



**KAROON GAS AUSTRALIA LTD
ABN 53 107 001 338**

**QUARTERLY REPORT FOR THE QUARTER ENDED 31 DECEMBER 2010 AND
APPENDIX 5B**

Review of Operations

Highlights:

- Petroleo Brasileiro S.A. ("Petrobras") made a discovery from the Maruja exploration well and achieved an equipment constrained production oil flow rate of 6,142 barrels of oil per day through a 5/8 inch choke during the clean up flow. This was followed by a main flow period of 24 hours that achieved a stabilised flow rate of 4,675 barrels of oil per day and 0.8 mmscf/d of gas through a 1/2 inch choke, with a flowing wellhead pressure of 1,050 psia.
- 2,828 square kilometre 3D seismic data over the greater Poseidon structure continued to be processed and interpreted providing a better definition of the Poseidon Field and surrounding prospects.
- 750 square kilometre wide azimuth 3D seismic data acquired over Karoon's wholly owned Santos Basin offshore blocks in Brazil in early in 2010 continued to be processed with data expected to be ready for interpretation during the second quarter 2011.
- 1,500 square kilometre 3D seismic data acquired in the Tumbes Basin Z-38 Block, Peru acquired early in 2010 is being interpreted and early results indicate several new leads and prospects.
- Karoon agreed to increase its equity in WA-314-P from 40% to 90% subject to executing final documentation and obtaining regulatory approvals.

Australia

Browse Basin Permits WA-314-P, WA-315-P and WA-398-P

During the quarter, the interpretation of the 2,828 square kilometre 3D seismic data acquired over the greater Poseidon structure continued and the first full time cube has provided encouraging results. The interpretation from the seismic will be used in determining the location of future wells in the upcoming Poseidon drilling campaign.

Throughout the quarter, Karoon's joint venture partner, ConocoPhillips made preparations and submissions for a multi-well drilling program to begin early in the second quarter 2011 subject to environmental approvals and to continue into 2012. Wells drilled as part of this multi-well exploration and appraisal program will define the size and deliverability of the Poseidon discovery. The data from these wells will form the basis of a potential future development decision.

During November 2010, Karoon and ConocoPhillips executed a heads of agreement under which Karoon will acquire an additional 50% interest in the WA-314-P permit taking its total equity interest to 90%. Karoon has assessed seven leads and

prospects in the WA-314-P block, including the Grace prospect, with a prospective resource potential size of 3.3 trillion cubic feet and 45 million barrels of condensate. A well will be drilled in WA-314-P as part of the upcoming Browse drilling campaign.

The offshore Browse Basin is located 350 km offshore from the North-Western Australian coastline.

Permit interests of the participants in WA-315-P and WA-398-P are:

Karooon Gas (Browse Basin) Pty Ltd	40%
ConocoPhillips (Browse Basin) Pty Ltd (Operator)	60%

Permit interests of the participants in WA-314-P are:

Karooon Gas (Browse Basin) Pty Ltd	40%
ConocoPhillips (Browse Basin) Pty Ltd (Operator)	60%

Bonaparte Basin AC/P8

During the quarter, Karoon commenced the processing and interpretation of a Controlled Source Electro-Magnetic survey data set. The data from this survey will contribute to the understanding of the geology and prospectivity of potential drilling targets in AC/P8.

The AC/P8 permit contains two prospects and a number of leads which will need to be further defined by Karoon and its joint venture partner, Talisman Oil & Gas (Australia) Pty Limited.

Permit interests of the participants in AC/P8 are:

Karooon Energy International Ltd (Operator)	66.67%
Talisman Oil & Gas (Australia) Pty Limited	33.33%

South America

Brazil

Blocks 1037, 1101, 1102, 1165 and 1166.

The processing of a 750 square kilometre wide azimuth 3D seismic acquisition program over Karoon's 100% held Santos Basin blocks is continuing and will be followed by interpretation during the first half of 2011.

The objective of the wide azimuth seismic is to provide a uniform, high-quality, 3D seismic coverage with a focus on better depth imaging beneath and around salt structures allowing more accurate prospect delineation. This wide azimuth 3D seismic acquisition program is the first of its kind in Brazil.

The new seismic data will aid in the positioning of exploration wells expected to be drilled during late 2011, early 2012. Preparations for drilling are continuing with the ordering of long lead items and completion of negotiations for a shore base and will continue throughout 2011.

The Santos Basin is offshore from the Santa Catarina region of Brazil, just south of Rio de Janeiro, which has recently yielded multiple oil discoveries. Recent discoveries in the Santos Basin include the Tupi and Carioca oil fields, the Newton oil discovery, the Caravela and Coral fields, the Merluza field and the Tiro, Sidon and Maruja discoveries.

Karooon has a 100% working interest and is the operator of its Santos Basin Blocks 1037, 1101, 1102, 1165 and 1166.

Blocks 1352 and 1354, 100% owned and operated by Petrobras

Karoon's wholly owned subsidiary, Karoon Petroleo & Gas S.A., has entered into an agreement to acquire a 20% interest in Blocks BM-S-41/S-M-1352 ("Maruja Prospect") and BM-S-41/S-M-1354 ("Quasi Prospect") which are subject to regulatory approval from the Agencia Nacional do Petroleo, the Brazilian Petroleum Agency.

Subsequent to farming into Block BM-S-41, Karoon was involved in the drilling of two exploration wells operated by Petrobras.

The first well, Quasi-1, was a high risk target which subsequently proved uncommercial and the intention is to relinquish the S-M-1354 block.

The second well, Maruja-1, which commenced on the 23 September 2010, made a discovery at 2,201-2,210 metres in the high porosity Oligocene sandstone reservoir. During production testing, the Maruja-1 well achieved an equipment constrained oil flow rate of 6,142 barrels of oil per day through a 5/8 inch choke during the clean up flow. This test was followed by a main flow period of 24 hours that achieved a stabilised flow rate of 4,675 barrels of oil per day and 0.8 mmscf/d of gas through a 1/2 inch choke, with a flowing wellhead pressure of 1,050 psia. An oil gravity of 38 API was also measured. Maruja-1 was drilled to a total depth 3,789 metres and the well data from the Maruja-1 well will now be used for appraisal drill planning.

After completion of the farm-in work programs and regulatory approvals equity interests in BM-S-41/S-M-1352 and BM-S-41/S-M-1354 will be:

Petroleo Brasileiro S.A. (Operator)	80%*
Karoon Petroleo e Gas S.A.	20%

*Equity interests stated are based on the completion of post farm-in obligations and are subject to regulatory approval from the Agencia Nacional do Petroleo, the Brazilian Petroleum Agency.

Peru

Block Z-38

During the quarter, the 1,500 square kilometre 3D seismic processing was completed and interpretation commenced. The objective of the seismic acquisition is to provide prospect delineation for a planned drilling campaign during 2012 and to gain a better understanding of previously underexplored areas within Block Z-38.

Early results from the 3D seismic are encouraging with several new leads and prospects being delineated. This data will now be used to high grade prospects for drilling early in 2012. Karoon has now commenced preparations for drilling and the process is expected to continue well into 2012.

Block Z-38 is located in the Tumbes Basin, offshore in the northwest of Peru. It is a region that is experiencing renewed activity after a series of successful exploration programs by the holder of the license area adjoining Block Z-38. The Talara Basin, to the south of the Tumbes Basin, has produced more than 1 billion barrels of oil. The Talara Basin is reported to be the location of the first oil production in South America in the late 1800's.

After completion of the farm-in work programs and regulatory approvals equity interests in Block Z-38 will be:

KEI (Peru Z38) Pty Ltd, Sucursal del Peru (Operator)	75%*
Vietnam American Exploration Company LLC	25%

*Equity interests stated are based on the post farm-in ownership. KEI (Peru Z-38) Pty Ltd, Sucursal del Peru is a subsidiary of Karoon.

Block 144

Karoon continued its geotechnical, social and environmental work in the Block and continued interpretation of 1,000 kilometres of existing reprocessed 2D seismic data.

Karoon has a 100% working interest in Block 144.

Corporate Activity

During the quarter, Karoon planned a public offering on the BM&FBOVESPA in São Paulo, Brazil, of 31.9% of the common shares in its wholly owned subsidiary, Karoon Petróleo & Gás S.A., however, due to unfavourable financial market conditions Karoon decided not to proceed with the offering.

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ASX QUARTERLY FINANCIAL REPORT FOR THE QUARTER ENDED 31 DECEMBER 2010

Appendix 5B (Unaudited)

Introduced 1/7/96. Origin: Appendix 8. Amended 1/07/97, 1/07/98, 30/09/01, 01/06/10, 17/12/10.

Name of entity

Karooon Gas Australia Ltd

ABN

53 107 001 338

Quarter ended ("Current Quarter")

31 December 2010

Consolidated statement of cash flows

	Current Quarter \$A'000	Year to date (6 months) \$A'000
Cash flows related to operating activities		
1.1 Receipts from product sales and related debtors	-	-
1.2 Payments for:		
(a) exploration and evaluation	(4,466)	(17,849)
(b) development	-	-
(c) production	-	-
(d) administration	(8,175)	(11,394)
1.3 Dividends received	-	-
1.4 Interest and other items of a similar nature received	2,562	3,848
1.5 Interest and other costs of finance paid	(36)	(86)
1.6 Income taxes paid	16	(220)
1.7 Other - GST refunds	883	1,099
Net operating cash flows	(9,216)	(24,602)
Cash flows related to investing activities		
1.8 Payment for purchases of:		
(a) prospects	-	-
(b) security deposits (net)	(304)	(304)
(c) other fixed assets	(653)	(861)
1.9 Proceeds from sale of:		
(a) prospects	-	-
(b) equity investments	-	-
(c) other fixed assets	(1)	13
1.10 Loans to other entities	-	-
1.11 Loans repaid by other entities	-	-
1.12 Other (provide details if material)	(35)	-
Net investing cash flows	(993)	(1,152)
1.13 Total operating and investing cash flows (carried forward)	(10,209)	(25,754)

	Current Quarter \$A'000	Year to date (6 months) \$A'000
1.13 Total operating and investing cash flows (brought forward)	(10,209)	(25,754)
Cash flows related to financing activities		
1.14 Proceeds from issues of shares, options, etc.	83,612	272,837
1.15 Proceeds from sale of forfeited shares	-	-
1.16 Proceeds from borrowings	-	-
1.17 Repayment of borrowings	-	-
1.18 Dividends paid	-	-
1.19 Other – Equity raising costs	(979)	(8,645)
Net financing cash flows	82,633	264,192
Net increase (decrease) in cash held		
1.20 Cash as at beginning of Current Quarter/ year to date	250,034	87,123
1.21 Exchange rate adjustments to item 1.20	(3,511)	(6,614)
1.22 Cash as at end of Current Quarter	318,947	318,947

Payments to directors of the entity and associates of the directors

Payments to related entities of the entity and associates of the related entities

	Current Quarter \$A'000
1.23 Aggregate amount of payments to the parties included in item 1.2	652
1.24 Aggregate amount of loans to the parties included in item 1.10	Nil

1.25 Explanation necessary for an understanding of the transactions

Directors' remuneration included in 1.23: \$298,410
Consulting fees included in 1.23: \$353,627

Non-cash financing and investing activities

2.1 Details of financing and investing transactions which have had a material effect on consolidated assets and liabilities but did not involve cash flows

Nil

2.2 Details of outlays made by other entities to establish or increase their share in projects in which the reporting entity has an interest

Nil

Financing facilities available

Add notes as necessary for an understanding of the position.

	Amount available \$A'000	Amount used \$A'000
3.1 Loan facilities	Nil	Nil
3.2 Credit standby arrangements	Nil	Nil

Estimated cash outflows for the next quarter

	\$A'000
4.1 Exploration and evaluation expenditure	6,700
4.2 Development expenditure	Nil
4.3 Production expenditure	Nil
4.4 Administration expenditure	2,500
Total	9,200

Reconciliation of cash

Reconciliation of cash as at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts is as follows		Current Quarter \$A'000	Previous quarter \$A'000
5.1	Cash at banks and on hand	67,247	57,427
5.2	Short term bank deposits	251,700	192,607
5.3	Bank overdraft	-	-
5.4	Other	-	-
	Total: Cash as at end of Current Quarter (item 1.22)	318,947	250,034

Changes in interests in tenements

	Tenement reference	Nature of interest (note (2))	Interest as at beginning of Current Quarter	Interest as at end of Current Quarter
6.1	Interests in tenements relinquished, reduced or lapsed	-	-	-
6.2	Interests in tenements acquired or increased	-	-	-

Issued and quoted securities as at end of Current Quarter

Description includes rate of interest and any redemption or conversion rights together with prices and dates.

	Total number	Number quoted	Issue price per security (see note 3) (cents)	Amount paid up per security (see note 3) (cents)
7.1 Preference + securities <i>(description)</i>				
7.2 Changes during Current Quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs, redemptions				
7.3 +Ordinary shares (fully paid)	217,295,769	217,295,769		
7.4 Changes during Current Quarter (a) Increases through issues (b) Decreases through returns of capital, buy-backs	425,000 30,000 90,000 11,692,642	425,000 30,000 90,000 11,692,642	295 cents 500 cents 400 cents 700 cents	295 cents 500 cents 400 cents 700 cents
7.5 +Convertible debt securities <i>(description)</i>				
7.6 Changes during Current Quarter (a) Increases through issues (b) Decreases through securities matured, converted				
7.7 Options <i>(description and conversion factor)</i>	250,000 1,500,000 2,375,000 200,000 1,800,000 1,530,000 1,045,000 500,000 100,000		<i>Exercise price</i> 400 cents 450 cents 500 cents 684 cents 1150 cents 1407 cents 977 cents 948 cents 977 cents	<i>Expiry date</i> 30 April 2011 30 April 2011 30 April 2011 30 October 2011 18 November 2013 12 November 2013 31 October 2014 18 November 2014 18 November 2014
7.8 Issued during Current Quarter			<i>Exercise price</i>	<i>Expiry date</i>
7.9 Exercised during Current Quarter	425,000 30,000 90,000		<i>Exercise price</i> 295 cents 500 cents 400 cents	
7.10 Expired during Current Quarter				
7.11 Debentures <i>(totals only)</i>				
7.12 Unsecured notes <i>(totals only)</i>				

Compliance statement

- A. This statement has been prepared under accounting policies which comply with accounting standards as defined in the Corporations Act or other standards acceptable to ASX (see note 5).
- B. This statement does give a true and fair view of the matters disclosed.

Signed: Date: 31 January 2011
(Company Secretary)
Name: Scott Hosking

Notes:

- 1 The quarterly report provides a basis for informing the market how the entity’s activities have been financed for the past quarter and the effect on its cash position. An entity wanting to disclose additional information is encouraged to do so, in a note or notes attached to this report.
- 2 The “Nature of interest” (items 6.1 and 6.2) includes options in respect of interests in tenements acquired, exercised or lapsed during the reporting period. If the entity is involved in a joint venture agreement and there are conditions precedent which will change its percentage interest in a tenement, it should disclose the change of percentage interest and conditions precedent in the list required for items 6.1 and 6.2.
- 3 **Issued and quoted securities** The issue price and amount paid up is not required in items 7.1 and 7.3 for fully paid securities.
- 4 The definitions in, and provisions of, AASB 6 ‘*Exploration for and Evaluation of Mineral Resources*’ and AASB 107 ‘*Statement of Cash Flows*’ apply to this report.
- 5 **Accounting Standards** ASX will accept, for example, the use of International Financial Reporting Standards for foreign entities. If the standards used do not address a topic, the Australian standard on that topic (if any) must be complied with.

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Appendix 1

Schedule of Interests

Held by the Karoon Gas Australia Ltd Group

As at 31 December 2010

<u>Exploration permit</u>	<u>Basin</u>	<u>Operator</u>	<u>% interest held</u>
AC/P8	Bonaparte, Australia	Karoon	66.67
WA-314-P	Browse, Australia	ConocoPhillips	40.00 ⁽¹⁾
WA-315-P	Browse, Australia	ConocoPhillips	40.00 ⁽¹⁾
WA-398-P	Browse, Australia	ConocoPhillips	40.00
Block 1037	Santos, Brazil	Karoon	100.00
Block 1101	Santos, Brazil	Karoon	100.00
Block 1102	Santos, Brazil	Karoon	100.00
Block 1165	Santos, Brazil	Karoon	100.00
Block 1166	Santos, Brazil	Karoon	100.00
Block 1352	Santos, Brazil	Karoon	20.00 ⁽³⁾
Block 1354	Santos, Brazil	Karoon	20.00 ⁽³⁾
Block 144	Maranon, Peru	Karoon	100.00
Block Z-38	Tumbes, Peru	Karoon	75.00 ⁽²⁾

- (1) 1.5% over-riding royalty for first five years of production, going to 2% thereafter.
- (2) The Group's 75.00% ownership interest is subject to obtaining regulatory approvals and completion of second and third year work commitments.
- (3) The Group's 20.00% Block equity interest is subject to satisfying farm-in obligations and obtaining regulatory approvals in Brazil, including from the Brazilian Petroleum Agency.