

31<sup>st</sup> January 2007

The Manager Companies  
Australian Stock Exchange  
20 Bridge Street  
Sydney NSW 2000

Dear Sir/Madam,

**Exploration Report for the quarter ended 31<sup>st</sup> December, 2006**

**Drilling Program**

**1.) South Bourg Prospect, Terrebonne Parish, Louisiana.**

A drilling rig will become available to test the Callahan #1 well in February, 2007. Location construction is now scheduled to commence in February, 2007. South Bourg Prospect has estimated reserve potential ranging up to 21 BCF gas.

K2 holds a 5% working interest and a 3.67 % net revenue interest in the prospect

**2.) Hidden Lake Prospect, Brazoria County, Texas.**

The Gayle #1 well is awaiting availability of a drilling rig. The operator, Dewbre Petroleum, determined that a larger rig was necessary. Current estimates are for availability in March, 2007. Reserve potential up to 16 BCF may be recovered from the prospect, which is competitive with another producing well on the same fault block.

K2 holds a 9.0616% working interest and a 7.058% net revenue interest in the prospect.

**3.) North Case 26 Prospect, Presque Isle County, Michigan.**

The company elected to participate in the re-drill (sidetrack) of the Haskill 1-26 well. This well is targeting a Silurian pinnacle reef above 4,000' true vertical depth.

K2 holds a 30% working interest and a 22.5% net revenue interest in the prospect.

#### 4.) **Shary Prospect, Hidalgo County, Texas.**

The Black Stone – Shary #1 well is slated for a production test to determine sustainable gas rates and pipeline specifications. This test is now scheduled for February, 2007. Estimated gas reserves based on the drill results are undetermined at this time. However, a prospective drill site higher on structure, and in the same fault block, is being evaluated at this time and may be proposed in 2007. The company has secured access to the pipeline gathering system owned by Chesapeake Energy Corp in exchange for the shallow mineral rights on a 40 acres lease controlled by the Shary Prospect owners. Chesapeake's deep well encountered gas shows in a separate fault segment, which may also result in a future well proposal in which K2 will have participation rights.

K2 holds a 6.8% working interest and 5.03% net revenue interest in the Black Stone – Shary #1 well.

#### 5.) **Samano Prospect, Starr County, Texas**

In December, 2006, the company acquired an informal option to participate in the Samano Prospect, Starr County, Texas. The 9,900' well targets a Vicksburg sand package estimated to have reserve potential ranging up to 5 BCF. The Samano Prospect is a development well into the Samano and Flores Field.

The option allows for participation of up to 10% working interest and an approximate 7.3% net revenue interest.

### **Drilling Results**

#### **Black Stone – Shivers #1 Well, Hidalgo County, Texas**

The Shivers #1 well was drilled to 12,100' and encountered good gas shows. Poor reservoir sands, due to high shale content, dictated that the well be plugged and abandoned for economic reasons. K2 Energy had a 6.8% interest in the well and its budgeted share of prospect and dry hole costs was US\$165,000. No further operations are planned.

#### **Kelly 26-6 #1 Well, Escambia County, Alabama**

The Kelly 26-6 #1 test well was drilled to 14,500' targeting the Smackover dolomite formation. The proper reservoir lithology was located, but the stratigraphic trap was not sealed laterally and no producible oil accumulations were encountered. The well was plugged and abandoned. K2 Energy had a 1.2% interest in the prospect and its budgeted share of prospect and drilling costs was US\$42,000. No further operations are planned.

### **New Prospects**

The company continues to evaluate a drilling proposal and expects to participate in a number of new wells in this calendar year.

### **Expenditure**

Expenditure on exploration and administration costs during the quarter amounted to \$664,000.



Michael S. Reed  
Director