Frontera Resources Corporation and Subsidiaries

Consolidated Financial Statements
December 31, 2012 and 2011

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Independent Auditor's Report

To the Board of Directors of
Frontera Resources Corporation:

We have audited the accompanying consolidated financial statements of Frontera Resources Corporation and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of comprehensive loss, stockholders' deficit and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation 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 the consolidated financial statements based on our audits. We conducted our audits 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 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 our 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, we consider internal control relevant to the Company'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 Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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 is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Frontera Resources Corporation and its subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

June 26, 2013

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Frontera Resources Corporation and Subsidiaries
Consolidated Balance Sheets
December 31, 2012 and 2011

	2012	2011
Assets		
Current assets		
Cash and cash equivalents	$ 712,447	$ 1,718,410
Accounts receivable, net	226,145	229,241
Inventory	5,649,408	5,131,044
Prepaid expenses and other current assets	1,124,935	171,960
Total current assets	7,712,935	7,250,655
Property and equipment, net	1,195,198	1,067,508
Oil and natural gas properties, full cost method		
Properties being depleted	125,982,861	125,411,637
Less: accumulated depletion	(118,805,439)	(117,419,454)
Net oil and gas properties	7,177,422	7,992,183
Deferred financing costs, net	247,698	196,734
Total assets	$ 16,333,253	$ 16,507,080
Liabilities and Stockholders' Deficit		
Current liabilities		
Accounts payable	$ 971,189	$ 2,142,120
Accrued liabilities	3,275,530	2,705,215
Related party notes payable	3,720,000	–
Current maturities of notes payable	1,290,835	253,249
Total current liabilities	9,257,554	5,100,584
Convertible notes payable	20,652,119	18,590,358
Derivative stock warrant liabilities	4,191	191,990
Total liabilities	29,913,864	23,882,932
Commitments and contingencies		
Stockholders' deficit		
Common stock	93,810	82,621
Additional paid-in capital	397,852,106	395,190,976
Accumulated deficit	(411,526,527)	(402,649,449)
Total stockholders' deficit	(13,580,611)	(7,375,852)
Total liabilities and stockholders' deficit	$ 16,333,253	$ 16,507,080

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

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Frontera Resources Corporation and Subsidiaries
Consolidated Statements of Comprehensive Loss
Years Ended December 31, 2012 and 2011

	2012	2011
Revenue - crude oil sales	$ 7,525,307	$ 7,448,102
Operating expenses		
Field operating and project costs	5,075,826	4,217,988
General and administrative	7,172,703	10,408,146
Depreciation, depletion and amortization	1,626,860	1,654,787
Total operating expenses	13,875,389	16,280,921
Loss from operations	(6,350,082)	(8,832,819)
Other income (expense)		
Interest income	7,217	8,798
Interest expense	(2,663,458)	(12,321,550)
Inducement expense	–	(99,391,736)
Derivative income	187,799	649,677
Other, net	(58,554)	(59,725)
Total other income (expense)	(2,526,996)	(111,114,536)
Loss before income taxes	(8,877,078)	(119,947,355)
Provision for income taxes	–	–
Net loss and comprehensive loss	$ (8,877,078)	$ (119,947,355)
Loss per share		
Basic and diluted	$ (0.00)	$ (0.13)
Number of shares used in calculating loss per share		
Basic and diluted	2,190,020,209	928,590,305

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, 2012 and 2011

	Common Stock	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Total Stockholders' Deficit
Balance at December 31, 2010	$ 5,366	$ 172,338,018	$ (567,832)	$ (282,702,094)	$ (110,926,542)
Issuance of common stock	7,840	10,720,141	–	–	10,727,981
Stock based compensation expense	160	479,199	–	–	479,359
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)
Issuance of common stock	11,247	2,748,779	–	–	2,760,026
Stock based compensation expense	–	5,745	–	–	5,745
Purchase of company common stock	(58)	(93,394)	–	–	(93,452)
Net loss	–	–	–	(8,877,078)	(8,877,078)
Balances at December 31, 2012	$ 93,810	$ 397,852,106	–	$ (411,526,527)	$ (13,580,611)

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

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Frontera Resources Corporation and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Net loss	$ (8,877,078)	$(119,947,355)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation, depletion and amortization	1,626,860	1,654,787
Inducement expense	–	99,391,736
Derivative income	(187,799)	(649,677)
Noncash interest expense and amortization	2,517,041	12,321,550
Stock based compensation	5,745	479,359
Changes in operating assets and liabilities:		
Accounts receivable	3,096	(39,401)
Inventory	(518,364)	(86,997)
Prepaid expenses and other current assets	(952,975)	8,417
Accounts payable	(808,333)	(227,363)
Accrued liabilities	348,142	(436,454)
Net cash used in operating activities	(6,843,665)	(7,531,398)
Cash flows from investing activities		
Investment in oil and gas properties	(1,107,821)	(2,231,286)
Investment in property and equipment	(194,565)	(117,770)
Net cash used in investing activities	(1,302,386)	(2,349,056)
Cash flows from financing activities		
Proceeds from related party notes payable	3,720,000	2,910,000
Proceeds from notes payable	3,645,000	–
Repayments of borrowings	(2,616,484)	–
Purchase of Company common stock	(93,454)	(261,286)
Proceeds from issuance of common stock and warrants	2,760,026	8,791,608
Cost of debt issuance	(275,000)	–
Net cash provided by financing activities	7,140,088	11,440,322
Net (decrease) increase in cash and cash equivalents	(1,005,963)	1,559,868
Cash and cash equivalents		
Beginning of year	1,718,410	158,542
End of year	$ 712,447	$ 1,718,410
Supplemental cash flow information		
Cash paid for interest	$ 155,487	$ –
Non-cash investing and financing activities		
Issuance of convertible notes payable in lieu of interest payments	$ 1,999,368	$ 7,671,527
Change in accrued investment in oil and gas properties	(536,597)	(749,270)
Non-cash issuance of common stock	–	2,627,896
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.

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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 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, 2012 and December 31, 2011 (dollars in thousands):

	December 31, 2012	December 31, 2011
Cash and cash equivalents	$ 712	$ 1,718
Working capital	$ (1,545)	$ 2,150
Total debt	$ 25,663	$ 18,844

The Company has incurred net losses and negative cash flows from operations in most fiscal periods since inception. Management plans to continue to reduce costs and continue to raise additional financing in order to continue to facilitate the Company's 2013 operating plan. Throughout 2011 and 2012, 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 is likely to be adversely affected. There can be no assurance that these discussions will result in a successful financing.

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 marketingsuch 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 July 2013, 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.

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, 2012 and 2011.

	2012 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, 2012:				
Derivative stock Warrant liabilities	$ –	$ 4,191	$ –	$ 4,191
Total liabilities	$ –	$ 4,191	$ –	$ 4,191

	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

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,	
	2012	2011
Materials and supplies	$ 5,205,338	$ 4,630,619
Crude oil	444,070	500,425
	$ 5,649,408	$ 5,131,044

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, 2012 and 2011:

	2012	2011
Field equipment (7 years)	$ 4,319,215	$ 3,950,650
Automobiles (5 years)	501,000	501,000
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	(6,178,805)	(5,937,930)
	$ 1,195,198	$ 1,067,508

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, 2012 and 2011, the ceiling test calculation used a first day of month trailing12-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 either year ended December 31, 2012 or 2011, the Company recorded no impairment related to its fields in Georgia.

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, 2012 and 2011 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 million and $0.4 million at December 31, 2012 and 2011.

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, 2012 and 2011, 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, 2012 and 2011 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, 2012, 4.8 million stock options were unvested.

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,	
	2012	**2011**
Accrued payables	$ 3,067,203	$ 2,627,781
Accrued interest	204,428	–
Accrued benefits	3,899	77,434
	$ 3,275,530	$ 2,705,215

5. Debt

Debt consists of the following:

	December 31,	
	2012	**2011**
Related party notes payable	$ 3,720,000	$ –
Convertible notes payable	20,652,119	18,843,607
Other notes payable	1,290,835	–
Total debt	25,662,954	18,843,607
Less: Current notes payable	5,010,835	253,249
Total long-term debt	$ 20,652,119	$ 18,590,358

Related Party Notes Payable
During 2012 and 2011, the Company entered into a series of notes payable with two of the Company's officers in the aggregate amounts of $3.7 million and $2.9 million, respectively. These notes have a one-year term, bear interest of 15%, and were classified within Related Party Notes Payable on Balance Sheet. During the Merger in 2011, $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 2012 and 2011, the Company elected to pay the quarterly interest payments in kind on the convertible notes and issued approximately $2.0 million and $7.7 million, respectively, in additional convertible notes in accordance with terms of the note purchase agreement.

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**	**2012**	**2011**	**2012**	**2011**
Common stock	UK £ 0.105	-	65,743,893	-	129,511
Common Stock	UK £ 0.093	74,501,366	-	-	-
Common stock	UK £ 0.060	500,000	500,000	-	435
Common stock	UK £ 0.040	12,558,307	12,558,307	181	62,044
Common stock	UK £ 0.018	15,000,000	-	4,010	-
		102,559,673	78,802,200	$ 4,191	$ 191,990

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. Also, 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. Again, during 2012 due to the same anti–dilution provisions contained in the warrant agreements, the warrants became exercisable into 74,501,366 shares in the aggregate at an exercise price of £0.093 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. All of these warrants expire on July 3, 2013.

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. Of these warrants, 11,870,807 expire on August 2, 2013 and 687,500 expire on August 2, 2014.

Under the terms of SEDA-backed Loan Agreement in respect of Initial Advance in January 2012 Yorkville has been granted 15,000,000 warrants exercisable within 2 years with an exercise price of £0.018 per share. These warrants expire on January 31, 2014.

The change in the fair value of the warrants results in derivative income of $0.2 million and $0.6 million, respectively, for 2012 and 2011. The Company determined the fair value of these warrants as of December 31, 2012 using the following assumptions: risk-free interest rates ranging from 0.01% to 0.22%, expected volatilities ranging from 71.36% to 97.60%, no expected dividend yield and terms ranging from 0.11 years to 1.59 years.

6. Income Taxes

The Company has incurred losses since inception and, therefore, has not been required to pay federal income taxes. As of December 31, 2012, the Company has generated net operating loss ("NOL") carryforwards of approximately $124.6 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 2012 and 2011, the valuation allowance increased $1.5 million and $5.6 million, respectively, primarily due to the Company's losses. The effective tax rate for 2012 and 2011 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, 2012 and 2011, are as follows:

	2012	2011
Deferred tax liabilities		
Geological & geophysical	$ –	$ (185,746)
Other	–	(244,852)
Deferred tax assets		
Net operating losses – U.S.	42,374,849	40,852,456
Depreciation and amortization	(65,374)	333,369
Realized loss on investments	280,436	280,436
Allowance for bad debts	–	–
Other	10,074	22,089
Stock compensation	4,575,624	4,582,493
	47,175,609	45,640,245
Valuation allowance	(47,175,609)	(45,640,245)
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, 2012. 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, 2012 or 2011.

7. 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,	
2013	$ 415,697
2014	155,415
2015	119,142
2016 and thereafter	70,643
	$ 760,897

Rental expense for the years ended December 31, 2012 and 2011 was approximately $410,755 and $366,000, 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 remained in default on payments due August - December 2009. FEGL applied to the arbitration panel for entry of an agreed award pursuant to the settlement agreement. The panel held a hearing on FEGL’s application in March 2010, and in April 2010 entered a final, binding award in the amount of $1.43 million in favor of FEGL (“Final Award”).

In April 2010, FEGL filed an action in the U.S. District Court for the Southern District of Texas ("District Court") seeking confirmation of the Final 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 Final Award. On August 15, 2011, the District Court entered final judgment ("Final Judgment") confirming the Final Award and granting FEGL total amount of $1,552,707.01, which include total amount of the Final 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"). On July 16, 2012, Court of Appeals dismissed ARAR's appeal and affirmed District Court's Judgment in its entirety. ARAR attempted to further appeal Court of Appeal's decision via "motion for rehearing"; on August 16, 2012, Court of Appeals denied ARAR's motion and affirmed its earlier decision.

In order to enforce the Final Award against assets of ARAR located in Turkey, in July 2010 FEGL filed an enforcement action in the 4th Commercial Court in Ankara, Turkey. 4th Commercial Court conducted a series of hearings on the enforcement action, and by its order dated November 23, 2012, rejected FEGL's request for enforcement. FEGL filed its appeal of the court order with the appeals court in Ankara on June 7, 2013, and expects that the appeals court will reverse the lower court order. Appeals court's decision is expected sometime during the third quarter of 2013. In parallel, in July 2010 an affiliate of ARAR filed a lawsuit against FEGL in the 7th Commercial Court in Ankara, Turkey claiming damages of $0.3 million in connection with the exportation of the drilling rig from Georgia. On July 5, 2012, 7th Commercial Court dismissed ARAR's lawsuit in its entirety.

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 Final Award in the UK against the defendants' assets located 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. Defendants vigorously contested the court order and filed a response requesting to vacate it. On January 23, 2013, the London High Court issued its Final Charging Order affirming its earlier decision and dismissing defendants' contentions.

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 chose not to pursue the arbitration and withdrew his claim.

8. Stockholders' Equity

Common Stock
As of December 31, 2012, the Company is authorized to issue 3,000,000,000 shares of common stock, par value $.00004 per share. As of December 31, 2012 and 2011, the Company had 2,346,409,824 and 2,066,677,643 shares of common stock issued and outstanding, respectively. At December 31, 2012 and 2011, additional shares in the amount of 120,282,918 and 92,603,254, respectively, of common stock were reserved for the exercise of existing options and warrants.

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, 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
Granted	4,807,692	0.03
Exercised	–	–
Canceled	(885,501)	0.28
Options outstanding at December 31, 2012	17,723,245	$ 0.54
Options exercisable at December 31, 2012	12,915,553	$ 0.72

The following table summarizes information about stock options outstanding at December 31, 2012:

Range of Exercise Prices	Number Outstanding at December 31, 2012	Weighted–Average Remaining Contractual Life (Years)	Weighted–Average Exercise Price	Number Exercisable at December 31, 2012	Weighted–Average Exercise Price
$0.00–1.99	15,873,245	6.58	$ 0.27	11,065,553	$ 0.38
2.00–3.99	1,850,000	4.08	2.78	1,850,000	2.78
	17,723,245	6.32	$ 0.54	12,915,553	$ 0.72

Stock option information related to the nonvested options for the year ended December 31, 2012, was as follows:

	Number of Shares Underlying Options	Weighted–Average Grant Date Fair Value
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	–	–
Granted	4,807,692	0.03
Vested	–	–
Canceled	–	–
Nonvested options outstanding at December 31, 2012	4,807,692	0.03

The Company granted 4,807,692 options to employees during 2012 with exercise prices for $0.03. No options were granted in 2011.

9. Related Party Transactions

In conjunction with an ongoing consulting agreement a director of the Company received consulting fees for the years ended December 31, 2012 and 2011 of $275,000 and $244,167, respectively.

Additionally, the Company entered into a series of Notes Payable with two of the Company's officers. During the Merger in 2011, $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. The Company borrowed an additional $3.7 million in principal in 2012.

10. Subsequent Events

Events occurring after December 31, 2012 were evaluated through June 26, 2013, 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.