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**EARTH HEAT RESOURCES LTD  
AND CONTROLLED ENTITIES  
ABN 86 115 229 984**

**ANNUAL REPORT  
(IN AUSTRALIAN DOLLARS)**

**FOR THE YEAR ENDED  
SEPTEMBER 30, 2012**

## COMPANY INFORMATION

### Directors

|                     |   |
|---------------------|---|
| Dr Raymond Shaw     | Chairman, Non-Executive Director                  |
| Torey Marshall      | Managing Director                                 |
| Malcolm Lucas-Smith | Non-Executive Director (appointed April 23, 2012) |
| Norman Zillman      | Non-Executive Director (resigned April 23, 2012)  |

### Secretary

|                     |                   |
|---------------------|-------------------|
| Malcolm Lucas-Smith | Company Secretary |
|---------------------|-------------------|

### Registered Office

|              |  |
|--------------|--|
| In Canada    | 711-675 West Hastings Street, Vancouver, BC, Canada                                |
| In Australia | Suite 9 Lester Court, 75a Angas Street, Adelaide, 5000, South Australia, Australia |
|              | Ph: 08 8223 01681 Fax: 08 8223 1685  |

### Auditors

|                              |   |
|------------------------------|---|
| Grant Thornton Audit Pty Ltd | Level 1, 67 Greenhill Road<br>Wayville, South Australia 5034, Australia |
|------------------------------|---|

### Share Registry

|              |  |
|--------------|--|
| In Canada    | Computershare Investor Services Inc<br>3 <sup>rd</sup> Floor, 510 Burrard Street, Vancouver, BC, Canada                                |
| In Australia | Computershare Investor Services Pty Ltd<br>Yarra Falls 452 Johnston Street, Abbotsford, Victoria 3067, Australia<br>Ph: 61 3 9415 5000 |

### Stock Exchange Listing

Australian Securities Exchange (ASX) – Australia – Code EHR (previously FRV)

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**CHAIRMAN'S STATEMENT**  
**SEPTEMBER 30, 2012**

Dear Shareholders

As the Chairman of the Board of Directors it is a pleasure to present to you the Company's Annual Report for the year ended September 30, 2012.

In my Chairman's Statement last year I made reference to the enormous challenges ahead and that there is a real dilemma for smaller capitalized companies, such as Earth Heat, obtaining project development funding. Unfortunately this has proven to be far more prophetic than estimated, as poor and uncertain economic conditions continued to worsen during the 2011-2012 Financial Year.

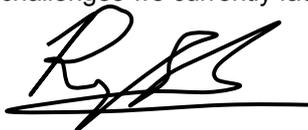
During the year we undertook two relatively modest capital risings, balancing the requirements of maintaining our operational momentum whilst minimizing the dilutionary impact on our existing shareholders. However, and as you will be aware, despite our advancements in continuing to de-risk our projects both technically and financially, equity raisings have become increasingly more onerous, if at all possible, for small companies. This situation appears all the more so for those participants of the geothermal sector, such as Earth Heat. Persistent sector wide share price decline trends throughout the year have made it increasingly apparent that the market is abandoning pure geothermal plays. This trend, if unabated and not proactively addressed, could see our share price decline to levels that, in the relatively short term, would result in the downfall of your Company.

Following the engagement of corporate advisors, and completion of a major internal strategic review of current and future projects and funding requirements, your Board has accepted that there are insufficient levels of investor interests to justify our perseverance with a purely geothermal asset base. In summary your Company needs to embrace a broader spectrum of energy interests, in the short and medium terms, which will bring with them meaningful market traction and general investor appeal.

Much of the below surface geothermal technology emerged from the petroleum industry and your Company retains a competitive advantage through its key management having extensive experience in oil and gas exploration and development. Indeed the Company retains some oil and gas interests in North America, which together with the attraction of very robust and exciting emerging unconventional plays there represents the natural arena in which to pursue broader based energy opportunities. Although we still have some way to go before we formally consummate some new deals, we believe that this will occur in a shorter time frame and thus set us on a course of redressing the negative value perceptions which have unfortunately dogged your Company and the sector over the past 12 months.

It has been an extremely difficult year for Shareholders, as it has been for your Board and employees. Your Managing Director, Torey Marshall, has worked tirelessly against all the adversities which the current market conditions have delivered including some quite harsh personal and financial challenges!. I am extremely grateful to have had such a dedicated and tenacious champion working for the Company, as indeed I am grateful for the enormous contributions of our staff in Adelaide, Argentina and Africa and particularly Mal Lucas-Smith my fellow director and Company Secretary and Vicky Allinson our Chief Financial Officer.

The combination of broader based, energy opportunities and the significant support of DJ Carmichael Pty Limited, which is assisting with the raising of approximately \$1.5 million will, I believe, allow Earth Heat to successfully meet the challenges we currently face and re-emerge in a much stronger form.

A handwritten signature in black ink, appearing to read "R. Shaw", with a horizontal line underneath.

Dr Raymond Shaw  
Chairman  
Sydney, 21<sup>st</sup> day of December 2012

## **DIRECTORS' INFORMATION**

### **SEPTEMBER 30, 2012**

The Directors' present their report together with the Financial Report of Earth Heat Resources Ltd ("the Company") and of the Consolidated Entity, being the Company and its controlled entities ("the Consolidated Entity") for the financial year ended September 30, 2012.

#### **Directors**

The Directors of the Company at any time during and since the end of the financial year are:

| <b>Name</b>         | <b>Position</b>         | <b>Date appointed</b> | <b>Date Resigned</b> |
|---------------------|-------------------------|-----------------------|----------------------|
| Dr Raymond Shaw     | Chairman –Non-Executive | January 22, 2010      | -                    |
| Torey Marshall      | Managing Director       | January 22, 2010      | -                    |
| Malcolm Lucas-Smith | Non-Executive Director  | April 23, 2012        | -                    |
| Norman Zillman      | Non-Executive Director  | February 26, 2010     | April 23, 2012       |

Directors held office for the entire period unless otherwise stated.

#### **Information on Directors'**

##### ***Dr Raymond Shaw – Non-Executive Chairman***

###### *Experience and expertise*

Dr Raymond Shaw is a geologist and geophysicist with more than 30 years' experience in the resources and energy sector including the oil, gas and coal industries. He commenced his professional career as a petroleum explorationist with Shell Development Australia in Perth, prior to working for various consulting groups including the Swiss based international consulting firm Petroconsultants SA, as resident director based in Singapore and responsible for its Far East operations.

Dr Shaw was founding Managing Director of Great Artesian Oil and Gas Limited, prior to its listing on the ASX in 2003, until April 2007. In May 2007 he became Executive Chairman of ASX listed Enterprise Energy Limited. In 2008 he oversaw the merger and backdoor listing of some \$250 million of coal assets into Enterprise Energy as part of a restructuring and change in business to form Bandanna Energy Limited, of which he was Managing Director until March 2012.

He has consulted extensively to industry, government, and international aid agencies on a variety of resource projects throughout Australia and Asia, including the World Bank, Asia Development Bank and Ausaid. He was a part time consultant with the New South Wales Department of Mineral Resources for 7 years providing input for industry initiatives during the late 1990's and early 2000's. Dr Shaw holds a B.Sc (Hon 1) and Ph.D from the University of Sydney and Dip Law (SAB). He is a member of the Australasian Institute of Mining and Metallurgy and the American Association of Petroleum Geologists.

He is also a director of ASX listed Red Gum Resources Ltd.

###### *Special responsibilities*

Chairman of Board of Directors

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**DIRECTORS' INFORMATION (CONTINUED)  
SEPTEMBER 30, 2012**

***Torey Marshall – Managing Director***

*Experience and expertise*

Mr Torey Marshall is a geologist with broad based technical and business development experience in the petroleum, mineral and geothermal sectors. This has resulted in the successful execution of various exploration programs (some resulting in discoveries), in a number of different areas. Having worked extensively as an exploration geoscientist in Australia, South America, Africa & the Middle East, his skills have been considerably expanded to include senior management experience of various private and public (unlisted) companies.

As part of his consulting practice, he has developed strategies for, and acquired projects on behalf of a number of clients at a number of scales (between \$1m and \$100m).

Mr Marshall has a B.Sc (Hons) and M.Sc from University of South Australia and is a Chartered Professional member of the Australasian Institute of Mining and Metallurgy and an associate member of the American Association of Petroleum Geologists.

Mr Marshall has been Managing Director of Earth Heat since January 2011 and was responsible for assembling its geothermal assets.

He is a director of ASX listed Red Gum Resources Ltd.

*Special responsibilities*  
Managing Director

***Malcolm Lucas-Smith – Non-Executive Director (appointed April 23, 2012) and Company Secretary.***

*Experience and expertise*

Mal Lucas-Smith has over 40 years' experience in finance, executive and non executive management, property development, corporate secretarial and administrative services.

During that period he spent 12 years with State Bank of New South Wales and 18 years with the property finance and the property joint venture divisions of Australian Guarantee Corporation Limited (AGC), at the time a listed subsidiary of Westpac Bank.

Mal left AGC of his own accord in September 1987 to form a corporate services business and has since worked within and consulted to the corporate sector often assisting new start ups and existing operations proposing to list on the Australian Securities Exchange, and also providing local representative and registered office services for offshore entities.

He is the Company Secretary of the following ASX listed companies; Healthlinx Limited, Medivac Limited and Red Gum Resources Limited.

*Special responsibilities*  
Company Secretary

**DIRECTORS' INFORMATION (CONTINUED)**  
**SEPTEMBER 30, 2012**

***Norman Zillman– Non-Executive Director (resigned April 23, 2012)***

*Experience and expertise*

Mr Zillman has held positions of Exploration Manager and subsequently Deputy General Manager of Crusader Limited, General Manager Exploration and Production with Claremont Petroleum NL and Beach, and Manager of the Petroleum Branch of the Queensland Department of Mines and Energy and State Mining Engineer for Petroleum.

Mr Zillman has also held the position of Regional Manager of Northern Queensland for the Department of Mines and Energy based in Charters Towers where he supervised all aspects of mineral exploration and mining activities in that region including among others, the Ravenswood, Pajingo, Mt Leyshon and Thalanga mines. This broad experience base provided Mr Zillman with an intimate knowledge of the Queensland resource sector.

Consequently he has held a wide variety of public company positions including foundation Managing Director of Queensland Gas Company Limited, foundation Chairman of Great Artesian Oil and Gas Limited, Chairman of Chinalco Yunnan Copper Resources Limited, director of Planet Gas Limited, non-executive Chairman of Blue Energy Limited and non-executive Chairman of Hot Rocks Limited. Mr Zillman is a Member of the Australasian Institute of Mining and Metallurgy and the Petroleum Exploration Society of Australia.

Mr Zillman holds a Bachelor of Science degree in Geology and a Bachelor of Science (with Honours) degree in Botany from the University of Queensland. Mr Zillman has nearly 40 years experience as a professional geologist. His initial training was as a petroleum geologist with international companies Aquitaine Petroleum in Papua New Guinea and Union Oil Company of California (UNOCAL) in Indonesia.

*Special responsibilities*

Member of the audit committee

**Meetings of Directors**

The number of meetings of the Company's Board of Directors and of each board committee held during the year ended September 30, 2012 and the number of meetings attended by each Director is as follows:

| <b>Director</b> | <b>Directors' Meetings</b> |                              |
|-----------------|----------------------------|------------------------------|
|                 | <b>Attended</b>            | <b>Held whilst in office</b> |
| R Shaw          | 14                         | 14                           |
| T Marshall      | 13                         | 14                           |
| M Lucas-Smith   | 4                          | 4                            |
| N Zillman       | 9                          | 10                           |

Only one audit committee meeting was held during the year following the earlier resignations of Directors Sutton, Pearce and Rose-Innes and the resignation during the year Norman Zillman, the Company does not presently have any independent directors and accordingly cannot form a properly structured Audit Committee. Consequently all Audit Committee functions are handled by the full Board.

**DIRECTORS' INFORMATION (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Directors' Interests**

The relevant interest of each director in the securities of the company as at the date of this report is set out below:

| <b>Director</b>                    | <b>Number of shares owned or<br/>over which control is<br/>exercised</b> | <b>Number of options owned or<br/>over which control is<br/>exercised - including<br/>exercise price</b> |
|------------------------------------|--|--|
| Raymond Shaw <sup>(1)</sup>        | 72,130,592   | Nil  |
| Torey Marshall <sup>(2)</sup>      | 69,363,925   | Nil  |
| Malcolm Lucas Smith <sup>(3)</sup> | 1,000,000  | Nil  |
| Norman Zillman <sup>(4)</sup>      | -  | -  |

Notes:

- <sup>(1)</sup> 63,414,641 of Dr Raymond Shaw's shares were released from voluntary escrow on January 22, 2012 and in February 2012 4,040,951 shares were issued to him in lieu of accumulated remuneration.
- <sup>(2)</sup> 63,414,641 of Torey Marshall's shares were released from voluntary escrow on January 22, 2012. In February 2012 40,000,000,000 Performance Rights were issued as part of his executive remuneration at no cost, subject to the achievement of the Key Performance Indicators ("KPIs") at the discretion of the Board. At the date of this report the Board has resolved that the KPIs could not be met (refer to Note 11 for further details).
- <sup>(3)</sup> Malcolm Lucas-Smith acquired 1,000,000 shares at \$0.03 on March 12, 2012.
- <sup>(4)</sup> Norman Zillman resigned as a director on April 23, 2012. During the period to the date of his resignation, Norman Zillman was issued 2,840,118 shares in lieu of accumulated remuneration; in addition, 63,414,628 of his shares were released from voluntary escrow on January 22, 2012.

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**REMUNERATION REPORT  
SEPTEMBER 30, 2012**

This report outlines the remuneration agreements in place for directors and executives of Earth Heat Resources Ltd.

**Nomination & Remuneration Committee**

Due to the size of the Company's operations and the present small number of Directors it will not be possible to properly constitute a Nomination & Remuneration Committee until additional Director(s) are appointed. All matters that would normally be the responsibility of a Nomination & Remuneration Committee are dealt with by the full board of Directors. The Chairman is responsible for the annual review of Directors remuneration.

**Executive Compensation and Non-Executive Remuneration**

The full Board of Directors sets remuneration policies and practices generally and makes specific recommendations on remuneration packages and other terms of employment for Executive Directors, other Senior Executives and Non-Executive Directors.

Executive remuneration and other terms of employment are reviewed annually having regard to performance against goals set at the start of the year, relevant comparative information and independent expert advice. As well as basic salary, remuneration packages include superannuation. Remuneration packages are inclusive of superannuation.

The Managing Director, Torey Marshall is employed on an annual contract, the initial contract commenced on January 22, 2011. His remuneration consists of a base salary of \$330,000 per annum, subject to review from time to time as determined by the Board. In January 2011, Torey Marshall's salary was reviewed by the Board and increased from \$230,000 to \$330,000.

Until his resignation on May 11, 2011, the Executive Director, Alexander Rose-Innes was employed on a three year contract commencing on August 3, 2010. Alexander Rose-Innes remuneration consisted of a base salary of \$120,000 per annum (including superannuation) payable following successful capital raising of not less than \$2,000,000 and options that vest, subject to Shareholder approval and successful capital raising as follows:

- 10,000,000 vesting immediately, at 3 cents and expiring on August 3, 2011;
- 10,000,000 vesting on 3 August 2011, at 5 cents and expiring on August 3, 2012; and
- 10,000,000 vesting on 3 August 2011, at 8 cents and expiring on August 3, 2013.

Following Mr Rose-Innes resignation on May 11, 2011, 20,000,000 options lapsed immediately in accordance with the terms of his employment contract, and the remaining 10,000,000 expired subsequently in accordance with the terms of the options issued

Remuneration packages are set at levels that are intended to attract and retain executives capable of managing the Consolidated Entity's operations.

Remuneration of Non-Executive Directors is determined by the Board within the maximum amount approved by shareholders from time to time.

Additional information of key management personnel is disclosed in Note 14 related party transactions.

**REMUNERATION REPORT (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Key Management Personnel Compensation**

Table of Benefits and Payments for the Year Ended September 30, 2012

The following table sets forth all annual and long term compensation for services in all capacities to the Consolidated Entity for the two most recently completed financial years, in respect of the individual(s) who were, at the end of the most recently completed financial year, acting as directors or executive officers.

| <b>Name and Position</b>  | <b>Year</b> | <b>Salary<sup>(1) (2) (3)</sup></b><br>\$ | <b>Bonus</b><br>\$ | <b>Options and Rights<sup>(4)</sup></b><br>\$ | <b>Other Annual Compensation<sup>(5)</sup> and Superannuation</b><br>\$ | <b>Total<sup>(6)</sup></b><br>\$ |
|---|-------------|---|--------------------|---|---|----------------------------------|
| Dr Raymond Shaw<br>Chairman<br>Non-executive Director   | 2012        | 65,000                                    | -                  | -   | -   | 65,000                           |
|   | 2011        | 65,000                                    | -                  | -   | -   | 65,000                           |
| Torey Marshall<br>Managing Director   | 2012        | 302,752                                   | -                  | -   | 48,694  | 351,446                          |
|   | 2011        | 279,816                                   | -                  | -   | 58,822  | 338,638                          |
| Mal Lucas Smith<br>Non-Executive Director and Company Secretary<br>Appointed April 23, 2012               | 2012        | 20,933                                    | -                  | -   | -   | 20,933                           |
|   | 2011        | -   | -                  | -   | -   | -                                |
| Norman Zillman<br>Non-Executive Director<br>Resigned April 23, 2012                                       | 2012        | 27,067                                    | -                  | -   | -   | 27,067                           |
|   | 2011        | 48,000                                    | -                  | -   | -   | 48,000                           |
| Stephen Pearce<br>Independent non-executive Director and Joint Company Secretary<br>Resigned May 11, 2011 | 2012        | -   | -                  | -   | -   | -                                |
|   | 2011        | 28,760                                    | -                  | -   | -   | 28,760                           |
| David Sutton<br>Executive Director<br>Resigned May 11, 2011   | 2012        | -   | -                  | -   | -   | -                                |
|   | 2011        | 28,760                                    | -                  | -   | -   | 28,760                           |
| Alexander Rose-Innes<br>Executive<br>Resigned May 11, 2011  | 2012        | -   | -                  | -   | -   | -                                |
|   | 2011        | 50,000                                    | -                  | 6,000   | -   | 56,000                           |
| <b>Total</b>  | <b>2012</b> | <b>415,752</b>                            | <b>-</b>           | <b>-</b>                                      | <b>48,694</b>   | <b>464,446</b>                   |
|   | <b>2011</b> | <b>500,336</b>                            | <b>-</b>           | <b>6,000</b>                                  | <b>58,822</b>   | <b>565,158</b>                   |

**REMUNERATION REPORT (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Notes:**

- (1) Remuneration is not based on performance criteria.
- (2) Remuneration is not currently linked to company performance or share price (refer to Note 11 regarding Performance Rights).
- (3) The following key personnel's unpaid fees that were paid in shares on February 24, 2012.

| Name                 | Wages and<br>superannuation | Shares issued     | Share price     |
|----------------------|-----------------------------|-------------------|-----------------|
|                      | \$                          | Number            | \$              |
| Raymond Shaw         | 136,988                     | 4,040,951         | \$0.0339        |
| Norman Zillman       | 96,280                      | 2,840,118         | \$0.0339        |
| Stephen Pearce       | 73,722                      | 2,174,717         | \$0.0339        |
| Alexander Rose-Innes | 50,000                      | 1,474,926         | \$0.0339        |
| David Sutton         | 79,364                      | 2,341,105         | \$0.0339        |
| <b>Total</b>         | <b>436,354</b>              | <b>12,871,817</b> | <b>\$0.0339</b> |

- (4) In the prior year Alexander Rose-Innes was issued with 10,000,000 options following satisfaction of certain conditions, including shareholder approval at the Annual General meeting. The vested options were valued using Black-Scholes at \$6,000 as at August 3, 2010.
- (5) Annual leave charge amounted to \$21,445 (2011: \$33,639).
- (6) At the year end the following compensation remain unpaid:

| Related party   | Debtor/(Creditor)<br>Balance<br>September 30,<br>2011<br>\$ | (Charge)/Credit to<br>Consolidated<br>Restated Income<br>Statement<br>\$ | Paid/(received)<br>during the period<br>\$ | Debtor/(Creditor)<br>Balance<br>September 30,<br>2012<br>\$ |
|---|---|--|--|---|
| <u>Remuneration Payable to Directors<br/>including superannuation</u> |   |  |  |   |
| S Pearce  | (73,722)  | -  | 73,722 <sup>(1)</sup>                      | -   |
| D Sutton  | (73,171)  | -  | 73,171 <sup>(1)</sup>                      | -   |
| R Shaw  | (109,905)   | (65,000)   | 136,988 <sup>(1)</sup>                     | (37,917)  |
| N Zillman   | (76,280)  | (27,067)   | 96,280 <sup>(1)</sup>                      | (7,067)   |
| M Lucas-Smith   | -   | (20,933)   | 7,733                                      | (13,200)  |
| A Rose-Innes  | (50,000)  | -  | 50,000 <sup>(1)</sup>                      | -   |
| T Marshall  | (37,384)  | (351,446)  | 245,229                                    | (143,601)   |
|   | <b>(420,462)</b>  | <b>(464,446)</b>   | <b>683,123</b>                             | <b>(201,785)</b>  |

**EARTH HEAT RESOURCES LTD  
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**MANAGEMENT DISCUSSION AND ANALYSIS (IN AUSTRALIAN DOLLARS)  
SEPTEMBER 30, 2012**

The following management's discussion and analysis ("MD&A") focuses on significant factors that affected Earth Heat Resources Ltd ("EHR" or the "Company") and its subsidiaries ("Consolidated Entity") during the relevant reporting period and to the date of this report. It contains a review and analysis of the financial results for the twelve months ended September 30, 2012, identifies business risks that the Company faced and comments on the financial resources required for the development of the business.

The MD&A supplements, but does not form part of the audited annual consolidated financial statements of the Company and the notes thereto for the twelve months ended September 30, 2012 (the "September 30 Annual Financial Statements" or "consolidated financial statements") and consequently should be read in conjunction with the aforementioned financial statements and notes thereto. The information in this MD&A is current as of December 21, 2012.

All amounts, unless specifically identified as otherwise, both in the consolidated financial statements and this MD&A are expressed in Australian dollars.

**Forward Looking Information**

This MD&A contains certain "forward-looking information" which may include, but is not limited to, statements with respect to future events or future performance, management's expectations regarding the Company's growth, results of operations, estimated future revenues, requirements for additional capital, production costs and revenue, future demand for and prices of electricity, business prospects and opportunities. In addition, statements relating to estimates of recoverable geothermal energy "reserves" or "resources" or energy generation are forward-looking information, as they involve implied assessment, based on certain estimates and assumptions, that the geothermal resources and reserves described can be profitably produced in the future. Such forward-looking information reflects management's current beliefs and is based on information currently available to management. Often, but not always, forward-looking statements can be identified by the use of words such as "plans", "expects", "is expected", "budget", "scheduled", "estimates", "forecasts", "predicts", "intends", "targets", "aims", "anticipates" or "believes" or variations (including negative variations) of such words and phrases or may be identified by statements to the effect that certain actions "may", "could", "should", "would", "might" or "will" be taken, occur or be achieved. A number of known and unknown risks, uncertainties and other factors may cause the actual results or performance to materially differ from any future results or performance expressed or implied by the forward-looking information. Such factors include, among others, general business, economic, competitive, political and social uncertainties; the actual results of current geothermal energy production, development and/or exploration activities and the accuracy of probability simulations prepared to predict prospective geothermal resources; changes in project parameters as plans continue to be refined; possible variations of production rates; failure of plant, equipment or processes to operate as anticipated; accidents, labour disputes and other risks of the geothermal industry; political instability or insurrection or war; labour force availability and turnover; delays in obtaining governmental approvals or in the completion of development or construction activities or in the commencement of operations; as well as those factors discussed in the section entitled "Risks and Uncertainties" in this MD&A. These factors should be considered carefully and readers of this MD&A should not place undue reliance on forward-looking information.

Although the forward-looking information contained in this MD&A is based upon what management believes to be reasonable assumptions, there can be no assurance that such forward-looking information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such information. Accordingly, readers should not place undue reliance on forward-looking information. Such forward-looking information is made as of the date of this MD&A and, other than as required by applicable securities laws, Earth Heat Resources Ltd assumes no obligation to update or revise such forward-looking information to reflect new events or circumstances.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### **Use of Non-GAAP Measures**

In this document, we refer to terms that do not have any standardized meaning prescribed by International Financial Reporting Standards ("IFRS"). Our usage of these terms may vary from the usage adapted by other companies. In this document and in the Company's financial statements, unless otherwise noted, all financial data is prepared in accordance with IFRS as issued by the International Accounting Standards Board.

#### **Business Overview and Strategy**

The Company was previously known as Fall River Resources Ltd. ("Fall River"). Fall River traded on the TSX-Ventures Exchange ("TSX-V"), and Australian Securities Exchange ("ASX"), and was engaged in the exploration and development of oil and gas interests. Fall River was de-listed from the TSX-V on September 30, 2007 and continued to trade on the ASX. In July 2010 Fall River changed its name to Earth Heat Resources ("EHR").

In January 2010, when under the previous name, Fall River, the Company successfully entered the geothermal market becoming a "new energy company" through the acquisition of Earth Heat Australia Pty Ltd ("EHR Australia").

The Consolidated Entity is currently engaged in the operation, development, exploration and acquisition of energy projects (Oil/Gas & Geothermal projects globally). The Company is working avidly to build on its residual North American oil and gas interest to create a situation where first earnings can be generated in the shortest possible timeframe. Geothermal assets in today's capially challenging environment are regarded as long term value drivers within the current business portfolio.

#### **Overview**

During the period the principal continuing activities of the Consolidated Entity was geothermal exploration in Argentina, and oil and gas new venture appraisal in the United States of America.

#### **Projects**

As part of the Group's strategy, a considerable number of new venture opportunities in North America were reviewed in support of the business expansion strategy. This has not yielded any high value projects yet, but the Company expects this to change during the first half of calendar 2013.

Considerable progress was made in the Argentinean Copahue Project during the year where:

- Additional Power Purchase Agreement demand was identified and announced to market;
- Additional debt funding appetite was announced to the market; and
- Additional operational works, inclusive of a Stage 2 Environmental Impact Assessment, Transmission Studies, Engineering Studies (by Alstom), and Community Liaison were completed or commenced

The footprint that EHR has in Argentina is potentially expandable via the participation in several new properties in Mendoza, though the assessment of both the Las Molles and Peteroa properties is not yet complete thus a formal participation is not guaranteed.

In Djibouti progress was slowed by the inability of the Company to find a suitable Joint Venture partner to participate in the project. No progress is expected unless such a partner can be identified and terms agreed with. Equally in Kenya and Botswana, applications that have not been actioned by the state authorities will not be pursued without an equivalent partnership and therefore could be withdrawn.

Residual projects in Australia were relinquished in their entirety as they were considered by the board to be low value properties in comparison to the balance of the portfolio in Argentina and Africa.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### **North America Listing**

Due to the prevailing fragile economic climate, the Company will not proceed with a listing in North America at this time. This will be reviewed on a six monthly basis for the foreseeable future.

#### **Significant changes in the state of affairs**

The significant changes in the state of affairs of the Consolidated Entity during the financial year comprises:

- The raising of \$1,946,100 through a placement of 64,870,001 shares in March of 2012.
- The announcement of the intention to purchase its Joint Venture partner in Copahue, Geothermal One Inc for total consideration of CDN \$6,000,000 in cash or stock. To fund the transaction and the ongoing project costs, a US\$30m preference share raising was launched. The Company has been unable to raise the funds to complete this transaction as at the end of the Financial Year and its completion in the current economic circumstances remains uncertain.
- The raising of \$670,000 through a placement in August of 2012 to support ongoing operations of the Company
- Subsequent to the end of the financial year, a placement was completed prior to a fully underwritten rights issue being launched the funds from which are to assist the company in its identification and participation in shorter term energy projects, focused predominantly (but not exclusively) in North America

There were no other significant changes to the state of affairs of the Consolidated Entity during the financial year.

#### **Operational Overview**

The Company's operational overview includes operational, exploration and development activities for the period October 1, 2011 to the date of the release of this report, December 21, 2012.

#### **Copahue Project Argentina**

In May 2010 Earth Heat entered into a Heads of Agreement to farm in to the Copahue Geothermal Development Project ('Copahue Project') located in Argentina.

The Copahue Project is located within a large caldera in the Neuquen Province of Argentina, approximately 300 km from the provincial capital and within a few kilometres of the Chilean border. The geothermal resource on which the Project is based occurs on the northeast flank of the Copahue volcano.

At Copahue, geothermal exploration and development activities have been undertaken since the 1970's, including a number of superficial and shallow exploratory surveys – in particular geology, geochemistry, geophysics and temperature gradient drilling. Four deep wells, reaching depths of approximately 1,414m, drilled in the area demonstrated the presence of an exploitable hot dry vapour (steam) dominated geothermal reservoir.

One of these wells, COP-1, was used to supply a pilot power plant, with a capacity of slightly less than 1MW for several years. The most recent well, COP-4, was drilled to supply a district heating system at Termas de Copahue where a pipeline was constructed from the well field.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

A full pre-feasibility study completed by the Japanese International Cooperation Agency in 1992 indicated that an area covering approximately 4 km<sup>2</sup> around the pilot power plant had the potential to support an initial 30MWe power station, with individual wells capable of producing more than 7MWe. Numerous shallow gradient holes and subsequent studies indicated the geothermal potential might support over 100 MW of power generation on the basis that these reservoirs extend over an area of 30km<sup>2</sup> or more. The Company reviewed the available information, and also commissioned an independent review by Sinclair Knight Merz ("SKM"), which resulted in a material 150% increase in total resources, and quite a positive concept study illustrating the technical potential of the project itself.

Overall significant progress was made during the period with:

- The announcement of up to US\$210m of debt funding through the Inter-American Development bank to fund up to a 50Mwe plant (subject to formal close conditions);
- The identification of key investors in and the announcement of a US\$22.5m Drilling Loan which would enable three out of the four proposed development wells to be completed during a phase 1 development at Copahue;
- The announcement of Xstrata Copper (Pachon) issuing a Letter of Intent to enter into a binding Power Purchase Agreement with the Company covering a minimum 50MWe of future output;
- Completion of the inaugural field program at Copahue/Caviahue with experts from New Zealand (SKM) and Mexico (Alstom) This resulted in a number of very positive technical outcomes such as confirmation of the high quality resource over an extended area and the confirmation of technology type and approximate price of a turnkey EPC through one of the world's biggest companies;
- Initiation of a second stage Environmental Impact Assessment in preparation for drilling;
- Initiation and near completion of an electrical transmission study as part of the future full feasibility study
- Tendering for the first phase geophysical program to be completed (under concession contract) during the next financial year.

The operational progress overall has been significantly constrained by the lack of funds available to accelerate the project. As it stands currently the progress completed to date is at risk of its future value being significantly compromised through the inability to move to the next stage. This could result in key items having to be re-completed in future and or will affect the ability to close key financial transactions by not being completed properly.

#### **Fiale Geothermal Project, Djibouti**

The lack of communication from the Djiboutian Government in terms of Power Purchase Agreements, in concert with the lack of progress on other confidential initiatives involving Joint Venture parties saw the progress on Fiale stall over the year. It is unlikely that the project will progress without a suitable partner or motivation to discuss key issues from within the Government of Djibouti itself.

The Board of Earth Heat regards this as an interesting and potentially very high upside project, but at this point in time within the cash constraints that the Company has, it cannot be pursued on a 100% risk basis.

#### **Australian Geothermal Exploration Assets, South Australia**

Due to market deterioration for geothermal companies as a whole, all the South Australian tenements were relinquished, subsequent to the end of the Financial Year (confirmed on October 25, 2012).

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### **Broadening the Asset Base – A Review**

Following the continuing decline of investor interest in pure geothermal plays the Company engaged corporate advisors as well as undertook an internal review of its fundamental business strategy. Given the synergy between geothermal and petroleum industry subsurface activities, and the substantial in-house expertise in the oil and gas sector an active program of assessing viable oil and gas opportunities commenced during the year as a means of broadening our asset base and introducing projects with more market traction and investor appeal. This is to counteract the negativity of being cast as a geothermal pure play only company and provide a significant boost to near term potential cash flows and ability to effectively raise future funding via the equity markets. Since the end of the financial year the focus of these evaluations and negotiations has been within the oil and gas energy space, and in particular the “unconventional” plays in North America. While no formal agreements have been consummated, this is expected to change during 2013.

#### **Financial Overview**

##### **Results of operations**

The consolidated comprehensive loss of the Consolidated Entity after providing for income tax for the financial year ended September 30, 2012 was \$5,077,388 compared to a loss for the previous corresponding period of \$1,507,701. The significant differences since the previous period:

- Impairment of the following projects:
  - South Australian Geothermal Projects \$2,762,694
  - African projects \$615,207
  - Total \$3,377,901
- During the year, the Company paid \$467,434 (2011 \$nil) in finance fees to the future project financiers of the Copahue project. The finance fees include:
  - AGS Capital Group LLC’s Capital Contingency Finance,
  - Corporation Interamericana para el Financiamiento de Infraestructura’s Drilling Loan and
  - Inter-America Development Bank’s Senior Debt Facility.

##### **Summary of Results**

The following table sets forth selected financial information for each of the most recent eight quarters and three previous years prepared in accordance with international financial reporting standards (“IFRS”) and interpretations issued by the International Accounting Standards Board (“IASB”).

The functional currency of the Company and each subsidiary is Australian dollars, except for Spring River Resources Inc whose functional currency is U.S. dollars.

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

*Summary of Financial Results for the Eight Recent Quarters*

| Quarter Ending     | Revenue | Net Profit/(Loss) | Net Profit/(Loss) per Share |
|--------------------|---------|-------------------|-----------------------------|
|                    | AUD \$  | AUD \$            | AUD \$                      |
| September 30, 2012 | -       | (4,108,612)       | (0.0058)                    |
| June 30, 2012      | -       | (365,334)         | (0.0005)                    |
| March 31, 2012     | -       | (382,707)         | (0.0006)                    |
| December 31, 2011  | -       | (220,735)         | (0.0004)                    |
| September 30, 2011 | -       | (327,000)         | (0.0006)                    |
| June 30, 2011      | -       | (427,428)         | (0.0008)                    |
| March 31, 2011     | -       | (385,256)         | (0.0007)                    |
| December 31, 2010  | -       | (368,017)         | (0.0007)                    |

*Summary of Financial Results for the Three Recent Years*

| Year Ending        | Revenue | Net Comprehensive Profit/(Loss) For the Year | Net Profit/(Loss) per Share Basic | Total Assets | Total Liabilities |
|--------------------|---------|--|-----------------------------------|--------------|-------------------|
|                    | AUD \$  | AUD \$                                       | AUD \$                            | AUD \$       | AUD \$            |
| September 30, 2012 | -       | (5,077,388)                                  | (0.84)                            | 2,614,385    | 470,491           |
| September 30, 2011 | -       | (1,507,701)                                  | (0.28)                            | 4,120,403    | 665,732           |
| September 30, 2010 | -       | 349,142                                      | 0.09                              | 3,005,890    | 314,029           |

**Liquidity and Capital Resources**

The Company has financed its operations mainly through the sale of its common shares or securities convertible into common shares to investors.

The Company had a working capital deficiency of \$52,635 at September 30, 2012 compared to a working capital deficiency of \$293,451 at September 30, 2011. The improvement in working capital is primarily related to a decrease in amounts due to related parties, as a result of \$436,403 being paid in shares. Since the year end the Company has raised over \$200,000 in equity and has a fully underwritten renounceable pro-rata rights issue at an issue price of \$0.002 per new share to raise up to approximately \$1,290,000 cash before expenses.

The Company has announced project financing facilities covering both Senior Debt and a Drilling Loan. These facilities are subject to a number of formal close conditions which were not met during the year. It is unclear whether these conditions will be met during the next financial year which would enable funds to be drawn down on an agreed project schedule.

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Share Capital**

During the period from October 1, 2011 to September 30, 2012 the Company issued the following shares:

|   | Number                       |                              | Consideration               |                             |
|---|------------------------------|------------------------------|-----------------------------|-----------------------------|
|   | September 30,<br>2012<br>No. | September 30,<br>2011<br>No. | September 30,<br>2012<br>\$ | September 30,<br>2011<br>\$ |
| Balance, beginning of period  | <b>569,532,643</b>           | 524,178,687                  | <b>19,772,010</b>           | 17,554,135                  |
| <b>Shares issued in period</b>  |                              |                              |                             |                             |
| October 31, 2011 Securities issued on exercise of Options <sup>(1)</sup>                                    | <b>10,000,000</b>            | -                            | <b>200,000</b>              | -                           |
| December 15, 2011 Securities issued to sophisticated investors <sup>(2)</sup>                               | <b>20,000,000</b>            | -                            | <b>600,000</b>              | -                           |
| February 24, 2012 Securities issued <sup>(3)</sup>  | <b>12,871,817</b>            | -                            | <b>436,354</b>              | -                           |
| March 12, 2012 Securities issued as a special share placement <sup>(4)</sup>                                | <b>64,870,001</b>            | -                            | <b>1,946,100</b>            | -                           |
| August 10, 2012 Securities issued as a special share placement <sup>(5)</sup>                               | <b>67,000,000</b>            | -                            | <b>670,000</b>              | -                           |
| August 10, 2012 Securities issued in settlement of services provided <sup>(6)</sup>                         | <b>10,000,000</b>            | -                            | <b>100,000</b>              | --                          |
| <b>Shares issued in prior period</b>  |                              |                              |                             |                             |
| October 26, 2010 Security issued as consideration for the acquisition of African opportunities              | -                            | 9,125,000                    | -                           | 228,125                     |
| October 26, 2010 Security issued in settlement of a commercial agreement for African opportunities          | -                            | 912,500                      | -                           | 22,813                      |
| October 26, 2010 Security issued to sophisticated investors   | -                            | 10,000,000                   | -                           | 250,000                     |
| February 14, 2011 Security issued to Socius CG II pursuant to a Share Subscription Agreement <sup>(8)</sup> | -                            | 25,316,456                   | -                           | 2,000,000                   |
| <b>Share issue costs</b>  | -                            | -                            | <b>(215,421)</b>            | (283,063)                   |
| <b>Balance, end of period</b>   | <b>874,274,461</b>           | 569,532,643                  | <b>23,509,043</b>           | 19,772,010                  |

Notes:

<sup>(1)</sup>On October 31, 2011 Securities issued on exercise of Options at \$0.02 per share.

<sup>(2)</sup>On December 15, 2011 Securities issued to sophisticated investors at \$0.03 per share.

<sup>(3)</sup>On February 24, 2012 Securities issued to directors in lieu of cash payment for accumulated directors' fees at \$0.0339 (based on VWAP over the 5 trading days immediately prior to date of the AGM, when the issue was approved).

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

- <sup>(4)</sup>On March 12, 2012 Securities issued as a special share placement to sophisticated investors at \$0.03 per share.
- <sup>(5)</sup>On August 10, 2012, Securities issued to sophisticated investors at \$0.01 per share.
- <sup>(6)</sup>On August 10, 2012, Securities issued in settlement of services provided escrowed until next general meeting (released October 25, 2012).
- <sup>(7)</sup>December 6, 2012 110,000,000 Securities issued as a special share placement with 55,000,000 free attaching options exercise price of \$0.007 expiring January 31, 2016. The options are subject to shareholder approval at the 2013 AGM.
- <sup>(8)</sup>On February 14, 2011, 25,316,456 ordinary shares and 12,658,228 unquoted options were issued Socius CG II for \$2,000,000 as the first tranche in pursuant to a Share Subscription Agreement dated February 14, 2011 Under the Agreement the total investment of up to \$5,000,000 over the next six months, in two tranches of \$2,000,000 and one \$1,000,000 at issue prices for the shares equivalents to the closing bid price of the Company's CDI/ORD shares the day before closing, plus unquoted five year options to 50% in number of the share issue at an exercise price equivalent to the related share issue price. The 12,658,228 unquoted options issued have an exercise price of \$0.079 and expire on February 14, 2016.

**Shares under option or issued on exercise of options**

During the period from October 1, 2011 to September 30, 2012 the Company adopted its current employee share and option scheme (the "Scheme") effective February 23, 2011. Under the Scheme, the Company may grant options to acquire ordinary shares in Earth Heat Resources Ltd to a maximum of 5% of the issued and outstanding common shares at the date of grant. No options have been issued under the Scheme. The fair value of share options is estimated using the Black-Scholes option pricing model.

The Company has the following history of share options outstanding:

|  | Number of<br>Options | Weighted Average<br>Exercise Price |
|--|----------------------|------------------------------------|
| Balance, September 30, 2010                          | 73,333               | \$0.540                            |
| Expired unexercised on November 10, 2010             | (73,333)             | \$0.540                            |
| Issued on 14 February 2011 <sup>(1)</sup>            | 12,658,228           | \$0.079                            |
| Issued on 25 February 2011 <sup>(2)</sup>            | 42,000,000           | \$0.044                            |
| Lapsed on May 11, 2011 <sup>(2)</sup>                | (20,000,000)         | \$0.065                            |
| Lapsed on August 3, 2011 <sup>(2)</sup>              | (10,000,000)         | \$0.030                            |
| <b>Balance at September 30, 2011</b>                 | <b>24,658,228</b>    | <b>\$0.045</b>                     |
| Balance, September 30, 2010                          | 24,658,228           | \$0.045                            |
| Expired exercised on October 30, 2011 <sup>(3)</sup> | (10,000,000)         | \$0.020                            |
| Issued on December 15, 2011 <sup>(4)</sup>           | 10,000,000           | \$0.060                            |
| Issued on August 10, 2012 <sup>(5)</sup>             | 23,500,000           | \$0.010                            |
| Issued on December 6, 2012 <sup>(6)</sup>            | 55,000,000           | \$0.010                            |
| <b>Balance at December 21, 2012</b>                  | <b>103,158,228</b>   | <b>\$0.036</b>                     |

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

The following table summarises information about the stock options outstanding and exercisable at the date of this report:

| <b>Expiry Date</b>               | <b>Exercise Price<br/>December 21,<br/>2012</b> | <b>Number of<br/>Options<br/>December 21,<br/>2012</b> | <b>Exercise Price<br/>December 30,<br/>2011</b> | <b>Number of<br/>Options<br/>December 30,<br/>2011</b> |
|----------------------------------|---|--|---|--|
| July 30, 2013 <sup>(2)</sup>     | -   | -  | \$0.020   | 5,000,000  |
| July 30, 2013 <sup>(2)</sup>     | \$0.030   | 1,000,000  | \$0.030   | 1,000,000  |
| July 30, 2013 <sup>(2)</sup>     | -   | -  | \$0.020   | 5,000,000  |
| July 30, 2013 <sup>(2)</sup>     | \$0.030   | 1,000,000  | \$0.030   | 1,000,000  |
| February 14, 2016 <sup>(1)</sup> | \$0.079   | 12,658,228   | \$0.079   | 12,658,228   |
| December 15, 2012 <sup>(4)</sup> | -   | -  | -   | -  |
| August 10, 2015 <sup>(5)</sup>   | \$0.010   | 23,500,000   | -   | -  |
| January 31, 2016 <sup>(6)</sup>  | \$0.007   | 55,000,000   | -   | -  |
|                                  | <b>\$0.040</b>                                  | <b>93,158,228</b>                                      | <b>\$0.045</b>                                  | <b>24,658,228</b>                                      |

All options granted had exercise prices equal to or higher than market on the day of grant.

**Notes**

<sup>(1)</sup>On February 14, 2011, 25,316,456 ordinary shares and 12,658,228 unquoted options were issued Socius CG II for \$2,000,000 as the first tranche in pursuant to a Share Subscription Agreement dated February 14, 2011 Under the Agreement the total investment of up to \$5,000,000 over the next six months, in two tranches of \$2,000,000 and one \$1,000,000 at issue prices for the shares equivalents to the closing bid price of the Company's CDI/ORD shares the day before closing, plus unquoted five year options to 50% in number of the share issue at an exercise price equivalent to the related share issue price. The 12,658,228 unquoted options issued have an exercise price of \$0.079 and expire on February 14, 2016.

<sup>(2)</sup>On February 25, 2011, as part of the Executive Director, Alexander Rose-Innes remuneration package, 30,000,000 options are to be issued, subject to certain conditions, including shareholder approval. The Black-Scholes valuation of vested options at the effective grant date of August 3, 2010 of those options vested amounted to \$6,000. On 11 May 2011 Mr Rose Innes resigned and as a result 20,000,000 options lapsed and the remaining 10,000,000 lapsed unexercised on August 3, 2011. In addition on 25 February 2011, 12,000,000 options were issued to David Anderson as consideration for the acquisition of certain African opportunities. The Black-Scholes valuation of vested options at the effective grant date of August 3, 2010 and July 30, 2011 amounted to \$58,500. The Black-Scholes valuation was based on an interest free rate of 5.5% and 75% volatility. In the geothermal industry and in the current market the volatility generally used is high, the directors have estimated a 75% volatility for the Company.

<sup>(3)</sup>On October 31, 2011, 10,000,000 Options at \$0.02 were exercised raising \$200,000.

<sup>(4)</sup>On December 15, 2011, 10,000,000 Attaching Options were issued to sophisticated investors, these options expired December 15, 2012.

<sup>(5)</sup>On August 10, 2012, 23,500,000 Attaching Options were issued to sophisticated investors.

<sup>(6)</sup>December 6, 2012 Securities issued as a special share placement with 55,000,000 free attaching options exercise price of \$0.007 expiring January 31, 2016, subject to shareholder approval at the AGM.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### **Performance Rights Reserve**

On February 24, 2012, as part of a long term incentive 40,000,000 Performance Rights were issued to Mr Torey Marshall, Managing Director. The Black-Scholes valuation of Performance Rights at the effective grant period over five years of those rights vested amounted to \$240,000 per annum over the next five years. During the half-year \$20,000 of equity based remuneration was charged to the Comprehensive Income Statement.

The Board has reviewed the Performance Right Key Performance Indicators ("KPIs") and concluded that no discretion is expected to be used to award any shares under the Managing Director's performance rights. At the September 30, 2012 the Managing Director is not expected to be awarded any Performance Right shares and as a result the \$20,000 charge to the Statement of Comprehensive Income Statement for the Managing Director's Performance Rights is no longer required.

#### **Securities on issue**

The Company had the following securities on issue at December 21, 2012:

|  | <u>Number</u>      |
|--|--------------------|
| Ordinary shares quoted on the ASX                    | 861,010,038        |
| Common shares issued in Canada not quoted on the ASX | 3,264,423          |
| Total ordinary shares                                | <u>864,274,461</u> |
| Unquoted performance rights                          | 40,000,000         |
| Unquoted stock options issued                        | <u>93,158,228</u>  |

#### **Subsequent to September 30, 2012**

On December 6, 2012 110,000,000 Securities issued as a special share placement with 55,000,000 free attaching options exercise price of \$0.007 expiring January 31, 2016, subject to shareholder approval at the AGM.

The Board has reviewed the Performance Right Key Performance Indicators ("KPIs") and resolved that the Managing Directors 40,000,000 performance rights are no longer capable of being met and are therefore cancelled.

Unquoted options totalling 10,000,000 with an exercise price of \$0.06 were not exercised and have expired on December 15, 2012.

#### **Subsequent to December 21, 2012**

The Company had announced a fully underwritten renounceable rights issue. 645,757,529 new ordinary Share are expected to be issued on January 21, 2013 for \$0.002 consideration for each share free attaching option:

- Short dated options 322,878,764 exercise price of \$0.005 expiring January 31, 2014 for every two new shares issued and
- Long dated options up to 971,010,038 including underwriting and broker fees exercise price of \$0.007 expiring January 31, 2016 for every three new shares issued

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Related Party Transactions**

**I) Related Party Transactions**

During the year the Company entered into employment contracts and loan agreements with directors and consultants that are considered to be related parties. The purpose of the transactions entered into with related parties was to facilitate the Company's strategic, operating and financing activities.

The Related party transactions mentioned above are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Amounts due to related parties are unsecured with no specific terms of repayment.

| <b>Related party<br/>September 30, 2012</b>                           | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2011<br/>\$</b> | <b>(Charge)/Credit to<br/>Consolidated<br/>Restated Income<br/>Statement<br/>\$</b> | <b>Paid/(received)<br/>during the period<br/>\$</b> | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2012<br/>\$</b> |
|---|--|---|---|--|
| <u>Remuneration Payable to Directors<br/>including superannuation</u> |  |   |   |  |
| S Pearce  | (73,722)   | -   | 73,722 <sup>(1)</sup>                               | -  |
| D Sutton  | (73,171)   | -   | 73,171 <sup>(1)</sup>                               | -  |
| R Shaw  | (109,905)  | (65,000)  | 136,988 <sup>(1)</sup>                              | (37,917)   |
| N Zillman   | (76,280)   | (27,067)  | 96,280 <sup>(1)</sup>                               | (7,067)  |
| M Lucas-Smith   | -  | (20,933)  | 7,733   | (13,200)   |
| A Rose-Innes  | (50,000)   | -   | 50,000 <sup>(1)</sup>                               | -  |
| T Marshall  | (37,384)   | (351,446)   | 245,229   | (143,601)  |
|   | (420,462)  | (464,446)   | 683,123   | (201,785)  |

| <b>Related party<br/>September 30, 2011</b>                           | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2010<br/>AUD\$</b> | <b>(Charge)/Credit to<br/>Consolidated<br/>Restated Income<br/>Statement<br/>AUD\$</b> | <b>Paid/(received)<br/>during the period<br/>AUD\$</b> | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2011<br/>AUD\$</b> |
|---|---|--|--|---|
| <u>Remuneration Payable to Directors<br/>including superannuation</u> |   |  |  |   |
| S Pearce  | (44,962)  | (28,760)   | -  | (73,722)  |
| D Sutton  | (44,411)  | (28,760)   | -  | (73,171)  |
| R Shaw  | (44,905)  | (65,000)   | -  | (109,905)   |
| N Zillman   | (28,280)  | (48,000)   | -  | (76,280)  |
| A Rose-Innes  | -   | (56,000)   | 6,000 <sup>(1)</sup>                                   | (50,000)  |
| T Marshall –annual leave provision                                    | (3,745)   | (338,638)  | 304,999  | (37,384)  |
|   | (166,303)   | (565,158)  | 310,999  | (420,462)   |

**Notes**

<sup>(1)</sup> Equity based payment (net of GST) refer to Note 11(a) for further details.

<sup>(2)</sup> Equity based payment in lieu of cash refer to Note 11(b) for further details.

During the year, salaries of \$351,446 (2011: 338,638) and directors fees of \$113,000 (2011: \$226,520) were paid or accrued by the Company to Directors. The following Director's unpaid remuneration that was paid in shares on February 24, 2012.

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

| Name                 | Wages and<br>superannuation | Shares issued | Share price<br>per share |
|----------------------|-----------------------------|---------------|--------------------------|
|                      | \$                          | Number        | \$                       |
| Raymond Shaw         | 136,988                     | 4,040,951     | \$0.0339                 |
| Norman Zillman       | 96,280                      | 2,840,118     | \$0.0339                 |
| Stephen Pearce       | 73,722                      | 2,174,717     | \$0.0339                 |
| Alexander Rose-Innes | 50,000                      | 1,474,926     | \$0.0339                 |
| David Sutton         | 79,364                      | 2,341,105     | \$0.0339                 |
| Total                | 436,354                     | 12,871,817    | \$0.0339                 |

**II) Key management personnel**

Key management personnel include the directors and company secretary.

The names of persons who were directors of the Company at any time during the financial year were:

Key management personnel include the directors and company secretary.

The names of persons who were directors of the Company at any time during the financial year were:

Dr R Shaw (appointed January 22, 2010)

T Marshall (appointed January 22, 2010)

M Lucas-Smith (appointed April 23, 2012)

N Zillman (appointed February 26, 2010, resigned April 23, 2012)

M Lucas-Smith is Company Secretary (appointed January 22, 2010)

**III) Remuneration of key management personnel**

Shares or options over unissued shares in the Company held during the financial year by any key management personnel of the Company including their related parties as at September 30, 2012 are disclosed in the Directors Information section of this Report.

The full Board of Directors sets remuneration policies and practices generally and makes specific recommendations on remuneration packages and other terms of employment for Executive Directors, other Senior Executives and Non-Executive Directors.

Remuneration arrangement of key management personnel are disclosed in the Remuneration Report that forms part of the Directors Report.

**IV) Directors' Interests**

Shares or options over unissued shares in the Company held by any director of the Company including their related parties as at September 30, 2012 are as follows:

| Director                           | Number of shares owned or<br>over which control is<br>exercised | Number of options owned or<br>over which control is<br>exercised - including<br>exercise price |
|------------------------------------|---|--|
| Raymond Shaw <sup>(1)</sup>        | 72,130,592  | Nil  |
| Torey Marshall <sup>(2)</sup>      | 69,363,925  | Nil  |
| Malcolm Lucas Smith <sup>(3)</sup> | 1,000,000   | Nil  |
| Norman Zillman <sup>(4)</sup>      | -   | Nil  |

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### Notes:

- (1) In February 2012, 4,040,951 shares were issued in lieu of accumulated remuneration. In addition, 63,414,641 of Dr Raymond Shaw's shares were released from voluntary escrow on January 22, 2012.
- (2) 63,414,641 of Torey Marshall's shares were released from voluntary escrow on January 22, 2012. In February 2012 40,000,000 Performance Rights were issued as part of the Executives remuneration at no cost, subject to the achievement of the Key Performance Indicators ("KPIs") at the discretion of the Board. At the date of this report the Board resolved that the KPI could not be met (refer to Note 11 for further details).
- (3) Malcolm Lucas-Smith acquired 1,000,000 shares at \$0.03 on March 12, 2012.
- (4) Norman Zillman resigned as a director on April 23, 2012. During the period to the date of his resignation, Norman Zillman acquired 3,000,000 shares at \$0.01 and was issued 2,840,118 shares in lieu of remuneration; in addition, 63,414,628 of his shares were released from voluntary escrow on January 22, 2012.

#### **Subsequent Events**

The Board has reviewed the Performance Right Key Performance Indicators ("KPIs") and resolved that the Managing Directors 40,000,000 performance rights are no longer capable of being met and are therefore cancelled.

Unquoted options totalling 10,000,000 with an exercise price of \$0.06 were not exercised and have expired on December 15, 2012.

Subsequent to the end of the financial year, a placement of 110,000,000 shares raised \$220,000 and a fully underwritten rights issue has been launched to assist the company in its identification and participation in shorter term energy projects, focussed predominantly (but not exclusively) in North America

The Company has announced a fully underwritten renounceable rights issue. 645,757,529 new ordinary Share are expected to be issued on January 21, 2013 for \$0.002 consideration for each share free attaching option:

- Short dated options 322,878,764 exercise price of \$0.005 expiring January 31, 2014 for every two new shares issued; and
- Long dated options up to 971,010,038 including underwriting and broker fees exercise price of \$0.007 expiring January 31, 2016 for every three new shares issued

The Underwriting Agreement makes provisions for certain covenants to be observed by the Company and also circumstances in which the Underwriter may terminate the Underwriting Agreement. Some of those provisions which allow termination of the Underwriting Agreement are summarised as following:

- i. If the ASX All Ordinaries Index is at any time after the date of this Agreement at a level that is 10% or more below its respective level as at the close of trading on the Business Day prior to the date of the Underwriting Agreement Business Days after the date of the Underwriting Agreement;
- ii. If the Company's Shares have a closing price at any time after the date of the Underwriting Agreement less than the Price of the Rights Shares for two consecutive days;
- iii. The Company does not lodge the Prospectus on the lodgment Date, being December 13, 2012, or the Offer is withdrawn.
- iv. ASX notifies that Official Quotation will not be granted, or once granted, is withdrawn.

In December 2012, the Company announced a broadened direction; this follows the continuing decline of investor interest in pure geothermal plays.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

The Company received PIRSA confirmation that all Australian projects have been surrendered, effective October 25, 2012.

Except for the matters referred to above, there is no other matter or circumstance that has arisen since September 30, 2012 that has significantly affected or may significantly affect:

- a) the operations, in financial years subsequent to September 30, 2012, of the Consolidated Entity;
- b) the results of those operations; or
- c) the state of affairs, in financial years subsequent to September 30, 2012 of the Consolidated Entity.

#### **Dividends**

The directors do not recommend the payment of a dividend.

#### **Moving Forward and Likely Developments**

The Company is aggressively pursuing its new strategy to become a major part of the New Energy Economy as a New Energy Company. This involves the continued screening of suitable opportunities that will meet advanced project status criteria set by the Company.

An essential part of moving forward will be balancing out the long term value drivers inside the existing geothermal portfolio with shorter term drivers which will bring forward first cashflow and ultimately enable a more rounded company asset portfolio to perform at a peak level. This is likely to take the form of continuing to analyse and negotiation on suitable new ventures in the oil and gas space which address the key criteria that the board has used successfully in the past.

Depending on the opportunities identified, it is likely that the mix of assets and values will change substantially during the coming year.

Except for information disclosed on certain developments and the expected results of those developments included under review of operations, further information on likely developments in operations of the consolidated group and the expected results of those operations have not been disclosed in this report because the Directors' believe it would be likely to result in unreasonable prejudice to the Consolidated Entity.

#### **Environmental Regulations**

There are significant environmental regulations surrounding mining activities which have been conducted by Earth Heat Resources Ltd. However, there has been no breach of these regulations during the financial year or in the period subsequent to the end of the financial year and up to the date of this report.

#### **Auditors**

On November 22, 2011 the Company appointed Grant Thornton as the casual auditor of the Company; this appointment was to be confirmed by shareholders at the 2012 annual general meeting of the company. K S Black & Co resigned as the auditor on November 29, 2011.

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Non-Audit Services**

The directors have adopted specific policies and procedures for the engagement of non-audit services and are satisfied that the provision of non-audit services during the period by the auditor (or by another person or firm on the auditors' behalf) is compatible with the general standard of independence for auditors imposed by the IFRS.

The aggregate fees paid or liable to be paid by the Company's external auditors for the last financial year are as follows:

|                           | <b>2012</b>   | 2011   |
|---------------------------|---------------|--------|
|                           | <b>AUD\$</b>  | AUD\$  |
| <b>K S Black &amp; Co</b> |               |        |
| Audit fees – Full Year    | -             | -      |
| – Half Year               | -             | 8,250  |
| – Other Reports           | -             | 18,690 |
| Tax related services      | -             | 2,000  |
| Other                     | -             | -      |
|                           | <hr/>         | <hr/>  |
|                           | -             | 28,940 |
| <b>Grant Thornton</b>     |               |        |
| Audit fees – Full Year    | <b>28,480</b> | 28,480 |
| – Half Year               | <b>9,900</b>  | -      |
| – Other Reports           | -             | 10,000 |
|                           | <hr/>         | <hr/>  |
|                           | <b>38,380</b> | 38,480 |
|                           | <hr/>         | <hr/>  |
| <b>Total</b>              | <b>38,380</b> | 67,420 |

**Indemnifying Officers**

During the financial year, the company paid a premium in respect of a contract insuring the Australian directors of the company (as named above), the Australian company secretary, and all executive officers of the company and of any related body corporate against a liability incurred as such a director, secretary or executive officer to the extent permitted by IFRS. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

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

**Proceedings on Behalf of the Company**

No person has applied for leave of court to bring proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of those proceedings. The Company was not a party to any such proceedings during the year.

**Critical Accounting Policies and Estimates**

**Determining 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 upon 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.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### Geothermal, Oil and Gas Interests

Exploration, evaluation and development expenditure incurred is accumulated in respect of each current identifiable area of interest. These costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage that permits reasonable assessment of the existence of economically recoverable reserves. Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

When production commences, the accumulated costs for the relevant area of interest are amortised over the life of the area according to the rate of depletion of the economically recoverable reserves.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

Exploration and evaluation assets are assessed for impairment when fact and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. The recoverable amount of the exploration and evaluation asset is estimated to determine the extent of the impairment loss (if any). Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in previous years.

The Consolidated Entity follows the full cost method of accounting for natural gas and petroleum property interests and geothermal interests whereby all costs of acquisitions, exploring for and developing geothermal, natural gas and petroleum reserves are initially capitalised into areas of interest. Such costs include land acquisition costs, geological and geophysical expenses, and carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

#### **Accounting standards and interpretations issued but not yet effective:**

Certain pronouncements were issued by the IASB or the International Financial Reporting Interpretations Committee that are mandatory for accounting periods after September 30 2012 or later periods. Many are not applicable or do not have a significant impact to Earth Heat Resources Limited and have been excluded from the table below. The following have not yet been adopted and are being evaluated to determine their impact on Earth Heat Resources Limited.

- (i) IFRS 9 'Financial Instruments' ("IFRS 9") was issued by the IASB in October 2010 and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after April 1, 2013.
- (ii) IFRS 10 'Consolidated Financial Statements' is effective for annual periods beginning on or after April 1, 2013, with early adoption permitted, establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
- (iii) IFRS 11 'Joint Arrangements' ("IFRS 11") was issued by the IASB in May 2011 and will replace IAS 31 Interests in Joint ventures and SIC 13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 is effective for annual period beginning on or after April 1, 2013.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

- (iv) IFRS 12 'Disclosure of Interests in Other Entities' is effective for annual periods beginning on or after April 1, 2013, with early adoption permitted, requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.
- (v) IFRS 13 'Fair Value Measurement' is effective for annual periods beginning on or after April 1, 2013, with early adoption permitted, provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy.

#### **Financial Instruments and Other Instruments**

The Company has not entered into any specialized financial agreements to minimize its investment risk, currency risk or commodity risk. As of the date hereof, the Company's investment in geothermal, oil and gas properties has full exposure to commodity risk, both upside and downside. As the commodity price moves so too does the underlying value of the Company's projects.

The Company's property interests overseas make it subject to foreign currency fluctuations which may adversely affect the Company's financial position and results.

#### **Risks and Uncertainties**

The risks and uncertainties described in this section are considered by management to be the most important in the context of the Company's business. The risk and uncertainties below are not inclusive of all the risks and uncertainties the Company may be subject to and other risks may apply.

#### **Risk Relating to EHR's Business and Industry**

***Geothermal exploration and development programs are highly speculative, are characterized by significant inherent risk and costs and may not be successful***

EHR's future performance depends on its ability to discover and establish economically recoverable and sustainable geothermal resources on EHR's properties through its exploration and development programs. Geothermal exploration and development involves a high degree of risk and few properties that are explored are ultimately developed into generating power plants. There is no assurance that EHR's exploration programs will be successful. Despite historical exploration work, EHR's properties are without a known geothermal resource. Substantial exploration and development work is required in order to determine if any economically recoverable and sustainable geothermal resources are located on these exploration properties. Successfully discovering geothermal resources is dependent on a number of factors, including the technical skill of exploration personnel involved. Even in the event commercial quantities of geothermal resources are discovered, it may not be commercially feasible to bring power generation facilities into a state of commercial production from such geothermal resources. The commercial viability of a geothermal resource once discovered is dependent on a number of factors, some of which are particular attributes of the resource, such as heat content (the relevant composition of temperature and flow rate/pressure), useful life, operational factors relating to the extraction of fluids from the geothermal resource, proximity to infrastructure, capital costs to construct a power plant and related infrastructure and energy prices. Many of these factors are beyond EHR's control.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

Geothermal exploration and development costs are high and are not fixed. A geothermal resource cannot be relied upon until substantial development, including drilling and testing, has taken place. The costs of development drilling are subject to numerous variables such as unforeseen geologic conditions underground that could result in substantial cost overruns. Drilling at EHR's properties may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs.

EHR's drilling operations may be curtailed, delayed or cancelled as a result of numerous factors, many of which are beyond EHR's control, including economic conditions, mechanical problems, title problems, weather conditions, compliance with governmental requirements and shortages or delays of equipment and services.

If EHR's drilling activities are not successful, it could materially adversely affect its business, financial condition, future results and cashflow.

#### ***EHR has a limited operating history***

EHR has a very limited history of operations and will be subject to many of the risks common to start up enterprises, including under-capitalization, cash shortages, limitations with respect to personnel, financial, and other resources and lack of revenues. There is no assurance that EHR will be successful in achieving a return on shareholders' investment and the likelihood of success must be considered in light of its early stage of operations.

As a result of EHR's planned exploration and plant expansion projects, over the near term EHR does not expect that its operating revenues will be sufficient to cover its expenses. EHR's ability to generate greater revenues and become profitable will depend on a number of factors, including its ability to:

- successfully complete its planned expansion programs for its Copahue and Djibouti projects;
- advance planned and future development programs on EHR's properties to commercial operation;
- verify geothermal resources on EHR's properties that are sufficient to generate a favourable economic return from electricity sales;
- acquire electrical transmission and interconnection rights for EHR's geothermal power plant development projects;
- enter into PPAs for the sale of electricity from EHR's geothermal power plant development projects at prices that support its operating and financing costs;
- finance and complete the development and construction of geothermal power plants on EHR's properties;
- operate producing geothermal power plants on a profitable basis;
- secure adequate capital to support EHR's expansion, exploration and development programs and finance its acquisitions;
- attract and retain qualified personnel; and
- arrange project financing on reasonable terms.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### ***EHR's financial performance depends on its successful operation of geothermal power plants, which is subject to various operational risks***

EHR's financial performance depends on its successful operation of geothermal power plants. The cost of operation and maintenance and the operating performance of a geothermal power plant may be adversely affected by a variety of factors, including some that are discussed elsewhere in these risk factors and the following:

- regular and unexpected maintenance and replacement expenditures;
- shutdowns due to the breakdown or failure of the plant's equipment or the equipment of the transmission serving utility;
- labour disputes;
- catastrophic events such as fires, explosions, earthquakes, landslides, floods, releases of hazardous materials, severe storms or similar occurrences affecting a power plant, any of the power purchasers from a power plant or third parties providing services to a power plant; and
- the aging of power plants, which may reduce their operating performance and increase the cost of their maintenance.

Any of these events could significantly increase the expenses incurred by a power plant or reduce the overall generating capacity of a power plant and could significantly reduce or entirely eliminate the revenues generated by a power plant, which in turn would reduce EHR's net income and could materially and adversely affect its business, financial condition, future results and cashflow.

#### ***EHR's geothermal resources may decline over time and may not remain adequate to support the life of its power plants***

The operation of geothermal power plants depends on the continued availability of adequate geothermal resources. Although EHR believes its geothermal resources will be fully renewable if managed properly, it cannot be certain that any geothermal resource will remain adequate for the life of a geothermal power plant. Any geothermal resource may suffer an unexpected decline in capacity to generate electricity. A number of events could cause such a decline or shorten the operational duration of a geothermal resource.

These events include:

- failure to recycle all of the geothermal fluids used in connection with the applicable geothermal resource; and
- failure to properly maintain the hydrological balance of the applicable geothermal resource.
- failure of a well due to casing, cementing, improper or faulty equipment, or general reservoir damage
- the unexpected depletion of the reservoir itself, ahead of schedule versus financing commitments

If the geothermal resources available to a power plant developed by EHR become inadequate, EHR may be unable to perform under the PPA for the affected power plant, which in turn could reduce its revenues and materially and adversely affect its business, financial condition, future results and cash flow. If EHR suffers a decline in its geothermal resources, it may have an adverse impact on the covenants in the related projected financing documents and may impair its ability to repay its debt and provide for the anticipated tax benefits.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### ***Uncertainty in the calculation of geothermal resources and probabilistic estimates of gross MW capacity***

There is a degree of uncertainty attributable to the calculation of geothermal resources and probabilistic estimates of gross MW capacity. Until a geothermal resource is actually accessed and tested by production and injection wells, the temperature and composition of underground fluids must be considered estimates only. In addition, estimates as to the percentage of the heat that can be expected to be recovered at the surface is subject to a number of assumptions including, but not limited to, resource base temperature, areal extent of the geothermal reservoir, thickness of the geothermal reservoir, percentage of resource recovery and the expected lifetime of the geothermal reservoir. If any of these assumptions prove to be materially incorrect, it may affect the gross MW capacity of a property.

#### ***Geological occurrences beyond EHR control may compromise its operations and their capacity to generate power***

In addition to the substantial risk that production wells that are drilled will not be productive or may decline in productivity after commencement of production, hazards such as unusual or unexpected geologic formations, downhole conditions, mechanical failures, blowouts, cratering, localized ground subsidence, localized ground inflation, explosions, uncontrollable releases or flows of well fluids, pollution and other physical and environmental risks are inherent in geothermal exploration and production. These hazards could result in substantial losses to the Company due to injury and loss of life, severe damage to and destruction of property and equipment, pollution and other environmental damage, failure to find a proper injection zone and suspension of operations.

Additionally, active geothermal areas, such as the areas in which EHR's operations and properties are located, are subject to frequent low-level seismic disturbances. Serious seismic disturbances are possible and could result in damage to its projects or equipment or degrade the quality of its geothermal resources to such an extent that EHR could not perform under the PPA for the affected project, which in turn could reduce its net income and materially and adversely affect EHR's business, financial condition, future results and cash flow. If EHR suffers a serious seismic disturbance, its business interruption and property damage insurance may not be adequate to cover all losses sustained as a result thereof. In addition, insurance coverage may not continue to be available in the future in amounts adequate to insure against such seismic disturbances.

#### ***EHR may be unable to obtain the financing it needs to pursue its growth strategy***

When EHR identifies a geothermal property that it may seek to acquire or to develop, a substantial capital investment often will be required. EHR continued access to capital, through project financing or through credit facilities or other arrangements with acceptable terms is necessary for the success of its growth strategy. EHR attempts to secure the necessary capital may not be on favourable terms, or successful at all. Market conditions and other factors may not permit future project and acquisition financings on terms favourable to EHR. EHR's ability to arrange for financing on favourable terms, and the costs of such financing, are dependent on numerous factors, including general economic and capital market conditions, investor confidence, the continued success of current projects, the credit quality of the project being financed, the political situation in the jurisdiction in which the project is located and the continued existence of tax laws which are conducive to raising capital. If EHR is unable to secure capital through credit facilities or other arrangements, it may have to finance its projects using equity financing which will have a dilutive effect on the common shares of EHR. Also, in the absence of favourable financing or other capital raising options, EHR may decide not to build new plants or acquire properties from third parties. Any of these alternatives could have a material adverse effect on EHR's growth prospects and financial condition.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

#### ***It is very costly to place geothermal resources into commercial production***

Before the sale of any power can occur, it will be necessary to construct a gathering and disposal system, a power plant, and a transmission line, and considerable administrative costs will be incurred, together with the drilling of production and injection wells. Future development and expansion of power production at EHR's properties may result in significantly increased capital costs related to increased production and injection well drilling and higher costs for labour and materials. To fund expenditures of this magnitude, EHR may have to seek additional financing and sources of capital. There can be no assurance that additional capital can be found and, if found, it may result in EHR having to substantially reduce its interest in the project.

#### ***EHR may continue to incur negative operating cash flow for the foreseeable future***

EHR currently has a negative operating cash flow and may continue to do so for the foreseeable future. EHR's failure to achieve profitability and positive operating cash flows could have a material adverse effect on its financial condition and results of operations.

#### ***Energy prices are subject to dramatic and unpredictable fluctuations***

The market price of energy is volatile and cannot be controlled. If the price of electricity should drop significantly, the economic prospects of the properties that EHR has an interest in, the power from which is not contracted for, could be significantly reduced or rendered uneconomic. There is no assurance that, even if commercial quantities of geothermal resources are discovered, a profitable market may exist for the sale of geothermal energy. Factors beyond EHR's control may affect the marketability of any geothermal resources discovered. Prices have fluctuated widely, particularly in recent years. The marketability of geothermal energy is also affected by numerous other factors beyond EHR's control, including government regulations relating to royalties, allowable production and exporting of energy sources, the effect of which cannot be accurately predicted.

Dramatic and unpredictable fluctuations in the market price for energy may affect the ability of EHR to enter into new PPAs on favourable terms to it, or at all, which would have a negative impact on the revenues of EHR and its decisions regarding development of additional properties.

#### ***Industry competition may impede EHR's ability to access suitable geothermal resources***

Significant and increasing competition exists for the limited number of quality geothermal opportunities available. As a result of this competition, some of which is with large established companies with substantial capabilities and greater financial and technical resources than EHR, it may be unable to acquire additional geothermal operations or properties on terms it considers acceptable. There can be no assurance that EHR's acquisition programs will yield new geothermal operations or properties.

#### ***EHR may be unable to enter into PPAs on terms favourable to EHR, or at all***

The electrical power generation industry, of which geothermal power is a sub-component, is highly competitive and EHR may not be able to compete successfully or grow its business. The industry is complex as it is composed of public utility districts, cooperatives and investor-owned power companies. Many of the participants produce and distribute electricity. Their willingness to purchase electricity from an independent producer may be based on a number of factors and not solely on pricing and surety of supply. If EHR cannot enter into PPAs on favourable terms to it, or at all, it would negatively impact EHR's revenue and its decisions regarding development of additional properties.

## **MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**

### **SEPTEMBER 30, 2012**

The power generation industry is characterized by intense competition from electric utilities, other power producers and power marketers. In recent years, there has been increasing competition in the sale of electricity, in part due to an emphasis on short-term or “spot” markets, and competition has contributed to a reduction in electricity prices. For the most part, EHR expects that power purchasers interested in long-term arrangements will engage in “competitive bid” solicitations to satisfy new capacity demands.

This competition could adversely affect EHR’s ability to obtain PPAs and the price paid for electricity by the relevant power purchasers. There is also increasing competition between electric utilities. This competition has put pressure on electric utilities to lower their costs, including the cost of purchased electricity, and increasing competition in the future will put further pressure on power purchasers to reduce the prices at which they purchase electricity from EHR.

#### ***Environmental and other regulatory requirements may add costs and uncertainty***

EHR’s current and future operations, including exploration and development activities and electricity generation from power plants, require licenses and permits from various governmental authorities and such operations are and will be subject to laws and regulations governing exploration and development, geothermal resources, production, exports, taxes, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, project safety and other matters. Companies can experience increased costs, and delays in production and other schedules as a result of the need to comply with applicable laws, regulations, licenses and permits. There is no assurance that all approvals or required licenses and permits will be obtained. Additional permits, licenses and studies, which may include environmental impact studies conducted before licences and permits can be obtained, may be necessary prior to the exploration or development of properties, or the operation of power plants, in which EHR has an interest, and there can be no assurance that EHR will be able to obtain or maintain all necessary licenses or permits that may be required on terms that enable operations to be conducted at economically justifiable costs. Failure to comply with applicable laws, regulations, licensing or permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. EHR may be required to compensate those suffering loss or damage by reason of its activities, and may have civil or criminal fines or penalties imposed upon it for violations of applicable laws or regulations. Applicable laws and regulations, including environmental requirements and licensing and permitting processes, may require public disclosure and consultation. It is possible that a legal protest could be triggered through one of these requirements or processes that could delay, or require the suspension of, an exploration or development program or the operation of a power plant and increase EHR’s costs. Because of these requirements, EHR could incur liability to governments or third parties for any unlawful discharge of pollutants into the air, soil or water, including responsibility for remediation costs.

EHR could potentially discharge such materials into the environment: from a well or drilling equipment at a drill site; leakage of fluids or airborne pollutants from gathering systems, pipelines, power plants or storage tanks; damage to geothermal wells resulting from accidents during normal operations; and blowouts, cratering and explosions.

No assurance can be given that new laws and regulations will not be enacted or that existing laws and regulations will not be applied in a manner that could limit or curtail EHR’s exploration and development programs or its operation of power plants. Amendments to current laws, regulations, licenses and permits governing operations and activities of geothermal companies, or more stringent implementation thereof, could have a material adverse impact on EHR and cause increases in capital expenditures or production costs, or reduction in levels of production or abandonment, or delays in development of the business.

**MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**  
**SEPTEMBER 30, 2012**

***EHR's insurance policies may be insufficient to cover losses***

As protection against operating hazards, EHR intends to maintain insurance coverage against some, but not all, potential losses. EHR may not fully insure against all risks associated with its business either because such insurance is not available or because the cost of such coverage is considered prohibitive. The occurrence of an event that is not covered, or not fully covered, by insurance could have a material adverse effect on EHR's financial condition and results of operations.

***Current global financial conditions have been subject to increased volatility***

Current global financial conditions have been subject to increased volatility and numerous financial institutions have either gone into bankruptcy or have had to be rescued by governmental authorities. Access to public financing has been negatively impacted by both sub-prime mortgages and the liquidity crisis affecting the asset-backed commercial paper market. These factors may impact EHR's ability to obtain equity or debt financing in the future and, if obtained, on terms favourable to it. If these increased levels of volatility and market turmoil continue, EHR's operations could be adversely impacted and the trading price of the common shares of EHR could be adversely affected.

**Further information**

For further information refer to [www.earthheat.com.au](http://www.earthheat.com.au) and our announcements lodged on the ASX ([www.asx.com.au](http://www.asx.com.au)) and on SEDAR ([www.sedar.com](http://www.sedar.com)).

**EARTH HEAT RESOURCES LTD  
AND CONTROLLED ENTITIES  
ABN 86 115 229 984**

**DIVERSITY REPORT  
SEPTEMBER 30, 2012**

**Introduction**

The following is the Diversity Report prepared for the purposes of the Company's Annual Report for the financial year ended 30 September 2012 for Earth Heat Resources Ltd ("the Company").

The ASX introduced a requirement for all listed companies to adopt a Diversity Policy and a Diversity Strategy by no later than June 30, 2011, to disclose those documents to the shareholders, and to report to the shareholders each year on the current diversity position in the Company including culture, gender and age, and the progress towards achievement of the strategy objectives.

**Diversity Policy**

The Diversity Policy is based upon the recommendations of the ASX and the Australian Institute of Company Directors ("AICD") and as such will include requirements that may not be appropriate for a small company such as Earth Heat Resources Ltd. As with all matters included in the ASX Corporate Governance Principles and Recommendations, any recommendation that is not considered appropriate for the Company will be disclosed on an "if not why not" basis. The Policy is outlined in the Statement of Corporate Governance at page 78 of this Annual Report and is available on the Company's web site.

**Responsibility**

The Nomination & Remuneration Committee (if formed otherwise the Board) is charged with the responsibility for implementation of the Diversity Policy and the oversight of the Diversity Strategy progress, and delegates that responsibility to the CEO. The Company Secretary is charged with the responsibility for reporting to the Committee each year in accordance with the requirements of the Policy.

**Current Position**

As at September, 30 2012 there was an aggregate of 13 including Directors, employees, contractors and advisors in the Company including those acting in a part time capacity. Of the aggregate 4 are female being 31% of the organisation (none of whom are Directors) and one is the Chief Financial Officer, being 50% of the senior executives. There are 5 employees or contractors of different ethnic or cultural background and one mature age Director. The Company is well aware of the value of diversity and practices its attributes as far as possible given the small size of the Company and the nature of its enterprise. The Company has no plans to increase the Board numbers at this time.

**Diversity Strategy**

The Diversity Strategy is also based upon the recommendations of the ASX and the AICD and sets various strategies, initiatives and programs designed to as far as possible achieve the aims and objectives of the Diversity Policy.

The current position with each of the strategy items and the time frame for achievement or otherwise is listed in the following Table 1:

**DIVERSITY REPORT (CONTINUED)**  
**SEPTEMBER 30, 2012**

Table 1

| <b>Strategy, initiative or program</b>   | <b>By when</b> | <b>Current position</b>   |
|--|----------------|---|
| <b>Phase 1 - Strategies</b>  |                |   |
| 1.1(a) The development and adoption of the Policy  | 5/05/2011      | Completed   |
| 1.1(b) Embody within the Statement of Corporate Governance   | 5/05/2011      | Completed   |
| 1.1(c) Assignment of responsibility  | 5/05/2011      | Completed   |
| <b>Phase 2 - Initiatives and Programs</b>  |                |   |
| At Board / board Committee Level   |                |   |
| 1.2(a)(i)(A) Diversity is embedded as a relevant attribute   | 5/05/2011      | Completed   |
| 1.2(a)(i)(B) Any skill / gap analysis matrix includes due regard for the attributes of diversity               | As required    | Will be prepared when required                                      |
| 1.2(a)(i)(C) Clear statement exists as to the mix of skills and diversity that the Board is looking to achieve | 5/05/2011      | Stated below and Included in the Charter for the Board of Directors |
| 1.2(a)(ii) When addressing Board succession planning   | 5/05/2011      | Enshrined in the Charter for the Board of Directors                 |
| 1.2(a)(iii) Inclusion of Diversity related KPIs for CEO and senior executives                                  | 30/09/2011     | Completed   |
| 1.2(b)(i) Review the Company's HR policies   | 30/06/2011     | Completed   |
| 1.2(b)(ii) Review the Company's physical environment & cultural practices to ensure compliance with the Policy | 30/06/2011     | Completed   |
| 1.2(b)(iii) Ensure that the Company's recruitment practices follow the Policy requirements                     | 5/05/2011      | Completed   |
| 1.2(c)(i) Commit to career development   | 5/05/2011      | Completed   |
| 1.2(c)(ii) Develop standing program and provide budget for career development                                  | 30/06/2011     | Incorporated in 2012/13 budget                                      |

**Specific Gender Diversity targets**

It should be noted that the ASX recognises that there is an historical "skewed" pipeline of qualified and experienced personnel in the market and accordingly the gender diversity targets must be regarded as "soft" and subject to the overriding caveat stated at Item 8 in the Diversity Policy. The gender diversity targets are detailed at Item 2(c) of the Diversity Strategy.

**Statements of Skills and Diversity Objectives**

The following statements were adopted by the Board and included in the Charter for the Board of Directors at the appropriate locations:

"Since good governance principles require independence, transparency, diversity and flexibility, the Board acknowledges the importance of Board structure and, as a consequence, the Board seeks to use the following provisions as guidance when implementing an effective governance structure in the Company."

**DIVERSITY REPORT (CONTINUED)**  
**SEPTEMBER 30, 2012**

**Board Skills**

The Board shall contain a relevant blend of expertise and diversity attributes appropriate for a Company of its size in:

- Accounting;
- Finance;
- Business;
- Mining;
- Financial instruments;
- Legal matters (especially when not present in the Company Secretary); and
- Marketing.

**Diversity at Board Level and Generally**

The Board respects the values and the competitive advantage of culture, gender, ethnicity and age "diversity", and the benefits of its integration throughout the Company.

The Board has adopted a specific Diversity Policy in order to enrich the Company's perspective, improve corporate performance, increase shareholder value, and enhance the probability of achievement of the Company's objectives.

When addressing Board succession planning (and other appointments throughout the Company) the Board has ensured that the Diversity Policy is respected, efforts are made to identify prospective appointees who have Diversity attributes and efforts are made for any short list of prospective appointees to include at least one male and one female candidate."

**Nomination & Remuneration Committee Terms of Reference**

The Terms of Reference for the Nomination & Remuneration Committee has been amended to incorporate the necessary references to its new responsibility for the Diversity Policy.

**Compliance**

Having regard to the size of the Company and the nature of its enterprise, it is considered that the Company complies as far as possible with the spirit and intentions of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations in respect to diversity.

## **INDEPENDENT AUDITOR'S REPORT EARTH HEAT RESOURCES LIMITED**

We have audited the accompanying consolidated financial statements of Earth Heat Limited, which comprise the consolidated statements of financial position as at 30 September 2012, 30 September 2011 and 1 October 2010, and the consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### **Management's responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, 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 consolidated financial statements 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 management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Earth Heat Limited as at September 30, 2012, September 30, 2011, and October 1, 2010, and its financial performance and its cash flows for the years ended September 30, 2012 and September 30, 2011 in accordance with International Financial Reporting Standards.

### **Material uncertainty regarding continuation as a going concern**

Without qualifying our opinion, we draw attention to Note 1(r) in the financial report which indicates that the consolidated entity incurred a net loss of \$5,077,388 during the year ended September 30, 2012 and, as of that date, the consolidated entity's net current liabilities exceeded its net current assets by \$52,365. These conditions, along with other matters as set forth in Note 1(r), indicate the existence of a material uncertainty which may cast significant doubt about the consolidated entity's ability to continue as a going concern and therefore, the consolidated entity may be unable to realise its assets and discharge its liabilities in the normal course of business, and at the amounts stated in the financial report.



GRANT THORNTON AUDIT PTY LTD  
Chartered Accountants



S J Gray  
Partner – Audit & Assurance

Adelaide, 21 December 2012

**FINANCIAL REPORT (IN AUSTRALIAN DOLLARS)**  
**SEPTEMBER 30, 2012**

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**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

AS AT SEPTEMBER 30, 2012

|  | September 30,<br>2012 | September 30,<br>2011 |
|--|-----------------------|-----------------------|
|  | \$                    | \$                    |
| <b>ASSETS</b>                              |                       |                       |
| <b>Current</b>                             |                       |                       |
| Cash and cash equivalents                  | 344,399               | 282,120               |
| Trade and other receivables (Note 7)       | 73,457                | 90,161                |
|  | <u>417,856</u>        | <u>372,281</u>        |
| <b>Non-Current</b>                         |                       |                       |
| Restricted Cash                            | 1                     | 1                     |
| Property and Equipment (Note 8)            | 5,375                 | 8,533                 |
| Geothermal, Oil and Gas Interests (Note 9) | 2,191,153             | 3,739,588             |
|  | <u>2,196,529</u>      | <u>3,748,122</u>      |
| <b>Total Assets</b>                        | <b>2,614,385</b>      | <b>4,120,403</b>      |
| <b>LIABILITIES</b>                         |                       |                       |
| <b>Current</b>                             |                       |                       |
| Trade and other payables (Note 10)         | 470,491               | 665,732               |
| <b>Total Liabilities</b>                   | <u>470,491</u>        | <u>665,732</u>        |
| <b>Net Assets/(Deficiency)</b>             | <u>2,143,894</u>      | <u>3,454,671</u>      |
| <b>EQUITY</b>                              |                       |                       |
| Issued Capital (Note 11)                   | 23,509,043            | 19,772,010            |
| Share Option Reserve (Note 11)             | 64,500                | 64,500                |
| Foreign Exchange Reserve                   | (71,458)              | (101,036)             |
| Other Components of Shareholders Equity    | 1,406,355             | 1,406,355             |
| Accumulated Losses                         | (22,764,546)          | (17,687,158)          |
| <b>TOTAL EQUITY (DEFICIENCY)</b>           | <u>2,143,894</u>      | <u>3,454,671</u>      |
| <b>Going Concern</b> (Note 1.r)            |                       |                       |
| <b>Contingent Liabilities</b> (Note 12)    |                       |                       |
| <b>Commitments</b> (Note 13)               |                       |                       |
| <b>Subsequent Events</b> (Note 17)         |                       |                       |

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

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**  
FOR THE FINANCIAL YEAR ENDED SEPTEMBER 30, 2012

|   | 2012<br>\$         | 2011<br>\$         |
|---|--------------------|--------------------|
| <b>Revenues</b>   |                    |                    |
| Natural gas and petroleum   | -                  | -                  |
| <b>Expenses (Note 4)</b>  |                    |                    |
| Directors fees  | 113,000            | 170,520            |
| Equipment depreciation  | 4,106              | 2,362              |
| Finance costs   | 470,981            | 18,648             |
| Foreign exchange loss /(gain)   | 47,151             | 880                |
| Office  | 66,358             | 84,369             |
| Professional fees   | 438,890            | 435,728            |
| Insurance   | 38,502             | 31,321             |
| Shareholder costs   | 88,657             | 70,712             |
| Regulatory and filing fees  | 1,816              | 3,024              |
| Salaries and benefits   | 237,911            | 321,548            |
| Travel and promotion  | 120,643            | 251,933            |
| <b>Total Expenses</b>   | <b>1,628,015</b>   | <b>1,391,045</b>   |
| <b>Profit/(Loss) Before Other Items</b>   | <b>(1,628,015)</b> | <b>(1,391,045)</b> |
| <b>Other Items</b>  |                    |                    |
| Current asset impairment expense - Capitalised project costs (Note 9)             | (3,377,901)        | -                  |
| Geothermal project expenses written off   | (5,791)            | (158,446)          |
| Interest income (Note 3)  | 6,265              | 41,790             |
| Other revenue   | -                  | -                  |
| <b>Profit/(Loss) Before Income Tax Expense</b>                                    | <b>(5,005,442)</b> | <b>(1,507,701)</b> |
| <b>Income Tax Expense (Note 5)</b>  | <b>71,946</b>      | -                  |
| <b>Total Income For The Year</b>  | <b>(5,077,388)</b> | <b>(1,507,701)</b> |
| <b>Other Comprehensive income for the year, net of tax</b>                        |                    |                    |
| Exchange gain/(loss) differences arising on the translation of foreign operations | 29,578             | (11,864)           |
| <b>Total Comprehensive Income/(Loss) For The Year Attributable to Members</b>     | <b>(5,047,810)</b> | <b>(1,519,565)</b> |
| <b>Earnings Per Share:</b> Basic and diluted in cents                             | <b>(0.84)</b>      | <b>(0.28)</b>      |
| <b>Weighted Average Number Of Common Shares Outstanding,</b><br>Basic and diluted | <b>605,527,587</b> | <b>538,864,518</b> |

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

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
FOR THE YEAR ENDED SEPTEMBER 30, 2012

|   | Issued<br>Capital | Foreign<br>Exchange<br>Reserve | Share<br>Option<br>Reserve | Other<br>Components<br>of<br>Shareholders<br>Equity | Accumulated<br>Losses | Total            |
|---|-------------------|--------------------------------|----------------------------|---|-----------------------|------------------|
|   | \$                | \$                             | \$                         | \$  | \$                    | \$               |
| Balance September 30, 2010              | 17,554,135        | (89,172)                       | -                          | 1,406,355   | (16,179,457)          | 2,691,861        |
| Shares Issued During The Year           | 2,500,938         | -                              | -                          | -   | -                     | 2,500,938        |
| Share Issue Costs For The Year          | (283,063)         | -                              | -                          | -   | -                     | (283,063)        |
| Total Comprehensive Income For The Year | -                 | (11,864)                       | -                          | -   | (1,507,701)           | (1,519,565)      |
| Equity settled payment                  | -                 | -                              | 64,500                     | -   | -                     | 64,500           |
| <b>Balance September 30, 2011</b>       | <b>19,772,010</b> | <b>(101,036)</b>               | <b>64,500</b>              | <b>1,406,355</b>                                    | <b>(17,687,158)</b>   | <b>3,454,671</b> |
| Shares Issued During The Year           | 3,952,454         | -                              | -                          | -   | -                     | 3,952,454        |
| Share Issue Costs For The Year          | (215,421)         | -                              | -                          | -   | -                     | (215,421)        |
| Total Comprehensive Income For The Year | -                 | 29,578                         | -                          | -   | (5,077,388)           | (5,047,810)      |
| <b>Balance September 30, 2012</b>       | <b>23,509,043</b> | <b>(71,458)</b>                | <b>64,500</b>              | <b>1,406,355</b>                                    | <b>(22,764,546)</b>   | <b>2,143,894</b> |

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

**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2012**

|   | 2012<br>\$            | 2011<br>\$            |
|---|-----------------------|-----------------------|
| <b>Cash Flows Provided By / (Used In)</b>               |                       |                       |
| <b>Operating Activities</b>                             |                       |                       |
| Net Profit/(Loss)                                       | (5,077,388)           | (1,507,701)           |
| Adjustment for items not requiring an outlay of cash:   |                       |                       |
| Equipment amortisation                                  | 4,106                 | 2,362                 |
| Unrealized foreign exchange loss                        | 47,151                | 880                   |
| Impairment of current assets                            | 3,377,901             | 13,425                |
| Share options expensed                                  | -                     | 64,500                |
| Tax on share issue costs                                | 71,946                |                       |
| Shares issued in lieu of cash                           | 436,352               | -                     |
|   | <u>(1,139,932)</u>    | <u>(1,426,534)</u>    |
| Changes in non-cash working capital                     |                       |                       |
| Accounts receivable                                     | 16,991                | (3,225)               |
| Accounts payable and accrued liabilities                | (326,443)             | 329,107               |
|   | <u>(309,452)</u>      | <u>325,882</u>        |
| Net cash provided by / (used in) operating activities   | <u>(1,449,384)</u>    | <u>(1,100,652)</u>    |
| <b>Investing Activities</b>                             |                       |                       |
| Property and equipment - purchases                      | (948)                 | (5,931)               |
| Geothermal Interest - purchases                         | (1,716,014)           | (833,494)             |
| Proceeds of Oil and Gas Interests                       | -                     | 75,000                |
| Net cash provided by / (used in) investing activities   | <u>(1,716,962)</u>    | <u>(764,425)</u>      |
| <b>Financing Activities</b>                             |                       |                       |
| Share subscriptions received net of share issue cost    | 3,228,625             | 1,989,750             |
| Due to related parties                                  | -                     | -                     |
| Net cash provided by / (used in) financing activities   | <u>3,228,625</u>      | <u>1,989,750</u>      |
| <b>Increase (Decrease) In Cash and Cash Equivalents</b> | <b>62,279</b>         | <b>124,673</b>        |
| <b>Cash and cash equivalents, Beginning Of Year</b>     | <u><b>282,120</b></u> | <u><b>157,447</b></u> |
| <b>Cash and cash equivalents, End Of Year</b>           | <u><b>344,399</b></u> | <u><b>282,120</b></u> |

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

**EARTH HEAT RESOURCES LTD  
AND CONTROLLED ENTITIES  
ABN 86 115 229 984**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES**

**Reporting Entity**

The consolidated annual financial report for the financial year ended September 30, 2012, comprise the Company, Earth Heat Resources Ltd and its subsidiaries (together referred to as the “Consolidated Entity”).

The Company was incorporated under the Alberta *Business Corporations Act* as 777231 Alberta Ltd. on February 5, 1998. On April 24, 1998, it changed its name to Trent-Severn Watershed Ltd.; on November 14, 2002 to Fall River Resources Ltd and in July 2010 to Earth Heat Resources Ltd. The Company was continued in British Columbia effective December 23, 2004. The Company registered as a foreign company in Australia on August 29, 2005. The principal business activities include the evaluation, acquisition, exploration and development of geothermal, natural gas and petroleum properties.

**Statement of Compliance**

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

**Use of Estimates and Judgments**

Management has also made estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

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

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Notes 15 – utilisation of tax losses.

**Basis of measurement**

The financial statements have been prepared on an accruals basis and are based on historical costs, modified where applicable by the measurement at fair value of selected non-current assets, financial assets and financial liabilities.

**Functional and presentation currency**

The functional currency of the Company and Earth Heat Australia Pty Ltd is Australian dollars; Spring River Resources functional currency is United States dollars. The financial report is presented in Australian dollars unless otherwise stated.

The consolidated annual financial report of the Consolidated Entity as at and for the year ended September 30, 2011 is available upon request from the Company’s registered office at Suite 9 Lester Court, 75a Angas Street, Adelaide SA 5000 or at [www.earthheat.com.au](http://www.earthheat.com.au).

The Financial Report was authorised for issue by the Directors on December 21, 2012.

The following is a summary of significant accounting policies adopted in the preparation of the financial report. The accounting policies have been consistently applied unless otherwise stated.

**EARTH HEAT RESOURCES LTD  
AND CONTROLLED ENTITIES  
ABN 86 115 229 984**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**a) Consolidation**

The consolidated financial statements include the accounts of the Company, and its wholly owned subsidiaries:

- Spring River Resources Ltd., a company incorporated to carry out the Company's resource operations in the United States of America ("U.S.A."); and
- Earth Heat Australia Pty Ltd, a company acquired on January 22, 2010 to carry out the Company's geothermal operations in Australia. The subsidiary is incorporated in Australia.

Intra-group balances, any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial report.

**Business Combinations**

Business combinations occur where an acquirer obtains control over one or more businesses and results in the consolidation of its assets and liabilities.

A business combination is accounted for by applying the acquisition method, unless it is a combination involving entities or businesses under common control. The acquisition method requires that for each business combination one of the combining entities must be identified as the acquirer (ie parent entity). The business combination will be accounted for as at the acquisition date, which is the date that control over the acquiree is obtained by the parent entity. At this date, the parent shall recognise, in the consolidated accounts, and subject to certain limited exceptions, the fair value of the identifiable assets acquired and liabilities assumed. In addition, contingent liabilities of the acquiree will be recognised where a present obligation has been incurred and its fair value can be reliably measured.

The acquisition date fair value of the consideration transferred for a business combination plus the acquisition date fair value of any previously held equity interest shall form the cost of the investment in the separate financial statements. Consideration may comprise the sum of the assets transferred by the acquirer, liabilities incurred by the acquirer to the former owners of the acquiree and the equity interests issued by the acquirer.

Fair value uplifts in the value of pre-existing equity holdings are taken to the statement of comprehensive income. Where changes in the value of such equity holdings had previously been recognised in other comprehensive income, such amounts are recycled to profit or loss.

Included in the measurement of consideration transferred is any asset or liability resulting from a contingent consideration arrangement. Any obligation incurred relating to contingent consideration is classified as either a financial liability or equity instrument, depending upon the nature of the arrangement. Rights to refunds of consideration previously paid are recognised as a receivable. Subsequent to initial recognition, contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability is remeasured each reporting period to fair value through the statement of comprehensive income unless the change in value can be identified as existing at acquisition date.

All transaction costs incurred in relation to the business combination are expensed to the statement of comprehensive income.

**EARTH HEAT RESOURCES LTD  
AND CONTROLLED ENTITIES  
ABN 86 115 229 984**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**b) Foreign Currency Translation**

The Company's primary presentation currency is the Australian dollar. Transactions in foreign currencies are translated into Australian dollars as follows:

- I) Monetary items, at the rate prevailing at the balance sheet date;
- II) Non-monetary items, at the historical exchange rate; and
- III) Revenues and expenses, at the rate in effect at the time of the transaction.

Gains or losses arising on translation are included in the statement of comprehensive income.

**c) Property and Equipment**

**I) Geothermal, Oil and Gas Interests**

Exploration, evaluation and development expenditure incurred is accumulated in respect of each current identifiable area of interest. These costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage that permits reasonable assessment of the existence of economically recoverable reserves. Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

When production commences, the accumulated costs for the relevant area of interest are amortised over the life of the area according to the rate of depletion of the economically recoverable reserves.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

Exploration and evaluation assets are assessed for impairment when fact and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. The recoverable amount of the exploration and evaluation asset is estimated to determine the extent of the impairment loss (if any). Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in previous years.

All costs of acquisitions, exploring for and developing geothermal, natural gas and petroleum reserves are initially capitalised into areas of interest. Such costs include land acquisition costs, geological and geophysical expenses, and carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

**EARTH HEAT RESOURCES LTD  
AND CONTROLLED ENTITIES  
ABN 86 115 229 984**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

II) Provision for restoration and rehabilitation

Costs of site restoration are provided over the life of the facility from when exploration commences and are included in the costs of that stage. Site restoration costs include the dismantling and removal of mining plant, equipment and building structures, waste removal, and rehabilitation of the site in accordance with clauses of the mining permits. Such costs have been determined using estimates of future costs, current legal requirements and technology on discounted basis. Any changes in the estimates for the costs are accounted on a prospective basis. In determining the costs of site restoration, there is uncertainty regarding the nature and extent of the restoration due to community expectations and future legislation. Accordingly the costs have been determined on the basis that the restoration will be completed within one year of abandoning the site.

III) Office Equipment

Equipment is stated at cost less accumulated amortisation, which is recorded over the useful lives of the assets on the declining balance basis at the rate of 30%.

**d) Financing Fees**

Discount and deferred financing fees arising from debt issues are amortized over the term of debt applying the effective interest rate method.

**e) Revenue Recognition**

Revenue from the sale of natural gas, natural gas liquids and crude oil is recognised when title passes from the Company to its customers. Costs associated with the operating of wells and facilities, delivery and production-based royalty expenses, are recognised in the same period in which the related revenue is earned.

**f) Earnings Per Share**

Earnings per share is calculated based on the weighted average number of common shares outstanding. The Consolidated Entity uses the treasury stock method to compute the dilutive effect of options, warrants and other similar instruments. Under this method, the dilutive effect on earnings per share is calculated to reflect on the use of the proceeds that could be obtained upon the exercise of options and warrants.

It assumes that the proceeds would be used to purchase common shares at the average market price during the period. Basic and diluted earnings per share are equal as the effects of the assumed conversion of outstanding options and warrants would be anti-dilutive.

**g) Income Taxes**

The Consolidated Entity follows the balance sheet method of accounting for income taxes. Under this method future income tax assets and liabilities are determined based on differences between the financial statements carrying values and their respective income tax basis (temporary differences) and on unclaimed losses carried forward. Future income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse or when losses are expected to be utilised. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially assured. The amount of deferred income tax assets recognised is limited to the amount of the benefit that has a probability of recovery.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**h) Financial Instrument Policies**

*Recognition and Initial Measurement*

Financial instruments, incorporating financial assets and financial liabilities, are recognised when the entity becomes a party to the contractual provisions of the instrument. Trade date accounting is adopted for financial assets that are delivered within timeframes established by marketplace convention.

Financial instruments are initially measured at fair value plus transactions costs where the instrument is not classified as at fair value through profit or loss. Transaction costs related to instruments classified as at fair value through profit or loss are expensed to profit or loss immediately. Financial instruments are classified and measured as set out below.

*Derecognition*

Financial assets are derecognised where the contractual rights to receipt of cash flows expires or the asset is transferred to another party whereby the entity no longer has any significant continuing involvement in the risks and benefits associated with the asset. Financial liabilities are derecognised where the related obligations are either discharged, cancelled or expired. The difference between the carrying value of the financial liability extinguished or transferred to another party and the fair value of consideration paid, including the transfer of non-cash assets or liabilities assumed, is recognised in profit or loss.

*Classification and Subsequent Measurement*

i. Financial assets at fair value through profit or loss

Financial assets are classified at fair value through profit or loss when they are held for trading for the purpose of short term profit taking, where they are derivatives not held for hedging purposes, or designated as such to avoid an accounting mismatch or to enable performance evaluation where a group of financial assets is managed by key management personnel on a fair value basis in accordance with a documented risk management or investment strategy. Realised and unrealised gains and losses arising from changes in fair value are included in profit or loss in the period in which they arise.

ii. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are subsequently measured at amortised cost using the effective interest rate method.

iii. Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets that have fixed maturities and fixed or determinable payments, and it is the Consolidated Entity's intention to hold these investments to maturity. They are subsequently measured at amortised cost using the effective interest rate method.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

iv. Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are either designated as such or that are not classified in any of the other categories. They comprise investments in the equity of other entities where there is neither a fixed maturity nor fixed or determinable payments.

v. Financial Liabilities

Non-derivative financial liabilities (excluding financial guarantees) are subsequently measured at amortised cost using the effective interest rate method.

**i) Leased assets**

Leases in terms of which the Consolidated Entity assumes substantially all the risks and benefits of ownership are classified as finance leases.

Other leases are operating leases and the leases are not recognised on the Consolidated Entity's statement of financial position. For operating leases lease expenses are charged on a straight line basis over the lease term irrespective of the period in which the payment occur.

**j) Impairment**

(i) Financial assets

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 flow 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.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in the statement of comprehensive income. Any cumulative losses in respect of an available-for-sale financial asset recognised previously in equity is transferred to the statement of comprehensive income. 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, the reversal is recognised in the statement of comprehensive income. For available-for-sale financial asset that are equity securities, the reversal is recognised directly in equity.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

ii) Non-financial assets

The carrying amounts of the Consolidated Entity's assets, other than deferred tax assets (see accounting policy g), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see accounting policy l(i)).

An impairment loss is recognised whenever 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 statement of comprehensive income. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of 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 assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indication 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 and amortisation, if no impairment loss had been recognised.

**k) Employee benefits**

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the statement of comprehensive income when they are due.

(ii) Long-term service benefits

The Consolidated Entity's net obligation in respect of long-term service benefits, other than pension plans, is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates, and is discounted using the rates attached to the Commonwealth Government bonds at the balance sheet date which have maturity dates approximating to the terms of the Consolidated Entity's obligations.

(iii) Wages, salaries, annual leave, sick leave and non-monetary benefits

Liabilities for employee benefits for wages, salaries, annual leave and sick leave, that are expected to be settled within 12 months of the reporting date, represent present obligations resulting from employees' services provided to reporting date, 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.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(iv) Share-based payment transactions

The employee and officer share scheme allows Company employees to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a Black-Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

**l) Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits.

**m) Goods and Services Tax**

Revenue, 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 ATO is included as a current asset or liability in the statement of financial position.

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

**n) Payables**

Liabilities are recognised for amounts to be paid in the future for goods or services received. Trade accounts payable are normally settled within 60 days.

**o) Comparatives**

Where applicable, prior year amounts have been adjusted to place a comparable basis with current year amounts.

**p) New Standards but not yet effective**

Certain pronouncements were issued by the IASB or the International Financial Reporting Interpretations Committee that are mandatory for accounting periods after September 30 2012 or later periods. Many are not applicable or do not have a significant impact to Earth Heat Resources Limited and have been excluded from the table below. The following have not yet been adopted and are being evaluated to determine their impact on Earth Heat Resources Limited.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (i) IFRS 9 'Financial Instruments' ("IFRS 9") was issued by the IASB in October 2010 and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after April 1, 2013.
- (ii) IFRS 10 'Consolidated Financial Statements' is effective for annual periods beginning on or after April 1, 2013, with early adoption permitted, establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
- (iii) IFRS 11 'Joint Arrangements' ("IFRS 11") was issued by the IASB in May 2011 and will replace IAS 31 Interests in Joint ventures and SIC 13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 is effective for annual period beginning on or after April 1, 2013.
- (iv) IFRS 12 'Disclosure of Interests in Other Entities' is effective for annual periods beginning on or after April 1, 2013, with early adoption permitted, requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.
- (v) IFRS 13 'Fair Value Measurement' is effective for annual periods beginning on or after April 1, 2013, with early adoption permitted, provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy.

**q) New Standards not previously applied**

The Consolidated Entity has adopted new and revised IFRS issued by the IASB during the current financial year. Disclosures required by these Standards that are deemed material have been included in this financial report on the basis that they represent a significant change in information from that previously made available. There is no material financial impact from adopting the new Standards.

**r) Going concern**

The financial report has been prepared on a going concern basis. The consolidated Group has recorded a loss for the year of \$5,077,388 and at September 30, 2012 net current liabilities exceeded net current assets by \$52,635.

Since the year end the Group has raised \$220,000 from the placement of 110,000,000 shares. In addition, a fully underwritten Rights issue was offered to shareholders and will raise a further \$1,290,000. The Group will require additional capital to continue as a going concern. If additional capital is not raised going concern may not be appropriate, with the result that the entity may have to realise its assets and extinguish its liabilities, other than in the ordinary course of business and at amounts different from those stated in the financial report.

No allowance for such circumstances have been made in the financial report.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**2. DETERMINING 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 upon 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) Geothermal Properties

The fair value of geothermal properties recognized as a result of a business combination is based on market values. The market value of items of plant, equipment, fixtures and fittings is based upon the quoted market prices of similar items.

**3. OTHER REVENUE**

|                        | 2012<br>\$   | 2011<br>\$    |
|------------------------|--------------|---------------|
| Interest revenue –bank | <u>6,265</u> | <u>41,790</u> |

**4. EXPENSES**

|  | 2012<br>\$              | 2011<br>\$            |
|--|-------------------------|-----------------------|
| (Loss)/Profit on continuing operations included:   |                         |                       |
| Depreciation                                       | <u>4,106</u>            | <u>2,362</u>          |
| Geothermal project impairment expense              | <b>3,377,901</b>        | -                     |
| Geothermal project expenses written off            | <u>5,791</u>            | <u>158,446</u>        |
|  | <b><u>3,383,692</u></b> | <b><u>158,446</u></b> |
| Salaries and benefits                              |                         |                       |
| Wages and salaries –other                          | -                       | 22,095                |
| Managing Director's fees –total (Note 16)          | <b>351,446</b>          | 394,638               |
| Managing Director's fees –reallocated to tenements | <b>(113,535)</b>        | <b>(95,185)</b>       |
| Wages and benefits –income statement               | <u>237,911</u>          | <u>321,548</u>        |
| Finance Costs                                      | <u>470,891</u>          | <u>18,648</u>         |

During the year, the Company paid \$467,433 (2011 \$nil) in finance fees to the future project financiers of the Copahue project. The finance fees include:

- AGS Capital Group LLC's Capital Contingency Finance,
- Corporation Interamericanapara el Financiamiento de Infraestructura's Drilling Loan and
- Inter-America Development Bank's Senior Debt Facility.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**5. INCOME TAX EXPENSE**

The Company is subject to income taxes on its non-consolidated financial statements in Australia, Canada and the U.S.A. The consolidated provision for income taxes varies from the amount that would be computed from applying the aggregate federal and provincial income tax rates to the profit/(loss) before income taxes as follows:

|  | 2012<br>\$           | 2011<br>\$  |
|--|----------------------|-------------|
| a. The components of tax expense comprise:   |                      |             |
| Current tax  | <u>71,946</u>        | -           |
| b. The prima facie tax on the loss before income tax is reconciled to the income tax as follows: |                      |             |
| Profit/(loss) before tax   | <u>(5,005,442)</u>   | (1,507,701) |
| Prima facie tax payable on profit/(loss) before income tax at 30% (2011: 30%)                    | <u>(1,501,633)</u>   | (452,310)   |
| Increase/(decrease) in income tax expense due to:  |                      |             |
| Non-allowable capital items  | 71,946               | -           |
| Non-deductible expenses  | 353                  | 154         |
| Other deductions   | -                    | -           |
| (Under)/over provision in prior year   | -                    | -           |
| Tax losses carried forward and not brought into account  | <u>1,501,280</u>     | 452,156     |
| <b>Income tax expense/(benefit)</b>  | <u><u>71,946</u></u> | -           |

**6. FINANCIAL INSTRUMENTS**

The Company classifies its financial instruments into loans and receivables, held-to-maturity, held-for-trading or available-for-sale categories.

**Financial Risk Management**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework.

**Financial Instrument Risk Exposure**

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board approves and monitors the risk management process.

The Company is exposed to the following risks related to its financial assets and liabilities:

**Currency Risk**

The Company is exposed to foreign currency fluctuations to the extent expenditures incurred are not denominated in Australian dollars. The Company has not entered into any foreign currency contracts to manage foreign currency risk.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**6. FINANCIAL INSTRUMENTS (Continued)**

**Credit Risk**

The Company is not exposed to significant credit risk arising from its financial instruments. This risk is minimised as the majority of cash and restricted cash have been placed with major financial institutions.

The maximum exposure to credit risk at balance date is as follows:

|                     | 2012<br>\$ | 2011<br>\$ |
|---------------------|------------|------------|
| Accounts receivable | 73,457     | 90,161     |

The maximum exposure to credit risk by country is as follows:

|                        | 2012<br>\$ | 2011<br>\$ |
|------------------------|------------|------------|
| Australia              | 73,457     | 90,161     |
| United States / Canada | -          | -          |
|                        | -          | -          |

**Market and Interest Rate Risk**

The only significant market risk exposure to which the Company is exposed is interest rate risk. Interest rate risk consists of two components:

- b) To the extent that payments made or received on the Company's monetary assets and liabilities are affected by changes in prevailing market interest rates, the Company is exposed to interest rate cash flow risk.
- c) To the extent that changes in prevailing market interest rates differ from the interest rates in the Company's monetary assets and liabilities, the Company is exposed to interest rate price risk.

The Company's convertible debentures and notes payable are principally at fixed interest rates and, therefore, the Company's exposure to interest rate cash flow risk over the term of the debentures is minimal. The Company is exposed to interest rate price risk on its notes payable and convertible debentures to the extent that changes in prevailing market interest rates differ from the fixed interest rate.

|  | %    | Floating<br>Interest<br>Rate | Fixed Interest Maturing<br>in |                      | Non-<br>Interest<br>Bearing | Total   |
|--|------|------------------------------|-------------------------------|----------------------|-----------------------------|---------|
|  |      |                              | 1 Year or<br>Less             | Over 1 to 5<br>Years |                             |         |
|  |      | \$                           | \$                            | \$                   | \$                          | \$      |
| <b>September 30, 2012</b>                |      |                              |                               |                      |                             |         |
| <b>Financial Assets</b>                  |      |                              |                               |                      |                             |         |
| Cash and cash equivalents                | 0.5% | 289,459                      | -                             | -                    | 54,940                      | 344,399 |
| Accounts receivable                      |      | -                            | -                             | -                    | 73,457                      | 73,457  |
| Restricted cash                          |      | -                            | -                             | -                    | 1                           | 1       |
|  |      | 289,459                      | -                             | -                    | 128,398                     | 417,857 |
| <b>Financial Liabilities</b>             |      |                              |                               |                      |                             |         |
| Accounts payable and accrued liabilities |      | -                            | -                             | -                    | 470,491                     | 470,491 |
|  |      | -                            | -                             | -                    | 470,491                     | 470,491 |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**6. FINANCIAL INSTRUMENTS (Continued)**

|  | %  | Floating<br>Interest<br>Rate | Fixed Interest Maturing<br>in |                      | Non-<br>Interest<br>Bearing | Total          |
|--|----|------------------------------|-------------------------------|----------------------|-----------------------------|----------------|
|  |    |                              | 1 Year or<br>Less             | Over 1 to 5<br>Years |                             |                |
|  |    | \$                           | \$                            | \$                   | \$                          | \$             |
| <b>September 30, 2011</b>                |    |                              |                               |                      |                             |                |
| <b>Financial Assets</b>                  |    |                              |                               |                      |                             |                |
| Cash and cash equivalents                | 5% | 282,120                      | -                             | -                    | -                           | 282,120        |
| Accounts receivable                      |    | -                            | -                             | -                    | 90,161                      | 90,161         |
| Restricted cash                          |    | -                            | -                             | -                    | 1                           | 1              |
|  |    | <u>282,120</u>               | <u>-</u>                      | <u>-</u>             | <u>90,162</u>               | <u>372,282</u> |
| <b>Financial Liabilities</b>             |    |                              |                               |                      |                             |                |
| Accounts payable and accrued liabilities |    | -                            | -                             | -                    | 665,732                     | 665,732        |
|  |    | <u>-</u>                     | <u>-</u>                      | <u>-</u>             | <u>665,732</u>              | <u>665,732</u> |

**Sensitivity Analysis**

The following tables demonstrate the sensitivity to a change in interest rates in relation to the Consolidated Entity's results and assets.

The Consolidated Entity's exposure to interest rate rise extends only to financial assets as financial liabilities are the subject of fixed interest rates.

|                           | Carrying Amount AUD | + 1.0% of AUD interest rate | -1.0% of AUD interest rate |
|---------------------------|---------------------|-----------------------------|----------------------------|
|                           | \$                  | \$                          | \$                         |
| <b>September 30, 2012</b> |                     |                             |                            |
| Financial assets          | 289,459             | 2,895                       | (2,895)                    |
| Tax charge 30%            | -                   | (868)                       | 868                        |
|                           | <u>289,459</u>      | <u>2,027</u>                | <u>(2,027)</u>             |
| <b>September 30, 2011</b> |                     |                             |                            |
| Financial assets          | 282,120             | 2,821                       | (2,821)                    |
| Tax charge 30%            | -                   | (846)                       | 846                        |
|                           | <u>282,120</u>      | <u>1,975</u>                | <u>(1,975)</u>             |

The above analysis assumes all other variables remain constant.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**6. FINANCIAL INSTRUMENTS (Continued)**

**Liquidity Risk**

The Company ensures that there is sufficient capital in order to meet short-term business requirements, after taking into account the Company's holdings of cash. The Company's cash is invested in business accounts, which are available on demand. The carrying amount in respect of fair value.

| <b>Maturity Analysis</b>  | <b>Carrying<br/>Amount<br/>\$</b> | <b>Contractual<br/>Cash flows<br/>\$</b> | <b>&lt; 6 months<br/>\$</b> | <b>6-12 months<br/>\$</b> | <b>1-3 years<br/>\$</b> |
|---------------------------|-----------------------------------|--|-----------------------------|---------------------------|-------------------------|
| <b>September 30, 2012</b> |                                   |  |                             |                           |                         |
| Accounts payable          | 470,491                           | 470,491                                  | 470,491                     | -                         | -                       |
| <b>September 30, 2011</b> |                                   |  |                             |                           |                         |
| Accounts payable          | 665,732                           | 665,732                                  | 665,732                     | -                         | -                       |

**7. TRADE AND OTHER RECEIVABLES**

|                                   | <b>September 30,<br/>2012<br/>\$</b> | <b>September 30,<br/>2011<br/>\$</b> |
|-----------------------------------|--------------------------------------|--------------------------------------|
| <b>Current</b>                    |                                      |                                      |
| Trade receivables and prepayments | 63,916                               | 49,767                               |
| Other receivables                 | 9,541                                | 40,394                               |
|                                   | <b>73,457</b>                        | <b>90,161</b>                        |

a. Trade receivables past due but not impaired:

As of September 30, 2012, consolidated trade receivables of \$nil (2011: \$nil) were past due but not impaired.

The other balances within trade receivables are not past due and do not contained impaired assets. Based on the credit history of these receivables, it is expected that these amounts will be received when due.

b. Impaired trade receivables

As at September 30, 2012, trade receivables of \$nil (2011: \$nil) were impaired.

c. Other receivables

Other receivables arise from transaction outside the usual operating activities of the Company and are unsecured, interest free and repayable on demand.

There are no balances that are past due and impaired. It is expected these balances will be received when demanded.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2012**

**8. PROPERTY AND EQUIPMENT**

|                       | Cost<br>\$    | Accumulated<br>Amortisation<br>\$ | Write-Down<br>of Interests<br>\$ | September 30,<br>2012<br>Net<br>Book<br>Value<br>\$ | September 30,<br>2011<br>Net<br>Book<br>Value<br>\$ |
|-----------------------|---------------|-----------------------------------|----------------------------------|---|---|
| Oil and gas interests | -             | -                                 | -                                | -   | -   |
| Office equipment      | 19,153        | (13,778)                          | -                                | 5,375   | 8,533   |
|                       | <u>19,153</u> | <u>(13,778)</u>                   | <u>-</u>                         | <u>5,375</u>  | <u>8,533</u>  |

**Capitalised Expenditure**

During the period \$948 (September 30, 2011: \$6,991) of office equipment was acquired.

**9. GEOTHERMAL, OIL AND GAS INTERESTS**

|                                   | Opening<br>Cost<br>\$ | Additions<br>\$  | Disposals/<br>Write-Down<br>of Interests<br>\$ | September 30,<br>2012<br>Net<br>Book<br>Value<br>\$ | September 30,<br>2011<br>Net<br>Book<br>Value<br>\$ |
|-----------------------------------|-----------------------|------------------|--|---|---|
| Undeveloped oil and gas interests | -                     | -                | -  | -   | -   |
| Undeveloped geothermal interests  |                       |                  |  |   |   |
| - Africa                          | 474,586               | 140,621          | (615,207)                                      | -   | 474,586   |
| - Argentina                       | 522,087               | 1,669,066        | -  | 2,191,153   | 522,087   |
| - Australia                       | 2,742,915             | 19,779           | (2,762,694)                                    | -   | 2,742,915   |
|                                   | <u>3,739,588</u>      | <u>1,829,466</u> | <u>(3,377,901)</u>                             | <u>2,191,153</u>                                    | <u>3,739,588</u>                                    |

**Capitalised Expenditure**

There has been \$1,829,466 (2011: \$1,071,472) of capitalised geothermal project expenditure in the Consolidated Entity since the prior period.

During the period \$5,791 (2011: \$13,424) of non-capitalized expenditure was written off to the statement of comprehensive income statement.

A strategic broadening of the group's operation has resulted in \$3,377,901 (2011: \$nil) of capitalized expenditure was written off to the statement of comprehensive income statement and related to the following projects:

- Australian geothermal projects are being surrendered and as a result the current asset was impaired in full, \$2,762,694.
- African projects are not longer being pursued and as a result the current asset was impaired in full \$615,207.

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**9. GEOTHERMAL, OIL AND GAS INTERESTS (Continued)**

Interests held by the Group are listed below.

***Spring River's Oil and gas interests:***

| Tenement description        | Tenement details/code   | Location     | Interest held       |
|-----------------------------|---|--------------|---------------------|
| Baxter Joint Venture        | Township 19 North Range 106 West<br>Section 12: All<br>Section 24: All                        | Wyoming USA  | 15%                 |
| Baxter Joint Venture        | Township 19 North, Range 106 West<br>Section 4: Lots 5-8<br>Section 24: Lots 8-14             | Wyoming USA  | 15%                 |
| Baxter Joint Venture        | Township 19 North, Range 106 West<br>Section 2: Lots 5-8<br>Section 10: All<br>Section 22: E2 | Wyoming USA  | 15%                 |
| Baxter Joint Venture        | Township 19 North, Range 106 West<br>Section 18: Lots 5-8<br>Section 20: All                  | Wyoming USA  | 15%                 |
| Baxter Joint Venture        | Township 19 North, Range 106 West<br>Section 22: All  | Wyoming USA  | 15%                 |
| Baxter Joint Venture        | Township 19 North, Range 106 West<br>Section 22: W2   | Wyoming USA  | 15%                 |
| West Florence Joint Venture | Township 18 through 20 South Ranges 69 and 70<br>West Freemont County Colorado                | Colorado USA | Nil% <sup>(1)</sup> |

***Capitalised Tenement Costs:***

| Tenement description                    | Tenement details/code | September 30,<br>2012<br>\$ | September 30,<br>2011<br>\$ |
|---|-----------------------|-----------------------------|-----------------------------|
| Fiale Project, Djibouti                 | Fiale                 | -                           | 474,586                     |
| Copahue Project, Argentina              | Copahue               | 2,191,153                   | 522,087                     |
| Mt Grainger SA Australia <sup>(1)</sup> | GEL 337               | -                           | 900,831                     |
| Paratoo SA Australia <sup>(1)</sup>     | GEL 338               | -                           | 900,832                     |
| Waroonee SA Australia <sup>(1)</sup>    | GEL 339               | -                           | 900,832                     |
| Bulninnie SA Australia <sup>(1)</sup>   | GEL 503               | -                           | 6,712                       |
| Mt Grainger SA Australia <sup>(1)</sup> | GEL 504               | -                           | 6,712                       |
| Price Hill <sup>(1)</sup>               | GEL 507               | -                           | 6,712                       |
| Kimberlite Project <sup>(1)</sup>       | GEL 523               | -                           | 6,840                       |
| Kimberlite Project <sup>(1)</sup>       | GEL 524               | -                           | 6,722                       |
| Kimberlite Project <sup>(1)</sup>       | GEL 525               | -                           | 6,722                       |
| <b>Total</b>                            |                       | <b>2,191,153</b>            | <b>3,739,588</b>            |

Notes:

<sup>(1)</sup> The Company received PIRSA confirmation that all Australian projects have been surrendered, effective October 25, 2012.

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**10. CURRENT LIABILITIES – TRADE AND OTHER PAYABLES**

|                                     | September 30,<br>2012<br>\$ | September 30,<br>2011<br>\$ |
|-------------------------------------|-----------------------------|-----------------------------|
| <b>Current</b>                      |                             |                             |
| Accounts payable and accrued income | <b>470,491</b>              | 665,732                     |

**11. ISSUED CAPITAL**

a) Shares Issued and Outstanding

|   | Number                       |                              | Consideration               |                             |
|---|------------------------------|------------------------------|-----------------------------|-----------------------------|
|   | September 30,<br>2012<br>No. | September 30,<br>2011<br>No. | September 30,<br>2012<br>\$ | September 30,<br>2011<br>\$ |
| Balance, beginning of period  | 569,532,643                  | 524,178,687                  | <b>19,772,010</b>           | 17,554,135                  |
| <b>Shares issued in period</b>  |                              |                              |                             |                             |
| October 31, 2011 Securities issued on exercise of Options <sup>1</sup>                                    | <b>10,000,000</b>            | -                            | <b>200,000</b>              | -                           |
| December 15, 2011 Securities issued to sophisticated investors <sup>2</sup>                               | <b>20,000,000</b>            | -                            | <b>600,000</b>              | -                           |
| February 24, 2012 Securities issued <sup>3</sup>  | <b>12,871,817</b>            | -                            | <b>436,354</b>              | -                           |
| March 12, 2012 Securities issued as a special share placement <sup>4</sup>                                | <b>64,870,001</b>            | -                            | <b>1,946,100</b>            | -                           |
| August 10, 2012 Securities issued as a special share placement <sup>5</sup>                               | <b>67,000,000</b>            | -                            | <b>670,000</b>              | -                           |
| August 10, 2012 Securities issued in settlement of services provided <sup>6</sup>                         | <b>10,000,000</b>            | -                            | <b>100,000</b>              | -                           |
| <b>Shares issued in prior period</b>  |                              |                              |                             |                             |
| October 26, 2010 Security issued as consideration for the acquisition of African opportunities            | -                            | 9,125,000                    | -                           | 228,125                     |
| October 26, 2010 Security issued in settlement of a commercial agreement for African opportunities        | -                            | 912,500                      | -                           | 22,813                      |
| October 26, 2010 Security issued to sophisticated investors   | -                            | 10,000,000                   | -                           | 250,000                     |
| February 14, 2011 Security issued to Socius CG II pursuant to a Share Subscription Agreement <sup>7</sup> | -                            | 25,316,456                   | -                           | 2,000,000                   |
| <b>Share issue costs</b>  | -                            | -                            | <b>(215,421)</b>            | (283,063)                   |
| <b>Balance, end of period</b>   | <b>754,274,461</b>           | 569,532,643                  | <b>23,509,043</b>           | 19,772,010                  |

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**11. ISSUED CAPITAL (Continued)**

Notes:

- <sup>(1)</sup>On October 31, 2011 Securities issued on exercise of Options at \$0.02 per share.
- <sup>(2)</sup>On December 15, 2011 Securities issued to sophisticated investors at \$0.03 per share.
- <sup>(3)</sup>On February 24, 2012 Securities issued to directors in lieu of cash payment for accumulated directors' fees at \$0.0339 (based on VWAP over the 5 trading days immediately prior to date of the AGM, when the issue was approved).
- <sup>(4)</sup>On March 12, 2012 Securities issued as a special share placement to sophisticated investors at \$0.03 per share.
- <sup>(5)</sup>On August 10, 2012, Securities issued to sophisticated investors at \$0.01 per share.
- <sup>(6)</sup>On August 10, 2012, Securities issued in settlement of services provided escrowed until next general meeting (released October 25, 2012).
- <sup>(7)</sup>On February 14, 2011, 25,316,456 ordinary shares and 12,658,228 unquoted options were issued Socius CG II for \$2,000,000 as the first tranche in pursuant to a Share Subscription Agreement dated February 14, 2011 Under the Agreement the total investment of up to \$5,000,000 over the next six months, in two tranches of \$2,000,000 and one \$1,000,000 at issue prices for the shares equivalents to the closing bid price of the Company's CDI/ORD shares the day before closing, plus unquoted five year options to 50% in number of the share issue at an exercise price equivalent to the related share issue price. The 12,658,228 unquoted options issued have an exercise price of \$0.079 and expire on February 14, 2016.

b) Share Option Reserve

|  | <b>September 30,<br/>2012</b> | September 30,<br>2011 |
|--|-------------------------------|-----------------------|
|  | <b>\$</b>                     | <b>\$</b>             |
| Performance Rights Reserve - Equity based remuneration | -                             | -                     |
| Share Options Reserve - Equity based remuneration      | <b>64,500</b>                 | 64,500                |
|  | <b>64,500</b>                 | 64,500                |

The share option reserve records items recognised on the valuation of vested share options.

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**11. ISSUED CAPITAL (Continued)**

*Performance Rights Reserve*

On February 24, 2012, as part of a long term incentive 40,000,000 Performance Rights were issues to Mr Torey Marshall, Managing Director. The Black-Scholes valuation of Performance Rights at the effective grant period over five years of those rights vested amounted to \$240,000 per annum over the next five years. During the half-year \$20,000 of equity based remuneration was charged to the Comprehensive Income Statement.

The Board has reviewed the Performance Right Key Performance Indicators (“KPIs”) and concluded that no discretion is expected to be used to award any shares under the Managing Director’s performance rights. At the September 30, 2012 the Managing Director is not expected to be awarded any Performance Right shares and as a result the \$20,000 charge to the Statement of Comprehensive Income Statement for the Managing Director’s Performance Rights is no longer required.

*Share Option Reserve*

The Share Option Reserve records items recognised on the valuation of vested share options.

On February 25, 2011, as part of the Executive Director, Alexander Rose-Innes remuneration package, 30,000,000 options are to be issued, subject to certain conditions, including shareholder approval. On May 11, 2011 Mr Rose Innes resigned and as a result 20,000,000 options lapsed. The Black-Scholes valuation of remaining vested options at the effective grant date of August 3, 2010 of those options vested amounted to \$6,000.

On February 25, 2011, 12,000,000 options were issued to David Anderson as consideration for the acquisition of certain African opportunities. The Black-Scholes valuation of vested options at the effective grant date of August 3, 2010 and July 30, 2011 amounted to \$58,500. The Black-Scholes valuation was based on an interest free rate of 5.5% and 75% volatility.

c) Stock Options

The Company has adopted a new current stock option plan (the “Plan”) effective October 12, 2011. Under the Plan, the Company may grant options to acquire common shares to a maximum of 5% of the Company’s total issued ordinary shares at the date of the grant. The fair value of share options is estimated using the Black-Scholes option pricing model.

Under the previous Plan, the Company may grant options to acquire common shares to a maximum of 10% of the issued and outstanding common shares at the date of the grant. The fair value of share options is estimated using the Black-Scholes option pricing model.

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**11. ISSUED CAPITAL (Continued)**

The Company has the following history of stock options outstanding:

|  | Number of<br>Options | Weighted Average<br>Exercise Price |
|--|----------------------|------------------------------------|
| Balance, September 30, 2010                          | 73,333               | \$0.540                            |
| Expired unexercised on November 10, 2010             | (73,333)             | \$0.540                            |
| Issued on February 14, 2011 <sup>(1)</sup>           | 12,658,228           | \$0.079                            |
| Issued on February 25, 2011 <sup>(2)</sup>           | 42,000,000           | \$0.044                            |
| Lapsed on May 11, 2011 <sup>(2)</sup>                | (20,000,000)         | \$0.065                            |
| Lapsed on August 3, 2011 <sup>(2)</sup>              | (10,000,000)         | \$0.030                            |
| <b>Balance at September 30, 2011</b>                 | <b>24,658,228</b>    | <b>\$0.045</b>                     |
| Balance, September 30, 2011                          | 24,658,228           | \$0.045                            |
| Expired exercised on October 30, 2011 <sup>(3)</sup> | (10,000,000)         | \$0.020                            |
| Issued on December 15, 2011 <sup>(4)</sup>           | 10,000,000           | \$0.060                            |
| Issued on August 10 2012 <sup>(5)</sup>              | 23,500,000           | \$0.010                            |
| <b>Balance at September 30, 2012</b>                 | <b>48,158,228</b>    | <b>\$0.036</b>                     |

The following table summarises information about the stock options outstanding:

| Expiry Date                      | Number of                               |                                  | Number of                               |                                  |
|----------------------------------|---|----------------------------------|---|----------------------------------|
|                                  | Exercise Price<br>September 30,<br>2012 | Options<br>September 30,<br>2012 | Exercise Price<br>September 30,<br>2011 | Options<br>September 30,<br>2011 |
| July 30, 2013 <sup>(2)</sup>     | -                                       | -                                | \$0.020                                 | 5,000,000                        |
| July 30, 2013 <sup>(2)</sup>     | \$0.030                                 | 1,000,000                        | \$0.030                                 | 1,000,000                        |
| July 30, 2013 <sup>(2)</sup>     | -                                       | -                                | \$0.020                                 | 5,000,000                        |
| July 30, 2013 <sup>(2)</sup>     | \$0.030                                 | 1,000,000                        | \$0.030                                 | 1,000,000                        |
| February 14, 2016 <sup>(1)</sup> | \$0.079                                 | 12,658,228                       | \$0.079                                 | 12,658,228                       |
| December 15, 2012 <sup>(4)</sup> | \$0.006                                 | 10,000,000                       | -                                       | -                                |
| August 10, 2015 <sup>(5)</sup>   | \$0.010                                 | 23,500,000                       | -                                       | -                                |
|                                  | <b>\$0.036</b>                          | <b>48,158,228</b>                | <b>\$0.045</b>                          | <b>24,658,228</b>                |

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**11. ISSUED CAPITAL (Continued)**

**Notes**

- <sup>(1)</sup>On February 14, 2011, 25,316,456 ordinary shares and 12,658,228 unquoted options were issued Socius CG II for \$2,000,000 as the first tranche in pursuant to a Share Subscription Agreement dated February 14, 2011. Under the Agreement the total investment of up to \$5,000,000 over the next six months, in two tranches of \$2,000,000 and one \$1,000,000 at issue prices for the shares equivalent to the closing bid price of the Company's CDI/ORD shares the day before closing, plus unquoted five year options to 50% in number of the share issue at an exercise price equivalent to the related share issue price. The 12,658,228 unquoted options issued have an exercise price of \$0.079 and expire on February 14, 2016.
- <sup>(2)</sup>On February 25, 2011, as part of the Executive Director, Alexander Rose-Innes remuneration package, 30,000,000 options are to be issued, subject to certain conditions, including shareholder approval. The Black-Scholes valuation of vested options at the effective grant date of August 3, 2010 of those options vested amounted to \$6,000. On 11 May 2011 Mr Rose Innes resigned and as a result 20,000,000 options lapsed and the remaining 10,000,000 lapsed unexercised on August 3, 2011. In addition on 25 February 2011, 12,000,000 options were issued to David Anderson as consideration for the acquisition of certain African opportunities. The Black-Scholes valuation of vested options at the effective grant date of August 3, 2010 and July 30, 2011 amounted to \$58,500. The Black-Scholes valuation was based on an interest free rate of 5.5% and 75% volatility. In the geothermal industry and in the current market the volatility generally used is high, the directors have estimated a 75% volatility for the Company.
- <sup>(3)</sup>On October 31, 2011 10,000,000 Options at \$0.02 were exercised raising \$200,000.
- <sup>(4)</sup>On December 15, 2011 10,000,000 Attaching Options were issued to sophisticated investors.
- <sup>(5)</sup>On August 10, 2012 23,500,000 Attaching Options were issued to sophisticated investors.

**12. CONTINGENT LIABILITIES**

The Consolidated Entity has no contingent liabilities at September 30, 2012.

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**13. COMMITMENTS**

(a) Exploration commitments

**Copahue Development Project in Argentina**

The exploration expenditure commitments relate to the entity's share of Argentinean exploration and evaluation expenditure required to comply with the licence terms issued by the relevant regulatory body and the Heads of Agreement dated May, 13 2010 ("Agreement").

The Company has signed a conditional agreement with Geothermal One Inc to acquire it and its residual Copahue interest for CDN\$6 million. The concession agreement underlying the Project provides for the completion of a 30MWe power plant within the 5 year term; it is subject to annual work tests rather than fixed economic tests. Based on the planned two phase development, the total cost over 5 years is estimated to be up to US\$200 million.

**Fiale Development Project in Djibouti**

There are no minimum exploration expenditure commitments at the date of this report.

**Earth Heat Australian geothermal interests**

As a result of the prevailing economic climate, the Group has broadened its strategic direction and all Australian interests have been surrendered, effective October 25, 2012.

**Spring River's oil and gas interests**

The exploration expenditure commitments relate to the economic entity's share of the exploration and evaluation expenditure required to comply with the licence terms issued by the relevant regulatory body. There is no fixed financial commitment under the licence terms.

(b) Other commitments

In April 2012 signed a 12 month license agreement for office accommodation, the annual license fee being \$11,000 (2011: lease rental \$36,000) per annum. In addition, the Company has engaged Allinson Accounting Solutions Pty Ltd to provide annual accounting and administrative services at a fee of \$48,000 per annum (2011: \$147,478).

The Company has an employment agreement with the Managing Director, Torey Marshall; the remuneration payable is \$330,000 from January 1, 2011 (previously \$230,000 per annum).

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**14. RELATED PARTY TRANSACTIONS**

I) Related Party Transactions

During the year the Company entered into employment contracts and loan agreements with directors and consultants that are considered to be related parties. The purpose of the transactions entered into with related parties was to facilitate the Company's strategic, operating and financing activities.

The Related party transactions mentioned above are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Amounts due to related parties are unsecured with no specific terms of repayment.

| <b>Related party</b>  | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2011<br/>\$</b> | <b>(Charge)/Credit to<br/>Consolidated<br/>Restated Income<br/>Statement<br/>\$</b> | <b>Paid/(received)<br/>during the period<br/>\$</b> | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2012<br/>\$</b> |
|---|--|---|---|--|
| <u>Remuneration Payable to Directors<br/>including superannuation</u> |  |   |   |  |
| S Pearce  | (73,722)   | -   | 73,722 <sup>(1)</sup>                               | -  |
| D Sutton  | (73,171)   | -   | 73,171 <sup>(1)</sup>                               | -  |
| R Shaw  | (109,905)  | (65,000)  | 136,988 <sup>(1)</sup>                              | <b>(37,917)</b>  |
| N Zillman   | (76,280)   | (27,067)  | 96,280 <sup>(1)</sup>                               | <b>(7,067)</b>   |
| M Lucas-Smith   | -  | (20,933)  | 7,733   | <b>(13,200)</b>  |
| A Rose-Innes  | (50,000)   | -   | 50,000 <sup>(1)</sup>                               | -  |
| T Marshall  | (37,384)   | (351,446)   | 245,229   | <b>(143,601)</b>   |
|   | <b>(420,462)</b>   | <b>(464,446)</b>  | <b>683,123</b>                                      | <b>(201,785)</b>   |

| <b>Related party</b>  | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2010<br/>\$</b> | <b>(Charge)/Credit to<br/>Consolidated<br/>Restated Income<br/>Statement<br/>\$</b> | <b>Paid/(received)<br/>during<br/>the period<br/>\$</b> | <b>Debtor/(Creditor)<br/>Balance<br/>September 30,<br/>2011<br/>\$</b> |
|---|--|---|---|--|
| <u>Remuneration Payable to Directors<br/>including superannuation</u> |  |   |   |  |
| S Pearce  | (44,962)   | (28,760)  | -   | (73,722)   |
| D Sutton  | (44,411)   | (28,760)  | -   | (73,171)   |
| R Shaw  | (44,905)   | (65,000)  | -   | (109,905)  |
| N Zillman   | (28,280)   | (48,000)  | -   | (76,280)   |
| A Rose-Innes  | -  | (56,000)  | 6,000 <sup>(2)</sup>                                    | (50,000)   |
| T Marshall  | (3,745)  | (338,638)   | 304,999   | (37,384)   |
|   | <b>(166,303)</b>   | <b>(565,158)</b>  | <b>310,999</b>  | <b>(420,462)</b>   |

**Notes:**

<sup>(1)</sup> Equity based payment (net of GST) refer to Note 11(a) for further details.

<sup>(2)</sup> Equity based payment (net of GST) refer to Note 11(b) for further details.

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**14. RELATED PARTY TRANSACTIONS (Continued)**

During the year, managing director's remuneration amounted to \$351,446 (2011: \$338,838) and directors fees of \$113,000 (2011: \$226,520) were paid or accrued by the Company to Directors. The following Director's unpaid remuneration that was paid in shares on February 24, 2012:

| Name                 | Wages and<br>superannuation<br>\$ | Shares issued<br>Number | Share price<br>per share<br>\$ |
|----------------------|-----------------------------------|-------------------------|--------------------------------|
| Raymond Shaw         | 136,988                           | 4,040,951               | \$0.0339                       |
| Norman Zillman       | 96,280                            | 2,840,118               | \$0.0339                       |
| Stephen Pearce       | 73,722                            | 2,174,717               | \$0.0339                       |
| Alexander Rose-Innes | 50,000                            | 1,474,926               | \$0.0339                       |
| David Sutton         | 79,364                            | 2,341,105               | \$0.0339                       |
| <b>Total</b>         | <b>436,354</b>                    | <b>12,871,817</b>       | <b>\$0.0339</b>                |

II) Key Management personnel

Key management personnel include the directors and company secretary.

The names of persons who were directors of the Company at any time during the period were:

Dr R Shaw (appointed January 22, 2010)  
T Marshall (appointed January 22, 2010)  
M Lucas-Smith (appointed April 23, 2012)  
N Zillman (appointed February 26, 2010, resigned April 23, 2012)  
A Rose-Innes (appointed August 3, 2010, resigned May 11, 2011)  
S Pearce (resigned May 11, 2011)  
D Sutton (resigned May 11, 2011)

S Pearce is a Joint Company Secretary (resigned May 11, 2011)  
M Lucas-Smith is a Company Secretary (appointed January 22, 2010)

III) Remuneration of key management personnel

Shares or options over unissued shares in the Company held during the financial year by any key management personnel of the Company including their related parties as at September 30, 2011 are disclosed in the Directors Information that forms part of this Report.

The full Board of Directors sets remuneration policies and practices generally and makes specific recommendations on remuneration packages and other terms of employment for Executive Directors, other Senior Executives and Non-Executive Directors.

Remuneration arrangement of key management personnel are disclosed in the Remuneration Report that forms part of this Report.

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**15. INCOME TAXES**

|                    | September 30,<br>2012<br>\$ | September 30,<br>2011<br>\$ |
|--------------------|-----------------------------|-----------------------------|
| <b>Liabilities</b> |                             |                             |
| CURRENT            |                             |                             |
| Income Tax         | -                           | -                           |
| <b>Assets</b>      |                             |                             |
| NON-CURRENT        |                             |                             |
| Deferred tax asset | -                           | -                           |

Deferred tax assets not brought to account, the benefits of which will only be realised if the conditions for deductibility set out in Note 1(g) occur:

— tax losses: Australian operating losses to date \$9,958,362 (2011: \$8,457,082)

In addition, the Company has available tax losses of approximately \$6,175,000 (CAD\$5,928,000<sup>1</sup>) that may be offset against future Canadian taxable income. The Company has resource pools of approximately \$7,407,292 (CAD\$7,111,000<sup>3</sup>) available to offset future taxable income. The tax benefit of these amounts is available for carry-forward indefinitely, but has not been recognised.

**16. PARENT ENTITY DISCLOSURES**

The accounting policies of the parent entity, which have been applied in determining the financial information shown below, are the same as those applied in the consolidated financial statements. Refer to note 1 for a summary of the significant accounting policies relating to the Group.

| Financial Position       | 2012<br>\$       | 2011<br>\$       |
|--------------------------|------------------|------------------|
| <b>Assets</b>            |                  |                  |
| Current Assets           | 417,860          | 372,041          |
| Non-Current Assets       | 2,196,528        | 3,605,206        |
| <b>Total Assets</b>      | <u>2,614,388</u> | <u>3,977,247</u> |
| <b>Liabilities</b>       |                  |                  |
| Current Liabilities      | 470,491          | 664,989          |
| <b>Total Liabilities</b> | <u>470,491</u>   | <u>664,989</u>   |
| <b>Net Assets</b>        | <u>2,143,897</u> | <u>3,312,258</u> |

<sup>1</sup> AUD\$1:CAD\$0.96

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**16. PARENT ENTITY DISCLOSURES (Continued)**

| <b>Financial Position</b>                | <b>2012</b>         | <b>2011</b>        |
|--|---------------------|--------------------|
|  | <b>\$</b>           | <b>\$</b>          |
| <b>Equity</b>                            |                     |                    |
| Issued Capital                           | <b>23,509,043</b>   | 19,772,010         |
| Share Option Reserves                    | <b>64,500</b>       | 64,500             |
| Other Components of Shareholders Equity  | <b>1,406,355</b>    | 1,406,355          |
| Foreign Exchange Reserve                 | <b>8,533</b>        | 4,549              |
| Accumulated Losses                       | <b>(22,844,534)</b> | (17,935,156)       |
| <b>Total Equity</b>                      | <b>2,143,897</b>    | <b>3,312,258</b>   |
| <b>Financial Performance</b>             |                     |                    |
| Comprehensive Income/(Loss) for the year | <b>(4,909,378)</b>  | (1,495,276)        |
| Other comprehensive income               | -                   | -                  |
| <b>Total comprehensive loss</b>          | <b>(4,909,378)</b>  | <b>(1,495,276)</b> |

**17. SUBSEQUENT EVENTS**

The Board has reviewed the Performance Right Key Performance Indicators (“KPIs”) and resolved that the Managing Directors 40,000,000 performance rights are no longer capable of being met and are therefore cancelled.

Unquoted options totalling 10,000,000 with an exercise price of \$0.06 were not exercised and have expired on December 15, 2012.

Subsequent to the end of the financial year, a placement of 110,000,000 shares raised \$220,000 and a fully underwritten rights issue has been launched to assist the company in its identification and participation in shorter term energy projects, focussed predominantly (but not exclusively) in North America

The Company has announced a fully underwritten renounceable rights issue. 645,757,529 new ordinary Share are expected to be issued on January 21, 2013 for \$0.002 consideration for each share free attaching option:

- Short dated options 322,878,764 exercise price of \$0.005 expiring January 31, 2014 for every two new shares issued; and
- Long dated options up to 971,010,038 including underwriting and broker fees exercise price of \$0.007 expiring January 31, 2016 for every three new shares issued

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**17. SUBSEQUENT EVENTS (continued)**

The Underwriting Agreement makes provisions for certain covenants to be observed by the Company and also circumstances in which the Underwriter may terminate the Underwriting Agreement. Some of those provisions which allow termination of the Underwriting Agreement are summarised as following:

- i. If the ASX All Ordinaries Index is at any time after the date of this Agreement at a level that is 10% or more below its respective level as at the close of trading on the Business Day prior to the date of the Underwriting Agreement Business Days after the date of the Underwriting Agreement;
- ii. If the Company's Shares have a closing price at any time after the date of the Underwriting Agreement less than the Price of the Rights Shares for two consecutive days;
- iii. The Company does not lodge the Prospectus on the lodgment Date, being December 13, 2012, or the Offer is withdrawn.
- iv. ASX notifies that Official Quotation will not be granted, or once granted, is withdrawn.

In December 2012, the Company announced a broadened direction; this follows the continuing decline of investor interest in pure geothermal plays.

The Company received PIRSA confirmation that all Australian projects have been surrendered, effective October 25, 2012.

Except for the matters referred to above, there is no other matter or circumstance that has arisen since September 30, 2012 that has significantly affected or may significantly affect:

- a) the operations, in financial years subsequent to September 30, 2012, of the Consolidated Entity;
- b) the results of those operations; or
- c) the state of affairs, in financial years subsequent to September 30, 2012 of the Consolidated Entity.

**18. MANAGEMENT OF CAPITAL**

The Company manages its cash, ordinary shares and stock options as capital. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the development of its mineral properties and to maintain a flexible capital structure, which optimizes the costs of capital at an acceptable risk. The Company does not have any externally imposed capital requirements to which it is subject.

The Company manages the capital structure and makes adjustment to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets, or adjust the amount of cash and cash equivalents.

In order to facilitate the management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions.

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**18. MANAGEMENT OF CAPITAL (Continued)**

There are no externally imposed capital requirements.

There have been no changes in the strategy adopted by management to control the capital of the group since the prior year, which is to maintain the debt to equity ratio at not more than 100%. The debt-equity ratios as at September 30, 2012 and September 30, 2011 are as follows:

|                                | <b>September 30,<br/>2012</b> | September 30,<br>2011 |
|--------------------------------|-------------------------------|-----------------------|
|                                | \$                            | \$                    |
| Total loans and borrowings     | -                             | -                     |
| Less: Cash and cash equivalent | (344,399)                     | (282,120)             |
| Net borrowings                 | (344,399)                     | (282,120)             |
| Total equity                   | 2,143,894                     | 3,454,671             |
| Total capital                  | 23,509,043                    | 19,772,010            |
| Gearing ratio                  | (1.6)%                        | (1.4)%                |

The further decrease in the gearing ratio during 2012 is primarily due to the use of capital funds raised in the period being invested in the Company's geothermal projects.

**19. AUDITORS REMUNERATION**

Details of the amounts paid or payable to the auditors for services provided during the year are set out below:

|                           | <b>2012</b>   | 2011          |
|---------------------------|---------------|---------------|
|                           | AUD\$         | AUD\$         |
| <b>K S Black &amp; Co</b> |               |               |
| Audit fees – Full Year    | -             | -             |
| – Half Year               | -             | 8,250         |
| – Other Reports           | -             | 18,690        |
| Tax related services      | -             | 2,000         |
| Other                     | -             | -             |
|                           | -             | 28,940        |
| <b>Grant Thornton</b>     |               |               |
| Audit fees – Full Year    | 28,480        | 28,480        |
| – Half Year               | 9,900         | -             |
| – Other Reports           | -             | 10,000        |
|                           | 38,380        | 38,480        |
| <b>Total</b>              | <b>38,380</b> | <b>67,420</b> |

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**20. OPERATING SEGMENTS**

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

The Consolidated Entity previously operated one industry in North America and one principal activity being oil and gas. However, information reported to the Consolidated Entity's chief operating decision makers for the purposes of resource allocation and assessment of segmental reporting is more specifically focused on operating division by specific geographical location. The Consolidated Entity's reporting segments under IFRS 8 are therefore as follows:

- Geothermal - Africa
- Argentina
- Australia
  
- Oil and Gas - USA
  
- Corporate - Australia

Information regarding the Consolidated Entity's reportable segments is presented below. Amounts reported for the prior year have been restated to conform to the requirements of IFRS.

**Operating Segments**

|  | <b>Africa</b> | <b>Argentina</b> | <b>Australia</b> | <b>USA</b>  | <b>Australia</b>   | <b>Total</b> |
|--|---------------|------------------|------------------|-------------|--------------------|--------------|
|  | Geothermal    | Geothermal       | Geothermal       | Oil and Gas | Corporate expenses | Total        |
|  | \$            | \$               | \$               | \$          | \$                 | \$           |
| <b>September 30, 2012</b>                            |               |                  |                  |             |                    |              |
| <b>REVENUE</b>                                       |               |                  |                  |             |                    |              |
| Total revenue -external sales                        | -             | -                | -                | -           | -                  | -            |
| <b>RESULT</b>  |               |                  |                  |             |                    |              |
| Segment result                                       | -             | -                | (997)            | -           | (1,156,040)        | (1,157,037)  |
| Unallocated expenses net of unallocated revenue      | -             | -                | -                | -           | -                  | -            |
| Current asset impairment – Capitalised project costs | (615,207)     | -                | (2,762,694)      | -           | -                  | (3,377,901)  |
| Geothermal project expenses written off              | (5,791)       | -                | -                | -           | -                  | (5,791)      |
| Finance income/(costs)                               | -             | (467,434)        | -                | -           | 2,721              | (464,713)    |
| Profit/(loss) before income tax                      | (620,998)     | (467,434)        | (2,763,691)      | -           | (1,153,319)        | (5,005,442)  |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**20. OPERATING SEGMENTS (Continued)**

**Operating Segments**

|  | <b>Africa</b><br>Geothermal<br>\$ | <b>Argentina</b><br>Geothermal<br>\$ | <b>Australia</b><br>Geothermal<br>\$ | <b>USA</b><br>Oil and Gas<br>\$ | <b>Australia</b><br>Corporate<br>expenses<br>\$ | <b>Total</b><br>\$ |
|--|-----------------------------------|--------------------------------------|--------------------------------------|---------------------------------|---|--------------------|
| <b>September 30, 2012</b>                          |                                   |                                      |                                      |                                 |   |                    |
| Income tax expense/(benefit)                       | -                                 | -                                    | -                                    | -                               | 71,946  | 71,946             |
| Profit/(loss) after income tax                     | (620,998)                         | (467,434)                            | (2,763,691)                          | -                               | (1,225,265)                                     | (5,077,388)        |
| <b>ASSETS</b>                                      |                                   |                                      |                                      |                                 |   |                    |
| Segment assets                                     | 1,886                             | 2,196,512                            | -                                    | -                               | 415,987   | 2,614,385          |
| <b>LIABILITIES</b>                                 |                                   |                                      |                                      |                                 |   |                    |
| Segment liabilities                                | 15,971                            | 106,748                              | -                                    | -                               | 347,772   | 470,491            |
| Reconciliation of segmental assets to group assets |                                   |                                      |                                      |                                 |   |                    |
| Inter-segment eliminations                         |                                   |                                      |                                      |                                 |   | -                  |
| Total group assets from continuing operations      |                                   |                                      |                                      |                                 |   | <u>2,143,894</u>   |
| <b>OTHER</b>                                       |                                   |                                      |                                      |                                 |   |                    |
| Depreciation and amortisation of segment assets    | -                                 | -                                    | -                                    | -                               | 4,106   | 4,106              |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**20. OPERATING SEGMENTS (Continued)**

**Operating Segments**

|   | <b>Africa</b><br>Geothermal<br>\$ | <b>Argentina</b><br>Geothermal<br>\$ | <b>Australia</b><br>Geothermal<br>\$ | <b>USA</b><br>Oil and Gas<br>\$ | <b>Australia</b><br>Corporate<br>expenses<br>\$ | <b>Total</b><br>\$ |
|---|-----------------------------------|--------------------------------------|--------------------------------------|---------------------------------|---|--------------------|
| <b>September 30, 2011</b>                                     |                                   |                                      |                                      |                                 |   |                    |
| <b>REVENUE</b>  |                                   |                                      |                                      |                                 |   |                    |
| Total revenue -external sales                                 | -                                 | -                                    | -                                    | -                               | -   | -                  |
| <b>RESULT</b>   |                                   |                                      |                                      |                                 |   |                    |
| Segment result  | (44,182)                          | -                                    | -                                    | -                               | (1,346,863)                                     | (1,391,045)        |
| Unallocated expenses net of unallocated revenue               | -                                 | -                                    | -                                    | -                               | -   | -                  |
| Convertible notes, debentures and other liabilities reduction | -                                 | -                                    | -                                    | -                               | -   | -                  |
| Write-down of project expenses                                | (18,653)                          | (126,369)                            | (13,424)                             | -                               | -   | (158,446)          |
| Finance income/(costs)  | -                                 | -                                    | -                                    | -                               | 41,790  | 41,790             |
| Profit/(loss) before income tax                               | (62,835)                          | (126,369)                            | (13,424)                             | -                               | (1,305,073)                                     | (1,507,701)        |
| Income tax expense  | -                                 | -                                    | -                                    | -                               | -   | -                  |
| Profit/(loss) after income tax                                | (62,835)                          | (126,369)                            | (13,424)                             | -                               | (1,305,073)                                     | (1,507,701)        |
| <b>ASSETS</b>   |                                   |                                      |                                      |                                 |   |                    |
| Segment assets  | 474,586                           | 522,717                              | 2,743,156                            | -                               | 379,944   | 4,120,403          |
| <b>LIABILITIES</b>  |                                   |                                      |                                      |                                 |   |                    |
| Segment liabilities   | 14,455                            | 54,092                               | 744                                  | -                               | 596,441   | 665,732            |
| Reconciliation of segmental assets to group assets            |                                   |                                      |                                      |                                 |   |                    |
| Inter-segment eliminations                                    |                                   |                                      |                                      |                                 |   | -                  |
| Total group assets from continuing operations                 |                                   |                                      |                                      |                                 |   | <u>3,454,671</u>   |
| <b>OTHER</b>  |                                   |                                      |                                      |                                 |   |                    |
| Depreciation and amortisation of segment assets               | -                                 | -                                    | -                                    | -                               | 2,362   | 2,362              |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**20. OPERATING SEGMENTS (Continued)**

**Basis for accounting for purposes of operating segments**

a. Accounting policies adopted

Unless stated otherwise, all amounts reported to the Board of Directors as chief decision makers with respect to operating segments are determined in accordance with accounting policies that are consistent with those disclosed in Note 1.

b. Inter-segmental transaction

Segment revenues and expenses are those directly attributable to the segments. Segment assets include all assets used by a segment and consist principally of cash, receivables, inventories, intangibles and property, plant and equipment, net of allowances and accumulated depreciation and amortisation. While most such assets can be directly attributed to individual segments, the carrying amount of certain assets used jointly by two or more segments is allocated to the segments on a reasonable basis. Segment liabilities consist principally of payables, employee benefits, accrued expenses, provisions and borrowings.

**Geographical information**

Geographical information is provided within the Consolidated Entity's operating segments.

**Major customers**

The Consolidated Entity is an exploration company and as such has no major customers.

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## **CORPORATE GOVERNANCE STATEMENT**

Earth Heat Resources Ltd ("the "Company") and the Board are committed to achieving and demonstrating the appropriate standards of corporate governance, consistent with the size and nature of the Company. This statement outlines the main corporate governance practices in place.

The ASX Corporate Governance Council ("Council") released revised Corporate Governance Principles and Recommendations on August 2, 2007 and further amendments in June 2010 ("ASX Principles") and this Statement complies with those revised ASX Principles except where otherwise noted.

Having regard to the size of the Company and the nature of its enterprise, it is considered that the Company complies as far as possible with the spirit and intentions of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations

### **CHARTER FOR THE BOARD OF DIRECTORS**

An important and basic corporate governance policy is the Charter for the Board of Directors which is regularly reviewed. The Charter is a composite document which deals with all of the ASX principles of good corporate governance and is available on the Company's website.

The Charter, as supported by the Director's Code of Conduct detailed at Principle 3, sets out the following requirements:

- The role of the Board;
- The Board structure;
- The skills required on the Board; and
- The Director's general roles.

The relevant references in the Charter are noted under each of the principles listed below.

### **ASX CORPORATE GOVERNANCE PRINCIPLES**

The following is a summary of the 8 Corporate Governance Principles including comments where applicable on the Recommendations, and extracts from the policies adopted by the Company which demonstrate how compliance has been achieved.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**PRINCIPLE 1: Lay solid foundations for management and oversight**

**Operations of the Board**

The Board of Directors of the Company is responsible for all aspects of the management of the Company. The Board guides and monitors the businesses and affairs of the Company on behalf of the Shareholders and is committed to achieving and demonstrating the appropriate standards of corporate governance commensurate with the size of the Company and the nature of the business. The principle functions, responsibilities and performance review requirements of the Board and the Managing Director are detailed in the Charter for the Board of Directors.

The functions, responsibilities, remuneration and terms of each Directors appointment are detailed in individual Letters of Appointment, and for Senior Executives in individual Employment Agreements, all prepared in accordance with the guidelines included in the Charter for the Board of Directors.

The Chairman reviews the performance of the Board, the individual Directors and the Board Committees on an annual basis utilising the detailed performance criteria set out in the Charter for the Board of Directors, and the relevant committee charters' as a basis for measurement and such reviews will take on a regular basis. As a matter of principle, the Board is committed to the ongoing development of both Individual Directors and the Board as a whole. In addition to the Chairman's review, the Board will also conduct an evaluation of its performance each year. The objective of these evaluations is to provide best practice corporate governance to the Company.

Such a review can be;

- Qualitative, quantitative or a mixture of both;
- Formal or informal;
- Concentrated on reviewing the Board as a whole or Directors individually;
- Self administered, administered by the Chairman / fellow Directors or administered by an independent expert;
- or
- Focused internally on the Directors or involve the wider body of corporate stakeholders including, but not limited to, customers, suppliers, employees and the community.

The Chairman will action the evaluations, and obtain any assistance required.

**Board responsibilities**

As the Board acts on behalf of Shareholders and is accountable to them, the Board seeks to satisfy the financial and management expectations of the Shareholders, as well as other regulatory and ethical expectations and obligations. In addition, the Board is responsible for identifying areas of significant business risk and ensuring arrangements are in place to adequately manage those risks.

The Board appoints a Chief Executive Officer ("CEO") in this case a Managing Director ("MD"), and the responsibility for the operation and administration of the Company is delegated to that person and the Executive team supported by detailed position descriptions and or KPIs (as applicable) for each position.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

The Board will develop the proper procedures as required, to assess the performance of the CEO and the Executive team and to ensure that the Executive team is appropriately qualified and experienced to discharge its responsibilities:

- The Remuneration Committee (or the Board if a Remuneration Committee is not established) undertakes evaluation of the CEO, with the process coordinated by the Chairman.
- CEO evaluation will occur annually. At this time the Board and CEO will discuss and agree goals (both quantitative and qualitative) for the upcoming year.
- The Remuneration Committee (if established) will prepare a brief report for the full Board after discussion with the CEO. However, the performance of the CEO is a matter for full Board deliberation and is a separate agenda item at the relevant Board meeting.

The Board is responsible for ensuring that management's objectives, activities and outcomes are aligned to the expectations, vision and business risks identified by the Board. The Board has a number of mechanisms in place to ensure this is achieved including receipt of detailed reports, site visits and regular personal presentations to the Board.

**Board policies**

Board policies or obligations have been established in the following areas:

- diversity;
- continuous disclosure;
- dealing in securities;
- related party dealings;
- conflict of interest and external advice;
- release of information;
- significant business risks; and
- ethical standards.

**Diversity**

The Board has always been aware of the advantages that may flow from diversity in respect to gender, age, ethnicity and cultural background and has taken those factors into account when considering new appointments at all levels within the Company. At present there are no female Directors, one mature age part time employee, nine part time contractors including five of differing ethnic background including two females, four part time female employees including the CFO, out of an aggregate of 17 including the Directors.

The Board adopted a Diversity Policy on May 5, 2011 which is provided in full below. In addition the Board also adopted a Diversity Strategy which includes measurable objectives for achieving cultural, gender and age diversity, and the progress in achieving the objectives will be reported in each Annual Report to shareholders.

Having regard to small size of the Company and the current diversity of the Company's management, employees and contractors, the Board considers that it has complied as far as possible with the policy and objectives adopted.

## **CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

### **Diversity Policy**

the Diversity Policy adopted by the Board is as follows:

#### **DIVERSITY POLICY**

##### **1. General Purposes and Principle**

- (a) The Company respects and values the competitive advantage of "Diversity", and the benefits of its integration throughout the Company, in order to enrich the Company's perspective, improve corporate performance, increase shareholder value, and enhance the probability of achievement of the Company's objectives ("Principle").
- (b) This Principle will manifest itself in the following areas:
  - (i) strategic and operational:
    - (A) being attuned to diverse strategies to deliver the Company's objectives;
    - (B) being attuned to diverse corporate, business and market opportunities; and
    - (C) being attuned to diverse tactics and means to achieve those strategies in (A) and to take advantage of those opportunities in (B).
  - (ii) management:
    - (A) adding to, nurturing and developing the collective relevant skills, and diverse experience and attributes of personnel within the Company;
    - (B) ensuring the Company's culture and management systems are aligned with and promote the attainment of the Principle, including having regard for domestic responsibilities.

Note: in the context of this paragraph 1(b)(ii) "Diversity" constitutes people at relevant levels within the Company (including board, senior executive, management and otherwise) with a diverse blend of skills, experiences, perspectives, styles and attributes gained from life's journey, including on account of their culture, gender, age or otherwise.

- (c) The Company will develop strategies, initiatives and programs to promote the Principle, including the achievement of gender diversity with respect to the matters referred to in paragraph 1(b)(ii).
- (d) In particular, the Company will set measurable objectives, and targets or key performance indicators (KPIs), for the strategies, initiatives and programs to achieve gender diversity with respect to the matters referred to in paragraph 1(b)(ii).
- (e) The Company will implement the strategies, initiatives, programs and measurable objectives referred to in (c) and (d).
- (f) Management will monitor, review and report to the Board (including via the Nomination and Remuneration Committee) on the achievement of gender diversity with respect to the matters referred to in paragraph 1(b)(ii), and the Company's progress under this policy.

## **CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

### **2. Responsibility for the Policy**

(a) Although the Board retains ultimate accountability for this Policy, the Board has delegated responsibility for Policy implementation to the CEO.

(b) In turn the CEO has delegated to the Company Secretary responsibility for administration of this Policy (including its reporting to the Board, or its relevant sub-committee, as appropriate).

### **3. Measurable Objectives, targets and Key Performance Indicators (KPIs) - Gender Diversity**

With respect to gender diversity, management will:

(a) develop, for approval by the Board or its relevant sub-committee, as appropriate:

- (i) measurable objectives concerning the strategies, initiatives and programs referred to in paragraph 1(c);
- (ii) targets or KPIs to verify progress towards attainment of those measurable objectives.

(b) measure performance against those targets and KPIs;

(c) report from time to time on the progress of the matters referred to in (a) and (b).

### **4. Compliance Requirements**

(a) The Company will meet its obligations with respect to the issue of "Diversity", as may be required under the ASX Corporate Governance Principles and Recommendations (2nd Edition) ("ASX Principles") and other regulatory requirements (if any) including by:

(i) establishing this Policy as a compliant policy under ASX Guideline 3.2(a) by:

- (A) establishing measurable objectives for achieving gender diversity;
- (B) the Board assessing annually the measurable objectives for achieving gender diversity and the progress in achieving them.

(ii) disclosing this policy or a summary of it under ASX Guideline 3.2 (b);

(iii) in its annual report, and in the terms of ASX Guideline 2.4, disclosing the processes the Board adopts and the criteria the Board takes into consideration in its selection of prospective new Board members;

(iv) in its annual report, and in the terms of ASX Principles 3.3 and 3.4, disclosing:

- (A) the measurable objectives for achieving gender diversity set by the Board in the terms of this Policy;
- (B) the progress from time to time towards achieving them;
- (C) the proportions in the Company (relative to their male counterparts) of:
  - female employees;
  - females in senior executive positions;
  - females on the Board.

(v) incorporating in the corporate governance statement in the Company's annual report a statement as to the mix of skills and diversity that the Board is looking to achieve in membership of the Board, in the terms of ASX Guideline 2.6.

(b) The Company Secretary will assume line responsibility to ensure the Company meets its compliance and reporting obligations referred to in (a), including by collecting and collating all relevant data and ensuring that management processes and systems are adequate and effective for such reporting obligations to be met.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**5. Communication**

The Company commits to the communication of this policy within the Company, to its shareholders and the market, including via its website:

- (i) by way of transparency and accountability; and
- (ii) to better promote the prospects of attainment of the Principle.

**6. Accountability**

- (a) Reporting and accountability in the terms of this Policy will be a periodic item on the Board agenda.
- (b) At least annually the Nomination and Remuneration Committee will report to the Board on progress towards attainment of the Principle with respect to the matters referred to in paragraph 1(b)(ii), and otherwise to facilitate the Board in meeting its Compliance requirements under paragraph 4.

**7. Addenda to this Policy**

The following shall constitute addenda to this Policy as if set out in this Policy:

- (a) approved strategies, initiatives and programs and measurable objectives, targets and KPIs referred to in paragraph 1(c); and
- (b) approved measurable objectives, targets and KPIs referred to in paragraph 1(d); as may apply from time to time.

**8. Overriding Caveat**

Nothing in this policy shall be taken, interpreted or construed so as to endorse:

- (a) the principle criteria for selection and promotion of people to work within the Company, other than their overall relative prospect of adding value to the Company and enhancing the probability of achievement of the Company's objectives;
- (b) any discriminatory behavior by or within the Company contrary to the law, or any applicable codes of conduct or behavior for the Company or its personnel;
- (c) any existing person within the Company in any way feeling threatened or prejudiced by this policy in their career development or otherwise, merely because of their Diversity attributes at any time may be more, rather than less, common with others.

**Diversity Strategy**

The Diversity Strategy lists the strategies, initiatives and programs, measurable objectives, targets and KPIs adopted by the Board on 5 May 2011 for the Group. Many of the strategies, initiatives and programs have already been achieved or put in place necessitating amendments to the Charter for the Board of Directors and to the Charter for the Nomination & Remuneration Committee. The amended Charters may be viewed on the Company's web site.

The Strategy includes initiatives and programs designed to foster Diversity at Board level, at executive and management level and generally, commensurate with the nature and size of the Group. Progress with achievement of the Diversity Strategy will be reviewed by the Nomination & Remuneration Committee on an annual basis and the result reported to the Board. Progress will also be reported each year in the Diversity Report section of the Annual Report.

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## **CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

### **The role of the Chairman**

The role of the Chairman is clearly defined in the Charter for the Board of Directors. In summary, the Chairman is responsible for leading the Board, ensuring Directors are properly briefed in all matters relevant to their role and responsibilities, facilitating Board discussions and managing the Board's relationship with Shareholders and with the Company's senior executives. The Chairman formally reviews the performance of the Board and the individual Directors on an annual basis.

### **The role of the CEO**

The role of the CEO is also clearly defined in the Charter for the Board of Directors. In summary, the CEO is responsible for implementing the Company strategies and policies, achieving the Company objectives and managing the business of the Company. The CEO reviews the performance of his senior executives on an annual basis utilizing criteria similar to that applicable to himself, having regard to the position under review, the relevant position description and KPIs. Such reviews will lead in to the annual remuneration reviews.

### **Board committees**

Establishment of Board committees is commensurate with the size of the Company. Terms of Reference or Charters have been adopted for each committee responsibility and in the event that the Board retains a particular responsibility and does not establish a relevant committee, the adopted Terms of Reference or Charter for that responsibility will be utilised by the Board in the discharge of that responsibility.

### Letters of Appointment and Employment Agreements

The functions, responsibilities, remuneration and terms of each Director's appointment are detailed in individual Letters of Appointment as are the same for Senior Executives in individual Employment Agreements all prepared in accordance with the guidelines included in the Charter for the Board of Directors.

### **Governance**

In view of the small size of the Company, the duty of governance is handled by the full Board and dealt with in accordance with the Charter for the Board of Directors and the Directors' Code of Conduct.

### **Nomination**

In view of the small size of the Company, the duty of Nomination is handled by the full Board and dealt with in accordance with the specific charter adopted for a Nomination & Remuneration Committee and in accordance with the Charter for the Board of Directors and the Diversity Policy.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**PRINCIPLE 2: Structure the Board to add value**

The composition of the Board is determined in accordance with the following principles and guidelines:

- The Board should comprise at least three and no more than 9 Directors (determined by the Constitution) and at least two of the Directors shall ordinarily reside in Australia.
- The Chairman should preferably be an Independent Director.
- The Board shall comprise Directors with a diverse and appropriate range of qualifications and expertise and in the event of retirement of a Director with particular expertise, the Board, with the assistance of the Nomination & Remuneration Committee (if formed), will seek to appoint a Director with skills, experience and diversity attributes required to balance the needs of the Board in the operations of the Company.
- The Board shall meet on a regular basis as agreed by the Directors and follow meeting guidelines established to ensure that all Directors are made aware of, and have available all necessary information in a timely manner, to participate in an informed discussion of all agenda items.
- The Directors of the Company (except the Managing Director) are elected at an Annual General Meeting

The Directors in office at the date of this statement are:

- Chairman (non executive) - Raymond Douglas Shaw
- Managing Director - Torey Robert Marshall
- Non-executive Director - Norman Joseph Zillman (resigned April 23, 2012)
- Non-executive Director – Malcolm Lucas-Smith (appointed April 23, 2012)

Notwithstanding the ASX recommendations that a majority of the Board should be Independent Directors, the Board does not consider that there is a need to increase the number of Directors at this time. The Board maintains strict protocols to ensure that any potential or actual conflicts of interest and duty are properly identified and managed, to ensure Directors act in accordance with their fiduciary responsibilities.

Independent Directors are independent of management, do not have a substantial shareholding (i.e. less than 5%) and are free from any business or other relationship which could materially interfere with the exercise of their judgement. The commentary provided by the ASX Corporate Governance Principles and Guidelines has been considered when evaluating the independence of the Directors concerned.

Non-Executive Directors are independent of management but either have or control a substantial shareholding in the Company, i.e. 5% or more.

The Director's Code of Conduct detailed in Principle 3 includes an acknowledgement that Directors may obtain independent legal advice in order to discharge their duties properly.

The Board may establish a Nomination & remuneration Committee and adopt suitable terms of reference. The role of this committee is to provide advice and assistance to the Board on recruitment, appointment, removal, desirable competencies and performance appraisal of Directors and succession planning for the Board. The Directors have resolved to handle this responsibility at Board level.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**PRINCIPLE 3: Promote ethical and responsible decision-making**

The Charter for the Board of Directors deals with this issue in respect to Directors, the senior executives, staff and consultants of the Company. The Board has adopted a Directors' Code of Conduct which clarifies the standards of ethical behaviour required of the Directors and is relevant to several of the ASX Corporate Governance Principles. The Directors' Code of Conduct is available on the Company's web site. The following is a summary:

**Directors' Code of Conduct - Overview**

The Code of Conduct outlines the principles and standards Directors are required to abide by, and governs the way in which each of the Directors should conduct themselves in the discharge of their duties. This Code of Conduct should operate in addition to relevant laws that are in force from time to time and also in conjunction with all other Board Governance Policies.

1. Directors must act honestly, in good faith and in the best interests of the Company as a whole at all times.
2. Directors have a duty to use due care and diligence in fulfilling the functions of office and exercising the powers attached to that office.
3. Directors must always use the powers of the office for a proper purpose.
4. Directors must recognise that their primary responsibility is to the Company's members as a whole but must, where appropriate, have regard for the interests of all stakeholders of the Company.
5. Directors must not make improper use of information acquired as a Director.
6. Directors must not allow personal interests, or the interests of any Associated Person, to conflict with the interests of the Company.
7. Directors have an obligation to be independent in judgement and actions and to take all reasonable steps to be satisfied as to the soundness of all decisions taken by the Board.
8. Confidential information received by a Director in the course of the exercise of Directors' duties remains the property of the Company from which it was obtained and it is improper to disclose it, or allow it to be disclosed, unless that disclosure has been authorised by that company, or required by law.
9. Directors should not engage in conduct likely to bring discredit upon the Company.
10. Directors have an obligation, at all times, to comply with the spirit, as well as the letter of the law and with the principles of this Code.

The policy includes detailed guidelines for interpretation of the principles of the Code of Conduct

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## **CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

### **Charter for the Board of Directors**

The Charter for the Board of Directors is structured to promote ethical and responsible decision-making throughout the Company. All Directors, executives, employees and consultants of the Company are expected to act with integrity and objectivity and maintain appropriate ethical standards and have the following duties:

- to act honestly, fairly and without prejudice in all commercial dealings and to conduct business with professional courtesy and integrity;
- to work in a safe, healthy and efficient manner, using their skills, time and experience to the maximum of their ability;
- to comply with applicable awards, Company policies and job requirements;
- not to knowingly make any misleading statements to any person or to be a party to any improper practice in relation to dealings with or by the Company;
- to ensure that the Company's resources and property are used properly;
- not to disclose information or documents relating to the Company or its business, other than as required by law and the ASX Listing Rules and not to misuse any information about the Company or any other members of the Group.

### **Trading in Company Securities**

The Board has adopted a Directors and Officers Share Trading Policy which applies to all Directors, officers, senior management and other employees of the Company ("Designated Persons") and supports this Principle through its provisions against insider trading and market manipulation. The Policy is available on the Company's web site. In summary the trading restrictions are:

#### Inside Information

If a Designated Person has Inside Information (as defined in the policy) relating to the Company it is illegal for the Designated person to:

- (a) deal in (that is, apply for, acquire or dispose of) the Securities or enter into an agreement to do so; or
- (b) procure another person to apply for, acquire or dispose of the Securities or enter into an agreement to do so; or
- (c) directly or indirectly communicate, or cause to be communicated, that information to any other person if the Designated Person knows, or ought reasonably to know, that the person would or would be likely to use the information to engage in the activities specified in paragraphs (a) or (b) above.

All Designated Persons are prohibited from trading in any Securities of the Company during recognised blackout periods and until 24 hours after an announcement to the ASX.

#### Black Out Period

Officers are not permitted to buy or sell the Company's shares from March 31 each year until after the half yearly results announcement is made to the market and from September 30 each year until after the announcement of the full year's results to the market or during the period commencing 4 weeks prior to the conclusion of any AGM of the Company.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

Excluded Trading

Certain types of share trading transactions which are beyond the control of the Officer or result in no change to the beneficial holding of the Officer, are excluded from the restrictions imposed by the trading policy.

Financial Products

Designated Persons are not permitted to deal at any time in financial products without the prior approval of the Board, such as options, warrants, futures or other financial products issued over the Securities by third parties such as banks and other institutions. An exception may apply where the Securities form a component of a listed portfolio or index product.

**PRINCIPLE 4: Safeguard integrity in financial reporting**

The Audit Committee is charged with safeguarding the integrity of the Company's financial reporting by advising on and supervising internal controls and appropriate ethical standards for the financial and operational management and risk management of the Company. The committee also confirms the quality and reliability of the financial information prepared. The Company has adopted a detailed Charter for the Audit Committee.

The Charter for the Board of Directors sets out the membership and responsibilities of the Committee as follows. Ideally, the Audit Committee will comprise a majority of independent directors and / or non-executive directors one of

whom will chair the meetings and should not contain any executive directors. The Committee responsibilities are:

- to review the adequacy of systems and standards of internal control with emphasis on risk management, financial reporting procedures and compliance;
- to review proposed announcements of financial results, financial statements, management questionnaires and external audit reports in advance of the Board;
- to receive any information it requires from management;
- to report its findings and recommendations directly to the Board;
- to provide a direct link from the Board to the external auditor, the nomination of the external auditor and reviewing the adequacy of the scope and quality of the annual statutory audit and half year audit review;
- to assess whether non-audit services provided by the external auditor are consistent with maintaining the external auditor's independence. Each reporting period the external auditor provides an independence declaration in relation to the audit or review; and
- to provide advice to the Board in respect of whether the provision of the non-audit services by the external auditor is compatible with the general standard of independence of auditors imposed by the Corporations Act 2001.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

Following the resignation during the year of Directors Sutton, Pearce and Rose-Innes the Company does not have sufficient independent directors and accordingly cannot form a properly structured Audit Committee. Consequently all Audit Committee functions are handled by the full Board. As previously noted the Company continues to pursue a re-listing on the TXSV and if successful will then consider the appointment of additional directors more than likely based in Canada.

The MD and Chief Financial Officer, as appropriate, must declare in writing to the board (see below) that the financial records of the Company for the financial year have been properly maintained, and that the Company's financial reports for the financial year comply with accounting standards and present a true and fair view of the Company's financial condition and operational results. This statement is required annually.

In the absence of an Audit Committee, the Chairman of the Board meets separately with the auditors as required from time to time to discuss the audit reviews and reports, to ensure that there are no outstanding issues and to assess the auditor's continuing independence.

The Company Auditor is invited to attend the Annual General Meeting and be available to answer any questions the Shareholders may care to ask in respect to the financial statements of the Company. The Company has not yet adopted formal procedures for the selection, appointment and rotation of external auditors.

Each year the MD or CFO will provide a statement to the Board in writing in respect to the integrity of the financial statements and the effective operation of the risk management and internal compliance and control systems.

Each year the MD or CFO will provide a statement to the Board that the Company's financial reports present a true and fair view, in all material respects, of the Company's financial condition and operational results and are in accordance with the relevant accounting standards. The statement also confirms that the assurance is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**PRINCIPLE 5: Make timely and balanced disclosure**

The Board is very conscious of its continuous and periodic disclosure obligations as set out in ASX Listing Rules 3 and 4 and has procedures in place to ensure that the requirements of those listing rules are met at all times. The standard Board meeting agenda includes a review of past, current and forthcoming events and results to determine if there is information that should be disclosed in accordance with the Company's Continuous and Periodic Disclosure Policy. The Company's Continuous and Periodic Disclosure Policy is reinforced in the Charter for the Board of Directors. The policy is as follows:

**Policy**

That the Company will do all things necessary to ensure compliance with Listing Rules 3 and 4 and to follow the guidelines and best practice recommendations as set out in Principle 5 where, in the opinion of the Board, those guidelines and recommendations are appropriate to the Company.

**Policy Objectives**

1. To establish a vetting and authorisation process designed to ensure that Company announcements:
  - are made in a timely manner;
  - are factual;
  - do not omit material information; and
  - are expressed in a clear and objective manner that allows investors to assess the impact of the information when making investment decisions.
2. To establish a process to promote understanding of compliance within the Company.
3. To safeguard the confidentiality of corporate information to avoid premature disclosure.

In respect to Periodic Disclosure, the Listing Rules and guidelines require that the Board will ensure that the Shareholders and the market are periodically provided with all information necessary to assess the performance of the Company and the Directors.

Information to allow investors to monitor the performance of the Company is communicated by means of:

- the Annual Report which is available for distribution to all Shareholders;
- the Half-Yearly Report which is available for distribution to all Shareholders;
- periodic reports and special reports when matters of material interest arise; the Annual General Meeting and other meetings called to obtain approval of any Board action as required; and
- The Company website.

**Responsibility**

All Directors, Senior Executives and the Company Secretary are responsible to ensure that the Company's continuous and periodic disclosure policy is adhered to. The MD works with the Chairman in respect to dealing with media contact and any external communications, such as analyst briefings.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**PRINCIPLE 6: Respect the rights of Shareholders**

The Charter for the Board of Directors and the Director's Code of Conduct detailed at the beginning of this statement and the Directors and Officers Share Trading Policy detailed at Principle 3, all recognise legal and other obligations and support the legitimate interests of all stakeholders.

Fundamental to the rights of shareholders is an effective communication system utilising the methods detailed in Principle 5, and the Company web site.

It is very important to ensure a clear and balanced understanding of the aims and objectives of the Company and the progress being made towards them, is readily determinable by interested parties.

The full text of Notices of General Meetings and any Explanatory Memoranda plus any other relevant announcements made to the market, and information provided to analysts, is placed on the Company web site immediately following release to the ASX.

**PRINCIPLE 7: Recognise and manage risk**

The Audit Committee Charter requires the Committee (in this case the Board) to:

- ensure the Company's risk management policies and procedures are adequate;
- monitor compliance with the Company's risk management policies and procedures;
- keep itself apprised of the latest developments, policies and trends in relation to financial matters, rules and regulations to the extent that they may affect the Company or the market(s) in which the Company operates;
- oversee the establishment and implementation of a risk management system and review (at least annually) the effectiveness of the Company's implementation of that system;
- review the Company's internal financial control mechanisms and risk management policies;
- compile a risk profile of the material risks (including financial and non-financial matters) facing the Company;
- establish and implement a system for identifying, assessing, monitoring and managing material risk throughout the Company;
- review major non-financial regulatory matters through the use of a compliance monitoring reporting regime which covers the following areas of exposure:
  - environment;
  - safety and health;
  - asset protection (including insurance);
  - trade practices;
  - discrimination and harassment;
  - conflict of interest; and
  - ethical standards.

The Board oversees the establishment, implementation and annual review of the Company's risk management system. Management has established and implemented a risk management system for assessing, monitoring and managing all risks, including material business risks for the Group. The MD will provide a statement to the Board in writing in respect to the integrity of the financial statements and the effective operation of the risk management and internal compliance and control systems.

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**CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

**PRINCIPLE 8: Remunerate fairly and responsibly**

If a Nomination & Remuneration Committee is established (see previous comments regarding committees) the committee is charged with the responsibility to review and make recommendations to the Board on remuneration packages and policies related to the Non-executive Directors, MD and senior executives of the Company, and ensure that the remuneration policies and practices are consistent with the Company's strategic goals and human resource objectives. At the date of this statement, the Directors have resolved to handle this responsibility at Board level.

The Committee, in conjunction with the Chairman of the Company, will review the performance of the MD against the agreed parameters and responsibilities.

The Board has adopted a detailed Charter for a Nomination & Remuneration Committee. The Charter includes the following:

- Objectives;
- Composition;
- Meetings;
- Access; and
- Duties & responsibilities including:
  - Recommendations for the appointment or removal of Directors;
  - assessment of necessary and desirable competencies including diversity attributes;
  - review succession plans;
  - evaluation of Board performance;
  - advice on Director's remuneration;
  - advice on MD's remuneration;
  - advice on senior management remuneration;
  - employment packaging;
  - staff policy and procedures;
  - reporting; and
  - remuneration reviews.

**Directors' Remuneration**

If an Executive Director is appointed, suitable remuneration will be approved by the Board. The Non-executive Directors are paid Director's fees by the Company which may be in the form of a cash payment to the Director, cash conditional upon the purchase of shares in the Company or the issue of Options to acquire shares. Proper expenses incurred in the course of the Company's operations are reimbursed. The maximum aggregate amount of Non-Executive Director's fees must be approved by the Company in a General Meeting and in accordance with the Company's Constitution.

The Board may, as it sees fit, established a Long Term Incentive Plan to encourage and reward enhanced performance by senior management and staff subject to the performance of the Company. The Managing Director, independent and Non-executive Directors do not participate in the scheme.

## **CORPORATE GOVERNANCE STATEMENT (CONTINUED)**

The Remuneration Report included each year in the Annual Report, details the remuneration policies of the Company.

The Charter for the Nomination & Remuneration Committee (where appointed) includes the responsibility to assess the necessary and desirable competencies of the Board members and to evaluate the performance of the Board.

### **Company Web Site**

This Statement of Corporate Governance, together with any other relevant Corporate Governance information, is available in the Corporate Governance section of the Company website at [www.earthheatresources.com](http://www.earthheatresources.com).

### **Governance and policy reviews**

The Corporate Governance policies and practices of the Company are reviewed annually in accordance with the standards required of the Company by the Directors, the ASX, ASIC and other relevant stakeholders, to ensure that the appropriate governance standards are maintained.

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**AUSTRALIAN SECURITIES EXCHANGE LIMITED**

**ADDITIONAL INFORMATION AS AT 19 DECEMBER 2012**

Additional information required by the Australian Securities Exchange Limited and not shown elsewhere in this report is as follows:

a) Distribution of Equity Securities

Currently there are 864,274,461 shares held by 1,012 shareholders.

| Range            | Holders      |
|------------------|--------------|
| 1 - 1,000        | 19           |
| 1,001 - 5,000    | 78           |
| 5,001 - 10,000   | 71           |
| 10,001 - 100,000 | 481          |
| 100,001 - over   | 396          |
| Total            | <u>1,045</u> |

b) Twenty largest holders of common shares and CDI

**SHAREHOLDER**

|   | Number Of Shares   | Held %       |
|---|--------------------|--------------|
| Mr Norman Zillman & Mrs Lorraine Zillman Group                  | 85,581,745         | 9.90         |
| Dr Raymond Douglas Shaw & Ms Rita Barbara Jones Group           | 72,130,592         | 8.35         |
| Mr Torey Robert Marshall & Mr Robert Geoffrey Marshall Group    | 69,363,925         | 8.03         |
| RIZK Investment Holdings Pty Ltd <Luxor family A/C>             | 50,000,000         | 5.79         |
| Washington H Soul Pattinson & Company Ltd                       | 24,833,334         | 2.87         |
| MAPU Pty Ltd <Vaxa Super Fund A/C>                              | 20,000,000         | 2.31         |
| Frere & Associates Pty Limited <Derick Frere Super Fund A/C>    | 14,844,163         | 1.72         |
| 1147 Pty Ltd <TJ & CJ Mann S/F PEN A/C>                         | 12,500,320         | 1.45         |
| SL Curtis Pty Ltd <The Richard Ian Rice A/C>                    | 11,000,000         | 1.27         |
| All States Secretariat Pty Limited <All States Sec Ltd S/F A/C> | 9,000,000          | 1.04         |
| Mr Nigel David Lock   | 8,800,000          | 1.02         |
| Planet Gas Limited  | 8,212,500          | 0.95         |
| Ms Alicia Nicole Honey  | 7,950,000          | 0.92         |
| Leet Investments Pty Limited <Superannuation Fund A/C>          | 7,500,000          | 0.87         |
| Leilani Investments Pty Ltd <Rice Family Investment A/C>        | 7,500,000          | 0.87         |
| N & J Mitchell Holdings Pty Ltd                                 | 7,500,000          | 0.87         |
| Mr Giovanni Spagnolo <Marcus Deluca A/C>                        | 7,500,000          | 0.87         |
| Talltree Holdings Pty Ltd                                       | 7,500,000          | 0.87         |
| B & B Property Assets Pty Ltd                                   | 7,000,000          | 0.81         |
| Comsec Nominees Pty Ltd   | 6,000,000          | 0.69         |
| Top 20 Total  | <u>444,716,579</u> | <u>51.46</u> |
| Total Remaining Holders Balance                                 | <u>419,557,882</u> | <u>48.54</u> |

c) The number of holders of less than a marketable parcel

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**AUSTRALIAN SECURITIES EXCHANGE LIMITED**

**ADDITIONAL INFORMATION AS AT 19 DECEMBER 2012**

Less than marketable parcel of shares

534 holding 13,384,513 shares

d) Escrowed securities

There are 10,000,000 escrowed shares at the date of this report, which were released October 25, 2012.

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**FORM 52-109F1**

**CERTIFICATION OF ANNUAL FILINGS**

**FULL CERTIFICATE**

I, Torey Marshall, the Manager of Earth Heat Resources Limited, in the capacity of Chief Executive Officer of Earth Heat Resources Limited, certify the following:

1. **Review:** I have reviewed the AIF, if any, annual financial statements and annual MD&A, including, for greater certainty, all documents and information that are incorporated by reference in the AIF (together, the "annual filings"), of Earth Heat Resources Limited (the "issuer") for the financial year ended September 30, 2012.

2. **No misrepresentations:** Based on my knowledge, having exercised reasonable diligence, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, for the period covered by the annual filings.

3. **Fair presentation:** Based on my knowledge, having exercised reasonable diligence, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date of and for the periods presented in the annual filings.

4. **Responsibility:** The issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as those terms are defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*, for the issuer.

5. **Design:** Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer's other certifying officer(s) and I have, as at the financial year end

- (a) designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that
  - (i) -material information relating to the issuer is made known to us by others, particularly during the period in which the annual filings are being prepared; and
  - (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
- (b) designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.

5.1 **Control framework:** The control framework the issuer's other certifying officer(s) and I used to design the issuer's ICFR is the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

5.2 **ICFR Material weakness relating to design:** N/A.

5.3 **Limitation on scope of design:** N/A.

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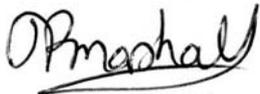
6. **Evaluation:** The issuer's other certifying officer(s) and I have

- (a) evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's DC&P at the financial year end and the issuer has disclosed in its annual MD&A our conclusion about the effectiveness of DC&P at the financial year end based on that evaluation; and
- (b) evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's ICFR at the financial year end and the issuer had disclosed in its annual MD&A
  - (i) our conclusions about the effectiveness of ICFR at the financial year end based on that evaluation; and
  - (ii) N/A.

7. **Reporting changes in ICFR:** The issuer has disclosed in its annual MD&A any change in the issuer's ICFR that occurred during the period beginning on October 1, 2011 and ended on September 30, 2012 that has materially affected, or is reasonably likely to materially affect, the issuer's ICFR.

8. **Reporting to the issuer's auditors and board or directors or audit committee:** The issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of ICFR, to the issuer's auditors, and the board of directors or the audit committee of the board of directors any fraud that involved management or other employees who have a significant role in the issuer's ICFR.

Date: December 21, 2012



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Torey Marshall  
In the capacity of Chief Executive Officer

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**FORM 52-109F1**

**CERTIFICATION OF ANNUAL FILINGS**

**FULL CERTIFICATE**

I, Victoria Allinson, the Manager of Earth Heat Resources Limited, in the capacity of Chief Financial Officer of Earth Heat Resources Limited, certify the following:

1. **Review:** I have reviewed the AIF, if any, annual financial statements and annual MD&A, including, for greater certainty, all documents and information that are incorporated by reference in the AIF (together, the "annual filings"), of Earth Heat Resources Limited (the "issuer") for the financial year ended September 30, 2012.

2. **No misrepresentations:** Based on my knowledge, having exercised reasonable diligence, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, for the period covered by the annual filings.

3. **Fair presentation:** Based on my knowledge, having exercised reasonable diligence, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date of and for the periods presented in the annual filings.

4. **Responsibility:** The issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as those terms are defined in National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings, for the issuer.

5. **Design:** Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer's other certifying officer(s) and I have, as at the financial year end

- (a) designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that
  - (ii) -material information relating to the issuer is made known to us by others, particularly during the period in which the annual filings are being prepared; and
  - (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
- (b) designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.

5.1 **Control framework:** The control framework the issuer's other certifying officer(s) and I used to design the issuer's ICFR is the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

5.2 **ICFR Material weakness relating to design:** N/A.

5.3 **Limitation on scope of design:** N/A.

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6. **Evaluation:** The issuer's other certifying officer(s) and I have

- (c) evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's DC&P at the financial year end and the issuer has disclosed in its annual MD&A our conclusion about the effectiveness of DC&P at the financial year end based on that evaluation; and
- (d) evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's ICFR at the financial year end and the issuer had disclosed in its annual MD&A
  - (iii) our conclusions about the effectiveness of ICFR at the financial year end based on that evaluation; and
  - (iv) N/A.

7. **Reporting changes in ICFR:** The issuer has disclosed in its annual MD&A any change in the issuer's ICFR that occurred during the period beginning on October 1, 2010 and ended on September 30, 2012 that has materially affected, or is reasonably likely to materially affect, the issuer's ICFR.

8. **Reporting to the issuer's auditors and board or directors or audit committee:** The issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of ICFR, to the issuer's auditors, and the board of directors or the audit committee of the board of directors any fraud that involved management or other employees who have a significant role in the issuer's ICFR.

Date: December 21, 2012



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Victoria Allinson  
In the capacity of Chief Financial Officer