Frontera Resources Corporation and Subsidiaries

Consolidated Financial Statements

December 31, 2011 and 2010

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December 31, 2011 and 2010

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Report of Independent Auditors

To the Board of Directors of
Frontera Resources Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' deficit and comprehensive loss and cash flows present fairly, in all material respects, the financial position of Frontera Resources Corporation and its subsidiaries (the "Company") at December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

June 25, 2012

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Frontera Resources Corporation and Subsidiaries
Consolidated Balance Sheets
December 31, 2011 and 2010

	2011	2010
Assets		
Current assets		
Cash and cash equivalents	$ 1,718,410	$ 158,542
Accounts receivable, net	229,241	189,840
Inventory	5,131,044	5,044,047
Prepaid expenses and other current assets	171,960	180,377
Total current assets	7,250,655	5,572,806
Property and equipment, net	1,067,508	1,205,132
Oil and natural gas properties, full cost method		
Properties being depleted	125,411,637	123,929,621
Less: accumulated depletion	(117,419,454)	(116,020,061)
Net oil and gas properties	7,992,183	7,909,560
Deferred financing costs, net	196,734	2,321,438
Total assets	$ 16,507,080	$ 17,008,936
Liabilities and Stockholders' Deficit		
Current liabilities		
Accounts payable	$ 2,142,120	$ 3,078,058
Accrued liabilities	2,705,215	3,766,449
Current derivative stock warrant liabilities	–	583,879
Related party notes payable	–	5,304,918
Current maturities of notes payable	253,249	–
Total current liabilities	5,100,584	12,733,304
Convertible notes payable	18,590,358	114,944,386
Derivative stock warrant liabilities	191,990	257,788
Total liabilities	23,882,932	127,935,478
Commitments and contingencies		
Stockholders' deficit		
Common stock	82,621	5,366
Additional paid-in capital	395,190,976	172,338,018
Treasury stock, at cost	–	(567,832)
Accumulated deficit	(402,649,449)	(282,702,094)
Total stockholders' deficit	(7,375,852)	(110,926,542)
Total liabilities and stockholders' deficit	$ 16,507,080	$ 17,008,936

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

Frontera Resources Corporation and Subsidiaries
Consolidated Statements of Operations
Years Ended December 31, 2011 and 2010

	2011	2010
Revenue - crude oil sales	$ 7,448,102	$ 8,256,818
Operating expenses		
Field operating and project costs	4,217,988	6,095,290
General and administrative	10,408,146	9,909,607
Depreciation, depletion and amortization	1,654,787	507,574
Impairment	–	44,571,951
Total operating expenses	16,280,921	61,084,422
Loss from operations	(8,832,819)	(52,827,604)
Other income (expense)		
Interest income	8,798	20,420
Interest expense	(12,321,550)	(14,785,485)
Inducement expense	(99,391,736)	–
Derivative income	649,677	2,388,205
Other, net	(59,725)	1,337,563
Total other income (expense)	(111,114,536)	(11,039,297)
Loss before income taxes	(119,947,355)	(63,866,901)
Provision for income taxes	–	–
Net loss	$ (119,947,355)	$ (63,866,901)
Loss per share		
Basic and diluted	$ (0.13)	$ (0.48)
Number of shares used in calculating loss per share		
Basic and diluted	928,590,305	132,382,392

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

Frontera Resources Corporation and Subsidiaries
Consolidated Statements of Stockholders' Deficit and Comprehensive Loss
Years Ended December 31, 2011 and 2010

	Common Stock	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Total Stockholders' Deficit
Balance at December 31, 2009	$ 5,225	$ 170,691,064	$ (567,832)	$ (218,835,193)	$ (48,706,736)
Issuance of common stock	141	381,392	–	–	381,533
Stock based compensation expense	–	1,265,562	–	–	1,265,562
Net loss	–	–	–	(63,866,901)	(63,866,901)
Balances at December 31, 2010	$ 5,366	$ 172,338,018	$ (567,832)	$ (282,702,094)	$ (110,926,542)
Stock based compensation expense	$ 160	479,199	–	–	479,359
Issuance of common stock	7,840	10,720,141	–	–	10,727,981
Purchase of company common stock	(160)	–	(261,126)	–	(261,286)
Retirement of treasury shares	–	(828,958)	828,958	–	–
Conversion of convertible notes payable	63,754	203,309,033	–	–	203,372,787
Conversion of related party notes payable	5,661	9,173,543	–	–	9,179,204
Net loss	–	–	–	(119,947,355)	(119,947,355)
Balances at December 31, 2011	$ 82,621	$ 395,190,976	–	$ (402,649,449)	$ (7,375,852)

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

Frontera Resources Corporation and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2011 and 2010

	2011	2010
Cash flows from operating activities		
Net loss	$(119,947,355)	$ (63,866,901)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation, depletion and amortization	1,654,787	507,574
Loss on disposal of asset	–	1,838
Inducement expense	99,391,736	–
Impairment	–	44,571,951
Derivative income	(649,677)	(2,388,205)
Noncash interest expense and amortization	12,321,550	12,948,283
Stock based compensation	479,359	1,265,562
Forgiveness of debt - M-STARS settlement	–	(861,751)
Bad debt expense	–	409,009
Changes in operating assets and liabilities:		
Accounts receivable	(39,401)	(11,370)
Inventory	(86,997)	2,338,508
Prepaid expenses and other current assets	8,417	162,041
Accounts payable	(227,363)	1,980,425
Accrued liabilities	(436,454)	1,299,357
Other long term liabilities	–	(20,654)
Net cash used in operating activities	(7,531,398)	(1,664,333)
Cash flows from investing activities		
Investment in oil and gas properties	(2,231,286)	(4,262,103)
Investment in property and equipment	(117,770)	(9,547)
Redemption of investments	–	8,080,000
Net cash provided by (used in) investing activities	(2,349,056)	3,808,350
Cash flows from financing activities		
Proceeds from related party notes payable	2,910,000	5,304,918
Repayments of borrowings	–	(8,698,249)
Purchase of Company common stock	(261,286)	–
Proceeds from issuance of common stock and warrants	8,791,608	–
Restricted cash	–	594,356
Net cash provided by (used in) financing activities	11,440,322	(2,798,975)
Net increase (decrease) in cash and cash equivalents	1,559,868	(654,958)
Cash and cash equivalents		
Beginning of year	158,542	813,500
End of year	$ 1,718,410	$ 158,542
Supplemental cash flow information		
Cash paid for interest	$ –	$ 1,837,202
Non-cash investing and financing activities		
Issuance of convertible notes payable in lieu of interest payments	$ 7,671,527	$ 10,810,446
Change in accrued investment in oil and gas properties	$ (749,270)	$ 303,946
Non-cash issuance of common stock	$ 2,627,896	–
Issuance of common stock in lieu of interest payments	–	$ 381,533
Conversion of convertible notes payable to common stock	$ 103,382,865	–
Conversion of related party notes payable to common stock	$ 9,179,204	–

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

1. Nature of Operations

Frontera Resources Corporation, a Cayman Islands 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 projects that have significant exploration upside. Since 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 are 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.

Frontera's future revenues depend on operating results from its operations in the Republic of Georgia. The success of Frontera's operations is subject to various contingencies beyond management control. These contingencies include general and regional economic and political conditions, prices for crude oil, competition and changes in regulation. Frontera is subject to various additional political and economic uncertainties in Georgia which could include restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

On August 2, 2011, the Company completed a merger with and into a new Cayman Islands exempted company ("Frontera Cayman"), with Frontera Cayman being the surviving entity (the "Merger"). By operation of the Merger, all assets, liabilities, properties, corporate acts, plans, policies, contracts, approvals and authorizations of each of the Company and Frontera Cayman and their respective shareholders, boards of directors, committees elected or appointed thereby, officers and agents, which were effective immediately before the Merger, were vested in, assumed by or taken, as applicable, for all purposes as the acts, plans, policies, contracts, approvals and authorizations of Frontera Cayman and are effective and binding on Frontera Cayman in the same manner as they were with respect to the Company or Frontera Cayman, as the case may be, before the Merger.

Simultaneously with the Merger, Frontera Cayman completed a private equity fundraising pursuant to which Frontera Cayman received aggregate gross proceeds (before deduction of placing agent commissions, corporate finance fees and offering expenses) of approximately £6.8 million ($11.0 million), through (i) the issue of 115,678,351 new Frontera Cayman ordinary shares ("Frontera Cayman Shares") under a Placing Agreement with Strand Hanson Limited (as nominated advisor), and Arbuthnot Securities Limited and Old Park Lane Capital plc as Placing Agents, and (ii) subscription agreements with an affiliate of one of the Company's directors and a member of senior management for the purchase of 53,959,053 new Frontera Cayman Shares (the "Equity Fundraising"). Frontera Cayman also entered into a Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV, Ltd. ("YAGM"), pursuant to which YAGM has agreed (subject to certain conditions) to make available over a 36-month period, a facility of up to £21.6 million ($35.0 million) in consideration for the issue of Frontera Cayman Shares.

Frontera Cayman simultaneously exchanged $121.6 million aggregate amount of the Company's 10% convertible notes payable plus accrued interest, for (i) 1,593,853,570 Frontera Cayman Shares, and (ii) $18.2 million aggregate principal amount of new 10% convertible notes due 2016 issued by Frontera Resources Holdings, LLC, a Delaware limited liability company and a wholly-owned subsidiary of Frontera Cayman. These convertible notes payable were exchanged for shares of common stock at a price lower than the conversion price at inception of the notes. The difference in the value of the original conversion price to the actual conversion price was recorded as inducement expense in the statement of operations of approximately $99.4 million. Frontera Cayman also exchanged $9.2 million principal amount plus accrued interest of its related party notes payable for 141,515,879 newly issued Frontera Cayman Shares pursuant to note exchange agreements.

By operation of the Merger, each share of common stock of the Company has been converted into and represents the right to receive either (i) one Frontera Cayman Share (the "Stock Consideration") or (ii) £0.04 ($US0.065) (the "Cash Consideration"). As a result, all stockholders of the Company received the Stock Consideration, except for US stockholders who were not "accredited investors" as defined in Rule 501 under the US Securities Act of 1933, who received the Cash Consideration.

2. Liquidity and Capital Resources

The following key financial measurements reflect the Company's financial position and capital resources as of December 31, 2011 and December 31, 2010 (dollars in thousands):

	December 31, 2011	December 31, 2010
Cash and cash equivalents	$ 1,718	$ 159
Working capital	$ 2,150	$ (7,160)
Total debt	$ 18,844	$ 120,249

The Company has incurred net losses and negative cash flows from operations in most fiscal periods since inception. Management plans to continue to manage costs and obtain additional financing to gain additional liquidity for 2012 and has commenced discussions with various financial institutions to seek additional financing in order to accelerate the Company's 2012 operating plan. Throughout 2010 and 2011, there has been volatility and disruption in the global capital and credit markets. While these market conditions persist, the Company's ability to access the capital and credit markets may be adversely affected. There can be no assurance that these discussions will result in further successful financings.

Notwithstanding management's plan to manage costs and raise additional financing, the Company's viability is dependent upon producing oil and gas in sufficient quantities and marketing such oil and gas at sufficient prices to provide positive operating cash flow to the Company. Management expects to commence production from its Mtsarekhavi gas field in August 2012, which together with periodic access to the SEDA facility should provide positive cash flows for the foreseeable future.

The Company is solely responsible for providing all of the funding for the development of Block 12 in Georgia and will require additional funding in order to obtain certain levels of production and generate sufficient cash flows to meet future capital and operating spending requirements. This is dependent upon, among other factors, achieving significant increases in production, production of oil and gas at costs that provide acceptable margins, reasonable levels of taxation from local authorities, and the ability to market the oil and gas produced at or near world prices.

Management's plan for addressing the above uncertainties is partially based on forward looking events which have yet to occur, including the commencement of additional production, and accordingly, there is no assurance that those events will transpire as initially contemplated.

3. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Frontera Resources Corporation and its wholly owned subsidiaries. All intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent asset and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Estimates of oil and natural gas reserves and their values, future production rates and future costs and expenses are inherently uncertain for numerous reasons, including many factors beyond the Company's control. Reservoir engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. The accuracy of any reserve estimate is a function of the quality of data available and of engineering and geological interpretation and judgment. In addition, estimates of reserves may be revised based on actual production, results of subsequent exploitation and development activities, prevailing commodity prices, operating costs and other factors. These revisions may be material and could materially affect the Company's future depletion, depreciation and amortization expenses.

The Company's revenue, profitability, and future growth are substantially dependent upon the prevailing and future prices for oil and natural gas, which are dependent upon numerous factors beyond its control such as economic, regulatory developments and competition from other energy sources. The energy markets have historically been volatile and there can be no assurance that oil and natural gas prices will not be subject to wide fluctuations in the future. A substantial or extended decline in oil and natural gas prices could have a material adverse effect on the Company's financial position, results of operations, cash flows and quantities of oil and natural gas reserves that may be economically produced.

Cash and Cash Equivalents

Cash and cash equivalents include all cash balances, money market accounts and certificates of deposit, all of which have original maturities of three months or less.

Derivative Stock Warrant Liabilities

In accordance with authoritative guidance issued by the FASB relating to financial instruments indexed to an entity's own stock, the Company has classified its common stock warrants as liabilities. The fair value of these liabilities is re–measured at the end of every reporting period with the change in fair value recorded in the statement of operations. The liabilities will continue to be adjusted for changes in fair value until the earlier event of the exercise date or the cancellation of the warrants at the end of their respective terms.

Fair Value Measurements

Frontera's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, derivative stock warrant liabilities, and convertible notes payable. The fair value of cash, accounts receivable and accounts payable are estimated to approximate the carrying value due to the liquid nature of these instruments. The fair value of the notes payable was determined based upon discount rates which approximate variable interest rates for borrowings of a similar nature. The fair values of the convertible notes payable at December 31, 2011 and 2010 were approximately $18.8 million and $89.2 million, respectively.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The guidance requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The statement requires fair value measurements be classified and disclosed in one of the following categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Measured based on prices or valuation models that required inputs that are both significant to the fair value measurement and less observable for objective sources (i.e., supported by little or no market activity).

The Company classifies financial assets and liabilities based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

The Company estimates the fair value of its common stock warrants using the black-scholes model. The Company classified the derivative stock warrant liabilities as level 2 due to the fact that the warrants are not traded in an active market, but have observable inputs.

The following table summarizes the valuation of the Company's financial assets and liabilities by pricing levels as of December 31, 2011 and 2010.

	2011 Fair Value Measurement Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Liability at Fair Value
Liabilities at December 31, 2011:				
Derivative stock Warrant liabilities	$ –	$ 191,990	$ –	$ 191,990
Total liabilities	$ –	$ 191,990	$ –	$ 191,990

	2010 Fair Value Measurement Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Liability At Fair Value
Liabilities at December 31, 2010:				
Derivative stock Warrant liabilities	$ –	$ 841,667	$ –	$ 841,667
Total liabilities	$ –	$ 841,667	$ –	$ 841,667

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:

	December 31,	
	2011	2010
Materials and supplies	$ 4,630,619	$ 4,670,688
Crude oil	500,425	373,359
	$ 5,131,044	$ 5,044,047

Property and Equipment

Property and equipment are stated at cost. Expenditures for major renewals and betterments, which extend the original estimated economic useful lives of applicable assets, are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The costs and related accumulated depreciation of assets sold or retired are removed from the accounts, and any gain or loss thereon is reflected in operations. Depreciation of property and equipment is computed using the straight–line method over the estimated useful lives of the assets, ranging from three to seven years.

The following is a summary of property and equipment for December 31, 2011 and 2010:

	2011	2010
Field equipment (7 years)	$ 3,950,650	$ 3,939,865
Automobiles (5 years)	501,000	394,012
Telecommunication equipment (7 years)	407,831	407,831
Furniture, fixtures, and computers (7 years)	2,066,858	2,066,858
Leasehold improvements (5 years)	79,099	79,099
Less: accumulated depreciation	(5,937,930)	(5,682,533)
	$ 1,067,508	$ 1,205,132

Oil and Gas Properties

The Company follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with acquisition, exploration and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves, are depleted on the unit–of–production method using estimates of proved reserves. Investments in unproved properties and major development projects are not depleted until proved reserves associated with the projects can be determined or until impairment occurs. In addition, the capitalized costs are subject to a “ceiling test,” which limits such costs to the aggregate of the future net revenues from proved reserves, based on current economic and operating conditions, discounted at a 10% interest rate, plus the lower of cost or fair market value of unproved properties. A ceiling test calculation is performed at each year–end. For the year ended December 31, 2011 and 2010, the ceiling test calculation used a 12-month natural gas and oil average, as adjusted for basis or location differentials using a 12-month average, and held constant over the life of the reserves. The future cash outflows associated with future development or abandonment of wells are included in the computation of the discounted present value of future net revenues for purposes of the ceiling test calculation. For the year ended December 31, 2010, the Company recorded a ceiling test impairment of $44.6 million related to its fields in Georgia. No such impairment was recorded in 2011.

Sales or other dispositions of oil and gas properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in earnings.

Costs Excluded

The costs associated with unproved properties, initially excluded from the amortization base, relate to unproved leasehold acreage, wells and production facilities in progress and wells pending determination of the existence of proved reserves, together with capitalized interest costs for these projects. Unproved leasehold costs are transferred to the amortization base with the costs of drilling the related well once a determination of the existence of proved reserves has been made or upon impairment of a lease. Costs of seismic data are allocated to various unproved leaseholds and transferred to the amortization base with the associated leasehold costs on a specific project basis. Costs associated with wells in progress and completed wells that have yet to be evaluated are transferred to the amortization base once a determination is made whether or not proved reserves can be assigned to the property. Costs of dry wells are transferred to the amortization base immediately upon determination that the well is unsuccessful.

There were no costs associated with unproved properties related to continuing at December 31, 2011 and 2010 due to changes in the Company's development strategy and management's plans to reduce capital spending in certain oil and gas properties.

Income Taxes

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statements and the tax basis of assets and liabilities using enacted rates in effect for the years in which the differences are expected to reverse. Valuation allowances are established, when appropriate, to reduce deferred tax assets to the amount expected to be realized.

The Company accounts for uncertain tax positions by reporting a liability for tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The Company recognizes interest and penalties, if any, related to tax benefits in income tax expense.

Revenue Recognition

Oil and natural gas revenues are recorded when title passes to the customer, net of royalties, discounts and allowances, as applicable. Oil and natural gas sold is not significantly different from the Company's share of production.

Allowance for Doubtful Accounts

The Company has established an allowance for doubtful accounts that is based on the Company's review of the collectability of the receivables in light of historical experience, the nature and volume of the receivables and other subjective factors. Accounts receivable are charged against the allowance when they are deemed uncollectible. The allowance for doubtful accounts balance was $0.4 million at December 31, 2011 and 2010.

Foreign Currency Transactions

The financial statements of the foreign subsidiaries are prepared in United States dollars, and the majority of transactions are denominated in United States dollars. Gains and losses on foreign currency transactions are the result of changes in the exchange rate between the time a foreign currency–denominated invoice is recorded and when it is ultimately paid and are included in operations.

Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and accounts receivable. The Company maintains its cash in bank deposits with various major financial institutions. These accounts, at times, may exceed federally insured limits. Deposits in the United States are guaranteed by the Federal Deposit Insurance Corporation up to $250,000. The Company monitors the financial condition of the financial institutions and does not anticipate any losses on such accounts.

For the years ended December 31, 2011 and 2010, 100% of the Company's crude oil sales were to one unrelated customer.

Loss Per Share

Basic and diluted loss per share amounts is calculated based on the weighted average number of common stock outstanding during the year. Diluted loss per share is calculated using the weighted average number of shares of common stock outstanding during the year, including the dilutive effect of stock options, warrants and convertible notes. Basic and diluted loss per share for the years ended December 31, 2011 and 2010 are the same since the effect of all common stock equivalents would be antidilutive to the Company's net loss per share.

Stock–Based Compensation

The Company accounts for all share–based payments to employees, including grants of employee stock options, in the financial statements based on their grant–date fair values using a Black-Scholes fair valuation model. The Company estimated forfeiture rates for the year based on its historical experience of approximately 3%. At December 31, 2011 all stock options were vested.

The Black–Scholes model incorporates assumptions to value stock–based awards. The risk–free rate of interest is the related U.S. Treasury yield curve for periods within the expected term of the option at the time of grant. The dividend yield on our common stock is assumed to be zero as we have historically not paid dividends and have no current plans to do so in the future. The expected volatility is based on historical volatility of the Company's common stock.

Due to the Company's net operating loss position; there are no anticipated windfall tax benefits upon exercise of options.

4. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31,	
	2011	**2010**
Accrued payables	$ 2,627,781	$ 3,299,918
Accrued interest	–	326,189
Accrued benefits	77,434	140,342
	$ 2,705,215	$ 3,766,449

5. Debt

Debt consists of the following:

	December 31,	
	2011	**2010**
Related party notes payable	$ –	$ 5,304,918
Convertible notes payable	18,843,607	114,944,386
Total debt	18,843,607	120,249,304
Less: Current notes payable	253,249	5,304,918
Total long-term debt	$ 18,590,358	$ 114,944,386

Related Party Notes Payable

During 2011 and 2010, the Company entered into a series of notes payable with two of the Company's officers in the aggregate amounts of $2.9 million and $5.3 million, respectively. These notes were due in 2011, bore interest of 15%, and were classified within Related Party Notes Payable on Balance Sheet. During the Merger, $9.2 million principal amount plus accrued interest of the related party notes were exchanged for 141,515,879 shares of Frontera Cayman shares.

Convertible Notes Payable

During May 2007, the Company raised approximately $67.0 million through a private placement of convertible unsecured notes due May 2012. The notes were issued at par and bear interest at 10% per annum, payable quarterly in arrears in cash or in kind at the Company's discretion. The notes are convertible into shares of common stock at a conversion price of $1.67 per share. The notes will be automatically converted into common stock at the conversion price if the stock price exceeds two times the conversion price for at least 20 consecutive trading days. On August 2, 2011 85.1% of the 2012 Notes were converted into the common stock and another 14.6% were exchanged for the 2016 Notes.

On July 3, 2008, the Company raised $23.5 million through a private placement of convertible unsecured notes due July 2013. The notes were issued at par and bear interest at 10% per annum, payable quarterly in arrears in cash or in kind at the Company's discretion. The notes are convertible into common stock at a conversion price of $1.71 per share. On August 2, 2011 84.0% of the 2013 Notes were converted into the common stock and another 16.0% were exchanged for the 2016 Notes.

On August 2, 2011 note holders exchanged $18,220,312 of 2012 and 2013 Notes into new notes issued under the 2016 Note Purchase Agreement due August 2016. The 2016 Notes accrue interest at the rate of 10% per annum, mature five years from the date of issuance and are convertible into Frontera Cayman Shares, at the option of the holder, at a conversion rate of $0.25 per share.

During 2011 and 2010, the Company elected to pay the quarterly interest payments in kind on the convertible notes and issued approximately $7.7 million and $10.8 million, respectively, in additional convertible notes in accordance with terms of the note purchase agreement.

6. Derivative Stock Warrant Liabilities

	Change in Fair Value Measurement:				
	Exercise Price per	Shares as of December 31,		Fair Value as of December 31,	
Underlying Stock:	**warrant**	**2011**	**2010**	**2011**	**2010**
Common stock	US $ 1.690	-	6,593,037	$ -	$ 257,788
Common stock	UK £ 0.105	65,743,893	-	129,511	-
Common stock	UK £ 0.060	500,000	-	435	-
Common stock	UK £ 0.040	12,558,307	-	62,044	-
Common stock	UK £ 0.150	-	46,542,132	-	583,879
		78,802,200	53,135,169	$ 191,990	$ 841,667

In July 2008, the Company solicited consents from holders of its 10% convertible notes due May 2012 to amend the note purchase agreements governing such notes to permit the issuance of the new notes and to release the remaining escrowed proceeds of $5.0 million from the May 2007 private placement. In connection with the solicitation, each consenting holder received a warrant exercisable into shares of common stock in an amount equal to 7.5% of the number of shares of common stock into which such consenting holder's existing notes were convertible. The warrants were exercisable for approximately 3,151,000 shares of common stock in the aggregate. Each warrant entitled the holder to purchase one share of common stock at a price of $3.50 per share. During 2009, due to anti–dilution provisions contained in the warrant agreements, the warrants became exercisable into 6,593,037 shares in the aggregate at an exercise price of $1.69 per share. Again, during 2011 due to the same anti–dilution provisions contained in the warrant agreements, the warrants became exercisable into 65,743,893 shares in the aggregate at an exercise price of £0.105 per share. The warrants have a five–year term and include a cashless exercise provision along with other customary terms and provisions. The issuance date fair value of these warrants was estimated to be $0.9 million and has been recorded as a derivative stock warrant liability. The warrants were valued on the issuance date using the following assumptions: risk-free interest rate of 3.42%, expected volatility of 146.3%, no expected dividend yield and a term of 5 years.

In September 2009, the Company issued 45,186,536 units each comprised of one Common Share and one Common Share purchase warrant at an issue price of $0.1684 per unit, for gross proceeds of approximately $7.6 million. Each warrant entitles the holder the ability to purchase from the Company one Common Share for a period of two years following the transaction closing date at an exercise price of £0.15 per Common Share. An additional 1,355,596 units were issued to an advisor in exchange for issuance fees. These additional units have the same provisions, with the exception that the term for these warrants is 18 months versus 2 years for those related to the offering. During 2011, due to anti–dilution provisions contained in the warrant agreements, the warrants became exercisable into 139,079,809 shares in the aggregate at an exercise price of £0.047 per share. The issuance date fair value of these warrants was estimated to be $3.8 million and has been recorded as a derivative stock warrant liability. The warrants were valued on the issuance date using the following assumptions: risk-free interest rates of 0.58% and 0.82%, expected volatilities of 103.5% and 110.3%, no expected dividend yield and terms ranging from 1.5 years and 2 years. All of these warrants expired in September 2011.

On February 8, 2011 the Company issued a warrant instrument entitling Arbuthnot, broker of Company, to purchase 500,000 Shares of Common Stock at an exercise price of £0.06 per share. These warrants expire on February 8, 2013.

On August 2, 2011 as part of the fees and commissions payable to Arbuthnot, OPL and Strand Hanson for their respective roles in the Placing, Company has issued 12,558,307 warrants with an exercise price of £0.04 per share with terms ranging from 2 to 3 years.

The change in the fair value of the warrants results in derivative income of $0.6 million and $2.4 million, respectively, for 2011 and 2010. The Company determined the fair value of these warrants as of December 31, 2011 using the following assumptions: risk-free interest rates ranging from 1.331% to 1.349%, expected volatilities ranging from 95.70% to 119.41%, no expected dividend yield and terms ranging from 1.11 years to 2.59 years.

7. Income Taxes

The Company has incurred losses since inception and, therefore, has not been required to pay federal income taxes. As of December 31, 2011, the Company has generated net operating loss ("NOL") carryforwards of approximately $120.2 million that may be available to reduce future income taxes. These carryforwards begin to expire in 2012 with a limited annual utilization.

Several factors may further limit the Company's ability to utilize these carryforwards, including a lack of future taxable income, a change of Company ownership (as defined by federal income tax regulations) or the expiration of the utilization period allowed by federal income tax regulations.

During 2011 and 2010, the valuation allowance increased $5.6 million and $7.1 million, respectively, primarily due to the Company's losses. The effective tax rate for 2011 and 2010 differs from the statutory tax rate due primarily to the valuation allowance. The components of the Company's deferred tax liabilities and assets at December 31, 2011 and 2010, are as follows:

	2011	2010
Deferred tax liabilities		
Geological & geophysical	$ (185,746)	$ (654,758)
Other	(244,852)	(244,852)
Deferred tax assets		
Net operating losses – U.S.	40,852,456	35,919,425
Depreciation and amortization	333,369	327,717
Realized loss on investments	280,436	226,630
Allowance for bad debts	–	139,063
Other	22,089	65,790
Stock compensation	4,582,493	4,273,701
	45,640,245	40,052,716
Valuation allowance	(45,640,245)	(40,052,716)
Net deferred tax assets	$ –	$ –

Deferred tax assets are reduced by a valuation allowance when a determination is made that it is more likely than not that some or all of the deferred assets will not be realized based on the weight of all available evidence. The Company determined it was appropriate to record a full valuation allowance against its net deferred tax asset.

Profits derived from oil and gas operating activities are subject to a profits tax on taxable income as defined by Georgian law. However, under the terms of the Block 12 PSA, Georgian Oil is responsible for paying the Company's profit tax liabilities with respect to income derived from these activities. Although the Company has incurred operating losses in Georgia, no adjustment with respect to deferred tax assets or a potentially related valuation allowance has been made, as any future benefit related to these operating losses would serve to reduce Georgian Oil's liability.

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 December 31, 2011. The Company and its subsidiaries file income tax returns in the US federal jurisdiction. 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 December 31, 2011 or 2010.

8. Commitments and Contingencies

Operating Leases

The Company has noncancelable operating leases for office facilities and lodging. Approximate future minimum annual rental commitments under these operating leases are as follows:

Years Ending December 31,	
2012	$ 403,371
2013	400,487
2014	155,415
2015 and thereafter	261,186
	$ 1,220,459

Rental expense for the years ended December 31, 2011 and 2010 was approximately $366,000 and $574,000, respectively.

ARAR Arbitration

In January 2008, Frontera Eastern Georgia Limited ("FEGL"), served a notice of arbitration and claim on ARAR, Inc. ("ARAR"), for breach of contract under a drilling services contract dated May 2007, specifically for, among other things, failure to commence work by the time specified in the contract, failure of the drilling rig to meet required specifications and failure to reconcile advance payments made by FEGL with work actually performed. FEGL terminated the contract after ARAR failed to mobilize the rig to the required location and failed to commence work as otherwise required under the contract. FEGL claimed damages of approximately $7.0 million in the arbitration. ARAR denied FEGL's claims and filed counterclaims against FEGL, seeking payments of approximately $7.1 million for, among other things, standby charges for the period of time the rig was undergoing inspection and repairs to bring it into contract specification, early termination fees and demobilization fees. The parties entered into a settlement agreement in December 2008 pursuant to which ARAR was required to make a series of payments to FEGL through December 2009 in the aggregate amount of $1.25 million. The settlement resolved all outstanding claims and counterclaims between Frontera and ARAR arising out of the drilling services contract. Beginning in August 2009, ARAR defaulted on its monthly payments and remains in default on payments due August - December 2009. The Company applied to the arbitration panel for entry of an agreed award pursuant to the settlement agreement. The panel held a hearing on the Company's application in March 2010, and in April 2010 entered a final, binding award in the amount of $1.4 million in favor of FEGL.

In April 2010, FEGL filed an action in the U.S. District Court for the Southern District of Texas seeking confirmation of the final arbitration award pursuant to the Convention on Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 as a precursor to further enforcement action in the U.S. In May 2010, ARAR filed a counterclaim in the district court seeking to deny confirmation and to vacate the award. On August 15, 2011, the U.S. District Court for the Southern District of Texas entered final judgment ("Final Judgment") confirming the final arbitration award and granting FEGL total amount of $1.6 million, which include total amount of the arbitration award and FEGL's attorney's fees and expenses. On September 13, 2011, ARAR appealed the Final Judgment with the United States Court of Appeals for the Fifth Circuit ("Court of Appeals"). An oral argument on ARAR's appeal will be held by the Court of Appeals in July 2012. FEGL considers ARAR's appeal to be without merits and intends to continue to vigorously pursue its case before the Court of Appeals.

In July 2010, FEGL filed an enforcement action in the 4th Commercial Court in Ankara, Turkey, seeking to enforce the final award against assets of ARAR located in Turkey. In parallel, an affiliate of ARAR initiated a lawsuit against FEGL in the 7th Commercial Court in Ankara, Turkey in July

2010 claiming damages of $0.3 million in connection with the exportation of the rig from Georgia. The Company believes the claims made by ARAR in the Turkish lawsuit are subject to the arbitration clause of the contract, were resolved by the December 2008 settlement, and in any event are completely without merit, and intends to continue to vigorously defend itself. Oral hearing on ARAR lawsuit is expected on July 5, 2012 and oral hearing on enforcement action is expected on September 19, 2012.

In parallel to the enforcement action in Turkey, on January 13, 2012, FEGL filed a petition in the High Court of Justice, Queens Bench Division, in London, UK (“London High Court”), seeking enforcement of the arbitration award in the UK against the defendants’ assets in the UK. Additionally, FELG sought an injunction prohibiting the defendants to dispose of any assets in the UK while the enforcement action is pending. On January 31, 2012, the London High Court entered an order granting FEGL’s both petition for enforcement and motion for injunction. On May 8, 2012, defendants filed response requesting to vacate the court order. FEGL intends to vigorously pursue its enforcement action in the UK before the London High Court.

Randy Theilig vs. Frontera Resources Corporation

On November 11, 2011, Randy Theilig, Frontera’s former Chief Financial Officer, filed an Original Petition against Frontera in District Court of Harris County, Texas, in which he alleged that Frontera breached Mr. Theilig’s employment agreement by not paying certain monies to Mr. Theilig following his departure from Frontera in early 2011. On December 5, 2011, Frontera filed a motion to compel the arbitration as provided under employment contract between Frontera and Mr. Theilig. On January 23, 2012, the Court granted the motion. Following the grant of the motion, Mr. Theilig has not filed a claim in arbitration. Frontera considers Mr. Theilig’s claims to be without merit and intends to vigorously defend itself should Mr. Theilig choose to file a claim in arbitration.

9. Stockholders’ Equity

Common Stock

As of December 31, 2011, the Company is authorized to issue 3,000,000,000 shares of common stock, par value $.00004 per share. As of December 31, 2011 and 2010, the Company had 2,066,677,643 and 135,318,282 shares of common stock issued and outstanding, respectively. At December 31, 2011 and 2010, additional shares in the amount of 92,603,254 and 69,301,629, respectively, of common stock were reserved for the exercise of existing options and warrants.

Treasury Stock

As of December 31, 2011 and 2010, the Company had 0 and 5,739,855 shares of treasury stock, respectively, all held as common stock.

2000 Nonqualified Stock Option and Stock Award Plan

In 2000, the Company’s Board of Directors approved the 2000 Nonqualified Stock Option and Stock Award Plan (the “Stock Award Plan”), pursuant to which options may be granted to purchase up to 15% of the Company’s common stock authorized to be issued by the Company, reduced by the total number of shares of stock subject to stock options and stock awards that have been granted under the Stock Award Plan and the Frontera Resources Corporation 1998 Employee Stock Incentive Plan. The Board of Directors has appointed Frontera’s chief executive officer as administrator (the "Administrator") of the Stock Award Plan. In this capacity, the Administrator determines which employees will receive options, the number of shares covered by any option agreement, and the exercise price and other terms of each such option. The Board of Directors is responsible for administering the Stock Award Plan as it relates to options granted to the chief executive officer.

Under the terms of the Stock Award Plan, any issued options expire ten years after the date of grant or upon earlier of termination of employment or affiliation relationship between the grantee and the Company. Options granted vest over periods ranging from immediate vesting to vesting in equal increments over three years from the date of grant.

A summary of the Company's stock option activity and related information is as follows:

	Options	Weighted–Average Exercise Price
Options outstanding at December 31, 2009	16,593,153	$ 0.74
Granted	500,000	0.12
Exercised	–	–
Canceled	(986,422)	1.74
Options outstanding at December 31, 2010	16,106,731	$ 0.66
Granted	–	–
Exercised	–	–
Canceled	(2,305,677)	2.40
Options outstanding at December 31, 2011	13,801,054	$ 0.71
Options exercisable at December 31, 2011	13,801,054	$ 0.71

The following table summarizes information about stock options outstanding at December 31, 2011:

Range of Exercise Prices	Number Outstanding at December 31, 2011	Weighted–Average Remaining Contractual Life (Years)	Weighted–Average Exercise Price	Number Exercisable at December 31, 2011	Weighted–Average Exercise Price
$0.00–1.99	11,951,054	6.03	$ 0.39	11,951,054	$ 0.39
2.00–3.99	1,850,000	5.08	2.78	1,850,000	2.78
	13,801,054	5.90	$ 0.71	13,801,054	$ 0.71

Stock option information related to the nonvested options for the year ended December 31, 2011, was as follows:

	Number of Shares Underlying Options	Weighted–Average Grant Date Fair Value
Nonvested options outstanding at December 31, 2009	8,219,460	$ 0.31
Granted	500,000	0.12
Vested	(5,429,460)	0.36
Canceled	(55,000)	0.19
Nonvested options outstanding at December 31, 2010	3,235,000	$ 0.20
Granted	–	–
Vested	(3,085,000)	0.25
Canceled	(150,000)	0.18
Nonvested options outstanding at December 31, 2011	–	–

The Company granted 500,000 options to employees during 2010 with exercise prices for $0.12, which was at the market value of the Company's common stock at the time of grant. The weighted average fair value of the options granted in 2010 was $0.12. The fair value of the option grants were calculated using a Black–Scholes option pricing model, with the following weighted average assumptions: risk free interest rate of 2.43%; no dividend yield; volatility factor of 301%; and an expected option life of 9.31 years. No options were granted in 2011.

10. Related Party Transactions

In conjunction with an ongoing consulting agreement a director of the Company received consulting fees for the years ended December 31, 2011 and 2010 of $244,167 and $150,750, respectively.

Additionally, the Company entered into a series of Notes Payable with two of the Company's officers. As of December 31, 2010 the outstanding principal of the notes was $5.3 million. The Company borrowed an additional $2.9 million in principal in 2011. During the Merger, $9.2 million principal amount plus accrued interest of the related party notes were exchanged for 141,515,879 shares of Frontera Cayman shares. See Note 5.

11. Subsequent Events

Events occurring after December 31, 2011 were evaluated through June 25, 2012, the date this report was available to be issued, to ensure that any subsequent events meeting the criteria for recognition or disclosure were included. There were no such subsequent events.