



PETSEC ENERGY ANNUAL REPORT 2009

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Annual General Meeting to be held at:

10.00 am (AEST) on Friday, 21 May 2010,
at The Museum of Sydney,
corner of Bridge and Phillip Streets,
Sydney, Australia

PETSEC ENERGY LTD

ABN 92 000 602 700

The Company is listed on the Australian Stock Exchange (symbol: PSA) and traded over the counter in the USA in the form of ADRs (symbol: PSJEY.PK). Its corporate office is in Sydney, Australia, and its USA operations offices are in Lafayette, Louisiana and Houston, Texas.

2009

JANUARY

- 2008 Production – 12.1 Bcfe, revenues – US\$105.3 million, cashflow (EBITDAX) – US\$79.6 million

APRIL

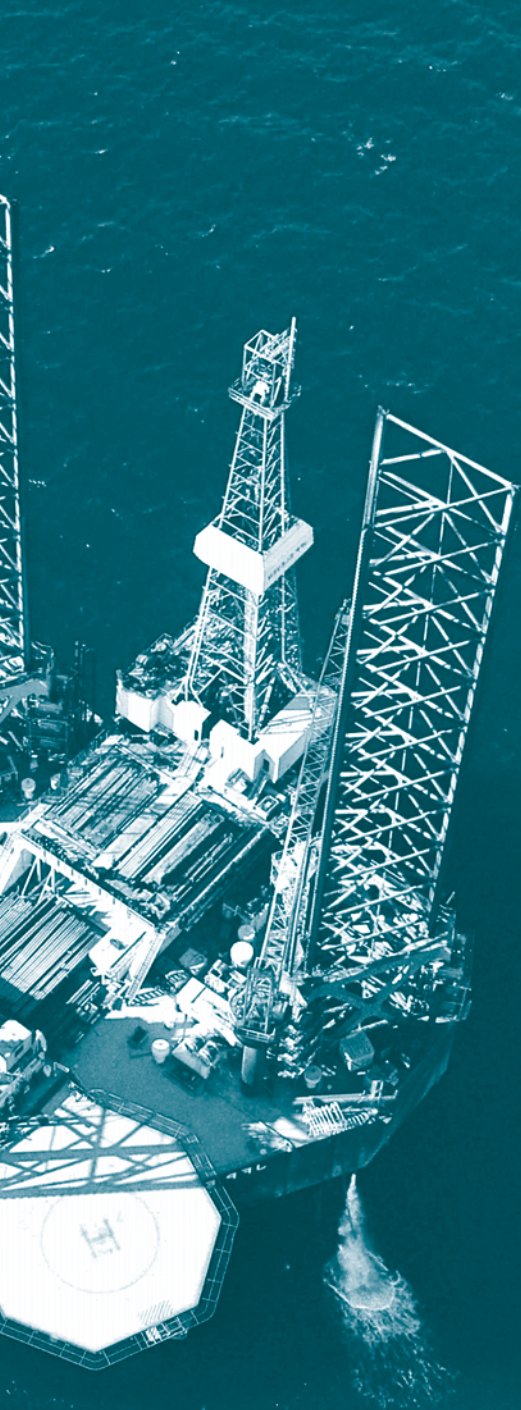
- China National Offshore Oil Corporation (CNOOC) Feasibility Study completed for the development of the 6.12, 6.12 South and 12.8 West oil fields, 27 to 52 million barrels of oil recoverable (P50-P10), for Block 22/12, Beibu Gulf, China, sharing CNOOC processing and pipeline facilities

JUNE

- CNOOC commences Overall Development Plan (ODP) for development of the 6.12, 6.12 South and 12.8 West oil fields

DECEMBER

- A\$15.4 million (US\$13.8 million) rights issue completed to support 2010 exploration and development programme
- Technical section of ODP completed for 6.12, 6.12 South and 12.8 West oil fields, economics section awaiting completion of CNOOC terms of access to processing and pipeline facilities



Over the past two years of excessively high drilling and construction costs and the global financial crisis, Petsec Energy has consolidated its financial and oil and gas potential reserve position through capital conservation, debt repayment, restructuring and enhancement of its USA drilling prospect inventory and progression of the development approvals for its five China oil fields. With US\$25 million in working capital and drilling costs reduced by 60% since 2007/2008 highs, Petsec Energy is poised to resume drilling activities in the Gulf of Mexico, USA, in April 2010 with a three to five well exploration programme for 2010 on targets exceeding 20 Bcfe, and exposing the Company to a net 20 to 50 Bcfe.

With plans for 2010 to recommence drilling in the Gulf of Mexico, USA, and to begin development of its 6.12/12.8 West oil fields project in Beibu Gulf, China, Petsec Energy is confident it will unlock for shareholders the substantial potential value inherent in the Company's existing assets.

2010

- Commenced initial feasibility studies for the development of the 12.8 East and 12.3.1 oil fields, 15 to 72 million barrels of oil recoverable (P50-P10) in the Beibu Gulf, China
- Outstanding debt under bank revolving credit facility fully repaid
- Two year review, restructuring and enhancement of US drilling prospect inventory, substantially completed. Prospect sizes generally range from 20 to 100 Bcfe

JANUARY

- 2009 Production 7.1 Bcfe, revenues – US\$52 million, cashflow (EBITDAX) – US\$31.3 million

MARCH

- High bidder on eight leases at the OCS Central Gulf lease sale. Anticipate grant of leases June 2010

APRIL

- Re-commence exploration and drilling programme in Gulf of Mexico, USA; three to five wells expected to be drilled in 2010 exposing the Company to a net 20 to 50 Bcfe. First well to spud in April, second by mid-year

- Lodge CNOOC-approved ODP for 6.12, 6.12 South and 12.8 West oil fields, China, with Chinese authorities for formal approval

MAY

- Drill results from first well spud in April. Success de-risks five nearby similar prospects

JUNE/JULY

- Final Investment Decision (FID) expected on China oil project; start development, initial gross production of 19,000 bopd anticipated first half 2012

Year in brief 2009

Financial

- Oil and gas sales (net of royalties): US\$52.0 million (US\$7.36/Mcfe) – down 51% on 2008;
- EBITDAX: US\$31.3 million (US\$4.43/Mcfe) – down 61% on 2008;
- Net underlying profit (before exploration write-offs, provisions and tax): US\$3.3 million;
- Net loss after tax: US\$14.9 million;
- Acquisition, development and exploration expenditure: US\$5.2 million;
- Debt under bank revolving credit facility fully repaid;
- Cash on hand: US\$25.4 million;
- Term Debt: US\$29.4 million;
- Net debt: US\$4.0 million – down 89% on 2008; and
- Capital raising: US\$13.8 million from 1:2 pro-rata rights issue.

Operations USA

- Production: 7.1 Bcfe – down 42% on 2008;
1.1.2010: Independently (Ryder Scott Company) estimated proved and probable (2P) oil and gas reserves: 18.0 Bcfe; and
- Restructuring of drilling prospect inventory to larger, deeper prospects with higher production rates with associated oil and condensate. Prospects generated for 2010 MMS lease sale.

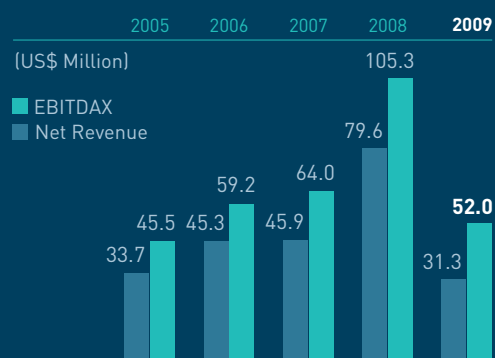
Development China

- Booked proved and probable (2P) oil reserves 6.12, 6.12 South and 12.8 West, net of CNOOC 51% back-in: 3.6 million barrels of oil (21.5 Bcfe); total China oil resources net to Company: 5-15 million barrels;
- CNOOC feasibility study for development of 6.12, 6.12 South and 12.8 West oil fields (27 to 52 million barrels P50-P10), sharing CNOOC facilities, completed in April 2009;
- CNOOC commences Overall Development Plan (ODP) in June;
- Technical section of ODP completed in December. Completion of CNOOC-approved ODP anticipated in April 2010;
- Lodgement of CNOOC-approved ODP with Chinese authorities expected April 2010, with final investment decision and commencement of development mid-year, for first production at initial gross rate of 19,000 bopd in first half 2012; and
- Commence feasibility studies in December of 12.8 East, 12.3.1 oil fields (15 to 72 million barrels, P50-P10).

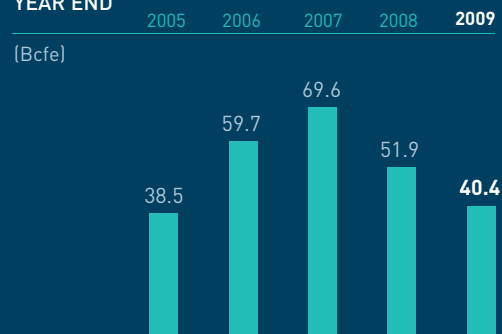
PRODUCTION



EBITDAX AND NET REVENUE



PROVED AND PROBABLE RESERVES YEAR END



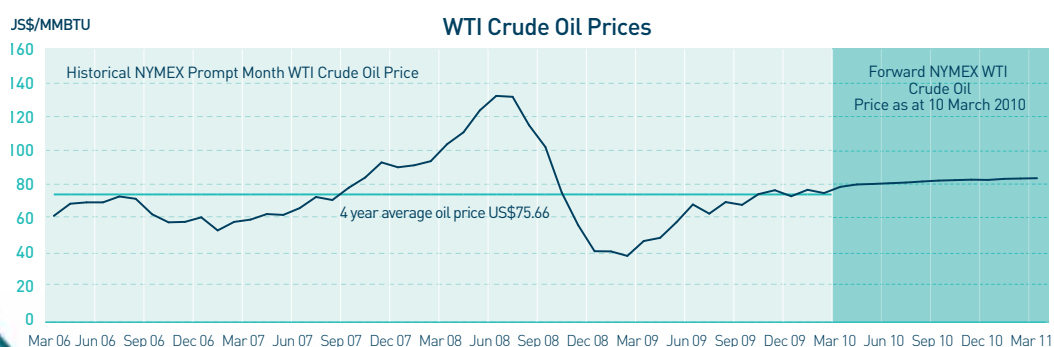
Chairman's Report

During 2009 Petsec Energy reduced its capital expenditures, used much of its cashflow from operations to repay debt, enhanced its drilling prospect portfolio, progressed the development approvals for its China oil fields and positioned itself for a substantial increase in activity in 2010.

2009 was an uncertain and challenging year with highly distressed credit and equity markets worldwide and highly volatile commodity prices. Petsec Energy's highest priority for the year was capital conservation and debt repayment. All exploration drilling remained on hold as it had been through much of 2008 because of excessively high drilling and development costs.

Oil prices have risen from less than US\$40/barrel at the beginning of 2009 to more than US\$80/barrel in April 2010, due to continuing robust Asian demand and a weakening US dollar. This upward trend in oil prices bodes well for a final investment decision on Petsec Energy's Beibu Gulf oil project in China, which is due to be made mid-year.

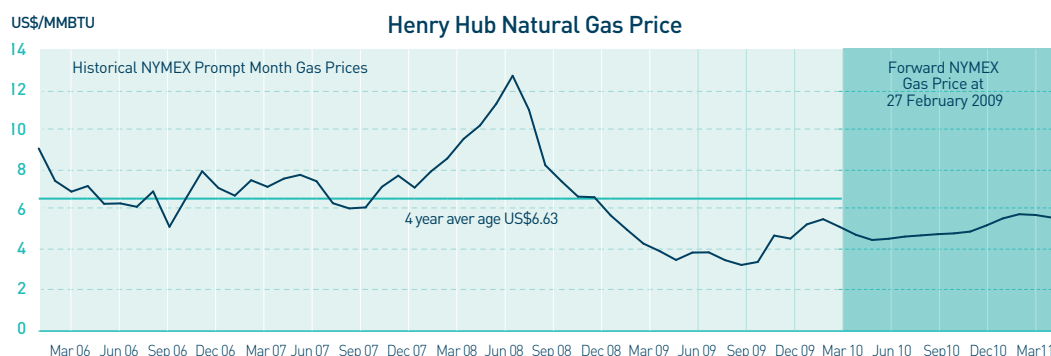
Diminished demand for US natural gas because of the US recession and continuing high supply from shale gas and imported LNG continued to put pressure on the natural gas spot price, which fell to a low of US\$2.50/Mcf in the summer months, then recovered strongly in response to the severe winter. The Henry Hub spot price (NYMEX) which is the marker price for the Gulf of Mexico, averaged US\$4.06/Mcf for the year, a little better than we had expected but significantly lower than the US\$9.12/Mcf for 2008, and at 29 March 2010, the NYMEX forward strip price for 12-month gas was approximately US\$4.60/Mcf and the three year forward approximately US\$5.21/Mcf. We anticipate gas prices will range between US\$4 to US\$5/Mcf over 2010 and 2011, being the apparent breakeven point for most shale gas producers. The lowering of gas prices from 2008 has caused a 60% reduction in drilling and development service costs from the peaks of 2007/08. We view 2010/11 as a particularly good time to explore for and acquire gas reserves.



TN Fern
Chairman and Managing Director

US\$280M

OF CASHFLOW
GENERATED
BETWEEN 2002-2009



Preparing for growth

Prior to the global economic crisis of 2008/2009, Petsec Energy recorded robust growth in production, cash flow and reserves, realising compound annual growth rates for the period 2002 to 2008 of 22% in production, 33% in net revenue and 22% in reserves. Since 2002 Petsec Energy has drilled 44 wells including two side-track wells in China, for 31 successful wells, a 70% success rate. The Company added 71.1 Bcfe of reserves in the US and booked 3.6 million barrels of oil reserves in China, produced 52.2 Bcfe in the US and generated US\$280 million of cashflow (EBITDAX).

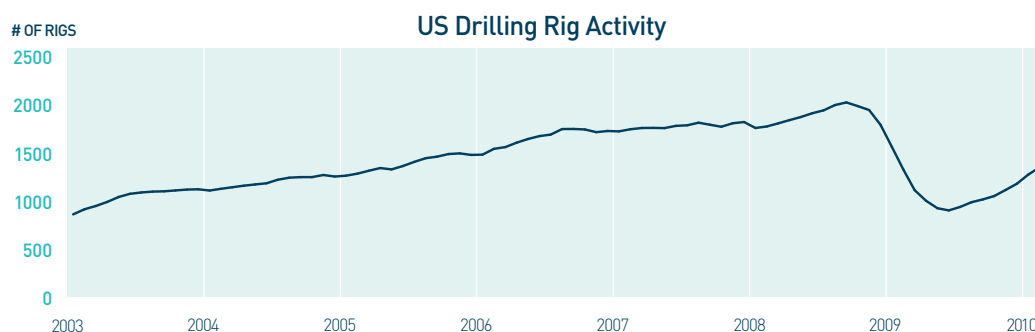
Much of the Company's growth historically has come from successful exploration which resulted in a consistent rise in the share price from \$0.20/share prior to the start of drilling in 2002 to \$3.50/share in 2006 following the Main Pass 18, USA and 6.12 South, China, discoveries.

In preparation for oil and gas reserves growth, the Company raised US\$13.8 million through a 1:2 pro-rata rights issue to shareholders, increasing its cash to US\$25.4 million to finance the 2010 exploration and development programme. In the US, we have largely restructured our drilling prospect inventory to consist of deeper, larger, higher production rate and more oily prospects than previously held.

USA activity

2009 production of 7.1 Bcfe was in line with expectations, although down 42% on the previous year's level, because the Company has not added reserves since 2007. At year end Petsec estimated reserves in the US were 18.9 Bcfe.

The high drilling and development cost environment of 2007/2008 prompted the Company to review the style of its drilling prospects in the Gulf of Mexico and investigate the potential benefits of pursuing non-conventional oil and gas and tertiary oil recovery onshore. The Company's strength is its technical people, all of whom have in excess of 25 years' experience in the Gulf of Mexico, and a track record of success. After lengthy consideration we determined that the shelf still retains excellent potential and that we should play to our Gulf exploration strengths.



25%

WORKING INTEREST
IN FIVE OIL FIELDS
IN BLOCK 22/12,
BEIBU GULF, CHINA

The deeper geologic section of the Gulf of Mexico shelf, below 12,000 feet, has been only lightly explored but we believe it contains great potential which modern 3D seismic can unlock, evidenced by a number of recent major gas discoveries by significant US E&P players such as McMoran Exploration with the Davy Jones discovery (est 1-3 Tcf) and Contango Oil & Gas with the Dutch and Mary Rose discoveries (est 0.5.-1 Tcf).

Petsec Energy will remain on the Gulf of Mexico shelf in less than 300 feet of water, because of the extensive availability of infrastructure and the relative low-cost and speed of drilling and development, which combine to enable first production usually within six months of discovery. We will continue to require a high assessed probability of success (generally >50%) and intend to expose less than US\$3 million in the drilling of each well, until such times as we have significantly increased our available working capital. We will seek larger (greater than 20 Bcfe), more oily drill targets, and gas with high condensate content in the geologic section from 12,000 to 18,000 feet, which should deliver initial production rates in excess of 20 MMcfd. This change in style of target prospects, from our previous 5 to 10 Bcfe targets in less than 12,000 feet of geologic section and initial production rates of 3 to 5 MMcfd, led to a reduction in the number of offshore leases to 21, not including the 8 leases we recently bid at the March sale.

To lead this new approach in exploration, the Company appointed Ron Krenzke as Executive Vice President of Exploration. Mr Krenzke is a geophysicist with extensive experience in the Gulf of Mexico shelf. In 2000, he co-founded Gryphon Exploration Company, as its Exploration President, together with Mike Harvey, who joined the Petsec Energy board in 2008. Gryphon was an early explorer in the 12,000 to 18,000 feet geologic section. Gryphon raised US\$80 million in equity, had great exploration success, and was sold to Woodside Petroleum in 2005 for US\$285 million.

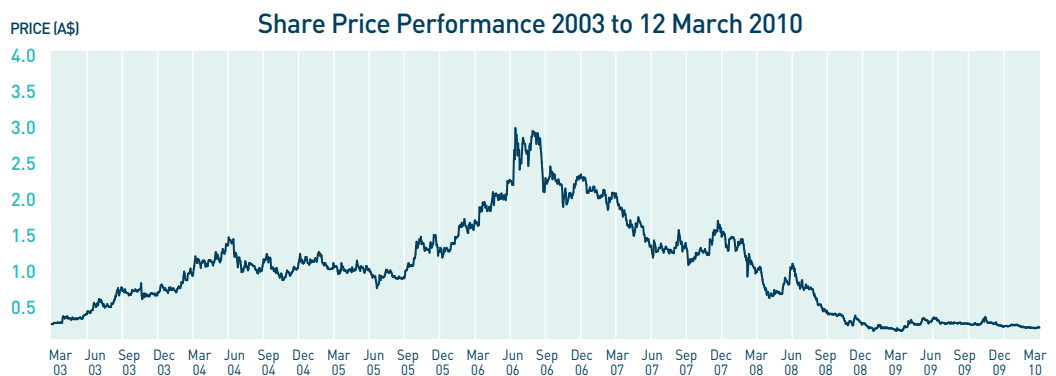
Petsec Energy now has a very solid prospect inventory in the Gulf of Mexico with prospect size generally larger than 20 Bcfe, ranging up to 100 Bcfe, with likelihood of high condensate content. Success in any one target will deliver a significant increase in the Company's oil and gas reserves, which can be readily brought into production.

China activity

Petsec Energy owns a 25% working interest in five oil fields in Block 22/12, Beibu Gulf, China, which hold potentially recoverable reserves in the range of 43 to 124 million barrels of oil (P50-P10) of which Petsec Energy owns a net 5 to 15 million barrels on the basis CNOOC would back-in for 51%. Eight undrilled prospects in Block 22/12 hold an additional 100 million barrels gross potential.



During 2009, China National Offshore Oil Corporation (CNOOC) completed a feasibility study on the 6.12, 6.12 South and 12.8 West oil fields, estimated to hold 27 to 52 million barrels of gross recoverable oil (P50–P10), based on sharing production, pipeline and oil storage facilities with CNOOC on its adjacent 12.1.1 oil field. The technical section of the Overall Development Plan (ODP) was completed by CNOOC in December 2009. CNOOC approval of the ODP is anticipated in April 2010, which should lead to start of development in mid-2010 with first oil production in the first half of 2012. The fields are capable of producing 7 million barrels of oil in the first twelve months of production which, at current oil prices, should deliver cashflow of the order of US\$60 million to Petsec Energy. Block 22/12 is a substantial asset of the Company, represented not only by its existing oil reserves but the remaining high exploration potential. Each field should have a productive life in excess of 15 years.



Capital Structure – as at 12 March 2010

Australia	
Exchange	ASX
Ticker	PSA
Shares on issue	231.3 million
Options on issue	6.7 million
Share price	A\$0.195
Market capitalisation	A\$45.1 million
USA	
Exchange	OTC Pink Sheets
Ticker	PSJEY

Source: ASX

2010 Budget

Drilling planned	3-5 wells in USA
Exploration and Development	US\$9-18 million
Estimated production	4.4 Bcfe
Estimated operating cash flow	US\$11 million
Estimated debt repayments	\$0.3 million
Cash (at 1 Jan 10)	US\$25.4 million

2010 Exploration & Development Programme

		Wells	Net Reserves	2009				2010			
USA			(Bcfe)								
Onshore Louisiana	Development/Production										
Gulf of Mexico	Drilling	3-5	20-50								
Gulf of Mexico	Development/Production										
China			(MMbbl)								
6-12/6-12 South	FID/Development		2.3-3.3								
12-8 West	FID/Development		1.25								
12.8 East/12.3.1	Feasibility/FID										
				1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr

■ Development ■ Drilling ■ Production ■ Feasibility/FID

2010 plan of action

The Company's objective over the next three years is to grow from our current reserve based value of approximately US\$100 million, net of debt, to a US\$500 million level or greater, predominately through exploration success and the development of our five China oil fields. We have the prospect inventory in the US and development potential in China to achieve this lofty goal.

USA plan

Drilling of three to five wells in the Gulf of Mexico is planned for 2010 starting in April and will expose the Company to net reserves of 20 to 50 Bcfe. Drilling costs net to Petsec Energy are estimated at less than US\$3 million/well, and success-based development costs of a similar magnitude. It is anticipated discovery wells can be brought onstream within six months of well completion.

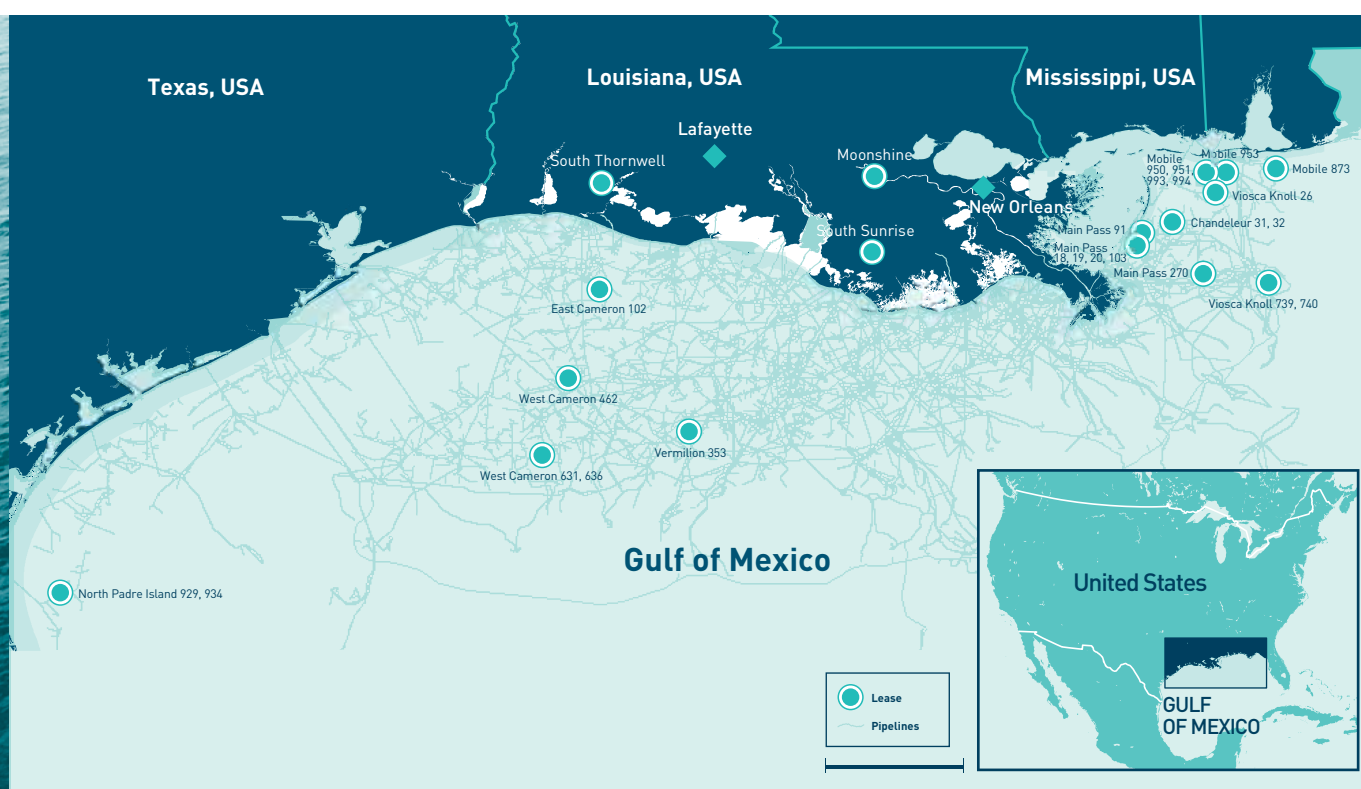
The Company will continue to seek to acquire quality producing assets with exploration potential in the Gulf of Mexico and also seek to refinance the outstanding term loan of US\$29 million currently due for repayment over 2011.

Production of 4.4 Bcfe in 2010 should generate revenues in the order of US\$30 million as 50% of the gas is hedged at prices near US\$7.50/Mcf.

China plan

The Company anticipates that CNOOC approval for the Overall Development Plan (ODP) for the development of the Wei 6.12, 6.12 South and 12.8 West oil fields, will be granted early in second quarter 2010, followed by Final Investment Decision (FID) and start of development mid-year. It is anticipated the two well head platforms will be set in early 2011, drilling of the 11 plus development wells completed by that year end, completion of CNOOC's new processing platform in early 2012, on which the joint venture would have a dedicated

→
20-50^{Bcfe}
OF NET RESERVES
TARGETED POTENTIAL



15-72

MILLION BARRELS
OF OIL (P50 TO P10)

20,000 bopd production train, with first production in the first half of 2012. Petsec Energy's estimated share of the likely development cost is in the order of US\$35 million, a large portion of which is anticipated to be debt financed.

Exploration prospects with 20 million barrels potential, which can be accessed from the 6.12 South platform, are expected to be tested at the time of development drilling in 2011. Initial feasibility studies have begun for the development of the 12.8 East and 12.3.1 oil fields, which are estimated to hold gross recoverable reserves ranging from 15 to 72 million barrels of oil (P50-P10). Development of these two oil fields is anticipated to commence 2011/2012.

Unlocking value

Due to the global financial crisis, Petsec's lack of drilling for almost two years, lower gas prices in the USA and delays to the commencement of development of the China oil fields, the Company's share price has fallen from a peak of A\$3.50 to the current 25 cents/share, which is less than 50% of the Company's net present value of its production and development assets.

Our five oil fields in China, our sizeable US drilling prospect portfolio and our technical staff, are significant assets which hold the capacity to greatly increase the value of your Company. We will start unlocking that value in 2010 with commencement of our US Gulf of Mexico drilling programme and the long anticipated start of development of our China oil fields.

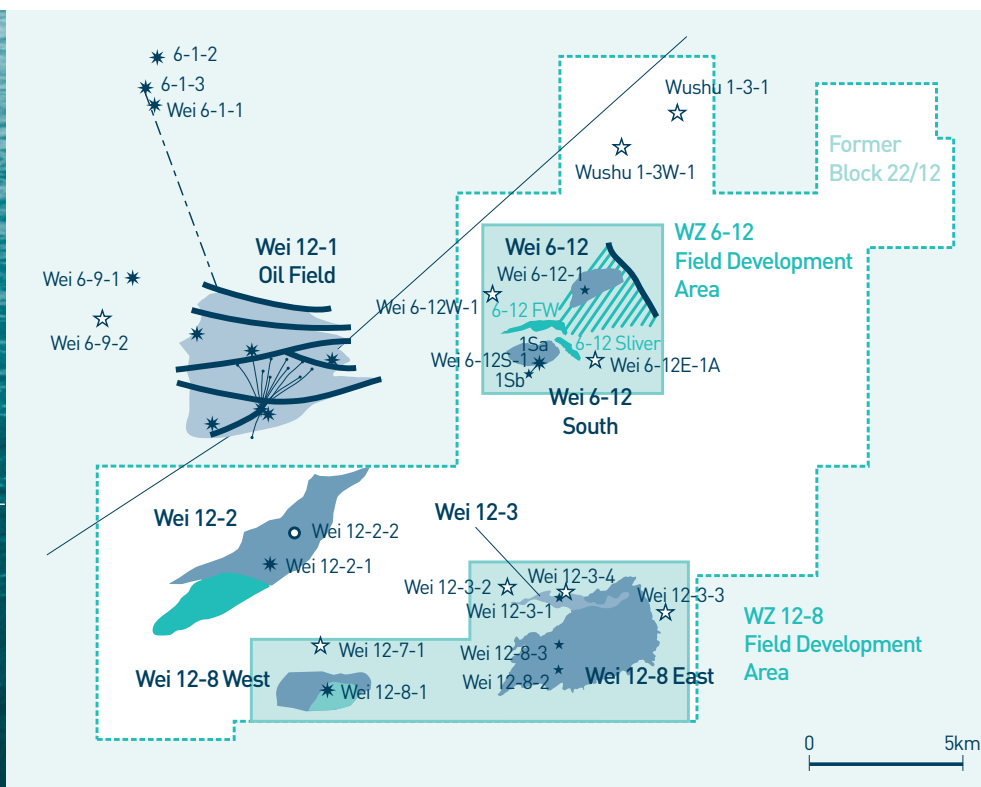
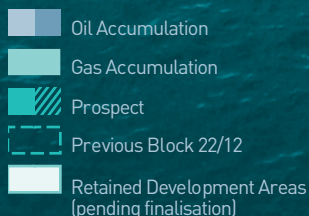
The Board, the staff of Petsec Energy and I, are excited by the drilling programme for 2010 and the prospect that, after three years since the discovery of the 6.12 South oil field in China, we are very close to commencing development.

I am confident that Petsec Energy will extract the potential value from its assets and can command growth as we have done in the past.



TN Fern

Chairman and Managing Director





DIRECTORS' REPORT AND FINANCIAL REPORTS

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Directors' Report

For the year ended 31 December 2009

The directors present their report together with the Financial Report of Petsec Energy Ltd ("the Company") and of the consolidated entity, being the Company and its subsidiaries, for the financial year ended 31 December 2009 and the independent auditor's report thereon.

1. Directors

The names and particulars of the qualifications and experience of each director during or since the end of the financial year are:

Terrence N Fern **Chairman and Chief Executive Officer**

Mr Fern has been a director since 1987 and has over 30 years of extensive international experience in petroleum and minerals exploration, development and financing. He holds a Bachelor of Science degree from the University of Sydney and has followed careers in both exploration geophysics and natural resource investment. Mr Fern is also a director of Oceana Gold Corporation.

David A Mortimer AO **Non-executive Director** **Chairman of the Audit Committee and the Nomination and Remuneration Committee**

Mr Mortimer was appointed to the Board in 1985 and has over 35 years of corporate finance experience. He was a senior executive of TNT Limited Group from 1973, serving as Finance Director and then as Chief Executive Officer until his resignation in October 1997. He is Chairman of Leighton Holdings Limited and Australia Post and is a director of Intoll Management Limited (formally MIG) and Macquarie Atlas Roads Limited. Mr Mortimer holds a Bachelor of Economics degree (First Class Honours) from the University of Sydney.

Mr Mortimer was formerly a Director of ASX listed companies Sigma Pharmaceuticals Limited from 2002 until July 2007 and Adsteam Marine Limited from 1997 until March 2007.

Peter E Power **Non-executive Director** **Member of the Audit Committee and the Nomination and Remuneration Committee**

Dr Power joined the Board in July 1999 and has over 45 years of experience in petroleum exploration worldwide. Dr Power has a Bachelor of Science degree from the University of Sydney and gained his doctorate at the University of Colorado, USA. He has served as Chairman of the Australian Petroleum Production and Exploration Association and President of the Australian Geoscience Council. Dr Power was Managing Director of Ampolex Limited from 1987 to 1996. He is Chairman of Elk Petroleum Limited, Austex Ltd and Metgasco Limited.

Michael L Harvey **Non-executive Director** **Member of the Audit Committee and the Nomination and Remuneration Committee**

Mr Harvey joined the Board in October 2008 and is a third generation Texan oil man who brings a wealth of experience of establishment and successful growth of exploration and production (E&P) companies in S-E Asia and the Gulf of Mexico, USA. After receiving his degree from Texas A&M in 1970, Mr Harvey served as an officer in the US Army in Vietnam.

Subsequently, he began his career in the oil industry with Shell Oil Company in their Corporate Planning and Economics department. Since 1987 to date, he has founded and been the CEO of four private US E&P companies operating in the Gulf of Mexico and the Gulf Coast of the USA. Between 1987 and 1998 he established, grew and sold Gulfstar Petroleum Corporation and Gulfstar Energy Inc. In 2000 he founded Gryphon Exploration Inc., which was acquired by Woodside Petroleum Ltd for US\$285 million in 2005. In 2007 he founded Stonegate Production Company, where he is Chairman and CEO. Mr Harvey is a non-executive director of the listed Norwegian company Scorpion Offshore that builds and deploys offshore rigs for international operations.

2. Executive Officers

Ross A Keogh

President of Petsec Energy Inc. (PEI)

Mr Keogh joined the Company in 1989 and has over 30 years experience in the oil and gas industry. Between 1979 and 1989, Mr Keogh worked in the financial accounting and budgeting divisions of Total Oil Company and as Joint Venture Administrator for Bridge Oil Limited in Australia. Mr Keogh holds a Bachelor of Economics degree, with a major in Accounting, from Macquarie University in Sydney. Mr Keogh was appointed Chief Financial Officer in November 1998 until April 2002, and appointed President of PEI in April 2002.

Ron Krenzke

Executive Vice President of Exploration of Petsec Energy Inc.

Mr Krenzke joined the Company in November 2009 as the Executive Vice President of Exploration of Petsec Energy Inc. Mr Krenzke has over 35 years of experience in the oil and gas exploration and production company management and growth, strategic planning, exploration program development, prospect generation and acquisition, prospect sales and joint ventures, and corporate sales. From 1990 to date Mr Krenzke has founded and co-founded three private E&P companies operating in the Gulf of Mexico region of the USA. In 2000 he co-founded Gryphon Exploration Company which was ultimately sold for US\$285 million. From 2006 through 2008, Mr Krenzke worked as a consultant in business development and evaluation of exploration and producing properties in the Gulf Coast, Gulf of Mexico and North Sea. In 2008 he joined Saxet Petroleum as Executive Vice President of Exploration. Mr Krenzke holds a Bachelor of Science degree in Geophysics from Texas A&M University.

Denis Swords

General Counsel and Corporate Secretary of Petsec Energy Inc.

Mr Swords joined the Company in 2005 as the General Counsel and Corporate Secretary of Petsec Energy Inc. Mr Swords has over 25 years of experience working in and with the oil and gas industry. He earned a Master of Science degree in Geology from the University of New Orleans and worked as an exploration geologist from 1982 until he enrolled in the Louisiana State University Law School in 1989. After receiving his Juris Doctor Degree in 1992, Mr Swords became a partner in a mid-sized law firm where he counselled numerous oil and gas clients.

Frank Steele

Vice President Land of Petsec Energy Inc.

Mr Steele joined the Company in 2006, and is a Certified Professional Landman (CPL) with over 30 years of experience in the oil and gas exploration and production industry, principally in the Gulf of Mexico, the Gulf Coast regions of the USA and in Latin America. Mr Steele held various land management positions with Shell Oil Company between 1979 and January 1996, and subsequently with Meridian Resource Corporation and LLOG Exploration Company, LLC.

Fiona A Robertson

Chief Financial Officer

Ms Robertson joined the Company in 2002 as the Chief Financial Officer of the Petsec Energy Ltd group. Ms Robertson has over 30 years of corporate finance experience including more than 20 in the resources industry. She spent 14 years working for The Chase Manhattan Bank in London, New York and Sydney, and eight years with Delta Gold Ltd as General Manager, Finance/Chief Financial Officer. In October 2009, Ms Robertson became a Non-executive Director of Drillsearch Energy Limited. Ms Robertson holds a Master of Arts degree in geology from Oxford University, is a Fellow of the Australian Institute of Company Directors and a Member of the Australasian Institute of Mining and Metallurgy.

Paul Gahdmar

Company Secretary and Group Financial Controller

Mr Gahdmar joined the Company in 1999 as the Financial Accountant of the Petsec Energy Ltd group and has since held a number of management positions within the Company. Mr Gahdmar was appointed as the Company Secretary of Petsec Energy Ltd in 2008 and has over 15 years experience in corporate accounting and finance in listed companies within the resources industry. Mr Gahdmar holds a Master of Business and Technology degree from The University of New South Wales and a Diploma in Investor Relations from the Australasian Investor Relations Association, and is a Fellow of the National Institute of Accountants.

Directors' Report continued

For the year ended 31 December 2009

3. Directors' meetings

The Board has a formally constituted Audit Committee and a Nomination and Remuneration Committee, of which each director is a member. A non-executive director chairs both committees.

The number of directors' meetings (including meetings of committees of directors) and number of meetings attended by each of the directors of the Company during the financial year are:

	Regular Board Meetings	Additional Board Meetings	Audit Committee Meetings	Nomination & Remuneration Committee Meetings
Total number held during the year	11	2	5	2
T N Fern	11	2	5	2
D A Mortimer	11	2	5	2
P E Power	10	2	4	2
M L Harvey	10	2	5	2

4. Remuneration report

The Remuneration Report is set out on pages 17 to 24 and forms part of the Directors' Report for the financial year ended 31 December 2009.

5. Principal activities

The principal activities of the consolidated entity during the course of the financial year were oil and gas exploration and production in the shallow waters of the Gulf of Mexico and onshore Louisiana Gulf Coast region of the USA, and oil exploration in the shallow waters of the Beibu Gulf off the south coast of China.

6. Financial review

Highlights

During the year, the Company generated net revenues after royalties from its U.S. operations of US\$52.0 million from production of 7.1 Bcfe at an average gas equivalent sales price of US\$7.36/Mcfe. This represents a 51% decrease on net revenues after royalties for the previous corresponding period of US\$105.3 million (2008: Production of 12.1 Bcfe; and average gas equivalent sales price of US\$8.70/Mcfe) which benefited from the initial boost to production provided by the acquisition of interests in seven producing US gas fields in late 2007 and a generally higher natural gas price environment. 2009 full year production was also impacted by the cessation of production from the Vermilion 258 and Main Pass 20 fields in March 2009 and August 2009, respectively.

Earnings before interest, income tax, DD&A and exploration expense ("EBITDAX") was US\$31.3 million, 61% less than the previous corresponding period EBITDAX of US\$79.6 million, reflecting a 42% reduction in production and a 15% reduction in the average net gas equivalent sales price received.

The EBITDAX (cash operating) margin of US\$4.43/Mcfe (2008: US\$6.58/Mcfe) for the current period, represents a 60% gross operating margin.

Depreciation, depletion, amortisation and rehabilitation ("DD&A") for the twelve months to 31 December 2009 was US\$21.0 million, down 63% on the previous corresponding period charge of US\$57.3 million, reflecting the lower carrying values of the U.S. oil and gas properties following the substantial impairments recognised at 31 December 2008.

Earnings before dry hole, impairment and abandonment expense and income tax for the year ("Underlying Earnings") were US\$3.3 million (2008: US\$12.1 million), down 73% due to lower revenues offset to some extent by lower DD&A, lease operating costs and geological, geophysical & administrative ("GG&A") expense.

Net loss after tax of US\$14.9 million (2008: Loss of US\$44.5 million) was incurred after impairment and abandonment expense of US\$10.8 million and income tax expense of US\$7.8 million.

The Company periodically reviews the carrying values ("book value") of its oil and gas properties and, in accordance with accounting standards and Company policy, is required to demonstrate that the carrying value of its properties are no less than the estimated future cash flow to be generated from the expected production from these properties.

Accordingly, the Company recognised dry hole, impairment and abandonment expense of US\$10.3 million (2008: US\$71.9 million) for the current period. This comprised:

- US\$2.4 million in relation to the write-off of the remaining carrying value of the Vermilion 258 field which ceased production in March 2009;

6. Financial review continued

Highlights continued

- US\$4.4 million impairment as a result of a reduction in Petsec Energy estimated recoverable reserves;
- US\$2.0 million impairment due to lower commodity prices at 31 December 2009 than at 31 December 2008;
- US\$2.3 million impairment against a number of primary term leases and the relinquishment of its interest in the Main Pass 7 lease, where the prospects were determined not to be economic;
- US\$0.5 million impairment against the recoverable value of spare equipment due to current market conditions and the physical condition of the equipment; and
- US\$2.3 million increase in the Company's rehabilitation provision due to the reassessment of future plug and abandonment cost estimates.

The impact of these impairments was tempered by a US\$3.6 million reversal of an impairment provision previously recognised against the Main Pass 270 gas field, resulting from an increase in estimated remaining reserves.

Under Australian Accounting Standards, the Company is also required to assess at each reporting period, the extent to which deferred tax assets in respect of the carry-forward of unused tax losses and temporary differences qualify for recognition on the balance sheet based on current facts and circumstances, including projected future taxable profits.

Consequently, the Company has recognised a provision of US\$9.6 million against US deferred tax assets due to the impact of lower gas prices on current projections of future US taxable profits, including US\$1.8 million against the US tax benefit derived within the current period and US\$7.8 million in respect of US deferred tax assets previously brought to account.

Financial position

Available cash plus US\$28.0 million of net cash generated from operating activities for the twelve months to 31 December 2009 was used to repay US\$21.1 million of debt and to fund US\$10.3 million of acquisition, exploration and development expenditure during the year.

Petsec Energy's cash position at 31 December 2009 increased to US\$25.4 million, up from US\$13.7 million at 31 December 2008 following the Company's underwritten pro-rata rights issue in December 2009, which raised approximately US\$13.7 million (before equity issue costs) potentially to assist with the funding of the Company's proposed three-to five-well drilling programme in the Gulf of Mexico, USA commencing first quarter 2010 and commencement of the development in China.

In December 2009, the Company fully repaid the principal loan balance due under its revolving credit facility, reducing total debt outstanding to US\$29.4 million of subordinated fixed term debt that matures in late 2011, down 42% on the US\$50.5 million outstanding at 31 December 2008.

At 31 December 2009, the total amount utilised under the revolving credit facility was US\$8.3 million in letters of credit that support the Company's bonding requirements with the U.S. Minerals Management Service.

Net debt (total outstanding debt less cash) fell by a significant 89% to US\$4.0 million at 31 December 2009 (2008: US\$36.8 million) following the repayment during the year of the principal loan balance under the Company's revolving credit facility and US\$13.7 million (before equity issue costs) equity raised in December 2009 through the rights issue.

7. Operations review

USA, Gulf of Mexico/Onshore Louisiana

Production

The Company currently produces oil and gas only in the USA, in the Gulf Coast of Louisiana and offshore shallow waters. The Company has interests in 16 producing leases of which Main Pass 18/19, Main Pass 270, and Chandeleur 31/32 are the main fields. During the year, the Vermilion 258 and Main Pass 20 fields ceased production in late March 2009 and August 2009 respectively, as all commercial reserves had been produced, and the Main Pass 270 gas field, which had been shut-in since April 2008 pending completion of third-party pipeline repairs, was restored to production in early March 2009.

Acquisitions and Exploration

No acquisitions were made during the year ended 31 December 2009.

The Company has been actively pursuing US Gulf of Mexico acquisitions of producing fields that possess good quality, high-rate production that lend themselves to hedging, and have exploration and exploitation potential that can be readily accessed from existing infrastructure. High cost of services and declining gas prices have dictated that acquisitions should generate a more certain return than exploration. During the year, the Company has reviewed a number of opportunities and made a number of unsuccessful bids. The Company will continue to pursue acquisition opportunities to complement its strategy of growing its reserve through successful exploration drilling.

Directors' Report continued

For the year ended 31 December 2009

7. Operations review continued

Acquisitions and Exploration continued

The Company has not drilled a well since the second quarter of 2008 in response to high service costs, declining gas prices and the instability of financial markets. Exploration activities during 2009 have been directed to further high-grading and de-risking of exploration prospects in preparation for the commencement of exploratory drilling in late March/early April 2010. Industry and service costs for the Gulf of Mexico shelf have fallen since 2008 significantly and are now at levels that the Company believes make it economically feasible to resume drilling for reserves.

For the twelve months to 31 December 2009, the development activities of the USA operations have been limited, a reflection of the Company ceasing exploratory drilling for the past year and a half. The only development in the year was that of the Miles Timber No. 1 well in the Chegby field, an onshore gas/condensate discovery in July 2008, which was brought into production in February 2009 and the recompletion of wells at Main Pass 18 and the Mobile Bay Area.

China, Beibu Gulf

Development of the 6.12, 6.12 South & 12.8 West Oil Fields

As reported in the consolidated financial report for the year ended 31 December 2008, the China National Offshore Oil Corporation ("CNOOC") declared development areas over the Wei 6.12, 6.12 South, 12.8 West, 12.8 East and 12.3.1 oil fields, for the Block 22/12, Beibu Gulf Joint Venture ("JV"). These five oil fields contain oil in place of 185 to 262 million barrels of oil (P50 to P10) and potentially recoverable reserves of 43 to 124 million barrels of oil. Feasibility studies have been completed on all five fields and the JV has decided to proceed with the development of the 6.12, 6.12 South and 12.8 West oil fields which are estimated to hold P50 recoverable reserves of 27.2 million barrels of oil, and P10 recoverable reserves of 52 million barrels of oil.

Feasibility studies undertaken by CNOOC in conjunction with the JV, investigated two development options – a stand alone production platform at 6.12 South; and shared facilities with CNOOC adjacent to its 12.1.1 platform. The results of these studies were presented to the Chinese Expert Review Committee in June 2009, which made a recommendation to CNOOC and the JV to proceed with an Overall Development Plan ("ODP") on the preferred development option using a shared production facility with CNOOC adjacent to its 12.1.1 platform.

Negotiations between the JV and CNOOC, on tariffs and access terms to CNOOC's sales pipeline and proposed new production facilities, which commenced in early September 2009 are expected to be completed shortly.

The technical section of the ODP for the development of the 6.12, 6.12 South and 12.8 West oil fields, prepared by CNOOC/CLZ in conjunction with the JV, was completed on schedule on 20 December 2009 and delivered to the JV on 25 December 2009. Finalisation of the economic section of the ODP is pending completion and finalisation of commercial negotiations.

The CNOOC-approved ODP is expected to be lodged during first quarter 2010 with formal Chinese government approval to be granted within 90 days of lodgement. A final investment decision (FID) is likely to be made in second quarter 2010, followed immediately with the commencement of development. Initial production of the order of 19,000 barrels of oil per day is likely to commence in first half 2012 from these fields.

Exploration prospects adjacent to the 6.12 South oil field are expected to be tested at the time of development drilling in 2011. Development of the 12.8 East and 12.3.1 oil fields, which are estimated to hold recoverable reserves ranging from 15 to 72 million barrels of oil (P50 to P10), is anticipated after the start of production from the 6.12, 6.12 South and 12.8 West oil fields.

Oil and gas reserves – USA and China

Petsec Energy's internally estimated proved and probable (2P) USA oil and gas reserves at 31 December 2009 were 18.9 Bcfe. China reserves remain unchanged from previous estimates of 3.6 million barrels of oil (or 21.5 Bcfe) for the 6.12, 6.12 South and 12.8 West oil fields based on the assumption that CNOOC would back-in for its full entitlement of 51% leaving Petsec Energy with a 12.25% interest.

During the current period, the Company recorded downward reserve revisions of 4.4 Bcfe against the Petsec Energy estimates of 2P reserves in the USA, resulting from the onset of water production at Chandeleur 31/32; an unsuccessful recompletion in the Mobile Bay Area; the early cessation of production from the Vermilion 258 gas field in March 2009; lower than predicted well performance from the onshore wells; and lower prices reducing the estimated economic life of certain fields. The resultant impairments have been recognised in the financial statements at 31 December 2009.

7. Operations review continued

Oil and gas reserves – USA and China continued

Gas Equivalent (Bcfe)	Independent Assessment ¹			Petsec Energy
	Proved Reserves	Probable Reserves	Proved and Probable Reserves	Estimated Recoverable Proved and Probable Reserves
USA Reserves				
Reserves at 1 January 2009	24.2	6.6	30.8	30.4
Net additions	–	–	–	–
Net revisions	(3.1)	(2.6)	(5.7)	(4.4)
Production	(7.1)	–	(7.1)	(7.1)
USA Reserves at 31 December 2009	14.0	4.0	18.0	18.9

¹ The independent reserve assessments at 31 December 2009 were estimated by independent petroleum engineers Ryder Scott Company.

Competent Person Statement

In accordance with ASX Listing Rules, the Petsec Energy USA internal reserve estimates information in this report is based upon information compiled, reviewed and signed off by Mr Dana Westphal, Reservoir Engineer a full time employee of Petsec Energy. Mr Westphal has at least five years' relevant experience within the sector and consents to the disclosure of this information in the form and context in which it appears.

8. Objectives, strategy and future performance

It is the consolidated entity's objective to increase shareholder value through successful oil and gas exploration, development, and production and through acquisitions. The consolidated entity intends to produce its current reserves, recommence exploration drilling activities in the Gulf of Mexico shelf and onshore Louisiana, USA, review potential acquisitions of producing reserves in the Gulf of Mexico, USA and progress the development of the Wei 6.12, 6.12 South and 12.8 West oil fields in the Beibu Gulf in China.

9. Dividends

Directors do not recommend the payment of a dividend for the financial year ended 31 December 2009. No dividends were paid during the financial year.

10. Significant changes in state of affairs

There were no significant changes to the state of affairs of Petsec Energy during the financial year, other than those detailed in the "Financial review" and "Operations review" sections of this report.

11. Environmental regulation

The consolidated entity's oil and gas exploration and production activities are subject to significant environmental regulation under U.S. Federal and State legislation and laws and decrees of the People's Republic of China.

The consolidated entity is committed to achieving a high standard of environmental performance and compliance with all lease conditions. Directors are not aware of any breach of environmental compliance requirements relating to the consolidated entity's activities during the year.

12. Likely developments

China

Beibu Gulf, Block 22/12 Joint Venture

The consolidated entity anticipates that the Beibu Gulf, Block 22/12 joint venture will shortly conclude commercial negotiations for the development of the Wei 6.12, 6.12 South and 12.8 West oil fields, complete the economics and commercial sections of the Overall Development Plan ("ODP"), and lodge the CNOOC-approved ODP for Chinese Government approval.

USA

The consolidated entity expects to commence drilling the first of three to five high impact exploration wells in the Gulf of Mexico, USA in late March/early April 2010.

Directors' Report continued

For the year ended 31 December 2009

13. Directors' interests

The relevant interest of each director in the shares or options over such instruments issued by the Company, as notified by the directors to the Australian Securities Exchange in accordance with S205G (1) of the Corporations Act 2001, at the date of this report is as follows:

Director	Ordinary Shares	Options over Ordinary Shares
T N Fern	28,826,876	2,000,000
D A Mortimer	9,326,550	Nil
P E Power	337,985	Nil
M L Harvey	Nil	Nil

14. Share options

Options granted to directors and officers of the Company

During or since the end of the financial year, grants of 835,000 options were made to directors or the five most highly remunerated officers of the Company as part of their remuneration.

As at 31 December 2009, there were 5,699,500 options over ordinary shares in Petsec Energy Ltd on issue, all of which are employee options exercisable at prices ranging from A\$0.20 to A\$3.11 per share expiring at various dates between 31 December 2009 and 18 October 2012 with exercise dependent on completion of vesting period and satisfaction of share price hurdles ranging from A\$0.30 to A\$6.84 being achieved on the Australian Securities Exchange. During the year 836,500 were granted, 376,500 options were forfeited and no options were exercised.

Subsequent to 31 December 2009 through the date of this report, no employee options have been exercised.

Unissued shares under option

At the date of this report, unissued ordinary shares of the Company under option are:

Expiry date	Exercise price	Number of shares
31 December 2009	A\$1.15	15,000
20 October 2010	A\$1.40	250,000
21 December 2010	A\$1.82	100,000
24 February 2011	A\$2.13	225,000
12 April 2011	A\$2.38	27,000
24 July 2011	A\$2.90	200,000
4 December 2011	A\$2.46	25,000
23 January 2012	A\$2.27	55,000
30 January 2012	A\$2.38	655,000
12 February 2012	A\$2.40	500,000
12 February 2012	A\$3.11	500,000
13 April 2012	A\$1.91	65,000
14 June 2012	A\$2.40	1,500,000
14 June 2012	A\$3.11	500,000
17 July 2012	A\$1.48	30,000
18 October 2012	A\$1.60	150,000
12 February 2013	A\$1.19	75,000
31 December 2013	A\$0.20	827,500
		5,699,500

Shares issued on exercise of options

During the financial year, there were no ordinary shares issued by the Company as result of the exercise of options.

15. Indemnification and insurance of officers

During the year ended 31 December 2009, the Company maintained policies of insurance in respect of directors and officers liability. The policies insure persons who are directors or officers of the Company and its controlled entities against certain costs and expenses which may be incurred by them in defending proceedings and against other liabilities which may arise from their positions. The insured directors and officers are the directors, executive officers and secretaries of the Company and the directors, executive officers and secretaries of controlled entities.

The insurance contracts prohibit the disclosure of particulars of the premiums and the nature of the liabilities insurance.

15. Indemnification and insurance of officers continued

The Company has entered into Deeds of Indemnity and Access with directors on the terms approved by shareholders. The agreements stipulate that the Company will meet the full amount of any liabilities to another person that might arise from their position (except where the liability arises out of conduct involving a lack of good faith).

The Company has made during or since the end of the financial year no payments in relation to indemnification. The Company provides the normal indemnities to directors and officers in relation to the work carried out on behalf of or at the request of the Company.

16. Non-audit services

During the year KPMG, the Company's auditor, has performed certain other services in addition to their statutory duties.

The Board has considered the non-audit services provided during the year by the auditor and in accordance with advice provided by resolution of the audit committee, is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise, the auditor independence requirements of the *Corporation Act 2001* for the following reasons:

- All non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the audit committee to ensure they do not impact the integrity and objectivity of the auditor; and
- The non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants*, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision-making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services provided during the year are set out in Note 8 of the accompanying Financial Statements.

17. Lead auditor's independence declaration

The Lead Auditor's Independence Declaration is set out on page 25 and forms part of the Directors' Report for the financial year ended 31 December 2009.

18. Rounding off

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the Financial Report and Directors' Report have been rounded off to the nearest one thousand dollars, unless otherwise stated.

19. Events subsequent to balance date

Other than any matter disclosed, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity, in future years.

This report is made with a resolution of the directors:



T N Fern
Director

Sydney, 25 February 2010

20. Remuneration Report – Audited

20.1 Nomination and Remuneration Committee

The Nomination Committee oversees the appointment and induction process for directors and committee members, and the selection, appointment and succession planning process of the Company's Managing Director. The Committee makes recommendations to the Board on the appropriate skill mix, personal qualities, expertise and diversity of each position. When a vacancy exists or there is a need for particular skills, the Committee in consultation with the board determines the selection criteria based on the skills deemed necessary.

The Remuneration Committee reviews and makes recommendations to the Board on compensation packages and policies applicable to the executive officers and directors themselves of the Company and of other group executives for the consolidated entity. It is also responsible for oversight of share option schemes, incentive performance packages, superannuation entitlements, retirement and termination entitlements, fringe benefits policies and professional indemnity and liability insurance policies.

Executive compensation and other terms of employment are reviewed annually by the Nomination and Remuneration Committee having regard to performance against goals set at the start of the year, relevant corporate information and where appropriate independent expert advice.

Directors' Report continued

For the year ended 31 December 2009

20. Remuneration Report – Audited continued

20.1 Nomination and Remuneration Committee continued

The Nomination and Remuneration Committee comprised the following members during the year:

- D A Mortimer (Chairman) – Independent Non-executive
- P E Power – Independent Non-executive
- M L Harvey – Independent Non-executive
- T N Fern – Managing Director (Mr Fern resigned from the Committee in January 2009)

The Board policy is that the Nomination and Remuneration Committee will comprise a majority of non-executive directors and a non-executive chairman.

The Nomination and Remuneration Committee meets at least once a year and as required. The Committee met two times during the year and Committee members' attendance record is disclosed in the table of directors' meetings.

The Nomination and Remuneration Committee's charter is available on the Company's website.

20.2 Principles of compensation

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company and the consolidated entity, including other executives. Key management personnel comprise the directors of the Company and executives for the Company and the consolidated entity including the five most highly remunerated S300A executives.

Compensation levels for key management personnel and secretaries of the Company and key management personnel of the consolidated entity are competitively set to attract and retain appropriately qualified and experienced directors and senior executives. The Remuneration Committee obtains peer comparisons and/or independent advice on the appropriateness of compensation packages of both the Company and the consolidated entity, given trends in comparative companies both locally and internationally and the objectives of the Company's compensation strategy.

The compensation structures explained below are designed to attract suitably qualified candidates, reward the achievement of the Company's objectives, and achieve the broader outcome of creation of value for shareholders. The compensation structures take into account:

- the capability and experience of the key management personnel; and
- the key management personnel's ability to control the relevant performance of their segment of operation.

Compensation packages include a mix of fixed compensation and performance-based including equity-based incentives.

In addition to their salaries, the consolidated entity also provides non-cash benefits to its key management personnel, and contributes to several post-employment defined contribution superannuation plans in Australia and also matches contributions made by U.S.-based key management personnel to a voluntary savings plan under Section 401(k) of the U.S. tax code.

Fixed compensation

Fixed compensation consists of base compensation (which is calculated on a total cost basis and includes any FBT charges related to employee benefits), as well as employer contributions to superannuation funds.

The Nomination and Remuneration Committee review compensation levels and other terms of employment annually through a process that considers individual, segment and overall performance of the consolidated entity against goals set at the start of the year. In addition, where necessary, external consultants provide analysis and advice to ensure the directors' and senior executives' compensation is competitive in the market place.

Performance-linked compensation

Performance-linked compensation includes both short-term and long-term incentives and is designed to reward key management personnel for meeting or exceeding the Company's financial objectives and agreed individual objectives. The short-term incentive (STI) is an "at risk" bonus provided in the form of cash, while the long-term incentive (LTI) is provided as options over ordinary shares of the Company under the rules of the Employee Option Plan (see note 18(c) to financial statements).

Short-term incentive bonus

Performance-linked cash bonuses are payable to eligible employees under the Company's Incentive Plan. Under the bonus criteria that operated until December 2008, the consolidated entity accrued up to 6.5% of the earnings before interest and tax (EBIT) of the U.S. operations, to be paid as a bonus to eligible employees. The bonus was paid annually in the first quarter of the year following determination of the annual results. In addition to the Company's Incentive Plan the Nomination and Remuneration Committee has the right to grant discretionary bonuses. Factors considered by the Committee when granting discretionary bonuses include achievement of strategic objectives, retention and motivation of employees. No bonus was paid under the above incentive plan in respect of the 2008 year.

20. Remuneration Report – Audited continued

Short-term incentive bonus continued

In December 2008, the above “percentage of EBIT” based incentive entitlement was terminated and target based annual performance measures were introduced for the year commencing 1 January 2009 based on the advice of external remuneration consultants. Under the revised arrangements, eligible employees may be entitled to a bonus based on the company’s performance in the year relative to a number of pre-determined performance targets and based on an annual evaluation of individual performance. The target bonus is set as a percentage of an employee’s base salary and will vary above or below the target level based on the extent to which agreed targets are exceeded or underachieved. No bonus will be paid under the above incentive plan in respect of the 2009 year.

Long-term incentive

Eligible employees are also provided with long-term incentives through participation in the Company’s Employee Option Plan, subject to the approval of the Remuneration Committee. Employees are typically granted options upon commencement of employment and periodically thereafter. These options are issued for a term of five years and vest in four tranches. The first tranche becomes exercisable one year from the date of issue with subsequent tranches vesting, subject to the satisfaction of hurdles, which specify minimum share price growth.

In December 2008 the Board resolved to offer options on an annual basis comprising three tranches which vest annually with the first tranche becoming exercisable up to one year from the date of issue subject to the share price (at the time options are exercised) being not less than a hurdle price of the higher of 30 cents per share or 25% above the exercise price. The exercise price of options is based on the weighted average market price of the Company’s ordinary shares for the five trading days preceding the date of issue, subject to a minimum exercise price of 20 cents.

Service agreements

Remuneration and other terms of engagement of executive employees are formalised in service agreements that are unlimited in term but capable of termination by varying periods of notice or by payment of an amount in lieu of notice. The service agreements generally outline the components of compensation paid, but do not prescribe how compensation levels are modified year-to-year. Compensation levels are reviewed each year to consider factors such as cost-of-living changes, performance of and changes in the scope of the role performed by the executive and changes required to meet the principles of the compensation policy.

The Managing Director, Mr Fern, is engaged via a company of which Mr Fern is a director. The Company may terminate this agreement without cause by giving not less than twelve months’ notice or pay an amount equal to the fees for twelve months in lieu of notice. Mr Fern may terminate the agreement with not less than six months’ notice. With cause, Mr Fern may terminate the agreement by giving one month’s notice and would be entitled to a payment equal to fees for a twelve-month period.

The President of Petsec Energy Inc., Mr Keogh has an employment agreement, which is capable of termination without cause by the company by a lump sum payment equal to one and one-half times his annual Base Salary. Mr Keogh may terminate the agreement without cause by giving the company at least thirty days notice in writing. Mr Keogh may terminate the agreement for cause and in this event is entitled to receive a lump sum payment equal to one and one-half times his annual base salary at that time.

Other executives have service agreements which are capable of termination by the Company without cause by the payment of between one and three months’ notice, or are “at-will” employment contracts entered into in the USA where either party may terminate the employment relationship at any time and for any reason without any further liability, except as required by law.

Non-executive directors

Directors’ fees are set having regard to periodic advice from external remuneration consultants, market surveys and the level of fees paid relative to that of other comparable companies. Directors’ fees for the 2009 year were unchanged from the 2008 year and comprise base fees, plus statutory superannuation for Australian directors. Directors are also entitled to reasonable travel, accommodation and other expenses incurred in attending meetings or while engaged on Company business.

Non-executive directors do not receive performance-related compensation. Directors’ fees cover all main Board activities and membership of committees and are subject to the aggregate limit of A\$300,000 approved by shareholders at the 1996 Annual General Meeting.

Non-executive directors appointed prior to 2003 are entitled to receive a retirement benefit that is equivalent to the remuneration received in the three years prior to retirement. Incoming non-executive directors are not entitled to retirement benefits.

Directors' Report continued

For the year ended 31 December 2009

20. Remuneration Report – Audited continued

20.3 Directors' and Executive Officers' Remuneration Report

Details of the nature and amount of remuneration for the key management personnel consisting of each director and executive officer of the Company and the consolidated entity are:

		Short-term benefits				Post-employment benefits		Share-based payment	Total US\$	Proportion of remuneration performance related %	Value of options as proportion of remuneration %
		Salary & fees US\$	Short-term incentive cash bonus US\$	Other benefits US\$	Service agreements US\$	Super-annuation benefits US\$	Retirement benefits US\$	Accounting fair value of options US\$			
Key management personnel – Directors ¹											
Executive											
T N Fern ¹ (Note 1)	2009	–	–	22,320	521,400	–	–	92,508	636,228	–	14.5
Chairman, Managing Director	2008	–	–	24,442	645,806	–	–	140,797	811,045	–	17.4
Non-executive											
D A Mortimer ¹	2009	51,350	–	–	–	4,622	11,850	–	67,822	–	–
Director	2008	55,608	–	–	–	5,005	12,883	–	73,496	–	–
P E Power ¹	2009	51,350	–	–	–	2,311	11,850	–	65,511	–	–
Director	2008	55,608	–	–	–	5,005	12,883	–	73,496	–	–
M L Harvey	2009	50,000	–	–	–	–	–	–	50,000	–	–
Director	2008	10,734	–	–	–	–	–	–	10,734	–	–
Total directors	2009	152,700	–	22,320	521,400	6,933	23,700	92,508	819,561		11.3
	2008	121,950	–	24,442	645,806	10,010	25,766	140,797	968,771	–	14.5

¹ Directors' remuneration amounts except for Mr Harvey are actually paid in Australian dollars and presented in US dollars at the following FX rates
i) 2009 – 0.7900 ii) 2008 – 0.8555.

20. Remuneration Report – Audited continued

20.3 Directors' and Executive Officers' Remuneration Report continued

Details of the nature and amount of remuneration for the key management personnel consisting of each director of the Company and executive officer of the Company and the consolidated entity are:

Key management personnel		Short-term benefits				Post-employment benefits		Share-based payment	Total US\$	Proportion of remuneration performance related %	Value of options as proportion of remuneration %
		Salary & fees US\$ Note 5	Short-term incentive cash bonus US\$	Other benefits US\$ Note 6	Service agreement US\$	Super-annuation/ 401K benefits US\$	Retirement benefits US\$	Accounting fair value of options US\$ Note 7			
R A Keogh, President, Petsec Energy Inc. (PEI)	2009	259,776	–	22,482	–	17,200	–	84,062	383,520	–	21.9
	2008	246,012	–	16,414	–	11,700	–	123,421	397,547	–	31.0
R Krenzke (Note 2) Executive Vice President Exploration, PEI	2009	26,361	–	1,605	–	–	–	–	27,966	–	–
	2008	–	–	–	–	–	–	–	–	–	–
F Steele Vice President Land, PEI	2009	194,716	–	22,482	–	9,350	–	17,369	243,917	–	7.1
	2008	192,677	–	16,414	–	9,350	–	30,633	249,074	–	12.3
D Swords General Counsel/ Corporate Secretary, PEI	2009	189,456	–	22,449	–	8,850	–	8,727	229,482	–	3.8
	2008	179,440	–	16,338	–	8,850	–	17,471	222,099	–	7.9
F Robertson ¹ (Note 3) Chief Financial Officer	2009	–	–	4,781	116,000	–	–	12,525	133,306	–	9.4
	2008	–	–	4,872	200,264	–	–	27,697	232,833	–	11.9
C Jones ¹ (Note 4) General Manager Corporate, Company Secretary	2009	–	–	1,706	16,488	–	–	–	18,194	–	–
	2008	–	–	1,678	175,049	–	–	27,697	204,424	–	13.5
P Gahdmar ¹ Group Financial Controller, Company Secretary	2009	131,671	–	1,083	–	11,850	–	7,116	151,720	–	4.7
	2008	133,422	–	808	–	12,008	–	11,488	157,726	–	7.3
Total executive officers	2009	801,980	–	76,588	132,488	47,250	–	129,799	1,188,105	–	10.9
	2008	842,269	–	64,972	375,313	46,773	–	238,407	1,567,734	–	15.2
Total compensation: key management personnel (Consolidated)	2009	954,680	–	98,908	653,888	54,183	23,700	222,307	2,007,666	–	11.1
	2008	964,219	–	89,414	1,021,119	56,783	25,766	379,204	2,536,505	–	14.9
Total compensation: key management personnel (Company)	2009	234,371	–	29,890	653,888	18,783	23,700	112,149	1,072,781	–	10.5
	2008	244,638	–	31,800	1,021,119	22,018	25,766	207,679	1,553,020	–	13.4

¹ Australian-based executive officers' remuneration amounts are actually paid in Australian dollars and presented in US dollars at the following FX rates
i) 2009 – 0.7900 ii) 2008 – 0.8555.

Directors' Report continued

For the year ended 31 December 2009

20. Remuneration Report – Audited continued

20.3 Directors' and Executive Officers' Remuneration Report continued

Notes

1. Included in service agreements above is an amount of US\$521,400 (2008: US\$645,806) which was paid or is payable to, a company of which Mr Fern is a director.

During the year, a company of which Mr Fern is a director provided management services to the Company and its controlled entities. The dealings were in the ordinary course of business and on normal terms and conditions.

2. Mr Krenzke was appointed as Executive Vice President, Exploration of Petsec Energy Inc. on 23 November 2009. Mr Krenzke's annualised salary is US\$234,000.
3. Included in service agreements above is an amount of US\$116,000 (2008: US\$200,264), which was paid, or is payable to the above company (of which Mr Fern is a director) and through which Ms Robertson provided services.

4. Included in service agreements above is an amount of US\$16,488 (2008: US\$175,049), which was paid, or is payable to the above company (of which Mr Fern is a director) and through which Mr Jones provided services.

Mr Jones resigned from his position of General Manager Corporate, Company Secretary on 5 March 2009.

5. Salary and fees for certain specified executives includes the movement during the reporting period of accruals for annual leave and long service leave.
6. Other benefits represent amounts paid on behalf of the Managing Director and Executive Officers in respect of insurance and car parking benefits.
7. The fair value of options is calculated at the date of the grant using the Black-Scholes model and allocated to each reporting period over the period from grant date to vesting date.

No termination benefits or other long-term benefits were paid to key management personnel for the years ended 31 December 2009 and 2008.

The following table sets out the factors and assumptions used in determining the fair value of the options issued to the above individuals.

Grant date	Expiry date	Average fair value per option	Exercise price	Price of shares on grant date	Estimated volatility	Risk-free interest rate	Dividend yield
20/10/05	20/10/10	A\$0.537	A\$1.40	A\$1.40	51.0%	5.10%	–
1/03/06	24/02/11	A\$0.725	A\$2.13	A\$2.10	48.1%	5.11%	–
2/03/07	30/01/12	A\$0.509	A\$2.38	A\$1.95	46.5%	5.91%	–
2/03/07	12/02/12	A\$0.497	A\$2.40	A\$1.95	46.5%	5.91%	–
2/03/07	12/02/12	A\$0.373	A\$3.11	A\$1.95	46.5%	5.91%	–
1/06/07	14/06/12	A\$0.214	A\$2.40	A\$1.49	40.5%	6.23%	–
1/06/07	14/06/12	A\$0.141	A\$3.11	A\$1.49	40.5%	6.23%	–
14/1/09	31/12/13	A\$0.044	A\$0.20	A\$0.15	101.9%	2.90%	–
25/2/09	31/12/13	A\$0.030	A\$0.20	A\$0.15	88.1%	3.27%	–

20. Remuneration Report – Audited continued

20.4 Analysis of short-term incentive cash bonuses included in remuneration

Amounts included in remuneration for the financial year, within the table included in note 20.3 of this Directors' Report, represent the amount that vested in the financial year based on achievement of personal goals and satisfaction of specified performance criteria.

No amounts vest in future financial years in respect of the bonus schemes for the 2009 year.

No amounts were forfeited due to the performance or service criteria not being met in relation to the current financial year.

20.5 Equity instruments

All options refer to options over ordinary shares of Petsec Energy Ltd, which are exercisable on a one-for-one basis under the Employee Option Plan.

Options over equity instruments granted as compensation

235,000 options over ordinary shares in the Company were granted as compensation to key management persons during the reporting period (2008: Nil). Details on options over ordinary shares that were granted as compensation to key management persons during the previous corresponding period are as follows:

	Number of options granted during 2009	Grant date	Fair value per option at grant date	Exercise price per option	Expiry date	Number of vested during 2009
Executives						
D Swords	60,000	14/01/09	A\$0.044	A\$0.20	31/12/13	–
R Keogh	150,000	25/02/09	A\$0.030	A\$0.20	31/12/13	–
P Gahdmar	25,000	25/02/09	A\$0.030	A\$0.20	31/12/13	–

2,146,000 options have been granted and 1,140,000 options have been cancelled since the end of the financial year through the date of this report. The options were provided at no cost to the recipients.

All options expire on the earlier of their expiry date or termination of the individual's employment. These options were issued with an exercise price of A\$0.23 per share and a term of five years, vesting in three equal tranches, with the first tranche becoming exercisable one year from the date of issue with subsequent tranches vesting annually subject to the satisfaction of share price-based hurdles. These options were issued at an exercise price of A\$0.23 per share with a price hurdle of A\$0.30 per share.

For options granted during the year ended 31 December 2009, the earliest exercise date is 1 January 2010.

Modification of terms of equity-settled share-based payment transactions

No terms of equity-settled share-based payment transactions (including options granted as compensation to a key management person) have been altered or modified by the issuing entity during the reporting period or the prior period.

Exercise of options granted as compensation

No shares were issued, during the reporting period, on the exercise of options previously granted as compensation to key management personnel (previous corresponding period: Nil).

Directors' Report continued

For the year ended 31 December 2009

20. Remuneration Report – Audited continued

20.5 Equity instruments continued

Analysis of Movement in Options

During the reporting period, 836,500 options were granted, 376,500 options were cancelled and no options were exercised.

The movement during the previous corresponding period, by value, of options over ordinary shares in the Company held by each director and each of the five named Company executives and relevant group executives is detailed below.

	Value of Options		
	Granted in year ^(A) A\$	Exercised in year ^(B) A\$	Total option value in year A\$
2009			
Executives			
R Keogh	A\$8,773	–	A\$8,773
D Swords	A\$4,711	–	A\$4,711
P Gahdmar	A\$1,462	–	A\$1,462

^(A) The value of options granted in the year is the fair value of the options calculated at grant date using the Black-Scholes model. This amount is allocated to remuneration over the vesting period.

^(B) The value of options exercised during the year is calculated as the market price of shares of the Company on the ASX as at the close of trading on the date the options were exercised after deducting the price paid to exercise the option.

Lead Auditor's Independence Declaration

under Section 307C of the Corporations Act 2001



To: the directors of Petsec Energy Ltd

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2009 there have been:

- no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- no contraventions of any applicable code of professional conduct in relation to the audit.

A handwritten signature in dark ink, appearing to read 'Paul Zammit'.

KPMG

A handwritten signature in dark ink, appearing to read 'Paul Zammit'.

Paul Zammit
Partner

Sydney, 25 February 2010

Statements of comprehensive income

For the year ended 31 December 2009

	Note	Consolidated		The Company	
		2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Revenues from sale of oil & gas and royalties	5	57,124	123,798	–	–
Royalties paid		(5,088)	(18,517)	–	–
Net revenues after royalties		52,036	105,281	–	–
Other income and expenses	5	–	(716)	2,526	3,318
Lease operating expenses		(10,862)	(12,658)	–	–
Geological, geophysical and administrative expenses		(9,882)	(12,277)	(1,901)	(2,719)
EBITDAX ¹		31,292	79,630	625	599
Depreciation, depletion, amortisation and rehabilitation		(20,982)	(57,252)	(12)	(13)
EBITX ²		10,310	22,378	613	586
Seismic and repair expense		(1,561)	(3,253)	–	–
Dry hole, impairment and abandonment expense	7	(10,311)	(71,885)	–	–
Net movement in provisions against loans to and investments in controlled entities	7	–	–	(56,332)	(31,165)
EBIT ³		(1,562)	(52,760)	(55,719)	(30,579)
Financial income	9	176	735	133	1,283
Financial expenses	9	(5,671)	(7,790)	–	–
Net financial income/(expense)	9	(5,495)	(7,055)	133	1,283
Profit/(loss) before income tax		(7,057)	(59,815)	(55,586)	(29,296)
Income tax benefit/(expense)	10	(7,842)	15,344	–	(550)
Profit/(loss) for the period		(14,899)	(44,471)	(55,586)	(29,846)
Other comprehensive income/(loss)					
Foreign exchange translation differences		974	581	30,273	(34,556)
Cash flow hedges, net of tax		(5,600)	6,116	–	–
Total comprehensive income/(loss) for the period		(19,525)	(37,774)	(25,313)	(64,402)
			US Cents	US Cents	
Earnings/(loss) per share					
Basic and diluted earnings/(loss) per share	11	(9.5)	(28.8)		

¹ Earnings before interest (financial income and expense), income tax, depreciation, depletion, amortisation, rehabilitation and exploration (including dry hole, impairment and abandonment expense; seismic and repair expense).

² Earnings before interest (financial income and expense), income tax and exploration (including dry hole, impairment and abandonment expense; seismic and repair expense).

³ Earnings before interest (financial income and expense) and income tax.

The statement of comprehensive income is to be read in conjunction with the notes to the consolidated financial statements set out on pages 31 to 70.

Statements of changes in equity

For the year ended 31 December 2009

	In thousands of USD					
	Share capital US\$'000	Translation reserve US\$'000	Cashflow hedge reserve US\$'000	Share-based compensation US\$'000	Accumulated losses US\$'000	Total equity US\$'000
Consolidated						
Balance at 1 January 2008	169,829	1,077	2,228	1,021	(50,858)	123,297
Total comprehensive income for the period						
Profit or loss	–	–	–	–	(44,471)	(44,471)
Other comprehensive income						
Foreign exchange translation differences	–	581	–	–	–	581
Cash flow hedges, net of tax	–	–	6,116	–	–	6,116
Total other comprehensive income/(loss)	–	581	6,116	–	–	6,697
Total comprehensive income/(loss) for the period	–	581	6,116	–	(44,471)	(37,774)
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends paid	–	–	–	–	(12)	(12)
Share options exercised by employees	13	–	–	–	–	13
Vesting of share options	434	–	–	(434)	–	–
Share-based payments expense	–	–	–	364	–	364
Total transactions with owners	447	–	–	(70)	(12)	352
Balance at 31 December 2008	170,276	1,658	8,344	951	(95,341)	85,888
Balance at 1 January 2009	170,276	1,658	8,344	951	(95,341)	85,888
Total comprehensive income/(loss) for the period						
Profit or loss	–	–	–	–	352	(14,899)
Other comprehensive income/(loss)						
Foreign exchange translation differences	–	974	–	–	–	974
Cash flow hedges, net of tax	–	–	(5,600)	–	–	(5,600)
Total other comprehensive income/(loss)	–	974	(5,600)	–	–	(4,626)
Total comprehensive income/(loss) for the period	–	974	(5,600)	–	(14,899)	(19,525)
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Shares issued	13,223	–	–	–	–	13,223
Vesting of share options	528	–	–	(528)	–	–
Share-based payments expense	–	–	–	366	–	366
Total transactions with owners	13,751	–	–	(162)	–	13,589
Balance at 31 December 2009	184,027	2,632	2,744	789	(110,240)	79,952

The statement of changes in equity is to be read in conjunction with the notes to the consolidated financial statements set out on pages 31 to 70.

Statements of changes in equity continued

For the year ended 31 December 2009

	In thousands of USD					
	Share capital US\$'000	Translation reserve US\$'000	Cashflow hedge reserve US\$'000	Share-based compensation US\$'000	Accumulated losses US\$'000	Total equity US\$'000
The Company						
Balance at 1 January 2008	169,829	28,600	–	1,021	6,422	205,872
Total comprehensive income for the period						
Profit or loss	–	–	–	–	(29,846)	(29,846)
Other comprehensive income						
Foreign exchange translation differences	–	(34,556)	–	–	–	(34,556)
Total other comprehensive income/(loss)	–	(34,556)	–	–	–	(34,556)
Total comprehensive income/(loss) for the period	–	(34,556)	–	–	(29,846)	(64,402)
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Share options exercised by employees	13	–	–	–	–	13
Vesting of share options	434	–	–	(434)	–	–
Share-based payments expense	–	–	–	364	–	364
Total transactions with owners	447	–	–	(70)	–	377
Balance at 31 December 2008	170,276	(5,956)	–	951	(23,424)	141,847
Balance at 1 January 2009	170,276	(5,956)	–	951	(23,424)	141,847
Total comprehensive income/(loss) for the period						
Profit or loss	–	–	–	–	(55,586)	(55,586)
Other comprehensive income/(loss)						
Foreign exchange translation differences	–	30,273	–	–	–	30,273
Total other comprehensive income/(loss)	–	30,273	–	–	–	30,273
Total comprehensive income/(loss) for the period	–	30,273	–	–	(55,586)	(25,313)
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Shares issued	13,223	–	–	–	–	13,223
Vesting of share options	528	–	–	(528)	–	–
Share-based payments expense	–	–	–	366	–	366
Total transactions with owners	13,751	–	–	(162)	–	13,589
Balance at 31 December 2009	184,027	24,317	–	789	(79,010)	130,123

The statement of changes in equity is to be read in conjunction with the notes to the consolidated financial statements set out on pages 31 to 70.

Balance sheets

As at 31 December 2009

	Note	Consolidated		The Company	
		2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
ASSETS					
Current assets					
Cash and cash equivalents		25,356	13,735	17,182	4,725
Trade and other receivables	12	4,302	8,034	1,325	1,133
Fair value of derivative financial instruments	21	4,222	12,153	–	–
Prepayments		1,630	1,004	79	61
Total current assets		35,510	34,926	18,586	5,919
Non-current assets					
Receivables from controlled entities	12	–	–	30,068	20,782
Investments	13	–	–	89,825	121,461
Property, plant and equipment		328	373	41	39
Exploration, evaluation and development expenditure – Tangible	14(a)	75,272	98,064	–	–
Exploration and evaluation expenditure – Intangible	14(b)	6,917	8,636	–	–
Intangible assets – Software		48	121	–	–
Deferred tax assets	15	12,513	17,325	–	–
Fair value of derivative financial instruments	21	69	2,213	–	–
Total non-current assets		95,147	126,732	119,934	142,282
Total assets		130,657	161,658	138,520	148,201
LIABILITIES					
Current liabilities					
Trade and other payables	16	6,278	12,896	788	369
Fair value of derivative financial instruments	21	–	868	–	–
Loans and borrowings	17	300	2,475	–	–
Rehabilitation provisions	19	3,624	674	–	–
Employee benefits provisions		184	150	37	20
Total current liabilities		10,386	17,063	825	389
Non-current liabilities					
Trade and other payables	16	–	–	7,195	5,691
Loans and borrowings	17	28,134	46,307	–	–
Rehabilitation provisions	19	11,808	12,126	–	–
Employee benefits provisions		377	274	377	274
Total non-current liabilities		40,319	58,707	7,572	5,965
Total liabilities		50,705	75,770	8,397	6,354
Net assets		79,952	85,888	130,123	141,847
EQUITY					
Issued capital		184,027	170,276	184,027	170,276
Reserves		6,165	10,953	25,106	(5,005)
Accumulated losses		(110,240)	(95,341)	(79,010)	(23,424)
Total equity		79,952	85,888	130,123	141,847

The balance sheet is to be read in conjunction with the notes to the consolidated financial statements set out on pages 31 to 70.

Statements of cashflow

For the year ended 31 December 2009

	Note	Consolidated		The Company	
		2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Cashflows from operating activities					
Cash receipts from customers		58,911	134,698	–	–
Cash payments for royalties		(5,629)	(20,867)	–	–
Cash payments to suppliers and employees		(21,122)	(21,547)	(1,699)	(2,498)
Interest received		180	752	133	437
Interest received – related parties		–	–	–	6,054
Management fees received – related parties		–	–	1,109	2,356
Dividend received		–	–	–	1,212
Taxes paid		–	(550)	–	(550)
Interest paid		(4,297)	(7,331)	–	–
Net cash from operating activities		28,043	85,155	(457)	7,011
Cashflows from investing activities					
Payments for property, plant and equipment		(215)	(145)	(6)	(10)
Payments for exploration, evaluation and development expenditure		(10,348)	(43,601)	–	–
Loans to controlled entities		–	–	(1,931)	(8,944)
Payments for investments		–	(26)	–	–
Proceeds from disposal of investments		–	330	–	–
Proceeds from sale of assets		391	–	1	–
Net cash from investing activities		(10,172)	(43,442)	(1,936)	(8,954)
Cashflows from financing activities					
Debt facility repayments		(21,100)	(53,500)	–	–
Debt facility establishment fees		–	(181)	–	–
Proceeds from shares issued – net of transaction costs		13,655	–	13,655	–
Proceeds from share options exercised by employees		–	9	–	9
Net cash from financing activities		(7,445)	(53,672)	13,655	9
Net increase/(decrease) in cash and cash equivalents		10,426	(11,959)	11,262	(1,934)
Cash and cash equivalents at 1 January		13,735	27,214	4,725	8,167
Effects of exchange rate changes on cash held		1,195	(1,520)	1,195	(1,508)
Cash and cash equivalents at 31 December		25,356	13,735	17,182	4,725

The statement of cashflows is to be read in conjunction with the notes to the consolidated financial statements set out on pages 31 to 70.

Notes to the consolidated financial statements

For the year ended 31 December 2009

1. Reporting entity

Petsec Energy Ltd (the "Company") is a company domiciled in Australia. The registered office of the Company is Level 13, 1 Alfred Street Sydney NSW 2000. The consolidated financial statements of the Company as at and for the year ended 31 December 2009 comprise the Company and its subsidiaries (together referred to as the "consolidated entity").

The financial report is presented in United States dollars, which is the consolidated entity's choice of presentation currency.

2. Basis of preparation

(a) Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards ("AASBs") (including Australian Interpretations) adopted by the Australian Accounting Standards Board ("AASB") and the *Corporations Act 2001*. The consolidated financial report of the consolidated entity and the financial report of the Company comply with International Financial Reporting Standards ("IFRSs") and interpretations adopted by the International Accounting Standards Board (IASB).

The Board of Directors approved the financial statements on 25 February 2010.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- Derivative financial instruments are measured at fair value; and
- Available-for-sale financial assets are measured at fair value.

The methods used to measure fair values are discussed further in note 4.

The consolidated entity is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and in accordance with that Class Order, all financial information presented in US dollars has been rounded to the nearest thousand unless otherwise stated.

(c) Use of estimates and judgements

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 3 (d) – Exploration, evaluation and development expenditure – Intangible and tangible, Note 3(m) Rehabilitation provision and Note 3 (r) – Income tax.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Company and consolidated entity.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the consolidated entity.

In the Company's financial statements, investments in subsidiaries are carried at the lower of cost or recoverable amount.

(ii) Joint operating arrangements

Joint operating arrangements are those entities over whose activities the consolidated entity has joint control, established by contractual agreement. The interest of the consolidated entity in unincorporated joint operating arrangements and jointly operated assets are brought to account by recognising in its financial statements the assets it controls, the liabilities and the expenses it incurs and its share of income that it earns from the sale of goods or services by the joint operations.

(iii) Transactions eliminated on consolidation

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

3. Significant accounting policies continued

(b) Foreign currency

(i) Functional and presentation currency

Items included in the financial statements of each of the consolidated entity's subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The functional currency of the Company and its Australian subsidiaries is Australian dollars (A\$) and the functional currency of the Company's overseas subsidiaries is United States dollars (US\$).

The financial statements are presented in United States dollars. The consolidated entity believes the US dollar is the best measure of performance for Petsec Energy Ltd because oil and gas, the consolidated entity's dominant sources of revenue, are priced in US dollars and the consolidated entity's main operations are based in the USA and China with most of the costs incurred in US dollars.

Prior to consolidation, the results and financial position of each entity within the group are translated from the functional currency into the group's presentation currency as follows:

- Assets and liabilities for each balance sheet are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each income statement are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
- Components of equity are translated at the historical rates; and
- All resulting exchange differences are recognised as a separate component of equity.

(ii) Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency at the exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the respective functional currency at the foreign exchange rate ruling at that date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised directly in equity in the foreign currency translation reserve (FCTR).

(c) Derivative financial instruments and hedging activities

The consolidated entity's revenues are exposed to changes in commodity prices. From time to time, the consolidated entity enters into derivative financial instruments to manage a portion of its oil and gas sales price risks.

The consolidated entity's interest expense is exposed to changes in short-term interest rates. From time to time, the consolidated entity enters into derivative financial instruments to manage a portion of its interest rate risks.

The consolidated entity does not hold derivative financial instruments for speculative purposes.

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value each reporting date. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The consolidated entity designates certain derivatives as hedges of highly probable forecast transactions (cash flow hedges).

The consolidated entity documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The consolidated entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions have been and will continue to be highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Cash flow hedge

Changes in the fair value of the derivative-hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in the income statement.

3. Significant accounting policies continued

(c) Derivative financial instruments and hedging activities continued

(i) Cash flow hedge continued

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to the income statement in the same period that the hedged item affects profit or loss.

(ii) Derivative financial instruments that do not qualify for hedge accounting

Certain derivative financial instruments do not qualify for hedge accounting. Changes in the fair value of any derivative financial instrument that does not qualify for hedge accounting are recognised immediately in the income statement.

(d) Exploration, evaluation and development expenditure – Intangible and tangible

Exploration, evaluation and development costs are accumulated in respect of each separate area of interest. The consolidated entity's capitalisation policy for its natural gas and crude oil exploration and development activities is to capitalise costs of productive exploratory wells, development drilling and productive wells, and costs to acquire mineral interests. Exploration costs, including personnel costs, certain geological and geophysical expenses including seismic costs where exploration rights have not been obtained for oil and natural gas leases, are charged to expense as incurred. Exploratory drilling costs are initially capitalised, but charged to expense if and when the well is determined not to have found reserves in commercial quantities.

Exploration and evaluation expenditures relating to an area of interest are capitalised as intangible deferred costs where exploration rights have been obtained. These intangible deferred costs are carried forward only to the extent that they are expected to be recouped through successful development and exploitation, or sale of the area, or where exploration and evaluation activities have not yet reached a stage which permits a reasonable assessment of the existence of economically recoverable reserves, and active and significant exploration operations are continuing. These intangible deferred costs are not subject to amortisation. Once management has determined the existence of economically recoverable reserves for an area of interest, deferred costs are reclassified from intangible

to tangible assets on the balance sheet. Tangible deferred costs are amortised using a units-of-production method, as further discussed in note 3(e).

Development expenditures relating to an area of interest are capitalised as tangible deferred costs, and are carried forward to the extent that, they are expected to be recouped either through the sale or successful exploitation of the area of interest.

Exploration, evaluation and development assets are assessed for impairment when facts and circumstances suggest that the carrying amount of the asset may exceed its recoverable amount. In the event that indicators of impairment are present, an impairment loss is recorded based on the higher of an asset's fair value less costs to sell and value in use (see note 3(h)(ii)). When an area of interest is abandoned or the directors decide that it is not commercial, any accumulated costs in respect of that area are written off in the financial period the decision is made.

(e) Amortisation of exploration, evaluation and development expenditure

Exploration, evaluation and development expenditure in the production phase is amortised on a units-of-production method based on the ratio of actual production to remaining proved and probable reserves (2P). Remaining 2P reserves are at the lower of 2P reserves estimated by external independent petroleum engineers and internal estimates.

Amortisation is not charged on costs carried forward in respect of areas of interest in the development phase until commercial production commences.

(f) Intangible assets – Software

Software acquired by the consolidated entity, which have finite useful lives, is measured at cost less accumulated amortisation.

(g) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of the equipment. Borrowing costs related to the acquisition or construction of qualifying assets are recognised in profit and loss as incurred.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

3. Significant accounting policies continued

(g) Property, plant and equipment continued

(i) Recognition and measurement continued

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within "other income" in profit and loss.

(ii) Leased assets

Leases in terms of which the consolidated entity assumes substantially all the risks and rewards of ownership are classified as finance leases. Lease payments are accounted for as described in accounting policy 3(p).

(iii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the consolidated entity and its costs can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in the income statement as incurred.

(iv) Depreciation and amortisation

Depreciation of property, plant and equipment is recognised in the income statement on a straight-line basis over the estimated useful lives of each part of an item. Leased assets are depreciated over the shorter of the lease term and their useful lives. Assets are depreciated or amortised from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use.

Depreciation methods, useful lives and residual values are reassessed at the reporting date. When changes are made, adjustments are reflected prospectively in current and future periods only.

The estimated useful lives or the amortisation method used for each class of asset in the current and comparative periods are as follows:

	2009	2008
Property, plant and equipment		
Furniture and fittings	5 – 8 years	5 – 8 years
Office equipment	3 – 4 years	3 – 4 years
Leasehold improvements	5 – 7 years	5 – 7 years

(h) Impairment – Non-financial assets

The carrying amounts of the consolidated entity's and the Company's non-financial assets, other than deferred tax assets (see note 3(r)), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets or groups. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a *pro rata* basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset.

The measurement of recoverable amount for the consolidated entity's exploration, evaluation and development expenditure requires significant estimation and judgement. Note 14 provides further details of the key assumptions adopted by the consolidated entity in measuring the recoverable amount of exploration, evaluation and development expenditure.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(i) Trade and other receivables

Trade receivables, which generally have 30-60 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

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

3. Significant accounting policies continued

(j) Cash and cash equivalents

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

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

(k) Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of debt issue costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

(l) Borrowing costs

Borrowing costs comprise interest payable on borrowings calculated using the effective interest rate method, lease finance charges and amortisation of discounts or premiums relating to borrowings. Borrowing costs are expensed as incurred unless they relate to qualifying assets.

(m) Provisions

A provision is recognised if, as a result of a past event, the consolidated entity has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Rehabilitation

The consolidated entity recognises a provision for the legal obligation associated with the retirement of long-lived assets that results from the acquisition, construction, development, and (or) the normal operation of oil and natural gas properties. The initial recognition of a liability for rehabilitation, which is discounted using a credit-adjusted risk-free interest rate, increases the carrying amount of the related long-lived asset by the same amount as the liability. In periods subsequent to initial measurement, period-to-period changes in the liability are recognised for the passage of time (unwinding of discount) as financial expense. Additionally, the capitalised asset retirement cost is subsequently allocated to expense on a units-of-production basis over its estimated useful life.

Changes in the estimate of the liability arising from revised timing or estimated cost-to-complete the rehabilitation are recognised with a corresponding adjustment to the relevant long-lived asset.

The rehabilitation provision requires significant estimation and judgement. These estimates include:

- Expected method of remediation;
- Forecast costs-to-complete the future remediation; and
- Anticipated timing of the remediation work.

The consolidated entity monitors the estimates and judgements involved in measuring this provision. Changes in estimated rehabilitation provisions are accounted for on a prospective basis and affect provisions.

(n) Employee benefits and director benefits

(i) Short-term employee benefits

Liabilities for employee benefits for wages, salaries, annual leave and sick leave represent present obligations resulting from employees' services provided to reporting date and are calculated at undiscounted amounts based on remuneration wage and salary rates that the consolidated entity expects to pay as at reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

(ii) Long-term employee benefits

The provision for employee benefits for long service leave represents the present value of the estimated future cash outflows to be made resulting from employees' services provided to reporting date.

The provision is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates based on turnover history and is discounted using the rates attaching to national government bonds at reporting date which most closely match the terms of maturity of the related liabilities.

(iii) Defined contribution pension plans

The Company and other controlled entities contribute to several defined contribution pension plans. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement when they are due.

(iv) Employee incentive plans

Under the employee incentive plan, a liability may be recognised for bonuses for eligible employees based on the consolidated entity's performance for the year based on a number of pre-determined performance criteria.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

3. Significant accounting policies continued

(n) Employee benefits and director benefits continued

(v) Share-based compensation transactions

Share-based compensation benefits are provided to employees of the consolidated entity, including directors, via the Company's Employee Option Plan and Employee Share Plan.

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options.

(o) Leases

Leases in terms of which the consolidated entity assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(p) Revenue and other income recognition

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

Sale of oil and gas

Revenues are recognised when the product is in the form in which it is to be delivered and an actual physical quantity has been provided or allocated to a purchaser pursuant to a contract. Revenue from oil and gas sales is measured at the fair value of the consideration receivable.

Revenue from oil and gas royalties is recognised on an accrual basis in accordance with the terms of underlying royalty agreements. Revenue from oil and gas royalties is measured at the fair value of the consideration receivable.

Sale of non-current assets

Gains or losses on sale of non-current assets are recognised as other income at the date control of the asset passes to the buyer, usually when an unconditional contract of sale is signed.

Dividend income

Dividend income is recognised by the Company when controlled subsidiaries declare dividends.

Interest income

Interest income is recognised as the interest accrues (using the effective interest method, which is the rate that discounts estimated future cash receipts through the expected life of the financial instrument).

(q) Earnings per share

The consolidated entity presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

(r) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit nor differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

3. Significant accounting policies continued

(r) Income tax continued

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference or tax losses can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Tax consolidation

The Company and its wholly owned Australian resident entities have formed a tax-consolidated group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Petsec Energy Ltd.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within group' approach by reference to the carrying amount of assets and liabilities in the separate financial statements of each entity and the tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused Australian tax losses of the subsidiaries are assumed by the head entity in the tax-consolidated group and are recognised by the Company as amounts payable (receivable) to/(from) other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution or distribution.

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability are recognised by the head entity only.

Nature of tax funding arrangements and tax sharing arrangements

The head entity, in conjunction with other members of the Australian tax-consolidated group, has entered into a tax funding arrangement, which sets out the funding obligations of members of the tax-consolidated group

in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability/(asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable/(payable) equal in amount to the tax liability/(asset) assumed. The inter-entity receivable/(payable) is at call.

The head entity in conjunction with other members of the Australian tax-consolidated group has also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement, as payment of any amounts under the tax sharing agreement is considered remote.

(s) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the taxation authority is included as a current asset or liability in the balance sheet.

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

(t) Segment reporting

An operating segment is a distinguishable component of the consolidated entity whose information is reviewed regularly by the CEO, the Group's chief decision making officer who is engaged in providing related products or services which are subject to risk and rewards that are different to other segments.

As of 1 January 2009, the consolidated entity has applied the requirements of AASB 8 *Operating Segments*, which replaced the requirements of AASB 114 *Segment Reporting*. This change in accounting policy had no impact on presentation and disclosure; there is no impact on earnings per share.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

4. Determination of fair values

A number of the consolidated entity's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Commodity and interest rate derivatives

The fair value of commodity and interest rate derivative hedging instruments are based on the relationship between the agreed contracted fixed and floor prices and quoted market prices at period end.

5. Revenue and other income and expenses

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Revenue				
Revenues from sale of oil and gas	35,545	133,754	–	–
Derivative hedging gains/(losses)	21,579	[9,956]	–	–
	57,124	123,798	–	–
Other income and expenses				
Drilling, production and prospect overhead income	137	296	–	–
Management fee income	–	–	905	1,109
Dividend income	–	–	3,075	1,358
Net foreign exchange gains/(losses)	(101)	[1,616]	(1,454)	851
Net gain on disposal of producing properties	–	671	–	–
Net loss on disposal of property, plant and equipment	(36)	[7]	–	–
Net loss on disposal of investments	–	[117]	–	–
Sundry income	–	57	–	–
	–	[716]	2,526	3,318

6. Personnel expenses

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Wages and salaries	2,596	2,993	195	252
Service agreements for executives	654	1,021	654	1,021
Contract labour	1,475	1,034	–	–
Superannuation & 401(k) plans	132	158	22	29
Retirement benefits	24	26	24	26
Share-based payment compensation	323	441	84	208
Other employee-related expenses	–	93	–	35
	5,204	5,766	979	1,571

7. Profit/(loss) for the period

Profit/(loss) for the period includes the following items that are significant because of their nature, size or incidence:

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Expenses				
Dry hole, impairment and abandonment expense	(10,311)	(71,885)	–	–
Net movements in provisions against loans to and investments in controlled entities	–	–	(56,332)	(31,165)

Dry hole, impairment and abandonment expense

The estimated recoverable amount of all oil and gas assets is based on discounted cash flow projections that are based on a range of estimates and assumptions that are subject to change. Accordingly impairment losses are sensitive to reasonably possible changes in the key assumptions.

For the year ended 31 December 2009, the consolidated entity recognised US\$10,311,000 in dry hole, impairment and abandonment expense, comprising:

- US\$2.4 million in relation to the write-off of the remaining carrying value of the Vermilion 258 field which ceased production in March 2009;
- US\$4.4 million impairment as a result of a reduction in Petsec Energy estimated recoverable reserves;
- US\$2.0 million impairment due to lower commodity prices at 31 December 2009 than at 31 December 2008;
- US\$2.3 million impairment against a number of primary term leases and the relinquishment of its interest in the Main Pass 7 lease, where the prospects were determined not to be economic;
- US\$0.5 million impairment against the recoverable value of spare equipment due to current market conditions and the physical condition of the equipment; and
- US\$2.3 million increase in the Company's rehabilitation provision due to the reassessment of future plug and abandonment cost estimates.

The impact of the above impairments was tempered by a US\$3.6 million reversal of impairment previously recognised against the Main Pass 270 gas field, due to an increase in estimated remaining reserves.

In 2008, the consolidated entity recognised dry hole, impairment and abandonment expense of US\$71,885,000 comprising US\$13,826,000 of exploration write-offs and US\$58,059,000 in impairment provisions against certain oil & gas properties.

Net movement in provisions against loans to and investments in controlled entities

During the year ended 31 December 2009, the company recognised a further provision of US\$56,332,000 in provision against the carrying amount of its investments in controlled entities (2008: US\$31,165,000). This additional provisioning reflects the cumulative effect of reserve depletion and revisions and the impact of lower commodity prices on estimates of recoverable amounts of US oil and gas properties. Refer to Note 14 for further discussion of the factors that influence the estimation uncertainty associated with the underlying US oil and gas properties.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

8. Auditors' remuneration

	Consolidated		The Company	
	2009 US\$	2008 US\$	2009 US\$	2008 US\$
Audit services:				
<i>Auditors of the Company</i>				
KPMG Australia				
Audit and review of financial reports	80,000	126,000	80,000	126,000
Overseas KPMG Firms				
Audit and review of financial reports	46,000	53,000	–	–
Other services:				
<i>Auditors of the Company</i>				
KPMG Australia				
Corporate, tax and compliance services	13,000	–	13,000	–
Overseas KPMG Firms				
Corporate, tax and compliance services	33,000	58,000	–	–
	172,000	237,000	93,000	126,000

9. Finance income and expense

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Interest income – Related parties	–	–	–	846
Interest income – Other parties	176	735	133	437
Financial income	176	735	133	1,283
Interest expense	(4,247)	(6,549)	–	–
Unwinding of discount	(1,424)	(1,241)	–	–
Financial expense	(5,671)	(7,790)	–	–
Net financial income	(5,495)	(7,055)	133	1,283

10. Income tax expense

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Recognised in the income statement				
<i>Current tax expense</i>	–	(550)	–	(550)
<i>Deferred tax expense</i>				
Origination and reversal of temporary differences	7,842	15,894	–	–
Total income tax benefit/(expense) in income statement	7,842	15,344	–	(550)

10. Income tax expense continued

Numerical reconciliation between tax expense and pre-tax net profit

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Profit/(loss) before tax	(7,057)	(59,816)	(55,586)	(29,296)
Income tax expense/(benefit) using the Australian corporation tax rate of 30% (2008: 30%)	(2,117)	(17,945)	(16,676)	(8,789)
Increase/(decrease) in income tax expense due to:				
Non-assessable income	–	–	(922)	(407)
Non-deductible expenses	290	3,355	16,929	9,415
U.S. income taxes at different rate	(275)	(2,422)	–	–
Australian tax losses utilised	–	(219)	–	(219)
Deferred tax movements not brought to account in current year	2,102	–	669	–
U.S. withholding tax amount payable	–	550	–	550
Provisions against deferred tax assets recognised in prior years	7,842	–	–	–
Under/(over) provided in prior years	–	1,337	–	–
Income tax expense/(benefit) on pre-tax net profit	7,842	(15,344)	–	550

Deferred tax recognised directly in equity

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Relating to cash flow hedges	3,015	(3,293)	–	–
	3,015	(3,293)	–	–

The consolidated entity's tax expense for the year ended 31 December 2009 includes a provision of US\$7,842,000 to reduce the carrying value of the recognised deferred tax asset. This provision reflects the impact of revised estimates of probable future US taxable income. Refer to Note 14 for further discussion of the factors that influence the estimation uncertainty associated with the recoverability of oil and gas properties, and consequently the generation of probable US taxable income.

11. Earnings per share

The Company has only one type of security, being ordinary shares, included in the basic earnings per share calculation.

In addition to the ordinary shares, the Company has 5,699,500 (2008: 5,239,500) options outstanding under the Employee Option Plan. In determining potential ordinary shares, 4,872,000 (2008: 5,239,500) are not dilutive.

During the year, 836,500 options were granted, 376,500 options were forfeited and no options were exercised and converted to ordinary shares.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

11. Earnings per share continued

Basic earnings/(loss) per share

The calculation of basic earnings/(loss) per share at 31 December 2009 was based on the loss attributable to ordinary shareholders of US\$14,899,000 (2008: Loss of US\$44,471,000) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2009 of 156,512,245 (2008: 154,179,185), calculated as follows:

Profit/(loss) attributable to ordinary shareholders

	Consolidated	
	2009 US\$'000	2008 US\$'000
Profit/(loss) for the period	(14,899)	(44,471)

Weighted average number of shares (basic)

	Consolidated	
	2009 US\$'000	2008 US\$'000
In thousands of shares		
Issued ordinary shares at 1 January	154,189	154,151
Effect of shares issued in 2009 and 2008, respectively	2,323	28
Weighted average number of ordinary shares at 31 December	156,512	154,179

Earnings/(loss) per share

	Consolidated	
	2009 US\$'000	2008 US\$'000
In USD cents		
Basic earnings/(loss) per share	(9.5)	(28.8)
Diluted earnings/(loss) per share	(9.5)	(28.8)

12. Trade and other receivables

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Current				
Trade receivables	4,271	8,011	–	–
Other receivables	30	23	30	23
Loans receivable from controlled entities	–	–	1,295	1,110
Interest receivable from controlled entities	–	–	–	–
	4,302	8,034	1,325	1,133
Non-current				
Dividends receivable from controlled entities	–	–	6,468	3,646
Loans receivable from controlled entities	–	–	23,600	17,136
	–	–	30,068	20,782

13. Other investments

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Non-current				
Investment in controlled entities – at recoverable amount	–	–	89,825	121,461
	–	–	89,825	121,461

The Company reassesses annually its estimate of recoverable amount in its investment in controlled entities.

In 2008, the Company restructured a number of its loans and investments in controlled entities.

14. Exploration, evaluation and development expenditure

	Consolidated	
	2009 US\$'000	2008 US\$'000
(a) Tangible		
Costs carried forward in respect of areas of interest in the following phases:		
<i>Production phase – at WDV</i>		
Balance at 1 January	83,571	159,447
Additions	4,379	14,430
Reclassification from development phase	3,396	–
Reclassification from tangible exploration phase	–	40
Reclassification from intangible exploration phase	–	129
Impairment and abandonment expense	(7,538)	(33,476)
Current year amortisation expense	(20,687)	(56,999)
Balance at 31 December	63,121	83,571
<i>Development phase – at cost</i>		
Balance at 1 January	3,072	–
Additions	324	6,537
Reclassification from intangible exploration phase	–	289
Reclassification from tangible exploration phase	–	14
Reclassification to production phase	(3,396)	–
Impairment expense	–	(3,768)
Balance at 31 December	–	3,072
<i>Exploration and/or evaluation phase – at cost</i>		
Balance at 1 January	11,421	11,134
Additions	1,329	14,948
Reclassification to production phase	–	(40)
Reclassification to development phase	–	(14)
Dry hole and impairment expense	(599)	(14,607)
Balance at 31 December	12,151	11,421
Total costs carried forward	75,272	98,064

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

14. Exploration, evaluation and development expenditure continued

	Consolidated	
	2009 US\$'000	2008 US\$'000
(b) Intangible		
Costs carried forward in respect of areas of interest in the following phase:		
<i>Exploration and/or evaluation phase – at cost</i>		
Balance at 1 January	8,636	25,374
Additions	455	3,714
Reclassification to tangible production phase	–	(129)
Reclassification to tangible development phase	–	(289)
Impairment expense	(2,174)	(20,034)
Balance at 31 December	6,917	8,636

Recoverable amount

The ultimate recoupment of costs carried forward for exploration and evaluation phases is dependent on the successful development and commercial exploitation or sale of the respective areas.

The estimated recoverable amount of all cash generating units in the development and production phases is determined by discounting the estimated future cash flows to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets. The consolidated entity utilises discounted future cash flows as estimated by independent petroleum engineers for this assessment. The key assumptions used include:

- Estimated proved and probable reserves (2P reserves);
- For wells now in production – initial production rates based on current producing rates for those wells;
- For wells not currently in production – initial production rates based on test data and other related information;
- Estimated rates of production decline based on current trends;
- Hydrocarbon prices that the consolidated entity estimates to be reasonable taking into account historical prices, current prices, and prices used in making its exploration and development decisions;
- Operating costs directly applicable to the leases or wells;
- Development costs based on authorisations for expenditure for the proposed work or actual costs for similar projects; and
- Pre-tax discount rate of 10%.

15. Deferred tax assets

Recognised deferred tax assets and liabilities

	Assets		Liabilities		Net	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Consolidated						
Exploration, evaluation and development expenditure	5,415	7,923	–	–	5,415	7,923
Cash flow hedges	–	–	(1,478)	(4,493)	(1,478)	(4,493)
Other items	600	574	–	–	600	574
Tax value of loss carry-forwards recognised	7,976	13,321	–	–	7,976	13,321
Deferred tax assets/(liabilities)	13,991	21,818	(1,478)	(4,493)	12,513	17,325

	Assets		Liabilities		Net	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
The Company						
Provisions	169	174	–	–	169	174
Equity issue costs	145	–	–	–	145	–
Deferred tax balances not brought to account	(314)	(174)	–	–	(314)	(174)
Deferred tax assets/(liabilities)	–	–	–	–	–	–

Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Deductible temporary differences in Australia (net)	314	174	314	174
Tax operating loss carry-forwards in Australia (net)	1,929	1,170	1,929	1,170
	2,243	1,344	2,243	1,344

The deductible temporary differences and tax losses in Australia do not expire under current tax legislation though these losses are subject to testing under loss recoupment rules, in order for them to be utilised.

Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit in Australia will be available against which the Company can utilise the benefits therefrom.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

15. Deferred tax assets continued

Movement in temporary differences during the year

	Consolidated				
	Balance 1 Jan 08 US\$'000	Recognised in income US\$'000	Recognised in equity US\$000	Reclassified to other balance sheet account US\$000	Balance 31 Dec 08 US\$'000
Exploration, evaluation and development expenditure	(7,965)	15,888	–	–	7,923
Cash flow hedges	(1,200)	–	(3,293)	–	(4,493)
Other items	2,809	(2,246)	–	11	574
U.S. operating loss carry-forwards	11,069	2,252	–	–	13,321
	4,713	15,894	(3,293)	11	17,325

	Consolidated				
	Balance 1 Jan 09 US\$'000	Recognised in income US\$'000	Recognised in equity US\$000	Reclassified to other balance sheet account US\$000	Balance 31 Dec 09 US\$'000
Exploration, evaluation and development expenditure	7,923	(2,508)	–	–	5,415
Cash flow hedges	(4,493)	–	3,015	–	(1,478)
Other items	574	11	–	15	600
U.S. operating loss carry-forwards	13,321	(5,345)	–	–	7,976
	17,325	(7,842)	3,015	15	12,513

15. Deferred tax assets continued

Movement in temporary differences during the year continued

	The Company				
	Balance 1 Jan 08 US\$'000	Recognised in income US\$'000	Recognised in equity US\$'000	Reclassified to other balance sheet account US\$'000	Balance 31 Dec 08 US\$'000
Provisions	226	(52)	–	–	174
Deferred tax balances in Australia not brought to account	(226)	52	–	–	(174)
	–	–	–	–	–

	The Company				
	Balance 1 Jan 09 US\$'000	Recognised in income US\$'000	Recognised in equity US\$'000	Reclassified to other balance sheet account US\$'000	Balance 31 Dec 09 US\$'000
Provisions	174	(5)	–	–	169
Equity issue costs	–	–	145	–	145
Deferred tax balances in Australia not brought to account	(174)	5	(145)	–	(314)
	–	–	–	–	–

16. Trade and other payables

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Trade and other payables, stated at cost				
Trade payables	2,675	8,105	616	70
Exploration and development accruals	1,235	2,234	–	–
Joint operating arrangement advances	157	158	–	–
Operational and administration accruals	2,175	2,372	136	272
Related party payables	36	27	36	27
	6,278	12,896	788	369
Non-current liabilities				
Loans payable to controlled entities	–	–	7,195	5,691
	–	–	7,195	5,691

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

17. Loans and borrowings

This note provides information about the contractual terms of the consolidated entity's interest-bearing loans and borrowings. For more information about the consolidated entity's exposure to interest rate risk see note 21.

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Current liabilities				
Secured bank loans	300	2,475	–	–
Transaction costs	–	–	–	–
	300	2,475	–	–
Non-current liabilities				
Secured bank loans	29,100	48,025	–	–
Original issue discount	(124)	(206)	–	–
Transaction costs	(842)	(1,512)	–	–
	28,134	46,307	–	–
	28,434	48,782	–	–

Terms and debt repayment schedule

Terms and conditions of outstanding loans and letters of credit of the consolidated entity were as follows:

	Currency	Average nominal interest rate at period end	Year of maturity	31 December 2009		31 December 2008	
				Face value US\$000	Carrying amount US\$000	Face value US\$000	Carrying amount US\$000
Revolving credit facility							
Loans	USD	–	2010	–	–	20,800	20,218
Letters of credit	USD	–	2010	8,260	–	8,375	–
2nd lien term loan	USD	6.50	2011	29,400	28,434	29,700	28,564
Total outstanding loans and letters of credit				37,660	28,434	58,875	48,782

At 31 December 2009, the borrowing base under the revolving credit facility was US\$14.9 million (2008: US\$53.0 million).

On 1 January 2010, the borrowing base under the revolving credit facility was set at US\$10.25 million with monthly reductions of US\$1.25 million commencing 1 February 2010 through to 1 June 2010.

For further details relating to the credit facility and terms loans see note 21.

The bank loans are secured by assets of the Company's U.S.A. subsidiary Petsec Energy Inc., including oil and gas and cash assets, with a carrying amount of US\$86,300,000 (2008: US\$91,469,000).

18. Employee benefits

(a) Defined contribution plans

The consolidated entity contributes to several defined contribution employee superannuation plans in Australia. Employer contributions are based on various percentages of their gross salaries. The consolidated entity is under no legal obligation to make contributions in excess of those specified in Superannuation Industry (Supervision) legislation. The amount recognised, as expense was US\$22,000 for the year ended 31 December 2009 (2008: US\$29,000).

U.S. based employees are eligible to participate in a voluntary savings plan under Section 401(k) of the US tax code ("401(k) plan"). The matching contributions recognised, as expense was US\$110,000 for the year ended 31 December 2009 (2008: US\$129,000).

(b) Employee incentive plans

The Company has an employee incentive plan, under which a liability may be recognised for bonuses for eligible employees based on the consolidated entity's performance for the year based on a number of pre-determined performance criteria. No bonus is payable in respect of the 2009 year (2008: Nil).

(c) Share-based payments

The following sets forth the share-based compensation transactions under the Company's Employee Option Plan.

The number and weighted average exercise prices of share options, is as follows:

In thousands of options	Weighted average exercise price 2009	Number of options 2009	Weighted average exercise price 2008	Number of options 2008
Outstanding at the beginning of the period	A\$2.40	5,240	A\$2.46	6,087
Granted during the period	A\$0.20	837	A\$1.19	90
Exercised during the period	-	-	A\$0.40	(38)
Forfeited during the period	A\$2.02	(377)	A\$2.77	(899)
Outstanding at the end of the period	A\$2.10	5,700	A\$2.40	5,240
Exercisable at the end of the period	A\$2.36	2,669	\$2.27	1,686

The options outstanding at 31 December 2009 have an exercise price in the range of A\$0.20 to A\$3.11 and a weighted average contractual life of 2.39 years.

During the year, no share options were exercised (2008: 38,000 share options exercised and the weighted average share price at the date of exercise was A\$0.73).

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

18. Employee benefits continued

(c) Share-based payments continued

The Employee option plan provides for employees, executives and directors to be granted options over ordinary shares at the discretion of the Nomination and Remuneration Committee.

Each option is convertible to one ordinary share. The exercise prices of the options, determined in accordance with the Rules of the plan, are based on the ruling market prices when the options are issued.

All options expire on the earlier of their expiry date or when the holder's employment ceases unless otherwise approved by the Remuneration Committee. Options may not be exercised until they are vested and thereafter exercise is conditional on satisfaction of share price hurdles and the terms of issue. The vesting periods range from six months to four years after granting. The plan does not represent remuneration for past services.

The terms and conditions of the grants are as follows, whereby all options are settled by physical delivery of shares:

Grant date/employees entitled	Number of instruments	Contractual life of options
Option grant to other personnel at 25 February 2005	15,000	4.35 years
Option grant to key management personnel at 20 October 2005	250,000	4.50 years
Option grant to key management personnel at 1 March 2006	450,000	4.49 years
Option grant to other personnel at 28 April 2006	192,000	4.46 years
Option grant to other personnel at 1 June 2006	100,000	4.06 years
Option grant to other personnel at 24 July 2006	200,000	4.50 years
Option grant to other personnel at 20 December 2006	25,000	4.46 years
Option grant to other personnel at 2 March 2007	80,000	4.40 years
Option grant to other personnel at 2 March 2007	655,000	4.42 years
Option grant to key management personnel at 2 March 2007	600,000	4.45 years
Option grant to key management personnel at 2 March 2007	500,000	4.45 years
Option grant to other personnel at 30 May 2007	65,000	4.37 years
Option grant to key management personnel at 1 June 2007	1,500,000	4.54 years
Option grant to key management personnel at 1 June 2007	500,000	4.54 years
Option grant to other personnel at 10 September 2007	30,000	4.35 years
Option grant to other personnel at 1 November 2007	150,000	4.46 years
Option grant to other personnel at 27 February 2008	90,000	4.46 years
Option grant to key management personnel at 14 January 2009	60,000	3.52 years
Option grant to other personnel at 14 January 2009	395,500	3.52 years
Option grant to key management personnel at 25 February 2009	175,000	3.35 years
Option grant to other personnel at 25 February 2009	206,000	3.35 years
Total share option schemes with all or a portion of options outstanding at 31 December 2009	6,238,500	

18. Employee benefits continued

(c) Share-based payments continued

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on a Black-Scholes model. The contractual life of the option is used as an input into this model. During the year ended 31 December 2009, grants of 235,000 options were made to key management personnel (2008: Nil).

The following table summarises the fair value assumptions of share options granted to key management personnel during the years ended 31 December 2009 and 2008.

	Key management personnel 2009	Key management personnel 2008
Weighted average fair value at measurement date	A\$0.06	–
Weighted average share price	A\$0.14	–
Weighted average exercise price	A\$0.20	–
Expected volatility (expressed as weighted average used in the modelling under Black-Scholes model)	91.59%	–
Expected option life (expressed as weighted average used in the modelling under Black-Scholes model)	3.4 years	–
Expected dividends	–	–
Risk-free interest rate (based on national government bonds)	2.90% – 3.27%	–

The expected volatility is based on historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information.

Share options are granted under a service condition and minimum share price hurdles. Such conditions are not taken into account in the grant date fair value measurement of the services received, however, are considered in assumptions about the number of options that are expected to become exercisable.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

19. Rehabilitation provisions

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Current				
Balance at 1 January	674	–	–	–
Provisions made during the year	–	573	–	–
Provisions reclassified from non-current classification	2,589	1,306	–	–
Provisions used during the year	(1,464)	(1,205)	–	–
Provisions revised during the year	1,415	–	–	–
Unwind of discount	410	–	–	–
Balance at 31 December	3,624	674	–	–
Non-current				
Balance at 1 January	12,126	12,395	–	–
Provisions made during the year	–	452	–	–
Provisions reclassified to current classification	(2,589)	(1,306)	–	–
Provisions used during the year	–	(102)	–	–
Provisions revised during the year	1,282	(427)	–	–
Unwind of discount	989	1,114	–	–
Balance at 31 December	11,808	12,126	–	–
	15,432	12,800	–	–

20. Capital and reserves

Share capital

Ordinary shares

In thousands of shares	The Company	
	2009	2008
On issue at 1 January	154,189	154,151
Shares issued for cash	77,095	–
Share options exercised by employees	–	38
On issue at 31 December – fully paid	231,284	154,189

The Company does not have authorised capital or par value in respect of its issued shares.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

20. Capital and reserves continued

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of operations where their functional currency is different to the presentation currency of the reporting entity.

Cash flow hedge reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet transpired.

Share-based compensation

The share-based compensation represents the value of unvested options issued under the Company's Employee Option Plan.

Capital management

The Board's policy is to maintain an appropriate capital base to sustain future development of the consolidated entity. This capital base comprises equity and borrowings.

There was no change in the consolidated entity's approach to capital management during the year. Debt reduction was a focus during 2009.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

21. Financing arrangements and additional financial instruments disclosures

Financing arrangements

At 31 December 2009, the consolidated entity had available debt facilities of US\$44.3 million (2008: US\$82.7 million), under which US\$29.4 million of loans and US\$8.3 million of letters of credit were outstanding (2008: US\$50.5 million of loans and US\$8.4 million of letters of credit). The debt facilities were entered into in November 2007 primarily to fund the acquisition of interests in seven gas fields in 2007 and to support letters of credit.

Funding

In November 2007, Petsec Energy Inc. (PEI), a wholly owned subsidiary, entered into two new borrowing facilities:

- US\$170 million revolving facility and letter of credit facility ("Revolving facility") and US\$30 million term loan; and
- US\$30 million second lien credit agreement.

Proceeds from these facilities were used to fund the purchase of oil and gas properties. The US\$170 million revolving and US\$30 million term loan replaced the existing facility, which was terminated on entering into these new arrangements. The term loan matured in April 2008. Principal repayments under the term loan were US\$6.5 million per month starting in December 2007 for four months, with the balance of US\$4.0 million paid on maturity.

(i) Revolving facility

The revolving facility agreement provides for up to US\$170 million in a revolving and letter of credit facility, which is subject to borrowing base determinations and includes up to US\$25 million available for letters of credit.

The borrowing base under the revolving facility is determined with reference to PEI's proved reserves. The borrowing base was initially established at US\$75 million and is subject to no less than semi-annual review. The borrowing base review may also establish a monthly reduction amount to reduce the principal outstanding. Effective 1 January 2010, the borrowing base was set at US\$10.25 million with monthly reductions of US\$1.25 million per month beginning 1 February 2010 through 1 June 2010.

Interest on the revolving facility is floating rate, plus a margin. Outstanding loans accrue interest at Petsec's election at either (i) the bank's prime rate plus 0.25% to 1.25% margins per annum, or at (ii) LIBOR plus 2% to 3% per annum. The total interest on the revolving facility is subject to a 5.0% per annum floor. At 31 December 2009 the average interest rate under the revolving facility is 5.0% (2008: 5.0%).

At 31 December 2009, the principal loan balance outstanding under the revolving facility was nil (2008: US\$20.8 million).

The revolving facility and letters of credit facilities mature in November 2010.

Total outstanding letters of credit as at 31 December 2009 were US\$8.3 million (2008: US\$8.4 million). The letters of credit secure bonding, potential plug and abandonment, and environmental contingent liabilities in connection with PEI's oil and natural gas operations.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

21. Financing arrangements and additional financial instruments disclosures continued

Funding continued

(ii) Second Lien Credit Agreement

The Second Lien agreement involves a term loan of US\$30 million with a maturity of 8 November 2011. The facility was issued at an original issue discount of 1%. Proceeds received at drawdown were US\$29.7 million.

Interest on the US\$30 million is floating, based on LIBOR plus a margin of 6.25% per annum. The current interest rate at 31 December 2009 is 6.50% (2008: 7.71%) and is paid monthly.

In December 2007, PEI entered into an interest rate swap that effectively fixed the interest rate (base rate and margin) on the second lien term loan at 10.4% until 31 December 2009. See "Interest rate risk" within this note for further information.

The loan balance at 31 December 2009 was US\$29.4 million. This loan has scheduled repayments of US\$0.3 million per annum (US\$0.075 million per quarter) during 2009 and 2010, with the balance of US\$29.1 million payable in equal quarterly instalments during 2011.

Security

Both the Revolving Facility and the Second Lien agreements are secured by mortgages over all of PEI's oil and gas properties.

Covenants

Both the Revolving Facility and term loan and the Second Lien agreements include financial covenants and other restrictions. The financial covenants include the requirement that PEI:

- Maintain a prescribed ratio of current assets to current liabilities; and
- Restrict the level of bank debt and interest by reference to earnings.

The second lien agreement also restricts the level of net funded bank debt by reference to discounted cash flow estimates from production of PEI's proved reserves.

These restrictions also limit the ability of PEI to return cash to Petsec Energy Ltd.

Foreign exchange exposures

During 2008 and 2009, operating costs were incurred in both Australian and US dollars.

Throughout 2008 and 2009, the consolidated entity held the majority of its liquid funds in US dollars. Fluctuations in the Australian dollar/US dollar exchange rate have impacted the underlying performance of the consolidated entity. The consolidated entity's policy is not to hedge the Australian dollar/US dollar exchange rate risk as income (cash in flows) and expenses (cash out flows), are predominantly denominated in US dollars, with the exception of Australian dollar denominated equity funding. Consequently surplus funds are generally held in US dollars.

Commodity price exposures

The revenue and income of the consolidated entity are affected by changes in natural gas and crude oil prices, and various financial transactions have been undertaken (purchased put options and swaps involving commodity prices for natural gas) to reduce the effect of these changes. The consolidated entity has proved reserves of these commodities sufficient to cover all these transactions and it only enters into such derivatives to match its anticipated underlying physical production and reserves. The consolidated entity has limited the term of the transactions and the percentage of the Company's expected aggregate oil and natural gas production that may be hedged at any time.

Swaps

In a natural gas swap agreement the consolidated entity receives from the counterparty the difference between the agreed contracted fixed price and the quoted or published reference settlement price if the latter is lower than the fixed price. If the reference settlement price is higher than the agreed fixed price, the consolidated entity will pay the difference to the counterparty.

21. Financing arrangements and additional financial instruments disclosures continued

Commodity price exposures continued

Collars

In a collar agreement, a floor price and a ceiling price are established. If there is no cash outlay upon entering a collar arrangement, it is called a "costless" or "cashless" collar. If quoted reference prices at the specified date (expiration date) are lower than the floor price, then the counterparty pays the price difference multiplied by the notional quantity to the consolidated entity. If the quoted reference prices at the specified date are higher than the ceiling price, then the consolidated entity pays the price difference multiplied by the notional quantity to the counterparty.

Put options

In a put option agreement, a floor price is established. If quoted reference prices at a specified date (expiration date) are lower than the floor price (strike price), then the counterparty pays the price difference multiplied by the notional quantity to the consolidated entity.

At 31 December 2009, the consolidated entity had the following outstanding natural gas hedges in place:

Production period	Hedge type	Average daily volume	Weighted average USD price*
2010	Swaps	6,656 MMBtu	7.43
2011	Collars	2,162 MMBtu	6.00 – 7.56

* Fixed price for swaps and floor and ceiling prices for collars.

At 31 December 2008, the consolidated entity had the following outstanding natural gas hedges in place:

Production period	Hedge type	Average daily volume	Weighted average USD price*
2009	Swaps	11,877 MMBtu	8.46
	Puts	2,312 MMBtu	6.33
2010	Swaps	2,896 MMBtu	9.12

* Fixed price for swaps and floor price for puts – Put floor price shown net of premium.

The consolidated entity has determined that all swap agreements outstanding as at 31 December 2009 are highly effective and thus qualify for hedge accounting treatment. Accordingly, gain or losses on the swaps that qualify for hedge accounting treatment will be included in oil and natural gas revenues when the underlying production is delivered in the periods indicated above.

The consolidated entity has determined that the intrinsic value portion of the put options, were highly effective and qualified for hedge accounting treatment. Accordingly, gains, if any, associated with the intrinsic value of put options were included in oil and natural gas revenues, net of premiums paid for the options, when the underlying production was delivered. The time value components of changes in value of put options are recorded in earnings each period. During 2009, a net loss of less than US\$0.1 million (2008: gain of US\$0.4 million) arising from changes in the time value component was recognised in the income statement. There are no outstanding put options at 31 December 2009.

At 31 December, payments of put premiums totalling nil (2008: US\$0.4 million) have been deferred until the time of settlement of a portion of the put options.

The consolidated entity does not use hedge accounting treatment for its collars. Accordingly, changes in the fair value of the collars are recognised in income immediately.

At 31 December 2009, the consolidated entity had recorded derivative assets of US\$4.3 million and derivative liabilities of nil, representing the fair value of the commodity hedge instruments at that date of which US\$4.2 million of associated net gains have been deferred in equity, net of taxes of US\$1.5 million. At 31 December 2008, the consolidated entity recorded derivative assets of US\$14.4 million and derivative liabilities of US\$0.9 million representing the fair value of the commodity hedge instruments at that date of which US\$8.9 million of associated net gains have been deferred in equity, net of taxes of US\$4.8 million. Refer to accounting policy note 3(c).

The fair values for commodity hedge agreements will vary with movements in market prices until the contracts settle.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

21. Financing arrangements and additional financial instruments disclosures continued

Credit risk exposures

Credit risk represents the loss that would be recognised if counterparties failed to perform as contracted. The credit risk on financial assets of the consolidated entity that have been recognised is the carrying amount, net of any provision for doubtful debts. Financial market distress in the USA and worldwide, which occurred in the second half of 2008 and continued into 2009, has increased the consolidated entity's credit risk exposure. While the counterparty credit risk exposure on derivative contracts has increased, the consolidated entity has assessed that the counterparty's credit ratings determined by a recognised ratings agency remains acceptable.

Interest rate risk

The consolidated entity's variable-rate borrowings are exposed to a risk of change in cash flows due to changes in interest rates. Investments in equity securities and short-term receivables and payables are not exposed to interest rate risk.

In December 2007, the consolidated entity entered into an interest rate swap; effectively converting the variable rate interest on the second lien term loan to a fixed rate of 10.4% per annum through 31 December 2009. The interest rate swap had a notional amount of US\$30 million amortising quarterly, matching the amortisation schedule of the second lien term loan. Under the swap agreement, the consolidated entity received a floating interest rate based on the three-month LIBOR rate and pays a fixed rate of 4.15%.

The consolidated entity determined that interest rate swap agreements outstanding at 31 December 2008 were highly effective and thus qualified for hedge accounting treatment. Accordingly, gains or losses on the swaps were included in interest expense upon each monthly settlement.

At 31 December 2008, the consolidated entity had recorded a derivative liability of US\$0.9 million representing the fair value of the interest rate swap of which all of the deferred loss was deferred in equity net of US\$0.3 million of income taxes.

Sensitivity analysis

In managing commodity price and interest rate risks the consolidated entity aims to reduce the impact of short-term fluctuations on the consolidated entity's earnings. The consolidated entity and the Company do not use derivative instruments to manage foreign exchange rate risk. Over the longer-term, however, permanent changes in commodity prices, interest rates and exchange rates will have an impact on profit.

The estimated impact of a 10 per cent change in the average commodity price for the year ended 31 December would have increased or decreased the consolidated entity's profit or loss by US\$692,000 (2008: US\$4,421,000) excluding potential impact of impairments. The estimated impact of a change of 100 basis points in interest rates would have increased or decreased the consolidated entity's profit or loss by US\$39,000 (2008: US\$505,000). The estimated impact of a 10 per cent change in the USD/AUD exchange rates would have increased or decreased the consolidated entity's and the Company's profit or loss by US\$215,000 (2008: US\$318,000).

21. Financing arrangements and additional financial instruments disclosures continued

Fair values of financial assets and liabilities

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

Consolidated	Note	2009		2008	
		Carrying amount US\$'000	Fair value US\$'000	Carrying amount US\$'000	Fair value US\$'000
Trade and other receivables		4,302	4,302	8,034	8,034
Cash and cash equivalents		25,356	25,356	13,735	13,735
Natural gas hedge contracts (cash flow hedges):					
Assets		4,291	4,291	14,366	14,366
Liabilities		-	-	-	-
Interest rate swaps (cash flow hedges):					
Liabilities		-	-	(868)	(868)
Secured bank loans		(28,434)	(29,400)	(48,782)	(50,500)
Trade and other payables		(6,278)	(6,278)	(12,896)	(12,896)
		(763)	(1,729)	(26,411)	(28,129)
Unrecognised loss			(966)		(1,718)

The carrying values of all other financial assets and liabilities are estimated to approximate fair value because of their short maturity.

The carrying amounts shown in the balance sheet of the Company are equal to fair value.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

22. Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Less than one year	524	528	144	176
Between one and five years	917	924	300	–
	1,441	1,452	444	176

The consolidated entity leases office space in Australia and the USA under operating leases. The leases typically run for a period of 3 to 5 years. Lease payments are subject to review every year to reflect market rentals. None of the leases includes contingent rentals.

One of the leased properties has been sublet by the consolidated entity. The lease and subleases expire in 2012. Sub-lease payments of A\$36,000 are expected to be received during the following financial year.

During the year ended 31 December 2009, US\$1,538,000 was recognised as an expense in the income statement in respect of operating leases (2008: US\$1,537,000). US\$28,000 (2008: US\$31,000) was recognised as income in the income statement in respect of sub-leases.

23. Capital and other commitments

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Capital expenditure commitments				
Exploration, evaluation and development expenditure				
<i>Contracted but not provided for and payable:</i>				
Within one year	2,205	1,072	–	–
One year or later and no later than five years	348	534	–	–
	2,553	1,606	–	–
Joint operating arrangements commitments				
<i>Share of capital commitments of the joint operating arrangements:</i>				
Within one year	396	822	–	–

24. Contingencies and legal matters

The consolidated entity is a defendant from time to time in legal proceedings. Where appropriate the consolidated entity engages legal counsel.

The production, handling, storage, transportation and disposal of oil and natural gas, by-products thereof and other substances and materials produced or used in connection with oil and natural gas operations were subject to regulation under U.S. federal, state and local laws and regulations primarily relating to protection of human health and environment. To date, expenditure related to complying with these laws and for remediation of existing environmental contamination has not been significant in relation to the results of operations of the Company.

The Company's U.S. subsidiary, Petsec Energy Inc. ("PEI") is required to provide bonding or security for the benefit of U.S. regulatory authorities and lease owners in relation to its obligations to pay lease rentals and royalties, the plugging and abandonment of oil and natural gas wells, and the removal of related facilities. As of 31 December 2009, the consolidated entity was contingently liable for US\$10,575,000 of surety and supplemental bonds (2008: US\$12,200,000) issued through a surety company to secure those obligations. US\$6,625,000 of these bonds was collateralised by letters of credit and a further US\$1,635,000 in letters of credit collateralised PEI's abandonment obligations to a joint venture partner.

In the corresponding period, US\$6,625,000 of these bonds was collateralised by letters of credit and a further US\$1,750,000 in letters of credit collateralised PEI's obligations to a joint venture partner.

25. Deed of cross guarantee

Pursuant to an ASIC Class Order 98/1418 dated 13 August 1998, relief is granted to certain wholly owned Australian subsidiaries of the Company from the Corporations Act requirements for preparation, audit, and publication of Financial Reports and Directors' Reports.

It is a condition of the Class Order that the Company and each of its subsidiaries enter into a Deed of Cross Guarantee Indemnity. The effect of the deed is that the Company guarantees to each creditor payment in full of any debt in the event of winding up of any of the subsidiaries under certain provisions of the Corporations Act. If a winding-up occurs under other provisions of the Act, the Company will only be liable in the event that after six months any creditor has not been paid in full. The subsidiaries have also given similar guarantees in the event that the Company is wound up.

The subsidiaries subject to the Deed are:

- Petsec Investments Pty. Limited
- Petroleum Securities Pty. Limited
- Najedo Pty. Ltd
- Petroleum Securities Share Plan Pty. Limited
- Laurel Bay Petroleum Limited
- Ginida Pty. Limited
- Western Medical Products Pty. Limited

A consolidated income statement and consolidated balance sheet, comprising the Company and subsidiaries which are a party to the Deed, after eliminating all transactions between parties to the Deed of Cross Guarantee, as at 31 December 2009 and 2008, is set out as follows:

Summarised income statement and retained earnings/(accumulated losses)

	Consolidated	
	2009 US\$'000	2008 US\$'000
Retained earnings/ (accumulated losses) at beginning of year	(23,455)	6,383
Profit/(loss) after related income tax expense	(55,589)	(29,838)
Retained earnings/ (accumulated losses) at end of year	(79,044)	(23,455)

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

25. Deed of cross guarantee continued

Balance sheet

	Consolidated	
	2009 US\$000	2008 US\$000
ASSETS		
Current Assets		
Cash and cash equivalents	17,182	4,725
Other receivables	1,325	1,133
Prepayments	79	61
Total current assets	18,586	5,919
Non-current assets		
Loan receivable from controlled entities	20,710	14,852
Other financial assets	6,468	3,645
Other investments	85,516	118,054
Property, plant and equipment	41	40
Total non-current assets	112,735	136,591
Total assets	131,321	142,510
LIABILITIES		
Current liabilities		
Trade and other payables	788	378
Employee benefits provision	37	11
Total current liabilities	825	389
Non-current liabilities		
Employee benefits provision	377	274
Total non-current liabilities	377	274
Total liabilities	1,202	663
Net assets	130,119	141,847
Equity		
Issued capital	184,027	170,276
Reserves	25,136	(4,974)
Retained earnings/(accumulated losses)	(79,044)	(23,455)
Total equity	130,119	141,847

26. Consolidated entities

	Country of Incorporation	Ownership interest	
		2009 %	2008 %
Parent entity			
Petsec Energy Ltd			
Significant subsidiaries			
Petsec Investments Pty. Limited	Australia	100	100
Petroleum Securities Pty. Limited	Australia	100	100
Najedo Pty. Limited	Australia	100	100
Petroleum Securities Share Plan Pty. Limited	Australia	100	100
Petsec America Pty. Limited	Australia	100	100
Petsec (U.S.A.) Inc.	USA	100	100
Petsec Petroleum LLC	USA	100	100
Petsec Energy Inc.	USA	100	100
Laurel Bay Petroleum Limited	Australia	100	100
Ginida Pty. Limited	Australia	100	100
Western Medical Products Pty. Limited	Australia	100	100

All entities carry on business in the country where they were incorporated with the exception of Petsec Petroleum LLC, which holds the consolidated entity's interests in the Beibu Gulf, China.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

27. Segment reporting

The consolidated entity operates in the oil and gas industry.

Segment information is presented in the consolidated financial statements in respect of the consolidated entity's geographic segments, which reflects the presentation of information to the chief operating decision maker.

Segment results include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Segment acquisition of property, plant and equipment, intangibles and exploration, evaluation and development assets is the total cost incurred during the period to acquire segment assets that are expected to be utilised for more than one period.

In presenting information on the basis of geographical segments, segment revenue and assets are based on the geographical location of operations.

	Australia		USA		China		Consolidated	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Oil and gas sales and royalties	–	–	57,124	123,798	–	–	57,124	123,798
Royalties paid	–	–	(5,088)	(18,517)	–	–	(5,088)	(18,517)
Net revenues after royalties*	–	–	52,036	105,281	–	–	52,036	105,281
Segment result from continuing operations	(2,098)	(3,810)	(4,495)	(46,659)	(464)	(9,346)	(7,057)	(59,815)
Income tax benefit	–	–	–	–	–	–	(7,842)	15,344
Profit after tax	–	–	–	–	–	–	(14,899)	(44,471)
Depreciation, depletion, amortisation and rehabilitation	12	13	20,970	57,239	–	–	20,982	57,252
Dry hole, impairment and abandonment expense	–	–	10,316	63,295	(5)	8,590	10,311	71,885
Seismic and repair expense	–	–	1,561	3,253	–	–	1,561	3,253
Segment assets	17,331	4,857	100,393	145,167	12,933	11,634	130,657	161,658
Acquisition of property, plant and equipment and exploration, evaluation and development assets	6	10	9,266	34,070	1,291	9,666	10,563	43,746
Segment liabilities	1,203	674	48,760	74,785	742	311	50,705	75,770
Cash flows from operating activities	(1,566)	(1,469)	30,060	86,624	(451)	–	28,043	85,155
Cash flows from investing activities	(5)	294	(8,876)	(34,070)	(1,291)	(9,666)	(10,172)	(43,442)
Cash flows from financing activities	13,655	9	(21,100)	(53,681)	–	–	(7,445)	(53,672)

* There are no inter-segment sales

28. Interests in unincorporated joint operating arrangements

Included in the assets of the consolidated entity are the following items which represent the consolidated entity's interest in the assets and liabilities in joint operating arrangements:

	Consolidated	
	2009 US\$'000	2008 US\$'000
Assets		
Exploration, evaluation and development expenditure – Tangible:		
<i>Leases now in production</i>		
Producing leases – at cost	141,307	133,571
Less: accumulated amortisation and impairment	(91,389)	(73,539)
	49,918	60,212
Represented by the following lease carrying values:		
– Main Pass 19	15,205	18,566
– Mobile Bay Area	354	4,373
– Main Pass 89	–	113
– Main Pass 270	34,359	35,648
– Onshore Louisiana	–	1,512
	49,918	60,212
<i>Leases not yet in production</i>		
– Block 22/12 Beibu Gulf, China	11,630	10,330
– Onshore Louisiana	–	3,119
– Other Gulf of Mexico leases	–	7
	11,630	13,456
Total exploration, evaluation and development expenditure – Tangible	61,548	73,668
Exploration and evaluation expenditure – Intangible:		
<i>Not in production</i>		
– Block 22/12 Beibu Gulf, China	1,301	1,304
– Onshore Louisiana	2,814	2,953
– Other Gulf of Mexico leases	314	258
Total exploration, evaluation and development expenditure – Intangible	4,429	4,515
	Consolidated	
	2009 US\$'000	2008 US\$'000
Liabilities		
Rehabilitation provision:		
– Main Pass 19	1,217	1,090
– Mobile Bay Area	3,463	2,277
– Main Pass 270	300	269
– Onshore Louisiana	588	841
– Other Gulf of Mexico leases	57	–
	5,625	4,477

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

28. Interests in unincorporated joint operating arrangements continued

The contribution of the consolidated entity's joint operating arrangements to EBIT (including exploration write-offs and impairments; and excluding the effects of hedging):	Consolidated	
	2009 US\$'000	2008 US\$'000
– Main Pass 19	979	10,056
– Mobile Bay Area	(4,981)	(6,293)
– Main Pass 270	2,391	(1,628)
– Block 22/12 Beibu Gulf, China	(485)	(9,346)
– Onshore Louisiana	(3,566)	(21,799)
– Other Gulf of Mexico leases	297	(14,700)
	(5,365)	(43,710)

The principal activity of all the joint operating arrangements is oil & gas exploration. Listed below is the name of each of the joint operating arrangements and the percentage working interest held in the joint operating arrangement by the consolidated entity as at and during the year ended 31 December:

	Interest held 2009	Interest held 2008
– Main Pass 19	55.00%	55.00%
– Mobile Bay Area	40.00% to 50.00%	40.00% to 50.00%
– Main Pass 270	25.00%	25.00%
– Block 22/12 Beibu Gulf, China	25.00%	25.00%
– Onshore Louisiana	46.00% to 80.00%	46.25% to 87.50%
– Other Gulf of Mexico leases	25.00% to 54.00%	25.00% to 54.00%

29. Wholly owned areas of interest

Included in the assets and liabilities of the consolidated entity are the following items which represent the consolidated entity's wholly owned areas of interest:

	Consolidated	
	2009 US\$'000	2008 US\$'000
Assets		
Exploration, evaluation and development expenditure – Tangible:		
<i>Leases now in production</i>		
Producing leases – at cost	107,379	105,624
Less: accumulated amortisation and impairments	(94,175)	(82,265)
	13,204	23,359
Represented by the following lease carrying values:		
– Main Pass 18	9,826	10,826
– Chandeleur 31/32	3,378	9,808
– Vermilion 258 ¹	–	2,653
– Main Pass 20	–	72
	13,204	23,359
<i>Not in production</i>		
– Spare equipment	503	1,030
– Other Gulf of Mexico leases	17	7
	520	1,037
Total exploration, evaluation and development expenditure – Tangible	13,724	24,396
Exploration and evaluation expenditure – Intangible:		
<i>Not in production</i>		
– Main Pass 7	–	952
– Main Pass 91	1,247	1,198
– North Padre Island 929/934	1,241	762
– West Cameron 631/636	–	1,209
Total exploration and evaluation expenditure – Intangible	2,488	4,121
Non-current liabilities		
Rehabilitation provision:		
– Vermilion 258	3,081	2,589
– Main Pass 18	126	119
– Main Pass 20	3,996	3,393
– Chandeleur 31/32	2,604	2,222
	9,807	8,323

¹ The Vermilion 258 gas field ceased production in March 2009.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

29. Wholly owned areas of interest continued

The contribution of the consolidated entity's areas of interest to EBIT (including exploration write-offs and impairments; and excluding the effects of hedging):	Consolidated	
	2009 US\$'000	2008 US\$'000
– Chandealeur 31/32	2,399	20,810
– Main Pass 18	(1,355)	1,778
– Main Pass 20	(1,227)	(5,145)
– Vermilion 258	(1,161)	(1,413)
– Vermilion 257	–	(456)
– Main Pass 103	–	(971)
– Main Pass 7	(956)	–
– West Cameron 631/636	(1,271)	–
	(3,571)	14,603

30. Reconciliation of cash flows from operating activities

	Consolidated		The Company	
	2009 US\$'000	2008 US\$'000	2009 US\$'000	2008 US\$'000
Cash flows from operating activities				
Profit/(loss) for the period	(14,899)	(44,471)	(55,586)	(29,846)
Adjustments for:				
Depreciation, depletion & amortisation and rehabilitation	20,982	57,252	12	13
Dry-hole, impairment and abandonment expense	10,311	71,885	–	–
Repair expense	458	1,325	–	–
Net movement in provisions against investments and loans to controlled entities	–	–	56,332	31,165
Management fee income	–	–	(905)	(1,109)
Dividend income	–	–	(3,075)	(1,331)
Net foreign exchange losses/(gains)	101	1,616	1,454	(851)
Net loss/(gain) on property, plant and equipment	36	(664)	–	–
Share-based payment expenses	323	441	84	208
Operating profit before changes in working capital and provisions	17,312	87,384	(1,684)	(1,751)
Decrease/(Increase) in receivables, prepayments and other assets	3,084	10,987	(210)	8,850
Decrease/(Increase) in deferred tax assets	4,812	(12,609)	–	–
(Decrease)/Increase in payables and provisions	2,835	(607)	1,437	(88)
Net cash from operating activities	28,043	85,155	(457)	7,011

31. Related parties

The following were key management personnel of the consolidated entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

Executive director	T N Fern (Chairman and Managing Director)
Non-executive directors	D A Mortimer
	P E Power
	M L Harvey
Executives	R A Keogh (President, Petsec Energy Inc.)
	R Krenzke (Executive Vice President Exploration, Petsec Energy Inc.) – Appointed 23 November 2009
	F Steele (Vice President Land, Petsec Energy Inc.)
	D Swords (General Counsel/Corporate Secretary, Petsec Energy Inc.)
	F Robertson (Chief Financial Officer, Petsec Energy Ltd)
	P Gahdmar (Group Financial Controller and Company Secretary, Petsec Energy Ltd)
	C Jones (General Manager – Corporate and Company Secretary, Petsec Energy Ltd) – Resigned 5 March 2009

Key management personnel compensation

The key management personnel compensation included in personnel expenses (see note 6) is as follows:

	Consolidated		The Company	
	2009 US\$	2008 US\$	2009 US\$	2008 US\$
Wages and salaries	954,680	964,219	234,371	244,638
Service agreements for executives	653,888	1,021,119	653,888	1,021,119
Employee short-term incentive cash bonus and discretionary cash bonus	–	–	–	–
Superannuation & 401(k) plans	54,183	56,783	18,783	22,018
Retirement benefits	23,700	25,766	23,700	25,766
Share-based payment compensation	222,307	379,204	112,149	207,679
Other benefits	98,908	89,414	29,890	31,800
	2,007,666	2,536,505	1,072,781	1,553,020

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

31. Related parties continued

Individual directors and executives compensation disclosures

Information regarding individual directors' and executives' compensation and some equity instruments disclosures as permitted by Corporations Regulations 2M.3.03 and 2M.6.04 are provided in the Remuneration Report section of the Directors' Report on pages 17 to 24.

Apart from the details disclosed in this note, no director has entered into a material contract with the Company or consolidated entity since the end of the previous financial year and there were no material contracts involving directors' interests existing at year-end.

Non-executive directors appointed prior to 2003 are entitled to receive a retirement benefit that is equivalent to the remuneration received in the three years prior to retirement. Directors' retirement obligations are presently US\$268,000 in total (2008: US\$255,000).

Transactions with key management personnel

Key management personnel of the Company and their immediate relatives control approximately 17.5 percent of the voting shares of the Company. No loans were made to key management personnel during the year and no such loans were outstanding.

The aggregate amounts recognised during the year relating to key management personnel and their personally related entities, were a total expense of US\$654,000 (2008: US\$1,021,000). Refer to Remuneration Report for further details.

Assets and liabilities arising from the related party transactions

	2009 US\$000	2008 US\$000
Current liabilities		
Related party payables	5	11

Other related party disclosures

Information relating to subsidiaries is set out in Note 26.

Refer to Notes 5 and 9 for information regarding related party transactions during the year.

Refer to Notes 12 and 16 for information regarding balances outstanding with subsidiaries at year-end.

31. Related parties continued

Options and rights over equity instruments

The movement during the reporting period in the number of options over ordinary shares in Petsec Energy Ltd held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

	Held at 1 January 2009	Granted as compensation	Exercised	Other changes ¹	Held at 31 December 2009	Vested during the year	Vested and exercisable at 31 December 2009
Directors							
T Fern	2,000,000	–	–	–	2,000,000	500,000	–
Executives							
R Keogh	1,000,000	150,000	–	–	1,150,000	250,000	–
R Krenzke ²	–	–	–	–	–	–	–
F Steele	200,000	–	–	–	200,000	50,000	–
D Swords	250,000	60,000	–	–	310,000	62,500	125,000
F Robertson	225,000	–	–	–	225,000	56,250	–
P Gahdmar	75,000	25,000	–	–	100,000	18,750	–
C Jones ³	225,000	–	–	225,000	–	–	–

	Held at 1 January 2008	Granted as compensation	Exercised	Other changes ¹	Held at 31 December 2008	Vested during the year	Vested and exercisable at 31 December 2008
Directors							
T Fern	2,000,000	–	–	–	2,000,000	475,000	–
Executives							
R Keogh	1,000,000	–	–	–	1,000,000	225,000	–
F Steele	200,000	–	–	–	200,000	50,000	–
D Swords	250,000	–	–	–	250,000	62,500	125,000
F Robertson	225,000	–	–	–	225,000	56,250	–
P Gahdmar	75,000	–	–	–	75,000	18,750	–
C Jones	225,000	–	–	–	225,000	56,250	–

¹ Other changes represent options that expired or were forfeited during the year.

² Mr R Krenzke was appointed on 23 November 2009.

³ Mr C Jones resigned on 5 March 2009.

No options held by key management personnel are vested but not exercisable at 31 December 2008 or 2009.

Key management personnel related parties held no options.

Notes to the consolidated financial statements continued

For the year ended 31 December 2009

31. Related parties continued

Movements in shares

The movement during the reporting period in the number of ordinary shares in Petsec Energy Ltd held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

	Held at 1 January 2009	Rights Issue Entitlement	Purchases	Received on exercise of options	Sales/ Disposal of relevant interest	Held at 31 December 2009
Directors						
T Fern	24,825,549	12,412,775	–	–	8,411,448	28,826,876
D Mortimer	610,068	305,034	8,411,448	–	–	9,326,550
P Power	225,323	112,662	–	–	–	337,985
M Harvey	–	–	–	–	–	–
Executives						
R Keogh	1,075,000	537,500	–	–	–	1,612,500
R Krenzke	–	–	–	–	–	–
F Steele	–	–	–	–	–	–
D Swords	–	–	–	–	–	–
F Robertson	115,083	57,542	–	–	–	172,625
P Gahdmar	40,000	40,000	40,000	–	–	120,000

	Held at 1 January 2008	Purchases	Received on exercise of options	Sales/ Disposal of relevant interest	Held at 31 December 2008
Directors					
T Fern	24,825,549	–	–	–	24,825,549
D Mortimer	610,068	–	–	–	610,068
P Power	225,323	–	–	–	225,323
M Harvey	–	–	–	–	–
Executives					
R Keogh	1,075,000	–	–	–	1,075,000
F Steele	–	–	–	–	–
D Swords	–	–	–	–	–
F Robertson	115,083	–	–	–	115,083
P Gahdmar	40,000	–	–	–	40,000
C Jones	150,000	–	–	–	150,000

No shares were granted to key management personnel during the reporting period as compensation in 2008 or 2009.

32. Events subsequent to balance date

There have been no events subsequent to balance date that would have a material effect on the consolidated entity's financial statements at 31 December 2009.

Directors' Declaration

- 1 In the opinion of the directors of Petsec Energy Ltd ("the Company"):
 - (a) the financial statements and notes and the Remuneration report in the Directors' Report, set out on pages 17 to 70, are in accordance with the Corporations Act 2001 including:
 - (i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 31 December 2009 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulation 2001; and
 - (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2; and
 - (c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- 2 There are reasonable grounds to believe that the Company and the controlled entities identified in Note 25 will be able to meet any obligations or liabilities to which they are or may become subject to by virtue of the Deed of Cross Guarantee between the Company and those controlled entities pursuant to ASIC Class Order 98/1418.
- 3 The directors have been given the declarations required by Section 295A of the Corporations Act 2001 from the chief executive officer and chief financial officer for the financial year ended 31 December 2009.

Signed in accordance with a resolution of the directors:



T N Fern
Director

Sydney, 25 February 2010

Independent auditor's report to the members of Petsec Energy Ltd

Report on the financial report

We have audited the accompanying financial report of Petsec Energy Ltd (the Company), which comprises the balance sheets at 31 December 2009, and statements of comprehensive income, statements of changes in equity and statements of cash flows for the year ended on that date, a description of significant accounting policies and other explanatory notes 1 to 32 and the directors' declaration of the Group comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the Company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In note 2, the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards (including the Australian Accounting Interpretations), a view which is consistent with our understanding of the Company's and the Group's financial position and of their performance.

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

Independence

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

Auditor's opinion

In our opinion:

- (a) the financial report of Petsec Energy Ltd is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the Company's and the Group's financial position as at 31 December 2009 and of their performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2.

Report on the remuneration report

We have audited the Remuneration Report included in section 20 of the directors' report for the year ended 31 December 2009. 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 auditing standards.

Auditor's opinion

In our opinion, the remuneration report of Petsec Energy Ltd for the year ended 31 December 2009 complies with Section 300A of the *Corporations Act 2001*.



KPMG



Paul Zammit
Partner

Sydney, 25 February 2010

Corporate Governance Statement

The Board of Petsec Energy Ltd is committed to good corporate governance.

This statement sets out the main corporate governance practices adopted by the Company in the format of the Corporate Governance Principles and Recommendations (Revised Principles) issued by the ASX Corporate Governance Council.

Unless otherwise stated, the Company's corporate governance practices were in place throughout the 2009 year and comply with the Revised Principles. In a limited number of instances there are departures from the Revised Principles, with the details and reasons for the departures stated below.

1. Laying Solid Foundations for Management and Oversight

The Board operates within the requirements of the Company's Constitution and Board Charter which sets out the functions and responsibilities reserved for the Board and the matters which have been delegated to executive management. The Board Charter is posted on the Company's website.

The performance of the CEO and senior executives is reviewed annually by the Remuneration and Nomination Committee and is reported to and confirmed by the full Board.

2. Structure the Board to Add Value

Board Composition and Director Independence

A majority of the Board are independent Directors. Currently the Board comprises four Directors, being one executive Director and three non-executive Directors. The non-executive Directors are considered by the Board to be independent, based on the criteria in the Revised Principles.

Mr T N Fern acts in the roles of both Chairman and Managing Director. Although the Revised Principles recommend that the Chairman should be an independent director and the roles of Chairman and Managing Director should not be exercised by the same individual, Directors consider that the current composition of the Board is appropriate for the Company at its current stage of development.

To ensure that independent judgment is achieved and maintained in respect of its decision-making processes, the Board has adopted a number of measures which include the following:

- Directors are entitled to seek independent professional advice at the Company's expense;

- Directors having a conflict of interest in relation to a particular item of business must declare their interest and not vote on that item of business and absent themselves from the Board Meeting if required by the Board before commencement of discussion on the topic; and
- Non-executive Directors confer on a needs basis without management in attendance.

The Board is balanced in its composition with each Director bringing a range of complementary skills and experience to the Company as set out in the Directors' Report.

Board Committees

To assist the Board in discharging its responsibilities, the Board has a Remuneration and Nomination Committee and an Audit Committee. Each of these committees has its own written charter which has been approved by the Board.

Both Committees now comprise three independent Directors and are chaired by Mr D A Mortimer. The executive Director, Mr T N Fern resigned from both Committees in January 2009 following the appointment of Mr M L Harvey to the Committees.

It is the Board's policy that Board Committees should:

- be chaired by a non-executive Director;
- should comprise a majority of non-executive Directors;
- be entitled to obtain independent professional or other advice at the cost of the Company; and
- be entitled to obtain such resources and information from the Company, including direct access to employees of and advisors to the Company, as they may require.

The qualifications and experience of Directors and Committee Members are included in the Directors' Report as are details of the number of Board and Committee meetings held during the year.

Evaluation of performance of the Board, its Committees and individual Directors.

A review of the Board's own performance is conducted annually together with reviews of the performance of Board Committees and individual Directors. Each Director completes a questionnaire, with the collective responses being discussed by the Board to identify actions and goals to guide performance improvement. The questionnaire covers general and governance issues, overall Board performance and performance of individual Directors. Each of these evaluations has been performed during the past year.

Further details of the Company's performance evaluation processes are detailed in the Board Charter and Nomination and Remuneration Committee Charter, which are posted on the Company's website.

3. Promoting Ethical and Responsible Decision Making

Code of Corporate Conduct

Petsec Energy has always placed great importance on the maintenance of high ethical standards. The Board has adopted a Code of Corporate Conduct which is contained within the Board Charter posted on the Company's website. A similar document has been issued to all employees setting out the principles and standards with which they are expected to comply. Petsec Energy participates in a "whistle-blower" programme with an independent third party which provides a means for staff to report any violation of the Company's Code of Ethics and Corporate Conduct or other wrongdoing.

Director and Employee Dealings in Company Shares

The Board recognises that it is the responsibility of each Director and employee to comply with the spirit and the letter of insider trading laws and to assist Directors and employees in this regard has adopted a Share Trading Policy.

In summary, the Policy requires the approval from the Managing Director or in his absence the Company Secretary, or the Chairman of the Audit Committee (in the case of Directors), before buying or selling the Company's securities. Given the Continuous Disclosure requirements of the ASX, the Board has chosen not to rely on specific trading windows to restrict trading, but notes that it is inappropriate for individuals to seek approval to buy or sell shares immediately prior to the periodic profit announcements or other announcements of which they are aware. The Share Trading Policy is posted on the Company's website.

4. Safeguarding Integrity in Financial Reporting

The Audit Committee is comprised of three independent Directors, each with relevant financial and technical experience, and is chaired by Mr D A Mortimer. Details of the qualifications of the Audit Committee members are set out in the Directors' Report.

The responsibilities of the Audit Committee include the monitoring and review of the external audit function, management reporting and internal controls, integrity of financial reporting and risk management. The Committee's Charter is posted on the Company's website.

The Audit Committee also appoints the auditor and monitors the 5-year auditor rotation policy, as set out in the Company's Auditor Appointment Policy posted on the website.

5. Making Timely and Balanced Disclosure

The Company has policies and procedures in place to ensure the timely and appropriate release of all information required to be disclosed to shareholders in accordance with the ASX Continuous Disclosure regime. The Company Secretary has been appointed as the Continuous Disclosure Officer and with the approval of the Managing Director is responsible for ensuring compliance by overseeing and coordinating the release of information to the ASX, brokers, shareholders, the media and the public. The Continuous Disclosure policy is posted on the Company's website.

6. Respecting the Rights of Shareholders

In addition to market disclosure through the ASX, Directors ensure that shareholders and other interested parties are informed through a range of other means including the Company's website: www.petsec.com.au which contains copies of all key disclosure information including announcements to the market, periodic reports, broker and analyst briefings and notices of meetings. The website also contains corporate governance information and general information regarding the Company's activities.

Shareholders and other interested parties are also able to register their email address with the Company to receive announcements made to the ASX.

It is the Company's policy that its external auditors attend each Annual General Meeting and be available to respond to questions from shareholders.

The Communications Policy is posted on the Company's website.

7. Recognising and Managing Risk

The Company recognises that an effective system of risk oversight, management and internal control is critical for its success.

A brief summary of the Company's processes are set out below. A more detailed summary is posted in the Corporate Governance section of the Company's website.

(a) Control Environment

The Board oversees the overall risk management and control framework of the Company to ensure an appropriate control environment is established and maintained spanning Petsec's operations, financial reporting and compliance activities.

The Audit Committee assists the Board in fulfilling its responsibilities in this regard by reviewing and monitoring financial and reporting matters, and the Company's risk management and internal control processes.

Corporate Governance Statement continued

7. Recognising and Managing Risk continued

(b) Risk Assessment

Petsec runs two parallel risk management processes, one to identify and manage business and operational risk and the other to manage the financial reporting risks and underlying internal controls.

Identification and evaluation of *key business and operational risks* is conducted through:

- (i) the annual risk management review, a formal process which is based on the approach prescribed in Australian Standard AS/NZS ISO 31000:2009 and carried out in the fourth quarter each year in conjunction with the preparation of the budget and strategic plan; and
- (ii) assessment of risk as part of all business proposals for management or Board approval.

Key financial statement and financial reporting risks are reviewed and assessed, prior to the commencement of the internal and external audit programmes each year.

(c) Mitigation and Control

Petsec employs a range of techniques to mitigate and control risk including insurance, oil and gas price hedging, establishment of management accountabilities, and compliance with policies and procedures documented in the Company's Internal Control Policy manual and supporting documents.

(d) Information and Communication

Monthly management reports to the Board, which draw from both structured management information systems and management input, provide a regular and formal channel of communication within Petsec.

(e) Monitoring

Formal monitoring of risk and controls at senior management and Board level is achieved by means of:

- (i) the monthly management report to the Board;
- (ii) detailed audit questionnaires and management sign-offs, which form part of the semi-annual audit process, and
- (iii) an internal audit programme to evaluate and test the key controls over financial reporting that is conducted by an external audit firm (a different organisation to the statutory auditors) in conjunction with management over the course of each year.

Petsec Energy's Managing Director and Chief Financial Officer provide a written statement to the Audit Committee in relation to each six-month reporting period in accordance with section 295A of the Corporations Act stating whether, to the best of their knowledge and belief:

- the declaration given is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board; and
- the Company's risk management and internal compliance and control framework is operating efficiently and effectively in all material respects.

8. Remunerate Fairly and Responsibly

The objective of the Company's remuneration policies is to provide fair and competitive remuneration to its Board, executives and staff in order for the Company to benefit by attracting and retaining a high quality team. The level and composition of Directors' and senior executives' remuneration is set out in the Remuneration Report in the Directors' Report together with further information on the structure and basis of remuneration paid.

The Nomination and Remuneration Committee is responsible for reviewing and making recommendations on remuneration policies for Directors and senior executives based on assessment of relevant market conditions, and linking remuneration to the Company's financial and operational performance. The Nomination and Remuneration Committee consists of three independent Directors, and is chaired by Mr D A Mortimer.

Executive remuneration may comprise salary, short-term bonuses and share participation. All equity-based remuneration is made in accordance with thresholds approved by shareholders.

Non-executive Directors do not participate in equity-based remuneration and are remunerated by fees which are not performance-based. Non-executive Directors appointed prior to 2003 are entitled to receive a retirement allowance which is equivalent to the remuneration received in the three years prior to retirement. Incoming non-executive Directors are not entitled to receive retirement benefits, in accordance with the recommendations in the Revised Principles.

Exploration and Production Interests

						Before Prospect Payout		After Prospect Payout (if applicable)	
Lease/Project	Wells	Lease Date	Term (Years)	Operator	Status	Working Interest	Net Revenue Interest	Working Interest	Net Revenue Interest
Onshore Louisiana, USA									
Moonshine Field	E. Laurent No. 1 Well			Petsec Energy	HBP	0.80000	0.60607		
	W.P. Miles Timber No. 1 Well					0.62000	0.46024		
South Sunrise Field				Badger Oil	HBP	0.75000			
	Lawrence Theriot No. 1 Well Serial No. 233936					0.75000	0.56464		
	Anthony Theriot No. 1 Well Serial No. 234166					0.75000	0.56056		
South Thornwell Field (Biscuit Island)				Manti	HBP	0.46000			
	Broussard No. 1 Well Serial No. 233464					0.46206	0.32395		
Gulf of Mexico, USA									
Chandeleur 31	OCS-G 27215	1/6/05	5	Petsec Energy	HBP	1.00000	0.81333		
	A 001 Well Serial No. 1772840870					1.00000	0.81333		
	A 002 ST 1 Well Serial No. 1772840871					1.00000	0.81333		
Chandeleur 32	OCS-G 27214	1/6/05	5	Petsec Energy	HBP	1.00000	0.81333		
	A 001/1D Well Serial No. 1772840872								
East Cameron 102	OCS-G 32127	1/7/08	5	Petsec Energy	Primary	1.00000	0.76500	1.00000	0.74000
Main Pass 18	OCS-G 27194	1/7/05	5	Petsec Energy	HBP	1.00000	0.83333		
	G-6 Well API No. 17-725-40815-00					1.00000	0.83333		
Main Pass 19	OCS-G 26146	1/7/04	5	Petsec Energy	HBP	0.55000	0.45833		
	G-1 Well API No. 17-725-40800-00					0.55000	0.45833		
	G-2 Well API No. 17-725-40801-00					0.55000	0.45833		
	G-3 Well API No. 17-725-40802-00					0.55000	0.45833		
	G-4 Well API No. 17-725-40813-00					0.55000	0.45833		
	G-5 Well API No. 17-725-40814-00					0.55000	0.45833		
	G-7 Well API No. 17-725-40817-00					0.55000	0.45833		
Main Pass 20	OCS-G 27195	1/5/05	5	Petsec Energy	HBP	1.00000	0.81333		
	No. 3 / 3D Serial No. 1772540825					1.00000	0.81333		
	No. B001 Serial No. 1772540820					1.00000	0.81333		
	GH No. B002 Serial No. 1772540822					1.00000	0.81333		
Main Pass 20 "Deep"	OCS-G 27195	1/5/05	5	LLOG	Primary	0.50000	0.40667		

Exploration and Production Interests continued

						Before Prospect Payout		After Prospect Payout (if applicable)	
Lease/Project	Wells	Lease Date	Term (Years)	Operator	Status	Working Interest	Net Revenue Interest	Working Interest	Net Revenue Interest
Main Pass 91	OCS-G 27964	1/7/06	5	Petsec Energy	Primary	1.00000	0.83333		
Main Pass 103	OCS-G 27200	1/7/05	5	Petsec Energy	Primary	1.00000	0.83333		
Main Pass 270	OCS-G 22812	1/7/01	5	ENI US Operating	HBP	0.25000	0.20833		
	A 001 Well Serial No. 1772440889					0.25000	0.20833		
	A 002 Well Serial No. 1772440890					0.25000	0.20833		
	A 003 Well Serial No. 1772440906					0.25000	0.20833		
North Padre Island 929	OCS-G 32720	1/10/08	5	Petsec Energy	Primary	1.00000	0.77920		
North Padre Island 934	OCS-G 32721	1/10/08	5	Petsec Energy	Primary	1.00000	0.77920		
Mobile Bay 873	OCS-G 27224	1/5/05	5	Royal Explor Co	HBP	0.50000	0.39417	0.40000	0.30533
	001 Well API No. 60-815-40139-01								
Mobile Bay 950	OCS-G 27225	1/5/05	5	Royal Explor Co	HBP	0.50000	0.39417		
	001 Well API No. 60-815-40142-00					0.50000	0.39417	0.40000	0.30533
Mobile Bay 951	OCS-G 27226	1/5/05	5	Royal Explor Co	HBP	0.50000	0.39417	0.40000	0.30533
	001 Well API No. 60-815-40140-00					0.50000	0.39417	0.40000	0.30533
Mobile Bay 953	OCS-G 5756	1/7/83	5	Petsec Energy	HBP	0.50000	0.41667		
	003 Well API No. 60-815-40122-00					0.50000	0.41667		
Mobile Bay 993	OCS-G 27227	1/7/05	5	Royal Explor Co	HBP	0.50000	0.39417	0.40000	0.30533
	001 Well API No. 60-815-40141-00					0.50000	0.39417	0.40000	0.30533
Mobile Bay 994	OCS-G 27228	1/5/05	5	Royal Explor Co	HBP	0.50000	0.39417	0.40000	0.30533
	002 Well API No. 60-815-40144-00					0.50000	0.39417	0.40000	0.30533
Mobile Bay 994	OCS-G 27228	1/5/05	5	Royal Explor Co	HBP	0.50000	0.39417	0.40000	0.30533
[Viosca Knoll 26]	001 Well API No. 60-815-40143-00					0.50000	0.39417	0.40000	0.30533
Vermilion 353	OCS-G 31351	1/1/08	5	Royal Explor Co	Primary	0.54000	0.43110	0.54000	0.41760
Viosca Knoll 739	OCS-G 27241	1/6/05	5	Petsec Energy Inc.	Primary	0.50000	0.39334	0.40000	0.30467
Viosca Knoll 740	OCS-G 27242	1/7/05	5	Petsec Energy Inc.	Primary	0.50000	0.39334	0.40000	0.30467
West Cameron 462	OCS-G 22555	1/5/01	5	ATP O&G			0.04000 ORRI		
West Cameron 631	OCS-G 32122	1/6/08	5	Petsec Energy	Primary	1.00000	0.83333		
West Cameron 636	OCS-G 32123	1/6/08	5	Petsec Energy	Primary	1.00000	0.83333		

HBP = Held by production

Shareholder Information

as at 12 March 2010

Number of Shareholders

Issued capital was 231,283,622 ordinary shares held by 5,742 shareholders.

All issued shares carry equal voting rights on a one for one basis.

Distribution of Shareholders

Size of Holding	No of Holders
1-1,000	1,443
1,001-5,000	1,861
5,001-10,000	865
10,001-100,000	1,360
100,001 and over	213
Total number of shareholders	5,742
Number holding less than a marketable parcel	2,312

Largest Twenty Shareholders

The largest twenty shareholders held 126,311,593 ordinary shares being 54.61% of the issued ordinary capital.

Name of Holder	No of Shares	%
CANNING OIL PTY LTD	25,709,116	11.12
MARTIN PLACE SECURITIES NOMINEES PTY LTD	24,426,981	10.56
LIPPO SECURITIES NOMINEES (BVI) LTD <CLIENT A/C>	11,332,500	4.90
HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	11,180,631	4.83
MR DAVID A MORTIMER & MRS BARBARA L MORTIMER <WALLAROE PROVIDENT FUND A/C>	8,636,448	3.73
CITICORP NOMINEES PTY LIMITED	7,901,363	3.42
HESTIAN PTY LTD	4,281,950	1.85
ANZ NOMINEES LIMITED <CASH INCOME A/C>	4,242,204	1.83
NATIONAL NOMINEES LIMITED	3,728,132	1.61
HUMBOLDT CAPITAL CORPORATION	3,674,532	1.59
DEN DUYTS CORPORATION PTY LTD	3,057,635	1.32
CALVESTON WORLDWIDE LTD	2,460,000	1.06
SINO CHAMPION DEVELOPMENT LIMITED	2,459,579	1.06
ASIAN CORPORATE ADVISERS (BVI) LIMITED	2,250,000	0.97
EVELIND PTY LTD <THE ALPHA A/C>	2,063,198	0.89
MRS ELIZABETH HEATH	2,050,000	0.89
PIAT CORP PTY LTD	2,000,000	0.87
KEY RESOURCE ANALYSTS LTD	1,754,824	0.76
MR ROSS A KEOGH	1,612,500	0.70
HILLRIDGE PTY LTD	1,490,000	0.64
Substantial shareholders disclosed in substantial shareholder notices given to the Company are as follows:		
CANNING OIL PTY LTD including its associates	28,826,876	12.46

Five Year Comparative Data Summary

Financial Performance		2005	2006	2007	2008	2009	% change
Net Production (Bcfe) ¹		6.5	8.2	8.1	12.1	7.1	-42%
Average Gas Price Received	(US\$/Mcfe)	7.04	7.24	7.93	8.70	7.36	-15%
US\$ millions							
Net Revenue	(US\$m)	45.5	59.2	64.0	105.3	52.0	-51%
EBITDAX ²	(US\$m)	33.7	45.3	45.9	79.6	31.3	-61%
EBITDAX Margin/Mcfe	(US\$/Mcfe)	5.94	5.54	5.69	6.58	4.43	-33%
Depreciation, Depletion & Amortisation	(US\$m)	15.7	20.9	27.7	57.3	21.0	-63%
Net Financial Income/(Expense)	(US\$m)	0.3	0.5	-1.0	-7.1	-5.5	n/a
Underlying Net Profit ³	(US\$m)	18.1	24.7	16.6	12.1	3.3	-73%
Exploration Write-offs, Provisions & Expenses	(US\$m)	-8.5	-16.7	-19.4	-71.9	-10.3	n/a
Net Profit after Tax ⁴	(US\$m)	9.5	5.1	-2.0	-44.5	-14.9	n/a
Operating Cashflow after Tax	(US\$m)	37.1	44.4	35.1	85.2	28.0	-67%
Balance Sheet							
Total Assets	(US\$m)	91.2	132.9	254.7	161.7	130.7	-19%
Cash	(US\$m)	10.1	26.5	27.2	13.7	25.4	85%
Debt ⁵	(US\$m)	-	-	101.8	48.8	28.4	-42%
Shareholders Equity	(US\$m)	58.2	115.1	123.3	85.9	80.0	-7%
Cashflow and Capital Expenditures							
Net Cashflow from:							
Operations	(US\$m)	37.1	44.4	35.1	85.2	28.0	-67%
Investing	(US\$m)	-36.8	-71.5	-146.5	-43.5	-10.2	n/a
Financing	(US\$m)	0.5	43.4	110.7	-53.7	-7.4	n/a
		0.8	16.3	-0.7	-12.0	10.4	
Capital Expenditures⁶							
Exploration	(US\$m)	20.9	34.2	22.1	30.8	1.5	-95%
Development	(US\$m)	14.0	22.9	20.0	11.4	3.5	-70%
Acquisition	(US\$m)	2.0	14.2	103.8	1.1	0.2	-84%
		36.9	71.3	145.9	43.3	5.2	
A\$ million							
EBITDAX ²	(A\$m)	44.3	60.0	54.8	93.0	39.6	-57%
Underlying Net Profit ³	(A\$m)	23.8	32.5	19.8	14.1	4.1	-71%
Net Profit after Tax ⁴	(A\$m)	12.5	6.8	-2.4	-52.0	-18.9	n/a
Operating Cashflow after Tax	(A\$m)	48.7	58.8	41.9	99.6	35.5	-64%
(US\$/A\$ exchange rate)		0.76	0.76	0.84	0.86	0.79	-8%
Operating Margins & Costs							
Average Gas Price Received	(US\$/Mcfe)	7.04	7.24	7.93	8.70	7.36	-15%
+ Other Income	(US\$/Mcfe)	0.19	0.03	0.04	-0.06	-	n/a
- Operating Costs (GG&A + LOE)	(US\$/Mcfe)	1.29	1.73	2.28	2.06	2.93	42%
= EBITDAX ²	(US\$/Mcfe)	5.94	5.54	5.69	6.58	4.43	-33%
Depreciation, Depletion & Amortisation	(US\$/Mcfe)	2.43	2.56	3.44	4.73	2.97	-37%
Finding and Development Costs (three year average 2P) ⁸	(US\$/Mcfe)	2.31	2.52	4.10	6.20	24.38	293%
Reserves							
Proved and Probable Reserves (2P) ⁷	(Bcfe)	38.5	59.7	69.6	51.9	40.4	-64%
Reserves Replacement Ratio (%)		241	359	222	-46	-62	

¹ Bcfe = billion cubic feet of gas equivalent. Mcfe = thousand cubic feet of gas equivalent.

² EBITDAX = earnings before interest, tax, depreciation, depletion, amortisation, and exploration costs.

³ Underlying Net Profit (Earnings before exploration write-offs, provisions and tax).

⁴ Net Profit after Tax:

2008 and 2009 results were reduced by a total of US\$71.9m and US\$10.3m, respectively, relating to exploration write-offs and impairment provisions (refer to note 7 of the Notes to the Consolidated Financial Statements for detailed

breakdown). 2009 results were also impacted by a provision of US\$7.8m against the carrying value of the recognised deferred tax asset (refer to note 10 of the Notes to the Consolidated Financial Statements for further details).

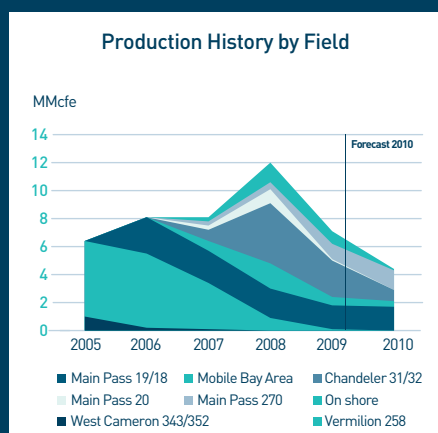
⁵ 2007 through 2009 debt is shown net of original issue discount and transaction costs (refer note 17 of the Notes to the Consolidated Financial Statements).

⁶ Excludes minor (non oil & gas) property, plant & equipment expenditure and investments.

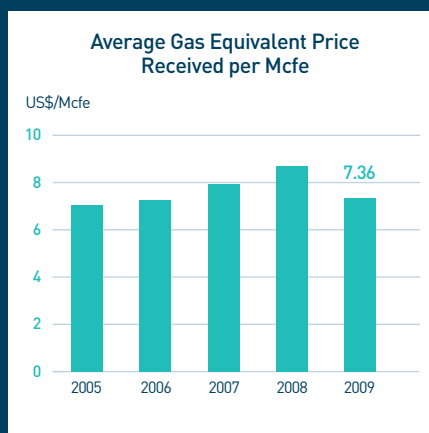
⁷ Petsec Energy – estimated recoverable proved and probable (2P) reserves.

⁸ Finding & Development (F&D) costs include all exploration write-offs. 2007 through 2009 includes the acquisition of interests in producing assets.

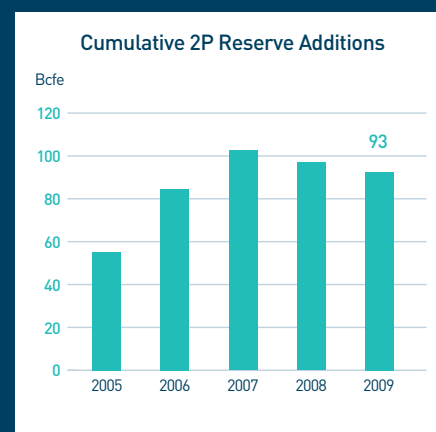
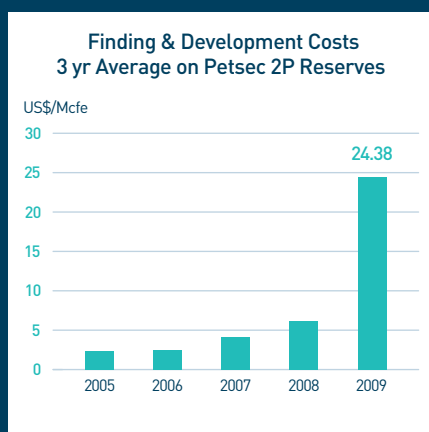
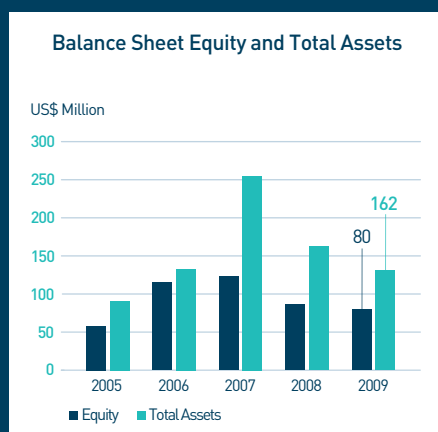
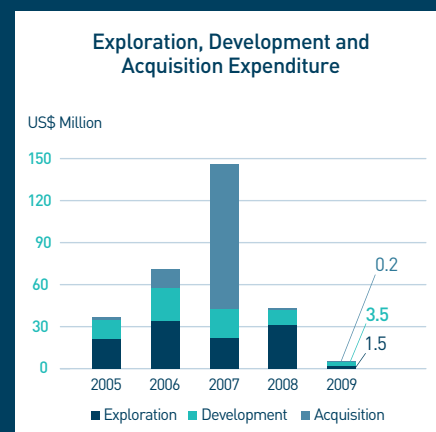
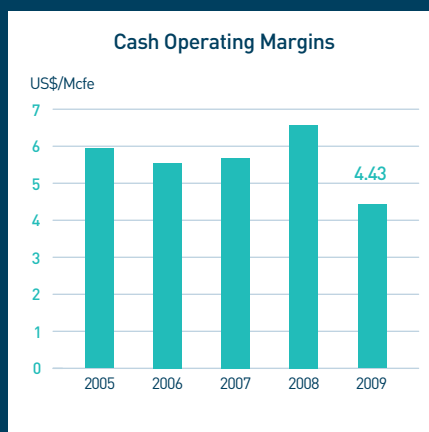
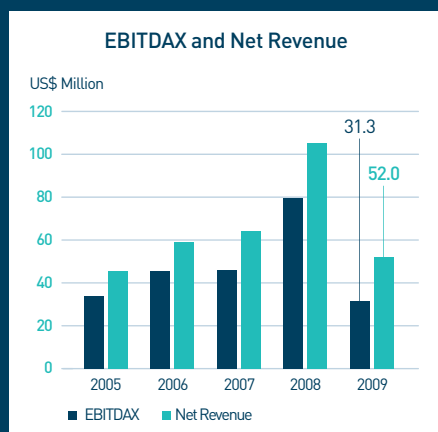
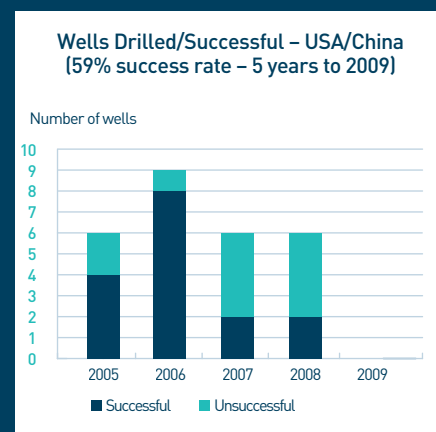
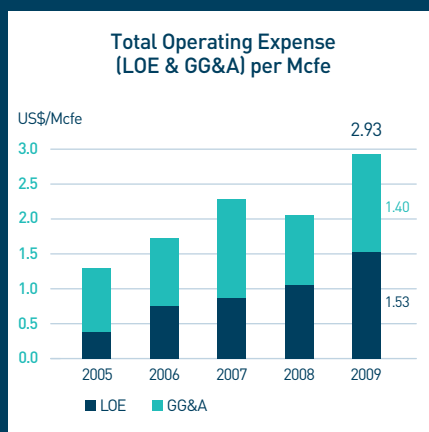
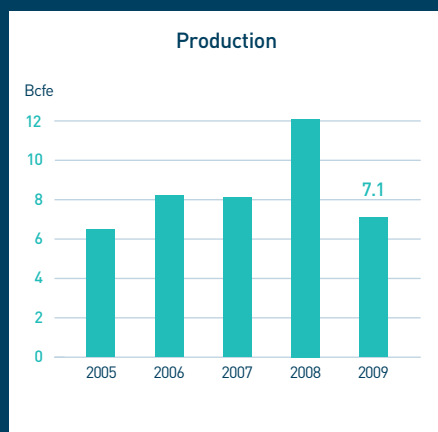
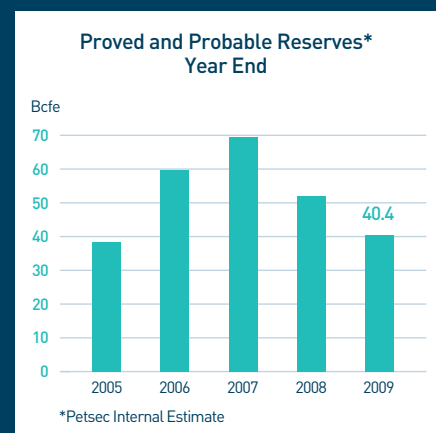
Results



Operating Margins



Reserves/Drilling



CORPORATE DIRECTORY

Board of Directors

Terry N Fern – Chairman & Managing Director
Mike L Harvey – Non-executive Director
David A Mortimer – Non-executive Director
Peter E Power – Non-executive Director

Company Secretary

Paul Gahdmar

Australian Management

Fiona A Robertson – Chief Financial Officer
Paul Gahdmar – Group Financial Controller & Company Secretary

USA Management

Ross A Keogh – President, Petsec Energy Inc
Ron A Krenzke – Executive Vice President – Exploration
Nick M Repar – Exploration Manager
Frank A Steele – Vice President – Land
Denis C Swords – General Counsel & Corporate Secretary

Registered Office and Principal Business Office

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Telephone: 1300 737 760 International: + 61 2 9290 9600
Facsimile: 1300 653 459 International: +61 2 9279 0664
Email: registries@registries.com.au

Depository Receipts Register

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6th Floor
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Auditors

KPMG Chartered Accountants
King Street Wharf
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Sydney NSW 2000 Australia

Stock Exchange

Listed on the Australian Stock Exchange, Symbol: PSA
Traded in USA on ADRs, Symbol: PSJEY.PK

For further information:

Web: www.petsec.com.au



PETSEC ENERGY LTD
ABN 92 000 602 700

Certain statements in this report regarding future expectations and plans of the Company may be regarded as "forward-looking statements." Although the Company believes that its expectations and plans are based upon reasonable assumptions, it can give no assurance that its goals will be met. Actual results may vary significantly from those anticipated due to many factors, including oil and gas prices, operating hazards, drilling risks, environmental risks and uncertainties in interpreting engineering and other data relating to oil and gas reservoirs, as well as other risks.

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