A photograph of a puffin in flight against a clear blue sky. The puffin is shown from a side profile, flying towards the right. Its wings are fully extended, showing dark feathers on the upper side and lighter feathers on the lower side. The puffin's body is white with a black cap and a large, colorful beak (orange, yellow, and black).

**Nautical Petroleum plc**  
*Report and Accounts*  
**2007**

**Nautical Petroleum**



## Highlights



Courtesy of Dolphin Drilling Limited

**22**<sup>mmbo</sup>

Reserves

Nautical is about to drill its first 3 wells.

Secured rig slots to drill 3 wells in Q4 2007: The Kraken appraisal and Mermaid exploration wells, and the Grenade appraisal well in France.

**56**<sup>mmbo</sup>

Contingent resources

Agreed to farmout 10% of Mermaid to Silverstone in September 2007.

Success in all 24th Round applications: 4 licences (7 traditional, 1 promote) with 2 discoveries and 1 firm well.

**97**<sup>mmbo</sup>

Prospective resources

Nautical now has:

- 13 UK Licences (17 full and part time blocks) and 1 French licence. Nautical operates 9 of the UK licences.
- 8 discoveries in the portfolio.
- 22 mmbo probable reserves, 56 mmbo contingent resources; and a further 97 mmbo prospective resources.

**18**

Blocks

## Chairman's statement

I am pleased to present this Report and Accounts for Nautical Petroleum for the year to 30 June 2007.



### Introduction

The Company has not deviated from the objectives set and strategies defined at the time of admission to AIM in 2005 as a very early mover in the heavy oil sector. Nautical has made remarkable progress over the past two years and now enjoys the recognition of our peers and industry at large as a leading player in our field. The strategy was born of conviction which continues to guide our focus and disciplined approach.

World trends and developments in the oil and energy sectors have broadly followed the path anticipated and strongly endorse the role and value of heavy oil in the future international market mix.

The combination of global acceptance of the structural change and the impact of declining mature field production has led to something of a scramble for heavy oil prospects, both conventional and non-conventional, with majors assuming enormous new exposures in both sectors.

The Company, having secured a quality portfolio, shared risk with aligned partners and defined an optimum multi-block appraisal programme, is now fully prepared to proceed with confidence to the drilling phase and thereafter to production development, oil flow and revenue.

### Financial results

The benefits of the "outsourced services" model were again evident in the results for 2007. Overhead costs were contained at a very modest level despite the substantial increase in activity on licence work programme commitments and preparatory to the appraisal drilling scheduled for late 2007 onwards.

The Farmout programme served to spread risk and reduce costs for Nautical. This combined with the funds raised in 2006, eliminated the need for any new equity placing during the period.

Nautical closed the financial year with sufficient funds to cover overheads and the projected net share of all confirmed appraisal activity through to early 2008.

The Company policy of equity financing in the pre-revenue phase will continue to guide the funding programme until the balance of risk and certainty changes. Dependent on the results of the drilling activities reconsideration of policy may be appropriate in the coming year.

New share issue was very limited and was only used for part payment of the acquisition of the BlueBeard and Skipper assets from Engen Resources Limited.

### Assets and interests

Selective acquisition continued over the period to extend the portfolio within our preferred sector. Our policy of selective application resulted in the award of all four of the blocks applied for with partners under UKCS 24th Seaward Licensing Round. Nautical has adopted a guideline of a maximum 50% exposure in new licence applications to further spread risk while securing opportunity. All of the resulting participations are considered both prospective and a sound strategic fit.

The multi block farmout with Celtic Oil Limited (a subsidiary of SK Corporation of South Korea) closed as planned late 2006 marking the beginning of a close and constructive working relationship on activities preparatory to the associated licence commitment programmes.

Nautical appreciate the basis on which Chevron elected to withdraw from the Mariner field in the context of their world wide activities. On balance, the Company view this as a positive development opening the opportunity for an operator more closely aligned with our view on timing and approach to field development.

“The Company, having secured a quality portfolio, shared risk with aligned partners and defined an optimum multi-block appraisal programme, is now fully prepared to proceed with confidence to the drilling phase and thereafter to production development, oil flow and revenue.”



Courtesy of Dolphin Drilling Limited

By 30 June 2007, the Company had progressed from the two “promote” licences held on admission to AIM in March 2005, to participations on 13 UK licences containing 8 discoveries. Nautical is designated Operator in 9 blocks.

The combination of an expanded asset base, substantial secured participations and continued industry interest, will enable Nautical to rationalise and “high grade” the portfolio in the next phase of our development towards production and revenue. While appraisal results will clearly guide decisions on retention and disposal, optimising the portfolio will become a key focus and is fully compatible with the policy of affordable appraisal exposure and judicious sharing of associated risk. The Company may even consider relinquishing low ranked assets on a selective basis to conserve resources.

#### Directors, staff and associates

The combination of sound counsel from the non-executive directors and the talent, capabilities and dedication of the executive management have resulted in a further year of remarkable progress for Nautical.

Despite major growth in the portfolio of interests and associated activity, the outsource policy has been applied with commendable discipline with a focus on high quality services from selective associates and suppliers. This has been achieved at a time when pressure on skilled resources and engineering and related facilities capacity is at an all time high.

Nautical has a small in-house executive team who have been fully stretched by the expanding scope of interests. Their efforts, commitment and performance have been outstanding by any standard. It has, however, become clear that additional full time professional support will be required in both the technical and commercial areas to achieve a sound internal-external balance in the next phase of the Company’s development.

#### Outlook

Nautical was an “early mover” in the heavy oil sector and subsequent developments have fully vindicated the underlying concept and prospects.

World oil outlook, best indicated by continuing high oil price, is one of high demand growth driven by developing Eastern economies combined with supply uncertainty due to declining production from mature sources. The average production barrel becomes heavier and production development focus moves in the same direction.

Demand for scarce services has driven costs to all time highs but this may be expected to normalise and restore margin to an industry which will adjust to operating within new structural parameters. The demand driven structural price change has reduced the potential impact of OPEC policy while, in addition, OPEC itself has become more aligned to current values than past norms.

These factors have driven a major reconsideration of the role of heavy oil in meeting the future supply call and we could, ourselves, hardly have scripted a more favourable scenario.

The interest and pace of intrusion of majors and national oil companies into the heavy oil sector has increased dramatically – both in the conventional and the non-conventional (shale and tar sands) sectors where the exposures are enormous and the margins less certain. Nautical strategy has thus far been to secure discovered undeveloped heavy oil in the UKCS and Europe. The Company is squarely in the “conventional heavy oil” space and selects opportunity which has the potential for production using proven technologies.

The combination of early mover advantage, low cost resource acquisition and selective participation in the conventional sector, positions the Company to significant advantage at the high value end of the burgeoning heavy oil sector with a large portfolio of quality prospective resources.

Nautical appears to be very much in the right place, with the right opportunity, at the right time.

The Company moves forward to a key phase with the first of several drilling commitments starting from October 2007. We have great expectations for the future and a belief that the support of our shareholders, investors, and partners will be suitably rewarded as Nautical progresses towards first production and beyond.

**Ian Williams**  
Chairman  
1 October 2007

## Heavy crude oil

The world has been producing conventional oil and gas for more than 130 years. It is now becoming harder to find and reserves are no longer being replaced at the same rate as they are being used. This has caused the oil industry to look more closely at non-conventional resources such as heavy oil. The industry has tended to produce the more valuable and least costly reserves first, but now it is faced with developing these more challenging resources.

The two main areas where heavy oil accumulations can be found are Canada and Venezuela, although there are sizable undeveloped resources in the USA, UK North Sea, Colombia, Central and West Africa, Madagascar and the Far East. At current consumption rates conventional oil reserves can meet demand for the next 40 years. However, conventional oil production will start to decline much earlier than that and the energy shortfall will have to be met from other sources. **Heavy oil will be required to meet most of this gap.**

# 270k<sup>bopd</sup>

UK production of <23° API

# 20%

of UK production is from <23° API oil

**The Mariner  
discovery has  
14.5 API oil**

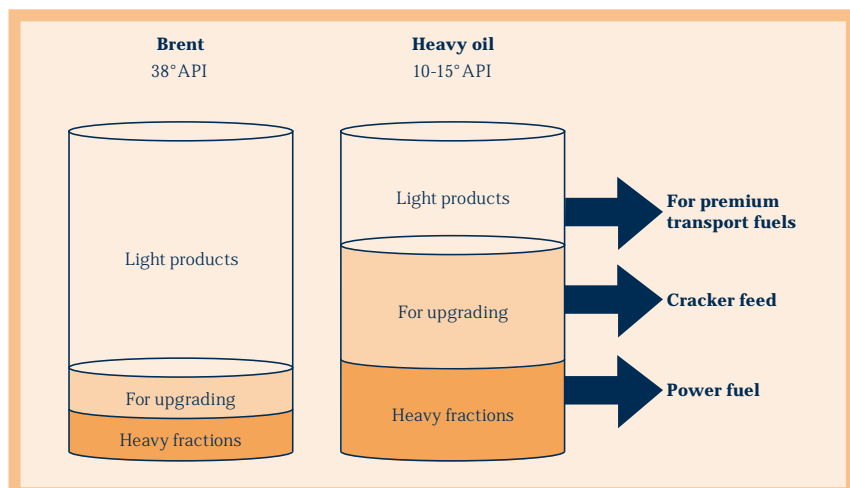
### What is heavy oil?

Crude Oil gravity is measured in degrees API (American Petroleum Institute). A conventional oil such as UK North Sea Brent is 38° API, whereas heavy oil is considered anything below 20° API. There is very little production of heavy oil below 10° API as it commands a lower price, is more expensive to produce and more costly to transport. The heavy crude oil that Nautical Petroleum will produce is mainly 14-16° API.

All crude oils are a complex combination of chemical elements, the make-up being determined by the source that generated the oil and what the oil has been exposed to since it was generated. Through refining, each oil can be divided into many fractions, ranging from the almost solid residue to light gas.

Heavy oil is a substance that has lost most of the light fractions. This occurs due to two main reasons: either the oil has been biodegraded by bacteria which have consumed most of the light fractions or the light fractions have escaped into the atmosphere over time.

The more valuable oils have a higher proportion of light fractions. The light fractions are used by refiners to make the more valuable products such as gasoline and diesel. The heavy oils have a higher proportion of heavy residue which is used to make low-priced fuel oils.



“A less viscous heavy oil in a high-quality reservoir with good water drive can produce heavy oil using conventional technology.”

“The Mariner discovery produced on average of 10,000bopd on an extended well test from one well which compares to 300bopd from each well in a Canadian steam injection project.”

**How is it produced?**

As well as being heavy these oils also tend to be very viscous. It is this characteristic that makes it more difficult and costly to produce. In order to produce these viscous oils various techniques can be applied to get them to surface.

By heating the oil in situ it will become less viscous. It will then flow and can be pumped to surface. The most effective method of heating subsurface heavy oil is by injecting steam into the oil-bearing reservoir. This can be a very effective and efficient production method and is mainly applied to onshore reserves because the associated facilities required to generate the steam would be too expensive to locate offshore. The amount of oil that can be extracted from the original oil in place is known as the recovery factor. With this type of production technique it is possible to have a recovery factor of up to 70%.

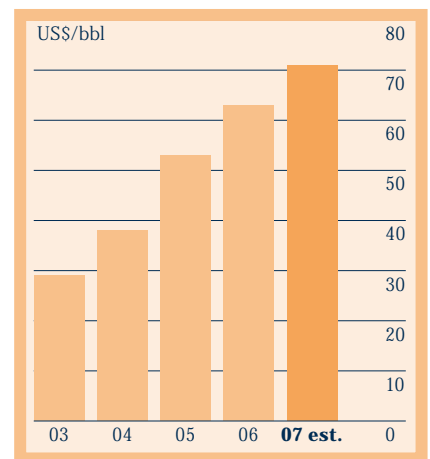
In areas where heavy oil accumulations are found at shallow depths of less than 100 metres, it is possible to mine the heavy oil. Here the oil and sand mixture is excavated and processed to separate the oil from the sand. The recovery factor can be greater than 90%. This technique is not suitable for an offshore environment.

A less viscous heavy oil in a high-quality reservoir with good water drive can

produce heavy oil using conventional technology. These circumstances exist with heavy oil reserves in the UK North Sea. The expected recovery factors for these fields are between 15-30%. Steam is not required for these developments. The Mariner discovery produced on average of 10,000bopd on an extended well test from one well which compares to 300bopd from each well in a Canadian steam injection project.

The heavy oils in the UK North Sea all tend to be acidic and are suitable for specialist refiners. Acidity can be problematic for conventional refiners, but there is a demand for these oils from refiners in the specialist base oil (lubricants) and road bitumen markets. These oils are also suitable for upgrading facilities where the heavy residue is processed to create more valuable products. There has been substantial investment in these facilities over recent years.

Nautical has concentrated on heavy oil resources because it was able to accumulate reserves at low prices, but anticipated that demand pressures would improve the value as the commodity prices increased. Nautical acquired its first licence in 2003 when the average spot price of Brent Crude was \$28.83/bbl. Today Brent Crude is trading in excess of \$70/bbl.



North Sea average Brent Crude oil spot price

## Chief Executive's review

Your company has demonstrated that even smaller companies can be acknowledged experts in specific regions. We have an industry envied understanding of the hydrocarbon plays on the East Shetland Platform.



Nautical continues to build a broad base of heavy oil assets focused on the East Shetland Platform of the UKCS, augmented and complemented by carefully selected discoveries/blocks in the UKCS and Europe. Nautical remains the only UK listed company offering pure exposure to heavy oil development and near term, low risk exploration for considerable resources.

The current period has been one of preparation for Nautical's first operated wells and seismic acquisition in the UKCS coupled with expansion of our extensive portfolio of appraisal opportunities and low risk, high impact exploration prospects.

Highlights of the period have been securing drill slots for our operated wells, along with boats for seismic acquisition and our resounding success, in aligned partnerships in the 24th Seaward Licensing Round.

### Expanding our portfolio East Shetland platform – our core area

Your company has demonstrated that even smaller companies can be acknowledged experts in specific regions. We have an industry envied understanding of the hydrocarbon plays on the East Shetland Platform through the integrated interpretation of an extensive seismic and well database. Nautical has mapped the distribution of the Maureen formation across the platform, extending the play away from Mariner to Mermaid and to the north in Blocks 8/5 and 9/1. Similarly, with the Heimdal Formation, predictions of distribution will be tested in the Kraken well. Finally, the Dornoch Formation delta hydrocarbon distribution can now be confidently predicted. This knowledge reduces the risk on prospects and enables blocks to be selected for both licensing round applications (such as 2/3a and 2/4b) and acquisition.

### 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, farmins 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.
- Farmout to mitigate portfolio risk.

*Resulting in enhanced shareholder value.*

“By the end of 2007, your company will have drilled its first two operated wells, participated in a third well and acquired its first seismic survey.”

### West Central Platform and UKCS

Your Company has built up an extensive data base of the heavy oil plays which enabled the selection of blocks 28/9 and 28/10b in the 24th Licensing Round. Similarly a regional study of the East Irish Sea basin identified the sleeper blocks of 113/29c and 113/30 enabling us to attract a partner and make a successful application.

### Managing our growing portfolio

Nautical continues to follow a conservative policy, focusing on discovered oil, with minimal exposure to exploration risk, operating where appropriate and increasingly in ever more competitive licensing rounds, taking a smaller interest in Traditional licences offering firm or contingent well commitments. This proved successful in the 24th Licensing Round where Nautical operated its first Traditional award (Blocks 113/29c and 113/30) and participated in Joint ventures (ranging from 15% to 33.33%) in blocks 28/9, 28/10b, 14/30a, 2/3a and 2/4b. Our success in the round and some small acquisitions has increased the UK portfolio to 13 licences, consisting of 17 full and part blocks containing seven discoveries. Nautical is operator of nine licences and recognises the opportunity to share risk and cost through farmout and swaps, consequently we look forward to announcing further farmouts. Your company continuously high grades its portfolio by diligent analysis and realises that not all blocks will prove economically prospective/viable thus relinquishments will happen in the future.

Meanwhile in France we hope to add to our current licence with two further applications as partner in an Egdon Resources led group.

### Mariner – a new energised operator

Chevron announced that they were going to market their interest in Mariner in June 2007. Considerable industry interest

endorsed Nautical's heavy oil strategy. The process resulted in a Sale and Purchase Agreement being signed with Norsk Hydro ASA. We look forward to working with this new operator who has considerable experience in developing offshore heavy oil. Nautical hopes that development will be accelerated led by this new energised operator.

### Unlocking potential – imminent drilling

By the end of 2007, your Company will have drilled its first two operated wells, participated in a third well and acquired its first seismic survey. The Kraken appraisal well will be drilled in October 2007 on the crest of the structure, with the intention of confirming our model of thicker reservoir development, hydrocarbon column and best estimate contingent resources of 23.9 million barrels net to Nautical.

Kraken will be followed by an exploration well on the Mermaid prospect (directly south of Mariner). We plan to intersect hydrocarbons in both the Maureen and Heimdal formations confirming net best estimate resources of 64.5 million barrels.

Concurrently, an appraisal well is to be drilled on the Grenade discovery which, if the reservoir is as prognosed, will yield our first production in Spring 2008.

A well on the Catcher Prospect will be Nautical's first in 2008, followed by an exploration well on the Selkie Prospect. Assuming that the seismic being acquired over block 3/27a firms up a prospect on the Hydra leads this will be our third well in 2008.

### Technology

Nautical owns specialist process equipment suitable for use in the testing of heavy oils down to 10 API. The equipment can handle up to 40,000 barrels per day (bopd) of liquid production of which 25,000bopd can be oil. This new technology could be used

on the testing of the Kraken discovery as well as future Nautical development programmes, and when not in use there are opportunities to hire the equipment out to third parties.

### Oil portfolio audit

RPS Energy audited our oil portfolio held at 30 June 2007. Reserves and resources quoted in this report refer to the figures verified by this audit. All reserves are proven plus probable and all contingent resources and prospective resources are best estimates.

### High value barrels escalating costs

Your Company expects the oil price to remain high in the medium term and we have seen evidence of a narrowing of heavy crude oil discounts in the UKCS, as production from key fields declines. Higher prices are coupled with escalating costs which we will control by high grading the portfolio, farming down and reducing drill risk through diligent technical evaluations. Nautical will continue to lobby the UK Treasury for improved fiscal terms for heavy oil development.

Skill shortages continue to prevail, however Nautical has established relationships with contractors who provide support to the small core team across all disciplines. Our expertise has been further strengthened by a secondment of a Drilling Manager from our major partner Celtic Oil Ltd.

### The future

We look forward to an extensive seismic and imminent drilling campaign through the remainder of 2007 and 2008, which will release the potential of the largest independent heavy oil portfolio in the UKCS.

### Steve Jenkins

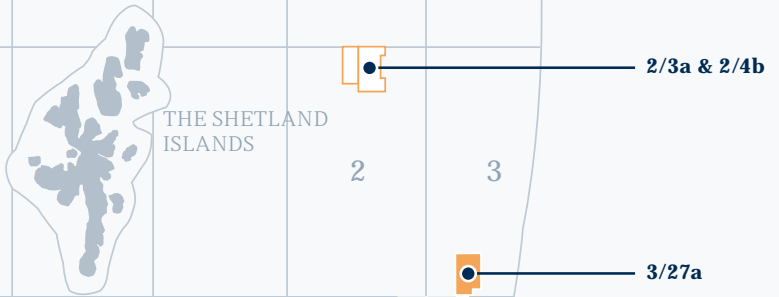
Chief Executive Officer  
1 October 2007

# Operational review

## Our portfolio

as at 1 October 2007

KEY  
□ - 24TH ROUND BLOCK

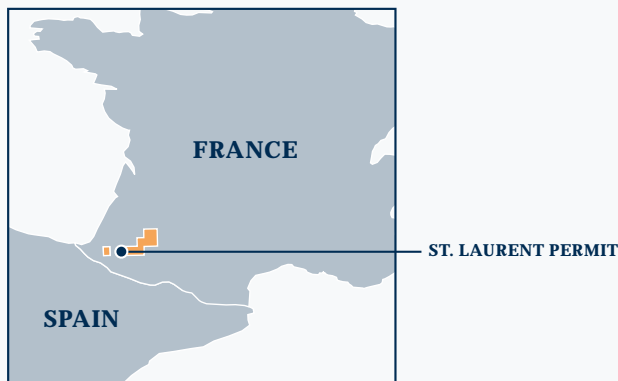


THE ORKNEY ISLANDS

MARINER (9/11a)  
MERMAID (9/11c)

UK NORTH SEA

UNITED KINGDOM



**BLOCKS 2/3A & 2/4B Dragon (LICENCE P1492 – 33.33% interest)**

- Awarded 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 two prospects, one with crestal oil.

**BLOCK 3/27A Hydra (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 being acquired in September 2007 to define prospects for drilling.

**BLOCK 8/5 AND BLOCK 9/1 Scylla (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 reprocessed leading to the delineation of two leads in the Tertiary. Up to 50km of new 2D high resolution seismic to be acquired September 2007.

**BLOCK 8/25A Selkie (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 9/2B Kraken (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.
- An appraisal well will be drilled in October 2007.

**BLOCK 9/11A Mariner (LICENCE P335 – 26.67% interest)**

- 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.
- The shallower Heimdal sandstone member has flowed up to 1,800bopd on a vertical test.

**BLOCK 9/11C Mermaid (LICENCE P979 – 50% interest)**

- The 3D seismic has been reprocessed, interpreted and has confirmed the robustness of the trap with around 129mmbo best estimate prospective resources.
- A well will be drilled in November 2007.

**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.

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

- A discovery well on the block encountered a 16 metre oil column in excellent quality Palaeocene Dornoch Formation Sands.

**BLOCK 14/30A ((LICENCE P1463 – 20% interest)**

- Awarded in February 2007 in the 24th round. The block is in the Outer Moray Firth, 3D seismic is being processed and geochemical studies are ongoing.
- The block contains the Tudor Rose discovery.

**BLOCK 15/7 Seahorse (LICENCE P1296 – 50% interest)**

- Initial mapping of 170km<sup>2</sup> of 3D and 145km of 2D seismic data has confirmed a four-way dip-closed structure. Both 3D and 2D seismic have subsequently been reprocessed.

**BLOCKS 28/9 & 28/10B Catcher ((LICENCE P1430 – 15% interest)**

- Awarded 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.

**BLOCKS 113/29C & 113/30 ((LICENCE P1475 – 50% interest)**

- Offered and accepted in February 2007 in the 24th round. The blocks lie on the edge of the East Irish sea Basin. Over 600km of 2D seismic are being reprocessed leading to a drill or drop decision. The block contains the large Merrow prospect which can be drilled from onshore.

**ST. LAURENT PERMIT (22% interest)**

- Located in Aquitaine Basin, SW France, The Grenade-Sur-Adour well produced 8000 barrels in a series of tests.
- A rig has been secured to drill a well in November 2007 followed by a test in Spring 2008.
- Further gas prospectivity is present on the permit.

## Operational review

# UK Continental Shelf

Nautical is to drill its first wells in the UK continental shelf in October/November 2007, to appraise the Kraken discovery and drill the Mermaid exploration well, which together may contain over 180mmbo (gross).

### Key Stats

#### Kraken

- Contains Kraken oil discovery
- Reprocessed 3D seismic confirms large three-way dip-closure
- 15 API oil, no oil water contact encountered
- Contingent resources of 53mmbo
- Drilling October 2007



#### Block 9/2b (Licence P1077) (Nautical 45% Operator)

Nautical's first awarded licence in the UKCS is located on the East Shetland Platform, west of the North Viking Graben and contains the 9/2-1A discovery well drilled in 1985. The well tested 15 API oil on drill stem test (DST) from the Tertiary Palaeocene Heimdal Sandstone Member. Analysis to date has confirmed an oil column of at least 33 metres (with no oil-water contact encountered in the well).

Interpretation of over 200km<sup>2</sup> of reprocessed 3D seismic data has confirmed the large, three-way dip-closed structure (Kraken Discovery) and revealed a crestal, high amplitude anomaly. Petrophysical studies and seismic modelling have indicated that the amplitude response is most likely to be a gas cap, up-dip from the oil leg

encountered in well 9/2-1A.

Encouragingly, the Heimdal reservoir, and its contained hydrocarbons, appear to thicken up-dip from the well towards the crest of this structure. The resultant best estimate contingent resources in the Kraken Discovery, discovery is 53mmbo (24mmbo net to Nautical).

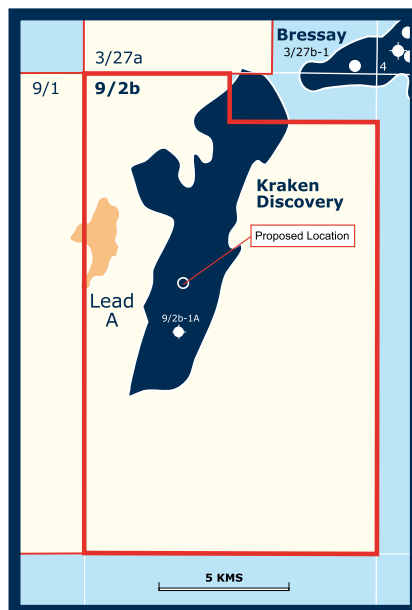
Further detailed seismic mapping has identified a crestal, appraisal location which will be drilled in October 2007. The well is designed to confirm and core the predicted thicker reservoir and to prove and sample up-dip hydrocarbons. The farmout to Celtic Oil Limited at a premium means Nautical is exposed to significantly less of the cost than its 45% equity share of the well. Additional seismic is also being acquired in the northern part of the block at the same time as the 3/27a programme in September 2007.

The Department of Business Enterprise and Regulatory Reform (BERR) has extended the initial term of the licence by three months to enable the commitment well to be drilled.

To comply with licence terms we will relinquish the non prospective eastern portion of the licence before entering the next licence term. The drilling of the well will fulfil all the initial term commitments.

# 53<sup>mmbo</sup>

Kraken: Blocks 9/2b – Gross best estimate contingent resources



■ Fields & Discoveries

■ Prospects & Leads



Courtesy of Dolphin Drilling Limited



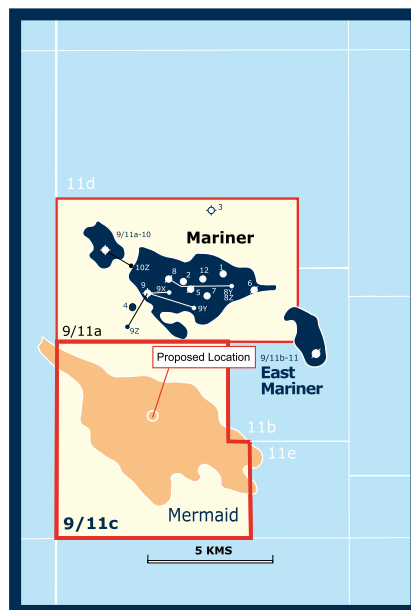
**Block 9/11c (Licence P979)**  
(Nautical 50% Operator)

Located on the East Shetland Platform, directly south of the Mariner discovery, the block contains the low risk, large, undrilled Mermaid Prospect. Reservoir targets are analogous to Mariner (Palaeocene, Maureen and Heimdal Sands) and interpretation of the reprocessed 3D seismic data has increased the confidence of a Maureen pinchout to the north, south and west, and confirmed separation from Mariner. Furthermore a significant, thick northwest, southeast trending Maureen channel slope deposit (similar to Mariner) has been identified, leading to further confidence in a viable reservoir.

In the shallower section seismic anomalies have been noted at various levels in the Lista Formation which may indicate significant hydrocarbon bearing Heimdal sand channels (in common with Mariner), which add further prospective resources, not included in the current estimates.

The resultant best estimate prospective resources are 129mmbo (65mmbo net to Nautical) in the Tertiary Maureen Formation.

An exploration well will be drilled in the 4th quarter 2007 (directly after Kraken) to intersect the prognosed thick Maureen Sandstone on a small four way dip closed high. If hydrocarbons are present they will be sampled. Additionally, if the oil column extends beyond structural closure a contingent sidetrack will be drilled towards a structurally lower area to determine the oil water contact, which will be used to calculate the resources in the Mermaid structure. The Farmout to Celtic Oil Limited and Silverstone Energy, at a premium, means Nautical is exposed to significantly less than its 50% equity share of the well.



■ Fields & Discoveries

■ Prospects & Leads

## Key Stats

### Mermaid

- Contains large Mermaid prospect
- Analogous to Mariner
- Prospective resources of 129mmbo
- Drilling November 2007

**129** mmbo

Mermaid: Block 9/11c – Gross best estimate prospective resources

## Operational review

# UK Continental Shelf

The highly appraised Mariner Field enters a new phase with change to a new energised operator.

### Key Stats

#### Mariner

- Gross 2P reserves in Maureen Sandstone 82mmbo
- Highly appraised (16 well penetrations of reservoirs)
- Extended well test produced 662,000 barrels at up to 14,991bopd of 14.5 API oil
- Excellent reservoir characteristics (porosity = 31%, permeability = 5D)

#### Upside

- Shallow Heimdal Sandstone with 51mmbo contingent resources
- Heimdal has flowed 1,800bopd on test

# 82<sup>mmbo</sup>

Proven and probable reserves

# 51<sup>mmbo</sup>

Gross best estimate contingent resources



#### Mariner Block 9/11a (Licence P726) (Licence P335) (Nautical 26.67%)

Located on the East Shetland Platform, west of the Viking Graben, block 9/11a contains the Mariner discovery drilled in 1981. Since then data from several 3D surveys have been acquired, nine vertical wells and six high-angle horizontal wells have been drilled. The vertical wells produced 1,000 to 1,595bopd.

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). The main reservoir is the Tertiary Paleocene Maureen Sandstone which has a gross thickness of up to 122 metres and excellent reservoir characteristics. The trap is both structural and stratigraphic, with the reservoir pinching out to the west, north and south. A shallower reservoir,

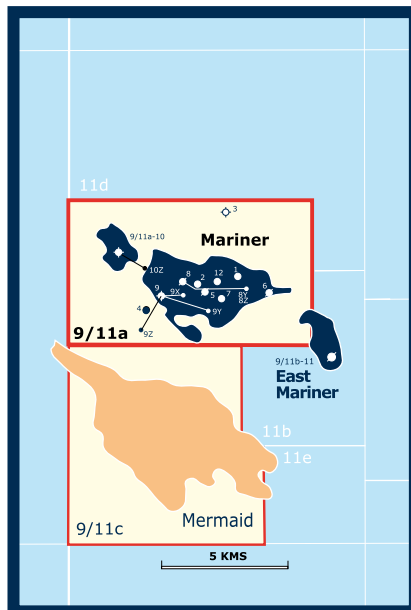
Heimdal Sandstone Member, could recover gross contingent resources of 51mmbo (14mmbo net to Nautical). This reservoir has flowed up to 1,800bopd on a vertical test.

Mapping of the reprocessed merged 3D seismic data has resulted in better imaging of the Maureen reservoir, thus reducing the range of hydrocarbon volumes, as well as the stratigraphic and structural uncertainty. The improved geological model and subsequent dynamic modelling of the main Maureen reservoir estimates 82mmbo proven and probable reserves within Block 9/11a (22mmbo net to Nautical).

During the period, the co-venturers, led by the operator Chevron, delineated three reservoir compartments and identified the optimal development scenario (establishing the well count for both oil producers and water injectors). Development facilities were designed and costed in anticipation of the submission of a Field Development Plan.

In 2007, Chevron determined that although an economic project, Mariner was not material in their global portfolio and decided to market the opportunity. Considerable interest was generated from majors to independents and in August 2007 a Sale and Purchase Agreement was signed with Norsk Hydro ASA, a major developer of worldwide offshore heavy oil fields. Nautical anticipates an acceleration of Mariner's development by the new operator.

In addition to Nautical's 26.67%, Nautical is carrying a 6.67% interest in the Mariner block. Upon field development plan approval, Nautical may either be required to pay £1 to acquire this interest or will be reimbursed past costs through the development phase, being £8.3m at June 2007.



■ Fields & Discoveries

■ Prospects & Leads

“On Block 8/25a the combined best estimate prospective resources for Selkie and Kelpie are 35mmbo (21mmbo net to Nautical). A site survey will be acquired in September/October 2007 over the larger Selkie prospect, in anticipation of drilling in 2008.”

**Block 9/12b (Licence P1079)**  
(Nautical 98.5% Operator)

Located directly east of the Mariner discovery, the block contains two small discoveries in the Maureen Formation and in the shallower Eocene, Mousa Formation. Detailed mapping of the 3D seismic has revealed a low relief lead to the north of the 9/12-3 which is very sensitive to depth conversion, made more complex by the presence of shallow Miocene channels.

The previewed farmout was not concluded and Nautical are reviewing the economic viability of the discoveries.

**Block 9/21 (Licence P1080)**  
(Nautical 98.5% Operator)



**Block 8/25a**  
(Licence P976)



(Nautical 60% Operator)

The block lies on the East Shetland Platform to the south of the Mariner discovery. Interpretation of both our proprietary 3D seismic and an extensive grid of speculative 2D seismic has revealed a cluster of prospects and leads on a large south easterly plunging nose in the Dornoch formation. Two large, low risk, shallow four way dip closed prospects (Selkie and Kelpie) are located in Block 8/25a with Kelpie East in Block 9/21. These prospects are all the more promising since the oil change of the Dornoch Formation reservoir is proved by the Skipper discovery to the north east, which also exhibits excellent reservoir characteristics. Further smaller leads have been mapped to the east of Skipper.

A more rigorous depth conversion over the blocks has enabled more robust delineation of the Skipper discovery leading to a reduction in hydrocarbon volumes. However, the mapped crest is 25 metres up-dip from the discovery well (9/21-2) which encountered a 16 metres oil column, implying a substantially thicker column on the crest.

On Block 8/25a the combined best estimate prospective resources for Selkie and Kelpie are 35mmbo (21mmbo net to Nautical). A site survey will be acquired in September/October 2007 over the larger Selkie prospect, in anticipation of drilling in 2008. The farmout to Celtic Oil Limited at a premium means Nautical is exposed to significantly less than its 60% equity share of the well.



■ Fields & Discoveries ■ Prospects & Leads

**Key Stats**

**Selkie and Kelpie**

- Two large, low risk prospects (Selkie and Kelpie)
- Analogous to Skipper discovery
- Prospective resource of 35mmbo
- Site survey in 2007
- Well planned in 2008

**35** mmbo

Gross best estimate prospective reserves

## Operational review

# UK Continental Shelf

Nautical is progressing to firm up leads into prospects, with seismic being shot on 3/27a and a well planned in 2008.

### Key Stats

#### Hydra

- Numerous leads at tertiary and jurassic
- Gas chimneys seen on seismic
- 1,500km of 2D seismic being acquired September 2007



#### Block 3/27a (Licence P1203) (Nautical 45% Operator)

Located directly north of Block 9/2b (Kraken discovery) on the East Shetland Platform, the licence was converted from promote to traditional in October 2006. Most recently the interpretation of the original 2D seismic (476km) 90km of reprocessed 2D seismic, Bressay 3D seismic and 100km<sup>2</sup> of speculative 3D seismic has confirmed the prospectivity of the block.

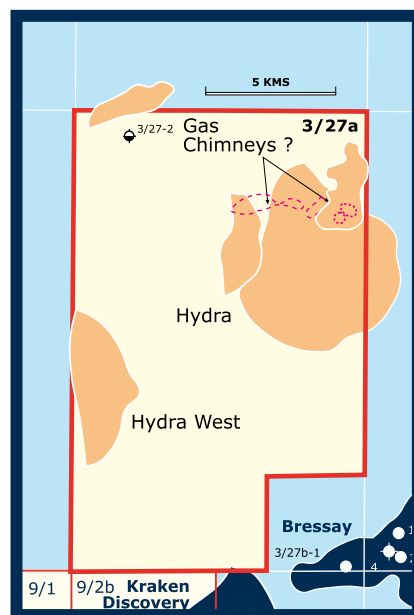
In the east the Hydra leads have been mapped at Heimdal, Dornoch and most interestingly at Jurassic levels. In the latter, the Jurassic sands encountered in 3/28b-3 appear to thin and pinchout to the west across a terrace and shale out to the north and south. Encouragingly, gas chimneys can be interpreted on the seismic to coincide with the prognosed

zero sand edge. To the west, Hydra West lead appears to be a continuation of the proven Heimdal play in the Kraken discovery further south.

To further delineate the Hydra leads and elevate them to prospect status 1500km of close spaced, high resolution 2D seismic will be acquired in September/October 2007. Although the survey is centred on Block 3/27a, seismic will also be acquired in blocks 9/2b and 3/22. Our partner Celtic Oil Limited farmed into both the seismic and contingent well to be drilled in 2008, dependent on the mapping of a robust, economically viable prospect. The financial exposure to these programmes is as a result significantly less than Nautical's 45% equity share.

# 1,500<sup>kms</sup>

2D seismic being acquired



■ Fields & Discoveries

■ Prospects & Leads

“2D seismic interpretation indicates that the Brent sand thickens down-dip of the crest, forming the Unicorn prospect.”

**Blocks 2/3a and 2/4b  
(Licence P1492)**

(Nautical 33.33%)

Awarded as a Promote Licence in the 24th Seaward Licensing Round in February 2007, the blocks are located in the north of the East Shetland Platform directly west of the Heather and Broom oil fields and contain two oil discoveries. Well 2/4-1 encountered 16.6° API in the Triassic on a bald Brent high. 2D seismic interpretation indicates that the Brent sand thickens down-dip of the crest, forming the Unicorn prospect. A second prospect, Dragon, was mapped in the north, to the east of the oil bearing 2/3-1 well.

Further 2D and 3D seismic will be purchased and reprocessed to define these shallow prospects and further Tertiary and Jurassic leads. A

geochemical study is planned on the encountered oil to confirm API gravity and to estimate viscosity.

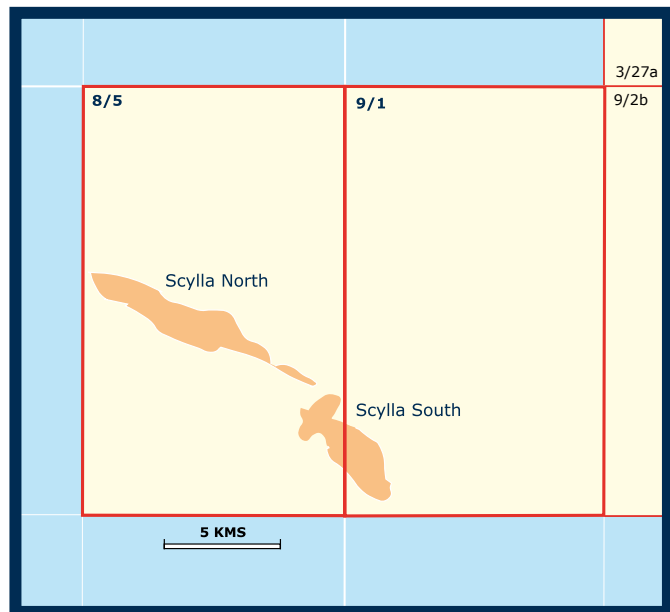
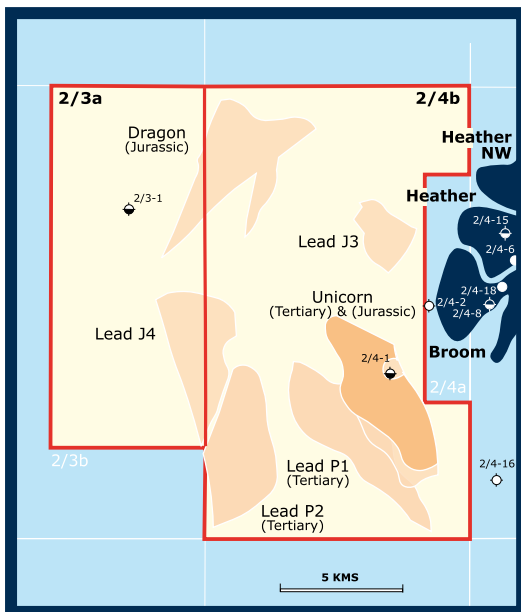


**Blocks 8/5 and 9/1  
(Licence P1277)**

(Nautical 100% Operator)

Blocks 8/5 and 9/1 are contiguous to the west of block 9/2b (containing the Kraken discovery). Initial mapping of an extensive 2D seismic database highlighted two culminations on a north west, south east trending channel like feature at both the Heimdal and Maureen levels. The seismic signature is analogous to sand rich channels elsewhere on the platform. The reprocessing of 231km of 2D seismic has significantly enhanced the character of the two reservoir horizons and the Base Tertiary. Up to 50km of new 2D high resolution seismic will be acquired in

October 2007, contingent on weather. The expanded and enhanced seismic grid will be interpreted in anticipation of a farmout, before the licence is converted from promote to traditional at the end of December 2007.



■ Fields & Discoveries

■ Prospects & Leads

## Operational review

# UK Continental Shelf

A large prospect (Merrow) has been mapped on a 2D seismic grid (of marine, transition and land seismic), at both Triassic (Ormskirk Sandstone) and the Permian (Collyhurst Sandstone).

Preliminary investigations indicate that the prospect can be tested by an onshore well, deviated offshore.

### Key Stats

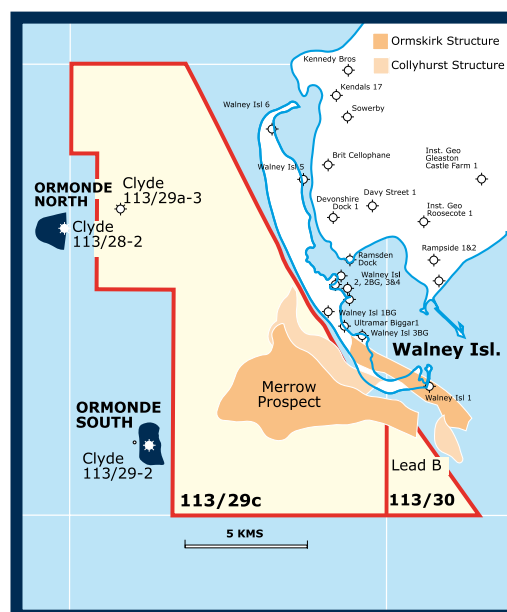
- Large Merrow prospect
- Triassic and Permian reservoirs
- Excellent extensive seismic grid being reprocessed
- Merrow can be tested from onshore

### Blocks 113/29c and 113/30 (Licence P1475) (Nautical 50% Operator)

Awarded as a Traditional licence in the 24th Seaward Licensing Round in 2007, the blocks are located in the East Irish Sea Basin adjacent to Walney Island on the Cumbrian coast. There are numerous oil and gas shows in the offshore wells and hydrocarbon migration through the blocks are proven by heavy oil columns/shows in the onshore wells to the east.

A large prospect (Merrow) has been mapped on a 2D seismic grid (of marine, transition and land seismic), at both Triassic (Ormskirk Sandstone) and the Permian (Collyhurst Sandstone). Both reservoirs are proven in the basin, the Ormskirk being a prolific gas producer in numerous fields (including Morecambe and the soon to be developed Ormonde North and South fields, immediately to

the west of the blocks). Expected hydrocarbons are heavy oil or gas. Nautical has committed to purchase and reprocess 2D seismic leading to a drill or drop decision within four years of licence award (by early 2011). Currently over 600km of 2D seismic is being reprocessed (a significant proportion of which has been acquired since licence award). Additionally gravity and magnetic data will be purchased, then all data interpreted to hopefully further delineate the Merrow prospect at both reservoir levels. Preliminary investigations indicate that the prospect can be tested by an onshore well, deviated offshore.



■ Fields & Discoveries

■ Prospects & Leads

“The 24th Round success has introduced further prospects into the portfolio including the Tudor Rose discovery.”

**Block 14/30a (Licence P1463)**  
(Nautical 20%)

Located in the Outer Moray Firth adjacent to Ivanhoe, Rob Roy and Goldeneye fields this traditional block, awarded in the 24th Licensing Round, contains one undeveloped discovery, 14/30a-2 (Tudor Rose). The well encountered a 24 metre oil column beneath a 3 metre gas cap at around 1,000 metres subsea within Tertiary, Dornoch Formation Sands. Further prospects have been mapped on 3D seismic within the Lower Cretaceous (Kopervik Sand) and the Jurassic Sgaith Sand.

The four year work programme for the block includes reprocessing 3D seismic data and a contingent well on the 14/30a-2 discovery. Nautical attributes 34.6mmbo best estimate contingent resources to Tudor Rose discovery and the operator is currently reprocessing

208km<sup>2</sup> of 3D seismic. Analysis of wet cuttings is aimed at determining the API gravity of the oil column.



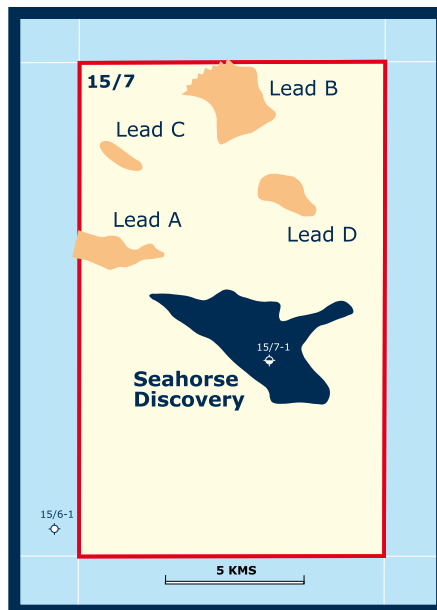
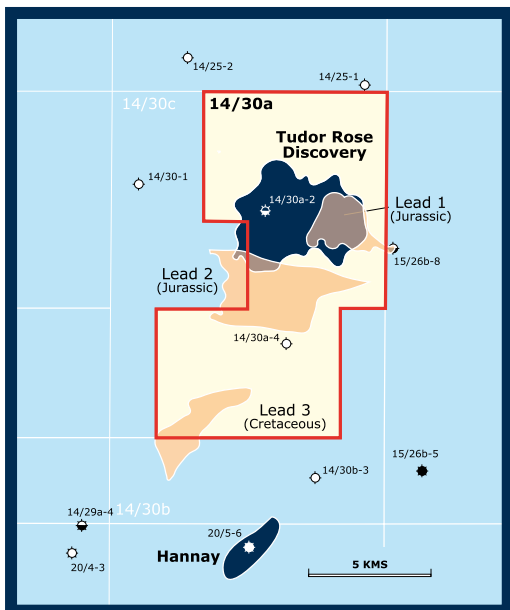
**Block 15/7 (Licence P1296)**  
(Nautical 50% Operator)

Awarded in the 23rd Seaward Licensing Round in 2005, Block 15/7 is located in the Outer Moray Firth, north of the Witch Ground Graben and North Piper Basin and contains the Seahorse heavy oil discovery made by Texaco in 1977. Oil columns were encountered in both the Tertiary Forties and Dornoch sands.

Initial mapping of 170km<sup>2</sup> of 3D seismic and 145km of 2D seismic data has confirmed a four-way dip-closed structure with best estimate contingent resources of 17mmbo (8.5mmbo net to Nautical) and 17mmbo prospective resources (8.5mmbo net to Nautical).

Preliminary analysis of oil recovered from the discovery well 15/7-1 implies an API of 17 with a low viscosity of 22cp at reservoir temperature. Additional potential has been identified in structures along strike and to the north of Seahorse. Additional potential has been identified.

Recently reprocessed 2D and 3D has increased clarity at both reservoir horizons and the seal of the Dornoch Formation oil column can now be mapped. Interpretation of these new data is currently under way with the aim of further delineating the Seahorse discovery at both reservoir levels and elevating the other leads to prospects.



■ Fields & Discoveries      ■ Prospects & Leads

## Operational review

# UK Continental Shelf

The 24th Round success has added near term drilling with the Catcher prospect in early 2008.

### Key Stats

#### Catcher

- Direct Hydrocarbon Indicators (DHI's) on extensive 3D seismic
- Gross best estimate of prospective resources – 21.8mmbo
- Drilling Q1 2008
- Numerous follow up. Tertiary leads and prospects

#### Blocks 28/9 and 28/10b (Licence P1430)

(Nautical 15%)

This traditional 24th Seaward Licensing Round Block is located on the West Central Platform, west of the Central Graben and the nearby Guillemot fields.

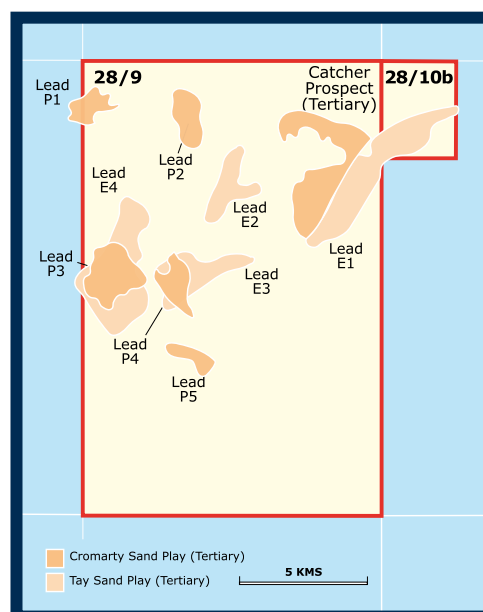
The blocks are undrilled but contain numerous structural/stratigraphic leads and prospects at both Eocene (Tay Sandstone) and two large Jurassic leads. Traps are defined on recent 3D seismic which is currently being reprocessed

and the subject of detailed AVO studies. The main prospect Catcher is a structural trap with an observed direct hydrocarbon indicator.

Apart from reprocessing existing seismic, the work programme includes a firm well in Q1 2008 to test the Catcher prospect. In anticipation of drilling by a rig already contracted to the operator (Oilexco) a site survey will be acquired shortly. Nautical is carried for 20% of its costs of this well.

# 21.8<sup>mmbo</sup>

Catcher gross best estimate prospective resources



■ Prospects & Leads

“In-depth subsurface, facilities engineering and marketing studies have shown the field to have potential for commercial development. In light of these conclusions a horizontal well will be drilled in November 2007.”

### St. Laurent Permit† (Nautical 22%)

The St. Laurent Permit in South West France contains the undeveloped Grenade heavy oil accumulation and several further hydrocarbon exploration plays. Nautical purchased a 22% interest from International Energy Group AG in November 2005 with the primary focus on the development of the Grenade discovery. The discovery well, Grenade-Sur-Adour-1 was drilled by SNEAP (Elf) in 1975 and encountered a 97 metre oil column of 10 API oil in Cretaceous Albian carbonates. Between 1976 and 1985 around 8,000 barrels of oil were recovered from intermittent tests, the well being finally plugged and abandoned during a period of low oil prices in 1985.

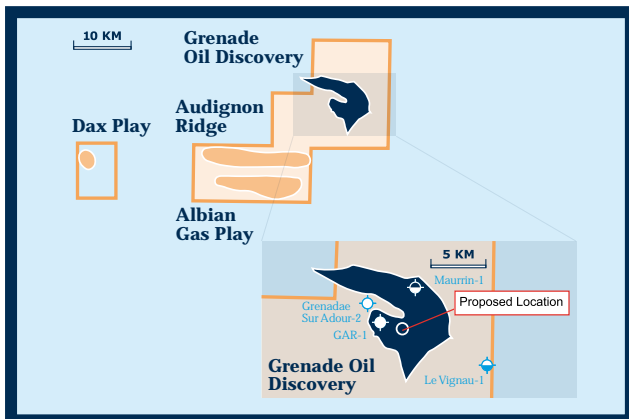
At the end of 2005, the Company acquired 40km of 2D seismic and 12km<sup>2</sup> of 3D seismic data over Grenade, and by integrating the new data with both existing reprocessed 2D seismic data and the results of an extensive core study on the Grenade-Sur-Adour 1 and 2 and Maurrin-1 reservoirs, were able to better define the trap. The resultant mapped trap is a large three-way up-dip pinchout

of the reservoirs on a low energy carbonate platform. Best estimate oil in place is with best estimate contingent resources of 12.6mmbo (2.8mmbo net to Nautical).

In-depth subsurface, facilities engineering and marketing studies have shown the field to have potential for commercial development. In light of these conclusions a horizontal well will be drilled in November 2007. A start access road has been constructed and site preparation is well under way in anticipation of a November spud. Initially a vertical pilot hole will be drilled and cored. Then a horizontal well will be drilled and suspended for testing in Spring 2008. During this period the remaining, highly prospective exploration plays will be matured through the integration of extensive well data and interpretation of reprocessed 2D seismic data.

### Further French applications

As a co-venturer of an Egdon Resources led group, two licence applications have been submitted to strengthen our French portfolio.



### Fields & Discoveries

† Permit is awaiting French Government approval.

## Key Stats

- Contains Grenade discovery (1975)
- 97 meter oil column.
- New seismic acquired end 2005.
- Large stratigraphic trap confirmed.
- Horizontal appraisal well to be drilled in 2007.
- Further exploration upside.

# 12.6<sup>mmbo</sup>

Best estimate gross  
contingent resources

## Finance Director's review



“We continue to place a strong emphasis on our financial strategy and risk management strategy in order to ensure that it not only complements and supports the business development plan but also provides for a rapid but carefully managed progression to revenue.”

### Introduction

The prime focus for the Group and its management during the year was to develop a better understanding of its assets and prepare itself for its first exploration and appraisal drilling programme which is scheduled for the last quarter of 2007. At the same time, the Group was successful in its 24th Round licence applications, securing interest in four new licences, and also managed to acquire an interest in the Bluebeard and Skipper discoveries from Engen Resources Ltd. All this has been attained without putting excessive demand on the Group's existing resources or taking unmanageable risks.

### Results for the year

The Group is still in a pre-revenue stage but posted a modest after-tax loss for the year of £0.4m through careful utilisation of resources. The general and administrative expenses amounted to £1.3m, including a charge for the share options of £0.4m. The only revenue generated in the year was bank deposit interest of £0.5m. There was also a tax credit of £0.5m relating to the deferred tax liability arising from changes in UK tax rates from 30% to 28%.

Loss per share was 0.05p.

### Cash flow and capital expenditure

The Group had cash resources of £8.9m as at 30 June 2007, down from £12.3m at the beginning of the year. Apart from covering the normal operating expenses, £0.4m was applied to cover the cash portion of the acquisition cost of the Bluebeard and Skipper discoveries from Engen Resources Ltd and £2.7m was utilised for further development expenditure on the Group's portfolio of North Sea and French assets.

The current planned exploration and appraisal drilling programme on Kraken, Mermaid and Grenade discoveries should be adequately covered by the Group's existing resources for its share of the costs. Beyond that, the Board will consider several funding alternatives, as and when appropriate, and implement an effective funding programme to take the business forward.

#### **Capital structure**

The Group currently has 1,077,689,619 Ordinary Shares in issue out of its authorised share capital of 1,600,000,000 Ordinary Shares. Taking into consideration the outstanding options, warrants and committed shares, the Board presently has a remaining authority to issue 445,868,159 Ordinary Shares under section 80 and 259,782,470 Ordinary Shares under section 89 of the Companies Act 1985. These authorities will be reviewed at the next AGM, as appropriate.

#### **Treasury and financial risk management**

Control over treasury and risk management is exercised by the Board and its Audit Committee through the setting of policy and the regular review of forecasts and financial exposures. Presently, the Group's financial instruments comprise principally of cash and liquid resources and other items, such as accounts receivable and payable, which arise directly from its operations. It is still the Group's policy not to undertake any trading activity in financial instruments, including derivatives.

The principal risks arising from the Group's financial instruments are interest risk, liquidity risk and foreign exchange risk. The Board reviews and establishes appropriate policies for the management of such risks and monitors them on a regular basis.

#### **Taxation**

The Group's current and brought forward losses give rise to material deferred tax assets. These amount to approximately £1.1m as at 30 June 2007 but have not been recognised in the financial statements as a result of the uncertainties of their realisation in the foreseeable future.

On conversion to IFRS a deferred tax liability of £6.6m has been recognised in the financial statements on the acquisition of a subsidiary company prior to the transition date for IFRS (1 January 2005). The tax rate applicable for the periods after April 2007 has, however, been reduced from 30% to 28% in line with the latest UK Budget changes.

#### **Transition to International Financial Reporting Standards**

The Group has successfully transitioned to International Financial Reporting Standards (IFRS) from UK GAAP during the year under review. This involved restating prior periods' results and updating the Group's accounting policies as necessary. Details of these are covered by the notes accompanying the Group financial statements.

#### **Outlook**

The objective of building up a carefully selected portfolio of heavy oil assets in the UK and Europe and taking them through to development remains our core business strategy. At the same time, we continue to place a strong emphasis on our financial strategy and risk management strategy in order to ensure that it not only complements and supports the business development plan but also provides for a rapid but carefully managed progression to revenue.

The next period has already started off with a great deal of activity in respect of our current exploration and appraisal drilling programme and we remain hopeful of its successful outcome. This, we believe, will not only have a material positive impact on our hydrocarbons reserve base but also enhance shareholder values further.

#### **Hemant Thanawala**

Finance Director  
1 October 2007

# Board of Directors



**1. Ian Williams****Chairman**

Ian's wide-ranging industry experience encompasses 27 years with the Royal Dutch/Shell Group including appointments as Managing Director and Deputy Chairman, Shell South Africa, Vice President (Downstream), Shell Philippines and Head of Strategy & Consultancy (Downstream) at Shell International Petroleum Company.

Ian became Chairman of Nautical on 1 April 2005. Ian joined the Masefield Group in 1999 and holds directorships in several Group companies.

**2. Steve Jenkins****Chief Executive**

Stephen has an MSc in Petroleum Geology and DIC from Imperial College of Science and Technology (University of London), a BSc Hons in Geology from the Queen's University Belfast, and is a Fellow of the Geological Society of London.

As part of a 20 year career in oil and gas, Stephen spent the 11 years prior to joining Masefield at Nimir Petroleum as Business Development and HSE Manager, where he was responsible for acquisition strategy and technical dimensions of strategic planning.

Stephen became Chief Executive of Nautical on 1 April 2005, having joined the Masefield Group in 2003 to be responsible for all upstream technical management prior to floating the Masefield assets through Nautical.

**3. Hemant Thanawala****Finance Director**

Hemant is a Chartered Accountant with over 25 years' professional and commercial experience, qualifying in 1981 with KMG Thomson McLintock (now KPMG). Post qualification, he was in professional practice for eight years before serving as Chief Financial Officer of Rostel Holdings Group for nine years and Premier Telesports Group for three years.

Hemant became Finance Director of Nautical on 1 April 2005. Having joined the Masefield Group in 2001, Hemant holds directorships in several Group companies.

**4. Paul Jennings****Commercial Director**

Paul has over 25 years' experience in the oil and gas sector spanning the roles of accountant, economist and commercial and business development director. He has worked with BP and acted as adviser to the Russian and Chinese Governments.

Paul became Commercial Director of Nautical on 1 April 2005. Paul joined the Masefield Group in 2000, assuming responsibility for exploration and production finance and business development.

**5. Philip Dimmock****Non-Executive Director**

Philip has over 30 years' experience in the upstream oil and gas business, both in the UK and internationally and is currently chief operating officer of Equator Exploration Ltd.

Philip spent a significant part of his career at BP in a wide variety of senior positions, and at Ranger Oil where he held the post of Vice President of the International Division, and served as Chairman. He has also been an Executive Officer of the UK Offshore Operators Association.

**6. Patrick Kennedy****Non-Executive Director**

Patrick is a Chartered Accountant with bachelors and masters degrees in Economics and has over 20 years experience in business development and strategy, working with corporate leaders and high net worth individuals in the UK and overseas. He is CEO of PK Group, the London based financial services group and serves on the Boards of both publicly listed and private companies.

A Director since 30 May 2002, Patrick is Chairman of Nautical's Audit Committee.

**7. Christopher Gill****Company Secretary**

Christopher is Fellow of the Institute of Chartered Accountants in England and Wales with an Honours degree in Law and with over 30 years' experience of working as a company secretary. During that time, he has been assistant secretary with the Institute of Advanced Motorists, secretary of Antony Gibbs & Sons plc and of Harrisons & Crosfield plc.

## Shareholder information

**Registered and Corporate Office**

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[www.nauticalpetroleum.com](http://www.nauticalpetroleum.com)

**Nominated Adviser and Broker**

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London  
EC2N 1PH

+44 (0)20 7418 8900

**Solicitors**

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17 Hanover Square  
London  
W1S 1HU

**Financial Public Relations**

**Buchanan Communications Limited**  
45 Moorfields  
London  
EC2Y 9AE

**Registrars**

**Capita Registrars**  
The Registry  
34 Beckenham Road  
Beckenham  
Kent  
BR3 4TU

**Auditors**

**Ernst & Young**  
Blenheim House  
Fountainhall Road  
Aberdeen  
AB15 4DT

## Directors' report

The Directors present their report together with the Group and Company financial statements for the year ended 30 June 2007.

### Business review and future activities

The principal activity of the Company is heavy oil exploration, development and production in the UK and Europe. The Company is a public limited company incorporated in England and Wales and is listed in London on AIM. A discussion of the business and future developments are set out in the Chairman's and Chief Executive's reviews and the Operational review.

### Results and dividends

The Group's loss for the year was £0.39m (18 months to June 2006: £7.18m), including a foreign exchange gain of £0.27m (18 months to June 2006 £0.05m) and a £0.39m charge for share option costs (18 months to June 2006: £1.21m). The directors do not recommend the payment of a dividend.

### Events since the balance sheet date

On 19 September 2007 the Company signed an agreement with Silverstone Energy Limited to Farmout 10% of block 9/11c (Mermaid). Silverstone are to pay 20% of the costs of drilling the imminent vertical exploration well on the Mermaid prospect, scheduled to be spudded in late October 2007.

### Directors and their interests

The beneficial and other interests of the directors and their families in the shares of the Company for the directors holding office at 30 June 2007 were:

Number of ordinary shares and options held:

	At 30 June 2007		At 30 June 2006	
	Ordinary shares Number	Share options Number	Ordinary shares Number	Share options Number
I Williams (Chairman)	25,631,286	9,500,000	25,631,286	8,000,000
S Jenkins (Chief Executive)	17,521,929	13,500,000	17,521,929	11,000,000
H Thanawala (Finance Director)	15,773,043	8,000,000	15,773,043	7,000,000
P Jennings (Commercial Director)	17,521,929	9,500,000	17,521,929	8,000,000
P Dimmock (Non-Executive Director)	Nil	3,500,000	Nil	3,000,000
P Kennedy (Non-Executive Director)	1,500,000	3,500,000	1,500,000	3,000,000

The above directors have been directors throughout the year.

The interests of I Williams are held through Tile House Limited, a Jersey registered company whose ultimate beneficiaries are members of I Williams' family. The interests of H Thanawala are held through Fosco International Limited, a British Virgin Islands registered company whose ultimate beneficiaries are members of H Thanawala's family. S Jenkins and P Jennings hold part of their shareholding with OMX Securities Nominees Limited.

### Retirement of directors

S Jenkins and P Dimmock retire in accordance with section 108 of the Company's articles of association and offer themselves for re-election.

### Directors' third party indemnity provisions

The Company maintains indemnity insurance for its Directors and Officers against liability in respect of proceedings brought by third parties, subject to the terms and conditions of the Companies Act 1985.

### Substantial shareholders

At 12 September 2007 the following had a disclosable interest in 3% or more of the nominal value of the ordinary share capital of the Company:

	Number of shares	Percentage
International Energy Group AG	475,736,755	44.1%
Goldman Sachs Securities (Nominees) Ltd (SEG acct.)	100,553,738	9.3%
Goldman Sachs Securities (Nominees) Ltd (ILSEG acct.)	73,941,442	6.9%
OMX Securities Nominees Limited	35,452,896	3.3%
Mellon Nominees (UK) Ltd	34,041,587	3.2%

## *Directors' report* continued

### **Employees**

The success of the business depends upon maintaining a highly qualified and well-motivated workforce and every effort is made to achieve a common awareness of the financial and economic factors affecting the performance of the Group. Nautical Petroleum, despite being a young company, is committed to being an equal opportunity employer and plans to engage employees with broad backgrounds and skills.

### **Status**

The Company is not a close company as defined in the Income and Corporation Taxes Act 1988.

### **Nominated adviser and broker**

On 8 June 2007 the Company announced the change of the Nominated Adviser and Broker to KBC Peel Hunt Limited.

### **Supplier payment policy and practice**

It is the Group's policy to settle the terms of payment with suppliers when agreeing the terms of the transaction, to ensure that suppliers are aware of these terms and to abide by them. Trade creditors at 30 June 2007 amount to 36 days of purchases made in the period (2006: 39 days).

### **Financial instruments**

The Group's principal financial instruments comprise cash balances, balances with related parties, and other debtors or creditors that arise through the normal course of business as set out in note 17. The financial risk management objectives and policies are discussed in the Finance Director's Review and note 17.

### **Principal business risks**

As a participant in the upstream oil & gas industry, Nautical encounters and has to manage several business risks of varying degrees. These include:

- Loss of key employees
- Taxation – legislative changes
- Delays and cost over-run on major projects
- Lack of operational resources
- Poor reservoir performance
- Commercial misalignment with co-venturers
- Oil price movements and fluctuations in discounts for heavy oil
- Exploration and appraisal well failures

These risks are considered typical for an upstream group of Nautical's size and stage of development. The Board conducts an annual review of the Group's system of risk management for the specific risks it faces.

### **Board committees**

Information on the Audit Committee and the Remuneration Committee is included in the Corporate Governance section of the Annual Report. The report of the Remuneration Committee will be the subject of an ordinary resolution at the Annual General Meeting.

### **Disclosure of information to the auditors**

Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that, to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of the relevant audit information and to establish that the Company's auditors are aware of that information.

### **Auditors**

A resolution to reappoint Ernst & Young LLP as auditors will be proposed at the forthcoming Annual General Meeting at a fee to be agreed in due course by the Audit Committee and the directors.

### **Annual General Meeting**

The Annual General Meeting will be held on 11 December 2007 as stated in the Notice of Meeting, which accompanies this Annual Report.

By Order of the Board.

### **Christopher Gill**

Company Secretary  
1 October 2007

# Remuneration report

## Directors' emoluments

The Remuneration Committee of the Board of Directors is responsible for determining and reviewing compensation arrangements for all executive directors and the Executive Team. The Remuneration Committee assesses the appropriateness of the nature and amount of emoluments of such officers on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality Board and executive team.

To assist in achieving these objectives, the Remuneration Committee links the nature and amount of executive directors' and officers' emoluments to the Company's financial and operational performance.

Details of the nature and amount of each element of the emoluments of each director of the Company for the previous 12 months are as follows:

Name	Salary £'000	Fees £'000	Bonus £'000	Pension £'000	Total June 2007 £'000	Total 18 months to June 2006 £'000
S Jenkins	139	–	87	10	<b>236</b>	191
I Williams	–	88	–	–	<b>88</b>	60
H Thanawala	–	71	–	–	<b>71</b>	50
P Jennings	–	107	–	–	<b>107</b>	68
P Dimmock	–	12	–	–	<b>12</b>	15
P Kennedy	–	12	–	–	<b>12</b>	15
Total	139	290	87	10	<b>526</b>	399

I Williams, H Thanawala and P Jennings provide services to the Company through a service agreement with International Energy Services Limited, which is a related party.

S Jenkins has entered into a loan agreement with the Company for £3,592 with an outstanding balance at 30 June 2007 of £1,496. The pension is a defined contribution scheme.

## Share options granted to directors

	Year to June 2007		18 months to June 2006			
	Issued 18 January 2007		Issued 26 September 2005		Issued 7 March 2005	
	Number of shares	Exercise price per share	Number of shares	Exercise price per share	Number of shares	Exercise price per share
I Williams	<b>1,500,000</b>	<b>8.85p</b>	4,000,000	11.0p	4,000,000	4.0p
S Jenkins	<b>2,500,000</b>	<b>8.85p</b>	6,000,000	11.0p	5,000,000	4.0p
H Thanawala	<b>1,000,000</b>	<b>8.85p</b>	3,000,000	11.0p	4,000,000	4.0p
P Jennings	<b>1,500,000</b>	<b>8.85p</b>	4,000,000	11.0p	4,000,000	4.0p
P Dimmock	<b>500,000</b>	<b>8.85p</b>	1,500,000	11.0p	1,500,000	4.0p
P Kennedy	<b>500,000</b>	<b>8.85p</b>	1,500,000	11.0p	1,500,000	4.0p

For the options granted in the year, 25% are exercisable after 17 July 2007, 25% after 17 January 2008, 25% after 17 July 2008 and 25% after 17 January 2009. The options must be exercised by 18 January 2015. None of the directors exercised options during the year.

### Philip Dimmock

Chairman of the Remuneration Committee  
1 October 2007

## Corporate governance

As the Company is listed on the Alternative Investment Market (AIM) of the London Stock Exchange, it is not required to comply with the provisions of the Combined Code. However, the Board is committed to the high standards of good corporate governance embodied in the Combined Code on Corporate Governance and seeks to apply the principles of the Combined Code where practicable for a company of Nautical's size and complexity.

### Board of Directors

The Board is responsible for the direction and overall performance of the Group with emphasis on policy and strategy, financial results and major operational issues.

The Code recommends that smaller companies should have at least two non-executive directors. The Board comprises four executive and two non-executive directors who are independent of management and do not participate in the Group's bonus or pension schemes although both non-executive directors have share options and Mr P Kennedy is a shareholder. Mr Kennedy is also a partner in PK Partners LLP which has provided consultancy services to the Group and the services of Mr C Gill, the Company Secretary.

The roles of the Chairman and Chief Executive, both of which are executive, are separate, thus ensuring a division of responsibility at the head of the Group.

The Chief Executive is employed under a service contract with the Company but the services of the other executive directors are secured through a contract for services with International Energy Services Limited, a related party.

All directors are subject to re-election by shareholders every three years and, on appointment, at the first Annual General Meeting after appointment. Appropriate directors and officers' liability insurance has been arranged by the Company.

### Meetings of the Board of Directors

The Board meets at least four times a year after all relevant information has been circulated in good time, to discuss a formal scheduled agenda covering key areas of the Group's affairs including operational and financial performance and quarterly management accounts.

All members of the Board are expected to attend Board Meetings which are scheduled in advance. Each of the non-executives could not attend one meeting during the year. There was full attendance at all other meetings throughout the period.

### Audit Committee

The Audit Committee comprises the two non-executive directors and is chaired by P Kennedy. Executive directors may attend by invitation. The minutes of every meeting are taken by the Audit Committee Chairman and circulated to the Board at the next Board Meeting at which the Chairman provides a verbal report of meetings of the Committee.

The Audit Committee, which meets at least twice a year, is responsible for keeping under review the scope and results of the audit, its cost effectiveness and the independence and objectivity of the auditors. It also has oversight responsibility for public reporting and the Company's internal controls.

### Remuneration Committee

The Remuneration Committee is chaired by P Dimmock and its other member is P Kennedy. The minutes of every meeting are taken by the Remuneration Committee Chairman and circulated to the Board at the next Board Meeting at which the Chairman provides a verbal report of meetings of the Committee.

The Remuneration Committee, which meets at least twice a year, is responsible for considering the remuneration packages for executive directors and the bonus and share option strategy for the Group and making recommendations as appropriate.

The Remuneration Committee is also responsible for reviewing the performance of the executive directors and ensuring that they are fairly and responsibly rewarded for their individual contributions to the Group's overall performance. The Committee's scope extends to all remuneration of directors including bonus and share options.

None of the Committee has any day-to-day involvement in running the Company and no director participates in discussions about his own remuneration.

### Internal control

The Board is responsible for the effectiveness of the Group's internal control and is supplied with information to enable it to discharge its duties. Internal control systems are designed to meet the particular needs of the Group and to manage rather than eliminate the risk of failure to meet business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

## *Directors' responsibilities for the financial statements*

### **Group financial statements**

The directors are responsible for preparing the annual report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards (IFRS) as adopted by the European Union.

The directors are required to prepare Group financial statements for each financial year, which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with specific requirements in IFRS's is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- state that the Group has complied with IFRS, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## *Independent auditors' report to the members of Nautical Petroleum plc*

We have audited the Group financial statements of Nautical Petroleum plc for the year ended 30 June 2007 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated Statement of Changes in Equity and the Consolidated Cash Flow Statement and the related notes 1 to 28. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Nautical Petroleum plc for the year ended 30 June 2007.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the highlights, the chairman's statement, the explanation of heavy crude oil, the chief executives review, the operational review, the finance director's review, the board of directors, shareholder information, the remuneration report, the corporate governance statement, the supplementary information and the glossary. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

### **Opinion**

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 30 June 2007 and of its loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the directors' report is consistent with the group financial statements.

**Ernst & Young LLP**  
Registered auditor  
Aberdeen  
1 October 2007

# Consolidated income statement

For the year ended 30 June 2007

	Notes	2007 £'000	18 months ended 30 June 2006 £'000
Cost of sales		(161)	(79)
<b>Gross loss</b>		<b>(161)</b>	(79)
Administrative expenses		(1,269)	(2,237)
		<b>(1,430)</b>	(2,316)
Goodwill on reverse acquisition		-	(5,077)
<b>Operating loss</b>	5	<b>(1,430)</b>	(7,393)
Finance income	10	741	432
Finance costs	10	(174)	(222)
<b>Loss before tax</b>		<b>(863)</b>	(7,183)
Tax	11	472	-
<b>Loss for the period</b>		<b>(391)</b>	(7,183)
<b>Attributable to:</b>			
Equity holders of the Company		(490)	(7,172)
Minority interests		99	(11)
		<b>(391)</b>	(7,183)
		<b>Pence</b>	Pence
<b>Basic and diluted loss per share</b>	12	<b>(0.05)</b>	(0.78)

The results above were entirely derived from continuing operations.

# Consolidated balance sheet

As at 30 June 2007

	Notes	At 30 June 2007 £'000	At 30 June 2006 £'000
<b>Non-current assets</b>			
Intangible assets	13	49,768	49,279
Property, plant and equipment	13	2,588	2,732
		<b>52,356</b>	52,011
<b>Current assets</b>			
Trade and other receivables	14	290	733
Cash and cash equivalents	15	8,943	12,300
		<b>9,233</b>	13,033
<b>Total assets</b>		<b>61,589</b>	65,044
<b>Current liabilities</b>			
Trade and other payables	16	(1,386)	(1,902)
<b>Non-current liabilities</b>			
Deferred tax	16	(6,609)	(7,830)
Other payables	16	(2,974)	(3,388)
		<b>(10,969)</b>	(11,218)
<b>Net assets</b>		<b>50,620</b>	51,924
<b>Equity attributable to equity holders</b>			
Called up share capital	18	9,683	9,627
Share premium		20,491	20,116
Other reserves		29,169	29,169
Cumulative translation reserve		(1,330)	(12)
Accumulated losses		(11,612)	(11,513)
<b>Equity attributable to equity holders</b>		<b>46,401</b>	47,387
<b>Minority interests</b>		<b>4,219</b>	4,537
<b>Total equity</b>		<b>50,620</b>	51,924

The financial statements were approved by the Board on 1 October 2007 and were signed on its behalf by:

**I Williams**  
Chairman

**H Thanawala**  
Finance Director

## Consolidated statement of changes in equity

For the year ended 30 June 2007

	Share capital £'000	Share premium £'000	Other reserves £'000	Cumulative translation reserve £'000	Retained earnings £'000	Minority interests £'000	Total equity £'000
At 1 January 2005	100	5,189	16,733	–	(843)	6,162	27,341
Transitional adjustment on first time adoption of IFRS	–	–	–	(822)	(4,713)	(1,845)	(7,380)
<b>Equity at 1 January 2005 as restated</b>	<b>100</b>	<b>5,189</b>	<b>16,733</b>	<b>(822)</b>	<b>(5,556)</b>	<b>4,317</b>	<b>19,961</b>
Currency translation adjustments	–	–	–	810	–	231	1,041
Total expense recognised directly in equity	–	–	–	810	–	231	1,041
Loss for the period	–	–	–	–	(7,172)	(11)	(7,183)
Total recognised income and expense for the period	–	–	–	810	(7,172)	220	(6,142)
Share-based payments	–	–	–	–	1,215	–	1,215
Reverse acquisition capital adjustment	6,556	–	–	–	–	–	6,556
Proceeds from issue of ordinary shares and warrants for cash	1,865	–	263	–	–	–	2,128
Premium on ordinary shares issued for cash	–	15,874	–	–	–	–	15,874
Cost associated with issuance of shares	–	(947)	–	–	–	–	(947)
Shares issued for the acquisition of Alba Resources (Holdings) Group	845	–	9,306	–	–	–	10,151
Shares issued for the acquisition of First Mariner Limited	261	–	2,867	–	–	–	3,128
<b>At 30 June 2006</b>	<b>9,627</b>	<b>20,116</b>	<b>29,169</b>	<b>(12)</b>	<b>(11,513)</b>	<b>4,537</b>	<b>51,924</b>
Currency translation adjustments	–	–	–	(1,318)	–	(417)	(1,735)
Total expenses recognised directly in equity	–	–	–	(1,318)	–	(417)	(1,735)
Loss for the period	–	–	–	–	(490)	99	(391)
Total recognised income and expense for the period	–	–	–	(1,318)	(490)	(318)	(2,126)
Share-based payments	–	–	–	–	391	–	391
New shares issued	56	375	–	–	–	–	431
<b>At 30 June 2007</b>	<b>9,683</b>	<b>20,491</b>	<b>29,169</b>	<b>(1,330)</b>	<b>(11,612)</b>	<b>4,219</b>	<b>50,620</b>

At 30 June 2007 equity attributable to equity holders of the parent company is £46,401,000 (2006: £47,387,000).

## Consolidated cash flow statement

For the period ended 30 June 2007

	Notes	2007 £'000	18 months ended 30 June 2006 £'000
<b>Operating activities</b>			
Cash generated outflow from operating activities	20	(677)	(1,380)
Finance income		493	302
<b>Net cash flow from operating activities</b>		<b>(184)</b>	<b>(1,078)</b>
<b>Cash flows from investing activities</b>			
Expenditure on intangible assets		(2,695)	(2,302)
Purchase of property, plant and equipment		-	(99)
Acquisition of Alba Resources (Holdings) Group		-	(3,475)
Net cash received on acquisition of Bullion Resources plc		-	1,545
<b>Net cash flow from investing activities</b>		<b>(2,695)</b>	<b>(4,331)</b>
<b>Financing activities</b>			
Proceeds from issue of ordinary shares		-	18,002
Costs associated with share issues		-	(947)
Repayment of loans		(360)	-
(Decrease)/increase in balances due to related undertakings		(118)	646
<b>Net cash flow from financing activities</b>		<b>(478)</b>	<b>17,701</b>
<b>(Decrease)/increase in cash and cash equivalents</b>		<b>(3,357)</b>	<b>12,292</b>
Cash and cash equivalents at beginning of period		12,300	8
<b>Cash and cash equivalents at end of period</b>	15	<b>8,943</b>	<b>12,300</b>

# Notes to the financial statements

## 1. Authorisation of Financial Statements and Statement of Compliance with IFRS

The Group's financial statements of Nautical Petroleum plc for the year ended 30 June 2007 were authorised for issue by the Board of Directors on 1 October 2007 and the balance sheet was signed on the Board's behalf by Ian Williams and Hemant Thanawala. Nautical Petroleum plc is a public limited company incorporated in England and Wales. The Company's ordinary shares are traded on AIM on the London Stock Exchange.

## 2. Accounting policies for the Consolidated Financial Statements

### (2.1) Basis of preparation

The consolidated financial information presented has been prepared on a historical cost basis. 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 the requirements of International Financial Reporting Standard 1 (First-time adoption of International Financial Reporting Standards), and other IFRSs (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 28.

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 consolidated financial statements of the Group comprise the financial statements of Nautical Petroleum plc ("Nautical") and its subsidiaries as at 30 June 2007, including the results 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 financial statements are prepared under IFRS.

#### 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 28 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.

## Notes to the financial statements *continued*

### 2. Accounting policies for the Consolidated Financial Statements *continued*

#### (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 2.9.
- The estimates determining the unwinding of the discount on long-term payables, being the expected timings of field development approval and first oil on the Mariner field.

#### (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 phase.

#### (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.

The treatment of Goodwill arising on the reverse acquisition is set out in note 3.

#### (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.

## 2. Accounting policies for the Consolidated Financial Statements continued

### 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.

### 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

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.

## Notes to the financial statements *continued*

### 2. Accounting policies for the Consolidated Financial Statements *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.

#### 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, with the unwinding of the discount passing through income statement as a finance cost. At each balance sheet, the estimates used to determine the discount period and discount rates are assessed and changes made as appropriate, with the effect of the change being recorded in the current period. Where amounts are denominated in a foreign currency, retranslation is made in accordance with the foreign currency accounting policy previously stated.

#### (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.

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;
- (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 that the temporary differences will reverse in the foreseeable future; and
- (c) deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which deductible temporary differences, carried forward tax credits or tax losses can be utilised.

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 recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

## 2. Accounting policies for the Consolidated Financial Statements continued

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.

### (2.14) Employee benefits

The Group operates a defined contribution pension scheme. Contributions payable for the period are charged to the income statement.

### (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 an actuarial 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 disclosure of these items provides helpful information about the Group's underlying business performance.

### (2.17) 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.

### (2.18) 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. Interest payable is accounted for on the accruals basis in the income statement using the effective interest rate method. No interest or borrowing costs have been capitalised.

### (2.19) 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.

### (2.20) Commitments and contingencies

Commitments and contingent liabilities are not 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*

### 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 income statement (in the 18 month period to June 2006) because Bullion Resources plc had no continuing business and therefore no intrinsic value. In addition, the share capital of the Group is determined using reverse acquisition rules as set out in the note on share capital.

### 4. Turnover and segmental information

No turnover has arisen to date.

For the purposes of segmental information the primary segment reporting format is determined to be the business segment. The Group has one class of business segment, the exploration for and production of hydrocarbon liquids. No further disclosure is required in relation to primary segment reporting in this note as all the relevant disclosure is already detailed throughout the Group financial statements.

The secondary segment information is reported geographically. The Group's geographical segments are the United Kingdom and Europe. The following tables present certain asset information regarding the Group's geographical segments for the periods ended 30 June 2007 and 2006.

Segment assets	2007 £'000	18 months ended 30 June 2006 £'000
United Kingdom	52,427	52,585
Europe	219	159
Assets held centrally	8,943	12,300
	61,589	65,044

Capital expenditure	2007 £'000	18 months ended 30 June 2006 £'000
United Kingdom	3,065	22,642
Europe	60	159
	3,125	22,801

### 5. Operating loss

	Note	2007 £'000	18 months ended 30 June 2006 £'000
<b>Operating loss is stated after charging:</b>			
Goodwill on reverse acquisition	3	–	5,077
Depreciation of property, plant and equipment		144	71
Foreign exchange (gains)		(267)	(50)
Operating lease payments		–	24
		–	5,077

## 6. Auditors' remuneration

New requirements for the detailed disclosure of remuneration paid by the Company to the auditors of its individual and Group accounts were introduced in the Companies (Disclosure of Auditor Remuneration) Regulations 2005 (Statutory Instrument 2005/2417) (the "Regulations"). These requirements replace those that applied for periods commencing prior to 1 October 2005. The disclosures for 2007 below comply with the Regulations and the comparatives for 2006 have been restated to conform to the new requirements.

	2007 £'000	18 months ended 30 June 2006 £'000
Audit of the Group accounts	50	30
Audit of the Company's accounts	6	5
	<b>56</b>	<b>35</b>
Other fees to auditors:		
Audit of the Company's subsidiaries pursuant to legislation	14	22
Other services pursuant to legislation	62	34
Taxation services	43	30
Corporate finance services – transaction costs	40	22
	<b>159</b>	<b>108</b>

## 7. Information regarding directors' emoluments

Aggregate directors emoluments, which exclude pensions, are £516k (2006: £390k). The emoluments of the highest paid director were £226k (2006: £182k). In addition he received contributions to a defined contribution pension scheme of £10k (2006: £9k). Further information is included in the Remuneration report.

## 8. Employees

### Headcount

	2007 Number	18 months ended 30 June 2006 Number
Average number of employees of the Group (including executive directors) during the year was:		
Management	4	4
Technical staff/support/other	2	2

Three directors provide services to the Company through a service agreement with International Energy Services Limited, which is a related party.

### Staff costs

	2007 £'000	18 months ended 30 June 2006 £'000
Wage and salaries	469	356
Bonuses	97	47
Social security costs	39	20
Other pension costs	17	12
	<b>622</b>	<b>435</b>
Equity settled share-based payments	391	1,215
	<b>1,013</b>	<b>1,650</b>

Wages and salaries include fees for three executive directors through a service agreement with International Energy Services Limited.

## Notes to the financial statements *continued*

### 9. Pension commitments

For direct employees of Nautical Petroleum plc, the Company contributes 7% of salary to a defined contribution pension scheme. £17k has been charged to the income statement for the year (2006: £12k).

### 10. Interest and similar items

	2007 £'000	18 months ended 30 June 2006 £'000
Finance income		
Bank interest	493	432
Effect of changes in estimates to discounts on long-term payables	248	–
	<b>741</b>	432

	2007 £'000	18 months ended 30 June 2006 £'000
Finance costs		
Unwinding of discount on long-term payable	174	222

### 11. Tax on loss on ordinary activities

	2007 £'000	18 months ended 30 June 2006 £'000
Current and deferred taxation		
Loss before tax	(863)	(7,183)
Loss before tax at the standard UK corporation tax rate of 30% (2006: 30%)	(259)	(2,155)
Effects of:		
Disallowed (income) and expenses	(34)	1,594
Change in tax rates on deferred tax liability	(472)	–
Increase in deferred tax asset not recognised	293	561
Total tax credit on loss on ordinary activities	(472)	–

Movement on the deferred tax liability representing changes in exchange rates is accounted for through reserves whilst the movement attributable to tax rate changes is reflected through the income statement. The Group has tax losses of approximately £2.9m (2006: £2.5m) arising in the UK that are available indefinitely against future taxable profits. Deferred tax assets of approximately £1.1m at 28% (2006: £1.1m at 30%) have not been recognised as a result of existing uncertainties of their realisation.

### 12. Loss per share

	2007	18 months ended 30 June 2006
Loss for the period attributable to equity holders (£'000)	(490)	(7,172)
Basic weighted average number of shares in issue in the period (thousands)	1,075,450	917,802
Basic loss per ordinary share (pence)	(0.05)	(0.78)

In addition at 30 June 2007 there were a total of 49.75 million options (2006: 41.5 million) and 26.3 million warrants (2006: 26.3 million) in issue, which have not been included in the above calculations.

### 13. Goodwill, Intangible assets and property, plant and equipment

Movements during the year were as follows:

	Intangible assets		Property, plant and equipment		Total £'000
	Goodwill £'000	Exploration and evaluation assets £'000	Extended well test equipment £'000	Other £'000	
<b>Cost</b>					
At 1 January 2005	–	25,097	2,702	–	27,799
Reverse acquisition (note 3)	5,077	–	–	–	5,077
Additions	–	22,688	94	19	22,801
Exchange adjustments	–	1,494	–	–	1,494
Written off	(5,077)	–	–	(12)	(5,089)
At 30 June 2006	–	49,279	2,796	7	52,082
Additions	–	3,125	–	–	3,125
Exchange adjustments	–	(2,636)	–	–	(2,636)
<b>At 30 June 2007</b>	<b>–</b>	<b>49,768</b>	<b>2,796</b>	<b>7</b>	<b>52,571</b>
<b>Depletion and Depreciation</b>					
At 1 January 2005	–	–	–	–	–
Provided in period	–	–	70	1	71
At 30 June 2006	–	–	70	1	71
Provided in year	–	–	140	4	144
<b>At 30 June 2007</b>	<b>–</b>	<b>–</b>	<b>210</b>	<b>5</b>	<b>215</b>
<b>Net book value</b>					
<b>At 30 June 2007</b>	<b>–</b>	<b>49,768</b>	<b>2,586</b>	<b>2</b>	<b>52,356</b>
At 30 June 2006	–	49,279	2,726	6	52,011
At 1 January 2005	–	25,097	2,702	–	27,799

The exploration and evaluation balance represents the costs related to the fields currently being evaluated and appraised. No amounts have been charged to amortisation or impairment in respect of these intangible assets.

Two acquisitions made in August 2005 have been treated as asset acquisitions.

The above balances include amounts relating to a 6.67% interest in the Mariner Field, being carried by the Company. Upon field development approval, the party to the carry agreement has the option to earn back its 6.67% interest by reimbursement of costs during the development phase. These costs amount to approximately £8.3m as at June 2007. If the party declines to take up its option, the Company retains the 6.67% interest upon payment of £1.

### 14. Trade and other receivables

	30 June 2007 £'000	30 June 2006 £'000
Other debtors	160	583
Prepayments and accrued interest	130	150
	<b>290</b>	<b>733</b>

### 15. Cash and cash equivalents

	30 June 2007 £'000	30 June 2006 £'000
Cash at bank and in hand	556	573
Short-term deposits	8,387	11,727
	<b>8,943</b>	<b>12,300</b>

Further disclosure is made in note 17.

## Notes to the financial statements *continued*

### 16. Trade and other payables

	30 June 2007 £'000	30 June 2006 £'000
<b>Current liabilities</b>		
Trade creditors	383	416
Amounts owed to related companies	896	1,079
Taxation and Social Security	–	18
Accruals	107	29
Loan payable	–	360
	<b>1,386</b>	<b>1,902</b>

Amounts owed to related parties are due on demand and are treated as creditors.

	Deferred tax £'000	Conditional payments £'000
<b>Non-current liabilities</b>		
At 1 July 2006	7,830	3,388
Exchange adjustments	(749)	(340)
Effect of tax rate change	(472)	–
Effect of change in estimates	–	(248)
Unwinding of discount	–	174
<b>At 30 June 2007</b>	<b>6,609</b>	<b>2,974</b>

The deferred tax balance relates entirely to exploration assets which were acquired prior to the transition date for IFRS (1 January 2005). Hence the income statement movement was booked to reserves on transition. The transaction was based in US dollars. Hence there are exchange fluctuations. These movements are recorded in the cumulative translation reserve. The tax rate applying for periods after April 2007 has been reduced from 30% to 28%. Hence the deferred tax balance has been adjusted accordingly.

The conditional payments comprise two amounts relating to the Mariner Field of: (1) \$4.0m due on Field Development Plan (FDP) approval by the Department of Business, Environment and Regulatory Reform; and (2) \$2.8m due on first oil which are not anticipated to be paid before end 2008. The Company believes these events to be sufficiently probable as to provide for their payment. The liabilities were acquired as part of the acquisition of the Alba Resources (Holdings) Group in August 2005. At this date they were fair valued. The movement in the year includes both exchange movements and also unwinding of the discount, which are shown in the income statement. The change in estimates applies to both a revision of the estimated trigger dates and the discount rate used.

### 17. Financial instruments

#### Exposure to price, credit, liquidity and cash flow risk

Price risk arises on financial instruments because of changes in, for example commodity prices or equity prices. The Group does not hold investments and does not yet have a need for commodity hedging.

Credit risk is the risk of financial assets not realising their value. The primary financial assets are cash and receivables from Joint Venture partners, the risk to which are not significant.

Liquidity risk is the risk that obligations associated with financial liabilities will not be met. The Group aims to mitigate liquidity risk by managing cash requirements. The group has to date been funded by equity placings.

Cash flow risk is the risk of variable cash flows from its assets or liabilities. The Group is currently exposed to changes in interest rates on its cash deposits.

#### Interest rate risk profile of financial assets and liabilities

	30 June 2007 £'000	30 June 2006 £'000
<b>Financial assets: Cash and short-term deposits</b>		
Floating rate financial assets < 1 year	556	573
Fixed rate financial assets < 1 year	8,387	11,727
	<b>8,943</b>	<b>12,300</b>

At 30 June 2007, short-term deposits were earning interest at a weighted average fixed deposit rate of 5.45%. Cash at bank earns interest at floating rates based on a discount to GBP/US\$ LIBOR. Other financial assets are non-interest bearing.

## 17. Financial instruments continued

### Financial liabilities

There are no interest bearing financial liabilities in the Group at June 2007. At June 2006 there was one loan for £360,000 with an interest rate of 5.00%.

### Fair values of financial assets and liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial assets and liabilities.

	30 June 2007 Book value £'000	30 June 2006 Book value £'000	30 June 2007 Fair value £'000	30 June 2006 Fair value £'000
<b>Financial assets</b>				
Cash and cash equivalents	8,943	12,300	8,943	12,300
Trade and other receivables	290	733	290	733
<b>Financial liabilities</b>				
Trade and other payables – current	1,386	1,902	1,386	1,902
Trade and other payables – non-current	2,974	3,388	2,974	3,388

## 18. Share capital

	At 30 June 2007		At 30 June 2006	
	Number	£'000	Number	£'000
<b>Authorised</b>				
Ordinary shares of 1p each	1,600,000,000	16,000	1,200,000,000	12,000
<b>Allotted, called up and fully paid</b>				
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, but the Group results at the date of acquisition are as if Nautical Holdings Limited were the parent. The value of the shares at the date of acquisition is based on the value of the share capital of Nautical Holdings Limited at the date of acquisition (1st April 2005). Following the reverse acquisition, the Group shows the additions made for Nautical Petroleum plc only. 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.

The movement on issued shares is set out in the following table. All movements are for ordinary 1p shares.

	Date issued	Issue price	Number of shares issued
At 1 January 2005			77,500,000
Shares issued on AIM listing	1 April 2005	8.46p	697,500,000
Private equity placing	4 July 2005	9.00p	88,888,889
Alba Resources (Holdings) Group acquisition	16 August 2005	12.00p	84,591,328
First Mariner Limited acquisition	16 August 2005	12.00p	26,064,292
Private equity placing	3 January 2006	10.25p	97,585,371
At 30 June 2006			1,072,129,880
Purchase of Bluebeard & Skipper	24 November 2006	7.75p	5,559,739
<b>At 30 June 2007</b>			<b>1,077,689,619</b>

The Group announced on 24 November 2005 the acquisition of 22% of the St Laurent Permit onshore France field for £47,500 with the consideration to be satisfied by the issuance of 387,755 new ordinary shares of 1p each subject to approval from the Ministère de l'Economie des Finances et de l'Industrie, France. At the financial statements reporting date the Ministry approval has not been received and the shares have not yet been issued.

On 4 July 2005 the Group announced the issuance of 11,666,667 warrants to subscribe for new ordinary shares at 20p per share exercisable up to 3 July 2009. The Company has the right to require warrant holders to exercise their warrants should the closing price of the Company's ordinary shares remain above 40p per share for 90 consecutive trading days in the period to 3 July 2009.

On 3 January 2006 the Group announced the issuance of 14,637,800 warrants to subscribe for new ordinary shares at 20p per share exercisable up to 3 January 2010. The Company has the right to require warrant holders to exercise their warrants should the closing price of the Company's ordinary shares remain above 40p per share for 90 consecutive trading days in the period to 3 January 2010.

## Notes to the financial statements *continued*

### 18. Share capital continued

#### Equity settled share options

At the balance sheet date and at the date of this report, the following share options are outstanding:

Share options to subscribe for 20 million ordinary shares were granted on 7 March 2005, exercisable at 4p per share on or before 1 April 2008. 10 million were exercisable from 1 April 2006 and 10 million from 1 April 2007. None of the options have been exercised. They are all held by directors as set out in the Directors' report.

Share options to subscribe for 20.5 million ordinary shares were granted on 26 September 2005, exercisable at 11p per share on or before 26 April 2010. 10.25 million were exercisable from 27 September 2006 and 10.25 million from 27 September 2007. None of the options have been exercised. 20 million are held by directors as set out in the Directors' report.

Share options to subscribe for 1.0 million ordinary shares were granted on 23 September 2005 in association with the acquisition of the Alba Resources (Holdings) Group, exercisable at 12.5375p per share at any time on or before 23 September 2010. None of the options have been exercised.

Share options to subscribe for 8.25 million ordinary shares were granted on 18 January 2007, exercisable at 8.85p per share on or before 18 January 2015. 2,062,500 options are exercisable after 17 July 2007, 2,062,500 options are exercisable after 17 January 2008, 2,062,500 options are exercisable after 17 July 2008 and 2,062,500 options are exercisable after 17 January 2009. None of the options have been exercised. 7.5 million are held by directors as set out in the Directors' report.

The weighted average share price in the year was 8.95p (15 months to June 2006: 12.06p, being the period the shares were on AIM as Nautical Petroleum plc). The weighted average remaining contract life at 30 June 2007 was 2.79 years (30 June 2006: 2.84 years). The weighted average fair value of options granted in the year was 3.97p (18 months to June 2006: 3.62p). The expense recognised for share-based payments in the year to 30 June 2007 was £391k (18 months to June 2006: £1,215k).

The following table illustrates the number and weighted average exercise price (WAEP) of, and movements in, share options during the year.

	2007 Number	2007 WAEP	2006 Number	2006 WAEP
Outstanding at beginning of period	41,500,000	7.66	–	–
Granted during the period	8,250,000	8.85	41,500,000	7.66
<b>At 30 June</b>	<b>49,750,000</b>	<b>7.86</b>	41,500,000	7.66

At 30 June 2007, 31.25 million options are exercisable (2006: 11 million).

The fair value of the share options granted is estimated using a Binomial model. The following table lists the inputs and assumptions used in the model.

	2007	2006
Dividend yield	–	–
Expected share price volatility	52%	70%
Risk free interest rate	5.46%	4.78%
Leaver rate	5%	5%

Volatility has been based on a weighted average of Nautical's and its peer group's share prices.

## 19. Reconciliation of movements in equity

The reconciliation of movements in equity is detailed in the consolidated statement of changes in equity. The following is a description of the nature and purpose of each reserve.

### Share capital and share premium

The Group's share capital and share premium are explained in note 18.

### Cumulative translation reserve

The cumulative translation reserve is used to record exchange differences arising from the translation of the financial statements of subsidiaries whose functional currency is not pounds sterling and any fair value adjustments associated with their acquisition.

### Other reserves

Other reserves comprise the following:

	30 June 2007 £'000	30 June 2006 £'000
Capital contribution	2,702	2,702
Merger reserve	12,173	12,173
Warrant reserve	263	263
Capital reserve	14,031	14,031
	<b>29,169</b>	29,169

The capital contribution arose on the formation of Nautical Holdings Limited (see note 18 for explanation of reverse acquisition accounting) when equipment was contributed to the Company.

The merger reserve arises from UK law for merger relief, which sets out rules for subsidiaries acquired in whole or in part for shares, where at least 90% of the company is acquired. In such circumstances, where the Company prepares accounts under UK GAAP, the investment in the company's financial statements is at the nominal value of the shares issued. In the Group's financial statements, the premium is recorded in the merger reserve.

The warrant reserve shows the value of share warrants issued.

The capital reserve arose from the fair value exercise on acquisition of Nautical Petroleum AG.

## 20. Net cash flows from operating activities

	2007 £'000	18 months ended 30 June 2006 £'000
<b>Loss for the period</b>	<b>(391)</b>	(7,183)
Finance income	(741)	(432)
Finance costs	174	222
Taxation	(472)	–
Goodwill	–	5,077
Share-based payment charges	391	1,215
Depreciation	144	71
Foreign exchange movements	(267)	(50)
Operating cash flow before working capital movements	<b>(1,162)</b>	(1,080)
Decrease/(increase) in trade and other receivables	443	(146)
Increase/(decrease) in trade and other payables	42	(154)
<b>Net cash outflow from operating activities</b>	<b>(677)</b>	(1,380)

## Notes to the financial statements *continued*

### 21. Analysis of net cash/(debt)

	At 1 July 2006 £'000	Cash flow £'000	Acquisition £'000	Exchange differences £'000	At 30 June 2007 £'000
Cash at bank and in hand	12,300	(3,357)	–	–	<b>8,943</b>
Amounts due to related party undertakings	(1,079)	118	–	65	<b>(896)</b>
Short-term loan	(360)	360	–	–	–
<b>Net cash/(debt)</b>	<b>10,861</b>	<b>(2,879)</b>	<b>–</b>	<b>65</b>	<b>8,047</b>

### 22. Acquisitions

#### Reverse acquisition of Bullion Resources Plc

On 1 April 2005 Bullion Resources Plc acquired 100% of Nautical Holdings Limited. The nature of the acquisition was a reverse takeover as set out in note 3.

	Book and fair value of Bullion assets acquired £'000
<b>Net assets acquired of:</b>	
Debtors	36
Cash	1,545
Creditors	(102)
Net assets acquired	1,479
Goodwill	5,077
	<b>6,556</b>

In the absence of a reliable valuation of Nautical Holdings Limited, the cost of the business combination was calculated using the average price for the 10 dealing days prior to acquisition of 8.459p for the 77,500,000 shares in issue in Bullion Resources Plc at the date of acquisition.

In its last financial year to 31 December 2004 Bullion Resources Plc made a loss after tax of £115k. The summarised profit and loss for the period 1 January 2005 to 31 March 2005 is as follows:

	£'000
Operating loss	(331)
Interest income	17
<b>Loss for the three months ended 31 March 2005</b>	<b>(314)</b>

There were no recognised gains and losses in the three months ended 31 March 2005 other than the £314k loss above. Bullion Resources Plc, which changed its name to Nautical Petroleum plc on 1 April 2005 utilised £912k of the Group's operating cash flow, contributed £302k of interest income and utilised £600k for capital expenditure.

### 23. Commitments

The Group has satisfied the minimum expenditure obligations on all licences. The Group has capital commitments of £5.8m (2006: Nil) representing the Group's share of drilling and seismic programmes contracted to on its blocks.

### 24. Related party transactions

Executive directors, I Williams, H Thanawala and P Jennings provide services under a service agreement with International Energy Services Limited. The charges in the period were £266k (2006: £178k).

International Energy Services Limited is a 100% subsidiary of International Energy Group AG, the parent company of Nautical Petroleum plc and provides services to companies within the International Energy Group. Such shared services include the occupation of shared office space and facilities and some administrative functions and amounted to £257k (2006: £181k), which was in addition to the services of the directors. At the period end an amount of £302k (2006: £446k) was due to International Energy Services Limited.

Non-executive director P Kennedy is also a partner in PK Partners LLP which has provided consulting services to the Group and for the services of C Gill, the Company Secretary, for the amount of £14k (2006: £103k).

At the period end there was £401k (2006: £538k) due to International Energy Group and £193k (2006: £95k) to UAH Limited, a subsidiary of International Energy Group AG.

## 25. Events since the balance sheet date

On 19 September 2007 the Company signed an agreement with Silverstone Energy Limited to Farmout 10% of block 9/11c (Mermaid). Silverstone are to pay 20% of the costs of drilling the imminent vertical exploration well on the Mermaid prospect, scheduled to be spudded in late October 2007.

## 26. Ultimate parent undertaking and controlling party

The directors consider International Energy Group AG, a company registered in Switzerland, to be the ultimate controlling party by virtue of its 44.1% direct shareholding a 5.5% indirect shareholdings (7.1% including share options which could be exercisable at 30 June 2007), controlled by three executive directors, who are employed by International Energy Group AG. The Nautical Group is included in the International Energy Group AG consolidation, the accounts of which are not publicly available.

## 27. Subsidiary undertakings

Subsidiary	% interest held	Country of incorporation/ registration	Activity
Nautical Holdings Limited	100%	England	Investment and oil equipment
Nautical Petroleum AG	75%	Switzerland	Exploration, development and production
Alba Resources (Holdings) Limited	100%	Scotland	Investment
Alba Resources Limited	100%	Scotland	Exploration, development and production
Mountwest 560 Limited	100%	Scotland	Exploration, development and production
Mountwest 561 Limited	100%	Scotland	Exploration, development and production
Mountwest 562 Limited	100%	Scotland	Dormant
First Mariner Limited	100%	England	Exploration, development and production

Nautical Petroleum AG carries out its activities through a UK Branch.

## 28. 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 the accounting policy for exploration and evaluation assets. The reasons for the changes and their impact on the results are explained below:

### Change in Exploration and Evaluation policy.

In order to better align the policy with its peer group, previously expensed exploration costs have been capitalised as set out in note 2.9. In addition, pre-licence costs previously capitalised and written off have been expensed immediately and reclassified as administration expenses. The effect of the changes on the previous period are to increase intangibles by £299k and to reduce costs by £299k, thereby reducing the loss for the period and retained earnings by £299k. The effect on the cash flow is to reduce the loss by £299k and to increase the intangible spend by £299k.

### Discount on long-term payables

The accounting treatment for long-term payables has been revisited. The application of the effective interest method is considered appropriate and a retrospective restatement has been made to discount the long-term payable (note 16). Since the payables were acquired as part of the Alba Resources (Holdings) Limited purchase in August 2005, the impact of this reduction in the cost of purchase has been on the fair value of the assets acquired (as an adjustment to the UK GAAP numbers previously reported), with an adjustment to intangible assets, and subsequently to the income statement as unwinding of discount and foreign exchange, as the payables are dollar denominated.

### Share-based payments

Under UK GAAP, the Group recognised only the intrinsic value or cost of the potential awards for the equity-settled share-based payments as an expense. The cost of these awards were accrued over the vesting period of each award based on the intrinsic value of the equity settled awards.

IFRS requires the fair value of value of options and share awards which ultimately vest to be charged to the income statement over the vesting or performance period. The fair value is determined at the date of grant using an appropriate model. If an award fails to vest as the result of certain types of performance condition not being satisfied, the charge to the income statement will be adjusted to reflect this. Consequently the loss for period 30 June 2006 in both the Group and the Company has been reduced by £36k.

### Deferred tax liabilities

The balance arises on the fair values ascribed to assets acquired as part of a business combination, which arose prior to the date of transition. As such the group has not restated the transaction. Under UK GAAP no deferred tax liability arose, whereas under IFRS a deferred tax liability needs to be recognised. The balance is dollar denominated and hence foreign exchange movements occur. The initial impact is to create a deferred tax liability, increase losses brought forward and to decrease minority interest. Subsequent foreign exchange movements are recorded in the cumulative translation reserve.

## Notes to the financial statements *continued*

### 28. Transition to International Financial Reporting Standards *continued*

	18 months ended 30 June 2006 £'000	
Income statement impact		
<b>(Loss) for the period under UK GAAP previously reported</b>	<b>(7,291)</b>	
Changes in policy for accounting for exploration and evaluation assets:		
Exploration costs written off	684	
Administrative expenses	(385)	
Retrospective restatement of discount on long-term payables:		
Administrative expenses (foreign exchange effects)	(5)	
Finance costs	(222)	
<b>Revised (Loss) for the period under UK GAAP previously reported</b>	<b>(7,219)</b>	
Share-based payment charges	36	
<b>(Loss) for the period under IFRS</b>	<b>(7,183)</b>	
	As at 30 June 2006 £'000	As at 1 January 2005 £'000
Balance sheet impact		
<b>Intangible assets:</b>		
Under UK GAAP previously reported	49,551	25,097
Changes in policy for accounting for exploration and evaluation assets	299	–
Discount on long-term payables	(571)	–
<b>Revised UK GAAP and IFRS Balance</b>	<b>49,279</b>	<b>25,097</b>
<b>Deferred tax liabilities:</b>		
Under UK GAAP previously reported	–	–
Deferred tax on transition balances (including foreign exchange)	(7,830)	(7,380)
<b>IFRS balance</b>	<b>(7,830)</b>	<b>(7,830)</b>
<b>Non-current liabilities: conditional payments:</b>		
Under UK GAAP previously reported	(3,732)	–
Discount on long-term payables	344	–
<b>Revised UK GAAP and IFRS balance</b>	<b>(3,388)</b>	–
<b>Net assets:</b>		
Under UK GAAP previously reported	59,682	27,341
Changes in policy for accounting for exploration and evaluation assets	299	–
Discount on long-term payables	(227)	–
Revised UK GAAP Balance	59,754	27,341
Effects of IFRS	(7,830)	(7,380)
<b>IFRS Net assets</b>	<b>51,924</b>	<b>19,961</b>
<b>Equity:</b>		
Under UK GAAP previously reported	59,682	27,341
Changes in policy for accounting for exploration and evaluation assets	299	–
Discount on long-term payables	(227)	–
Revised UK GAAP Balance	59,754	27,341
Income statement impact of share-based payment charges	36	–
Equity impact of share-based payment charges	(36)	–
Deferred tax on transition balances:		
Attributable to equity holders	(5,872)	(5,535)
Attributable to minority interests	(1,958)	–
<b>IFRS equity</b>	<b>51,924</b>	<b>19,961</b>

# *Nautical Petroleum plc Company only accounts 2007*

## **Directors' responsibilities for the parent company financial statements**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the group for that period. In preparing those financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# *Nautical Petroleum plc Company only accounts 2007 continued*

## **Independent auditor's report to the members of Nautical Petroleum plc**

We have audited the parent company financial statements of Nautical Petroleum plc for the year ended 30 June 2007 which comprise the Company Balance Sheet and the related notes 29 to 38. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of Nautical Petroleum plc for the year ended 30 June 2007.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report and the parent company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the parent company directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Highlights, the chairman's statement, the explanation of heavy crude oil, the chief executive's review, the operational review, the finance directors review, the board of directors, shareholder information, the remuneration report, the corporate governance statement, the supplementary information and the Glossary. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements.

### **Opinion**

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 30 June 2007;
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the parent company financial statements.

### **Ernst & Young LLP**

Registered auditor  
Aberdeen  
1 October 2007

**Company balance sheet**

As at 30 June 2007

	Notes	2007 £'000	2006 (restated) £'000
<b>Fixed assets</b>			
Intangible assets	31	<b>1,482</b>	254
Tangible assets	32	<b>2</b>	4
Investments	33	<b>11,884</b>	11,884
<b>Total fixed assets</b>		<b>13,368</b>	12,142
<b>Current assets</b>			
Trade debtors and other receivables	34	<b>4,603</b>	2,716
Cash at bank and in hand		<b>8,921</b>	12,228
<b>Total current assets</b>		<b>13,524</b>	14,944
Creditors: amounts falling due within one year	35	<b>(729)</b>	(659)
<b>Net current assets</b>		<b>12,795</b>	14,285
<b>Net assets</b>		<b>26,163</b>	26,427
<b>Capital and reserves</b>	36		
Called up share capital		<b>10,777</b>	10,721
Share premium		<b>19,758</b>	19,383
Warrant reserve		<b>263</b>	263
Profit and loss reserve		<b>(4,635)</b>	(3,940)
<b>Total shareholders' funds</b>		<b>26,163</b>	26,427

The financial statements were approved by the Board on 1 October 2007 and were signed on its behalf by:

**I Williams**  
Chairman

**H Thanawala**  
Finance Director

## Notes to the Company financial statements *continued*

### 29. Accounting policies

#### (a) Basis of accounts preparation

The financial statements have been prepared under the historic cost convention and in accordance with applicable United Kingdom accounting standards. In addition to the requirements of UK accounting standards, the accounting for oil and gas exploration and production activities is guided by the Statement of Recommended Practice ("SORP") "Accounting for Oil and Gas Exploration, Production and Decommissioning Activities" issued by the UK Oil Industry Accounting Committee on 7 June 2001. The financial information has been prepared in accordance with the provisions of the SORP.

#### (b) Exploration, evaluation and development expenditure

All costs incurred after the rights to explore an area have been obtained are accumulated and capitalised as intangible exploration and evaluation (E&E) assets. If facts and circumstances indicate that the carrying value of the E&E asset may exceed its recoverable amount an impairment review is performed.

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

When production commences the capital costs incurred plus an estimate of future costs of development are depleted on the unit of production method based on proven and probable reserves for the cost centre. Changes in reserve quantities are recognised prospectively from the last reporting date.

#### (c) Depreciation

The cost of fixed assets is written off over their expected useful lives as follows:

Computer equipment	3 years
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#### (d) Foreign currencies

Assets, liabilities, revenues and costs denominated in foreign currencies are recorded at the rates of exchange ruling at the date of the transactions; monetary assets and liabilities at the balance sheet date are translated at the year end rate of exchange. The resulting profits or losses are dealt with in the profit and loss account.

#### (e) Share-based payments

Employees (including directors and senior executives) of the Company receive remuneration in the form of share-based payment transactions, whereby these individuals render services as consideration for equity instruments ("equity-settled transactions").

The Company adopted FRS 20 for the first time during the current year. The impact was to reduce the loss for the prior period by £36k. There is no impact on equity.

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 Company'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 an actuarial model.

#### (f) Investments in subsidiaries

The Company records investments in subsidiaries at cost less provision for impairment. Where subsidiaries have been acquired in part for shares and at least 90% of the Company has been acquired the Company applies section 131 of the Companies Act 1985 and accounting for the transactions using merger relief. The share element of the transaction is recorded at the nominal value of the shares issued.

#### (g) Change in accounting policy

The policy for exploration, evaluation and development assets has been changed in the year, following a change by the Nautical Petroleum plc group to align its policy more closely with that of its peers. The effect of the changes on the previous period are to increase intangibles by £33k and to reduce costs by £33k, thereby reducing the loss for the year and retained earnings by £33k.

### 30. Losses attributable to Nautical Petroleum plc

The loss for the period dealt with in the accounts of Nautical Petroleum plc was £1,086k (18 months to June 2006: loss of £1,817k, which includes £33k of losses as a result of the restatement with regard to the exploration and evaluation policy and £36k for the adoptive FRS 20). As provided by s230 of the Companies Act 1985, no profit and loss account is presented in respect of Nautical Petroleum plc.

### 31. Employees

#### Headcount

	2007 Number	18 months ended 30 June 2006 Number
Average number of employees of the Company (including executive directors) during the year was:		
Management	4	4
Technical staff/support/other	2	2

Three directors provide services to the Company through a service agreement with International Energy Services Limited, which is a related party.

#### Staff costs

	2007 £000	18 months ended 30 June 2006 £000
Wage and salaries	466	356
Bonuses	97	47
Social Security costs	39	20
Other Pension costs	17	12
	<b>619</b>	<b>435</b>

Wages and salaries include fees for three executive directors through a service agreement with International Energy Services Limited.

	2007 £000	18 months ended 30 June 2006 £000
Equity settled share-based payments	391	1,215

### 32. Intangible assets

	Total £'000
Exploration and evaluation assets	
At 1 July 2006	221
Adjustment from change in accounting policy	33
Restated balance at 1 July 2006	254
Additions in the period	1,228
<b>At 30 June 2007</b>	<b>1,482</b>

### 33. Tangible assets

	Total £'000
Computer equipment	
<b>Cost:</b>	
At 1 July 2006	5
Additions in the period	–
<b>At 30 June 2007</b>	<b>5</b>
<b>Depreciation:</b>	
At 1 July 2006	1
Additions in the period	2
<b>At 30 June 2007</b>	<b>3</b>
<b>Net book value</b>	
<b>At 30 June 2007</b>	<b>2</b>
At 30 June 2006	4

## Notes to the Company financial statements *continued*

### 34. Investments

Investments in subsidiary companies	Total £'000
Cost	
At 1 July 2006	11,884
Additions in the period	–
<b>At 30 June 2007</b>	<b>11,884</b>

Details of subsidiary companies are shown in note 27.

In accounting for the acquisitions of Nautical Holdings Limited, the Alba Resources (Holdings) Group and First Mariner Limited the Company has applied section 131 of the Companies Act 1985 and has accounted for the transactions using merger relief.

### 35. Trade debtors and other receivables

	2007 £'000	2006 £'000
Amounts owed by subsidiaries	4,270	2,470
Other debtors	202	96
Prepayments and accrued interest	137	150
	<b>4,609</b>	<b>2,716</b>

### 36. Creditors: amounts falling due to within one year

	2007 £'000	2006 £'000
Trade creditors	225	74
Amounts owed to related companies	397	538
Taxation and social security	–	18
Accruals	107	29
	<b>729</b>	<b>659</b>

### 37. Share capital and reserves

	Share capital £'000	Share premium £'000	Warrant reserve £'000	Profit and loss reserve £'000	Total equity £'000
At 1 July 2006	10,721	19,383	263	(3,973)	26,394
Adjustment from changes in accounting policy	–	–	–	69	69
Share option charges added back	–	–	–	(36)	(36)
Restated balance at 1 July 2006	10,721	19,383	263	(3,940)	26,427
Shares issued in the period	56	375	–	–	431
Share option charges added back	–	–	–	391	391
Loss for the period	–	–	–	(1,086)	(1,086)
<b>At 30 June 2007</b>	<b>10,777</b>	<b>19,758</b>	<b>263</b>	<b>(4,635)</b>	<b>26,163</b>

Details of share capital and share-based payments are set out in note 18.

### 38. Related party transactions

Executive directors, I Williams, H Thanawala and P Jennings provide services under a service agreement with International Energy Services Limited. The charges in the period were £266k (2006: £178k).

International Energy Services Limited is a 100% subsidiary of International Energy Group AG, the parent company of Nautical Petroleum plc and provides services to companies within the International Energy Group. Such shared services include the occupation of shared office space and facilities and some administrative functions and amounted to £257k (2006: £181k), which was in addition to the services of the directors. At the period end an amount of £292k (2006: £436k) was due to International Energy Services Limited.

Non-Executive Director P Kennedy is also a partner in PK Partners LLP which has provided consulting services to the Group and for the services of C Gill, the Company Secretary, for the amount of £14k (2006: £103k).

At the period end there was £25k (2006: £96k) due to International Energy Group and £155k (2006: £Nil) from UAH Limited, a subsidiary of International Energy Group AG.

## Supplementary information

### Audit of Reserves and Resource Volumes for Annual Report and Accounts of Nautical Petroleum plc (“the Company”)

We have been asked to provide an updated comment on the resources and reserves estimates of the Company. The Company asserts that there have been no material technical changes to the inputs and methods that the Company would use in the estimation of these quantities. The Company has also stated that it will not re-run economic evaluations of the properties despite changes in commodity prices.

On this basis, we can repeat our opinion that the Company’s estimates of Proved plus Probable reserves and Best Estimate Contingent and Prospective Resources are, in aggregate, reasonable and have been prepared in accordance with generally accepted petroleum engineering and evaluation principles as set forth in the Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserve Information promulgated by the Society of Petroleum Engineers.

Since 2006, the company has acquired new acreage. RPS has reviewed contingent and prospective resource estimates in the Tudor Rose discovery and Catcher prospect, respectively. The Company advises that the Catcher prospect in Block 28/9 will be drilled in 2008.

We draw your attention to the following points, one of which is repeated from last year:

- We advise you to report Contingent Resources and Reserves (of any class) separately and not to present them as additive quantities. We understand that you have accepted this recommendation.
- The recoverable volumes in the Mariner field (Core and West areas) are classified as reserves based on your assurance that the field will be developed within a reasonable timeframe which we take to be a maximum of five years from the date of evaluation. Significant delays to development planning would require these volumes to be re-classified as contingent resources.
- Furthermore, the ongoing corporate activity associated with the Mariner discovery, involving a change of Operator subject to certain approvals, will itself not affect your above mentioned assurance on the speed of development.
- Estimates of reserves and resources are inherently imprecise and uncertain. Presentation of a single estimate does not illustrate the uncertainty.
- Many of the Company’s projects remain relatively immature are the subject to ongoing technical evaluation by the Company. Although we deem the estimates to be reasonable, these estimates may be subject to significant change as new data becomes available.
- We have not reviewed the “risking” or “chance of success” associated with any of the Prospective or Contingent Resources in your portfolio.

Yours faithfully,

**Roy Kelly**  
Director, Valuations  
**RPS Group Plc**  
27 September 2007

## Glossary

<b>API</b>	American Petroleum Institute®	<b>EWT</b>	extended well test
<b>bbl</b>	barrels	<b>FDP</b>	field development plan
<b>bcf</b>	billion cubic feet	<b>km</b>	kilometres
<b>bn</b>	billion	<b>K</b>	thousand
<b>bopd</b>	barrels of oil per day	<b>m</b>	million
<b>cp</b>	centipoises	<b>mmbo</b>	million barrels of oil
<b>D</b>	Darcy	<b>MWD</b>	measurement while drilling
<b>DBERR</b>	Department of Business, Environment and Regulatory Reform	<b>OWC</b>	oil-water contact
<b>DST</b>	drill stem test	<b>UKCS</b>	United Kingdom Continental Shelf

