

**SYNTHESIS ENERGY SYSTEMS, INC.**

**INFORMATION STATEMENT**

For Broker-Dealer Due Diligence  
Pursuant to Rule 15c2-11  
under the Securities Exchange Act of 1934

Synthesis Energy Systems, Inc.  
(Exact name of issuer as specified in its charter)

A Delaware Corporation

The number of shares outstanding of each of the Registrant's classes of common equity, as of the date of this Information Statement, are as follows:

Common Stock: 100,000,000 authorized shares, 28,183,715 issued shares (as of January 28, 2007), \$0.01 par value

INFORMATION STATEMENT  
CUSIP NUMBER 871628 10 3

THE INFORMATION FURNISHED HEREIN HAS BEEN PREPARED FROM THE BOOKS AND RECORDS OF THE ISSUER BY THE OFFICERS AND DIRECTORS OF THE ISSUER IN ACCORDANCE WITH RULE 15c2-11 UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, AND IS INTENDED ONLY AS A SECURITIES DEALER INFORMATION FILE; AND

NO DEALER, SALESMAN OR ANY OTHER PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION, OR TO MAKE ANY REPRESENTATIONS NOT CONTAINED HEREIN IN CONNECTION WITH THE ISSUER, SUCH INFORMATION OR REPRESENTATIONS, IF MADE, MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE ISSUER; AND

DELIVERY OF THIS INFORMATION STATEMENT, AT ANY TIME DOES NOT IMPLY THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO THE DATE FIRST WRITTEN ABOVE.

The information contained in this Information Statement has been compiled to fulfill the disclosure requirements of Rule 15c2-11 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The enumerated items and captions correspond to the format set forth in the Rule. The effective date of this information statement is June 30, 2006, and no inference can or may be drawn that the information contained herein is current as of any subsequent date. The financial statements herein contained are presumed to be "current" for a period of six months after their date, barring extraordinary circumstances. No inference can be drawn that the financial condition of the issuer has not changed since the effective date of any financial statement contained herein.

**Item I: The exact name of the issuer and its predecessor (if any).**

The exact name of the issuer is Synthesis Energy Systems, Inc. The predecessor of the issuer is Tamborine Holdings, Inc. As used in this document, unless the context otherwise requires, “we,” the “Company,” the “issuer,” “us,” “our” or “Synthesis” refers to Synthesis Energy Systems, Inc. unless otherwise indicated or the context requires otherwise.

**Item II: The address of its principal executive offices.**

The issuer maintains its principal executive offices at:

6330 West Loop South, Suite 300  
Houston, Texas 77401  
Tel: (1) 713-579-0600  
Fax: (1) 713-579-0610

URL: [www.synthesisenergy.com](http://www.synthesisenergy.com)

Investor Relations:  
Suzanne McLeod  
Tel: (713) 579-0600  
E-mail: [suzanne.mcleod@synthesisenergy.com](mailto:suzanne.mcleod@synthesisenergy.com)

**Item III: The state of incorporation, if it is a corporation.**

State of Delaware

**Item IV: The exact title and class of the security.**

Common Voting Shares, Single Class  
CUSIP: 871628 10 3  
Trading Symbol: SYMX

**Item V: The par value or stated value of the security.**

The par value of the Company’s common stock is \$0.01 per share.

**Item VI: The number of shares or total amount of the securities outstanding as of the end of the issuer’s most recent fiscal year.**

As of January 28, 2007, the Company had 28,183,715 (twenty-eight million, one hundred and eighty-three thousand, seven hundred and fifteen) shares outstanding and 100,000,000 (one hundred million) authorized. As of January 28, 2007, the Company had approximately 290 shareholders.

**Item VII: The name and address of the transfer agent.**

Transfer Online, Inc.  
317 SW Alder Street, 2<sup>nd</sup> Floor  
Portland, Oregon 97204  
Tel: (1) 503-227-2950

This transfer agent is registered under the Exchange Act.

**Item VIII: The nature of the issuer's business.**

**General**

We are an emerging development stage company involved in the global development and commercialization of gasification technology. We have not earned any operating revenue as of the date of this filing. As described further herein, our principal asset is an exclusive license with the Gas Technology Institute (“GTI”), a U.S. based non-profit research and development organization for their U-GAS® gasification technology. Our license agreement with GTI has an initial term of ten years beginning on August 31, 2006, but may be extended for two additional ten years terms at the option of the Company. See “—License Agreement with GTI” for more information.

Synthesis Energy Systems, Inc., a corporation formed under the laws of the British Virgin Islands (“Synthesis BVI”), and Synthesis Energy Systems, LLC, a West Virginia limited liability company (“Synthesis LLC”), were formed as sister companies in November of 2003 to engage in the business of development and commercialization of the U-GAS® technology. On April 18, 2005, pursuant to the terms of an Agreement and Plan of Merger (the “Agreement”), SES Acquisition Corporation, a wholly-owned subsidiary of Tamborine Holdings, Inc., a Mississippi corporation (“Tamborine”), merged with and into Synthesis Energy Holdings, Inc., a Florida corporation (“Synthesis Florida”), whereby the holders of common stock of Synthesis Florida became shareholders of, and Synthesis Florida became a wholly-owned subsidiary of, Tamborine. As a condition of the above merger, Synthesis Florida completed a restructuring whereby each of Synthesis BVI, Synthesis LLC, International Hydrogen Technologies, Inc., a Florida corporation, and Innovative Engines, Inc., a Florida corporation became wholly owned subsidiaries of Synthesis Florida. On April 27, 2005, Tamborine changed its name to “Synthesis Energy Systems, Inc.” and on June 27, 2005, reincorporated in the state of Delaware. During 2006, International Hydrogen Technologies, Inc. and Innovative Engines, Inc. were dissolved.

**Overview of Gasification Technology and U-GAS®**

Gasification is a technology which converts solid hydrocarbon fuels such as coal, biomass or petroleum coke into synthesis gas, a mixture of hydrogen, carbon monoxide and other products, otherwise referred to as “syngas.” Gasification plants are extremely low emitters of certain regulated emissions, such as sulfur, nitrous oxides and particulates and allow, if desired, for the low cost capture of greenhouse gases such as carbon dioxide from the effluent steam. Typically, integrated gasification combined cycle (“IGCC”) power plants are more efficient than conventional combustion coal power plants. According to Green Car Congress, an energy product, policies and issues publication, conventional coal power plants have an efficiency of approximately 30%-35% while new IGCC power plants have achieved 38%-45% efficiency with efficiency targets of 50%-60%. In addition to power and steam production, such plants can supply a slate of chemical products including hydrogen, carbon monoxide, oxygen, nitrogen and steam, to chemical plants, petrochemical facilities, oil refineries and other industrial complexes.

*Technology*

Over the past 30 years, GTI has developed a fluidized bed gasification technology trademarked U-GAS®. In January 2004 we obtained a ten-year exclusive license to the medium and high-pressure U-GAS® applications for certain geographic areas from GTI. As described further below, we entered into an Amended and Restated License Agreement with GTI in August 2006 which grants us an exclusive license to manufacture, make, use and sell U-GAS® systems using the technology of GTI worldwide as to coal (and as to biomass blends made of up to

40% biomass) gasification systems and a non-exclusive license to manufacture, make, use and sell biomass gasification systems worldwide.

The primary advantage of U-GAS® relative to other leading gasification technologies is the ability to efficiently gasify a wide array of fuels including wastes from coal processing facilities, high ash coals and lignite coals. These “low rank” fuels may cost as little as \$0.25-1.20 per MMBtu while higher rank coals typically required by other gasification technologies can cost significantly more than \$1.50 per MMBtu. In addition, U-GAS® systems have been in operation worldwide for over 30 years, with the most recent project being a \$12 million facility at GTI’s Chicago technical campus built in 2004.

### *U-GAS® Gasification Process*

The U-GAS® gasification process is based on a single-stage fluidized-bed technology for production of low-to-medium heating value syngas from a wide array of biomass feedstocks and coals (including high-ash fuels). The U-GAS® technology was developed for gasification of all ranks of coal as well as coal and biomass blends.

In the U-GAS® gasification process, fuel is processed and conveyed into the gasifier vessel. Within the fluidized bed, the fuel reacts with steam, air and/or oxygen at a temperature of 840°C to 1100°C (1550°F to 2000°F). The temperature for gasification depends on the type of fuel used and is controlled to maintain high carbon conversion and non-slugging conditions for the ash. The U-GAS® process accomplishes four important functions in a single-stage fluidized bed gasifier: it decakes, devolatilizes, and gasifies fuel, and if necessary, agglomerates and separates ash from the reacting coal. The operating pressure of the gasifier depends on the end use for the syngas and may vary from 3 to 30 bars (40 to 435 psia) or more. After cleaning, the product gas can be used as industrial fuel gas for process heating, syngas for production of methanol, ammonia, hydrogen or liquids, and for power generation and fuel cells.

During operation, fuel is gasified rapidly within the fluidized bed and produces a gaseous mixture of hydrogen, carbon monoxide, carbon dioxide, water vapor and methane, in addition to small amounts of hydrogen sulfide and other trace impurities. If the operating temperature required to achieve acceptable carbon conversion exceeds the fuel ash softening temperature, the ash concentration of the fluidized bed is allowed to increase until a condition is reached that allows the ash particles to agglomerate into larger particles. The agglomerated particles are denser than the surrounding bed material and can thus be selectively removed from the bottom of the bed.

Reactant gases, including steam, air, and/or oxygen are introduced into the gasifier in two areas: 1) through a sloping distribution grid at the bottom of the bed and 2) through a terminal velocity-controlled ash discharge port at the center of the distribution grid. In both agglomerating and non-agglomerating operating modes, ash is removed by gravity from the fluidized bed and discharged into a lockhopper system for depressurization and disposal. In both operating modes, the gasifier maintains a low level of carbon in the bottom ash discharge stream, making overall carbon conversion of 95% or higher possible. Cold gas efficiencies of over 80% have been repeatedly demonstrated.

Fines purified from the fluidized bed are typically separated from the product syngas by up to three stages of external cyclone separators, one or two of which return the fines to the fluidized bed for increased carbon conversion. The product syngas is essentially free of tars and oils due to the temperature and residence time of the gases in the fluidized bed, simplifying downstream heat recovery and gas cleaning operations.

When used to gasify biomass or highly reactive wastes, an inert material such as sand, limestone or dolomite is used to maintain the fluidized bed. In this case, most of the ash from the fuel leaves the fluidized bed with the product syngas, with the bottom ash discharge serving primarily to discharge tramp material entering with the biomass or waste feed.

#### *U-GAS® Installation History*

Initial Test Facility in Chicago. GTI built a large-scale U-GAS® test facility in the Chicago area and completed installation and testing in the late 1970s. GTI continued periodic development of U-GAS® at this facility into the 1980's and early 1990's with a focus on biomass. These facilities ran for thousands of hours and demonstrated the technical and economic viability of the technology. This facility has since been decommissioned to make way for a more modern test facility.

U-GAS® Facility in Finland. In 1989, the U-GAS® technology for biomass fuels (and coal blends with over 40% biomass) was licensed to Tampella Power Inc., which built a multi-fuel pressurized pilot plant in Tampere, Finland to further develop and demonstrate the technology for air-blown IGCC power generation with coal and biomass. This fully integrated plant includes all gasification island components from fuel presentation through waste heat recovery and hot gas clean-up. The facility can process up to 42 tons/day of coal and 60 tons/day of biomass at pressures up to 435 psia. At the time of this filing, the plant has logged over 3,800 hours of operations with 5,900 tons of fuel processed in 26 test runs. The tested fuels include biomass and mixtures of coal and biomass.

Biomass Demonstration Project in Hawaii. In the early 1990's, GTI built a demonstration project in Hawaii in conjunction with the U.S. Department of Energy ("DOE"). The project involved building a medium pressure gasifier to convert sugarcane waste produced from a local sugar processing facility. The plant was fully constructed and was successfully tested and commissioned. However, after a period of successful operations, the local sugar grower changed the sugarcane harvesting process resulting in a waste product that would not flow through the originally designed fuel handling system. The DOE chose not to fund the fuel handling upgrade that was required to process the new fuel type citing that the test was successful and the required data was gathered. Currently the plant has been shutdown awaiting further funding.

Large Commercial Facility for Shanghai Coking and Chemical. A large low pressure, commercial installation at Shanghai Coking and Chemical ("SCC") was developed in 1994 that included eight gasifiers with a capability at full pressure of producing over 160,000 normal cubic meter/hr of syngas. The SCC facility, which was conceived and designed as a seasonal peaking facility, entered commercial operation in 1995 and remained in service supplying syngas to a large chemical complex until, in 2000, a free source of waste fuel gas became available from a neighboring sister facility. During its six years of operations, the SCC installation experienced some operational challenges dealing with improper coal purchasing and preparation. Despite these problems, three SCC gasifiers reached 8,000 operating hours each by 1998, three more in 1999 and a seventh in 2000. Total SCC gasifier operating hours exceeded 76,000 hours.

Large-scale Test Gasifier in Chicago. With historically high natural gas prices in the U.S., GTI recently put renewed emphasis on U-GAS® technology and in 2004 completed a \$12 million large-scale test gasifier facility on its technical campus northwest of Chicago. The facility evaluates advanced and innovative gasification processes using all ranks of coal and other low-cost solid fuels. The facility is also being used to facilitate commercialization of advanced gasification and other new technologies to improve the commercial competitiveness of U-GAS® technology. The facility's flexible design allows testing of a variety of syngas cleanup systems, and the gasifier and feed system is configured to allow simultaneous co-firing of coal with biomass or other opportunity fuels.

## **License Agreement with GTI**

Pursuant to the Amended and Restated License Agreement dated as of August 31, 2006 between Synthesis and GTI (the "License Agreement"), Synthesis has an exclusive global license to manufacture, make, use and sell U-GAS® systems for coal and coal and biomass blends made of up to 40% biomass and non-exclusive license to manufacture, make, use and sell U-GAS® systems for coal and biomass blends in excess of 40% biomass. The License Agreement has a term of ten years, but may be extended for two additional ten-year periods at the option of Synthesis.

As consideration for the license, Synthesis paid \$500,000 cash, and issued 190,500 shares of restricted common stock, to GTI. Synthesis is also restricted from offering a competing gasification technology during the term of the license. Additionally, for each U-GAS® unit which Synthesis licenses, designs, builds or operates which uses coal, or a coal and biomass mixture, as the feed stock, Synthesis must pay a royalty based upon a calculation using the per thermal megawatt/hr of dry syngas production of a rated design capacity, payable in installments at the beginning and at the completion of the project build. Synthesis must also provide GTI with a copy of each contract that Synthesis enters into relating to a U-GAS® system and report to GTI with their progress on development of the technology every six months. A failure to comply with any of the above requirements could result in the termination of the License Agreement by GTI if not cured by the Company within specified time periods.

In addition, Synthesis was required to (i) have a contract for the sale of a U-GAS® system with a customer in the territory covered by the License Agreement no later than August 31, 2007, (ii) fabricate and put into operation at least one U-GAS® system by July 31, 2008 and (iii) fabricate and put into operation at least one U-GAS® system for each calendar year of the License Agreement, beginning with the calendar year 2009. The Company has satisfied the obligation to have a contract for the sale of a U-GAS® system no later than August 31, 2007 through our contract with Hai Hua described below. Additionally, Synthesis is required to disclose to GTI any improvements related to the U-GAS® system which are developed and implemented by Synthesis and the manner of using and applying such improvements. Failure to satisfy the requirements as to these milestones could lead to the revocation of the license by GTI; provided, however, that GTI is required to give a twelve-month notice of termination and Synthesis is able to cure the default and continue the Agreement prior to the expiration of such time period.

During the term of the license, Synthesis has granted to GTI a royalty-free non-exclusive irrevocable license to make, manufacture, use, market, import, offer for sale and sell U-GAS® systems that incorporate the improvements of Synthesis. Such license only applies outside of the exclusive rights granted to Synthesis under the License Agreement. Without the prior written consent of GTI, Synthesis has no right to sublicense any U-GAS® system other than to customers for which Synthesis has constructed a U-GAS® system. For a period of ten years, Synthesis is restricted from disclosing any confidential information (as defined in the license) to any person other than employees of its affiliates or contractors who are required to deal with such information, and such persons will be bound by the confidentiality provisions of the license. Synthesis further indemnifies GTI and its affiliates from any liability or loss resulting from unauthorized disclosure or use of any confidential information that it receives.

## **Market Opportunity**

Over the past decade developing economies such as China and India, as well as established economies such as the United States, have had increased demand for energy to fuel growth and many commercial opportunities to address energy related concerns have emerged. Some of the specific trends over the past several years include:

- Demand for natural gas is outpacing supply and resulting in higher prices and potential interruptions in supply due to technological innovations related to natural gas combustion (primarily for power generation).
- Increased attention on air quality and greenhouse gas emissions.
- Higher energy price environments resulting from the absorption of excess petroleum capacities.
- Recognition by policy makers of national security issues related to reliance on external energy sources.

Similar to the advances, such as increased efficiencies and reduced emissions, in natural gas turbine technologies, emerging technologies that efficiently and cleanly convert coal into fuels for power generation, chemical production and even transportation will experience rapid market acceptance. With the expectation that those technical improvements should be achieved, coal has become a larger part of the long-term supply plans for governments and major energy companies worldwide.

In particular, within the Chinese and U.S. markets, coal gasification represents an opportunity to improve air quality, economically capture greenhouse gas emissions and replace energy imports from politically unstable sources with indigenous coal supplies. The United States Department of Energy has stated that Chinese and U.S. coal reserves make up approximately 40% of the global totals. China and the U.S. are also the largest importers of petroleum products. We believe a significant commercial opportunity exists for companies that can successfully introduce clean coal technologies to utilize these indigenous coal fuel sources.

We have elected to make China a priority market since China offers immediate opportunities to develop U-GAS®-based coal gasification projects and has a ready supply of low rank coal. According to The World Bank, China is the world's second largest and fastest growing energy market. They estimate that over the next 25 years China will require two trillion dollars of investment in the power sector alone, more than any other country or region. They believe growth in manufacturing and the rise of China's middle class are driving this demand, and this demand is far outstripping supply for electricity and other essential industrial commodities in China. The World Bank also believes that despite a 15% growth in electricity production and 100 million additional tons of coal mined in 2003, energy shortages in China will persist. Coal is China's most abundant, indigenous energy resource and is in high demand, which in turn causes economic and environmental pressures and forces the Chinese government and Chinese industries to re-think the way coal is used. In order to meet the demand for clean energy and industrial commodities, China is in the process of finding environmentally acceptable methods to convert coal into energy and chemical commodities.

Our goal is to develop projects, technologies and systems to meet these needs and to establish U-GAS® as a reliable and efficient alternative source of power, hydrogen and other gasification products to manufacturers. The primary drivers for growth is a large indigenous coal supply, heightened awareness of environmental issues, and a desire to develop a diversified energy mix and mitigate over-reliance on natural gas and imported crude oil.

### **Targeted Customers**

*Chemical Plants, Petrochemical Plants and Refineries.* We believe that many chemical, petrochemical plants and refineries are seeking a broad slate of products including electricity, steam, hydrogen, carbon monoxide, oxygen, nitrogen and compressed air. We also believe UGAS® gasification

systems provide an ideal solution for these plants and refineries because inherent integration opportunities allow these products to be produced with minimum additional capital and/or operating costs. Moreover, because such plants tend to be run on a continuous basis, low fuel cost is a key to economic competitiveness. General Electric and Shell have built multiple IGCC power or chemical feedstock facilities for petrochemical and refinery facilities around the world.

*Large Manufacturers.* Many manufacturers require power, steam and hot water as part of their production process. In addition, many industrial development zones are seeking co-generation facilities specially dedicated to manufacturers in that zone that require power, steam and hot water for industrial applications and for district heating and air conditioning. We believe that a clean U-GAS® facility can provide the necessary energy and chemical operating feedstocks in areas where scarcity or high prices of other energy sources make operations unprofitable.

*Ammonia and Fertilizer Plants.* Ammonia and fertilizer plants require large amounts of hydrogen, carbon monoxide, power and steam. We believe a significant opportunity exists for conversion of these plants to U-GAS® since most of these plants purchase power from the grid and produce their own syngas using old fixed bed gasification technology, which requires low ash and high priced coal for fuel. We also believe that, due to the wide use of inefficient fixed bed gasification systems, the vast majority of China's fertilizer plants will require replacement of their entire gasification systems in the near future.

*Alumina Refineries.* The production of alumina from bauxite requires a great deal of energy that is currently being provided by natural gas or heavy fuel oil. The integration of a U-GAS® coal gasification facility into an alumina refinery can lower the cost of production by reducing the raw material costs for the energy required and increase the efficiency by which the refinery can produce alumina. There are many alumina refineries in our target markets that are actively seeking alternatives to their current high cost energy structure, which may include our U-GAS® technology.

*Hydrogen Production.* Around the world, most hydrogen is produced from natural gas. With increased natural gas prices, hydrogen production costs have risen dramatically. U-GAS® technology can produce hydrogen at a cost which is much lower than the cost of hydrogen based on production using natural gas as a feedstock. Increasingly heavy crude oils, as well as increased chemical plant utilization, has driven the demand for hydrogen to unprecedented levels. Coal gasification is a viable alternative for large scale production of hydrogen. We believe that the U-GAS® process will allow us to take advantage of this expanding marketplace by being the low cost provider of coal-derived hydrogen.

*Coal-to-Liquids Plants.* Many countries desire to avoid their dependence on imported oil and have taken steps to make coal-to-liquid technology a viable energy alternative for transportation fuels. Such plants will need large quantities of hydrogen, electricity, steam and oxygen, which we believe can be provided by U-GAS® gasification plants. For example, two of China's largest coal companies are developing large coal-to-liquids facilities. Coal companies typically have substantial amounts of waste coal that are not adequately utilized. We believe the U-GAS® system could allow such a mining company to convert negative value waste into low cost feedstocks for these coal-to-liquid projects.

*Integrated Projects.* Projects with the highest margins will be located at, or within a very close distance to, opportunity fuels such as low rank coals, lignites and other waste coals. Such projects typically require multiple gasification commodities, such as power, steam, hydrogen, carbon monoxide, and nitrogen, where an entire product's value chain is integrated within one complex. For example, where a methanol complex is established at a coal mine, the basic structure of the project would be waste coal to power, steam, hydrogen, carbon monoxide, to methanol and then sales to domestic and international markets.

## **Competition**

We will seek to deploy U-GAS® plants in areas where the maximum integration of the process is possible. In the world gasification market, the largest providers are General Electric, Shell, Siemens and ConocoPhillips. Shell's gasification efforts remain focused on the production of syngas for chemical processes. Shell has recently announced a multi-million dollar contract to use its gasification technology to produce hydrogen for a large coal-to-liquids project in China. There are also several Chinese companies that utilize older, low pressure technologies, which utilize high-cost coals and are relatively immature, with low capital costs being their primary competitive advantage. In addition, there is a small Chinese coal gasification company that utilizes a low pressure fluidized bed technology which may compete with our U-GAS® technology.

In general, we believe that the primary competitive advantages of U-GAS® relative to the other technologies are: (a) the potential for U-GAS® gasifiers to utilize low quality, low cost coals, (b) the inherent flexibility of the U-GAS® technology allows a project to change fuels or utilize a mix of fuels over the life of the project, and (c) the ability to economically build relatively smaller plants. This ability to build plants that are economical at sizes required by many industrial companies opens up a potentially large under served market. We believe that the lower capital costs, shorter siting and construction time periods may allow us to build projects where our larger competitors would be economically disadvantaged.

## **Current Projects**

Our plan is to develop, finance, build, own and operate U-GAS® based coal gasification plants ranging in size from 20 MWs (equivalent) to greater than 250 MWs (equivalent) and at costs ranging from \$20 million to several hundred million dollars. Our strategy is to sell the outputs of the plants, which can be syngas, power, steam and other products (e.g. sulfur, ash) under long-term contracts to industrial and wholesale customers. We may sell capacity in the plants outright or under tolling agreements as a way to insulate the Company from commodity price volatility. We also have the right to sublicense any U-GAS® system to customers for which we have constructed a U-GAS® system.

For our first project, Synthesis Energy Systems Investments, Inc., a wholly-owned subsidiary of Synthesis Energy Holdings, Inc. ("SES Investments"), entered into a cooperative joint venture contract with Shandong Hai Hua Coal & Chemical Company Ltd. ("Hai Hua") which established Synthesis Energy Systems (Zaozhuang) New Gas Company Ltd. (the "Joint Venture"), a joint venture company that has the primary purposes of (i) developing, constructing and operating a synthesis gas production plant utilizing the U-GAS® technology in Zaozhuang City, Shandong Province, China and (ii) producing and selling syngas, steam and the various byproducts of the plant, including ash, elemental sulphur, hydrogen and argon. Hai Hua is an independent producer of coke and coke oven gas and owns a subsidiary engaged in methanol production. Hai Hua processes its coal in its own coal washery prior to using such coal in its coke ovens. This coal washing process produces a byproduct which is the design fuel for the Joint Venture's U-GAS® gasification plant. The technology will enable syngas to be produced from Hai Hua's coal sources and such syngas will be used in Hai Hua's methanol subsidiary, coke ovens and power plant. In exchange for their respective ownership shares in the Joint Venture, SES Investments agreed to contribute approximately \$9,300,000 in capital, and Hai Hua agreed to contribute land use rights to a parcel of land for construction of coal storage facilities and certain other management services. The contribution of SES Investments is payable in installments, with approximately \$3,800,000 being contributed as of December 31, 2006.

By November of 2006, the project had obtained approval of its feasibility study, environmental impact assessment and the Joint Venture was issued its business license. The groundbreaking for the plant

took place on December 5, 2006. Construction on the plant is expected to be completed in the second half of the calendar year 2007 at a projected cost of \$24 million. It is contemplated that the Joint Venture will obtain debt financing for a portion of the construction costs, although no agreements have been entered into at this time. The plant will be built on a site adjacent to the Hai Hua coke and methanol facility. Hai Hua is obligated to grant rights of way for construction access and other on-going operations of the plant. The land was purchased from the Chinese government with the assistance of the Shandong Xue Cheng Economic Development Zone.

If either of SES Investments or Hai Hua desires to invest in another coal gasification project within Zaozhuang City, the other company has a right to participate in up to 25% of the investment. For the first twenty years, after the date that the plant becomes operational (the "Operational Date"), 95% of all net profits of the Joint Venture will be distributed to SES Investments. After the initial twenty years, the profit distribution percentages will be changed, with SES Investments receiving 10% of the net profits of the JV Company and Hai Hua receiving 90% of the JV's net profits. The contract has a term of fifty years, subject to earlier termination if either SES Zaohuang files for bankruptcy or becomes insolvent or if the syngas purchase contract between the Joint Venture and Hai Hua (discussed in more detail below) is terminated. Hai Hua has also agreed that the License Agreement is the sole property of SES Investments and its affiliated entities and that it will not compete with SES Investments, or its affiliated entities, with respect to fluidized bed gasification technology for the term of the Joint Venture.

In addition, Hai Hua has agreed to purchase, once the plant is completed, syngas from the Joint Venture pursuant to the terms and conditions of a purchase and sale contract. Hai Hua will (i) pay a monthly capacity fee and a monthly energy fee; (ii) provide piping to the plant for the acceptance of steam and coke oven gas from Hai Hua and for the delivery of syngas from the Joint Venture to Hai Hua; and (iii) coordinate its operations and maintenance so as to ensure Hai Hua purchases as much syngas as possible. The energy fee is a per Ncum of syngas fee calculated by a formula which factors in the monthly averages of the prices of design base coal, coke, coke oven gas, power, steam and water, all of which are components used in the production of syngas. The capacity fee is paid based on the capacity of the plant to produce syngas, factoring in the number of hours (i) of production and (ii) of capability of production as compared to the guaranteed capacity of the plant, which for purposes of the contract is 22,000 Ncum per hour of syngas.

The Joint Venture is required to procure any other necessary consumables for operation of the plant, provided, however, the Joint Venture is entitled to reimbursement for these costs through the payment of the energy fee. As part of its registered capital contribution to the Joint Venture, Hai Hua shall, to the extent that it is required, provide up to 100,000 Ncum of coke oven gas and up to 600 tons of coke free to the Joint Venture during the first year of operation as start-up fuels for the gasifiers. Any requirements for coke or coke oven gas above these amounts shall be paid for by the Joint Venture. If Hai Hua is unable or unwilling to provide the required coke or coke oven gas, the plant will be deemed to be able to produce for purposes of calculating the capacity fee and Hai Hua will not be relieved of its payment obligations. Pursuant to the terms of the contract, the value of the items provided by Hai Hua to the Joint Venture (including the coke, coke oven gas, piping and acreage for the storage facilities) shall not exceed 5% of the equity of the Joint Venture.

Hai Hua is required to annually provide to the Joint Venture a preliminary syngas usage plan for that year, provided, however, that in no event shall the usage plan require less than 19,000, or more than 22,000, Ncum per hour of syngas. In connection with this, the Joint Venture shall annually provide a generation plan to Hai Hua which sets forth the anticipated syngas generation for that year, and it shall use its best efforts to match its generation plan with Hai Hua's usage plan. If the Joint Venture produces more syngas than the capacity that Hai Hua is required to purchase under the contract, Hai Hua shall have a right of first refusal to purchase such excess amount. The syngas to be purchased by Hai Hua is subject

to certain quality component requirements set forth in the contract. All byproducts of the gasification process are the property of the Joint Venture. The Joint Venture is entitled to provide services and sell products which it produces other than syngas to third parties, but Hai Hua has a right of first refusal for any such sales. Hai Hua is obligated to pay the capacity fee regardless of whether they use the gasification capacity, subject only to availability of the plant and exceptions for certain events of force majeure.

The agreement terminates twenty years from the Operational Date. Upon termination of the agreement for any reason other than the expiration of the term, the Joint Venture will have the right to either produce syngas for other customers in its current location or dismantle the plant and move the plant to another location. Within two years of October 22, 2006, the date of the contract, Hai Hua may request that the Joint Venture expand its syngas production in order to assist in the production of methanol by a subsidiary of Hai Hua and the Joint Venture is required to negotiate such increased production in good faith. Hai Hua has made such a request and as of the date hereof, the Joint Venture is in negotiations regarding the details and pricing of the expansion project.

### **Research and Development**

During the fiscal year ended June 30, 2006 and 2005, we spent \$373,282 and \$87,954, respectively, for research and development mainly related to the development and fuel testing of coal as well as the development of engine generators using syngas as fuel. During the years ended June 30, 2006 and 2005 we spent \$158,406 and \$26,804 in engineering salaries, respectively. We plan to continue increasing internal research and development with a goal of offering our customers the best and most efficient clean coal solutions.

### **Governmental and Environmental Regulation**

Our operations are subject to stringent federal, state and local laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. Numerous governmental agencies, such as the U.S. Environmental Protection Agency and various Chinese authorities, issue regulations to implement and enforce such laws, which often require difficult and costly compliance measures that carry substantial administrative, civil and criminal penalties or may result in injunctive relief for failure to comply. These laws and regulations may require the acquisition of a permit before operations at a facility commence, restrict the types, quantities and concentrations of various substances that can be released into the environment in connection with such activities, limit or prohibit construction activities on certain lands lying within wilderness, wetlands, ecologically sensitive and other protected areas, and impose substantial liabilities for pollution resulting from our operations. We believe that we are in substantial compliance with current applicable environmental laws and regulations and we have not experienced any material adverse effect from compliance with these environmental requirements.

In China, developing and constructing gasification facilities is highly regulated. In the development stage of a project, the key government approvals are of the project's environmental impact assessment report, feasibility study (also known as the project application report) and, in the case of a Sino-foreign joint venture, approval of the joint venture company's joint venture contract and articles of association. Approvals in China are required at the municipal, provincial and/or central government levels depending on the total investment in the project.

Although we have been successful in obtaining the permits that are required at this stage of the project, any retroactive change in regulations or an opinion that the approvals that have been obtained are inadequate, either at the federal, provincial or state level, could require us to obtain additional or new permits or spend considerable resources on complying with such regulations. Other developments, such

as the enactment of more stringent environmental laws and regulations, could require us to incur significant capital expenditures.

## **Employees**

As of January 28, 2007, we had 26 employees. None of our employees is represented by any collective bargaining unit. We have not experienced any work stoppages, work slowdowns or other labor unrest. We believe that our relations with our employees are good.

### **Item IX: The nature of the products and services offered.**

See Item VIII above.

### **Item X: The nature and extent of the issuer's facilities:**

Our corporate office occupies approximately 3,000 square feet of leased office space in Houston, Texas. We also lease approximately 3,500 square feet of office space in Shanghai, China and we also lease small offices in Miami, Florida and Beijing, China. Over time, additional facilities may be required as we add personnel to advance our commercial and technical efforts. See "Current Projects" under Item VIII for a discussion of facilities relating to our Joint Venture.

### **Item XI: The name of the chief executive officers and members of the board of directors:**

#### **A. Executive Officers:**

President and Chief Executive Officer – Timothy E. Vail

Mr. Vail joined the Company as a Director on September 20, 2005, and accepted the President and Chief Operating Officer position on May 30, 2006. Prior to joining us, beginning in 2002, Mr. Vail served as the Director of Commercialization for Fuel Cell Development for General Motors Corporation ("GM"). At GM, Mr. Vail's duties included the development of GM's Shanghai fuel cell office as well as coordination of engineering facilities in the US, Germany, Japan and China. Prior to his position at GM, Mr. Vail was the Vice President of product development for The New Power Company, a start-up subsidiary of Enron Corporation, where he was responsible for the development of new products and services to be delivered to New Power's customer bases. From 1995 until starting work for The New Power Company, Mr. Vail was a Vice President at Enron Energy Services. Mr. Vail was also a securities lawyer with Andrews Kurth, LLP from 1990 to 1993. Mr. Vail holds a J.D. from the University of Houston Law Center and a B.A. in Economics from The University of Texas at Austin.

Chief Financial Officer – Mr. David A. Eichinger

Mr. Eichinger has served as our Chief Financial Officer and Senior Vice President of Corporate Development since May 30 of 2006. Prior to joining us as an executive officer, Mr. Eichinger was a consultant to us since November 1, 2005, in which capacity he advised us on technology license negotiations and global expansion beyond the Chinese market. From 1991 to 1996, Mr. Eichinger spent five years in the Corporate Treasury function as an analyst in Corporate Finance and Tax at Exxon Corporation and Exxon Chemicals. From 1996 to 2000, Mr. Eichinger led merger and acquisition teams for Enron Corporation in the deregulating wholesale and retail markets in North and South

America. In addition, Mr. Eichinger led the spin off of The New Power Company and served as an executive officer in charge of corporate development. Mr. Eichinger has also advised a number of energy related firms including CAM Energy (a New York based hedge fund) and General Hydrogen. Mr. Eichinger holds both a B.S. and M.S. in Chemistry from The College of William and Mary, and an M.B.A. from Carnegie Mellon.

Chief Executive Officer/Asia Pacific Region - Mr. Donald P. Bunnell

Mr. Bunnell is our President and Chief Executive Officer – Asia Pacific, a Director and a co-founder of our company. From 2001 until the creation of our company, Mr. Bunnell was the Asia Business Development Vice President for BHP Billiton’s aluminum group. Between 1997 and 2001, Mr. Bunnell served in various capacities, including Vice President in charge of Enron China’s power group, and Country Manager, with the power development team of Enron Corporation. During this time, Mr. Bunnell spent three years leading the Enron/Messer/Texaco consortium for the Nanjing BASF Project. From 1995 to 1997, Mr. Bunnell was a manager with Coastal Power Corporation (now part of El Paso Corporation) in Beijing, where he was involved in development of gas turbine power plants and other power projects. Mr. Bunnell is an attorney licensed to practice in the United States and has practiced law in Hong Kong, advising clients on China investments, prior to entering the power business. Mr. Bunnell is fluent in Mandarin Chinese, has lived in China for over 11 years, and has 10 years of experience in the China power industry developing projects and managing joint ventures. Mr. Bunnell graduated from Miami University with a B.A. and from the William & Mary School of Law with a J.D.

**B. Directors:**

Mr. Vail and Mr. Bunnell listed under section A above are also the Company’s directors. In addition, other directors of the Company are:

Chairman - Mr. Lorenzo C. Lamadrid

Mr. Lamadrid has been our Chairman since April of 2005. Since 2001, Mr. Lamadrid has also served as Chairman and Chief Executive of Globe Development Group, LLC, a firm specializing in international energy advisory, investment, and development of major energy and power projects. He is also a Managing Director and Founding Partner of the Worldwide Power Group, Ltd., a developer of large-scale energy and power generation projects in Asia and Latin America, and is also a member of the International Advisory Board and the Executive Committee of Sirocco Aerospace International, a marketer of aerospace products. From 1999 to 2001, Mr. Lamadrid was President and Chief Executive Officer of Arthur D. Little, Inc., a global management consulting firm. Prior to joining Arthur D. Little, from 1996 to 1999, Mr. Lamadrid was President of Western Resources International, Inc., a subsidiary of Western Resources, Inc., and Managing Director of The Wing Group, a subsidiary of Western Resources that develops large-scale international electric power projects. Prior to that, Mr. Lamadrid spent seven years with General Electric, the last two as a Corporate Officer. He served as Vice President and General Manager of GE Aerospace, where he was responsible for international operations, domestic marketing and business development activities, and strategy development for the overall Aerospace Group. While at General Electric, Mr. Lamadrid also served as Corporate Staff Executive for strategic planning and business

development. Mr. Lamadrid also served on the Board of Directors of the General Electric Trading Company, GE/RCA Licensing Operation, Toshiba Electronic Systems Company (Japan), Ltd., and the Philadelphia World Affairs Council. Before joining General Electric, Mr. Lamadrid was a Manager at The Boston Consulting Group, and was also a founding investor of the Boston Beer Company. Mr. Lamadrid graduated from Yale University with a B.S. in Chemical Engineering and Administrative Sciences, Massachusetts Institute of Technology with a M.S. in Chemical Engineering, and Harvard with an M.B.A

Director – Michael Storey

Mr. Storey has served as one of our directors since November of 2005. From 2000 to 2004, he has served as President and CEO of Inmarsat Ventures, a global communications company. He resigned in March of 2004, but continues as an advisor. From 1993 to 1999, Mr. Storey ran several telecommunications businesses during European deregulation that became MCI Europe and is now Verizon Communications. In 1984, Mr. Storey established City Centre Communications, a business in the cable television and telecommunications industry. He grew his business and acquired several franchises before selling his interests in 1992 to Videotron and Bell Canada. He served as a Director and then Chairman of the Cable Communications Association from 1983 to 1990, representing all the investors in the U.K. cable industry. Starting in 1972, Mr. Storey served for 10 years as a Vice President and Partner of Booze Allen Hamilton International Management Consultants. Mr. Storey is a graduate of King's Fund Administrative Staff College and has an M.B.A. from the University of Chicago. From 1958 to 1968, he worked in the healthcare industry, operating hospitals in the U.K., Middle East, and North America. He also holds two professional certifications: Professionally Qualified Hospital Administrator and Professionally Qualified Personnel Manager.

Director – Denis Slavich

Mr. Slavich has served as a director since November of 2005 and currently serves as the Chairman of our Audit Committee. Mr. Slavich has over 35 years of experience in large-scale power generation development. He is currently an international consultant to a number of U.S. and China-based companies engaged in cross border transactions, as well as an advisor and board member for a number of additional firms. From 1998 to 2000 Mr. Slavich was the CFO and director of KMR Power Corporation and was responsible for the development of an international IPP company that developed projects in Columbia as well as other areas. Mr. Slavich also served as acting President for Kellogg Development Corporation, a division of M.W. Kellogg, during 1997. From 1991 to 1995, Mr. Slavich was also a Vice President of Marketing for Flour Daniel. From 1971 to 1991 Mr. Slavich served in various executive positions at Bechtel Corporation including Sr. VP, CFO, and director and Sr. VP and manager of the International Power Division. Mr. Slavich received his Ph.D. from Massachusetts Institute of Technology, M.B.A. from the University of Pittsburgh and his B.S. in Electrical Engineering from the University of California at Berkeley.

Director – Harry Rubin

Mr. Rubin has been a Director since August 5, 2006. Mr. Rubin is currently Chairman of Henmead Enterprises, in which capacity he advises various companies regarding strategy,

acquisitions and divestitures. He currently serves as a Director of Image-Metrics Plc, and has held board positions at a number of private and public companies such as the A&E Network, RCA/Columbia Pictures Home Video and the Genisco Technology Corporation. He was a founding partner of the Boston Beer Company. In the 12 years prior to 2006, Mr. Rubin held various senior management roles in the computer software industry, including Senior Executive Vice President and Chief Operating Officer of Atari, and President of International Operations and Chief Financial Officer for GT Interactive Software. Mr. Rubin entered the computer software business in 1993 when he became Executive VP for GT Interactive Software as a start-up company, and played a leadership role in GT's progression as the company went public in 1995 and became one of the largest industry players. Prior to 1993, he held various senior financial and general management positions at RCA, GE and NBC. He is a graduate of Stanford University and Harvard Business School, and resides in New York City.

**C. General Partners:**

None

**D. Promoters:**

None

**E. Control Persons:**

See description above.

**F. Counsel:**

The Company has appointed Porter & Hedges, LLP, 1000 Main Street, Houston, Texas 77002, as its external counsel. Other legal work is performed in-house.

**G. Auditor:**

The consolidated financial statements of Synthesis Energy Systems, Inc. as of June 30, 2006 and 2005, and for each of the years in the two-year period ended June 30, 2006 and 2006 and the period from November 4, 2003 (inception) to June 30, 2006, have been included herein in reliance upon the report of KPMG LLP, independent registered public accounting firm.

**H. Public Relations Consultant:**

Hill & Knowlton  
909 Third Avenue, 10th floor  
New York, NY 10022  
(t) 212-885-0300  
(f) 212-885-0570

**I. Advisory:**

None.

**Item XII: The issuer's most recent balance sheet and profit and loss and retained earnings statements:**

See attached financial statements.

**Item XIII: Similar financial information for such part of the two (2) preceding fiscal years of issuer's existence:**

See attached financial statements.

**Item XIV: Whether the broker/dealer or any associated person is affiliated, directly or indirectly, with the issuer:**

Management of the Company is not aware of any broker/dealer or associated persons or entities affiliated, either directly or indirectly, with the Company.

**Item XV: Whether the quotation being published/submitted on behalf of any other broker/dealer, and if so, the name of such broker or dealer:**

Management of the issuer is not aware of any broker/dealer submitting quotations with respect to the issuer's common stock on behalf of any other broker or dealer.

**Item XVI: Whether the quotation being submitted or published directly or indirectly on behalf of the issuer, or any director, officer or any person directly/indirectly the beneficial owner of more than 10% of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of such person:**

Management of the Company is not aware of any quotation or quotations being submitted on behalf of the Company or any director, officer or ten percent (10%) shareholder of the Company.

**Item XVII: Details of securities offerings by the issuer during the past two years:**

In March of 2005, we issued 2,000,000 shares of common stock to 23 accredited investors in a private placement. The aggregate consideration paid for such shares was approximately \$5 million. All the shares of common stock were offered and sold pursuant to the exemption from the registration requirements of the Securities Act provided by Rule 506 of Regulation D.

In August of 2006, we issued 3,345,715 shares of common stock to 4 accredited investors in a private placement. The aggregate consideration paid for such shares was approximately \$18 million. All the shares of common stock were offered and sold pursuant to the exemption from the registration requirements of the Securities Act provided by Rule 506 of Regulation D. Union Charter Financial acted as the sole and exclusive placement agent for the private placement and received a fee of \$1.4 million, or 8% of the total offering amount, plus expenses. The offering terminated on November 30, 2006.

**Forward Looking Statements.** Except for purely historical information, the statements contained in the foregoing disclosure are forward-looking and have been made in accordance with the requirements of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Readers are cautioned that these forward-looking statements are inherently subjective and reflect assumptions, known and unknown risks, uncertainties and other factors that may affect the Company's business and prospects and cause its actual results, performance or achievements to differ materially from those expressed or implied by the forward-looking statements. These factors are difficult or impossible to predict accurately, and many of them are outside of the Company's control. These factors include: the timely receipt of required governmental approvals for various aspects of the Company's business; market demand for and acceptance of its services; actions of its existing and any new competitors; the impact of competitive products, services and pricing; the adequacy of its proprietary information technology to support its business plan; general or specific economic conditions; government monetary policy; and other factors. The Company's forward-looking statements are made as of the date of this disclosure document, and except as may be required by law, we undertake no obligation to update our forward-looking statements as a result of any future events or developments.

[Signature Page Follows]

THE UNDERSIGNED HAS READ ALL OF THE ITEMS SET FORTH HEREIN AND, AS TO THE BEST OF THE UNDERSIGNED'S KNOWLEDGE AND BELIEF, THE INFORMATION CONTAINED HEREIN IS ACCURATE AND COMPLETE.

DATED THIS 6 DAY OF FEBRUARY, 2007.



---

Timothy E. Vail  
President and Chief Executive Officer



**Synthesis Energy Systems, Inc.**  
**(A Development Stage Enterprise)**

**Consolidated Financial Statements**  
**Years Ended June 30, 2006 and 2005**

## INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm .....	F-2
Consolidated Balance Sheets as of June 30, 2006 and 2005 .....	F-3
Consolidated Statements of Operations for the years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006 .....	F-4
Consolidated Statement of Stockholders' Equity for years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006 .....	F-5
Consolidated Statements of Cash Flows for years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006 .....	F-6
Notes to the Consolidated Financial Statements for years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006 .....	F-7

## **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Synthesis Energy Systems, Inc.:

We have audited the accompanying consolidated balance sheets of Synthesis Energy Systems, Inc. and subsidiaries (a development-stage enterprise) as of June 30, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the two-year period ended June 30, 2006 and for the period from November 4, 2003 (inception) to June 30, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Synthesis Energy Systems, Inc. and subsidiaries (a development-stage enterprise) as of June 30, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the two-year period ended June 30, 2006 and for the period from November 4, 2003 (inception) to June 30, 2006, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Houston, Texas  
January 25, 2007

# SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

## Consolidated Balance Sheets

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
<b>ASSETS</b>		
Current assets:		
Cash	\$ 3,154,096	\$ 2,706,602
Prepaid expenses and other current assets (Note 3)	<u>42,037</u>	<u>30,818</u>
Total current assets	<u>3,196,133</u>	<u>2,737,420</u>
Property, plant and equipment, net (Note 4)	9,854	5,929
Intangible asset, net (Note 5)	<u>7,561</u>	<u>8,561</u>
Total assets	\$ <u>3,213,548</u>	\$ <u>2,751,910</u>
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accrued expenses and other payables (Note 6)	\$ 328,198	\$ 114,003
Loan from a shareholder	<u>-</u>	<u>1,150</u>
Total liabilities	328,198	115,153
Stockholders' equity:		
Common stock, \$0.01 par value; 100,000,000 shares authorized; 24,647,500 and 28,030,000 shares issued and outstanding, respectfully (Note 10)	246,475	280,300
Additional paid-in capital (Note 10)	8,179,604	2,714,810
Deficit accumulated during development stage	<u>(5,540,729)</u>	<u>(358,353)</u>
Total stockholders' equity	<u>2,885,350</u>	<u>2,636,757</u>
Commitments and contingencies (Note 9)	-	-
Total liabilities and stockholders' equity	\$ <u>3,213,548</u>	\$ <u>2,751,910</u>

See accompanying notes to the consolidated financial statements.

# SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

## Consolidated Statements of Operations

	Year Ended June 30, 2006	Year Ended June 30, 2005	November 4, 2003 (inception) to June 30, 2006
Net sales	-	-	-
Costs of goods sold	\$ -	\$ -	\$ -
Gross Profit	-	-	-
General and administrative expenses and other expenses			
General and administrative expenses	(1,023,229)	(237,463)	(1,261,132)
Stock based compensation	(3,042,979)	-	(3,042,979)
Project development expenses	(871,882)	(43,679)	(915,561)
Technical development expenses	<u>(373,282)</u>	<u>(87,954)</u>	<u>(461,236)</u>
Operating loss	\$ <u>(5,311,372)</u>	\$ <u>(369,096)</u>	\$ <u>(5,680,908)</u>
Non-operating income			
Interest income	128,996	13,623	142,619
Interest expense	<u>-</u>	<u>(2,440)</u>	<u>(2,440)</u>
Net loss before income tax benefit	(5,182,376)	(357,913)	(5,540,729)
Income tax benefit	-	-	-
Net loss	\$ <u>(5,182,376)</u>	\$ <u>(357,913)</u>	\$ <u>(5,540,729)</u>
Net loss per share (Note 8):			
Basic and diluted	\$ (0.19)	\$ (0.01)	\$ (0.20)
Weighted average common shares outstanding:			
Basic and diluted shares	27,754,139	27,180,446	27,351,936

See accompanying notes to the consolidated financial statements.

**SYNTHESIS ENERGY SYSTEMS, INC.**

(A Development Stage Enterprise)

Consolidated Statements of Stockholders' Equity

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total</u>
Balance at November 4, 2003 (inception)	\$ -	\$ -	\$ -	\$ -
Net loss for the period November 4, 2003 to June 30, 2004	-	-	(440)	(440)
Balance at June 30, 2004	\$ -	\$ -	(440)	\$ (440)
Net loss for the year	-	-	(357,913)	(357,913)
Investor contributions	264,190	235,810	-	500,000
Conversion of debt to equity	5,810	5,190	-	11,000
Net proceeds from private placement offering	<u>10,300</u>	<u>2,473,810</u>	<u>-</u>	<u>2,484,110</u>
Balance at June 30, 2005	\$ <u>280,300</u>	\$ <u>2,714,810</u>	\$ <u>(358,353)</u>	\$ <u>2,636,757</u>
Net loss for the year	-	-	(5,182,376)	(5,182,376)
Net proceeds from private placement offering	9,700	2,378,290	-	2,387,990
Stock-based compensation	-	3,042,979	-	3,042,979
Adjustment related to return of shares	<u>(43,525)</u>	<u>43,525</u>	<u>-</u>	<u>-</u>
Balance at June 30, 2006	\$ <u><u>246,475</u></u>	\$ <u><u>8,179,604</u></u>	\$ <u><u>(5,540,729)</u></u>	\$ <u><u>2,885,350</u></u>

See accompanying notes to the consolidated financial statements.

# SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

## Consolidated Statements of Cash Flows

	Year Ended June 30, 2006	Year Ended June 30, 2005	November 4, 2003 to June 30, 2006 (Since Inception)
Cash flows from operating activities:			
Net loss	\$ (5,182,376)	\$ (357,913)	\$ (5,540,729)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Stock-based compensation	3,042,979	-	3,042,979
Depreciation of property, plant, and equipment	3,960	302	4,262
Amortization of intangible asset	1,000	999	2,439
Increase in prepaid expenses and other current assets	(11,219)	(30,818)	(42,037)
Increase in accrued expenses and other payables	<u>214,195</u>	<u>114,003</u>	<u>328,198</u>
Net cash used in operating activities	\$ <u>(1,931,461)</u>	\$ <u>(273,427)</u>	\$ <u>(2,204,888)</u>
Cash flows from investing activities:			
Capital expenditures	<u>(7,885)</u>	<u>(6,231)</u>	<u>(24,116)</u>
Net cash used in investing activities	\$ <u>(7,885)</u>	\$ <u>(6,231)</u>	\$ <u>(24,116)</u>
Cash flows from financing activities:			
Proceeds from issuance of common stock	2,387,990	2,984,110	5,372,100
Loans from (repayments to) shareholders	<u>(1,150)</u>	<u>150</u>	<u>11,000</u>
Net cash provided by financing activities	\$ <u>2,386,840</u>	\$ <u>2,984,260</u>	\$ <u>5,383,100</u>
Net increase in cash	447,494	2,704,602	3,154,096
Cash and cash equivalents at beginning of the period	<u>2,706,602</u>	<u>2,000</u>	<u>-</u>
Cash and cash equivalents at end of the period	\$ <u><u>3,154,096</u></u>	\$ <u><u>2,706,602</u></u>	\$ <u><u>3,154,096</u></u>
<b>Supplemental cash flow information:</b>			
Cash paid for interest	\$ 150	\$ 2,290	\$ 2,440
Cash received for interest	\$ 128,996	\$ 13,623	\$ 142,619
Non-cash transactions:			
Stock-based compensation	\$ 3,042,979	-	3,042,979
Conversion of debt to equity	\$ -	\$ 11,000	\$ 11,000

See accompanying notes to the consolidated financial statements.

**SYNTHESIS ENERGY SYSTEMS, INC.**  
(A Development Stage Enterprise)

Notes to the Consolidated Financial Statements  
For the years ended June 30, 2006 and 2005 and the  
period from November 4, 2003 (inception) to June 30, 2006

**Note 1 – Summary of Significant Accounting Policies**

*(a) Organization and description of business:*

Synthesis Energy Systems, Inc. (“SES” or “the Company”) is an emerging development stage technology company involved in the global development and commercialization of gasification technology. Its principal asset is a license with the Gas Technology Institute (“GTI”), a U.S. based non-profit research organization, for U-GAS® technology. See Note 13 “Subsequent events - License Agreement with GTI”.

The Company’s strategy is to commercialize GTI’s technology with the initial focus on development in Shanghai, China. The Company’s headquarters are located in Houston, Texas.

On April 18, 2005, SES Acquisition Corporation, a Florida corporation and wholly-owned subsidiary of Tamborine Holdings, Inc. (“Tamborine”), a Mississippi corporation, merged with and into Synthesis Energy Holdings, Inc., a Florida corporation (“Synthesis Florida”), whereby the holders of common stock of Synthesis Florida became shareholders of, and Synthesis Florida became a wholly-owned subsidiary of, Tamborine. The Company accounted for this business combination transaction using the purchase method of accounting, in accordance with FASB Statement No. 141, Business Combinations. This transaction was an exchange of stock in one company for stock in another company; therefore, no goodwill or intangibles were recorded in this transaction. On April 27, 2005, Tamborine changed its name to Synthesis Energy Systems, Inc. and on June 27, 2005, reincorporated in the State of Delaware.

As a condition of the above merger, Synthesis Florida completed a restructuring whereby each of Synthesis Energy Systems, Inc., a corporation formed under the laws of the British Virgin Islands, International Hydrogen Technologies, Inc., a Florida corporation, Innovative Engines, Inc., a Florida corporation, and Synthesis Energy Systems, LLC, a West Virginia limited liability company, became wholly owned subsidiaries of Synthesis Florida. The Company accounted for this transaction as an acquisition between entities under common control. Therefore, the results of operations, of these new subsidiary companies from the acquisition date of April 18, 2005 are included in the Company’s consolidated financial statements as if the restructuring had been formed at the earliest inception date of each of the subsidiaries. Accordingly, no goodwill was recorded as a result of this transaction.

*(b) Basis of presentation and principles of consolidation*

The accompanying consolidated financial statements are in US dollars and include SES, all of its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company has reclassified certain prior year amounts to conform to the current year presentation. The Company is currently in development stage and has not generated any operating revenue to date.

*(c) Use of estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Management considers many factors in selecting appropriate operational and financial accounting policies and controls, and in developing the assumptions that are used in the preparation of these financial statements. Management must apply significant judgment in this process. Among the factors, but not fully inclusive of all factors that may be considered by management in these processes are: the range of accounting policies permitted by accounting principles generally accepted in the United States of America; management’s understanding of the Company’s business – both historical results and expected future results; the extent to which operational controls exist that provide high degrees of assurance that all desired information to assist in the estimation is available and reliable or whether there is greater uncertainty in the information that is available upon

which to base the estimate; expectations of the future performance of the economy, both domestically, and globally, within various areas that serve the Company's principal customers and suppliers of goods and services; expected rates of exchange, sensitivity and volatility associated with the assumptions used in developing estimates; and whether historical trends are expected to be representative of future trends. The estimation process often times may yield a range of potentially reasonable estimates of the ultimate future outcomes and management must select an amount that lies within that range of reasonable estimates based upon the quantity, quality and risks associated with the variability that might be expected from the future outcome and the factors considered in developing the estimate. This estimation process may result in the selection of estimates which could be viewed as conservative or aggressive by others. Management attempts to use its business and financial accounting judgment in selecting the most appropriate estimate, however, actual amounts could and will differ from those estimates.

*(d) Cash and cash equivalents*

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents are carried at cost, which approximates market value.

*(e) Property, plant, and equipment*

Property and equipment are stated at cost. Depreciation is computed by using the straight-line method at rates based on the estimated useful lives of the various classes of property. Estimates of useful lives are based upon a variety of factors including durability of the asset, the amount of usage that is expected from the asset, the rate of technological change and the Company's business plans for the asset. Leasehold improvements are amortized on a straight line basis over the shorter of the lease term or estimated useful life of the asset. Should the Company change its plans with respect to the use and productivity of property and equipment, it may require a change in the useful life of the asset or incur a charge to reflect the difference between the carrying value of the asset and the proceeds expected to be realized upon the asset's sale or abandonment. Expenditures for maintenance and repairs are expensed as incurred and significant major improvements are capitalized.

*(f) Impairment of assets*

The Company evaluates fixed assets for impairment if an event or circumstance occurs that triggers an impairment test. Substantial judgment is necessary in the determination as to whether an event or circumstance has occurred that may trigger an impairment analysis and in the determination of the related cash flows from the asset. Estimating cash flows related to long-lived assets are a difficult and subjective process that applies historical experience and future business expectations to revenues and related operating costs of assets. Should impairment appear to be necessary, subjective judgment must be applied to estimate the fair value of the asset, for which there may be no ready market, which oftentimes results in the use of discounted cash flow analysis and judgmental selection of discount rates to be used in the discounting process. If the Company determines an asset has been impaired based on the projected undiscounted cash flows of the related asset or the business unit over the remaining amortization period, and if the cash flow analysis indicates that the carrying amount of an asset exceeds related undiscounted cash flows, the carrying value is reduced to the estimated fair value of the asset or the present value of the expected future cash flows.

*(g) Intangible asset*

Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with FASB Statement No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

*(h) Provision for income taxes*

The Company accounts for income taxes using the asset and liability method. Deferred tax liabilities and assets are determined based on temporary differences between the basis of assets and liabilities for income tax and financial reporting purposes. The deferred tax assets and liabilities are classified according to the financial statement classification of the assets and liabilities generating the differences. Valuation allowances are established when necessary based upon the judgment of management to reduce deferred tax assets to the amount expected to be

realized and could be necessary based upon estimates of future profitability and expenditure levels over specific time horizons in particular tax jurisdictions.

(i) *Foreign currency translation*

Assets and liabilities of the Company's foreign subsidiaries are translated into U.S. dollars at year-end rates of exchange and income and expenses are translated at average exchange rates during the year. Adjustments resulting from translating financial statements into U.S. dollars for the years ended June 30, 2006 and 2005 were immaterial and therefore the Company's financial statements do not reflect any cumulative translation adjustments which would normally be shown as a separate component of other comprehensive income (loss). Gains and losses from foreign currency transactions are included in net loss.

(j) *Research and development costs*

Research and development costs are expensed as incurred.

(k) *Stock option plan*

In accordance with the provisions of Statement of Financial Accounting Standard (SFAS) No. 123, "Accounting for Stock-Based Compensation," we have elected to account for our stock-based compensation plans under the intrinsic value method established by Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees." In accordance with the provisions of APB No. 25, amounts recorded in net income reflect only the amount by which fair market value is greater than the exercise price of the option at the date of grant. Due to the thinly traded nature of the Company's stock, the Company uses an average of several days of trades to calculate fair market value. In accordance with SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of SFAS No. 123," the effect on our net loss per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in thousands, except per share amounts):

	Year Ended June 30,		November 4, 2003
	2006	2005	(inception) to June 30, 2006
Net loss, as reported	\$ (5,182,376)	\$ (357,913)	\$ (5,540,729)
Add: Total stock-based compensation recorded, net of tax	3,042,979	-	3,042,979
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects (1)	(4,132,917)	-	(4,132,917)
Pro forma net loss	\$ (6,272,314)	\$ (357,913)	\$ (6,630,667)
Net loss per share:			
Basic and diluted, as reported	\$ (0.19)	\$ (0.01)	\$ (0.20)
Basic and diluted pro forma	(0.23)	(0.01)	(0.24)
Weighted-average fair value per share of options granted (1)	\$ 3.49	\$ N/A	\$ 3.49

(1) See Note 11 to the Consolidated Financial Statements for additional information regarding the computations presented above.

## Note 2 - Recently issued accounting standards

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No.123(R)") requiring the compensation cost relating to share-based payments be recognized over their vesting periods in the income statement based on their estimated fair values. In April 2005, the SEC issued Staff Accounting Bulletin No. 107, "Shared-Based Payment" providing for a phased-in implementation process for SFAS No. 123(R). The Statement will be effective for the Company for the fiscal year beginning July 1, 2006. The Company expects

to record approximately \$12.0 million of stock-based compensation over the next four years based upon options outstanding at June 30, 2006.

In May 2005, the FASB issued SFAS No. 154 *"Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3"* (*"SFAS No. 154"*). This pronouncement applies to all voluntary changes in accounting principle and revises the requirements for accounting for and reporting a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable to do so. This pronouncement also requires changes to the method of depreciation, amortization, or depletion for long-lived, non-financial assets are accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements, including those which are in a transition phase (such as SFAS No. 123(R)) as of the effective date of SFAS No. 154. The Company does not expect the adoption of SFAS No. 154 to have a material impact on its financial position, results of operations or cash flows.

In June 2006, the FASB issued FIN 48, *"Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109,"* which clarifies the accounting for uncertainty in tax positions. FIN 48 requires we recognize in our financial statements the impact of a tax position, if the position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on its financial position, results of operation or cash flows.

### Note 3 - Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following:

	<u>As of June 30,</u>	
	<u>2006</u>	<u>2005</u>
Prepaid insurance	\$ 13,158	\$ -
Prepaid legal & consulting services	17,781	10,000
Prepaid rent & related deposits	3,243	9,022
Employee advances	4,389	11,796
Other	3,466	-
	<u>\$ 42,037</u>	<u>\$ 30,818</u>

### Note 4 - Property, plant and equipment

Property, plant and equipment consisted of the following:

	<u>Estimated useful lives</u>	<u>As of June 30,</u>	
		<u>2006</u>	<u>2005</u>
Furniture and fixtures	2 to 3 years	\$ 3,129	\$ 2,957
Leasehold improvements	Lease term	2,298	2,297
Computer equipment	3 years	8,689	977
		<u>\$ 14,116</u>	<u>\$ 6,231</u>
Less: Accumulated depreciation		<u>4,262</u>	<u>302</u>
Net book value		<u>\$ 9,854</u>	<u>\$ 5,929</u>

Depreciation expense for the years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006 was \$3,960, \$302 and \$4,262, respectively.

## Note 5 - Intangible asset

The Company's only intangible asset is a license with the Gas Technology Institute ("GTI"); a U.S. based non-profit research organization, for U-GAS® technology in several world-wide geographic markets, including China, the Appalachian Mountain regions of the United States, India, Pakistan, Australia and the United Kingdom. This agreement was amended and restated on August 31, 2006. See Note 13 *Subsequent Events* "License Agreement with GTI".

	<u>Estimated useful life</u>	<u>As of June 30, 2006</u>		<u>As of June 30, 2005</u>	
		<u>Gross carrying amount</u>	<u>Accumulated amortization</u>	<u>Gross carrying amount</u>	<u>Accumulated amortization</u>
Use rights of "U-GAS:	10 years	<u>\$ 10,000</u>	<u>\$ 2,439</u>	<u>\$ 10,000</u>	<u>\$ 1,439</u>

Amortization expense for the years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006 was \$1,000, \$999 and \$2,439, respectively. Based upon the GTI Agreement that existed as of June 30, 2006, the annual estimated amortization expense, related to an intangible asset, for the next five years is \$1,000 per year.

## Note 6 - Accrued expenses and other payables

The components of the accrued expenses and other payables are as follows:

	<u>As of June 30,</u>	
	<u>2006</u>	<u>2005</u>
Reimbursable expenses	\$ 87,595	\$ 11,929
Technical, engineering and design services	118,143	-
Audit, tax and other consulting	91,269	-
Accrued payroll	24,153	55,000
Other	7,038	47,074
	<u>\$ 328,198</u>	<u>\$ 114,003</u>

## Note 7 - Income taxes

For financial reporting purposes, net loss before income taxes showing domestic and foreign sources was as follows:

	<u>Year ended June 30,</u>	
	<u>2006</u>	<u>2005</u>
Domestic	\$ (3,396,737)	\$ (36,598)
Foreign	<u>(1,785,639)</u>	<u>(321,315)</u>
Net loss	<u>\$ (5,182,376)</u>	<u>\$ (357,913)</u>

*Provision for income taxes*

The following is a reconciliation of income taxes at the statutory federal income tax rate of 35% to the income tax provision (benefit) recorded:

	<b>Year ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Net loss	\$ (5,182,376)	\$ (357,913)
Computed tax benefit at statutory rate	(1,813,832)	(125,270)
Other	1,347	516
Tax on income/(losses) from foreign operations	616,389	112,460
Valuation allowance	1,196,096	12,294
	<u>\$ -</u>	<u>\$ -</u>

*Deferred tax assets (liabilities)*

The components of the net deferred asset (liabilities) are as follows:

	<b>Year ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Deferred tax assets:		
Net operating loss carry forward	\$ 144,999	\$ 12,294
Depreciation and amortization	58	-
Accrued professional fees	10,500	-
Stock-based compensation	1,024,501	-
Other accruals	28,332	-
Subtotal	1,208,390	12,294
Valuation allowance	(1,208,390)	(12,294)
Net deferred assets (liabilities)	<u>\$ -</u>	<u>\$ -</u>

At June 30, 2006 we had approximately \$390,107 of federal net operating loss (“NOL”) carry forwards, and \$56,412 of China NOL carry forwards. The federal NOL carry forwards have expiration dates through the year 2026. The China NOL carry forwards will expire in 2011.

The Company has established valuation allowances for uncertainties in realizing the benefit of tax losses, and other deferred tax assets in all jurisdictions. Future changes in estimates of taxable income or in tax laws may change the need for the valuation allowance.

**Note 8 – Net loss per share data**

Historical net loss per common share is computed using the weighted average number of common shares outstanding. Basic loss per share excludes dilution and is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding for the period. For the years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006, the number of weighted average shares included in the calculation was 27,754,139, 27,180,446 and 27,351,936 respectively. Stock options are the only potential dilutive share equivalents the Company has outstanding for the periods presented. No shares related to options were included in diluted earnings per share for the years ended June 30, 2006 and 2005 and

the period from November 4, 2003 (inception) to June 30, 2006 as their effect would have been antilulitive as the Company incurred net loss during those periods.

## **Note 9 - Commitments and contingencies**

### *Lease commitments*

The Company' occupies approximately 3,000 square feet of leased office space in Houston, Texas, approximately 3,500 square feet of office space in Shanghai, China and small offices in Miami, Florida, and Beijing, China. Rental expenses incurred under operating leases for the years ended June 30, 2006 and 2005 and for the period from November 4, 2003 (inception) to June 30, 2006 were approximately \$27,085, \$6,267 and \$33,352, respectively. Future minimum lease payments under non-cancelable operating lease (with initial or remaining lease terms in excess of one year) as of June 30, 2006 are as follows:

<b>Year Ending June 30,</b>	
2007	\$ 8,033
2008	1,501
Total future minimum lease payments	<u>\$ 9,534</u>

### *License agreement*

On February 27, 2006, the Company amended its license agreement with the Gas Technology Institute ("GTI"); a U.S. based non-profit research organization, for U-GAS® technology. Commitments under the amended agreement at June 30, 2006 were as follows:

<b>Year Ending June 30,</b>	
2007	\$ 60,000
2008	5,000
Total future minimum lease payments	<u>\$ 65,000</u>

On August 31, 2006, the Company entered into an Amended and Restated License Agreement with GTI for which the company paid \$500,000 in cash and issued 190,500 shares of common stock in lieu of the payments above. (See Note 13 "Subsequent events - License Agreement with GTI").

### *Employment agreements*

The Company has entered into employment agreements with several of its top management executives which contain specific guaranteed bonuses and/or pay increases based upon certain specific targets. As of June 30, 2006 none of the specified targets had been met therefore no accrual has been made for these events.

### *Equity and financing transaction*

In March 2005, in connection with a private placement for a maximum of 2,000,000 shares of common stock, (See Note 10 – Stockholders Equity) the Company entered into an agreement with Union Charter Capital VII, Inc. ("UCF") which covered certain capital commitment obligations of UCF and the Company and set forth certain rights of UCF if certain commitment thresholds were met. UCF met these commitments in connection with the August 2006 private placement of 3,345,715 shares of common stock. On November 30, 2006, the Company amended and restated its agreement with UCF in its entirety to clarify certain statements in the previous agreement. As amended and restated, UCF is entitled to purchase up to 2,000,000 shares of the Company's common stock at a purchase price of \$2.50 per share on or prior to June 30, 2007. Upon exercise of this right, UCF may purchase all or a portion of the 2,000,000 shares. The Company estimates the fair value of these options to be \$9.8 million dollars, using a Black Scholes options pricing model. The following weighted average assumption used were as follows:

risk-free interest rates of 5.10%, dividend rate of 0.00%, expected life of 10 months and expected volatility of 58.66%

*Tamborine merger related representations and warranties*

Synthesis Energy Systems, Inc., a corporation formed under the laws of the British Virgin Islands (“Synthesis BVI”), and Synthesis Energy Systems, LLC, a West Virginia limited liability company (“Synthesis LLC”), were formed as sister companies in November of 2003 to engage in the business of development and commercialization of the U-GAS® technology. The founders of SES BVI believed that it was important to be a publicly traded company in order to obtain the capital necessary to engage in this business. Tamborine Holdings, Inc., a shell company trading on the Pink Sheets (“Tamborine”), a centralized quotation service that collects and publishes market maker quotes for securities traded in the over-the-counter market (the “Pink Sheets”), was receptive to a combination transaction with SES BVI. As such, on April 18, 2005, pursuant to the terms of an Agreement and Plan of Merger (the “Agreement”), SES Acquisition Corporation, a wholly-owned subsidiary of Tamborine, merged with and into Synthesis Energy Holdings, Inc., a Florida corporation (“Synthesis Florida”), whereby the holders of common stock of Synthesis Florida became shareholders of, and Synthesis Florida became a wholly-owned subsidiary of, Tamborine. As a condition of the above merger, Synthesis Florida completed a restructuring whereby each of Synthesis BVI and Synthesis LLC became wholly owned subsidiaries of Synthesis Florida. On April 27, 2005, Tamborine changed its name to “Synthesis Energy Systems, Inc.” and on June 27, 2005, reincorporated in the state of Delaware. At the time of the merger, there were 100,000,000 shares of Tamborine common stock outstanding, 94,000,000 of which were cancelled in connection with the merger. The remaining 6,000,000 shares became shares of the Company as the surviving entity as a result of the name change and the reincorporation. An additional 21,000,000 “restricted” shares were issued as consideration in the merger to former shareholders of Synthesis Florida, all of whom were accredited investors.

Tamborine made numerous representations and warranties in the Agreement, including a representation that all prior offers and sales of its common stock were duly registered or exempt from the registration requirements of the Securities Act or any applicable state securities laws. As noted above, one of the principal reasons that Synthesis Florida completed the merger was to have access to a public trading market, and Tamborine had represented that its shares were eligible for trading, and in fact were trading, on the Pink Sheets. The Company’s current management team, which took office beginning in May of 2006, re-examined the facts surrounding the Tamborine issuances prior to the merger and now believes that Tamborine’s representation in the Agreement as to its compliance with federal and state securities laws was incorrect. Although the Company’s current management has not been able to locate any definitive records regarding the prior issuances of Tamborine, they have been able to determine the following details.

Tamborine was formed in May 2004, and in connection with its formation, issued 100,000,000 shares of its common stock to its three founders, including IFG Investment Services (“IFG”). The certificates issued to two of the three founders contained the appropriate restrictive legend limiting transfer of the shares as is customary in an unregistered private placement. However, the certificate issued to IFG for 7,500,000 shares was apparently issued without such restrictive legends. In June 2004, IFG delivered its certificate to Transfer Online, which thereafter began acting as the transfer agent for Tamborine’s common stock. In January 2005, a broker-dealer diligence form was filed by Tamborine with the Pink Sheets under Rule 15c2-11 of the Exchange Act stating that 6,000,000 shares of Tamborine common stock had been sold in 2004 pursuant to an exemption from registration under Rule 504 of the Securities Act. We are unsure of which 6,000,000 shares this filing refers to, although it likely is referring to a portion of IFG’s shares. The Company’s current management team believes that this Rule 15c2-11 form was filed to permit trading of the common stock of Tamborine on the Pink Sheets. On March 29, 2005, a second Rule 15c2-11 filing was made by Tamborine which stated that there were 7,500,000 freely tradable shares in the “float,” meaning that those shares could be traded on the Pink Sheets, and also stating that 6,000,000 shares had been sold in 2004 to three investors in Texas under Rule 504.

The Company’s current management team believes that 6,000,000 shares of the 7,500,000 shares that were represented to be “freely tradable” in Tamborine’s second 15c2-11 filing, and which remained outstanding after the merger, were not in fact freely tradable when issued. As noted above, there are no available definitive records, other than the two Rule 15c2-11 filings, regarding the issuance of those shares or the possible exemptions from registration under federal and state securities laws that were used to issue the shares or permit trading of the shares on the Pink Sheets. IFG has not provided an opinion of counsel confirming that these shares were issued, and

subsequently transferred, subject to an available exemption. Moreover, the representation in the 15c2-11 filing that issuing these shares under Rule 504 permits those shares to become “freely tradable” is likely not correct. Under Rule 504, any shares sold thereunder are “restricted” shares and may not be sold in the public markets without the use of an exemption from registration. We believe that IFG may have based its view on an incorrect and outdated interpretation of Rule 504. This means that resales of these shares by IFG on the Pink Sheets may have been in violation of applicable securities laws because the shares were in fact restricted. Trading by subsequent holders may have been in accordance with applicable securities laws based on other available exemptions, but we do not have any documentation to confirm any such conclusions.

The Company is taking a number of steps to deal with these issues and have notified its transfer agent to cease any further transfers of the Company’s common stock without the approval of management. Additionally, the Company may request that IFG surrender its remaining shares of common stock in return for restricted shares and/or for cancellation. Current Management of the Company has no reason to believe, at this time, that IFG will respond to their request. They also intend to contact all stockholders who purchased shares of common stock in our May 2005 and August 2006 private placements to inform them of these issues and give them the opportunity to have the aggregate purchase price that they paid returned, plus interest. We are also filing a registration statement on Form SB-2 to (a) cause the Company to become a reporting company under the Exchange Act, which simplifies the use of Rule 144 to trade Company securities, provides information that is more complete to stockholders and is a key requirement for listing on a national securities exchange, and (b) register resales of shares held by investors in the private placements noted above, which provides them with an opportunity to dispose of shares using the registration statement without any limitations on volume or concerns about the issues noted above. Lastly, the Company has filed an updated 15c2-11 filing on August 11, 2006 and intends to file another updated 15c2-11 filing in connection with the filing of the registration statement to provide current and correct information about the Company and the above matters.

As noted above, many aspects of these events cannot be corroborated by documentary evidence or otherwise. In addition, there is not sufficient evidence relating to the trading history of the Company’s common stock to analyze the range of potential damages, if any, arising out of these events. In fact, the trading price for our stock has generally increased since it began trading on the Pink Sheets, and we have made progress in executing its business plan, so it is possible that these events have not generated significant liabilities. Of course, federal and state regulatory agencies could also examine these events and commence proceedings against the Company, its officers and directors (former and current) and the other individuals involved. We do maintain officer and director liability insurance, and would of course utilize that coverage, if it is available under the terms of the policy, in the event any liabilities are assessed against officers and directors. Given the above facts, it is not possible at this time to predict the likelihood that the Company will in fact have any liability arising out of these events or the amount of such liability, if any.

## **Note 10 - Stockholders equity**

The authorized capital stock of the Company consists of 100,000,000 shares of common stock. Prior to the merger transaction between the Company and Synthesis Florida effective on April 18, 2005 as described in Note 1(a), the Company’s total issued and outstanding common stock was 100,000,000 shares. After the effective date of the merger, 94,000,000 shares of the issued and outstanding common stock of the Company were forfeited, and 21,000,000 shares of the Company were issued to the original shareholders of Synthesis Florida as consideration for the merger. As a result, 27,000,000 shares of the Company’s common stock were issued and outstanding on the effective date of the merger.

Subsequent to the merger, the Company offered for private placement a maximum of 2,000,000 shares of its common stock at a price of \$2.50 per share for a maximum aggregate amount of \$5,000,000 to certain accredited investors in 2005. The offering was fully subscribed and, after deducting for legal and other related expenses, net proceeds of \$4,872,100 were received by the Company. The difference between the offered price and the Company’s par value is recorded under “additional paid-in capital”. As a result, 29,000,000 shares of the Company’s common stock were issued and outstanding after the close of the private placement.

As part of the reincorporation of the Company from Mississippi to Delaware as described in Note 1(a), the par value of the Company’s common stock was converted from \$0.001 per share to \$0.01 per share, with the total number of outstanding shares remaining unchanged. The “capital stock” amount and the “additional paid-in capital”

amount in the accompanying financial statements, including the prior period comparative figures, have been reclassified and recapitalized to reflect such par value change, with nil net impact on stockholders' equity.

During the year ended June 30, 2006, certain shareholders of the Company agreed to surrender an aggregate of 4,352,500 shares of the Company's common stock. As a result, the issued and outstanding shares of the Company were reduced from 29,000,000 shares to 24,647,500 shares. The "capital stock" amount and the "additional paid-in capital" amount in the accompanying financial statements have been reclassified and recapitalized to reflect such reduction in the number of issued and outstanding shares, with no net impact on stockholders' equity.

## Note 11 – Accounting for stock-based compensation

Under our 2005 SES 2005 Incentive Plan we may grant (a) non-qualified stock options to our employees, directors and eligible consultants, (b) incentive stock options to employees only in accordance with the terms and conditions of the plan or (c) restricted stock. The total number of shares of common stock that may be subject to the granting of incentive awards under the plan is 15% of the Company's issued and outstanding shares on the last day of each calendar quarter preceding a grant. (See Note 13 "Subsequent Events – Amendment to the 2005 Incentive Plan"). The plan options vest up to five years and expire five years from the grant date.

The following is a summary of the status of our 2005 Incentive Plan at June 30, 2006 and 2005, and changes during the years then ended:

	2006		2005		November 4, 2003 (inception) to June 30, 2006	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year		\$ -	-	\$ -	-	\$ -
Granted	5,000,000	2.97	-	-	5,000,000	2.97
Exercised	-		-	-	-	-
Forfeited or canceled	197,500	2.91	-	-	197,500	2.91
Outstanding, end of year	<u>4,802,500</u>	2.97	<u>-</u>	-	<u>4,802,500</u>	2.97
Exercisable, end of year	1,015,000	\$ 2.96	-	-	1,015,000	\$ 2.96
Weighted average grant-date fair value of options granted		\$ 3.49		\$ -		\$ 3.49

The following table summarizes information about our outstanding stock options at June 30, 2006:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price Exercise	Number Exercisable	Weighted Average Exercise Price
\$2.50 to \$3.00	4,802,500	4.9	\$ 2.97	1,015,000	\$ 2.96

For purposes of the pro forma disclosures in Note 1(k), under SFAS No. 123, the fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used for grants during the years ended June 30, 2006 and 2005 and the period for November 4, 2003 (inception) to June 30, 2006, respectively: risk-free interest rates of 4.96%, 0.00% and 4.96%;

dividend rates of \$0, \$0 and \$0; expected lives of 3.50, 0.00 and 3.50 years; expected volatility of 67.6%, 0.00% and 67.6%.

The Black-Scholes option pricing model and other existing models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of, and are highly sensitive to, subjective assumptions including the expected stock price volatility. Our employee stock options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

## **Note 12 - Related party transactions**

Companies are considered to be related if a company has the ability, directly or indirectly, to control a second company or exercise significant influence over a second company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence. There was no material related party transactions during the year ended June 30, 2006.

On December 27, 2004, a shareholder advanced \$1,050,000 to the Company at an interest rate of approximately 1.6% per annum. The advance was repaid with interest expense, approximately \$2,290 on February 17, 2005. Since the net amount is zero these amounts are not shown on the Company's Statement of Cash Flows for the year ended June 30, 2005.

In 2005, loans from shareholders in the amount of \$11,000 were converted into paid-in-capital upon the Agreement of Forgiveness of loan signed on April 18, 2005.

## **Note 13 - Subsequent events**

### *Joint Venture Project in China*

On July 6, 2006, one of the Company's wholly-owned subsidiaries, Synthesis Energy Systems Investments, Inc., entered into a cooperative joint venture contract with Shandong Hai Hua Coal & Chemical Company Ltd. ("Hai Hua") which established Synthesis Energy Systems (Zaozhuang) New Gas Company Ltd. ("SES Zaozhuang"), a joint venture company that has the primary purpose of developing, constructing and operating a synthesis gas production plant utilizing the U-GAS® technology. Pursuant to the terms of the contract, in exchange for their respective ownership shares in SES Zaozhuang, SES Investments will contribute capital, and Hai Hua will contribute land use rights, storage facilities and certain other management services to the Company. Hai Hua will buy synthesis gas from the joint venture company at a specified contract amount. The contract has a term of fifty years, subject to earlier termination if either SES Zaozhuang files for bankruptcy or becomes insolvent or if the tolling contract between SES Zaozhuang and Hai Hua (discussed in more detail below) is terminated. Hai Hua has also agreed that the License Agreement is the sole property of SES Investments and its affiliated entities and that it will not compete with SES Investments, or its affiliated entities, with respect to fluidized bed gasification technology for the term of the contract.

The Company is currently estimating that it will contribute approximately \$9.3 million as equity into the newly formed joint venture company. Construction of the plant is expected to be completed in the second half of the calendar year 2007. The Company and Hai Hua have received government approvals for the establishment of the joint venture company. As of September 30, 2006 the Company had paid \$232,279 to equipment suppliers for downpayments on equipment to be built for the Hai Hua project.

On October 22, 2006, SES Zaozhuang entered into purchase and sale contract with Hai Hua pursuant to which Hai Hua will buy, once the plant is completed, synthesis gas from SES Zaozhuang at a specified contract amount. Pursuant to the terms of the contract, Hai Hua will pay a tolling fee based upon the available gasification capacity and an energy charge based upon the actual syngas consumed. Hai Hua is obligated to pay the tolling fee regardless of whether they use the gasification capacity. If SES Zaozhuang produces more syngas than the capacity that Hai Hua is required to purchase under the contract, Hai Hua shall have a right of first refusal to purchase such excess amount. The agreement terminates twenty years from the date the plant becomes operational.

### *License Agreement with GTI*

On August 31, 2006, the Company entered into an Amended and Restated License Agreement with GTI for which the Company paid \$500,000 in cash and issued 190,500 shares of common stock. Pursuant to the Amended and Restated License Agreement between the Company and GTI (the "License Agreement"), the Company has an exclusive license to manufacture, make, use and sell U-GAS® systems using the technology of GTI worldwide as to coal gasification, biomass blends up to 40% biomass, systems and non-exclusive license to manufacture, make, use and sell 40% biomass and coal mixture gasification systems. The License Agreement has an initial term of ten years, but may be extended for two additional ten years terms (total of 30 years) at the option of the Company. This agreement also outlines certain restrictive covenants relating to competing, gasification technologies. Additionally, for each U-GAS® unit for which the Company licenses, designs, builds or operates which uses coal, or a coal and biomass mixture, as the feed stock, the Company must pay a royalty and must also provide GTI with a copy of each contract that the Company enters into relating to a U-GAS® system and report to GTI with their progress on development of the technology every six months. A failure to comply with any of the above requirements could result in the termination of the License Agreement by GTI.

In addition, the Company is required to (i) have a contract for the sale of a U-GAS® system with a customer in the territory covered by the License Agreement no later than August 31, 2007, (ii) fabricate and put into operation at least one U-GAS® system within the territory covered by the License Agreement by July 31, 2008 and (iii) fabricate and put into operation at least one U-GAS® system within the territory covered by the License Agreement for each calendar year of the License Agreement, beginning with the calendar year 2009. The Company is required to disclose to GTI any improvements related to the U-GAS® system which are developed and implemented by the Company and the manner of using and applying such improvements. Failure to satisfy the requirements as to these milestones could lead to the revocation of the license by GTI; provided, however, that GTI is required to give a twelve-month notice of termination and the Company is able to cure the default and continue the Agreement prior to the expiration of such time period.

Without the prior written consent of GTI, the Company has no right to sublicense any U-GAS® system other than to customers for which the Company has constructed a U-GAS® system. For a period of ten years, the Company is restricted from disclosing any confidential information (as defined in the license) to any person other than employees of its affiliates or contractors who are required to deal with such information, and such persons will be bound by the confidentiality provisions of the license. The Company further indemnified GTI and its affiliates from any liability or loss resulting from unauthorized disclosure or use of any confidential information that it receives.

### *Amendment to the 2005 Incentive Plan*

Effective August 5, 2006, the Company's amended and restated its 2005 Incentive Plan. The Amended and Restated 2005 Incentive Plan (the "Plan") increases the number of shares reserved under the plan to 6,000,000 shares of common stock. The Company's Board of Directors adopted the Plan as amended and restated on August 5, 2006 and shareholder approval was obtained at the Annual Meeting of Stockholders on September 25, 2006.

### *Issuance of Common Stock*

In August 2006, the Company received approximately \$16,000,000 and issued 3,345,715 shares of common stock in a round of private placement financing which closed on November 30, 2006.

### *Amendment to the Union Charter Agreement*

On November 30, 2006, the Company amended and restated its agreement with UCF in its entirety to clarify certain statements in the previous agreement. As amended and restated, UCF is entitled to purchase up to 2,000,000 shares of the Company's common stock at a purchase price of \$2.50 per share on or prior to June 30, 2007. Upon exercise of this right, UCF may purchase all or a portion of the 2,000,000 shares. The Company estimates the fair value of these options to be \$9.8 million dollars, using a Black Scholes options pricing model. The following weighted average assumption used were as follows: risk-free interest rates of 5.10%, dividend rate of 0.00%, expected life of 10 months and expected volatility of 58.66%.

*First Amendment to the Amended and Restated Agreement and Plan of Merger*

On December 29, 2006, the Company amended the Agreement for the sole purpose of correcting the number of shares of common stock issued in the merger with Tamborine. The Agreement stated that 21,050,000 shares were issued when in actuality only 21,000,000 shares were issued.



**Synthesis Energy Systems, Inc.**  
**(A Development Stage Enterprise)**

**Unaudited Condensed Consolidated Financial Statements**  
**Quarters Ended September 30, 2006 and 2005**

## INDEX TO FINANCIAL STATEMENTS

Condensed Consolidated Balance Sheet as of September 30, 2006 (unaudited) and June 30, 2006 .....	F-2
Condensed Consolidated Statements of Operations for the three months ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006 (unaudited).....	F-3
Condensed Consolidated Statement of Stockholders' Equity for the three months ended September 30, 2006 (unaudited) .....	F-4
Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006 (unaudited).....	F-5
Notes to Unaudited Condensed Consolidated Financial Statements for the three months ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006 .....	F-6

## SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

### Unaudited Condensed Consolidated Balance Sheets

	<u>September 30, 2006</u>	<u>June 30, 2006</u>
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash	\$ 17,510,891	\$ 3,154,096
Prepaid expenses and other current assets	<u>97,394</u>	<u>42,037</u>
Total current assets	\$ <u>17,608,285</u>	\$ <u>3,196,133</u>
Property, plant and equipment, net	96,061	9,854
Project prepayment	232,279	-
Intangible asset, net	<u>1,868,036</u>	<u>7,561</u>
Total assets	\$ <u>19,804,661</u>	\$ <u>3,213,548</u>
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accrued expenses and other payables	\$ <u>538,126</u>	\$ <u>328,198</u>
Total liabilities	538,126	328,198
Common stock, \$0.01 par value; 100,000,000 shares authorized; 28,183,715 and 24,647,500 shares issued and outstanding, respectively	281,837	246,475
Additional paid-in capital	27,459,950	8,179,604
Deficit accumulated during development stage	(8,475,796)	(5,540,729)
Accumulated other comprehensive income	<u>544</u>	<u>-</u>
Total stockholders' equity	\$ 19,266,535	\$ 2,885,350
Commitments and contingencies	-	-
Total liabilities and stockholders' equity	\$ <u>19,804,661</u>	\$ <u>3,213,548</u>

See accompanying notes to the condensed consolidated financial statements.

# SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

## Unaudited Condensed Consolidated Statements of Operations

	<u>Three Months Ended</u> <u>September 30, 2006</u>	<u>Three Months Ended</u> <u>September 30, 2005</u>	<u>November 4, 2003</u> <u>(Inception) to</u> <u>September 30, 2006</u>
	(Unaudited)	(Unaudited)	(Unaudited)
Net sales	\$ -	\$ -	\$ -
Costs of goods sold	<u>-</u>	<u>-</u>	<u>-</u>
Gross Profit	-	-	-
General and administrative expenses and other expenses			
General and administrative expenses	(727,206)	(111,648)	(1,988,338)
Stock-based compensation	(1,779,545)	-	(4,822,524)
Project development cost	(375,832)	(102,705)	(1,291,393)
Technical development	(148,607)	(83,714)	(609,843)
Operating loss	\$ <u>(3,031,190)</u>	\$ <u>(298,067)</u>	\$ <u>(8,762,098)</u>
Non-operating income			
Interest income	96,123	25,978	238,742
Interest income	<u>-</u>	<u>-</u>	<u>(2,440)</u>
Net loss before income tax benefit	<u>(2,935,067)</u>	<u>(272,089)</u>	<u>(8,475,796)</u>
Income tax benefit	-	-	-
Net loss	\$ <u><u>(2,935,067)</u></u>	\$ <u><u>(272,089)</u></u>	\$ <u><u>(8,475,796)</u></u>
Net loss per share:			
Basic and diluted	\$ (0.11)	\$ (0.01)	\$ (0.31)
Weighted average common shares outstanding:			
Basic and diluted shares	26,070,648	28,762,889	27,240,572

See accompanying notes to the condensed consolidated financial statements.

## SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

### Unaudited Condensed Consolidated Statement of Stockholders' Equity

	<b><u>Common Stock</u></b> (Unaudited)	<b><u>Additional Paid-in Capital</u></b> (Unaudited)	<b><u>Deficit Accumulated During the Development Stage</u></b> (Unaudited)	<b><u>Accumulated Other Comprehensive Income</u></b> (Unaudited)	<b><u>Total</u></b>
Balance at June 30, 2006	\$ <u>246,475</u>	\$ <u>8,179,604</u>	\$ <u>(5,540,729)</u>	\$ <u>-</u>	\$ <u>2,885,350</u>
Net loss for the period	-	-	(2,935,067)	-	(2,935,067)
Currency translation adjustment	-	-	-	544	544
Net proceeds from private placement offering	33,457	16,126,343	-	-	16,159,800
Stock-based compensation	-	1,779,545	-	-	1,779,545
Shares issued for amended GTI license	<u>1,905</u>	<u>1,374,458</u>	<u>-</u>	<u>-</u>	<u>1,376,363</u>
Balance at September 30, 2006	\$ <u><u>281,837</u></u>	\$ <u><u>27,459,950</u></u>	\$ <u><u>(8,475,796)</u></u>	<u><u>\$ 544</u></u>	<u><u>19,266,535</u></u>

See accompanying notes to the condensed consolidated financial statements.

## SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

### Unaudited Condensed Consolidated Statements of Cash Flows

	<b>Three Months Ended September 30, 2006</b>	<b>Three Months Ended September 30, 2005</b>	<b>November 4, 2003 (inception) to September 30, 2006</b>
	(Unaudited)	(Unaudited)	(Unaudited)
Cash flows from operating activities:			
Net loss	\$ (2,935,067)	\$ (272,089)	\$ (8,475,796)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Stock-based compensation	1,779,545	-	4,822,524
Depreciation of property, plant, and equipment	1,998	778	6,260
Loss on disposal of property, plant, and equipment	2,296	-	2,296
Amortization of intangible assets	15,888	252	18,327
Increase in prepaid expenses and other current assets	(55,358)	(109,353)	(97,395)
Increase (decrease) in accrued expenses and other payables	<u>209,927</u>	<u>(76,592)</u>	<u>538,125</u>
Net cash used in operating activities	\$ <u>(980,771)</u>	\$ <u>(457,004)</u>	\$ <u>(3,185,659)</u>
Cash flows from investing activities:			
Capital expenditures	(90,499)	(4,015)	(114,615)
Amendment of GTI license rights	(500,000)	-	(500,000)
Project prepayment	<u>( 232,279)</u>	<u>-</u>	<u>(232,279)</u>
Net cash used in investing activities	\$ <u>(822,778)</u>	\$ <u>(4,015)</u>	\$ <u>(846,894)</u>
Cash flows from financing activities:			
Proceeds from issuance of common stock	16,159,800	2,387,990	21,531,900
Loans from (repayments to) shareholders	<u>-</u>	<u>(1,150)</u>	<u>11,000</u>
Net cash provided by financing activities	\$ <u>16,159,800</u>	\$ <u>2,386,840</u>	\$ <u>21,542,900</u>
Net increase in cash	14,356,251	1,925,821	17,510,347
Cash, beginning of the period	3,154,096	2,706,602	-
Effect of exchange rates on cash	<u>544</u>	<u>-</u>	<u>544</u>
Cash, end of the period	\$ <u>17,510,891</u>	\$ <u>4,632,423</u>	\$ <u>17,510,891</u>

See accompanying notes to the condensed consolidated financial statements.

## SYNTHESIS ENERGY SYSTEMS, INC.

(A Development Stage Enterprise)

### Notes to the Unaudited Condensed Consolidated Financial Statements For the three months ended September 30, 2006 and 2005

#### **Note 1 – Summary of Significant Accounting Policies**

##### *(a) Organization and description of business*

The Company is an emerging development stage technology company involved in the global development and commercialization of gasification technology. Its principal asset is a license with the Gas Technology Institute (“GTI”), a U.S. based non-profit research organization, for U-GAS® technology. The Company’s strategy is to commercialize GTI’s technology with the initial focus on development in Shanghai, China. The Company’s headquarters are located in Houston, Texas.

##### *(b) Basis of presentation and principles of consolidation*

The accompanying consolidated financial statements are in US dollars and include Synthesis Energy Systems, Inc., all of its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company has reclassified certain prior year amounts to conform to the current year presentation. The Company is currently in development stage and has not generated any operating revenue to date.

The accompanying unaudited consolidated financial statements for the three-month periods ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006 have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and disclosures normally present in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. The company believes that the disclosures provided are adequate to make the information presented not misleading.

These financial statements should be read in conjunction with the audited financial statements and explanatory notes for the years ended June 30, 2006 and 2005 and the period from November 4, 2003 (inception) to June 30, 2006.

The results of the three-month period ended September 30, 2006 are not necessarily indicative of the results of operations to be expected for the twelve-month period ending June 30, 2007.

##### *(c) Use of estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Management considers many factors in selecting appropriate operational and financial accounting policies and controls, and in developing the assumptions that are used in the preparation of these financial statements. Management must apply significant judgment in this process. Among the factors, but not fully inclusive of all factors that may be considered by management in these processes are: the range of accounting policies permitted by accounting principles generally accepted in the United States of America; management’s understanding of the Company’s business – both historical results and expected future results; the extent to which operational controls exist that provide high degrees of assurance that all desired information to assist in the estimation is available and reliable or whether there is greater uncertainty in the information that is available upon

which to base the estimate; expectations of the future performance of the economy, both domestically, and globally, within various areas that serve the Company's principal customers and suppliers of good and services; expected rates of exchange, sensitivity and volatility associated with the assumptions used in developing estimates; and whether historical trends are expected to be representative of future trends. The estimation process often times may yield a range of potentially reasonable estimates of the ultimate future outcomes and management must select an amount that lies within that range of reasonable estimates based upon the quantity, quality and risks associated with the variability that might be expected from the future outcome and the factors considered in developing the estimate. This estimation process may result in the selection of estimates which could be viewed as conservative or aggressive by others. Management attempts to use its business and financial accounting judgment in selecting the most appropriate estimate, however, actual amounts could and will differ from those estimates.

## **Note 2 – Accounting for stock-based compensation**

Under our 2005 SES 2005 Incentive Plan we may grant (a) non-qualified stock options to our employees, directors and eligible consultants, (b) Incentive Stock options to employees only in accordance with the terms and conditions of the plan or (c) restricted stock. The total number of shares of common Stock that may be subject to the granting of incentive awards under the plan is 15% of the Company's issued and outstanding shares on the last day of each calendar quarter preceding a grant. (See Note 13 "Subsequent Events – Amendment to the 2005 Incentive Plan"). The plan options vest up to five years and expire five years from the grant date.

Prior to July 1, 2006, we accounted for our stock option and stock-based compensation plans using the intrinsic-value method outlined by Accounting Principles Board ("APB") Opinion No. 25. Accordingly, we computed compensation cost for each employee stock option granted as the amount by which the fair market value was greater than the exerciser price of the option at the date of grant. Due to the thinly traded nature of the Company's stock, the Company uses an average of several days of trades to calculate fair market value. The amount of compensation cost was expensed over the vesting period. During the year ended June 30, 2006 the Company recognized \$3,042,979 of stock-based compensation.

Effective July 1, 2006, we adopted the provisions of the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standard ("SFAS") No. 123R, "Share Based Payment" and elected to use the modified prospective transition method. Under this method, compensation cost recognized for the three months ended September 30, 2006, includes the applicable amounts of: (a) compensation cost of all stock-based awards granted prior to, but not yet vested, as of June 30, 2006 based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123 and previously presented in pro forma footnote disclosures, and (b) compensation cost for all stock-based awards granted subsequent to June 30, 2006 (based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R)). Results for prior periods have not been restated.

SFAS No. 123R amends SFAS No. 95, "Statement of Cash Flows," to require reporting of tax benefits as a financing cash flow, rather than as a reduction of taxes paid. These tax benefits result from tax deductions in excess of the compensation expense recognized for options exercised. Prior to the adoption of SFAS No. 123R, no stock options were exercised.

On March 29, 2005, the SEC issued Staff Accounting Bulletin ("SAB") 107 to address certain issues related to SFAS No. 123R. SAB 107 provides guidance on transition methods, valuation methods, income tax effects and other share-based payment topics, and we had also applied this guidance in our adoption of SFAS No. 123R.

On November 10, 2005, the Financial Accounting Standards Board (the "FASB") issued FASB Staff Position ("FSP") No. FAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards" ("FSP 123R-3"). FSP 123R-3 provides for an alternative transition method for establishing the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123R. We have elected to adopt this alternative transition method, otherwise known as the "simplified method," in establishing our beginning APIC pool at July 1, 2006

*Effect of Adopting SFAS No. 123(R)*

The following is the effect of adopting SFAS No. 123(R) as of July 1, 2006:

	<b>Three Months Ended September 30, 2006</b>
Stock-based compensation	\$ 1,779,545
Related deferred income tax benefit	-
Decrease in basic and diluted earnings per share	\$ (0.07)

The amounts above relate to the impact of recognizing compensation expense related to stock options.

The Company recognizes expense for our stock-based compensation over the vesting period, which represents the period in which an employee is required to provide service in exchange for the award and recognizes compensation expense for stock-based awards immediately if the award has immediate vesting.

*Prior Period Pro Forma Presentation*

Under the modified prospective application method, results for prior periods have not been restated to reflect the effects of implementing SFAS No. 123 (R). The following pro forma information, as required by SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of FASB Statement No. 123" is presented for comparative purposes and illustrates the pro forma effect on net loss per share for the period presented as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation prior to July 1, 2006 (in thousands, except per-share amounts):

	<b>Three Months Ended September 30, 2005</b>
Net loss, as reported	\$ (272,089)
Add: total stock-based compensation recorded, net of tax	-
Less: total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	-
Pro forma net loss	\$ (272,089)
Net loss per share:	
Basic and diluted as reported	\$ (0.01)
Basic and diluted pro forma	\$ (0.01)

*Assumptions*

The fair values for the significant stock-based awards granted during the three months ended September 30, 2006 were estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions. No stock-based awards were issued during the three months ended September 30, 2005.

	<b>Three Months Ended September 30, 2006</b>
Risk-free rate of return	4.80%
Expected life of award	3.5 years
Expected dividend yield	0.00%
Expected volatility of stock	66.54%
Weighted-average fair value	\$3.81

The expected volatility of stock assumption was derived by referring to changes in the historical volatility of comparable companies. Forfeiture rates are estimated due to a lack of historical forfeiture data.

In accordance with SAB 107, we used the “simplified” method for “plain vanilla” options to estimate the expected term of options granted during 2006.

Stock-based award activity during the three months ended September 30, 2006 was as follows (aggregate intrinsic value in millions):

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at June 30, 2006	4,802,500	\$2.97	4.9	\$2.4
Granted	340,000	\$4.94	4.9	\$0.4
Exercised				
Canceled				
Outstanding at September 30, 2006	5,142,500	\$3.10	4.6	\$2.8

As of September 30, 2006, approximately \$9.7 million of estimated expense with respect to non-vested stock-based awards has yet to be recognized and will be recognized in expense over the employee’s remaining weighted average service period of approximately 4.6 years. As of September 30, 2006, 1,083,000 of the above options were exercisable.

The following table summarizes information with respect to stock options outstanding and exercisable at September 30, 2006.

<u>Range of Exercise Prices</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Life (Years)</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$2.50 to \$3.00	4,802,500	4.9	\$2.97	1,015,000	\$2.96
\$3.01 to \$6.75	340,000	4.9	\$4.94	68,000	\$4.94
Total	<u>5,142,500</u>			<u>1,083,000</u>	

Stock-based award activity for non-vested awards during the three months ended September 30, 2006 is as follows:

	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested at June 30, 2006	\$ 3,787,500	\$ 2.79
Granted	340,000	3.81
Vested	(68,000)	4.13
Canceled	-	-
Non-vested at September 30, 2006	\$ 4,059,500	\$ 2.85

### Note 3 - Intangible asset

The Company's only intangible asset is a license with the Gas Technology Institute ("GTI"), a U.S. based non-profit research organization, for U-GAS® technology.

On August 31, 2006, the Company entered into an Amended and Restated License Agreement with GTI. Pursuant to the Amended and Restated License Agreement between the Company and GTI (the "License Agreement"), the Company has an exclusive license to manufacture, make, use and sell U-GAS® systems using the technology of GTI worldwide as to coal gasification, biomass blends up to 40% biomass, systems and non-exclusive license to manufacture, make, use and sell 40% biomass and coal mixture gasification systems. The License Agreement has an initial term of ten years, but may be extended for two additional ten-year terms (total of 30 years) at the option of the Company.

As consideration for the license, the Company paid \$500,000, and issued 190,500 shares of restricted stock to GTI. As a part of the agreement the Company is restricted from offering a competing gasification technology within any market covered by the License Agreement. Additionally, for each U-GAS® unit for which the Company licenses, designs, builds or operates which uses coal, or a coal and biomass mixture as the feed stock, the Company must pay a royalty and must also provide GTI with a copy of each contract that the Company enters into relating to a U-GAS® system and report to GTI with their progress on development of the technology every six months. A failure to comply with any of the above requirements could result in the termination of the License Agreement by GTI.

In addition, the Company is required to (i) have a contract for the sale of a U-GAS® system with a customer in the territory covered by the License Agreement no later than August 31, 2007, (ii) fabricate and put into operation at least one U-GAS® system within the territory covered by the License Agreement by July 31, 2008 and (iii) fabricate and put into operation at least one U-GAS® system for each calendar year of the License Agreement, beginning with the calendar year 2009. The Company is required to disclose to GTI any improvements related to the U-GAS® system which are developed and implemented by the Company and the manner of using and applying such improvements. Failure to satisfy the requirements as to these milestones could lead to the revocation of the license by GTI; provided, however, that GTI is required to give a twelve-month notice of termination and the Company is able to cure the default and continue the Agreement prior to the expiration of such time period.

Without the prior written consent of GTI, the Company has no right to sublicense any U-GAS® system other than to customers for which the Company has constructed a U-GAS® system. For a period of ten years, the Company is restricted from disclosing any confidential information (as defined in the license) to any person other than employees of its affiliates or contractors who are required to deal with such information, and such persons will be bound by the confidentiality provisions of the license. The Company further indemnified GTI and its affiliates from any liability or loss resulting from unauthorized disclosure or use of any confidential information that it receives.

		<u>As of September 30, 2006</u>		<u>As of September 30, 2005</u>	
<u>Estimated useful life</u>		<u>Gross carrying amount</u>	<u>Accumulated amortization</u>	<u>Gross carrying amount</u>	<u>Accumulated amortization</u>
Use rights of U-GAS:	10 years	\$ 1,886,363	\$ 18,327	\$ 10,000	\$ 1,691

Amortization expense for the three months ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006 was \$15,898, \$252 and \$18,327, respectively.

#### **Note 4 - Income taxes**

Income taxes are recorded utilizing an asset and liability approach. This method gives consideration to the future tax consequences associated with the differences between the financial accounting basis and tax basis of the assets and liabilities, and the ultimate realization of any deferred tax asset resulting from such differences.

#### **Note 5 - Net loss per share data**

Historical net loss per common share is computed using the weighted average number of common shares outstanding. Basic loss per share excludes dilution and is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding for the period. For the three months ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006, the number of weighted average shares included in the calculation was 26,070,648, 28,762,889 and 27,240,572, respectively. Stock options are the only potential dilutive share equivalents the Company has outstanding for the periods presented. No shares related to options were included in diluted earnings per share for the three months ended September 30, 2006 and 2005 and the period from November 4, 2003 (inception) to September 30, 2006 as their effect would have been antidilutive as the Company incurred net losses during those periods.

#### **Note 6 – Commitments and Contingencies**

In March 2005, in connection with a private placement for a maximum of 2,000,000 shares of common stock. The Company entered into an agreement with Union Charter Capital VII, Inc. (“UCF”) which covered certain capital commitment obligations of UCF and the Company and set forth certain rights of UCF if certain commitment thresholds were met. UCF met these commitments in connection with the August 2006 private placement of 3,345,715 shares of common stock.

On November 30, 2006, the Company amended and restated its agreement with UCF in its entirety to clarify certain statements in the previous agreement. As amended and restated, UCF is entitled to purchase up to 2,000,000 shares of the Company’s common stock at a purchase price of \$2.50 per share on or prior to June 30, 2007. Upon exercise of this right, UCF may purchase all or a portion of the 2,000,000 shares. The Company estimates the fair value of these options to be \$9.8 million dollars, using a Black Scholes options pricing model. The following weighted average assumptions used were as follows: risk-free interest rates of 5.10%, dividend rate of 0.00%, expected life of 10 months and expected volatility of 58.66%.