

LODESTONE EXPLORATION LIMITED
ABN 20 075 877 075

ANNUAL REPORT
FOR YEAR ENDED 30 JUNE 2006

Contents

Corporate Directory	1
The Chairman's Perspective	2
Operational Review	3
Directors' Report	8
Corporate Governance Statement	16
Directors' Declaration	20
Financial Report	
Income Statement	21
Balance Sheet	22
Statement of Changes in Equity	23
Cash Flow Statement	24
Notes to the Financial Statements	25
Independent Audit Report to the Members	45
Shareholder Information	47

LODESTONE EXPLORATION LIMITED
ABN 20 075 877 075

CORPORATE DIRECTORY

Directors	John Shaw (Chairman) Martin Ackland Greg Baynton John McCawley
Secretary	Leni Stanley
Principal registered office in Australia	Level 1, 101 Edward Street Brisbane QLD 4000 (07) 3229 6606
Share register	Link Market Services Limited Level 12, 300 Queen Street Brisbane QLD 4000 (02) 8280 7454
Auditor	Pitcher Partners Level 21, 300 Queen Street Brisbane QLD 4000 (07) 3228 4000
Solicitors	Corrs Chambers Westgarth 1 Eagle Street Brisbane QLD 4000 (07) 3228 9424
Bankers	Westpac Banking Corporation 388 Queen Eagle Street Brisbane QLD 4000
Stock exchange listing	Lodestone Exploration Limited shares are listed on the Australian Stock Exchange.
Website address	www.lodestonex.com

Operational Review

The Chairman's Perspective

Lodestone's recent rights issue, in which \$2.1 million net of costs was raised, enables the company to get its teeth into the newly optioned Karinya Zinc-Lead-Silver Project in South Australia, start work on the optioned Bocoolima Gold Project near Gladstone, and complete the fifth phase of its airborne geophysical survey in Central Queensland's Mount Morgan district.

Karinya is well located in terms of infrastructure, and its geological setting has similarities with those of iconic shale-hosted discoveries in Canada (Sullivan), Alaska (Red Dog), and Australia (Mount Isa).

Buoyant zinc, lead, and silver prices add to the appeal of the style of mineralisation known at Karinya, and offer good incentives to explore.

The Bocoolima Project's Ridgeland prospect, where rock-chip sampling has returned strongly anomalous copper and gold values over narrow widths, will soon be drilled to determine the tenor and extent of mineralisation.

Near Mount Morgan, in Queensland, an innovative and powerful helicopter-borne electromagnetic system will be deployed for the first time in the district, to explore for orebodies that could occur under sandstone and volcanic cover rocks.

Karinya, Bocoolima, and the Mount Morgan district program will be the main focus of Lodestone's exploration in the next three months, and into the new year.

May I thank shareholders for their interest in and support of Lodestone, especially those who have been with us for some time, and welcome shareholders who have joined Lodestone during the past twelve months.

A handwritten signature in black ink, appearing to read "J T Shaw". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

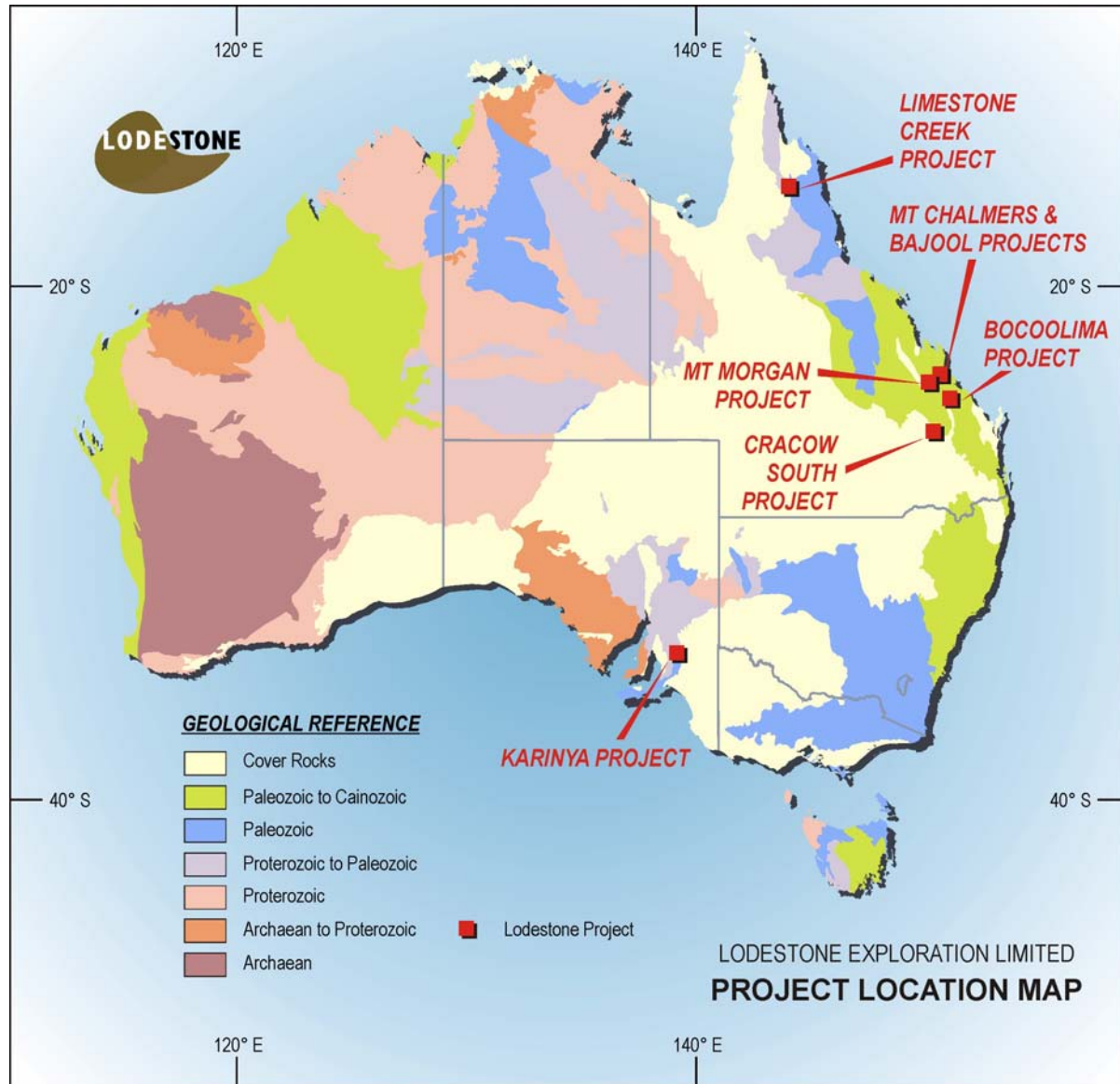
John T Shaw
Chairman

Operational Review

Introduction and Overview

Lodestone Exploration (LOD) is an Australian listed junior explorer, with tenements covering 500 square kilometers within richly endowed historic goldfields in Central and Northern Queensland, and optioned base and precious metals projects near Gladstone, Rockhampton and Adelaide.

Project Location Map



The company was established in 1996 and listed on the ASX in March 2003 to search for blind ore bodies in a prospective gold-copper region south of Mount Morgan in Central Queensland. Lodestone has deployed modern airborne electromagnetic survey equipment, high resolution aeromagnetic systems and advanced ground gravity tools in the Mount Morgan district's most extensive and comprehensive exploration program since the early nineteen eighties.

Assessment of additional opportunities within Central Queensland goldfields led the company to acquire tenements south of Cracow in 2004, and to option ground east of Mount Chalmers. Both townships were founded on historic gold fields.

Lodestone's fourth and long standing area of interest is Limestone Creek, some 20 kms west of the historic Maytown gold field in North Queensland. The Limestone Creek tenement was granted in June 2005, after a seven year application process.

A decision to diversify targeting led Lodestone to farm into the Bocoilima gold-copper project near Gladstone in Central Queensland and the Karinya zinc-lead-silver project near Eudunda, South Australia in 2006.

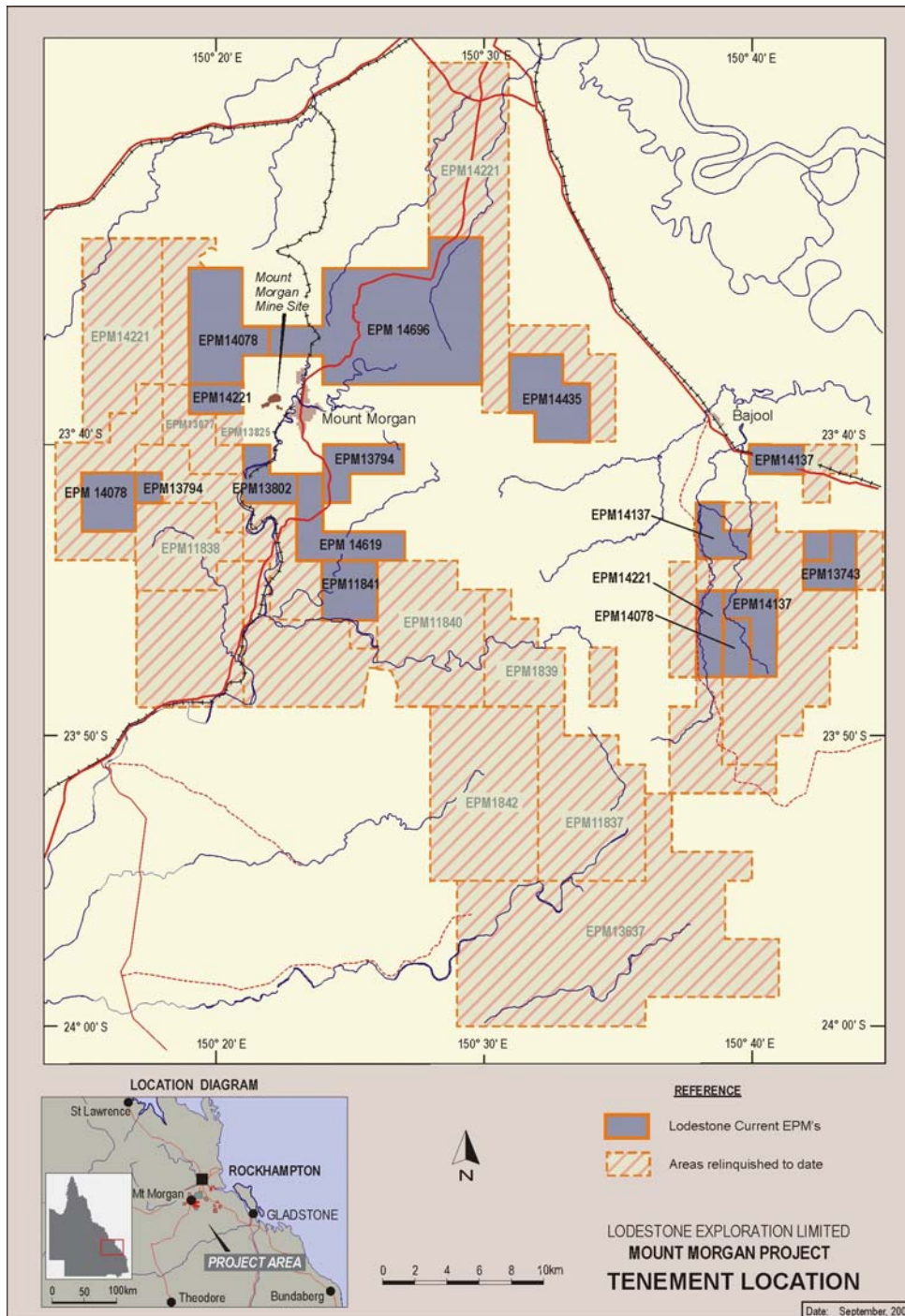
Mount Morgan District Project

The Mount Morgan ore deposit was Australia's premier volcanic-hosted massive sulphide deposit. The former mine yielded 9.4 million ounces of gold, and 360,000 tonnes of copper from operations spanning almost a century. In other countries, satellite deposits have been discovered around similar ore bodies.

Lodestone's extensive geophysical programs, detailed geological mapping and select geochemical surveys, plus other rigorous studies since 2003 have led to the recent and partly current focus on seven target areas within five kilometers of the historic mine site. These include Midas, Morganite, Jasper and Mount Victoria.

Lodestone drilled Mount Victoria and Jasper in 2004 and 2005. Results fell short of expectations, and Lodestone withdrew from these two optioned prospects in 2006.

Figure 2. Mount Morgan Project



Attention has now turned to the Midas and Morganite prospects, 3 kilometers northwest of the former Mount Morgan minesite, where historic copper-gold workings and favourable geological and geophysical features offer encouragement.

Access tracks, seldom used since 1990, are being rehabilitated by Lodestone now, to facilitate fieldwork in very rugged terrain.

Midas, Morganite, and several other Mount Morgan district prospects, will be surveyed with VTEM; a powerful heli-borne electromagnetic system, in October or November 2006.

The Station, Twelve Mile, and Eight Mile prospects; that form Lodestone's Bajool Project centred 25 kilometers east of Mount Morgan will be subjected to reconnaissance drilling this year.

Mount Chalmers Farm-In Project

The Mount Chalmers project in Central Queensland is a farm-in arrangement with Quadrio, a subsidiary of Dominion Mining, under which Lodestone has earned a 50% interest by completing 1,200m of drilling in 2005.

Lodestone encountered a substantial pyritic system while drilling at Tungamull, 2.5 kilometers from the former Mount Chalmers minesite.

Although visually impressive, drill core returned commercially insignificant assays.

Any additional exploration within the project area is likely to be north of the historic minesite.

Cracow South Project

Target definition continues and talks aimed at advancing shallow targets have been held with several explorers.

Some 300 square kilometers have been relinquished and 45 square kilometers granted, to form a coherent land package of 180 square kilometers over part of the belt of Camboon Andesite, that hosts and extends south from the Cracow gold mine.

Limestone Creek Project

The Limestone Creek tenement, located 20km west of the historic Maytown goldfield in North Queensland, was granted in June 2005.

The area covered by Lodestone's tenement has had no on-ground exploration since the late 1980s and includes surface gold grades of up to 7g/t in previous rockchip samples and coarse gold in adjacent stream sediments.

It was planned to commence fieldwork in September 2005, but access has been delayed by the Tungamull drilling program that took up most of the December quarter, heavy seasonal rains followed by cyclone Larry, and recent bushfires. After this chain of delays, work will begin as soon as possible.

Bocoolima Farm-In Project

Lodestone has signed a farm-in agreement with Copper Strike Limited to allow Lodestone to explore and earn an interest in Copper Strike's wholly-owned Bocoolima Gold Project (EPM 14963) located 50 km south-west of Gladstone, Queensland.

Under the terms of the agreement, Lodestone must drill a minimum of 500 meters during the initial exploration program that Lodestone began in August. A number of holes will be drilled to test continuity of grade along strike and down-dip of surface samples that show narrow high grade gold mineralisation at the Springlands prospect.

Karinya Farm-In Project

Lodestone has signed a farm-in agreement with Sedex to allow Lodestone to explore and earn a majority interest in the Karinya Zinc-silver Project (EL3420) in the resurgent base and precious metals region of Kanmantoo in South Australia. Karinya is in an area with well-developed infrastructure.

The Karinya Project contains abundant pyritic black shales, stratigraphic gossans with anomalous geochemistry, complex structures, and other features indicative of a classical shale hosted lead-zinc environment similar to that of the major zinc-lead deposits of Mount Isa, Sullivan (Canada) and Red Dog (Alaska).

A detailed geophysical program, followed by drilling, is planned.

UPCOMING SHORT-TERM MILESTONES

Lodestone's priorities for the next three months are to:

- Drill the Springlands copper-gold project southwest of Gladstone in October.
- Fly the Morganite, Midas and several other Mount Morgan district prospects with the VTEM heli-borne geophysical system in November.
- Drill the Karinya zinc-silver project northeast of Adelaide in December.
- Advance the Cracow South, Bajool and Limestone Creek gold prospects.

SUMMARY

Lodestone has drilled the Jasper, Mount Victoria and Tungamull Prospects since July 2005.

The Company has also farmed into the Bocoilima and Karinya projects, and plans to drill them within the next three months.

November should also see the powerful VTEM electromagnetic system deployed in the Mount Morgan district, to further Lodestone's search for concealed Mount Morgan satellite deposits.

These and other activities will be funded by proceeds of the July rights issue, that raised \$2.1 million net for Lodestone.

Tenement Schedule

Tenement	EPM Number	Area (sub-blocks) ³
MOUNT MORGAN ALLIANCE TENEMENTS ¹		
Walmul	11841	4
Mount Battery	13794	5
Mount Battery East	13802	3
MOUNT MORGAN TENEMENTS ²		
Mount Battery North	14078	16
Morganite East	14696	28
New Chum	14619	6
BAJOOL TENEMENTS ²		
Mount Kelly	14221	5
Station	14435	7
Alphadale	14137	10
Queenslander	13743	3
NORTH QUEENSLAND TENEMENTS ²		
Limestone Creek	11980	18
CRACOW SOUTH TENEMENTS ²		
Dawsonvale	14495	46
Shearing Creek	14936	15

Notes:

- 1 "Alliance Tenements" are included in the BHP Billiton Alliance.
- 2 Lodestone Exploration Limited has a 100% interest in these tenements.
- 3 Each sub-block approximates 3 sq. kms.

DIRECTORS' REPORT

Your directors present their report on the company for the year ended 30 June 2006.

Directors

The following persons were directors of Lodestone Exploration Limited during the whole of the financial year and up to the date of this report:

J T Shaw - Chairman
M Ackland
G A J Baynton
J L McCawley – Executive Director

Principal Activities

During the year the principal continuing activity of the company was mineral exploration. No changes are expected in the principal activity of the company in future years.

Review of Operations

The operating loss after income tax of the company for the year was \$1,491,790 (2005: loss \$910,476). The loss reflects the nature of the company's principal activity. Information on the operations of Lodestone Exploration Limited and its business strategies and prospects is set out in the review of operations and activities on pages 3 to 7 of this annual report.

Significant Changes in the State of Affairs

Significant changes in the state of affairs of the company during the financial year were as follows:

	2006 \$
An increase in contributed equity of \$707,180 (from \$3,216,409 to \$3,923,589) as a result of:	
Issue of 6,587,693 fully paid ordinary shares @ \$0.065 each under the share purchase plan	428,200
Issue of 4,864,618 fully paid ordinary shares @ \$0.065 each to sophisticated investors	316,200

	744,400
Less: Transaction costs arising on share issues, net of current income tax	(37,220)

Net increase in share capital	707,180 =====

Dividend

The directors do not recommend the payment of a dividend. No dividend was paid during the year.

Matters Subsequent to the End of the Financial Year

Other than as disclosed in note 19 in the financial report, at the date of this report there are no matters or circumstances which have arisen since 30 June 2006 that have significantly affected, or may significantly affect:

- (a) the company's operations in future financial years, or
- (b) the results of those operations in future financial years, or
- (c) the company's state of affairs in future financial years.

Likely Developments and Expected Results from Operations

There are no likely developments in the operations of the company that are expected to significantly affect the results of the company in future years.

Environmental Regulation

The company is subject to significant environmental regulation in respect of its exploration activities in Australia and is committed to undertaking all its operations in an environmentally responsible manner.

Information on Directors

J T Shaw B.Sc (Geological Engineering) FAusIMM, FAICD, MCIM, SME. *Chairman – non-executive.* Age 66.

Experience and expertise

Independent non-executive Chairman for 4 years. More than 40 years experience in gold, copper, silver and tungsten in exploration, development and operations.

Other current directorships

Non-executive Chairman of TriOrigin Minerals Limited (director since 2003).

Non-executive director of IAMGOLD Corp (director since March 2006).

Former directorships in last 3 years

Non-executive Chairman of Gallery Gold Limited from 2003 to 2006.

Non-executive director of Kingsgate Consolidated Limited from 2000 to 2005.

Non-executive director of Aurion Gold Limited from 2001 to 2003.

Special responsibilities

Chairman of the Board.

Member of the audit committee (appointed 25 September 2006)

Interests in shares and options

422,821 ordinary shares in Lodestone Exploration Limited.

517,949 options over ordinary shares in Lodestone Exploration Limited.

J L McCawley B.Com (Hons). *Executive Director.* Age 63.

Experience and expertise

Non-executive director for 8 years and executive director for 3 years.

Other current directorships

None.

Former directorships in last 3 years

Non-executive director of AtCor Medical Limited from 2001 to 2004.

Special responsibilities

Executive Director.

Interests in shares and options

5,212,532 ordinary shares in Lodestone Exploration Limited.

25,000 options over ordinary shares in Lodestone Exploration Limited.

M C Ackland B.App.Sc. (PrimMet), M.AusIMM, FAICD, MAIME. *Non-executive director.* Age 60.

Experience and expertise

Non-executive director for 4 years.

Other current directorships

Executive director of Mineral Deposits Limited (director since 2003).

Former directorships in last 3 years

Non-executive director of Sedimentary Holdings Limited from 1993 to 2006.

Non-executive director of Ausenco Limited from 1995 to 2003.

Special responsibilities

Chairman of the audit committee.

Interests in shares and options

266,988 ordinary shares in Lodestone Exploration Limited.

267,949 options over ordinary shares in Lodestone Exploration Limited.

G A J Baynton M.Econ St, MBA, B.Bus (Accounting), ASIA, FAICD. *Non-executive director.* Age 37.

Experience and expertise

Non-executive director for 5 years.

Other current directorships

Non-executive director of two other public companies: PIPE Networks Limited (director since 2004), Tissue Therapies Limited (director since 2003). Executive Director of Orbit Capital Pty Limited.

Former directorships in last 3 years

None.

Special responsibilities

Member of the audit committee.

Interests in shares and options

1,835,102 ordinary shares in Lodestone Exploration Limited.

200,000 options over ordinary shares in Lodestone Exploration Limited.

Meetings of Directors

The numbers of meetings of the company's board of directors and of each board committee held during the year ended 30 June 2006, and the numbers of meetings attended by each director were:

	Full Meetings of Directors	Meetings of Audit Committee
Number of meetings held	9	2
Number of meetings attended by:		
J T Shaw	9	N/A
J L McCawley	9	N/A
M C Ackland	7	2
G A J Baynton	9	2

Retirement, Election and Continuation in Office of Directors

Mr M C Ackland is the director retiring by rotation who, being eligible, offers himself for re-election.

Company Secretary

The company secretary is Ms Leni Stanley CA, B.Com. Ms Stanley was appointed to the position of company secretary in 2002. Before joining Lodestone Exploration Limited she held a similar position with another company. She currently is a partner with a Chartered Accounting firm.

Remuneration Report

The remuneration report is set out under the following main headings:

- A Principles used to determine the nature and amount of remuneration
- B Details of remuneration

A Principles used to determine the nature and amount of remuneration

Non-executive directors

Fees and payments to non-executive directors reflect the demands which are made on, and the responsibilities of, the directors. Non-executive directors' fees and payments are reviewed annually by the Board.

Directors' fees

Non-executive directors' fees are determined within an aggregate directors' fee pool limit, which is periodically recommended for approval by shareholders. The maximum currently stands at \$160,000 in aggregate plus statutory superannuation.

Executive pay

The combination of base pay and superannuation make up the executive director's total remuneration. Base pay for the executive director is reviewed annually to ensure the executive's pay is competitive with the market.

B Details of remuneration

Amounts of remuneration

Details of the remuneration of the directors and the key management personnel (as defined in AASB 124 *Related Party Disclosures*) of Lodestone Exploration Limited are set out in the following tables.

The key management personnel of Lodestone Exploration Limited includes the directors as per pages 9 – 10 above and Leni Stanley – Company Secretary.

Key management personnel of Lodestone Exploration Limited

2006	Short-term benefits	Post- employment benefits	Share-based payment	
Name	Cash salary and fees \$	Superannuation \$	Options \$	Total \$
<i>Non-executive directors</i>				
J T Shaw, <i>Chairman</i>	40,000	3,600	-	43,600
M C Ackland	30,000	2,700	-	32,700
G A J Baynton	30,000	2,700	-	32,700
Sub-total non-executive directors	100,000	9,000	-	109,000
<i>Executive director</i>				
J L McCawley	75,000	6,750	-	81,750
<i>Other key management personnel</i>				
L P Stanley	15,000	-	-	15,000
Totals	190,000	15,750	-	205,750

2005

	Short-term benefits	Post-employment benefits	Share-based payment	
Name	Cash salary and fees \$	Superannuation \$	Options \$	Total \$
<i>Non-executive directors</i>				
J T Shaw, <i>Chairman</i>	40,000	3,600	-	43,600
M C Ackland	30,000	2,700	-	32,700
G A J Baynton	30,000	2,700	-	32,700
Sub-total non-executive directors	100,000	9,000	-	109,000
<i>Executive director</i>				
J L McCawley	68,750	6,188	-	74,938
<i>Other key management personnel</i>				
L P Stanley	15,000	-	-	15,000
Totals	183,750	15,188	-	198,938

L P Stanley provides accounting services in addition to her appointment as company secretary. The company secretarial and accounting services are provided through a partnership of which she is a member based on normal commercial terms and conditions.

Share Options granted to Directors and the most highly remunerated officers

No options over unissued ordinary shares of Lodestone Exploration Limited have been granted during or since the end of the financial year to any of the directors or officers of the company as part of their remuneration.

Shares under Option

Unissued ordinary shares of Lodestone Exploration Limited under option at the date of this report are as follows:

Date options granted	Expiry date	Issue price of shares	Number under option
1 October 2002	30 September 2007	\$0.30	800,000
27 January 2006	27 January 2011	\$0.20	501,000
18 May 2006	18 May 2007	\$0.05	2,000,000

No option holder has any right under the options to participate in any other share issue of the company or of any other entity.

Shares Issued on the Exercise of Options

No ordinary shares of Lodestone Exploration Limited were issued during the year ended 30 June 2006 on the exercise of options granted. No shares have been issued on the exercise of options since that date.

Insurance of Officers

The company has not, during or since the financial year, in respect of any person who is or has been an officer or auditor of the company or a related body corporate paid or agreed to pay a premium in respect of a contract insuring against a liability incurred as an officer for the costs or expenses to defend legal proceedings.

Agreement to Indemnify Officers

Lodestone Exploration Limited is party to an agreement to indemnify the directors of the company.

The indemnity relates to any liability:

- (a) incurred in connection with or as a consequence of the directors acting in the capacity including, without limiting the foregoing, representing the company on any body corporate, and
- (b) for legal costs incurred in defending an action in connection with or as a consequence of the director acting in the capacity.

No liability has arisen under these indemnities as at the date of this report.

Proceedings on Behalf of Company

No person has applied to the Court under section 237 of the Corporations Act 2001 for leave to bring proceedings on behalf of the company, or to intervene in any proceedings to which the company is a party, for the purpose of taking responsibility on behalf of the company for all or part of those proceedings.

No proceedings have been brought or intervened in on behalf of the company with leave of the Court under section 237 of the Corporations Act 2001.

Non-audit services

The company may decide to employ the auditor on assignments additional to their statutory audit duties where the auditor's expertise and experience with the company are important.

Details of amounts paid or payable to the auditor (Pitcher Partners) for audit and non-audit services provided during the year are set out below.

The board of directors has considered the position and, in accordance with the advice received from the audit committee is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The directors are satisfied that the provision of non-audit services by the auditor, as set out below, did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the audit committee to ensure they do not impact the impartiality and objectivity of the auditor
- none of the services undermine the general principles relating to auditor independence as set out in Professional Statement F1, including reviewing or auditing the auditor's own work, acting in a management or a decision-making capacity for the company, acting as advocate for the company or jointly sharing economic risk and rewards.

A copy of the auditors' independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 15.

2006	2005
\$	\$

During the year the following fees were paid or payable for services provided by the auditor of the company:

Assurance services

1. Audit services

Fees paid to Pitcher Partners for audit and review of financial reports and other audit work under the Corporations Act 2001

20,500	17,000
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Total remuneration for assurance services

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20,500	17,000
=====	=====

Taxation services

Fees paid to Pitcher Partners for tax compliance services, including preparation of company income tax returns

3,650	3,000
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=====	=====
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Auditor

Pitcher Partners, Accountants Auditors & Advisors, continues in office in accordance with section 327 of the Corporations Act 2001.

This report is made in accordance with a resolution of the directors.

A handwritten signature in black ink, appearing to read "J T Shaw". The signature is written in a cursive style with a large, sweeping initial "J".

J T Shaw
Chairman

27 September 2006



PITCHER PARTNERS

ACCOUNTANTS AUDITORS & ADVISORS

Level 21
300 Queen Street
Brisbane
Queensland 4000

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**AUDITOR'S INDEPENDENCE DECLARATION
TO THE DIRECTORS OF LODESTONE EXPLORATION LIMITED**

As lead auditor for the audit of Lodestone Exploration Limited for the year ended 30 June 2006, I declare that, to the best of my knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Lodestone Exploration Limited.

PITCHER PARTNERS

S A Green
Partner

Brisbane, 27 September 2006

CORPORATE GOVERNANCE STATEMENT

Lodestone Exploration Limited (Lodestone) and the Board of Directors (“the Board”) are committed to achieving and demonstrating the highest standards of corporate governance.

A description of the company’s main corporate governance practices is set out below. All these practices, unless otherwise stated, were in place for the entire year.

A full set of Lodestone’s corporate governance policies and charters is available on the company’s website at www.lodestonex.com under the area of “Corporate Governance”.

Board Responsibilities

The Board is responsible to shareholders for the governance of Lodestone, its operations and its financial performance. The Board has adopted a Board and Governance Charter which set out, among other things, the roles and responsibilities of the Board. These include:

- Review, advance and approve Lodestone’s:
 - objectives and strategies,
 - exploration and development programs, and
 - capital management.
- Monitor Lodestone’s business, financial performance, and corporate governance including risk management, audit processes and compliance with laws, policies and procedures.
- Oversee the financial position of Lodestone.
- Report to shareholders.
- Ensure effective control systems are in place.
- Appoint and appraise the Executive Director.
- Oversee the senior management team in terms of performance evaluation, succession planning and remuneration.
- Establish and maintain a culture of high ethical, environmental, health and safety standards.
- Ensure the Board is effective.

Board Structure

The structure of Lodestone’s Board is consistent with Principle 2.1, 2.2 and 2.3 of the best practice recommendations released by the Australian Stock Exchange Corporate Governance Council in March 2003 (“the Recommendations”). It has a majority of Non-Executive Directors being comprised of three Non-Executive Directors and one Executive Director and it does have a majority of independent Directors in accordance with the definition of ‘independence’ as set out in the Recommendations. Mr J McCawley does not satisfy the definition of ‘independence’ due to his position of Executive Director and also due to his substantial shareholding in the company.

The skills, experience, qualifications and special responsibilities of each Director are set out in “Information on Directors” detailed earlier in this Annual Report. The term of each Director is limited to three years, and each year one-third of the Board retire pursuant to the Constitution and may offer themselves for re-election by shareholders at the Annual General Meeting. Each Director is expected to declare any actual or potential conflict of interest, and where necessary, a Director may obtain independent advice prior to notifying the Chairman of any such conflict.

Consistent with the recognition in Principle 2.4 of the Recommendations that a Nomination Committee may not be efficient for smaller boards, Lodestone’s nomination matters are considered by the Board as a whole, as set out in the Charter. The Board, as a whole, aims to ensure that it always has an appropriate depth and diversity of qualifications, experience and expertise consistent with Lodestone’s objectives.

Performance Review

In accordance with the Board & Governance Charter, the Chairman will conduct a performance review of the Board focusing on its overall effectiveness and competencies, and the availability and contribution of each Director in a manner consistent with Principle 8.1 of the Recommendations.

The Board as a whole is responsible for appraising the Executive Director in a manner consistent with Principle 8.1 of the Recommendations.

Audit Committee

The Audit Committee, which operates under a Charter approved by the Board, provides advice and assistance to the Board in fulfilling the Board's responsibilities relating to Lodestone's financial statements, financial and market reporting processes, internal accounting and financial control systems, external audit, risk management and such other matters as the Board may request from time to time.

The Audit Committee processes are consistent with Principles 4.2 through 4.4 of the Recommendations except that the Committee has only two members. The Directors consider this appropriate given the size of the Board.

The Committee is composed of all Non-Executive Directors of the Board, a majority of Independent Directors and is chaired by an Independent Director who is not the Chairman of the Company, Mr M Ackland. The Audit Committee consists of members who have sufficient industry, business and financial expertise to be effective members of the Committee. During the year the members of the Audit Committee were Mr M Ackland and Mr G Baynton.

Effective 25 September 2006 John Shaw was appointed to the audit committee.

The specific responsibilities of the Committee include:

- Overseeing the adequacy and effectiveness of the company's accounting and financial policies and controls including compliance with all regulatory requirements;
- Overseeing the company's financial reporting process, specifically, its annual and interim financial statements;
- Reviewing the scope and plans for external audit, and all reports issued by the external auditor;
- Reviewing performance, approving remuneration, and, as needed, recommending to the Board the appointment of the external auditor;
- Reviewing any proposed activity or service by the providers of external audit unrelated to external audit assurance activities;
- Examining the adequacy of the nature, extent and effectiveness of the internal control process of the company; and
- Overseeing the risk management framework of the company and reviewing risk management reports.

The complete Audit Committee Charter is available on the company's website.

Remuneration Policy

Fees and payments to Non-Executive Directors reflect the demands that are made on, and the responsibilities of, the Directors. Non-Executive Directors' fees and payments are reviewed annually by the Board.

Non-Executive Directors' fees are determined within an aggregate Directors' fee pool limit, which is periodically recommended for approval by shareholders. The maximum currently stands at \$160,000 in aggregate plus statutory superannuation.

The combination of base pay and superannuation make up the Executive Director's total remuneration. Base pay for the Executive Director is reviewed annually to ensure the pay is competitive with the market.

Further information on remuneration matters is included in Note 16 of the Financial Statements.

The structure and disclosure of the company's remuneration arrangements is consistent with Principles 9.1, 9.3 and 9.4 of the Recommendations. Currently the company has no equity based remuneration plans.

Remuneration Committee

Consistent with the recognition in Principle 9.2 of the Recommendations that a Remuneration Committee might not be efficient for smaller boards, Lodestone's remuneration matters are considered by the Board as a whole, as set out in the Charter. The Board, as a whole, aims to ensure that it always has an appropriate depth and diversity of qualifications, experience and expertise consistent with Lodestone's objectives.

Executive Assurance

The Executive Director and Company Secretary have provided the following assurance to the Lodestone Board in connection with Lodestone's full year financial statements and reports, to the best of their knowledge and belief:

- The financial statements and associated notes give a true and fair view, in all material respects, of the financial position as at 30 June 2006 and the performance of the company for the year then ended and comply in all material respects with Accounting Standards;
- The statements made above regarding the integrity of the financial statements is founded on a system of risk management and internal compliance and control which, in all material respects, implements the policies adopted by the Board of Directors; and
- The risk management and internal compliance and control systems of the company relating to financial reporting, compliance and operations objectives are operating efficiently and effectively, in all material respects.

The executive assurance is consistent with Principles 4.1 and 7.2 of the Recommendations.

Code of Conduct

The company seeks to maintain high standards of integrity and is committed to ensuring that Lodestone conducts all its business in accordance with high standards of ethical behaviour.

The company requires all employees, consultants and contractors to comply with the spirit and the letter of all laws and other statutory requirements governing the conduct of Lodestone's activities. The Code of Conduct applies to all employees, consultants and contractors including the company's Executives and Directors.

The Company has developed a Securities Trading Policy which provides guidance to Directors, employees, consultants and contractors on the purchase and sale of securities of Lodestone in order to ensure:

- that breaches of the Australian Corporations Act 2001 do not occur; and
- dealings by Directors, employees, consultants and contractors in Lodestone's securities are fair, and are seen to be fair.

Summaries of the Code of Conduct and the Securities Trading Policy are available on the company's website.

The company's actions, outlined above, to promote ethical and responsible decision making are consistent with principles 3.1, 3.2 and 10.1 of the Recommendations.

Risk Management

Lodestone views risk recognition and risk management as integral to the company's objectives of creating and maintaining shareholder value, and the successful execution of Lodestone's strategies.

The Board as a whole is responsible for the oversight of the processes by which risk is considered for both ongoing operations and prospective actions. In specific areas, it is assisted by the Audit Committee.

Management is responsible for establishing procedures which provide assurance that major business risks are identified, consistently assessed and appropriately addressed. The management of operational risk is explicitly considered in the selection and monitoring of the contractors through whom most of Lodestone's operations are conducted.

The formal processes for identification and addressing all key risks is ongoing and is reviewed on an ongoing basis.

Not all aspects of risk management can be formalised, and Lodestone places considerable reliance on the skill, experience and judgement of its people to take risk based decisions within the policy framework, and to communicate openly on all risk related matters.

The company's risk management procedures are consistent with Principle 7.1 of the Recommendations and the Risk Management Policy of Lodestone is available on the company's website.

Disclosure Policy

Lodestone's Continuous Disclosure Policy sets out the company's commitment to comply with its continuous disclosure obligations. Directors and consultants to Lodestone are required to adhere to procedures set out in the Policy to ensure compliance with the legal requirements for disclosure. Underpinning the Continuous Disclosure Policy is the disclosure protocol which governs Lodestone's policy in relation to interactions with external individuals, investors, stockbroking analysts and market participants.

When Lodestone makes an announcement to the market, it is released through the Australian Stock Exchange (ASX) where the company's shares are quoted.

The Company Secretary, as the designated Disclosure Officer, is responsible for Lodestone's compliance with its continuous disclosure obligations and for overseeing and co-ordinating disclosures to the ASX and other interested parties.

The company's Continuous Disclosure Policy is consistent with Principle 5.1 of the Recommendations and is available on the company's website.

Investor Relations and Communications

Lodestone is committed to communicating with its investors in an effective and timely manner. The company investor relations program includes briefings and presentations to accompany annual and half yearly release of results, a website that displays all the company announcements and notices as soon as they have been released to the Australian Stock Exchange, as well as all major management and roadshow presentations which are also released to the Australian Stock Exchange and posted on the website. In addition, the company's external auditor is available at the Annual General Meeting to answer questions from shareholders about the conduct of the audit and the preparation and content of the audit report and the company's financial reports.

The Investor Relations and Communications Policy is consistent with Principles 6.1 and 6.2 of the Recommendations, and all of the specified information requirements of Principles 2.5, 3.3, 4.5, 5.2 and 9.5 are met.

DIRECTORS' DECLARATION

In the directors' opinion:

- (a) the financial statements and notes set out on pages 21 to 44 are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
 - (ii) giving a true and fair view of the company's financial position as at 30 June 2006 and of its performance, as represented by the results of its operations and its cash flows, for the financial year ended on that date; and

- (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

This declaration has been made after receiving the declarations required to be made to the directors by the chief executive officer and chief financial officer in accordance with section 295A of the *Corporations Act 2001* for the year ended 30 June 2006.

This declaration is made in accordance with a resolution by the directors.



J T Shaw
Chairman

Brisbane, 27 September 2006

**INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006**

	Notes	2006 \$	2005 \$
Revenue from operations	5	11,822	27,739
Other income		-	-
Exploration abandoned		(1,173,255)	(650,919)
Professional services expenses		(86,496)	(80,161)
Corporate overhead expenses		(91,407)	(54,936)
Depreciation expenses		(10,754)	(7,011)
Directors remuneration		(141,700)	(145,188)
		_____	_____
Loss from before income tax	6	(1,491,790)	(910,476)
Income tax expense	7	-	-
		_____	_____
Loss from operations		(1,491,790)	(910,476)
		_____	_____
Loss attributable to members of Lodestone Exploration Limited	15	(1,491,790) =====	(910,476) =====
		Cents	Cents
Earnings per share for profit attributable to the ordinary equity holders of the company			
Basic earnings per share	22	(3.46)	(2.72)
Diluted earnings per share	22	(3.46)	(2.72)

The above income statement should be read in conjunction with the accompanying notes.

**BALANCE SHEET
AS AT 30 JUNE 2006**

	Notes	2006 \$	2005 \$
ASSETS			
Current assets			
Cash and cash equivalents	8	112,109	294,431
Receivables	9	74,543	21,270
		-----	-----
Total current assets		186,652	315,701
		-----	-----
Non-current assets			
Plant and equipment	10	43,446	25,026
Exploration expenditure	11	475,803	1,030,814
Other	12	50,180	48,180
		-----	-----
Total non-current assets		569,429	1,104,020
		-----	-----
Total assets		756,081	1,419,721
		=====	=====
LIABILITIES			
Current liabilities			
Trade and other payables	13	103,962	43,055
		-----	-----
Total current liabilities		103,962	43,055
		-----	-----
Total liabilities		103,962	43,055
		=====	=====
Net assets		652,119	1,376,666
		=====	=====
EQUITY			
Contributed equity	14	3,923,589	3,216,409
Reserves	15	60,063	-
Accumulated losses	15	(3,331,533)	(1,839,743)
		-----	-----
Total equity		652,119	1,376,666
		=====	=====

The above balance sheet should be read in conjunction with the accompanying notes.

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2006**

	2006	2005
	\$	\$
Total equity at the beginning of the financial year	1,376,666	1,896,892
Contractor share options	60,063	-
Loss for the year	(1,491,790)	(910,476)
Transactions with equity holders in their capacity as equity holders:		
Contributions of equity, net of transaction costs (note 14)	707,180	390,250
	<u> </u>	<u> </u>
Total equity at the end of the financial year	<u>652,119</u> =====	<u>1,376,666</u> =====

The above statement of changes in equity should be read in conjunction with the accompanying notes.

**CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006**

	Notes	2006 \$	2005 \$
Cash flows from operating activities			
Receipts from customers (inclusive of goods and services tax)		72,255	74,822
Payments to suppliers (inclusive of goods and services tax)		(374,205)	(349,532)
Interest received		12,572	29,897
Net cash outflows from operating activities	20	<u>(289,378)</u>	<u>(244,813)</u>
Cash flows from investing activities			
Payments for exploration		(568,950)	(725,252)
Payments for property, plant and equipment		(29,174)	-
Payment for security deposit		(2,000)	(19,920)
Net cash outflows from investing activities		<u>(600,124)</u>	<u>(745,172)</u>
Cash flows from financing activities			
Proceeds from share issue		744,400	410,250
Payment of share issue costs		(37,220)	(20,000)
Net cash inflows from financing activities		<u>707,180</u>	<u>390,250</u>
Net increase/(decrease) in cash and cash equivalents		(182,322)	(599,735)
Cash and cash equivalents at the beginning of the financial year		294,431	894,166
Cash and cash equivalents at the end of the financial year		<u>112,109</u> =====	<u>294,431</u> =====

The above cash flow statement should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

Note 1 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS's), other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations and the *Corporations Act 2001*.

Compliance with IFRSs

Australian Accounting Standards include Australian equivalents to International Financial Reporting Standards. Compliance with AIFRSs ensures that the financial statements and notes of Lodestone Exploration Limited comply with International Financial Reporting Standards (IFRSs).

Application of AASB 1 First-time Adoption of Australian Equivalents to International Financial Reporting Standards
These financial statements are the first Lodestone Exploration Limited financial statements to be prepared in accordance with AIFRSs. AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* has been applied in preparing these financial statements.

Financial statements of Lodestone Exploration Limited until 30 June 2005 had been prepared in accordance with previous Australian Generally Accepted Accounting Principles (AGAAP). AGAAP differs in certain aspects from AIFRS. When preparing Lodestone Exploration Limited 2006 financial statements, management has amended certain accounting methods applied in the AGAAP financial statements to comply with AIFRS. With the exception of financial instruments, the comparative figures in respect of 2005 were restated to reflect these adjustments. The company has taken the exemption available under AASB 1 to only apply AASB 132 and AASB 139 from 1 July 2005.

Reconciliations and descriptions of the effect of transition from previous AGAAP to AIFRSs on the Group's equity and its net income are given in note 24.

Early adoption of standard

The company has elected to apply AASB 119 *Employee Benefits* (issued in December 2004) to the annual reporting period beginning 1 July 2005. This includes applying AASB 119 to the comparatives in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities (including derivative instruments) at fair value through profit or loss, certain classes of property, plant and equipment and investment property.

Critical accounting estimates

The preparation of financial statements in conformity with AIFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

(b) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment and is subject to risks and returns that are different from those of segments operating in other economic environments.

(c) Taxes

Current income tax expense or revenue is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted by changes in deferred tax assets and liabilities.

A balance sheet approach is adopted under which deferred tax assets and liabilities are recognised for temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred tax asset or liability is recognised in relation to temporary differences arising from the initial recognition of an asset or a liability if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Deferred tax assets are recognised for temporary differences and unused tax losses only when it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

(d) Exploration expenditure

Exploration expenditure incurred by or on behalf of the entity is accumulated separately for each area of interest until such time as the area moves into development phase, or is abandoned or sold. The realisation of the value of expenditure carried forward depends upon any commercial results that may be obtained through successful development and exploitation of the area of interest or alternatively by its sale. If an area of interest is abandoned or is considered to be of no further commercial interest the accumulated exploration costs relating to the area are written off against income in the year of abandonment.

(e) Acquisitions of assets

The purchase method of accounting is used for all acquisitions of assets. Cost is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus incidental costs directly attributable to the acquisition.

(f) Recoverable amount of non-current assets

The recoverable amount of an asset is the net amount expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal.

Where the carrying amount of a non-current asset is greater than its recoverable amount, the asset is written down to its recoverable amount. The decrement in the carrying amount is recognised as an expense in the net profit or loss in the reporting period in which the recoverable amount write-down occurs.

(g) Depreciation of property, plant and equipment

Depreciation is calculated on a straight line basis to write off the net cost or revalued amount of each item of property, plant and equipment over its expected useful life to the entity. Estimates of remaining useful lives are made on a regular basis for all assets, with annual reassessments for major items. The expected useful lives are as follows:

Plant and equipment	5 – 10 years
---------------------	--------------

Note 1 Summary of significant accounting policies (continued)

(h) Trade and other creditors

These amounts represent liabilities for goods and services provided to the entity prior to the end of the financial year and which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

(i) Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts.

(j) Contributed equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options, or for the acquisition of a business, are included in the cost of the acquisition as part of the purchase consideration.

(k) Earnings per share

(i) Basic earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

(ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

(l) Website costs

Costs in relation to web sites are charged as expenses in the period in which they are incurred. Costs in relation to the development of a web site, and ongoing costs of maintenance during the operating phase are considered to be expenses.

Note 1 Summary of significant accounting policies (continued)

(m) New accounting standards and UIG interpretations

Certain new accounting standards and UIG interpretations have been published that are not mandatory for 30 June 2006 reporting periods. The Company's assessment of the impact of these new standards and interpretations is set out below.

Reference	Title and topic	Applicable from*	Impact on financial report
AASB 119	Employee Benefits: Accounting for actuarial gains and losses and group plans	1/1/2006	(1)
AASB 2005-1	Amendments to Australian Accounting Standard (AASB 139): Cash flow hedge accounting of forecast intra-group transactions	1/1/2006	(1)
AASB 2005-4	Amendments to Australian Accounting Standards (AASB 139, AASB 132, AASB 1. AASB 1023 and AASB 1038): Fair value option	1/1/2006	(1)
UIG 4	Determining whether an asset contains a lease	1/1/2006	(1)
UIG 5	Rights to interests arising from decommissioning restoration and rehabilitation funds	1/1/2006	(1)
AASB 2005-6	Amendments to Australian Accounting Standard (AASB 3): Business combinations involving entities under common control	1/1/2006	(1)
AASB 2005-9	Amendments to Australian Accounting Standards (AASB 4, AASB 1023, AASB 139, and AASB 132): Financial guarantee contracts	1/1/2006	(1)
AASB 7	Financial instruments: disclosures	1/1/2007	(2)
AASB 2005-10	Amendments to Australian Accounting Standards (AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 and AASB 1038): consequential amendments arising as a result of the release of AASB 7	1/1/2007	(2)
UIG 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment	1/12/2005	(1)
AASB 2006-1	Amendments to Australian Accounting Standards (AASB 121): Clarification regarding monetary items forming part of the net investment in a foreign operation	1/1/2006	(1)

* The Company expects to implement these standards from their applicable dates.

(1)Implementation is not expected to change the accounting for any of the Company's current arrangements

(2)Application of the standard will not affect any of the amounts recognised in the financial statements, but may impact the type of information disclosed in relation to the Company's financial instruments.

Note 2. Financial risk management

The Company's activities expose it to a variety of financial risks; liquidity risk and cash flow interest rate risk.

Cash flow and fair value interest rate risk

As the Company has no significant interest-bearing assets or borrowings, the Company's income and operating cash flows are not materially exposed to changes in market interest rates.

Note 3. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

Critical judgements in applying the entity's accounting policies

The Company has capitalised exploration expenditure of \$475,803. This amount includes costs directly associated with exploration. These costs are capitalised as an intangible asset until assessment and/or drilling of the permit is complete and the results have been evaluated. These costs include employee remuneration, materials, rig costs, delay rentals and payments to contractors. The expenditure is carried forward until such a time as the area moves into the development phase, is abandoned or sold.

Note 4 Segment information

The company operates solely within one business segment, being the mineral exploration industry in Australia.

	2006 \$	2005 \$
Note 5 Revenue		
<i>Other revenue</i>		
Interest	11,822 =====	27,739 =====

Note 6 Expenses

Loss before income tax includes the following specific expenses:

Exploration abandoned	1,173,255	650,919
Depreciation	10,754	7,011

	2006 \$	2005 \$
Note 7 Income tax expense		
(a) Numerical reconciliation of income tax expense to prima facie tax payable		
Loss from operations before income tax expense	(1,491,790) =====	(910,476) =====
Tax at the Australia tax rate of 30% (2005: 30%)	(447,537)	(273,143)
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Non-deductible legal fees	831 -----	- -----
	(446,706)	(273,143)
Net adjustment to deferred tax assets and liabilities for tax losses and temporary differences not recognised	446,706	273,143
Income tax expense	----- - =====	----- - =====
(b) Unrecognised net deferred tax assets		
Unused tax losses for which no deferred tax asset has been recognised	4,009,296	2,985,123
Temporary differences for which no deferred tax asset / (liability) has been recognised:		
- Property, plant and equipment	83	83
- Accruals	15,000	15,000
- Prepayments	-	5,527
- Capital raising costs	171,331	157,733
- Exploration expenditure	(475,803)	(1,030,814)
- Interest receivable	(490)	(1,240)
	----- 3,719,417 =====	----- 2,131,412 =====
Potential tax effect at 30%	1,115,825 =====	639,424 =====

Note 8 Current assets – Cash and cash equivalents

Cash at bank and in hand	3,909	19,431
Deposits at call	108,200	275,000
	----- 112,109 =====	----- 294,431 =====

(a) Cash at bank and on hand

These are non-interest bearing.

(b) Deposits at call

The deposits are bearing an interest rate of 4.75% (2005 – 4.5% to 4.75%).

	2006 \$	2005 \$
Note 9 Current assets – Receivables		
Interest receivable	490	1,240
Other debtors	74,053	20,030
	-----	-----
	74,543	21,270
	=====	=====

Note 10 Non-current assets – Plant and equipment

	Motor vehicles \$	Plant and equipment \$	Total \$
As at 1 July 2004			
- Cost	49,319	3,630	52,949
Accumulated depreciation	(20,283)	(629)	(20,912)
	<hr/>		
Net book amount	29,036	3,001	32,037
	<hr/>		
Year ended 30 June 2005			
Opening net book amount	29,036	3,001	32,037
Additions	-	-	-
Disposals	-	-	-
Depreciation charge	(6,285)	(726)	(7,011)
	<hr/>		
Closing net book amount	22,751	2,275	25,026
	<hr/>		
At 30 June 2005			
- Cost	49,319	3,630	52,949
Accumulated depreciation	(26,568)	(1,355)	(27,923)
	<hr/>		
Net book amount	22,751	2,275	25,026
	<hr/>		
	Motor vehicles \$	Plant and equipment \$	Total \$
Year ended 30 June 2006			
Opening net book amount	22,751	2,275	25,026
Additions	27,811	1,363	29,174
Disposals	-	-	-
Depreciation charge	(9,755)	(999)	(10,754)
	<hr/>		
Closing net book amount	40,807	2,639	43,446
	<hr/>		
At 30 June 2006			
- Cost	77,130	4,993	82,123
Accumulated depreciation	(36,323)	(2,354)	(38,677)
	<hr/>		
Net book amount	40,807	2,639	43,446
	<hr/>		

	2006	2005
	\$	\$

Note 11 Non-current assets - Exploration expenditure

Exploration phase property costs

Deferred geological, geophysical, drilling and other expenditure – at cost	475,803	1,030,814
	=====	=====

The capitalised exploration expenditure carried forward above has been determined as follows:

Opening balance	1,030,814	959,898
Expenditure incurred during the year	618,244	721,835
Exploration abandoned	(1,173,255)	(650,919)
	-----	-----
Closing balance as shown above	475,803	1,030,814
	=====	=====

Note 12 Non-current assets – Other

Security deposit	50,180	48,180
	=====	=====

Note 13 Current liabilities – Trade and other payables

Trade payables	103,962	43,055
	=====	=====

Note 14 Contributed equity

	2006 Shares	2005 Shares	2006 \$	2005 \$
(a) Share capital				
Ordinary shares Fully paid	46,419,715 =====	34,967,404 =====	3,923,589 =====	3,216,409 =====

(b) Movements in ordinary share capital:

Date	Details		Number of Shares	Issue Price	\$
1 July 2004	Opening balance		30,916,154		2,826,159
13 November 2004	Placement	(e)	4,000,000	\$0.10	400,000
9 December 2004	Exercise of options issued under prospectus	(d)	51,250	\$0.20	10,250
	Share issue expenses		-		(20,000)
30 June 2005	Balance		34,967,404		3,216,409
6 October 2005	Placement	(e)	6,587,693	\$0.065	428,200
27 October 2005	Placement	(e)	4,864,618	\$0.065	316,200
	Share issue expenses		-		(37,220)
	Closing balance		<u>46,419,715</u>		<u>3,923,589</u>

(c) Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of and amounts paid on the shares held.

On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

(d) Options

At balance date 3,301,000 options over ordinary shares of Lodestone Exploration Limited were on issue. 800,000 of these options were issued on 1 October 2002 with an exercise price of \$0.30 and an expiry date of 30 September 2007. 2,000,000 options were issued on 18 May 2006 with an exercise price of \$0.05 expiring on 18 May 2007. 501,000 options were issued on 27 January 2006 with an exercise price of \$0.20 expiring on 27 January 2011.

During the prior financial year 51,250 options that were issued under the Prospectus were exercised and 6,193,750 options that were issued under the Prospectus expired. These options were exercisable at \$0.20 and expired on 7 December 2004.

(e) Placement

On 6 October 2005 6,587,693 ordinary shares were issued under a share purchase plan for \$0.065 per share to raise \$428,200.

On 27 October 2005 a placement of 4,864,618 ordinary shares was made to sophisticated investors at \$0.065 per share to raise \$316,200.

On 13 November 2004 a placement of 4,000,000 ordinary shares was made to institutional and sophisticated investors at \$0.10 per share to raise \$400,000.

	2006 \$	2005 \$
Note 15 Reserves and accumulated losses		
(a) Reserves		
Share-based payments reserve	60,063 =====	-
Movements:		
Balance 1 July	-	-
Option expense	60,063 -----	-
Balance 30 June	60,063 =====	-
(b) Accumulated losses		
Balance 1 July	(1,839,743)	(929,267)
Net loss for the year	(1,491,790) -----	(910,476) -----
Balance 30 June	(3,331,533) =====	(1,839,743) =====

Note 16 Key management personnel disclosures

(a) Directors

The following persons were directors of Lodestone Exploration Limited during the financial year:

(i) *Chairman – non-executive*
J T Shaw

(ii) *Executive director*
J L McCawley

(iii) *Non-executive directors*
M C Ackland
G A J Baynton

(b) Other key management personnel

L P Stanley, as a result of her position of company secretary, is considered to be a key management person. Due to the small size of the entity there are no other specified executives. L P Stanley was also a key management person during the year ended 30 June 2005.

(c) Key management personnel compensation

	2006 \$	2005 \$
Short-term employee benefits	190,000	183,750
Post-employment benefits	15,750	15,188
	----- 205,750 =====	----- 198,938 =====

The company has taken advantage of the relief provided by ASIC Class Order 06/50 and has transferred the detailed remuneration disclosures to the directors' report. The relevant information can be found in the remuneration report on pages 11 to 12.

Note 16 Key management personnel disclosures (continued)

(d) Equity instrument disclosures relating to key management personnel

(i) Option holdings

The number of options over ordinary shares in the company held during the financial year by each director of Lodestone Exploration Limited and other key management personnel, including their personally related parties, are set out below.

2006						
Name	Balance at the start of the year	Granted during the year as compensation	Exercised during the year	Other changes during the year	Balance at the end of the year	Vested and exercisable at the end of the year
Directors of Lodestone Exploration Limited						
J T Shaw	400,000	-	-	-	400,000	400,000
M C Ackland	200,000	-	-	-	200,000	200,000
G A J Baynton	200,000	-	-	-	200,000	200,000

2005						
Name	Balance at the start of the year	Granted during the year as compensation	Exercised during the year	Other changes during the year	Balance at the end of the year	Vested and exercisable at the end of the year
Directors of Lodestone Exploration Limited						
J T Shaw	405,000	-	-	(5,000)	400,000	400,000
M C Ackland	218,750	-	-	(18,750)	200,000	200,000
G A J Baynton	427,500	-	-	(227,500)	200,000	200,000

(ii) Share holdings

The number of ordinary shares in the company held during the financial year by each director of Lodestone Exploration Limited and other key management personnel, including their personally related parties, are set out below. There were no shares granted during the year as compensation.

2006				
Name	Balance at the start of the year	Received during the year on the exercise of options	Other changes during the year	Balance at the end of the year
Directors of Lodestone Exploration Limited				
J T Shaw	110,000	-	76,923	186,923
M C Ackland	37,500	-	76,923	114,423
G A J Baynton	1,604,333	-	230,769	1,835,102
J L McCawley	5,147,147	-	15,385	5,162,532
Other key management personnel				
L P Stanley	7,000	-	23,077	30,077

2005				
Name	Balance at the start of the year	Received during the year on the exercise of options	Other changes during the year	Balance at the end of the year
Directors of Lodestone Exploration Limited				
J T Shaw	110,000	-	-	110,000
M C Ackland	37,500	-	-	37,500
G A J Baynton	1,604,333	-	-	1,604,333
J L McCawley	5,147,147	-	-	5,147,147
Other key management personnel				
L P Stanley	7,000	-	-	7,000

Note 16 Key management personnel disclosures (continued)

(f) Other transactions with key management personnel

During the year to 30 June 2006 the company paid fees for accounting and administration services provided by Stanley Yeates & Associates, a firm of Chartered Accountants, of which L P Stanley is a partner, on normal commercial terms and conditions.

G Baynton is a director of Orbit Capital Pty Limited, which received a management fee in respect of equity raised during the prior financial year, such service being provided in the ordinary course of business to the company.

Aggregate amounts of each of the above types of other transactions with directors and their director-related entities:

	2006	2005
	\$	\$
Management fee	-	7,500
Accounting and administration fee	45,000	45,000

Note 17 Remuneration of auditors

During the year the following fees were paid or payable for services provided by the auditor, its related practices and non-related audit firms:

Assurance services

1. Audit services

Fees paid to Pitcher Partners for audit and review of financial reports and other audit work under the Corporations Act 2001

20,500	17,000
--------	--------

Total remuneration for assurance services

----- 20,500 =====	----- 17,000 =====
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Taxation services

Fees paid to Pitcher Partners for tax compliance services, including review of company income tax returns

3,650 =====	3,000 =====
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It is the company's policy to employ Pitcher Partners on assignments additional to their statutory audit duties where Pitcher Partners' expertise and experience with the company are important. These assignments are mainly tax advice.

Note 18 Related parties

Directors

Disclosures relating to key management personnel are set out in note 16.

Note 19 Events occurring after reporting date

Since 30 June 2006 the company has issued 61,892,953 ordinary shares and 30,946,501 listed options under the Rights Issue announced to the ASX on 16 June 2006. 61,892,953 ordinary shares were issued for 3.8 cents each raising a total of \$2,351,932. The 30,946,501 listed options are exercisable at 5 cents each and expire on 21 July 2008.

Note 20 Reconciliation of loss from ordinary activities after income tax to net cash outflow from operating activities

	2006 \$	2005 \$
Loss from ordinary activities after income tax	(1,491,790)	(910,476)
Exploration abandoned	1,173,255	650,919
Depreciation	10,754	7,011
Change in operating assets and liabilities:		
(Increase)/decrease in other debtors	(59,024)	4,962
(Increase)/decrease in interest receivable	750	2,158
Increase/(decrease) in trade creditors	76,677	613
Net cash outflow from operating activities	<u>(289,378)</u> =====	<u>(244,813)</u> =====

Note 21 Commitments for expenditure

Operating leases

Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:

Within one year	-	-
	=====	=====

Exploration commitments

Commitments for payments under exploration permits for minerals in existence at the reporting date but not recognised as liabilities payable are as follows:

Within one year	764,000	942,200
Later than one year but not later than 5 years	1,090,000	1,456,400
Later than 5 years	-	-
Commitments not recognised in the financial statements	<u>1,854,000</u> =====	<u>2,398,600</u> =====

So as to maintain current rights to tenure of various exploration tenements, the company will be required to outlay amounts in respect of tenement exploration expenditure commitments. These outlays, which arise in relation to granted tenements are noted above. The outlays may be varied from time to time, subject to approval of the relevant government departments, and may be relieved if a tenement is relinquished.

Exploration commitments total \$1,854,000. They extend over 13 exploration tenements and are calculated on the assumption that each of these tenements will be held for its full term. But, in fact, commitments will decrease materially as exploration advances and ground that is shown to be unprospective is progressively surrendered. Expenditure commitments on prospective ground will be met out of existing funds, joint ventures, and new capital raisings.

Note 22 Earnings per share

	2006 Cents	2005 Cents
(a) Basic earnings per share		
Profit attributable to ordinary equity holders of the company	(3.46) =====	(2.72) =====
(b) Diluted earnings per share		
Profit attributable to ordinary equity holders of the company	(3.46) =====	(2.72) =====
	2006 \$	2005 \$
(c) Reconciliation of earnings used in calculating earnings per share		
<i>Basic earnings per share</i>		
Profit from operations	(1,491,790) =====	(910,476) =====
<i>Diluted earnings per share</i>		
Profit from operations	(1,491,790) =====	(910,476) =====
(d) Weighted average number of shares used as the denominator		
	2006 Number	2005 Number
<i>Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share</i>	43,058,846	33,455,798
Adjustments for calculation of diluted earnings per share:		
Options	-	-
	-----	-----
<i>Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share</i>	43,058,846 =====	33,455,798 =====

Note 23 Share-based payments

During the financial year Lodestone Exploration Limited granted 501,000 options to a contractor for no consideration. The options are granted for a five year period, and 33.33% of each new tranche vests and is exercisable after the first anniversary of the date of grant, 33.33% is exercisable after two anniversaries of the grant date and 33.33% is exercisable after three anniversaries of the grant date.

During the year 2,000,000 options were granted as part consideration for Lodestone's acquisition of up to 70% of the Karinya Silver-Zinc project.

Options granted carry no dividend or voting rights.

When exercisable, each option is convertible into one ordinary share.

The exercise price of options is based on the weighted average price at which the company's shares are traded on the Australian Stock Exchange during the five trading days immediately before the options are granted.

Set out below are summaries of options granted:

	Grant date	Expiry date	Exercise price	Balance at start of the year Number	Granted during the year Number	Exercised during the year Number	Expired during the year Number	Balance at end of the year Number	Exercisable at end of the year Number
A	27/01/2006	27/01/2011	\$0.20 to \$0.30	-	501,000	-	-	501,000	-
B	18/05/2006	18/05/2007	\$0.05	-	2,000,000	-	-	2,000,000	2,000,000

The weighted average remaining contractual life of share options outstanding at the end of the period was 1.62 years (2005 – n/a)

Fair value of options granted

The assessed fair value at grant date of options granted was independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the impact of dilution, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option.

The model inputs for options granted during the year ended 30 June 2006 included:

Issue A

- (a) options are granted for no consideration. Options vest and are exercisable 33.33% after one anniversary of the grant date, 33.33% are exercisable after two anniversaries of the grant date and 33.33% are exercisable after three anniversaries of the grant date.
- (b) exercise price \$0.20 to \$0.30
- (c) grant date: 27 January 2006
- (d) expiry date: 27 January 2011
- (e) share price at grant date: \$0.043
- (f) expected price volatility of the shares: 159%
- (g) expected dividend yield: 0%
- (h) risk-free interest rate: 5.31%

Note 23 Share-based payments (continued)

Issue B

- (a) options are granted as part consideration for Lodestones part acquisition of an interest in the Karinya Silver-Zinc project, all options vest and are exercisable immediately.
- (b) exercise price \$0.05
- (c) grant date: 18 May 2006
- (d) expiry date: 18 May 2007
- (e) share price at grant date: \$0.048
- (f) expected price volatility of the shares: 159%
- (g) expected dividend yield: 0%
- (h) risk-free interest rate: 5.73%

The expected price volatility is based on the historic volatility (based on the remaining life of the options), adjusted for any expected changes to future volatility due to publicly available information.

(b) Expenses arising from share-based payment transactions

Total expenses arising from share-based payment transactions recognised during the period as part of exploration expenditure were as follows:

	2006	2005
	\$	\$
Options issued	60,063	-

Note 24 Explanation of transition to Australian equivalents to IFRSs

(1) Reconciliation of equity reported under previous Australian Generally Accepted Accounting Principles (AGAAP) to equity under Australian equivalents to IFRSs (AIFRS)

(a) At the date of transition to AIFRS: 1 July 2004

	Previous AGAAP \$	Effect of transition to AIFRS \$	AIFRS \$
ASSETS			
Current assets			
Cash and cash equivalents	894,166	-	894,166
Receivables	27,567	-	27,567
Total current assets	921,733	-	921,733
Non-current assets			
Plant and equipment	32,037	-	32,037
Exploration expenditure	959,898	-	959,898
Other	28,260	-	28,260
Total non-current assets	1,020,195	-	1,020,195
Total assets	1,941,928	-	1,941,928
LIABILITIES			
Current liabilities			
Payables	45,036	-	45,036
Total current liabilities	45,036	-	45,036
Total liabilities	45,036	-	45,036
Net assets	1,896,892	-	1,896,892
EQUITY			
Contributed equity	2,826,159	-	2,826,159
Accumulated losses	(929,267)	-	(929,267)
Total equity	1,896,892	-	1,896,892

Note 24 Explanation of transition to Australian equivalents to IFRSs (continued)

(b) At the end of the last reporting period under previous AGAAP: 30 June 2005

	Previous AGAAP \$	Effect of transition to AIFRS \$	AIFRS \$
ASSETS			
Current assets			
Cash and cash equivalents	294,431	-	294,431
Receivables	21,270	-	21,270
Total current assets	315,701	-	315,701
Non-current assets			
Plant and equipment	25,026	-	25,026
Exploration expenditure	1,030,814	-	1,030,814
Other	48,180	-	48,180
Total non-current assets	1,104,020	-	1,104,020
Total assets	1,419,721	-	1,419,721
LIABILITIES			
Current liabilities			
Payables	43,055	-	43,055
Total current liabilities	43,055	-	43,055
Total liabilities	43,055	-	43,055
Net assets	1,376,666	-	1,376,666
EQUITY			
Contributed equity	3,216,409	-	3,216,409
Accumulated losses	(1,839,743)	-	(1,839,743)
Total equity	1,376,666	-	1,376,666

Note 24 Explanation of transition to Australian equivalents to IFRSs (continued)**(2) Reconciliation of profit under previous AGAAP to profit under Australian equivalents to IFRSs (AIFRS)**

		Previous AGAAP \$	Effect of transition to AIFRS \$	AIFRS \$
Revenue		27,739	-	27,739
Other income		-	-	-
Professional services expenses		(80,161)	-	(80,161)
Exploration abandoned		(650,919)	-	(650,919)
Corporate overhead expenses		(54,936)	-	(54,936)
Depreciation expenses		(7,011)	-	(7,011)
Directors' remuneration		(145,188)	-	(145,188)
Profit before income tax		(910,476)	-	(910,476)
Income tax expense		-	-	-
Profit for the half-year		(910,476)	-	(910,476)

(3) Reconciliation of cash flow statement for the year ended 30 June 2005

The adoption of AIFRSs has not resulted in any material adjustments to the cash flow statement.

(4) Notes to the reconciliations

As can be seen from the reconciliations above the adoption of AIFRS has not resulted in any adjustments to the Balance Sheet or Income Statement.



INDEPENDENT AUDIT REPORT TO THE MEMBERS OF LODESTONE EXPLORATION LIMITED

Scope

The financial report and directors' responsibility

The financial report comprises the income statement, balance sheet, statement of changes in equity, cash flow statement, accompanying notes to the financial statements, and the Directors' declaration for Lodestone Exploration Limited ("the company") for the year ended 30 June 2006.

The company has disclosed information about the remuneration of key management personnel ("remuneration disclosures"), as required by Accounting Standard AASB 124 Related Party Disclosures under the heading "Remuneration Report" on pages 11 to 12 of the Directors' Report, as permitted by the Corporations Regulations 2001.

The Directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

We conducted an independent audit in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's financial position, and of its performance as represented by the results of its operations and cash flows and whether the remuneration disclosures comply with Accounting Standard AASB 124 and the Corporations Regulations 2001.

**INDEPENDENT AUDIT REPORT TO THE MEMBERS OF
LODESTONE EXPLORATION LIMITED
(continued)**

Audit approach (continued)

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report and remuneration disclosures; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the Directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Audit opinion

In our opinion,

- (1) the financial report of Lodestone Exploration Limited is in accordance with:
 - (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the company's financial position as at 30 June 2006 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
 - (b) other mandatory financial reporting requirements in Australia.
- (2) the remuneration disclosures that are contained on pages 11 and 12 of the Directors' Report comply with Accounting Standard AASB 124 and the Corporations Regulations 2001.



PITCHER PARTNERS



S A Green
Partner

Brisbane, 27 September 2006

SHAREHOLDER INFORMATION

The shareholder information set out below was applicable as at 25 September 2006.

A. Distribution of equity securities

Analysis of numbers of equity security holders by size of holding:

	Class of equity security	
	Ordinary Shares	Options
1 – 1,000	14	1
1,001 – 5,000	27	8
5,001 – 10,000	155	16
10,001 – 100,000	293	84
100,001 and over	164	64
	653	173

There were 229 holders of less than a marketable parcel of ordinary shares and 59 holders of less than a marketable parcel of options.

B. Equity security holders

Twenty largest quoted equity security holders

The names of the twenty largest holders of quoted equity securities are listed below:

Name	Ordinary shares	
	Number held	Percentage of issued shares
Nefco Nominees Pty Ltd	18,498,742	16.33
John Lachlan McCawley	5,162,532	4.56
Paso Holdings Pty Ltd	2,871,362	2.53
Bernard Wessels Holtshousen	2,500,000	2.21
M F J Holdings Limited	2,500,000	2.21
TBIC Pty Limited	2,279,487	2.01
Berne No 132 Nominees Pty Ltd	2,261,537	2.00
ANZ Nominees Limited	2,225,000	1.96
Mr Raul Used	2,183,334	1.93
Goffacan Pty Ltd	1,512,000	1.33
Toltec Holdings Pty Ltd	1,502,223	1.33
Maria Julienne Barron	1,455,691	1.28
Gecko Resources Pty Ltd	1,400,000	1.24
Carlo Chiodo	1,398,582	1.23
Allegro Capital Nominees Pty Limited	1,354,846	1.20
Colbern Fiduciary Nominees Pty Ltd	1,254,875	1.11
Leslie Marta	1,200,000	1.06
Mohidien Khan	1,141,507	1.01
Bedel & Sowa Corp Pty Ltd	1,000,000	0.88
Noel Clarence White	1,000,000	0.88
	54,701,718	48.29

Name	Options	
	Number held	Percentage of issued options
Nefco Nominees Pty Ltd	9,111,871	29.44
Paso Holdings Pty Ltd	927,532	3.00
Toltec Holdings Pty Ltd	751,112	2.43
Goffacan Pty Ltd	750,000	2.42
Carlo Chiodo	699,291	2.26
Raul Used	666,667	2.15
TBIC Pty Ltd	651,282	2.10
Berne No 132 Nominees Pty Ltd	646,154	2.09
Mohidien Khan	570,754	1.84
Nonda Pty Ltd	501,282	1.62
Royal Sunset Pty Ltd	498,929	1.61
Gecko Resources Pty Ltd	400,000	1.29
Peter John Douglas	394,512	1.27
Ian Randal Thompson	385,377	1.25
Bruce Graham Barker and Wendy Ann Barker	370,990	1.20
The A Khan Account	370,990	1.20
Kevin Arthur Thomas and Barbara Thomas	370,990	1.20
Neehar Super Fund	350,000	1.13
City Corp Pty Ltd	336,667	1.09
Julian Jones	306,839	0.99
	19,061,239	61.58

Unquoted equity securities

	Number of issue	Number of holders
Unquoted options	3,301,000	6

Holders of greater than 20% of unquoted equity securities

Name	Unlisted options	
	Number Held	Percentage of unquoted options
MFJ Holdings Pty Ltd	1,000,000	30.29
B W Holtshousen	1,000,000	30.29

C. Substantial holders

Substantial holders in the company are set out below:

	Number held	Percentage
Ordinary shares		
Nefco Nominees Pty Ltd	18,498,742	16.33

D. Voting rights

The voting rights attaching to each class of equity securities are set out below:

- (a) Ordinary shares
On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.
- (b) Options
No voting rights.