31 August 2011.

Jose Coutinho spent 38 years with Petróbras, beginning his career in a number of technical and management positions, culminating in his appointment as Acting President and CEO of Petróbras, one of the world's largest petroleum exploration and production companies.

Earlier in his career, Jose Coutinho was Executive Vice-President and CEO of Petróbras Internacional SA (otherwise known as Braspetro) and was Managing Director for Exploration and Production of Petróbras until his retirement during February 2003. Since then, he has managed his own independent consulting firm, Net Pay Óleo & Gás Consultoria Ltda, headquartered in Rio de Janeiro, Brazil, operating in areas of the petroleum industry. Jose Coutinho brings knowledge and experience to the Company, including experience with geology, exploration and production and local knowledge of the oil and gas industry in Brazil and internationally.

Current and past directorships of other listed companies include Lupatech SA (Director from 24 March 2008 to 29 April 2011 and reappointed 4 May 2012. Resigned 28 March 2014).

Jose Coutinho is also the Temasek Representative Director on the Board of Directors of Odebrecht Oleo e Gas (unlisted).

Company Secretary



Mr Scott Hosking

B. Commerce

Appointed 10 March 2006.

Scott has a significant international financial and commercial management background and has been involved with several commercial ventures over the past 19 years with experience in international trade, finance and corporate management. He has previously held support positions to Company Secretaries of Australian listed companies, worked as part of the finance and management teams of private international resource and industrial enterprises and was involved in the listing of Karoon Gas Australia Ltd.

Meetings

The number of Directors' meetings (including meetings of committees of Directors) and attendance by each Director of the Company during the financial year were:

| Director | Board Meetings | | Audit Committee Meetings | | Remuneration Committee Meetings | | Nomination Committee Meetings | | Risk and Governance Committee Meetings | |
|--------------------------|----------------|----|--------------------------|---|---------------------------------|---|-------------------------------|---|--|---|
| | A | B | A | B | A | B | A | B | A | B |
| | | | | | | | | | | |
| Dr David Klingner | 11 | 11 | - | - | 4 | 4 | - | - | 6 | 6 |
| Mr Robert Hosking | 11 | 10 | - | - | - | - | - | - | - | - |
| Mr Mark Smith | 11 | 11 | - | - | - | - | - | - | - | - |
| Ms Luciana Rachid | 10 | 10 | - | - | - | - | 2 | 2 | 5 | 5 |
| Mr Geoff Atkins | 11 | 11 | 3 | 3 | - | - | 3 | 3 | - | - |
| Mr Clark Davey | 11 | 11 | 3 | 3 | 4 | 4 | 3 | 2 | 6 | 5 |
| Mr Peter Turnbull | 11 | 10 | 3 | 3 | 4 | 4 | 3 | 3 | 6 | 6 |
| Mr Jose Coutinho Barbosa | 11 | 11 | - | - | - | - | - | - | - | - |
| Mr Bernard Wheelahan | 7 | 6 | - | - | - | - | 1 | 1 | 4 | 4 |

A. The number of meetings held during the time the Director held office during the financial year.

B. The number of meetings attended during the time the Director held office during the financial year.

Directors' Interests in the Company's Shares, Share Options and Performance Rights

As at the date of this Directors' Report, the Directors held the following number of ordinary shares, share options and performance rights over unissued ordinary shares in the Company:

| Director | Ordinary Shares, Fully Paid | Unlisted Share Options | Unlisted Performance Rights |
|--------------------------|-----------------------------|------------------------|-----------------------------|
| Dr David Klingner | 103,591 | - | - |
| Mr Robert Hosking | 11,877,649 | 914,285 | 367,702 |
| Mr Mark Smith | 2,870,938 | 914,285 | 261,988 |
| Ms Luciana Rachid | - | - | - |
| Mr Geoff Atkins | 696,784 | - | - |
| Mr Clark Davey | 24,294 | - | - |
| Mr Peter Turnbull | 41,000 | - | - |
| Mr Jose Coutinho Barbosa | - | - | - |

Principal Activities

The principal activity of the Group during the course of the financial year continued to be investment in hydrocarbon exploration and evaluation in Australia, Brazil and Peru.

DIRECTORS' REPORT (continued)

Significant Changes in State of Affairs

The Company's share buy-back commenced on 3 September 2014 and was continued on 3 September 2015 for a further 12 months. The share buy-back lapsed on 2 September 2016. During the financial year, a total of 514,945 ordinary shares had been purchased and cancelled at an average price of \$1.305 per share, with prices ranging from \$1.275 to \$1.34. The total reduction in contributed equity as a result of the share buy-back and cancellation of ordinary shares was \$672,481.

Results

The consolidated result of the Group for the financial year was a loss after tax income of \$81,527,513 (2016: \$105,126,345).

The loss for the financial year included:

- the write-off of capitalised exploration and evaluation expenditure associated with Block 144 (Marañón Basin, Peru), as it was relinquished during the financial year, of \$6,821,318;
- the write-off of drilling rig mobilisation costs capitalised as at 30 June 2016 associated with the release of the rig for Brazil, which was contracted with Pacific Exploration and Production Corp.'s ('Pacific') prior to it applying for insolvency protection and its exit from the Santos Basin Blocks, of \$3,836,441;
- along with expensing further costs associated with the drilling rig mobilisation incurred during the financial year, as the rig was released without drilling any of the planned wells during the financial year, of \$16,513,578;
- impairment of capitalised exploration and evaluation expenditure associated with Block S-M-1166 (Santos Basin Block, Brazil), including the Bilby oil discovery, of \$21,638,168;
- net employee benefits expense of \$12,651,679 (2016: \$11,888,746), which included share-based payments expense of \$3,797,668 (2016: \$3,253,193); and
- net foreign currency losses of \$13,909,734 (2016: net foreign currency gains \$19,061,558).

The net foreign currency losses were almost entirely attributable to the depreciation in the United States dollar against the Australian dollar (from AUD1:USD0.7426 as at 30 June 2016 to AUD1:USD0.7692 as at 30 June 2017) on cash assets and security deposits held in United States dollars by the Group during the financial year.

The financial year also included exploration and evaluation expenditure expensed of \$3,067,253 (2016: \$1,508,493) from reviewing new exploration opportunities predominantly in Australia and Brazil and \$4,526,430 (2016: \$1,674,246) on business development and other project activities that included internal time allocation of employees and consultants and associated office charges, geotechnical data and external advice relating to due diligence reviews on potential asset acquisitions.

Partially offsetting the loss for the financial year was interest income of \$858,356 (2016: \$1,608,292) and tax income of \$10,200,335 (2016: tax income of \$44,304,488) relating largely to a decrease in deferred tax liabilities on unrealised foreign currency losses due to the depreciation in the United States dollar against the Australian dollar.

Cash Flows

Operating activities resulted in a cash outflow for the financial year of \$38,257,337 (2016: \$31,209,795), predominantly for payments to suppliers and employees. Cash outflow from investing activities for the financial year was \$50,947,053 (2016: cash outflow of \$53,961,479) relating principally to the payment for exploration and evaluation expenditure in Australia, Brazil and Peru. Cash outflow from financing activities for the financial year was \$738,837 (2016: \$2,566,955) related predominantly to the Company's on-market share buy-back.

The negative effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies, primarily in United States dollars, for the financial year was \$14,577,712 (2016: \$14,237,255 positive).

Financial Position

At the end of June 2017, the Group had a cash and cash equivalents balance of \$375,069,427 (30 June 2016: \$479,590,366).

The Group's working capital, being current assets less current liabilities, decreased from \$475,731,658 as at 30 June 2016 to \$366,574,781 as at 30 June 2017 predominantly as a result of expenditure on exploration and evaluation assets; and depreciation in the United States dollar against the Australian dollar on cash assets and security deposits held in United States dollars; partially offset by the security deposit for Block 144 returned following relinquishment during the financial year.

During the financial year, total assets decreased from \$917,187,319 to \$806,569,836, total liabilities decreased from \$59,224,572 to \$47,677,671 and total equity decreased by \$99,070,582 to \$758,892,165. The major changes in the consolidated statement of financial position were largely due to the following:

- acquisition of Pacific's 35% equity interest and long lead inventory in the jointly held Santos Basin Blocks;
- expensing drilling rig mobilisation costs associated with the release of the rig for Brazil, which was contracted with Pacific prior to it applying for insolvency protection and exiting the Santos Basin Blocks;
- write-off of capitalised exploration and evaluation expenditure associated with relinquishment of Block 144 (Marañón Basin, Peru);
- impairment of capitalised exploration and evaluation expenditure associated with Block S-M-1166 (Santos Basin, Brazil);
- depreciation in the United States dollar against the Australian dollar (from AUD1:USD0.7426 as at 30 June 2016 to AUD1:USD0.7692 as at 30 June 2017) on cash assets and security deposits held in United States dollars;
- reduction in deferred tax liabilities due to a decrease in unrealised foreign currency gains as a result of the depreciation of the United States dollar against the Australian dollar;
- the negative movement in the foreign currency translation reserve as a result of the depreciation of the Brazilian REAL against the Australian dollar; and
- use of cash and cash equivalents for the Company's on-market share buy-back.

The contributed equity of the Company decreased by \$672,481 during the financial year through the Company's on-market share buy-back.

Exploration and evaluation expenditure of \$41,730,248 was incurred during the financial year, with major expenditure in the following operating segments:

- Brazil, the Group acquired Pacific's 35% equity interest in the jointly held Santos Basin Blocks with an upfront cash payment. It also continued initial work for the appraisal drilling campaign, prior to the release of the drilling rig, preparatory work for the Echidna development concept, along with detailed geological, geophysical, reservoir modelling and production scenario work, at a total cost of \$33,442,453;
- Peru, the Group continued with drill planning and advanced geophysical studies (amplitude versus offset ('AVO') analysis) using the existing 3D seismic data for the offshore Block Z-38 (Tumbes Basin), along with geotechnical, social and environmental work for the onshore Block 144 (Marañón Basin) prior to relinquishing the block, at a total cost of \$5,847,278; and
- Australia, the Group was awarded exploration permit EPP46 during the financial year; permit WA-482-P, operated by Quadrant Northwest Pty Ltd, continued interpretation of the Chrysalids marine 3D seismic survey over the western section of the permit and interpretation of the Capreolus marine 3D seismic survey over the eastern part of the WA-482-P, along with hydrocarbon charge modelling and AVO analysis; for permit WA-314-P, reprocessing of the acquired Kraken 3D marine seismic was ongoing during the financial year, at a total cost of \$2,440,517.

Review of Operations

Information on the operations of the Group is set out in the Operations Review on pages 10 to 19 of this Annual Report.

Business Strategies and Prospects, Likely Developments and Expected Results of Operations

The Operations Review sets out information on the business strategies and prospects for future financial years, refers to likely developments in operations and the expected results of those operations in future financial years. Information in the Operations Review is provided to enable shareholders to make an informed assessment about the business strategies and prospects for future financial years of the Group. Details that could give rise to likely material detriment to Karoon, for example, information that is confidential, commercially sensitive or could give a third party a commercial advantage has not been included. Other than the matters included in this Directors' Report or elsewhere in the Annual Report, information about other likely developments in the Group's operations and the expected results of those operations have not been included.

Dividends

No dividend has been paid or declared by the Company to shareholders since the end of the previous financial year. The Company intends to pay future dividends during financial periods when appropriate to do so.

DIRECTORS' REPORT (continued)

Share Options and Performance Rights

As at the date of this Directors' Report, the details of share options over unissued ordinary shares in the Company were as follows:

| Type of Share Option | Grant Date | Date of Expiry | Exercise Price Per Share Option | Number of Share Options |
|----------------------|------------------|----------------|---------------------------------------|----------------------------|
| ESOP options | 9 October 2015 | 30 June 2019 | \$3.04 | 1,013,888 |
| ESOP options | 30 October 2015 | 30 June 2019 | \$3.04 | 981,818 |
| ESOP options | 30 November 2016 | 30 June 2020 | \$1.82 | 1,100,476 |
| ESOP options | 2 December 2016 | 30 June 2020 | \$1.82 | 846,752 |
| ESOP options | 2 December 2016 | 30 June 2020 | \$1.82 | 503,685 |
| Total ESOP options | | | | 4,446,619 |

As at the date of this Directors' Report, the details of performance rights over unissued ordinary shares in the Company were as follows:

| Type | Grant Date | Date of Expiry | Exercise Price Per Performance Right | Number of Performance Rights |
|--------------------------|------------------|----------------|--|------------------------------------|
| Performance rights | 9 October 2015 | 30 June 2018 | \$- | 140,165 |
| Performance rights | 9 October 2015 | 30 June 2019 | \$- | 451,395 |
| Performance rights | 30 October 2015 | 30 June 2019 | \$- | 138,460 |
| Performance rights | 2 December 2016 | 30 June 2018 | \$- | 105,714 |
| Performance rights | 30 November 2016 | 30 June 2019 | \$- | 638,556 |
| Performance rights | 2 December 2016 | 30 June 2019 | \$- | 459,561 |
| Performance rights | 30 November 2016 | 30 June 2020 | \$- | 636,546 |
| Performance rights | 2 December 2016 | 30 June 2020 | \$- | 385,516 |
| Performance rights | 2 December 2016 | 30 June 2020 | \$- | 362,289 |
| Total performance rights | | | | 3,318,202 |

For details of share options and performance rights issued to Directors and other key management personnel of the Group as remuneration, refer to the Remuneration Report in this Directors' Report.

370,181 fully paid ordinary shares have been issued since 1 July 2017 as a result of the vesting and conversion of Karoon Gas Australia Performance Rights Plan ('PRP') performance rights.

Information relating to the Company's PRP, ESOP and other share options, including details of performance rights and share options granted, exercised, cancelled, forfeited and expired during the financial year and performance rights and share options outstanding at the end of the financial year, is set out in Note 27 of the consolidated financial statements.

No share option or performance right holder has any right under the share options or performance rights to participate in any other share issue of the Company or any other entity.

Indemnification of Directors, Officers and External Auditor

An indemnity agreement has been entered into between an insurance company and the Directors of the Company named earlier in this Directors' Report and with the full-time executive officers, Directors and secretaries of all Australian subsidiaries. Under this agreement, the insurance company has agreed to indemnify these Directors, full-time executive officers, directors and secretaries against any claim or for any expenses or costs which may arise as a result of work performed in their respective capacities. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

As approved by shareholders at the 2009 Annual General Meeting, the Company will continue to pay those Director insurance premiums for a period of 10 years following termination of their directorships of the Company and will provide each Director with access, upon ceasing for any reason to be a Director of the Company and for a period of 10 years following cessation, to any Company records which are either prepared or provided to the Director during the time period they were a Director of the Company.

The Company has not otherwise, during or since the end of the financial year, except to the extent permitted by law, indemnified or agreed to indemnify an officer or external auditor of the Company or of any related body corporate against a liability incurred as such by an officer or external auditor.

Proceedings on Behalf of the Company

No person has applied to the Court under Section 237 of the *Corporations Act 2001* for leave to bring proceedings on behalf of the Company, or to intervene in any proceedings to which the Company is a party, for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

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

Corporate Governance

In recognising the need for the highest standards of corporate governance in order to drive performance and accountability, the Directors support the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations. The Company's Corporate Governance Statement can be found under the Governance tab on the Company's website at www.karoongas.com.au.

Environmental Regulation

The Company and its subsidiaries are subject to a range of relevant Commonwealth, state and international environmental laws.

The Board of Directors believes the Company has adequate systems in place for managing its environmental obligations and is not aware of any breach of those environmental obligations as they apply to the Company and/or Group. No circumstances arose during the financial year that required an incident to be reported by the Company and/or Group under environmental legislation.

Greenhouse Gas Emissions and Reporting Requirements

Relevant entities are required to report greenhouse gas emissions, energy consumption and energy under the *National Greenhouse and Energy Reporting Scheme*. The Group was not required to register and report greenhouse gas emissions, energy consumption or energy production under the scheme for this financial year, as it did not meet the relevant thresholds for the relevant period. However, the Group's global carbon footprint during the financial year was 227 tonnes of carbon dioxide equivalent based on equity share and including scope 1 and scope 2 emissions (2016: 2,653 tonnes).

As there was no exploration activity during this financial year, the total emissions are purely from the administration of global offices and Karoon vehicles. This represents a significant decrease in total emissions compared to the previous financial year, which included 2,429 tonnes of carbon dioxide equivalent greenhouse gas emissions resulting from the Karoon share of emissions from the Levitt-1 exploration well drilled in the Carnarvon Basin during July and August 2015.

The Company continues to seek cost-effective, reliable and environmentally efficient methods for addressing future greenhouse gas emissions and energy consumption. Further details of Karoon's approach to climate change challenges can be found in the Sustainability Report.

Non-audit Services

The Company may decide to engage its external auditor, PricewaterhouseCoopers, on assignments additional to its statutory audit duties where the external auditor's expertise and experience with the Company and/or Group are important.

Details of the amounts paid or payable to the external auditor for non-audit services provided during the financial year are set out in Note 7 of the consolidated financial statements.

The Board of Directors has considered the position and, in accordance with written advice received from the Audit Committee, is satisfied that the provision of non-audit services is compatible with the general standard of independence for external auditors imposed by the *Corporations Act 2001*. The Board of Directors is satisfied that the provision of non-audit services by the external auditor did not compromise the external auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- (a) all non-audit services have been reviewed by the Audit Committee to ensure they do not impact the impartiality and objectivity of the external auditor; and
- (b) none of the services undermine the general principles relating to external auditor independence as set out in APES 110 'Code of Ethics for Professional Accountants', including reviewing or auditing the external auditor's own work, acting in a management or a decision making capacity for the Group, acting as advocate for the Group or jointly sharing economic risk and reward.

External Auditor's Independence Declaration

A copy of the external Auditor's Independence Declaration for the financial year, as required under Section 307C of the *Corporations Act 2001*, is set out on page 61 of this Annual Report.

No officer of the Company has previously belonged to an audit practice auditing the Company during the financial year.

Remuneration Report (Audited)

Dear Shareholders,

On behalf of the Board of Directors and Remuneration Committee, I am pleased to present Karoon's Remuneration Report for the financial year ended 30 June 2017.

1. Overview

In last year's Remuneration Report, I wrote that the preceding year had been a turbulent one in the oil and gas industry with many geopolitical and commercial challenges affecting the sector globally. The reality is that this state of affairs remains the case today. In these circumstances, there are both opportunities and challenges, which Karoon is actively embracing and which its remuneration policy and practice must recognise.

2. Remuneration – Guiding Principles and Shareholder Alignment

Karoon's guiding principles and framework for remuneration strategy continues to ensure that the focus is maintained on the following:

- **Safety, culture and ethics** – ensuring that clear vesting gateways exist for safety outcomes and the ethical management of the business;
- **Shareholder value is paramount:**
 - remuneration outcomes (particularly incentive based outcomes) are designed to take account of share price movements across the reporting period and therefore the value delivered to shareholders; and
 - a close alignment is created between operational performance, reward and sustained growth in shareholder value – this is done through achieving robust company building milestones year-on-year (via the Short-term Incentive ('STI') Plan) and through outperforming a select group of 18 industry peer companies in the longer term (via the Long-term Incentive ('LTI') Plan);
- **People:**
 - ability to attract, motivate and retain the very best people whilst remunerating them reasonably and competitively; and
 - encouraging its people to hold equity in the company which builds a culture of viewing management decisions as an owner thereby helping to further align executives and shareholder's interests;
- **Transparency** – remuneration measures, outcomes and reporting are as simple and transparent as possible for shareholders and other stakeholders; and
- **Longer term focus** – key decision making is longer term in its focus.

We recognise that the role of the STI and LTI plans is not to reward employees for "business as usual" outcomes but rather out-performance by achieving key company building goals. Our STIs are specifically designed to "stretch" business as usual outcomes, for example, by being specifically and heavily oriented to achieving the biggest value creation goals including bringing our own discoveries in Brazil into production and acquiring production assets from third parties in the fastest possible timeframe, the success of which will be measured by a corresponding uplift in shareholder value through sustained share price appreciation.

No significant changes are proposed in relation to our overall remuneration framework for the 2017/2018 year ahead.

3. Remuneration Framework and Links to Strategy

The Board and management are very aware of the need to ensure that executive performance outcomes are aligned to building asset value and securing share price growth for our shareholders over time.

Key links between the remuneration framework, Karoon's strategy and shareholder value are demonstrated as follows:

- the STI framework is based on a set of ambitious Company building goals on a rolling short term basis;
- the LTI targets are based on a relative total shareholder return ('TSR') measure – meaning, our team needs to outperform an industry peer group of companies in terms of share price performance for any performance incentive to vest;
- rewards for long-term value creation and executive retention by applying a one-year deferral of STI vesting after performance conditions are achieved and measuring LTI outcomes over a three-year testing period;
- having a clear gateway for safety outcomes before any STI awards can be made and a clawback (negative discretion) provision in relation to bribery and/or corruption issues;
- LTI awards will be delivered as a mix of performance rights and share options, to be tested using the usual relative TSR performance condition, rather than in cash assisting with capital preservation; and
- exercising appropriate restraint in relation to salary levels and only vesting of incentives after having regard to market conditions and where considered appropriate, exercising negative discretion to reduce respective incentive awards.

4. 2016/2017 Reporting Period

Our operational focus in the current reporting period (and the focus of our STI) has been to advance the development of the oil discoveries in the Santos Basin in Brazil as well as to identify and evaluate a range of assets in production (or near to production) in various parts of the world for possible acquisition whilst also reducing the cost of running the business as a whole.

In terms of outcomes, very good progress was made in Brazil with the Echidna light oil discovery advancing to the FEED stage of development. In terms of possible acquisitions, multiple targets were evaluated but no transaction was brought to a legally binding status during the financial year. Due diligence work and negotiations are continuing in relation to a range of possible acquisitions around the world, with several key processes ongoing. Safety and anti-bribery and corruption outcomes for the period continued to be excellent.

Significant agreements were also signed with DEA in relation to the possible acquisition of production assets in Brazil, an opportunity to farm-in to Karoon's Kangaroo and Echidna light oil discoveries and joint bidding for newly released acreage in Brazil.

Outcomes and decisions for the period are:

- **STI** – 40% of the available STI pool will be awarded for the 2016/2017 year based on the achievement of a proportion of the 2016/2017 goals. A 10% negative discretion was applied this year to take an actual 50% outcome to 40% given market conditions. The STI is now subject to a one-year retention period before vesting;
- **LTI** – 80% of the LTI hurdle was achieved for the 2016/2017 year based on independent confirmation by Egan & Associates of Karoon's relative TSR compared to its industry peer group of Australian and offshore companies, however, in the circumstances, negative discretion was applied to reduce the award to a 0% outcome given that the absolute return, like all but one of our industry peers, was negative;
- **Executive salaries** – there will be no increase to key management personnel ('KMP') salaries for the 2017/2018 year. Cash remuneration for KMP's has remained fixed and is below many of its peers, meaning that the importance of, and reliance on STI and LTI outcomes is heightened; and
- **Board fees** – there will be no increase in the base Board fee paid to Non-Executive Directors for the 2017/2018 year (which has remained unchanged since 2013).

In summary, over the last year we have made very good operational progress with our development campaign in Brazil and are well positioned for the 2017/2018 year but recognise that challenging conditions continue in our sector.

Our corporate strategy and all remuneration related targets are designed and managed to improve shareholder value into the future. In these circumstances, the Board and Remuneration Committee have exercised considerable restraint by directing that there be no changes to salaries and base Director fees for the 2017/2018 year ahead, reducing the 2016/2017 STI outcome through negative discretion and applying full negative discretion to the LTI outcome.

We will continue to engage with our shareholders, both retail and institutional, proxy advisors and our own remuneration advisors in an effort to seek feedback to help us continue to improve our remuneration framework outcomes, transparency and disclosures.



Peter Turnbull

Chairman, Remuneration Committee
21 September 2017

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

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Section 1. Introduction

The Board of Directors is pleased to provide Karoon's Remuneration Report, which details the remuneration for its KMP, defined as those persons having the authority and responsibility for planning, directing and controlling, directly or indirectly, the activities of the Group.

For the financial year ended 30 June 2017, KMP disclosed in the Remuneration Report are as follows:

| Name | Position | Term as KMP |
|--------------------------------|---|---------------------------|
| Executive Directors | | |
| Mr Robert Hosking | Managing Director | Full financial year |
| Mr Mark Smith | Executive Director and Exploration Director | Full financial year |
| Non-Executive Chairman | | |
| Dr David Klingner | Independent Non-Executive Chairman | Full financial year |
| Non-Executive Directors | | |
| Ms Luciana Rachid | Independent Non-Executive Director | Appointed 26 August 2016 |
| Mr Geoff Atkins | Independent Non-Executive Director | Full financial year |
| Mr Clark Davey | Independent Non-Executive Director | Full financial year |
| Mr Peter Turnbull | Independent Non-Executive Director | Full financial year |
| Mr Bernard Wheelahan | Independent Non-Executive Director | Resigned 30 November 2016 |
| Mr Jose Coutinho Barbosa | Non-Executive Director | Full financial year |
| Other KMP | | |
| Mr Edward Munks | Chief Operating Officer | Full financial year |
| Mr Scott Hosking | Company Secretary (Company) and Chief Financial Officer (Group) | Full financial year |
| Mr Tim Hosking | South American General Manager and Chief Executive Officer Brazil | Full financial year |

For the purposes of the Remuneration Report, the term 'executive' refers to the Managing Director, the Executive Director/Exploration Director and other KMP of the Group.

The Remuneration Report for the financial year ended 30 June 2017 outlines the remuneration arrangements of KMP of the Group in accordance with the requirements of the *Corporations Act 2001* and its regulations. The information provided in this Remuneration Report has been audited by Karoon's external auditor, as required by Section 308(3C) of the *Corporations Act 2001*. The Remuneration Report forms part of the Directors' Report.

Section 2. Remuneration Committee Oversight

To assist in ensuring good remuneration governance at Karoon, the Board of Directors has in place a Remuneration Committee that provides oversight and recommendations on all aspects of the remuneration arrangements for executives and Non-Executive Directors.

The Remuneration Committee currently consists solely of independent Non-Executive Directors and is responsible for reviewing and making recommendations to the Board of Directors regarding:

- the quantum of executive remuneration;
- the executive remuneration framework, including the operation of and performance-based outcomes under Karoon's share-based remuneration schemes;
- the recruitment, retention and termination policies and procedures for executives; and
- related party remuneration.

The Board of Directors, assisted by the Remuneration Committee, conducts annual remuneration reviews for its Non-Executive Chairman, Non-Executive Directors, executives and employees to ensure that remuneration remains market competitive, fair and aligned with both market practice and the best interests of shareholders.

Further information on the role and responsibilities of the Remuneration Committee is contained in the Remuneration Committee Charter, which can be found under the Governance tab on Karoon's website at www.karongas.com.au.

Use of Independent Remuneration Consultants

During the financial year ended 30 June 2017, the Chairman of the Remuneration Committee re-engaged Egan Associates as its independent Remuneration Consultant. The Remuneration Consultant reported directly to the Remuneration Committee. In selecting the Remuneration Consultant, the Remuneration Committee considered potential conflicts of interest and required the Remuneration Consultant's independence from management as part of Egan Associates' terms of engagement. Egan Associates was asked to provide a recommendation in relation to testing the performance milestones under the 2015 LTI conditions, which were tested at 30 June 2017. The recommendation was provided to, and discussed directly with, the Chairman of the Remuneration Committee.

2016 Remuneration Report Vote

At Karoon's 2016 Annual General Meeting, Karoon's 2016 Remuneration Report received a positive 94.63% vote FOR. Feedback on the 2016 Remuneration Report was not received during the 2016 Annual General Meeting. However, Karoon did seek and received feedback from institutional and retail shareholders and proxy advisory organisations during the financial year ended 30 June 2017. Views expressed during these meetings have contributed to decision making by the Remuneration Committee on Karoon's 2017 reward practices, the setting of incentive hurdles being developed for application during the financial year ending 30 June 2018 and beyond. In reviewing reward arrangements, assessing industry practice and the availability of global talent, the Board of Directors acknowledges that today, given the nature of Karoon's challenges and opportunities, it is fortunate to have a team of highly experienced and internationally regarded executives who have a track record of success and who can execute the next value creating opportunities for Karoon.

The Board of Directors and Remuneration Committee have continued to address shareholder and proxy advisor views and suggestions and, as a result, make the following points in relation to Karoon's executive remuneration framework:

- in recognition of the current oil and gas industry market conditions, country base salary for Non-Executive Directors and executives will not increase for the financial year ending 30 June 2018;
- the STI Plan performance conditions for executives will be based on an up-to-date list of Company-wide Operational Objectives and in some instances, role-specific objectives, in order to focus executives on the achievement of value-adding operational progress as well as value-adding asset acquisitions in the short-term and relative Company performance in the long-term. A safety hurdle will continue to be used as a gateway measure, and negative discretion based on poor Anti-bribery and Corruption Policy implementation and outcomes will also continue to be used to modify short term incentives; and
- appropriate restraint continues to be exercised having due regard to market conditions, such as in the case of negative discretion being applied to the LTI outcomes for the 2017 LTI testing.

The Board of Directors is also continuing to improve the quality of remuneration disclosures in its Remuneration Report, clearly separating discussion of the executive remuneration framework from actual outcomes received by executives under the incentive plans, and providing further explanation for the remuneration structures in place.

Remuneration Report (Audited) continued

Section 2. Remuneration Committee Oversight continued

Share Trading Policy

The trading of ordinary shares issued to Non-Executive Directors and executives under any of Karoon's share-based remuneration schemes is subject to, and conditional upon, compliance with Karoon's Share Trading Policy.

Under Karoon's Share Trading Policy, an individual may not limit his or her exposure to risk in relation to securities (including unlisted share options and performance rights). Directors and executives are prohibited from entering into any hedging arrangements over unvested share options or performance rights under Karoon's share-based remuneration schemes. Any employee or Director wishing to trade in Karoon securities must consult the Chairman or Company Secretary to gain approval to trade and ensure that trading restrictions are not in force. All trades by Directors and executives during the financial year were conducted in compliance with Karoon's Share Trading Policy.

Karoon's Share Trading Policy can be found under the Governance tab on Karoon's website at www.karoongas.com.au.

Section 3. Executive Remuneration

The Board of Directors and the Remuneration Committee have developed a remuneration policy that ensures executive remuneration supports the current business strategy and needs of the business. In particular, the decision to use performance tested share-based grants for its incentive plans reflects the Board of Directors' belief that this best aligns executive and shareholder interests in the short and long-term. Karoon's success is measured by its ability to acquire, assess and confirm new hydrocarbon discoveries, along with its ability to allocate capital to the highest value creating activities. The executive remuneration arrangements for the financial year ended 30 June 2017 were structured to be directly aligned with the business outcomes by including engineering and farm-out milestones as well as creating value-accretive opportunities, which add clear value to Karoon's portfolio of assets.

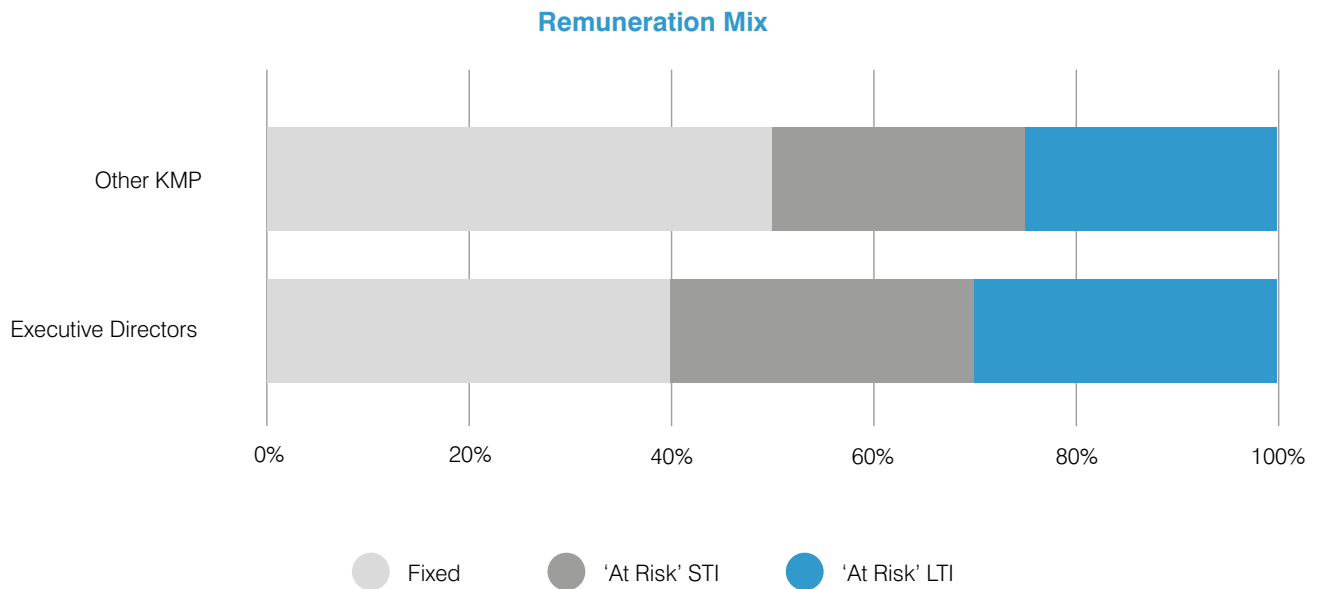
In designing Karoon's variable or 'At Risk' remuneration plans, and to incentivise executives, the Remuneration Committee and the Board of Directors have linked variable remuneration directly to Karoon's operational performance in the short-term and to relative TSR performance compared to industry peer group companies in the long-term. This is considered appropriate to create performance-based rewards that are tailored to each phase of Karoon's operations, the lifecycle of its assets and how it delivers on its business strategy.

Broadly, the objectives of Karoon's executive remuneration framework are to ensure:

- remuneration is reasonable and competitive in order to attract, retain and motivate talented and high calibre executives capable of managing Karoon's diverse international operations;
- remuneration is set at a level acceptable to shareholders, has regard to Karoon's performance and rewards individual capability and experience;
- remuneration structures create sufficient alignment between performance, reward and sustained growth in shareholder value through operational progression and success while creating an increase in value relative to industry peer group companies over the long-term;
- remuneration outcomes provide recognition of contribution to overall long-term growth in the value of Karoon's asset portfolio and are transparent to both participants and shareholders;
- the remuneration framework assists in facilitating prudent capital management through the use of share-based remuneration; and
- remuneration incentivises the best possible health and safety outcomes, along with best practice in preventing bribery and/or corruption.

A. Executive Remuneration Framework for the Financial Year Ended 30 June 2017

The following table summarises the remuneration outcome mix for executives for the financial year ended 30 June 2017, based on maximum achievement of incentive plan outcomes:



Fixed Remuneration

Fixed remuneration consists of cash salary, superannuation contributions and any salary sacrifice items or non-monetary benefits (including health insurance, motor vehicles, expatriate travel, certain membership and associated fringe benefits tax, depending on each individual's respective employment arrangements).

Fixed remuneration is reviewed annually by the Remuneration Committee. Broadly, fixed remuneration is positioned within a range that references the median of the relevant market for each role.

The level of cash salary for each executive is determined considering:

- scope of the individual's role;
- the individual's personal performance;
- the individual's level of skill and experience;
- the individual's overall contribution to the success of the business;
- the size and complexity of the executive's role;
- Karoon's geographical footprint;
- the employment location and labour market conditions at that location; and
- overall industry and global market conditions.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 3. Executive Remuneration continued

A. Executive Remuneration Framework for the Financial Year Ended 30 June 2017 continued

Superannuation

The Australian executives of the Company received statutory superannuation contributions of 9.5% of cash remuneration, up to the maximum statutory contribution. Individuals may choose to sacrifice part of their salary to increase payments towards superannuation. The Australian executives of Karoon do not receive any other retirement benefits.

Social Security and Indemnity Fund Contributions

Karoon's Brazilian based executive is subject to specific Brazilian employment regulations, whereby the Group is required to contribute 27.3% of Brazilian cash compensation as social security to fund government pensions paid in retirement. The executive upon retirement will only be entitled to a portion of this contribution. A further 8% of his cash remuneration is required to be contributed to a Federal Severance Indemnity Fund ('FGTS'). In the situation of unfair dismissal without just cause, the Group would have to pay a fine equivalent to 50% of the accumulated balance of the individual's FGTS account.

'At Risk' Remuneration

Karoon aims to align the interests of executives with those of shareholders by having a significant proportion of executive remuneration 'At Risk'. 'At Risk' remuneration represents the proportion of remuneration that requires predetermined performance conditions to be met before the remuneration is vested to the executive. Annually, the Remuneration Committee reviews the operational goals and targets, looking broadly at where the building blocks for long-term value exist, then sets performance conditions that not only motivate, reward and retain executives by generating a link between operating performance and remuneration received, but also encourages executives to achieve their personal and business targets that seek to maximise the performance of Karoon and, in turn, provide value for shareholders.

All executives received grants of share options and performance rights during the financial year ended 30 June 2017, under the Karoon Gas Australia 2016 Employee Share Option Plan ('2016 ESOP') and 2016 Performance Rights Plan ('2016 PRP').

STI Plan

Executives have the opportunity to earn an annual incentive award through the STI Plan. The percentage of salary allocated to STI remains 'At Risk' until the performance conditions are tested, if the performance conditions are not met this portion of remuneration is not vested and lapses. The STI is payable as performance rights under the 2016 PRP approved by shareholders at Karoon's 2016 Annual General Meeting. The key features of the 2016 PRP award for the financial year ended 30 June 2017 ('FY17 award') are outlined in the table below:

| | |
|------------------------|--|
| Participation | All executives. Participation in the STI Plan is at the discretion of the Board of Directors on the recommendation of the Remuneration Committee. No employee has a contractual right to receive performance rights. |
| STI Opportunity | The STI opportunity level of each executive is a predetermined proportion of an executive's total remuneration. The quantum of performance rights received is determined by dividing the STI opportunity for each employee by Karoon's weighted average share price in the 20 trading day period leading up to the first day of the performance period. The STI opportunity available to an executive is between 15%-30% of total remuneration and performance conditions are required to be met before any FY17 award is received. The Remuneration Committee calculates the incentive value and establishes a maximum number of performance rights 'At Risk' at the beginning of the period. |
| Form of Award | Executives receive performance rights. Each performance right provides the participant with the right to receive one fully paid ordinary share in Karoon, or its equivalent value, for no consideration. Vesting is subject to the achievement of the relevant performance conditions. Under the rules of the PRP, ordinary shares issued as a result of the exercise of vested and converted performance rights may be issued as new ordinary shares, ordinary shares acquired on-market or an equivalent value in cash at Karoon's discretion. |

| | |
|-------------------------------|---|
| Performance Period | 1 year. |
| Deferral Period | Vested performance rights are subject to a deferral period of 12 months, being the continuation of employment with Karoon, immediately following the satisfaction of performance conditions. |
| Performance Conditions | As part of the 2017 remuneration review, for the financial year ended 30 June 2017 the Remuneration Committee set out the FY17 award for short-term incentives based on a mix of the following performance hurdles: |

| | Company-wide Operational Objectives | Role-specific Objectives |
|---------------------|--|-------------------------------------|
| Executive Directors | 100% | Nil% |
| Other KMP | 80% | 20% |

Company-wide Operational Objectives

The Company-wide Operational Objectives included:

| Criteria | Hurdle | FY17 Award Percentage 'At Risk' |
|---------------------------------------|---|--|
| Safety | Total Recordable Incident Rate ('TRIR') of < 2 required for any FY17 award to proceed. | Gateway |
| Operational | Progression of key appraisal, field pre-development and joint operational targets. | 40% |
| Financial | Completion of key South American farm-outs (Brazil and Peru). | 25% |
| New asset acquisition | Completion of a value-accretive asset acquisition, as judged by resulting Karoon share price performance. | 25% |
| | (Remuneration Committee/Board of Directors' discretion to re-allocate 'At Risk' percentages if the timing or size of an acquisition requires 'Operational' hurdles to be varied, so as to achieve the best value for shareholders.) | |
| Cost control and capital preservation | Actual costs are below Karoon Group budget targets for the financial year ended 30 June 2017. | 10% |
| Anti-bribery and corruption | Negative discretion will be applied based on management's implementation and enforcement of the Anti-bribery and Corruption Policy. | Clawback |

Role-specific Objectives

Role-specific objectives were set at the beginning of the performance period and related directly to the individual's specific portfolio of responsibility.

Further details on the performance conditions, targets and outcomes for the FY17 award are provided in the STI outcomes within Section 3B on page 44.

| | |
|----------------------------------|--|
| Grant Date | Maximum amount of performance rights available were determined following finalisation of the 30 June 2016 audited accounts and remained 'At Risk' until tested during July 2017 and retention conditions are met 1 July 2018. Grant date occurs following the offer and acceptance of performance rights. However, any performance rights offered and accepted by the Executive Directors will be subject to shareholder approval at the next AGM. |
| Termination of Employment | Unvested performance rights will lapse upon cessation of employment with Karoon, subject to the discretion of the Remuneration Committee depending on the nature and circumstances of the termination. |
| Change of Control | Upon a change of control, the Board of Directors may determine that a portion of the individual's unvested performance rights will vest based on pro-rata achievement of the performance conditions. |

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 3. Executive Remuneration continued

A. Executive Remuneration Framework for the Financial Year Ended 30 June 2017 continued

STI Plan continued

Link Between Performance and Reward

Linking STI outcomes to operational performance develops an essential alignment between Karoon's year-to-year inherent value growth through identification, evaluation and drilling of exploration and evaluation targets and the reward provided to those who establish that value. The Remuneration Committee annually reviews and recommends operational performance metrics, including safety and Anti-bribery and Corruption Policy compliance, which demonstrate a clear pathway toward value creation, either through the discovery of new hydrocarbons, commercial arrangements to monetise assets or movement closer to development for previous discoveries.

In setting objectives for the performance period, the Remuneration Committee assesses the goals for the performance period in light of the long-term strategic building blocks and upcoming key value drivers within Karoon's operations, allowing for transparent measurement of performance against these objectives.

The Remuneration Committee recognises the risks associated with offshore drilling and considers safety paramount to its operations. Safety will continue to be used as a gateway for vesting conditions.

LTI Plan

LTI issues of share options and performance rights to executives aim to reward long-term performance and superior shareholder returns. Share options and performance rights will only vest if the predetermined performance conditions are achieved, and the individual remains employed by Karoon for the duration of the performance period.

Share options granted have a 30% premium to the share price at the beginning of the performance period, providing an additional absolute performance measure before ESOP options have a value.

The key features of the 2016 ESOP and 2016 PRP grant for the financial year ended 30 June 2017 ('FY17 grant') are outlined in the table below:

Participation

All executives.

Participation in the ESOP and PRP plans is at the discretion of the Board of Directors on the recommendation of the Remuneration Committee. No executive has a contractual right to receive a FY17 grant under the respective plan.

LTI Opportunity

The LTI opportunity level of each executive is a predetermined proportion of an employee's total remuneration, as outlined above in Section 3A on page 39.

Form of Grant

The quantum of ESOP options and PRP performance rights received is determined by dividing the LTI opportunity for each executive by the fair value of ESOP options under the ESOP, using the Black-Scholes option pricing model and dividing by the 20 day weighted average share price at the beginning of the test period for the PRP performance rights.

Each ESOP option provides the participant with the right to acquire one fully paid ordinary share in Karoon at the exercise price determined upon grant, subject to the achievement of the relevant performance conditions, or its equivalent value in cash at Karoon's discretion, for no consideration.

Each PRP performance right provides the participant with the right to receive one fully paid ordinary share in Karoon, or its equivalent value in cash at Karoon's discretion, for no consideration.

The LTI opportunity available to an executive is between 15% and 30% of total remuneration.

Performance Period

3 years.

Performance Conditions For the financial year ended 30 June 2017, Karoon's relative TSR performance was measured against the following industry peer group:

| Australian Market Peers | | Global Peers |
|--------------------------------|----------------------------|---------------------------------|
| AWE Limited | Origin Energy Limited | Cobalt International Energy Inc |
| Beach Energy Limited | Oil Search Limited | Gran Tierra Energy Inc |
| Buru Energy Limited | Santos Limited | GeoPark Limited |
| Carnarvon Petroleum Limited | Senex Energy Limited | Kosmos Energy Ltd |
| FAR Limited | Woodside Petroleum Limited | Ophir Energy plc |
| Horizon Oil Limited | | QGEP Participacoes SA |
| | | Tullow Oil plc |

Vesting will occur in accordance with the following schedule:

| Performance Against the Industry Peer Group | Proportion of ESOP Options and/or PRP Performance Rights Vesting |
|--|--|
| Less than 50th percentile | Nil% |
| At 50th percentile | 50% |
| Between 50th and 75th percentile | 50% plus 2% for each additional percentile ranking above the 50th percentile |
| At or above 75th percentile | 100% |
| At 100% percentile | 120% |

In the event of delisting, merger or acquisition of any of the above industry peer group companies, the Remuneration Committee will apply its discretion to assess the relative performance of that entity by normalising its performance over the testing period in the case of delisting or substituting the performance of the new entity from the day of acquisition in the case of merger or acquisition.

| | |
|--|--|
| Grant Date | ESOP options and PRP performance rights were granted during the financial year ended 30 June 2017, following finalisation of the 30 June 2016 audited accounts. |
| Exercise Period | ESOP options and PRP performance rights will remain exercisable for a period of one year following vesting, provided the individual remains an employee of Karoon during this period. |
| Termination of Employment | Unvested (and unexercised) ESOP options and unvested (and unconverted) PRP performance rights will lapse upon cessation of employment with Karoon, subject to the discretion of the Remuneration Committee depending on the nature and circumstances of the termination. |
| Change of Control | Upon a change of control, the Board of Directors may determine that a portion of the individual's unvested ESOP options and PRP performance rights will vest, based on pro-rata achievement of the performance conditions. |
| Link Between Performance and Reward | The Board of Directors and Remuneration Committee consider it important to link remuneration to share price performance relative to Karoon's industry peer group companies over the longterm, in order to align executive reward with increases in shareholder value. In the case where performance does not reach the 50th percentile, no incentive will be paid. A portion of the LTI is delivered in 'premium' priced ESOP options, ESOP options granted have a 30% premium to the trading share price at the beginning of the performance period. This ensures that value to the executive is only achieved if the Company has a positive absolute return over the performance period. |

B. Executive Remuneration Outcomes

Relationship between the Executive Remuneration Framework and Company Performance

Karoon has a transparent and rigid performance-based remuneration structure in place that provides a direct link between Company performance and remuneration in the short and long-term. As part of this structure, executive rewards are directly linked to operational, safety and financial performance metrics along with relative market performance. 'At Risk' remuneration is only awarded if predetermined Company building milestones are achieved.

Karoon sets ESOP option exercise prices at a level that provides for an inherent 30% premium to the market prices at the time of offer. This premium ensures a simple share price accretion hurdle of 10% per year over the three-year testing period is achieved before LTI ESOP options achieve a value and are exercisable and therefore provide a connection between incentive and shareholder value.

Whilst Karoon has created significant value through its continued development of its Santos Basin assets, has good opportunities for investment in the current portfolio and from the opportunistic acquisition of production assets, Karoon has not created value for shareholders through share price appreciation during the financial year. This has resulted in only partial vesting of incentives for executives being 40% of the STI and 0% of the LTI pool. Incentives that were paid related to the Echidna light oil discovery (Santos Basin, Brazil) development concept planning and progression to the next phase in the development, FEED. The Board of Directors therefore believes its current policy was effective in linking remuneration to Company performance.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 3. Executive Remuneration continued

B. Executive Remuneration Outcomes continued

STI Outcomes

The table below outlines actual achievements against STI performance targets for the financial year ended 30 June 2017:

| Criteria | Hurdle | Award Percentage 'At Risk' | Short-term Incentive Outcomes |
|--|---|-------------------------------|--|
| Safety | TRIR of < 2 required for any award to proceed. | Gateway | TRIR 0.00 |
| Operational | Progression of key appraisal, field pre-development and operational targets. | 40% | Echidna light oil discovery development concept approved and progressed to FEED phase. 40% |
| Financial | Completion of key South American farm-outs (Brazil and Peru). | 25% | No South American farm-out completed. 0% |
| New Asset Acquisition | Completion of a value-accretive asset acquisition as judged by resulting Karoon share price performance. (Remuneration Committee/Board of Directors' discretion to re-allocate 'At Risk' percentages if the timing or size of an acquisition requires 'Operational' hurdles to be varied, so as to achieve the best value for shareholders.) | 25% | Recent transaction success was hampered by local issues in Brazil and resulting share price experience, while positive in the initial instance, was not sustained. 0% |
| Cost Control and Capital Preservation | Actual costs are below Karoon Group budget targets for the financial year ended 30 June 2017. | 10% | 0% due to the exercise of Board of Directors' discretion, even though actual costs were below Group budget. |
| Anti-bribery and Corruption | Negative discretion will be applied based on management's implementation and enforcement of the Anti-bribery and Corruption Policy. | Clawback | No 'clawback'. |

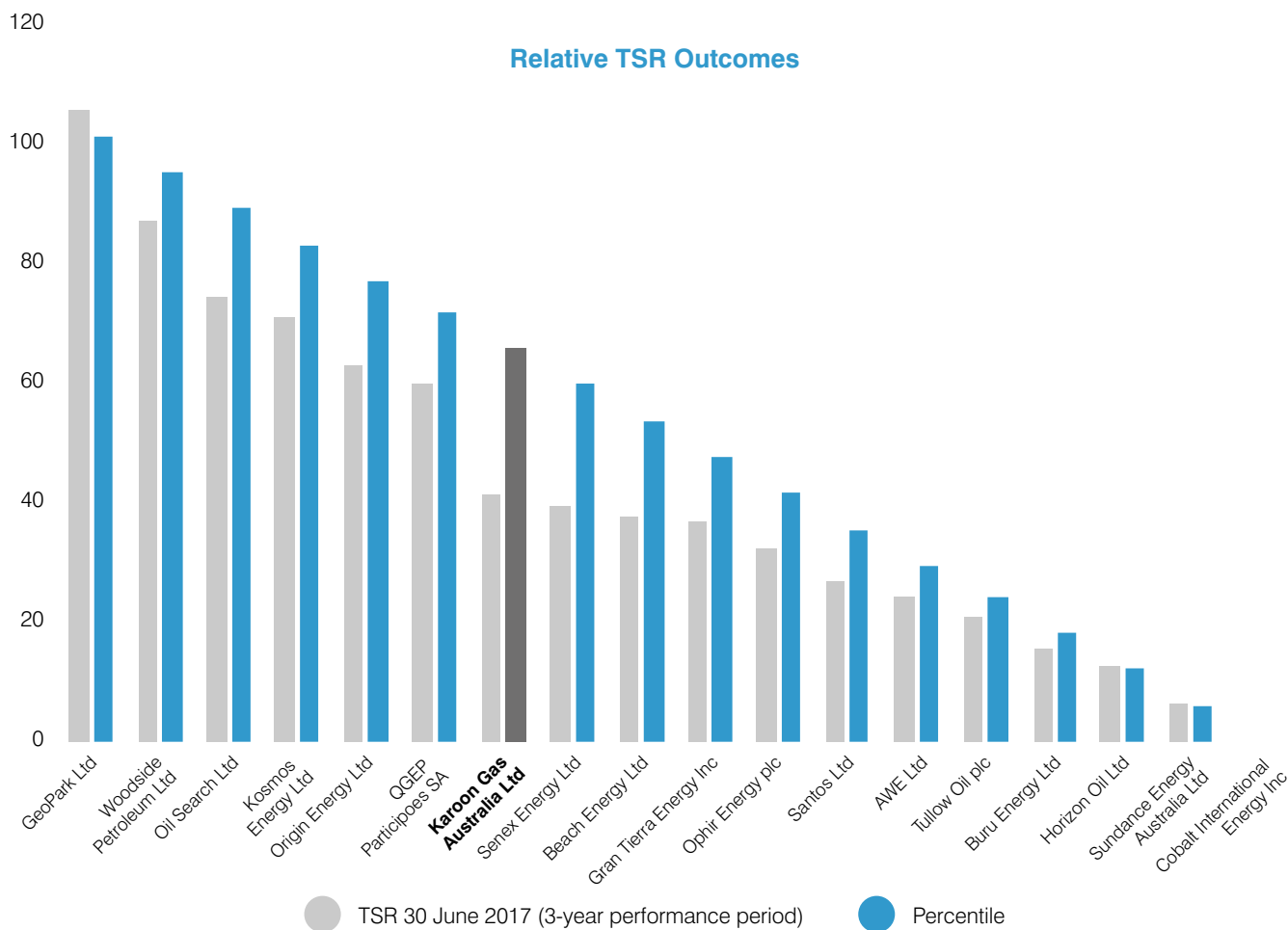
As outlined above, a total of 40% of the available STI opportunity vested to Executive Directors based on actual results against the performance targets. For other KMP, a total of 47% of the available STI opportunity vested based on actual results against the performance targets.

The resulting STI performance rights now have a one-year retention period ending 30 June 2018 before they become exercisable and convertible into fully paid ordinary shares or paid for the equivalent value in cash. These STI performance rights expire on 30 June 2019.

LTI Outcomes

LTIs tested during the financial year are settled in ESOP options with an exercise price of \$4.06, and were granted during the financial year 2015 under the Karoon Gas Australia 2012 Employee Share Option Plan. As that grant had a three-year performance period, performance against the relevant conditions was tested at the completion of the financial year ended 30 June 2017.

The performance condition was Karoon's relative TSR when compared with its industry peer group over the period from 1 July 2014 to 30 June 2017. The outcome was a 65th percentile ranking, as a result 80% of the LTI grant is eligible to be vested. However, given the current environment and recognising the shareholder experience over this period, the Board of Directors chose to apply negative discretion and therefore 0% vesting occurred.



Voluntary Information: 2017 'Remuneration Received'

The amounts disclosed below reflect the actual benefits received by each executive during the financial year ended 30 June 2017. The amounts disclosed below include the actual value of any equity-settled and/or cash-settled award received from STI and/or LTI.

The amounts disclosed in the table below are not the same as the statutory remuneration expensed in relation to each executive in accordance with Australian Accounting Standards shown in the statutory table in Section 5 of the Remuneration Report. The remuneration values disclosed below have been determined as follows:

Fixed Remuneration

Fixed remuneration includes cash salary and fees, non-monetary benefits, superannuation contributions and paid long service leave.

Fixed remuneration excludes any accruals of annual or long service leave.

Short-term Incentives

Includes the equity-settled and/or cash-settled award received from STI incentives by executives. The value of STI equity-settled and cash-settled awards received reflects the amounts disclosed to the relevant tax authorities during the financial year ended 30 June 2017.

Long-term Incentives

Includes the equity-settled and/or cash-settled award received from LTI incentives by executives. The value of LTI equity-settled awards and cash-settled awards received reflects the amounts disclosed to the relevant tax authorities during the financial year ended 30 June 2017.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 3. Executive Remuneration continued

B. Executive Remuneration Outcomes continued

Voluntary Information: 2017 'Remuneration Received' continued

| Name | Fixed Remuneration \$ | Short-term Incentives \$ | Long-term Incentives \$ | Total Remuneration Received \$ |
|---|--------------------------|-----------------------------|----------------------------|-----------------------------------|
| Executive Directors | | | | |
| Mr Robert Hosking | 716,108 | 126,979 | - | 843,087 |
| Mr Mark Smith | 629,380 | 126,979 | - | 756,359 |
| Other key management personnel (Group) | | | | |
| Mr Scott Hosking | 458,688 | 59,978 | - | 518,666 |
| Mr Tim Hosking | 526,023 | 43,309 | - | 569,332 |
| Mr Edward Munks | 545,158 | 54,414 | - | 599,572 |

The Board of Directors believes that 'remuneration received' is more relevant to shareholders for the following reasons:

- the statutory remuneration expensed through share-based payments (ESOP options and/or PRP performance rights) is based on historic cost and does not reflect the value of equity-settled and/or cash-settled amounts when they are actually received;
- the statutory remuneration shows benefits before they are actually received by executives;
- where ESOP options or PRP performance rights do not vest because a market-based performance condition is not satisfied (for example, an increase in Karoon's share price), Karoon must still recognise the full amount of the share-based payments expense even though the executives will never receive any benefits; and
- share-based payment awards are treated differently under Australian Accounting Standards depending on whether the performance conditions are market conditions (no reversal of share-based payments expense) or non-market conditions (reversal of share-based payments expense when ESOP options or PRP performance rights fail to vest), even though the benefit received by the executive is the same (\$Nil where the ESOP option or PRP performance right fail to vest).

The information in this section has been audited together with the rest of the Remuneration Report.

C. Executive Remuneration for the Financial Year Ending 30 June 2018

As part of the annual review of remuneration arrangements conducted on behalf of the Board of Directors, the Remuneration Committee makes the following points for the financial year ending 30 June 2018:

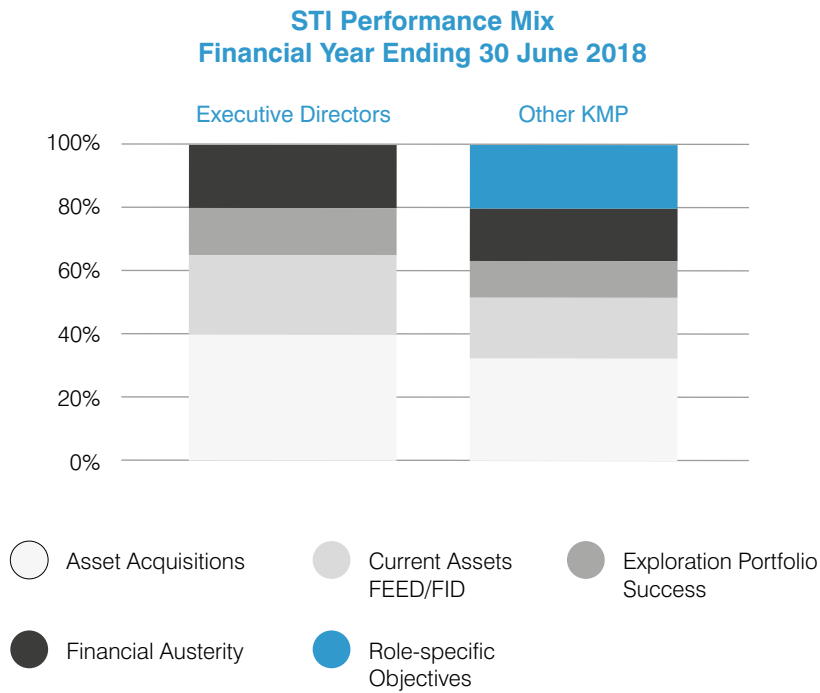
- no change to country base salary or overall remuneration structure has been made for executives for the financial year ending 30 June 2018;
- STI will be delivered to executives in the form of 'At Risk' performance rights, to be tested against appropriate Company-wide Operational Objectives and in some instances, role-specific objectives. Safety performance remains a gateway, with express negative discretion to be applied by the Board of Directors to modify STI outcomes resulting from Anti-bribery and Corruption Policy implementation and enforcement issues;
- the LTI performance condition includes a refined list of industry peer group companies; and
- LTI will be delivered via a mix of ESOP options and/or PRP performance rights to be again tested using relative TSR performance conditions.

These refinements also reflect general feedback received from institutional shareholders, retail shareholders, industry funds and proxy advisory organisations following the 2016 Annual General Meeting.

'At Risk' Remuneration

Short-term Incentives

The STI performance hurdles for the performance period from 1 July 2017 to 30 June 2018 are outlined in the table below. Vesting under each objective will occur upon satisfaction of the Company-wide Operational Objectives, and in some cases role-specific objectives.



Gateway

Karoon operates in a high-risk industry where Health, Safety, Security and Environment Management System ('HSSEMS') procedures are paramount and therefore a TRIR of < 2 is required for any grant to proceed.

Clawback

Karoon has zero tolerance for bribery and/or corruption and therefore negative discretion will be applied based on any incidence of bribery or corruption, and management's implementation and enforcement of the Anti-bribery and Corruption Policy.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 3. Executive Remuneration continued

C. Executive Remuneration for the Financial Year Ending 30 June 2018 continued

'At Risk' Remuneration continued

Company-wide Operational Objectives

For the performance period from 1 July 2017 to 30 June 2018, the Company-wide Operational Objectives are outlined in the table below. Vesting under each objective will occur upon satisfaction of the relative performance condition.

| Criteria | Hurdle | Award Percentage 'At Risk' |
|--|---|----------------------------|
| Safety | TRIR of < 2 required for any award to proceed. | Gateway |
| Acquisition Strategy | To acquire an interest in a production and/or near-term development asset by: <ul style="list-style-type: none"> • completion of legally binding terms for a value-accretive asset acquisition as judged by an increase in the Karoon share price of not less than 20%, sustained for a period of not less than 30 days following the ASX announcement of the transaction; and • the asset acquisition should provide accretive (positive) cash flow within a reasonable commercial period after acquisition, to be determined by the Board of Directors at its discretion. | 40% |
| Operational | Brazil (Santos Basin): <ul style="list-style-type: none"> • complete the FEED stage for the Echidna light oil discovery in Brazil; or • attract a strategic partner who will jointly proceed to FID on the Echidna light oil discovery. | 25% |
| Asset Management | Completion of key farm-outs in Australia, Brazil and Peru. | 25% |
| Cost Control and Capital Preservation | Reduction of variable administration and operating costs by 20% for the financial year ending 30 June 2018. (Note Board of Directors' discretion maybe applied resulting from the achievement of one or more of the above objectives that significantly alter the overall cost profile of the Group.) | 10% |
| Anti-bribery and Corruption | Negative discretion will be applied based on management's implementation and enforcement of the Anti-bribery and Corruption Policy. | Clawback |

Role-specific Objectives

Role-specific objectives are set at the beginning of the performance period and relate directly to the individual's specific area of responsibility.

Long-term Incentive

The LTI performance hurdle for the period commencing 1 July 2017 and ending 30 June 2020 will be relative TSR performance as assessed against a list of closely comparable and representative industry peer group companies, whose business models and/or regions of operations are similar to those of Karoon.

For the period commencing 1 July 2017, the refined list of industry peer group companies will be as follows:

| Australian Market Peers | | Global Peers |
|-----------------------------|----------------------------|---------------------------------|
| AWE Limited | Cairn Energy plc | Cobalt International Energy Inc |
| Beach Energy Limited | Oil Search Limited | Gran Tierra Energy Inc |
| Buru Energy Limited | Santos Limited | GeoPark Limited |
| Carnarvon Petroleum Limited | Senex Energy Limited | Kosmos Energy Ltd |
| FAR Limited | Woodside Petroleum Limited | Ophir Energy plc |
| Horizon Oil Limited | | QGEP Participacoes SA |
| | | Tullow Oil plc |

Vesting consideration details for the industry peer group companies is outlined in the LTI Plan table above on page 43.

Vesting outcomes will be determined in accordance with the LTI Plan table above on page 43.

D. Executive Agreements

Remuneration and other terms of employment for the executives are formalised in employment agreements. Each of these agreements may provide for the provision of benefits such as health insurance, motor vehicles, one expatriate business class flight for an executive and his family, and participation, when eligible, in the Company's PRP and ESOP. Other major provisions of the agreements relating to remuneration are set out below.

Termination payments for executives, if any, are agreed by the Remuneration Committee in advance of employment and stated in the relevant employment agreements. Upon retirement, executives are paid employee benefit entitlements accrued to the date of retirement.

Details of existing employment agreements between the Company and the Executive Directors and other key management personnel are as follows:

| Name | Term | Expiry | Notice/ Termination Period | Termination Payments | Share Option Eligible | Performance Right Eligible |
|---------------------------------------|-------------------------------|---------|----------------------------------|---|--------------------------|-------------------------------|
| Executive Directors | | | | | | |
| Mr Robert Hosking | From 1 May 2011, ongoing | Ongoing | In writing six months | Fundamental change upon a change of control: one year, two weeks' salary for each year of service | Yes | Yes |
| Mr Mark Smith | From 1 May 2011, ongoing | Ongoing | In writing six months | Fundamental change upon a change of control: one year, two weeks' salary for each year of service | Yes | Yes |
| Other key management personnel | | | | | | |
| Mr Scott Hosking | Ongoing | Ongoing | In writing six months | Fundamental change upon a change of control: one year, two weeks' salary for each year of service | Yes | Yes |
| Mr Tim Hosking | From 1 December 2010, ongoing | Ongoing | In writing one month | Fundamental change upon a change of control: one year Redundancy: one year | Yes | Yes |
| Mr Edward Munks | From 1 January 2011, ongoing | Ongoing | In writing six months | Fundamental change upon a change of control: one year | Yes | Yes |

The employment agreements of executives are on a continuing basis, the terms of which are not expected to change in the immediate future.

Section 4. Independent Non-Executive Chairman and Non-Executive Directors

Fees and payments to the independent Non-Executive Chairman and other Non-Executive Directors reflect the demands, which are placed on, and the responsibilities of the Directors of Karoon. The Company reviews independent Non-Executive Chairman and other Non-Executive Director remuneration annually and assesses the change to the Company's activities and overall responsibilities of each Non-Executive Director.

Excluding changes to the superannuation guarantee, there have been no changes to Non-Executive Directors' base or Committee member fees for the financial year ended 30 June 2017 or for the period ending 30 June 2018. The table at the end of this section provides a summary of Karoon's Non-Executive Director fee policy for the financial year.

Non-Executive Directors' fees are determined within an aggregate Directors' fee pool limit, which is periodically approved by shareholders. The maximum aggregate amount, including superannuation contribution, that may be paid to Non-Executive Directors of the Company as remuneration for their services per annum is \$1,200,000, as approved by shareholders at the Company's 2015 Annual General Meeting.

Superannuation contributions are paid, in accordance with Australian superannuation guarantee legislation, on Directors' fees paid to Australian resident Non-Executive Directors.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 4. Independent Non-Executive Chairman and Non-Executive Directors continued

Share-based Remuneration

Non-Executive Directors do not ordinarily receive performance-related remuneration. The Company has determined that it will not grant bonus or incentive related share-based remuneration to Non-Executive Directors. Non-Executive Directors will continue to be encouraged to purchase ordinary shares in the Company on-market.

Retirement Allowance for Directors

Karoon does not provide any Non-Executive Director with a retirement allowance.

Non-Executive Director Fees for the Financial Year Ending 30 June 2018

No changes will be made to the base or relevant Committee fee structure for the financial year ending 30 June 2018.

Non-Executive Directors' fees for the financial year ended 30 June 2017 and financial year ending 30 June 2018 (excluding superannuation contribution) are outlined in the following table:

| | |
|-------------------------------|-----------|
| Base fee: | |
| Non-Executive Chairman* | \$220,000 |
| Non-Executive Directors | \$100,000 |
| Committee member fees: | |
| Audit Committee | |
| Chairman | \$20,000 |
| Member | \$15,000 |
| Nomination Committee | |
| Chairman | \$15,000 |
| Member | \$12,000 |
| Remuneration Committee | |
| Chairman | \$15,000 |
| Member | \$12,000 |
| Risk and Governance Committee | |
| Chairman | \$15,000 |
| Member | \$12,000 |

* Non-Executive Chairman's base fee includes compensation for appointment to relevant committees.

Section 5. Statutory and Share-based Reporting

Details of the Remuneration of the Directors and Other Key Management Personnel

Details of the remuneration of the Directors and other key management personnel of the Group for the financial year and previous financial year are set out in the following tables:

| Financial Year Ended 30 June 2017 | Short-term Benefits | | Post-employment Benefits | | Long- term Benefits | Share-based Payments Expense | Remuneration Consisting of Share Options and Performance Rights* | Total Remun- eration |
|---|----------------------------|------------------------------|---------------------------------|--|---------------------------|---|---|----------------------------|
| | Cash Salary and Fees | Non- monetary Benefits | Superannuation Contributions | Social Security and Indemnity Fund Contributions | Long Service Leave | Share Options/ Performance Rights** | | |
| Name | \$ | \$ | \$ | \$ | \$ | \$ | % | \$ |
| Executive Directors | | | | | | | | |
| Mr Robert Hosking | 599,691 | 96,801 | 19,616 | - | 11,800 | 521,917 | 41.8% | 1,249,825 |
| Mr Mark Smith | 579,702 | 18,529 | 19,616 | - | 18,234 | 521,917 | 45.1% | 1,157,998 |
| Non-Executive Directors | | | | | | | | |
| Dr David Klingner | 220,000 | - | 19,616 | - | - | - | - | 239,616 |
| Ms Luciana Rachid (appointed 26 August 2016) | 105,241 | - | - | - | - | - | - | 105,241 |
| Mr Geoff Atkins | 142,000 | - | 13,490 | - | - | - | - | 155,490 |
| Mr Clark Davey | 156,000 | - | 14,820 | - | - | - | - | 170,820 |
| Mr Peter Turnbull | 157,000 | - | 14,915 | - | - | - | - | 171,915 |
| Mr Bernard Wheelahan (resigned 30 November 2016) | 51,667 | - | 4,908 | - | - | - | - | 56,575 |
| Mr Jose Coutinho Barbosa | 100,000 | - | - | - | - | - | - | 100,000 |
| Total Directors' remuneration | 2,111,301 | 115,330 | 106,981 | - | 30,034 | 1,043,834 | | 3,407,480 |
| Other key management personnel (Group) | | | | | | | | |
| Mr Scott Hosking | 418,000 | 21,072 | 19,616 | - | 4,265 | 158,305 | 25.5% | 621,258 |
| Mr Tim Hosking | 452,807 | 70,922 | - | 41,409 | - | 141,370 | 20.0% | 706,508 |
| Mr Edward Munks | 522,500 | 3,042 | 19,616 | - | 9,961 | 367,831 | 39.9% | 922,950 |
| Total other key management personnel remuneration (Group) | 1,393,307 | 95,036 | 39,232 | 41,409 | 14,226 | 667,506 | | 2,250,716 |
| Total key management personnel remuneration (Group) | 3,504,608 | 210,366 | 146,213 | 41,409 | 44,260 | 1,711,340 | | 5,658,196 |

* The percentage of total remuneration consisting of share options and performance rights, based on the value of share options and performance rights expensed in the consolidated statement of profit or loss and other comprehensive income during the financial year.

** Includes non-cash share-based payments expense of \$167,057 relating to 2017 STI performance rights yet to be granted to Executive Directors, which were subject to achievement of performance hurdles from 1 July 2016 to 30 June 2017. The share-based payments expense was based on the achievement of 40% of the executive's performance hurdles and an estimation of fair value at grant date, with a vesting period of 1 July 2016 to 30 June 2018. The grant of 2017 STI performance rights for each of the Executive Directors is subject to shareholder approval at the 2017 Annual General Meeting.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 5. Statutory and Share-based Reporting continued

Details of the Remuneration of the Directors and Other Key Management Personnel continued

| Financial Year Ended 30 June 2016 | Short-term Benefits | | Post-employment Benefits | | Long-term Benefits | Share-based Payments Expense | Remuneration Consisting of Share Options and Performance Rights | Total Remun- eration |
|---|-------------------------------------|------------------------------------|---------------------------------------|--|--------------------------------|--|--|----------------------------|
| Name | Cash Salary and Fees \$ | Non- monetary Benefits \$ | Superannuation Contributions \$ | Social Security and Indemnity Fund Contributions \$ | Long Service Leave \$ | Share Options/ Performance Rights** \$ | %* | \$ |
| Executive Directors | | | | | | | | |
| Mr Robert Hosking | 599,691 | 62,570 | 19,308 | - | 13,757 | 327,767 | 32.0% | 1,023,093 |
| Mr Mark Smith | 573,782 | 16,533 | 19,308 | - | 3,725 | 327,767 | 34.8% | 941,115 |
| Non-Executive Directors | | | | | | | | |
| Dr David Klingner | 220,000 | - | 19,308 | - | - | - | - | 239,308 |
| Mr Geoff Atkins | 142,000 | - | 13,490 | - | - | - | - | 155,490 |
| Mr Clark Davey | 156,000 | - | 14,820 | - | - | - | - | 170,820 |
| Mr Peter Turnbull | 157,000 | - | 14,915 | - | - | - | - | 171,915 |
| Mr Bernard Wheelahan | 124,000 | - | 11,780 | - | - | - | - | 135,780 |
| Mr Jose Coutinho Barbosa | 100,000 | - | - | - | - | 35,630 | 26.3% | 135,630 |
| Total Directors' remuneration | 2,072,473 | 79,103 | 112,929 | - | 17,482 | 691,164 | | 2,973,151 |
| Other key management personnel (Group) | | | | | | | | |
| Mr Scott Hosking | 418,000 | 26,165 | 19,308 | - | 16,686 | 209,575 | 30.4% | 689,734 |
| Mr Tim Hosking | 393,712 | 10,562 | - | 32,966 | - | 184,832 | 29.7% | 622,072 |
| Mr Edward Munks | 522,500 | 2,060 | 19,308 | - | 12,032 | 345,393 | 38.3% | 901,293 |
| Total other key management personnel remuneration (Group) | 1,334,212 | 38,787 | 38,616 | 32,966 | 28,718 | 739,800 | | 2,213,099 |
| Total key management personnel remuneration (Group) | 3,406,685 | 117,890 | 151,545 | 32,966 | 46,200 | 1,430,964 | | 5,186,250 |

* The percentage of total remuneration consisting of share options and performance rights, based on the value of share options and performance rights expensed in the consolidated statement of profit or loss and other comprehensive income during the previous financial year.

** Included non-cash share-based payments expense of \$236,478 relating to 2016 STI performance rights yet to be granted to Executive Directors, which were subject to achievement of performance hurdles from 1 July 2015 to 30 June 2016. The share-based payments expense was based on the achievement of 55% of the executive's performance hurdles and an estimation of fair value at grant date, with a vesting period of 1 July 2015 to 30 June 2017. The grant of 2016 STI performance rights for each of the Executive Directors was subsequently approved by shareholders at the 2016 Annual General Meeting.

The amounts disclosed for the remuneration of Directors and other key management personnel include the assessed fair values of share options and performance rights granted during the financial year, at the date they were granted. The value attributable to share options and performance rights is allocated to particular financial periods in accordance with AASB 2 'Share-based Payment', which requires the value of a share option and performance right at grant date to be allocated equally over the period from grant date to vesting date, adjusted for not meeting the vesting condition. For share options and performance rights that vest immediately, the value is disclosed as remuneration immediately, in accordance with the accounting policy described in Note 1(p) of the consolidated financial statements.

Fair value of share options are assessed under the Black-Scholes option pricing model. The Black-Scholes option pricing model takes into account the exercise price, the term of the share option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the share option.

Fair values of performance rights were based on the Company's closing share price at grant date.

The relative percentage proportions of remuneration that are linked to performance conditions, those that are not and those that are fixed are as follows:

| Name | Related to Performance Conditions | | | | | | | | | | | |
|---|-----------------------------------|-------|--------------------------|-------|--------------------------|------|------------------|-------|--------------|------|--|--------------------|
| | Fixed Remuneration | | STI (Performance Rights) | | LTI (Performance Rights) | | LTI [^] | | Cash-settled | | Remuneration Consisting of Share Options ^{^^} | |
| | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2017 | 2017 | 2016 |
| Executive Directors | | | | | | | | | | | | |
| Mr Robert Hosking | 58.3% | 67.9% | 13.8% | 15.7% | 8.6% | 1.5% | 19.3% | 14.9% | - | - | 19.3% | 14.9% |
| Mr Mark Smith | 55.0% | 65.2% | 14.9% | 17.0% | 9.3% | 1.6% | 20.8% | 16.2% | - | - | 20.8% | 16.2% |
| Non-Executive Directors | | | | | | | | | | | | |
| Dr David Klingner | 100% | 100% | - | - | - | - | - | - | - | - | - | - |
| Ms Luciana Rachid (appointed 26 August 2016) | 100% | - | - | - | - | - | - | - | - | - | - | - |
| Mr Geoff Atkins | 100% | 100% | - | - | - | - | - | - | - | - | - | - |
| Mr Clark Davey | 100% | 100% | - | - | - | - | - | - | - | - | - | - |
| Mr Peter Turnbull | 100% | 100% | - | - | - | - | - | - | - | - | - | - |
| Mr Bernard Wheelahan (resigned 30 November 2016) | 100% | 100% | - | - | - | - | - | - | - | - | - | - |
| Mr Jose Coutinho Barbosa | 100% | 73.7% | - | - | - | - | - | - | - | - | - | 26.3% [#] |
| Other key management personnel (Group) | | | | | | | | | | | | |
| Mr Scott Hosking | 74.5% | 69.6% | - | 12.1% | - | 1.8% | 7.9% | 16.5% | 10.0% | 7.6% | 7.9% | 16.5% |
| Mr Tim Hosking | 80.0% | 70.3% | - | 12.5% | - | 1.9% | 6.1% | 15.3% | 8.5% | 5.4% | 6.1% | 15.3% |
| Mr Edward Munks | 60.1% | 61.7% | 14.5% | 11.5% | 9.1% | 2.4% | 16.3% | 24.4% | - | - | 16.3% | 24.4% |

[^] Karoon Gas Australia 2016 Employee Share Option Plan and Karoon Gas Australia 2012 Employee Share Option Plan options (2016: Karoon Gas Australia 2012 Employee Share Option Plan option).

^{^^} The percentage of total remuneration consisting of share options, based on the value of share options expensed in the consolidated statement of profit or loss and other comprehensive income during the financial year and previous financial year.

[#] 26.3% was represented by other share options.

Further information on share options and performance rights is set out in Note 27 of the consolidated financial statements.

Amounts disclosed for remuneration of Directors and other key management personnel exclude insurance premiums paid by the Company in respect of Directors' and officers' liability insurance contracts, as the contracts do not specify premiums paid in respect of individual Directors and officers. Information relating to insurance contracts is set out in this Directors' Report.

Share-based Remuneration

The issuance of share options and performance rights under the 2016 ESOP, 2016 PRP, 2012 ESOP and 2012 PRP is capped at 5% of the Company's total number of ordinary shares on issue and the Board of Directors is conscious of ensuring that the dilutionary effect of the issuance of share options and performance rights is kept to a minimum. The lowest exercise price of any share option on issuance is currently \$1.82 and the highest exercise price is \$3.04. There is currently 4,446,619 share options (4,446,619 remain unvested) and 3,318,202 performance rights issued under the 2016 or 2012 ESOPs and 2016 or 2012 PRPs respectively, representing approximately 3.16% of the Company's total number of ordinary shares issued.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 5. Statutory and Share-based Reporting continued

Share-based Remuneration continued

The terms and conditions of each grant of share options and performance rights over unissued ordinary shares in the Company affecting remuneration in the current or a future financial year are as follows:

| Grant Date | Date Vested and Exercisable | Expiry Date | Exercise Price Per Share Option or Performance Right | Fair Value Per Share Option or Performance Right at Grant Date | % Vested | Performance Condition Achieved |
|---------------------------|-----------------------------|------------------|--|--|----------|--------------------------------|
| ESOP options | | | | | | |
| 22 August 2014 | 1 July 2017 | 30 June 2018 | \$4.06 | \$1.38 | - | 0% |
| 29 August 2014 | 1 July 2017 | 30 June 2018 | \$4.06 | \$1.49 | - | 0% |
| 3 November 2014 | 1 July 2017 | 30 June 2018 | \$4.06 | \$0.77 | - | 0% |
| 17 February 2015 | 1 July 2017 | 30 June 2018 | \$4.06 | \$0.59 | - | 0% |
| 23 January 2015 | 1 January 2018 | 30 December 2018 | \$4.06 | \$0.43 | - | 0% |
| 9 October 2015 | 1 July 2018 | 30 June 2019 | \$3.04 | \$0.66 | - | To be determined |
| 30 October 2015 | 1 July 2018 | 30 June 2019 | \$3.04 | \$0.48 | - | To be determined |
| 30 November 2016 | 1 July 2019 | 30 June 2020 | \$1.82 | \$0.69 | - | To be determined |
| 2 December 2016 | 1 July 2019 | 30 June 2020 | \$1.82 | \$0.78 | - | To be determined |
| 2 December 2016 | 1 July 2019 | 30 June 2020 | \$1.82 | \$0.78 | - | To be determined |
| Performance rights | | | | | | |
| 9 October 2015 | 1 July 2018 | 30 June 2019 | \$- | \$2.08 | - | To be determined |
| 30 October 2015 | 1 July 2018 | 30 June 2019 | \$- | \$1.775 | - | To be determined |
| 2 December 2016 | 1 July 2017 | 30 June 2018 | \$- | \$1.97 | - | 55% |
| 30 November 2016 | 1 July 2018 | 30 June 2019 | \$- | \$1.86 | - | 47% |
| 2 December 2016 | 1 July 2018 | 30 June 2019 | \$- | \$1.97 | - | 47% |
| 30 November 2016 | 1 July 2019 | 30 June 2020 | \$- | \$1.86 | - | To be determined |
| 2 December 2016 | 1 July 2019 | 30 June 2020 | \$- | \$1.97 | - | To be determined |
| 2 December 2016 | 1 July 2019 | 30 June 2020 | \$- | \$1.97 | - | To be determined |

Share options and performance rights are granted for no consideration.

Share options and performance rights granted carry no dividend or voting rights.

Number of Share Options and Performance Rights Provided as Remuneration during the Financial Year

Details of share options and performance rights over unissued ordinary shares in the Company provided as remuneration to each Director and each of the other key management personnel are set out below:

| Name | Number of Share Options and Performance Rights Granted During Financial Year | Fair Value Per Share Options and Performance Rights at Grant Date* | Value of Share Options and Performance Rights at Grant Date* | Number of Share Options and Performance Rights Vested During Financial Year | Number of Share Options and Performance Rights Forfeited | Value of Share Options and Performance Rights Forfeited** |
|---|--|--|--|---|--|---|
| Executive Directors | | | | | | |
| Mr Robert Hosking | | | | | | |
| – ESOP options | 423,376 | \$0.78 | \$330,233 | - | - | - |
| – Performance rights | 298,472 | \$1.97 | \$587,990 | 73,187 | - | - |
| Mr Mark Smith | | | | | | |
| – ESOP options | 423,376 | \$0.78 | \$330,233 | - | - | - |
| – Performance rights | 298,472 | \$1.97 | \$587,990 | 73,187 | - | - |
| Non-Executive Directors | | | | | | |
| Mr Jose Coutinho Barbosa | | | | | | |
| – ESOP options | 12,140 | \$0.78 | \$9,469 | - | - | - |
| – Performance rights | 31,321 | \$1.97 | \$61,702 | - | - | - |
| Other key management personnel (Group) | | | | | | |
| Mr Scott Hosking | | | | | | |
| – ESOP options | 98,368 | \$0.69 | \$67,874 | - | 91,112 | \$119,357 |
| – Performance rights | 253,786 | \$1.86 | \$472,042 | - | 32,154 | \$42,122 |
| Mr Tim Hosking | | | | | | |
| – ESOP options | 158,748 | \$0.78 | \$123,823 | - | 59,009 | \$77,302 |
| – Performance rights | 216,828 | \$1.97 | \$427,151 | - | 31,134 | \$40,786 |
| Mr Edward Munks | | | | | | |
| – ESOP options | 122,960 | \$0.69 | \$84,842 | - | 109,170 | \$143,013 |
| – Performance rights | 317,232 | \$1.86 | \$590,052 | 42,511 | 40,192 | \$52,652 |
| Total key management personnel | | | | | | |
| – Share options | 1,238,968 | | \$946,474 | - | 259,291 | \$339,672 |
| – Performance rights | 1,416,111 | | \$2,726,927 | 188,885 | 103,480 | \$135,560 |

* The value at grant date, calculated in accordance with AASB 2 'Share-based Payment', of share options and performance rights granted during the financial year as part of their remuneration.

** The value of other performance rights forfeited during the financial year because a vesting condition was not satisfied was determined at the time of forfeit (28 July 2016), but assuming the condition was satisfied, based on the intrinsic value of the performance rights at that date.

No share options or performance rights over unissued ordinary shares in the Company, held by any Director or other key management personnel, lapsed during the financial year, except for 362,771 share options that were forfeited by other key management personnel.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 5. Statutory and Share-based Reporting continued

Shares Issued on the Exercise of Share Options Provided as Remuneration

No share options were exercised by any Director or other key management personnel during the financial year.

Shares Issued on the Conversion of Performance Rights Provided as Remuneration

Details of fully paid ordinary shares in the Company issued as a result of the exercise and conversion of remuneration performance rights to each Director and other key management personnel during the financial year are set out below:

| Name | Date of Conversion of Performance Rights | Number of Ordinary Shares Issued | Value at Conversion Date* | Amount Paid Per Performance Right |
|---|--|----------------------------------|---------------------------|-----------------------------------|
| Other key management personnel (Group) | | | | |
| Mr Robert Hosking | 7 February 2017 | 73,187 | \$127,711 | \$- |
| Mr Mark Smith | 7 February 2017 | 73,187 | \$127,711 | \$- |
| Mr Edward Munks | 2 August 2016 | 42,511 | \$54,414 | \$- |
| | | 188,885 | \$309,836 | |

* The value at conversion date of performance rights that were granted as part of their remuneration and were converted during the financial year has been determined as the intrinsic value of the performance rights at that date.

No amounts are unpaid on any ordinary shares issued on the conversion of the above remuneration performance rights.

Details of Remuneration – Share Options and Performance Rights

For each grant of share options or performance rights in current or previous financial years which results in an amount being disclosed in the Remuneration Report as a share-based payment expense in the financial year to Directors and other key management personnel, the percentage of the grant that vested in the financial year and the percentage that was forfeited because the individual did not meet the service and/or predetermined performance conditions is set out below:

| Name | Financial Year End Granted | Vested % | Forfeited % | Financial Years in Which Share Options or Performance Rights May Vest | Maximum Total Value of Grant Yet to Vest |
|----------------------------|----------------------------|----------|-------------|---|--|
| Executive Directors | | | | | |
| Mr Robert Hosking | | | | | |
| – ESOP options | 30 June 2015 | - | - | 30 June 2018 | \$- |
| – ESOP options | 30 June 2016 | - | - | 30 June 2019 | \$44,308 |
| – Performance rights | 30 June 2016 | - | - | 30 June 2019 | \$23,106 |
| – ESOP options | 30 June 2017 | - | - | 30 June 2020 | \$256,185 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2018 | \$- |
| – Performance rights | 30 June 2017 | - | - | 30 June 2020 | \$293,838 |
| Mr Mark Smith | | | | | |
| – ESOP options | 30 June 2015 | - | - | 30 June 2018 | \$- |
| – ESOP options | 30 June 2016 | - | - | 30 June 2019 | \$44,308 |
| – Performance rights | 30 June 2016 | - | - | 30 June 2019 | \$23,106 |
| – ESOP options | 30 June 2017 | - | - | 30 June 2020 | \$256,185 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2018 | \$- |
| – Performance rights | 30 June 2017 | - | - | 30 June 2020 | \$293,838 |

| Name | Financial Year End Granted | Vested % | Forfeited % | Financial Years in Which Share Options or Performance Rights May Vest | Maximum Total Value of Grant Yet to Vest |
|---|-------------------------------|-------------|----------------|---|--|
| Other key management personnel (Group) | | | | | |
| Mr Scott Hosking | | | | | |
| – ESOP options | 30 June 2015 | - | - | 30 June 2018 | \$- |
| – ESOP options | 30 June 2016 | - | - | 30 June 2019 | \$2,043 |
| – Performance rights | 30 June 2016 | - | 36% | 30 June 2018 | \$- |
| – Performance rights | 30 June 2016 | - | - | 30 June 2019 | \$22,382 |
| – ESOP options | 30 June 2017 | - | - | 30 June 2020 | \$15,991 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2018 | \$62,748 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2020 | \$103,547 |
| Mr Tim Hosking | | | | | |
| – ESOP options | 30 June 2015 | - | - | 30 June 2018 | \$- |
| – ESOP options | 30 June 2016 | - | - | 30 June 2019 | \$1,978 |
| – Performance rights | 30 June 2016 | - | 36% | 30 June 2018 | \$- |
| – Performance rights | 30 June 2016 | - | - | 30 June 2019 | \$21,672 |
| – ESOP options | 30 June 2017 | - | - | 30 June 2020 | \$25,862 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2018 | \$60,969 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2020 | \$71,769 |
| Mr Edward Munks | | | | | |
| – ESOP options | 30 June 2015 | - | - | 30 June 2018 | \$- |
| – ESOP options | 30 June 2016 | - | - | 30 June 2019 | \$12,356 |
| – Performance rights | 30 June 2016 | - | 36% | 30 June 2018 | \$- |
| – Performance rights | 30 June 2016 | - | - | 30 June 2019 | \$29,794 |
| – ESOP options | 30 June 2017 | - | - | 30 June 2020 | \$65,679 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2018 | \$126,030 |
| – Performance rights | 30 June 2017 | - | - | 30 June 2020 | \$93,525 |

No share options or performance rights will vest if the service and/or predetermined performance conditions are not met, therefore the minimum value of the share option or performance right yet to vest is \$Nil.

The maximum value of share options and performance rights yet to vest was determined as the amount of the grant date fair value of the share options or performance rights that is yet to be expensed in the consolidated statement of profit or loss and other comprehensive income.

Share Options and Performance Rights over Unissued Ordinary Shares in the Company as at 30 June 2017

During the financial year 1,238,968 share options over unissued ordinary shares in the Company were issued to Directors and other key management personnel, including their personally related parties.

During the financial year 1,416,111 performance rights over unissued ordinary shares in the Company were issued to Directors and other key management personnel, including their personally related parties.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 5. Statutory and Share-based Reporting continued

Share Options and Performance Rights over Unissued Ordinary Shares in the Company as at 30 June 2017 continued

The movement of share options and performance rights over unissued ordinary shares in the Company held by Directors and other key management personnel, including their personally related parties, during the financial year was as follows:

| | Balance as at 1 July 2016 | Granted as Remuneration | Exercised (Share Options)/ Vested and Converted (Performance Rights) | Cash-settled | Share Options or Performance Rights Forfeited | Balance as at 30 June 2017 | Total Vested and Exercisable as at 30 June 2017 | Total Unvested as at 30 June 2017 |
|--|---------------------------|-------------------------|--|--------------|---|----------------------------|---|-----------------------------------|
| Executive Directors | | | | | | | | |
| Mr Robert Hosking | | | | | | | | |
| – ESOP options | 915,219 | 423,376 | - | - | - | 1,338,595 | - | 1,338,595 |
| – Performance rights | 142,417 | 298,472 | (73,187) | - | - | 367,702 | - | 367,702 |
| Mr Mark Smith | | | | | | | | |
| – ESOP options | 915,219 | 423,376 | - | - | - | 1,338,595 | - | 1,338,595 |
| – Performance rights | 142,417 | 298,472 | (73,187) | - | - | 367,702 | - | 367,702 |
| Non-Executive Directors | | | | | | | | |
| Dr David Klingner | - | - | - | - | - | - | - | - |
| Ms Luciana Rachid (appointed 26 August 2016) | - | - | - | - | - | - | - | - |
| Mr Geoff Atkins | - | - | - | - | - | - | - | - |
| Mr Clark Davey | - | - | - | - | - | - | - | - |
| Mr Peter Turnbull | - | - | - | - | - | - | - | - |
| Mr Bernard Wheelahan (resigned 30 November 2016) | - | - | - | - | - | - | - | - |
| Mr Jose Coutinho Barbosa | | | | | | | | |
| – ESOP options | - | 12,140 | - | - | - | 12,140 | - | 12,140 |
| – Performance rights | - | 31,321 | - | - | - | 31,321 | - | 31,321 |
| Other key management personnel | | | | | | | | |
| Mr Scott Hosking | | | | | | | | |
| – ESOP options | 424,474 | 98,368 | - | - | (91,112) | 431,730 | - | 431,730 |
| – Performance rights | 167,983 | 253,786 | - | (34,009) | (32,154) | 355,606 | - | 355,606 |
| Mr Tim Hosking | | | | | | | | |
| – ESOP options | 364,443 | 158,748 | - | - | (59,009) | 464,182 | - | 464,182 |
| – Performance rights | 159,663 | 216,828 | - | (29,937) | (31,134) | 315,420 | - | 315,420 |
| Mr Edward Munks | | | | | | | | |
| – ESOP options | 457,776 | 122,960 | - | - | (109,170) | 471,566 | - | 471,566 |
| – Performance rights | 232,308 | 317,232 | (42,511) | - | (40,192) | 466,837 | - | 466,837 |
| Total key management personnel | | | | | | | | |
| – Share options | 3,077,131 | 1,238,968 | - | - | (259,291) | 4,056,808 | - | 4,056,808 |
| – Performance rights | 844,788 | 1,416,111 | (188,885) | (63,946) | (103,480) | 1,904,588 | - | 1,904,588 |

All ESOP options issued during the financial year were issued under the Karoon Gas Australia 2016 Employee Share Option Plan. All performance rights issued during the financial year were issued under the Karoon Gas Australia 2016 PRP.

The number of ordinary shares held by Directors and other key management personnel, including their personally related parties, as at 30 June 2017 was as follows:

| | Balance as at 1 July 2016 | Received as Remuneration | Exercised (Share Options)/ Vested and Converted (Performance Rights) | Ordinary Shares Purchased | Ordinary Shares Sold | Other | Balance as at 30 June 2017 |
|--|---------------------------|--------------------------|--|---------------------------|----------------------|----------|----------------------------|
| Executive Directors | | | | | | | |
| Mr Robert Hosking | 12,244,222 | - | 73,187 | - | (70,000) | - | 12,247,409 |
| Mr Mark Smith | 2,892,037 | - | 73,187 | - | (200,000) | - | 2,765,224 |
| Non-Executive Directors | | | | | | | |
| Dr David Klingner | 103,591 | - | - | - | - | - | 103,591 |
| Ms Luciana Rachid (appointed 26 August 2016) | - | - | - | - | - | - | - |
| Mr Geoff Atkins | 720,676 | - | - | - | - | - | 720,676 |
| Mr Clark Davey | 24,294 | - | - | - | - | - | 24,294 |
| Mr Peter Turnbull | 32,500 | - | - | 8,500 | - | - | 41,000 |
| Mr Bernard Wheelahan (resigned 30 November 2016) | 80,000 | - | - | - | - | (80,000) | - |
| Mr Jose Coutinho Barbosa | - | - | - | - | - | - | - |
| Other key management personnel | | | | | | | |
| Mr Scott Hosking | 195,206 | - | - | - | - | - | 195,206 |
| Mr Tim Hosking | 244,571 | - | - | - | - | - | 244,571 |
| Mr Edward Munks | 787,186 | - | 42,511 | - | - | - | 829,697 |
| Total key management personnel | 17,324,283 | - | 188,885 | 8,500 | (270,000) | (80,000) | 17,171,668 |

None of the ordinary shares are held nominally by any Director or any of the other key management personnel. 'Held nominally' refers to the situation where the ordinary shares are in the name of the Director or other key management person, but he is not the beneficial owner.

Loans to Directors and Other Key Management Personnel

There were no loans to Directors or other key management personnel during the financial year.

Other Transactions with Directors and Other Key Management Personnel

A formal Related Party Protocol was adopted by the Board of Directors during the 2015 financial year, this protocol requires the approval by the Risk and Governance Committee and, thereafter, the Board of Directors of all new related party transactions.

There were no new related party transactions during the financial year. The relationships described below are carried forward from the previous financial year.

During the financial year, Mr Jose Coutinho Barbosa, a Non-Executive Director, had an interest in Net Pay Óleo & Gás Consultoria Ltda that provided business and geology consulting services to the Group. The value of these transactions during the financial year in the Group was \$332,210. The balance outstanding included in current trade and other payables is \$27,149. Given Karoon's relative size to other operators in Brazil, the consulting services provided by Net Pay Óleo & Gás Consultoria Ltda are critical to Karoon's ability to operate within the Brazilian oil industry.

During the financial year, Ms Flavia Barbosa, the daughter of a Non-Executive Director, was employed by the Group as the in-house Legal Counsel in Brazil. The total value of her remuneration (including share-based payments expense) during the financial year was \$242,372, which includes social security and indemnity fund contributions of \$16,535. Ms Barbosa has been an employee of the Company since 2011, and has a comprehensive understanding of the Brazilian legal and regulatory framework.

During the financial year Ms Marina Sayao, the wife of Mr Tim Hosking (a key management person), was employed by the Group on a full-time basis until August 2016 and then on a part-time basis from September 2016 as the Sustainability and Communications Manager South America. The total value of her remuneration during the financial year was \$152,478, which includes social security and indemnity fund contributions of \$34,967. Ms Sayao is a key member of the South American operations. The Brazilian and Peruvian regulatory and business environments require transparent and clear communication on social and environmental issues with local and federal governments.

DIRECTORS' REPORT (continued)

Remuneration Report (Audited) continued

Section 5. Statutory and Share-based Reporting continued

Other Transactions with Directors and Other Key Management Personnel continued

During the financial year, Mr Mark Smith, an Executive Director, had an interest in IERS (Australia) Pty Ltd, which has an ongoing informal agreement with the Group to provide geophysical fault seal analysis software. This agreement does not include monetary compensation, instead the Group provides testing and ongoing development of the geophysical fault seal analysis software in return for its use.

Matters Arising Subsequent to the End of the Financial Year

Other than the matters disclosed in Note 30 of the consolidated financial statements, no other matter or circumstance has arisen since 30 June 2017 that has significantly affected, or may significantly affect:

- (a) the Group's operations in future financial years;
- (b) the results of those operations in future financial years; or
- (c) the Group's state of affairs in future financial years.

This Directors' Report, incorporating the Remuneration Report, is made in accordance with a resolution of the Directors.

On behalf of the Directors:



Dr David Klingner
Independent Non-Executive Chairman



Mr Robert Hosking
Managing Director

21 September 2017

AUDITOR'S INDEPENDENCE DECLARATION



Auditor's Independence Declaration

As lead auditor for the audit of Karoon Gas Australia Ltd for the financial year ended 30 June 2017, I declare that to the best of my knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

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

A handwritten signature in black ink, appearing to read 'Charles Christie'.

Charles Christie
Partner
PricewaterhouseCoopers

Melbourne
21 September 2017

PricewaterhouseCoopers, ABN 52 780 433 757
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Liability limited by a scheme approved under Professional Standards Legislation.

CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017

Karoon Gas Australia Ltd (the 'Company') is a public company limited by shares and is listed on the ASX. It is incorporated and domiciled in Australia. The registered office of Karoon Gas Australia Ltd is Office 7A, 34-38 Lochiel Avenue, Mt Martha VIC 3934. The principal place of business is Level 25, 367 Collins Street, Melbourne VIC 3000.

The consolidated financial statements are for the consolidated entity consisting of Karoon Gas Australia Ltd and its subsidiaries.

The consolidated financial statements are presented in Australian dollars.

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|---|----|
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CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the Financial Year Ended 30 June 2017

| | | Consolidated | |
|---|------|----------------------|----------------------|
| | Note | 2017 \$ | 2016 \$ |
| Revenue | 4 | 858,356 | 1,608,292 |
| Other income | 4 | - | 21,989,448 |
| Total revenue and other income | | 858,356 | 23,597,740 |
| Business development and other project costs | 5 | (4,526,430) | (1,674,246) |
| Computer support | | (1,669,920) | (1,333,518) |
| Consulting fees | | (731,292) | (585,850) |
| Depreciation and amortisation expense | 5 | (1,048,998) | (1,207,125) |
| Drilling rig mobilisation expense | 5 | (16,513,578) | - |
| Employee benefits expense (net) | | (12,651,679) | (11,888,746) |
| Exploration and evaluation expenditure expensed, impaired or written-off | 5 | (34,496,452) | (150,466,951) |
| Farm-out costs | | (418,848) | (430,310) |
| Finance costs | 5 | (339,322) | (209,149) |
| Insurance expense | | (354,334) | (274,921) |
| Write-down of inventory to net realisable value | | (1,326,811) | - |
| Legal fees | | (294,799) | (138,636) |
| Net foreign currency losses | | (13,909,734) | - |
| Property costs | | (2,279,177) | (2,199,899) |
| Share registry and listing fees | | (182,727) | (211,705) |
| Telephone and communication expenses | | (302,819) | (329,146) |
| Travel and accommodation expenses | | (597,297) | (902,068) |
| Other expenses | | (941,987) | (1,176,303) |
| Total expenses | | (92,586,204) | (173,028,573) |
| Loss before income tax | | (91,727,848) | (149,430,833) |
| Tax income | 6 | 10,200,335 | 44,304,488 |
| Loss for financial year attributable to equity holders of the Company | | (81,527,513) | (105,126,345) |
| Other comprehensive income, net of income tax: | | | |
| Items that may be reclassified subsequently to profit or loss | | | |
| Exchange differences arising from the translation of financial statements of foreign subsidiaries | | (20,215,327) | 3,892,203 |
| Other comprehensive income (loss) for financial year, net of income tax | | (20,215,327) | 3,892,203 |
| Total comprehensive loss for financial year attributable to equity holders of the Company, net of income tax | | (101,742,840) | (101,234,142) |
| Loss per share attributable to equity holders of the Company: | | | |
| Basic loss per ordinary share | 9 | (0.3327) | (0.4275) |
| Diluted loss per ordinary share | 9 | (0.3327) | (0.4275) |

The above consolidated statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2017

| | | Consolidated | |
|--|------|--------------------|--------------|
| | Note | 2017 | 2016 |
| | | \$ | \$ |
| Current assets | | | |
| Cash and cash equivalents | 10 | 375,069,427 | 479,590,366 |
| Receivables | 11 | 1,430,487 | 3,672,007 |
| Inventories | 12 | 10,858 | 3,361,581 |
| Security deposits | 13 | 24,746 | 421,318 |
| Current tax asset | 6 | 391,020 | 431,059 |
| Other assets | 14 | 2,129,830 | 2,055,438 |
| Total current assets | | 379,056,368 | 489,531,769 |
| Non-current assets | | | |
| Inventories | 12 | 46,368,852 | 38,487,405 |
| Plant and equipment | 15 | 1,139,163 | 1,603,216 |
| Intangible assets | 16 | 1,167,575 | 1,116,739 |
| Exploration and evaluation expenditure carried forward | 17 | 371,029,112 | 376,766,598 |
| Security deposits | 13 | 7,808,766 | 9,681,592 |
| Total non-current assets | | 427,513,468 | 427,655,550 |
| Total assets | | 806,569,836 | 917,187,319 |
| Current liabilities | | | |
| Trade and other payables | 18 | 12,234,940 | 13,512,663 |
| Provisions | 19 | 246,647 | 287,448 |
| Total current liabilities | | 12,481,587 | 13,800,111 |
| Non-current liabilities | | | |
| Trade and other payables | 18 | 318,976 | 504,771 |
| Deferred tax liabilities | 6 | 34,585,784 | 44,655,826 |
| Provisions | 19 | 291,324 | 263,864 |
| Total non-current liabilities | | 35,196,084 | 45,424,461 |
| Total liabilities | | 47,677,671 | 59,224,572 |
| Net assets | | 758,892,165 | 857,962,747 |
| Equity | | | |
| Contributed equity | 20 | 802,295,334 | 802,967,815 |
| (Accumulated losses) retained earnings | | (32,948,904) | 48,578,609 |
| Share-based payments reserve | | 43,534,615 | 40,189,876 |
| Foreign currency translation reserve | | (53,988,880) | (33,773,553) |
| Total equity | | 758,892,165 | 857,962,747 |

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the Financial Year Ended 30 June 2017

| | Contributed Equity \$ | Consolidated Retained Earnings (Accumulated Losses) \$ | Share-based Payments Reserve \$ | Foreign Currency Translation Reserve \$ | Total Equity \$ |
|---|-----------------------------|---|--|---|-----------------------|
| Balance as at 1 July 2015 | 805,529,759 | 153,704,954 | 36,936,683 | (37,665,756) | 958,505,640 |
| Loss for financial year | - | (105,126,345) | - | - | (105,126,345) |
| Exchange differences arising from the translation of financial statements of foreign subsidiaries | - | - | - | 3,892,203 | 3,892,203 |
| Total comprehensive loss for financial year | - | (105,126,345) | - | 3,892,203 | (101,234,142) |
| Transactions with owners in their capacity as owners: | | | | | |
| Ordinary shares bought back (on-market) and cancelled | (2,564,577) | - | - | - | (2,564,577) |
| Share buy-back transaction costs | 2,633 | - | - | - | 2,633 |
| Share-based payments expense | - | - | 3,253,193 | - | 3,253,193 |
| | (2,561,944) | - | 3,253,193 | - | 691,249 |
| Balance as at 30 June 2016 | 802,967,815 | 48,578,609 | 40,189,876 | (33,773,553) | 857,962,747 |
| Loss for financial year | - | (81,527,513) | - | - | (81,527,513) |
| Exchange differences arising from the translation of financial statements of foreign subsidiaries | - | - | - | (20,215,327) | (20,215,327) |
| Total comprehensive loss for financial year | - | (81,527,513) | - | (20,215,327) | (101,742,840) |
| Transactions with owners in their capacity as owners: | | | | | |
| Ordinary shares bought back (on-market) and cancelled | (671,998) | - | - | - | (671,998) |
| Share buy-back transaction costs, net of tax | (483) | - | - | - | (483) |
| Share-based payments expense | - | - | 3,590,639 | - | 3,590,639 |
| Prior year adjustment to recognise cash-settled share-based payments | - | - | (245,900) | - | (245,900) |
| | (672,481) | - | 3,344,739 | - | 2,672,258 |
| Balance as at 30 June 2017 | 802,295,334 | (32,948,904) | 43,534,615 | (53,988,880) | 758,892,165 |

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

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Financial Year Ended 30 June 2017

| | Note | Consolidated | |
|--|-------|---------------------|--------------|
| | | 2017 \$ | 2016 \$ |
| Cash flows from operating activities | | | |
| Receipts from customers (inclusive of GST refunds) | | 2,009,829 | 1,785,684 |
| Payments to suppliers and employees (inclusive of GST) | | (38,048,826) | (19,572,992) |
| Payments for exploration and evaluation expenditure expensed | | (3,095,573) | (1,450,293) |
| Interest received | | 1,055,846 | 1,624,155 |
| Interest and other costs of finance paid | | (323,035) | (209,149) |
| Income taxes (paid) refund | | 144,422 | (13,387,200) |
| Net cash flows used in operating activities | 26(a) | (38,257,337) | (31,209,795) |
| Cash flows from investing activities | | | |
| Purchase of plant and equipment | | (200,862) | (297,921) |
| Purchase of computer software | | (216,670) | (878,694) |
| Payments for exploration and evaluation expenditure capitalised | | (52,476,682) | (52,798,565) |
| Repayment of security deposits | | 1,947,061 | 10,615 |
| Proceeds from disposal of non-current assets | | 100 | 3,086 |
| Net cash flows used in investing activities | | (50,947,053) | (53,961,479) |
| Cash flows from financing activities | | | |
| Share buy-back (on-market) | 20(b) | (672,687) | (2,566,955) |
| Payments for finance lease | | (66,150) | - |
| Net cash flows used in financing activities | | (738,837) | (2,566,955) |
| Net decrease in cash and cash equivalents | | (89,943,227) | (87,738,229) |
| Cash and cash equivalents at beginning of financial year | | 479,590,366 | 553,091,340 |
| Effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies | | (14,577,712) | 14,237,255 |
| Cash and cash equivalents at end of financial year | 10 | 375,069,427 | 479,590,366 |

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017

Note 1. Significant Accounting Policies

The consolidated financial statements are for the consolidated entity consisting of Karoon Gas Australia Ltd and its subsidiaries (the 'Group'). Information on the nature of the operations and principal activities of the Group are described in the Directors' Report.

The following is a summary of significant accounting policies adopted by the Group in the preparation of these consolidated financial statements. The accounting policies have been consistently applied to all the financial years presented, unless otherwise stated.

(a) Basis of Preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board (the 'AASB') and the *Corporations Act 2001*. Karoon Gas Australia Ltd is a for-profit entity for the purpose of preparing financial statements.

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

Currency of Presentation

The consolidated financial statements are presented in Australian dollars, which is the Company's functional and presentation currency.

Historical Cost Convention

The consolidated financial statements have been prepared on an accrual basis under the historical cost convention as modified, when relevant, by the revaluation of selected financial assets and financial liabilities for which the fair value basis of accounting has been applied.

Significant Accounting Estimates, Assumptions and Judgements

The preparation of financial statements requires the use of certain significant accounting estimates. It also requires management to exercise its judgement in the process of applying Group accounting policies. The areas involving a high degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 2.

Compliance with International Financial Reporting Standards

The consolidated financial statements comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

New or Revised Australian Accounting Standards and Interpretations that are First Effective in the Current Reporting Period

The Group has adopted all of the new and/or revised Australian Accounting Standards and Interpretations issued by the AASB that are relevant to its operations and effective for the financial year ended 30 June 2017.

New and revised Australian Accounting Standards and amendments thereof and Interpretations effective for the financial year that are relevant to the Group include:

- (i) AASB 2014-3 'Amendments to Australian Accounting Standards – Accounting for Acquisitions of Interests in Joint Operations'; and
- (ii) AASB 2015-2 'Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101'.

The adoption of all of the relevant new and/or revised Australian Accounting Standards and Interpretations has not resulted in any changes to the Group's accounting policies and has had no effect on either the amounts reported for the current or previous financial years.

Early Adoption of Australian Accounting Standards

The Group has not elected to apply any new or revised Australian Accounting Standards before their operative date in the financial year beginning 1 July 2016.

(b) Basis of Consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Karoon Gas Australia Ltd as at 30 June 2017 and the results of all subsidiaries for the financial year then ended.

Subsidiaries are all entities (including special purpose entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Interests in subsidiaries are set out in Note 21.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 1. Significant Accounting Policies continued

(b) Basis of Consolidation continued

All subsidiaries have a financial year end of 30 June, with the exception of: Karoon Petróleo and Gas Ltda; KEI (Peru 112) Pty Ltd, Sucursal del Peru; and KEI (Peru Z38) Pty Ltd, Sucursal del Peru. These subsidiaries and branches have a financial year end of 31 December in accordance with relevant Brazilian and Peruvian tax and accounting regulations respectively.

Accounting policies of subsidiaries have been changed, where necessary, to ensure consistency with the policies applied by the Group.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated on consolidation. Unrealised losses are also eliminated, unless the transaction provides evidence of the impairment of the asset transferred.

(c) Segment Information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for assessing performance and in determining the allocation of resources of the operating segments, has been identified as the Managing Director and the Executive Director/Exploration Director.

(d) Revenue

Revenue is recognised and measured at the fair value of the consideration received or receivable to the extent it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest Income

Interest income is recognised using the effective interest rate method, which, for floating rate financial assets, is the rate inherent in the relevant financial asset.

(e) Foreign Currency Transactions and Balances

Functional and Presentation Currency

Items included in the financial statements of each of the Group's subsidiaries are measured using the currency of the primary economic environment in which the subsidiary or branch operates (the 'functional currency').

Transactions and Balances

Foreign currency transactions are translated into the functional currency using the foreign exchange rates prevailing at the dates of the transactions. Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at financial year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of profit or loss and other comprehensive income, except when they are attributable to part of the net investment in a foreign operation.

Non-monetary items measured at historical cost continue to be carried at the foreign exchange rate at the date of transaction. Foreign exchange differences arising on the translation of non-monetary items are recognised directly in equity to the extent that the gain or loss is directly recognised in equity, otherwise foreign exchange differences are recognised in the consolidated statement of profit or loss and other comprehensive income.

Foreign exchange gains and losses are presented in the consolidated statement of profit or loss and other comprehensive income on a net basis within other income or expenses.

Group Companies

The results and financial position of foreign subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at end of reporting period foreign exchange rates prevailing at the end of each reporting period;
- income and expenses are translated at average foreign exchange rates for the financial period; and
- all resulting foreign exchange differences are recognised in other comprehensive income.

On consolidation, foreign exchange differences arising on translation of foreign subsidiary financial statements are transferred directly to the foreign currency translation reserve in the consolidated statement of financial position. The relevant differences are recognised in the consolidated statement of profit or loss and other comprehensive income during the financial period when the investment in a foreign subsidiary is disposed.

(f) Income Taxes and Other Taxes

Current Tax

Current tax (expense) income is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or loss for the financial period. It is calculated using income tax rates that have been enacted or are substantively enacted by the end of each reporting period. Current tax for current and previous financial periods is recognised as a liability (or asset) to the extent that it is unpaid or (refundable).

Deferred Tax

Deferred tax is accounted for using the statement of financial position liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. The tax base of an asset or liability is the amount attributed to that asset or liability for income taxation purposes.

No deferred tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are enacted or substantively enacted by the end of the financial period and are expected to apply to the financial period when the asset is realised or liability is settled. Deferred tax is credited in the consolidated statement of profit or loss and other comprehensive income except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary tax differences or unused tax losses and tax offsets can be utilised.

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

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the Group will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by law.

Tax Consolidation

The Parent Company and its wholly owned Australian subsidiaries are part of an income tax-consolidated group under Australian taxation law. Karoon Gas Australia Ltd is the head entity in the income tax-consolidated group. Tax income (expense), deferred tax liabilities and deferred tax assets arising from temporary tax differences of the members of the income tax-consolidated group are recognised in the separate financial statements of the members of the income tax-consolidated group using the 'stand alone taxpayer' approach by reference to the carrying amounts in the separate financial statements of each company and the tax values applying under tax consolidation. Current tax liabilities and tax assets and deferred tax assets arising from unused tax losses and tax credits of members of the income tax-consolidated group are recognised by the Parent Company (as head entity of the income tax-consolidated group).

Due to the existence of a tax funding agreement between the companies in the income tax-consolidated group, each company contributes to the income tax payable or receivable in proportion to their contribution to the income tax-consolidated group's taxable income. Differences between the amounts of net tax assets and tax liabilities derecognised and the net amounts recognised pursuant to the funding agreement are recognised as either a contribution by, or distribution to, the head entity.

Goods and Services Tax ('GST')

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office ('ATO'). In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or equity or as part of an item of expense.

Receivables and payables in the consolidated statement of financial position are shown inclusive of GST.

The net amount of GST recoverable from, or payable to, the ATO is included as current receivables or payables respectively in the consolidated statement of financial position.

Cash flows are included on a gross basis in the consolidated statement of cash flows. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, the ATO, are classified as operating cash flows.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 1. Significant Accounting Policies continued

(f) Income Taxes and Other Taxes continued

Petroleum Resource Rent Tax ('PRRT')

PRRT is accounted for as income tax under AASB 112 'Income Taxes'.

Research and Development Tax Incentives

Companies within the Group may be entitled to claim special tax deductions in relation to qualifying expenditure (e.g. the Research and Development Tax Incentive regime in Australia). A tax incentive refund is recognised when it is possible that the claim will be received. The claim is based upon the Group's interpretation as to the eligibility of its specific research and development activities. The Group accounts for such refunds as tax credits, which means that the incentive reduces income tax payable and current tax expense.

(g) Cash and Cash Equivalents

Cash and cash equivalents in the consolidated statement of financial position and for presentation in the consolidated statement of cash flows comprise cash at banks and on hand (including share of joint operation cash balances) and short-term bank deposits that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

(h) Receivables

Receivables, which generally have 30-day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less any accumulated impairment losses. They are presented as current assets unless collection is not expected for more than 12 months after the reporting date.

Cash flows relating to receivables are not discounted if the effect of discounting would be immaterial.

Collectability of receivables is reviewed on an ongoing basis. Individual receivables that are known to be uncollectible are written-off when identified.

Receivables are tested for impairment in accordance with the accounting policy described in Note 1(n). An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. The amount of the impairment loss is the receivable's carrying amount compared to the discounted value of estimated future cash flows, discounted when material, at the original effective interest rate.

(i) Inventories

Inventories are measured at the lower of cost and net realisable value. Inventories are represented by assets acquired from third parties, in the form of casing and other drilling inventory to be consumed or used in exploration and evaluation activities. They are presented as current assets unless inventories are not expected to be consumed or used in exploration and evaluation activities within 12 months.

The cost of casing and other drilling inventory includes direct materials, direct labour and transportation costs.

(j) Security Deposits

Certain financial assets have been pledged as security for performance guarantees, bank guarantees and bonds related to exploration tenements and operating lease rental agreements. Their realisation may be restricted subject to terms and conditions attached to the relevant exploration tenement agreements or operating lease rental agreements.

Security deposits are non-derivative financial assets that are not quoted in an active market. Security deposits are initially recognised at cost. Such assets are subsequently carried at amortised cost using the effective interest method. They are included in current assets, except for those with maturities greater than 12 months after the end of the reporting period which are classified as non-current assets.

Security deposits are derecognised when the terms and conditions attached to the relevant exploration tenement agreements or operating lease rental agreements have expired or been transferred.

Security deposits are tested for impairment in accordance with the accounting policy described in Note 1(n).

(k) Plant and Equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing parts that are eligible for capitalisation when the cost of replacing the parts is incurred. Similarly, when each major inspection is performed, its cost is recognised in the carrying amount of the plant and equipment as a replacement only if it is eligible for capitalisation. All other repairs and maintenance are recognised as an expense in the consolidated statement of profit or loss and other comprehensive income as incurred.

Commencing from the time the plant and equipment is held ready for use, depreciation expense is calculated on a straight-line basis to allocate their cost amount, net of their residual values, over their estimated useful lives ranging from 2 to 10 years.

Plant and equipment residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at the end of each reporting period.

Gains and losses on disposals are determined by comparing proceeds with the net carrying amount. These gains and losses are included in the consolidated statement of profit or loss and other comprehensive income.

Plant and equipment are tested for impairment in accordance with the accounting policy described in Note 1(n).

(l) Intangibles

Computer Software

Computer software is stated at cost less accumulated amortisation and any accumulated impairment losses. Computer software costs have a finite life.

Commencing from the time the computer software is held ready for use, amortisation expense is calculated on a straight-line basis to allocate their cost amount, net of their residual values, over their estimated useful lives ranging from 2 to 2.5 years.

The assets' residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at the end of each reporting period.

Computer software is tested for impairment in accordance with the accounting policy described in Note 1(n).

(m) Exploration and Evaluation Expenditure

Expenditure on exploration and evaluation activities is accounted for in accordance with the 'area of interest' method of AASB 6 '*Exploration for and Evaluation of Mineral Resources*'. Exploration and evaluation expenditure is capitalised at cost, as an intangible, provided the right to tenure of the area of interest is current and either:

- the exploration and evaluation activities are expected to be recouped through successful development and exploitation of the area of interest or, alternatively, by its sale; or
- exploration and evaluation activities in the area of interest have not at the end of the reporting period reached a stage that permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the area of interest are continuing.

Otherwise, exploration and evaluation expenditure is expensed as incurred.

Accumulated costs in relation to an abandoned area are written-off in full in the consolidated statement of profit or loss and other comprehensive income during the financial period in which the decision to abandon the area of interest is made.

As capitalised exploration and evaluation expenditure is not available for use, it is not amortised.

Cash flows associated with exploration and evaluation expenditure (comprising amounts capitalised) are classified as investing activities in the consolidated statement of cash flows. Whereas, cash flows associated with exploration and evaluation expenditure expensed are classified as operating activities.

When the technical feasibility and commercial viability of extracting economically recoverable reserves have been demonstrated, any related capitalised exploration and evaluation expenditure is reclassified as development expenditure in the consolidated statement of financial position. Prior to reclassification, capitalised exploration and evaluation expenditure is assessed for impairment.

Farm-out

The Group does not record any exploration and evaluation expenditure made by a farmee. It also does not recognise any gain or loss on its exploration and evaluation farm-out arrangements, but redesignates any exploration and evaluation expenditure previously capitalised in relation to the whole area of interest as relating to the partial interest retained.

Any cash consideration received on sale or farm-out of an area within an exploration area of interest is offset against the carrying value of the particular area involved. Where the total carrying value of an area of interest has been recouped in this manner, the balance of the proceeds is brought to account in the consolidated statement of profit or loss and other comprehensive income as a gain on disposal.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 1. Significant Accounting Policies continued

(m) Exploration and Evaluation Expenditure continued

Impairment of Capitalised Exploration and Evaluation Expenditure

The carrying value of capitalised exploration and evaluation expenditure is assessed for impairment at the asset or cash-generating unit level (which usually is represented by an exploration tenement) whenever facts and circumstances (as defined in AASB 6) suggest that the carrying amount of the asset may exceed its recoverable amount. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

An impairment loss exists when the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. The asset or cash-generating unit is then written-down to its recoverable amount. Impairment losses are recognised as an expense in the consolidated statement of profit or loss and other comprehensive income.

Capitalised exploration and evaluation expenditure that suffered impairment are tested for possible reversal of the impairment loss whenever facts or changes in circumstances indicate that the impairment may have reversed.

(n) Impairment of Assets (Other than Capitalised Exploration and Evaluation Expenditure)

All other current and non-current assets (other than inventories and deferred tax assets) are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

At the end of each reporting period, the Group conducts an internal review of asset values, which is used as a source of information to assess for any indicators of impairment. External factors, such as changes in economic conditions, are also monitored to assess for indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

An impairment loss exists when the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. The asset is then written-down to its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets (cash-generating units).

Impairment losses are recognised as an expense in the consolidated statement of profit or loss and other comprehensive income.

Assets that suffered impairment are tested for possible reversal of the impairment loss whenever events or changes in circumstances indicate that the impairment may have reversed.

(o) Trade and Other Payables

Trade and other payables are initially recognised at their fair value and subsequently measured at amortised cost using the effective interest method. These amounts represent liabilities for goods and services provided to the Group prior to the end of the reporting period that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of goods and services. The amounts are unsecured and are usually paid within 30 days of recognition. They are presented as current liabilities unless payment is not due within 12 months from the reporting date.

(p) Employee Benefits

Wages, Salaries, Annual Leave and Personal Leave

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months after the end of the reporting period in which the employees render the related services are recognised in respect of employees' services up to the end of the reporting period. They are measured at the amounts expected to be paid when the liabilities are settled plus related on-costs. Expenses for non-vesting personal leave are recognised when the leave is taken and are measured at the rates paid or payable.

The obligations are presented as current liabilities in the consolidated statement of financial position if the Group does not have an unconditional right to defer settlement for at least 12 months after the reporting date, regardless of when the actual settlement is expected to occur.

Share-based Payments

Share-based remuneration benefits are provided to Executive Directors and employees via the Company's PRP and ESOP (refer Note 27). The Group issues equity-settled and cash-settled share-based payments to certain employees.

The fair value of share options and performance rights granted is recognised as a share-based payments expense in the consolidated statement of profit or loss and other comprehensive income. The total amount to be expensed is determined by reference to the fair value of the share options and performance rights granted, which includes any market performance conditions, but excludes the impact of any service and non-market performance vesting conditions. Non-market performance vesting conditions are included in assumptions about the number of share options or performance rights that are expected to vest.

The fair value is measured at grant date. For equity-settled share-based payments the corresponding credit is recognised directly in the share-based payments reserve in equity. For cash-settled share-based payments a liability is recognised based on fair value of the payable earned by the end of the reporting period. The liability is remeasured to fair value at each reporting date up to, and including the vesting date, with changes in fair value recognised in share-based payments expense. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the Group revises its estimates of the number of share options and performance rights that are expected to vest based on the non-market performance vesting conditions. It recognises the impact of the revision to original estimates, if any, in the consolidated statement of profit or loss and other comprehensive income.

The fair value of share options at grant date is independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the share option, the impact of dilution, the non-tradeable nature of the share option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the share option.

The fair value of performance rights, granted for \$Nil consideration, at grant date is based on the Company's closing share price at that date.

(q) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Long Service Leave

A provision has been recognised for employee entitlements relating to long service leave measured at the discounted value of estimated future cash outflows. In determining the provision, consideration is given to employee wage increases and the probability that the employee may satisfy vesting requirements. The cash outflows are discounted using market yields with terms of maturity that match the expected timing of cash outflows.

Employee entitlements relating to long service leave are presented as a current provision in the consolidated statement of financial position if the Group does not have an unconditional right to defer settlement for at least 12 months after the reporting period, regardless of when the actual settlement is expected to occur.

(r) Contributed Equity

Ordinary shares are classified as equity.

Transaction costs directly attributable to the issue of new ordinary shares, share options or performance rights are shown in equity as a deduction, net of any related income tax, from the proceeds. Transaction costs are the costs that are incurred directly in connection with the issue of new ordinary shares and which would not have been incurred had those ordinary shares not been issued. These directly attributable transaction costs include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and marketing costs.

Where the Company acquires its own ordinary shares, as a result of a share buy-back, those ordinary shares are cancelled. No gain or loss is recognised and the consideration paid to acquire the ordinary shares, including any transaction costs directly attributable, net of any related income tax, is recognised directly as a reduction from equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 1. Significant Accounting Policies continued

(s) Interests in Joint Operations

A joint operation is a joint arrangement whereby the participants that have joint control of the arrangement (i.e. joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement.

The Group recognises assets, liabilities, revenues and expenses according to its share in the assets, liabilities, revenues and expenses of a joint operation or similar as determined and specified in contractual arrangements (joint operating agreements). These have been incorporated in the consolidated financial statements under the appropriate headings.

The Group's share of assets, liabilities, revenues and expenses employed in joint operations is set out in Note 23.

(t) Leases

A lease is classified as finance lease whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Group as a Lessee

Assets held under finance leases are initially recognised as an asset of the Group at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated statement of financial position. Lease payments are apportioned between finance charges and reduction of the finance lease liability so as to achieve a constant rate of interest on the remaining balance of the finance lease liability. Finance charges are recognised as finance costs in the consolidated statement of profit or loss and other comprehensive income. Leased assets are amortised over the term of the finance lease.

Operating lease payments (net of any incentives received from the lessor) are recognised as an expense in the consolidated statement of profit or loss and other comprehensive income on a straight-line basis over the financial period of the lease.

(u) Earnings Per Share

Basic Earnings Per Share

Basic earnings per ordinary share is calculated by dividing the profit or loss attributable to owners of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for any bonus elements in ordinary shares issued during the financial year.

Diluted Earnings Per Share

Diluted earnings per ordinary share adjusts the figures used in the determination of basic earnings per ordinary share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

(v) Parent Company Financial Information

The financial information for the Parent Company, Karoon Gas Australia Ltd, disclosed in Note 29 has been prepared on the same basis as the consolidated financial statements, except as set out below:

Investments in Subsidiaries

Investments in subsidiaries are accounted for at cost in the financial statements of Karoon Gas Australia Ltd.

The Parent Company does not designate any investments in subsidiaries as being subject to the requirements of Australian Accounting Standards specifically applicable to financial instruments. They are held for strategic and not trading purposes.

Investments in subsidiaries and receivables from subsidiaries are tested for impairment in accordance with the accounting policy described in Note 1(n).

Share-based Payments

The grant by the Company of equity-settled share options and performance rights over its ordinary shares to the employees of subsidiary companies in the Group is treated as a capital contribution to that subsidiary company. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investments in subsidiaries, with a corresponding credit to equity.

(w) New Australian Accounting Standards and Interpretations for Application in Future Financial Years

Certain new Australian Accounting Standards and Interpretations have been published that are not mandatory for this financial year. The Group's assessment of the impact of the relevant new Australian Accounting Standards and Interpretations is set out below:

(i) AASB 15 'Revenue from Contracts with Customers'

AASB 15 'Revenue from Contracts with Customers' is the new standard for revenue recognition, replacing AASB 118 'Revenue', which covers revenue arising from the sale of goods and the rendering of services and AASB 111 'Construction Contracts', which covers construction contracts. It is applicable for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The new standard's core principle will require the Group to recognise revenue to depict when control over a good or service is transferred to a customer in amounts that reflect the consideration (that is, payment) to which the Group expects to be entitled in exchange for those goods or services. The Group is yet to assess AASB 15's full impact. The Group does not intend to adopt the new standard before its operative date, which means that it would first be applied during the financial year ending 30 June 2019.

(ii) AASB 16 'Leases'

AASB 16 'Leases' is the new standard for lease recognition, replacing AASB 117 'Leases'. AASB 16 is applicable for annual reporting periods beginning on or after 1 January 2019, but is available for early adoption. AASB 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. The new standard removes the current distinction between operating and finance leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for almost all lease contracts. The Group is yet to assess AASB 16's full impact, but the change is likely to have a pervasive impact as it will result in the recognition of almost all non-cancellable operating lease commitments in the consolidated statement of financial position, and in the classification of cash flows. The Group does not intend to adopt the new standard before its operative date, which means that it would first be applied during the financial year ending 30 June 2020.

(iii) AASB 9 'Financial Instruments'

AASB 9 'Financial Instruments' addresses the classification, measurement and de-recognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets. The new standard is applicable to annual reporting periods beginning on or after 1 January 2018, but is available for early adoption. The Group is yet to assess AASB 9's full impact, but at this time it appears it will have limited impact for the Group. The Group does not intend to adopt the new standard before its operative date, which means that it would first be applied during the financial year ending 30 June 2019.

(iv) AASB 2016-2 'Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 107'

The AASB has amended AASB 107 'Statement of Cash Flows'. The amendments introduce additional disclosures that will enable users of financial statements to better evaluate changes in liabilities arising from financing activities. The amendments require disclosure of changes arising from: cash flows, such as drawdowns and repayments of borrowings; and non-cash changes, such as acquisitions, disposals and unrealised foreign currency differences. The amendments are applicable to annual reporting periods beginning on or after 1 January 2017, but is available for early adoption. The Group is yet to assess the amended AASB 107's full impact. The Group does not intend to adopt the revised standard before its operative date, which means that it would first be applied during the financial year ending 30 June 2018.

(v) AASB 2016-5 'Amendments to Australian Accounting Standards – Classification and Measurement of Share-based Payment Transactions'

The AASB has amended AASB 2 'Share-based Payment'. The amendments to AASB 2 address the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, the classification of share-based payment transactions with a net settlement feature for withholding tax obligations, and the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments are applicable to annual reporting periods beginning on or after 1 January 2018, but is available for early adoption. The Group is yet to assess the amended AASB 2's full impact on cash-settled share-based payments. The Group does not intend to adopt the revised standard before its operative date, which means that it would first be applied during the financial year ending 30 June 2019.

(vi) Interpretation 23 'Uncertainty Over Income Tax Treatments'

Issued by the AASB during July 2017, this Interpretation clarifies how to apply the recognition and measurement requirements in AASB 112 'Income Taxes' when there is uncertainty over income tax treatments. The Interpretation is applicable to annual reporting periods beginning on or after 1 January 2019, but is available for early adoption. The Group is yet to assess the Interpretation's full impact. The Group does not intend to adopt the revised standard before its operative date, which means that it would first be applied during the financial year ending 30 June 2020.

There are no other Australian Accounting Standards that are not yet effective and that are expected to have a material impact on the Group in the current or future financial years and on foreseeable future transactions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 2. Significant Accounting Estimates, Assumptions and Judgements

Revenues and expenses and the carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. In applying the Group's significant accounting policies, the Board of Directors and management evaluate estimates and judgements based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data obtained both externally and within the Group.

Significant estimates, assumptions and/or judgements made by the Board of Directors and management in the preparation of the consolidated financial statements were:

(a) Capitalised Exploration and Evaluation Expenditure

Exploration and evaluation expenditure is carried forward on the basis that exploration and evaluation activities in the areas of interest have not at the end of the reporting period reached a stage that permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the areas of interest are continuing.

The future recoverability of capitalised exploration and evaluation expenditure is dependent on a number of factors, including whether the Group decides to exploit the related exploration tenement itself or, if not, whether it successfully recovers the related exploration and evaluation asset through sale. Factors that could affect the future recoverability include the level of economically recoverable reserves, future technological changes which could impact the cost of development, future legal changes (including changes to environmental and restoration obligations) and changes to commodity prices. To the extent that capitalised exploration and evaluation expenditure is determined not to be recoverable in the future, the relevant capitalised amount will be written-off to consolidated statement of profit or loss and other comprehensive income and net assets will be reduced during the financial period in which this determination is made.

Information on the reasonable existence or otherwise of economically recoverable reserves is progressively gained through geological analysis and interpretation, drilling activity and prospect evaluation during a normal exploration tenement term. A reasonable assessment of the existence or otherwise of economically recoverable reserves can generally only be made, therefore, at the conclusion of those exploration and evaluation activities.

(b) Share-based Payments

The Group measures the cost of share-based payment transactions with Directors and employees by reference to the fair value of the share options at the date they were granted. Fair value is ascertained using the Black-Scholes option pricing model taking into account the terms and conditions upon which the share options were granted. The cumulative share-based payments expense recognised reflects the extent, in the opinion of management, to which the vesting period has expired and the number of share options and performance rights granted that will ultimately vest or be settled in cash. At the end of each reporting period, the unvested share options, performance rights and cash-settled share-based payment liability are adjusted by the number forfeited during the reporting period to reflect the actual number of share options and performance rights outstanding and cash liability to be settled. Management is of the opinion that this represents the most accurate estimate of the number of share options and performance rights that will ultimately vest.

(c) Income Tax

The Group is subject to income taxes in Australia and jurisdictions where it has foreign operations. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The Group estimates its tax liabilities based on the Group's understanding of the relevant tax laws. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax balances in the financial period in which such determination is made.

The Group has not recognised deferred tax assets in respect of Brazilian and Peruvian tax losses and temporary tax differences as the future utilisation of these losses and temporary tax differences is not considered probable at this point in time. Assessing the future utilisation of tax losses and temporary tax differences requires the Group to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws. To the extent that future utilisation of these tax losses and temporary tax differences becomes probable, this could result in significant changes to deferred tax assets recognised, which would in turn impact future financial results.

(d) Joint Arrangements

Exploration and evaluation activities of the Group are conducted primarily through arrangements with other participants. Each arrangement has a contractual agreement (joint operating agreement) that provides the participants with rights to the assets and obligations for the liabilities of the arrangement. Under certain agreements, more than one combination of participants can make decisions about the relevant activities and therefore joint control does not exist. Where the arrangement has the same legal form as a joint operation, but is not subject to joint control, the Group accounts for its interest in accordance with the contractual agreement by recognising its share of jointly held assets, liabilities, revenues and expenses of the arrangement.

Note 3. Financial Risk Management

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and interest rate risk); credit risk; and liquidity risk. The Group's overall financial risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group. The Group uses different methods to measure the different types of financial risk to which it is exposed. These methods include sensitivity analysis in the case of foreign exchange and interest rates.

The overall financial risk management strategy of the Group is governed by the Board of Directors through the Risk and Governance Committee and is primarily focused on ensuring that the Group is able to finance its business plans, while minimising potential adverse effects on financial performance. The Board of Directors provides written principles for overall financial risk management, as well as written policies covering specific areas, such as mitigating foreign exchange, interest rate and credit risks, use of derivative financial instruments and investment of excess cash. Financial risk management is carried out by the Company's finance function under policies approved by the Board of Directors. The finance function identifies, evaluates and if necessary hedges financial risks in close co-operation with the Managing Director. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and Group activities.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised in respect of each class of financial asset and financial liability are disclosed in Note 1.

The Group's financial instruments consist of cash and cash equivalents, receivables, security deposits, trade and other payables.

The Group had no off-statement of financial position financial assets or financial liabilities at either 30 June 2017 or 30 June 2016.

The totals for each category of financial instruments in the consolidated statement of financial position are as follows:

| | Note | Consolidated 2017 \$ | 2016 \$ |
|--|------|----------------------------|-------------|
| Financial assets | | | |
| Cash and cash equivalents | 10 | 375,069,427 | 479,590,366 |
| Receivables | 11 | 1,430,487 | 3,672,007 |
| Security deposits | 13 | 7,833,512 | 10,102,910 |
| Total financial assets | | 384,333,426 | 493,365,283 |
| Financial liabilities | | | |
| Trade and other payables (refer note (a) below) | | 11,124,528 | 12,674,242 |
| Total financial liabilities | | 11,124,528 | 12,674,242 |
| (a) Trade and other payables above exclude amounts relating to leave liabilities, which are not considered a financial instrument. The reconciliation to the amount in the consolidated statement of financial position is as follows: | | | |
| Trade and other payables | 18 | 12,553,916 | 14,017,434 |
| Less: Leave liabilities | | (1,429,388) | (1,343,192) |
| | | 11,124,528 | 12,674,242 |

(a) Market Risk

(i) Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Foreign exchange risk arises when future commercial transactions and recognised financial assets and financial liabilities are denominated in a currency that is not the Company's functional currency.

The Group operates internationally and is exposed to foreign exchange risk arising from currency exposures predominantly to the United States dollar and Brazilian REAL. The Group manages foreign exchange risk at the corporate level by monitoring forecast cash flows in currencies other than Australian dollars and ensuring that adequate United States dollar and Brazilian REAL cash balances are maintained.

Foreign currencies are bought on the spot market in excess of immediate requirements. Where currencies are purchased in advance of requirements, these balances do not usually exceed three months' requirements. The appropriateness of United States dollar holdings are reviewed regularly against future commitments and current Australian dollar market expectations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 3. Financial Risk Management continued

(a) Market Risk continued

(i) Foreign Exchange Risk continued

Periodically, sensitivity analysis is conducted to evaluate the potential impact of unfavourable exchange rates on the Group's future financial position. The results of this evaluation are used to determine the most appropriate risk mitigation tool to be used. The Group will hedge when it is deemed the most appropriate risk mitigation tool to be used.

Foreign currency hedging transactions were not entered into during the financial year or previous financial year.

An analysis of the Group's exposure to foreign exchange risk for financial assets and liabilities, expressed in Australian dollars, at the end of the financial year is set out below:

| Consolidated | 2017 | | | | 2016 | | | |
|------------------------------------|------------------|--------------------|------------------|--------------------|-----------|-------------|------------|-------------|
| | AUD \$ | USD \$ | REAL \$ | Total \$ | AUD \$ | USD \$ | REAL \$ | Total \$ |
| Financial assets | | | | | | | | |
| Cash and cash equivalents | 1,593,332 | 372,613,005 | 863,090 | 375,069,427 | 355,493 | 467,714,025 | 11,520,848 | 479,590,366 |
| Receivables | 39,781 | 1,382,239 | 8,467 | 1,430,487 | 26,673 | 2,784,910 | 860,424 | 3,672,007 |
| Security deposits | 430,694 | 7,364,726 | 38,092 | 7,833,512 | 375,335 | 9,677,390 | 50,185 | 10,102,910 |
| Total financial assets | 2,063,807 | 381,359,970 | 909,649 | 384,333,426 | 757,501 | 480,176,325 | 12,431,457 | 493,365,283 |
| Financial liabilities | | | | | | | | |
| Trade and other payables | 2,644,329 | 1,013,168 | 7,467,031 | 11,124,528 | 1,209,435 | 6,706,954 | 4,757,853 | 12,674,242 |
| Total financial liabilities | 2,644,329 | 1,013,168 | 7,467,031 | 11,124,528 | 1,209,435 | 6,706,954 | 4,757,853 | 12,674,242 |

Foreign Exchange Sensitivity Analysis

The following table details the Group's sensitivity to a 10.0% increase or decrease in the Australian dollar against the United States dollar and Brazilian REAL respectively, with all other variables held constant. The sensitivity analysis includes only outstanding foreign currency denominated amounts at the end of the financial year and adjusts their translation for a 10.0% change in the relevant foreign exchange rate.

The sensitivity analysis is not fully representative of the inherent foreign exchange risk, as the financial year end exposure does not necessarily reflect the exposure during the course of a financial year. These sensitivities should not be used to forecast the future effect of movements in United States dollar or Brazilian REAL exchange rates on future cash flows.

| | Consolidated REAL Impact | | Consolidated USD Impact | |
|---|--------------------------|-------------|-------------------------|--------------|
| | 2017 \$ | 2016 \$ | 2017 \$ | 2016 \$ |
| Change in profit (loss) before income tax | | | | |
| – Improvement in AUD by 10.0% | - | - | (34,508,426) | (42,738,493) |
| – Decline in AUD by 10.0% | - | - | 42,176,965 | 52,235,936 |
| Change in financial assets | | | | |
| – Improvement in AUD by 10.0% | (82,695) | (1,130,132) | (34,669,088) | (43,652,393) |
| – Decline in AUD by 10.0% | 101,072 | 1,381,273 | 42,373,330 | 53,352,925 |
| Change in financial liabilities | | | | |
| – Improvement in AUD by 10.0% | 678,821 | 432,532 | 92,106 | 609,723 |
| – Decline in AUD by 10.0% | (829,670) | (528,650) | (112,574) | (745,217) |
| Change in foreign currency translation reserve | | | | |
| – Improvement in AUD by 10.0% | (596,126) | 697,600 | 68,556 | 304,177 |
| – Decline in AUD by 10.0% | 728,598 | (852,623) | (83,791) | (371,772) |

(ii) Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of financial assets and financial liabilities will fluctuate because of changes in market interest rates. Interest rate risk is managed on a Group basis at the corporate level.

As at 30 June 2017 and 30 June 2016, there was no interest rate hedging in place.

The Group's interest rate risk arises from relevant financial assets, primarily cash and cash equivalents deposited at variable rates of interest and security deposits related to Australia. As the majority of cash and cash equivalents is in United States dollars, the primary exposure is to United States interest rates.

An analysis of the Group's exposure to interest rate risk for financial assets and financial liabilities at the end of the financial year is set out below:

| | Consolidated | | | | | |
|------------------------------|---------------------------------------|---------------------------|------------------------|-------------------------|---------------|--------------------|
| | Weighted Average Interest Rate % p.a. | Floating Interest Rate \$ | Fixed Interest Rate \$ | Non-interest Bearing \$ | Fair Value \$ | Carrying Amount \$ |
| 2017 | | | | | | |
| Financial assets | | | | | | |
| Cash and cash equivalents | 0.03 | 367,494,725 | 6,527,239 | 1,047,463 | 375,069,427 | 375,069,427 |
| Receivables | - | - | - | 1,430,487 | 1,430,487 | 1,430,487 |
| Security deposits | 1.27 | 4,812 | 7,743,708 | 84,992 | 7,833,512 | 7,833,512 |
| Total financial assets | | 367,499,537 | 14,270,947 | 2,562,942 | 384,333,426 | 384,333,426 |
| Financial liabilities | | | | | | |
| Trade and other payables | 8.45 | - | 209,400 | 10,915,128 | 11,124,528 | 11,124,528 |
| Total financial liabilities | | - | 209,400 | 10,915,128 | 11,124,528 | 11,124,528 |

| | Consolidated | | | | | |
|------------------------------|---------------------------------------|---------------------------|------------------------|-------------------------|---------------|--------------------|
| | Weighted Average Interest Rate % p.a. | Floating Interest Rate \$ | Fixed Interest Rate \$ | Non-interest Bearing \$ | Fair Value \$ | Carrying Amount \$ |
| 2016 | | | | | | |
| Financial assets | | | | | | |
| Cash and cash equivalents | 0.4 | 477,610,476 | - | 1,979,890 | 479,590,366 | 479,590,366 |
| Receivables | - | - | - | 3,672,007 | 3,672,007 | 3,672,007 |
| Security deposits | 0.7 | 4,813 | 9,988,163 | 109,934 | 10,102,910 | 10,102,910 |
| Total financial assets | | 477,615,289 | 9,988,163 | 5,761,831 | 493,365,283 | 493,365,283 |
| Financial liabilities | | | | | | |
| Trade and other payables | - | - | - | 12,674,242 | 12,674,242 | 12,674,242 |
| Total financial liabilities | | - | - | 12,674,242 | 12,674,242 | 12,674,242 |

Interest Rate Sensitivity Analysis

The following table details the Group's sensitivity to a 1.0% p.a. increase or decrease in interest rates, with all other variables held constant. The sensitivity analysis is based on the balance of floating interest rate amounts held at the end of the financial year.

The sensitivity analysis is not fully representative of the inherent interest rate risk, as the financial year end exposure does not necessarily reflect the exposure during the course of a financial year. These sensitivities should not be used to forecast the future effect of movements in interest rates on future cash flows.

| | Consolidated | |
|--|--------------|-----------|
| | 2017 \$ | 2016 \$ |
| Change in profit (loss) before income tax | | |
| - Increase of interest rate by 1.0% p.a. | 3,674,995 | 4,776,153 |
| - Decrease of interest rate by 1.0% p.a. | (16,392) | (255,588) |
| Change in financial assets | | |
| - Increase of interest rate by 1.0% p.a. | 3,674,995 | 4,776,153 |
| - Decrease of interest rate by 1.0% p.a. | (16,392) | (255,588) |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 3. Financial Risk Management continued

(b) Credit Risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. Credit risk arises from cash and cash equivalents and security deposits held with banks, financial institutions and joint operators, as well as credit exposures to customers, including outstanding receivables.

Credit risk is managed on a Group basis at the corporate level. To minimise credit risk, the Group has adopted a policy of only dealing with recognised and creditworthy third parties. Receivable balances are monitored on an ongoing basis with the result being the Group's exposure to bad debts is minimised. The Group does not hold collateral, nor does it securitise its receivables.

The Group has policies in place to ensure that services are made to customers with an appropriate credit history.

Cash and cash equivalents and security deposit counterparties are limited to high credit quality banks and financial institutions. For banks and financial institutions in Australia, only independently rated counterparties with a minimum rating of A/A2 are accepted. For banks and financial institutions in Brazil and Peru, only independently rated counterparties with a minimum rating of BBB+/Baa1 are accepted. For banks and financial institutions in Brazil and Peru with independently rated counterparties ratings below BBB+/Baa1, exposure cannot exceed the short-term country specific cash requirements. Where commercially practical, the Group seeks to limit the amount of credit exposure to any one bank or financial institution. The Group's credit exposure and credit ratings of its counterparties are monitored on an ongoing basis.

The maximum exposure to credit risk at the end of the financial year is the carrying amount of the financial assets as disclosed in the consolidated statement of financial position and notes to the consolidated financial statements.

The Group is exposed to credit risk in relation to cash and cash equivalents and security deposits held with the National Australia Bank Limited and HSBC Group, the maximum amount of exposure as at 30 June 2017 was \$367,409,992 (30 June 2016: \$466,216,964) and \$7,772,220 (30 June 2016: \$21,659,511) respectively. The Group is also exposed to credit risk in relation to cash and cash equivalents held with the Commonwealth Bank Limited in Australia and Banco Bradesco SA in Brazil, the maximum amount of exposure as at 30 June 2017 was \$6,527,239 and \$862,006 respectively.

As at 30 June 2017, there were \$Nil (30 June 2016: \$Nil) financial assets past due.

(c) Liquidity Risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities.

At the end of the financial year, the Group held cash and cash equivalents at call of \$368,542,188 (30 June 2016: \$479,590,366) that are expected to readily generate cash inflows for managing liquidity risk.

The Group manages liquidity risk by ensuring that there are sufficient funds available to meet financial obligations on a day-to-day basis and to meet unexpected liquidity needs in the normal course of business. Emphasis is placed on ensuring there is sufficient funding in place to meet the ongoing requirements of the Group's exploration and evaluation activities.

The following mechanisms are utilised to manage liquidity risk:

- preparing and maintaining rolling forecast cash flows in relation to operational, investing and financing activities;
- comparing the maturity profile of financial liabilities with the realisation profile of financial assets;
- managing credit risk related to financial assets;
- when necessary, utilising short-term loan facilities;
- investing surplus cash only in credit quality banks and financial institutions; and
- maintaining a reputable credit profile.

An analysis of the Group's financial liability maturities at the end of the financial year is set out below:

| | Consolidated | | | Total \$ |
|------------------------------|-----------------------------|----------------------|--------------------|-------------|
| | Less than 6 Months \$ | 6-12 Months \$ | 1-2 Years \$ | |
| 2017 | | | | |
| Financial liabilities | | | | |
| Trade and other payables | 10,759,604 | 45,948 | 318,976 | 11,124,528 |
| Total financial liabilities | 10,759,604 | 45,948 | 318,976 | 11,124,528 |
| 2016 | \$ | \$ | \$ | \$ |
| Financial liabilities | | | | |
| Trade and other payables | 12,169,471 | - | 504,771 | 12,674,242 |
| Total financial liabilities | 12,169,471 | - | 504,771 | 12,674,242 |

(d) Fair Value Estimation

For disclosure purposes only, the fair values of financial assets and financial liabilities as at 30 June 2017 and 30 June 2016 are presented in the table under Note 3(a)(ii) and can be compared to their carrying values as presented in the consolidated statement of financial position. Fair values are those amounts at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values estimated for disclosure purposes are based on information that is subject to judgement, where changes in assumptions may have a material impact on the amounts estimated.

The following summarises the significant methods and assumptions used in estimating fair values of financial assets and financial liabilities for disclosure purposes:

Cash and Cash Equivalents

The carrying amount is fair value due to the liquid nature of these assets.

Receivables

The carrying amounts of receivables are assumed to approximate their fair values due to their short-term nature.

Security Deposits

The carrying amounts of security deposits are assumed to represent their fair values based on their likely realisability profile.

Trade and Other Payables

Due to the nature of these financial liabilities, their carrying amounts are a reasonable approximation of their fair values.

| | Consolidated | |
|---|--------------|------------|
| | 2017 \$ | 2016 \$ |
| Note 4. Revenue | | |
| Interest income from unrelated entities | 858,356 | 1,608,292 |
| Total revenue | 858,356 | 1,608,292 |
| Net foreign currency gains | - | 19,061,558 |
| Reversal of provision for restoration | - | 2,471,244 |
| Reversal of discount unwinding on provision for restoration | - | 112,036 |
| Services revenue from joint operations | - | 342,696 |
| Net gain on disposal of non-current assets | - | 1,914 |
| Total other income | - | 21,989,448 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

| | Note | Consolidated 2017 \$ | 2016 \$ |
|--|-------|----------------------------|-------------|
| Note 5. Expenses | | | |
| Loss before income tax includes the following specific expenses: | | | |
| Depreciation and amortisation expense: | | | |
| – depreciation of plant and equipment | 15 | 672,460 | 969,324 |
| – amortisation of computer software | 16 | 376,538 | 237,801 |
| Total depreciation and amortisation expense | | 1,048,998 | 1,207,125 |
| Exploration and evaluation expenditure expensed, impaired or written-off: | | | |
| – exploration and evaluation expenditure expensed | | 3,067,253 | 1,508,493 |
| – exploration and evaluation expenditure written-off | 17 | 9,791,031 | 148,958,458 |
| – exploration and evaluation expenditure impaired | 17 | 21,638,168 | - |
| Total exploration and evaluation expenditure expensed, impaired or written-off | | 34,496,452 | 150,466,951 |
| Finance costs: | | | |
| – finance charges under finance lease | | 16,287 | - |
| – bank charges | | 323,035 | 209,149 |
| Total finance costs | | 339,322 | 209,149 |
| Share-based payments expense | 27(d) | 3,797,668 | 3,253,193 |
| Rental expense on operating leases – minimum lease payments | | 1,920,137 | 1,869,534 |
| Business development and other project costs (refer (a) below) | | 4,526,430 | 1,674,246 |
| Drilling rig mobilisation expense (refer (b) below) | | 16,513,578 | - |
| (a) Reviewing new exploration opportunities predominantly in Australia and Brazil on business development and other project activities that includes internal time allocation of employees and consultants and associated office charges, geotechnical data and external advice relating to due diligence reviews on potential asset acquisitions. | | | |
| (b) The drilling rig for Brazil was released during the financial year, without drilling any of the Santos Basin Block planned wells. Accordingly, drilling rig mobilisation costs incurred during the financial year were expensed. | | | |

| | Consolidated 2017 \$ | 2016 \$ |
|---|----------------------------|-------------|
| Note 6. Income Tax | | |
| (a) Income Tax Recognised in the Consolidated Statement of Profit or Loss and Other Comprehensive Income | | |
| Income tax comprises: | | |
| Current tax | (971,764) | 1,930,376 |
| Adjustments in respect of current tax of previous financial years | 57,269 | 7,617,433 |
| Deferred tax | 11,114,830 | 34,756,679 |
| Total tax income | 10,200,335 | 44,304,488 |
| The prima facie tax on loss before income tax is reconciled to tax income as follows: | | |
| Prima facie tax payable on loss before income tax, calculated at the Australian tax rate of 30% | 27,518,355 | 44,829,250 |
| Add the tax effect of: | | |
| Share-based payments expense (non-cash) | (1,077,192) | (975,958) |
| Other non-deductible items | (4,053,605) | (1,631,606) |
| Tax losses and temporary tax differences not previously recognised | (15,272,358) | (6,768,809) |
| Subtract the tax effect of: | | |
| Difference in overseas tax rates | 1,933,514 | 105,789 |
| Adjustment for current tax of previous financial years | 57,269 | 7,617,433 |
| Non-assessable income | 1,094,352 | 1,128,389 |
| Total tax income | 10,200,335 | 44,304,488 |

| | Note | Consolidated 2017 \$ | 2016 \$ |
|--|-------|----------------------------|------------|
| (b) Amounts Recognised Directly In Equity | | | |
| Aggregate current and deferred tax arising during the financial year and not recognised in net profit or loss, but directly debited or credited in equity: | | | |
| Deferred tax – credited directly in contributed equity | 20(b) | 206 | 5,011 |
| (c) Current Tax Asset | | | |
| Income tax refund receivable | | 391,020 | 431,059 |
| Total current tax asset | | 391,020 | 431,059 |

(d) Deferred Tax Balances

| | Balance as at 1 July 2016 \$ | Charged (Credited) to Profit or Loss \$ | Charged (Credited) Directly to Equity \$ | Consolidated Balance as at 30 June 2017 \$ |
|---|---------------------------------------|---|--|--|
| <i>Temporary differences</i> | | | | |
| Exploration and evaluation expenditure | (14,748,012) | (552,708) | - | (15,300,720) |
| Provisions and accruals | 557,201 | 75,517 | - | 632,718 |
| Equity raising transaction costs | 796,682 | (394,293) | 206 | 402,595 |
| Unrealised foreign currency gains | (33,316,896) | 11,995,830 | - | (21,321,066) |
| Farm-out expenditures | 86,704 | 6,242 | - | 92,946 |
| Other | 32,670 | (15,758) | - | 16,912 |
| Total temporary differences | (46,591,651) | 11,114,830 | 206 | (35,476,615) |
| <i>Unused tax losses</i> | | | | |
| Tax losses | 1,935,825 | (1,044,994) | - | 890,831 |
| Total unused tax losses | 1,935,825 | (1,044,994) | - | 890,831 |
| Net deferred tax liabilities | (44,655,826) | 10,069,836 | 206 | (34,585,784) |
| Presented in the consolidated statement of financial position as follows: | | | | |
| Deferred tax liabilities | (44,655,826) | | | (34,585,784) |

| | Consolidated 2017 \$ | 2016 \$ |
|---|----------------------------|--------------|
| Deferred tax liabilities expected to be settled within 12 months | (5,330,267) | (14,326,266) |
| Deferred tax liabilities expected to be settled after more than 12 months | (29,255,517) | (30,329,560) |
| Deferred tax liabilities | (34,585,784) | (44,655,826) |

(e) Unrecognised Deferred Tax Assets

A deferred tax asset has not been recognised in the consolidated statement of financial position as the benefits of which will only be realised if the conditions for deductibility set out in Note 1(f) occur:

| | | |
|---|------------|------------|
| Tax losses: Brazilian operating losses at a tax rate of 34% | 26,336,834 | 13,284,442 |
| Tax losses: Peruvian operating losses at a tax rate of 32% | 2,333,332 | - |
| Potential tax income | 28,670,166 | 13,284,442 |

(f) Unrecognised Taxable Temporary Differences

| | | |
|--|--------------|--------------|
| Temporary tax differences relating to deferred tax liabilities | (19,842,555) | (24,798,125) |
| Offset by deferred tax assets relating to operating losses | 19,842,555 | 24,798,125 |
| Total deferred tax liabilities (unrecognised) | - | - |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 6. Income Tax continued

(f) Unrecognised Taxable Temporary Differences continued

PRRT

PRRT applies to all the Group's Australian petroleum projects in offshore areas under the *Petroleum Resource Rent Tax Assessment Act 1987*, other than some specific production licences. PRRT is assessed on a project basis or production licence area and will be levied on the taxable profits of a relevant petroleum project at a rate of 40%. Certain specified undeducted expenditures are eligible for compounding. The expenditures can be compounded annually at set rates and the compounded amount can be deducted against assessable receipts in future financial years.

The Group estimates that it has incurred compounded carried forward undeducted PRRT expenditure in excess of accounting carrying values as at 30 June 2017 of \$217,337,527 (2016: \$227,278,736). The resulting deferred tax asset calculated at an effective tax rate of 28%, that has not been recognised in the consolidated statement of financial position, was \$60,854,508 (2016: \$63,633,046).

In order for the Group to utilise undeducted expenditures for PRRT purposes from previous financial years, it will be required to substantiate eligible expenditure in relation to respective Australian offshore permits since the date of their granting to the Group. Any amount that the Group is not able to substantiate will not be able to be utilised against assessable receipts in future financial years. Interests in undeducted PRRT expenditure may be transferred between projects within the Group or to other third parties on acquisitions of interests in the Group's Australian offshore permits.

| | Consolidated | |
|--|--------------|------------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 7. Remuneration of External Auditors | | |
| Remuneration received or due and receivable by the external auditor of Karoon Gas Australia Ltd for: | | |
| (a) PricewaterhouseCoopers Australia | | |
| (i) Audit and other assurance services | | |
| Audit and review of financial statements | 157,590 | 144,840 |
| Total remuneration for audit and other assurance services | 157,590 | 144,840 |
| (ii) Other services | | |
| Australian tax advice | 15,000 | - |
| International tax advice | 62,500 | 25,000 |
| Total remuneration of PricewaterhouseCoopers Australia | 235,090 | 169,840 |
| (b) Related Practices of PricewaterhouseCoopers Australia | | |
| (i) Audit and other assurance services | | |
| Audit and review of financial statements | 165,227 | 162,976 |
| Due diligence services | 209,363 | 57,460 |
| Total remuneration for audit and other assurance services of related practices | 374,590 | 220,436 |
| (ii) Other services | | |
| International tax advice | - | 37,405 |
| Total remuneration of related practices of PricewaterhouseCoopers Australia | 374,590 | 257,841 |
| Total remuneration of external auditors | 609,680 | 427,681 |
| Note 8. Dividends | | |
| There were no ordinary dividends declared or paid during the financial year by the Group (2016: \$Nil). | | |
| Balance of franking account available for subsequent reporting periods | 13,164,770 | 13,164,770 |
| The above amount is calculated from the balance of the Company's franking account as at the end of the financial year. Franking credits are based on the Australian tax rate of 30%. | | |

| | Consolidated | |
|---|---------------------|---------------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 9. Earnings Per Share | | |
| Loss for the financial year used to calculate basic and diluted earnings per ordinary share: | (81,527,513) | (105,126,345) |
| (a) Basic loss per ordinary share | (0.3327) | (0.4275) |
| (b) Diluted loss per ordinary share* | (0.3327) | (0.4275) |
| * Diluted loss per ordinary share equates to basic loss per ordinary share in the financial year because a loss per ordinary share is not considered dilutive for the purposes of calculating earnings per share pursuant to AASB 133 'Earnings per Share'. | | |
| Weighted average number of ordinary shares on issue during the financial year used in calculating basic earnings per ordinary share: | 245,034,116 | 245,930,828 |
| Weighted average number of potential ordinary shares: | 4,012,485 | 1,320,974 |
| Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted earnings per ordinary share (excluding anti-dilutive share options outstanding): | 249,046,601 | 247,251,802 |
| Weighted average number of anti-dilutive share options: | 7,267,017 | 6,371,729 |
| Potential ordinary shares | | |
| Share options and performance rights over unissued ordinary shares of the Company outstanding at the end of the financial year are considered to be potential ordinary shares and have been included in the determination of diluted earnings per ordinary share to the extent to which they are dilutive. The share options and performance rights have not been included in the determination of basic earnings per ordinary share. | | |
| Note 10. Cash and Cash Equivalents | | |
| Cash at banks and on hand (refer note (a) below) | 368,390,294 | 468,189,934 |
| Short-term bank deposits (refer note (b) below) | 6,679,133 | 11,400,432 |
| Total cash and cash equivalents | 375,069,427 | 479,590,366 |

(a) Cash and Cash Equivalents of Joint Operations

Cash and cash equivalents includes share of joint operation cash and short-term bank deposit balances. Refer to Note 23 for further details.

(b) Short-term Bank Deposits

Short-term bank deposits are made for varying periods of between one day and 120 days, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term bank deposit rates.

(c) Financial Risk Management

Information concerning the Group's exposure to financial risks on cash and cash equivalents is set out in Note 3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

| | Consolidated | |
|--|--------------|------------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 11. Receivables | | |
| Current | | |
| Other receivables | 1,430,487 | 3,672,007 |
| Total current receivables | 1,430,487 | 3,672,007 |
| (a) Financial Risk Management | | |
| Information concerning the Group's exposure to financial risks on receivables is set out in Note 3. | | |
| Note 12. Inventories | | |
| Current | | |
| Casing and other drilling inventory | 10,858 | 3,361,581 |
| Total current inventories | 10,858 | 3,361,581 |
| Non-current | | |
| Casing and other drilling inventory | 46,368,852 | 38,487,405 |
| Total non-current inventories | 46,368,852 | 38,487,405 |
| Note 13. Security Deposits | | |
| Current | | |
| Karoon Gas Australia Ltd (refer note (b) below) | - | 370,522 |
| Karoon Petróleo & Gas Ltda, KEI (Peru Z38) Pty Ltd, Sucursal del Peru (refer Note (c) below) | 24,746 | 50,796 |
| Total current security deposits | 24,746 | 421,318 |
| Non-current | | |
| Karoon Gas Australia Ltd (refer note (a) below) | 7,317,827 | 9,617,641 |
| Karoon Gas Australia Ltd (refer note (b) below) | 430,693 | 4,813 |
| KEI (Peru Z38) Pty Ltd, Sucursal del Peru (2016: KEI (Peru Z38) Pty Ltd, Sucursal del Peru and KEI (Peru 112) Pty Ltd, Sucursal del Peru) (refer Note (c) below) | 60,246 | 59,138 |
| Total non-current security deposits | 7,808,766 | 9,681,592 |

(a) Performance Guarantees

Performance guarantee (via a letter of credit) provided to Peru Petro SA (the Peruvian oil and gas regulator) for Block Z-38 by the Group (refer Note 24) for third period work commitments. The letter of credit is fully funded by way of payment of a security deposit, which will be released once the work commitments are met. The performance guarantee (via a letter of credit) provided to Peru Petro SA in the previous financial year for Block 144 was returned during the financial year.

(b) Bank Guarantees

Cash deposits are held as security against bank guarantee facilities for bank guarantees (refer Note 24) given to lessors for the Group's compliance with its obligations in respect of operating lease rental agreements for office premises.

(c) Bonds

Cash deposits are held as bonds for the Group's compliance with its obligations in respect of agreements for the guarantee (refer Note 24) of payment obligations for various accommodation in Brazil and Peru.

(d) Financial Risk Management

Information concerning the Group's exposure to financial risks on security deposits is set out in Note 3.

| | Note | Consolidated 2017 \$ | 2016 \$ |
|--|-------|----------------------------|-------------|
| Note 14. Other Assets | | | |
| Current | | | |
| Prepayments | | 2,129,830 | 2,055,438 |
| Total current other assets | | 2,129,830 | 2,055,438 |
| Note 15. Plant and Equipment | | | |
| Plant and equipment | | | |
| At cost | | 5,527,586 | 6,191,938 |
| Accumulated depreciation | | (4,388,423) | (4,588,722) |
| Total plant and equipment | | 1,139,163 | 1,603,216 |
| Reconciliation | | | |
| The reconciliation of the carrying amount for plant and equipment is set out below: | | | |
| Balance at beginning of financial year | | 1,603,216 | 2,301,659 |
| Additions | 22(c) | 254,565 | 303,850 |
| Disposals | | - | (1,172) |
| Net foreign currency difference on translation of financial statements of foreign subsidiaries | | (46,158) | (31,797) |
| Depreciation expense | 5 | (672,460) | (969,324) |
| Carrying amount at end of financial year | | 1,139,163 | 1,603,216 |
| Note 16. Intangible Assets | | | |
| Computer software | | | |
| At cost | | 3,185,839 | 3,213,908 |
| Accumulated amortisation | | (2,018,264) | (2,097,169) |
| Total intangibles | | 1,167,575 | 1,116,739 |
| Reconciliation | | | |
| The reconciliation of the carrying amounts for computer software is set out below: | | | |
| Balance at beginning of financial year | | 1,116,739 | 489,372 |
| Additions | 22(c) | 492,473 | 875,286 |
| Net foreign currency difference on translation of financial statements of foreign subsidiaries | | (65,099) | (10,118) |
| Amortisation expense | 5 | (376,538) | (237,801) |
| Carrying amount at end of financial year | | 1,167,575 | 1,116,739 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

| | Note | Consolidated 2017 \$ | 2016 \$ |
|--|-------|----------------------------|---------------|
| Note 17. Exploration and Evaluation Expenditure Carried Forward | | | |
| Geological, geophysical, drilling and other exploration and evaluation expenditure, including directly attributable general administrative costs | | | |
| | | 371,029,112 | 376,766,598 |
| Reconciliation | | | |
| The reconciliation of exploration and evaluation expenditure carried forward is set out below: | | | |
| Balance at beginning of financial year | | 376,766,598 | 485,539,123 |
| Additions | 22(c) | 41,730,248 | 38,164,303 |
| Exploration and evaluation expenditure written-off (refer note (a) below) | 5 | (9,791,031) | (148,958,458) |
| Exploration and evaluation expenditure written-off (refer note (b) below) | 5 | (21,638,168) | - |
| Net foreign currency difference on translation of financial statements of foreign subsidiaries | | (16,038,535) | 2,021,630 |
| Total exploration and evaluation expenditure carried forward (refer note (c) below) | | 371,029,112 | 376,766,598 |
| Intangible | | 371,029,112 | 376,766,598 |

(a) Exploration and evaluation expenditure carried forward associated with Block 144 (Peru) has been written-off in accordance with Note 1(m), as the block was relinquished during the financial year. In addition, exploration and evaluation expenditure carried forward associated with drilling rig mobilisation costs capitalised as at 30 June 2016 was written-off, as the rig for Brazil was released without drilling any of the planned Santos Basin Block wells during the financial year.

(b) Whilst a significant oil in-place resource was identified with the Bilby-1 exploration well, the reservoir quality in the well location is now considered to be insufficient for a producing field unless better quality reservoirs are found elsewhere in Block S-M-1166. There remains potential for a better quality reservoir elsewhere in the structure, however, more recent evaluation of 3D marine seismic data has indicated that better quality reservoir than at the Bilby-1 location is unlikely to exist within the interpreted extent of the oil discovery. On the basis of the evaluation to date on this Block and the Group's focus on the development of Echidna and Kangaroo oil discoveries in the near term, exploration and evaluation expenditure carried forward associated with Block S-M-1166, including the Bilby oil discovery, has been fully impaired as at 30 June 2017.

(c) Exploration and evaluation expenditure carried forward relates to areas of interest in the exploration and evaluation phase for exploration tenements EPP46, WA-314-P, WA-482-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166 and Block Z-38 (2016: WA-314-P, WA-482-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166, Block Z-38 and Block 144).

The expenditure is carried forward on the basis that exploration and evaluation activities in the areas of interest have not reached a stage that permits reasonable assessment of the existence or otherwise of economically recoverable reserves and active and significant activity in, or in relation to the areas is continuing. The future recoverability of the carrying amount of capitalised exploration and evaluation expenditure is dependent on successful development and commercial exploitation or, alternatively, the sale of the respective areas of interest.

| | Note | Consolidated 2017 \$ | 2016 \$ |
|--|-------|----------------------------|------------|
| Note 18. Trade and Other Payables | | | |
| Current (unsecured) | | | |
| Trade payables | | 7,888,550 | 7,051,342 |
| Sundry payables and accrued expenditure | | 4,113,505 | 6,461,321 |
| Cash-settled share-based payments | 28(f) | 140,990 | - |
| Finance lease liability | | 91,895 | - |
| Total current trade and other payables | | 12,234,940 | 13,512,663 |
| Non-current (unsecured) | | | |
| Sundry payables | | - | 504,771 |
| Cash-settled share-based payments | 28(f) | 201,471 | - |
| Finance lease liability | | 117,505 | - |
| Total current trade and other payables | | 318,976 | 504,771 |

(a) Financial Risk Management

Information concerning the Group's exposure to financial risks on trade and other payables is set out in Note 3.

| | Consolidated | |
|---|--------------|---------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 19. Provisions | | |
| Current | | |
| Provision for long service leave (refer note (a) below) | 246,647 | 287,448 |
| Total current provision | 246,647 | 287,448 |
| Non-current | | |
| Provision for long service leave (refer note (a) below) | 291,324 | 263,864 |
| Total non-current provisions | 291,324 | 263,864 |

(a) Provision for Long Service Leave

A provision was recognised for employee entitlements relating to long service leave. The measurement and recognition criteria relating to long service leave entitlements are as described in Note 1(q).

The current portion of this provision includes all the unconditional entitlements to long service leave where employees have completed the required period of service and also those where employees are entitled to pro-rata payments in certain circumstances.

| | Consolidated | | Consolidated | |
|---|--------------|-------------|--------------|-------------|
| | 2017 | 2016 | 2017 | 2016 |
| | Number | Number | \$ | \$ |
| Note 20. Contributed Equity and Reserves Within Equity | | | | |
| (a) Contributed Equity | | | | |
| Ordinary shares, fully paid | 245,217,605 | 245,260,124 | 802,295,334 | 802,967,815 |
| Total contributed equity | | | 802,295,334 | 802,967,815 |

Ordinary shares have no par value and the Company does not have a limited amount of authorised capital.

Voting rights of shareholders are governed by the Company's Constitution. In summary, on a show of hands every holder of ordinary shares present at a meeting in person or by proxy is entitled to one vote, and upon a poll each such attending shareholder is entitled to one vote for every fully paid ordinary share held.

Ordinary shares participate in dividends as declared from time to time and the proceeds on winding up of the Company in proportion to the number of fully paid ordinary shares held.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 20. Contributed Equity and Reserves Within Equity continued

(b) Movement in Ordinary Shares

| Date | Details | Note | Number of Ordinary Shares | Issue Price Per Ordinary Share | \$ |
|--------------|---|-------|---------------------------|--------------------------------|-------------|
| 1 July 2015 | Opening balance in previous financial year | | 246,655,739 | 805,529,759 | |
| | Performance rights conversion | 27(c) | 264,704 | - | - |
| | Ordinary shares bought back (on-market) and cancelled | (i) | (1,660,319) | | (2,564,577) |
| | Share buy-back transaction costs | | | | (2,378) |
| | Deferred tax credit recognised directly in equity | 6(b) | | | 5,011 |
| 30 June 2016 | Balance at end of previous financial year | | 245,260,124 | 802,967,815 | |
| | Performance rights conversion | 27(c) | 472,426 | - | - |
| | Ordinary shares bought back (on-market) and cancelled | (i) | (514,945) | | (671,998) |
| | Share buy-back transaction costs | | | | (689) |
| | Deferred tax credit recognised directly in equity | 6(b) | | | 206 |
| 30 June 2017 | Balance at end of financial year | | 245,217,605 | 802,295,334 | |

(i) Share Buy-back (On-market)

The Company's on-market share buy-back commenced on 3 September 2014 and was continued on 3 September 2015 for a further 12 months. The share buy-back lapsed on 2 September 2016. There is no current on-market share buy-back.

During the financial year, a total of 514,945 ordinary shares (2016: 1,660,319) had been purchased and cancelled at an average price of \$1.305 per share (2016: \$1.55), with prices ranging from \$1.275 to \$1.34 (2016: \$1.34 to \$1.70). The total reduction in contributed equity, as a result of the share buy-back and cancellation of ordinary shares, was \$672,481 (2016: \$2,561,944).

(c) Capital Management

The Board of Directors controls the capital of the Company in order to ensure that the Group can fund its operations and continue as a going concern. The aim is to maintain a capital structure that ensures the lowest cost of capital to the Company.

The Managing Director manages the Company's capital by monitoring future rolling cash flows and adjusting its capital structure, as required, in consultation with the Board of Directors to meet Group business objectives. As required, the Group will balance its overall capital structure through the issue of new ordinary shares, share buy-backs and utilising short-term loan facilities when necessary.

There were no externally imposed capital management restrictions on the Group during the financial year.

(d) Reserves Within Equity

(i) Share-based Payments Reserve

The share-based payments reserve is used to recognise the grant date fair value of equity-settled share-based payments to Directors, other key management personnel and employees as part of their remuneration, as described in Note 1(p).

(ii) Foreign Currency Translation Reserve

The foreign currency translation reserve is used to recognise exchange differences arising from the translation of financial statements of foreign subsidiaries, as described in Note 1(e). The relevant amounts included in the foreign currency translation reserve will be recognised in the consolidated statement of profit or loss and other comprehensive income when each relevant investment in foreign subsidiary is disposed.

Note 21. Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in Note 1(b):

| Name | Country of Incorporation or Registration | Business Activities Carried on in | Percentage of Equity and Voting Interests Held | |
|---|--|-----------------------------------|--|--------|
| | | | 2017 % | 2016 % |
| Parent Company: | | | | |
| Karooon Gas Australia Ltd | Australia | Australia | | |
| Unlisted subsidiaries of Karooon Gas Australia Ltd: | | | | |
| Karooon Energy International Pty Ltd | Australia | Australia | 100 | 100 |
| Karooon Gas Browse Basin Pty Ltd | Australia | Australia | 100 | 100 |
| Karooon Gas (FPSO) Pty Ltd | Australia | Australia | 100 | 100 |
| Unlisted subsidiaries of Karooon Energy International Pty Ltd: | | | | |
| KEI (Brazil Santos) Pty Ltd | Australia | Australia | 100 | 100 |
| KEI (Peru 112) Pty Ltd | Australia | Australia | 100 | 100 |
| KEI (Peru Z38) Pty Ltd | Australia | Australia | 100 | 100 |
| Jointly owned unlisted subsidiary of Karooon Energy International Pty Ltd and KEI (Brazil Santos) Pty Ltd: | | | | |
| Karooon Petróleo & Gas Ltda | Brazil | Brazil | 100 | 100 |
| Branch of KEI (Peru 112) Pty Ltd: | | | | |
| KEI (Peru 112) Pty Ltd, Sucursal del Peru | Peru | Peru | 100 | 100 |
| Branch of KEI (Peru Z38) Pty Ltd: | | | | |
| KEI (Peru Z38) Pty Ltd, Sucursal del Peru | Peru | Peru | 100 | 100 |

Note 22. 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 Managing Director and Executive Director/Exploration Director (identified as the 'chief operating decision maker') in assessing performance and in determining the allocation of resources.

The operating segments are based on the Group's geographical location of its operations.

The Group has identified operating segments based on the following three geographic locations:

- Australia – in which the Group is currently involved in the exploration and evaluation of hydrocarbons in three offshore exploration permit areas: WA-314-P, WA-482-P and EPP46. Exploration permit EPP46 was acquired during the financial year;
- Brazil – in which the Group is currently involved in the exploration and evaluation of hydrocarbons in five offshore exploration blocks: Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165 and Block S-M-1166; and
- Peru – in which the Group is currently involved in the exploration and evaluation of hydrocarbons in offshore exploration Block Z-38. Onshore exploration Block 144 was relinquished during the financial year.

'All other segments' include amounts not specifically attributable to an operating segment.

The accounting policies of the reportable operating segments are the same as the Group's accounting policies.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 22. Segment Information continued

(a) Description of Segments continued

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

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

(b) Operating Segments

| Segment Performance | Australia \$ | Brazil \$ | Peru \$ | All Other Segments \$ | Consolidated \$ |
|--|-----------------|--------------|-------------|-----------------------------|--------------------|
| Result for financial year ended 30 June 2017 | | | | | |
| Segment revenue (interest income from unrelated entities) | 146,747 | 711,557 | 52 | - | 858,356 |
| Business development and other project costs | (136,206) | (4,390,224) | - | - | (4,526,430) |
| Depreciation and amortisation expense | (350,456) | (408,782) | (289,760) | - | (1,048,998) |
| Drilling rig mobilisation expense | - | (16,513,578) | - | - | (16,513,578) |
| Employee benefits expense (net) [^] | (8,797,547) | (2,736,569) | (1,117,563) | - | (12,651,679) |
| Exploration and evaluation expenditure expensed, impaired or written-off | 641,063 | (27,316,536) | (6,831,249) | (989,730) | (34,496,452) |
| Finance costs | (17,608) | (239,572) | (82,142) | - | (339,322) |
| Write-down of inventory to net realisable value | - | (1,326,811) | - | - | (1,326,811) |
| Net foreign currency losses | (14,808,172) | 859,328 | 39,110 | - | (13,909,734) |
| Property costs | (776,352) | (1,169,944) | (332,881) | - | (2,279,177) |
| Administration and other operating expenses | (2,854,461) | (1,478,891) | (1,160,671) | - | (5,494,023) |
| Loss before income tax | (26,952,992) | (54,010,022) | (9,775,104) | (989,730) | (91,727,848) |
| Tax income | 10,200,335 | - | - | - | 10,200,335 |
| Loss for financial year | (16,752,657) | (54,010,022) | (9,775,104) | (989,730) | (81,527,513) |
| Result for financial year ended 30 June 2016 | | | | | |
| Segment revenue (interest income from unrelated entities) | 215,376 | 1,392,610 | 306 | - | 1,608,292 |
| Other income | 18,335,745 | 3,821,374 | (167,671) | - | 21,989,448 |
| Business development and other project costs | (136,026) | (1,538,220) | - | - | (1,674,246) |
| Depreciation and amortisation expense | (389,663) | (589,457) | (228,005) | - | (1,207,125) |
| Employee benefits expense (net) ^{^^} | (8,729,354) | (1,954,893) | (1,204,499) | - | (11,888,746) |
| Exploration and evaluation expenditure expensed or written-off | (150,019,729) | (341,043) | (41,011) | (65,168) | (150,466,951) |
| Finance costs | (54,454) | (139,401) | (15,294) | - | (209,149) |
| Property costs | (755,324) | (1,099,382) | (345,193) | - | (2,199,899) |
| Administration and other operating expenses | (3,796,738) | (614,104) | (971,615) | - | (5,382,457) |
| Loss before income tax | (145,330,167) | (1,062,516) | (2,972,982) | (65,168) | (149,430,833) |
| Tax income | 44,304,488 | - | - | - | 44,304,488 |
| Loss for financial year | (101,025,679) | (1,062,516) | (2,972,982) | (65,168) | (105,126,345) |

[^] Includes share-based payments expense of \$3,038,026 (Australia), \$661,591 (Brazil) and \$98,051 (Peru) during the financial year.

^{^^} Includes share-based payments expense of \$2,537,456 (Australia), \$499,340 (Brazil) and \$216,397 (Peru) during the previous financial year.

| | Australia \$ | Brazil \$ | Peru \$ | All Other Segments \$ | Consolidated \$ |
|--|-----------------|--------------|------------|-----------------------------|--------------------|
| Segment Assets | | | | | |
| As at 30 June 2017 | | | | | |
| Segment asset information | | | | | |
| Cash and cash equivalents | 373,920,044 | 898,220 | 251,163 | - | 375,069,427 |
| Exploration and evaluation expenditure carried forward | 52,467,284 | 254,225,048 | 64,336,780 | - | 371,029,112 |
| Security deposits | 430,694 | 38,092 | 7,364,726 | - | 7,833,512 |
| Inventories | 10,858 | 21,145,461 | 25,223,391 | - | 46,379,710 |
| Other | 1,256,717 | 2,958,744 | 2,042,614 | - | 6,258,075 |
| Segment assets | 428,085,597 | 279,265,565 | 99,218,674 | - | 806,569,836 |

As at 30 June 2016

Segment asset information

| | | | | | |
|--|-------------|-------------|-------------|---|-------------|
| Cash and cash equivalents | 466,316,880 | 11,558,411 | 1,715,075 | - | 479,590,366 |
| Exploration and evaluation expenditure carried forward | 49,160,039 | 260,521,706 | 67,084,853 | - | 376,766,598 |
| Security deposits | 375,335 | 50,185 | 9,677,390 | - | 10,102,910 |
| Inventories | 15,197 | 15,706,892 | 26,126,897 | - | 41,848,986 |
| Other | 1,858,827 | 3,529,032 | 3,490,600 | - | 8,878,459 |
| Segment assets | 517,726,278 | 291,366,226 | 108,094,815 | - | 917,187,319 |

| | Australia \$ | Brazil \$ | Peru \$ | All Other Segments \$ | Consolidated \$ |
|--------------------------------------|-----------------|--------------|------------|-----------------------------|--------------------|
| Segment Liabilities | | | | | |
| As at 30 June 2017 | | | | | |
| Segment liability information | | | | | |
| Trade and other payables | 3,424,634 | 8,232,785 | 896,497 | - | 12,553,916 |
| Deferred tax liabilities | 34,585,784 | - | - | - | 34,585,784 |
| Provisions | 537,971 | - | - | - | 537,971 |
| Segment liabilities | 38,548,389 | 8,232,785 | 896,497 | - | 47,677,671 |

As at 30 June 2016

Segment liability information

| | | | | | |
|--------------------------|------------|-----------|---------|---|------------|
| Trade and other payables | 7,466,521 | 5,604,969 | 945,944 | - | 14,017,434 |
| Deferred tax liabilities | 44,655,826 | - | - | - | 44,655,826 |
| Provisions | 551,312 | - | - | - | 551,312 |
| Segment liabilities | 52,673,659 | 5,604,969 | 945,944 | - | 59,224,572 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 22. Segment Information continued

(c) Other Segment Information

Additions to non-current assets, other than financial assets (refer Note 3), during the reporting periods were:

| | Australia \$ | Brazil \$ | Peru \$ | All Other Segments \$ | Consolidated \$ |
|--|-----------------|--------------|------------|-----------------------------|--------------------|
| Financial year ended 30 June 2017 | | | | | |
| Plant and equipment | 33,450 | 211,342 | 9,773 | - | 254,565 |
| Intangible assets | 2,068 | 486,894 | 3,511 | - | 492,473 |
| Exploration and evaluation expenditure carried forward | 2,440,517 | 33,442,453 | 5,847,278 | - | 41,730,248 |
| Financial year ended 30 June 2016 | | | | | |
| Plant and equipment | 236,517 | 49,321 | 18,012 | - | 303,850 |
| Intangible assets | 72,741 | 782,588 | 19,957 | - | 875,286 |
| Exploration and evaluation expenditure carried forward | 9,840,238 | 21,250,949 | 7,073,116 | - | 38,164,303 |

Note 23. Joint Operations

The Group has an equity interest in the following joint operations as at 30 June 2017 as follows:

| Exploration Permit/Block | Unincorporated Equity Interest (%) | | Principal Activities | Operator of Joint Operation |
|--|------------------------------------|-----------------|----------------------------|--|
| | 2017 | 2016 | | |
| WA-482-P | 50 | 50 | Exploration and evaluation | Quadrant Northwest Pty Ltd |
| Block Z-38 | 75 [^] | 75 [^] | Exploration and evaluation | KEI (Peru Z38) Pty Ltd, Sucursal del Peru |
| Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165, S-M-1166 | - ^{^^} | 65 | Exploration and evaluation | Karoon Petróleo & Gas Ltda |

[^] The Group's 75% Block Z-38 equity interest is subject to completion of farm-in obligations. Under the terms of the farm-in, Karoon is currently funding 100% of all exploration expenditure.

^{^^} Karoon's purchase of Pacific's 35% equity interest in the Santos Basin exploration blocks during the financial year was approved by the Agência Nacional do Petróleo, Gás Natural e Biocombustíveis (the 'ANP') and then settled. As Karoon Petróleo & Gas Ltda now owns an equity interest of 100% of the Santos Basin exploration blocks, it ceased to be a joint operation during the financial year.

The following amounts represented the Group's share of assets, liabilities, revenues and expenses employed in joint operations. The amounts are included in the consolidated financial statements, in accordance with the accounting policy described in Note 1(s), under the following classifications:

| | Consolidated | |
|--|--------------|-------------|
| | 2017 \$ | 2016 \$ |
| Cash and cash equivalents | - | 3,294,255 |
| Receivables (current) | 74 | 788,597 |
| Inventories (current) | 10,858 | 3,361,580 |
| Other assets (current) | - | 410,526 |
| Inventories (non-current) | - | 12,360,509 |
| Exploration and evaluation expenditure carried forward (non-current) | 105,238,634 | 359,410,723 |
| Trade and other payables (current) | (72,837) | (4,038,793) |
| Share of net assets employed in joint operations | 105,176,729 | 375,587,397 |
| Other income | 29,252 | 3,961,596 |

Contingent liabilities in respect of joint operations are set out in Note 24. Exploration expenditure commitments in respect of joint operations are set out in Note 25.

Consolidated
2017 **2016**
\$ **\$**

Note 24. Contingent Liabilities and Contingent Assets

(a) Contingent Liabilities

The Group has contingent liabilities as at 30 June 2017 that may become payable in respect of:

| | | |
|--|------------------|-----------|
| (i) Performance guarantee (via a letter of credit) provided to Peru Petro SA (the Peruvian oil and gas regulator) for Block Z-38 by the Group for third period work commitments. The Directors are of the opinion that the work commitments will be satisfied. The letter of credit is fully funded by way of payment of a security deposit (refer Note 13), which will be released once the work commitments are met. The performance guarantee (via a letter of credit) provided to Peru Petro SA in the previous financial year for Block 144 by the Parent Company was returned during the financial year. | 7,317,827 | 9,617,641 |
| (ii) Bank guarantees were provided in respect of operating lease rental agreements for the Group. These guarantees may give rise to liabilities in the Group if obligations are not met under these guarantees. The bank guarantees given to lessors are fully funded by way of payment of security deposits (refer Note 13). | 430,693 | 375,335 |
| (iii) Cash deposits (refer Note 13) are held as bonds for the Group's compliance with its obligations in respect of agreements for the guarantee of payment obligations for various accommodation in Brazil and Peru. | 84,992 | 109,934 |

(iv) Block Acquisition

As part of the acquisition of Pacific's equity interest of the Santos Basin exploration blocks during the financial year, the Group has agreed to pay Pacific a deferred contingent consideration of US\$5.0 million payable upon first production reaching a minimum of 1 million barrels of oil equivalent from the Blocks. The deferred contingent obligation has not been provided for as at 30 June 2017, as it is dependent upon uncertain future events not wholly within the Group's control.

(v) Brazilian Local Content

The Concession Contracts for Santos Basin Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166 require Karoon Petróleo & Gas Ltda to acquire a minimum proportion of goods and services from Brazilian suppliers, with the objective to stimulate industrial development, promote and diversify the Brazilian economy, encourage advanced technology and develop local capabilities. The minimum Brazilian local content requirement under the Concession Contracts during the exploration and appraisal phase is 55%. If Karoon Petróleo & Gas Ltda fails to comply with this minimum requirement, Karoon Petróleo & Gas Ltda may be subject to a fine by the ANP.

It is not practical to estimate a potential shortfall in meeting the local content requirement as at 30 June 2017, nor the financial effect of any potential fine by the ANP.

(vi) Joint Operations

In accordance with normal industry practice, the Group has entered into joint operations with other parties for the purpose of exploring and evaluating its exploration tenements. If a participant to a joint operation defaults and does not contribute its share of joint operation obligations, then the remaining joint operation participants are jointly and severally liable to meet the obligations of the defaulting participant. In this event, the interest in the exploration tenements held by the defaulting participant may be redistributed to the remaining joint operation participants.

In the event of a default, a contingent liability exists in respect of expenditure commitments due to be met by the Group in respect of the defaulting joint operation participant.

(vii) Other Matters

There are also legal claims and exposures, which arise from the Group's ordinary course of business. There is significant uncertainty as to whether a future liability will arise in respect of these legal claims and exposures. No material loss to the Group is expected to result.

(b) Contingent Assets

The Group has no contingent assets as at 30 June 2017 (30 June 2016: \$Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

| | Consolidated | |
|--|--------------|------------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 25. Commitments | | |
| (a) Capital Expenditure Commitments | | |
| Contracts and/or signed Authorities for Expenditure for capital expenditure in relation to assets not provided for in the consolidated financial statements and payable: | | |
| Drilling operations | | |
| Not later than one year | 2,819,813 | 16,123,176 |
| Total capital expenditure commitments | 2,819,813 | 16,123,176 |

(b) Operating Lease Rental Commitments

Non-cancellable operating lease rentals not provided for in the consolidated financial statements and payable:

| | | |
|---|-----------|-----------|
| Not later than one year | 1,859,879 | 1,826,221 |
| Later than one year but not later than five years | 1,216,073 | 85,859 |
| Total operating lease rental commitments | 3,075,952 | 1,912,080 |

The Group leases various offices under non-cancellable operating leases expiring within one to three years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

| | Consolidated | |
|---|--------------|-------------|
| | 2017 | 2016 |
| | \$ | \$ |
| (c) Exploration Expenditure Commitments | | |
| The Group has commitments for exploration expenditure arising from obligations to government, to perform minimum exploration and evaluation work and expend minimum amounts of money pursuant to the award of exploration tenements EPP46, WA-314-P, WA-482-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166 and Block Z-38 (30 June 2016: WA-314-P, WA-482-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166, Block Z-38 and Block 144) not provided for in the consolidated financial statements and payable. Included in exploration expenditure commitments are \$439,745,268 (30 June 2016: \$253,472,031) of commitments that relate to the non-guaranteed work commitments: | | |
| Not later than one year | - | - |
| Later than one year but not later than five years | 769,920,329 | 556,673,149 |
| Total exploration expenditure commitments | 769,920,329 | 556,673,149 |

The above commitments include exploration expenditure commitments relating to joint operations:

| | | |
|---|-------------|-------------|
| Not later than one year | - | - |
| Later than one year but not later than five years | 216,895,151 | 485,710,073 |
| Total joint operation exploration expenditure commitments | 216,895,151 | 485,710,073 |

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 and/or signed Authorities for Expenditure, the amount will be included in both categories (a) and (c) above.

| | Consolidated | |
|---|--------------|---------------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 26. Reconciliation to the Consolidated Statement of Cash Flows | | |
| (a) Reconciliation of Loss for Financial Year to Net Cash Flows Used In Operating Activities | | |
| Loss for financial year | (81,527,513) | (105,126,345) |
| Add (subtract) | | |
| Non-cash items included in loss for financial year: | | |
| Depreciation of plant and equipment and amortisation of computer software | 1,048,998 | 1,207,125 |
| Reversal of provision for restoration | - | (2,471,244) |
| Reversal of discount unwinding on provision for restoration | - | (112,036) |
| Share-based payments expense | 3,590,639 | 3,253,193 |
| Net foreign currency losses (gains) | 14,577,712 | (14,237,255) |
| Items classified as investing/ financing activities: | | |
| Net loss (gain) on disposal of non-current assets | 134 | (1,914) |
| Exploration and evaluation expenditure impaired or written-off | 31,429,199 | 148,958,458 |
| Net foreign currency gains | (667,978) | (4,824,303) |
| Write-down of inventory to net realisable value | 1,326,811 | - |
| Finance charges under finance lease | 16,287 | - |
| Change in operating assets and liabilities: | | |
| (Increase) decrease in assets | | |
| Receivables – current | 1,247,840 | (640,536) |
| Current tax asset | 13,923 | (222,430) |
| Other assets | 267,604 | (419,590) |
| Increase (decrease) in liabilities | | |
| Trade and other payables – current | 805,484 | 274,088 |
| Trade and other payables – non-current | (303,300) | 504,771 |
| Provisions – current | (40,801) | 287,448 |
| Provisions – non-current | 27,460 | (169,966) |
| Current tax liabilities | - | (20,776,754) |
| Deferred tax liabilities | (10,069,836) | (36,692,505) |
| Net cash flows used in operating activities | (38,257,337) | (31,209,795) |
| (b) Non-cash Financing Activities | | |
| Acquisition of computer software by means of a finance lease | 273,386 | - |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 27. Share-based Payments

The share-based payment plans are described below. There has been no cancellation to a plan during the financial year.

(a) Employee Share Option Plan ('ESOP')

The Company currently has two ESOP plans in place, the Karoon Gas Australia 2016 Employee Share Option Plan approved by shareholders at the 2016 Annual General Meeting and the Karoon Gas Australia 2012 Employee Share Option Plan, which was approved by shareholders at the 2012 Annual General Meeting. ESOP options expire up to four years after they are granted. The exercise price of ESOP options, issued during the financial year, is based on the volume weighted average price at which the Company's ordinary shares are traded on the ASX during the 20 days of trading before the ESOP options were offered plus a premium to the market price.

Each ESOP option provides eligible employees with the right to acquire one fully paid ordinary share of the Company at the exercise price determined upon grant, or its equivalent value, subject to the achievement of the relevant performance conditions.

Share options granted under the ESOP carry no dividend or voting rights.

If there is a change of control of the Company:

- for all unexercised Karoon Gas Australia 2012 Employee Share Option Plan options, a percentage amount of unvested ESOP options may vest on the basis of the pro-rata achievement of predetermined performance conditions; and
- for all unexercised Karoon Gas Australia 2016 Employee Share Option Plan options, a percentage amount of unvested ESOP options may vest on the basis of the pro-rata achievement of predetermined performance conditions.

During the financial year, the Group granted 846,752 ESOP options (2016: 981,818) over unissued ordinary shares in the Company to Executive Directors. Share options issued to Directors are approved on a case-by-case basis by shareholders at relevant general meetings.

The following summary reconciles the outstanding ESOP options over unissued ordinary shares in the Company at the beginning and end of the financial year:

| | Consolidated | | Consolidated | |
|--|--------------|---------------------------------|--------------|---------------------------------|
| | 2017 | 2017 | 2016 | 2016 |
| | Number | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| Balance at beginning of financial year | 5,872,110 | \$4.11 | 6,751,143 | \$5.73 |
| Granted during financial year | 2,515,632 | \$1.82 | 2,058,324 | \$3.04 |
| Exercised during financial year | - | - | - | - |
| Cancelled during financial year | (225,506) | \$3.18 | (45,106) | \$4.13 |
| Expired during financial year | - | - | (1,800,000) | \$7.30 |
| Forfeited during financial year | (895,304) | \$6.74 | (1,092,251) | \$6.85 |
| Balance at end of financial year | 7,266,932 | \$3.02 | 5,872,110 | \$4.11 |
| Exercisable at end of financial year | - | - | - | - |

All ESOP options issued during the financial year were issued under the Karoon Gas Australia 2016 Employee Share Option Plan.

There was no exercise of ESOP options during the financial year or previous financial year.

The weighted average fair value of ESOP options granted during the financial year was \$0.74 (2016: \$0.57).

ESOP options outstanding as at 30 June 2017 had a range of exercise prices from \$1.82 to \$4.06 (30 June 2016: range of exercise prices from \$3.04 to \$6.74) with a weighted average remaining contractual life of 713 days (30 June 2016: 803 days).

Details of ESOP options outstanding at the end of the financial year are:

| Grant Date | Expiry Date | Exercise Price Per ESOP Option | Number |
|--------------------|--------------------|---------------------------------------|------------------|
| 22 August 2014 | 30 June 2018 | \$4.06 | 1,022,901 |
| 29 August 2014 | 30 June 2018 | \$4.06 | 521,457 |
| 3 November 2014 | 30 June 2018 | \$4.06 | 848,620 |
| 17 February 2015 | 30 June 2018 | \$4.06 | 370,731 |
| 23 January 2015 | 30 December 2018 | \$4.06 | 56,604 |
| 9 October 2015 | 30 June 2019 | \$3.04 | 1,013,888 |
| 30 October 2015 | 30 June 2019 | \$3.04 | 981,818 |
| 30 November 2016 | 30 June 2020 | \$1.82 | 1,100,476 |
| 2 December 2016 | 30 June 2020 | \$1.82 | 846,752 |
| 2 December 2016 | 30 June 2020 | \$1.82 | 503,685 |
| Total ESOP options | | | 7,266,932 |

(b) Fair Value of Share Options

The fair value of each share option issued during the financial year was estimated on grant date using the Black-Scholes option pricing model. The Black-Scholes option pricing model takes into account the exercise price, the term of the share option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the share option.

The Group applied the following assumptions and inputs in estimating the weighted average fair value:

| | 2017 | 2016 |
|--|-------------------|-------------|
| Weighted average exercise price | \$1.82 | \$3.04 |
| Weighted average life of share options | 1,307 days | 1,347 days |
| Weighted average share price | \$1.92 | \$1.93 |
| Expected share price volatility | 46% | 55% |
| Risk free interest rate | 2.42% | 2.29% |
| Weighted average share option value | \$0.74 | \$0.57 |

Historical volatility was the basis for determining expected share price volatility as it is assumed that this is indicative of future trends, which may not eventuate.

(c) Performance Rights Plan ('PRP')

The Company currently has two PRP plans in place, the Karoon Gas Australia 2016 PRP approved by shareholders at the 2016 Annual General Meeting and the Karoon Gas Australia 2012 PRP approved by shareholders at the 2012 Annual General Meeting.

Under the PRP, eligible employees are given performance rights to be issued and allotted fully paid ordinary shares in the Company, or its equivalent value, for no consideration provided certain conditions have been met. Vesting of performance rights is conditional on the achievement of performance measures, over a one-year performance period, and provided the employee remains employed by the Company for an additional year. In each case, the Remuneration Committee will be responsible for assessing whether the performance measures have been achieved. When vested, each performance right is convertible into one ordinary share of the Company.

Performance rights granted carry no dividend or voting rights.

If there is a change of control of the Company, for all unexercised performance rights issued pursuant to the Company's PRP, a percentage amount of unvested performance rights may vest on the basis of the pro-rata achievement of predetermined performance conditions.

During the financial year, the Group granted 596,944 performance rights (2016: 284,834) over unissued ordinary shares in the Company to Executive Directors. Performance rights issued to Directors are approved on a case-by-case basis by shareholders at relevant general meetings.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 27. Share-based Payments continued

(c) Performance Rights Plan ('PRP') continued

The following summary reconciles the outstanding performance rights over unissued ordinary shares in the Company at the beginning and end of the financial year:

| | Consolidated | |
|--|----------------|----------------|
| | 2017 Number | 2016 Number |
| Balance at beginning of financial year | 1,792,398 | 294,569 |
| Granted during financial year | 3,573,686 | 1,810,055 |
| Vested and converted during financial year | (472,426) | (264,704) |
| Cancelled during financial year | (166,446) | (47,522) |
| Cash-settled during financial year | (63,946) | - |
| Forfeited during financial year | (192,472) | - |
| Balance at end of financial year | 4,470,794 | 1,792,398 |

All performance rights issued during the financial year were issued under the Karoon Gas Australia 2016 PRP.

There were 472,426 (2016: 264,704) performance rights vested during the financial year, which were converted into 472,426 (2016: 264,704) fully paid ordinary shares.

The weighted average fair value of performance rights granted during the financial year was \$1.91 (2016: \$2.00). The fair value of the performance rights at grant date was based on the closing market price of the Company's ordinary shares on that date.

Performance rights outstanding as at 30 June 2017 had a weighted average remaining contractual life of 793 days (30 June 2016: 735 days).

Details of performance rights outstanding at the end of the financial year are:

| Grant Date | Expiry Date | Number |
|--------------------------|--------------|-----------|
| 9 October 2015 | 30 June 2018 | 404,632 |
| 9 October 2015 | 30 June 2019 | 451,395 |
| 30 October 2015 | 30 June 2019 | 138,460 |
| 2 December 2016 | 30 June 2018 | 211,428 |
| 30 November 2016 | 30 June 2019 | 1,138,919 |
| 2 December 2016 | 30 June 2019 | 741,609 |
| 30 November 2016 | 30 June 2020 | 636,546 |
| 2 December 2016 | 30 June 2020 | 385,516 |
| 2 December 2016 | 30 June 2020 | 362,289 |
| Total performance rights | | 4,470,794 |

(d) Share-based Payments Expense

Total expenses arising from share-based payment transactions recognised during the financial year, included as part of employee benefits expense in the consolidated statement of profit or loss and other comprehensive income, were as follows:

| | Consolidated | |
|---|--------------|------------|
| | 2017 \$ | 2016 \$ |
| Share options issued under ESOP | 1,548,412 | 2,057,814 |
| Other share options | - | 35,630 |
| Performance rights issued under PRP | 2,042,227 | 1,159,749 |
| Share-based payments expense (non-cash) | 3,590,639 | 3,253,193 |
| Share-based payments expense (cash-settled) | 207,029 | - |
| Total share-based payments expense | 3,797,668 | 3,253,193 |

Note 28. Related Party Transactions

Transactions between related parties are on normal commercial terms and conditions, no more favourable than those available to other parties, unless otherwise stated.

(a) Parent Company

The ultimate Parent Company within the Group is Karoon Gas Australia Ltd.

(b) Subsidiaries

Interests in subsidiaries are set out in Note 21.

During the financial year, the Group provided accounting, administrative and technical services to subsidiaries at cost. This allocation was based on costs recharged on a relevant time allocation of employees and consultants and associated office charges.

Other transactions that occurred were provision of funding by the Parent Company to its overseas subsidiaries via an increase in contributed equity and intercompany loans to the Australian subsidiaries. The intercompany loans provided are at a Nil% interest rate (2016: Nil%) and no fixed term for repayment and therefore will not be repaid within 12 months. Loans are unsecured and are repayable in cash.

Where equity-settled share options and performance rights are issued to employees of subsidiaries within the Group, the transaction is recognised as an investment in the subsidiary by the Parent Company and in the subsidiary, a share-based payments expense and an equity contribution by the Parent Company.

The above transactions are eliminated on consolidation.

(c) Remuneration of Key Management Personnel

Directors and other key management personnel remuneration is summarised as follows:

| | Consolidated | |
|---|--------------|-----------|
| | 2017 | 2016 |
| | \$ | \$ |
| Short-term employee benefits | 3,714,974 | 3,524,575 |
| Post-employment benefits | 187,622 | 184,511 |
| Long-term employee benefits (non-cash) | 44,260 | 46,200 |
| Share-based payments expense | 1,711,340 | 1,430,964 |
| Total key management personnel remuneration | 5,658,196 | 5,186,250 |

Detailed remuneration disclosures for the Directors and other key management personnel are provided in Section 5 of the audited Remuneration Report on pages 51 to 52.

In addition to the above, the Group is committed to pay the Executive Directors and other key management personnel up to \$3,160,046 (2016: \$3,204,451) in the event their role is fundamentally reduced upon a change in control of the Group.

Apart from the details disclosed in this note, no Director or other key management personnel has entered into a material contract with the Group since the end of the previous financial year and there were no material contracts involving Directors' or other key management personnel interests subsisting as at 30 June 2017.

(d) Superannuation Contributions

During the financial year, the Group contributed to accumulation type benefit funds administered by external fund managers or an employee's self-managed superannuation fund. The funds cover all Australian domiciled employees and Directors of the Company. The current contribution rate is 9.5% p.a. (2016: 9.5% p.a.) of employee cash remuneration up to a cap of \$19,616 (2016: \$19,308). Contributions to superannuation funds, on behalf of Directors and employees, during the financial year by the Group amounted to \$528,643 (2016: \$523,295).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Financial Year Ended 30 June 2017 (continued)

Note 28. Related Party Transactions continued

(e) Other Related Party Transactions Within the Group

During the financial year, Mr Jose Coutinho Barbosa, a Non-Executive Director, had an interest in Net Pay Óleo & Gás Consultoria Ltda that provided business and geology consulting services to the Group. The value of these transactions during the financial year in the Group was \$332,210 (2016: \$341,492). The balance outstanding included in current trade and other payables is \$27,149 (2016: \$60,363). Given Karoon's relative size to other operators in Brazil, the consulting services provided by Net Pay Óleo & Gás Consultoria Ltda are critical to Karoon's ability to operate within the Brazilian oil industry.

During the financial year, Ms Flavia Barbosa, the daughter of a Non-Executive Director, was employed by the Group as the in-house Legal Counsel in Brazil. The total value of her remuneration (including share-based payments expense) during the financial year was \$242,372 (2016: \$169,513), which includes social security and indemnity fund contributions of \$16,535 (2016: \$12,188). Ms Barbosa has been an employee of the Company since 2011, and has a comprehensive understanding of the Brazilian legal and regulatory framework.

During the financial year, Ms Marina Sayao, the wife of Mr Tim Hosking (a key management person), was employed by the Group on a full-time basis until August 2016 and then on a part-time basis from September 2016 as the Sustainability and Communications Manager South America. The total value of her remuneration during the financial year was \$152,478 (2016: \$139,605), which includes social security and indemnity fund contributions of \$34,967 (2016: \$11,336). Ms Sayao is a key member of the South American operations. The Brazilian and Peruvian regulatory and business environments require transparent and clear communication on social and environmental issues with local and federal governments.

During the financial year and the previous financial year, Mr Mark Smith, an Executive Director, had an interest in IERS (Australia) Pty Ltd, which has an ongoing informal agreement with the Group to provide geophysical fault seal analysis software. This agreement does not include monetary compensation, instead the Group provides testing and ongoing development of the geophysical fault seal analysis software in return for its use.

(f) Related Party Payables

During the financial year, as part of their 'At Risk' remuneration Mr Scott Hosking and Mr Tim Hosking were issued cash-settled share-based payments for which a liability is recognised based on fair value earned by the end of the reporting period. The balance outstanding included in current trade and other payables is \$140,990 (2016: \$Nil) and in non-current trade and other payables \$201,471 (2016: \$Nil).

| | Company | |
|--|----------------------|--------------------|
| | 2017 | 2016 |
| | \$ | \$ |
| Note 29. Parent Company Financial Information | | |
| (a) Summary Financial Information | | |
| The individual financial statements for Karoon Gas Australia Ltd show the following aggregate amounts: | | |
| Statement of financial position | | |
| Current assets | 374,469,705 | 467,526,648 |
| Non-current assets | 310,093,584 | 327,913,001 |
| Total assets | 684,563,289 | 795,439,649 |
| Current liabilities | 1,998,063 | 2,919,518 |
| Non-current liabilities | 23,456,171 | 33,888,904 |
| Total liabilities | 25,454,234 | 36,808,422 |
| Net assets | 659,109,055 | 758,631,227 |
| Contributed equity | 802,295,334 | 802,967,815 |
| Accumulated losses | (186,720,894) | (84,526,464) |
| Share-based payments reserve | 43,534,615 | 40,189,876 |
| Total equity | 659,109,055 | 758,631,227 |
| Loss for financial year | (102,194,430) | (3,344,417) |
| Total comprehensive loss for financial year | (102,194,430) | (3,344,417) |

| | Company | |
|--|-----------|-----------|
| | 2017 | 2016 |
| | \$ | \$ |
| (b) Contingent Liabilities of Parent Company | | |
| (i) Bank guarantees were provided in respect of operating lease rental agreements. These guarantees may give rise to liabilities in the Parent Company if obligations are not met under these guarantees. The bank guarantees given to lessors are fully funded by way of payment of security deposits (refer Note 13). | 430,693 | 375,335 |
| (ii) Performance guarantee (via a letter of credit) was provided to Peru Petro SA (the Peruvian oil and gas regulator) for Block Z-38 by the Parent Company for third period work commitments. The Directors are of the opinion that the work commitments will be satisfied. The letter of credit is fully funded by way of payment of a security deposit (refer Note 13), which will be released once the work commitments are met. The performance guarantee (via a letter of credit) provided to Peru Petro SA in the previous financial year for Block 144 by the Parent Company was returned during the financial year. | 7,317,827 | 9,617,641 |
| (iii) The Company's present intention is to provide the necessary financial support for all Australian incorporated subsidiaries, whilst they remain wholly owned subsidiaries, as is necessary for each company to pay all debts as and when they become due. | | |

Note 30. Subsequent Events

The Annual Report was authorised for issue by the Board of Directors on 21 September 2017. The Board of Directors has the power to amend and reissue the consolidated financial statements and notes.

Since 30 June 2017, the following material events have occurred:

(a) Echidna Oil Discovery Development Concept Approved for FEED

During July 2017, the Board approved the development concept for the Echidna light oil discovery, progressing the project to the next phase in the development, Front End Engineering and Design.

(b) Framework Co-operation Agreement with DEA

Also during July 2017, the Group entered into agreements with DEA Deutsche Erdoel AG ('DEA') to review and evaluate and, if thought appropriate, jointly bid for oil and gas assets in selected areas offshore Brazil. As part of these arrangements, an exclusive option has been granted to DEA for the acquisition of a non-operated interest of up to 50% in Karoon's five Santos Basin Blocks, including the Echidna and Kangaroo oil discoveries. Exercise of such option being subject to satisfactory due diligence and agreement of terms.

Unless otherwise indicated, the financial effect of these events has not been recognised in either the consolidated financial statements or notes for the financial year.

DIRECTORS' DECLARATION

In the Directors' opinion:

- (a) the consolidated financial statements and notes, set out on pages 63 to 103, are in accordance with the *Corporations Act 2001*, including:
- (i) complying with relevant Australian Accounting Standards and the *Corporations Regulations 2001*; and
 - (ii) giving a true and fair view of the Group's financial position as at 30 June 2017 and of its performance for the financial year ended on that date; 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.

Note 1(a) confirms that the consolidated financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

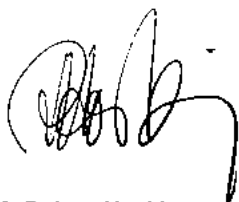
The Directors have been given the declarations by the Managing Director and Chief Financial Officer required by Section 295A of the *Corporations Act 2001*.

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

On behalf of the Directors:



Dr David Klingner
Independent Non-Executive Chairman



Mr Robert Hosking
Managing Director

21 September 2017

INDEPENDENT AUDITOR'S REPORT



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

Report on the audit of the financial report

Our opinion

In our opinion:

The accompanying financial report of Karoon Gas Australia Ltd (the Company) and its controlled entities (together, the Group) is in accordance with the *Corporations Act 2001*, including:

- a) giving a true and fair view of the Group's financial position as at 30 June 2017 and of its financial performance for the financial year then ended; and
- b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

What we have audited

The Group financial report comprises the:

- consolidated statement of profit or loss and other comprehensive income for the financial year then ended
- consolidated statement of financial position as at 30 June 2017
- consolidated statement of changes in equity for the financial year then ended
- consolidated statement of cash flows for the financial year then ended
- notes to the consolidated financial statements, which include the significant accounting policies, and
- Directors' Declaration.

Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial report* section of our report.

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

Independence

We are independent of the Company in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

Our audit approach

An audit is designed to provide reasonable assurance about whether the financial report is free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

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We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial report as a whole, taking into account the geographic and management structure of the Group, its accounting processes and controls, and the industry in which it operates.



Materiality

For the purpose of our audit we used overall group materiality of \$8.1 million, which represents approximately 1% of the Group's total assets.

We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the financial report as a whole.

We chose total assets because it is a commonly accepted benchmark for exploration companies in the oil and gas industry that do not currently have producing assets. The Group does not currently have revenue from producing assets, meaning profit and revenue based thresholds are less relevant. We chose 1% based on our professional judgement, noting it is within the range of commonly accepted thresholds.

Audit scope

Our audit focused on where the Group made subjective judgements, for example significant accounting estimates involving assumptions and inherently uncertain future events.

The Group has three main operating segments in Australia, Brazil and Peru. In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed by us, as the group engagement team, and by component auditors under our instruction. Due to their financial significance, audit procedures were performed over the three main operating segment's financial information.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report for the financial year. We communicated the key audit matters to the Audit Committee. The key audit matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. Further, any commentary on the outcomes of a particular audit procedure is made in that context.

Key audit matter**How our audit addressed the key audit matter*****Carrying value assessment of exploration and evaluation assets***

(Refer to note 17 in the financial report)

As at 30 June 2017, the Group has capitalised exploration and evaluation expenditure of \$371.0 million, related primarily to geological, geophysical, drilling and other exploration and evaluation expenditure.

The exploration and evaluation assets are assessed for indicators of impairment for each area of interest at each period end. Assessing whether the carrying amount of the exploration and evaluation assets is likely to be recovered in full from a successful development or by sale requires the Group to make a number of estimates and assumptions. These estimates include the long-term oil price, resource estimates, production volume and cost profiles.

As discussed in Note 17, during the financial year, an expense of \$6.8 million was recorded in the consolidated statement of profit or loss and other comprehensive income to reflect the relinquishment of Block 144 (Marañón Basin, Peru). An impairment charge of \$21.6 million was recorded against the capitalised exploration and evaluation expenditure associated with Block S-M-1166 (Santos Basin Block, Brazil.)

The carrying value assessment was a key audit matter due to the size of the capitalised exploration and evaluation expenditure and the nature of the estimates and judgements required in determining whether there are any impairment indicators.

To evaluate the Group's carrying value assessment, we performed the following procedures:

- Obtained an understanding of the Group's impairment indicator assessment process;
- Considered the market data and industry forecasts for the long-term oil price;
- Considered approved budgets and business plans, current drilling operations, permit tenure and other evidence of future intentions for individual exploration areas of interest; and
- Compared the write-off and impairment charge recorded against Block 144 and Block S-M-1166 respectively against historical capitalised costs.

Liquidity to fund future exploration expenditure
(Refer to note 25 in the financial report)

The Group has significant exploration expenditure commitments arising from its obligations to perform minimum exploration and evaluation work, which are not recorded as liabilities in the consolidated statement of financial position. The Group's guaranteed exploration expenditure was \$330.2 million as at 30 June 2017. In addition, non-guaranteed work commitments totalled \$439.7 million at financial year end. These commitments are not due in the 2018 financial year.

The Group holds cash and cash equivalents of approximately \$375.1 million and has no committed external debt arrangements as at 30 June 2017. Notwithstanding this, the Group currently has no cash-generating assets in operation. Therefore, our assessment of the Group's determination that there are sufficient funds available to allow the Group to continue as a going concern was a key audit matter.

We performed the following procedures, amongst others, in evaluating the Group's determination:

- Obtained the Group's analysis of future exploration expenditure commitments and considered the guaranteed and non-guaranteed classification of these amounts;
- Checked that the Group's cash flow forecast for the 12 months from the date of the financial report (the cash flow forecast) included guaranteed exploration expenditure commitments;
- Evaluated other additional non-guaranteed exploration expenditure commitments and operational cash outflows included in the Group's cash flow forecast;
- Assessed whether there were any deficiencies in the Group's cash flow forecast position; and
- Obtained written representations from management and the Board of Directors regarding their plans for future action and the feasibility of these plans.

Other information

The Directors are responsible for the other information. The other information comprises the information included in the Group's annual report for the financial year ended 30 June 2017, including the Chairman and Managing Director's Review, Resource Summary, Operations Review, Corporate Sustainability Report, Directors' Report and Additional Securities Exchange Information, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial report

The Directors of the Company are responsible for the preparation of the 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 financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the Directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf. This description forms part of our auditor's report.

Report on the Remuneration Report

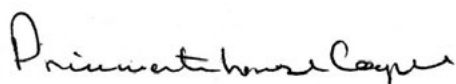
Our opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 34 to 60 of the Directors' Report for the financial year ended 30 June 2017.

In our opinion, the Remuneration Report of Karoon Gas Australia Ltd for the financial year ended 30 June 2017 complies with section 300A of the *Corporations Act 2001*.

Responsibilities

The Directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.



PricewaterhouseCoopers



Charles Christie
Partner

Melbourne
21 September 2017

ADDITIONAL SECURITIES EXCHANGE INFORMATION

Additional information required by the ASX Listing Rules and not disclosed elsewhere in the Annual Report is set out below. The information was applicable for the Company as at 12 September 2017.

Distribution of Shareholding

The number of shareholders ranked by size of holding is set out below:

| Size of Holding | Number of Holders | Number of Ordinary Shares on Issue |
|-------------------|-------------------|------------------------------------|
| Less than 1,000 | 2,616 | 1,168,269 |
| 1,001 to 5,000 | 3,121 | 8,684,488 |
| 5,001 to 10,000 | 1,310 | 9,958,425 |
| 10,001 to 100,000 | 1,458 | 39,703,592 |
| More than 100,000 | 168 | 186,073,012 |
| Total | 8,673 | 245,587,786 |

There were 1,349 shareholders holding less than a marketable parcel of ordinary shares to the value of \$500.

Substantial Shareholders

The number of ordinary shares held by substantial shareholders and their associates (who held 5% or more of total fully paid ordinary shares on issue), as disclosed in substantial holder notices given to the Company, is set out below:

| Shareholder | Fully Paid Ordinary Shares | |
|---|----------------------------|-----------------------------|
| | Number Held | % of Issued Ordinary Shares |
| Talbot Group Holdings Pty Ltd | 26,358,356 | 10.73 |
| Henderson Global Investors Limited | 20,721,146 | 8.44 |
| Wellington Management Group, LLP and its related bodies corporate | 20,599,482 | 8.39 |
| Total | 67,678,984 | 27.56 |

Twenty Largest Shareholders

The names of the twenty largest shareholders of the Company's ordinary shares are listed below:

| Shareholder | Fully Paid Ordinary Shares | |
|--|----------------------------|-----------------------------|
| | Number Held | % of Issued Ordinary Shares |
| 1 HSBC Custody Nominees (Australia) Limited | 50,644,307 | 20.62 |
| 2 J P Morgan Nominees Australia Limited | 24,995,941 | 10.18 |
| 3 Talbot Group Holdings Pty Ltd <Talbot Equities A/C> | 15,317,043 | 6.24 |
| 4 Citicorp Nominees Pty Limited | 14,649,826 | 5.97 |
| 5 BNP Paribas Noms Pty Ltd <DRP> | 13,090,615 | 5.33 |
| 6 Talbot Group Investments Pty Ltd | 11,000,313 | 4.48 |
| 7 Ropat Nominees Pty Ltd | 9,210,022 | 3.75 |
| 8 National Nominees Limited | 3,191,738 | 1.30 |
| 9 UBS Nominees Pty Ltd | 1,787,677 | 0.73 |
| 10 National Nominees Limited <DB A/C> | 1,699,090 | 0.69 |
| 11 Mrs Mara Spong | 1,127,888 | 0.46 |
| 12 IERS (Australia) Pty Ltd <Smith Family Investment A/C> | 1,071,500 | 0.44 |
| 13 BNP Paribas Nominees Pty Ltd <IB AU Noms Retail Client DRP> | 1,033,137 | 0.42 |
| 14 Mr Mark Alexander Smith | 991,658 | 0.40 |
| 15 Aranim Pty Ltd | 851,096 | 0.35 |
| 16 IERS (Australia) Pty Ltd <Bonnie Doon Super Fund A/C> | 807,780 | 0.33 |
| 17 Mr Samuel Thomas Henderson | 800,000 | 0.33 |
| 18 Mrs Pauline Frolley | 770,746 | 0.31 |
| 19 BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C> | 713,077 | 0.29 |
| 20 Merrill Lynch (Australia) Nominees Pty Limited | 690,601 | 0.28 |
| Total | 154,444,055 | 62.90 |

Unlisted Equity Securities: Share Options and Performance Rights

The following share options and performance rights over unissued ordinary shares of the Company are not quoted:

| | Number of Holders | Number of Unlisted Share Options and Performance Rights on Issue |
|---|----------------------|---|
| Share options issued pursuant to Karoon Gas Australia Employee Share Option Plans | 44 | 4,446,619 |
| Performance rights issued pursuant to Company's Performance Rights Plans | 45 | 3,318,202 |
| Total | 89 | 7,764,821 |

Voting Rights

(a) Ordinary Shares, Fully Paid

Voting rights of shareholders are governed by the Company's Constitution. In summary, on a show of hands every holder of ordinary shares present at a meeting in person or by proxy is entitled to one vote, and upon a poll each such attending shareholder is entitled to one vote for every fully paid ordinary share held.

(b) Unlisted Share Options and Performance Rights

No voting rights.

Other Information

The Company was incorporated as a public company on 11 November 2003.

The Company was admitted to the ASX official list during June 2004 and quotation of its ordinary shares commenced on 8 June 2004.

The register of securities is held at Computershare Investor Services Pty Limited, GPO Box 2975 Melbourne VIC 3001 Australia. Investor enquiries can be made via telephone on 1300 850 505 (within Australia).

Schedule of Interests in Petroleum Tenements

| Exploration Permit/Block | Basin | % Interest Held |
|--------------------------|-------------------------------|--------------------|
| EPP46 | Ceduna Sub-basin, Australia | 100 |
| WA-314-P | Browse, Australia | 100 [#] |
| WA-482-P | Northern Carnarvon, Australia | 50 [^] |
| Block S-M-1037 | Santos, Brazil | 100 |
| Block S-M-1101 | Santos, Brazil | 100 |
| Block S-M-1102 | Santos, Brazil | 100 |
| Block S-M-1165 | Santos, Brazil | 100 |
| Block S-M-1166 | Santos, Brazil | 100 |
| Block Z-38 | Tumbes, Peru | 75 ^{^^} |

[#] 1.5% over-riding royalty for first five years of production, going to 2% thereafter.

[^] Liberty Petroleum Corporation is entitled to certain milestone cash bonuses and a royalty in the event of production.

^{^^} The Group's 75% equity interest is subject to completion of farm-in obligations.

GLOSSARY OF TERMS

| Term | Definition |
|----------------------------------|---|
| 2D seismic | Two-dimensional seismic. |
| 3D seismic | Three-dimensional seismic. |
| \$ or cents | Units of Australian currency. |
| AASB | Australian Accounting Standards Board. |
| amplitude anomaly | A change in seismic amplitude that may represent a change in subsurface properties, such as the presence of hydrocarbons or improved reservoir. |
| ANP | Agência Nacional do Petróleo, Gás Natural e Biocombustíveis. |
| API | American Petroleum Institute's inverted scale for denoting the 'lightness' or 'heaviness' of crude oils and other liquid hydrocarbons. |
| appraisal well | A well drilled to confirm the size or quality of a hydrocarbon discovery. |
| associated gas | Natural gas found in association with oil, dissolved either in the oil or as a cap of free gas above the oil. |
| ASX | ASX Limited (ACN 008 624 691), trading as Australian Securities Exchange. |
| ATO | Australian Taxation Office. |
| AUD | Australian currency. |
| AVO | Amplitude versus offset. |
| barrel or bbl | Barrel of oil, inclusive of condensate. A quantity of 42 United States gallons; equivalent to approximately 159 litres. |
| basin | A natural depression on the Earth's surface in which sediments, eroded from higher surrounding ground levels, accumulated and were preserved. |
| Bcf | Billion cubic feet (1,000,000,000 cubic feet); equivalent to approximately 28.3 million cubic metres. |
| Bcfe | Billion cubic feet equivalent. |
| 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. |
| BOP | Blowout preventer. |
| BTU | British Thermal Unit. The unit of measurement of the quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit, equivalent to 1055.056 joules. |
| CDP | Carbon Disclosure Project. |
| CO₂ | Carbon dioxide. |
| Company or Parent Company | Karoon Gas Australia Ltd. |
| 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. |

| Term | Definition |
|--|---|
| contingent resources | Those quantities of hydrocarbons estimated, as of a given date, to be potentially recoverable from known accumulations by application of development projects, but which are not currently considered to be commercially recoverable (as evaluation of the accumulation is insufficient to clearly assess commerciality). 1C- Denotes low estimate scenario of contingent resources. 2C- Denotes best estimate scenario of contingent resources. 3C- Denotes high estimate scenario of contingent resources. |
| CPP | Citizen Participation Plan. |
| DEA | DEA Deutsche Erdoel AG. |
| Director | A Director of Karoon Gas Australia Ltd. |
| DHI | Direct hydrocarbon indicator. |
| discovery well | The first successful well on a new prospect. |
| DSEWPaC | Department of Sustainability, Environment, Water, Population and Communities in Peru. |
| DST | Drill stem test. |
| economically recoverable reserves | The estimated quantity of hydrocarbons in an area of interest that can be expected to be profitably extracted, processed and sold under current and foreseeable economic conditions. |
| EIA | Environmental Impact Assessment. A report on the study of the effect of proposed works on the local people and environment. |
| E&P | Exploration and production. |
| EPS | Early production system. |
| ESG | Environmental, social and governance. |
| ESOP | Karoon Gas Australia 2016 Employee Share Option Plan and Karoon Gas Australia 2012 Employee Share Option Plan. |
| EWT | Extended well test. |
| 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 operation participant (the 'farmee') earns an interest in an exploration tenement by funding a proportion of exploration and evaluation expenditures, while the participant owning the interest in the exploration tenement (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. |
| FBT | Fringe Benefits Tax in Australia. |
| FEED | Front End Engineering and Design. |
| FID | Final Investment Decision. |
| field | An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature or stratigraphic condition. The field name refers to the surface area although it may refer to both the surface and underground productive formation. |

GLOSSARY OF TERMS (continued)

| Term | Definition |
|-------------------------------|---|
| financial year | Financial year ended 30 June 2017. |
| FPSO | Floating production, storage and off-loading facility. |
| G&G | Geological and geophysical. |
| GAB | Great Australian Bight. |
| GABRWC | Great Australian Bight Right Whale Study in Australia. |
| GOR | Gas to oil ratio. |
| GST | Goods and Services Tax in Australia. |
| H₂S | Hydrogen sulfide. |
| HSE | Health, safety, security and environment. |
| HSSEMS | Health, Safety, Security and Environment Management System. |
| 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 | Kilometres. |
| 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. |
| IIAP | Peruvian Amazon Research Institute. |
| LNG | Liquefied natural gas. |
| LPG | Liquid petroleum gas. |
| LTI | Long-term incentive. |
| LWD | Logging while drilling. |
| m | Metres. |
| market capitalisation | The product of a company's share price multiplied by the total number of ordinary shares issued by the company. |
| migration | Hydrocarbons are often found in formations other than those in which their organic source was deposited. This movement often covers considerable distances and is known as migration. |
| mm | Million. |
| mmbbls | Millions of barrels (1,000,000 barrels). |
| mmscf | Millions of standard cubic feet. |
| mmscf/d | Millions of standard cubic feet per day; equivalent to 28,317 cubic metres per day. |
| mmtpa | Million tonne per annum. A common measurement of LNG facility production capacity. |
| 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. |

| Term | Definition |
|--------------------------------|--|
| mRT | Metres Rotary Table. |
| ms | Millisecond. |
| NOPTA | National Offshore Petroleum Titles Administrator. |
| OMS | Operating Management System. |
| Operator | One joint operation participant that has been appointed to carry out all operations on behalf of all the joint operation participants. |
| ordinary shares | The ordinary shares in the capital of Karoon Gas Australia Ltd. |
| OWC | Oil-water-contact. |
| p.a. | Per annum. |
| Pacific | Pacific Exploration and Production Corp. |
| PAD | Discovery Appraisal Plan (Plano de Avaliação de Descobertas). |
| performance rights | Performance rights issued under the PRP. |
| permit | A hydrocarbon tenement, lease, licence, concession or block. |
| Petróbras | 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. |
| previous financial year | Financial year ended 30 June 2016. |
| PRP | Karoon Gas Australia 2016 Performance Rights Plan and Karoon Gas Australia 2012 Performance Rights Plan. |
| 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 | <p>Those quantities of hydrocarbons estimated, as of a given date, to be potentially recoverable from undiscovered accumulations.</p> <p>Low estimate (P90): P90 refers to a 90% chance that an estimated quantity, such as a prospective resources volume or associated quantity, will be equalled or exceeded.</p> <p>Median estimate (P50): P50 refers to a 50% chance that an estimated quantity, such as a prospective resources volume or associated quantity, will be equalled or exceeded.</p> <p>High estimate (P10): P10 refers to a 10% chance that an estimated quantity, such as a prospective resources volume or associated quantity, will be equalled or exceeded.</p> <p>Mean estimate (Mean): Mean is the expected value, equal to the sum of the values in that distribution divided by the number of values.</p> |
| prospectivity | Referring to the likelihood of finding commercial hydrocarbons. |
| PRRT | Petroleum Resource Rent Tax in Australia. |
| psia | Pounds per square inch absolute. |
| REAL | Brazilian currency. |

GLOSSARY OF TERMS (continued)

| Term | Definition |
|---------------------------|--|
| recoverable gas | An estimated measure of the total amount of gas which could be brought to surface from a given reservoir. In a good quality reservoir this is usually in the order of 70-80% of the estimated gas-in-place. |
| reserves | Quantities of economically recoverable hydrocarbons estimated to be present within a trap. |
| reservoir | A porous and permeable rock formation to store and transmit fluids such as hydrocarbons and water. |
| rig | The equipment needed for drilling a well. It includes the onshore and offshore vehicles, mobile platforms or vessel on which the equipment is stored. |
| 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. |
| Rotary Table | A flat plate in the drill floor which is turned mechanically at varying speeds and directions imparting the rotary action to the drill string which passes through its centre. |
| 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 and form of stratigraphic units and in making subsurface structural contour maps and ultimately in delineating prospective structures. |
| SPE PRMS standards | Society of Petroleum Engineers Petroleum Resource Management System Petroleum resources are the estimated quantities of hydrocarbons naturally occurring on or within the Earth's crust. Resource assessments estimate total quantities in known and yet to be discovered accumulations, resource evaluations are focused on those quantities that can potentially be recovered and marketed by commercial projects. A petroleum resource management system provides a consistent approach to estimating petroleum quantities, evaluating development projects and presenting results within a comprehensive classification framework. |
| spud | To start drilling a new well. |
| sq km | Square kilometres. |
| STI | Short-term incentive. |
| tcf | Trillion cubic feet (1,000,000,000,000 cubic feet). |
| TCFD | Task Force on Climate-related Financial Disclosures. |
| tcfe | Trillion cubic feet equivalent. |
| trap | A formation in the Earth's subsurface which prevents the onward migration of hydrocarbons. |
| TRIR | Total Recordable Incident Rate. |
| TSR | Total shareholder return. |
| unrisked | A risk value has not been applied to an estimate of hydrocarbon volume either in place or recoverable. |
| USD or US\$ | United States dollars. |

CORPORATE DIRECTORY

Board of Directors

Dr David Klingner – Independent Non-Executive Chairman
Mr Robert Hosking – Managing Director
Mr Mark Smith – Executive Director
Ms Luciana Rachid – Independent Non-Executive Director
Mr Geoff Atkins – Independent Non-Executive Director
Mr Clark Davey – Independent Non-Executive Director
Mr Peter Turnbull – Independent Non-Executive Director
Mr Jose Coutinho Barbosa – Non-Executive Director

Company Secretary

Mr Scott Hosking

Audit Committee Members

Mr Clark Davey (Chairman of Committee)
Mr Geoff Atkins
Mr Peter Turnbull

Nomination Committee Members

Mr Geoff Atkins (Chairman of Committee)
Ms Luciana Rachid
Mr Clark Davey
Mr Peter Turnbull

Remuneration Committee Members

Mr Peter Turnbull (Chairman of Committee)
Dr David Klingner
Mr Clark Davey

Risk and Governance Committee Members

Mr Peter Turnbull (Chairman of Committee)
Dr David Klingner
Ms Luciana Rachid
Mr Clark Davey

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Website www.computershare.com

Securities Exchange Listing

The Company's ordinary shares are listed on the ASX.
The home exchange is Melbourne VIC.

ASX code KAR

Notice of Annual General Meeting

The Annual General Meeting of Karoon Gas Australia Ltd will be held at:

Club Pavilion at the RACV City Club
Level 2, 501 Bourke Street
Melbourne VIC 3000

Time 10.00am Melbourne time
(registration opens at 9.00am)

Date Thursday 9 November 2017

