Sino Australia Oil and Gas Ltd.

ADDRESS
Level 2, Spectrum
100 Railway Road
SUBIACO WA 6008

WEBSITE
www.sinoaustoil.com

EMAIL
info@sinoaustoil.com

10 June 2014

Dear Shareholder

Sino Australia Oil & Gas Ltd - Shareholder Update

ASIC investigation and related Australian Federal Court proceeding

Executive Summary

- The Australian corporate regulator, ASIC, has obtained an injunction that prevents the Company from using money in its Australian bank accounts to fund its business in China.
- It is the unanimous opinion of the Company's directors that the injunction is hurting the Company, is not in shareholders' best interest, is unwarranted and should be removed.
- This Announcement sets out ASIC's concerns and explains why those concerns are either without foundation or do not warrant the restrictions that have been imposed.

Introduction

Money raised by the Company on its IPO is subject to an injunction that prevents the Company from transferring funds out of its Australian bank accounts to be used by the Company's operating business in China.

These intrusions are as a consequence of actions taken by ASIC in the Australian Federal Court. ASIC has sought orders freezing the Company's Australian bank accounts while it investigates concerns it has expressed about the Company.

This Announcement is an update on the financial performance of the Company, sets out what ASIC's concerns are and what the Company's answers are to each of those concerns.

Year to date results

The Company is pleased to report that the growth that the Company experienced in 2013 has flowed into the first half of 2014. Revenues have continued to improve with May 2014 revenues totalling ¥20,104,759 and year-to-date revenues totalling ¥64,812,359. Year to date Net Profit After Tax as a percentage of revenues has been maintained at a very strong level of 34.1%.

As at 30 April 2014 a total of 721 wells using hydraulic jet drilling have been contracted but not yet performed and a total of 653 pump inspections have been contracted but not yet performed. The value of the unperformed contracts is ¥350,570,400 (AUD$60.35M).

In recent months the Company has substantially reformed its corporate governance which puts it on a much stronger footing. The Board has been significantly strengthened with the appointment of four new independent directors. The new directors bring to the Board decades of business and legal experience in the governance of corporations in the oil and gas resources sector in Australia, China and South East Asia.

Australian Federal Court proceeding

On 30 May 2014 the Court made Orders extending an injunction preventing the Company from transferring money out of its Australian bank accounts other than to pay certain trade creditors and expenses. The Orders remain in place up to 4pm on 28 August 2014.

The Orders are interim orders. This means that if the Orders are to be continued ASIC will need to make a further application and justify to the Court why a further extension should be granted. It also means that the Company may make an application to the Court to have the Orders removed.

ASIC's concerns and the Company's answers

It is the unanimous opinion of the Company's directors that the restrictions imposed by the interim injunction are unwarranted, disproportionate and contrary to the best interests of the Company, its shareholders and staff.

ASIC's concerns are as follows.

ASIC's equipment purchase concern

ASIC has expressed a concern that the prospectuses issued on the recent capital raising did not clearly set out the intended use for the funds raised.

The Company does not consider that there was anything unclear in the offer documents about the intended use of the funds raised. The offer documents stated in plain terms that the proceeds of the offer would be used in the acquisition of specialised plant and equipment, for the purpose of increasing production capacity and the margins on services offered, modernising and upgrading existing technical equipment and for working capital.

The Company has told ASIC that it wants to use the funds raised on the IPO as working capital in its business in China and to buy equipment. ASIC has been told that money is to be advanced to the operating business in China for those purposes.

Having received this information ASIC has expressed concerns that the terms of the equipment contracts entered into by the Company's operating business in China, to which float proceeds are to be applied, were not explained in the prospectuses. ASIC has also expressed concerns about the Company complying with Chinese laws and regulations that may apply to advances or transfers of money made by the Company to its Chinese operations.

The prospectus said in plain terms that one of the intended purposes of the capital raising was to enable the company to buy equipment. The equipment that is to be purchased is necessary for the continuing growth of the business and once acquired will make a profitable business more profitable. ASIC has not said (and there would be no basis for it to say otherwise) that the terms of the equipment purchasing agreements are unusual, inappropriate or anything other than arm's length transactions.

The Company's Chinese management is familiar with approval and registration procedures for transfers and loans but given ASIC's concern the company has retained the services of its auditors in China to oversee compliance with Chinese regulatory requirements.

ASIC's profit forecast concern

For the year ended 31 December 2013 the Company's total comprehensive income attributable to members was AUD$12,686,014 (comprising net profit of AUD$8,395,837 and exchange differences on translation of foreign operations of AUD$4,290,177). The forecast profit projection in the prospectus for the year ended 31 December 2013 was AUD$13,660,000.

ASIC is investigating the circumstances of the variance between actual profit and the forecast profit.

In 2013 the Company's revenues increased principally because we entered into new contracts to service oil wells in the Xinjiang and Chang Qing Oilfields, however, the costs of sales also increased. The variance between forecast and actual profit was communicated to the market in the Company's Appendix 4E and Annual Report on 1 April 2014 and 9 April 2014, respectively.

The explanation for the variance between the profit forecast in the prospectus and actual profit is that the forecast assumed that the capital raising would have been completed in July 2013; that two additional pieces of drilling equipment would have been purchased; that the company would, as a result of the equipment purchases, be less reliant on leased equipment and more profitable. As events transpired the capital raising was delayed and the purchase of additional equipment has not completed.

The profit forecast sensitivity analysis in the prospectus contemplated that a delay in the purchasing of additional drilling equipment until after FY2013 would result in a variance in EBITDA of $2.7M. As events transpired this is what has happened. The company's dependence on leased equipment has remained and the company was therefore less profitable in 2013 than forecast.

On a consolidated basis SAO's net profit was also impacted by the IPO costs being higher than forecast.

The impact on profit from the company having a dependence on leased equipment will be resolved if and when the Company can access the funds raised on the IPO to complete the purchase of the additional drilling equipment. The impact on profit resulting from the IPO costs being higher than forecast is a one off event.

The ironies will not be lost. ASIC is concerned about an historical variance in forecast profit to actual profit caused by the Company's reliance on leased equipment but is actively preventing the company from expending its money, in a manner entirely in accordance with what was disclosed, to purchase equipment that would reduce the reliance on leased equipment and increase profitability. The orders that ASIC seek perpetuate the very thing that is the subject of its concern.

ASIC's liquidity concern

The Company's customers are Chinese government oil and gas industry State owned enterprises (**SOEs**). It is the observation of management that as a result of reforms of SOEs being undertaken by the Chinese government that the Company's SOE customers have in recent times become slower in paying their debts. It is on this basis that ASIC has expressed concern about the liquidity of the Chinese operations.

There is no basis for ASIC's liquidity concern. The Company's customers are enterprises owned by the government of China. There is no impairment of receivables.

There is also no material issue with collections. Debtor recovery is slower than the Company would like but management fully expects that all debts will be collected and that collections will pick up in the coming months.

The cash flows in our Chinese operations have been affected by the business outlaying in 2013 AUD$11.8M in prepayments for 60% deposits on each of three major pieces of drilling equipment. That equipment will be delivered when final payments are made out of the proceeds of the capital raising. Cash flows have also been affected because the costs of the IPO have paid out of the operating profits of the business.

Effect of the Orders

The immediate effect of the Orders is that it prevents the Company advancing funds to the business in China to enable it to complete the purchase of one piece of drilling equipment. That payment was due to be paid on 30 May 2014.

The Company not completing the 30 May 2014 equipment purchase exposes the Company to contractual risks with its supplier, including the payment of penalty sums.

Deploying the drilling rig equipment that the Company has contracted to buy will increase profitability and completing those contracts remains a priority. The Company is in discussions with its supplier and all options to complete the equipment purchases are being explored.

If you require a Chinese language translation of this letter it can be provided on request.

Yours sincerely

Shao Tianpeng
Chairman

Wrix Gasteen
Independent Director

Guangbin Zhong
Independent Director

Perry He
Independent Director

David Cornwell
Independent Director