Premier Oil plc

# Annual Report and Financial Statements

Year to 31 December 2010

234781

**Our business is strong.**

Our company is soundly managed.
Our people are determined to be
the best in their field...

# Building quality businesses... using our existing strengths

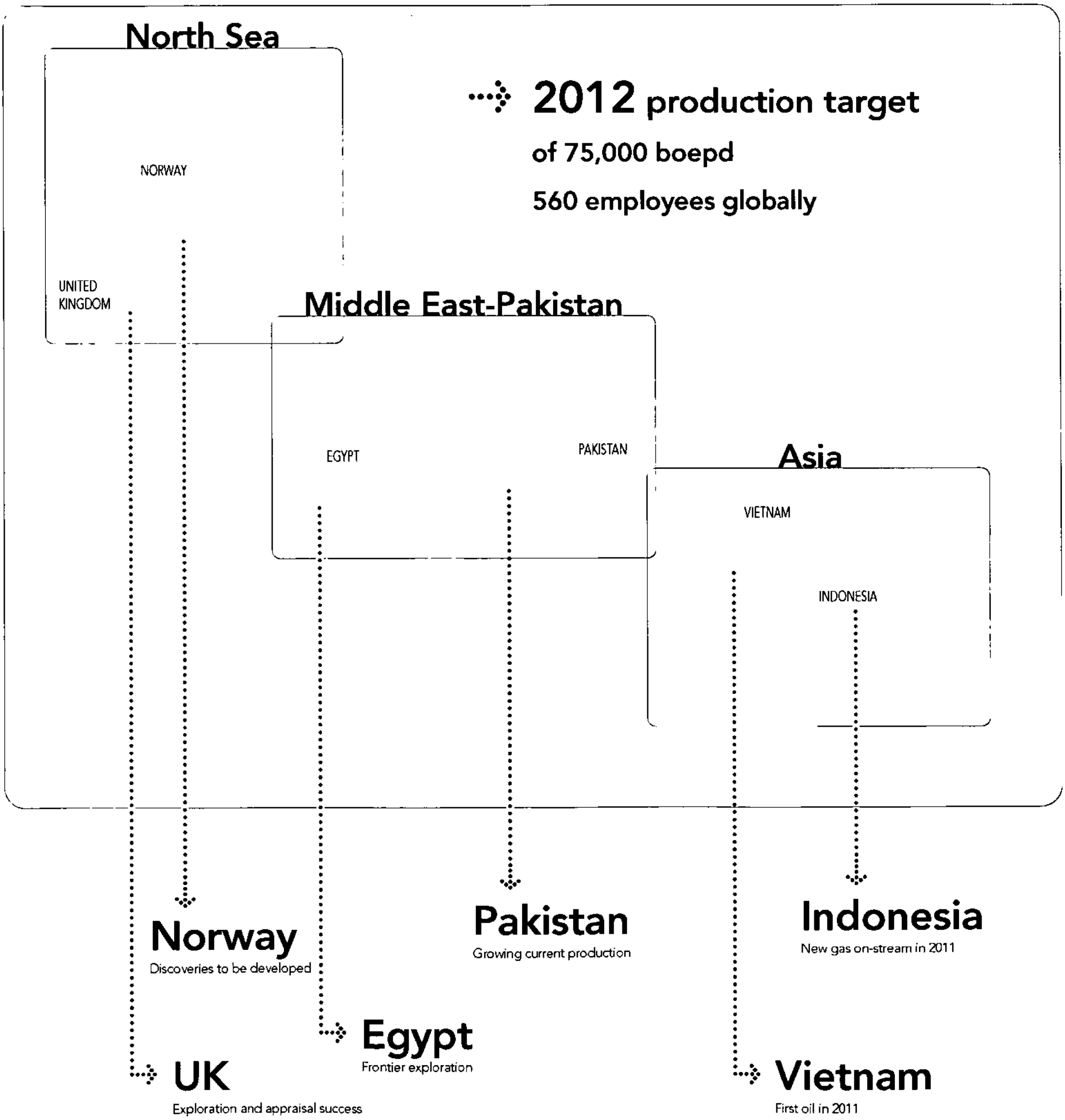
**Premier has made significant strides in meeting its strategic targets... we look forward to the future with confidence.**

"2010 was a year of exploration success and development project progress. 2011 has already seen further progress towards meeting our future growth targets."

Simon Lockett, Chief Executive

# Targeting further growth... across three regions

"Each of our three business units has production, development and exploration opportunities. In total we manage a growing reserve and resource base of 488 mmboe."



## Consistent growth across our businesses

**Production**
2008-2012

**Reserves and resources**
2006-2010

**Operating cash flow**
2006-2010

**Profit after tax**
2006-2010

## Operational highlights

- 2010 production of 42.8 kboepd (2009: 44.2 kboepd); on target for 75 kboepd in 2012
- Material progress on operated Chim Sáo and Gajah Baru fields, due on-stream in 2011; Huntington on track with first oil and gas expected within 12 months
- Portfolio of development projects approaching project sanction which will contribute towards production of around 100 kboepd by 2014
- Eight out of 14 exploration and appraisal wells drilled in 2010 were successful, including the discoveries in the Catcher area in the UK
- Proven and probable reserves increased to 261 mmboe (2009: 255 mmboe), a reserve replacement ratio of 138 per cent. Reserves and resources increased to 488 mmboe (2009: 468 mmboe)

## Financial highlights

- Record profit after tax of US$129.8 million (2009: US$113.0 million)
- Operating cash flow of US$436.0 million (2009: US$347.7 million), an increase of 25 per cent
- US$1,100 million of UK tax allowances mitigating impact of proposed UK tax changes
- Rising cash flows and increased funding in place to cover ongoing development and growing exploration programme. Debt facilities expanded and maturities extended
- Net debt was US$405.7 million (2009: US$315.6 million), representing gearing of 36 per cent. Cash and undrawn bank facilities (including letter of credit facilities) of US$1,202 million at year-end (2009: US$649 million)

From left to right:

**Tony Durrant**, Finance Director
**Neil Hawkings**, Operations Director
**Andrew Lodge**, Exploration Director
**Stephen Huddle**, Company Secretary
**Robin Allan**, Director – Asia
**Nigel Wilson**, North Sea and West Africa Regional Manager
**Tom Clarence-Smith**, Middle East-Pakistan Regional Manager

## Catcher (Premier 35.00 per cent)

Premier acquired its 35 per cent interest in Block 28/9 in the UK North Sea as part of the Oilexco acquisition in 2009. The block is located on the western margin of the Central North Sea rift basin. The 28/9-1 well, drilled in May 2010, encountered a good quality reservoir with estimated net oil pay of 80 feet. Follow-up side-tracks also encountered quality oil-bearing sandstones and a common pressure regime. A further exploration and appraisal programme is currently under way with oil and gas discoveries already made at the Varadero, Burgman and Catcher North locations.

- The Catcher Block has the potential to be the largest UK oil discovery for a number of years
- Pre-development work for the block is already under way

## Chim Sáo (Premier 53.125 per cent)

The project is the first oil development in the Nam Con Son Basin of Vietnam. The platform jacket and topsides were installed during 2010 and an associated gas pipeline tied back to the Nam Con Son gas export infrastructure. Conversion of the FPSO for the project is close to completion in Singapore and development drilling is in progress.

- First oil is scheduled for July 2011
- Development of the nearby Dua field is expected to follow Chim Sáo first oil
- An active exploration programme continues in the area

## Gajah Baru (Premier 28.67 per cent)

The project is the first of a number of fields to be developed by Premier to supply additional gas to Singapore and Batam (Indonesia) under three gas sales agreements signed in 2008. Fabrication of the wellhead platform was completed and installation successfully achieved during 2010, allowing the five-well development drilling programme to proceed, completing during the first quarter of 2011. Fabrication of the central processing platform continues in Batam and is scheduled to be installed during the second quarter of 2011.

- First gas is scheduled for October 2011
- Contract gas sales will be 140 mmscfd (gross)

## Kadanwari (Premier 15.79 per cent)

The Kadanwari gas field in Pakistan has seen increased production of 40 per cent in 2010 through the tie-in of new development wells (K-21, K-23 and K-24) and successful step-out exploration (K-18 side-track and K-19). Further exploration and development wells are planned for 2011 to maintain current levels of production.

- 2010 production from the field averaged 62 mmscfd (gross)
- The Kadanwari production lease runs until 2022

*Catcher photo courtesy of Transocean Corporate Communications*

# Utilising our strong development and project management skills in…

# Asia

Robin Allan
Director – Asia

"Our development projects are on schedule and on budget, a tribute to the skills and tenacity of our teams in Vietnam and Indonesia. We look forward to first oil and gas during 2011 and the transition to the next generation of projects in the region."

### Strategy

We seek to develop the full potential of our operated position in the Natuna Sea and Nam Con Son Basin bringing relationships, knowledge and technical skills to bear and developing new business opportunities in related technical or geographical areas.

### 2010 highlights and achievements

- Record gas sales from Natuna Sea Block A, significantly exceeding contractual share in the Singapore market
- Chim Sáo and Gajah Baru development projects remain on target and on schedule
- 20-year PSC extension signed for Block A Aceh, facilitating the gas development project on the block

### Outlook

- First oil in Vietnam and first gas from the Gajah Baru project in Indonesia expected during the second half of 2011
- Programme of six exploration and appraisal wells scheduled for 2011, focused on the Natuna Sea and Nam Con Son Basin

# Extending our footprint across the...

# Middle East-Pakistan

Tom Clarence-Smith
Middle East-Pakistan
Regional Manager

“Performance from our producing fields in Pakistan remains strong. We continue to build on our exploration portfolio in areas of existing geological skills. Using both existing and new relationships in the region, we are looking to build our presence.”

**Strategy**

We seek to maximise the value of our Pakistan producing gas fields and extend our technical skills to new regional opportunities.

**2010 highlights and achievements**

- Successful progress in implementing new compression projects at Qadirpur, Zamzama and Bhit gas fields
- Increased production from the Kadanwari field following new development wells and step-out exploration success
- Award (awaiting ratification) of the South Darag Block and farm-in to the Northern Red Sea Block builds Egyptian exploration position

**Outlook**

- Planned record levels of production from Pakistan gas fields in 2011
- Play-opening Northern Red Sea well scheduled for the first half of 2011
- Focus on acquisition opportunities, including with our regional partner Petromal (EIIC)

# Building on a growing asset base in the...

# North Sea

Nigel Wilson
North Sea and West Africa
Regional Manager

> "Following on from the Oilexco acquisition in 2009, we have built further on our UK asset base through development and exploration success. Our discovered reserve base in Norway is moving into the development phase."

### Strategy

We seek to maximise output from our current production base and commercialise undeveloped discoveries already held in the portfolio. We will build on our existing position in the North Sea through an active exploration programme in Norway and the UK, participation in new licensing rounds and acquisition of additional assets in the areas which we know well.

### 2010 highlights and achievements

- Huntington field development project received joint venture partner and DECC approval
- Catcher discoveries promise to be one of the largest new oil accumulations in the UK for a number of years
- Additional exploration success was achieved with the West Rochelle well in the UK North Sea and the Blåbaer discovery in Norway
- Premier captured interests in nine new blocks in the UK 26th Licence Round and two new licences in the Norwegian 2010 APA Round

### Outlook

- Huntington project on schedule for first oil early in 2012
- Anticipated progress on portfolio of future development projects in both the UK and Norway
- Full evaluation of the potential of the Catcher Block and transition into development planning phase

# Behind the success...
# Great People work for Premier

"Premier's growth and success is a direct consequence of the values we all subscribe to, namely dynamism, professionalism, creativity, tenacity and respect. Our people thrive on new challenges and ideas, and the relationships they inspire are the foundation of the business."

↑↑ **Andrew Jack**, Production Operations
↑ **Shaqeeq Baluch**, Systems and Procurement Administrator

↑↑ **Fiona Mulvihill**, Receptionist
↑ **Christopher Sinclair**, Production Operations

↓ **Phil MacLaurin**, Vietnam – Country Manager
↓↓ **Dadang Sudarya**, Field Maintenance Supervisor

↑↑ **Donnyanto T Abram**, Senior Authorised Electrical Engineer
↑ **Xuan, Luu Thi Anh**, Accounting Manager

**Premier seeks to be the employer of choice...**

in all areas of operation, Premier prides itself on a diverse, high-achieving workforce, which is currently expanding rapidly to reflect Premier's growing operational presence. The company will continue to evolve its employment practices and policies to attract and retain the best talent and to develop all staff to their full potential.

# Continued growth through commitment and responsibility...

**Premier is committed to applying the high ethical standards necessary to maintain our reputation as a world-class operator in oil and gas. Our reputation for doing the right thing enables us to access new licences, enter new countries, build lasting relationships with local communities and ultimately secure the licence to operate. We have policies and procedures in place to ensure that our investment and operational decisions take appropriate account of the impacts that might arise from our activities. This last year saw the implementation and communication of a new health, safety and environment policy at all Premier operations worldwide.**

"We have a responsibility to ensure our operations cause no harm to people or the environment. This remains a priority equal to our other key business objectives."

Simon Lockett
Chief Executive

**Highlights in 2010**

- It is our policy to support social investment that contributes to the sustainable development goals of the communities and countries where we operate. In 2010, Premier spent US$800,000 on community investment in the vicinity of our operations and joint ventures in Indonesia, Pakistan, the UK North Sea and Vietnam mainly in the areas of improving local infrastructure and disaster relief
- Premier has been certified to OHSAS 18001 and ISO 14001 since 2004 for global drilling and since 2006 for our Indonesian production operations. With our Balmoral operation recently achieving OHSAS 18001, all of our operated activities are now certified to both standards
- Our operated greenhouse gas emissions intensity in 2010 was 185 tonnes per thousand tonnes of production. This is a slight increase from 2009 due to the inclusion of our UK North Sea assets for the first full calendar year
- Average oil in produced water declined significantly from 19 parts per million (ppm) in 2009 to 11 ppm in 2010. This reduction is attributed to improvements in the treatment process that lead to increased removal of oil from produced water before discharge
- We have taken additional steps to strengthen our process for preventing and responding to oil spills. This includes regular pollution prevention audits and an independent review of our Anoa oil spill contingency plan. We maintain oil spill contingency plans for each of our operations and have ongoing contracts with oil spill response specialists to provide support in the unlikely event of a major incident

# Premier is a leading FTSE 250 independent exploration and production company with oil and gas interests in the North Sea, Asia and in the Middle East-Pakistan regions.

Our strategy is to add significant value for shareholders through exploration and appraisal success, astute commercial deals and optimal asset management.

# Highlights

**Operational**

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**Financial**

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**Outlook**

- New projects on-stream will push first quarter 2012 production run-rate to around 75 kboepd
- Development drilling on Gajah Baru successfully completed during the first quarter, Chim Sáo development drilling continues well and Huntington development drilling programme will commence in the second quarter
- Final development sanction for several projects expected during the year. Agreement reached to acquire a 60 per cent interest in the Solan field
- Pre-development planning for the Catcher area under way to follow successful completion of exploration programme
- Planned 20 exploration wells in 2011 programme targeting 400 mmboe of unrisked potential; encouraging start with first quarter 2011 wells; currently drilling in the UK, Egypt and Vietnam

# Chairman's Statement

### Our business environment

The prospects of recovery in the world economy, led by stronger energy demand in Asia, pushed oil and gas prices higher during the course of 2010. In response to the recession, governments around the world maintained interest rates at historically low levels providing a favourable financing environment for companies with access to the debt capital markets. Though there are concerns about future inflation, the oil industry benefitted during 2010 from a period of comparative cost stability. Against this positive economic background, the industry was reminded of the inherent dangers it faces as the task of finding large quantities of oil and gas becomes more complex. Preservation of our natural environment relies on strict adherence to safety standards. Politically, there are considerable uncertainties in a number of countries in which we are seeking to grow. This instability is mitigated by our spread of activities around the world and we expect our industry to continue to address these challenges in all its operations.

### Premier's performance

2010 was a strong year for Premier resulting in considerable added value for its shareholders. Rising oil and gas prices, combined with stable production, generated record revenues and profits for the group. At the same time, great progress in our development projects and success in our North Sea exploration programme validated our growth targets and ambitions. We expect to see first production from our three most advanced oil and gas developments within the next 12 months. Further forward, we can see a clear path to attaining 100,000 boepd of production by 2014. We continue to have good access to the debt capital markets to finance our investments and, from our rising cash flows, we are able to fund a growing exploration programme. As a result, we are confident of not just replacing reserves but adding to our resource base which will form the basis for future growth beyond 2014.

> “2010 was a strong year for Premier resulting in considerable added value for its shareholders. We expect to see first production from our three most advanced oil and gas developments within the next 12 months. Further forward, we can see a clear path to attaining 100,000 boepd of production by 2014.”

### Governance and the Board

Your Board is fully committed to the principles of good corporate governance and responsibility. As Premier's business has expanded, the need to become more sophisticated in the analysis of risk and performance has become more critical. Assessment of risk factors, actions to mitigate risk and the measurement of performance against key indicators are updated and reported to the Board on a monthly basis. Premier's performance in the area of health, safety and environmental management has, over a number of years, significantly improved and the Board continues to focus on this critical area.

In line with the recommendations of the Combined Code, the Board used external advisors this year to review its effectiveness. The conclusions of this review confirmed the Board to be an effective body. Recommendations were made to enhance the performance and effectiveness of the Board and a process of continuous improvement is now under way.

I would like to pay particular thanks to Premier's senior independent director, John Orange, who after 14 years on the Board has decided not to seek re-election at the Annual General Meeting in May 2011. John's experience at Board level, his chairmanship of the Remuneration Committee and his detailed knowledge of the company have been invaluable. I am particularly grateful for his advice and support on my arrival as Chairman during 2009. I am pleased to report that the Board has asked Joe Darby, who joined the Premier Board in 2007, to take on the role of senior independent director.

In August 2010, we were pleased to report that Jane Hinkley, who has extensive experience at management and board level in both the shipping and oil and gas sectors, joined the Board. Jane has also agreed to chair the Remuneration Committee after John's retirement.

### Shareholder returns

Premier's share price increased by 76 per cent during 2010, providing shareholders with very significant returns on the rights issue proceeds subscribed in May 2009 to fund the Oilexco North Sea Ltd (Oilexco) acquisition. Over the five-year period to 31 December 2010, Premier's share price, adjusting for the rights issue, has increased by 193 per cent. I would like to pay tribute to the hard work and skills of our employees, partners and suppliers as we look forward together to continued growth and success.

**Mike Welton**
Chairman

# Chief Executive's Review

Simon Lockett
Chief Executive

### Strategy and targets

Premier's business model is to achieve continuous growth in our production and development portfolio, whilst offering shareholders material upside through our exploration programme.

Our business is organised in three regional units. We seek to grow and improve the quality of each of these businesses through investment in the full range of exploration, development and production activities.

In 2009, following the successful acquisition of Oilexco, we established a production target of 75,000 barrels of oil equivalent per day (boepd) for 2012. It is pleasing to report that, with strong progress on our three principal development projects in Vietnam, Indonesia and the UK, we are on track to meet that target. Beyond those three projects, we have a portfolio of reserves and resources around the world which will form the next generation of developments. As a result of the progress made on many of these projects we are confident that we will reach an average of 100,000 boepd by 2014. The pre-development work carried out during 2010 in the UK on the future Catcher and Solan oil fields and in Indonesia on the Pelikan and Naga gas fields are examples of the good progress made on these projects.

Over and above our existing reserves and resources position, we have set out a plan to add 200 million barrels of oil equivalent (mmboe) from our exploration efforts. This is targeted to increase the overall level of reserves to at least 400 mmboe, capable of sustaining production growth beyond 100,000 boepd. As a result of the exploration success achieved during the year, we are also on track to achieve this ambitious target. We expect to increase expenditure on exploration over time and our new venture teams are working hard to secure new high-quality acreage.

Critical to achieving our growth objectives is the maintenance of a strong balance sheet and good liquidity. This funds our existing development assets, pre-funds future projects and also gives us the capability to add to the portfolio where we see good quality acquisition opportunities.

Overriding all of our corporate growth targets is an absolute commitment to operating responsibly and meeting our health, safety and environmental standards. We are pleased to report that all of our operations have been awarded or have retained OHSAS 18001 and ISO 14001 certifications. Our operated greenhouse gas emissions intensity now shows a consistent downwards trend and average oil in produced water declined significantly. Additional steps have been taken to prevent hydrocarbon spills including the strengthening of our pollution prevention audit process.

"2010 was an excellent year for the group with exploration success and development project progress. We have added significant value for our shareholders and are on track to meet our ambitious production growth targets. 2011 has already built on progress made with development drilling complete, further exploration successes and new licences awarded across our three regional businesses."

**2010 financial and operating performance**

Brent oil prices averaged US$79.5 per barrel (bbl) in 2010, some 29 per cent higher than the average of US$61.7/bbl in 2009. Gas prices realised in the Singapore market, which are directly linked to High Sulphur Fuel Oil (HSFO) prices, averaged US$13.9 per thousand standard cubic feet (mscf), a 26 per cent increase on 2009. Combined with continuing strong demand for our gas in Singapore, higher prices generated record sales revenues for the group of US$763.6 million (2009: US$621.1 million). Though overall production remained stable at 42.8 kboepd (2009: 44.2 kboepd), profits after tax of US$129.8 million (2009: US$113.0 million) also reached record levels.

Operating cash flow after tax was US$436.0 million (2009: US$347.7 million), an increase of 25 per cent. Strong cash flows helped to fund the significant investment programme undertaken during 2010, which will drive an increase in production levels during 2011 and 2012. Development expenditure was US$347.1 million (2009: US$192.5 million). We also increased our exploration and appraisal programme, drilling a total of 14 wells at a cost, including seismic and other exploration activity, of US$164.7 million (2009: US$107.5 million). We remained active in the capital markets with two increases in bank facilities during the course of the year, providing capacity not just for current investment but for continuing expansion. At year-end, total debt facilities stood at US$1,822 million, with cash and undrawn bank and letter of credit facilities of US$1,202 million.

Our investment programmes continue to expand our reserves and resources base. Oil and gas proven and probable reserves increased to 261 mmboe (2009: 255 mmboe). Reserves and resources increased to 488 mmboe (2009: 468 mmboe), the principal addition being our discoveries in the Catcher area in the UK North Sea.

Our exploration and appraisal programme in 2010 delivered eight discoveries from 14 wells, most notably with four successful wells in Block 28/9 in the UK, the Catcher area. This series of wells and the ongoing exploration programme across this block are likely to result in the largest new oil project in the UK sector of the North Sea for a number of years. Elsewhere in the North Sea, we also had successful discoveries at West Rochelle in the UK and at Blåbaer in Norway.

We continue to build on our acreage position in areas in which we have a good understanding of the geology and a database of subsurface information. We acquired interests in nine new blocks in the 26th Licensing Round in the UK Central North Sea and a further two licences in the most recent round in Norway. Building on our knowledge of rift plays in several parts of the world, we have taken an interest in the northern Red Sea block south of the Gulf of Suez and were recently awarded, subject to negotiation of terms, two licences offshore Kenya, further south within the African rift play fairway.

**2011 outlook**

Our project execution teams in Asia and the North Sea remain focused on delivering our principal development projects on schedule during the coming months. Completion of construction and upgrade work in yards and the development drilling programmes offshore are progressing well.

There is also much focus on future development projects which bring together the full range of subsurface, engineering, project management, business development and financing skills within the group. We anticipate the achievement of further significant milestones on many of these projects during 2011.

Our exploration programme for the year targets 20 wells with unrisked resource potential of around 400 mmboe. We have already discovered further oil and gas in the Catcher area in the UK. The data acquired is now being integrated with our existing knowledge from prior wells on this block. We look forward to the outcome of the ongoing programmes in Egypt, Vietnam, Indonesia, Norway and the UK and to the continuing efforts of our new venture teams to add future drilling opportunities to the portfolio.

# Chief Executive's Review (continued)

Neil Hawkings
Operations Director

## OPERATIONS REVIEW

**Production, development and reserves**

Average working interest production for the full-year was 42.8 kboepd (2009: 44.2 kboepd). This was lower than that achieved in 2009 due to unplanned maintenance requirements on UK North Sea fields in the Balmoral, Scott and Wytch Farm areas and due to some flooding-related downtime at the Zamzama field in Pakistan. Production in other areas remained steady, with strong gas demand and good production performance in both Pakistan and Indonesia.

| | Working interest | | Entitlement | |
|---|---|---|---|---|
| Production (boepd) | 2010 | 2009 | 2010 | 2009 |
| Asia | **11,650** | 11,050 | **7,300** | 7,300 |
| Middle East-Pakistan | **14,900** | 16,000 | **14,900** | 15,850 |
| North Sea | **15,500** | 16,200 | **15,500** | 16,200 |
| West Africa | **700** | 950 | **600** | 800 |
| **Total** | **42,750** | 44,200 | **38,300** | 40,150 |

"Significant progress continued to be made on our operated development projects. Both Chim Sáo and Gajah Baru projects remain on track to deliver first oil and gas on schedule in 2011."

Significant progress continued to be made on our operated development projects. Both Chim Sáo and Gajah Baru projects remain on track to deliver first oil and gas on schedule in 2011. On Gajah Baru, fabrication of the wellhead platform was completed and successfully installed. Development drilling is in progress and fabrication of the processing platform is on schedule. On Chim Sáo, the platform jacket, topsides and in-field pipelines were installed, while the floating production, storage and offtake vessel (FPSO) conversion was 87 per cent complete at year-end. Development drilling has been progressing well.

The Huntington field in the UK North Sea achieved final project sanction in November 2010 with the Department of Energy and Climate Change (DECC) approving the field development plan (FDP). The FPSO charter party agreement was executed and upgrade work on the FPSO has commenced. A drilling rig contract has been awarded and development drilling is planned to commence in April 2011. First oil is planned for early 2012. On the non-operated Block A Aceh (previously known as North Sumatra Block A) in Indonesia, a fully termed extension to the production sharing contract (PSC) was executed and the principal gas sales agreement (GSA) became unconditional. Issuance of engineering, procurement, construction and installation (EPCI) tender documents for the processing facilities is expected in 2011 with first gas planned for mid-2013.

As at 31 December 2010 proven and probable reserves, on a working interest basis, were 261 mmboe (2009: 255 mmboe).

| | Proven and probable (2P) reserves (mmboe) | 2P reserves and 2C contingent resources (mmboe) |
|---|---|---|
| Start of 2010 | 255 | 468 |
| Production | (16) | (16) |
| Net additions and revisions | 22 | 36 |
| **End of 2010** | **261** | **488** |

At year-end, the percentage of liquids in total reserves increased from 32 per cent at the end of 2009 to 35 per cent. The equivalent volume of 2P reserves on an entitlement basis amounted to 222 mmboe (2009: 229 mmboe) based on a price assumption of US$75/bbl (2009: US$75/bbl).

Booked reserve additions were mainly due to the exploration successes of Catcher and Varadero in the UK North Sea. Other reserves additions included increases to the Pakistan portfolio following on from exploration successes at Kadanwari. Contingent resources at year-end increased to 227 mmboe (2009: 213 mmboe). Increases in contingent resources included tight gas volumes at Kadanwari, along with discovered volumes at Blåbaer and West Rochelle in the North Sea.

## Asia

In Indonesia we continued to develop the full potential of our Natuna Sea and Block A Aceh gas positions with the accelerated development of new fields in Natuna Sea Block A to capture additional gas market demand and with the execution of the Block A Aceh PSC extension. In Vietnam, while the Chim Sáo development progresses well, we are seeking to grow our presence with work continuing to define the Dua and Cá Rồng Đỏ (CRD) accumulations as well as by undertaking new exploration activities.

# Chief Executive's Review (continued)

### Indonesia

During 2010, the Premier-operated Natuna Sea Block A sold an overall average of 160 billion British thermal units per day (BBtud) (gross) (2009: 153 BBtud) from its gas export facility, whilst the non-operated Kakap Block contributed a further 54 BBtud (gross) (2009: 42 BBtud). Gross liquids production from the Block A Anoa field averaged 1,758 barrels of oil per day (bopd) (2009: 1,920 bopd) and 2,993 bopd (2009: 3,540 bopd) from Kakap. The Kakap field experienced downtime during the year as a result of change out of the FPSO vessel. Overall, net production from Indonesia amounted to 11,650 boepd (2009: 11,050 boepd) on a working interest basis.

Significant progress continued to be made on the Gajah Baru project which remains on track to deliver first gas on schedule and within budget in October 2011. Gajah Baru is the first of a number of fields to be developed to supply additional gas to Singapore and to Batam Island, in Indonesia, under three new GSAs signed in 2008 and reported previously. Fabrication of the wellhead platform was completed and installation successfully achieved to support the start of development drilling in September, with the drilling rig on location during this period. Three of the first phase of five wells have been drilled, logged and tested with results that exceeded expectations. Meanwhile fabrication of the central processing platform at Batam continues as planned. The overall EPCI contract was 75 per cent complete at year-end. The central processing platform and export pipeline are due to be installed during the second quarter of 2011 and detailed hook-up and commissioning planning is being progressed.

Also on the operated Natuna Sea Block A PSC, accelerated development work on the Pelikan and Naga fields is in progress in order to be able to take on additional GSA market share from 2014. The project passed through the concept selection gate, front end engineering and design (FEED) is in progress and final project sanction is expected in 2011.

On the non-operated Block A Aceh, a fully termed extension to the Block A Aceh PSC was executed with the Government of Indonesia and the provincial Government of Aceh on 28 October 2010, with the extended PSC being effective from 1 September 2011. Sales agreements with the principal buyers of gas from the field have been completed and work continues towards optimising the project prior to the issuing of EPCI tender documents for the processing facilities in 2011. First gas is expected in mid-2013. Preparations also commenced for the drilling of the Matang exploration well during 2011.

### Vietnam

Progress on the Chim Sáo development remained on schedule for first oil during July 2011. In 2010, the platform jacket, topsides and in-field pipelines were installed, and the Chim Sáo associated gas export pipeline was tied into the Nam Con Son pipeline. The conversion of the FPSO at Keppel's yard in Singapore was 87 per cent complete at year-end. Development drilling commenced in June and is on schedule to deliver the wells required for first oil. All cost elements of the development remain in line with budget.

Detailed subsurface and facilities work was undertaken to define the development plan for the Dua field, a tie-in to the Chim Sáo FPSO. FEED is in progress and a final project decision is targeted for the second half of 2011.

### India

No progress has been made in 2010 with the Government of India in signing the Ratna licence and Premier has closed its representative office in Delhi.

## North Sea and West Africa

Building upon the acquisition of Oilexco in 2009, Premier has passed significant milestones in growing its North Sea business. These included achieving project sanction on Huntington, the successful Catcher and Varadero exploration wells (Premier 35 per cent), which discovered a significant quantity of high-quality oil reserves, and the West Rochelle boundary well which confirmed the extension of the Rochelle discovery into Block 15/26b. We continue to pursue actively new assets that are capable of delivering near-term production in the North Sea.

### UK

Total UK production in 2010 was 15,500 boepd (2009: 16,200 boepd). This included 7,100 boepd (2009: 5,000 boepd) from our fields which utilise the Balmoral facilities and other material contributions from the Scott/Telford, Kyle and Wytch Farm fields.

The lower overall production in 2010 was largely due to unplanned maintenance requirements on the Balmoral, Scott and Wytch Farm areas, although oil revenues increased due to the higher oil price which averaged US$79/bbl across all fields. 2010 average production was also affected by the earlier than planned permanent cessation of production on the Shelley field. However, there was notable production success in the Scott field from the J39 infill well drilled in January, successful workovers of wells J33 and J24 in March, and the re-perforation of well J37Y in June.

Premier commissioned a gas compression upgrade on the Balmoral floating production vessel (FPV) in February to facilitate the production performance of Premier-operated oil fields Brenda and Nicol. These fields and the non-operated Kyle field delivered strong consistent production throughout the year.

The Burghley field was successfully tied back to the Balmoral FPV in October. The Burghley third party oil production will contribute pro rata to the FPV shared operating costs, which will lower the costs allocated to the Premier oil fields that are tied back to the vessel.

Premier completed the purchase of an additional 0.80 per cent in the Telford field on 23 December, thereby increasing our equity in Telford to 1.59 per cent. The Telford operator successfully completed two infill wells which will start up in 2011.

The Huntington field (Premier 40 per cent) progressed to the development phase following joint venture and DECC approval of the Huntington FDP. The FPSO charter party agreement has been executed and upgrade work on the FPSO has commenced at the yard in Norway. Long lead items for the topsides and key subsea equipment are on order. A drilling rig contract has been awarded and development drilling is planned to commence in April 2011. Installation activities are planned for summer 2011, with the FPSO due to arrive in the field late in the third quarter or early in the fourth quarter. First oil is planned for early 2012.

Reservoir modelling and pre-development engineering conceptual studies were funded during 2010 for the Ptarmigan and Caledonia fields. Economic screening has indicated that it may be commercially feasible to develop Caledonia North by subsea tie-back to the Premier-operated Balmoral FPV. The Caledonia redevelopment opportunity may be enhanced by the Premier-operated Bluebell prospect, which will be drilled in 2011. Ptarmigan concept studies have been completed based on a subsea tie-back to the Balmoral FPV and are currently being evaluated.

# Chief Executive's Review (continued)

Premier actively pursued business development opportunities in 2010 leading to two new potential field developments: the Solan and Fyne fields. Premier paid US$1.5 million to Chrysaor Ltd to fund pre-development conceptual studies for the Solan field in exchange for an option to farm-in to a portion of Chrysaor's 100 per cent equity. The field is located in the west of Shetlands in Block 205/26a, to the south of the Schiehallion field. Post year-end, a conditional agreement has been signed with Chrysaor for Premier to take a 60 per cent working interest in the development, in exchange for funding Chrysaor's share of development costs. Premier will also pay US$20 million in consideration. Full development sanction for the Solan field is anticipated for mid-2011. Premier paid US$2 million to Antrim Energy to fund pre-development conceptual studies for the Fyne field in exchange for an option to farm-in to acquire 40 per cent of the Fyne area on Block 21/28a. Antrim currently owns 75 per cent equity and operates the block. Work continues on reviewing field development options in the area.

### Norway

In Norway, Premier has made further progress on two significant pre-development assets: Frøy (Premier 50 per cent) and Bream (Premier 20 per cent). At Blåbaer (Premier 15 per cent), hydrocarbons were discovered in the Lower Jurassic Cook formation; this discovery has the potential to tie-back to the adjoining Jordbaer development.

On the Frøy field, the joint venture has continued to mature a stand-alone concept for development. In particular, the joint venture has evaluated an improved drainage strategy with use of water and gas injection. Further studies carried out in the second half of 2010 looked at three third party fields in the Frøy area as potential tie-back volumes. The results of these studies indicate that the tie-backs are feasible, though further work is required to complete viable commercial arrangements. Given successful outcomes from the current work programme, the joint venture will be in a position to achieve project sanction later in 2011.

The Bream field development has been advanced during 2010, with a tender exercise for an FPSO being completed and a contractor/vessel being shortlisted. Work on the FPSO and subsea well concept has progressed well, and a project sanction decision is expected to be taken during the second half of 2011.

### Mauritania

In Mauritania, 2010 working interest production from the Chinguetti field averaged 700 boepd (2009: 950 boepd), higher than earlier expectations. The operator continues to assess and optimise production performance from the field.

The joint venture partnerships continue discussions with the Mauritanian Government to extend the existing PSCs covering the remaining potential in the area, with the aim of concluding these discussions in 2011. Partners have been undertaking gas development studies for the Banda and Tevet fields, whilst in parallel they have been evaluating the further exploration potential of the areas.

## Middle East-Pakistan

Our Middle East-Pakistan business unit continues to focus on enhancing the value of our Pakistan producing assets by maximising production through exploration and development within the existing fields. We are seeking to extend our presence to new areas in the Middle East through new exploration and by evaluating acquisition opportunities.

### Pakistan

Average production was 14,900 boepd (2009: 15,720 boepd). This was mainly attributed to natural depletion of our gas fields and to some interruptions at the Zamzama field caused by the significant flooding suffered in August 2010. Looking forward, production will be boosted by implementing ongoing front end compression projects, full utilisation of all production facilities, and increased production from the successful exploration and development wells drilled at the Kadanwari field during 2010.

The Qadirpur gas field average production in 2010 was 3,550 boepd (2009: 4,150 boepd). The decrease in 2010 production of 14 per cent was due to natural decline in reservoir pressure. However, after the completion of the installation of front end compressors in October 2010, gas production has been increased from around 480 million standard cubic feet per day (mmscfd) to 600 mmscfd (gross) and this level is expected to be maintained with the installation of additional compressors by the end of 2011. Two production wells (QP-40 and QP-41) were drilled and tied in during the year. Supply of 60 mmscfd permeate gas (a side stream of low heating value gas from process facilities) to local power plants commenced in February 2010 as planned, with the added benefit of simultaneously reducing gas flaring/venting from the facilities.

The Kadanwari gas field average production in 2010 was 1,750 boepd (2009: 1,250 boepd). This increase of 40 per cent was achieved by the drilling and tie-in of two development wells, K-21 and K-23, and two successful exploration wells, K-19 and K-24. Further development and exploration wells are planned for 2011 to maintain production.

The Zamzama gas field average production in 2010 was 6,050 boepd (2009: 6,890 boepd). The lower production was due to natural decline in reservoir pressure, as well as two production wells having to be shut in from September through December 2010 due to the exceptional floods in the area. In order to mitigate natural decline, the major front end compression project (gross capex of US$145 million) is making good progress and is scheduled for completion in June 2011.

The Bhit/Badhra gas fields average production in 2010 was 3,550 boepd (2009: 3,430 boepd). The wellhead compression project, which commenced in 2009, remained on schedule and by the end of 2010 all wells in Bhit were connected to compression.

Field development at Zarghun South was delayed following higher than expected facilities bids. The joint venture now awaits the passing of the impending "Tight Gas Policy" (presently under approval process by the government) to take advantage of higher gas prices. All costs pertaining to Premier's 3.75 per cent interest are carried by the operator.

# Chief Executive's Review (continued)

**Andrew Lodge**
Exploration Director

## EXPLORATION REVIEW

Our exploration strategy, first set out in 2009, envisaged the addition of 200 mmboe of net 2P reserves by 2015. This will be achieved by focusing on geographies and geological themes in which Premier has demonstrable skills and expertise. These are the exploration of rift basins in Asia, North Sea and North Africa, and onshore frontal fold belt provinces as exemplified by our asset base in Pakistan and certain areas of Indonesia. Since 2009, reserves and resources amounting to 56 mmboe have been added towards the 200 mmboe target. With further evaluation and appraisal, we estimate that this could rise to over 100 mmboe of additions.

In 2010, Premier participated in 14 exploration and appraisal wells, of which eight were successful; a success rate of 57 per cent. The most notable successes in 2010 were the three Catcher discoveries in UK Block 28/9, on the western margin of the Central North Sea rift basin. These play-opening successes were followed up by the Varadero discovery at the end of the year. Further wells are planned to test the play in 2011.

In addition to play-opening wells, Premier continues to explore for low risk opportunities adjacent to existing or planned infrastructure, and notable successes were achieved at West Rochelle, near the Scott/Telford facilities in the UK, at Kadanwari in Pakistan and Blåbaer in Norway.

During the year, Premier captured 3,022km$^2$ of net new acreage in the UK (eight licences) and 9,445km$^2$ in Egypt (one licence). Post year-end, two new licences were awarded in Norway. The Egyptian licence, a frontier play in deeper water, is a step change for Premier, but consistent with our rift basin theme. The exploration well in water depth of 700m commenced in December 2010 with the results expected in the second quarter of 2011.

New business activity in central and northeast Africa resulted in the commencement of negotiations for two production sharing agreements offshore Kenya (Blocks L10A and L10B). Premier will have an average 22.5 per cent interest in these blocks.

Premier continues to acquire high-quality datasets in support of exploration and appraisal drilling and in 2010 1,910km$^2$ of 3D seismic data were acquired to advance the interpretation in preparation for 2012 drilling in Vietnam and the UK.

20 exploration and appraisal wells are planned for 2011, inclusive of important play tests in Vietnam, Indonesia and Egypt.

"Since 2009, reserves and resources amounting to 56 mmboe have been added towards the 200 mmboe target. With further evaluation and appraisal, we estimate that this could rise to over 100 mmboe of additions."

## Asia

### Indonesia

On the Premier-operated Tuna Block, final plans were completed for the drilling of two exploration wells, Gajah Laut Utara and Belut Laut, in the first half of 2011. These wells will follow on from the nearby Cá Rồng Đỏ (CRD) appraisal well in the neighbouring Vietnamese block as part of a three well programme using the same drilling rig.

On Natuna Sea Block A, plans were completed for the drilling of two near-field exploration wells, Anoa Deep and Biawak Besar, scheduled for drilling in the third and fourth quarters of 2011. A review is in progress to refine the remaining prospective resource potential of the entire block. This study is set for completion in the first half of 2011, for incorporation into a five-year exploration plan on the block.

On Block A Aceh, plans were completed for the drilling of one exploration well, Matang, scheduled for drilling in the third quarter of 2011.

Elsewhere, on the Buton Block in Sulawesi, plans were finalised for an exploration well, Benteng, now expected to be drilled in the second half of 2011.

### Vietnam

Following the 2009 exploration success at CRD in Block 07/03, Premier integrated the well results into the new 3D seismic data and then sought and obtained Government of Vietnam approval for an appraisal plan for CRD. The first appraisal well on CRD was spudded in February 2011. Continued activity elsewhere on Block 07/03 included the acquisition of 900km$^2$ of new 3D seismic data over the southern part of the block. Interpretation of these data and of the previously acquired data in the east of the block will allow selection of prospects for exploration drilling in 2012.

In Block 104-109/05, offshore northern Vietnam, 445km$^2$ of new 3D seismic data and reconnaissance 2D lines were acquired and interpreted to aid the final selection of the location for an exploration well, planned for the third quarter of 2011.

## North Sea and West Africa

### UK

In April, the Bugle North well was drilled as a joint appraisal well on the boundary of Blocks 15/23c and 15/23d. Premier effectively paid 37 per cent of the joint well cost to earn a 50 per cent equity in 15/23d. The well was targeting the northern extension of the Bugle oil discovery and encountered minor quantities of hydrocarbon, but these are considered insufficient to support a Bugle development at this time.

In May, the Catcher exploration discovery well 28/9-1 (Premier 35 per cent) encountered 80 feet of high-quality oil in the Cromarty reservoir. Catcher East was drilled as a side-track to the main well, approximately 0.5km to the east. This well found hydrocarbons in younger Tay sands which are in communication with the initial discovery in the Cromarty sand. A core recovered 44 feet of net oil-bearing Tay sand with an average porosity of 34 per cent.

A second side-track, Catcher South West, encountered 68 feet of net hydrocarbon pay and a common oil water contact with the Catcher main well.

# Chief Executive's Review (continued)

Phase 2 of the Catcher area exploration began with the drilling of the Varadero well. The initial analysis indicated 84 feet of net hydrocarbon pay in the main Tay sandstones, plus a further 22 feet of net pay in thinner sands above the main Tay sands. The oil is of similar good quality to the Catcher discovery well. Further drilling of the block is planned for the first half of 2011.

Premier concluded drilling operations on the Oates farm-in well 22/19c-6 in August, but logging from the Forties target indicated that no hydrocarbons were present. The well was plugged and abandoned. Premier acquired a 50 per cent equity in 22/19c from the farm-in well. Remaining prospectivity on the block is being evaluated in light of the well result.

In October, Nexen operated the drilling of the joint exploration boundary well between West Rochelle Block 15/26c (100 per cent Endeavour) and 15/26b (Premier 50 per cent). Premier earned 25 per cent of 15/26c by promoting part of the joint well. The well confirmed oil and gas pay in excellent quality Kopervik sandstone reservoir and was subsequently side-tracked up dip. The side-track confirmed the presence of gas-bearing Kopervik sands. The contacts and fluids seen in the West Rochelle primary well and side-track are the same as the Rochelle discovery, suggesting a single field. The Rochelle fields will be tied back to the Scott production facility in which Premier has a 21.83 per cent interest. The first phase of the Rochelle development received government approval in early 2011.

In October, Premier received five licence awards across nine blocks in the UK 26th Round including two as operator. The awards were:

| Block No. | Premier % | Comment |
|---|---|---|
| 14/30b | 50 | West Rochelle/Kildare extension |
| 15/9, 15/10, 15/14, 15/15 | 50 | Fladen Ground Spur margin |
| 15/23g* | 50 | Blackhorse extension |
| 21/7b* | 70 | Typhoon prospect |
| 22/26c, 22/21c (part) | 30 | Two Jurassic prospects |

* Premier-operated

Premier was also awarded exploration acreage in the West Orkney Basin in May, following a UK 25th Round application.

In December, Premier paid US$2.8 million, funding 50 per cent of the cost of a seismic acquisition on the Eagle prospect (licence P1212, Block 15/13b) to earn a 50 per cent interest in the block.

### Norway

The Greater Luno extension well 16/4-5 on licence PL359 (Premier 30 per cent) completed drilling operations in March. The well objective was to test the hydrocarbon potential in Jurassic age sediments and fractured basement. The well was plugged and abandoned as a dry hole. The joint venture has been granted a two-year licence extension to investigate additional prospectivity on PL359.

The Blåbaer PL374S exploration well 34/5-1S (Premier 15 per cent) was drilled in the first quarter of 2010 on an adjacent block to the third party Jordbaer discovery. The well successfully discovered hydrocarbons in the Cook formation and was side-tracked across a bounding fault to test an adjacent fault compartment that was water wet. The well results are being integrated into the regional understanding and a potential appraisal campaign, as part of a tie-back to the neighbouring Jordbaer development, is being evaluated.

The Gnatcatcher PL378 exploration well 35/12-3 commenced on 24 December. The well was drilled to test the Upper Jurassic Sognefjord formation. The well encountered minor hydrocarbon shows and was plugged and abandoned as a dry hole. The joint venture plans to appraise the Grosbeak discovery on this licence in 2011.

Premier was awarded two licences in January 2011, one operated, in response to two applications made in the Norwegian 2010 APA Licence Round. The non-operated licence is an extension of the PL378 licence. The operated licence, Block 2/6 in the southern part of the Norwegian North Sea, contains the Freki prospect.

### Congo

Following the evaluation of the Frida well results (drilled in 2009), and having integrated this with the regional play understanding, the decision was taken at the end of 2010 to withdraw from the Congo Marine IX licence. Premier is currently working with the remaining partners and the Congolese Government to facilitate Premier's withdrawal from the licence.

### SADR

This area remains in force majeure and we await reconciliation of the political situation before progressing further technical evaluation.

## Middle East-Pakistan

### Pakistan

In the first quarter of 2010, the Pirkoh-1 exploration well was drilled in Qadirpur to test the potential of the shallow Pirkoh limestone formation. Logging results showed high water saturation and the well was plugged and abandoned.

Testing of the K-19 step-out well in the Kadanwari area was carried out in January and tied in to the system in March 2010. This well is currently producing around 40 mmscfd and has helped in substantially boosting field production during the year.

In the second half of 2010, a step-out appraisal well, K-25, encountered gas. The decision was taken to side-track the well, which targets the reservoir area outside of the K-25 drilled compartment.

The K18-ST exploration well tested gas at a flow rate of 18 mmscfd with a 42/64" choke at 1,980psi wellhead pressure. Tie-in operations of the K18-ST well have commenced, with gas expected on-stream in the first quarter of 2011.

### Egypt

The award of the South Darag Block in the Gulf of Suez (Premier 100 per cent) awaits formal government approvals.

Premier farmed into the North Red Sea Block 1 in December 2010, taking a 20 per cent interest, and will contribute to the cost of the NRS-2 (Cherry) exploration well. The well will be the first test of a significant deep water play in the northern Red Sea. The drilling of the well commenced in December 2010, with results expected in the second quarter.

Elsewhere in Egypt, Premier continues to review new venture opportunities, consistent with its exploration rift basin theme.

# Financial Review

Tony Durrant
Finance Director

### Economic background

Oil prices strengthened during the course of 2010 as hopes rose of economic recovery, particularly in Asia. Brent crude prices averaged US$79.5/bbl for the year, against US$61.7/bbl in 2009. Premier's portfolio of crudes sells at an average of 20 cents premium to Brent and, taking into account the timing of our crude oil liftings, average actual realisations for the year were US$79.7/bbl (2009: US$66.3/bbl).

Stronger economic conditions in South and South East Asia provided a positive backdrop for our gas operations in these regions. Total gas demand in Singapore, driven by increasing population and new industrial developments, mainly on Jurong Island, rose from 814 BBtud in 2009 to 872 BBtud in 2010. According to independent analysts, it is expected to continue to rise over the next few years, allowing our gas sales to steadily increase above current contracted levels. Though LNG import facilities are now under construction in Singapore, there continues to be good prospects for additional pipeline gas sales in the future. Offtake under our existing gas sales contracts in 2010 averaged 160 BBtud (2009: 153 BBtud) with the share of the Premier-operated Block A rising from 41 per cent to 45 per cent, due to strong production performance from the Anoa field.

In Pakistan, gas remains a critical component of the country's energy needs, meeting around 45 per cent of total energy requirement. Total domestic gas production has remained at around 4 billion cubic feet (bcf) per day and with demand continuing to grow at around 10 per cent per annum, an increasing production shortfall is likely to arise in the coming years. With significant gas reserves remaining, we are well placed to maintain or increase production through additional compression facilities and development drilling.

### Income statement

Production levels in 2010, on a working interest basis, averaged 42.8 kboepd (2009: 44.2 kboepd). On an entitlement basis, which under the terms of our PSCs allows for additional government take at higher oil prices, production was 38.3 kboepd (2009: 40.2 kboepd). Working interest gas production averaged 156 mmscfd (2009: 156 mmscfd) during the year, or approximately 63 per cent of total production. Average gas prices for the group were US$6.26/mscf (2009: US$5.18/mscf). Gas prices in Singapore, which are linked to HSFO pricing, in turn closely linked to crude oil pricing, averaged US$13.9/mscf (2009: US$11.0/mscf) for the year.

> "Profit after tax is a record US$129.8 million. Cash flow from operating activities increased by 25 per cent to US$436.0 million. Our balance sheet and liquidity position remain strong."

**Production**
2008-2012

Total sales revenue from all operations reached record levels of US$763.6 million (2009: US$621.1 million) driven by the higher commodity prices. Cost of sales was US$530.5 million (2009: US$361.4 million). Unit operating costs were US$13.9 per barrel of oil equivalent (boe) (2009: US$12.2/boe) reflecting higher unit costs in the UK sector as production levels declined.

The tie-in in October 2010 of the Burghley field to our Balmoral facility in the UK North Sea will have a positive impact on unit costs during 2011 and beyond as Balmoral complex costs will now be shared pro rata to production levels.

Amortisation and depreciation includes an impairment charge of US$65.3 million relating to the Scott and Balmoral fields in the UK (2009: US$24.0 million for the Chinguetti field in Mauritania) which mainly arose as a result of a significant increase in estimated future decommissioning costs. The charge was calculated using a long-term Brent crude oil price of US$75/bbl (2009: US$70/bbl). Underlying unit amortisation (excluding impairment) rose to US$12.6/boe (2009: US$9.6/boe) largely as a result of increasing future abandonment provisions.

**Reserves and resources**
2006-2010

Exploration expense and pre-licence exploration costs amounted to US$68.2 million (2009: US$57.0 million) and US$18.9 million (2009: US$20.3 million) respectively. This includes the write-off of exploration wells (Oates, Bugle North, Greater Luno) in the UK and Norway sectors. It also includes the effect of an impairment charge of US$12.8 million in respect of the Banda field in Mauritania. Despite extensive discussions with the Mauritanian Government, no agreement has been reached on the nature or terms of a future gas development and it is felt appropriate to write-off capitalised costs relating to this asset.

Net administrative costs were stable at US$18.3 million (2009: US$18.3 million).

Operating profits were US$127.7 million (2009: US$169.7 million). Finance costs and other charges, net of interest revenue and other gains, were US$65.5 million (2009: US$28.7 million) reflecting lower levels of interest income and higher levels of borrowing costs as borrowings from our capital investment programmes increased. Also included in finance costs were fees of US$15.6 million (2009: US$10.5 million) largely relating to the refinancing of US$1.1 billion of Premier's bank facilities in November 2010. The charge arising due to the unwinding of the discounted decommissioning provision increased to US$16.2 million (2009: US$8.7 million) reflecting the increase in total decommissioning provisions.

**Profit after tax**
2006-2010

Pre-tax profits of US$100.8 million (2009: US$79.9 million) also reflect a positive adjustment of US$38.6 million in respect of the group's commodity hedge portfolio (2009: US$61.1 million, charge). This was driven by the unwinding of prior year provisions in respect of our oil and gas hedges.

The current tax charge for 2010 is US$61.4 million, an effective tax rate of 48 per cent of operating profits. This charge is offset by a deferred tax credit of US$90.4 million, resulting in a net tax credit of US$29.0 million (2009: US$33.1 million, credit). The deferred tax credit arises from the setting up of an additional deferred tax asset of US$94.7 million, reflecting higher expected utilisation of UK tax losses in line with generally increased oil prices. As at year-end the group had an estimated US$1,112 million of carried forward UK allowances, of which it is anticipated that US$972 million will be utilised in future years based on a long-term oil price of US$75/bbl. This has resulted in recognition of a total deferred tax asset of US$278.2 million. Profit after tax is therefore a record US$129.8 million (2009: US$113.0 million) resulting in basic earnings per share of 111.9 cents (2009: US$104.1 cents).

### Cash flow

Cash flow from operating activities was US$436.0 million (2009: US$347.7 million) after accounting for tax payments of US$67.9 million (2009: US$71.5 million).

Capital expenditure in 2010 totalled US$514.1 million (2009: US$303.1 million).

# Financial Review (continued)

**Operating cash flow**
2006-2010

| Capital expenditure ($ million) | 2010 | 2009 |
|---|---|---|
| Fields/development projects | **347.1** | 192.5 |
| Exploration | **164.7** | 107.5 |
| Other | **2.3** | 3.1 |
| **Total** | **514.1** | 303.1 |

The principal field and development projects were the Chim Sáo, Gajah Baru and Huntington projects, together with the Balmoral field infill well programme and the abandonment of the UK Shelley field.

### Balance sheet position

Net debt at 31 December 2010 amounted to US$405.7 million (2009: US$315.6 million), with cash resources of US$299.7 million (2009: US$250.6 million). Cash of £43.3 million (US$69.2 million) previously held in an abandonment trust and classified in the balance sheet under trade and other receivables, was released from the trust in December 2010 and replaced by the equivalent sum in letters of credit.

| Net debt ($ million) | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | **299.7** | 250.6 |
| Convertible bonds* | **(220.4)** | (213.2) |
| Other long-term debt | **(485.0)** | (353.0) |
| **Total net debt** | **(405.7)** | (315.6) |

* Convertible bonds have a nominal value of US$250 million, an equity conversion price of £13.56 and a final maturity date of 27 June 2014.

Following a successful refinancing in November 2010, total bank facilities amount to US$1,572 million. As at year-end, drawn borrowings were US$485 million and issued letters of credit and performance bonds were US$185 million. Undrawn facilities were therefore US$902 million, which, together with cash on hand, amounted to US$1,202 million.

### Financial risk management

### Commodity prices

The Board's commodity pricing and hedging policy continues to be to lock in oil and gas price floors for a proportion of expected future production at a level which ensures that investment programmes for sanctioned projects are adequately funded. Floors are purchased for cash or via collars, funded by selling caps at a ceiling price. This policy has provided sensible downside protection for the company over the period since 2008 and going forward to 2012, during which period over US$1 billion will have been invested in new development projects. The requirement for future hedging for 2013 and beyond will be considered as new projects are sanctioned, taking into account expected future cash flows of the group and the size of the relevant investment programme.

At year-end, a total of 5.0 million barrels (mmbbls) of Dated Brent oil were hedged via collars for the period to end 2012 with an average floor price of US$47/bbl and an average cap of US$87/bbl. This volume represents approximately 26 per cent of the group's expected liquids production over the period. 282,000 metric tonnes (mt) of HSFO, which drives our gas contract pricing in Singapore, was subject to collars covering the period to mid-2013. These have a cap of US$500/mt (equivalent to around US$85/bbl) and represent around 19 per cent of our expected Indonesian gas production over the same period.

During 2010, oil price collars for 3.2 mmbbls and fuel oil collars for 120,000 metric tonnes expired at a cost of US$2.7 million (2009: US$nil). In addition, forward sales of 0.4 mmbbls, transacted at the time of the Oilexco acquisition in May 2009, and a further 1.0 mmbbls sold forward in 2010, also matured, with a cash cost of US$5.4 million. No forward sales were outstanding at year-end.

Oil hedges are now incorporated within the pricing terms of physical offtake agreements, avoiding the requirement to revalue the outstanding hedges. A credit of US$18.2 million (2009: US$8.5 million) arises in respect of past mark to market provisions for oil hedges which have now expired.

Gas price hedging is still required to be marked to market as the hedges are held by counterparties independent of physical product sales. A credit of US$20.4 million (2009: US$26.9 million, charge) arises in respect of such mark to market movements, resulting in a total credit to the income statement of US$38.6 million in respect of commodity contracts (2009: US$61.1 million, charge).

Foreign exchange
Premier's functional and reporting currency is US dollars. Exchange rate exposures relate only to local currency receipts and expenditures within individual business units. Local currency needs are acquired on a short-term basis. The group recorded a loss of US$0.4 million on such short-term hedging during 2010 (2009: US$2.8 million, gain).

Interest rates
Although the group's borrowing facilities are defined in floating rate terms, substantially all current drawings effectively have been converted to fixed interest rates using the interest rate swap markets, given the very low level of fixed interest rates available relative to historical rates. On average, therefore, the cost of drawn bank funds for the year was 5.2 per cent. Mark to market movements on these interest rate swaps amounted to US$12.1 million (2009: US$0.8 million), charged to other comprehensive income.

Cash balances are invested in short-term bank deposits and AAA rated liquidity funds, subject to Board approved limits and with a view to minimising counterparty risks.

Insurance
The group undertakes a significant insurance programme to reduce the potential impact of the physical risks associated with its exploration, development and production activities. In addition, business interruption cover is purchased for a proportion of the cash flow from producing fields.

Going concern
The group monitors its capital position and its liquidity risk regularly throughout the year to ensure that it has sufficient funds to meet forecast cash requirements. Sensitivities are run to reflect latest expectations of expenditures, forecast oil and gas prices and other negative economic scenarios in order to manage the risk of funds shortfalls or covenant breaches and to ensure the group's ability to continue as a going concern.

Despite economic volatility, the directors consider that the expected operating cash flows of the group and the headroom provided by the available borrowing facilities gives them confidence that the group has adequate resources to continue as a going concern. As a result, they continue to adopt the going concern basis in preparing the 2010 Annual Report and Financial Statements.

**Business risks**
Premier is an international business which has to face a variety of strategic, operational, financial and external risks. Under these distinct classes, the company has identified certain risks pertinent to its business including: exploration and reserve risks, loss of key human resources, drilling and operating risks, security risk in area of operations, costs and availability of materials and services, economic and sovereign risks, market risk, foreign currency risk, loss of or changes to production sharing or concession agreements, joint venture or related agreements, and volatility of future oil and gas prices.

Effective risk management is critical to achieving our strategic objectives and protecting our assets, personnel and reputation. Premier manages its risks prudently by maintaining a balanced portfolio, through compliance with the terms of its agreements and strict application of appropriate policies and procedures, and through the recruitment and retention of highly skilled individuals throughout the organisation. Further, the company has mitigated risks by focusing its activities mainly in known hydrocarbon basins in jurisdictions that have previously established long-term oil and gas ventures with foreign oil and gas companies, existing infrastructure of services and oil and gas transportation facilities, and reasonable proximity to markets.

A summary of the principal risks facing the company and the way in which these risks are mitigated is provided on the company's website (www.premier-oil.com).

# Key Performance Indicators

Premier measures its performance through seven key performance indicators (KPIs) that are aligned with our strategy of achieving continuous growth in the business. Three KPIs (LTI and RWDC frequency, production and cash flow from operations) are linked to the bonus element of the executive directors' and management's remuneration.

| | 2010 | 2009 | Change: improvement/ (deterioration) |
|---|---|---|---|
| LTI/RWDC frequency* | **1.70** | 0.55 | (1.15) |
| Production (kboepd) | **42.8** | 44.2 | (1.4) |
| Cash flow from operations ($ million) | **436.0** | 347.7 | 88.3 |
| Operating cost per boe ($) | **13.9** | 12.2 | (1.7) |
| Gearing** | **35.9%** | 32.5% | (3.4%) |
| Realised oil price per barrel ($) | **79.7** | 66.3 | 13.4 |
| Realised gas price per mscf ($) | **6.26** | 5.18 | 1.08 |

* Lost time injuries (LTI) and restricted workday cases (RWDC) per million man-hours worked.
** Gearing is net debt divided by net assets.

### Lost time injuries (LTI) and restricted workday cases (RWDC)
Historically we have consistently out-performed our annual LTI/RWDC frequency targets. In 2010, for the first time in seven years, we under-performed against these targets. This was largely due to an increased number of relatively minor restricted workday cases many of which were hand injuries. Premier has since introduced a "hands-off loads" initiative on all of its contracted drilling rigs that prohibits lifting and rigging crews from handling suspended loads without the use of "push-pull" sticks or tag lines at all times.

### Production
Average working interest production for the full-year was 42.8 kboepd (2009: 44.2 kboepd). This was lower than that achieved in 2009 due to unplanned maintenance requirements on UK North Sea fields in the Balmoral, Scott and Wytch Farm areas and due to some flooding-related downtime at the Zamzama field in Pakistan.

### Cash flow from operations
Cash flow from operating activities was US$88.3 million higher at US$436.0 million due to higher realised oil and gas prices which were partially offset by lower production.

### Operating cost
Unit operating costs were US$13.9/boe (2009: US$12.2/boe) reflecting higher unit costs in the UK sector as production levels declined.

### Realised oil and gas prices
Premier's portfolio of crudes was sold at an average of 20 cents premium to Brent and average actual realisations for the year were US$79.7/bbl (2009: US$66.3/bbl). Realised average gas prices, a significant portion of which tracks oil price movements, were also 21 per cent higher at US$6.26/mscf (2009: US$5.18/mscf).

# Social Performance Review

Premier is committed to applying the high ethical standards necessary to maintain our reputation as a world-class operator in oil and gas. Our reputation for doing the right thing enables us to access new licences, enter new countries, build lasting relationships with local communities and ultimately secure the licence to operate. We have policies and procedures in place to ensure that our investment and operational decisions take appropriate account of the impacts that might arise from our activities.

Premier carries out independent audits of its policies to ensure compliance with the requirements of the following bodies: the Global Reporting Initiative; the International Petroleum Industry Environmental Conservation Association (IPIECA) Oil and Gas Industry Guidance on Voluntary Sustainability Reporting 2010; the Carbon Disclosure Project; FTSE4Good; and the United Nations Global Compact (of which Premier is a signatory).

Our last report identified areas for improvement relating to policy statements on political donations, a global pay and benefits framework, security services and human rights, as well as aspects of community engagement including prior and informed consultation and the existence of appropriate grievance mechanisms. Steps were taken in 2010 to strengthen existing policies and underlying management systems, as well as our alignment with global standards. Disclosure of our performance in this area and for all of the commitments made in 2009 is presented in our Social Performance Report 2010.

We report below on how we have evolved, applied and delivered on our stated policies in 2010, and we explain any areas where we have not complied.

Further details on our policies and procedures are available on our website (www.premier-oil.com).

**Social responsibility**
Social responsibility is primarily about how we engage, assess and manage our community and societal issues and risks. Our corporate social responsibility and human rights policies are applicable to all Premier-operated entities and may be adapted to address local priorities. Our code of conduct, business ethics and conduct policy and employment policy are managed through the legal and human resources functions respectively. All policies are compliant with relevant legislation and take due account of appropriate initiatives and standards, industry guidance and relevant best practice.

**Corporate social responsibility policy**
We recognise that we have responsibilities to a diverse group of stakeholders including shareholders, customers, employees, business partners, local communities and society at large, including special interest groups that represent public interest concerns. Our investment decisions take account of economic, environmental and social impacts and their management.

In all its operations, Premier will always comply with local laws and regulatory requirements as a minimum, and make representations to the relevant authorities if we believe that policies and practices of host governments undermine our policies. We complete environmental and social impact assessments prior to undertaking any new investment and evaluate these impacts regularly to ensure that they are responsibly managed on an ongoing basis. We expect our contractors, suppliers, joint venture and alliance partners to respect our policies. Their concurrence with the principles upheld by our policies is an important factor in our decision to form or remain in a relationship with them.

# Social Performance Review (continued)

It is our policy to support social investment that contributes to the sustainable development goals of the communities and countries where we operate. This means working in partnership with professional social development organisations, government agencies and local non-governmental organisations to ensure our investment addresses relevant and material issues in a rigorous manner with positive impacts on society. Our investment focuses mainly on the delivery of local infrastructure, disaster relief and the well-being of local communities.

There were no reported non-compliances with this policy in the review period.

**Human rights policy**

Human rights policy is based on the fundamental rights pronounced in the Universal Declaration of Human Rights and is guided by those rights enshrined in the core labour conventions of the International Labour Organisation. These rights are to be protected and promoted throughout Premier's business operations and in our relations with both business and local community partners. The scope of our policy includes the rights of our employees – and their health and safety as well as their security arrangements and working conditions – and the development rights of our external stakeholders, in particular local communities. Where appropriate, we will also use our legitimate influence to promote the protection of human rights outside of our areas of operation.

There were no reported violations of this policy in the review period.

**Employment policy and social justice in the work place**

We aim to provide our staff with safe working conditions as well as just and competitive terms of employment. This means respect for the individual regardless of ethnic origin, creed, age or gender. We are an equal opportunities employer. We aim to recruit, train and promote from within the country of operation. We respect the right of individual employees to join a legitimate trade union. Through training and appraisal we encourage staff to develop their own professional skills to the mutual advantage of both the individual and the company.

Any employee who has a concern regarding the application of this policy should make use of the company's grievance policy.

All employees must:

- co-operate with any measures introduced to ensure equal opportunity;
- report any suspected discriminatory acts or practices;
- not induce or attempt to induce others to practice unlawful discrimination;
- not victimise anyone as a result of them having reported or provided evidence of discrimination;
- not harass, abuse or intimidate others on account of their race, creed, colour etc; and
- not canvass job applicants in an attempt to discourage them from applying or taking up a post.

Where there has been a clear breach of the equal employment opportunities policy, disciplinary procedures will follow. Serious offences will be dealt with as gross misconduct.

There were no reported violations of our employment policy in 2010. There were also no reported incidents of discrimination or formal grievance procedures reported in 2010.

**Our global code of conduct**

Integrity, honesty and fairness are fundamental to the way we conduct our business. We are committed to transparency in all our dealings. As part of this commitment, we will not engage in any activities that undermine the legitimate business environment, including bribery or corruption in any form.

Premier has developed a global code of conduct that supports the existing business ethics and conduct policy. The new code of conduct continues to be informed by and is compliant with the Bribery Act 2010 and its evolving guidance in the United Kingdom. It applies to all employees at every level in the business and all those associated with Premier, all of whom are required to behave ethically and with personal integrity. This includes adhering to laws in the countries where we operate, performing our duties in accordance with the code of conduct and disclosing all potential and actual conflicts between personal interests and those of Premier.

The code of conduct covers the following key issue areas:

- anti-bribery;
- gifts and hospitality;
- charitable and political donations;
- intermediaries; and
- facilitation payments.

Premier prohibits bribery and corruption in any form by all employees and by those working for and/or connected with the business. This includes facilitation payments. Premier avoids accepting hospitality or gifts that might place it under an obligation. All business transactions must be properly recorded and accounted for. We expect the same ethical standards to be applied in all our business relationships in all areas of operation and we promote our code of conduct and associated anti-bribery policy with all our business associates. Employees are expected to report bribery or attempted bribery to their line managers, even if only suspected or attempted.

Premier encourages employees, contractors and agency workers to voice their concerns to line managers if they feel the company or anyone working on behalf of the company has not acted in accordance with our code of conduct and associated policies. Premier provides a confidential third party reporting hotline for employees that feel unable to raise concerns in the normal way. This hotline is available 24 hours a day, seven days a week. No reports were made through this service in 2010 or at any point over the last three years.

No incidents of corruption or non-compliance with these policies were identified in 2010.

**Health, safety and environment policy**

Premier is committed to operating responsibly and will never knowingly compromise our health, safety or environmental standards to meet our operational objectives.

Our goals are to ensure the safety of everyone involved with our operations and to protect the environment.

To achieve this we will:

- encourage open and honest communication;
- seek ways to continually improve our performance;
- assess and manage risks;
- provide appropriate resources;
- maintain clean, safe and healthy workplaces;
- investigate and learn from any incidents;
- plan and prepare for potential emergencies;
- maintain high-quality documented systems and processes;
- seek external certification of key management systems; and
- meet or surpass statutory requirements.

In 2010, Premier implemented and communicated a new health, safety and environment (HSE) policy at all operations worldwide. This policy was developed as part of our planned review and continuous improvement process. It is the responsibility of everybody involved in Premier to comply with our policies and to assist the company in their implementation.

**Occupational health and safety performance**

In 2010, we worked 8.8 million man-hours (0.7 million in drilling). This represents a 132 per cent increase on the previous year (2009: 3.8 million man-hours of which 0.25 million were in drilling) and is mainly due to the ongoing construction of our Gajah Baru and Chim Sáo operations in Indonesia and Vietnam respectively. Most of these man-hours (7.7 million) were worked by contractors on our operations.

| Key safety parameters and indicators | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Fatalities | **1** | – | – | 1 | 1 |
| Lost time injuries (LTI) | **5** | 2 | 1 | 2 | 3 |
| Restricted workday cases (RWDC) | **9** | – | – | 4 | – |
| LTI/RWDC frequency* | **1.70** | 0.55 | 0.40 | 1.86 | 1.27 |
| High potential incident frequency* | **1.59** | 2.10 | 2.00 | 5.50 | 3.50 |
| Total recordable injuries frequency (TRIF)* | **2.84** | 1.10 | 0.80 | 3.40 | 2.50 |

* per million man-hours worked.

Note: All safety statistics include both Premier employees and contractors.

# Social Performance Review (continued)

**High potential incidents**

This last year saw a net reduction in high potential incidents per million man-hours from 2.10 to 1.59. The reduction in frequency, despite a small increase in the number of incidents, was largely due to the additional man-hours accrued in the construction of our Gajah Baru and Chim Sáo operations.

**Total recordable injuries**

As a group we have consistently out-performed our annual LTI/RWDC frequency targets. In 2010, for the first time in seven years, we under-performed against these targets. This was largely due to an increased number of relatively minor RWDCs, many of which were hand injuries. Premier has since introduced a "hands-off loads" initiative on all of its contracted drilling rigs that prohibits lifting and rigging crews from handling suspended loads without the use of "push-pull" sticks or tag lines at all times. Armoured gloves were also introduced on all drilling operations.

There was, however, one very unfortunate fatality amongst our contracted workforce at the Chim Sáo drilling operations in Vietnam. This represents a totally unacceptable lapse in performance and we extend our most sincere condolences to family, friends and colleagues of the deceased. The fatality was thoroughly investigated by Premier, the contracting companies as well as the relevant authorities, and analysed to establish both cause and remedy. All remedial actions are being tracked by our HSE departments with ongoing reporting on progress to our Executive Committee and the Board.

Premier has been certified to OHSAS 18001 and ISO 14001 since 2004 for global drilling and since 2006 for our Indonesian production operations. In 2010, we completed a number of OHSAS 18001 and ISO 14001 surveillance and certification audits on our production and drilling operations. Global drilling and Indonesia production retained their certifications. Balmoral retained ISO 14001 and gained OHSAS 18001. Our future production operations in Indonesia (Gajah Baru) and Vietnam (Chim Sáo) have completed pre-operational pre-assessment audits with a view to being OHSAS 18001 and ISO 14001 compliant when they start producing in 2011.

**Process safety performance**

Process safety focuses on the design and engineering of facilities to prevent fires, explosions or accidental chemical releases, as well as maintenance and operation. Premier integrates process safety protocols into the project safety reviews (PSRs) of all its projects. These reviews provide assurance that material HSE issues have been identified and are being effectively managed throughout the project lifecycle. A typical project lifecycle will require six strategic reviews as a project moves from concept to construction and to operation. These PSRs align closely with our project approval gates, at which time strategic decisions are made to either progress a project further towards the operations stage or to delay or divest.

Safety cases are in place at Anoa in Indonesia and Balmoral in the North Sea as well as at our assets still in the construction and installation stage, i.e. Gajah Baru and Chim Sáo. This safety case regime is aligned with the regulated standards in the United Kingdom. We believe this represents best practice, and it is our policy to have United Kingdom style safety cases in place for all our operated production facilities worldwide, even when they are not required by the local regulatory regime. Safety cases are developed during the project and become increasingly detailed as a project nears the operation stage. Safety cases must be in place before production commences.

During 2010, there were no reported loss of primary containment (LOPC) events of "greater consequence" (as defined in the IPIECA Oil and Gas Industry Guidance on Voluntary Sustainability Reporting 2010). Such incidents are characterised as unintended process safety events with severe consequences. These can include multiple fatalities, widespread environmental impact and/or significant property damage. There were 18 LOPC events of "lesser consequence" reported, which includes five gas leaks and 13 minor spills as outlined below and in our Social Performance Review 2010.

### Environmental performance

Environmental assessment, management and reporting forms a major part of Premier's HSE risk management process. We conduct baseline surveys and environmental and social impact assessments for each new operated activity. This involves an assessment of the physical, socio-economic and biological environments including biodiversity. We measure and review each impact in turn and gauge both its significance and how it can be reduced to as low as reasonably practicable (ALARP) by adopting best available techniques, in line with our internal environmental ALARP process. Potential actions to improve environmental performance are screened based on cost, duration and impact to determine which are reasonably practicable for implementation. We periodically review these environmental impacts and actions for our existing facilities to ensure we comply with our policy of continuous improvement.

### Environmental indicators and targets

We report our environmental performance in line with the IPIECA Oil and Gas Industry Guidance on Voluntary Sustainability Reporting 2010. We then benchmark our performance by contributing data to an industry database compiled and published by the International Association of Oil and Gas Producers. As an oil company with production facilities in the North Sea, we also participate in the European Union Emissions Trading Scheme and submit an annual, externally-verified report on our emissions profile to the Department of Energy and Climate Change (DECC).

| Key environmental parameters and indicators | **2010** | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Greenhouse gases (tonnes per thousand tonnes of production) | **185** | 171 | 167 | 171 | 232 |
| Oil spills (tonnes) | **1.3** | 1.5 | – | 13.7 | 3.9 |
| Oil in produced water (parts per million) | **11** | 19 | 23 | 20 | 21 |
| Energy use (gigajoules per tonne of production) | **2.1** | 1.7 | 2.0 | 1.8 | 1.9 |

### Climate change and greenhouse gas emissions

Greenhouse gas emissions associated with hydrocarbon combustion at our operated assets amounted to 350,000 tonnes in 2010 (2009: 300,000 tonnes). This increase in absolute emissions from 2009 was largely due to the inclusion of our North Sea assets for the first full calendar year. These operations (Balmoral and Shelley) were added in May 2009. Shelley ceased production in mid-July 2010. Our operated emissions intensity increased slightly to 185 tonnes per thousand tonnes of production (2009: 171 tonnes per thousand tonnes of production).

We calculate our greenhouse gas ($CO_2$ equivalent) emissions both for operated assets and on an equity basis for production across our global portfolio. Greenhouse gas emissions from flaring and fuel gas combustion associated with our full equity portfolio amounted to 155 tonnes per thousand tonnes of production (2009: 149 tonnes per thousand tonnes of production).

### Spills and discharges

The total volume of produced water discharged from our operations in 2010 amounted to 2,900,000 tonnes (2009: 1,800,000 tonnes). This increase was largely due to the first full-year of accounting for our North Sea operations. Despite the increase in absolute produced water discharges, the average oil in produced water declined significantly from 19 parts per million (ppm) in 2009 to 11 ppm in 2010. This reduction in the oil concentration of produced water can be attributed to improvements in the treatment process, which has optimised the performance of the equipment and chemicals used to remove oil from produced water before discharge.

There were 13 spills (losses of primary containment) in 2010, including seven hydrocarbon spills to the environment (2009: seven). All of these spills were minor in nature with the total volume amounting to 1.3 tonnes (2009: 1.5 tonnes). This reflects the additional steps taken to prevent and respond to oil spills, including regular pollution prevention audits and an independent review of our Anoa oil spill contingency plan. We maintain oil spill contingency plans for each of our operations and have ongoing contracts with oil spill response specialists to provide support in the unlikely event of a major incident. Six other minor chemical spills occurred in 2010 (total 6.9 tonnes) with the majority release (6.6 tonnes) being as calcium chloride (salts) discarded into the sea.

# Board of Directors

Robin Allan, Joe Darby, Tony Durrant, Neil Hawkings

Jane Hinkley, David Lindsell, Simon Lockett, Andrew Lodge

John Orange, Professor David Roberts, Michel Romieu, Mike Welton

Robin Allan (51), joined Premier from Burmah Oil in July 1986, working initially as a geologist. After technical and new venture roles he spent six years in South East Asia, initially managing Premier's Asian existing and new venture business and later becoming Premier's Country Manager in Indonesia. He became a member of the Premier Board in December 2003 as Director of Business Development. Mr Allan returned to Asia in 2009 as Director – Asia, and manages the Asian portfolio from the Singapore office.

Joe Darby (62), joined Premier's Board as a non-executive director in September 2007. Mr Darby has over 40 years of experience in the energy sector, including eight years with Shell Petroleum before becoming Managing Director of Thomson North Sea Ltd. He has held a number of senior roles, including Chief Executive, with LASMO plc. Mr Darby is a non-executive director of Nordaq Energy Inc and Alkane Energy plc, and has held non-executive roles at British Nuclear Fuels plc, Mowlem plc and Centurion Energy Inc. He was Chairman of Mowlem plc (2005-2006) and Faroe Petroleum plc (2003-2007). Mr Darby is a member of Premier's Audit and Risk, Remuneration and Nomination Committees.

Tony Durrant (52), joined Premier in June 2005. After qualifying as a chartered accountant with Arthur Andersen, he joined Lehman Brothers in London, initially as an oil sector analyst. He joined the investment banking division of Lehman in 1987 and from 1997 was a Managing Director and Head of the European Natural Resources Group. In this role, he managed both client relationships and numerous transactions for a variety of European and North American clients. He joined the Premier Board in July 2005 as Finance Director.

Neil Hawkings (49), joined Premier in May 2005 after more than 20 years with ConocoPhillips where he worked in a variety of engineering, commercial and management roles around the world, undertaking assignments in the UK, Dubai and Indonesia. He joined the Premier Board in March 2006 as Operations Director.

Jane Hinkley (60), joined Premier's Board in September 2010 as a non-executive director. Ms Hinkley is a member of the Remuneration and Nomination Committees. She is a qualified chartered accountant with executive experience primarily in international shipping. She has held managing directorships at Navion Shipping AS and Gotaas-Larsen Shipping Corporation. She has been an independent director on the board of Teekay GP LLC, an international provider of marine transportation services for LNG, LPG and crude oil, since 2005 and also previously held the position of non-executive director of Revus Energy ASA, a Norwegian exploration and production company.

David Lindsell (63), joined Premier's Board in January 2008 as a non-executive director. He was a partner at Ernst & Young LLP for nearly 30 years and has extensive experience across a range of industry sectors, with a strong knowledge of the oil and gas sector. Mr Lindsell is currently a non-executive director of Drax Group plc and Gartmore Group Ltd and is Deputy Chairman of the Financial Reporting Review Panel. Mr Lindsell is the Chairman of Premier's Audit and Risk Committee and a member of the Remuneration and Nomination Committees.

Simon Lockett (46), Chief Executive, joined Premier in January 1994 from Shell and has worked in a variety of roles for Premier, including the management of investor relations, as Commercial Manager in Indonesia and as Country Manager in Albania. He became a member of the Premier Board in December 2003 as Operations Director. He was appointed Chief Executive in March 2005. Mr Lockett is a member of Premier's Nomination Committee.

Andrew Lodge (54), has been Exploration Director of Premier since April 2009. Prior to joining Premier, Mr Lodge was Vice President – Exploration at Hess, where he was responsible for Europe, North Africa, Asia and Australia for nine years. Previously, he was Vice President – Exploration, Asset Manager and Group Exploration Advisor for BHP Petroleum, based in London and Australia. Prior to joining BHP Petroleum, Andrew worked for BP as a geophysicist.

John Orange (68), joined Premier's Board as a non-executive director in February 1997. He held a variety of senior international management and legal posts during his 30 years with the BP Group. Mr Orange was Chairman of Exile Resources Inc from 2009 to 2010 and is currently a director of Vostok Energy, an independent upstream gas and oil exploration, development and production company. He is Premier's senior independent non-executive director, Chairman of the Remuneration Committee and a member of the Audit and Risk and Nomination Committees.

Professor David Roberts (67), joined Premier in June 2006 as a non-executive director. Professor Roberts has over 30 years experience in all aspects of exploration worldwide and extensive knowledge of deep water areas, sedimentary basins, stratigraphy and prospect assessment. He spent 22 years with BP in a number of technical roles, including Global Exploration Adviser and Distinguished Exploration Adviser. Professor Roberts is a non-executive director of GETECH plc and Medserv plc and has established his own geoscience consultancy. He is a visiting professor and fellow of Royal Holloway, University of London, the University of Southampton and IFP School in Paris. Professor Roberts is a member of Premier's Remuneration and Nomination Committees.

Michel Romieu (71), joined Premier's Board as a non-executive director in January 2008. Mr Romieu has over 30 years experience in the international energy sector, including 25 years with the Elf Group, where he held several senior positions including Chief Executive of Elf UK and the group's gas division. He was elected President of the UK Offshore Operator's Association for the year 1995, and held the position of Director for Gas of CRE, the French energy regulator, from 2000 to 2003. He has established his own consultancy specialising in providing advice to the gas industry, and is a lecturer at the French Petroleum Institute. Mr Romieu is also President of Uprigaz. He is a member of Premier's Audit and Risk and Nomination Committees.

Mike Welton (64), joined Premier's Board in June 2009 as a non-executive director and became Chairman in October 2009. Mr Welton is also Chairman of Southern Water Services Ltd and a director of Morrison Utility Services and High Speed Two, the government-owned LLC set up to examine high speed rail connections between London and the West Midlands. He sits on the advisory board of Montrose Associates. Mr Welton was previously Chairman of Hanson plc (2005-2007), the Turkish/British Business Council and the UK Government's Railway Sector Advisory Group. He was also Chief Executive of Balfour Beatty plc (1999-2004). Mr Welton is the Chairman of Premier's Nomination Committee.

# Corporate Governance Report

## The role of our Board and compliance

The overall purpose of the Board is to represent the company's owners, ensure that the company's strategic objectives are properly pursued and that the major business risks are actively monitored and managed. This goes beyond regulatory compliance and puts the interests of our shareholders as the Board's primary focus.

The company has established procedures and policies to ensure compliance with the Combined Code (the Code). The company has complied throughout the accounting period with provisions set out in Section 1 of the Code, except where reported below. While this is an important exercise, the Board does not believe that good governance can be defined merely in terms of compliance with a set of rules.

## The Board

The Board of Directors comprises the Chairman, Chief Executive, four other executive directors and six independent non-executive directors. Biographical details of each, including membership of Board committees are set out in the Board of Directors section of the Annual Report and Financial Statements. Details of the executive directors' service contracts and the non-executive directors' letters of appointment are laid out in the Remuneration Report.

Premier is an international business which has to manage a variety of political, technical and commercial risks. It is therefore important that the Board contains the appropriate mix of skills and experience to meet these challenges. To this end, the Nomination Committee reviews the structure, size and composition of the Board and where appropriate, makes recommendations to the Board with regard to any adjustments that are deemed necessary. In selecting new directors, the Nomination Committee prepares a description of the role and capabilities required for a particular appointment.

Selection of suitable non-executive directors is a matter for Board approval following recommendations made by the Nomination Committee. Non-executive directors are appointed for a specified time of three years subject to re-election and to Companies Acts provisions relating to the removal of a director. The terms and conditions of their appointment are made available for inspection. Letters of appointment do not specifically set out expected time commitment as this may vary considerably. However, all non-executive directors undertake that they will have sufficient time to meet what is expected of them and any significant commitments are disclosed to the Board prior to appointment. Changes to such commitments are disclosed to the Board on an ongoing basis.

The non-executive directors bring independent judgement to bear on issues of strategy, performance and resources, including key appointments and standards of conduct.

We require that our non-executive directors are free from any relationship or circumstances that could materially interfere with the exercise of their independent judgement. The Board has determined that each of the non-executive directors, with the exception of the Chairman, is independent.

New directors to the company receive a full induction to the company. This consists of information covering the operations of the Board as well as meetings with the Board, Chief Executive and other executive directors. All non-executives have direct contact with the company's senior executives between Board meetings and also visit the company's operations in order to familiarise themselves with its activities and to meet and engage with staff. Shareholders are given the opportunity to meet with new directors upon request or at the next Annual General Meeting (AGM) following their appointment.

The company has directors' and officers' liability insurance in place, and details of the policy are given to new directors on appointment.

Matters Reserved for Board Decision are laid down in writing, including the appointment of the Company Secretary who is responsible for ensuring that Board procedures and rules are applied. A copy of the Matters Reserved for Board Decision can be found on the company's website (www.premier-oil.com). Formal procedures are in place to enable individual Board members to take independent advice where appropriate.

The Board is responsible for overall group strategy, acquisition and divestment policy, approval of major capital expenditure projects, the overall group debt and equity structure and consideration of significant financing matters. The Board has continued to focus its efforts in 2010 on strategic issues which will create shareholder value, monitoring performance against agreed objectives and planning future business opportunities.

The Board meets at least eight times each year and in addition a regular update conference call takes place in the months when no formal meeting is scheduled. The agenda for each Board meeting is set by the Chairman in consultation with the Chief Executive and the Company Secretary. Board members receive a monthly report of the company's activities which incorporates an update on progress against objectives and the management of business risks.

Formal procedures are in place to ensure the Board's powers of authorisation of conflicts or potential conflicts of interest of directors are operated effectively. The Board determined that during 2010 these procedures were enforced and adhered to appropriately.

### The Chairman
The Chairman's role is part-time and he is a non-executive director. His key responsibility is the leadership of the Board, ensuring its effectiveness on all aspects of its role and setting its agenda. Between Board meetings the Chairman is responsible for ensuring the integrity and effectiveness of the Board/Executive relationship. This is effected through regular contact with the Chief Executive between Board meetings, as well as contact with other Board members, shareholders, joint venture partners and host governments. The Chairman and the non-executive directors meet periodically without the executive directors present and the non-executive directors meet once a year without the Chairman.

The roles of Chairman and Chief Executive are separate and their responsibilities are clearly established, set out in writing and agreed by the Board.

Mr M W Welton also chairs the board of Southern Water Services Ltd.

### Senior independent director
Mr J R W Orange is Chairman of the Remuneration Committee and the company's senior independent non-executive director. He is available to shareholders who have concerns that cannot be resolved through discussion with the Chairman or Chief Executive.

Whilst Mr J R W Orange's service on the Board exceeds the term of nine years suggested by the Code, the Board considers that as a result of his experience, his long-term perspective of Premier's business and his independence of spirit and objectivity of mind, his contributions are of great value as an independent director.

### Re-election of directors
The Company's Articles of Association require those directors who have been appointed since the last AGM, and those who have held office at the time of the two preceding AGMs and who did not retire at either of them, to retire at the next AGM. In addition, any non-executive director having held office for more than nine years is subject to re-election on an annual basis. However, in accordance with best practice for FTSE 350 companies as published in the Financial Reporting Council's UK Corporate Governance Code, directors will stand for annual re-election by shareholders.

### Board committees
The Board has established Audit and Risk, Remuneration and Nomination Committees. Each committee has formal terms of reference approved by the Board which can be found on the company's website (www.premier-oil.com). The Company Secretary provides advice and support to the Board and all Board committees. Board committees are authorised to engage the services of external advisers as they deem necessary.

The number of meetings of the Board and its committees during 2010, and individual attendance by directors, is shown below:

| | Board | Audit and Risk | Remuneration | Nomination |
|---|---|---|---|---|
| **Number of meetings** | **8** | **4** | **7**[1] | **2** |
| **Attendance:** | | | | |
| R A Allan | 8/8 | – | – | – |
| J Darby | 8/8 | 4/4 | 6/7 | 2/2 |
| A R C Durrant | 8/8 | – | – | – |
| N Hawkings | 8/8 | – | – | – |
| I J Hinkley[2] | 3/3 | – | 2/2 | 1/2 |
| D C Lindsell | 8/8 | 4/4 | 6/7 | 2/2 |
| S C Lockett | 8/8 | – | – | 2/2 |
| A G Lodge | 8/8 | – | – | – |
| J R W Orange | 8/8 | 4/4 | 7/7 | 2/2 |
| Professor D G Roberts | 8/8 | – | 7/7 | 2/2 |
| M Romieu | 8/8 | 4/4 | – | 2/2 |
| M W Welton | 7/8 | – | – | 2/2 |

Notes:
1. There were six scheduled meetings of the Remuneration Committee during the year. The remaining meeting (only attended by Mr J R W Orange and Professor D G Roberts) was called to approve the detail of arrangements approved in principle by a prior scheduled meeting of the Remuneration Committee.
2. Ms I J Hinkley was appointed to the Board and the Remuneration and Nomination Committees on 1 September 2010.

### Executive Committee
The Board has delegated the day-to-day running of the group to the Chief Executive who has established an Executive Committee to assist him in this role. The Committee is made up of each of the executive directors and the Company Secretary. The Executive Committee is chaired by the Chief Executive.

# Corporate Governance Report (continued)

The responsibilities of the Executive Committee include the development of group strategy for approval by the Board, portfolio management and the delivery of performance against the targets set by the Board. At its meetings it reviews health, safety, environmental and security performance and operational business performance reports.

Three regional business units – North Sea and West Africa, Middle East-Pakistan and Asia – manage the geographical spread of business in the group. Each business unit is headed by a regional business unit manager who delivers against specific strategies and performance targets set by the Executive Committee.

## Internal control

The Board is responsible for developing, maintaining, and regularly reviewing the group's system of internal controls. This system is designed to meet the particular needs of the group but by their nature can only provide reasonable but not absolute assurance against material misstatement or loss. The key procedures in the control system have been in place for the year under review and up to the date of approval of the Annual Report and Financial Statements.

*Management of business risks* – This is an ongoing process, in accordance with best practice, that identifies, evaluates and manages risks faced by the group. This is based on each business unit and corporate function producing a risk matrix which identifies the key business risks, the probability of those risks occurring, their impact if they do occur and the actions being taken to manage those risks to the desired level. Risk acceptance and reduction objectives are defined with particular attention given to safety and environmental factors, and applied to ensure that the risks are at a level that is as low as reasonably practicable.

The directors receive assurance directly from the business units and functional management through the completion of annual declarations confirming compliance with the group's policies, procedures and risk management processes. These processes are designed to manage rather than eliminate risk of failure to achieve business objectives.

*Monitoring* – A business management system (BMS) is in force which regulates a wide range of day-to-day activities both in the UK and overseas offices, including environmental controls, health and safety regulations and political risks. Part of this BMS is a documented review and assurance activity, which deals with the risk review and audit processes. The purpose of the risk review process is to identify the significant risks to the business, rate them consistently, and ensure that mitigating measures are in place to manage them. The purpose of the audit process is to ensure that the policies and procedures within the BMS are being adhered to and that a process of continuous improvement and update ensues. In April 2010, a full-time Group Audit and Risk Control Manager was appointed internally from the senior management team and has assumed accountability for the overall running of the process, with the Group Financial Controller remaining specifically responsible for the financial aspects.

The effective operation of internal control procedures is reviewed by planned audits. In addition, where we are the operator, audits of joint venture operations are carried out by our joint venture partners. Where one of our partners is the operator, we participate in audits of these joint venture partners.

A process of business control reviews has been developed and implemented across the group. This process is designed, inter alia, to provide assurance to the Board that Premier is embedding effective risk management into its operations. Significant findings from each review are presented to the Audit and Risk Committee. A rolling three-year plan to cover all operations is in place.

During 2010, a number of financial control and operational reviews were carried out. All recommended actions following these reviews are being implemented.

During 2010, the key business risks and internal control weaknesses identified were formally discussed by the Executive Committee and the Board on a periodic basis. This process will continue during 2011.

The Board receives regular reports on any major problems that have occurred and how the risks have changed over the period under review.

*Management structure* – The Board has overall responsibility for the group and there is a formal schedule of matters specifically reserved for decision by the Board. Each executive director has been given responsibility for specific aspects of the group's affairs. The executive directors together with the Company Secretary constitute the Executive Committee which normally meets weekly.

*Delegation of authority* – Responsibility levels are communicated throughout the group as part of corporate accounting and through an authorisation manual which sets out, inter alia, delegated authority levels, segregation of duties and other control procedures.

*Quality and integrity of personnel* – The integrity and competence of personnel is ensured through high recruitment standards and subsequent training.

*Budgetary process* – There is a comprehensive budgeting system with an annual budget approved by the Board covering capital expenditure, cash flow, the income statement and balance sheet. Monthly results are reported against budget, and revised forecasts for the year are prepared regularly. Separate approval processes and limits are in place for unbudgeted expenditure items.

*Investment appraisal* – The group has clearly defined procedures for capital expenditure. These include authority levels, commitment records and reporting, annual budget and detailed appraisal and review procedures. The authority of the directors is required for key treasury matters including changes to equity and loan financing, interest rate and foreign currency policy including foreign currency hedging, oil price hedging, cheque signatories and opening of bank accounts. Comprehensive due diligence work is carried out if a business or an asset is to be acquired.

During 2010, the Board reviewed the group's system of internal controls and is satisfied that all the controls in place are appropriate to provide reasonable assurance against any material misstatement or loss. The review is conducted on a regular basis and changes are made to internal control systems to address any new risks or exposures arising as a result of changes to the business or the business environment.

### Board performance evaluation

During the year, an evaluation of the performance of the Board, its committees, the individual directors and the Chairman, was conducted. The Board and committee evaluations were externally facilitated and comprised a written questionnaire and a series of one-to-one interviews with all directors. The questionnaire and interviews covered a number of key areas including strategy, succession planning, Board size and composition, risk management and the relationship between the Board and management. The results of the reviews were then considered by the Chairman and discussed by the Board as a whole.

The performance of individual non-executive directors was evaluated by the Chairman, with input from the committee chairmen and the other directors. The performance of the Chief Executive and other executive directors was evaluated by the Chairman and non-executive directors.

The directors have concluded that, following this evaluation, the Board and its committees operate effectively. Recommendations were made to further enhance the performance and effectiveness of the Board and a process of continuous improvement is now being led by the Chairman.

### Communication with shareholders

Communication with shareholders is given significant attention. Extensive information about the group's activities is provided in the Annual Report and Financial Statements, the Half Yearly Report, Trading Updates and Interim Management Statements, all of which are available to shareholders. The company has also produced a summary review document in each of the last eight years highlighting Premier's capabilities and operations. These documents are available to all shareholders. The company's website (www.premier-oil.com) also provides detailed information on the group's activities.

In accordance with current regulations, the company uses its website as its default method of publication for statutory documents to reduce printing costs and help benefit the environment. The company operates a process of deemed consent; shareholders are given 28 days to indicate whether they wish to continue receiving hard copies of all statutory documents by post, before being deemed as consenting to web-based communications. Consenting shareholders are sent notification in the post each time the company places a statutory document on its website.

All new shareholders receive hard copies of statutory documents until the next deemed consent process is undertaken.

Shareholders can request all future communications to be sent by post, or request a hard copy of a particular document which has been published on the company's website (www.premier-oil.com).

The company promotes the use of online shareholder services at www.premier-oil-shares.com. On this website, shareholders are able to access their shareholding and to update their address or submit queries on their account directly to the company's registrars. Shareholders also have the ability to vote online prior to the 2011 AGM. The share portal also encourages shareholders to register to receive communications by e-mail, rather than by post, thus further reducing the number of documents printed and distributed. Shareholders who have registered receive an e-mail notifying them when the company has added a statutory document to its website. For each new registration processed, the company will donate £1 to PURE the Clean Planet Trust, a UK charity dedicated to combating climate change.

The company has posted guidelines on its website, advising shareholders of how to deal with potential scams, where shareholders may have received unsolicited phone calls concerning investment matters, often where callers have stated they work for a subsidiary of, or on behalf of, the company. Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at discount, or offers of free analysis reports, as the company does not retain the services of any such business for these purposes.

There is regular dialogue with institutional investors, and the Chairman, Chief Executive and Finance Director, who are the directors responsible for dealing with shareholders, ensure that other members of the Board receive full reports of these discussions. Enquiries from individuals on matters relating to their shareholding and the business of the group are welcomed and are dealt with in a timely manner. All shareholders are encouraged to attend the AGM to discuss the progress of the group.

By order of the Board

**S C Huddle**
Company Secretary
23 March 2011

# Audit and Risk Committee Report

The Audit and Risk Committee (the Committee) is appointed by the Board from the non-executive directors of the company. The Committee's terms of reference include all matters indicated by the Disclosure and Transparency Rule 7.1 and the Combined Code.

The Committee is responsible for:

- monitoring the integrity of the financial statements of the company and formal announcements relating to the company's financial performance and reviewing any significant financial reporting judgements contained therein;
- reviewing the company's internal financial and operational control and risk management systems, including the results of business control reviews;
- overseeing the company's relationship with its external auditors, including making recommendations as to the appointment or reappointment of the external auditors, reviewing their terms of engagement, monitoring their independence and developing and implementing policy governing any engagement of the external auditors to supply non-audit services; and
- reviewing the effectiveness of the company's whistleblowing procedures.

The Committee is required to report its findings to the Board, identifying any matters on which it considers that action or improvement is needed, and make recommendations on the steps to be taken.

### Composition of the Audit and Risk Committee

The Committee comprises only non-executive directors. Its members are Messrs D C Lindsell (Chairman), J Darby, J R W Orange and M Romieu. The Company Secretary acts as secretary to the Committee. Mr D C Lindsell is a chartered accountant with expertise in accounting and auditing. The Board considers all members of the Committee to have the relevant commercial and financial experience to assess effectively the complex financial reporting, risk and internal control issues relevant to the company.

The Committee may engage the services of external advisers as it deems necessary in the furtherance of its duties, at the company's expense. No external advisers materially assisted the Committee during the year.

### Meetings

The Committee is required to meet at least three times per year and has an agenda linked to events in the company's financial calendar.

Minutes of Committee meetings are distributed to all Board members and the Committee Chairman reports to the Board on each Committee meeting and matters arising from it.

The Committee is satisfied that it receives sufficient, reliable and timely information from management in order to enable it to fulfil its responsibilities.

### Overview of the actions taken by the Audit and Risk Committee to discharge its duties

The Committee met four times in 2010. In January it considered accounting and reporting issues relating to the full-year results in March. In March it reviewed the full-year results, the Annual Report and Financial Statements and its annual assessment of the effectiveness of internal controls to enable the Board to make its statement on internal control in the Corporate Governance Report. In July it considered the accounting and reporting issues relating to the half-year results, and in August it reviewed the half-year results. At each meeting other than March, the results of the group's internal control reviews performed since the previous meeting, including any recommendations for improvements, were reported to and discussed by the Committee.

More specifically, the responsibilities of the Committee were discharged as follows:

- the Committee reviewed the risk management process designed to identify the key risks facing the group and how these risks were being managed. It also reviewed the findings from financial and operating controls reviews carried out during the year, together with progress in implementing any required improvements. Additionally it has reviewed the effectiveness of the group's internal controls and disclosures made in the Annual Report and Financial Statements. Controls reviews are carried out by third party firms as well as by Premier staff with the necessary expertise;
- the Committee reviewed the findings from the external auditors' audit of the 2009 financial statements and their 2010 half-yearly review, and the audit plan for the 2010 audit. The fee proposals for the audit and half-yearly review were considered and agreed, and the Committee reviewed the scope and fees for non-audit assignments awarded to the external auditors to satisfy itself that the assignments concerned did not give rise to threats to the auditors' independence and objectivity;
- the Committee met with the Finance Director and external auditors as part of the half-yearly and final financial statements review and approval process. The Committee considered assumptions about the future and other sources of estimation uncertainty, as well as the most appropriate treatment and disclosure of any new or judgemental matters that may have a significant effect on amounts in the financial statements;
- the performance and effectiveness of the Committee was reviewed as part of the Board performance evaluation process. The Committee was considered to be operating effectively and in accordance with the Financial Reporting Council Guidance on Audit Committees; and
- the Committee met twice in the absence of management with the external auditors in March and in July and no matters of significance were drawn to the Committee's attention at either of these meetings.

### Internal audit

The Committee also carried out its annual review into whether it is appropriate for the company to establish an internal audit function. The Board places great emphasis on the importance of risk management and control at all operating levels in the business and is confident that this culture is in place. The Committee took account of the fact that the company obtains independent confirmation of its internal financial controls from a variety of sources; these include joint venture and government audits and the use of specific reviews using third party specialists. As a result, the Committee concluded that there was no need for a dedicated internal financial audit resource.

As reported last year, the Committee took the decision to appoint an Operational Audit and Risk Control Manager, with the prime responsibility for managing the operational audit and control review process. This appointment was made in April 2010 with one of our senior managers being appointed to this role under the title of Group Audit and Risk Control Manager. The main focus of the role in 2010 has been to review and begin the process of updating our audit and risk assurance policy and procedures.

### External auditor

Deloitte LLP (Deloitte) was initially appointed external auditor of the company in 2004.

The Committee regularly reviews the issue of the independence of the external auditors. This review considers the overall relationship between the auditors and the company, based on feedback from the company's finance team and from the auditors, and the nature and extent of non-audit services provided by the auditors, and takes account of the safeguards established by the auditors against loss of audit independence, including rotation of the audit partner and other key members of the audit team.

The Committee has a policy on the use of auditors in a non-audit capacity which is aimed at ensuring their continued independence. The use of the external auditors for services relating to accounting systems or financial statements is not permitted, as are various other services that could give rise to conflicts of interest or other threats to the auditors' objectivity that cannot be reduced to an acceptable level by applying safeguards. The Committee believes that there is non-audit work such as certain assurance and advisory services that may be best performed by the auditors as a result of their unique knowledge of the company. Any material non-audit work of this nature requires approval by the Committee. The policy and overall fees paid to our auditors are also reviewed on an annual basis by the Committee.

Deloitte are required to confirm to the Committee that they have both the appropriate independence and objectivity to allow them to continue to serve the members of the company. The Committee also requires the external auditor to confirm that in providing non-audit services, it complies with the Ethical Standards of the UK Auditing Practices Board. This confirmation was received for 2010.

The Committee reviews the expertise, performance and effectiveness of the auditors. On the basis of the reviews carried out, the Committee recommended to the Board that it should propose the reappointment of Deloitte as the external auditor of the company.

By order of the Board

**D C Lindsell**
Chairman of the Audit and Risk Committee
23 March 2011

# Company Risk Factors

### Risk factors
Premier is an international business which has to face a variety of strategic, operational, financial and external risks.

Premier's business, financial standing, results and reputation may be impacted by various risks. Not all of these risks are within the company's control and the company may be affected by risks other than those listed below.

### Clear responsibility
The Board is responsible for overall group strategy, acquisition and divestment policy, approval of major capital expenditure projects, corporate costs and significant financing matters and the management of risks. The Board recognises that risk is inherent across Premier's operations, and all activities are subject to an appropriate review to ensure that risks are identified, monitored and if possible, managed.

### Risk management process
Premier has an established business management system which includes an integrated risk management process for identifying, evaluating and managing risks faced by the group. This is based on each business unit and corporate function producing a risk matrix which identifies the key business risks – strategic, operational, financial and external – the probability of those risks occurring, their impact if they do occur and the actions being taken to manage those risks to the desired level. Risk acceptance and reduction objectives are defined with particular attention given to reducing them to as low as reasonably practicable. These risk matrices are updated on a regular basis and made available to the Executive Committee.

Key risks facing Premier, their potential impacts and the company's responses are outlined below. Effective risk management is critical to achieving the company's strategic objectives and protecting the company's assets, personnel and reputation. Premier manages its risks by maintaining a balanced portfolio, through compliance with the terms of its agreements and application of appropriate policies and procedures and through the recruitment and retention of skilled individuals throughout the organisation.

### Key business risks
#### Reserve replacement
Future oil and gas production will depend on our access to new reserves through exploration, negotiations with governments and other owners of reserves and acquisitions. Failures in exploration or in identifying and finalising transactions to access potential reserves could slow our oil and gas production and replacement of reserves. Premier manages these risks by proactive project planning and milestone driven performance criteria. For exploration, effective peer reviews and thorough diligence on new areas allow us to mitigate risk of failure.

#### Competition
Premier operates in a very challenging business environment and faces competition on access to exploration acreage, gas markets, oil services and rigs, technology and processes and human resources. We mitigate this by focusing our activities on acreage and businesses where we hold a competitive advantage.

#### Production
The delivery of Premier's production depends on the successful development of its key projects. In developing these projects we face numerous challenges. These include uncertain geology, availability of technology and engineering capacity, availability of skilled resources, maintaining project schedules and managing costs, as well as technical, fiscal, regulatory, political and other conditions. Such potential obstacles may impair the company's delivery of these projects and, in turn, the company's operational performance and financial position (including the financial impact from failure to fulfil contractual commitments related to project delivery). We mitigate these risks by maintaining a balanced portfolio of producing assets and applying best practice to our operations.

#### Health, safety, environment and security (HSES)
Given the range of Premier's operated and joint venture production operations globally, our HSES risks cover a wide spectrum. These risks include major process safety incidents; failure to comply with approved policies; effects of natural disasters and pandemics; social unrest; civil war and terrorism; exposure to general operational hazards; personal health and safety; and crime. The consequences of such risks materialising can be injury, loss of life, environmental harm and disruption to business activities. Depending on their cause and severity, they can affect Premier's reputation, operational performance and financial position. Premier has an effective and comprehensive HSES management system to mitigate this risk and support safe and secure execution of all critical activities.

#### Reputation
Premier strives to be a good corporate citizen globally and has strong and positive relationships with the governments and communities in the countries where we do business. This is important for maintaining our licence to operate and our ability to secure new resources. Our business principles govern how Premier conducts its affairs. Failure – real or perceived – to follow these principles, or any of the risk factors materialising, could harm our reputation, which could impact our licence to operate, financing and access to new opportunities.

### Human resources
Premier's key human resources are essential for the successful delivery of its projects and continuing operations. Loss of personnel to competitors or our inability to attract quality human resources could affect our operational performance and growth strategy. Premier has created salary, bonus and long-term incentive arrangements designed to incentivise loyalty and good performance.

### Commodity prices
Oil and gas prices are affected by global supply of and demand for these commodities. Factors that influence these include operational issues, natural disasters, weather, political instability or conflicts and economic conditions or actions by major oil-exporting countries. Price fluctuations can affect our business assumptions and can impact investment decisions and financial position. Premier manages this risk with an oil and gas hedging programme to underpin our financial strength and capacity to fund our future developments and operations.

### Financial discipline
Premier has established financial policies and processes to ensure that it is able to maintain an appropriate level of liquidity and financial capacity and to manage the level of assessed risk associated with the financial instruments. A detailed set of financial and treasury policies and a delegation of authority manual are also in place to reasonably protect against risk of financial fraud in the group.

All major investment decisions taken consider an appropriate financial benchmark to secure against downside risk of such investments. The group also undertakes an insurance programme to reduce the potential impact of the physical risks associated with exploration and production activities. In addition, business interruption cover is purchased for a proportion of the cash flow from producing fields. Cash balances are invested in short-term deposits with minimum A credit rating banks, AAA managed liquidity funds and A1/P1 commercial paper subject to Board approved limits.

Further information on financial instruments and financial risk factors can be found in note 17 in the notes to the consolidated financial statements.

### Host government – political and fiscal risks
Premier operates in some countries where political, economic and social transition is taking place. Developments in politics, laws and regulations can affect our operations and earnings. Potential developments include forced divestment of assets; limits on production or cost recovery; import and export restrictions; international conflicts, including war; civil unrest and local security concerns that threaten the safe operation of company facilities; price controls, tax increases and other retroactive tax claims; expropriation of property; cancellation of contract rights; and environmental regulations. It is difficult to predict the timing or severity of these occurrences or their potential effect. If such risks materialise they could affect the employees, reputation, operational performance and financial position of the group.

### Joint ventures and partners
Inherently, oil and gas operations globally are conducted in a joint venture environment. Many of our major projects are operated by our partners. Our ability to influence our partners is sometimes limited, due to our small shares in major non-operated development and production operations. Non-alignment on various strategic decisions in joint ventures may result in operational or production inefficiencies or delay. Premier mitigates this risk by continuous and regular engagement of its partners in operated and non-operated projects.

# Nomination Committee Report

The Nomination Committee (the Committee) presents its report in relation to the financial year ended 31 December 2010.

### Composition and role of the Nomination Committee

The Committee meets as and when required and comprises Messrs M W Welton (Chairman), J Darby, D C Lindsell, S C Lockett, M Romieu, J R W Orange, Professor D G Roberts and Ms I J Hinkley. The Board considers the membership of the Nomination Committee to be in compliance with the Combined Code.

The Committee met twice in 2010. Formal meetings are held to consider standing items of business; there is also a significant level of ad hoc discussion between members of the Committee, particularly when a recruitment exercise is taking place.

The role of the Committee includes:

- reviewing the structure, size and composition of the Board and making recommendations to the Board with regard to any adjustments that are deemed necessary. This requires an ongoing assessment of the appropriate skills-mix required at Board level in light of the strategy of the company in the medium-term;
- responsibility for identifying and nominating candidates, subject to Board approval, to fill Board vacancies as and when they arise and to prepare a description of the role and capabilities required for a particular appointment; and
- reviewing the development and leadership potential of senior executives below Board level and ensuring that appropriate succession plans are in place for both Board and senior positions.

During 2010, following an evaluation of the skills, knowledge and experience on the Board, the primary work of the Committee has been the process to select an additional non-executive director. To assist in this task, the company engaged external consultants to identify appropriate candidates for the role. The Committee proposed its candidate for appointment and, following disclosure of the candidate's other significant commitments, the full Board concluded that Ms I J Hinkley be appointed to the Board.

### Induction procedure

The Company Secretary supports the Chairman and the Chief Executive in ensuring new directors receive appropriate induction and training. On joining the Board, a director undergoes a structured induction programme, including the receipt of a comprehensive induction pack which includes various governance related issues. The new director meets with each of the executive directors and senior management. If appropriate, the new director also attends external training courses following his or her appointment which are tailored to his or her requirements.

By order of the Board

**M W Welton**
Chairman
23 March 2011

# Report of the Directors

The directors present their annual report on the affairs of the group, together with the audited group financial statements for the year ended 31 December 2010. The Corporate Governance Report set out on pages 28 to 31 forms part of this report.

### Results and dividends
The group's net profit for the year amounted to US$129.8 million (2009: profit of US$113.0 million). A dividend is not proposed (2009: US$nil).

### Principal activities
The principal activities of the group are oil and gas exploration, development and production. The group operates through subsidiary undertakings and joint ventures, details of which are shown in note 10 in the notes to the consolidated financial statements.

### Business review
The company is required by the Companies Act 2006 to set out in this report a fair review of the business of the group during the financial year ended 31 December 2010 and of the position of the group at the end of the year (the business review). The information that fulfils the requirements of the business review can be found in the following sections of the Annual Report and Financial Statements:

- Chief Executive's Review
- Financial Review
- Company Risk Factors
- Key Performance Indicators
- Environmental, employee, social and community matters, within the Social Performance Review

The Chairman's Statement, Chief Executive's Review and the Financial Review also include details of expected future developments in the business of the group.

### Annual General Meeting (AGM)
The company's 9th AGM will be held on Friday 20 May 2011 at 11.00am. The Notice of the AGM, together with details of all resolutions which will be placed before the meeting accompanies this report.

### Directors
The directors who served throughout the year (except as noted) were as follows:

- Mr Mike Welton (Chairman)[3]
- Mr Robin Allan
- Mr Joe Darby[4,5,6]
- Mr Tony Durrant
- Mr Neil Hawkings
- Ms Jane Hinkley (appointed 1 September 2010)[4,6]
- Mr David Lindsell[2,4,6]
- Mr Simon Lockett (Chief Executive)[6]
- Mr Andrew Lodge
- Mr John Orange (senior independent non-executive director)[1,5,6]
- Professor David Roberts[4,6]
- Mr Michel Romieu[5,6]

Notes:
1. Chairman of the Remuneration Committee
2. Chairman of the Audit and Risk Committee
3. Chairman of the Nomination Committee
4. Member of the Remuneration Committee
5. Member of the Audit and Risk Committee
6. Member of the Nomination Committee

Biographical details of all directors can be found in the Board of Directors section set out on pages 26 and 27 of this report.

# Report of the Directors (continued)

## Directors' election

In accordance with best practice for FTSE 350 companies as published in the Financial Reporting Council's UK Corporate Governance Code (the Code), directors will stand for annual re-election by shareholders.

Mr J R W Orange, who will be retiring from the Board at the forthcoming AGM, will not stand for re-election. Ms I J Hinkley, having been appointed by the directors since the last AGM, will step down at the forthcoming AGM and, being eligible, will offer herself for election by shareholders. All other directors will retire at the forthcoming AGM and, being eligible, will offer themselves for re-election by shareholders.

With regard to the appointment and replacement of directors, the company is governed by its Articles of Association, the Code, the Companies Act 2006 and related legislation. The powers of directors are described in the Corporate Governance Report and in the Matters Reserved for Board Decision, a copy of which can be found on the company's website (www.premier-oil.com). The company's Articles of Association may only be amended by special resolution at a General Meeting of the shareholders.

## Directors' interests

The directors who held office at 31 December 2010 had the following interests in the Ordinary Shares of the company:

| Name | At 1 January 2010 or date of appointment | At 31 December 2010 | At 23 March 2011 |
|---|---|---|---|
| R A Allan[1] | 31,961 | 106,854 | 156,992 |
| J Darby[2] | 5,777 | 5,777 | 5,777 |
| A R C Durrant[1] | 47,252 | 96,092 | 145,631 |
| N Hawkings[1,4] | 4,471 | 30,669 | 73,552 |
| I J Hinkley | – | – | – |
| D C Lindsell[2] | 4,333 | 4,333 | 4,333 |
| S C Lockett[1] | 78,616 | 187,110 | 268,699 |
| A G Lodge[1] | 73 | 13,829 | 13,847 |
| J R W Orange[2,3] | 12,277 | 6,777 | 6,777 |
| Professor D G Roberts | – | – | – |
| M Romieu | – | – | – |
| M W Welton | – | 1,830 | 1,830 |

Notes:

1. The beneficial interests of the executive directors include personal shareholdings together with Share Incentive Plan Partnership Shares and any Matching Shares held for more than three years.
2. The beneficial interests of the non-executive directors comprise personal shareholdings.
3. This includes 1,444 Ordinary Shares held by Mr J R W Orange's wife.
4. This includes Ordinary Shares held by Mr N Hawkings' wife (nil Ordinary Shares held as at 1 January 2010, 14,991 Ordinary Shares held as at 31 December 2010 and 34,604 Ordinary Shares held as at 23 March 2011).

Directors' interests in share options, deferred bonus shares, Deferred and Matching Share Awards under the Asset and Equity Plan, Performance Share Awards under the Long Term Incentive Plan and Deferred Share Incentive Plan entitlements are shown in the Remuneration Report together with details of the remuneration of all directors who served during the year.

## Directors' indemnities

The company has granted an indemnity to all of its directors under which the company will, to the fullest extent permitted by law and to the extent provided by the Articles of Association, indemnify them against all costs, charges, losses and liabilities incurred by them in the execution of their duties.

## Share capital

Details of the issued share capital, together with details of the movements in the company's issued share capital during the year are shown in note 19 to the consolidated financial statements. The company has one class of Ordinary Share which carries no right to fixed income. Each share carries the right to one vote at General Meetings of the company.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association and prevailing legislation. The directors are not aware of any agreements between holders of the company's shares that may result in restrictions on the transfer of securities or on voting rights. Details of employee share schemes are set out in note 19. The voting rights in relation to the shares held within the Employee Benefit Trust are exercisable by the trustees. Details of the number of shares held by the Employee Benefit Trust are set out in the Remuneration Report on pages 40 to 58. No person has any special rights of control over the company's share capital and all issued shares are fully-paid.

## Substantial shareholders

At 23 March 2011 the company had received notification from the following institutions, in accordance with Chapter 5 of the Disclosure and Transparency Rules, of interests in excess of 3 per cent of the company's issued Ordinary Shares with voting rights:

| Name of shareholder | Notified number of voting rights | Notified percentage of voting rights | Nature of holding[1] |
|---|---|---|---|
| BlackRock Inc | 11,224,700 | 9.790 | Indirect |
| AXA S.A. & group companies | 7,498,283 | 9.130 | Indirect |
| Ameriprise Financial Inc | 4,028,672 | 5.076 | Indirect |
| Schroders plc | 5,781,636 | 4.970 | Indirect |
| Aviva plc | 3,859,897 | 4.870 | Direct |
| Legal & General Group plc | 4,586,471 | 3.990 | Direct |
| Bear, Stearns International Trading Ltd | 2,552,847 | 3.109 | Direct |

Note:
1. Where the nature of the holding is both direct and indirect, the larger holding has been quoted.

## Supplier payment policy

The group's policy in respect of its suppliers is to establish terms of payment when agreeing the terms of business transactions and to abide by the terms of payment. The group's normal payment terms are four weeks.

## Hedging and risk management

Details of the group's policy on hedging and risk management are provided in the Financial Review. A further disclosure has been made in note 17 of the notes to the consolidated financial statements related to various financial instruments and exposure of the group to price, credit, liquidity and cash flow risk.

## Subsequent events

Post balance sheet events are disclosed in note 26 of the notes to the consolidated financial statements.

## Charitable and political donations

During the year the group made charitable contributions amounting to US$708,614 (2009: US$231,337). No political contributions were made during the year (2009: US$nil).

## Significant agreements – change of control

There are a number of agreements that take effect, alter or terminate upon a change of control of the company such as commercial contracts, bank loan agreements, property lease arrangements and employees' share plans. None of these is considered to be significant in terms of their likely impact on the business of the group as a whole.

Furthermore, the directors are not aware of any agreements between the company and its directors or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid.

## Auditors

Each of the persons who is a director at the date of approval of this Annual Report and Financial Statements confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- the director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006. A resolution to reappoint Deloitte LLP as auditors will be put to shareholders at the forthcoming AGM.

By order of the Board

**S C Huddle**
Company Secretary
23 March 2011

# Remuneration Report

This report explains our remuneration policy for executive directors and senior executives and sets out payments made to executive directors in relation to the year under review. The company rewards its executives in a variety of ways which are intended to ensure that remuneration is competitive and aligned with shareholders' interests. To this end, in addition to base salary and benefits there is an annual bonus paid on the achievement of annually set targets and share awards designed to reward long-term performance. Under both the annual bonus and Long Term Incentive Plan (LTIP) a portion of any award is deferred and under the LTIP is dependent on further significant performance. Details of the various schemes, which cover awards granted in previous years as well as the policy for those for 2011 are detailed in this report.

As the chart below shows, £100 invested in Premier Oil shares on 1 January 2006 would now be worth £293.10, a growth of 193.1 per cent. This compares with growth of the FTSE All Share Oil & Gas Producers Index of 34.6 per cent over the same period and growth in the price of oil of 87.2 per cent. The management team has demonstrated an ability to create substantial value for shareholders. As a result, we are satisfied that they should be rewarded well for delivering this performance in 2010.

The Remuneration Committee's key challenge in relation to future policy is to balance the incentivisation of the management team to create further shareholder value against the need to ensure that this does not put at risk the value created to date and the overall stability and sustainability of the business.

In this regard we believe we have balanced the remuneration policy appropriately, recognising the following factors:

- base salaries for executive directors are now broadly in line with our desired positioning of paying at around the median of our peer group, following adjustments this year and possibly a further adjustment to the Chief Executive's salary next year;
- our annual bonus plan is based on a balanced scorecard of operational metrics. The achievement of these metrics is carefully assessed each year by the Remuneration Committee, the result being that maximum bonuses have not been paid in the last five years. Significant bonuses will continue to be subject to an element of share-based deferral;
- the most significant potential remuneration for all employees comes through the LTIP. Under this share-based plan, performance is assessed over three years (six years if the matching scheme is included), requiring both strong share price growth and relative stock market out-performance over the period. To ensure that any potential for reward for failure is minimised and to optimise the link between reward and performance, this plan has certain safeguards. In particular, the amount that executives may receive is subject to various caps and discretion to scale back awards based on broader factors beyond the precise performance targets set; and
- for 2011 we are further improving the risk profile of the package by adding a provision for clawback of incentive payments in certain situations and adding minimum shareholding guidelines for senior executives.

## Compliance

This report has been prepared in accordance with schedule 8 of the Companies Act 2006 and the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008. The report has been divided into separate sections for audited and unaudited information. Part A of the report is not subject to audit. Part B contains information which has been audited.

As required, this report is being put to shareholders at the forthcoming AGM for an advisory vote.

Throughout 2010 the company complied with the provisions of the Combined Code on Corporate Governance (the Code) regarding best practice on the design of performance-related remuneration.

## Remuneration Committee

The Remuneration Committee (the Committee) normally meets at least four times a year (2010: six scheduled meetings) and determines the remuneration of the Chairman, the executive directors and senior management. The Committee is composed entirely of non-executive directors and comprises Mr J R W Orange, who chairs the Committee and is the company's senior independent non-executive director, Ms I J Hinkley and Messrs J Darby, D C Lindsell and Professor D G Roberts. The Board considers that the membership of the Committee is compliant with the Code recommendations. Mr M W Welton, the company's Chairman, is not a member of the Committee, but attends meetings by invitation. Mr S C Lockett is not a member of the Committee but attends meetings by invitation, except when his own remuneration is being discussed, to ensure that the Chief Executive is fully aware of discussions concerning remuneration policy and the remuneration packages of its most senior management.

No director of the company is involved in determining his own remuneration. The determination of the remuneration of the non-executive directors is a matter reserved for Board decision.

The Committee acts within its agreed written terms of reference and complies with the relevant provisions of the Code in implementing its remuneration policy. The terms of reference are published on the company's website (www.premier-oil.com).

The role of the Committee includes:

- considering and determining the remuneration policy for the Chairman, executive directors and senior management;
- within this agreed policy, considering and determining the total compensation package of each executive director of the company;
- considering and advising on the general principles under which remuneration is applied to employees of the company;
- considering the design of the annual bonus plan for senior executives;
- determining the quantum and performance conditions for awards to be made under the company's long-term incentive schemes; and
- determining the policy for pension arrangements, service agreements and termination payments to directors and senior management.

# Remuneration Report (continued)

Matters considered by the Committee during its 2010 meetings

| 2010 | Standing agenda items | Other agenda items |
|---|---|---|
| January | • Determination of 2009 annual bonus plan award<br>• Determination of vesting of 2007 AEP awards<br>– calculation of Equity Pool<br>• 2010 bonus plan design<br>– metrics and performance conditions<br>• 2010 LTIP award<br>– grant levels under equity pool and Performance Share Awards<br>– performance conditions: selection of Total Shareholder Return (TSR) group for Performance Shares and Matching Shares | • Policy for treatment of de-listed companies in TSR comparator group<br>• Early vesting of outstanding deferred share awards and change to forfeitable share structure |
| March | • Determination of vesting of 2007 AEP awards<br>– calculation of Asset Pool<br>• Confirmation of 2007 Matching Award | • Consideration of initial advice on senior executive pensions |
| May | • Approval of 2010 LTIP awards<br>• Review of executive remuneration strategy | • Consideration of Indonesian employee incentive arrangements<br>• Consideration of funding level of pension scheme |
| August | • Review of progress against 2010 annual bonus metrics<br>• Review of progress against long-term incentive plan performance metrics | • Review of senior executive pensions policy<br>• Consideration of approach to capping payments under the 2008-2010 cycle of AEP and for policy going forward<br>• Review of senior executive remuneration strategy (management received advice from PwC) |
| October | • Update of progress against 2010 annual bonus metrics and outstanding LTIP and matching share awards | • Consideration of policy in relation to capping 2008-2010 AEP awards and policy going forward<br>• Conclusions drawn form review of executive remuneration policy |
| November | • Additional meeting to discuss matters outside normal standing agenda items | • Conclusions drawn from review of senior executive pensions policy<br>• Finalisation of proposed changes to remuneration policy for 2011<br>• Finalisation of proposal in relation to capping 2008-2010 AEP awards and policy going forward<br>• Consideration of draft shareholder consultation letter regarding changes to remuneration policy<br>• Consideration of appropriate remuneration benchmarking comparators |

Hewitt New Bridge Street (a trading name of Aon Corporation) is the independent adviser to the Remuneration Committee. Neither Hewitt New Bridge Street nor any other part of Aon Corporation provided other services to the company during the year. During the period under review, the Committee sought the assistance of the Chairman and the Chief Executive on matters relating to directors' and senior management's performance and remuneration. During the year the Committee also took advice from Capita Hartshead in relation to pension policy.

### Part A: Remuneration policy for 2011
### Summary of Premier Oil's remuneration policy for 2011

| Fixed remuneration | Performance linked remuneration – subject to payout caps and clawback provisions | |
|---|---|---|
| Base salary<br><br>Benefits: e.g. private medical cover, life assurance<br><br>Pension: final salary based | **Annual bonus**<br>• 100 per cent of salary max<br>• KPI scorecard based<br>• Share-based deferral above 50 per cent of salary | **Long Term Incentive Plan**<br>• Performance shares – TSR<br>• Share of equity growth – share price<br>• Matching shares – TSR<br>• Up to six-year performance period overall |

Minimum shareholding requirement of 200 per cent of base salary for Chief Executive and 100 per cent of salary for other executive directors

## Part A: Remuneration policy for 2011 (continued)

The company's remuneration policy for executive directors is to provide remuneration packages which reward employees fairly and responsibly for their contributions and aims to deliver superior remuneration for superior performance. Remuneration packages are intended to be sufficiently competitive to attract, retain and motivate individuals of the quality required to achieve the group's objectives and thereby enhance shareholder value. The Committee takes account of the level of remuneration paid in respect of comparable positions in similar companies within the industry, as well as broadly similar sized companies by market cap in the FTSE 250 index, and also pay and conditions throughout the remainder of the group.

The main components of executive directors' remuneration are basic salary, an annual bonus scheme with cash and deferred share elements, benefits, eligibility to participate in the company's long-term incentive schemes (and all employee share schemes) and pension provision. The company seeks to strike an appropriate balance between fixed and performance-related elements. In respect of its senior management, the approach is that the greater part of total remuneration should be delivered through performance-related incentives and, in particular, long-term share-based incentives. These incentive schemes are designed to align the interests of executives with those of shareholders and establish a clear link between pay and performance.

The chart below illustrates the average mix between the fixed and variable elements of remuneration of the executive directors at on-target and maximum performance. Target performance assumes 60 per cent bonus payout and a fair value of long-term incentive awards calculated using an options pricing model. Stretch performance assumes all bonus, performance share and matching awards vest in full with share price growth of 15 per cent per annum compound. This shows the significant level of gearing in the package towards stretch performance targets:

Average mix of executive director remuneration for on-target and maximum performance

In line with the Association of British Insurers' Guidelines on Responsible Investment Disclosure, the Committee ensures that the company's remuneration policy will not raise environmental, social or governance risks by inadvertently motivating irresponsible behaviour (e.g. one of the important factors in determining bonus performance is the achievement of specific HSE targets). More generally, the Committee ensures that the overall remuneration policy does not encourage inappropriate operational risk.

The Committee has recently conducted a review of the company's remuneration arrangements which concluded that the current remuneration arrangements were broadly appropriate but that some correctional changes should be made to the salaries of the executive directors and the operation of the LTIP. The company has also introduced clawback provisions into the annual bonus and LTIP arrangements and shareholding guidelines for the executive directors and members of the Executive Committee. Prior to implementing these changes the Committee consulted with major shareholders.

### Base salary

The Committee aims to position the base salaries for the executive directors at a mid-market level for comparable positions in similar companies within the industry and the FTSE 250 taking into account the performance of the company and the performance of the individual. In this regard the policy has changed compared to prior years, where the policy had been to position salaries between median and upper quartile. The company's policy for all other employees is to target salaries at the upper quartile of comparable positions within the industry. The Committee believes that this positioning is appropriate given the competitive marketplace that exists within the industry in which it operates.

While the Committee does not slavishly follow market data it has been aware that Mr S C Lockett's salary has been below its assessment of a mid-market level for some time. Recognising the outstanding track record of performance of the individual and the company, the Committee has decided that it is now time to correct this anomaly and intends to increase his salary to a broadly mid-market level over the next two years. The increase of 14.9 per cent for 2011 represents a significant step toward achieving the Committee's desired positioning. Awards of between 3.3 per cent to 6.3 per cent for the other executive directors reflect the level of increases for the wider workforce and the performance achieved.

# Remuneration Report (continued)

### Base salary (continued)

The salaries of the executive directors as at 1 January 2011 are as follows:

| | Position | Salary (£) | Percentage increase from 2010 |
|---|---|---|---|
| S C Lockett | Chief Executive | 500,000 | 14.9 |
| R A Allan | Director – Asia | 310,000 | 3.3 |
| A R C Durrant | Finance Director | 340,000 | 6.3 |
| N Hawkings | Operations Director | 310,000 | 3.3 |
| A G Lodge | Exploration Director | 310,000 | 3.3 |

### Annual bonus scheme

Executive directors and other employees are eligible to participate in non-pensionable discretionary bonus arrangements. The Committee sets targets for executive directors which are based on the achievement of challenging corporate targets. Bonuses for executive directors are subject to a maximum of 100 per cent of base salary. Other employees can earn an annual bonus payment of up to a maximum of 45 per cent of base salary based on the achievement of corporate and personal targets.

The Committee sets targets on the basis of a balanced scorecard comprising KPIs and other corporate objectives. The main elements of the scorecard for 2011 are described in the table below:

| Metric | Objective |
|---|---|
| HSES | Achieving improvement in our HSE performance relative to the previous year as measured by total recorded injury frequency rate and high potential occurrences |
| Production and development | Deliver projects on time and on budget moving toward the medium-term target of 100,000 boepd |
| Exploration and exploration new ventures | Make a material exploration success and deliver new ventures to replenish the portfolio of reserves as measured by resource additions |
| Finance and business development | Acquire new assets to build the core business and improve the quality of our core business whilst maintaining a healthy balance sheet as measured by value creation |
| Organisation | Continue to improve the HR and the business-related systems within each area of the business and improve succession and competency planning |

The balanced scorecard is used as a guide for the Committee, which reserves the right to override the formulaic outturn based on a broader assessment of overall company performance.

For the 2010 annual bonus plan 50 per cent of any bonus was deferred in shares for three years. With effect from 2011, the Committee's policy for executive directors and other senior executives is that any bonus earned up to 50 per cent of salary is payable immediately in cash. The balance of any bonus earned above 50 per cent of salary must be deferred in shares and will remain subject to a 'bad leaver' provision such that deferred shares will lapse in the event that an executive were to leave to join a competitor.

From 2011, the annual bonus plan will also be subject to a clawback provision in the event of a material misstatement of the company's financial results, gross misconduct or error in the calculation of performance conditions.

### The Long Term Incentive Plan

The company currently operates an all employee Long Term Incentive Plan (LTIP), a Share Incentive Plan and a Save As You Earn Scheme for UK-based and expatriate employees only.

Details of the Share Incentive Plan and the Save As You Earn Scheme are set out in Part B of this report.

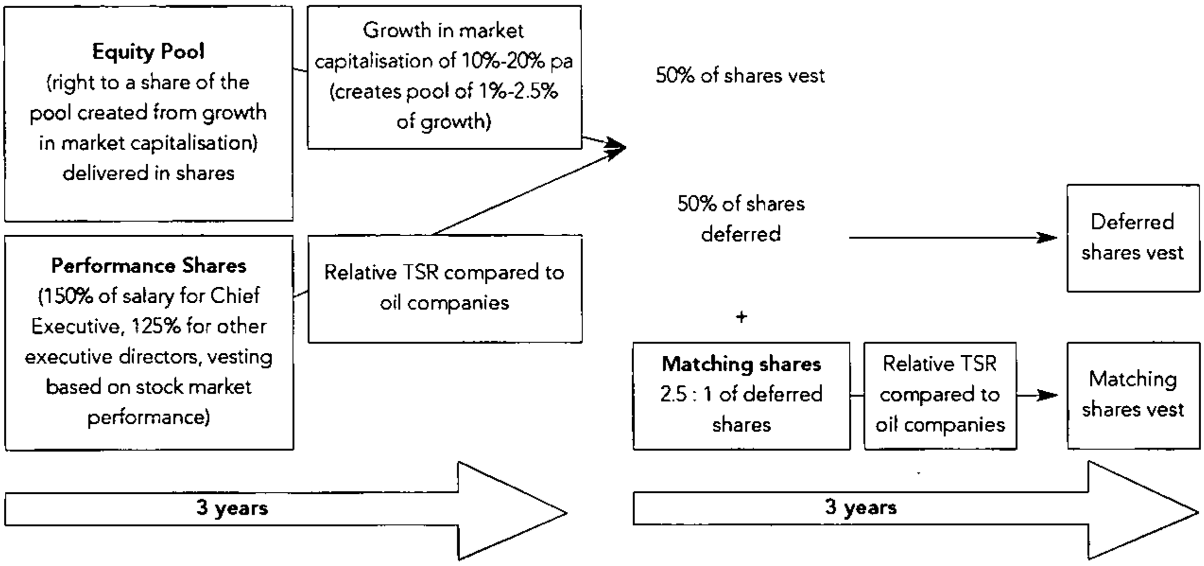
The LTIP was approved by shareholders at the 2009 AGM. The first awards were made in 2009 and will mature at the end of 2011. Further awards were made in 2010 and will mature at the end of 2012, and it is intended that awards will be made in 2011, which will mature at the end of 2013.

The Committee believes that the operation of a long-term incentive in which all of the company's employees participate encourages a focus on longer-term performance and alignment with shareholders. The performance conditions provide alignment between the interests of shareholders and employees and the emphasis on relative TSR performance against peers ensures that the company has delivered competitive returns when compared to the company's competitors over the performance period, irrespective of general market conditions and movements in the oil price.

### The Long Term Incentive Plan (continued)

Awards under the LTIP comprise three elements: Equity Pool Awards and Performance Share Awards that vest after the expiry of a three-year performance period, and a potential Matching Award that vests at the expiry of a further three-year performance period, commencing at the end of the three-year performance period for Equity Pool and Performance Share Awards.

The schematic below helps explain the operation of a single award under the LTIP:




### Equity Pool

The Equity Pool element of the long-term incentive policy is designed to ensure that the long-term incentive policy is aligned to the returns generated for shareholders, through rewarding absolute growth in market value in excess of a challenging growth range.

A pool of value is created based on a percentage of the growth in market capitalisation over three years. Individuals are allocated a pro rata entitlement to the pool at the start of the performance period.

#### The Equity Pool is created as follows:

The Equity Pool Award is created on the basis of the compound annual growth in the company's market capitalisation over the performance period being at least 10 per cent. If growth meets or exceeds this level, a pool of value is created as follows:

| Compound annual growth in market capitalisation | Notional pool of value created as a percentage of the increase in the compound annual growth |
|---|---|
| Less than 10 per cent | 0 per cent |
| 10 per cent | 1 per cent |
| More than 10 per cent but less than 20 per cent | Between 1 per cent and 2.5 per cent on a straight-line basis |
| 20 per cent or more | 2.5 per cent |

In determining the size of the Equity Pool, in addition to the above formula the Committee must be satisfied that the growth in market capitalisation is reflective of the underlying financial and operational performance of the company and may scale back the size of the Equity Pool accordingly if this is not the case. In making their assessment of whether to scale back the pool size, the Committee will take account of, amongst other things:

- return on invested capital;
- reserve replacement;
- cash flow;
- earnings per share; and
- health and safety.

#### Individual entitlement to the Equity Pool is determined as follows:

Each employee is allocated a pro rata entitlement to the Equity Pool based on seniority (expressed as a number of participation points) at the start of the three-year performance period. For 2011 the Chief Executive will be granted an entitlement to 6 per cent of the Equity Pool, with other executive directors granted an entitlement to 4.25 per cent of the Equity Pool. The value of an individual entitlement is then calculated after three years and delivered in shares.

# Remuneration Report (continued)

## The Long Term Incentive Plan (continued)

**Individual entitlement to the Equity Pool is determined as follows (continued):**
Where growth in market capitalisation is such that the value of the individual entitlement is higher than 100 per cent of salary, there is a cap to the value of the individual entitlement to an amount equivalent to 100 per cent of salary. The Committee has discretion to lift the 100 per cent of salary cap (potentially up to the full value of the individual entitlement) provided it is satisfied that, notwithstanding the growth in market capitalisation achieved, there has been a long-term underlying improvement in the performance of the company. The factors which the Committee might take into account when assessing whether or not to increase the cap include the same factors described above in relation to the Committee's assessment of the Equity Pool.

To add further rigour to the process it has been decided, following consultation with institutional shareholders, that the Committee may increase the 100 per cent of base salary cap on payouts on the following basis:

- for growth in market capitalisation between the level of growth at which the 100 per cent of salary cap is first reached and 15 per cent pa growth, the Committee has discretion to increase the cap from 100 per cent to no higher than 200 per cent of salary on a straight-line basis; and
- for growth in market capitalisation between 15 per cent pa and 20 per cent pa or more, it has discretion to increase the cap from 200 per cent of salary up to the full value of the individual entitlement (i.e. as if no cap applied) on a straight-line basis.

The Committee's deliberations in relation to determining the size of the pool or the lifting of the 100 per cent of salary cap will be disclosed fully to shareholders in the following year's Annual Report.

The company operates an appropriate hedging strategy under which the likely number of shares required to satisfy awards is considered from time-to-time and the Employee Benefit Trust funded with shares as required and/or headroom is set aside within our dilution limits for new issue shares.

### Performance Share Award

The Performance Share Award is over a number of Ordinary Shares in the company, with a value on grant of up to 150 per cent of salary, and is subject to a TSR performance condition. For 2011 the Chief Executive will be awarded a performance share award worth 150 per cent of base salary.

Performance shares will not vest unless the company's TSR performance over the three-year performance period is at least at the median of a comparator group comprising approximately 33 listed companies in the oil and gas sector (excluding the oil majors) whereby the shares subject to the Performance Share Award will vest as follows:

| TSR position of the company relative to the comparator group | Percentage of shares which vest |
|---|---|
| Below median | 0 per cent |
| Median | 25 per cent |
| Between median and upper quartile | Between 25 per cent and 100 per cent on a straight-line basis |
| Upper quartile or above | 100 per cent |

### Matching Award

50 per cent of the total number of shares vesting out of an employee's Equity Pool Award and Performance Share Award will be transferred to the employee while the balance will be deferred (the Deferred Award). For executive directors and certain other members of senior management the deferral period is three years and in return a Matching Award over further shares is made. For all other employees the Deferred Award will vest six months after grant, unless the employee elects to defer the vesting for three years in return for a grant of a Matching Award.

Deferred shares are eligible for a potential match of up to 2.5 : 1 dependent on the TSR performance of the company against the same comparator group used for Performance Share Awards. However, full vesting will only occur if the company's TSR is at or above the upper decile. The shares subject to the Matching Award will vest as follows:

| TSR position of the company relative to the comparator group | Percentage of shares which vest |
|---|---|
| Below median | 0 per cent |
| Median | 25 per cent |
| Between median and upper decile | Between 25 per cent and 100 per cent on a straight-line basis |
| Upper decile or above | 100 per cent |

### Clawback

Effective from 2011 a clawback provision will be attached to LTIP awards in the event of a material misstatement of the company's financial results, gross misconduct or error in the calculation of performance conditions.

Details of the awards granted to executive directors under this plan are set out in Part B: Outstanding long-term incentive awards.

## Shareholding guidelines

The Committee has established formal shareholding guidelines which will encourage the Chief Executive and other members of the Executive Committee to retain no less than 50 per cent of the net of tax value of shares vesting under the company's deferred bonus and long-term incentive arrangements, until such time as they have achieved a holding worth 200 per cent of base salary in the case of the Chief Executive and 100 per cent of salary in the case of other members of the Executive Committee.

The table below shows the level of share ownership as at 31 December 2010*, based on the share price on that day. This shows that the value of the executive directors' current shareholdings is higher than the minimum threshold.

| | Percentage of base salary | | |
|---|---|---|---|
| | Actual share ownership as at 31 December 2010* | Guideline on level of share ownership | Guideline met currently Y/N |
| S C Lockett | 1,215% | 200% | Y |
| R A Allan | 1,125% | 100% | Y |
| A R C Durrant | 929% | 100% | Y |
| N Hawkings | 655% | 100% | Y |
| A G Lodge | 138% | 100% | Y |

* Includes value of Deferred Awards under the annual bonus and AEP (where performance conditions have been achieved and such awards are subject to a holding period).

## Executive directors' contracts of service

Details of the service contracts of the executive directors of the company are as follows:

| | Contract date | Notice period | Unexpired term of contract | Potential termination payment |
|---|---|---|---|---|
| S C Lockett | 9 December 2003 | 12 months | Rolling contract | 12 months' salary and benefits |
| R A Allan | 9 December 2003 | 12 months | Rolling contract | 12 months' salary and benefits |
| A R C Durrant | 1 July 2005 | 12 months | Rolling contract | 12 months' salary and benefits |
| N Hawkings | 23 March 2006 | 12 months | Rolling contract | 12 months' salary and benefits |
| A G Lodge | 20 April 2009 | 12 months | Rolling contract | 12 months' salary and benefits |

The service contract of each executive director may be terminated on 12 months' notice in writing by either side, in accordance with current market practice. In such an event, the compensation commitments in respect of their contracts could amount to one year's remuneration based on base salary and benefits in kind and pension rights during the notice period. In line with normal market practice, an individual may receive an annual bonus for the proportion of a financial year worked before cessation of employment but there will be no right to any bonus for any period of notice not worked. There are provisions for termination with less than 12 months' notice by the company in certain circumstances. If such circumstances were to arise, the executive director concerned would have no claim against the company for damages or any other remedy in respect of the termination. The Committee would apply general principles of mitigation to any payment made to a departing executive director and would consider each case on an individual basis.

## External appointments

Executive directors are entitled to accept non-executive appointments outside the company providing that the Board's approval is sought. Mr A R C Durrant held one external non-executive directorship with Clipper Windpower plc up to 13 December 2010 and is entitled to retain the fees earned connected therewith (2010: US$69,000 and 2009: US$64,860).

## Non-executive directors

Non-executive directors have letters of appointment, which are all effective for a period of three years (subject to reappointment by the members in General Meeting), all of which have a notice period of three months.

| Director | Date of appointment letter | Notice period | Unexpired term |
|---|---|---|---|
| M W Welton | 23 September 2009 | 3 months | 18 months |
| J R W Orange | 23 September 2009 | 3 months | 15 months |
| Professor D G Roberts | 23 September 2009 | 3 months | 15 months |
| J Darby | 1 September 2010 | 3 months | 29 months |
| I J Hinkley | 1 September 2010 | 3 months | 29 months |
| D C Lindsell | 17 January 2011 | 3 months | 33 months |
| M Romieu | 17 January 2011 | 3 months | 33 months |

# Remuneration Report (continued)

### Non-executive directors (continued)

The company's Articles of Association provide that the remuneration paid to non-executive directors is to be determined by the Board within the limits set by the shareholders. Fees for non-executives are reviewed at least every two years, having regard to the size of the company and the time commitments of the non-executives.

The Board reviewed the fees of the non-executives at the end of 2010 and decided to increase them for 2011. This recognises the steadily increasing time commitment and expertise required of the roles and, after careful consideration of benchmark data, they have been set at a level which is broadly in line with comparable businesses as follows:

| | | Other non-executive directors | | |
|---|---|---|---|---|
| | Chairman (£) | Basic fee (£) | Committee chairmanship (£) | Senior independent director (£) |
| 2010 | 150,000 | 40,000 | 8,000 | 2,000 |
| 2011 | 160,000 | 50,000 | 10,000 | 10,000 |

### Part B: The information in this part of the report has been audited

### Directors' emoluments

Total emoluments paid to directors for the year ended 31 December 2010 was £2,951,300 (2009: £2,905,600).

The remuneration paid to the executive directors during the year under review is summarised in the table below:

| | Salary | Benefits* | Cash bonus‡ | Other[3,4,5,6] | Total | | Pension contributions | Shares vested and realised** | Total remuneration received in 2010 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 2010 | 2009 | | | |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| S C Lockett[1] | | | | | | | | | |
| (Chief Executive) | 435.0 | 17.6 | 130.5 | – | **583.1** | 637.3 | 55.2 | 2,138.2 | 2,776.5 |
| R A Allan[2,3,7,8] | 282.0 | 209.2 | 90.0 | 75.0 | **656.2** | 613.6 | 60.0 | 1,489.0 | 2,205.2 |
| A R C Durrant[4] | 320.0 | 25.3 | 96.0 | 56.7 | **498.0** | 534.3 | – | 969.0 | 1,467.0 |
| N Hawkings[2,6] | 285.0 | 17.0 | 90.0 | 2.6 | **394.6** | 430.7 | 57.1 | 881.2 | 1,332.9 |
| A G Lodge[2,5] | 293.3 | 18.0 | 90.0 | 36.8 | **438.1** | 306.5 | 18.5 | 64.0 | 520.6 |
| **Total** | **1,615.3** | **287.1** | **496.5** | **171.1** | **2,570.0** | **2,522.4** | **190.8** | **5,541.4** | **8,302.2** |

Notes:

1. A contribution of £55,212 was paid in 2010 to Mr S C Lockett's personal money purchase pension scheme.
2. Messrs R A Allan, N Hawkings and A G Lodge sacrificed £18,000, £15,000 and £6,750 of their salary respectively into the money purchase pension scheme.
3. Mr R A Allan was paid a non-pensionable and non-bonusable overseas premium of £75,000 relating to his position in Singapore.
4. Mr A R C Durrant received a non-bonusable salary supplement of £56,736 as part of his pension arrangements.
5. Mr A G Lodge received a non-bonusable salary supplement of £36,756 as part of his pension arrangements.
6. Mr N Hawkings received a non-bonusable salary supplement of £2,606 as part of his pension arrangements.
7. Mr R A Allan received £194,239 of expatriate benefits during the year.
8. The company deducts a hypothetical tax equivalent to UK tax rates on Mr R A Allan's salary, bonus and long-term incentive payments. This is used to offset against local Singapore tax due – the maximum tax rate in Singapore is a lower percentage than in the UK resulting in a tax credit back to the company.

* The main benefits provided are medical insurance, car allowance and a subsidised gym membership.

** Shares vested and realised is the sum of the value of various share awards (as at the date of vesting) in relation to the AEP, matching shares and deferred annual bonus, based on performance periods stretching back as far as 2004 in some cases.

‡ Following a review of the 2010 performance, the Committee determined that the finance and organisation targets had been achieved (20 per cent of the total maximum award) and agreed a 40 per cent award out of the maximum 80 per cent in relation to the health, safety, environment and security, the production and development and the exploration and new business targets, as these targets were only partially met. This resulted in a total bonus award of 60 per cent of salary, 30 per cent of salary paid as cash (as disclosed in the table above). In addition to the cash awards above, an equal amount is to be awarded in shares deferred for three years (2009: 85 per cent of salary, paid as 42.5 per cent cash and 42.5 per cent Deferred Shares). The number of Deferred Shares to be awarded will be determined by reference to the mid-market closing price of Premier Oil shares on the first open day for share dealing following the company's results announcement on 24 March 2011.

## Directors' emoluments (continued)

Remuneration paid to the non-executive directors during the year under review is summarised in the table below:

| | Fees | |
|---|---|---|
| | 2010 £'000 | 2009 £'000 |
| M W Welton (Chairman) | **150.0** | 46.6 |
| J Darby | **40.0** | 40.0 |
| I J Hinkley[1] | **13.3** | – |
| D C Lindsell | **48.0** | 48.0 |
| J R W Orange | **50.0** | 50.0 |
| Professor D G Roberts | **40.0** | 40.0 |
| M Romieu | **40.0** | 40.0 |
| Former director[2] | **–** | 118.6 |
| **Total** | **381.3** | 383.2 |

Notes:
1. Ms I J Hinkley's total remuneration in 2010 is calculated from 1 September 2010, being the date of her appointment to the Board.
2. Relates to non-executive director fees for Sir David John, who retired from the Board in 2009.

## Pension schemes

The company operates a defined contribution pension scheme in the UK, together with a defined benefit pension scheme – the Premier Oil plc Retirement and Death Benefits Plan (the Scheme). The Scheme was closed to new members in 1997. Mr S C Lockett is a member of the Scheme, subject to the earnings cap. The Scheme is a funded, registered final salary scheme, which provides a pension on broadly a fiftieths accrual basis of up to two-thirds salary at the normal pension age of 60. Benefits are actuarially reduced on early retirement before age 60 and pensions in payment increase in line with the lower of inflation or 5 per cent per annum.

The company has operated its own cap on pensionable earnings since April 2006, when the external cap was removed. In the Scheme, the cap is determined at 1 January each year and, for the year to 31 December 2010, this was set at £123,600 and will stay the same for the year to 31 December 2011. In the company's money purchase pension arrangement, the cap is determined at 6 April each year and, for 2009/10 this was set at £123,600 and will stay the same for April 2010/11.

During 2010, the UK Government issued further details about the longer-term basis on which tax relief will be afforded to the provision of pension rights; in particular, the proposed reduction in the Annual Allowance and Lifetime Allowance from April 2011 and April 2012 respectively. As a result, the company is reviewing the pension arrangements of executive directors.

The company has agreed to provide Messrs S C Lockett, R A Allan, A R C Durrant, N Hawkings and A G Lodge with a pension substantially as if they were contributing members of the Scheme and, in regard to service completed subsequent to their appointment as directors, not subject to the earnings cap (the 'pension promise'). The additional value of this target pension provision, relative to the standard terms applied to employees, is made available at the directors' option in the form of either an enhanced scale of pension contributions or a non-pensionable salary supplement. As at the year-end, Messrs S C Lockett and R A Allan had elected to receive pension contributions. Mr A R C Durrant had elected to receive a salary supplement and Messrs A G Lodge and N Hawkings had elected for a combination of the two. Messrs A R C Durrant, A G Lodge and N Hawkings received a salary supplement, during 2010, of £56,736, £36,756 and £2,606 respectively.

Messrs R A Allan, N Hawkings and A G Lodge are members of the company's group personal pension plan. During 2010, the company contributed £24,720, £24,720 and £18,540 respectively to this plan on their behalf. In addition, in respect of the pension promise, the company contributed £35,280 and £32,340 respectively to Messrs R A Allan's and N Hawkings' pension funds with the group personal pension plan. Mr S C Lockett has established his own personal pension plan, to which, during 2010, the company contributed £55,212 in regard to the pension promise. This is in addition to the company contributions paid into the Scheme on his behalf. Details of the company's contributions to these arrangements are disclosed in the emoluments table.

# Remuneration Report (continued)

## Pension schemes (continued)

The accrued pension entitlements of the directors who were members (or deemed members) of the Scheme during 2010 are as follows:

| | (a) Accrued pension as at 31 December 2010 £'000 pa | (b) Transfer value in respect of (a) as at 31 December 2010 £'000 | (c) Accrued pension as at 31 December 2009 £'000 pa | (d) Transfer value in respect of (c) as at 31 December 2009 £'000 | (e) Increase from (d) to (b) less contributions by director during 2010 £'000 | (f) Transfer value of increase in accrued benefit £'000 | (g) Increase in accrued pension (excluding inflation) £'000 |
|---|---|---|---|---|---|---|---|
| S C Lockett | 78.1 | 1,041.1 | 66.6 | 839.3 | 175.9 | 153.2 | 11.5 |
| R A Allan | 38.9 | 626.2 | 32.1 | 491.1 | 118.3 | 109.5 | 6.8 |
| A R C Durrant | 32.2 | 534.7 | 24.9 | 392.3 | 124.4 | 121.2 | 7.3 |
| N Hawkings | 25.6 | 393.5 | 18.8 | 274.6 | 102.1 | 104.5 | 6.8 |
| A G Lodge | 9.0 | 162.4 | 3.4 | 59.0 | 86.6 | 101.0 | 5.6 |

Notes:
- The amounts of accrued pension under (a) and (c) represent the accrued pension entitlements of the director as at the stated dates.
- The transfer values under (b), (d) and (f) have been calculated in line with the Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 (SI 2008/1050).
- The increases under (e) are principally due to the additional pension accrued over the year.
- The amounts under (f) represent the increase in value of the directors' benefits in terms of the value, on the transfer value basis in force at the end of the year, of the excess of the end-year accrued benefits over the start-year accrued benefits (as revalued by price inflation) less contributions by the directors.
- The values stated above correspond with the target level of final salary pension provision; in practice, the pension benefits for these directors are principally established through individual money purchase arrangements and salary supplements. Thus, in the case of Mr A R C Durrant, who has elected not to receive enhanced pension contributions, the company's pension obligation will be met entirely by the payment of salary supplements.
- In addition to the current provision noted above, Mr R A Allan is entitled to a deferred pension under the Scheme in respect of a prior service period with the company between September 1986 and November 1999.
- Members of the Scheme have the option to pay additional voluntary contributions; none of the directors have elected to do so.

The following payments were made to a former director of the company in respect of unfunded pension liabilities:

| | **Amount of unfunded pension paid during 2010 (£)** | Amount of unfunded pension paid during 2009 (£) |
|---|---|---|
| J A Heath | **33,606** | 32,818 |

## Annual bonus scheme

Details of shares held in trust in respect of the deferred element of previous annual bonus awards for directors are as follows:

| | Date of grant | Number of shares held at 1 January 2010[1] | Number of shares made subject to award during 2010 | Event and number of shares | Market price of shares on date of award[3] | Number of shares held at 31 December 2010 | Earliest vesting date |
|---|---|---|---|---|---|---|---|
| S C Lockett | 17 January 2007 | 12,206 | – | 12,206[a] | 1128.0p | – | 17 January 2010 |
| | 11 January 2008 | 11,296 | – | 6,664[b] 4,632[c] | 1317.0p | 6,664 | 11 January 2011[2] |
| | 22 January 2009 | 17,930 | – | 10,578[b] 7,352[c] | 741.5p | 10,578 | 22 January 2012 |
| | 7 January 2010 | – | 14,731 | 8,691[b] 6,040[c] | 1255.0p | 8,691 | 7 January 2013 |
| | | **41,432** | **14,731** | **56,163** | | **25,933** | |
| R A Allan | 17 January 2007 | 9,561 | – | 9,561[a] | 1128.0p | – | 17 January 2010 |
| | 11 January 2008 | 8,124 | – | 4,793[b] 3,331[d] | 1317.0p | 4,793 | 11 January 2011[2] |
| | 22 January 2009 | 12,936 | – | 7,632[b] 5,304[d] | 741.5p | 7,632 | 22 January 2012 |
| | 7 January 2010 | – | 10,159 | 5,993[b] 4,166[d] | 1255.0p | 5,993 | 7 January 2013 |
| | | **30,621** | **10,159** | **40,780** | | **18,418** | |

Annual bonus scheme (continued)

| | Date of grant | Number of shares held at 1 January 2010[1] | Number of shares made subject to award during 2010 | Event and number of shares | Market price of shares on date of award[3] | Number of shares held at 31 December 2010 | Earliest vesting date |
|---|---|---|---|---|---|---|---|
| A R C Durrant | 17 January 2007 | 9,561 | – | 9,561[(a)] | 1128.0p | – | 17 January 2010 |
| | 11 January 2008 | 8,154 | – | 4,810[(b)]<br>3,344[(c)] | 1317.0p | 4,810 | 11 January 2011[2] |
| | 22 January 2009 | 13,164 | – | 7,766[(b)]<br>5,398[(c)] | 741.5p | 7,766 | 22 January 2012 |
| | 7 January 2010 | – | 10,836 | 6,393[(b)]<br>4,443[(c)] | 1255.0p | 6,393 | 7 January 2013 |
| | | **30,879** | **10,836** | **41,715** | | **18,969** | |
| N Hawkings | 17 January 2007 | 9,561 | – | 9,561[(a)] | 1128.0p | – | 17 January 2010 |
| | 11 January 2008 | 7,369 | – | – | 1317.0p | 7,369 | 11 January 2011[2] |
| | 22 January 2009 | 11,801 | – | – | 741.5p | 11,801 | 22 January 2012 |
| | 7 January 2010 | – | 10,159 | – | 1255.0p | 10,159 | 7 January 2013 |
| | | **28,731** | **10,159** | **9,561** | **–** | **29,329** | |
| A G Lodge | 7 January 2010 | – | 6,530 | 3,852[(b)]<br>2,678[(c)] | 1255.0p | 3,852 | 7 January 2013 |
| | | **–** | **6,530** | **6,530** | | **3,852** | |

(a) Vested on 22 January 2010. The mid-market closing price on date of vesting was 1076.0p.
(b) Modified – converted to restricted shares on 29 March 2010 following the accelerated vesting of the Deferred Shares for tax planning purposes*. The mid-market closing price on 29 March 2010 was 1242.0p.
(c) Shares sold to pay income tax and National Insurance contributions arising upon the accelerated vesting of awards but subject to clawback*.
(d) Shares withheld in respect of a notional tax payment equivalent to UK income tax. Any overseas tax paid on behalf of the participant in respect of the vesting of the shares is subject to clawback*.
* On 29 March 2010, these awards were changed from conditional awards of shares to restricted shares. Some of the shares were sold to pay income tax and National Insurance contributions payable by Messrs S C Lockett, A R C Durrant and A G Lodge upon the accelerated vesting of the awards, but the amounts received from the sale remain subject to clawback in the event of the participant leaving Premier, other than as a 'good leaver'. In the case of Mr R A Allan, who as an expatriate is not subject to UK tax, a percentage of the shares were withheld equal to the percentage tax rate that would have applied had he been subject to UK income tax. These shares reverted to the Trust and the company will pay any overseas duties payable by Mr R A Allan as a result of the vesting of his shares, but the amount paid remains subject to clawback if Mr R A Allan leaves Premier, other than as a 'good leaver'. The remaining shares are held in a nominee account within the Premier Oil plc Employee Benefit Trust until the end of the original deferral period. The shares would be forfeited if the director leaves other than as a 'good leaver'.

Notes:
1. The number of deferred bonus shares awarded in 2007, 2008 and 2009 were adjusted following the rights issue which took place in May 2009.
2. On 13 January 2011, following completion of the original deferral period, 6,664 shares, 4,793 shares, 4,810 shares and 7,369 shares were released from the Employee Benefit Trust to Messrs S C Lockett, R A Allan, A R C Durrant and N Hawkings respectively.
3. The published 2009 figures included an incorrect market price for the 22 January 2009 award of 714.5p. The correct number is 741.5p which is shown in the table above.

As at the date of this report, the number of Deferred Shares to be awarded to directors for the year ended 31 December 2010 is still to be determined by the Remuneration Committee. The number of shares will be calculated by reference to the amount of the award outlined on page 48 divided by the mid-market closing price of Premier Oil shares on the first open day for share dealing following the company's results announcement on 24 March 2011.

## Outstanding long-term incentive awards

### Asset and Equity Plan (AEP)

The AEP expired in 2009 and the award granted in 2008, which matured at the end of 2010, was the last award remaining under the plan. Accordingly, there are no further awards outstanding under the plan.

The AEP has two elements: the Asset Pool and the Equity Pool. The Asset Pool is created by reference to the increase in the net asset value per share of the company over a three-year period and the Equity Pool is created by reference to the increase in equity value per share of the company over a three-year period. In both cases, no pool is created where the compound annual growth in the relevant measure (asset value or share price) is below 10 per cent per annum. At 10 per cent compound growth per annum, 1 per cent of the growth becomes the pool. At 20 per cent compound growth per annum, 2.5 per cent of the growth becomes the pool. The size of the pool increases on a straight-line basis between these two points. In addition, the vesting of awards is subject to the Committee being satisfied that there has been satisfactory improvement in the performance of the company. The pool is allocated to eligible employees based on their pro rata entitlement.

# Remuneration Report (continued)

## 2007 award (based on performance over 2007, 2008 and 2009)

In relation to the 2007 AEP award, an independent external valuation of the Asset Pool was undertaken and the Committee determined the 2007 vesting level as set out in the table below. 50 per cent of the awards made to directors were released in shares and 50 per cent in deferred shares which are eligible for a Matching Award on the same basis as awards under the LTIP. The minimum vesting threshold for the Equity Pool was not achieved resulting in this part of the award lapsing.

| | Shares awarded | Deferred Shares awarded[1] | Matching Awards granted during the year[2] |
|---|---|---|---|
| S C Lockett | 36,243 | 36,243 | 90,607 |
| R A Allan | 23,784 | 23,784 | 59,460 |
| A R C Durrant | 23,784 | 23,784 | 59,460 |
| N Hawkings | 23,784 | 23,784 | 59,460 |
| A G Lodge | 5,289 | 5,289 | 13,222 |

Notes:
1. The market price of shares on date of award was 1211.0p.
2. The Matching Awards granted during the year relate to the Deferred Shares and are the maximum award possible under the Matching Award scheme, subject to performance criteria. The market price was 1214.0p on the date of grant of Matching Awards.

## 2008 award (based on performance over 2008, 2009 and 2010)

The executive directors have been allocated the following points under the 2008 award out of a total of 7,634.60 points currently outstanding:

| | Number of participation points |
|---|---|
| S C Lockett | 310 |
| R A Allan | 205 |
| A R C Durrant | 205 |
| N Hawkings | 205 |
| A G Lodge[1] | 113.9 |

Note:
1. Mr A G Lodge received compensatory points under the 2008 award following his appointment to the Board on 20 April 2009.

The Equity Pool of the 2008 award was calculated by comparing the market capitalisation calculated by reference to the average share price for the three months prior to the date of award (1 January 2008), with the market capitalisation similarly calculated to 31 December 2010. Growth over this period was equivalent to 24.3 per cent pa compound.

The Asset Pool of the 2008 award was calculated following the sign-off of the year-end results. Growth over this period was equivalent to 12.48 per cent pa compound.

In line with the rules of the plan, which state that a 2x salary cap on payouts may be lifted (on such proportionate basis as it determines) where growth in either pool is in excess of 20 per cent pa compound, the Committee determined that the cap should be increased to 243 per cent of salary.

If it is determined that the minimum vesting threshold has been achieved, half of any executive director's vested award will be received in shares and the other half in the form of an award of Deferred Shares which are eligible for a Matching Award on the same basis as awards under the LTIP, which will vest three years later.

## Details of outstanding AEP awards

Details of Deferred Shares and Matching Awards granted to directors under the Asset and Equity Plan are set out below:

| | Date of grant | Type of award | Awards held at 1 January 2010[1] | Number of shares made subject to award during 2010[2] | Number of Matching Awards granted during 2010[3] | Event and number of shares | Awards held at 31 December 2010 | Market price of shares on date of award | Performance period | Earliest vesting date |
|---|---|---|---|---|---|---|---|---|---|---|
| S C Lockett | 17.01.07 | Deferred Share | 51,736 | – | – | 51,736[a] | – | 1128.0p | – | 01.01.10 |
| | 27.03.07 | Matching Award | 129,340 | – | – | 81,328[b]<br>48,012[c] | – | 1235.0p | 01.01.07 – 31.12.09 | 01.01.10 |
| | 11.01.08 | Deferred Share | 41,256 | – | – | 24,341[d]<br>16,915[e] | 24,341 | 1317.0p | – | 01.01.11 |
| | 13.03.08 | Matching Award | 103,140 | – | – | – | 103,140 | 1343.0p | 01.01.08 – 31.12.10 | 01.01.11 |
| | 20.04.09 | Deferred Share | 20,752 | – | – | 12,243[d]<br>8,509[e] | 12,243 | 1228.0p | – | 01.01.12 |
| | 29.05.09 | Matching Award | 51,882 | – | – | – | 51,882 | 1136.0p | 01.01.09 – 31.12.11 | 01.01.12 |
| | 26.03.10 | Deferred Share | – | 36,243 | – | 21,383[d]<br>14,860[e] | 21,383 | 1211.0p | – | 01.01.13 |
| | 17.06.10 | Matching Award | – | – | 90,607 | – | 90,607 | 1214.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | | **398,106** | **36,243** | **90,607** | **279,327** | **303,596** | | | |
| R A Allan | 17.01.07 | Deferred Share | 36,230 | – | – | 36,230[a] | – | 1128.0p | – | 01.01.10 |
| | 27.03.07 | Matching Award | 90,576 | – | – | 56,954[b]<br>33,622[c] | – | 1235.0p | 01.01.07 – 31.12.09 | 01.01.10 |
| | 11.01.08 | Deferred Share | 24,619 | – | – | 14,525[d]<br>10,094[f] | 14,525 | 1317.0p | – | 01.01.11 |
| | 13.03.08 | Matching Award | 61,548 | – | – | – | 61,548 | 1343.0p | 01.01.08 – 31.12.10 | 01.01.11 |
| | 20.04.09 | Deferred Share | 15,062 | – | – | 8,886[d]<br>6,176[f] | 8,886 | 1228.0p | – | 01.01.12 |
| | 29.05.09 | Matching Award | 37,656 | – | – | – | 37,656 | 1136.0p | 01.01.09 – 31.12.11 | 01.01.12 |
| | 26.03.10 | Deferred Share | – | 23,784 | – | 14,032[d]<br>9,752[f] | 14,032 | 1211.0p | – | 01.01.13 |
| | 17.06.10 | Matching Award | – | – | 59,460 | – | 59,460 | 1214.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | | **265,691** | **23,784** | **59,460** | **190,271** | **196,107** | | | |
| A R C Durrant | 17.01.07 | Deferred Share | 19,062 | – | – | 19,062[a] | – | 1128.0p | – | 01.01.10 |
| | 27.03.07 | Matching Award | 47,656 | – | – | 29,965[b]<br>17,691[c] | – | 1235.0p | 01.01.07 – 31.12.09 | 01.01.10 |
| | 11.01.08 | Deferred Share | 24,619 | – | – | 14,525[d]<br>10,094[e] | 14,525 | 1317.0p | – | 01.01.11 |
| | 13.03.08 | Matching Award | 61,548 | – | – | – | 61,548 | 1343.0p | 01.01.08 – 31.12.10 | 01.01.11 |
| | 20.04.09 | Deferred Share | 15,062 | – | – | 8,886[d]<br>6,176[e] | 8,886 | 1228.0p | – | 01.01.12 |
| | 29.05.09 | Matching Award | 37,656 | – | – | – | 37,656 | 1136.0p | 01.01.09 – 31.12.11 | 01.01.12 |
| | 26.03.10 | Deferred Share | – | 23,784 | – | 14,032[d]<br>9,752[e] | 14,032 | 1211.0p | – | 01.01.13 |
| | 17.06.10 | Matching Award | – | – | 59,460 | – | 59,460 | 1214.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | | **205,603** | **23,784** | **59,460** | **130,183** | **196,107** | | | |

# Remuneration Report (continued)

## Details of outstanding AEP awards (continued)

| | Date of grant | Type of award | Awards held at 1 January 2010[1] | Number of shares made subject to award during 2010[2] | Number of Matching Awards granted during 2010[3] | Event and number of shares | Awards held at 31 December 2010 | Market price of shares on date of award | Performance period | Earliest vesting date |
|---|---|---|---|---|---|---|---|---|---|---|
| N Hawkings | 17.01.07 | Deferred Share | 16,164 | – | – | 16,164[(a)] | – | 1128.0p | – | 01.01.10 |
| | 27.03.07 | Matching Award | 40,410 | – | – | 25,409[(b)] 15,001[(c)] | – | 1235.0p | 01.01.07 – 31.12.09 | 01.01.10 |
| | 11.01.08 | Deferred Share | 21,613 | – | – | 12,751[(d)] 8,862[(e)] | 12,751 | 1317.0p | – | 01.01.11 |
| | 13.03.08 | Matching Award | 54,033 | – | – | – | 54,033 | 1343.0p | 01.01.08 – 31.12.10 | 01.01.11 |
| | 20.04.09 | Deferred Share | 15,062 | – | – | 8,886[(d)] 6,176[(e)] | 8,886 | 1228.0p | – | 01.01.12 |
| | 29.05.09 | Matching Award | 37,656 | – | – | – | 37,656 | 1136.0p | 01.01.09 – 31.12.11 | 01.01.12 |
| | 26.03.10 | Deferred Share | – | 23,784 | – | 14,032[(d)] 9,752[(e)] | 14,032 | 1211.0p | – | 01.01.13 |
| | 17.06.10 | Matching Award | – | – | 59,460 | – | 59,460 | 1214.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | | **184,938** | **23,784** | **59,460** | **117,033** | **186,818** | | | |
| A G Lodge | 26.03.10 | Deferred Share | – | 5,289 | – | 3,120[(d)] 2,169[(e)] | 3,120 | 1211.0p | – | 01.01.13 |
| | 17.06.10 | Matching Award | – | – | 13,222 | – | 13,222 | 1214.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | | **–** | **5,289** | **13,222** | **5,289** | **16,342** | | | |

(a) Awards vested on 22 January 2010. The mid-market closing price on date of vesting was 1076.0p.
(b) Awards vested on 29 March 2010. The mid-market closing price on date of vesting was 1242.0p.
(c) Awards lapsed on 29 March 2010.
(d) Modified – converted to restricted shares on 29 March 2010 following the accelerated vesting of the Deferred Shares for tax planning purposes*. The mid-market closing price on 29 March 2010 was 1242.0p.
(e) Shares sold to pay income tax and National Insurance contributions arising upon the accelerated vesting of awards but subject to clawback*.
(f) Shares withheld in respect of a notional tax payment equivalent to UK income tax. Any overseas tax paid on behalf of the participant in respect of the vesting of the awards is subject to clawback*.
* On 29 March 2010, these awards were changed from conditional awards of shares to restricted shares. Some of the shares were sold to pay income tax and National Insurance contributions payable by Messrs S C Lockett, A R C Durrant, N Hawkings and A G Lodge upon the accelerated vesting of the awards, but the amounts received from the sale remain subject to clawback in the event of the participant leaving Premier, other than as a 'good leaver'. In the case of Mr R A Allan, who as an expatriate is not subject to UK tax, a percentage of the shares were withheld equal to the percentage tax rate that would have applied had he been subject to UK income tax. These shares reverted to the Trust and the company will pay any overseas duties payable by Mr R A Allan as a result of the vesting of his shares, but the amount paid remains subject to clawback if Mr R A Allan leaves Premier, other than as a 'good leaver'. The remaining shares are held in a nominee account within the Premier Oil plc Employee Benefit Trust until the end of the original deferral period. The shares would be forfeited if the director leaves other than as a 'good leaver'.

Notes:
1. The number of Deferred Shares and Matching Award shares awarded under the Asset and Equity Plan in 2007, 2008 and 2009 were adjusted following the rights issue which took place in May 2009. The adjusted numbers are quoted in the table above.
2. There are no performance criteria for the Deferred Shares.
3. Matching Awards granted are the maximum award possible under the Matching Award scheme, subject to performance criteria based on TSR against a comparator group of approximately 33 listed companies in the oil and gas sector. Full vesting requires upper decile performance.

## Details of outstanding LTIP awards

### 2009 award (based on performance over 2009, 2010 and 2011)

As at 31 December 2010, a total of 10,425.3 participation points have been allocated under the 2009 Equity Pool Award.

The executive directors have been allocated the following points under the 2009 Equity Pool Award:

| | Number of participation points |
|---|---|
| S C Lockett | 525 |
| R A Allan | 420 |
| A R C Durrant | 420 |
| N Hawkings | 420 |
| A G Lodge | 420 |

**2009 award (based on performance over 2009, 2010 and 2011)** (continued)

For Performance Shares made under the LTIP in 2009, the Committee has granted awards over shares with a maximum value of 150 per cent of salary for Mr S C Lockett and 125 per cent of salary for the other executive directors.

**2010 award (based on performance over 2010, 2011 and 2012)**

As at 31 December 2010, a total of 13,632.8 participation points have been allocated under the 2010 Equity Pool Award.

The executive directors have been allocated the following points under the 2010 Equity Pool Award:

| | Number of participation points |
|---|---|
| S C Lockett | 682 |
| R A Allan | 545 |
| A R C Durrant | 545 |
| N Hawkings | 545 |
| A G Lodge | 545 |

For Performance Shares made under the LTIP in 2010, the Committee has granted awards over shares with a maximum value of 150 per cent of salary for Mr S C Lockett and 125 per cent of salary for the other executive directors.

Details of Performance Shares granted to directors under the LTIP in 2009 and 2010 are set out below:

| | Date of grant | Awards held at 1 January 2010 | Granted | Lapsed | Vested | Awards held at 31 December 2010 | Market price of shares on date of award | Performance period | Earliest vesting date |
|---|---|---|---|---|---|---|---|---|---|
| S C Lockett | 28.08.09 | 51,216 | – | – | – | 51,216 | 1274.0p | 01.06.09 – 31.12.11 | 01.01.12 |
| | 27.05.10 | – | 57,948 | – | – | 57,948 | 1126.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | **51,216** | **57,948** | – | – | **109,164** | | | |
| R A Allan | 28.08.09 | 29,434 | – | – | – | 29,434 | 1274.0p | 01.06.09 – 31.12.11 | 01.01.12 |
| | 27.05.10 | – | 33,303 | – | – | 33,303 | 1126.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | **29,434** | **33,303** | – | – | **62,737** | | | |
| A R C Durrant | 28.08.09 | 31,397 | – | – | – | 31,397 | 1274.0p | 01.06.09 – 31.12.11 | 01.01.12 |
| | 27.05.10 | – | 35,523 | – | – | 35,523 | 1126.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | **31,397** | **35,523** | – | – | **66,920** | | | |
| N Hawkings | 28.08.09 | 29,434 | – | – | – | 29,434 | 1274.0p | 01.06.09 – 31.12.11 | 01.01.12 |
| | 27.05.10 | – | 33,303 | – | – | 33,303 | 1126.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | **29,434** | **33,303** | – | – | **62,737** | | | |
| A G Lodge | 28.08.09 | 26,981 | – | – | – | 26,981 | 1274.0p | 01.06.09 – 31.12.11 | 01.01.12 |
| | 27.05.10 | – | 33,303 | – | – | 33,303 | 1126.0p | 01.01.10 – 31.12.12 | 01.01.13 |
| | | **26,981** | **33,303** | – | – | **60,284** | | | |

As at 31 December 2010, a total of 2,574,794 Performance Shares have been awarded under the LTIP.

# Remuneration Report (continued)

## Conditional Share Awards

Mr A G Lodge was awarded a Conditional Share Award equivalent in value to the shares he forfeited at his employer when he left to join the company. This award was considered essential to induce Mr A G Lodge to join the company. Vesting of the awards is contingent on Mr A G Lodge remaining in employment at the vesting date, but is not dependent on any further performance-related measures. Details of the Conditional Share Award are set out below:

| Date of grant | Awards held at 1 January 2010[1] | Event and number of shares | Awards held at 31 December 2010 | Market price of shares on date of award | Earliest vesting date |
|---|---|---|---|---|---|
| 20 April 2009 | 17,837 | 10,523[(a)]<br>7,314[(b)]<br>10,523[(c)] | – | 1195.0p | 20.04.10 |
| 20 April 2009 | 25,685 | 15,154[(a)]<br>10,531[(b)] | 15,154 | 1195.0p | 20.04.11 |

(a) Modified – converted to restricted shares on 29 March 2010 following the accelerated vesting of the Deferred Shares*. The mid-market closing price on 29 March 2010 was 1242.0p.

(b) Shares sold to pay income tax and National Insurance contributions arising upon accelerated vesting of the award but subject to clawback*.

(c) Shares released from the Employee Benefit Trust on 11 May 2010.

* On 29 March 2010, these awards were changed from conditional awards of shares to restricted shares. Some of the shares were sold to pay income tax and National Insurance contributions payable by Mr A G Lodge upon the accelerated vesting of the awards, but the amounts received from the sale remain subject to clawback in the event of Mr A G Lodge leaving Premier, other than as a 'good leaver'. The remaining shares were transferred to a nominee account within the Premier Oil plc Employee Benefit Trust until the end of the original deferral period. If Mr A G Lodge leaves Premier before the end of the original deferral period, other than for 'good leaver' reasons, he will forfeit the shares held in the nominee account.

Notes:
1. The number of Conditional Share Awards held were adjusted following the rights issue which took place in May 2009. The adjusted numbers are quoted in the table above.

## Share option schemes

### Executive Share Option Scheme 2003

The grant to Mr N Hawkings was made as part of his recruitment terms, where it was agreed that the grant would not be subject to any pre-vesting performance conditions. The Executive Share Option Scheme 2003 has expired.

Directors' interests under this scheme are shown below:

| | Date of grant | Exercisable dates | Acquisition price per share (£)[1] | Options held at 1 January 2010[1] | Granted | Exercised[2] | Lapsed | Options held at 31 December 2010 |
|---|---|---|---|---|---|---|---|---|
| N Hawkings | 16.05.05 | 16.05.08 – 15.05.15 | 4.37095 | 24,478 | – | 24,478 | – | – |

Notes:
1. The number of options held and the option exercise price were adjusted following the rights issue which took place in May 2009. The adjusted numbers are quoted in the table above.
2. The mid-market closing price was 1210.0p on the day of exercise (12 January 2010).

### Savings Related Share Option Scheme 2003

Directors' interests under this scheme are shown below:

| | Date of grant | Exercisable dates | Acquisition price per share (£)[1] | Options held at 1 January 2010[1] | Granted | Exercised | Lapsed | Options held at 31 December 2010 |
|---|---|---|---|---|---|---|---|---|
| S C Lockett | 03.05.07 | 01.06.10 – 30.11.10 | 8.13732 | 1,160 | – | 1,160[2] | – | – |
| R A Allan | 03.05.07 | 01.06.12 – 30.11.12 | 8.13732 | 2,012 | – | – | – | 2,012 |
| A R C Durrant | 04.05.06 | 01.06.11 – 30.11.11 | 6.66672 | 2,414 | – | – | – | 2,414 |
| N Hawkings | 04.05.06 | 01.06.11 – 30.11.11 | 6.66672 | 2,414 | – | – | – | 2,414 |

Notes:
1. The number of options held and the option acquisition price were adjusted following the rights issue which took place in May 2009. The adjusted numbers are quoted in the table above.
2. The mid-market closing price was 1865.0p on the day of exercise (17 November 2010).

### Savings Related Share Option Scheme 2009

Directors' interests under this scheme are shown below:

| | Date of grant | Exercisable dates | Acquisition price per share (£) | Options held at 1 January 2010 | Granted | Exercised | Lapsed | Options held at 31 December 2010 |
|---|---|---|---|---|---|---|---|---|
| S C Lockett | 05.05.10 | 01.06.13 – 30.11.13 | 10.42000 | – | 870 | – | – | 870 |
| A G Lodge | 05.05.10 | 01.06.13 – 30.11.13 | 10.42000 | – | 870 | – | – | 870 |

### Share Incentive Plan

Shares held beneficially in this plan by the directors during the financial year were as follows:

| | Shares held on 1 January 2010 | Total Partnership Shares purchased in 2010 at prices between 1057p and 1860p | Total Matching Shares awarded in 2010 at prices between 1057p and 1860p, vesting in 2013 | Shares held on 31 December 2010 | Partnership and Matching Shares acquired between 1 January and 23 March 2011 |
|---|---|---|---|---|---|
| S C Lockett | 3,851 | 113 | 113 | 4,077 | 36 |
| R A Allan | 3,842 | 113 | 113 | 4,068 | 36 |
| A R C Durrant | 1,304 | 113 | 113 | 1,530 | 36 |
| N Hawkings | 1,304 | 113 | 113 | 1,530 | 36 |
| A G Lodge | 146 | 113 | 113 | 372 | 36 |

# Remuneration Report (continued)

## Share price movements during 2010

The mid-market closing price of the company's shares at 31 December 2010 was £19.50 (31 December 2009: £11.05). The intra-day trading price of the company's shares during 2010 was between £10.03 and £20.32.

## Sourcing of shares and dilution limits

The company uses the Premier Oil plc Employee Benefit Trust (EBT) to satisfy the obligations of the Executive Share Option Schemes (ESOS), the AEP, the LTIP and the directors' deferred bonus shares.

Future obligations will be met using a combination of market purchases, financed by the company, and newly-issued shares. Details of the number of shares held by the EBT and the commitments to issue new shares within recommended guidelines on dilution as at 31 December 2010 are set out in the table below:

| Percentage of current issued Ordinary Share capital | 2010 | 2009 |
|---|---|---|
| New issue shares committed under AEP, LTIP and 2003 ESOS within limit of 5 per cent of issued share capital over 10 years | **4,060,540** | 4,935,654 |
| As above plus commitments under SAYE within recommended limit of 10 per cent of issued share capital over 10 years | **4,478,907** | 5,416,877 |
| Shares held in EBT | **1,714,601** | 1,077,711 |

On 25 March 2010, the company allotted and issued 1,700,000 Ordinary Shares of 50 pence each to the EBT to be used to satisfy future obligations in respect of the vesting of awards under the AEP and the LTIP. The shares were issued fully-paid and have full voting rights. The closing price of Premier Oil plc shares on the date of issue was £12.11.

By order of the Board

**J R W Orange**
Chairman of the Remuneration Committee
23 March 2011

# Statement of Directors' Responsibilities

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

## Group financial statements

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting 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; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In preparing these financial statements, International Accounting Standard 1 – 'Presentation of Financial Statements' requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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 (www.premier-oil.com). Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Directors' responsibility statement

We confirm to the best of our knowledge:

1. the financial statements, prepared in accordance with international financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
2. the business review, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

By order of the Board

| | |
|---|---|
| **S C Lockett** | **A R C Durrant** |
| Chief Executive | Finance Director |
| 23 March 2011 | 23 March 2011 |

# Accounting Policies

### General information
Premier Oil plc is a limited company incorporated in Scotland and listed on the London Stock Exchange. The address of the registered office is Premier Oil plc, 4th Floor, Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EN. The principal activities of the company and its subsidiaries (the group) are oil and gas exploration and production in the North Sea and West Africa, Asia and Middle East-Pakistan.

These financial statements are presented in US dollars since that is the currency in which the majority of the group's transactions are denominated.

### Adoption of new and revised standards
The following standards and amendments to existing standards were mandatory for the financial year beginning 1 January 2010:

- IFRS 3 (revised) – 'Business Combinations' introduces significant changes in the accounting for business combinations occurring on or after 1 January 2010 and IAS 27 (revised) – 'Consolidated and Separate Financial Statements' introduces requirements with regard to accounting for transactions with minority interests. There was no requirement to restate previous business combinations, there have been no business combinations in 2010 and there have been no transactions with minority interests, so therefore there has been no material impact on the group's annual results on the adoption of these revised standards.

A number of other amendments to existing standards and interpretations were also effective for the current period, the adoption of which did not have a material impact on the group's annual results.

At the date of authorisation of these financial statements, the following standards and interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the European Union):

- IFRS 9 – 'Financial Instruments'
- IAS 24 (amended) – 'Related Party Disclosures'
- IFRIC 19: 'Extinguishing Financial Liabilities with Equity Instruments'
- IFRIC 14 (amended): 'Prepayments of a Minimum Funding Requirement'
- Improvements to IFRSs (May 2010)

IFRS 9 – 'Financial Instruments' is effective for annual periods beginning on or after 1 January 2013 with transitional arrangements depending upon the date of initial application. The group has not yet decided the date of initial application and has not yet completed its evaluation of the effect of adoption. The new standard has not yet been adopted by the European Union.

The directors do not expect that the adoption of the other standards and interpretations listed above will have a material impact on the financial statements of the group in future periods.

### Basis of accounting
The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The financial statements are prepared under the historical cost convention except for the revaluation of financial instruments and certain oil and gas properties at the transition date to IFRS.

The financial statements have been prepared on the going concern basis. Further information relating to the going concern assumption is provided in the Financial Review.

The principal accounting policies adopted are set out below.

### Basis of consolidation
The consolidated financial statements incorporate the financial statements of the company and entities controlled by the company (its subsidiaries) made up to 31 December each year. Control is achieved where the company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess/deficiency of the cost of acquisition over/below the fair values of the identifiable net assets acquired is recognised as goodwill/excess of fair value over cost.

The results of subsidiaries acquired or disposed of during the year are included in the income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by other members of the group.

All significant inter-company transactions and balances between group entities are eliminated on consolidation.

### Interest in joint ventures
A joint venture is a contractual arrangement whereby the group and other parties undertake an economic activity that is subject to joint control.

Where a group company undertakes its activities under joint venture arrangements directly, the group's shares of jointly controlled assets and any liabilities incurred jointly with other venturers are recognised in the financial statements of the relevant company and classified according to their nature.

Liabilities and expenses incurred directly in respect of interests in jointly controlled assets are accounted for on an accrual basis. Income from the sale or use of the group's share of the output of jointly controlled assets, and its share of joint venture expenses, are recognised when it is probable that the economic benefits associated with the transactions will flow to/from the group and their amount can be measured reliably.

Joint venture arrangements which involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities. The group reports its interests in jointly controlled entities using proportionate consolidation – the group's share of the assets, liabilities, income and expenses of jointly controlled entities are combined with the equivalent items in the consolidated financial statements on a line-by-line basis.

Where the group transacts with its jointly controlled entities, unrealised profits and losses are eliminated to the extent of the group's interest in the joint venture.

### Sales revenue and other income
Sales of petroleum production are recognised when goods are delivered or the title has passed to the customer.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

### Oil and gas assets
The company applies the successful efforts method of accounting for exploration and evaluation (E&E) costs, having regard to the requirements of IFRS 6 – 'Exploration for and Evaluation of Mineral Resources'.

(a) Exploration and evaluation assets
Under the successful efforts method of accounting, all licence acquisition, exploration and appraisal costs are initially capitalised in well, field or specific exploration cost centres as appropriate, pending determination. Expenditure incurred during the various exploration and appraisal phases is then written off unless commercial reserves have been established or the determination process has not been completed.

Pre-licence costs
Costs incurred prior to having obtained the legal rights to explore an area are expensed directly to the income statement as they are incurred.

Exploration and evaluation costs
Costs of E&E are initially capitalised as E&E assets. Payments to acquire the legal right to explore, costs of technical services and studies, seismic acquisition, exploratory drilling and testing are capitalised as intangible E&E assets.

Tangible assets used in E&E activities (such as the group's vehicles, drilling rigs, seismic equipment and other property, plant and equipment used by the company's exploration function) are classified as property, plant and equipment. However, to the extent that such a tangible asset is consumed in developing an intangible E&E asset, the amount reflecting that consumption is recorded as part of the cost of the intangible asset. Such intangible costs include directly attributable overhead, including the depreciation of property, plant and equipment utilised in E&E activities, together with the cost of other materials consumed during the exploration and evaluation phases.

E&E costs are not amortised prior to the conclusion of appraisal activities.

Treatment of E&E assets at conclusion of appraisal activities
Intangible E&E assets related to each exploration licence/prospect are carried forward, until the existence (or otherwise) of commercial reserves has been determined subject to certain limitations including review for indications of impairment. If commercial reserves have been discovered, the carrying value, after any impairment loss, of the relevant E&E assets, is then reclassified as development and production assets. If, however, commercial reserves have not been found, the capitalised costs are charged to expense after conclusion of appraisal activities.

# Accounting Policies (continued)

Oil and gas assets (continued)

(b) Development and production assets

Development and production assets are accumulated generally on a field-by-field basis and represent the cost of developing the commercial reserves discovered and bringing them into production, together with the E&E expenditures incurred in finding commercial reserves transferred from intangible E&E assets, as outlined in accounting policy (a) above.

The cost of development and production assets also includes the cost of acquisitions and purchases of such assets, directly attributable overheads, finance costs capitalised, and the cost of recognising provisions for future restoration and decommissioning.

Depreciation of producing assets

The net book values of producing assets are depreciated generally on a field-by-field basis using the unit-of-production method by reference to the ratio of production in the year and the related commercial reserves of the field, taking into account future development expenditures necessary to bring those reserves into production.

Producing assets are generally grouped with other assets that are dedicated to serving the same reserves for depreciation purposes, but are depreciated separately from producing assets that serve other reserves.

Pipelines are depreciated on a unit-of-throughput basis.

(c) Impairment of development and production assets

An impairment test is performed whenever events and circumstances arising during the development or production phase indicate that the carrying value of a development or production asset may exceed its recoverable amount.

The carrying value is compared against the expected recoverable amount of the asset, generally by reference to the present value of the future net cash flows expected to be derived from production of commercial reserves. The cash generating unit applied for impairment test purposes is generally the field, except that a number of field interests may be grouped as a single cash generating unit where the cash flows of each field are interdependent.

Any impairment identified is charged to the income statement as additional depreciation. Where conditions giving rise to impairment subsequently reverse, the effect of the impairment charge is also reversed as a credit to the income statement, net of any depreciation that would have been charged since the impairment.

(d) Acquisitions, asset purchases and disposals

Acquisitions of oil and gas properties are accounted for under the acquisition method when the assets acquired and liabilities assumed constitute a business.

Transactions involving the purchase of an individual field interest, or a group of field interests, that do not constitute a business, are treated as asset purchases irrespective of whether the specific transactions involve the transfer of the field interests directly or the transfer of an incorporated entity. Accordingly, no goodwill and no deferred tax gross up arises, and the consideration is allocated to the assets and liabilities purchased on an appropriate basis.

Proceeds on disposal are applied to the carrying amount of the specific intangible asset or development and production assets disposed of and any surplus is recorded as a gain on disposal in the income statement.

(e) Decommissioning

Provision for decommissioning is recognised in full when the related facilities are installed. The amount recognised is the present value of the estimated future expenditure. A corresponding amount equivalent to the provision is also recognised as part of the cost of the related oil and gas property. This is subsequently depreciated as part of the capital costs of the production facilities. Any change in the present value of the estimated expenditure is dealt with prospectively as an adjustment to the provision and the oil and gas property. The unwinding of the discount is included as a finance cost.

Inventories

Inventories, except for petroleum products, are valued at the lower of cost and net realisable value. Petroleum products and under and overlifts of crude oil are recorded at net realisable value, under inventories and other debtors or creditors respectively.

Tax

The tax expense/credit represents the sum of the tax currently payable/recoverable and deferred tax movements during the year.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

### Tax (continued)

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill/excess of fair value over cost or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred 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 asset to be recovered. The group reassesses its unrecognised deferred tax asset each year taking into account changes in oil and gas prices, the group's proven and probable reserve profile and forecast capital and operating expenditures.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited in other comprehensive income, in which case the deferred tax is also dealt with in other comprehensive income.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same tax authority and the group intends to settle its current tax assets and liabilities on a net basis.

### Translation of foreign currencies

In the accounts of individual companies, transactions denominated in foreign currencies, being currencies other than the functional currency, are recorded in the local currency at actual exchange rates as of the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Any gain or loss arising from a change in exchange rate subsequent to the dates of the transactions is included as an exchange gain or loss in the income statement. Non-monetary assets held at historic cost are translated at the date of purchase and are not retranslated.

On consolidation, the assets and liabilities of the group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are generally translated at the average exchange rates for the year. Exchange differences arising, if any, are classified as equity and transferred to the group's translation reserve. Such translation differences are recognised as income or as expenses in the year in which the operation is disposed of.

### Group retirement benefits

Payments to defined contribution retirement benefit plans are charged as an expense as they fall due. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution plans where the group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit plan.

The group operates a defined benefit pension scheme, which requires contributions to be made to a separately administered fund. The cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised immediately in the statement of comprehensive income. Past service cost is also recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to unrecognised past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

### Royalties

Royalties are charged as production costs to the income statement in the year in which the related production is recognised as income.

### Leasing

Rentals payable for assets under operating leases are charged to the income statement on a straight-line basis over the lease term.

# Accounting Policies (continued)

### Financial instruments

Financial assets and financial liabilities are recognised in the group's balance sheet when the group becomes a party to the contractual provisions of the instrument.

### Trade receivables

Trade receivables are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

### Bank borrowings

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis to the income statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

### Borrowing costs

Borrowing costs directly relating to the construction or production of a qualifying capital project under construction are capitalised and added to the project cost during construction until such time as the assets are substantially ready for their intended use, i.e. when they are capable of commercial production. Where the funds used to finance a project form part of general borrowings, the amount capitalised is calculated using a weighted average of rates applicable to relevant general borrowings of the group during the period. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

### Trade payables

Trade payables are stated at their nominal value.

### Derivative financial instruments

The group uses derivative financial instruments (derivatives) to manage its exposure to changes in foreign currency exchange rates, interest rates and oil price fluctuations.

All derivative financial instruments are initially recorded at cost, including transaction costs. Derivatives are subsequently carried at fair value. Apart from those derivatives designated as qualifying cash flow hedging instruments, all changes in fair value are recorded as financial income or expense in the year in which they arise.

For the purposes of hedge accounting, hedging relationships may be of three types: fair value hedges are hedges of particular risks that may change the fair value of a recognised asset or liability; cash flow hedges are hedges of particular risks that may change the amount or timing of future cash flows; and hedges of net investment in a foreign entity are hedges of particular risks that may change the carrying value of the net assets of a foreign entity. Currently the group only has cash flow hedge relationships.

To qualify for hedge accounting the hedging relationship must meet several strict conditions on documentation, probability of occurrence, hedge effectiveness and reliability of measurement. If these conditions are not met, then the relationship does not qualify for hedge accounting. In this case the hedging instrument and the hedged item are reported independently as if there were no hedging relationship. In particular any derivatives are reported at fair value, with changes in fair value included in financial income or expense.

For qualifying cash flow hedges, the hedging instrument is recorded at fair value. The portion of any change in fair value that is an effective hedge is included in equity, and any remaining ineffective portion is reported in financial income. If the hedging relationship is the hedge of a firm commitment or highly probable forecasted transaction, the cumulative changes of fair value of the hedging instrument that have been recorded in equity are included in the initial carrying value of the asset or liability at the time it is recognised. For all other qualifying cash flow hedges, the cumulative changes of fair value of the hedging instrument that have been recorded in equity are included in financial income at the time when the forecasted transaction affects net income.

Derivatives embedded in other financial instruments or non-derivative host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement. Embedded derivatives which are closely related to host contracts, including in particular price caps and floors within the group's oil sales contracts, are not separated and are not carried at fair value.

Fair value is the amount for which a financial asset, liability or instrument could be exchanged between knowledgeable and willing parties in an arm's length transaction. It is determined by reference to quoted market prices adjusted for estimated transaction costs that would be incurred in an actual transaction, or by the use of established estimation techniques such as option pricing models and estimated discounted values of cash flows.

### Cash and cash equivalents

Cash comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Cash equivalents comprise funds held in term deposit accounts with an original maturity not exceeding three months.

### Share-based payments

The group issues equity-settled and cash-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions.

Fair value is measured by use of a Monte Carlo simulation. The main assumptions are provided in note 19.

A liability equal to the portion of the goods or services received is recognised at the current fair value determined at each balance sheet date for cash-settled, share-based payments.

### Convertible bonds

The net proceeds received from the issue of convertible bonds are split between a liability element and an equity component at the date of issue. The fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the group, is included in equity and is not re-measured. The liability component is carried at amortised cost.

Issue costs are apportioned between the liability and equity components of the convertible bonds based on their relative carrying amounts at the date of issue. The portion relating to the equity component is charged directly against equity.

The interest expense on the liability component is calculated by applying the prevailing market interest rate, at the time of issue, for similar non-convertible debt to the liability component of the instrument. The difference between this amount and the interest paid is added to the carrying amount of the convertible bonds.

### Critical accounting judgements and key sources of estimation uncertainty

Details of the group's significant accounting judgements and critical accounting estimates are set out in these financial statements and include:

- carrying value of intangible exploration and evaluation assets (note 8);
- carrying value of property, plant and equipment (note 9);
- proved and probable reserves estimates (note 9);
- decommissioning costs (note 16);
- derivative financial instruments (note 17);
- tax and recognition of deferred tax assets (note 18);
- share-based payments (note 19);
- pensions (note 23); and
- acquisition of subsidiaries (note 25).

# Independent Auditor's Report to the Members of Premier Oil plc

We have audited the group financial statements of Premier Oil plc for the year ended 31 December 2010 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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 auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, contained within the Directors' Report, in relation to going concern;
- the part of the Corporate Governance Report relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

## Other matter

We have reported separately on the parent company financial statements of Premier Oil plc for the year ended 31 December 2010 and on the information in the Remuneration Report that is described as having been audited.

**Matthew Donaldson (Senior statutory auditor)**
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
United Kingdom
23 March 2011

# Consolidated Income Statement

For the year ended 31 December 2010

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Sales revenues | 1 | **763.6** | 621.1 |
| Cost of sales | 2 | **(530.5)** | (361.4) |
| Exploration expense | 8 | **(68.2)** | (57.0) |
| Pre-licence exploration costs | | **(18.9)** | (20.3) |
| Acquisition of subsidiaries | 25 | **–** | 5.6 |
| General and administration costs | | **(18.3)** | (18.3) |
| **Operating profit** | | **127.7** | 169.7 |
| Interest revenue, finance and other gains | 5 | **2.5** | 15.7 |
| Finance costs and other finance expenses | 5 | **(68.0)** | (44.4) |
| Gain/(loss) on derivative financial instruments | 17 | **38.6** | (61.1) |
| **Profit before tax** | | **100.8** | 79.9 |
| Tax | 6 | **29.0** | 33.1 |
| **Profit after tax** | | **129.8** | 113.0 |
| **Earnings per share (cents):** | | | |
| Basic | 7 | **111.9** | 104.1 |
| Diluted | 7 | **103.1** | 103.9 |

The results relate entirely to continuing operations.

# Consolidated Statement of Comprehensive Income

For the year ended 31 December 2010

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Profit for the year | | **129.8** | 113.0 |
| Cash flow hedges – losses arising during the year: | | | |
| On commodity swaps | 17 | **(2.2)** | (9.8) |
| On interest rate swaps | 17 | **(12.1)** | (0.8) |
| Exchange differences on translation of foreign operations | | **(1.9)** | 8.7 |
| Actuarial gains/(losses) on long-term employee benefit plans | 23 | **0.6** | (3.5) |
| Other comprehensive expense | | **(15.6)** | (5.4) |
| **Total comprehensive income for the year** | | **114.2** | 107.6 |

# Consolidated Balance Sheet

As at 31 December 2010

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| **Non-current assets:** | | | |
| Intangible exploration and evaluation assets | 8 | **310.8** | 231.6 |
| Property, plant and equipment | 9 | **1,732.8** | 1,386.0 |
| Deferred tax assets | 18 | **285.3** | 190.6 |
| | | **2,328.9** | 1,808.2 |
| **Current assets:** | | | |
| Inventories | | **18.6** | 35.3 |
| Trade and other receivables | 11 | **311.2** | 393.6 |
| Tax recoverable | | **67.5** | 52.1 |
| Cash and cash equivalents | 12 | **299.7** | 250.6 |
| | | **697.0** | 731.6 |
| **Total assets** | | **3,025.9** | 2,539.8 |
| **Current liabilities:** | | | |
| Trade and other payables | 13 | **(446.8)** | (419.7) |
| Current tax payable | | **(56.4)** | (46.5) |
| | | **(503.2)** | (466.2) |
| **Net current assets** | | **193.8** | 265.4 |
| **Non-current liabilities:** | | | |
| Convertible bonds | 14 | **(218.1)** | (210.1) |
| Other long-term debt | 14 | **(466.4)** | (337.2) |
| Deferred tax liabilities | 18 | **(183.7)** | (179.8) |
| Long-term provisions | 16 | **(473.2)** | (307.6) |
| Long-term employee benefit plan deficit | 23 | **(15.2)** | (13.5) |
| Deferred revenue | 17 | **(35.9)** | (54.1) |
| | | **(1,392.5)** | (1,102.3) |
| **Total liabilities** | | **(1,895.7)** | (1,568.5) |
| **Net assets** | | **1,130.2** | 971.3 |
| **Equity and reserves:** | | | |
| Share capital | 19 | **98.3** | 97.0 |
| Share premium account | | **254.8** | 223.7 |
| Retained earnings | | **738.7** | 603.2 |
| Capital redemption reserve | | **4.3** | 4.3 |
| Translation reserves | | **5.2** | 7.1 |
| Equity reserve | | **28.9** | 36.0 |
| | | **1,130.2** | 971.3 |

The financial statements were approved by the Board of Directors and authorised for issue on 23 March 2011.

They were signed on its behalf by:

**S C Lockett**
Chief Executive

**A R C Durrant**
Finance Director

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2010

| | Note | Share capital $ million | Share premium account $ million | Retained earnings $ million | Capital redemption reserve $ million | Translation reserves $ million | Equity reserve $ million | Total $ million |
|---|---|---|---|---|---|---|---|---|
| At 1 January 2009 | | 73.6 | 9.7 | 472.9 | 1.7 | (1.6) | 42.6 | 598.9 |
| Issue of Ordinary Shares | | 26.0 | 226.2 | – | – | – | – | 252.2 |
| Expenses of issue of Ordinary Shares | | – | (12.2) | – | – | – | – | (12.2) |
| Cancellation of Ordinary Shares | | (2.6) | – | – | 2.6 | – | – | – |
| Purchase of shares for ESOP Trust | | – | – | (2.5) | – | – | – | (2.5) |
| Provision for share-based payments | 19 | – | – | 27.3 | – | – | – | 27.3 |
| Transfer between reserves* | | – | – | 6.6 | – | – | (6.6) | – |
| Total comprehensive income | | – | – | 98.9 | – | 8.7 | – | 107.6 |
| At 31 December 2009 | | 97.0 | 223.7 | 603.2 | 4.3 | 7.1 | 36.0 | 971.3 |
| Issue of Ordinary Shares | | 1.3 | 31.1 | (32.1) | – | – | – | 0.3 |
| Purchase of shares for ESOP Trust | | – | – | (8.3) | – | – | – | (8.3) |
| Provision for share-based payments | 19 | – | – | 52.7 | – | – | – | 52.7 |
| Transfer between reserves* | | – | – | 7.1 | – | – | (7.1) | – |
| Total comprehensive income | | – | – | 116.1 | – | (1.9) | – | 114.2 |
| **At 31 December 2010** | | **98.3** | **254.8** | **738.7** | **4.3** | **5.2** | **28.9** | **1,130.2** |

* The transfer between reserves relates to the non-cash interest on the convertible bonds, less the amortisation of the issue costs that were charged directly against equity.

# Consolidated Cash Flow Statement

For the year ended 31 December 2010

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| **Net cash from operating activities** | 21 | **436.0** | 347.7 |
| **Investing activities:** | | | |
| Capital expenditure | | **(514.1)** | (303.1) |
| Pre-licence exploration costs | | **(18.9)** | (20.3) |
| Acquisition of subsidiaries | 25 | **–** | (574.2) |
| Acquisition of oil and gas properties | | **(7.4)** | (83.9) |
| Proceeds from disposal of oil and gas properties | | **20.4** | 14.8 |
| Recovery of cash previously held in a decommissioning trust | | **69.2** | – |
| **Net cash used in investing activities** | | **(450.8)** | (966.7) |
| **Financing activities:** | | | |
| Proceeds from issuance of Ordinary Shares | | **0.3** | 252.2 |
| Expenses on issuance of Ordinary Shares | | **–** | (12.2) |
| Purchase of shares for ESOP Trust | | **(8.3)** | (2.5) |
| Proceeds from drawdown of long-term bank loans | | **310.0** | 353.0 |
| Debt arrangement fees | | **(17.9)** | (25.6) |
| Repayment of long-term bank loans | | **(178.0)** | – |
| Interest paid | | **(40.9)** | (21.2) |
| **Net cash from financing activities** | | **65.2** | 543.7 |
| Currency translation differences relating to cash and cash equivalents | | **(1.3)** | 2.2 |
| **Net increase/(decrease) in cash and cash equivalents** | | **49.1** | (73.1) |
| Cash and cash equivalents at the beginning of the year | | **250.6** | 323.7 |
| **Cash and cash equivalents at the end of the year** | 21 | **299.7** | 250.6 |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

## 1. Operating segments

The group's operations are located and managed in three regional business units – North Sea and West Africa, Asia and Middle East-Pakistan. These geographical segments are the basis on which the group reports its segmental information.

| | 2010<br>$ million | 2009<br>$ million |
|---|---|---|
| **Revenue:** | | |
| North Sea and West Africa | **445.7** | 351.7 |
| Asia | **195.7** | 146.4 |
| Middle East-Pakistan | **122.2** | 123.0 |
| Total group sales revenue | **763.6** | 621.1 |
| Interest and other finance revenue | **2.5** | 2.2 |
| **Total group revenue** | **766.1** | 623.3 |
| **Group operating profit/(loss):** | | |
| North Sea and West Africa | **(43.0)** | 31.4 |
| Asia | **107.9** | 75.9 |
| Middle East-Pakistan | **75.9** | 76.5 |
| Unallocated* | **(13.1)** | (14.1) |
| Group operating profit | **127.7** | 169.7 |
| Interest revenue, finance and other gains | **2.5** | 15.7 |
| Finance costs and other finance expenses | **(68.0)** | (44.4) |
| Gain/(loss) on derivative financial instruments | **38.6** | (61.1) |
| Profit before tax | **100.8** | 79.9 |
| Tax | **29.0** | 33.1 |
| **Profit after tax** | **129.8** | 113.0 |
| **Balance sheet** | | |
| **Segment assets:** | | |
| North Sea and West Africa | **1,353.3** | 1,249.8 |
| Asia | **1,142.1** | 822.6 |
| Middle East-Pakistan | **165.2** | 135.9 |
| Unallocated* | **365.3** | 331.5 |
| **Total assets** | **3,025.9** | 2,539.8 |
| **Liabilities:** | | |
| North Sea and West Africa | **(599.2)** | (459.1) |
| Asia | **(355.5)** | (267.7) |
| Middle East-Pakistan | **(111.9)** | (103.1) |
| Unallocated* | **(829.1)** | (738.6) |
| **Total liabilities** | **(1,895.7)** | (1,568.5) |
| **Other information** | | |
| **Capital additions and acquisitions:** | | |
| North Sea and West Africa | **353.3** | 637.6 |
| Asia | **352.0** | 266.6 |
| Middle East-Pakistan | **53.8** | 26.1 |
| **Total capital additions and acquisitions** | **759.1** | 930.3 |
| **Depreciation, depletion, amortisation and impairment:** | | |
| North Sea and West Africa | **213.3** | 131.8 |
| Asia | **31.2** | 31.4 |
| Middle East-Pakistan | **19.1** | 17.6 |
| **Total depreciation, depletion, amortisation and impairment** | **263.6** | 180.8 |

* Unallocated expenditure, assets and liabilities include amounts of a corporate nature and not specifically attributable to a geographical segment. These items include pre-licence exploration costs, cash, mark to market valuations of commodity contracts and interest rate swaps, convertible bonds and other long-term debt.

1. **Operating segments** (continued)

Included in revenues arising from the North Sea and West Africa segment are revenues of US$425.4 million (2009: US$336.1 million) which arose from sales to customers located in the UK.

Included in assets arising from the North Sea and West Africa segment are non-current assets (excluding deferred tax assets) of US$817.6 million (2009: US$749.4 million) located in the UK.

Revenue from four customers (2009: four customers) each exceeded 10 per cent of the group's consolidated revenue and amounted respectively to US$134.1 million and US$225.8 million arising from sales of crude oil (2009: US$139.5 million and US$128.5 million) and US$173.1 million and US$79.5 million arising from sales of gas (2009: US$132.9 million and US$72.6 million).

2. **Cost of sales**

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Operating costs | | **217.1** | 196.7 |
| Stock overlift/underlift movement | | **35.6** | (31.1) |
| Royalties | | **14.2** | 15.0 |
| Amortisation and depreciation of property, plant and equipment: | | | |
| Oil and gas properties | 9 | **196.0** | 155.2 |
| Other fixed assets | 9 | **2.3** | 1.6 |
| Impairment of oil and gas properties | 9 | **65.3** | 24.0 |
| | | **530.5** | 361.4 |

3. **Auditors' remuneration**

| | 2010 $ million | 2009 $ million |
|---|---|---|
| **Audit fees:** | | |
| Fees payable to the company's auditors for the company's annual report | **0.5** | 0.5 |
| Audit of the company's subsidiaries pursuant to legislation | **0.1** | 0.2 |
| | **0.6** | 0.7 |
| **Non-audit fees:** | | |
| Other services pursuant to legislation – interim review | **0.1** | 0.2 |
| Tax services | **0.5** | 1.1 |
| Corporate finance services* | – | 1.9 |
| Other services | **0.3** | 0.1 |
| | **0.9** | 3.3 |

* Corporate finance services in the prior year comprised financial due diligence (US$0.4 million), tax due diligence (US$0.6 million) and reporting accountants' services (US$0.9 million).

The Audit and Risk Committee has a policy on the use of auditors in a non-audit capacity which is aimed at ensuring their continued independence. The use of the external auditors for services relating to accounting systems or financial statements is not permitted, as are various other services that could give rise to conflicts of interest or other threats to the auditors' objectivity that cannot be reduced to an acceptable level by applying safeguards.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 4. Staff costs

| | 2010 $ million | 2009 $ million |
|---|---|---|
| **Staff costs, including executive directors:** | | |
| Wages and salaries | **113.8** | 107.5 |
| Social security costs | **9.6** | 3.5 |
| Pension costs: | | |
| Defined contribution | **2.6** | 2.0 |
| Defined benefit | **1.9** | 1.0 |
| | **127.9** | 114.0 |

A portion of the group's staff costs above are recharged to joint venture partners or capitalised where they are directly attributable to capital projects. The above costs include share-based payments to employees as disclosed in note 19.

| | 2010 | 2009 |
|---|---|---|
| **Average number of employees during the year*:** | | |
| Technical and operations | **378** | 335 |
| Management and administration | **183** | 173 |
| | **561** | 508 |

* Staff numbers include executive directors.

## 5. Interest revenue and finance costs

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| **Interest revenue, finance and other gains:** | | | |
| Short-term deposits | | **1.4** | 1.6 |
| Mark to market valuation of foreign exchange contracts | | **–** | 2.8 |
| Profit on disposal of oil and gas properties | | **–** | 9.3 |
| Others | | **1.1** | 0.6 |
| Exchange differences | | **–** | 1.4 |
| | | **2.5** | 15.7 |
| **Finance costs and other finance expenses:** | | | |
| Bank loans and overdrafts | | **(35.0)** | (15.9) |
| Payable in respect of convertible bonds | 14 | **(15.2)** | (14.6) |
| Unwinding of discount on decommissioning provision | 16 | **(16.2)** | (8.7) |
| Long-term debt arrangement fees | | **(15.6)** | (10.5) |
| Mark to market valuation of foreign exchange contracts | | **(0.4)** | – |
| Others | | **(0.3)** | (0.1) |
| Exchange differences | | **(2.2)** | – |
| Gross finance costs and other finance expenses | | **(84.9)** | (49.8) |
| Finance costs capitalised during the year | 9 | **16.9** | 5.4 |
| | | **(68.0)** | (44.4) |

The amount of finance costs capitalised was determined by applying the weighted average rate of finance costs applicable to the borrowings of the group of 6.34 per cent (2009: 5.69 per cent) to the expenditures on the qualifying asset.

During the year a charge of US$2.2 million of currency exchange losses was made by the group to income (2009: credit of US$1.4 million of currency exchange gains). An additional US$3.0 million (2009: US$nil) was charged through current tax. This excluded exchange gains and losses arising on financial instruments measured at fair value through profit or loss.

## 6. Tax

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| **Current tax:** | | | |
| UK corporation tax on profits | | – | (23.4) |
| UK petroleum revenue tax | | **25.9** | 23.2 |
| Overseas tax | | **56.9** | 73.0 |
| Adjustments in respect of prior years* | | **(21.4)** | (24.6) |
| **Total current tax** | | **61.4** | 48.2 |
| **Deferred tax:** | | | |
| UK corporation tax | | **(73.9)** | (67.1) |
| UK petroleum revenue tax | | **(20.8)** | (23.6) |
| Overseas tax | | **4.3** | 9.4 |
| **Total deferred tax** | 18 | **(90.4)** | (81.3) |
| **Tax on profit on ordinary activities** | | **(29.0)** | (33.1) |

* For 2010, the adjustments in respect of prior years consist principally of the release of a tax provision following the closure of an enquiry into a prior year tax return.

The tax credit for the year can be reconciled to the profit per the consolidated income statement as follows:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Group profit on ordinary activities before tax | **100.8** | 79.9 |
| Group profit on ordinary activities before tax at 47.9% weighted average rate (2009: 59.9%) | **48.3** | 47.9 |
| **Tax effects of:** | | |
| Income/expenses that are not taxable/deductible in determining taxable profit | **2.5** | 25.2 |
| Tax and tax credits not related to profit before tax (including UK petroleum revenue tax) | **4.9** | (19.2) |
| Unrecognised tax losses | **8.6** | 40.7 |
| Utilisation and recognition of tax losses not previously recognised | **(67.4)** | (135.6) |
| Adjustments in respect of prior years | **(25.9)** | (19.3) |
| Effect of change in tax rates | **–** | 27.2 |
| **Tax credit for the year** | **(29.0)** | (33.1) |
| **Effective tax rate for the year** | **(28.8%)** | (41.4%) |

The weighted average rate is calculated based on the tax rates weighted according to the profit or loss before tax earned by the group in each jurisdiction. The change in the weighted average rate year-on-year relates to the mix of profit and loss in each jurisdiction. The standard tax rate on UK ring fence profits is 50 per cent.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 7. Earnings per share

The calculation of basic earnings per share is based on the profit after tax and on the weighted average number of Ordinary Shares in issue during the year.

Basic and diluted earnings per share are calculated as follows:

| | Profit after tax | | Weighted average number of shares | | Earnings per share | |
|---|---|---|---|---|---|---|
| | **2010 $ million** | 2009 $ million | **2010 million** | 2009 million | **2010 cents** | 2009 cents |
| Basic | **129.8** | 113.0 | **116.0** | 108.6 | **111.9** | 104.1 |
| Outstanding share options | **–** | – | **9.9** | 0.2 | * | * |
| **Diluted** | **129.8** | 113.0 | **125.9** | 108.8 | **103.1** | 103.9 |

* The inclusion of the outstanding share options in the 2010 and 2009 calculations produces diluted earnings per share. The outstanding share options number includes any expected additional share issues due to future share-based payments. At 31 December 2010 9,337,340 (2009: 9,337,340) potential Ordinary Shares in the company that are underlying the company's convertible bonds and that may dilute earnings per share in the future have not been included in the calculation of diluted earnings per share because they are anti-dilutive for the year (2009: anti-dilutive).

## 8. Intangible exploration and evaluation (E&E) assets

| | Oil and gas properties | | | |
|---|---|---|---|---|
| | North Sea and West Africa $ million | Asia $ million | Middle East-Pakistan $ million | Total $ million |
| **Cost:** | | | | |
| At 1 January 2009 | 94.1 | 63.8 | – | 157.9 |
| Exchange movements | 11.2 | – | – | 11.2 |
| Additions during the year | 59.9 | 57.9 | 4.2 | 122.0 |
| Transfer to property, plant and equipment | (0.2) | (1.1) | (1.2) | (2.5) |
| Exploration expense | (41.1) | (12.9) | (3.0) | (57.0) |
| At 31 December 2009 | 123.9 | 107.7 | – | 231.6 |
| Exchange movements | (1.1) | – | – | (1.1) |
| Additions during the year | 124.7 | 18.9 | 29.6 | 173.2 |
| Transfer to property, plant and equipment | (20.9) | (2.8) | (1.0) | (24.7) |
| Exploration expense | (64.4) | (0.9) | (2.9) | (68.2) |
| **At 31 December 2010** | **162.2** | **122.9** | **25.7** | **310.8** |

The amounts for intangible E&E assets represent costs incurred on active exploration projects. These amounts are written off to the income statement as exploration expense unless commercial reserves are established or the determination process is not completed and there are no indications of impairment. The outcome of ongoing exploration, and therefore whether the carrying value of E&E assets will ultimately be recovered, is inherently uncertain.

## 9. Property, plant and equipment

| | Oil and gas properties | | | | |
|---|---|---|---|---|---|
| | North Sea and West Africa $ million | Asia $ million | Middle East-Pakistan $ million | Other fixed assets $ million | Total $ million |
| **Cost:** | | | | | |
| At 1 January 2009 | 586.6 | 527.5 | 175.7 | 9.7 | 1,299.5 |
| Exchange movements | – | – | – | 0.8 | 0.8 |
| Acquisitions | 486.5 | 83.9 | – | – | 570.4 |
| Additions during the year* | 88.5 | 124.7 | 21.6 | 3.1 | 237.9 |
| Disposals | – | (7.8) | (5.0) | (0.1) | (12.9) |
| Transfer from intangible E&E assets | 0.2 | 1.1 | 1.2 | – | 2.5 |
| At 31 December 2009 | 1,161.8 | 729.4 | 193.5 | 13.5 | 2,098.2 |
| Exchange movements | – | – | – | (0.2) | (0.2) |
| Acquisitions | 8.3 | – | – | – | 8.3 |
| Additions during the year* | 217.9 | 332.9 | 24.2 | 2.6 | 577.6 |
| Disposals | – | – | – | (0.2) | (0.2) |
| Transfer from intangible E&E assets | 20.9 | 2.8 | 1.0 | – | 24.7 |
| **At 31 December 2010** | **1,408.9** | **1,065.1** | **218.7** | **15.7** | **2,708.4** |
| **Amortisation and depreciation:** | | | | | |
| At 1 January 2009 | 300.0 | 129.5 | 96.8 | 5.8 | 532.1 |
| Exchange movements | – | – | – | 0.6 | 0.6 |
| Charge for the year | 106.4 | 31.3 | 17.5 | 1.6 | 156.8 |
| Impairment | 24.0 | – | – | – | 24.0 |
| Disposals | – | – | (1.2) | (0.1) | (1.3) |
| At 31 December 2009 | 430.4 | 160.8 | 113.1 | 7.9 | 712.2 |
| Exchange movements | – | – | – | (0.1) | (0.1) |
| Charge for the year | 145.9 | 31.1 | 19.0 | 2.3 | 198.3 |
| Impairment | 65.3 | – | – | – | 65.3 |
| Disposals | – | – | – | (0.1) | (0.1) |
| **At 31 December 2010** | **641.6** | **191.9** | **132.1** | **10.0** | **975.6** |
| **Net book value:** | | | | | |
| At 31 December 2009 | 731.4 | 568.6 | 80.4 | 5.6 | 1,386.0 |
| **At 31 December 2010** | **767.3** | **873.2** | **86.6** | **5.7** | **1,732.8** |

* Finance costs that have been capitalised within oil and gas properties during the year total US$16.9 million (2009: US$5.4 million), at a weighted average interest rate of 6.34 per cent (2009: 5.69 per cent).

Other fixed assets include items such as leasehold improvements, motor vehicles and office equipment.

The 2010 impairment charge relates to the Scott and Balmoral fields in the UK (2009: Chinguetti field in Mauritania) and arose mainly as a result of a significant increase in estimated future decommissioning costs. The impairment charge was calculated by comparing the future discounted cash flows expected to be derived from production of commercial reserves against the carrying value of the asset. The future cash flows were estimated using a long-term Brent crude oil price of US$75/bbl (2009: US$70/bbl) and were discounted using a discount rate of 10 per cent (2009: 10 per cent). Assumptions involved in impairment measurement include estimates of commercial reserves, future oil and gas prices and the level and timing of expenditures, all of which are inherently uncertain.

Amortisation and depreciation of oil and gas properties is calculated on a unit-of-production basis, using the ratio of oil and gas production in the period to the estimated quantities of proved and probable reserves on an entitlement basis at the end of the period plus production in the period, on a field-by-field basis. Proved and probable reserve estimates are based on a number of underlying assumptions including oil and gas prices, future costs, oil and gas in place and reservoir performance, which are inherently uncertain. Management uses established industry techniques to generate its estimates and regularly references its estimates against those of joint venture partners or external consultants. However, the amount of reserves that will ultimately be recovered from any field cannot be known with certainty until the end of the field's life.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 10. Investments

Principal subsidiary undertakings

The company has investments in the following 100 per cent owned subsidiaries which principally affected the profits or net assets of the group. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

| Name of company | Business and area of operation | Country of incorporation or registration |
|---|---|---|
| Premier Oil Group Ltd* | Intermediate holding company, UK | Scotland |
| Premier Oil Finance (Jersey) Ltd* | Convertible bond issuing company, Jersey | Jersey |
| Premier Oil Holdings Ltd | Intermediate holding company, UK | England and Wales |
| Premier Oil Overseas BV | Intermediate holding company, Netherlands | Netherlands |
| Premier Oil UK Ltd | Exploration, production and development, UK | Scotland |
| Premier Oil Natuna Sea BV | Exploration, production and development, Indonesia | Netherlands |
| Premier Oil Kakap BV | Exploration, production and development, Indonesia | Netherlands |
| Premier Oil Sumatra (North) BV | Exploration, production and development, Indonesia | Netherlands |
| Premier Oil Pakistan Holdings BV | Intermediate holding company, Netherlands | Netherlands |
| PKP Exploration Ltd | Exploration, production and development, Pakistan | England and Wales |
| PKP Kadanwari 2 Ltd | Exploration, production and development, Pakistan | Cayman Islands |
| PKP Kirthar 2 BV | Exploration, production and development, Pakistan | Netherlands |
| Premier Oil Vietnam Offshore BV | Exploration, production and development, Vietnam | Netherlands |
| Premier Oil (Vietnam) LLC | Exploration, production and development, Vietnam | United States of America |
| Premier Oil Norge AS | Exploration, production and development, Norway | Norway |

* Held directly by Premier Oil plc. All other companies are held through subsidiary undertakings.

Joint ventures

The group has a 49 per cent interest in Premco Energy Projects Company LLC, a company registered in the United Arab Emirates and a 50 per cent interest in Premco Energy Projects BV, a company registered in The Netherlands. The results of these two jointly controlled entities, which are indirectly held through subsidiary undertakings and which are involved in business development opportunities across the Middle East and North Africa region, are accounted for using proportionate consolidation and were immaterial to the group in 2010 and 2009.

## 11. Trade and other receivables

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Trade receivables | | **126.7** | 106.2 |
| Other receivables* | | **101.2** | 198.2 |
| Mark to market valuation of derivative financial instruments | 17 | **65.7** | 80.9 |
| Prepayments | | **17.6** | 8.3 |
| | | **311.2** | 393.6 |

* Included within other receivables in 2009 only is an amount of US$70.2 million held in an abandonment trust.

The carrying values of the trade and other receivables are equal to their fair value as at the balance sheet date.

## 12. Cash and cash equivalents

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Cash at bank and in hand | **21.5** | 12.8 |
| Short-term deposits | **278.2** | 237.8 |
| | **299.7** | 250.6 |

## 13. Trade and other payables

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Trade payables | | **43.5** | 56.5 |
| Accrued expenses | | **210.2** | 174.8 |
| Other payables | | **60.3** | 50.3 |
| Mark to market valuation of derivative financial instruments | 17 | **109.1** | 138.1 |
| Short-term provisions | 16 | **23.7** | – |
| | | **446.8** | 419.7 |

The carrying values of the trade and other payables are equal to their fair value as at the balance sheet date.

The short-term provisions relate to the current portion of the provision for decommissioning costs. Further details are given in note 16.

## 14. Borrowings

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Convertible bonds* | | **220.4** | 213.2 |
| Other long-term debt – bank loans* | 17 | **485.0** | 353.0 |
| **Total borrowings** | | **705.4** | 566.2 |

* The carrying values of the convertible bonds and the other long-term debt on the balance sheet are stated net of the unamortised portion of the issue costs of US$2.3 million (2009: US$3.1 million) and debt arrangement fees of US$18.6 million (2009: US$15.8 million) respectively.

A maturity analysis showing the aging profile of the total borrowings is shown in note 17.

The group renegotiated certain of its credit facilities in 2010. At the year-end date the group's principal credit facilities comprised a US$175.0 million term loan and a NOK 100.0 million (US$17.2 million) Exploration Financing Facility, both maturing in 2012, and a US$300.0 million term loan, a US$456.8 million revolving credit facility and a £399.5 million (US$623.2 million) letter of credit facility, all maturing in 2015.

### Convertible bonds

In June 2007, the group issued bonds at a par value of US$250.0 million which are convertible into Ordinary Shares of the company at any time from 6 August 2007 until six days before their maturity date of 27 June 2014.

At the initial conversion price of £15.82 per share there were 8,003,434 Ordinary Shares of the company underlying the bonds. In April 2009 the conversion price was adjusted from £15.82 per share to £13.56 per share, as a result of the company's four for nine rights issue of new Ordinary Shares. At the adjusted conversion price of £13.56 per share there are 9,337,340 Ordinary Shares of the company underlying the bonds.

If the bonds have not been previously purchased and cancelled, redeemed or converted, they will be redeemed at par value on 27 June 2014. Interest of 2.875 per cent per annum will be paid semi-annually in arrears up to that date.

The net proceeds received from the issue of the convertible bonds were split between a liability element and an equity component at the date of issue. The fair value of the liability component was estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the group, was included in equity reserves.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 14. Borrowings (continued)

Issue costs were apportioned between the liability and equity components of the convertible bonds based on their relative carrying amounts at the date of issue. The portion relating to the equity component was charged directly against equity.

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Liability component at 1 January | **210.1** | 202.7 |
| Interest charged | **15.2** | 14.6 |
| Interest paid | **(7.2)** | (7.2) |
| **Total liability component at 31 December** | **218.1** | 210.1 |

The total interest charged for the year has been calculated by applying an effective annual interest rate of 6.73 per cent (2009: 6.73 per cent) to the liability component for the period since the bonds were issued. The non-cash accrual of interest will increase the liability component (as the cash interest is only paid at 2.875 per cent) to US$250.0 million at maturity.

There is no material difference between the carrying amount of the liability component of the convertible bonds and its fair value. This fair value is calculated by discounting the future cash flows at the market rate.

### Capital management

The primary objective of the group's capital management is to ensure that it maintains healthy capital ratios in order to support its business and increase shareholder value. The group manages its capital structure and makes adjustments to it in light of changes in economic conditions. No changes were made in the objectives, policies or processes during the years ended 31 December 2010 and 31 December 2009.

The group monitors capital using a gearing ratio, which is net debt divided by net assets. The group's policy is to keep the long-term gearing ratio below 50 per cent. Net debt comprises interest-bearing bank loans and convertible bonds, less cash and short-term deposits.

| | Note | 2010 | 2009 |
|---|---|---|---|
| Net debt ($ million) | 21 | **(405.7)** | (315.6) |
| Net assets ($ million) | | **1,130.2** | 971.3 |
| **Gearing ratio (%)** | | **35.9** | 32.5 |

## 15. Obligations under leases

| | 2010 $ million | 2009 $ million |
|---|---|---|
| **Minimum lease payments under operating leases recognised as an expense in the year** | **7.2** | 6.6 |
| **Outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:** | | |
| Within one year | **23.9** | 6.7 |
| In two to five years | **298.5** | 183.0 |
| Over five years | **97.0** | 86.1 |
| | **419.4** | 275.8 |

Operating lease payments represent the group's share of lease costs payable by the group for FPSOs and for rentals of certain of its office properties, office equipment and motor vehicles.

## 16. Long-term provisions

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| **Asset and Equity Plan:** | | | |
| At 1 January | | **4.2** | 3.3 |
| Provision in the year | | – | 4.2 |
| Reclassification of provision to current liabilities | | – | (3.3) |
| Reclassification of provision to retained earnings | | **(4.2)** | – |
| **At 31 December** | | – | 4.2 |
| **Decommissioning costs:** | | | |
| At 1 January | | **303.4** | 139.9 |
| Acquisitions | | **0.9** | 114.3 |
| Revision arising from: | | | |
| New provisions and changes in estimates | | **189.6** | 24.4 |
| Exchange differences | | **(13.2)** | 16.1 |
| Unwinding of discount on decommissioning provision | 5 | **16.2** | 8.7 |
| Reclassification of provision to current liabilities | 13 | **(23.7)** | – |
| **At 31 December** | | **473.2** | 303.4 |
| **Total provisions** | | **473.2** | 307.6 |

The company has operated an Asset and Equity Plan to reward employees for improvement in the asset value of the business and the market value of the company over a three-year period. Further details of this plan are disclosed in note 19.

The decommissioning provision represents the present value of decommissioning costs relating to oil and gas interests in the UK, West Africa, Indonesia, Vietnam and Pakistan which are expected to be incurred up to 2030. These provisions have been created based on Premier's internal estimates and, where available, operator's estimates. Based on the current economic environment, assumptions have been made which the management believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning works required, which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain.

New provisions and changes in estimates result from an increase in decommissioning estimates for UK-operated fields following a detailed study undertaken during the year, increased operator estimates for non-operated UK fields, and new provisions for fields in development in Indonesia and Vietnam.

## 17. Financial instruments

Financial risk management objectives and policies

The group's principal financial liabilities, other than derivative financial instruments (derivatives), comprise accounts payable, bank loans and convertible bonds. The main purpose of these financial instruments is to manage short-term cash flow and raise finance for the group's capital expenditure programme. The group has various financial assets such as accounts receivable and cash and short-term deposits, which arise directly from its operations.

It is group policy that all transactions involving derivatives must be directly related to the underlying business of the group. The group does not use derivative financial instruments for speculative exposures.

The main risks that could adversely affect the group's financial assets, liabilities or future cash flows are commodity price risk, cash flow interest rate risk, foreign currency exchange risk, credit risk and liquidity risk. The group uses derivative financial instruments to hedge certain of these risk exposures. The use of financial derivatives is governed by the group's policies and approved by the Board of Directors, which provide written principles on the use of financial derivatives.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 17. Financial instruments (continued)

Derivative financial instruments

The group uses derivatives to manage its exposure to oil and gas price fluctuations and to changes in interest rates and foreign currency.

Oil and gas hedging is undertaken with collar options, reverse collars, swaps and hedges embedded in long-term crude offtake agreements. Oil is hedged using Dated Brent oil price options. Indonesian gas is hedged using HSFO Singapore 180cst which is the variable component of the gas price.

The group's exposure to interest rates is managed by maintaining an appropriate mix of both fixed and floating interest rate borrowings within its debt portfolio. However, given the very low level of fixed interest rates available relative to historical rates, substantially all of the current drawings have been converted to fixed interest rates using the interest rate swap markets.

As the group reports in US dollars, since that is the currency in which the majority of the group's transactions are denominated, significant exchange rate exposures currently relate only to certain receipts and expenditures in sterling and Norwegian krone. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts. From 2011 the group may also be materially exposed to exchange gains and losses in the Vietnamese đồng.

Fair value hierarchy

In line with IAS 39 – 'Financial Instruments: Recognition and Measurement' the group uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded value that are not based on observable market data.

As at 31 December 2010, the group held the following financial instruments measured at fair value (excluding any primary financial instruments such as cash and bank loans):

Assets measured at fair value

Financial assets at fair value through profit and loss:

| | At 31 December $ million | Level 1 $ million | Level 2 $ million | Level 3 $ million |
|---|---|---|---|---|
| **2010:** | | | | |
| Oil reverse collars | 65.7 | – | 65.7 | – |
| **Total** | **65.7** | **–** | **65.7** | **–** |
| 2009: | | | | |
| Oil reverse collars | 80.9 | – | 80.9 | – |
| Total | 80.9 | – | 80.9 | – |

## 17. Financial instruments (continued)

Liabilities measured at fair value

Financial liabilities at fair value through profit and loss:

| | At 31 December $ million | Level 1 $ million | Level 2 $ million | Level 3 $ million |
|---|---|---|---|---|
| **2010:** | | | | |
| Oil collars | 69.9 | – | 69.9 | – |
| Oil forward sale contracts | 4.2 | – | 4.2 | – |
| Gas collars | 21.5 | – | 21.5 | – |
| Interest rate swaps | 12.9 | – | 12.9 | – |
| Forward foreign exchange contracts | 0.6 | – | 0.6 | – |
| **Total** | **109.1** | **–** | **109.1** | **–** |
| 2009: | | | | |
| Oil collars | 82.5 | – | 82.5 | – |
| Oil forward sale contracts | 24.8 | – | 24.8 | – |
| Gas collars | 29.8 | – | 29.8 | – |
| Interest rate swaps | 0.8 | – | 0.8 | – |
| Forward foreign exchange contracts | 0.2 | – | 0.2 | – |
| Total | 138.1 | – | 138.1 | – |

All of the above fair values are based on Level 2 techniques.

Commodity price risk

Oil

At 31 December 2010, the group had 5.04 million barrels of Dated Brent oil hedged with collars at an average floor price of US$47.0/bbl and an average cap of US$87.0/bbl, all of which were embedded through offtake agreements to the end of 2012.

The group also has oil collars with banks which are marked to market through profit or loss. Additionally, the group has executed reverse collars with certain oil trading companies at strike prices identical to the bank collars. Similar to the bank collars, these reverse collars are derivatives that must be marked to market through profit or loss. They effectively offset each other, resulting in no net impact on the income statement or balance sheet. The hedges embedded in long-term crude offtake agreements are not fair valued as they qualify for "own-use" exemption under IAS 39.

During the year, oil hedges for 4.64 million barrels matured generating a net cost of US$8.0 million (2009: US$15.0 million). In the prior year, an unrealised fair value loss of US$9.8 million was calculated on the swaps which was recognised directly in retained earnings as the swaps were 100 per cent effective under hedge accounting rules. This US$9.8 million fair value loss reversed from retained earnings in the year ended 31 December 2010 due to the maturity of the swaps.

Indonesian gas

No changes have been made to the group's hedging position in Singapore 180 HSFO, which underlies the pricing mechanism for Indonesian gas sold into the Singapore market. As at 31 December 2010, 282,000 metric tonnes (mt) of future production from the existing contract is hedged to the period ending mid-year 2013, with a floor of US$250.0/mt and a cap of US$500.0/mt.

During the year, Singapore 180 HSFO contracts for 120,000 metric tonnes matured generating a cash cost of US$0.1 million (2009: US$nil). All of these contracts have been designated as cash flow hedges and were assessed to be effective. In the current year US$20.4 million of the movement in the fair value of these contracts was credited to the income statement (2009: charge of US$26.9 million), as this movement related to the time-value portion of hedges under IAS 39. The remaining movement, being a charge of US$12.0 million (2009: US$nil), related to the intrinsic value of such instruments and was recognised directly in retained earnings.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 17. Financial instruments (continued)

Movement in commodity collar and swap contracts

| Asset/(liability) | Oil $ million | Gas $ million | Total $ million |
|---|---|---|---|
| At 1 January 2009 | (11.1) | (2.9) | (14.0) |
| Premium paid in the year | 12.5 | – | 12.5 |
| Deduction against sales revenues | (15.0) | – | (15.0) |
| Charge to income statement for the year | (83.9) | (26.9) | (110.8) |
| Charge to retained earnings for the year | (9.8) | – | (9.8) |
| At 31 December 2009 | (107.3) | (29.8) | (137.1) |
| Cash settlement for swaps | 16.2 | – | 16.2 |
| Deduction against sales revenues | (8.0) | (0.1) | (8.1) |
| Credit to income statement for the year | 15.2 | 20.4 | 35.6 |
| Credit/(charge) to retained earnings for the year | 9.8 | (12.0) | (2.2) |
| **At 31 December 2010** | **(74.1)** | **(21.5)** | **(95.6)** |

Movement in commodity reverse collars

| Asset/(liability) | Oil $ million | Gas $ million | Total $ million |
|---|---|---|---|
| At 1 January 2009 | 10.7 | – | 10.7 |
| Recognised in the balance sheet | 29.0 | – | 29.0 |
| Credit to income statement for the year | 41.2 | – | 41.2 |
| At 31 December 2009 | 80.9 | – | 80.9 |
| Charge to income statement for the year | (15.2) | – | (15.2) |
| **At 31 December 2010** | **65.7** | **–** | **65.7** |

The fair values, which have been determined from counterparties with whom the trades have been concluded, have been recognised in the balance sheet in trade and other receivables and trade and other payables.

Commodity contract sensitivity analysis

The key variable which affects the fair value of the group's hedge instruments is market expectations about future commodity prices. The following illustrates the sensitivity of net income and equity to a ten per cent increase and a ten per cent decrease in this variable:

| Increase/(decrease) in mark to market value | Oil $ million | Gas $ million | Total $ million |
|---|---|---|---|
| Ten per cent increase | 43.7 | 11.7 | 55.4 |
| Ten per cent decrease | (31.3) | (9.7) | (41.0) |

Deferred revenue related to oil reverse collars

Deferred revenue has been created due to first-day gains arising from offtake agreements and related oil reverse collars. This deferred revenue is being released to the income statement over the life of each individual offtake agreement as shown below:

| Asset/(liability) | Oil $ million | Gas $ million | Total $ million |
|---|---|---|---|
| At 1 January 2009 | (33.6) | – | (33.6) |
| Recognised in the balance sheet | (29.0) | – | (29.0) |
| Credit to income statement for the year | 8.5 | – | 8.5 |
| At 31 December 2009 | (54.1) | – | (54.1) |
| Credit to income statement for the year | 18.2 | – | 18.2 |
| **At 31 December 2010** | **(35.9)** | **–** | **(35.9)** |

## 17. Financial instruments (continued)

### Interest rate risk

At 31 December 2010, US$450.0 million of the group's long-term bank borrowings have been swapped from floating rate to fixed rate. Under these interest rate swap contracts, the group has agreed to exchange the difference between fixed and floating interest amounts calculated on agreed notional principal amounts. Such contracts enable the group to mitigate the risk of changing interest rates and the cash flow exposure on the issued variable rate debt held.

These contracts have been designated as cash flow hedges and were assessed to be effective. The fair value of interest rate swaps at the reporting date is determined by discounting the future cash flows using the forward curves at this date. The movement in fair values is shown in the table below:

| Asset/(liability) | Total $ million |
|---|---|
| At 1 January 2009 | – |
| Charge to retained earnings for the year | (0.8) |
| At 31 December 2009 | (0.8) |
| Cash settlement for swaps | 7.0 |
| Charge to income statement for the year | (7.0) |
| Charge to retained earnings for the year | (12.1) |
| **At 31 December 2010** | **(12.9)** |

### Interest rate swaps sensitivity analysis

The key variable which affects the fair value of the group's hedge instruments is market expectations about future interest rates. The following illustrates the sensitivity of comprehensive income to an increase of fifty basis points in this variable:

| Increase/(decrease) in mark to market value | Total $ million |
|---|---|
| Increase of fifty basis points | (7.6) |

A decrease of fifty basis points in this variable has not been considered appropriate due to the current very low level of floating interest rates.

### Foreign currency exchange risk

To cover sterling exposures an amount of £198.0 million was purchased with forward contracts during the year (2009: £123.8 million). Premier's activities are largely conducted in US dollars. All borrowings at year-end were denominated in US dollars to match the currency of the assets.

The impact of variations in foreign exchange rates on the group's results would be immaterial.

### Other financial instruments

### Credit risk

The group's credit risk is attributable to its trade receivables and its bank deposits. The amount of receivables presented in the balance sheet are net of allowances for doubtful receivables which were immaterial in 2010 and 2009. The group does not require collateral or other security to support receivables from customers or related parties. The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with at least single A credit ratings assigned by international credit rating agencies.

An indication of the concentration of credit risk is shown in note 1, whereby the revenue from four customers each exceeded 10 per cent of the group's consolidated revenue in 2010 and 2009.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 17. Financial instruments (continued)

The ageing profile of the group's trade and other receivables and trade and other payables as at 31 December, including the related interest amounts, was:

| | Less than 1 month $ million | 2 to 3 months $ million | 3 months to 1 year $ million | 1 to 5 years $ million | Over 5 years $ million | Total $ million |
|---|---|---|---|---|---|---|
| **2010:** | | | | | | |
| Trade and other receivables | 182.6 | 17.8 | 27.5 | – | – | 227.9 |
| Trade and other payables | (97.2) | (6.4) | (0.2) | – | – | (103.8) |
| Bank loans | – | – | (23.3) | (539.0) | – | (562.3) |
| Convertible bonds | – | – | (7.2) | (268.0) | – | (275.2) |
| **Total** | **85.4** | **11.4** | **(3.2)** | **(807.0)** | – | **(713.4)** |
| 2009: | | | | | | |
| Trade and other receivables | 276.1 | 23.2 | 5.1 | – | – | 304.4 |
| Trade and other payables | (74.9) | (27.1) | (4.8) | – | – | (106.8) |
| Bank loans | – | – | – | (353.0) | – | (353.0) |
| Convertible bonds | – | – | (7.2) | (275.2) | – | (282.4) |
| Total | 201.2 | (3.9) | (6.9) | (628.2) | – | (437.8) |

### Liquidity risk

Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built an appropriate liquidity risk management framework for the management of the group's short, medium and long-term funding and liquidity management requirements. The group manages liquidity risk by maintaining adequate reserves, banking facilities and borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities and future capital and operating commitments.

### Borrowing facilities

The group has committed borrowing facilities of US$949.0 million and letter of credit facilities of £399.5 million (US$623.2 million), in addition to the convertible bonds. The undrawn cash balance from the committed borrowing facilities as at 31 December was:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Expiring in more than one year, but not more than two years | **17.2** | – |
| Expiring in more than two years, but not more than five years | **446.8** | 328.2 |

The undrawn balance on the letter of credit facilities as at 31 December 2010 was £280.9 million (US$438.2 million) (2009: £nil).

### Interest rate risk profile of financial liabilities

The interest rate profile of the financial liabilities of the group as at 31 December was:

| | Fixed rate $ million | Floating rate $ million | Total $ million | Fixed rate weighted average interest rate % |
|---|---|---|---|---|
| **2010:** | | | | |
| Bank loans | 450.0 | 35.0 | 485.0 | 5.171 |
| Convertible bonds | 250.0 | – | 250.0 | 2.875 |
| **Total** | **700.0** | **35.0** | **735.0** | – |
| 2009: | | | | |
| Bank loans | 150.0 | 203.0 | 353.0 | 5.126 |
| Convertible bonds | 250.0 | – | 250.0 | 2.875 |
| Total | 400.0 | 203.0 | 603.0 | – |

## 17. Financial instruments (continued)

The carrying values on the balance sheet of the bank loans and the convertible bonds, which are stated net of debt arrangement fees and issue costs, are as follows:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Bank loans | **466.4** | 337.2 |
| Convertible bonds: | | |
| Liability component | **218.1** | 210.1 |
| Equity component | **28.9** | 36.0 |

The floating rate financial liabilities at 31 December 2010 comprised bank borrowings bearing interest at rates set by reference to US$ LIBOR, exposing the group to a cash flow interest rate risk.

### Interest rate risk profile of financial assets

The interest rate profile of the financial assets of the group as at 31 December was:

| | Floating rate $ million | Interest free $ million | Total $ million |
|---|---|---|---|
| **2010** | | | |
| **Cash and short-term deposits:** | | | |
| Sterling | 11.1 | – | 11.1 |
| US$ | 260.1 | 5.7 | 265.8 |
| Other | 5.3 | 17.5 | 22.8 |
| **Total** | **276.5** | **23.2** | **299.7** |
| 2009 | | | |
| Cash and short-term deposits: | | | |
| Sterling | 0.4 | – | 0.4 |
| US$ | 226.8 | 9.1 | 235.9 |
| Other | 10.6 | 3.7 | 14.3 |
| Total | 237.8 | 12.8 | 250.6 |

The floating rate cash and short-term deposits consist of cash held in interest-bearing current accounts and deposits placed on the money markets for periods ranging from overnight to three months.

### Fair value of financial assets and financial liabilities

The fair values of the financial assets and financial liabilities (excluding current assets, current liabilities and derivative financial instruments) are:

| | 2010 Carrying amount $ million | 2010 Estimated fair value $ million | 2009 Carrying amount $ million | 2009 Estimated fair value $ million |
|---|---|---|---|---|
| **Primary financial instruments held or issued to finance the group's operations:** | | | | |
| Cash and short-term deposits | **299.7** | **299.7** | 250.6 | 250.6 |
| Bank loans | **(485.0)** | **(485.0)** | (353.0) | (353.0) |
| Liability component of convertible bonds | **(220.4)** | **(220.4)** | (213.2) | (213.2) |

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction, other than in a forced or liquidated sale. Where available, market values have been used to determine fair values. The estimated fair values have been determined using market information and appropriate valuation methodologies. Values recorded are as at the balance sheet date, and will not necessarily be realised. Non-interest bearing financial instruments, which include amounts receivable from customers and accounts payable are recorded materially at fair value reflecting their short-term maturity and are not shown in the above table.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 18. Deferred tax

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Deferred tax assets | **285.3** | 190.6 |
| Deferred tax liabilities | **(183.7)** | (179.8) |
| | **101.6** | 10.8 |

| | At 1 January 2009 $ million | Oilexco acquisition 21 May 2009 $ million | Other movement[3] $ million | (Charged)/ credited to income statement $ million | At 31 December 2009 $ million |
|---|---|---|---|---|---|
| UK deferred corporation tax: | | | | | |
| Fixed assets and allowances | (68.5) | 356.2 | – | (100.8) | 186.9 |
| Decommissioning | 29.0 | 57.2 | – | 30.1 | 116.3 |
| Deferred petroleum revenue tax | 17.6 | 0.5 | – | (11.2) | 6.9 |
| Tax losses and allowances | – | – | – | 17.7 | 17.7 |
| Unrecognised tax losses and allowances | – | (273.1) | – | 135.5 | (137.6) |
| Deferred revenue | 18.3 | – | – | (4.2) | 14.1 |
| Total UK deferred corporation tax | (3.6) | 140.8 | – | 67.1 | 204.3 |
| UK deferred petroleum revenue tax[1] | (35.2) | (2.1) | – | 23.6 | (13.7) |
| Overseas deferred tax[2] | (144.2) | – | (26.2) | (9.4) | (179.8) |
| Total | (183.0) | 138.7 | (26.2) | 81.3 | 10.8 |

| | At 1 January 2010 $ million | Other movement $ million | (Charged)/ credited to income statement $ million | At 31 December 2010 $ million |
|---|---|---|---|---|
| **UK deferred corporation tax:** | | | | |
| Fixed assets and allowances | 186.9 | – | (172.1) | 14.8 |
| Decommissioning | 116.3 | – | 72.3 | 188.6 |
| Deferred petroleum revenue tax | 6.9 | – | (10.5) | (3.6) |
| Tax losses and allowances | 17.7 | – | 121.0 | 138.7 |
| Unrecognised tax losses and allowances | (137.6) | – | 67.4 | (70.2) |
| Deferred revenue | 14.1 | – | (4.2) | 9.9 |
| **Total UK deferred corporation tax** | **204.3** | – | **73.9** | **278.2** |
| **UK deferred petroleum revenue tax[1]** | **(13.7)** | – | **20.8** | **7.1** |
| **Overseas deferred tax[2]** | **(179.8)** | **0.4** | **(4.3)** | **(183.7)** |
| **Total** | **10.8** | **0.4** | **90.4** | **101.6** |

1. The UK deferred petroleum revenue tax relates mainly to temporary differences associated with decommissioning provisions.
2. The overseas deferred tax relates mainly to temporary differences associated with fixed asset balances.
3. The other movement in the prior year mainly relates to the deferred effect of Norwegian tax rebates and exchange differences.

## 18. Deferred tax (continued)

The group's unutilised tax losses and allowances at 31 December 2010 are recognised to the extent that taxable profits are expected to arise in the future against which the tax losses and allowances can be utilised. In accordance with paragraph 37 of IAS 12 – 'Income Taxes' the group re-assessed its unrecognised deferred tax assets at 31 December 2010 with respect to ring fence tax losses and allowances. Taking into account the considerable increase in oil price in the last quarter of 2010 and the inclusion of additional UK fields in the group's proven and probable reserve profile, the group's corporate oil price assumption was increased from US$70/bbl in 2009 to US$75/bbl in 2010 and the corporate model used to assess whether additional deferred tax assets should be recognised was re-run using this price along with the inclusion of the additional UK fields. As a result, US$67.4 million of previously unrecognised deferred tax assets have been recognised in 2010.

In addition to the above, there are non-ring fence UK tax losses of approximately US$171.3 million (2009: US$92.1 million) and non-UK tax losses of approximately US$10.0 million for which a deferred tax asset has not been recognised.

None of the UK tax losses (ring fence and non-ring fence) have a fixed expiry date for tax purposes.

A deferred petroleum revenue tax (PRT) asset has been recognised to the extent that it is probable that the asset will reverse when the PRT field is fully decommissioned.

No deferred tax has been provided on unremitted earnings of overseas subsidiaries, following a change in UK tax legislation in 2009 which exempted foreign dividends from the scope of UK corporation tax, where certain conditions are satisfied.

## 19. Share capital

| | 2010 50p shares | 2010 £ | 2009 50p shares | 2009 £ |
|---|---|---|---|---|
| **Ordinary Shares:** | | | | |
| Called-up, issued and fully-paid | **116,395,912** | **58,197,956** | 114,673,066 | 57,336,533 |

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Balance at 1 January | **97.0** | 73.6 |
| Shares issued in respect of rights issue (nominal value) | **–** | 26.0 |
| Shares issued to the Premier Oil plc Employee Benefit Trust (nominal value) | **1.3** | – |
| Ordinary Shares cancelled | **–** | (2.6) |
| **Balance at 31 December** | **98.3** | 97.0 |

### Rights issue

On 25 March 2009, the company announced its proposal to raise approximately £171 million (US$252.2 million) by way of a fully underwritten rights issue. Under the proposal, the company offered its shareholders the opportunity to acquire four new Ordinary Shares for every nine Ordinary Shares held at a price of 485 pence per new Ordinary Share. The proposal was subject to authorisation by shareholders which was obtained at a General Meeting held on 20 April 2009. The offer period commenced on 21 April 2009 and closed for acceptance on 6 May 2009. Dealing in the new shares began on 7 May 2009.

### Share-based payments

£11,423 (US$16,988) of Ordinary Shares were issued during 2010 relating to the company's share option plans (2009: £12,113 (US$19,651)). In addition, 1,700,000 Ordinary Shares with a nominal value of £850,000 (US$1,327,955) were issued to the Premier Oil plc Employee Benefit Trust to be used to satisfy future awards under the company's long-term incentive arrangements (2009: £nil).

### Share option plans

The company has share option schemes under which options to subscribe for the company's shares have been granted to certain executives and employees. Options granted are normally exercisable not less than three years after their grant and will lapse on their tenth anniversary. Options cannot be exercised until pre-determined performance conditions have been achieved.

Under the Savings Related Share Option Scheme, eligible employees with six months or more continuous service can join the scheme. Employees can save to a maximum of £250 per month through payroll deductions for a period of three or five years, after which time they can acquire shares at up to a 20 per cent discount.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 19. Share capital (continued)

Under the Share Incentive Plan employees are invited to make contributions to buy Partnership Shares. If an employee agrees to buy Partnership Shares the company currently matches the number of Partnership Shares bought with an award of shares (Matching Shares), on a one-for-one basis.

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Options** | **Weighted average exercise price** | Options | Weighted average exercise price |
| Outstanding at the beginning of the year | **174,473** | **£4.72** | 189,722 | £4.69 |
| Adjustment for rights issue | – | – | 44,556 | £4.26 |
| Granted during the year | **38,906** | **£10.42** | 23,190 | £7.21 |
| Lapsed during the year | **(2,369)** | **£8.49** | (12,913) | £9.26 |
| Exercised during the year* | **(106,339)** | **£3.11** | (70,082) | £2.04 |
| **Outstanding at the end of the year** | **104,671** | **£8.33** | 174,473 | £4.72 |
| **Exercisable at the end of the year** | **5,831** | **£2.08** | 89,324 | £2.16 |

* There were 22,846 Ordinary Shares issued under the group's share option schemes during the year (2009: 24,226). The remaining 83,493 Ordinary Shares were issued from the Premier Oil plc Employee Benefit Trust (2009: 45,856).

The weighted average share price at the date of exercise for share options exercised during the year was £14.28. The options outstanding at 31 December 2010 had a weighted average exercise price of £8.33 and a weighted average remaining contractual life of 3.0 years.

The fair value of the options granted during the year was determined using the Black-Scholes valuation model and is not material.

The group recognised a cost of US$52.7 million and US$27.3 million related to equity-settled share-based payment transactions in 2010 and 2009 respectively.

### Asset and Equity Plan

The Asset and Equity Plan is designed to reward employees for improvement in the asset value of the business and the market value of the company over a three-year period and is operated by reference to two bonus pools – an equity bonus pool and an asset bonus pool. The asset bonus pool is created by reference to the increase in the net asset value per share of the company over a three-year period and the equity bonus pool is created by reference to the increase in the equity market value per share of the company over a three-year period.

The company uses a Monte Carlo simulation model to calculate the value of the equity bonus pool of the plan.

The main assumptions used for the calculations are as follows:

| | |
|---|---|
| Volatility: | 31.5% |
| Risk free rate of interest: | 4.4% |
| Historic market value growth factor: | 109.0% |

For the asset bonus pool a discounted cash flow model based on the average oil price over the period is used to calculate the final value of the pool and to estimate the value of future asset bonus pools.

The Asset and Equity Plan expired in 2009 and the award granted in 2008, which matured at the end of 2010, is the last award remaining under the plan.

## 19. Share capital (continued)

Long Term Incentive Plan

The Long Term Incentive Plan (LTIP) was introduced in 2009 to provide a long-term all employee scheme which motivates all employees and provides a longer-term perspective to the total remuneration package. Awards under the LTIP comprise three elements: Equity Pool Awards, Performance Share Awards that vest after the expiry of a three-year performance period, and a potential Matching Award that vests at the expiry of a further three-year performance period, commencing at the end of the three-year performance period for Equity Pool and Performance Share Awards.

Full details about this plan have been provided in the Remuneration Report.

The company uses a Monte Carlo simulation model to calculate the value of the equity bonus pool of the plan and of the Performance Share Awards.

The main assumptions used for the calculations are as follows:

| | |
|---|---|
| Volatility: | 40.0% to 41.0% |
| Risk free rate of interest: | 3.3% to 3.7% |
| Correlation factor with comparator group: | 0.29 to 0.30 |

For the year ended 31 December 2010, the total cost recognised by the group for long-term incentive arrangements is US$38.9 million (2009: US$46.1 million), with a cumulative liability on the balance sheet of US$nil (2009: US$28.4 million). A credit of US$52.7 million has been recorded in retained earnings (2009: US$27.3 million) for all equity-settled payments of the group. Like other elements of remuneration, this charge is processed through the time-writing system which allocates cost, based on time spent by individuals, to various entities within the Premier Oil plc group. Part of this cost is therefore capitalised as directly attributable to capital projects and part is charged to the income statement as operating costs, pre-licence exploration costs or general and administration costs.

Ordinary Shares

The rights and restrictions attached to the Ordinary Shares are as follows:

Dividend rights

The rights of the holders of Ordinary Shares shall rank pari passu in all respects with each other in relation to dividends.

Winding up or reduction of capital

On a return of capital on a winding up or otherwise (other than on conversion, redemption or purchase of shares) the rights of the holders of Ordinary Shares to participate in the distribution of the assets of the company available for distribution shall rank pari passu in all respects with each other.

Voting rights

The holders of Ordinary Shares shall be entitled to receive notice of, attend, vote and speak at any General Meeting of the company.

## 20. Own shares

| | Note | Treasury Shares $ million | ESOP Trust $ million | Total $ million |
|---|---|---|---|---|
| At 1 January 2009 | | 47.2 | 16.4 | 63.6 |
| Acquired in the year | | – | 2.5 | 2.5 |
| Release of shares for long-term incentive arrangements | | – | (2.4) | (2.4) |
| Cancellation of Ordinary Shares | | (47.2) | – | (47.2) |
| At 31 December 2009 | | – | 16.5 | 16.5 |
| Acquired in the year | | – | 8.3 | 8.3 |
| Issuance of Ordinary Shares (market value)* | 19 | – | 32.1 | 32.1 |
| Release of shares for long-term incentive arrangements | | – | (25.2) | (25.2) |
| **At 31 December 2010** | | **–** | **31.7** | **31.7** |

* During the year 1,700,000 Ordinary Shares were issued to the Premier Oil plc Employee Benefit Trust to be used to satisfy awards under the company's long-term incentive arrangement schemes.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 20. Own shares (continued)

The own shares reserve represents the net cost of shares in Premier Oil plc purchased in the market or issued by the company into the Premier Oil plc Employee Benefit Trust (ESOP Trust).

At 1 January 2009, the company held 2,798,186 Ordinary Shares as Treasury Shares. All of these Ordinary Shares were cancelled by the company on 23 March 2009.

The Premier Oil plc Employee Benefit Trust holds shares to satisfy options under the group's share award schemes. The number of Ordinary Shares held by the Premier Oil plc Employee Benefit Trust at 31 December 2010 was 1,714,601 (2009: 1,077,711).

## 21. Notes to the cash flow statement

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Profit before tax for the year | | **100.8** | 79.9 |
| Adjustments for: | | | |
| Depreciation, depletion, amortisation and impairment | | **263.6** | 180.8 |
| Exploration expense | | **68.2** | 57.0 |
| Pre-licence exploration costs | | **18.9** | 20.3 |
| Acquisition of subsidiaries | 25 | **–** | (11.6) |
| Net operating charge for long-term employee benefit plans less contributions | | **–** | 0.2 |
| Provision for share-based payments | | **13.8** | 27.3 |
| Interest revenue and finance gains | | **(2.5)** | (5.9) |
| Finance costs and other finance expenses | | **68.0** | 44.4 |
| Gain/(loss) on derivative financial instruments | | **(38.6)** | 61.1 |
| Operating cash flows before movements in working capital | | **492.2** | 453.5 |
| Decrease/(increase) in inventories | | **16.7** | (10.3) |
| Decrease/(increase) in receivables | | **18.1** | (10.8) |
| Decrease in payables | | **(25.8)** | (15.5) |
| Cash generated by operations | | **501.2** | 416.9 |
| Income taxes paid | | **(67.9)** | (71.5) |
| Interest income received | | **2.7** | 2.3 |
| **Net cash from operating activities** | | **436.0** | 347.7 |

Analysis of changes in net (debt)/cash:

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| **a) Reconciliation of net cash flow to movement in net (debt)/cash:** | | | |
| Movement in cash and cash equivalents | | **49.1** | (73.1) |
| Proceeds from drawdown of long-term bank loans | | **(310.0)** | (353.0) |
| Repayment of long-term bank loans | | **178.0** | – |
| Non-cash movements on debt and cash balances | | **(7.2)** | (6.8) |
| Decrease in net cash in the year | | **(90.1)** | (432.9) |
| Opening net (debt)/cash | | **(315.6)** | 117.3 |
| **Closing net debt** | | **(405.7)** | (315.6) |
| **b) Analysis of net debt:** | | | |
| Cash and cash equivalents | 12 | **299.7** | 250.6 |
| Borrowings* | 14 | **(705.4)** | (566.2) |
| **Total net debt** | | **(405.7)** | (315.6) |

* Borrowings consist of the convertible bonds and the other long-term debt. The carrying values of the convertible bonds and the other long-term debt on the balance sheet are stated net of the unamortised portion of the issue costs of US$2.3 million (2009: US$3.1 million) and debt arrangement fees of US$18.6 million (2009: US$15.8 million) respectively.

## 22. Capital commitments and guarantees

At 31 December 2010, the group had capital commitments on exploration and development licences totalling US$209.6 million (2009: US$217.0 million) and performance guarantees of US$2.0 million (2009: US$6.1 million). In addition the group had issued letters of credit for future decommissioning liabilities totalling £117.3 million (US$183.0 million) (2009: £73.9 million (US$119.7 million)).

## 23. Group pension schemes

Balance sheet

| | 2010 $ million | 2009 $ million |
|---|---|---|
| UK funded pension scheme | **4.1** | 5.6 |
| UK unfunded pension scheme | **0.9** | 0.9 |
| Indonesia unfunded termination benefit scheme | **10.2** | 7.0 |
| **Total liability in balance sheet** | **15.2** | 13.5 |

Other comprehensive income

| | At 31 December 2010 $ million | At 31 December 2009 $ million |
|---|---|---|
| Actuarial gains/(losses) | **0.6** | (3.5) |
| Cumulative amount of actuarial gains/(losses) recognised in other comprehensive income | **(13.4)** | (14.0) |

Funded pensions

The company operates a defined benefit pension scheme in the UK – The Premier Oil plc Retirement and Death Benefits Plan (the Scheme). The Scheme was closed to new members (aside from the provision of insured death in service benefits) in 1997 and a new scheme, providing benefits on a defined contribution basis, was started. Both schemes are funded by the payment of contributions to separately administered trust funds.

The disclosures set out below are based on calculations carried out as at 31 December 2010 by a qualified independent actuary. The figures have been prepared in compliance with IAS 19 – 'Employee Benefits'.

The Scheme's assets are held in a separate trustee-administered fund to meet long-term pension liabilities to past and present employees. The Trustee of the Scheme is required to act in the best interest of the Scheme's beneficiaries. The appointment of members of the Trustee Board is determined by the trust documentation.

The liabilities of the defined benefit Scheme are measured by discounting the best estimate of future cash flows to be paid out of the Scheme using the projected unit credit method.

The liabilities set out in this note have been calculated using membership data current as at 31 December 2010. The results of the calculations and the assumptions adopted are shown below.

As at 31 December 2010, contributions are payable to the Scheme at the rates set out in the schedule of contributions dated 26 September 2008. Under this schedule, the company contributes on a monthly basis at the rate of 25 per cent of the aggregate of members' pensionable salaries.

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 23. Group pension schemes (continued)

### Principal assumptions

The principal actuarial assumptions at the balance sheet date were:

| | At 31 December 2010 | At 31 December 2009 |
|---|---|---|
| Discount rate | **5.4% pa** | 5.6% pa |
| Expected return on Scheme assets | **5.7% pa** | 4.9% pa |
| Revaluation of deferred pensions | **3.2% pa** | 3.7% pa |
| Rate of increase in salaries | **5.7% pa** | 5.7% pa |
| Rate of increase in pensions in payment: LPI (max 5.0%) | **3.7% pa** | 3.7% pa |
| Withdrawals | **No allowance** | No allowance |
| Cash commutation | **1.0 x pre-commutation pension** | 1.0 x pre-commutation pension |
| Life expectancy of male aged 65 now | **23.8** | 23.7 |
| Life expectancy of male aged 65 in 20 years | **25.9** | 25.8 |
| Life expectancy of female aged 65 now | **26.3** | 26.2 |
| Life expectancy of female aged 65 in 20 years | **28.2** | 28.1 |

The pre and post-retirement mortality base table used for the Scheme in 2010 and 2009 is PCA00 YOB LC (minimum 1.0 per cent improvements).

### Asset breakdown

The major categories of Scheme assets as a percentage of total Scheme assets are:

| | At 31 December 2010 | At 31 December 2009 |
|---|---|---|
| Equities | **49.7%** | 37.3% |
| Gilts | **24.8%** | 26.0% |
| Corporate bonds | **23.6%** | 18.7% |
| Cash | **1.9%** | 18.0% |
| **Total** | **100.0%** | 100.0% |

Reconciliation of funded status and amount recognised in balance sheet:

| | At 31 December 2010 $ million | At 31 December 2009 $ million |
|---|---|---|
| Fair value of Scheme assets | **28.2** | 25.6 |
| Present value of defined benefit obligation | **(32.3)** | (31.2) |
| **Deficit** | **(4.1)** | (5.6) |

Components of pension expense for period:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Current service cost | **0.2** | 0.2 |
| Interest cost | **1.7** | 1.5 |
| Expected return on Scheme assets | **(1.2)** | (1.3) |
| Net actuarial (gain)/loss recognised | **(0.3)** | 3.0 |
| **Total** | **0.4** | 3.4 |

## 23. Group pension schemes (continued)

Changes in the present value of the defined benefit obligation:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Present value of defined benefit obligation at 1 January | **31.2** | 22.7 |
| Service cost | **0.2** | 0.1 |
| Interest cost | **1.7** | 1.5 |
| Actuarial losses | **1.2** | 4.9 |
| Benefits paid | **(0.8)** | (0.7) |
| Currency translation effects | **(1.2)** | 2.7 |
| **Present value of defined benefit obligation at 31 December** | **32.3** | 31.2 |

Changes in the fair value of Scheme assets:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Fair value of Scheme assets at 1 January | **25.6** | 20.7 |
| Expected return | **1.2** | 1.3 |
| Actuarial gains | **1.5** | 1.9 |
| Contributions by employer | **1.6** | 0.2 |
| Benefits paid | **(0.8)** | (0.7) |
| Currency translation effects | **(0.9)** | 2.2 |
| **Fair value of Scheme assets at 31 December** | **28.2** | 25.6 |
| **Actual return on Scheme assets** | **2.7** | 3.2 |

Reconciliation of balance sheet liability:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| At 1 January | **5.6** | 2.0 |
| Pension expense for year | **0.4** | 3.4 |
| Total contributions paid | **(1.6)** | (0.2) |
| Currency translation effects | **(0.3)** | 0.4 |
| **At 31 December** | **4.1** | 5.6 |

History of experience adjustments:

| | 2010 $ million | 2009 $ million | 2008 $ million | 2007 $ million | 2006 $ million |
|---|---|---|---|---|---|
| Defined benefit obligation | **(32.3)** | (31.2) | (22.7) | (31.9) | (31.4) |
| Scheme assets | **28.2** | 25.6 | 20.7 | 29.3 | 28.0 |
| Deficit | **(4.1)** | (5.6) | (2.0) | (2.6) | (3.4) |
| Experience adjustments on Scheme liabilities: | | | | | |
| Amount of (gain)/loss | **0.6** | (0.6) | 0.1 | – | (0.6) |
| Percentage of Scheme liabilities | **2%** | (2%) | – | – | (2%) |
| Changes in the assumptions for value of Scheme liabilities: | | | | | |
| Amount of (gain)/loss | **0.6** | 5.5 | (2.2) | (0.6) | (1.0) |
| Percentage of Scheme liabilities | **2%** | 18% | (10%) | (2%) | (3%) |
| Experience adjustments on Scheme assets: | | | | | |
| Amount of gain/(loss) | **1.5** | 1.9 | (5.1) | (0.4) | 0.2 |
| Percentage of Scheme assets | **5%** | 7% | (25%) | (1%) | 1% |
| Net actuarial gain/(loss) recognised | **0.3** | (3.0) | (3.0) | 0.2 | 1.8 |

# Notes to the Consolidated Financial Statements (continued)

For the year ended 31 December 2010

## 23. Group pension schemes (continued)

Projected components of pension expense for the year to 31 December 2011:

Due to of the significant volatility in investment markets, it is difficult to project forward the IAS 19 figures for the next year with confidence. The following projections should therefore be treated with caution. Assumptions implicit in the following projections are:

- the return on assets from 31 December 2010 is 5.7 per cent pa;
- contributions to the Scheme will continue throughout 2011 in accordance with the current schedule of contributions in place at the date of signing this report; and
- there will be no changes to the terms of the Scheme.

The amounts recognised in the components of pension expense are:

| | 2011 $ million |
|---|---|
| Current service cost | 0.2 |
| Interest cost | 1.7 |
| Expected return on Scheme assets | (1.6) |
| Total | 0.3 |

Unfunded pensions

In Indonesia the group operates a Service, Severance and Compensation pay scheme under a Collective Labour Agreement with the local workforce. This is an unfunded post-employment defined benefit scheme in nature.

In addition, the group is paying an unfunded pension to a former director in regard to which annual increases and a reversionary spouse's pension apply on the same basis as to pensions paid under the Scheme. On the same actuarial basis as used to assess the Scheme's pension costs, the present value as at 31 December 2010 of the future payments projected to be made in respect of UK unfunded pensions is US$0.9 million (2009: US$0.9 million).

Defined contribution benefit scheme

The group operates a defined contribution retirement benefit scheme. The only obligation of the group with respect to the retirement benefit scheme is to make specified contributions. Payments to the defined contribution scheme are charged as an expense as they fall due. The total cost charged to income of US$2.6 million (2009: US$2.0 million) represents contributions payable to these schemes by the group at rates specified in the rules of the scheme.

## 24. Related party transactions

Transactions between the company and its subsidiaries and joint ventures, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Directors and executive remuneration

The remuneration of directors and other key members of management during the year is highlighted below. Further information regarding the remuneration of individual directors is provided in the audited part of the Remuneration Report.

| | **2010 $ million** | 2009 $ million |
|---|---|---|
| Short-term employee benefits | **5.2** | 5.3 |
| Post-employment benefits | **0.4** | 0.4 |
| Other long-term benefits: share-based payments | **8.4** | 1.6 |
| | **14.0** | 7.3 |

## 25. Acquisition of subsidiaries

On 21 May 2009 the Premier Oil plc group, through its subsidiary Premier Oil Group Ltd, completed the acquisition of the entire issued share capital of Oilexco North Sea Ltd (ONSL) and its wholly-owned subsidiary Oilexco North Sea Exploration Ltd (ONSEL).

The group funded the acquisition and associated costs by way of a four for nine rights issue of new Ordinary Shares at a price of 485 pence per share to raise gross proceeds of approximately £171.0 million (US$252.2 million), new credit facilities and the group's existing cash resources.

ONSL was an oil and gas exploration and production company active in the UK, with its producing properties located in the UK Central North Sea. The acquisition provided the group with a greater presence in the North Sea, strengthening the group's existing operations in that area by adding a material package of assets comprising existing producing fields, development projects of existing discovered reserves and a portfolio of exploration prospects, together with high-quality UK operatorship capabilities.

The transaction has been accounted for by the acquisition method of accounting with an effective date of 21 May 2009, being the date that the group gained control of ONSL. The final fair values of the identifiable assets and liabilities are set out in the following table:

| | Final fair values $ million |
|---|---|
| Net assets acquired: | |
| Property, plant and equipment – oil and gas properties | 486.5 |
| Deferred tax assets | 140.8 |
| Current assets | 114.5 |
| Current liabilities | (39.6) |
| Deferred tax liabilities | (2.1) |
| Long-term provisions | (114.3) |
| Total acquired net assets | 585.8 |
| Total consideration* | (574.2) |
| Excess of fair value over cost** | 11.6 |

* Total consideration also included £43.3 million (US$63.0 million) of cash paid by the group which was held in trust for future abandonment obligations, and direct acquisition costs of US$10.5 million. The cash held in trust was released back to the group in December 2010.

** The excess of fair value over cost was recognised immediately in the consolidated income statement in the prior year, and was offset by related acquisition expenses of US$6.0 million.

Due to the inherently uncertain nature of the oil and gas industry the assumptions underlying the final assigned values are judgemental in nature.

## 26. Events after the balance sheet date

On 23 March 2011 it was announced that the supplementary charge on UK oil and gas production is to be increased from 20 per cent to 32 per cent with effect from 24 March 2011, thereby increasing the combined rate of tax on UK oil and gas production from 50 per cent to 62 per cent. The government has stated that the supplementary corporation tax rate may be reduced back to 20 per cent if oil prices stay low (below US$75/bbl) for a sustained period, however it is not clear at this time if this will be incorporated into legislation. This change in UK tax legislation will not impact the 2010 group financial results as these changes have not been substantively enacted at the balance sheet date, however it is likely to have a material effect on the value of the group's UK deferred tax assets and current tax charge in future reporting periods. Due to the unavailability of further details from the UK Government related to this legislation, at the time of approval of these financial statements it is not possible to quantify the financial effects on the group's future financial position or income statement.

# Independent Auditor's Report to the Members of Premier Oil plc

We have audited the parent company financial statements of Premier Oil plc for the year ended 31 December 2010 which comprise the parent company balance sheet, the parent company statement of total recognised gains and losses and the related notes 1 to 13. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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 auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

### Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2010;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent company financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

### Other matter

We have reported separately on the group financial statements of Premier Oil plc for the year ended 31 December 2010.

**Matthew Donaldson (Senior statutory auditor)**
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
United Kingdom
23 March 2011

# Parent Company Financial Statements: Balance Sheet

As at 31 December 2010

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Fixed assets: | | | |
| Investments in subsidiaries | 4 | 553.2 | 553.2 |
| Total fixed assets | | 553.2 | 553.2 |
| Current assets: | | | |
| Debtors | | | |
| Amounts falling due within one year | 5 | 0.1 | 0.1 |
| Amounts falling due after more than one year | 5 | 38.8 | 17.2 |
| Total current assets | | 38.9 | 17.3 |
| Creditors: amounts falling due within one year | 6 | (1.0) | (28.5) |
| Net current assets/(liabilities) | | 37.9 | (11.2) |
| Total assets less current liabilities | | 591.1 | 542.0 |
| Provision for liabilities | 7 | – | (2.1) |
| Net assets excluding pension liability | | 591.1 | 539.9 |
| Pension liability | 8 | (5.0) | (6.5) |
| Net assets including pension liability | | 586.1 | 533.4 |
| Capital and reserves: | | | |
| Called-up share capital | 10 | 98.3 | 97.0 |
| Share premium account | 11 | 254.8 | 223.7 |
| Profit and loss account | 11 | 176.9 | 156.6 |
| Capital redemption reserve | 11 | 4.3 | 4.3 |
| Equity reserve | 11 | 51.8 | 51.8 |
| Total equity shareholders' funds | 12 | 586.1 | 533.4 |

The financial statements of Premier Oil plc (registered number SC234781) were approved by the Board of Directors and authorised for issue on 23 March 2011.

They were signed on its behalf by:

**S C Lockett**
Chief Executive

**A R C Durrant**
Finance Director

# Statement of Total Recognised Gains and Losses

For the year ended 31 December 2010

| | Note | 2010 $ million | 2009 $ million |
|---|---|---|---|
| Profit for the financial year | 2 | 7.4 | 23.1 |
| Pension costs – actuarial gains/(losses) | 8 | 0.6 | (3.5) |
| Total recognised gains and losses relating to the year | | 8.0 | 19.6 |

# Notes to the Parent Company Financial Statements

For the year ended 31 December 2010

## 1. Significant accounting policies

### Basis of accounting

The separate financial statements of the company are presented as required by the Companies Act 2006. They have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards and law.

The financial statements have been prepared on the going concern basis. Further information relating to the going concern assumption is provided in the Financial Review.

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

### Investments

Fixed asset investments in subsidiaries are shown at cost less provision for impairment.

### Pension costs

The company operates a defined benefit pension scheme, which requires contributions to be made to a separately administered fund. The scheme was closed to new members (aside from the provision of insured death in service benefits) in 1997. The company accounts for pension costs in line with Financial Reporting Standard (FRS) 17 – 'Retirement Benefits'.

The amounts charged to operating profit regarding the defined benefit scheme are the current service costs and gains and losses on settlements and curtailments. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits do not vest immediately, the costs are recognised over the period until vesting occurs. The interest costs and the expected return on the assets are shown as a net amount of other financial costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit credit method, and discounted at a rate equivalent to the current rate of return on a high-quality corporate bond of equivalent currency and term to the scheme liabilities.

The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of related deferred tax, is presented separately after other net assets on the face of the balance sheet.

### Foreign exchange

Transactions denominated in foreign currencies are recorded in the local currency at actual exchange rates as of the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the year-end are reported at the rates of exchange prevailing at the year-end. Any gain or loss arising from a change in exchange rate subsequent to the dates of the transactions is included as an exchange gain or loss in the profit and loss account.

### Cash flow statement

No cash flow statement is prepared for the company under FRS 1 – 'Cash Flow Statements' as the cash flows of the company have been included in the group cash flow statement of Premier Oil plc.

### Related party transactions

The company has taken advantage of the exemption available under FRS 8 – 'Related Party Disclosures' with regard to the non-disclosure of transactions between group companies.

### Share-based payments

The company issues equity-settled and cash-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the company's estimate of shares that will eventually vest.

Fair value is measured by use of a Monte Carlo simulation. The main assumptions are provided in note 10.

A liability equal to the portion of the goods or services received is recognised at the current fair value determined at each balance sheet date for cash-settled share-based payments.

1. Significant accounting policies (continued)

Sales revenue

Sales of petroleum production are recognised when goods are delivered or the title has passed to the customer.

Tax

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more tax. The exception to this is that deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Fixed assets

Oil and gas assets

(a) Development and production assets

Development and production assets are accumulated generally on a field-by-field basis and represent the cost of developing the commercial reserves discovered and bringing them into production.

The cost of development and production assets also includes the cost of acquisitions and purchases of such assets, directly attributable overheads, finance costs capitalised and the cost of recognising provisions for future restoration and decommissioning.

Depreciation of producing assets

The net book values of producing assets are depreciated generally on a field-by-field basis using the unit-of-production method by reference to the ratio of production in the year and the related commercial reserves of the field, taking into account future development expenditures necessary to bring those reserves into production.

Producing assets are generally grouped with other assets that are dedicated to serving the same reserves for depreciation purposes, but are depreciated separately from producing assets that serve other reserves.

Pipelines are depreciated on a unit-of-throughput basis.

(b) Impairment of development and production assets

An impairment test is performed whenever events and circumstances arising during the development or production phase indicate that the carrying value of a development or production asset may exceed its recoverable amount.

The carrying value is compared against the expected recoverable amount of the asset, generally by reference to the present value of the future net cash flows expected to be derived from production of commercial reserves. The cash generating unit applied for impairment test purposes is generally the field, except that a number of field interests may be grouped as a single cash generating unit where the cash flows of each field are interdependent.

(c) Decommissioning

Provision for decommissioning is recognised in full when the related facilities are installed. The amount recognised is the present value of the estimated future expenditure. A corresponding amount equivalent to the provision is also recognised as part of the cost of the related oil and gas property. This is subsequently depreciated as part of the capital costs of the production facilities. Any change in the present value of the estimated expenditure is dealt with prospectively as an adjustment to the provision and the oil and gas property. The unwinding of the discount is included as a finance cost.

Stock and underlift

Non-production related stocks are valued at the lower of cost or net realisable value. Under and overlifts of crude oil are recorded at market value.

# Notes to the Parent Company Financial Statements (continued)

For the year ended 31 December 2010

## 1. Significant accounting policies (continued)

### Derivative financial instruments

The company accounts for derivative financial instruments in line with FRS 25 – 'Financial Instruments: Disclosure and Presentation' and FRS 26 – 'Financial Instruments: Recognition and Measurement'.

The company uses derivative financial instruments (derivatives) to manage its exposure to oil price fluctuations. All derivatives are initially recorded at cost, including transaction costs. Derivatives are subsequently carried at fair value. All changes in fair value are recorded as financial income or expense in the year in which they arise.

Fair value is the amount for which a financial asset, liability or instrument could be exchanged between knowledgeable and willing parties in an arm's length transaction. It is determined by reference to quoted market prices adjusted for estimated transaction costs that would be incurred in an actual transaction, or by the use of established estimation techniques such as option pricing models and estimated discounted values of cash flows.

## 2. Profit for the year

As permitted by section 408 of the Companies Act 2006, the company has elected not to present its own profit and loss account for the year. The company reported a profit for the financial year ended 31 December 2010 of US$7.4 million (2009: profit of US$23.1 million).

The auditors' remuneration for audit and other services is disclosed in note 3 to the consolidated financial statements.

## 3. Property, plant and equipment

| | Oil and gas properties (North Sea) | |
|---|---|---|
| | 2010 $ million | 2009 $ million |
| Cost: | | |
| At 1 January | – | 96.0 |
| Additions during the year | – | 0.9 |
| Disposals during the year | – | (96.9) |
| At 31 December | – | – |
| Amortisation and depreciation: | | |
| At 1 January | – | 29.9 |
| Charge for the year | – | 6.1 |
| Disposals during the year | – | (36.0) |
| At 31 December | – | – |
| Net book value: | | |
| At 1 January | – | 66.1 |
| At 31 December | – | – |

Amortisation and depreciation of oil and gas properties is calculated on a unit-of-production basis, using the ratio of oil and gas production in the period to the estimated quantities of proved and probable reserves on an entitlement basis at the end of the period plus production in the period, on a field-by-field basis. Proved and probable reserve estimates are based on a number of underlying assumptions including oil and gas prices, future costs, oil and gas in place and reservoir performance, which are inherently uncertain. Management uses established industry techniques to generate its estimates and regularly references its estimates against those of joint venture partners or external consultants. However, the amount of reserves that will ultimately be recovered from any field cannot be known with certainty until the end of the field's life.

On 30 June 2009, the company's interest in the Kyle field was transferred to another group company.

## 4. Fixed asset investments

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Cost and net book value: | | |
| Subsidiary undertakings | 553.2 | 553.2 |

The company has investments in the following 100 per cent owned subsidiaries which principally affected the profits or net assets of the group. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

| Name of company | Business and area of operation | Country of incorporation or registration |
|---|---|---|
| Premier Oil Group Ltd* | Intermediate holding company, UK | Scotland |
| Premier Oil Finance (Jersey) Ltd* | Convertible bond issuing company, Jersey | Jersey |
| Premier Oil Holdings Ltd | Intermediate holding company, UK | England and Wales |
| Premier Oil Overseas BV | Intermediate holding company, Netherlands | Netherlands |
| Premier Oil UK Ltd | Exploration, production and development, UK | Scotland |
| Premier Oil Natuna Sea BV | Exploration, production and development, Indonesia | Netherlands |
| Premier Oil Kakap BV | Exploration, production and development, Indonesia | Netherlands |
| Premier Oil Sumatra (North) BV | Exploration, production and development, Indonesia | Netherlands |
| Premier Oil Pakistan Holdings BV | Intermediate holding company, Netherlands | Netherlands |
| PKP Exploration Ltd | Exploration, production and development, Pakistan | England and Wales |
| PKP Kadanwari 2 Ltd | Exploration, production and development, Pakistan | Cayman Islands |
| PKP Kirthar 2 BV | Exploration, production and development, Pakistan | Netherlands |
| Premier Oil Vietnam Offshore BV | Exploration, production and development, Vietnam | Netherlands |
| Premier Oil (Vietnam) LLC | Exploration, production and development, Vietnam | United States of America |
| Premier Oil Norge AS | Exploration, production and development, Norway | Norway |

* Held directly by Premier Oil plc. All other companies are held through subsidiary undertakings.

## 5. Debtors

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Prepayments and accrued income | 0.1 | 0.1 |
| Total debtors due within one year | 0.1 | 0.1 |
| Amounts owed by subsidiary undertakings due after more than one year | 38.8 | 17.2 |
| Total debtors | 38.9 | 17.3 |

The amounts owed by subsidiary undertakings comprise a loan which bears interest based on LIBOR and which is not secured. This loan is denominated in US dollars and falls due for repayment in 2012.

The carrying values of the company's debtors approximate their fair value.

## 6. Creditors: amounts falling due within one year

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Other tax and social security | – | 14.4 |
| Accruals and deferred income | 1.0 | 14.1 |
| | 1.0 | 28.5 |

The carrying values of the company's creditors approximate their fair value.

# Notes to the Parent Company Financial Statements (continued)

For the year ended 31 December 2010

## 7. Provision for liabilities

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Asset and Equity Plan: | | |
| At 1 January | 2.1 | 3.3 |
| Provision in the year | – | 2.1 |
| Reclassification of provision to creditors falling due within one year | – | (3.3) |
| Reclassification of provision to profit and loss reserve | (2.1) | – |
| At 31 December | – | 2.1 |
| Decommissioning costs: | | |
| At 1 January | – | 6.6 |
| Provision for abandonment | – | (0.1) |
| Unwinding of discount on decommissioning provision | – | 0.1 |
| Exchange differences | – | 0.9 |
| Disposals | – | (7.5) |
| At 31 December | – | – |
| Total provisions | – | 2.1 |

The company has operated an Asset and Equity Plan to reward employees for improvement in the asset value of the business and the market value of the company over a three-year period. Further details of this plan are disclosed in note 10.

The provision for decommissioning costs related to the company's interest in the Kyle field which was transferred to another group company on 30 June 2009.

## 8. Pension liability

### Balance sheet

| | 2010 $ million | 2009 $ million |
|---|---|---|
| UK funded pension scheme | 4.1 | 5.6 |
| UK unfunded pension scheme | 0.9 | 0.9 |
| Total liability in balance sheet | 5.0 | 6.5 |

### Statement of total recognised gains and losses (STRGL)

| | At 31 December 2010 $ million | At 31 December 2009 $ million |
|---|---|---|
| Actuarial gains/(losses) | 0.6 | (3.5) |
| Cumulative amount of actuarial gains/(losses) recognised in the STRGL | (13.4) | (14.0) |

### Funded pensions

The company operates a defined benefit pension scheme in the UK – The Premier Oil plc Retirement and Death Benefits Plan (the Scheme). The Scheme was closed to new members (aside from the provision of insured death in service benefits) in 1997 and a new scheme, providing benefits on a defined contribution basis, was started. Both schemes are funded by the payment of contributions to separately administered trust funds.

The disclosures set out below are based on calculations carried out as at 31 December 2010 by a qualified independent actuary. The figures have been prepared in compliance with FRS 17 – 'Retirement Benefits' (incorporating the amendment announced in December 2006).

The Scheme's assets are held in a separate trustee-administered fund to meet long-term pension liabilities to past and present employees. The Trustee of the Scheme is required to act in the best interest of the Scheme's beneficiaries. The appointment of members of the Trustee Board is determined by the trust documentation.

8. Pension liability (continued)

The liabilities of the defined benefit Scheme are measured by discounting the best estimate of future cash flows to be paid out of the Scheme using the projected unit credit method.

The liabilities set out in this note have been calculated using membership data current as at 31 December 2010. The results of the calculations and the assumptions adopted are shown below.

As at 31 December 2010, contributions are payable to the Scheme at the rates set out in the schedule of contributions dated 26 September 2008. Under this schedule, the company contributes on a monthly basis at the rate of 25 per cent of the aggregate of members' pensionable salaries.

### Principal assumptions

The principal actuarial assumptions at the balance sheet date were:

| | At 31 December 2010 | At 31 December 2009 |
|---|---|---|
| Discount rate | 5.4% pa | 5.6% pa |
| Expected return on Scheme assets | 5.7% pa | 4.9% pa |
| Revaluation of deferred pensions | 3.2% pa | 3.7% pa |
| Rate of increase in salaries | 5.7% pa | 5.7% pa |
| Rate of increase in pensions in payment: LPI (max 5.0%) | 3.7% pa | 3.7% pa |
| Withdrawals | No allowance | No allowance |
| Cash commutation | 1.0 x pre-commutation pension | 1.0 x pre-commutation pension |
| Life expectancy of male aged 65 now | 23.8 | 23.7 |
| Life expectancy of male aged 65 in 20 years | 25.9 | 25.8 |
| Life expectancy of female aged 65 now | 26.3 | 26.2 |
| Life expectancy of female aged 65 in 20 years | 28.2 | 28.1 |

The pre and post-retirement mortality base table used for the Scheme in 2010 and 2009 is PCA00 YOB LC (minimum 1.0 per cent improvements).

On 8 July 2010, the UK Government announced that the Consumer Price Index (CPI) would henceforth become the inflation measure used for statutory defined benefit pension increases. Previously the Retail Price Index (RPI) had been used for this purpose. The Trustee of the Scheme decided to continue to use RPI for increases to pensions in payment. However, CPI rather than RPI should be used for the revaluation of deferred pensions. The effect of the change to CPI in the actuarial assumptions has had the effect of reducing the liabilities on the year-end basis by US$0.6 million.

### Asset breakdown

The major categories of Scheme assets as a percentage of total Scheme assets are:

| | At 31 December 2010 | At 31 December 2009 |
|---|---|---|
| Equities | 49.7% | 37.3% |
| Gilts | 24.8% | 26.0% |
| Corporate bonds | 23.6% | 18.7% |
| Cash | 1.9% | 18.0% |
| Total | 100.0% | 100.0% |

### Employee benefit obligations

The amounts recognised in the balance sheet are as follows:

| | At 31 December 2010 $ million | At 31 December 2009 $ million |
|---|---|---|
| Fair value of Scheme assets | 28.2 | 25.6 |
| Present value of funded obligations | (32.3) | (31.2) |
| Deficit | (4.1) | (5.6) |

# Notes to the Parent Company Financial Statements (continued)

For the year ended 31 December 2010

## 8. Pension liability (continued)

Total expense recognised in profit or loss:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Current service cost | 0.2 | 0.2 |
| Interest on obligation | 1.7 | 1.5 |
| Expected return on Scheme assets | (1.2) | (1.3) |
| Total | 0.7 | 0.4 |

Changes in the present value of the defined benefit obligation:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Present value of defined benefit obligation at 1 January | 31.2 | 22.7 |
| Service cost | 0.2 | 0.1 |
| Interest cost | 1.7 | 1.5 |
| Actuarial losses | 1.2 | 4.9 |
| Benefits paid | (0.8) | (0.7) |
| Currency translation effects | (1.2) | 2.7 |
| Present value of defined benefit obligation at 31 December | 32.3 | 31.2 |

Changes in the fair value of Scheme assets:

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Fair value of Scheme assets at 1 January | 25.6 | 20.7 |
| Expected return | 1.2 | 1.3 |
| Actuarial gains | 1.5 | 1.9 |
| Contributions by employer | 1.6 | 0.2 |
| Benefits paid | (0.8) | (0.7) |
| Currency translation effects | (0.9) | 2.2 |
| Fair value of Scheme assets at 31 December | 28.2 | 25.6 |
| Actual return on Scheme assets | 2.7 | 3.2 |

Movements over previous five year period:

| | 2010 $ million | 2009 $ million | 2008 $ million | 2007 $ million | 2006 $ million |
|---|---|---|---|---|---|
| Defined benefit obligation | (32.3) | (31.2) | (22.7) | (31.9) | (31.4) |
| Scheme assets | 28.2 | 25.6 | 20.7 | 29.3 | 28.0 |
| Deficit | (4.1) | (5.6) | (2.0) | (2.6) | (3.4) |
| Experience (gain)/loss on Scheme liabilities | 0.6 | (0.6) | 0.1 | – | (0.6) |
| (Gain)/loss from changes in the assumptions for value of Scheme liabilities | 0.6 | 5.5 | (2.2) | (0.6) | (1.0) |
| Experience gain/(loss) on Scheme assets | 1.5 | 1.9 | (5.1) | (0.4) | 0.2 |

## 8. Pension liability (continued)

Projected profit/loss recognition to 31 December 2011:
Due to the significant volatility in investment markets, it is difficult to project forward the FRS 17 figures for the next year with confidence. The following projections should therefore be treated with caution. Assumptions implicit in the following projections are:

- the return on assets from 31 December 2010 is 5.7 per cent pa;
- contributions to the Scheme will continue throughout 2011 in accordance with the current schedule of contributions in place at the date of signing this report; and
- there will be no changes to the terms of the Scheme.

The amounts recognised in the profit and loss account are:

| | 2011<br>$ million |
|---|---|
| Current service cost | 0.2 |
| Interest on obligation | 1.7 |
| Expected return on Scheme assets | (1.6) |
| Total | 0.3 |

### Sensitivity and risk

The results of the calculations are sensitive to the assumptions used. The balance sheet position revealed by FRS 17 calculations must be expected to be volatile, principally because the market value of assets (with a significant exposure to equities) is being compared with a liability assessment derived from corporate bond yields.

As at 31 December 2010, a one percentage point change in this assumption would have had the following effects on the closing defined benefit obligation:

| | Discount rate: 5.4% pa (as used for report) $ million | Discount rate: 4.4% pa $ million | Discount rate: 6.4% pa $ million |
|---|---|---|---|
| Defined benefit obligation | 32.3 | 38.6 | 27.0 |

The key risks which could significantly impact the balance sheet, and to a lesser extent the profit and loss account, are as follows:

- falls in asset values which are not offset by a rise in the discount rate used to value liabilities;
- a reduction in the discount rate, which will increase the value placed on the Scheme's liabilities;
- an increase in price inflation and/or salary inflation; and
- improving life expectation (lower mortality rates) resulting in benefits being paid for longer.

### Unfunded pensions

The company is paying an unfunded pension to a former director in regard to which annual increases and a reversionary spouse's pension apply on the same basis as to pensions paid under the Scheme. On the same actuarial basis as used to assess the Scheme's pension costs, the present value as at 31 December 2010 of the future payments projected to be made in respect of UK unfunded pensions is US$0.9 million (2009: US$0.9 million).

## 9. Commitments and guarantees

At the year-end date the company, together with certain subsidiary undertakings, had jointly guaranteed the group's borrowing facilities consisting of a US$175.0 million term loan and a NOK 100.0 million (US$17.2 million) Exploration Financing Facility, both maturing in 2012, and a US$300.0 million term loan, a US$456.8 million revolving credit facility and a £399.5 million (US$623.2 million) letter of credit facility, all maturing in 2015.

# Notes to the Parent Company Financial Statements (continued)

For the year ended 31 December 2010

## 10. Share capital

| | 2010 50p shares | 2010 £ | 2009 50p shares | 2009 £ |
|---|---|---|---|---|
| Ordinary Shares: | | | | |
| Called-up, issued and fully-paid | 116,395,912 | 58,197,956 | 114,673,066 | 57,336,533 |

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Balance at 1 January | 97.0 | 73.6 |
| Shares issued in respect of rights issue (nominal value) | – | 26.0 |
| Shares issued to the Premier Oil plc Employee Benefit Trust (nominal value) | 1.3 | – |
| Ordinary Shares cancelled | – | (2.6) |
| Balance at 31 December | 98.3 | 97.0 |

### Rights issue

On 25 March 2009, the company announced its proposal to raise approximately £171 million (US$252.2 million) by way of a fully underwritten rights issue. Under the proposal, the company offered its shareholders the opportunity to acquire four new Ordinary Shares for every nine Ordinary Shares held at a price of 485 pence per new Ordinary Share. The proposal was subject to authorisation by shareholders which was obtained at a General Meeting held on 20 April 2009. The offer period commenced on 21 April 2009 and closed for acceptance on 6 May 2009. Dealing in the new shares began on 7 May 2009.

### Share-based payments

£11,423 (US$16,988) of Ordinary Shares were issued during 2010 relating to the company's share option plans (2009: £12,113 (US$19,651)). In addition, 1,700,000 Ordinary Shares with a nominal value of £850,000 (US$1,327,955) were issued to the Premier Oil plc Employee Benefit Trust to be used to satisfy future awards under the company's long-term incentive arrangements (2009: £nil).

### Share option plans

The company has share option schemes under which options to subscribe for the company's shares have been granted to certain executives and employees. Options granted are normally exercisable not less than three years after their grant and will lapse on their tenth anniversary. Options cannot be exercised until pre-determined performance conditions have been achieved.

Under the Savings Related Share Option Scheme, eligible employees with six months or more continuous service can join the scheme. Employees can save to a maximum of £250 per month through payroll deductions for a period of three or five years, after which time they can acquire shares at up to a 20 per cent discount.

Under the Share Incentive Plan employees are invited to make contributions to buy Partnership Shares. If an employee agrees to buy Partnership Shares the company currently matches the number of Partnership Shares bought with an award of shares (Matching Shares), on a one-for-one basis.

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Options | Weighted average exercise price | Options | Weighted average exercise price |
| Outstanding at the beginning of the year | 174,473 | £4.72 | 189,722 | £4.69 |
| Adjustment for rights issue | – | – | 44,556 | £4.26 |
| Granted during the year | 38,906 | £10.42 | 23,190 | £7.21 |
| Lapsed during the year | (2,369) | £8.49 | (12,913) | £9.26 |
| Exercised during the year* | (106,339) | £3.11 | (70,082) | £2.04 |
| Outstanding at the end of the year | 104,671 | £8.33 | 174,473 | £4.72 |
| Exercisable at the end of the year | 5,831 | £2.08 | 89,324 | £2.16 |

* There were 22,846 Ordinary Shares issued under the group's share option schemes during the year (2009: 24,226). The remaining 83,493 Ordinary Shares were issued from the Premier Oil plc Employee Benefit Trust (2009: 45,856).

**10. Share capital** (continued)

The weighted average share price at the date of exercise for share options exercised during the year was £14.28. The options outstanding at 31 December 2010 had a weighted average exercise price of £8.33 and a weighted average remaining contractual life of 3.0 years.

The fair value of the options granted during the year was determined using the Black-Scholes valuation model and is not material.

The company recognised a cost of US$52.7 million and US$27.3 million related to equity-settled share-based payment transactions in 2010 and 2009 respectively.

### Asset and Equity Plan

The Asset and Equity Plan is designed to reward employees for improvement in the asset value of the business and the market value of the company over a three-year period and is operated by reference to two bonus pools – an equity bonus pool and an asset bonus pool. The asset bonus pool is created by reference to the increase in the net asset value per share of the company over a three-year period and the equity bonus pool is created by reference to the increase in the equity market value per share of the company over a three-year period.

The company uses a Monte Carlo simulation model to calculate the value of the equity bonus pool of the plan.

The main assumptions used for the calculations are as follows:

| | |
|---|---|
| Volatility: | 31.5% |
| Risk free rate of interest: | 4.4% |
| Historic market value growth factor: | 109.0% |

For the asset bonus pool a discounted cash flow model based on the average oil price over the period is used to calculate the final value of the pool and to estimate the value of future asset bonus pools.

The Asset and Equity Plan expired in 2009 and the award granted in 2008, which matured at the end of 2010, is the last award remaining under the plan.

### Long Term Incentive Plan

The Long Term Incentive Plan (LTIP) was introduced in 2009 to provide a long-term all employee scheme which motivates all employees and provides a longer-term perspective to the total remuneration package. Awards under the LTIP comprise three elements: Equity Pool Awards, Performance Share Awards that vest after the expiry of a three-year performance period, and a potential Matching Award that vests at the expiry of a further three-year performance period, commencing at the end of the three-year performance period for Equity Pool and Performance Share Awards.

Full details about this plan have been provided in the Remuneration Report.

The company uses a Monte Carlo simulation model to calculate the value of the equity bonus pool of the plan and of the Performance Share Awards.

The main assumptions used for the calculations are as follows:

| | |
|---|---|
| Volatility: | 40.0% to 41.0% |
| Risk free rate of interest: | 3.3% to 3.7% |
| Correlation factor with comparator group: | 0.29 to 0.30 |

For the year ended 31 December 2010, the total cost recognised by the company for long-term incentive arrangements is US$18.0 million (2009: US$26.0 million), with a cumulative liability on the balance sheet of US$nil (2009: US$11.1 million). A credit of US$52.7 million has been recorded in the profit and loss reserve (2009: US$27.3 million) for all equity-settled payments of the group. Like other elements of remuneration, this charge is processed through the time-writing system which allocates cost, based on time spent by individuals, to various entities within the Premier Oil plc group. Part of this cost is therefore capitalised as directly attributable to capital projects and part is charged to the profit and loss account as operating costs, pre-licence exploration costs or general and administration costs.

# Notes to the Parent Company Financial Statements (continued)

For the year ended 31 December 2010

## 10. Share capital (continued)

Ordinary Shares

The rights and restrictions attached to the Ordinary Shares are as follows:

Dividend rights

The rights of the holders of Ordinary Shares shall rank pari passu in all respects with each other in relation to dividends.

Winding up or reduction of capital

On a return of capital on a winding up or otherwise (other than on conversion, redemption or purchase of shares) the rights of the holders of Ordinary Shares to participate in the distribution of the assets of the company available for distribution shall rank pari passu in all respects with each other.

Voting rights

The holders of Ordinary Shares shall be entitled to receive notice of, attend, vote and speak at any General Meeting of the company.

## 11. Share capital and reserves

| | Share capital $ million | Share premium account $ million | Profit and loss account $ million | Capital redemption reserve $ million | Equity reserve $ million | Total $ million |
|---|---|---|---|---|---|---|
| At 1 January 2009 | 73.6 | 9.7 | 112.2 | 1.7 | 51.8 | 249.0 |
| Issue of Ordinary Shares | 26.0 | 226.2 | – | – | – | 252.2 |
| Expenses of issue of Ordinary Shares | – | (12.2) | – | – | – | (12.2) |
| Cancellation of Ordinary Shares | (2.6) | – | – | 2.6 | – | – |
| Purchase of shares for ESOP Trust | – | – | (2.5) | – | – | (2.5) |
| Profit for the year | – | – | 23.1 | – | – | 23.1 |
| Provision for share-based payments | – | – | 27.3 | – | – | 27.3 |
| Pension costs – actuarial losses | – | – | (3.5) | – | – | (3.5) |
| At 31 December 2009 | 97.0 | 223.7 | 156.6 | 4.3 | 51.8 | 533.4 |
| Issue of Ordinary Shares | 1.3 | 31.1 | (32.1) | – | – | 0.3 |
| Purchase of shares for ESOP Trust | – | – | (8.3) | – | – | (8.3) |
| Profit for the year | – | – | 7.4 | – | – | 7.4 |
| Provision for share-based payments | – | – | 52.7 | – | – | 52.7 |
| Pension costs – actuarial gains | – | – | 0.6 | – | – | 0.6 |
| At 31 December 2010 | 98.3 | 254.8 | 176.9 | 4.3 | 51.8 | 586.1 |

In June 2007, Premier Oil Finance (Jersey) Ltd, a 100 per cent subsidiary of the company, issued convertible bonds at a par value of US$250.0 million. These bonds are convertible into Ordinary Shares of the company at any time from 6 August 2007 until six days before their maturity date of 27 June 2014.

At the initial conversion price of £15.82 per share there were 8,003,434 Ordinary Shares of the company underlying the bonds. In April 2009 the conversion price was adjusted from £15.82 per share to £13.56 per share, as a result of the company's four for nine rights issue of new Ordinary Shares. At the adjusted conversion price of £13.56 per share there are 9,337,340 Ordinary Shares of the company underlying the bonds.

If the bonds have not been previously purchased and cancelled, redeemed or converted, they will be redeemed at par value on 27 June 2014. Interest of 2.875 per cent per annum will be paid semi-annually in arrears up to that date.

## 12. Reconciliation of movements in shareholders' funds

| | 2010 $ million | 2009 $ million |
|---|---|---|
| Opening shareholders' funds | 533.4 | 249.0 |
| Issue of Ordinary Shares | 0.3 | 252.2 |
| Expenses of issue of Ordinary Shares | – | (12.2) |
| Purchase of shares for ESOP Trust | (8.3) | (2.5) |
| Profit for the year | 7.4 | 23.1 |
| Provision for share-based payments | 52.7 | 27.3 |
| Pension costs – actuarial gains/(losses) | 0.6 | (3.5) |
| Net addition to shareholders' funds | 52.7 | 284.4 |
| Closing shareholders' funds | 586.1 | 533.4 |

## 13. Own shares

| | Note | Treasury Shares $ million | ESOP Trust $ million | Total $ million |
|---|---|---|---|---|
| At 1 January 2009 | | 47.2 | 16.4 | 63.6 |
| Acquired in the year | | – | 2.5 | 2.5 |
| Release of shares for long-term incentive arrangements | | – | (2.4) | (2.4) |
| Cancellation of Ordinary Shares | | (47.2) | – | (47.2) |
| At 31 December 2009 | | – | 16.5 | 16.5 |
| Acquired in the year | | – | 8.3 | 8.3 |
| Issuance of Ordinary Shares (market value)* | 10 | – | 32.1 | 32.1 |
| Release of shares for long-term incentive arrangements | | – | (25.2) | (25.2) |
| At 31 December 2010 | | – | 31.7 | 31.7 |

* During the year 1,700,000 Ordinary Shares were issued to the Premier Oil plc Employee Benefit Trust to be used to satisfy awards under the company's long-term incentive arrangement schemes.

The own shares reserve represents the net cost of shares in Premier Oil plc purchased in the market or issued by the company into the Premier Oil plc Employee Benefit Trust (ESOP Trust).

At 1 January 2009, the company held 2,798,186 Ordinary Shares as Treasury Shares. All of these Ordinary Shares were cancelled by the company on 23 March 2009.

The Premier Oil plc Employee Benefit Trust holds shares to satisfy options under the group's share award schemes. The number of Ordinary Shares held by the Premier Oil plc Employee Benefit Trust at 31 December 2010 was 1,714,601 (2009: 1,077,711).

# Five Year Summary

| **Financials** **Accounting basis** | | 2010 IFRS | 2009 IFRS | 2008 IFRS | 2007 IFRS | 2006 IFRS |
|---|---|---|---|---|---|---|
| Sales revenues | ($ million) | **763.6** | 621.1 | 655.2 | 578.2 | 402.2 |
| Profit before tax | ($ million) | **100.8** | 79.9 | 277.6 | 147.0 | 156.6 |
| Net profit for the year after tax | ($ million) | **129.8** | 113.0 | 98.3 | 39.0 | 67.6 |
| Cash flow from operating activities | ($ million) | **436.0** | 347.7 | 352.3 | 269.5 | 244.8 |
| Shareholders' funds | ($ million) | **1,130.2** | 971.3 | 598.9 | 552.9 | 449.1 |
| Net (debt)/cash | ($ million) | **(405.7)** | (315.6) | 117.3 | 79.0 | 40.9 |
| **Per share statistics:** | | | | | | |
| Revenue per share | (cents/share) | **658.3** | 571.9 | 659.8[1] | 705.1 | 491.7 |
| Earnings per share – basic | (cents/share) | **111.9** | 104.1 | 99.0[1] | 47.6 | 82.6 |
| Earnings per share – diluted | (cents/share) | **103.1** | 103.9 | 98.2[1] | 46.9 | 81.7 |
| Cash flow from operating activities per share | (cents/share) | **375.9** | 320.2 | 354.8[1] | 328.7 | 299.3 |
| Reserves per share – year-end | (boe/share) | **2.25** | 2.35 | 2.29[1] | 2.58 | 1.86 |
| Issued Ordinary Shares – average | (million) | **116.0** | 108.6 | 99.3[1] | 82.0 | 81.8 |
| **Operations:** | | | | | | |
| Production (working interest basis) | (kboepd) | **42.8** | 44.2 | 36.5 | 35.8 | 33.0 |
| Proved and probable reserves (working interest basis) | (mmboe) | **260.8** | 255.2 | 227.5 | 211.5 | 152.1 |
| Employees – UK | (number) | **119** | 110 | 62 | 60 | 60 |
| – Overseas | (number) | **442** | 398 | 406[2] | 300 | 249 |
| **Key indices:** | | | | | | |
| Realised average oil price | ($/bbl) | **79.70** | 66.30 | 94.50 | 72.30 | 64.90 |
| Average exchange rates | ($/£) | **1.55** | 1.57 | 1.85 | 2.00 | 1.84 |
| Closing exchange rates | ($/£) | **1.56** | 1.62 | 1.46 | 1.98 | 1.96 |

Notes:

1. The average issued Ordinary Shares for 2008 have been adjusted to reflect the bonus element related to the rights issue in 2009. The 2008 'per share statistics' have been restated accordingly. The 'per share statistics' for 2006 and 2007 are as reported.
2. The 2008 overseas employee numbers have been restated to reflect a reclassification of employee categories during 2009 and the inclusion of offshore staff. The numbers for 2006 and 2007 are as reported.

Certain operations presented as discontinuing in 2006 were re-presented as continuing operations in 2007. The numbers for 2006 have been restated accordingly.

# Shareholder Information

Analysis of shareholding as at 23 March 2011

| Size of shareholding | Number of holders | % | Number of shares | % |
|---|---|---|---|---|
| 1 – 5,000 | 10,979 | 94.03 | 5,982,474 | 5.14 |
| 5,001 – 10,000 | 206 | 1.76 | 1,455,183 | 1.25 |
| 10,001 – 50,000 | 253 | 2.17 | 5,727,278 | 4.92 |
| 50,001 – 100,000 | 74 | 0.63 | 5,393,021 | 4.63 |
| 100,001 – 500,000 | 121 | 1.04 | 26,355,312 | 22.64 |
| 500,001 and over | 43 | 0.37 | 71,482,644 | 61.42 |
| **Total** | **11,676** | **100.00** | **116,395,912** | **100.00** |

Dealing information
SEAQ short code – PMO

Financial calendar
Announcements:
Interim – August 2011
Preliminary – March 2012

# Oil and Gas Reserves

As at 31 December 2010

| | Working interest basis | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | North Sea and West Africa | | Middle East-Pakistan | | Asia | | TOTAL | | |
| | Oil and NGLs mmbbls | Gas bcf | Oil and NGLs mmbbls | Gas bcf | Oil and NGLs mmbbls | Gas bcf | **Oil and NGLs mmbls** | **Gas[3] bcf** | **Oil, NGLs and gas mmboe** |
| **Group proved plus probable reserves:** | | | | | | | | | |
| At 1 January 2010 | 45.7 | 32 | 1.1 | 296 | 34.1 | 666 | **80.9** | **994** | **255.2** |
| Revisions | 0.8 | (2) | (0.1) | 5 | (0.1) | 14 | **0.6** | **17** | **3.8** |
| Discoveries and extensions[1] | 17.6 | 4 | – | 2 | – | – | **17.6** | **6** | **18.7** |
| Acquisitions and divestments[2] | (1.3) | – | – | – | – | – | **(1.3)** | **–** | **(1.3)** |
| Production | (5.3) | (3) | (0.1) | (34) | (0.4) | (20) | **(5.8)** | **(57)** | **(15.6)** |
| **At 31 December 2010** | **57.5** | **31** | **0.9** | **269** | **33.6** | **660** | **92.0** | **960** | **260.8** |
| **Total group developed and undeveloped reserves:** | | | | | | | | | |
| Proved on production | 20.0 | 9 | 0.2 | 91 | 1.6 | 96 | **21.8** | **196** | **56.9** |
| Proved approved/justified for development | 19.4 | 9 | 0.4 | 87 | 22.9 | 376 | **42.7** | **472** | **125.3** |
| Probable on production | 7.3 | 9 | 0.2 | 71 | 0.2 | 15 | **7.7** | **95** | **23.6** |
| Probable approved/justified for development | 10.8 | 4 | 0.1 | 20 | 8.9 | 173 | **19.8** | **197** | **55.0** |
| **At 31 December 2010** | **57.5** | **31** | **0.9** | **269** | **33.6** | **660** | **92.0** | **960** | **260.8** |

Notes:
1. Includes reserves discovered at Catcher and Varadero (UK) and Kadanwari (Pakistan). Additional discoveries at West Rochelle (UK) and Blåbaer (Norway) of 8 mmboe working interest contingent resources are not shown here.
2. Excludes 6.45 per cent royalty interest at Janice and James.
3. Proved plus probable gas reserves include 70 bcf fuel gas.

Premier Oil plc categorises petroleum resources in accordance with the 2007 SPE/WPC/AAPG/SPEE Petroleum Resource Management System (SPE PRMS).

Proved and probable reserves are based on operator, third party reports and internal estimates and are defined in accordance with the Statement of Recommended Practice (SORP) issued by the Oil Industry Accounting Committee (OIAC), dated July 2001.

The group provides for amortisation of costs relating to evaluated properties based on direct interests on an entitlement basis, which incorporates the terms of the PSCs in Indonesia, Vietnam and Mauritania. On an entitlement basis reserves were 222.0 mmboe as at 31 December 2010 (2009: 229.0 mmboe). This was calculated in 2010 using an oil price assumption of US$75.0/bbl (2009: US$75.0/bbl).

# Worldwide Licence Interests

As at 23 March 2011

| | Licence | Block | Operator | PO Equity % | Field/discovery |
|---|---|---|---|---|---|
| Congo | Marine IX* | Marine IX | **Premier** | 31.50 | |
| Egypt | North Red Sea† | Block 1 | Hess | 20.00 | |
| | South Darag‡ | | **Premier** | 100.00 | |
| Indonesia | Buton | | Japex | 30.00 | |
| | Kakap | | Star Energy PT | 18.75 | Kakap |
| | Natuna Sea Block A | | **Premier** | 28.67 | Anoa |
| | Block A Aceh§ | | PT Medco E&P Malaka | 41.67 | Alur Siwah |
| | Tuna | | **Premier** | 65.00 | |
| Mauritania | PSC A | Block 3, 4 & 5 (shallow water) | Petronas | 4.615 | |
| | PSC B | Block 4 & 5 (deep water) | Petronas | 9.23 | |
| | PSC B | Chinguetti EEA | Petronas | 8.12 | Chinguetti |
| Norway | PL359 | 16/1 (part) & 16/4 (part) | Lundin | 30.00 | |
| | PL364 | 25/2 (part), 25/3 (part), 25/5 (part) & 25/6 (part) | Det norske | 50.00 | Frøy |
| | PL374S | 34/2 (part) & 34/5 (part) | BG | 15.00 | Blåbaer |
| | PL378 | 35/12 (part) & 36/10 (part) | Wintershall | 20.00 | Grosbeak |
| | PL378B | 35/12b | Wintershall | 20.00 | |
| | PL406 | 8/3 (part), 9/1 (part), 17/12 (part), 18/10 (part) & 18/11 (part) | **Premier** | 40.00 | |
| | PL407 | 17/8 (part), 17/9 (part), 17/11 (part), 17/12 (part), 18/7 (part) & 18/10 (part) | BG | 20.00 | Bream |
| | PL567 | 2/6 | **Premier** | 60.00 | |
| Pakistan | Production Leases | Bolan | Mari Gas | 3.75 | Zarghun South |
| | | Dadu | BHP | 9.375 | Zamzama |
| | | Kirthar | ENI | 6.00 | Badhra |
| | | Kirthar | ENI | 6.00 | Bhit |
| | | Qadirpur | OGDCL | 4.75 | Qadirpur |
| | | Tajjal | ENI | 15.79 | Kadanwari |
| United Kingdom | P077 | 22/12a | Shell | 50.00 | Nelson** |
| | P087 | 22/7-F1 | **Premier** | 46.50 | Nelson†† |
| | P101 | 23/21 (North & South Moth – below bottom chalk) | BG | 50.00 | Moth |
| | P110 | 22/14a (non-Everest deep) | **Premier** | 27.24 | Mallory |
| | P110 | 22/14a (non-Everest shallow) | **Premier** | 25.04 | Huntington East |
| | P119 | 15/29a (area P) | **Premier** | 60.00 | Ptarmigan |
| | P185 | 15/22 (rest of block, non-Palaeocene formation) | Nexen | 50.00 | Blackhorse |
| | P201 | 16/21a | **Premier** | 85.00 | Balmoral‡‡, Stirling§§ & Glamis |
| | P201 | 16/21a (Brenda field area) | **Premier** | 100.00 | Brenda (above 7,500ft) |
| | P213 | 16/26 (area P) | **Premier** | 100.00 | Caledonia |
| | P218 | 15/21a (Scott field) | Nexen | 45.83 | Scott*** |
| | P218 | 15/21a (Telford field area) | Nexen | 7.29 | Telford††† |
| | P233 | 15/25a | **Premier** | 70.00 | Nicol |
| | P257 | 14/25a | Talisman | 1.518 | |
| | P288 | 31/21a, 31/26a, 31/26f, 31/26g & 31/27a | Hess | 15.00 | Angus, Fife, Flora |
| | P300 | 14/26a (Oddjob area) | Nexen | 25.00 | |
| | P344 | 16/21b (Northern area) | **Premier** | 55.00 | |

# Worldwide Licence Interests (continued)

As at 23 March 2011

| | Licence | Block | Operator | PO Equity % | Field/Discovery |
|---|---|---|---|---|---|
| | P344 | 16/21b & 16/21c | **Premier** | 44.20 | Balmoral‡‡ & Stirling§§ |
| | P354 | 22/2a (non-Chestnut field area) | **Premier** | 30.00 | |
| | P489 | 15/23b | Nexen | 50.00 | Blackhorse |
| | P534 | 98/6a & 98/7a | BP | 12.50 | Wytch Farm (offshore)‡‡‡ |
| | P640 | 15/24b (area B) | ConocoPhillips | 50.00 | |
| | P748 | 29/2c | CNR | 40.00 | Kyle |
| | P758 | 31/26c | Hess | 35.00 | Fife |
| | P811 | 13/30b (Oddjob area) | Nexen | 25.00 | |
| | P815 | 15/23d | Nexen | 50.00 | Bugle |
| | P1042 | 15/25b | **Premier** | 100.00 | Brenda |
| | P1095 | 16/21d | Maersk | 50.00 | Bladon |
| | P1114 | 22/14b & 22/19b | EON Ruhrgas | 40.00 | Huntington |
| | P1157 | 15/25e | **Premier** | 100.00 | Brenda |
| | P1181 | 23/22b | **Premier** | 57.50 | |
| | P1212 | 15/13b | Nexen | 50.00 | |
| | P1220 | 21/23a | Sterling | 65.00 | Sheryl |
| | P1260 | 22/2b | **Premier** | 100.00 | Shelley |
| | P1298 | 15/26b | Nexen | 50.00 | Kildare/ West Rochelle |
| | P1420 | 22/13b | **Premier** | 72.73 | |
| | P1430 | 28/9 & 28/10c | Encore | 35.00 | Catcher/Varadero |
| | P1431 | 29/6b | **Premier** | 100.00§§§ | |
| | P1466 | 15/24c & 15/25f | **Premier** | 100.00**** | |
| | P1467 | 15/25d | Maersk | 50.00 | |
| | P1559 | 15/23e | **Premier** | 100.00 | |
| | P1577 | 201/5, 202/24, 202/25, 202/29, 202/30, 203/16, 203/21 & 203/26 | **Premier** | 100.00 | |
| | P1615 | 15/26c | Endeavour | 25.00 | West Rochelle |
| | P1620 | 22/19c | **Premier** | 50.00 | |
| | P1770 | 14/30b | Nexen | 50.00 | |
| | P1771 | 15/9, 15/10, 15/14 & 15/15 | Nexen | 50.00 | |
| | P1772 | 15/23g | **Premier** | 50.00 | |
| | P1784 | 21/7b | **Premier** | 70.00 | |
| | P1804 | 22/21c & 22/26c (part) | Maersk | 30.00 | |
| | PL089 | SY87b, SY88b, SY89b, SY97b, SY98a, SY99a, SZ/7 & SZ/8a | BP | 12.50 | Wytch Farm (onshore)‡‡‡ |
| Vietnam | | 12W | **Premier** | 53.125 | Chim Sáo |
| | | 07/03 | **Premier** | 30.00 | Cá Rồng Đỏ |
| | | 104-109/05 | **Premier** | 50.00 | |

* Notice has been served to withdraw from this licence
† This farm-in deal has been signed and completion is now subject to government approval
‡ This government concession has been signed and is awaiting ratification
§ Formerly named North Sumatra Block A, this block will be renamed Block A Aceh, with effect from September 2011
** Unitised share of 1.31404 per cent
†† Unitised share of 0.348750 per cent
‡‡ Unitised share of 78.11542 per cent
§§ Unitised share of 68.68 per cent
*** Unitised share of 21.83 per cent
††† Unitised share of 1.58677 per cent
‡‡‡ Unitised share of 12.38 per cent
§§§ This licence will be relinquished once government approval has been given
**** Subject to contract, and an earn-in agreement to transfer a 40 per cent interest to Canadian Overseas Petroleum (UK) Ltd, Premier's new interest will be 60 per cent

# Glossary

| | |
|---|---|
| bbl | barrel of oil |
| BBtud | billion British thermal units per day |
| bcf | billion cubic feet |
| boe | barrel of oil equivalent |
| boepd | barrels of oil equivalent per day |
| bopd | barrels of oil per day |
| DECC | Department of Energy and Climate Change |
| EPCI | engineering, procurement, construction and installation |
| FDP | field development plan |
| FEED | front end engineering and design |
| FPSO | floating production, storage and offtake vessel |
| FPV | floating production vessel |
| GSA | gas sales agreement |
| HSFO | High Sulphur Fuel Oil |
| kboepd | thousand barrels of oil equivalent per day |
| KPI | key performance indicator |
| LTI | lost time injury |
| mmbbls | million barrels of oil |
| mmboe | million barrels of oil equivalent |
| mmscfd | million standard cubic feet per day |
| mscf | thousand standard cubic feet |
| mt | metric tonne |
| PSC | production sharing contract |
| RWDC | restricted workday case |

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