

Frontera Resources
Corporation and Subsidiaries
Condensed Consolidated Financial Statements
Six Months Ended June 30, 2007

Frontera Resources Corporation and Subsidiaries

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Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)

	June 30, 2007	December 31, 2006
Assets		
Current assets		
Cash and cash equivalents	\$ 18,408,701	\$ 9,927,181
Restricted cash	15,072,562	-
Short-term investments	41,925,011	14,823,000
Accounts receivable	160,934	139,107
Inventory	6,148,201	3,124,858
Prepaid expenses and other current assets	4,957,081	267,720
Total current assets	<u>86,672,490</u>	<u>28,281,866</u>
Property and equipment, net	942,142	1,081,213
Oil and gas properties, full cost method		
Properties being depleted	23,750,981	23,750,981
Properties not subject to depletion	29,000,290	27,631,505
	<u>52,751,271</u>	<u>51,382,486</u>
Less: Accumulated depletion	<u>(21,281,707)</u>	<u>(21,107,707)</u>
Net oil and gas properties	<u>31,469,564</u>	<u>30,274,779</u>
Other assets	1,887,169	-
Total assets	<u>\$ 120,971,365</u>	<u>\$ 59,637,858</u>
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 312,372	\$ 566,396
Accrued liabilities	1,633,111	518,004
Current maturities of notes payable-vendor	3,450,941	3,450,941
Current maturities of notes payable-related party	-	51,097
Total current liabilities	<u>5,396,424</u>	<u>4,586,438</u>
Convertible notes payable	66,900,000	-
Other long-term liabilities	40,175	41,669
Total liabilities	<u>72,336,599</u>	<u>4,628,107</u>
Commitments and contingencies		
Stockholders' equity		
Common stock	2,820	2,818
Additional paid-in capital	150,780,400	149,499,177
Common stock warrants	1,266	1,266
Treasury stock, at cost	(567,832)	(567,832)
Accumulated deficit	(101,581,888)	(94,050,228)
Accumulated other comprehensive income	-	124,550
Total stockholders' equity	<u>48,634,766</u>	<u>55,009,751</u>
Total liabilities and stockholders' equity	<u>\$ 120,971,365</u>	<u>\$ 59,637,858</u>

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

Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)

	Six Months Ended	
	June 30,	
	2007	2006
Revenue - crude oil sales	\$ 1,878,540	\$ 758,630
Operating expenses		
Field operating and project costs	2,436,564	646,918
General and administrative	6,440,049	5,486,744
Depreciation, depletion and amortization	400,921	464,693
Total operating expenses	<u>9,277,534</u>	<u>6,598,355</u>
Loss from operations	<u>(7,398,994)</u>	<u>(5,839,725)</u>
Other income (expense)		
Forgiveness of debt	-	11,732
Interest income	819,447	926,381
Interest expense	(984,424)	(144,779)
Other, net	32,311	10,524
Total other income (expense)	<u>(132,666)</u>	<u>803,858</u>
Net loss	<u>\$ (7,531,660)</u>	<u>\$ (5,035,867)</u>
Loss per share		
Basic and diluted	\$ (0.11)	\$ (0.09)
Number of shares used in calculating loss per share		
Basic and diluted	70,384,190	58,856,834

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

Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Statement of Stockholders' Equity (Unaudited)

	Common Stock	Additional Paid-in Capital	Common Stock Warrants	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balances at December 31, 2006	\$ 2,818	\$ 149,499,177	\$ 1,266	\$ (567,832)	\$ (94,050,228)	\$ 124,550	\$ 55,009,751
Conversion of convertible debt	2	99,998	-	-	-	-	100,000
Compensation expense-common stock options	-	1,181,225	-	-	-	-	1,181,225
Unrealized gain on marketable securities	-	-	-	-	-	53,420	53,420
Reclassification adjustment for gains on marketable securities included in net income	-	-	-	-	-	(177,970)	(177,970)
Net loss	-	-	-	-	(7,531,660)	-	(7,531,660)
Total comprehensive loss for the year	-	-	-	-	-	-	(7,656,210)
Balances at June 30, 2007	<u>\$ 2,820</u>	<u>\$ 150,780,400</u>	<u>\$ 1,266</u>	<u>\$ (567,832)</u>	<u>\$(101,581,888)</u>	<u>\$ -</u>	<u>\$ 48,634,766</u>

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

Frontera Resources Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,	
	2007	2006
Cash flows from operating activities		
Net loss	\$ (7,531,660)	\$ (5,035,867)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation, depletion and amortization	400,921	464,693
Debt issuance cost amortization	48,126	-
Stock based compensation	1,181,225	1,578,692
Forgiveness of debt	-	(11,732)
Changes in operating assets and liabilities:		
Accounts receivable	(21,827)	(48,360)
Inventory	(3,023,343)	(193,612)
Prepaid expenses and other current assets	(4,689,361)	101,495
Accounts payable	(254,024)	(580,400)
Accrued liabilities	1,115,107	(1,214,511)
Other long-term liabilities	(1,494)	-
Net cash used in operating activities	<u>(12,776,330)</u>	<u>(4,939,602)</u>
Cash flows from investing activities		
Investment in oil and gas properties	(1,368,785)	(13,006,611)
Investment in property and equipment	(87,850)	(110,388)
Restricted cash	(5,000,000)	250,000
Restricted short-term investments	-	(1,475,000)
Net redemption (purchase) of short-term investments	<u>(27,226,561)</u>	<u>22,036,510</u>
Net cash provided by (used in) investing activities	<u>(33,683,196)</u>	<u>7,694,511</u>
Cash flows from financing activities		
Repayments of borrowings	(51,097)	-
Proceeds from convertible debt	66,500,000	-
Restricted cash	(10,072,562)	-
Exercise of common stock warrants	-	3,071,452
Debt issuance costs	(1,435,295)	-
Exercise of common stock options	-	525,000
Net cash provided by financing activities	<u>54,941,046</u>	<u>3,596,452</u>
Net increase in cash and cash equivalents	8,481,520	6,351,361
Cash and cash equivalents		
Beginning of year	<u>9,927,181</u>	<u>19,586,747</u>
End of period	<u>\$ 18,408,701</u>	<u>\$ 25,938,108</u>
Supplemental disclosure of noncash investing and financing activities		
Notes payable used to exercise common stock warrants	\$ -	\$ 212,174
Noncash debt issuance costs	500,000	-
Conversion of debt to common stock	100,000	-

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

Frontera Resources Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Nature of Operations

Frontera Resources Corporation, a Delaware corporation, and its subsidiaries (collectively "Frontera" or the "Company") are engaged in the development of oil and gas projects in emerging marketplaces. Frontera was founded in 1996 and is headquartered in Houston, Texas. The Company emphasizes development of reserves in known hydrocarbon-bearing basins, and is attracted to exploitation projects that have significant exploration upside. Beginning in 2002, the Company has focused substantially all of its efforts on the exploration and development of oilfields within the Republic of Georgia ("Georgia"), a member of the Former Soviet Union.

In June 1997, the Company entered into a 25 year production sharing agreement with the Ministry of Fuel and Energy of Georgia and State Company Georgian Oil ("Georgian Oil"), which gives the Company the exclusive right to explore, develop and produce crude oil in a 5500 square kilometer area in eastern Georgia known as Block 12, hereafter referred to as the "Block 12 PSA". The Block 12 PSA can be extended if commercial production remains viable upon its expiration in June 2022.

Under the terms of the Block 12 PSA, the Company is entitled to conduct exploration and production activities and is entitled to recover its cumulative costs and expenses from the crude oil produced from Block 12. Following recovery of cumulative costs and expenses from Block 12 production, the remaining crude oil sales, referred to as Profit Oil, are allocated between Georgian Oil and Frontera in the proportion of 51% and 49%, respectively.

Under the terms of the Block 12 PSA, Frontera is exempt from all taxes imposed by the government of Georgia, and any taxes imposed on the Company shall be paid by Georgian Oil on behalf of the Company from Georgian Oil's 51% share of Profit Oil. Taxes are defined by the Block 12 PSA to mean all levies, duties, payments, fees, taxes or contributions payable to or imposed by any government agency, subdivision, municipal or local authorities within the Government of Georgia.

2. Basis of Presentation and Summary of Significant Accounting Policies

The condensed consolidated balance sheet of the Company at December 31, 2006 was derived from the Company's audited consolidated financial statements as of that date. The condensed consolidated balance sheet at June 30, 2007, the condensed consolidated statements of operations for the six month periods ended June 30, 2007 and 2006, the condensed consolidated statement of changes in stockholders' equity for the six month period ended June 30, 2007, and the condensed consolidated statements of cash flows for the six month periods ended June 30, 2007 and 2006 were prepared by the Company.

In the opinion of Company management, all adjustments, consisting of normal recurring adjustments, necessary to state fairly the consolidated financial position, results of operations and cash flows were recorded. The results of operations for the six month period ended June 30, 2007 are not necessarily indicative of the operating results for a full year or of future operations.

Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's consolidated financial statements for the year ended December 31, 2006.

Frontera Resources Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Certain amounts in the unaudited condensed consolidated financial statements have been reclassified in the prior period to conform with current period presentation. Reclassifications have no impact on the Company's financial position, results of operations, or cash flows.

For a description of the Company's accounting policies, refer to Note 2 of the 2006 Consolidated Financial Statements.

Restricted Cash

At June 30, 2007 the Company had approximately \$15,072,000 of restricted cash. Restricted cash in the amount of \$5,000,000 serves as collateral for a \$5,000,000 line of credit that is used from time to time to support letters of credit that provide financial assurance that the Company will fulfill its obligations with respect to service contracts with certain vendors. The remaining \$10,072,000 is a portion of the proceeds from the \$67,000,000 convertible debt issuance in May 2007, plus related earned interest, which is being held in escrow until the Company's stock price meets certain agreed benchmarks. Assuming no event of default has occurred, \$5,000,000 will be released from escrow after the stock price of the shares of common stock has exceeded the conversion price for 20 consecutive trading days; the balance of the escrow account will be released when the stock price of the shares exceeds two times the conversion price for twenty consecutive trading days. See Note 5 for further discussion of the convertible notes terms. At December 31, 2006, the Company had no cash equivalents restricted as to use or availability.

Short-Term Investments

Short-term investments consist of Municipal Short Term Auction Rate Securities ("M-STARS") and corporate bonds both of which represent funds available for current operations. In accordance with the Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("SFAS No. 115"), these M-STARS are classified as available-for-sale and are carried at cost or par value, which approximates the fair market value. These securities have stated maturities beyond three months but are priced and traded as short-term instruments due to the liquidity provided through the interest rate mechanism of 7 to 35 days.

At June 30, 2007, short-term investments consist of investments in M-STARS with an estimated fair value of \$41,925,011, with no unrealized holding gains or losses. At December 31, 2006, short-term investments consisted of investments in corporate bonds with an estimated fair value of \$14,823,000 and net unrealized holding gains in the amount of \$124,550 which have been included in accumulated other comprehensive income.

3. Inventory

Inventory consists primarily of materials to be used in the Company's foreign oilfield operations and crude oil held in stock tanks. Inventory is valued using the first-in, first-out method and is stated at the lower of cost or market. Inventory consists of the following:

	June 30, 2007	December 31, 2006
Materials and supplies	\$ 5,540,050	\$ 1,405,610
Crude oil	608,151	1,719,248
	<u>\$ 6,148,201</u>	<u>\$ 3,124,858</u>

Frontera Resources Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

4. Notes Payable

Line of Credit

During 2006 the Company established a \$10,000,000 line of credit with a commercial bank by agreeing to collateralize \$15,000,000 of cash and marketable securities. The line was primarily set up to support letters of credit issued by the Company from time to time in support of its oil and gas operations. During 2007, the line was retired and replaced with a \$5,000,000 line of credit collateralized by \$5,000,000 of cash and cash equivalents. The line is primarily used to support letters of credit issued by the Company from time to time in support of its oil and gas operations.

Notes Payable-Related Party

Effective December 31, 2001, the Company raised \$500,394 through the issuance of a rights offering consisting of 6% notes payable plus warrants which entitled the holders to purchase an aggregate of 15,637,329 shares of common stock of the Company at an exercise price of \$0.032 per share. During 2006 the notes became due and were retired in full with the exception of one note holder as the Company was awaiting fund transfer instructions. This note holder was paid in full in early January 2007. Notes payable-related party outstanding as of June 30, 2007 and December 31, 2006 was \$0 and \$51,097, respectively.

During the first six months of 2006, warrant holders exercised warrants to purchase 8,863,279 common shares for approximately \$71,452.

Notes Payable-Vendor

Effective October 1, 2004, the Company converted a \$3,450,941 account payable to Saipem S.p.A. ("Saipem") into a note payable for the same amount. Under the terms of the Saipem note payable agreement, the Company agreed to pay Saipem quarterly interest-only payments until September 30, 2007, the maturity date, at which date the note is due in full. The note bears interest at 5% per annum. Notes payable-vendor outstanding as of June 30, 2007 and December 31, 2006 was \$3,450,941.

During the first six months of 2006, warrants were exercised to purchase 3,000,000 common shares for \$3,000,000 related to a prior senior note.

5. Convertible Notes

During May 2007, the Company raised \$67.0 million through a private placement of convertible unsecured notes due May 2012. The notes were issued at par and will bear interest at 10%, payable quarterly in arrears in cash or in kind at the Company's discretion. The notes are convertible into common shares at a conversion price of \$1.67 per share. The conversion price will be reset to \$1.30 per share if the stock price is at or below \$1.30 per share for 10 out of any 20 consecutive trading days at any time in the 12 months following the closing date. The notes will be automatically converted into common shares at the conversion price if the stock price exceeds two times the conversion price for at least 20 consecutive trading days. As part of the closing of the notes, debt issuance costs of approximately \$1.9 million were incurred, of which approximately \$1.4 million was paid in cash and \$0.5 million was allocated as additional convertible notes outstanding.

During June 2007, noteholders holding \$100,000 of convertible notes elected to convert their notes into 59,880 common shares.

For the six months ended June 30, interest payments were \$951,848 in 2007 and \$185,616 in 2006.

Frontera Resources Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

6. Income Taxes

The Company has incurred losses since inception and, therefore, has not been required to pay federal income taxes. In accordance with applicable generally accepted accounting principles, the Company estimates for each interim reporting period the effective tax rate expected for the full fiscal year and uses that estimated rate in providing income taxes on a current year to date basis. The Company has established a valuation allowance that is primarily attributable to U.S. federal deferred tax assets. Management believes enough uncertainty exists regarding the realization of the deferred items and has recorded a full valuation allowance.

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 ("FIN48"), *Accounting for Uncertainty in Income Taxes*. The Company has determined that no uncertain tax positions exist where the Company would be required to make additional tax payments. As a result, the Company has not recorded any additional liabilities for any unrecognized tax benefits as of June 30, 2007. The Company and its subsidiaries file income tax returns in the US federal jurisdiction. Tax years 2002 to present remain open for these taxing authorities. The Company's accounting policy is to recognize penalties and interest related to unrecognized tax benefits as income tax expense. The Company does not have an accrued liability for the payment of penalties and interest at June 30, 2007.

For the six months ended June 30, 2007 and 2006, no income tax payments were made.

7. Commitments and Contingencies

SOCAR Arbitration

In June 1998, Frontera Resources Azerbaijan Corporation, an indirect wholly owned subsidiary of the Company, entered into a production sharing agreement with SOCAR, the State Oil Company of Azerbaijan Republic, hereafter referred to as the "Azerbaijan PSA". The Azerbaijan PSA covered onshore oilfields in an area of Azerbaijan known as the K&K Block. The Company and an operating partner undertook an exploration and development program on the K&K Block. The Company's relationship with SOCAR deteriorated as a result of several disputes under the Azerbaijan PSA and the Company was unsuccessful at reaching a settlement with SOCAR.

In January 2006, Frontera Resources Azerbaijan Corporation was awarded approximately \$1.2 million plus interest from 2000 until payment is made in connection with its binding arbitration case with SOCAR. The arbitral panel found that the halting of exports of crude oil from the Kursangi & Karabagli oil fields in the Azerbaijan Republic was in violation of the Agreement on Rehabilitation, Exploration, Development and Production Sharing between SOCAR, Frontera, Delta/Hess and SOCAR Oil Affiliate. The arbitration panel rejected all other claims and counterclaims between the parties. Frontera initiated arbitration against SOCAR in October 2003 related to claims resulting from SOCAR's halting of exports from the onshore Kursangi & Karabagli oilfields in the Azerbaijan Republic during the fourth quarter of 2000. The arbitration was held in Sweden and is binding on the parties under the rules of UNCITRAL, the United Nations Commission on International Trade Law.

Frontera Resources Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

SOCAR has refused to pay the award and instead filed litigation in Svea Court of Appeals, in Stockholm, Sweden, seeking an order annulling the award. The Company has moved to dismiss SOCAR's Swedish lawsuit on procedural grounds, and the Svea Court of Appeals recently ruled in the Company's favor on a majority of the counts. Final disposition is expected in 2008. As a result of SOCAR's refusal to pay the award, the Company commenced an action in the United States District Court for the Southern District of New York in February 2006, seeking to confirm the award and convert it to a judgment in accordance with applicable law. SOCAR has opposed this proceeding. In March 2007, the New York Court granted SOCAR's Motion to Dismiss, and the Company appealed that decision in July 2007.

GAC Arbitration

On June 22, 2007, Frontera was served a notice of arbitration and claim by GAC Energy Company ("GAC"). GAC was a partner with Frontera on Block 12 from 2002–2004 and then reassigned its interest in Block 12 to Frontera when GAC failed to meet its financial and work program commitments. The notice of arbitration and claim was seeking to prove that GAC did not default on their obligations and should be awarded a 25% working interest in Block 12, a 12.5% ownership interest in the Block 12 operating company, and a proportionate share of the revenue from oil sales from July 2002 to August 2003. Frontera considers this claim to be without merit. Frontera has engaged counsel and intends to vigorously defend itself against this claim.

8. Stockholders' Equity

Preferred Stock

The Company has the authority to issue up to 10,000,000 shares, par value \$.00001, of serial preferred stock. No preferred stock is outstanding at June 30, 2007 and December 31, 2006. The Board of Directors may designate and authorize the issuance of such shares with such voting power and in such classes and series, and with such designation, preferences and relative participation, optional, or other special rights, qualifications, limitations, or restrictions as deemed appropriate by the Company's Board of Directors.

Common Stock

As of June 30, 2007 and December 31, 2006 the Company is authorized to issue 200,000,000 shares of common stock, par value \$.00004 per share. As of June 30, 2007 and December 31, 2006, the Company had 70,443,408 and 70,383,528, respectively, of common shares issued and outstanding. At June 30, 2007 and December 31, 2006, there are an additional 12,165,000 and 11,310,000 shares, respectively, of common stock reserved for the exercise of existing options and warrants.

Treasury Stock

At June 30, 2007 and December 31, 2006, the Company had 5,739,855 shares of treasury stock, all held as common shares.

For the six months ended June 30, the Company recognized stock-based compensation expense related to common stock options of approximately \$1.2 million in 2007 and \$1.6 million in 2006. Stock-based compensation expense is reflected in general and administrative expense in the consolidated statements of operations.