

A photograph of a puffin in flight, seen from a low angle. The puffin is flying from the left side of the frame towards the right. Its wings are spread, and its head is turned towards the viewer. The background is a clear, bright blue sky. The ocean is visible at the bottom of the frame, appearing as a dark blue-grey curve. The entire image is framed by a thin orange border.

Nautical Petroleum plc
Interim Report 2006

Highlights

Secured 3 rig slots for second half 2007 for the Kraken appraisal well, the low risk Mermaid exploration well and the appraisal well on Grenade.

Completed the farm out to Celtic Oil to share risk and cost on 5 wells and seismic.

Success in all 24th Round applications: 4 licences (3 traditional, 1 promote); 2 discoveries; 1 firm well.

Acquired 2 new blocks from Engen Resources Limited containing the Bluebeard and Skipper discoveries.

UK portfolio now comprises 13 licences (17 full and part blocks) with 8 discoveries.

71^{mmbo}

Verified reserves and contingent resources

107^{mmbo}

Verified prospective resources

18

Number of blocks (as at March 2007)

3

Rig slots secured

CEO and Chairman's statement

Nautical is well positioned to take further advantage of these encouraging trends by the augmentation of our portfolio through judicious acquisitions and licence round applications.

Our Strategy

Nautical Petroleum plc intends to become a significant producer of heavy oil, initially in the UKCS and in Europe.

- Secure further heavy oil discoveries in UKCS and EU through acquisitions, farm-ins and licensing rounds.
- Achieve near term production on current assets.
- Enhance crude value and mitigate risk through our relationships.
- Acquire heavy oil exploration blocks with low/moderate commitments.
- Farm-out to mitigate portfolio risk.

Resulting in enhanced shareholder value.

Increase of Global Interest in Heavy Oil

Global level of awareness and interest in heavy oil is increasing, and the fundamentals continue to support a firm demand led price outlook. Several oil majors and leading independents have formulated specific heavy oil strategies and are moving to secure opportunities, as evidenced by Nautical's farmout of 5 wells and seismic to Celtic Oil Limited (a wholly owned subsidiary of SK Corporation of South Korea).

Nautical is well positioned to take further advantage of these encouraging trends by the augmentation of our portfolio through judicious acquisitions and licence round applications, combined with high grading and rationalising of this expanded portfolio, to share risks and costs.

Continuing to develop our portfolio in the North Sea and Europe

In November 2006, we completed the acquisition of a 98.5% interest in the Bluebeard (Block 9/12b, Licence 1079) and Skipper (Block 9/21, Licence 1080) discoveries on the East Shetland Platform from Engen Resources Limited for £1m in shares and cash.

The transaction secured further contingent and prospective resources adjacent to our current portfolio. Bluebeard is located directly east of the Mariner discovery,

in close proximity to oil transportation facilities capable of accepting additional throughput. Further to the south, Skipper is located immediately east of Selkie and Kelpie prospects (Block 8/25a), all sharing a common reservoir (Dornoch Formation). A well is planned on Selkie in 2008.

The delayed results of the UKCS 24th Seaward Licencing Round were announced on 1st February 2007, Nautical being offered (and accepting) interests in 4 licences (3 Traditional and 1 Promote), comprising 7 blocks and part blocks; an excellent outcome for your company with all applications as both operator and partner proving successful. Our maximum equity interest is 50% in operated Traditional blocks 113/29c and 113/30 in the East Irish Sea Basin, and smaller interests, as partner, in the Tudor Rose discovery (20%, block 14/30a), and the Triassic and Jurassic discoveries in East Shetland blocks 2/3 and 2/4 (33⅓% interest). Additionally, Nautical has a 15% equity interest in blocks 28/9 and 28/10b, on the West Central Platform, containing the Catcher Prospect. The operator, Oilexco North Sea Limited, has offered to drill a firm well within 12 months of award, carrying 20% of Nautical's costs.

Actively Managing Our Expanding Portfolio

Nautical continues to follow a conservative policy focusing on discovered oil with minimal exposure

Kraken and Mermaid are important prospects for the Company as their net contingent and prospective resources total over 100 million barrels of oil, which we plan to convert to reserves through an agreed drilling and appraisal programme.

to pure exploration risk and even then, as part of a joint venture. Our success in the 24th Seaward Licencing Round has grown the UK portfolio to embrace 13 licences, consisting of 17 full and part blocks containing 7 discoveries. Nautical is operator of 8 licences but holds less than 100% equity interest in all but one licence. There is significant scope for sharing risk and cost through farmout and swaps, consequently the next phase of farm downs are already in progress.

Mariner – Accelerating Towards Development

The Company's participation in the Chevron operated Mariner discovery is an important component of our portfolio. We are especially pleased that the Mariner programme is moving towards submission of a Field Development Plan by end 2007, the commencement of Front End Engineering and Development (FEED) in the second half of 2007, followed by expected project sanction in the first half of 2008.

Realising The Potential

Your company is acutely aware that discovered oil and prospective resources in large prospects represent greater value when proved by drilling then produced. To this end we secured 2 drilling slots in November 2006 which meet the Company's requirements and programme for drilling the Kraken appraisal well and the large, low risk Mermaid prospect.

The Kraken discovery on Block 9/2b has best estimate contingent resources of 53 million barrels of oil (gross) of which Nautical has a net interest of 23.9 million barrels of oil following the farm-out to Celtic Oil. The Mermaid prospect on Block 9/11c has best estimate prospective resources of 129 million barrels of oil (gross) of which Nautical has a net interest of 77.4 million barrels of oil.

Kraken and Mermaid are important prospects for the Company as their net contingent and prospective resources total over 100 million barrels of oil, which we plan to convert to reserves through an agreed drilling and appraisal programme.

Nautical's third well is scheduled for September 2007 on the Grenade discovery in the St Laurent Permit in South West France. We anticipate our first production from the horizontal well later in 2007.

The well on the Catcher Prospect and seismic acquisition on block 3/27a adds up to a very exciting forward programme.

Progressing in a High Cost Environment

Nautical has no immunity from the escalation of cost which is affecting the industry due to shortages of skills and equipment, but we do have the advantage of having secured a very low cost reserve base with limited work

commitments. We intend mitigating increased costs through a combination of high grading the portfolio, farming down where advantageous and reducing appraisal drilling risk by undertaking thorough and extensive interpretation of our high quality extensive database.

The future

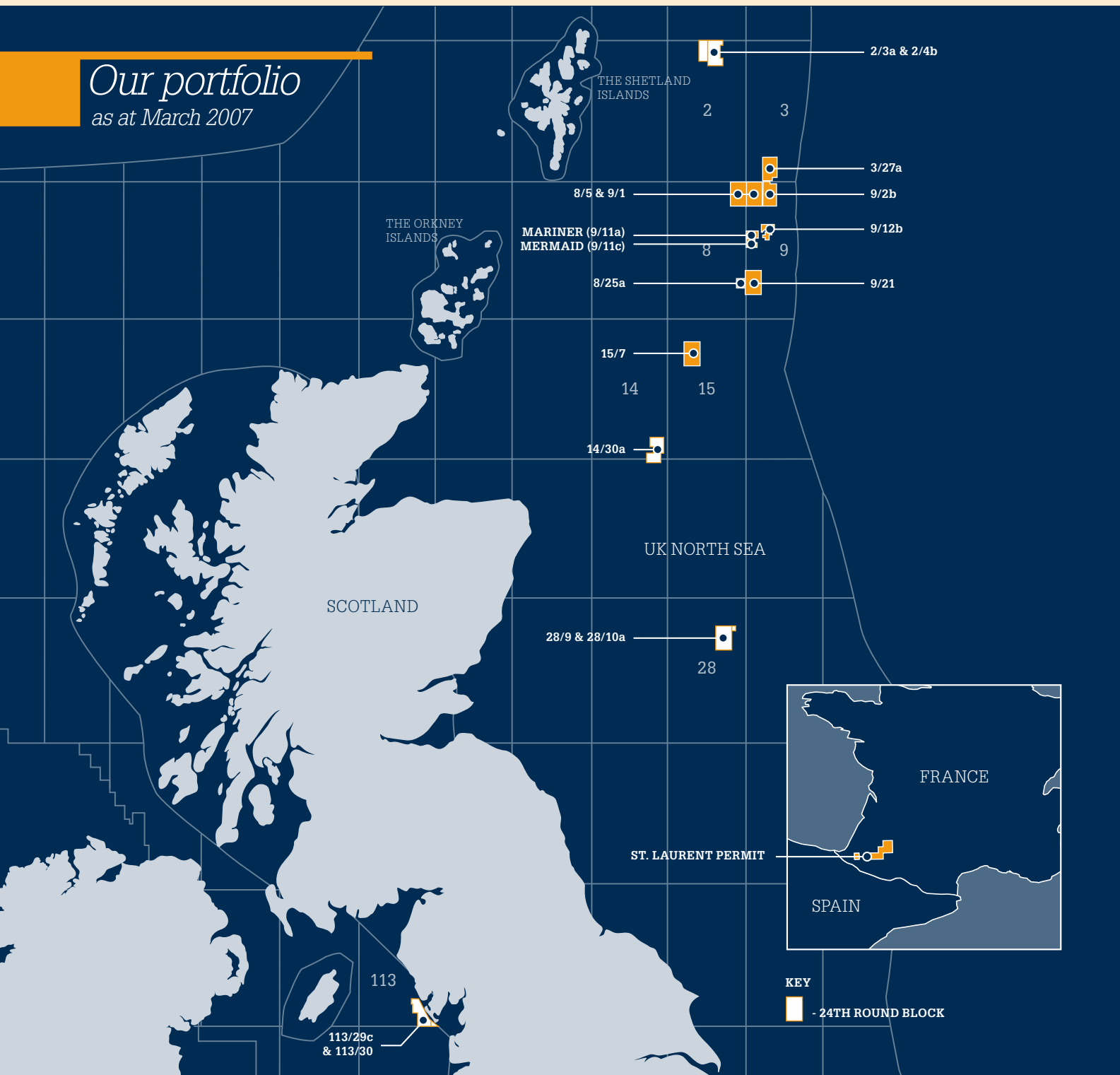
We look forward to an extensive seismic acquisition and drilling campaign which will crystallise shareholder value through the appraisal of the largest independent heavy oil licence portfolio in the UKCS.

Ian Williams
Chairman

Steve Jenkins
Chief Executive Officer

26 March 2007

Our portfolio
as at March 2007



BLOCK 8/5 AND BLOCK 9/1 (LICENCE P1277 – 100% interest)

- Located on the East Shetland Platform west of the North Viking Graben, contiguous with Block 9/2b.
- Across Blocks 9/1 and 8/5, 484km of 2D seismic has been acquired and identified two leads in the Tertiary. Reprocessing of the seismic to firm up these leads is continuing.

BLOCK 9/11A (LICENCE P729 – 26.67% interest)

- Front End Engineering and Development (FEED) to commence in second half of 2007, with development submission before end 2007.
- In 1997 an extended well test (EWT) produced 662,000 barrels of oil over 63 days at a maximum rate of 14,991bopd (14.5 API) from Maureen Formation Sands.

BLOCK 9/11C (LICENCE P979 – 60% interest)

- The 3D seismic has been reprocessed, interpreted and has confirmed the robustness of the trap with around 129mmbo best estimate prospective resources.
- A rig has been secured to drill a well in the second half of 2007, with the site survey already acquired in July 2006.

BLOCK 8/25A (LICENCE P976 – 60% interest)

- Selkie is mostly covered by recent 3D seismic and 2D seismic has been purchased. A four-way dip closure has been confirmed analogous to Skipper discovery. Together with the Kelpie prospect the block contains 35mmbo best estimate prospective resources.

BLOCK 15/17 (LICENCE P1296 – 50% interest)

- 2D and 3D seismic are being reprocessed to further define the Seahorse prospect and firm up the mapped leads.

BLOCK 3/27A (LICENCE 1203 – 45% interest)

- 50km of 2D seismic has been reprocessed and the data has been re-interpreted to confirm the leads. New high density 2D seismic is to be acquired in the second half of 2007 to define prospects for drilling.

BLOCK 9/2B (LICENCE P1077 – 45% interest)

- Over 200km of 1998 3D seismic has been reprocessed and interpreted along with the 3D seismic over the nearby Bressay discovery to confirm the large structural closure.
- A rig has been secured to drill an appraisal well in the summer of 2007, with the site survey already acquired in July 2006.

BLOCK 9/12B (LICENCE P1079 – 98.5% interest)

- Three wells have been drilled 9/12-3 (1975), 9/12b-6 (1985) and 9/12b-4 (1982), the first two wells flowing 144bopd and 728bopd respectively from the Maureen Formation. A farm out is planned prior to drilling a well.

BLOCK 9/21 (LICENCE P1080 – 98.5% interest)

- A discovery well on the block encountered a 16 metre oil column in excellent quality Palaeocene Dornoch Formation Sands.
- A Field Development Plan (FDP), based on best estimate contingent resources of 33.1mmbo (gross) and 2D seismic interpretation, was submitted to the DTI in October 2005.

ST. LAURENT PERMIT (22% interest)

- Located in Aquitaine Basin, SW France, The Grenade-Sur-Adour well produced 8000 barrels in a series of tests. 12km² 3D and 40km 2D seismic was acquired in 2005.
- A rig has been secured to drill a well in the second half of 2007 to be followed by an extended well test and production.
- Further gas prospectivity is present on the permit.

BLOCKS 113/29C & 113/30 (50% interest)

- Offered and accepted in February 2007 in the 24th round. The blocks lie on the edge of the East Irish sea Basin, with a programme to reprocess seismic leading to a drill or drop decision. The block contains the large Merrow prospect which can be drilled from onshore.

BLOCKS 28/9 & 28/10B (15% interest)

- Offered and accepted in February 2007 in the 24th round. The blocks are on the West Central Platform in the North Sea, with a well to be drilled in 12 months.
- The block contains the Catcher prospect and numerous leads and prospects defined on 3D seismic.

BLOCK 14/30A (20% interest)

- Offered and accepted in February 2007 in the 24th round. The block is in the Outer Moray Firth, with a programme to reprocess seismic and a contingent well.
- The block contains the Tudor Rose discovery.

BLOCKS 2/3A & 2/4B (33.33% interest)

- Offered and accepted in February 2007 in the 24th round. The blocks are on the East Shetland Platform, west of the Heather oil field. A programme to purchase and reprocess 2D and 3D seismic is underway, mainly over 2 prospects, one with crestal oil.

Consolidated income statement

For the 6 months ended 31 December 2006

	Notes	6 months ended 31 December 2006 (unaudited) £'000	6 months ended 31 December 2005 (unaudited) £'000	18 months ended 30 June 2006 (unaudited) £'000
Continuing operations				
Cost of sales		(83)	–	(79)
Gross (loss)		(83)	–	(79)
Administrative expenses	4	(777)	(1,144)	(2,237)
		(860)	(1,144)	(2,316)
Goodwill on reverse acquisition		–	–	(5,077)
Operating (loss)		(860)	(1,145)	(7,393)
Finance income		255	122	432
Finance costs		(125)	(90)	(222)
(Loss) before tax		(730)	(1,112)	(7,183)
Tax		–	–	–
(Loss) for the period		(730)	(1,112)	(7,183)
Attributable to:				
Equity holders of the company		(727)	(1,113)	(7,172)
Minority interests		(3)	1	(11)
		(730)	(1,112)	(7,183)
		pence	pence	pence
Earnings per share:				
Basic and diluted loss per share	5	(0.07)	(0.12)	(0.78)

Consolidated balance sheet

As at 31 December 2006

	Notes	As at 31 December 2006 (unaudited) £'000	As at 31 December 2005 (unaudited) £'000	As at 30 June 2006 (unaudited) £'000
Non-current assets				
Intangible assets	6	49,653	50,050	49,279
Tangible assets		2,661	2,707	2,732
		52,314	52,757	52,011
Current assets				
Trade and other receivables		893	296	733
Cash and cash equivalents		10,092	4,306	12,300
		10,985	4,602	13,033
Total assets		63,299	57,359	65,044
Current liabilities				
Trade and other payables		(2,297)	(1,150)	(1,902)
Non-current liabilities				
Deferred tax		(7,260)	(8,260)	(7,830)
Other payables		(3,262)	(3,831)	(3,388)
Total liabilities		(12,819)	(13,241)	(13,120)
Net assets		50,480	44,118	51,924
Equity attributable to equity holders				
Called up share capital	7	9,683	8,651	9,627
Share premium		20,492	10,417	20,116
Other reserves		29,114	33,033	30,518
Accumulated losses		(13,022)	(12,865)	(12,874)
Equity attributable to equity holders		46,267	39,206	47,387
Minority interests		4,213	4,912	4,537
Total equity		50,480	44,118	51,924

Consolidated statement of changes in equity

For the 6 months ended 31 December 2006

	6 months ended 31 December 2006 (unaudited) £'000	6 months ended 31 December 2005 (unaudited) £'000	18 months ended 30 June 2006 (unaudited) £'000
(Loss) for the period	(727)	(1,113)	(7,172)
Movement in cumulative translation adjustments	(987)	1,124	810
Proceeds of ordinary shares issued for cash	–	889	1,865
Premium on ordinary shares issued for cash	–	7,111	16,137
Cost associated with issuance of shares	–	(275)	(947)
Reverse acquisition capital adjustment	–	–	6,556
Shares issued for the acquisition of Alba Resources (Holdings) Group	–	10,151	10,151
Shares issued for the acquisition of First Mariner Limited	–	3,128	3,128
Shares issued for the purchase of Bluebeard and Skipper	431	–	–
Share-based payment charges	163	660	1,215
Net change in shareholders' funds	(1,120)	21,675	31,743
Shareholders' funds brought forward	47,387	17,531	15,644
Shareholders' funds at end of the period	46,267	39,206	47,387

Consolidated cash flow statement

For the 6 months ended 31 December 2006

	6 months ended 31 December 2006 (unaudited) £'000	6 months ended 31 December 2005 (unaudited) £'000	18 months ended 30 June 2006 (unaudited) £'000
(Loss) for the period	(730)	(1,112)	(7,183)
Finance income	(255)	(112)	(432)
Finance costs	125	90	222
Goodwill	–	–	5,077
Share-based payment charges	164	660	1,215
Depreciation	70	–	83
Foreign exchange movements	(267)	(20)	(50)
Operating cash flow before working capital movements	(893)	(504)	(1,068)
(Increase)/decrease in trade and other receivables	(5)	(88)	(146)
(Decrease)/increase in trade and other payables	414	274	(166)
Cash (outflow) from operation	(484)	(318)	(1,380)
Finance income	255	122	302
Cash flows from operating activities	(229)	(196)	(1,078)
Cash flows from investing activities			
Expenditure on intangible assets	(1,263)	(896)	(2,302)
Purchase of property, plant and equipment	–	–	(99)
Acquisition of Alba Resources (Holdings) Group	–	(3,475)	(3,475)
Net cash received on acquisition of Bullion Resources plc	–	–	1,545
Cash flows used in investing activities	(1,263)	(4,371)	(4,331)
Cash flows from financing activities			
Proceeds from issue of ordinary shares	–	8,000	18,002
Costs associated with share issues	–	(275)	(947)
(Repayment) of loans	(360)	–	–
(Repayment)/draw down under facility from related undertaking	(356)	–	646
Cash flows from financing activities	(716)	7,725	17,701
Net (decrease)/increase in cash and cash equivalents	(2,208)	3,158	12,292
Cash and cash equivalents at beginning of period	12,300	1,148	8
Cash and cash equivalents at end of period	10,092	4,306	12,300

Notes to the financial statements

1. General information

The information for the period ended 31 December 2006 does not constitute statutory accounts as defined in section 240 of the Companies Act 2005. The financial statements were authorised for issue on 26 March 2007 by the Board of Directors.

2. Accounting policies

(2.1) Basis of preparation

The consolidated financial information presented has been prepared on a historical cost basis, except for available-for-sale financial instruments which are valued at fair value. The consolidated financial statements are presented in UK sterling, ("£"), due to the nature of the Group's activities and the fact that the Group is expected to transact more of its business in UK sterling than any other currency. All values are rounded to thousands of pounds except when otherwise indicated.

These financial statements have been prepared in accordance with International Financial Reporting Standard 34 (Interim Financial Reporting) and the requirements of International Financial Reporting Standard 1 (First-time adoption of International Financial Reporting Standards), and other IFRS's (International Financial Reporting Standards) and IFRIC (International Financial Reporting Interpretations Committee) announcements which have been issued, and effective, or issued and early adopted, as at the date of these statements. The effect of implementing IFRS is set out in note 8.

The preparation of financial statements in conformity with IFRS accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. The Board has reviewed the accounting policies set out below and considers them to be the most appropriate to the Group's business activities.

(2.2) Basis of consolidation

These interim consolidated financial statements of the Group comprise the financial statements of Nautical Petroleum plc ("Nautical") and its subsidiaries as at 31 December 2006. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company using consistent accounting policies.

All intercompany balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. Control is normally evident when Nautical, or a company which it controls, owns more than 50% of the voting rights of a company's share capital.

(2.3) Changes in accounting principles

The accounting policies adopted are consistent with those of the previous financial period except for:

a) Adoption of IFRS

Previously the Group prepared its financial statements in accordance with UK GAAP. The Group has elected to publish its first consolidated financial statements to 30 June 2007 under IFRS with its transition date to IFRS being 1 January 2005. Accordingly these interim statements are prepared under IFRS.

2. Accounting policies continued

b) Exploration and evaluation assets

The company has amended its exploration and evaluation policy to the policy set out in 2.9 below. The effects of this change are shown in note 8 and more closely align the company's policy with that of its peer group.

c) Introduction of IFRS – First time adoption

The rules for first time adoption of IFRS are set out in IFRS 1, First-time Adoption of International Financial Reporting Standards. In general, selected accounting policies must be applied retrospectively in determining the opening balance sheet under IFRS. However, IFRS 1 allows a number of exemptions to this general principle. Exemptions which the Group have taken advantage of, are noted below:

Business combinations

Under the transitional arrangements of IFRS 1, there is the option of applying IFRS 3, Business Combinations, prospectively from the date of transition. The Group has exercised this option and has not restated past business combinations prior to the transition date.

Adoption date for individual Group companies

As permitted by IFRS 1, the individual Group companies continue to report under local GAAP.

d) Other changes

- i) The Group has adopted the following new and amended IFRS and IFRIC interpretations during the period. Adoption of these revised standards and interpretations did not have any effect on the equity of the Group.
 - IAS 1 and 19 Amendment – Actuarial Gains and Losses, Group Plans and Disclosures
 - IAS 21 Amendment – The Effect of Changes in Foreign Exchange Rates
 - IAS 39 Amendment – Cash Flow Hedge Accounting of Forecast Intra-group Transactions
 - IAS 39 Amendment – The Fair Value Option
 - IAS 39 and IFRS 4 – Financial Guarantee Contracts
 - IFRIC 4 – Determining whether an arrangement contains a Lease
- ii) The Group has elected not to early adopt IFRS 7, IFRIC 7, IFRIC 8, IFRIC 9, IFRIC 10, IFRIC 11 and IFRIC 12. Adoption of these standards is anticipated to have no effect on the financial statements of the Group.

(2.4) Significant accounting judgements and estimates

In the process of applying the Group's accounting policies, management make judgements and estimates. The key assumptions concerning the future, and other sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the financial period are:

- The Group determines whether the exploration and evaluation assets are impaired in accordance with policy 2.10.

(2.5) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenues can be reliably measured. To date the Group is in a pre-revenue generating start up phase.

Notes to the financial statements *continued*

2. Accounting policies continued

(2.6) Foreign currency translation

The consolidated financial statements are presented in UK sterling, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency using the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement.

The functional currency of the foreign operation, Nautical Petroleum AG, is US Dollars. As at the reporting date, the assets and liabilities of this subsidiary are translated into UK Sterling at the rate of exchange ruling at the balance sheet date and its income statement is translated at the weighted average rates for the period. The exchange differences arising on the translation are taken directly to a separate component of equity ("Cumulative Translation Adjustment"). On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement as part of the gain or loss on sale.

(2.7) Business combinations

The results of businesses acquired are consolidated from the effective date of acquisition, whereby upon the acquisition of a business, assets and liabilities are restated at fair value in accordance with IFRS.

(2.8) Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment loss. Goodwill is reviewed annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit (or group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

2. Accounting policies continued

(2.9) Intangible assets

Intangible assets – Exploration and evaluation assets capitalisation

Certain costs (other than payments to acquire the legal right to explore) incurred prior to acquiring the rights to explore are charged directly to the income statement. All costs incurred after the rights to explore an area have been obtained, such as geological and geophysical costs and other direct costs of exploration (drilling, trenching, sampling and technical feasibility and commercial viability activities) and appraisal are accumulated and capitalised as intangible exploration and evaluation (“E&E”) assets.

E&E costs are not amortised prior to the conclusion of appraisal activities. At completion of appraisal activities if technical feasibility is demonstrated and commercial reserves are discovered, then, following development sanction, the carrying value of the relevant E&E asset will be reclassified as a development and production asset, but only after the carrying value of the relevant E&E asset has been assessed for impairment, and where appropriate, its carrying value adjusted. If after completion of appraisal activities in an area, it is not possible to determine technical feasibility and commercial viability or if the legal right to explore expires or if the Company decides not to continue exploration and evaluation activity, then the costs of such unsuccessful exploration and evaluation is written off to the income statement in the period the relevant events occur.

Impairment

If and when facts and circumstances indicate that the carrying value of an E&E asset may exceed its recoverable amount an impairment review is performed. For E&E assets when there are such indications, an impairment test is carried out by grouping the E&E assets with the development and production assets belonging to the same geographic segment to form the Cash-Generating Unit (“CGU”) for impairment testing. The equivalent combined carrying value of the CGU is compared against the CGU’s recoverable amount and any resulting impairment loss is written off to the income statement. The recoverable amount of the CGU is determined as the higher of its fair value less costs to sell and its value in use.

(2.10) Development and production assets

Development and Production (D&P) assets are accumulated into single field cost centres and represent the cost of developing the commercial reserves and bringing them into production together with the E&E expenditures incurred in finding commercial reserves previously transferred from E&E assets as outlined in the policy above.

Depreciation

Costs relating to each single field cost centre are depleted on a unit of production method based on the commercial proven and probable reserves for that cost centre. Development assets are not depreciated until production commences. The amortisation calculation takes account of the estimated future costs of development of recognised proven and probable reserves, based on current price levels. Changes in reserve quantities and cost estimates are recognised prospectively from the last reporting date.

Notes to the financial statements *continued*

2. Accounting policies continued

Impairment

A review is performed for any indication that the value of the Group's D&P assets may be impaired. For D&P assets when there are such indications, an impairment test is carried out on the cash-generating unit. Each cash-generating unit is identified in accordance with IAS 36. Nautical's cash-generating units are those assets which generate largely independent cash flows and are normally, but not always, single development or production areas. If necessary, additional depletion is charged through the income statement, if the capitalised costs of the cash-generating unit exceed the associated estimated future discounted cash flows of the related commercial oil and gas reserves.

Nautical currently does not have any D&P assets.

(2.11) Plant and equipment

All equipment is stated at cost less depreciation unless otherwise shown. Cost includes all relevant external expenditure incurred in acquiring the asset. No property assets are held within the Group.

The initial cost of equipment comprises its purchase price, including import duties and non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the equipment has been placed into operation, such as repairs and maintenance and overhaul costs, are normally charged to the income statement in the period in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of equipment beyond its original assessed standard of performance, the expenditures are capitalised as an additional cost of equipment.

Depreciation

The Group selects its depreciation rates carefully and reviews them regularly to take account of any changes in circumstances. When determining expected economic lives, the Group considers the expected rate of technological developments and the intensity at which the assets are expected to be used. Depreciation is calculated on a straight line basis over the useful life. Useful lives of major classes of depreciable assets are:

Extended well test equipment	20 Years
Computer equipment	3 Years
Furniture and fittings	4 Years

The useful life and depreciation method are reviewed periodically to ensure that the method and period of depreciation are consistent with the expected pattern of economic benefits from items of equipment.

An item of equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognised.

2. Accounting policies continued

Impairment

At each balance sheet date, reviews are carried out of the carrying amounts of the assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent if any, of the impairment loss. Where the asset does not generate cash flows that are independent from the other assets, estimates are made of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value, less costs to sell, and value-in-use. In assessing value-in-use, estimated future cash flows are discounted to their present value using a discount rate appropriate to the specific asset or cash-generating unit. If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount. Impairment losses are recognised immediately in the income statement.

(2.12) Other financial assets

Financial assets are classified as either financial assets at fair value through the income statement, loans and receivables, held to maturity investments and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are at fair value plus, in the case of investments not at fair value through the income statement, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end. The Group currently holds only loans and available for sale financial assets which corresponds to this category of assets.

All regular way purchases and sales of financial assets are recognised on the trade date being, for example, the day that the Group commits to purchase the asset. Regular way purchases or sales of financial assets are those that require delivery of assets within the period generally established by regulation or convention in the market place.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised costs using the effective interest method. Gains or losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation period.

(2.13) Taxation

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from, or paid to, the tax authorities. The tax rates and the tax laws used are those that are enacted, or substantively enacted, by the balance sheet date.

Deferred tax

Deferred tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Notes to the financial statements *continued*

2. Accounting policies continued

Deferred tax liabilities are recognised for all taxable temporary differences except:

- (a) Where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss and;
- (b) In respect of taxable temporary differences associated with investment in subsidiaries and associates where the timing of the reversal of the temporary differences can be controlled, and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised except:

- (a) Where the deferred income tax asset relating to the deductible temporary differences arise from the initial recognition of an asset or liability and
- (b) in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are recognised only to the extent that it is probable.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be utilised. Unrecognisable deferred income tax assets are reassessed at each balance sheet date and are recognisable to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Sales tax

Revenue, expenses and assets are recognised net of the amount of sales tax except:

- (a) When the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authorities, in which case the sales tax is recognised as part of the costs of acquisition of the asset or as part of the expense item as applicable; and
- (b) In the case of receivables and payables that are stated with the amount of sales tax included the net amount of sales tax recoverable from, or payable to, the taxation authorities is included as part of the receivables or payables in the balance sheet.

(2.14) Employee benefits

The Group maintains a defined contribution plan for providing employee benefits, which conforms to laws and practices in the countries concerned. Retirement benefit plans are generally funded by contributions from both the employees and the companies to independent entities (multi-employer plan) that operate the retirement benefit schemes. Current service cost for defined contribution plans is equivalent to the employer's contributions due for that period. The Group's contributions to the defined contribution pension plans are charged to the income statement in the year to which they relate.

2. Accounting policies continued

(2.15) Share-based payments

Employees (including directors and senior executives) of the Group receive remuneration in the form of share-based payment transactions, whereby these individuals render services as consideration for equity instruments ("equity-settled transactions"). These individuals are granted share option rights as approved by the Board, which can only be settled in shares of the respective companies that award the equity-settled transactions. No cash-settled awards have been made or are planned.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant individuals become fully entitled to the award ("vesting point"). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments and value that will ultimately vest. The income statement charge for the period represents the movement in cumulative expense recognised as at the beginning and end of that period. No equity-settled awards have been modified or cancelled during the period.

The fair value of share-based remuneration is determined at the date of grant and recognised as an expense in the income statement on a straight-line basis over the vesting period, taking account of the estimated number of shares that will vest. The fair value is determined by use of a Black-Scholes model.

(2.16) Separately disclosable items

Items that are both material in size and unusual and infrequent in nature are presented as separately disclosable items in the income statement or separately disclosed in the notes to the financial statements. The directors are of the opinion that the separate recording of these items provides helpful information about the Group's underlying business performance.

(2.17) Financial risk management, recognition and accounting

The Group's operations and debt financing arrangements expose it to a variety of financial risks that include the effects of changes in debt making prices, foreign currency exchange rates, credit risks, equity securities prices, liquidity and interest rates. The Group has in place a risk management programme that seeks to limit the adverse effects on the financial performance of the Group. The Board has approved the risk management policies applied by the Group. These policies are implemented by central finance that receives regular reports from all operating companies to enable prompt identification of financial risks so that appropriate actions may be taken. The Group has a policy and procedures manual, that sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage these. No forward hedging activities are undertaken unless approved by the Group's FD.

(2.18) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash-in-hand bank balances, call money and unrestricted time deposit balances with an original maturity of 90 days or less.

Notes to the financial statements *continued*

2. Accounting policies continued

(2.19) Financial risk management objectives and policies

The main risks arising from the Group's activities are cash flow interest risk, liquidity risk, foreign currency risk, price risk (fair value) and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised as:

Cash flow interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's cash balances.

Liquidity risk

Liquidity risks arise from the possibility that the Group is unable to fund its ongoing projects. The Group continually monitors its funding requirements and funding options to mitigate liquidity risk.

Foreign currency risk

The Group's significant investment operations are in the UK; the Group's balance sheet can be affected significantly by movements in the US Dollar/UK Sterling exchange rates. The Group does not hedge this potential exposure. The Group has also transactional currency exposures in US Dollars as certain administration and operating expenses are paid through these currencies. The Group enters into limited forward currency contracts as the transactional foreign currency exposure is not considered material to the Group at present.

Price risk

The carrying amount of the following financial assets and liabilities approximate to their fair value due to their short term nature: cash accounts, accounts receivable, and accounts payable.

Credit risk

With respect to credit risk arising from other financial assets of the Group, which comprise cash and time deposits, accounts receivable and loans receivable, the Group's exposure to credit risk arises from default of the counterparty, with a minimum exposure equal to the carrying amount of these instruments. The credit risk on cash is limited as cash is placed with substantial financial institutions.

(2.20) Loans and receivables

Trade and other receivables and trade and other payables are initially recognised at fair value. Fair value is considered to be the original invoice amount, discounted where material, for short term receivables and payables. Long term receivables and payables are measured at amortised cost using the effective interest rate method. Where receivables are denominated in a foreign currency, retranslation is made in accordance with the foreign currency accounting policy previously stated.

(2.21) Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings, are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue cost and any discount or premium on settlement. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

2. Accounting policies continued

(2.22) Borrowing costs

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds and are expensed as incurred. Interest and costs are accounted for on the accruals basis and are recognised through the income statement in full. No interest or borrowing costs have been capitalised.

(2.23) Derecognition and impairment of financial assets and liabilities

Financial assets

A financial asset is derecognised where; (a) the right to receive cash flows from the asset have expired; (b) the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a pass-through arrangement; or (c) the Group has transferred the rights to receive cash flows from the asset and (i) either has transferred substantially all the risks and rewards of the asset or (ii) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

Impairment of financial assets

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

(2.24) Minority interests

Minority interests in the profit and loss of the Group are separately disclosed. The profit is attributed to the parent shareholders and minority interest. However, losses applicable to the minority may exceed the minority interest in the subsidiary's equity. The excess, and further losses applicable to the minority, are charged against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the subsidiary subsequently reports profits, such profits are allocated to the majority interest until the majority's share of losses previously absorbed by the majority has been recovered.

(2.25) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

(2.26) Commitments and contingencies

Commitments and contingent liabilities are recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

Notes to the financial statements *continued*

2. Accounting policies continued

(2.27) Events after the balance sheet date

Post period-end events that provide additional information about a company's position at the balance sheet date are reflected in the financial statements. Post period-end events that are not adjusting events are disclosed in the notes when material.

3. Reverse acquisition accounting

On 1 April 2005 the Company became the legal parent company of Nautical Holdings Limited in a share-for-share transaction and changed its name from Bullion Resources plc to Nautical Petroleum plc. Due to the relative size of the companies, Nautical Holdings Limited shareholders became the majority holders of the enlarged share capital. Further, the Company's continuing operations and executive management became those of Nautical Holdings Limited. Accordingly, the substance of the combination was that Nautical Holdings Limited acquired Nautical Petroleum plc in a reverse acquisition.

By adopting reverse acquisition accounting for consolidation purposes, goodwill of £5,077k arose on acquisition, which has been fully written off to the profit and loss account (in the 18 month period to June 2006) because Bullion Resources Plc had no continuing business and therefore no intrinsic value.

4. Administrative expenses

	6 months ended 31 December 2006 (unaudited) £'000	6 months ended 31 December 2005 (unaudited) £'000	18 months ended 30 June 2006 (unaudited) £'000
Administrative costs	880	504	1,072
Share-based payment charges	164	660	1,215
Foreign exchange (gain) / loss	(267)	(20)	(50)
	777	1,144	2,237

5. Earnings per share

	6 months ended 31 December 2006 (unaudited) £'000	6 months ended 31 December 2005 (unaudited) £'000	18 months ended 30 June 2006 (unaudited) £'000
(Loss) for the financial period (£'000)	(730)	(1,112)	(7,183)
Weighted average number of shares in issue in the period (000)	1,073,278	945,431	917,802
Basic (loss) per ordinary share (pence)	(0.07)	(0.12)	(0.78)

In addition there were a total of 41.5 million options and 26.3 million warrants in issue at December 2006, which have not been included in the above calculations as they were either antidilutive or the exercise price was higher than the average market price for the period.

6. Intangible assets

	£'000
At 1 July 2006	49,279
Additions	2,253
Exchange adjustments	(1,879)
At 31 December 2006	49,653

The additions include the acquisition of the Bluebeard and Skipper blocks from Engen Resources plc for £924k, being £493k cash and £431k in shares.

7. Share capital

On 11 September 2006, Nautical increased its authorised share capital by 400 million shares of 1p each. On 24 November 2006, Nautical issued 5,559,739 shares at 7.75p as part of the Bluebeard and Skipper asset acquisitions. The Group's share capital is summarised below:

Group	At 31 December 2006		At 30 June 2006	
	Number	£'000	Number	£'000
Authorised				
Ordinary shares of 1p each	1,600,000,000	16,000	1,200,000,000	12,000
Allotted, called up and fully paid				
Ordinary shares of 1p each	77,500,000	100	77,500,000	100
Reverse acquisition capital adjustment	697,500,000	6,556	697,500,000	6,556
Ordinary shares of 1p each	302,689,619	3,027	297,129,880	2,971
	1,077,689,619	9,683	1,072,129,880	9,627

Under reverse acquisition accounting, the legal parent is Nautical Petroleum plc (Nautical), but the Group results are a continuation of the legal subsidiary, Nautical Holdings Limited (NHL). The number and type of shares in issue is that of the parent (Nautical) but the amount recognised as equity, is the sum of the equity of the legal subsidiary (NHL) immediately prior to the reverse takeover plus shares issued for the reverse takeover (the reverse acquisition capital adjustment) and all subsequent issues by the parent (Nautical). Hence, at the date of the reverse acquisition (1 April 2005) NHL held 100,000 £1 shares with a value of £100k. However, Nautical held 77.5 million shares, so under reverse acquisition accounting, the presentation is that the 77.5 million shares had a value of £100k. The reverse acquisition capital adjustment is the deemed value of capital acquired on the reverse takeover and the associated number of shares is the share capital issued for the takeover.

Notes to the financial statements *continued*

8. Transition to International Financial Reporting Standards

The differences resulting from the transition to IFRS are summarised in the following tables. Also included is the effect of changing accounting policy for exploration and evaluation assets.

Income Statement impact	6 months to 31 Dec 2005 £'000	18 months to 30 June 2006 £'000
(Loss) for the period under UK GAAP previously reported	(1,243)	(7,291)
Changes in policy for accounting for exploration and evaluation assets:		
Exploration costs written off	282	684
Administrative expenses	(95)	(385)
Revised (Loss) for the period under UK GAAP previously reported	(1,056)	(6,992)
Discount on long term payables:		
Administrative expenses (foreign exchange effects)	20	(5)
Finance costs	(90)	(222)
Share-based payment charges	14	36
(Loss) for the period under IFRS	(1,112)	(7,183)

8. Transition to International Financial Reporting Standards continued

	As at 31 December 2005 £'000	As at 30 June 2006 £'000	As at 31 December 2004 £'000
Balance Sheet impact			
Intangible assets:			
Under UK GAAP previously reported	50,406	49,551	25,097
Changes in policy for accounting for exploration and evaluation assets:	215	299	–
Revised UK GAAP balance	50,621	49,850	25,097
Discount on long term payables	(571)	(571)	–
IFRS Intangible asset balance	50,050	49,279	25,097
Deferred tax liabilities			
Under UK GAAP previously reported	–	–	–
Deferred tax on transition balances (including foreign exchange)	(8,260)	(7,830)	(7,380)
IFRS deferred tax balance	(8,260)	(7,830)	(7,380)
Long term payables			
Under UK GAAP previously reported	(4,332)	(3,732)	–
Discount on long term payables	501	334	–
IFRS long term payables balance	(3,831)	(3,388)	–
Net assets			
Under UK GAAP previously reported	52,233	59,682	27,341
Changes in policy for accounting for exploration and evaluation assets:	215	299	–
Revised UK GAAP balance	52,448	59,981	27,341
Effects of IFRS	(8,260)	(8,057)	(7,380)
IFRS net assets	44,118	51,924	19,961
Equity			
Under UK GAAP previously reported	52,233	59,682	27,341
Changes in policy for accounting for exploration and evaluation assets:	215	299	–
Revised UK GAAP balance	52,448	59,981	27,341
Income statement impact of IFRS conversion	(46)	(191)	–
Share-based payment charges	(24)	(36)	–
Deferred tax on transition balances:			
Attributable to equity holders	(6,195)	(5,872)	(5,535)
Attributable to minority interests	(2,065)	(1,958)	(1,845)
IFRS equity	44,118	51,924	19,961

In addition to the above monetary adjustments, there has been a change in accounting for 2 acquisitions made in August 2005. These were previously accounted for as business combinations, whereas under IFRS they are categorised as asset acquisitions.

Glossary

AIM	Alternative Investment Market	FEED	Front End Engineering and Development
API	American Petroleum Institute®	IFRIC	International Financial Reporting Interpretations Committee
bbl	barrels	IFRS	International Financial Reporting Standards
bcf	billion cubic feet	K	thousand
bn	billion	km	kilometres
bopd	barrels of oil per day	m	million
CGU	Cash Generating Unit	mmbo	million barrels of oil
cp	centipoises	MWD	measurement while drilling
D&P	Development and Production	NHL	Nautical Holdings Limited
DST	drill stem test	OWC	oil-water contact
DTI	Department of Trade & Industry	UKCS	United Kingdom Continental Shelf
E&E	Exploration and Evaluation	UK GAAP	United Kingdom Generally Accepted Accounting Practice
EU	European Union		
EWT	extended well test		
FDP	field development plan		

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