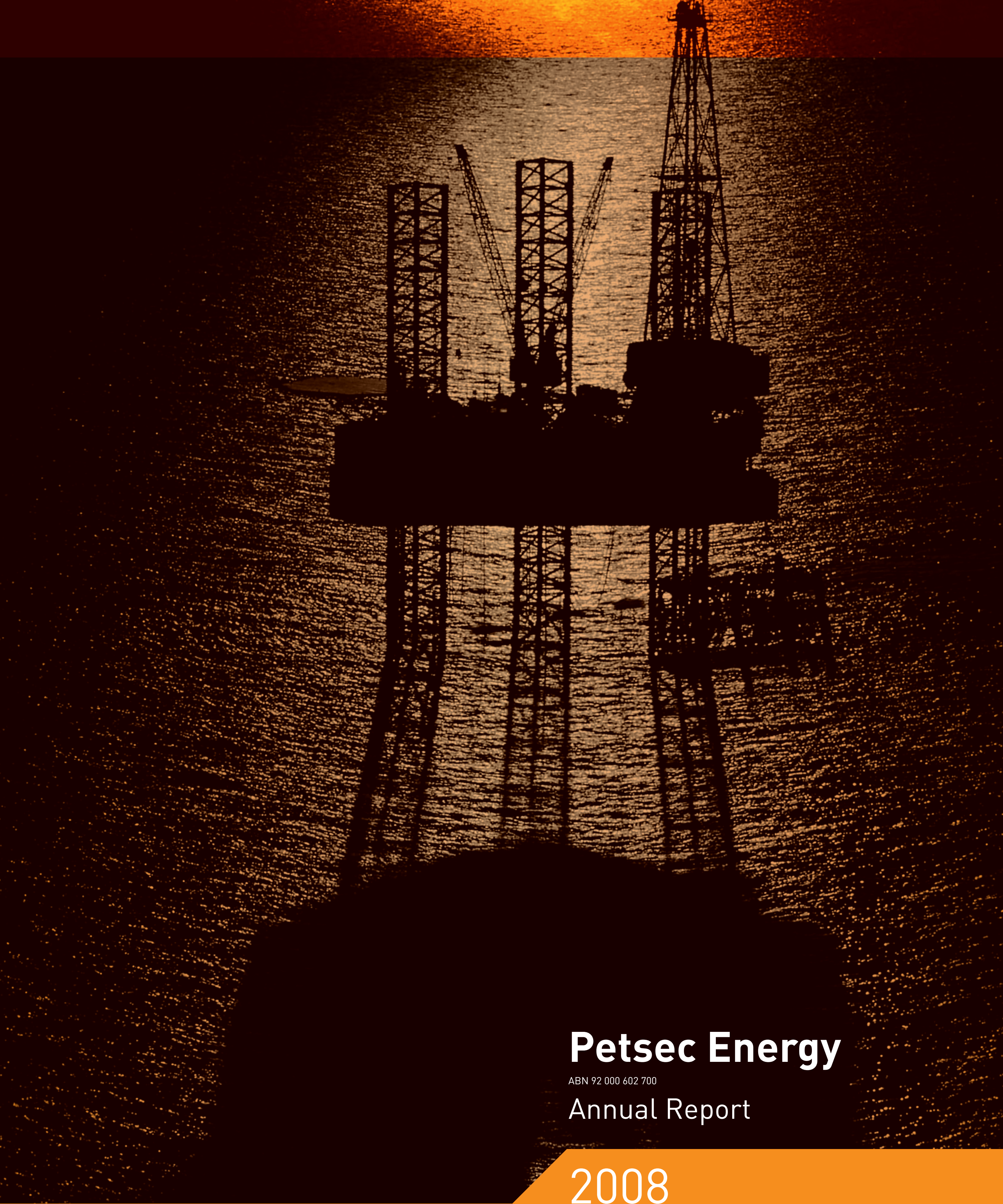


Petsec Energy

ABN 92 000 602 700

Annual Report

2008

Petsec Energy

CONTENTS

Annual General Meeting to be held at:
11.00 am on Wednesday 20 May 2009 at the Museum of Sydney, corner of Bridge & Phillip Streets, Sydney.

Year in Brief 2008

Financial

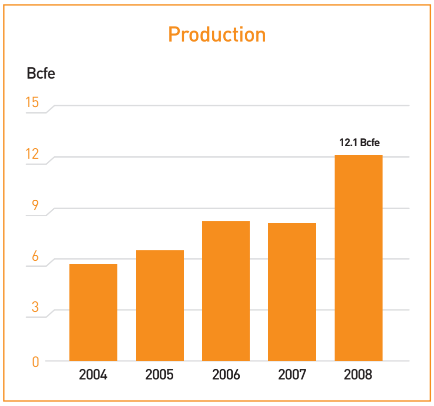
- Oil & gas sales (net of royalties): US$105.3 million – up 65% on 2007
- Average gas price received: US$8.70/Mcfe – up 10% on 2007
- EBITDAX: US$79.6 million (US$6.58/Mcfe) – up 73% on 2007
- Net underlying profit (before exploration write-offs, provisions & tax): US$12.1 million
- Net loss after tax: US$44.5 million after exploration write-offs of US$13.8 million and impairments of US$58.1 million
- Acquisition, development & exploration expenditure: US$43.3 million
- Net debt: US$36.8 million – down 52% on 2007

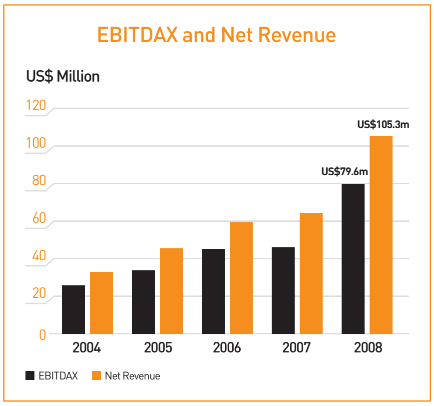
Operations USA

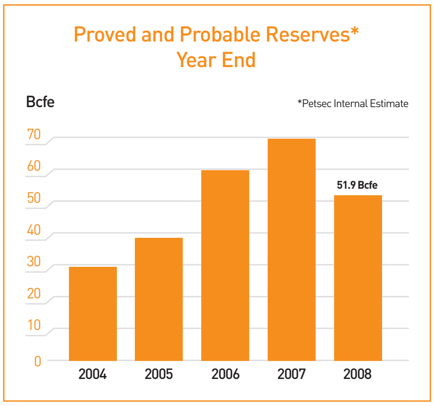
- Production: 12.1 Bcfe – up 50% on 2007
- Completed two wells for production from four wells drilled
- Independently (Ryder Scott Company) estimated proved and probable (2P) oil and gas reserves: 30.8 Bcfe
- Successfully integrated Gulf of Mexico gas fields acquired in 2007, resulting in highest production levels since 2002
- Acquired five new exploration leases in the Gulf of Mexico

Operations China Block 22/12

- CNOOC granted development areas over five oil fields: Wei 6-12, 6-12 South, 12-8 West and East, 12-3-1 oil fields, which contain 185 million barrels of oil in place (P 50) and an estimated 42.6 million barrels of recoverable oil
- Proved and probable (2P) oil reserves for the proposed development of the 6-12, 6-12 South, 12-8 West oil fields (assuming CNOOC backs in for 51%): 3.6 million barrels of oil (21.5 Bcfe) net to Petsec
- Drilled two wells; both plugged and abandoned
- Continued work on feasibility studies and overall development plans (ODP) for the 6-12, 6-12 South, 12-8 West oil fields; ODP lodgement with Chinese authorities planned in June, final investment decision expected in late 2009.







Corporate Summary

Petsec Energy is an independent oil and gas exploration and production company with operations in the shallow waters of the Gulf of Mexico and onshore Louisiana, USA, and the shallow waters of the Beibu Gulf, China.

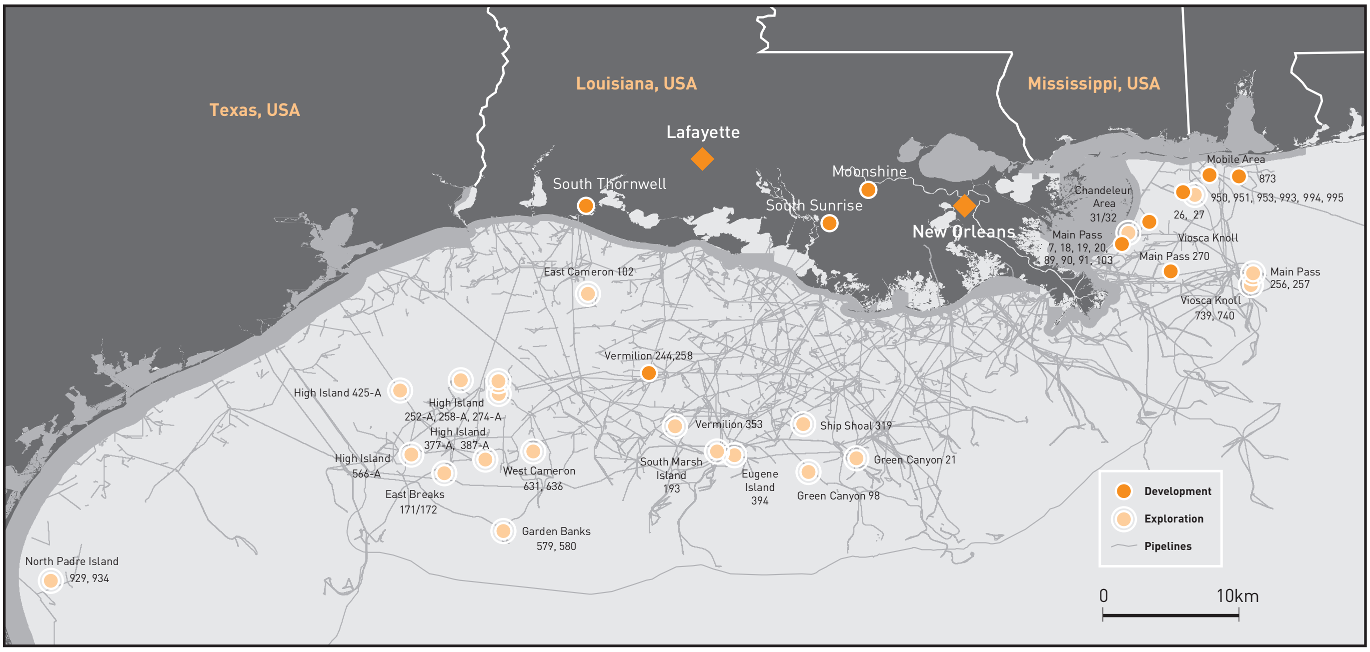
The Company is listed on the Australian Stock Exchange (symbol: PSA) and has its corporate office in Sydney, NSW, Australia, and operations offices in Lafayette, Louisiana and Houston, Texas, USA.

Objectives

Petsec Energy strives to create consistent and significant growth in shareholder value by increasing oil and gas reserves through successful oil and gas exploration and acquisitions. The Company seeks to grow in a rapid but disciplined manner, funded principally by internally generated cashflow, with a focus on financial returns.

Strategy

The Company's objectives will be met by seeking exploration and production opportunities in highly prospective areas where production and development infrastructure is available. In the near term, Petsec Energy will focus on growth in the Gulf of Mexico to take advantage of anticipated acquisition and farm-in opportunities presented by the economic downturn in this established market.



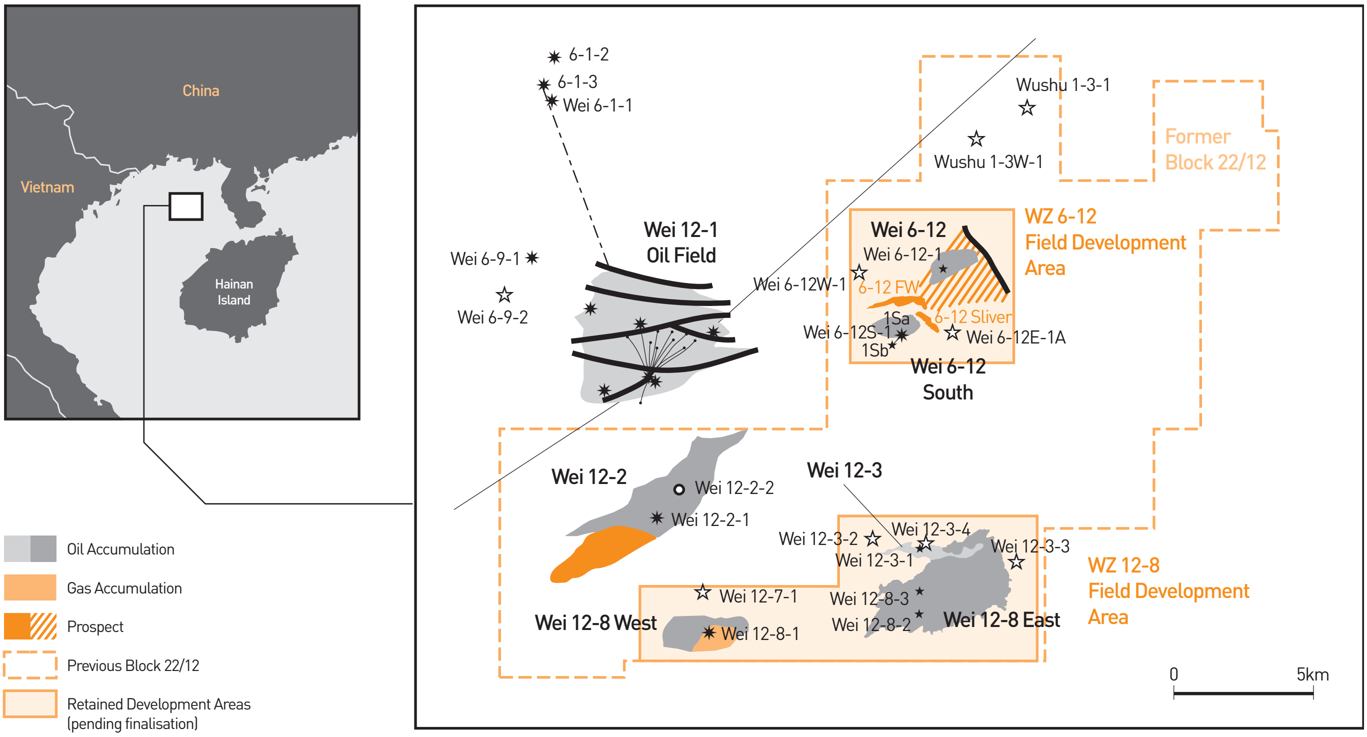
Petsec's US Interests

Achievements

In the past five years, Petsec Energy has achieved a solid compound annual growth rate in reserves of 15%, production 21%, revenue 34%, and EBITDAX 33%. In that period, the Company has produced approximately 45 Bcfe of gas and generated more than US$248 million of net operating cashflow. The Company's exploration success rate of 61% over the five years to 31 December 2008 resulted in 20 commercial discoveries from 33 wells drilled.

In the Beibu Gulf, China, Petsec Energy has interests in an offshore lease with five oil fields with oil resources net to the Company of 5.2 million barrels of oil, assuming CNOOC backs in for 51%, and additional exploration potential.

Year end 2008 net proved and probable oil and gas reserves stood at 30.8 Bcfe of gas in the USA and 3.6 million barrels of oil in China, assuming CNOOC backs in for the maximum 51%.



Block 22-12, Beibu Gulf, China

Chairman's Report

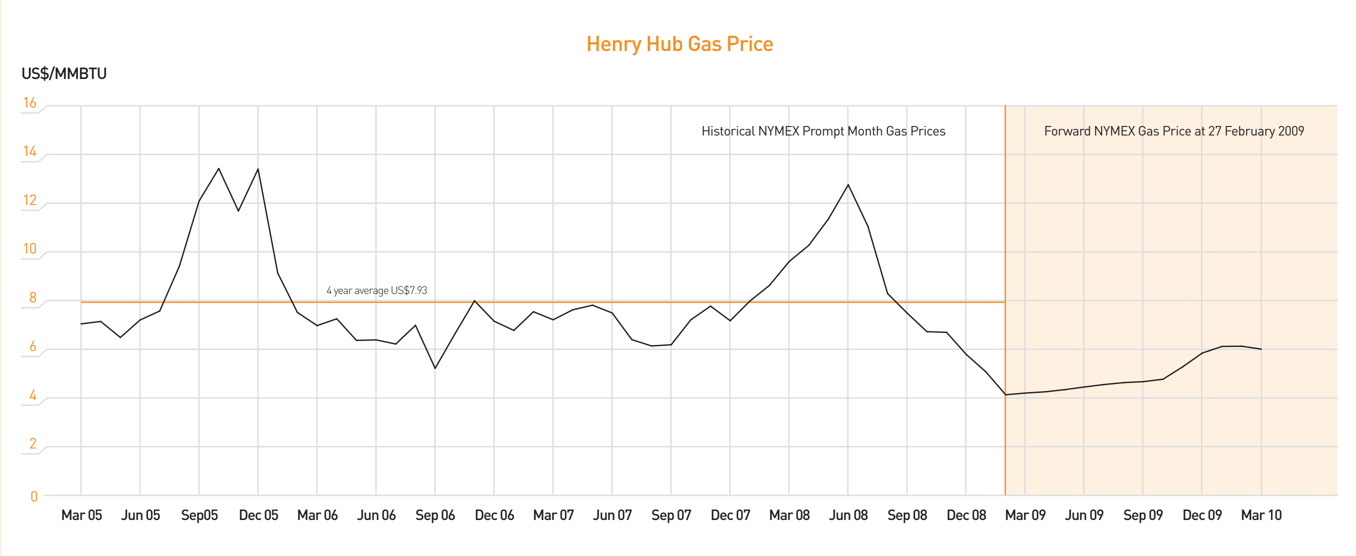
The 2008 global financial crisis has had a resounding impact on all sectors of the economy, contributing to a collapse in oil prices and a corresponding drop in the share price of all energy companies.

Oil prices have fallen some 75% from their July 2008 peak of US$150/bbl for West Texas Intermediate crude oil to a recent low of US$32/bbl. The price has been fluctuating around US$40/bbl over the past five months – a reversion to 2004 prices but still higher than the US$20 to US$25/bbl price range during 2000-2003, following the collapse of oil from US$20 to US$8/bbl in 1998/99 after the Asian Crisis of 1997.

Current world oil inventories are high and consumption has fallen as world economies contract. OPEC has made significant production cuts over the past six months, which appears to be stabilising oil prices. However, the rise in oil prices from 2003 to 2008 from US$20 to US$150/bbl was similarly reflected in the last oil boom between 1973 and 1981, when oil rose from US$3/bbl in 1973 and peaked at US$41/bbl in 1981. OPEC production cuts kept prices around US$25/bbl in the period 1982 to 1985, but a lack of discipline amongst OPEC members caused a collapse of oil prices from US$25/bbl to US$8/bbl in 1986 and it was not until 1996 before prices reached US$20/bbl.

The extent of the current world recession will in large part dictate the demand and therefore the price of oil. Current industry thinking has oil at US$40/bbl average for the next year or two, rising thereafter to perhaps US$60/bbl.

Petsec Share Price Jan 08 to Feb 09

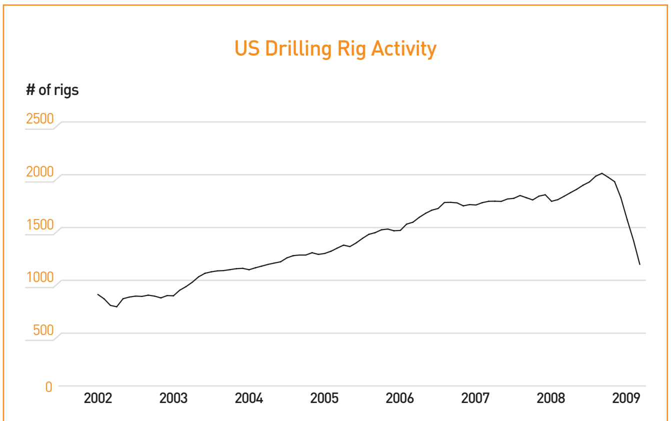


Natural gas in the USA did not follow the price of oil to the same extent, being more closely related to US gas supply and the state of the US economy. The gas price peaked at US$14/Mcf at the time that oil peaked at US$150/bbl. Currently Nymex, Henry Hub delivery gas is trading at 2003 prices of less than US$4/Mcf. The average price of natural gas in the US over the 2003-2008 period was US$8/Mcf; however, in the 10 years prior to 2003 the average price of gas was US$2.50/Mcf.

The supply of natural gas in the USA has significantly increased in the past year because of the success of non-conventional sources of gas, particularly gas from shale. Further supply is coming from LNG. The fall in the gas price has mirrored the decline in demand for electricity due to the fall in manufacturing demand.

The US energy industry response to these much lower oil and gas prices, limited credit and equity, is reflected in a general stoppage of drilling. The number of operating drilling rigs in the USA has declined from 2,100 last year to some 1,100 currently and is expected to fall to about 900 rigs in the second quarter of 2009, the level seen in 2002. This dramatic reduction of drilling will translate into a reduction in supply which, despite the reduction in demand, is anticipated would support a gas price of US$3.50 to US$4/Mcf until the US economy recovers, which may be 2 to 3 years.

Exploration and production company share prices in the US now reflect US$2/Mcfe or less for proved reserves, as spot gas prices fluctuate around US$4/Mcf and an increasing number of companies are seeking bankruptcy protection.



Data source: Baker Hughes

Chairman's Report continued

Petsec Energy strategy for 2009

We hedged our US production in 2007/2008 to the maximum amount our bankers would allow, stopped drilling in the second half of 2008, reduced our expenditures as best we could while maintaining our core team of people, and applied our excess cashflow to repaying debt. Our net debt was down to US$36.8 million at the end of 2008, a 52% reduction from US$76.8 million at the end of 2007.

We will conserve our capital and apply our energies to the acquisition of producing properties predominately in the US where the market, infrastructure and administrative rules allow profitable operations at current commodity prices. We plan to have our best prospects drill-ready when service costs have fallen to allow profitable exploration with current gas prices. We don't expect to drill until late 2009.

USA acquisitions

Our acquisition targets would be less than US$100 million, funded in large part by our banking facilities, underwritten by hedging. We will seek to extend our reach to larger targets, of the order of US$200 to US$500 million, by forming a joint venture of like-minded entities that see, as we do, that the current state of the market will offer many compelling opportunities to acquire producing reserves in the Gulf of Mexico at very satisfactory rates of return, as well as exploitation and exploration opportunities that can be addressed at a later date.

Petsec Energy established an acquisitions team in 2007 and set up an office in Houston in response to escalating service costs which had risen at a higher rate than oil and gas prices, rendering our typical exploration plays on the Gulf of Mexico Shelf uneconomic. Since the collapse of oil prices in the second half of last year we have strengthened our team with a VP of Business Development and have added a highly experienced, entrepreneurial Houston based oil man to the board, Mike Harvey. The members of our acquisitions team and our technical team in Lafayette each have over 30 years' experience in the Gulf of Mexico and Gulf Coast, all with demonstrable success in profitable acquisitions.

We are looking in those areas offshore Louisiana over which we have data and technical experience: West Cameron, Vermilion, Ship Shoal and Main Pass. We are seeking good quality, high rate production, which lends itself to hedging, with exploitation and exploration potential that can be accessed from the existing platforms.

While we are seeing a reasonable deal flow now, with lower gas prices expected in the US summer, possibly as low as US$2.50/Mcf, and the bi-annual redetermination of borrowing bases in May/June (which will reflect lower bank accepted gas prices than in late 2008), we expect that a large number of properties will become available.

We made our first acquisition in November 2007 of 25 Bcfe of developed reserves for US$104 million. The acquisition from LLOG, a very successful Gulf of Mexico player who was moving off the Shelf into deeper waters of the Gulf, was predominately in the Main Pass area, next to existing Petsec Energy production. We have been pleased with the overall performance of the acquisition.

China developments

While acquisition of producing properties is the strategy for the USA, China provides the opportunity of development of a significant amount of oil at a time when service costs will be low.

Petsec Energy owns a 25% working interest in five oil fields covered by development areas in Block 22/12, Beibu Gulf, China, representing 10.6 million barrels of oil. Three of these fields, 6-12, 6-12 South and 12-8 West hold 27.2 million barrels of recoverable oil and are currently subject to a feasibility study which is expected to be completed by end March, leading to the lodgement of an overall development plan (ODP) in June, and a final investment decision in the second half of 2009.

The fields had been declared commercial in February of 2007, and studies using a floating production storage and offloading vessel (FPSO) were progressed as CNOOC (China National Offshore Oil Corporation) stated it had no excess capacity in its nearby 12-1-1 processing platform. In September 2008, due to the number of exploration successes CNOOC had enjoyed to the north west of our block, it was proposed that the development of a shared processing platform and pipeline to Weizhou Island may be the best economic outcome for all parties. CNOOC commenced a feasibility study in September, which is expected to be completed by end of March 2009.

Even though oil prices have collapsed, so too have costs of steel, construction and services. The estimated capex of US$200 million in February 2007 to construct two well head platforms, drill 11 wells and connect by pipeline to a processing facility for this development of initial production rates of 14,000 barrels of oil per day, rose to US$450 million by June 2008. The cost indication from the current CNOOC led feasibility study is less than US$200 million, which should accommodate an economic development at current oil prices of US$40/bbl.

It is our expectation that CNOOC will participate to its full 51% right of back-in interest which would reduce Petsec Energy's net interest to 12.25%. The Company would receive its past expenditure of some US$28 million out of 62.5% of CNOOC's future cashflow.

2009 Exploration & Development Programme

Exploration budget	US$2 million
Drilling planned	??
Committed development	US$1 million
Estimated production	7 Bcfe
Estimated operating cash flow	US$32 million
Estimated debt repayments	US$21 million
Cash (at 1 Jan 09)	US$13.7 million

		Wells	Net Reserves	2008				2009			
				1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
USA			**(Bcfe)**								
Onshore Louisiana	Exploration	3	1.3						evaluation		?
Gulf of Mexico	Exploration	1	evaluation								?
Gulf of Mexico	Development										
China			**(MMbbl)**								
6-12/6-12 South	FID/Development		2.3-3.3								?
12-8 West	FID/Development		1.25								?
6-12 West/6-12 East	Exploration	2									

Drilling Production Feasibility/FID Development

Chairman's Report continued

2008 performance review

Having outlined our strategies for 2009, I will conclude with a quick appraisal of our performance for 2008, which you can read in detail in the Directors' Report.

2008 was our strongest year for production and cashflow since restarting our operations in the Gulf of Mexico in 2002. Production was up 50% on the previous year to 12.1 Bcfe, net revenues of US$105.3 million were up 65% and cashflow (EBITDAX) of US$79.6 million was up 73%, reflecting a 10% increase in received gas prices of US$8.70/Mcf for the year. The increase in production came from the start of production from the six discoveries in Mobile Bay and the purchase of producing properties in November 2007.

The operations side of the equation was satisfactory, but growth of reserves was not. We drilled six wells for a reserves addition of 1.3 Bcfe, and suffered downward revisions in existing reserves of 6.6 Bcfe because of poor reservoir performance. The two wells drilled in China discovered no economic oil and incurred significant cost overruns. One well was drilled in the Gulf of Mexico and found gas; however the cost structure at the time would not permit economic development therefore the well was plugged and abandoned. Three wells were drilled onshore Louisiana, two of which were successful in discovering gas and oil in the Moonshine Project area and were completed for production; again, the cost structure at the time necessitated taking an impairment on the carrying value of both these discoveries. The fall in gas and oil prices has caused us to book impairments at 31 December 2008 for some of our producing assets and for most of the Focus JV leases and Moonshine Project leases.

Petsec Energy estimated 2P reserves at year-end were 51.9 Bcfe, being 30.4 Bcfe of developed reserves in the USA and 21.5 Bcfe (3.6 million barrels) undeveloped in China, assuming CNOOC backs-in for its full entitlement of 51% for the proposed development of the 6-12, 6-12 South and 12-8 West oil fields. Petsec Energy's 25% interest in the 15.4 million barrels recoverable in the 12-8 East and 12-3-1 oil fields in China have not been booked.

We anticipate and are hopeful that the development of the 6-12, 6-12 South and 12-8 West fields is likely to commence late in 2009.

In the USA we expect to produce some 7 Bcfe of gas in 2009. We have 5.2 Bcfe hedged at an average price of the order of US$8/Mcfe so if spot gas averages US$4/Mcfe, this would generate revenues in the order of US$50 million.

It is intended that much of our cashflow will be used in 2009 to further reduce our net debt, which stood at US$36.8 million at year end, unless required for the acquisition of producing properties.

We have expectation of sufficient cash flow this year, banking accommodation, a dedicated team of accomplished professionals, and a determination to make a meaningful acquisition which will result in agreeable growth for the Company.

I am looking forward to 2009 with a positive expectation that Petsec Energy will prosper in these challenging times.

T N Fern
Chairman and Managing Director

DIRECTORS' REPORT & FINANCIAL REPORTS

Directors' Report

FOR THE YEAR ENDED 31 DECEMBER 2008

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 2008 and the 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 Managing Director

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 was a member of the Audit and Nomination and Remuneration Committees until January 2009. 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 Macquarie Infrastructure Investment Management Ltd. 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, Adsteam Marine Limited from 1997 until March 2007 and Virgin Blue Holdings Limited from 2004 to 2006.

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 South East Asia and the Gulf of Mexico, USA. After receiving his degree from Texas A&M in 1969, Mr Harvey served as a Captain 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 which 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 29 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.

Denis Swords

General Counsel and Corporate Secretary of Petsec Energy Inc.

Mr Swords joined the Company in October 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 November 2006, and is a Certified Professional Landman (CPL) with over 29 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, 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. 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.

Craig Jones

General Manager – Corporate and Company Secretary

Mr Jones has over 20 years corporate finance experience in listed companies in the resources and healthcare industries. Mr Jones has served as Chief Financial Officer and Company Secretary for Sedimentary Holdings Limited, ICS Global Limited, and Alpha Healthcare Limited and as General Manager, Treasury and Corporate Services with MIA Group Limited. Mr Jones holds a Bachelor of Business degree from the University of South Queensland, and is a Fellow of the Australian Society of CPA's and the Institute of Chartered Secretaries.

Paul Gahdmar

Group Financial Controller and Company Secretary

Mr Gahdmar joined the Company in 1999 and was appointed Company Secretary of Petsec Energy Ltd on 5 December 2008. Mr Gahdmar is a qualified accountant with over 15 years experience in corporate accounting and finance within the resources sector and holds a Master of Business and Technology degree from the University of New South Wales.

→3 Directors' meetings

The Board has a formally constituted Audit Committee and a Nomination and Remuneration Committee, of which each director is a member. Both committees are chaired by a non-executive director. 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**	**1**	**3**	**3**
T N Fern [1]	11	1	3	3
D A Mortimer	11	1	3	3
P E Power	10	1	2	3
M L Harvey [2]	3	1	1	1

1 Mr Fern resigned from the Audit and Nomination and Remuneration Committees in January 2009.

2 Mr Harvey joined the Board in October 2008.

Directors' Report continued

FOR THE YEAR ENDED 31 DECEMBER 2008

→4 Remuneration report

The Remuneration Report is set out on pages 19 to 24 and forms part of the Directors' Report for the financial year ended 31 December 2008.

→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 and operations review

Financial review

Highlights

Net revenues after royalties for the twelve months to 31 December 2008 increased by 65% on the previous corresponding period to US$105.3 million (2007: US$64.0 million) largely due to a combination of higher production volumes and a higher average gas equivalent sales price achieved for the year of US$8.70/Mcfe (2007: US$7.93/Mcfe).

Depreciation, depletion, amortisation and rehabilitation (DD&A) increased to US$57.3 million (2007: US$27.7 million), mainly reflecting the full year contribution to DD&A from Mobile Bay as well as the seven gas fields acquired in late 2007.

Earnings before interest, income tax, DD&A and exploration expense ("EBITDAX") of US$79.6 million represent a 73% increase on the previous year (2007: US$45.9 million).

The cash operating margin for the year was US$6.58 Mcfe (2007: US$5.69/Mcfe), lease operating expense US$1.05/Mcfe (2007: US$0.87/Mcfe) and GG&A US$1.01 /Mcfe (2007: US$1.41/Mcfe).

Earnings before dry hole, impairment and abandonment expense and income tax for the year were US$12.1 million (2007: US$16.6 million).

Dry hole, impairment and abandonment expense of US$71.9 million (2007: US$19.4 million) comprised exploration write-offs of US$13.8 million plus impairment provisions totalling US$58.1 million for the year.

The consolidated entity periodically reviews the carrying values of its oil and gas properties and in accordance with accounting standards and company policy will recognise impairment to the extent that the carrying value of an oil and gas property on the balance sheet exceeds its estimated recoverable amount. Accordingly, impairments for the year of US$58.1 million were recognised against the carrying values of a number of oil and gas properties resulting from net reserve revisions of 6.6 Bcfe relating to the Mobile Bay, South Sunrise, Main Pass 20 and Vermilion gas fields; the sharp fall in oil and gas prices impacting on the calculation of the estimated recoverable amounts, though the effect is ameliorated on the balance sheet to a significant extent by the increase in the mark-to-market value of the Company's hedge book; and in light of current market conditions the Company has decided to discontinue exploration efforts on a number of exploration leases. Further details are provided in Note 7 of the Notes to the Consolidated Financial Statements.

Net loss before tax of US$59.8 million (2007: loss before tax of US$2.8 million), and loss after tax of US$44.5 million (2007: loss after tax of US$2.0 million) reflect the impact on profitability of higher DD&A, dry hole, impairment and abandonment expense and net financial expense.

Financial Position

Available cash and net cash generated from operating activities of US$85.2 million for the year was used to repay US$53.5 million of debt and to fund US$43.6 million of exploration, evaluation and development.

The cash position at 31 December 2008 was US$13.7 million compared to US$27.2 million at year end 2007.

Effective 1 December 2008, the Company's borrowing base under its revolving credit facility was increased from US$39 million to US$53 million following the completion of a semi-annual review by the Company's banker, Guaranty Bank. The US$53 million facility currently reduces by US$2 million a month, and expires in November 2010. The next borrowing base and monthly reduction amount determination are scheduled for 1 May 2009.

On 31 December 2008, the amount drawn under the revolving credit facility was US$20.8 million in loans and a further US$8.4 million in letters of credit used to support US Minerals Management Service (MMS) bonding requirements and other commitments.

The Company also has a US$29.7 million subordinated fixed term facility maturing in 2011.

Total outstanding bank debt on 31 December 2008 was US$50.5 million, down 51% on the US$104.0 million outstanding on 31 December 2007.

Net debt at 31 December 2008 was US$36.8 million, down 52% on the US$76.8 million at 31 December 2007.

Debt reduction will remain a high priority for the Company over the course of the 2009 year.

At 31 December 2008, the Company's liquidity remains sound as evidenced by Current Assets of US$34.9 million (2007: US$52.6 million) and Current Liabilities of US$17.1 million (2007: US$38.1 million).

Operations review

Prospect inventory

During the 2008 year, Petsec Energy acquired five new exploration leases in the Gulf of Mexico: North Padre Island 929 & 934 (100% working interest); West Cameron 631 & 636 (100% working interest); and East Cameron 102 (54% working interest). The Company will further evaluate these prospects during 2009 readying them for drilling and possible farm-out to reduce risk.

Given the uncertain financial outlook and expectation of falling service costs, Petsec Energy does not plan to undertake any drilling until costs have responded to the fall in oil and gas prices, perhaps by late 2009. Instead the Company will focus on consolidating its financial position by continuing to repay outstanding debt and to seek opportunistic acquisitions of producing oil and gas reserves which hold exploration potential.

Petsec Energy will continue to review and bid for further exploration blocks at the semi-annual Gulf of Mexico lease sales conducted by the MMS in areas where the exploration potential and available infrastructure would indicate that profitable operations can be developed should the current low price environment continue.

Drilling

Six wells were drilled during the year, two of which were completed for production. The Company drilled one well in the Gulf of Mexico, three wells in onshore Louisiana, USA, and two in the Beibu Gulf, China.

At the Moonshine Project, onshore USA, two wells drilled resulted in modest gas discoveries; however expected production from these wells is less than anticipated. The E. Laurent #1 well (formerly Virginia Geason #1 well at the Dickel Prospect) intersected 6.3 metres (21 feet) of net gas pay and was completed for production in April. The W.P. Miles Timber #1 well (Crown Royal prospect) was completed over a 13-foot interval and commenced initial production on 14 February at a rate of 1.5 million cubic feet of gas and 75 barrels of oil per day.

Also onshore USA, at the Triple Play prospect, Terrebonne Parish, the CL&F #30-1 well (originally drilled and plugged in September 2007) was re-entered and deepened to test the Hollywood #2 sands. The well was plugged and abandoned after the sands were determined to be uneconomic to develop.

In the Gulf of Mexico, the West Cameron 379 #1 well was drilled in March and encountered 4.3 metres (14 feet) of net gas pay. This was insufficient to support development and was subsequently plugged and abandoned.

In the Beibu Gulf, China, two wells drilled in Block 22/12 to test prospects within three kilometres of the 6-12 South oil discovery failed to intersect commercial hydrocarbons and were plugged and abandoned.

Development and production

USA

Petsec Energy has interests in 12 producing fields in the Gulf of Mexico, USA, and four producing onshore fields in Louisiana, USA.

Net production for the 2008 year was 12.1 Bcfe, a 50% increase on 2007 levels and the highest production since 2002. This record production is slightly lower than forecast due to hurricane-related platform and pipeline shut-ins at all projects during September/October and shut-ins attributable to third party pipeline maintenance at Chandeleur 31/32 during November/December and third party pipeline damage at Main Pass 270 from April through December. Fortunately none of Petsec Energy's facilities suffered significant damage during the hurricanes.

The successful integration of seven producing fields that Petsec Energy acquired in the Gulf of Mexico in 2007 contributed greatly to 2008 production levels. Chandeleur 31/32 accounted for approximately a third of all production, with Main Pass 19/18, Main Pass 20, Mobile Bay and Vermilion accounting for the majority of the balance of production for the year.

A new well at E. Laurent #1 (Moonshine Project) onshore Louisiana was brought into production on 1 July 2008 at an initial rate of 5,000 Mcf per day and 125 barrels of oil per day. Shortly after commencement, the well began making water. Following remediation works, the well has been returned to an approximate production rate of 0.8 MMcf per day of gas and 15 barrels of oil per day.

A 3,000 barrel storage tank at Main Pass 19/18 was completed in July to avoid the necessity of frequently shutting in the entire field due to lack of oil storage capacity.

At year end, Petsec Energy sold its interest in the Humphreys field for US$400,000 due to declining production rates from its two wells which had decreased to 1.1 million cubic feet of gas per day.

China, Beibu Gulf

Petsec Energy has a 25% working interest in Block 22/12 in the Beibu Gulf, China, with ROC Oil as operator. The China National Offshore Oil Corporation (CNOOC) has rights to participate up to 51% in developments, which could reduce Petsec Energy's interest to 12.25%.

Block 22/12 is located 60 kilometres offshore southern China, northwest of Hainan Island. The block contains five oil fields, two of which (6.12 South and 6.12) were discovered by the current joint venture in 2006 and 2002 respectively. Oil in place is estimated at 300 – 400 million barrels of oil, of which, 56 – 66 million barrels is expected to be recoverable. Petsec Energy's 25% share is 14 – 16.5 million barrels.

A feasibility study was completed on the 6.12 South oil field in January 2007. Work continued throughout the year on front-end engineering and design studies (FEED) and

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an overall development plan (ODP) for the 6.12/6.12 South and 12.8 West oil fields for submission to the Chinese authorities.

A comprehensive study of the development options for the areas was reviewed in late September 2008 with CNOOC, who declared Wei 6.12, 6.12 South, 12.8 West, 12.8 East and 12.3.1 as development areas, taking the development planning into its closing stages. The final stages of work on the feasibility study and ODP for the 6.12/6.12 South and 12.8 West oil fields are being conducted in conjunction with CNOOC and lodgement of this plan is anticipated by mid 2009. A final investment decision is anticipated in late 2009.

The proposed development proposes well head platforms at the 6.12 and 12.8 West fields tied into CNOOC's processing and pipeline infrastructure.

Gross recoverable oil is estimated at 19-27 million barrels of oil for 6.12/6.12 South and 10 million barrels of oil for 12.8 West.

Oil and gas reserves – USA and China

Petsec Energy estimated proved and probable (2P) oil and gas reserves at the end of the year stood at 51.9 Bcfe comprising 3.6 million barrels of oil (or 21.5 Bcfe) in China for the 6.12/6.12 South and 12.8 West oil fields and 30.4 Bcfe in the USA. Downward reserve revisions of 6.6 Bcfe were recorded against the Mobile Bay, South Sunrise, Main Pass 20 and Vermilion 258 gas fields in the US in response to lower than predicted well performance. These resultant impairments have been recognised in the financial statements. Other fields continue to perform as, or better than, expected.

	Independent Assessment [1]			Petsec Energy
Gas Equivalent Bcfe	Proved Reserves	Probable Reserves	Proved and Probable Reserves	Estimated Recoverable Proved and Probable Reserves
USA				
Reserves at 1 January 2008	36.1	10.0	46.1	48.1
Net additions	0.6	1.3	1.9	1.3
Sold in place	–	–	–	(0.3)
Revisions	(0.4)	(4.7)	(5.1)	[2] (6.6)
Production	(12.1)	–	(12.1)	(12.1)
USA Reserves at 31 December 2008	**24.2**	**6.6**	**30.8**	**30.4**
China				
Reserves at 1 January 2008 [3]				3.6 million bbls or 21.5
Net additions				–
China Reserves at 31 December 2008				**3.6 million bbls or 21.5**
Total Reserves at 31 December 2008				**51.9**

1 million bbls is the equivalent of 6 Bcfe

Footnotes

U.S.A.

1. The independent reserve assessments at 1 January 2008 were estimated by independent petroleum engineers Ryder Scott Company and Netherland Sewell & Associates Inc. The independent reserve assessments at 31 December 2008 were estimated by Ryder Scott Company.
2. Downward revisions of 6.6 Bcfe primarily related to premature water encroachment at Mobile Bay, South Sunrise and Main Pass 20 and the unsuccessful recompletion of the Vermilion 258 G-2 well. This was offset to some extent by an increase in estimated recoverable reserves at Chandeleur 31/32.

China

Based on 12.25% net revenue interest after CNOOC back-in for 51%.

3. 12.8 West oil field: 1.25 million barrels of oil recoverable (or 7.5 Bcfe) and 6.12/6.12 South oil fields: 2.33 – 3.31 million barrels of oil (or 14 – 20 Bcfe).

→7 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, focus its efforts on preparing our prospects for drilling in the Gulf of Mexico and onshore Louisiana to take advantage of any improvements in market conditions, progress the development of the Wei 6.12, 6.12 South and 12.8 West oil fields in the Beibu Gulf in China, and to review potential acquisitions of producing reserves.

→8 Dividends

Directors do not recommend the payment of a dividend for the financial year ended 31 December 2008. No dividends were paid during the financial year.

→9 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 and operations review" section of this report.

→10 Significant events

As at the date of this report, the directors are not aware of any other matter or circumstance not otherwise dealt with in this report or the consolidated financial statements that has significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in subsequent financial years.

→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 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.

→13 Likely developments

China

Beibu Gulf, Block 22/12 Joint Venture

The consolidated entity expects that the Beibu Gulf, Block 22/12 joint venture will have completed an ODP for the Wei 6.12, 6.12 South and 12.8 West oil fields for submission to Chinese authorities by mid 2009. This may lead to a final investment decision in late 2009 to develop the fields.

USA

Exploration will concentrate on preparing our prospects for drilling and reviewing potential acquisitions.

→14 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	24,825,549	2,000,000
D A Mortimer	610,068	Nil
P E Power	225,323	Nil
M L Harvey	Nil	Nil

→15 Share options

Options granted to directors and officers of the Company

During or since the end of the financial year, grants of 60,000 options were made to directors or the five most highly remunerated officers of the Company as part of their remuneration.

There are on issue 5,239,500 options over ordinary shares in Petsec Energy Ltd, all of which are employee options exercisable at prices ranging from A$1.15 to A$3.11 per share expiring at various dates between 31 July 2009 and 18 October 2012 with exercise dependent on completion of vesting period and

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satisfaction of share price hurdles ranging from A$1.44 to A$6.84 being achieved on the Australian Securities Exchange. During the year 38,000 options were exercised, 899,500 options were forfeited and 90,000 options were granted. Subsequent to 31 December 2008 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 July 2009	A$1.25	37,500
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	450,000
12 April 2011	A$2.38	117,000
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	90,000
31 December 2013	A$0.20	455,500
		5,695,000

Shares issued on exercise of options

During the financial year, the Company issued the following ordinary shares as result of the exercise of options (there were no amounts unpaid on the shares issued):

Number of shares	Amount paid on each share
38,000	A$0.40
38,000	

→16 Indemnification and insurance of officers

During the year ended 31 December 2008, 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.

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).

No payments in relation to indemnification have been made during or since the end of the financial year by the Company. 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.

→17 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 Consolidated Financial Statements.

→18 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 2008.

→19 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.

This report is made with a resolution of the directors:

T N Fern
Director

Sydney, 26 February 2009

→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 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.

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[1]

1 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 three 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;
- the key management personnel's ability to control the relevant performance of their segment of operation.

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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.

Compensation levels and other terms of employment are reviewed annually by the Nomination and Remuneration Committee 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 19(c) of the Consolidated 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 which 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.

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 forthcoming 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.

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 which 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 2008 year were unchanged from the 2007 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 which is equivalent to the remuneration received in the three years prior to retirement. Incoming non-executive directors are not entitled to retirement benefits.

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$**	**Proportion of remuneration performance related %**	**Value of options as proportion of remuneration %**
Key management personnel – Directors [1]		Salary & fees US$	Short-term incentive cash bonus US$	Other benefits US$	Service agreements US$	Superannuation benefits US$	Retirement benefits US$	Accounting fair value of options US$			
Executive											
T N Fern [1] *(Note 1)* Chairman, Managing Director	**2008**	**–**	**–**	**24,442**	**645,806**	**–**	**–**	**140,797**	**811,045**	**–**	**17.4**
	2007	–	–	23,323	385,119	83,720	–	92,448	584,610	–	15.8
Non-executive											
D A Mortimer [1] Director	**2008**	**55,608**	**–**	**–**	**–**	**5,005**	**12,883**	**–**	**73,496**	**–**	**–**
	2007	54,418	–	–	–	4,898	12,558	–	71,874	–	–
P E Power [1] Director	**2008**	**55,608**	**–**	**–**	**–**	**5,005**	**12,883**	**–**	**73,496**	**–**	**–**
	2007	54,418	–	–	–	4,898	12,558	–	71,874	–	–
M L Harvey *(Note 2)* Director	**2008**	**10,734**	**–**	**–**	**–**	**–**	**–**	**–**	**10,734**	**–**	**–**
	2007	–	–	–	–	–	–	–	–	–	–
Total directors	**2008**	**121,950**	**–**	**24,442**	**645,806**	**10,010**	**25,766**	**140,797**	**968,771**	**–**	**14.5**
	2007	108,836	–	23,323	385,119	93,516	25,116	92,448	728,358	–	12.7

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) 2008 – 0.8555 ii) 2007 – 0.8372.

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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 – Executive officers		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 8)*	Short-term incentive cash bonus US$ *(Note 9)*	Other benefits US$ *(Note 10)*	Service agreements US$	Superannuation /401k benefits US$	Retirement benefits US$	Accounting fair value of options US$ *(Note 11)*			
R A Keogh President, Petsec Energy Inc.	**2008**	**246,012**	**–**	**16,414**	**–**	**11,700**	**–**	**123,421**	**397,547**	**–**	**31.0**
	2007	235,638	55,000	15,888	–	11,250	–	149,966	467,742	11.8	32.1
F Steele *(Note 3)* Vice President, Land Petsec Energy Inc.	**2008**	**192,677**	**–**	**16,414**	**–**	**9,350**	**–**	**30,633**	**249,074**	**–**	**12.3**
	2007	–	–	–	–	–	–	–	–	–	–
D Swords General Counsel/ Corporate Secretary, Petsec Energy Inc.	**2008**	**179,440**	**–**	**16,338**	**–**	**8,850**	**–**	**17,471**	**222,099**	**–**	**7.9**
	2007	165,548	40,000	15,888	–	8,500	–	29,582	259,518	15.4	11.4
M Radabaugh *(Note 4)* Vice President, Business Development and Planning, Petsec Energy Inc. (Resigned 20/6/08)	**2008**	**90,718**	**–**	**8,448**	**–**	**4,865**	**–**	**–**	**104,031**	**–**	**–**
	2007	186,702	45,000	14,268	–	9,250	–	163,564	418,784	10.7	39.1
F Robertson [1] *(Note 5)* Chief Financial Officer	**2008**	**–**	**–**	**4,872**	**200,264**	**–**	**–**	**27,697**	**232,833**	**–**	**11.9**
	2007	–	8,372	4,768	219,627	–	–	45,061	277,828	3.0	16.2
C Jones [1] *(Note 6)* General Manager Corporate, Company Secretary	**2008**	**–**	**–**	**1,678**	**175,049**	**–**	**–**	**27,697**	**204,424**	**–**	**13.5**
	2007	–	8,372	1,642	160,408	–	–	45,061	215,483	3.9	20.9
P Gahdmar [1] *(Note 7)* Group Financial Controller, Company Secretary	**2008**	**133,422**	**–**	**808**	**–**	**12,008**	**–**	**11,488**	**157,726**	**–**	**7.3**
	2007	–	–	–	–	–	–	–	–	–	–
Total executive officers	**2008**	**842,269**	**–**	**64,972**	**375,313**	**46,773**	**–**	**238,407**	**1,567,734**	**–**	**15.2**
	2007	587,888	156,744	52,454	380,035	29,000	–	433,234	1,639,355	9.6	26.4
Total compensation: key management personnel (Consolidated)	**2008**	**964,219**	**–**	**89,414**	**1,021,119**	**56,783**	**25,766**	**379,204**	**2,536,505**	**–**	**14.9**
	2007	696,724	156,744	75,777	765,154	122,516	25,116	525,682	2,367,713	6.6	22.2
Total compensation: key management personnel (Company)	**2008**	**244,638**	**–**	**31,800**	**1,021,119**	**22,018**	**25,766**	**207,679**	**1,553,020**	**–**	**13.4**
	2007	108,836	16,744	29,733	765,154	93,516	25,116	525,682	1,564,781	1.1	33.6

1 Australian-based executive officers' remuneration amounts are actually paid in Australian dollars and presented in US dollars at the following FX rates i) 2008 – 0.8555 ii) 2007 – 0.8372.

Notes

1 Included in service agreements and superannuation benefits, within the table included in Note 20.3 of this Directors' Report, is an amount of US$645,806 and nil, respectively, (2007: US$385,119 and US$83,720) 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 Harvey was appointed as a non-executive director of Petsec (USA) Inc. and Petsec Energy Ltd on 14 October 2008. Mr Harvey is remunerated in US dollars. Annualised fees are US$50,000.

3 Mr Steele became a member of key management personnel in July 2008 following the resignation of Mr Radabaugh. Amounts disclosed for 2008 represent twelve months' remuneration.

4 Mr Radabaugh resigned from his position of Vice President, Business Development and Planning of Petsec Energy Inc. on 20 June 2008.

5 Included in service agreements within the table included in Note 20.3 of this Directors' Report, is an amount of US$200,264 (2007: US$219,627) which was paid or is payable to the above company (of which Mr Fern is a director) and through which Ms Robertson provided services.

6 Included in service agreements within the table included in Note 20.3 of this Directors' Report, is an amount of US$175,049 (2007: US$160,408) which was paid or is payable to the above company (of which Mr Fern is a director) and through which Mr Jones provided services.

7 Mr Gahdmar became a member of key management personnel in December 2008 following his appointment as Company Secretary of Petsec Energy Ltd. Amounts disclosed for 2008 represent twelve months' remuneration.

8 Salary and fees for certain specified executives includes the movement during the reporting period of accruals for annual leave and long service leave.

9 Bonuses under the employee short-term incentive plan are granted annually following finalisation of the annual accounts based on a percentage of EBIT (calculated in accordance with U.S. GAAP). As a result of the negative EBIT for the financial year ended 31 December 2008 no bonus pool was available for payment and no discretionary amounts were paid. 2007 bonuses represent discretionary bonus amounts paid.

10 Other benefits represent amounts paid on behalf of the Managing Director and Executive Officers in respect of insurance and car parking benefits.

11 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 2008 and 2007.

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$0.421	A$1.40	A$1.40	51.0%	5.10%	–
1/03/06	24/02/11	A$0.535	A$2.13	A$2.10	48.1%	5.11%	–
13/06/06	12/06/11	A$0.578	A$3.11	A$2.84	48.1%	5.11%	–
2/03/07	30/01/12	A$0.399	A$2.38	A$1.95	46.5%	5.91%	–
2/03/07	12/02/12	A$0.215	A$2.40	A$1.95	46.5%	5.91%	–
2/03/07	12/02/12	A$0.143	A$3.11	A$1.95	46.5%	5.91%	–
1/06/07	14/06/12	A$0.061	A$2.40	A$1.49	40.5%	6.23%	–
1/06/07	14/06/12	A$0.037	A$3.11	A$1.49	40.5%	6.23%	–

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 2008 year.

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

Directors' Report continued

FOR THE YEAR ENDED 31 DECEMBER 2008

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

No options over ordinary shares in the Company were granted as compensation to key management persons during the reporting period. 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 2007	Grant date	Fair value per option at grant date	Exercise price per option	Expiry date	Number of options vested during 2007
Directors						
T Fern	1,500,000	1/06/07	A$0.061	A$2.40	14/06/12	–
T Fern	500,000	1/06/07	A$0.037	A$3.11	14/06/12	–
Executives						
R Keogh	500,000	2/03/07	A$0.215	A$2.40	12/02/12	–
R Keogh	500,000	2/03/07	A$0.143	A$3.11	12/02/12	–
F Steele	200,000	2/03/07	A$0.399	A$2.38	30/01/12	–
P Gahdmar	75,000	2/03/07	A$0.399	A$2.38	30/01/12	–
M Radabaugh	100,000	2/03/07	A$0.215	A$2.40	12/02/12	–

455,500 options have been granted 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$0.20 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$0.20 per share with a price hurdle of A$0.30 per share.

For options granted during the year ended 31 December 2008, the earliest exercise date is 12 February 2009.

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. During the previous corresponding period the following shares were issued on the exercise of options previously granted as compensation:

2007	Number of shares	Amount paid per share
Directors	–	–
Executives		
R Keogh	325,000	A$0.30

There are no amounts unpaid on the shares issued as a result of the exercise of the options in 2007.

Analysis of Movement in Options

During the reporting period, 350,000 options were cancelled and no options were granted or 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		
2007	Granted in year (A) $	Exercised in year (B) $	Total option value in year A$
Directors			
T Fern	A$483,385	–	A$483,385
Executives			
R Keogh	A$497,842	A$390,000	A$887,842
M Radabaugh	A$56,583	–	A$56,583

(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 2008 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.

KPMG

KPMG

Paul Zammit

Paul Zammit
Partner

Sydney, 26 February 2009

Income Statements

FOR THE YEAR ENDED 31 DECEMBER 2008

		Consolidated		The Company	
	Note	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Revenues from sale of oil and gas and royalties	5	**123,798**	68,026	**–**	–
Royalties paid		**(18,517)**	(4,051)	**–**	–
Net revenues after royalties		**105,281**	63,975	**–**	–
Other income and expenses	5	**(716)**	309	**3,318**	968
Lease operating expenses		**(12,658)**	(7,030)	**–**	–
Geological, geophysical and administrative expenses		**(12,277)**	(11,344)	**(2,719)**	(3,301)
EBITDAX [1]		**79,630**	45,910	**599**	(2,333)
Depreciation, depletion, amortisation and rehabilitation		**(57,252)**	(27,713)	**(13)**	(19)
Seismic and geological data expense		**(1,928)**	(645)	**–**	–
Major workover and repair expense		**(1,325)**	–	**–**	
Dry hole, impairment and abandonment expense	7	**(71,885)**	(19,408)	**–**	–
Net movement in provisions against loans to and investments in controlled entities	7	**–**	–	**(31,165)**	(22)
EBIT [2]		**(52,760)**	(1,856)	**(30,579)**	(2,374)
Financial income	9	**735**	1,456	**1,283**	2,932
Financial expenses	9	**(7,790)**	(2,403)	**–**	–
Net financial income/(expense)	9	**(7,055)**	(947)	**1,283**	2,932
Profit/(loss) before income tax		**(59,815)**	(2,803)	**(29,296)**	558
Income tax benefit/(expense)	10	**15,344**	799	**(550)**	(83)
Profit/(loss) for the period		**(44,471)**	(2,004)	**(29,846)**	475

		US Cents	US Cents
Basic earnings/(loss) per share	11	**(28.8)**	(1.3)
Diluted earnings/(loss) per share	11	**(28.8)**	(1.3)

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

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

The notes on pages 30 to 67 are an integral part of these financial statements.

Statements of Recognised Income and Expense

FOR THE YEAR ENDED 31 DECEMBER 2008

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Foreign exchange translation differences	**581**	1,083	**(34,556)**	21,630
Effective portion of change in fair value of cash flow hedges, net of tax:	**6,116**	(824)	**–**	–
Net income/(loss) recognised directly in equity	**6,697**	259	**(34,556)**	21,630
Profit/(loss) for the period	**(44,471)**	(2,004)	**(29,846)**	475
Total recognised income and expense for the period	**(37,774)**	(1,745)	**(64,402)**	22,105

Other movements in equity arising from transactions with owners as owners are set out in Note 21.

The notes on pages 30 to 67 are an integral part of these financial statements.

Balance Sheets

AS AT 31 DECEMBER 2008

		Consolidated		The Company	
	Note	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
ASSETS					
Current assets					
Cash and cash equivalents		**13,735**	27,214	**4,725**	8,167
Trade and other receivables	12	**8,034**	18,368	**1,133**	7,140
Fair value of derivative financial instruments	22	**12,153**	5,404	**–**	–
Prepayments		**1,004**	1,627	**61**	102
Total current assets		**34,926**	52,613	**5,919**	15,409
Non-current assets					
Receivables from controlled entities	12	**–**	–	**20,782**	41,226
Investments	13	**–**	497	**121,461**	156,792
Property, plant and equipment	14	**373**	448	**39**	50
Exploration, evaluation and development expenditure – Tangible	15(a)	**98,064**	170,581	**–**	–
Exploration and evaluation expenditure – Intangible	15(b)	**8,636**	25,374	**–**	–
Intangible assets – Software		**121**	167	**–**	–
Deferred tax assets	16	**17,325**	4,713	**–**	–
Fair value of derivative financial instruments	22	**2,213**	271	**–**	–
Total non-current assets		**126,732**	202,051	**142,282**	198,068
Total assets		**161,658**	254,664	**148,201**	213,477
LIABILITIES					
Current liabilities					
Trade and other payables	17	**12,896**	14,074	**369**	595
Fair value of derivative financial instruments	22	**868**	256	**–**	–
Loans and borrowings	18	**2,475**	23,622	**–**	–
Rehabilitation provisions	20	**674**	–	**–**	–
Employee benefits provisions	19	**150**	147	**20**	23
Total current liabilities		**17,063**	38,099	**389**	618
Non-current liabilities					
Trade and other payables	17	**–**	2,009	**5,691**	6,676
Loans and borrowings	18	**46,307**	78,144	**–**	–
Employee benefits provisions	19	**274**	311	**274**	311
Rehabilitation provisions	20	**12,126**	12,395	**–**	–
Fair value of derivative financial instruments	22	**–**	409	**–**	–
Total non-current liabilities		**58,707**	93,268	**5,965**	6,987
Total liabilities		**75,770**	131,367	**6,354**	7,605
Net assets		**85,888**	123,297	**141,847**	205,872
EQUITY					
Issued capital	21	**170,276**	169,829	**170,276**	169,829
Reserves	21	**10,953**	4,326	**(5.005)**	29,621
Retained earnings/(accumulated losses)	21	**(95,341)**	(50,858)	**(23,424)**	6,422
Total equity		**85,888**	123,297	**141,847**	205,872

The notes on pages 30 to 67 are an integral part of these financial statements.

Statements of Cash Flows

FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	Consolidated 2008 US$'000	Consolidated 2007 US$'000	The Company 2008 US$'000	The Company 2007 US$'000
Cash flows from operating activities					
Cash receipts from customers		**134,698**	58,409	**–**	–
Cash payments for royalties		**(20,867)**	(2,200)	**–**	–
Cash payments to suppliers and employees		**(21,547)**	(21,516)	**(2,498)**	(1,317)
Interest received		**752**	1,456	**437**	552
Interest received – related parties		**–**	–	**6,054**	–
Management fees received – related parties		**–**	–	**2,356**	–
Dividend received		**–**	–	**1,212**	–
Taxes paid		**(550)**	(83)	**(550)**	(83)
Interest paid		**(7,331)**	(1,002)	**–**	–
Net cash from operating activities	31	**85,155**	35,147	**7,011**	(765)
Cash flows from investing activities					
Payments for property, plant and equipment		**(145)**	(543)	**(10)**	(26)
Payments for acquisition of producing properties [1]		**–**	(102,411)	**–**	–
Payments for exploration, evaluation and development expenditure [1]		**(43,601)**	(43,490)	**–**	–
Loans to controlled entities [2]		**–**	–	**(8,944)**	(5)
Investments in controlled entities [2]		**–**	–	**–**	(12,973)
Payments for investments		**(26)**	(31)	**–**	–
Proceeds from disposal of investments		**330**	–	**–**	–
Net cash from investing activities		**(43,442)**	(146,475)	**(8,954)**	(13,004)
Cash flows from financing activities					
Proceeds from share options exercised by employees		**9**	145	**9**	145
Proceeds from issue of share capital, net of equity raising costs		**–**	8,878	**–**	8,878
Proceeds from debt facilities		**–**	116,500	**–**	–
Debt facility establishment fees		**(181)**	(2,350)	**–**	–
Debt facility repayments		**(53,500)**	(12,500)	**–**	–
Net cash from financing activities		**(53,672)**	110,673	**9**	9,023
Net increase/(decrease) in cash and cash equivalents		**(11,959)**	(655)	**(1,934)**	(4,746)
Cash and cash equivalents at 1 January		**27,214**	26,541	**8,167**	11,591
Effects of exchange rate changes on cash held		**(1,520)**	1,328	**(1,508)**	1,322
Cash and cash equivalents at 31 December		**13,735**	27,214	**4,725**	8,167

The notes on pages 30 to 67 are an integral part of these financial statements.

1 Non-cash investing activity: During the previous corresponding period, an interest in leases and production facilities at Mobile Bay 952, 953 and 955 was acquired in a non-cash transaction in which the consolidated entity assumed the rehabilitation obligation on the leases. The consolidated entity has since abandoned the Mobile Bay 955 field at an estimated cost of US$1,489,000 and currently estimates the fair value of its remaining rehabilitation obligation for the Mobile Bay 952 & 953 fields to be US$940,000.

In November 2007, as part of the acquisition of a number of producing oil and gas properties, the consolidated entity assumed the rehabilitation obligation on these leases. The estimated fair value of the rehabilitation obligation as at 31 December 2008 is US$6,395,000 (2007: US$5,518,000).

2 During 2008 and 2007, the Company restructured a number of its loans and investments in controlled entities.

Notes to the Consolidated Financial Statements

FOR THE YEAR ENDED 31 DECEMBER 2008

→1 Reporting entity

Petsec Energy Ltd (the "Company") is a company domiciled in Australia. The address of the Company's registered office is Level 13, 1 Alfred Street, Sydney 2000. The consolidated financial statements of the Company as at and for the year ended 31 December 2008 comprise the Company and its subsidiaries (together referred to as the "consolidated entity"). The consolidated entity primarily is involved in oil and gas exploration, development and production activities within the Gulf of Mexico and Gulf Coast, USA and Beibu Gulf, China.

→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 financial statements were approved by the Board of Directors on 26 February 2009.

(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;
- Available-for-sale financial assets are measured at fair value.

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

(c) Functional and presentation currency

These consolidated financial statements are presented in US dollars which is the consolidated entity's choice of presentation currency (see Note 3(b)). 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.

(d) 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 – Significant accounting policies.

Change in estimate – assessment of estimated remaining useful life

Effective 1 January 2008, the consolidated entity increased its estimate of the remaining useful life for production phase areas of interest. The increase in estimated useful life reflects an adoption of 2P (proved and probable) rather than 1P (proved) reserves as the estimate of the remaining useful life for an area of interest.

Accordingly, as of 1 January 2008, exploration, evaluation and development expenditure in the production phase will be amortised on the units-of-production method based on a ratio of actual production to remaining estimated 2P reserves.

Remaining 2P reserves are estimated at the lower of 2P reserves estimated by external independent petroleum engineers and internal estimates. The change in estimate had a benefit of reducing the current period depreciation and amortisation expense from US$61.4 million to US$57.3 million. It is not practical to estimate the impact of this change in estimate in individual future periods.

The change in estimate to a 2P useful life is consistent with industry practice in Australia.

→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.

(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

Notes to the Consolidated Financial Statements continued

FOR THE YEAR ENDED 31 DECEMBER 2008

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.

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, are 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.

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:

	2008	2007
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**

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

All impairment losses are recognised in the income statement. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to the income statement.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement.

(ii) 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(s)), 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.

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The measurement of recoverable amount for the consolidated entity's exploration, evaluation and development expenditure requires significant estimation and judgement. Note 15 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) Investments

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment, and are classified as non-current assets.

After initial recognition, investments, which are classified as held for trading and available-for-sale, are measured at fair value. Gains or losses on investments held for trading are recognised in the income statement.

Gains or losses on available-for-sale investments are recognised as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be permanently impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in the income statement.

Purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place are recognised on the trade date i.e. the date that the Group commits to purchase the asset.

(j) 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.

(k) 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.

(l) 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.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the debt issue cost amortisation process.

(m) 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.

(n) 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.

(o) **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 which was in operation for the current year, a liability is recognised for bonuses for eligible employees based on a percentage of earnings before interest and tax (EBIT) of the U.S. operations.

Effective 1 January 2009, a revised employee incentive plan will be implemented whereby eligible employees may be entitled to a bonus based on the consolidated entity's performance for the forthcoming year based on a number of pre-determined performance criteria.

(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.

(p) **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.

(q) **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:

(i) 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.

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FOR THE YEAR ENDED 31 DECEMBER 2008

(ii) 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.

(iii) Dividend income

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

(iv) 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).

(r) **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.

(s) **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.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary differences 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.

(i) 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.

(ii) 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.

(t) **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 Statements 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.

(u) **Segment reporting**

A segment is a distinguishable component of the consolidated entity that is engaged in providing related products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The consolidated entity's primary format for segment reporting is based on geographical segments.

(v) **New standards and interpretations not yet adopted**

The following standards, amendments to standards and interpretations have been identified as those which may impact the entity in the period of initial application. They are available for early adoption at 31 December 2008, but have not been applied in preparing these consolidated financial statements:

- *AASB 8 Operating Segments* introduces the "management approach" to segment reporting. AASB 8, which becomes mandatory for the consolidated entity's 31 December 2009 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the consolidated entity's chief operating decision maker in order to assess each segment's performance and to allocate resources to them. Currently the consolidated entity presents segment information in respect of its geographical segments (see Note 28). Under the management approach, the consolidated entity expects to continue to present segment information in respect of its geographical segments.
- Revised AASB 101 *Presentation of Financial Statements* introduces as a financial statement (formerly "primary' statement) the "statement of comprehensive income". The revised standard does not change the recognition, measurement or disclosure of transactions and events that are required by other AASBs. The revised AASB 101 will become mandatory for the consolidated entity's 31 December 2009 financial statements. The consolidated entity has not yet determined the potential effect of the revised standard on the consolidated entity's disclosures.
- Revised AASB 123 *Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The revised AASB 123 will become mandatory for the consolidated entity's 31 December 2009 financial statements and will constitute a change in accounting policy for the consolidated entity. In accordance with the transitional provisions the consolidated entity will apply the revised AASB 123 to qualifying assets for which capitalisation of borrowing costs commences on or after the effective date. The consolidated entity has not yet determined the potential effect of the revised standard.

→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.

(i) **Investments in equity securities**

For investments that are actively traded in organised financial markets, fair value is determined by reference to the Australian Securities Exchange quoted market bid prices at the close of business on the balance sheet date.

For investments where there is no quoted market price, fair value is determined based on the expected cash flows of the underlying net asset base of the investment or cost.

(ii) **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.

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5 Revenue and other income and expenses

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Revenue				
Revenues from sale of oil and gas	**133,754**	62,760	**–**	–
Derivative hedging gains/(losses)	**(9,956)**	5,266	**–**	–
	123,798	68,026	**–**	–
Other income and expenses				
Drilling, production and prospect overhead income	**296**	362	**–**	–
Management fee income	**–**	–	**1,109**	2,251
Dividend income	**–**	–	**1,358**	1,470
Net foreign exchange gains/(losses)	**(1,616)**	1	**851**	(2,753)
Net gain/(loss) on disposal of producing properties	**671**	–	**–**	–
Net gain/(loss) on disposal of property, plant and equipment	**(7)**	(50)	**–**	–
Net gain/(loss) on disposal of investments	**(117)**	–	**–**	–
Sundry income/(expenses)	**57**	(4)	**–**	–
	(716)	309	**3,318**	968

6 Personnel expenses

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Wages and salaries	**2,993**	3,015	**252**	263
Service agreements for executives	**1,021**	765	**1,021**	765
Contract labour	**1,034**	851	**–**	–
Employee short-term incentive cash bonus and discretionary cash bonus	**–**	453	**–**	25
Superannuation & 401(k) plans	**158**	221	**29**	111
Retirement benefits	**26**	25	**26**	25
Share-based payment compensation	**441**	893	**208**	893
Other employee-related expenses	**93**	76	**35**	30
	5,766	6,299	**1,571**	2,112

→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	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Expenses Dry hole, impairment and abandonment expense [1]	**(71,885)**	(19,408)	**–**	–
Net movements in provisions against loans to and investments in controlled entities	**–**	–	**(31,165)**	(22)

1 Dry hole, impairment and abandonment expense of US$71,885,000 comprised exploration write-offs of US$13,826,000 and impairment provisions of US$58,059,000 reflecting the write down to the estimated recoverable amount of the consolidated entity's oil and gas properties based on accounting standard requirements and is attributable to the fall in commodity price, reserve adjustment or a combination of the two, and provisions recognised against unproved properties that have or will be relinquished:

Prospects/Areas of interest		US$000
Exploration write-offs	Beibu Gulf, China – Wei 6.12 W.1 & Wei 6.12 E.1/1A wells	8,590
	West Cameron 379 #1 well, Gulf of Mexico U.S.A	3,254
	CL&F #30-1 well (Triple Play prospect, Terrebonne Parish)	1,890
	Other	92
		13,826
Impairment provisions	Mobile Bay Area	8,694
	Main Pass 20	7,987
	Moonshine	7,549
	Vermilion 258	4,582
	Main Pass 270	4,164
	South Sunrise	3,159
	Miles Timber	3,768
	E. Laurent	4,494
	Leasehold/prospect costs written off – unproved properties relinquished/to be relinquished	12,449
	Other Gulf of Mexico properties	1,213
		58,059
		71,885

In 2007, the consolidated entity recognised dry hole, impairment and abandonment expense of US$19,408,000 in respect of the following:

Prospects/Areas of interest		US$000
Exploration write-offs	Eugene Island #1 well	3,363
	Bowie Lumber & Associates #1 well (Skywagon prospect, Moonshine project)	2,014
	CL&F #28-1 well (Acapulco prospect)	2,787
	CL&F #30-1 well (Triple Play prospect, Terrebonne Parish)	1,823
	Wei 6.12W.1 well (Wei 6.12 West Prospect) – portion of exploration costs incurred prior to 31 December 2007	617
		10,604
Impairment provisions	Mobile Bay 873	5,025
	Leasehold/prospect costs written off – unproved properties relinquished/to be relinquished	3,519
	West Cameron 343/352 additional abandonment cost	260
		8,804
		19,408

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8 Auditor's remuneration

	Consolidated		The Company	
	2008 US$	2007 US$	2008 US$	2007 US$
Audit services:				
Auditors of the Company				
KPMG Australia				
Audit and review of financial reports	**126,000**	85,000	**126,000**	85,000
Overseas KPMG Firms				
Audit and review of financial reports	**53,000**	45,000	**–**	–
Other services:				
Auditors of the Company				
KPMG Australia				
Sarbanes-Oxley Act 2002 Section 404 health check advisory services	**–**	35,000	**–**	35,000
Overseas KPMG Firms				
Corporate, tax and compliance services	**58,000**	3,000	**–**	–
	237,000	168,000	**126,000**	120,000

9 Finance income and expense

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Interest income – Related parties	**–**	–	**846**	2,380
Interest income – Other parties	**735**	1,456	**437**	552
Financial income	**735**	1,456	**1,283**	2,932
Interest expense	**(6,549)**	(1,899)	**–**	–
Unwinding of discount	**(1,241)**	(504)	**–**	–
Financial expense	**(7,790)**	(2,403)	**–**	–
Net financial income	**(7,055)**	(947)	**1,283**	2,932

→10 Income tax expense

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Recognised in the income statement				
Current tax expense	**(550)**	(83)	**(550)**	(83)
Deferred tax expense				
Origination and reversal of temporary differences	**15,894**	882	**–**	–
Total income tax benefit/(expense) in income statement	**15,344**	799	**(550)**	(83)

Numerical reconciliation between tax expense and pre-tax net profit	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Profit/(loss) before tax	**(59,816)**	(2,803)	**(29,296)**	558
Income tax expense/(benefit) using the Australian corporation tax rate of 30% (2007: 30%)	**(17,945)**	(841)	**(8,789)**	167
Increase/(decrease) in income tax expense due to:				
Non-assessable income	**–**	–	**(407)**	(441)
Non-deductible expenses	**3,355**	280	**9,415**	276
U.S. income taxes at different rate	**(2,422)**	(283)	**–**	–
Australian tax losses utilised	**(219)**	(2)	**(219)**	(2)
Deferred tax movements not brought to account in current year	**–**	(112)	**–**	–
U.S. withholding tax amount payable	**550**	83	**550**	83
Under/(over) provided in prior years	**1,337**	76	**–**	–
Income tax expense/(benefit) on pre-tax net profit	**(15,344)**	(799)	**550**	83

Deferred tax recognised directly in equity	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Relating to cash flow hedges	**(3,293)**	443	**–**	–
	(3,293)	443	**–**	–

Notes to the Consolidated Financial Statements continued

FOR THE YEAR ENDED 31 DECEMBER 2008

→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 5,239,500 (2007: 6,087,000) options outstanding under the Employee Option Plan. In determining potential ordinary shares, 5,239,500 (2007: 5,522,000) are not dilutive.

During the year, 90,000 options were granted, 38,000 options were exercised and converted to ordinary shares and 899,500 options were forfeited.

Basic earnings/(loss) per share

The calculation of basic earnings/(loss) per share at 31 December 2008 was based on the loss attributable to ordinary shareholders of US$44,471,000 (2007: loss of US$2,004,000) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2008 of 154,179,185 (2007: 153,517,877), calculated as follows:

Profit/(loss) attributable to ordinary shareholders	Consolidated 2008 US$'000	2007 US$'000
Profit/(loss) for the period	**(44,471)**	(2,004)

Weighted average number of shares (basic) *In thousands of shares*	Consolidated 2008	2007
Issued ordinary shares at 1 January	**154,151**	148,684
Effect of shares issued in 2008 and 2007, respectively	**28**	4,834
Weighted average number of ordinary shares at 31 December	**154,179**	153,518

Weighted average number of shares (diluted) *In thousands of shares*	Consolidated 2008	2007
Weighted average number of ordinary shares (basic) at 31 December	**154,179**	153,518
Effect of share options on issue	**–**	109
Weighted average number of ordinary shares (diluted) at 31 December	**154,179**	153,627

Earnings/(loss) per share *In USD cents*	Consolidated 2008	2007
Basic earnings/(loss) per share	**(28.8)**	(1.3)
Diluted earnings/(loss) per share	**(28.8)**	(1.3)

→12 Trade and other receivables

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Current				
Trade receivables	**8,011**	18,315	**–**	–
Other receivables	**23**	53	**23**	53
Loans receivable from controlled entities	**–**	–	**1,110**	2,253
Interest receivable from controlled entities	**–**	–	**–**	4,834
	8,034	18,368	**1,133**	7,140
Non-current				
Dividends receivable from controlled entities	**–**	–	**3,646**	3,380
Loans receivable from controlled entities	**–**	–	**17,136**	37,846
	–	–	**20,782**	41,226

→13 Other investments

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Non-current				
Equity securities with no quoted market price	**–**	497	**–**	–
Investment in controlled entities – at recoverable amount	**–**	–	**121,461**	156,792
	–	497	**121,461**	156,792

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.

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→14 Property, plant and equipment

	Consolidated				The Company			
	Leasehold improvements US$'000	Furniture and fittings US$'000	Office equipment US$'000	Total US$'000	Leasehold improvements US$'000	Furniture and fittings US$'000	Office equipment US$'000	Total US$'000
Cost								
Balance as at 1 January 2007	168	87	409	664	128	37	175	340
Additions	131	36	198	365	7	–	19	26
Disposals	–	–	(11)	(11)	–	–	–	–
Effect of movements in foreign exchange	15	4	22	41	15	4	22	41
Balance at 31 December 2007	314	127	618	1,059	150	41	216	407
Balance as at 1 January 2008	**314**	**127**	**618**	**1,059**	**150**	**41**	**216**	**407**
Additions	**14**	**31**	**83**	**128**	**–**	**–**	**10**	**10**
Disposals	**–**	**–**	**(1)**	**(1)**	**–**	**–**	**(1)**	**(1)**
Effect of movements in foreign exchange	**(29)**	**(8)**	**(42)**	**(79)**	**(29)**	**(8)**	**(42)**	**(79)**
Balance at 31 December 2008	**299**	**150**	**658**	**1,107**	**121**	**33**	**183**	**337**
Depreciation								
Balance as at 1 January 2007	149	39	271	459	127	34	140	301
Depreciation charge for the year	18	18	88	124	1	1	18	20
Disposals	–	–	(8)	(8)	–	–	–	–
Effect of movements in foreign exchange	15	4	17	36	15	4	17	36
Balance at 31 December 2007	182	61	368	611	143	39	175	357
Balance as at 1 January 2008	**182**	**61**	**368**	**611**	**143**	**39**	**175**	**357**
Depreciation charge for the year	**53**	**19**	**120**	**192**	**1**	**–**	**9**	**10**
Disposals	**–**	**–**	**(1)**	**(1)**	**–**	**–**	**(1)**	**(1)**
Effect of movements in foreign exchange	**(27)**	**(8)**	**(33)**	**(68)**	**(27)**	**(8)**	**(33)**	**(68)**
Balance at 31 December 2008	**208**	**72**	**454**	**734**	**117**	**31**	**150**	**298**
Carrying amounts								
At 1 January 2007	19	48	138	205	1	3	35	39
At 31 December 2007	132	66	250	448	7	2	41	50
At 1 January 2008	**132**	**66**	**250**	**448**	**7**	**2**	**41**	**50**
At 31 December 2008	**91**	**78**	**204**	**373**	**4**	**2**	**33**	**39**

→15 Exploration, evaluation and development expenditure

(a) Tangible	Consolidated 2008 US$'000	Consolidated 2007 US$'000
Costs carried forward in respect of areas of interest in the following phases:		
Production phase – at WDV		
Balance at 1 January	**159,447**	31,689
Acquisitions [1]	**–**	109,766
Additions	**14,430**	28,012
Reclassification from development phase	**–**	22,810
Reclassification from tangible exploration phase	**40**	–
Reclassification from intangible exploration phase	**129**	–
Impairment and abandonment expense	**(33,476)**	(5,285)
Current year amortisation expense	**(56,999)**	(27,545)
Balance at 31 December	**83,571**	159,447
Development phase – at cost		
Balance at 1 January	**–**	22,810
Additions	**6,537**	–
Reclassification from intangible exploration phase	**289**	–
Reclassification from tangible exploration phase	**14**	–
Reclassification to production phase	**–**	(22,810)
Impairment expense	**(3,768)**	–
Balance at 31 December	**3,072**	–
Exploration and/or evaluation phase – at cost		
Balance at 1 January	**11,134**	10,383
Additions	**14,948**	13,016
Reclassification to production phase	**(40)**	
Reclassification to development phase	**(14)**	–
Dry hole and impairment expense	**(14,607)**	(12,265)
Balance at 31 December	**11,421**	11,134
Total costs carried forward	**98,064**	170,581

(b) Intangible		
Costs carried forward in respect of areas of interest in the following phase:		
Exploration and/or evaluation phase – at cost		
Balance at 1 January	**25,374**	23,892
Additions	**3,714**	3,340
Reclassification to tangible production phase	**(129)**	–
Reclassification to tangible development phase	**(289)**	–
Impairment expense	**(20,034)**	(1,858)
Balance at 31 December	**8,636**	25,374

1 Further details relating to these acquisitions are provided on the following page.

Notes to the Consolidated Financial Statements continued

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Acquisitions of producing oil and gas properties

No acquisitions of producing oil and gas properties were made during the current year.

In the previous corresponding period, the consolidated entity acquired interests in additional producing properties for total net consideration of US$110,657,000. These additions comprised:

- An interest in the leases and production facilities at Mobile Bay 952, 953 and 955. This interest was acquired in return for assuming the rehabilitation obligation on these leases. At the time of the acquisition, the consolidated entity estimated the fair value of the rehabilitation obligation to be US$1,837,000; and
- The November 2007 acquisition of seven onshore and offshore Louisiana gas fields for a total consideration of US$108,820,000 including US$891,000 of purchase price adjustments paid during 2008, comprising cash and the assumption of rehabilitation obligations (refer to table below for further details on the properties).

Gas Field	Location	Operator	Working Interest %	Net Revenue Interest%
Main Pass 20	Offshore	Petsec Energy	100%	81.8%
Main Pass 270	Offshore	ENI Petroleum	25%	20.8%
Chandeleur 31/32	Offshore	Petsec Energy	100%	81.8%
Humphreys [1]	Onshore	Petsec Energy	70% – 78%	52% – 58%
South Sunrise	Onshore	Badger Oil	75%	56%
South Thornwell	Onshore	Manti	46%	32%
Lapeyrouse	Onshore	Petsec Energy	74%	55%

1 The consolidated entity subsequently sold its interest in the Humphreys field, located in Terrebonne Parish, onshore Louisiana, USA effective 31 December 2008.

At the date of this acquisition, the consolidated entity estimated the fair value of the rehabilitation obligation to be US$5,518,000. This initial balance was also capitalised as part of the cost of the acquisition.

This acquisition was entirely funded through a combination of borrowing base debt under a revolving facility and term loans. Refer to Note 22 for further details of these arrangements.

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;
- Pre-tax discount rate of 10%.

→16 Deferred tax assets

Recognised deferred tax assets and liabilities

Consolidated	Assets 2008 US$'000	Assets 2007 US$'000	Liabilities 2008 US$'000	Liabilities 2007 US$'000	Net 2008 US$'000	Net 2007 US$'000
Exploration, evaluation and development expenditure	**7,923**	–	**–**	(7,965)	**7,923**	(7,965)
Cash flow hedges	**–**	–	**(4,493)**	(1,200)	**(4,493)**	(1,200)
Other items	**574**	2,809	**–**	–	**574**	2,809
Tax value of loss carry-forwards recognised	**13,321**	11,069	**–**	–	**13,321**	11,069
Deferred tax assets/(liabilities)	**21,818**	13,878	**(4,493)**	(9,165)	**17,325**	4,713
The Company						
Provisions	**174**	226	**–**	–	**174**	226
Deferred tax balances not brought to account	**(174)**	(226)	**–**	–	**(174)**	(226)
Deferred tax assets/(liabilities)	**–**	–	**–**	–	**–**	–

Unrecognised deferred tax assets

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

	Consolidated 2008 US$'000	Consolidated 2007 US$'000	The Company 2008 US$'000	The Company 2007 US$'000
Deductible temporary differences in Australia (net)	**174**	218	**174**	218
Tax operating loss carry-forwards in Australia (net)	**1,170**	1,772	**1,170**	1,772
	1,344	1,990	**1,344**	1,990

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 2008

Movement in temporary differences during the year

	Consolidated				
	Balance 1 Jan 07 US$'000	Recognised in income US$'000	Recognised in equity US$'000	Reclassified to other balance sheet account US$'000	Balance 31 Dec 07 US$'000
Exploration, evaluation and development expenditure	(9,400)	1,435	–	–	(7.965)
Cash flow hedges	(1,643)	–	443	–	(1,200)
Other items	574	2,105	–	130	2,809
U.S. operating loss carry-forwards	13,727	(2,658)	–	–	11,069
	3,258	882	443	130	4,713

	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**

	The Company				
	Balance 1 Jan 07 US$'000	Recognised in income US$'000	Recognised in equity US$'000	Reclassified to other balance sheet account US$'000	Balance 31 Dec 07 US$'000
Loans receivable from controlled entities	1,480	(1,480)	–	–	–
Interest receivable from controlled entities	(891)	891	–	–	–
Provisions	195	31	–	–	226
Deferred tax balances in Australia not brought to account	(784)	558	–	–	(226)
	–	–	–	–	–

	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)**
	–	**–**	**–**	**–**	**–**

→17 Trade and other payables

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Trade and other payables, stated at cost				
Trade payables	**8,105**	3,244	**70**	151
Exploration and development accruals	**2,234**	2,967	**–**	–
Joint operating arrangement advances	**158**	156	**–**	–
Operational and administration accruals	**2,372**	7,694	**272**	431
Related party payables	**27**	13	**27**	13
	12,896	14,074	**369**	595
Non-current liabilities				
Exploration and development accruals	**–**	1,626	**–**	–
Operational and administration accruals	**–**	383	**–**	–
Loans payable to controlled entities	**–**	–	**5,691**	6,676
	–	2,009	**5,691**	6,676

→18 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 22.

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Current liabilities				
Secured bank loans	**2,475**	23,800	**–**	–
Transaction costs	**–**	(178)	**–**	–
	2,475	23,622	**–**	–
Non-current liabilities				
Secured bank loans	**48,025**	80,200	**–**	–
Original issue discount	**(206)**	(288)	**–**	–
Transaction costs	**(1,512)**	(1,768)	**–**	–
	46,307	78,144	**–**	–
	48,782	101,766	**–**	–

Notes to the Consolidated Financial Statements continued

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Terms and debt repayment schedule

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

				Consolidated			
				31 December 2008		31 December 2007	
	Currency	Average nominal interest rate at period end %	Year of maturity	Face value US$'000	Carrying amount US$'000	Face value US$'000	Carrying amount US$'000
Revolving credit facility							
Loans	USD	5.00	2010	**20,800**	**20,218**	50,500	49,623
Letters of credit	USD	–	2010	**8,375**	**–**	7,375	–
1st lien term loan	USD	–	2008	**–**	**–**	23,500	23,322
2nd lien term loan	USD	7.71	2011	**29,700**	**28,564**	30,000	28,821
Total outstanding loans and letters of credit				**58,875**	**48,782**	111,375	101,766

At 31 December 2008, the borrowing base under the revolving credit facility was US$53 million (2007: US$75 million).

For further details relating to the credit facility and terms loans see Note 22.

The bank loans are secured by the oil and gas and cash assets of the Company's U.S.A. subsidiary Petsec Energy Inc. with a carrying amount of US$91,469,000 (2007: US$173,748,000) (see Note 28).

→19 Employee benefits

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Current liabilities				
Liability for annual leave	**11**	12	**11**	12
Employee related liabilities	**139**	135	**9**	11
	150	147	**20**	23
Non-current liabilities				
Liability for directors' retirement benefit and employee long-service leave	**274**	311	**274**	311

(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$29,000 for the year ended 31 December 2008 (2007: US$111,000).

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$129,000 for the year ended 31 December 2008 (2007: US$110,000).

(b) **Employee incentive plans**

Performance-linked cash bonuses are payable to eligible employees under an Employee Incentive Plan. Under the bonus criteria which 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 Employee 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 (2007: US$453,000).

In December 2008, the bonus criteria under the Employee Incentive Plan 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 forthcoming 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.

(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 2008	Number of options 2008	Weighted average exercise price 2007	Number of options 2007
Outstanding at the beginning of the period	**A$2.46**	**6,087**	A$1.97	2,614
Granted during the period	**A$1.19**	**90**	A$2.52	4,080
Exercised during the period	**A$0.40**	**(38)**	A$0.38	(457)
Forfeited during the period	**A$2.77**	**(899)**	A$1.94	(150)
Outstanding at the end of the period	**A$2.40**	**5,240**	A$2.46	6,087
Exercisable at the end of the period	**A$2.27**	**1,686**	A$2.06	616

The options outstanding at 31 December 2008 have an exercise price in the range of A$1.15 to A$3.11 and a weighted average contractual life of 3.05 years.

During the year, 38,000 share options were exercised (2007: 456,500). The weighted average share price at the dates of exercise was A$0.73 and A$1.52 during the years ended 31 December 2008 and 2007, respectively.

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.

Notes to the Consolidated Financial Statements continued

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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 31 October 2004	50,000	4.42 years
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
Total share option schemes with all or a portion of options outstanding at 31 December 2008	**5,452,000**	

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. The following table summarises the fair value assumptions of share options granted to key management personnel during the years ended 31 December 2008 and 2007.

	Consolidated	
	Key management personnel 2008	Key management personnel 2007
Weighted average fair value at measurement date	–	A$0.10
Weighted average share price	–	A$1.65
Weighted average exercise price	–	A$2.63
Expected volatility (expressed as weighted average used in the modelling under Black-Scholes model)	–	42.6%
Expected option life (expressed as weighted average used in the modelling under Black-Scholes model)	–	4.51 years
Expected dividends	–	–
Risk-free interest rate (based on national government bonds)	–	5.91% – 6.23%

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.

→20 Rehabilitation provisions

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Balance at 1 January	**12,395**	3,668	**–**	–
Assumed on acquisition [1]	**–**	7,355	**–**	–
Provisions made during the year	**1,025**	811	**–**	–
Provisions used during the year	**(1,307)**	(1,993)	**–**	–
Provisions revised during the year	**(423)**	2,198	**–**	–
Unwind of discount	**1,110**	356	**–**	–
Balance at 31 December	**12,800**	12,395	**–**	–

1 During the previous year, the consolidated entity acquired interests in additional producing properties for which it also assumed the rehabilitation obligations (see Note 15). The rehabilitation provision balance as at 31 December comprises current provision amounts of US$674,000 and non-current provision amounts of US$12,126,000.

→21 Capital and reserves

Reconciliation of movement in capital and reserves attributable to equity holders of the parent

Consolidated	Share capital US$'000	Translation reserve US$'000	Cash flow hedge reserve US$'000	Share-based compensation US$'000	Accumulated losses US$'000	Total equity US$'000
Balance at 1 January 2007	160,502	(6)	3,052	390	(48,854)	115,084
Total recognised income and expense	–	1,083	(824)	–	(2,004)	(1,745)
Shares issued [1]	8,878	–	–	–	–	8,878
Share options exercised by employees	145	–	–	–	–	145
Vesting of share options	304	–	–	(304)	–	–
Share-based payments' expense	–	–	–	935	–	935
Balance at 31 December 2007	169,829	1,077	2,228	1,021	(50,858)	123,297
Balance at 1 January 2008	**169,829**	**1,077**	**2,228**	**1,021**	**(50,858)**	**123,297**
Total recognised income and expense	**–**	**581**	**6,116**	**–**	**(44,471)**	**(37,774)**
Dividends paid [2]	**–**	**–**	**–**	**–**	**(12)**	**(12)**
Shares issued	**–**	**–**	**–**	**–**	**–**	**–**
Share options exercised by employees	**13**	**–**	**–**	**–**	**–**	**13**
Vesting of share options	**434**	**–**	**–**	**(434)**	**–**	**–**
Share-based payments' expense	**–**	**–**	**–**	**364**	**–**	**364**
Balance at 31 December 2008	**170,276**	**1,658**	**8,344**	**951**	**(95,341)**	**85,888**

1 Includes equity transaction costs of US$399,000.

2 Relates to dividend paid by Osglen Pty Ltd to a third party owner (Petsec Energy Ltd held a 66.6% ownership interest in Osglen prior to applying for the voluntary deregistration of this company).

Notes to the Consolidated Financial Statements continued

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The Company	Share capital US$'000	Translation reserve US$'000	Share-based compensation US$'000	Retained earnings US$'000	Total equity US$'000
Balance at 1 January 2007	160,502	6,970	390	5,947	173,809
Total recognised income and expense	–	21,630	–	475	22,105
Shares issued [1]	8,878	–	–	–	8,878
Share options exercised by employees	145	–	–	–	145
Vesting of share options	304	–	(304)	–	–
Share-based payments' expense	–	–	935	–	935
Balance at 31 December 2007	169,829	28,600	1,021	6,422	205,872
Balance at 1 January 2008	**169,829**	**28,600**	**1,021**	**6,422**	**205,872**
Total recognised income and expense	**–**	**(34,556)**	**–**	**(29,846)**	**(64,402)**
Shares issued	**–**	**–**	**–**	**–**	**–**
Share options exercised by employees	**13**	**–**	**–**	**–**	**13**
Vesting of share options	**434**	**–**	**(434)**	**–**	**–**
Share-based payments' expense	**–**	**–**	**364**	**–**	**364**
Balance at 31 December 2008	**170,276**	**(5,956)**	**951**	**(23,424)**	**141,847**

1 Includes equity transaction costs of US$399,000.

Share capital

Ordinary shares *In thousands of shares*	The Company 2008	2007
On issue at 1 January	**154,151**	148,684
Shares issued for cash	**–**	5,010
Share options exercised by employees	**38**	457
On issue at 31 December – fully paid	**154,189**	154,151

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.

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 2008 and is expected to remain a priority in 2009.

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

→22 Financing arrangements and additional financial instruments disclosures

Financing arrangements

At 31 December 2008, the consolidated entity had available debt facilities of US$82.7 million (2007: US$128.5 million), under which US$50.5 million of loans and US$8.4 million of letters of credit were outstanding (2007: US$104 million of loans and US$7.4 million of letters of credit). The debt facilities were entered into in November 2007 primarily to fund the 2007 acquisition of seven gas fields 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. In November 2008, the borrowing base was set at US$55 million with monthly reductions of US$2 million per month until the next redetermination review due in May 2009.

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 2008 the average interest rate under the revolving facility is 5.0% (2007: 7.91%).

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

Total outstanding letters of credit as at 31 December 2008 were US$8.4 million (2007: US$7.4 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 and obligations to a Main Pass 19 joint owner.

(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 2008 is 7.71% (2007: 11.08%) and is paid monthly.

In December 2007, PEI entered into an interest rate swap which 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 2008 was US$29.7 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 quarterly instalments during 2011.

Security

Both the Revolving Facility and the Second Lien agreements are secured by mortgages over oil and gas properties that represent at least 90% of PEI's proved reserves.

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.

Notes to the Consolidated Financial Statements continued

FOR THE YEAR ENDED 31 DECEMBER 2008

Foreign exchange exposures

During 2007 and 2008, operating costs were incurred in both Australian and US dollars.

Throughout 2007 and 2008, 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 primarily 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.

Put options

The consolidated entity's purchased put option agreements establish floor prices. 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.

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.

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.

At 31 December 2007, the consolidated entity had the following outstanding natural gas hedges in place:

Production period	Hedge type	Daily volume	Weighted average USD Price
First quarter 2008	Swaps	35,500 MMBtu	8.46
Second quarter 2008	Swaps	29,000 MMBtu	7.79
July – December 2008	Swaps	8,664 MMBtu	8.23
	Puts	11,266 MMBtu	6.37
2009	Swaps	8,842 MMBtu	8.43
	Puts	2,312 MMBtu	6.33

The consolidated entity has determined that all swap agreements outstanding as at 31 December 2008 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 time value component of changes in value of put options are recorded in earnings each period. During 2008, a net gain of US$0.4 million (2007: a loss of US$0.4 million) arising from changes in the time value component were recognised in the income statement. The consolidated entity has determined that the intrinsic value portion of the put options, are highly effective and qualifies for hedge accounting treatment. Accordingly, gains, if any, associated with the intrinsic value of put options will be included in oil and natural gas revenues, net of premiums paid for the options, when the underlying production is delivered.

Payments of put premiums totalling US$0.4 million (2007: US$1.2 million) have been deferred until the time of settlement of a portion of the put options.

At 31 December 2008, the consolidated entity had 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. At 31 December 2007, the consolidated entity recorded derivative assets of US$4.9 million and derivative liabilities of US$0.8 million representing the fair value of the commodity hedge instruments at that date of which all of the associated gains were deferred in equity, net of taxes of US$1.3 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.

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 which 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 is expected to continue 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 rating 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 has 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 receives a floating interest rate based on the three-month LIBOR rate and pays a fixed rate of 4.15%.

The consolidated entity has determined that interest rate swap agreements outstanding at 31 December 2008 are highly effective and thus qualify for hedge accounting treatment. Accordingly, gains or losses on the swaps will be 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 (2007: liability of US$0.3 million) representing the fair value of the interest rate swap of which all of the deferred loss has been deferred in equity net of US$0.3 million (2007: US$0.1 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$4,421,000 (2007: US$4,112,000). 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$505,000 (2007: US$119,000). 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$318,000 (2007: US$320,000).

Fair values of financial assets and liabilities

Fair values

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

	2008		2007	
Consolidated	**Carrying amount US$'000**	**Fair value US$'000**	Carrying amount US$'000	Fair value US$'000
Trade and other receivables	**8,034**	**8,034**	18,368	18,368
Cash and cash equivalents	**13,735**	**13,735**	27,214	27,214
Natural gas hedge contracts (cash flow hedges): Assets	**14,366**	**14,366**	5,675	5,675
Natural gas hedge contracts (cash flow hedges): Liabilities	**–**	**–**	(409)	(409)
Interest rate swaps (cash flow hedges): Liabilities	**(868)**	**(868)**	(256)	(256)
Secured bank loans	**(48,782)**	**(50,500)**	(101,766)	(104,000)
Trade and other payables	**(12,896)**	**(12,896)**	(14,074)	(14,295)
	(26,411)	**(28,129)**	(65,248)	(67,703)
Unrecognised (loss)/gain		**(1,718)**		(2,455)

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 2008

→23 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Less than one year	**528**	513	**176**	168
Between one and five years	**924**	1,390	**–**	172
	1,452	1,903	**176**	340

The consolidated entity leases office space in Australia and the USA under operating leases. The leases typically run for a period of five 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 2009. Sub-lease payments of A$36,000 are expected to be received during the following financial year.

During the year ended 31 December 2008, US$1,537,000 was recognised as an expense in the income statement in respect of operating leases (2007: US$1,122,000). US$31,000 (2007: US$30,000) was recognised as income in the income statement in respect of sub-leases.

→24 Capital and other commitments

	Consolidated		The Company	
	2008 US$'000	2007 US$'000	2008 US$'000	2007 US$'000
Capital expenditure commitments				
Exploration, evaluation and development expenditure				
Contracted but not provided for and payable:				
Within one year	**1,072**	659	**–**	–
One year or later and no later than five years	**534**	955	**–**	–
	1,606	1,614	**–**	–
Joint operating arrangements commitments				
Share of capital commitments of the joint operating arrangements:				
Within one year	**822**	12,600	**–**	–

→25 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 2008, the consolidated entity was contingently liable for US$12,200,000 of surety and supplemental bonds (2007: US$8,450,000) issued through a surety company to secure those obligations. US$6,625,000 of these bonds (2007: US$3,875,000) were collateralised by letters of credit.

A further US$1,750,000 in letters of credit (2007: US$3,500,000) collateralise PEI's obligations to a joint venture partner.

→26 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 2008 and 2007, are set out as follows:

	Consolidated	
Summarised income statement and retained earnings	2008 US$'000	2007 US$'000
Retained earnings at beginning of year	**6,383**	467
Profit/(loss) after related income tax expense	**(29,838)**	5,916
Retained earnings/(accumulated losses) at end of year	**(23,455)**	6,383
Balance sheet		
Assets		
Cash and cash equivalents	**4,725**	8,167
Other receivables	**1,133**	7,140
Prepayments	**61**	102
Total current assets	**5,919**	15,409
Loan receivable from controlled entities	**14,852**	34,886
Other financial assets	**3,645**	3,881
Other investments	**118,054**	152,570
Property, plant and equipment	**40**	50
Total non-current assets	**136,591**	191,387
Total assets	**142,510**	206,796
Liabilities		
Trade and other payables	**378**	606
Employee benefits provision	**11**	12
Total current liabilities	**389**	618
Employee benefits provision	**274**	311
Total non-current liabilities	**274**	311
Total liabilities	**663**	929
Net assets	**141,847**	205,867
Equity		
Issued capital	**170,276**	169,829
Reserves	**(4,974)**	29,655
Retained earnings/(accumulated losses)	**(23,455)**	6,383
Total equity	**141,847**	205,867

Notes to the Consolidated Financial Statements continued

FOR THE YEAR ENDED 31 DECEMBER 2008

→27 Consolidated entities

	Country of Incorporation	Ownership interest % 2008	Ownership interest % 2007
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
Osglen Pty. Limited [1]	Australia	**–**	66.7
Laurel Bay Petroleum Limited	Australia	**100**	100
Ginida Pty. Limited	Australia	**100**	100
Western Medical Products Pty. Limited	Australia	**100**	100

1 In December 2008, the owners applied to voluntarily deregister Osglen Pty. Limited.

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.

→28 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 are the primary basis of segment reporting.

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 used 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	
Primary reporting format **Geographic segments**	**2008** **US$'000**	2007 US$'000	**2008** **US$'000**	2007 US$'000	**2008** **US$'000**	2007 US$'000	**2008** **US$'000**	2007 US$'000
Oil and gas sales and royalties	–	–	123,798	68,026		–	123,798	68,026
Royalties paid	–	–	(18,517)	(4,051)		–	(18,517)	(4,051)
Net revenues after royalties *	–	–	105,281	63,975		–	105,281	63,975
Segment result from continuing operations	(3,810)	(2,642)	(46,659)	746	(9,346)	(907)	(59,815)	(2,803)
Income tax benefit							15,344	799
Profit after tax							(44,471)	(2,004)
Depreciation, depletion, amortisation and rehabilitation	13	19	57,239	27,694		–	57,252	27,713
Dry hole, impairment and abandonment expense	–	–	63,295	18,791	8,590	617	71,885	19,408
Major workover and repair expense	–	–	1,325	–	–	–	1,325	–
Segment assets	4,857	8,934	145,167	235,518	11,634	10,212	161,658	254,664
Acquisition of property, plant and equipment and exploration, evaluation and development assets	10	26	34,070	144,788	9,666	1,630	43,746	146,444
Segment liabilities	674	929	74,785	130,438	311	–	75,770	131,367
Cash flows from operating activities	(1,469)	(796)	86,624	35,943	–	–	85,155	35,147
Cash flows from investing activities	294	(57)	(34,070)	(144,788)	(9,666)	(1,630)	(43,442)	(146,475)
Cash flows from financing activities	9	9,023	(53,681)	101,650	–	–	(53,672)	110,673

* There are no inter-segment sales

Notes to the Consolidated Financial Statements continued

FOR THE YEAR ENDED 31 DECEMBER 2008

29 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 (tangible and intangible) and liabilities in joint operating arrangements:

Assets	Consolidated 2008 US$'000	Consolidated 2007 US$'000
Exploration, evaluation and development expenditure – Tangible:		
Leases now in production		
Producing leases – at cost	133,571	126,025
Less: accumulated amortisation and impairment	(73,359)	(27,181)
	60,212	98,844
Represented by the following lease carrying values:		
- Main Pass 19	18,566	17,990
- Mobile Bay Area	4,373	23,857
- Main Pass 89	113	182
- Main Pass 270	35,648	41,751
- South Thornwell	–	457
- Humphreys [1]	–	2,732
- Lapeyrouse	–	660
- South Sunrise	1,321	11,215
- E. Laurent	191	–
	60,212	98,844
Leases not yet in production		
- Block 22/12 Beibu Gulf	10,330	9,040
- Moonshine, Onshore Louisiana [2]	3,119	128
- Other Gulf of Mexico leases	7	51
	13,456	9,219
Total exploration, evaluation and development expenditure – Tangible	73,668	108,063
Exploration and evaluation expenditure – Intangible:		
Not in production		
- Block 22/12 Beibu Gulf	1,304	1,172
- Moonshine, Onshore Louisiana	2,953	11,492
- Other Gulf of Mexico leases	258	9,972
	4,515	22,636

Liabilities	Consolidated 2008 US$'000	Consolidated 2007 US$'000
Rehabilitation provision:		
- Main Pass 19	1,090	881
- Mobile Bay Area	2,277	2,087
- Main Pass 270	269	241
- South Thornwell	93	93
- Humphreys	–	172
- Lapeyrouse	306	283
- South Sunrise	193	162
- E. Laurent	153	–
- Miles Timber	96	–
	4,477	3,919

The contribution of the consolidated entity's joint operating arrangements to EBIT:	Consolidated 2008 US$'000	Consolidated 2007 US$'000
- Main Pass 19	10,056	8,736
- Mobile Bay Area	(6,293)	(5,278)
- West Cameron 379	(3,254)	–
- E. Laurent	(5,372)	–
- Miles Timber	(3,768)	–
- Eugene Island 310	(15)	(3,363)
- Main Pass 270	(1,628)	433
- South Thornwell	245	173
- Humphreys	408	(72)
- Lapeyrouse	91	(77)
- South Sunrise	(3,451)	(256)
- Terrebonne Parish, Onshore Louisiana	(1,967)	(4,800)
- Moonshine, Onshore Louisiana	(7,985)	(2,801)
- West Cameron 343/352	(102)	(369)
- Block 22/12 Beibu Gulf	(9,346)	(907)
- Other Gulf of Mexico leases	(11,329)	(709)
	(43,710)	(9,290)

1 The consolidated entity's interest in the Humphreys field was sold for US$400,000 (excluding transaction costs of US$19,000) plus the assumption of the relevant share of plugging and abandonment liability, effective 31 December 2008.

2 Current year includes carrying value of US$3,072,000 for the Miles Timber #1 well which commenced first production in February 2009.

The principal activity of all the joint operating arrangements is oil and gas exploration. Listed below is the name of each of the joint operating arrangements, and the percentage interest held in the joint operating arrangements, by the consolidated entity:

	Consolidated	
	Interest held 2008	Interest held 2007
West Cameron 343/352	**–**	56.25% – 100.00%
Main Pass 19	**55.00%**	55.00%
Mobile Bay Area	**40.00% – 50.00%**	50.00%
Main Pass 270	**25.00%**	25.00%
South Thornwell	**46.25%**	46.00%
Humphreys [1]	**–**	70.00% – 78.00%
Lapeyrouse	**72.84%**	74.00%
South Sunrise	**75.00%**	75.00%
Terrebonne Parish, Onshore Louisiana	**–**	14.40% – 20.00%
Block 22/12 Beibu Gulf	**25.00%**	25.00%
Moonshine, Onshore Louisiana	**50.00% – 87.50%**	50.00%
Other Gulf of Mexico leases	**25.00% – 54.00%**	25.00% to 50.00%

1 The consolidated entity's interest in the Humphreys field was sold for US$400,000 (excluding transaction costs of US$19,000) plus the assumption of the relevant share of plugging and abandonment liability, effective 31 December 2008.

→30 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	
Assets	**2008 US$'000**	2007 US$'000
Exploration, evaluation and development expenditure – Tangible:		
Leases now in production		
Producing leases – at cost	**105,624**	102,296
Less: accumulated amortisation	**(82,265)**	(41,701)
	23,359	60,595
Represented by the following lease carrying values:		
- Vermilion 258	**2,653**	6,264
- Main Pass 18	**10,826**	13,268
- Main Pass 20	**72**	13,855
- Chandeleur 31/32	**9,808**	27,208
	23,359	60,595
Not in production		
- Vermilion 257	**144**	600
- Other Gulf of Mexico leases	**7**	–
- Spare equipment	**886**	1,323
	1,037	1,923
Total exploration, evaluation and development expenditure – Tangible	**24,396**	62,518

	Consolidated	
Assets	**2008 US$'000**	2007 US$'000
Exploration and evaluation expenditure – Intangible :		
Not in production		
- Main Pass 7	**952**	934
- Main Pass 91	**1,198**	1,026
- Main Pass 103	**–**	778
- West Cameron 631 [1]	**868**	–
- West Cameron 636 [1]	**341**	–
- North Padre Island 929 [2]	**381**	–
- North Padre Island 934 [2]	**381**	–
Total exploration and evaluation expenditure – Intangible	**4,121**	2,738

1 Leases acquired in the Eastern Gulf of Mexico Lease sale conducted by the MMS in March 2008.

2 Leases acquired in the Western Gulf of Mexico Lease sale conducted by the MMS in August 2008.

Notes to the Consolidated Financial Statements continued

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Liabilities	Consolidated 2008 US$'000	2007 US$'000
Rehabilitation provision:		
- Vermilion 258	**2,589**	2,704
- Vermilion 257	**–**	1,000
- Main Pass 18	**119**	112
- Main Pass 20	**3,393**	2,731
- Chandeleur 31/32	**2,222**	1,929
	8,323	8,476
The contribution of the consolidated entity's areas of interest to EBIT:		
- Chandeleur 31/32	**20,810**	1,836
- Main Pass 18	**1,778**	(1,124)
- Main Pass 20	**(5,145)**	(173)
- Vermilion 258	**(1,413)**	15,293
- Vermilion 257	**(456)**	(548)
- Main Pass 103	**(971)**	–
- Vermilion 246	**–**	(442)
- Vermilion 41	**–**	(454)
- Vermilion 148	**–**	(390)
	14,603	13,998

→31 Reconciliation of cash flows from operating activities

Cash flows from operating activities	Consolidated 2008 US$'000	Consolidated 2007 US$'000	The Company 2008 US$'000	The Company 2007 US$'000
Profit/(loss) for the period	**(44,471)**	(2,004)	**(29,846)**	475
Adjustments for:				
Depreciation, depletion & amortisation and rehabilitation	**57,252**	27,713	**13**	19
Dry-hole, impairment and abandonment expense	**71,885**	19,408	**–**	–
Major workover and repair expense	**1,325**	–	**–**	–
Net movement in provisions against investments and loans to controlled entities	**–**	–	**31,165**	22
Management fee income	**–**	–	**(1,109)**	(2,251)
Dividend income	**–**	–	**(1,331)**	(1,470)
Net foreign exchange losses/(gains)	**1,616**	(1)	**(851)**	2,753
Net loss/(gain) on property, plant and equipment	**(664)**	50	**–**	–
Share-based payment expenses	**441**	893	**208**	893
Operating profit before changes in working capital and provisions	**87,384**	46,059	**(1,751)**	441
Decrease/(Increase) in receivables, prepayments and other assets	**10,987**	(11,168)	**8,850**	(4,926)
Decrease/(Increase) in deferred tax assets	**(12,609)**	(1,455)	**–**	–
(Decrease)/Increase in payables and provisions	**(607)**	1,711	**(88)**	3,720
Net cash from operating activities	**85,155**	35,147	**7,011**	(765)

→32 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 – Appointed 14/10/08
Executives	R A Keogh (President, Petsec Energy Inc.)
	F Steele (Vice President Land, Petsec Energy Inc.)
	D Swords (General Counsel/Corporate Secretary, Petsec Energy Inc.)
	M Radabaugh (Vice President Business Development and Planning, Petsec Energy Inc.) – Resigned 20/6/08
	F Robertson (Chief Financial Officer, Petsec Energy Ltd)
	C Jones (General Manager – Corporate and Company Secretary, Petsec Energy Ltd)
	P Gahdmar (Group Financial Controller and Company Secretary, Petsec Energy Ltd) – Appointed 5/12/08

Key management personnel compensation

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

	Consolidated		The Company	
	2008 US$	2007 US$	2008 US$	2007 US$
Wages and salaries	**964,219**	696,724	**244,638**	108,836
Service agreements for executives	**1,021,119**	765,154	**1,021,119**	765,154
Employee short-term incentive cash bonus and discretionary cash bonus	**–**	156,744	**–**	16,744
Superannuation & 401(k) plans	**56,783**	122,516	**22,018**	93,516
Retirement benefits	**25,766**	25,116	**25,766**	25,116
Share-based payment compensation	**379,204**	525,682	**207,679**	525,682
Other benefits	**89,414**	75,777	**31,800**	29,733
	2,536,505	2,367,713	**1,553,020**	1,564,781

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 19 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.

Current non-executive directors are entitled to receive a retirement benefit which is equivalent to the remuneration received in the three years prior to retirement. Directors' retirement obligations are presently US$255,000 in total (2007: US$289,000).

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.

A number of key management personnel, or their personally related entities, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities.

A number of these entities transacted with the Company or its subsidiaries in the reporting period. The terms and conditions of those transactions were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to unrelated entities on an arm's length basis.

The aggregate amounts recognised during the year relating to key management personnel and their personally related entities,

Notes to the Consolidated Financial Statements continued

FOR THE YEAR ENDED 31 DECEMBER 2008

were a total expense of US$1,021,000 (2007: US$849,000). Refer to Remuneration Report for further details.

The consolidated entity held unlisted shares in an investment fund of which Mr Mortimer is Chairman. These shares were disposed of during the year.

Assets and liabilities arising from the above related party transactions

	2008 US$'000	2007 US$'000
Non-current assets		
Other investments	–	489
Current liabilities		
Related party payables	11	13

Other related party disclosures

Information relating to subsidiaries is set out in Note 27.

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

Refer to Notes 12 and 17 for information regarding balances outstanding with subsidiaries at year end.

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 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
M Radabaugh [2]	600,000	–	–	600,000	–	150,000	–
F Robertson	225,000	–	–	–	225,000	56,250	–
P Gahdmar	75,000	–	–	–	75,000	18,750	–
C Jones	225,000	–	–	–	225,000	56,250	–

	Held at 1 January 2007	Granted as compensation	Exercised	Other changes [1]	Held at 31 December 2007	Vested during the year	Vested and exercisable at 31 December 2007
Directors							
T Fern	–	2,000,000	–	–	2,000,000	–	–
Executives							
R Keogh	325,000	1,000,000	325,000	–	1,000,000	–	–
F Steele	–	200,000	–	–	200,000	–	–
M Radabaugh [2]	500,000	100,000	–	–	600,000	100,000	–
D Swords	250,000	–	–	–	250,000	62,500	125,000
F Robertson	225,000	–	–	–	225,000	56,250	–
P Gahdmar	40,000	75,000	40,000	–	75,000	–	–
C Jones	225,000	–	–	–	225,000	56,250	–

1 Other changes represent options that expired or were forfeited during the year.
2 M Radabaugh resigned from his position of Vice President, Business Development and Planning of Petsec Energy Inc. on 20 June 2008.

No options held by key management personnel are vested but not exercisable at 31 December 2007 or 2008.
No options were held by key management person related parties.

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 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	–	–	–	–	–
M Radabaugh	–	–	–	–	–
F Robertson	**115,083**	–	–	–	**115,083**
P Gahdmar	**40,000**	–	–	–	**40,000**
C Jones	**150,000**	–	–	–	**150,000**

	Held at 1 January 2007	Purchases	Received on exercise of options	Sales/Disposal of relevant interest	Held at 31 December 2007
Directors					
T Fern	24,819,300	6,249	–	–	24,825,549
D Mortimer	610,068	–	–	–	610,068
P Power	225,323	–	–	–	225,323
Executives					
R Keogh	850,000	–	325,000	100,000	1,075,000
F Steele	–	–	–	–	–
D Swords	–	–	–	–	–
M Radabaugh	–	–	–	–	–
F Robertson	89,000	26,083	–	–	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 2007 or 2008.

→33 Events subsequent to balance date

There have been no events subsequent to balance date which would have a material effect on the consolidated entity's financial statements at 31 December 2008.

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 26 to 67, 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 2008 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 26 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 2008.

Signed in accordance with a resolution of the directors:

T N Fern
Director

Sydney, 26 February 2009

Independent Auditor's Report to the Members of Petsec Energy Ltd

KPMG

Report on the financial report

We have audited the accompanying financial report of Petsec Energy Ltd (the Company), which comprises the balance sheets as at 31 December 2008, and the income statements, statements of recognised income and expense and cash flow statements for the year ended on that date, a description of significant accounting policies and other explanatory Notes 1 to 33 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.

Independent Auditor's Report to the Members of Petsec Energy Ltd continued

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 2008 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 2008. 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 2008, complies with Section 300A of the *Corporations Act 2001*.

KPMG

KPMG

Paul Zammit

Paul Zammit
Partner

Sydney, 26 February 2009

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 Group's corporate governance practices were in place throughout the 2008 year and comply with the Revised Principles. In a limited number of instances there are departures from the Guidelines, with the details and reasons for the departure 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. A copy of the Board Charter can be obtained from the Company's website.

The performance of the CEO and senior executives are 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, each of whom 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 current Director bringing a range of complementary skills and experience to the Group 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. Copies of these Charters can be obtained from the Company's website.

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.

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.

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 Committee 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

Corporate Governance Statement continued

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 available 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 published 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.

→4 Safeguarding Integrity in Financial Reporting

The Audit Committee is comprised of three Members, all of whom are independent, and is chaired by Mr D A Mortimer.

The Audit Committee includes members with relevant financial and technical experience. 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. A copy of the Committee's Charter can be obtained from the Company's 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 Continuous Disclosure regime under ASX Listing Rules. The Company Secretary has been appointed as the designated compliance 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 public.

→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 in order to be copied on 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.

→7 Recognising and Managing Risk

The Company understands the need for an effective system of risk oversight, management and internal control.

The Board is responsible for the overall risk management and control framework for the Company. 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.

The Company has implemented a risk management policy framework designed to ensure that its principal risks are identified and that controls are adequate, in place and functioning effectively. This framework is periodically reviewed by the Board.

Responsibility for control and risk management is delegated to the appropriate level of management within the Group with the Managing Director and Chief Financial Officer having ultimate responsibility to the Board for the risk management and control framework.

Arrangements put in place by the Board to monitor risk management and internal control systems include:

(i) regular reporting to the Board and the Audit Committee in respect of operations, the financial position of the Group and compliance requirements;

(ii) reports by the Chairman of the Audit Committee and circulation to the Board of the minutes of each meeting held by the Audit Committee;

(iii) periodic review of the adequacy of the overall risk management policy framework.

(iv) periodic review of internal controls and the results of testing of internal control processes.

Petsec Energy's Managing Director and Chief Financial Officer provide a written declaration to the Audit Committee in relation to each six-month reporting period in accordance with section 295A of the Corporations Act that:

- 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 effectively in relation to financial reporting risks.

The Company maintains effective internal control by ensuring compliance with documented Internal Controls Policies which cover key risk areas including: code of ethics, financial reporting processes, authorisation of expenditure, treasury policies, new project evaluation, continuous disclosure, contractual commitments, reserve reporting, human resources management, occupational health and safety and environmental management.

→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 members, all of whom are 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

Lease/Project	Wells	Lease Date	Term (Years)	Operator	Status	Working Interest	Net Revenue Interest
Onshore Louisiana, USA							
Moonshine Project				Petsec Energy	HBP	0.50000 - 0.80000	0.36000 - 0.60000
	E. Laurent No. 1 Well					0.80000	.60000 (est.)
	W.P. Miles Timber No. 1 Well					0.62000	.45000 (est.)
South Sunrise Field				Badger Oil	HBP	0.75000	0.56000
	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	0.32000
	Broussard No. 1 Well Serial No. 233464					0.46206	0.32395
Lapeyrouse				Petsec Energy	HBP	0.74000	0.55000
	Walker No. 1 Alt. Well Serial No. 222553					0.72842	0.53981
	Dupont No. 1 Well Serial No. 229617					0.72910	0.55015
Gulf of Mexico, USA							
Chandeleur 31 OCS-G 27215		1/6/05	5	Petsec Energy	HBP	1.00000	0.81330
	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	0.81330
	A 001/1D Well Serial No. 1772840872						
Main Pass 7 OCS-G 27962		1/7/06	5	Petsec Energy	Primary	1.00000	0.83330
Main Pass 18 OCS-G 27194		1/7/05	5	Petsec Energy	HBP	1.00000	0.83330
	G-6 Well API No. 17-725-40815-00					1.00000	0.83333
Main Pass 19 OCS-G 26146				Petsec Energy	HBP	0.55000	0.45830
	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

Lease/Project		Wells	Lease Date	Term (Years)	Operator	Status	Working Interest	Net Revenue Interest
Main Pass 89	OCS-G 22790		1/7/01	5	Beryl Resources	HBP		0.04000 ORRI
		Beryl Resources 001 Well API No. 17-725-40826-00						
Main Pass 91	OCS-G 27964		1/7/06	5	Petsec Energy	Primary	1.00000	0.83330
Main Pass 103	OCS-G 27200		1/7/05	5	Petsec Energy	Primary	1.00000	0.83330
Main Pass 270	OCS-G 22812		1/7/01	5	ENI US Operating	HBP	0.25000	0.20800
		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	
North Padre Island 934	OCS-G 32721		1/10/08	5	Petsec Energy	Primary	1.00000	
Ship Shoal 191	OCS-G 22713		1/7/83	5	Hunt Petroleum	HBP		0.04000 ORRI
Vermilion 244	OCS-G 25986		1/5/04	5	Petsec Energy	HBP	1.00000	0.83330
		G 003 Well API No. 17-706-40929-01					1.00000	0.83333
Vermilion 258	OCS-G 21093		1/7/99	5	Petsec Energy	HBP	1.00000	0.83330
		G 001 Well API No. 17-706-40922-00					1.00000	0.83333
		G 002 Well API No. 17-706-40924-00					1.00000	0.83333
		G 007 Well API No. 17-706-40932-00					1.00000	0.83333
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	0.83330
West Cameron 636	OCS-G 32123		1/6/08	5	Petsec Energy	Primary	1.00000	0.83330

Lease/Project		Wells	Lease Date	Term (Years)	Operator	Status	Before Prospect Payout		After Prospect Payout	
							Working Interest	Net Revenue Interest	Working Interest	Net Revenue Interest
Focus JV Leases										
East Break 171	OCS-G 27553		1/2/06	8	Forest Oil	Primary	0.25000	0.20875	0.20000	0.16700
East Break 172	OCS-G 27554		1/2/06	5	Forest Oil	Primary	0.25000	0.19958	0.20000	0.15867
East Cameron 102	OCS-G 32127		1/7/08	5	Royal Explor Co	Primary	0.54000	0.43110 (est.)	0.54000	0.41760 (est.)
Eugene Island 394	OCS-G 31378		1/1/08	5	Petsec Energy	Primary	0.54000	0.43110	0.54000	0.41760
Garden Banks 579	OCS-G 27653		1/11/05	8	Focus Exploration	Primary	0.25000	0.20875	0.20000	0.16700
Garden Banks 580	OCS-G 27654		1/11/05	8	Focus Exploration	Primary	0.25000	0.20875	0.20000	0.16700
Green Canyon 21	OCS-G 31689		1/1/08	8	Royal Explor Co	Primary	0.54000	0.43110	0.54000	0.41760
Green Canyon 98	OCS-G 27398		1/7/05	5	Focus Exploration	Primary	0.50000	0.39917	0.40000	0.30933
High Island A-252	OCS-G 27522		1/11/05	5	Royal Explor Co	Primary	0.50000	0.39417	0.40000	0.30533
High Island A-258	OCS-G 27523		1/11/05	5	Royal Explor Co	Primary	0.50000	0.39417	0.40000	0.30533
High Island A-274	OCS-G 27533		1/11/05	5	Royal Explor Co	Primary	0.50000	0.39417	0.40000	0.30533
High Island A-377	OCS-G 27543		1/12/05	5	Focus Exploration	Primary	0.50000	0.39917	0.40000	0.30933
High Island A-387	OCS-G 27544		1/11/05	5	Focus Exploration	Primary	0.50000	0.39917	0.40000	0.30933

Exploration and Production Interests continued

Lease/Project		Wells	Lease Date	Term (Years)	Operator	Status	Before Prospect Payout		After Prospect Payout	
							Working Interest	Net Revenue Interest	Working Interest	Net Revenue Interest
High Island A-425	OCS-G 27524		1/1/06	5	Royal Explor Co	Primary	0.50000	0.39917	0.40000	0.30933
High Island A-566	OCS-G 27531		1/2/06	5	Forest Oil	Primary	0.25000	0.19833	0.20000	0.15867
Main Pass 256	OCS-G 27967		1/6/06	5	Focus Exploration	Primary	0.50000	0.39334	0.40000	0.30467
Main Pass 257	OCS-G 27968		1/6/06	5	Focus Exploration	Primary	0.50000	0.39334	0.40000	0.30467
Mississippi Canyon 617	OCS-G 27288		1/5/05	5	Focus Exploration	Primary	0.50000	0.39917	0.40000	0.30933
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	0.40670		
		001 Well API No. 60-815-40142-00					0.50000	0.39420	0.40000	0.30530
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	0.39420	0.40000	0.30530
Mobile Bay 953	OCS-G 5756		1/7/83	5	Petsec Energy	HBP	0.50000	0.40667		
		003 Well API No. 60-815-40122-00					0.50000	0.40670		
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	0.39420	0.40000	0.30530
Mobile Bay 994	OCS-G 27228		1/5/05	5	Royal Explor Co	HBP	0.50000	0.39420	0.40000	0.30530
		001 Well API No. 60-815-40144-00					0.50000	0.39420	0.40000	0.30530
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	0.39420	0.40000	0.30530
Mobile Bay 995	OCS-G 31456		1/1/08	5	Royal Explor Co	Primary	0.35000	0.27590	0.35000	0.26720
Ship Shoal 161	OCS-G 27129		1/5/05	5	Focus Exploration	Primary	0.50000	0.39417	0.40000	0.30533
Ship Shoal 319	OCS-G 27137		1/6/05	5	Focus Exploration	Primary	0.50000	0.39917	0.40000	0.30933
South Marsh Island 193	OCS-G 27095		1/6/05	5	Focus Exploration	Primary	0.50000	0.39917	0.40000	0.30933
Vermilion 186	OCS-G 27066		1/5/05	5	Focus Exploration	Primary	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 27	OCS-G 31457		1/1/08	5	Royal Explor Co	Primary	0.35000	0.27590	0.35000	0.26720
Viosca Knoll 122	OCS-G 27234		1/5/05	5	Focus Exploration	Primary	0.50000	0.39417	0.40000	0.30533
Viosca Knoll 300	OCS-G 27236		1/5/05	5	Focus Exploration	Primary	0.50000	0.39417	0.40000	0.30533
Viosca Knoll 739	OCS-G 27241		1/6/05	5	Petsec Energy	Primary	0.50000	0.39334	0.40000	0.30467
Viosca Knoll 740	OCS-G 27242		1/7/05	5	Petsec Energy	Primary	0.50000	0.39334	0.40000	0.30467

As of 30 April 2009, Petsec Energy Inc. will have relinquished its interest in the following leases: Mississippi Canyon 617, Ship Shoal 161, Vermilion 186, Viosca Knoll 122, and Viosca Knoll 300.

Shareholder Information

AS AT 10 MARCH 2009

Number of Shareholders

Issued capital was 154,188,841 ordinary shares held by 6,134 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	1,592
1,001 – 5,000	2,113
5,001 – 10,000	978
10,001 – 100,000	1,311
100,001 and over	140
Total number of shareholders	6,134
Number holding less than a marketable parcel	3,000

Largest Twenty Shareholders

The largest twenty shareholders held 73,195,671 ordinary shares being 47.47% of the issued ordinary capital.

Name of Holder	No of Shares	%
DEN DUYTS CORPORATION PTY LTD	18,312,722	11.88
HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	9,729,693	6.31
LIPPO SECURITIES NOMINEES (BVI) LTD <CLIENT A/C>	7,555,000	4.90
CITICORP NOMINEES PTY LIMITED	6,935,940	4.50
CANNING OIL PTY LTD	6,472,744	4.20
NATIONAL NOMINEES LIMITED	4,119,773	2.67
ANZ NOMINEES LIMITED <CASH INCOME A/C>	3,998,848	2.59
EVELIND PTY LTD <THE ALPHA A/C>	2,063,198	1.34
CALVESTON WORLDWIDE LTD	1,640,000	1.06
SINO CHAMPION DEVELOPMENT LIMITED	1,639,719	1.06
ASIAN CORPORATE ADVISORS (BVI) LIMITED	1,500,000	0.97
UBS WEALTH MANAGEMENT AUSTRALIA NOMINEES PTY LTD	1,279,559	0.83
J P MORGAN NOMINEES AUSTRALIA LIMITED	1,143,779	0.74
MR ROSS A KEOGH	1,075,000	0.70
HILLRIDGE PTY LTD	1,060,000	0.69
KEY RESOURCE ANALYSTS LTD	1,047,917	0.68
PIAT CORP PTY LTD	1,021,118	0.66
MRS ELIZABETH HEATH	942,931	0.61
G HARVEY NOMINEES PTY LIMITED	878,000	0.57
QUOTIDIAN NO 2 PTY LTD	779,730	0.51

Substantial shareholders disclosed in substantial shareholder notices given to the Company are as follows:

DEN DUYTS CORPORATION PTY LTD including its associates	24,825,549	16.1

Five Year Comparative Data Summary

		Consolidated					
Financial Performance		2004	2005	2006	2007	2008	% change
Net Production (Bcfe)[1]		5.7	6.5	8.2	8.1	**12.1**	50
Average Gas Price Received	(US$/Mcfe)	5.77	7.04	7.24	7.93	**8.70**	10
US$ millions							
Net Revenue	(US$m)	32.8	45.5	59.2	64.0	**105.3**	65
EBITDAX[2]	(US$m)	25.8	33.7	45.3	45.9	**79.6**	73
EBITDAX Margin /Mcfe	(US$/Mcfe)	4.53	5.94	5.54	5.69	**6.58**	16
Depreciation, Depletion & Amortisation	(US$m)	12.3	15.7	20.9	27.7	**57.3**	107
Net Financial Income/(Expense)	(US$m)	0.2	0.3	0.5	-1.0	**-7.1**	610
Underlying Net Profit[3]	(US$m)	12.7	18.1	24.7	16.6	**12.1**	-27
Exploration Writeoffs, Provisions & Expenses	(US$m)	-1.1	-8.5	-16.7	-19.4	**-71.9**	271
Net Profit/(Loss) after Tax[4]	(US$m)	18.9	9.5	5.1	-2.0	**-44.5**	2125
Operating Cashflow after Tax	(US$m)	22.3	37.1	44.4	35.1	**85.2**	143
Balance Sheet							
Total Assets	(US$m)	65.1	91.2	132.9	254.7	**161.7**	-37
Cash	(US$m)	9.5	10.1	26.5	27.2	**13.7**	-50
Debt[5]	(US$m)	1.2	–	–	101.8	**48.8**	-52
Shareholders Equity	(US$m)	52.5	58.2	115.1	123.3	**85.9**	-30
Cashflow and Capital Expenditures							
Net Cashflow from:							
Operations	(US$m)	22.3	37.1	44.4	35.1	**85.2**	143
Investing	(US$m)	-27.5	-36.8	-71.5	-146.5	**-43.5**	-70
Financing	(US$m)	1.9	0.5	43.4	110.7	**-53.7**	-149
		-3.3	0.8	16.3	-0.7	**-12.0**	
Capital Expenditures[6]							
Exploration	(US$m)	14.1	20.9	34.2	22.1	**30.8**	39
Development	(US$m)	14.2	14.0	22.9	20.0	**11.4**	-43
Acquisition	(US$m)	1.0	2.0	14.2	103.8	**1.1**	-99
		29.3	36.9	71.3	145.9	**43.3**	
A$ million							
EBITDAX[2]	(A$m)	35.1	44.3	60.0	54.8	**93.0**	70
Underlying Net Profit[3]	(A$m)	17.4	23.8	32.5	19.8	**14.1**	-29
Net Profit/(Loss) after Tax[4]	(A$m)	25.8	12.5	6.8	-2.4	**-52.0**	2077
Operating Cashflow after Tax	(A$m)	30.4	48.7	58.8	41.9	**99.6**	138
(US$/A$ exchange rate)		0.73	0.76	0.76	0.84	**0.86**	2
Operating Margins & Costs							
Average Gas Price Received	(US$/Mcfe)	5.77	7.04	7.24	7.93	**8.70**	10
+ Other Income	(US$/Mcfe)	0.04	0.19	0.03	0.04	**-0.06**	-250
– Operating Costs (GG&A + LOE)	(US$/Mcfe)	1.28	1.29	1.73	2.28	**2.06**	-10
= EBITDAX[2]	(US$/Mcfe)	4.53	5.94	5.54	5.69	**6.58**	16
Depreciation, Depletion & Amortisation	(US$/Mcfe)	2.17	2.43	2.56	3.44	**4.73**	37
Finding and Development Costs (three year average 2P)[8]	(US$/Mcfe)	1.46	2.31	2.52	4.10	**6.20**	51
Reserves							
Proved and Probable Reserves (2P)[7]	(Bcfe)	29.4	38.5	59.7	69.6	**51.9**	-25
Reserves Replacement Ratio (%)		215	241	359	222	**-46**	

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/(Loss) after Tax:
2007 and 2008 results were reduced by a total of US$19.4m and US$71.9m, respectively, relating to exploration write-offs and impairment provisions (Refer to note 7 of the Notes to the Consolidated Financial Statements for a detailed breakdown).

5 2007 and 2008 debt is shown net of original issue discount and transaction costs (see Note 18 of the notes to the accounts).

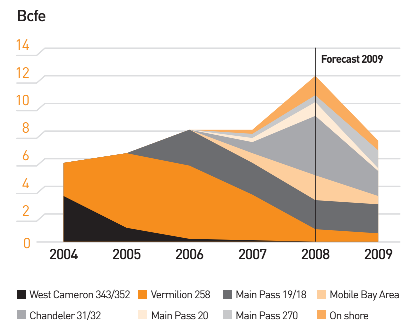
6 Excludes minor (non oil & gas) property, plant & equipment expenditure and investments.

7 Petsec Energy – estimated recoverable proved and probable reserves.

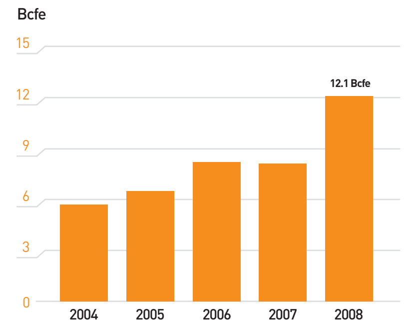
8 Finding & Development costs include all exploration writeoffs. 2007 includes the acquisition of producing assets.

Results

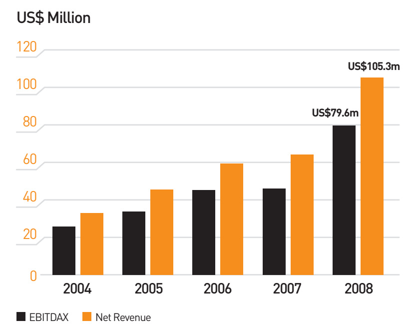
Production History by field



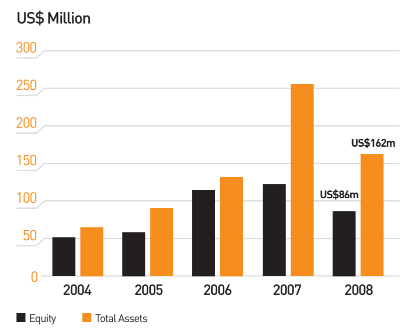
Production



EBITDAX and Net Revenue

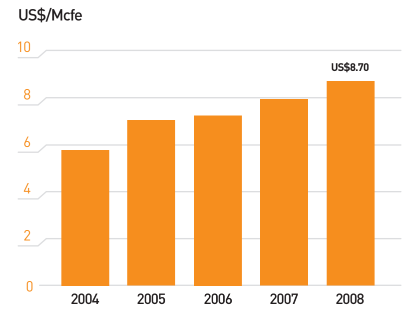


Balance Sheet Equity and Total Assets

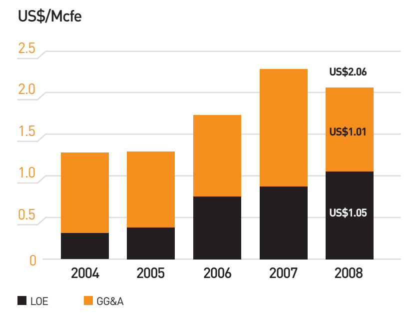


Operating Margins

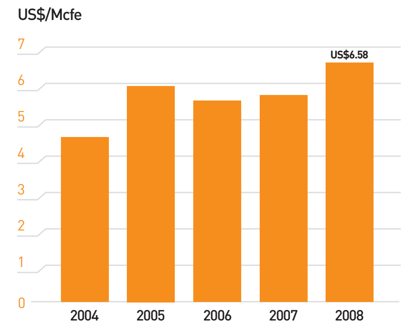
Average Gas Equivalent Price Received per Mcfe



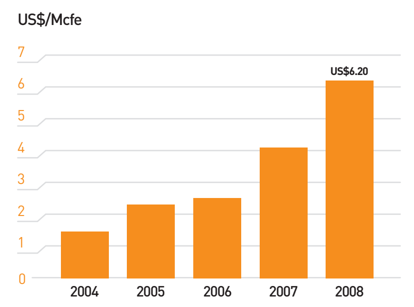
Total Operating Expense (LOE & GG&A) per Mcfe



Cash Operating Margins

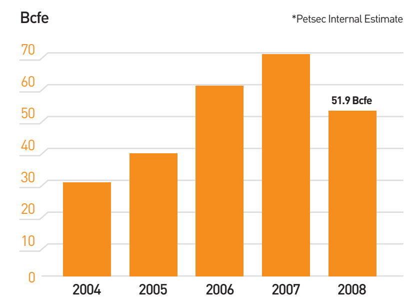


Finding & Development Costs 3 yr Average on Petsec 2P Reserves

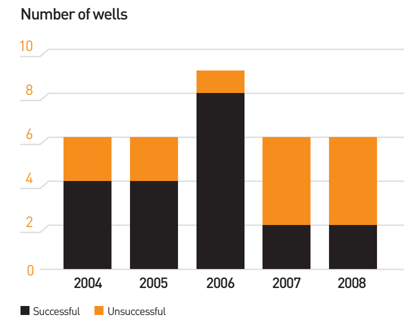


Reserves/Drilling

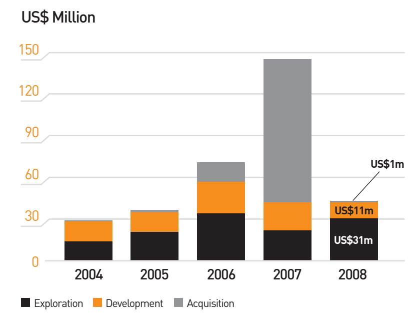
Proved and Probable Reserves* Year End



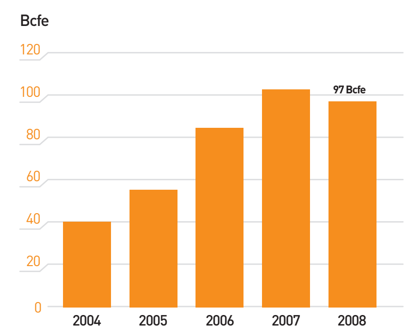
Wells Drilled / Successful



Exploration, Development and Acquisition Expenditure



Cumulative 2P Reserve Additions



CORPORATE DIRECTORY

Board of Directors

Terry N Fern – Chairman and 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

USA Management

Ross A Keogh – President, Petsec Energy Inc
Nick Repar – Exploration Manager
Frank A Steele – VP Land
Denis Swords – General Counsel & Corporate Secretary
John Thibeaux – VP Business Development

Registered Office and Principal Business Office

Level 13, 1 Alfred Street
Sydney NSW 2000 Australia
Telephone: +61 2 9247 4605
Facsimile: +61 9251 2410

USA Offices

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Telephone: +1 337 989 1942
Facsimile: +1 337 989 7271

Three Riverway
Suite 930
Houston, TX 77056 USA
Telephone: +1 713 457 5800
Facsimile: +1 713 457 5838

Share Register

Registries Limited
Office: Level 7, 207 Kent Street, Sydney NSW 2000 Australia
Postal: GPO Box 3993, Sydney NSW 2001
Telephone:1300 737 760 International: + 61 2 9279 0664
Facsimile:1300 653 459 International: +61 2 9279 0664
Email: callcentre@registries.com.au

Depositary Receipts Register

The Bank of New York
6th Floor
620 Avenue of the Americas
New York NY 10011 USA
Telephone: +1 646 885 3300
Facsimile: +1 646 885 3043

Auditors

KPMG Chartered Accountants
King Street Wharf
10 Shelley Street
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

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.