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STERLING ENERGY
PLC

Report and Accounts

Experience in Depth

2003

DIRECTORS' REPORT

The directors have pleasure in presenting their annual report on the affairs of Sterling Energy plc ("the Company") and its subsidiaries ("the Group"), together with the financial statements and auditors' report for the year ended 31 December 2003.

PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the Group throughout the year was the exploration for and production of oil and gas. The other activities of the Group, the significant developments during 2003, including the acquisition though an offer for the issued share capital of AIM listed Fusion Oil & Gas plc ("Fusion") for approximately £39.5 million in new ordinary shares and cash, plus the raising of approximately £11.5 million through a placing and the exercise of warrants, as well as the future prospects for the Group, are reviewed in detail in the Chairman and Chief Executive Statement, in the Operations and Financial Reports and elsewhere in this annual report.

RESULTS AND DIVIDENDS

The Group made a profit for the financial year of £1.586 million during 2003 (2002 - loss of £0.098 million). This leaves an accumulated Group deficit of £1.803 million (2002 - £3.389 million) to be carried forward as a balance on the Group profit and loss account. As a result of the accumulated deficit retained by the Company the directors cannot recommend the payment of a dividend (2002 - £nil).

SHARE CAPITAL

During the year, the issued ordinary share capital of the Company increased to 780,626,248 ordinary shares as at 31 December 2003 from 353,792,382 at 31 December 2002. This was principally due to shares issued in connection with the acquisition of Fusion, a share placing in October 2003 and the exercise of warrants that would otherwise have expired during the year. Further details are provided in note 19 to the financial statements.

SHARE OPTION SCHEME

At the end of 2003 a total of 35,300,000 share options were outstanding under the schemes approved in 2001. These are exercisable at prices of between 4p and 7p per share. A total of 9,000,000 options were granted in January 2003 at an exercise price of 7p per share, exercisable between 2005 and 2013. Of the options granted in 2003, 2,900,000 were granted to Mr Wilson, 1,900,000 to Mr Quinton, 1,700,000 to Mr Thomson, 1,250,000 to Mr O'Toole with no exercise in the first two years after granting. The remainder were issued to staff.

"The Group made a profit for the financial year of £1.586 million during 2003"

Since 1 January 2004, a further approximately 18 million share options have been awarded by the Remuneration Committee and issued to staff in the UK, Australia and in the USA at an exercise price of 12.5p per share, all with an exercise period of no longer than 10 years from the date of grant and not exercisable within the first two years. The Scheme rule is that the number of share options outstanding should not exceed 10% of the issued share capital from time to time, but the Company has undertaken, in recognition of best practice, to reduce this proportion progressively towards 5% of the issued share capital. As of the date of this report there was approximately 7% of the issued share capital under option or approved for grant.

DIRECTORS INTERESTS

The directors who served during the year, together with their beneficial interests in the issued share capital of the Company, were as follows:

	Ordinary shares of 1p each		
	28 April 2004	**31 December 2003**	**31 December 2002**
Dr. E.J. Butler*	329,550	329,550	329,550
R.A. O'Toole*	22,483,818	22,438,818+	1,073,293
N.A. Quinton	17,941,511	17,941,511+	1,120,571
G.P. Thomson	15,639,558	15,639,558+	800,713
P.K. Wilde*	600,000	600,000	600,000
H.G Wilson	27,696,092	27,696,092+	2,374,430

* non-executive director, member of the audit, remuneration and nominations committees

\+ includes beneficial interest in new ordinary shares allotted to Sterling Energy Limited Partnership ("SELP") on 31 December 2003 as final consideration for the purchase of Sterling Energy Limited in October 2002, distributed to the underlying partners on 9 February 2004. The increase in the holdings during 2003 also reflects the distribution to these partners of SELP of the Sterling shares previously held by it.

Beneficial shareholdings include the shareholdings of a director's spouse and infant children. Of the above interests at 31 December 2003 and 28 April 2004, Mr Quinton's includes 8,350,790 ordinary shares held by QX Energy Limited, a company wholly owned by him and his family, and Mr Wilson's includes 17,549,802 ordinary shares held by Roselea Limited, a company in which he has a 26% interest and is a director.

None of the directors have any non-beneficial shareholdings.

None of the directors have contracts of employment with notice periods in excess of 12 months. Details of remuneration paid to the directors who served in the year are included in note 7 to the financial statements.

DIRECTORS' REPORT

SUBSTANTIAL SHAREHOLDERS

Except for the holdings of ordinary shares listed below, the Company has not been notified by any person holding 3% or more of the issued ordinary shares of 1p each of the Company at 28 April 2004:

	Number	%
Westmount Energy Limited	75,000,000	9.11
H.G.Wilson*	27,696,092	3.36
HBOS plc	26,179,125	3.18

*See directors' interests in this report

SUPPLIER PAYMENT POLICY AND PRACTICE

The Company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensuring that suppliers are made aware of the terms of payment and abide by the terms of payment. At the year- end the number of supplier days outstanding for the Company was 31 days (2002 - 45 days).

ENVIRONMENT, HEALTH AND SAFETY POLICY

The Group is fully committed to high standards of environment, health and safety management and compliance with applicable regulations and laws, whilst recognising that it is a non-operator on some of its producing interests.

NOTICE OF ANNUAL GENERAL MEETING ("AGM")

The notice of the AGM to be held at 11.00 am on 22 June 2004 is set out on page 58. A form of proxy is also enclosed which permits voting via the internet as well as by post. The ordinary business to be dealt with in resolutions 1 to 4 includes the adoption of the financial statements (and related reports of the directors and auditors) for the financial year ended 31 December 2003, the re-election of Harry Wilson and Graeme Thomson as directors and the re-appointment of Deloitte & Touche LLP as auditors of the Company, and the authorisation for the directors to fix their remuneration. In addition, there are three Special Resolutions, details of which are set out below.

Resolution number 5 increases the authorised share capital of the Company by 60 per cent.. If this resolution is passed there will be an authorised ordinary share capital (1p each) of £20,000,000 in the Company.

Resolution number 6 is in respect of the authority granted by shareholders to the directors to allot shares or grant rights over shares. The last such authority was granted at the Company's extraordinary general meeting in 2002. This resolution will be proposed as an ordinary resolution to grant a new authority to allot unissued share capital up to an aggregate nominal value of £2,750,000, representing approximately 33 per cent. of the total issued ordinary share capital as at 28 April 2004. If given, this authority will expire at the annual general meeting in 2009 or on 21 June 2009, whichever is the earlier.

Resolution number 7 deals with the disapplication of pre-emption rights pursuant to section 95(1) of the Companies Act 1985 (the "Act") and was initially conferred upon the directors at the Extraordinary General Meeting of the Company held on 18 October 2002. It is intended to give the Company the flexibility to enter into transactions involving the issue of shares without requiring additional specific prior shareholder approval. The authority enables the directors to allot and sell shares in the Company, for cash, up to an aggregate nominal value of £3,500,000. The directors believe that this figure (which is identical to that authorised by the AGM held on 23 July 2003) is an appropriate level in light of the Company's stage of development and its plans. This is intended to give the Company the flexibility to enter into transactions involving the issue of shares without requiring additional specific prior shareholder approval.

The directors believe that this has been an important factor in permitting it to take advantage of opportunities since the new listing in October 2002. This net amount proposed is a decrease to approximately 43% of the current issued share capital as compared with nearly 100% in 2003. The resolution also allows the directors to sell shares that it holds as treasury shares pursuant to section 162A(3) of the Act ("treasury shares", which are outlined in resolution 6 below) as if rights of pre-emption did not apply to the sale. The authority renewed by this Special Resolution will expire at the conclusion of the AGM to be held in 2005, unless otherwise amended before then.

Resolution number 8 deals with the authority for the Company to buy its own ordinary shares in the markets up to a limit of 10 per cent. of its issued ordinary share capital. The maximum and minimum prices are stated in the resolution. Your directors believe that it is advantageous for the Company to have this flexibility to make market purchases of its own shares, but have no current plans to do so. In the event that the shares are purchased, they would either be cancelled (and the number of shares in issue would be reduced accordingly) or, subject to the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (the "Regulations") which came into force on 1 December 2003, retained as treasury shares. The Regulations enable companies to hold shares repurchased as treasury shares with a view to possible re-sale at a future date rather than having to cancel them. The Company will consider holding repurchased shares pursuant to the authority conferred by this resolution as treasury shares. This would give the Company the ability to re-issue treasury shares quickly and cost effectively and would provide the Company with additional flexibility in the management of its capital base. However, your directors will only exercise this authority if they are satisfied that a purchase would result in an increase in expected earnings per share and would be in the interests of shareholders generally.

Resolution number 9 deals with amendments to the Company's Articles of Association in order to bring them up-to-date with current best practice and developments in the CREST service. Specifically, the changes will formally allow those shareholders who hold their shares in uncertificated form ("uncertificated shareholders") to submit their proxies by means of the CREST system. The amendments will also allow uncertificated shareholders to amend the terms of appointment of their proxies in the same way. A copy of the proposed Articles of Association, showing changes to the existing Articles, will be available at the Company's registered office from the date of this notice until the date of the AGM, and will also be available for fifteen minutes prior to the AGM.

AUDITORS

On 1 August 2003 Deloitte & Touche, the Company's auditors, transferred their business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnership Act 2000. The Company has given its consent to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 1 August 2003 under the provision of section 26(5) of the Companies Act 1989. Accordingly, resolution 4 will be proposed at the forthcoming Annual General Meeting to re-appoint Deloitte & Touche LLP as auditors.

Approved by the Board of Directors and signed on behalf of the Board.

Graeme Thomson FCA
Finance Director

30 April 2004

FINANCIAL STATEMENTS

CONSOLIDATED PROFIT AND LOSS ACCOUNT
YEAR ENDED 31 DECEMBER 2003

	Note	2003	2002
		£'000	£'000
TURNOVER			
Existing operations	1(c),2	5,253	22
Acquisitions	1(c),2	280	566
		5,533	588
COST OF SALES			
Existing operations		(2,210)	(13)
Acquisitions		(138)	(365)
		(2,348)	(378)
GROSS PROFIT			
Existing operations		3,043	9
Acquisitions		142	201
		3,185	210
ADMINISTRATIVE EXPENSES			
Existing operations		(1,455)	(131)
Acquisitions		(26)	(157)
		(1,481)	(288)
OPERATING PROFIT/(LOSS)			
Existing operations		1,588	(122)
Acquisitions		116	44
		1,704	(78)
Interest receivable and similar income	4	219	22
Interest payable and similar charges	5	(114)	(42)
PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION	3	1,809	(98)
Taxation on profit/(loss) on ordinary activities	8	(228)	-
PROFIT/(LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION		1,581	(98)
Minority interest	21	5	-
PROFIT/(LOSS) FOR THE FINANCIAL YEAR		1,586	(98)
EARNINGS/(LOSS) PER SHARE			
Basic	10	0.38p	(0.1)p
Diluted	10	0.33p	(0.1)p

CONSOLIDATED BALANCE SHEET
31 DECEMBER 2003

	Note	2003	2002
		£'000	£'000
FIXED ASSETS			
Intangible assets	11	49,957	4,096
Tangible assets	12	10,433	6,560
		60,390	10,656
CURRENT ASSETS			
Debtors	14	1,512	673
Cash at bank and in hand	15	14,485	7,334
		15,997	8,007
CREDITORS: amounts falling due within one year	16	(5,600)	(1,006)
NET CURRENT ASSETS		10,397	7,001
TOTAL ASSETS LESS CURRENT LIABILITIES		70,787	17,657
CREDITORS: amounts falling due after more than one year	17	-	(808)
PROVISIONS FOR LIABILITIES AND CHARGES	18	(2,626)	(1,939)
NET ASSETS		68,161	14,910
CAPITAL AND RESERVES			
Called up equity share capital	19	7,806	3,538
Share premium account	20	50,753	13,334
Equity shares to be issued	19e, 19f	1,716	1,600
Currency translation reserve	20	(1,882)	(173)
Profit and loss account	20	(1,803)	(3,389)
EQUITY SHAREHOLDERS' FUNDS		56,590	14,910
Equity minority interest	21	11,571	-
TOTAL CAPITAL EMPLOYED		68,161	14,910

FINANCIAL STATEMENTS

COMPANY BALANCE SHEET
31 DECEMBER 2003

	Note	2003	2002
		£'000	£'000
FIXED ASSETS			
Intangible assets	11	22	18
Investments	13	47,278	8,412
		47,300	8,430
CURRENT ASSETS			
Debtors	14	7,548	1,195
Cash at bank and in hand	15	5,377	5,680
		12,925	6,875
CREDITORS: amounts falling due within one year	16	(3,267)	(140)
NET CURRENT ASSETS		9,658	6,735
Total Assets Less Current Liabilities, Being Net Assets		56,958	15,165
CAPITAL AND RESERVES			
Called up equity share capital	19e	7,806	3,538
Share premium account	20	50,753	13,334
Equity shares to be issued	19	1,716	1,600
Profit and loss account	20	(3,317)	(3,307)
Total Capital Employed		56,958	15,165

These financial statements were approved by the Board of Directors on 30 April 2004.

Signed on behalf of the Board of Directors:

G P Thomson, FCA
Director

H G Wilson
Director

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

YEAR ENDED 31 DECEMBER 2003

	2003	2002
	£'000	£'000
Profit/(loss) for the financial year	1,586	(98)
Currency translation adjustments	(1,709)	(209)
Total recognised losses relating to the year	(123)	(307)

RECONCILIATION OF MOVEMENTS IN GROUP SHAREHOLDERS' FUNDS

YEAR ENDED 31 DECEMBER 2003

	2003	2002
	£'000	£'000
Profit/(loss) for the financial year	1,586	(98)
Other recognised losses for the year	(1,709)	(209)
Shares issued (net of expenses)	41,687	13,147
Shares to be issued	116	1,600
Total movement in the year	41,680	14,440
Shareholders' funds at 1 January	14,910	470
Shareholders' funds at 31 December	56,590	14,910

CONSOLIDATED CASH FLOW STATEMENT

YEAR ENDED 31 DECEMBER 2003

	Note	2003	2002
		£'000	£'000
Net cash inflow/(outflow) from operations	24	3,340	(1,104)
Returns on investments and servicing of finance	25a	168	(3)
Capital expenditure	25a	(5,660)	(79)
Acquisitions	25a	(690)	405
Cash outflow before financing		(2,842)	(781)
Financing	25a	10,925	6,574
Increase in cash	25b	8,083	5,793

FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED 31 DECEMBER 2003

1. ACCOUNTING POLICIES

The principal accounting policies, which have all been applied consistently throughout the year and the preceding year, are set out below:

a) Basis of accounting

The financial statements are prepared under the historical cost convention, and in accordance with applicable United Kingdom accounting standards. The financial statements have also been prepared in accordance with the Statement of Recommended Practice "Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities" ("the SORP").

b) Consolidation

The Group financial statements consolidate the results of Sterling Energy plc and its subsidiary undertakings drawn up to 31 December annually. The results of subsidiaries acquired are consolidated for the periods from which control passed. Acquisitions are accounted for under the acquisition method with goodwill, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, being capitalised within intangible assets and amortised over its estimated useful economic life.

c) Turnover

Turnover represents the value of the Group's share of hydrocarbon production in the year.

d) Consortium accounting

The Group's exploration, development and production activities are generally conducted as co-licensee in joint operations with other companies. The financial statements reflect the relevant proportions of production, capital expenditure and operating costs applicable to the Group's interests.

e) Oil and gas interests

The Group accounts for oil and gas exploration under the full cost basis as set out in the SORP.

Licence acquisition costs, geographical and geophysical costs, costs of drilling exploration, appraisal and development wells, and an appropriate share of overheads (including appropriate directors' costs) are capitalised and accumulated in full cost pools within tangible fixed assets on a geographical basis. The Group's oil and gas assets are currently held in three cost pools, Western Europe, South East Asia and North America.

Costs relating to the exploration and appraisal of oil and gas interests, which the directors consider to be unevaluated, are initially held outside the cost pool as intangible fixed assets. These costs are reassessed at each year end and when there are indications of impairment or at the conclusion of an appraisal programme the related costs are transferred to the appropriate full cost pool within tangible fixed assets.

An impairment test is carried out at each balance sheet date to assess whether the net book value of the capitalised costs in each pool is covered by the associated recoverable amount, as outlined in FRS 11 "Impairment of Fixed Assets and Goodwill". Impairment losses are recognised in the profit and loss account.

Depletion is provided on balances held in each cost pool, plus the expected future costs to extract all commercial oil and gas reserves, using the unit of production method. Commercial oil and gas reserves are proven and probable oil and gas reserves as defined in the SORP. Depletion is not provided on interests held outside the cost pools.

f) Depreciation of other tangible fixed assets

Depreciation on other tangible fixed assets is provided at rates estimated to write off the cost, less estimated residual value, of each asset over its expected useful life as follows:

Computer and office equipment - 33% straight line

g) Decommissioning

Provision for decommissioning costs is recognised in accordance with Financial Reporting Standard No. 12 "Provisions, Contingent Liabilities and Contingent Assets". Provisions are recorded at the present value of the expenditures expected to be required to settle the Group's future obligations.

Provisions are reviewed at each balance sheet date to reflect the current best estimate of the cost at present value. The unwinding of the discount is reflected as a finance cost. A decommissioning asset is also established, since the future cost of decommissioning is regarded as part of the total investment to gain access to future economic benefits, and included in the relevant full cost pool. Depletion on this asset is calculated under the unit of production method based on estimated commercial reserves.

h) Foreign currencies

Transactions denominated in foreign currencies are translated into sterling at the rate of exchange ruling at the date of the transaction. Assets and liabilities in foreign currencies are translated into sterling at the rate of exchange ruling at the end of the financial year. All exchange differences are dealt with in the profit and loss account.

The results of overseas operations are translated at the average rates of exchange during the period and their balance sheet at the rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets and results of overseas operations are dealt with through the currency translation reserve.

i) Taxation

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 is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as 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 recognised in respect of the retained earnings of overseas subsidiaries only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

j) Investments

Fixed asset investments are shown at cost less provision for impairment.

k) Operating leases

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis.

l) Derivative financial instruments

The Group uses derivative financial instruments to manage its exposure to changes in prices of natural gas. These transactions are accounted for on an accruals basis.

FINANCIAL STATEMENTS

2. SEGMENT INFORMATION

The Group operates in one business segment, the exploration for and production of oil and gas. The Group has interests in four geographical segments, Western Europe, North America, South East Asia and Africa as follows:

	Western Europe		North America		South East Asia		Africa		Total	
	2003	**2002**	**2003**	**2002**	**2003**	**2002**	**2003**	**2002**	**2003**	**2002**
Turnover*	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
existing operations	-	-	5,253	22	-	-	-	-	5,253	22
acquisitions	-	-	280	566	-	-	-	-	280	566
Profit/(Loss) before taxation	(237)	(135)	2,063	37	-	-	(17)	-	1,809	(98)
Net assets**	1,956	4,611	14,955	10,264	211	35	51,039	-	68,161	14,910

* All turnover is sold to third parties within the segment of origin

** Net assets exclude intra-group financing. They include £45.1 million in respect of the Fusion acquisition during the year (see note 23b), of which £11.6 million is attributable to the minority interest (see note 21).

3. PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION

Profit/(loss) on ordinary activities before taxation is stated after charging:

	2003	**2002**
	£'000	£'000
Depletion of tangible fixed assets	1,350	166
Depreciation of tangible fixed assets – other assets	34	4
Auditors' remuneration (see below)		
Audit fees	52	25
Further assurance services	38	56
Operating lease rentals	62	11

Auditors' remuneration

The non-audit fees shown above for 2003 were recorded as part of the cost of investment in subsidiaries as they related to the acquisition of Fusion Oil and Gas plc described in note 23(b). The non-audit fees for 2002 were recorded against the share premium account as they related to a placing and open offer in October 2002.

All audit fees for both years were charged to the Company.

4. INTEREST RECEIVABLE AND SIMILAR INCOME

	2003	2002
	£'000	£'000
Interest receivable and similar income	203	18
Interest receivable on restricted account (see note 15)	5	4
Other	11	-
	219	22

5. INTEREST PAYABLE AND SIMILAR CHARGES

	2003	2002
	£'000	£'000
Interest and fees arising on bank loans	41	21
Unwinding of discount on provisions (see note 18)	73	21
	114	42

6. EMPLOYEE INFORMATION

The average monthly number of employees (including executive directors) during the year was 10 (2002-2).

Due to the small size of the Company there is no formal classification of duties.

Employee costs during the year (including executive directors) amounted to:

	2003	2002
	£'000	£'000
Wages and salaries	1,006	132
Social security costs	66	4
	1,072	136

Included within wages and salaries above is £180,000 (2002 - £23,000) which has been capitalised.

The Group does not provide pension arrangements or make pension contributions for its directors or staff.

FINANCIAL STATEMENTS

7. DIRECTORS' REMUNERATION

Aggregate remuneration

Directors' remuneration consists of the following:

	Fees/ basic salary £	Bonus £	Benefits in kind £	Total 2003 £	Total 2002 £
Executive directors					
H.G. Wilson	100,000	90,000	-	190,000	44,374
G.P. Thomson	100,000	65,000	2,546	167,546	25,269
N.A. Quinton	100,000	65,000	-	165,000	20,430
Non-executive directors					
R.A. O'Toole	30,000	10,000	-	40,000	12,875
P.K. Wilde	15,000	-	-	15,000	27,837
Dr E. J. Butler	15,000		-	15,000	17,837
Aggregate emoluments	360,000	230,000	2,546	592,546	148,621

The Company provides limited directors' and officers' liability insurance, at a cost of approximately £9,000 in 2003 (2002 - £7,000). This cost is not included in the above table.

Details of directors' interests in the issued shares of the Company are shown in the Directors' report.

Directors' and staff share options

Details of options to acquire ordinary shares in the Company under the scheme approved in 2001 are as follows:

	At 01 Jan 2003	Granted	At 31 Dec 2003	Exercise price	Exercise period
H.G.Wilson	700,000	-	700,000	4p	Up to 24 July 2011
	4,300,000	-	4,300,000	4p	Up to 18 October 2012
	-	2,900,000	2,900,000	7p	18 January 2005 to 18 January 2013
	5,000,000	2,900,000	7,900,000		
G.P. Thomson	700,000	-	700,000	4p	Up to 24 July 2011
	4,300,000	-	4,300,000	4p	Up to 18 October 2012
	-	1,700,000	1,700,000	7p	18 January 2005 to 18 January 2013
	5,000,000	1,700,000	6,700,000		
N.A. Quinton	700,000	-	700,000	4p	Up to 24 July 2011
	4,300,000	-	4,300,000	4p	Up to 18 October 2012
	-	1,900,000	1,900,000	7p	18 January 2005 to 18 January 2013
	5,000,000	1,900,000	6,900,000		
R.A. O'Toole	700,000	-	700,000	4p	Up to 24 July 2011
	4,300,000	-	4,300,000	4p	Up to 18 October 2012
	-	1,250,000	1,250,000	7p	18 January 2005 to 18 January 2013
	5,000,000	1,250,000	6,250,000		
P.K. Wilde	250,000	-	250,000	4p	Up to 24 July 2011
	1,250,000	-	1,250,000	4p	Up to 18 October 2012
	1,500,000	-	1,500,000		
Dr E.J. Butler	250,000	-	250,000	4p	Up to 24 July 2011
	1,250,000	-	1,250,000	4p	Up to 18 October 2012
	1,500,000	-	1,500,000		
Other grantees	50,000	-	50,000	4p	Up to 24 July 2011
	3,250,000	-	3,250,000	4p	Up to 18 October 2012
	-	1,250,000	1,250,000	7p	18 January 2005 to 18 January 2013
	3,300,000	1,250,000	4,550,000		
	26,300,000	9,000,000	35,300,000		

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7. DIRECTORS' REMUNERATION (CONTINUED)

No options were exercised or lapsed during the year.

At 31 December 2002, the directors also had the following warrants or interests in warrants to subscribe for further shares at 6p each no later than 30 June 2003: 125,000 for Dr Butler, 1,664,799 for Mr O'Toole, 1,738,134 for Mr Quinton, 1,241,997 for Mr Thomson, 161,000 for Mr Wilde and 3,683,014 for Mr Wilson. All these warrants or interests in warrants were disposed of on 13 May 2003.

The mid-market price of the ordinary shares at 31 December 2003 was 10.5p (2002: 7.0p) and the range during the year was 5.75p to 13.125p (2002: 3.6p to 7.5p).

8. TAXATION

The Group tax charge comprises:

	2003	***2002***
	£'000	£'000
Current tax	-	-
Deferred tax - origination and reversal of timing differences	228	-
	228	-

The difference between the current tax charge of £nil and the amount calculated by applying the applicable standard rate of tax is as follows:

	2003	**2002**
	£'000	£'000
Profit/(loss) on ordinary activities before tax	1,809	(98)
Tax on profit/(loss) on ordinary activities at standard US corporation tax rate of 34% (2002: 35%)	615	(34)
Effects of:		
Expenses not deductible for tax purposes	64	32
Capital allowances (in excess of)/exceeded by depreciation	(791)	52
Other temporary differences	12	(17)
Difference in overseas tax rates	1	(1)
Adjustment for tax losses	99	(32)
Current tax charge for the year	-	-

During 2002 and 2003, the Group generated its results primarily in the US. Therefore the tax rate in the above reconciliation for 2002 and 2003 is the standard rate for US corporation tax.

9. LOSS ATTRIBUTABLE TO STERLING ENERGY PLC

The loss for the financial year dealt with in the accounts of Sterling Energy plc was £10,000 (2002 - loss of £95,000). As provided by s230 of the Companies Act 1985, no profit and loss account is presented in respect of Sterling Energy plc.

10. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit for the financial year of £1,586,000 (2002 - loss of £98,000) and on 417,759,246 (2002 - 90,983,836) ordinary shares, being the weighted average number of ordinary shares in issue. The calculation of diluted earnings per share is based on the profit for the financial year as for basic earnings per share. The number of shares outstanding is adjusted as follows:

	2003 Number of shares
For basic earnings per share	417,759,246
Exercise of options	16,545,643
Exercise of warrants	3,192,172
Conversion of 2002 shares to be issued into ordinary shares (see note 19f)	40,000,000
Issue of remaining shares related to Fusion acquisition (see note 23b)	2,421,390
For diluted earnings per share	479,918,451

In 2002 diluted earnings per share was the same as basic earnings per share as the effect of potential ordinary shares was anti-dilutive.

11. INTANGIBLE FIXED ASSETS: UNEVALUATED OIL AND GAS INTERESTS

	Group £'000	Company £'000
At 1 January 2003	4,096	18
Acquisition of subsidiary undertakings (see note 23b)	45,797	-
Additions	498	4
Currency translation adjustment	(434)	-
At 31 December 2003	49,957	22

Group net book value at 31 December 2003 comprises £3,765,000 for North America, £62,000 for Western Europe, £211,000 for South East Asia, and £45,919,000 for Africa. Group net book value at 31 December 2002 comprised £4,037,000 for North America, £24,000 for Western Europe and £35,000 for South East Asia.

12. TANGIBLE FIXED ASSETS

	Oil and gas interests £'000	Computer & office equipment £'000	Total £'000
Group			
Cost			
At 1 January 2003	6,719	51	6,770
Acquisition of subsidiary undertakings (see note 23b)	-	208	208
Additions	5,720	48	5,768
Currency translation adjustment	(784)	-	(784)
At 31 December 2003	11,655	307	11,962
Accumulated depreciation			
At 1 January 2003	206	4	210
Charge for the year	1,350	34	1,384
Currency translation adjustment	(65)	-	(65)
At 31 December 2003	1,491	38	1,529
Net book value			
At 31 December 2003	10,164	269	10,433
At 1 January 2003	6,513	47	6,560

The net book value of oil and gas interests at 31 December 2003 comprises £10,140,000 (2002: £6,489,000) and £24,000 (2002: £24,000) relating to the North America and Western Europe cost pools respectively.

13. FIXED ASSET INVESTMENTS: INVESTMENT IN SUBSIDIARIES

	Company £'000
Cost	
At 1 January 2003	8,412
Additions	38,866
At 31 December 2003	47,278

Principal investments

In September 2003, the Company acquired 100% of the issued capital of Westmount Resources Limited ("Westmount") for a total consideration of £8,208,125 satisfied by the issue of ordinary shares. Westmount is incorporated in Jersey and holds an investment of approximately 20.40% of the issued share capital of Fusion Oil and Gas plc ("Fusion").

In December 2003, the Company announced that its offer for the whole of the remaining share capital of Fusion had become unconditional in all respects. The total consideration in respect of the Fusion acquisition, including the shares acquired via the Westmount transaction described above, was £39,538,000 and was paid and payable in a combination of shares and cash.

The company only addition shown above is inclusive of an intercompany loan inherited at acquisition which is eliminated on group consolidation. Fusion is incorporated in the United Kingdom and is an oil and gas exploration company with various subsidiary undertakings with beneficial interests in Western Africa.

Further details of these acquisitions are provided in note 23.

Following these acquisitions, as at 31 December 2003 the parent company had investments in the following subsidiary undertakings which principally affected the assets or profits of the Group:

	Country of incorporation	Class of shares held	Proportion of voting rights held	Nature of business
LEPCO Oil & Gas Canada Ltd.	Canada	Ordinary	100%	Exploration for & production of oil and gas
Sterling Energy (UK) Limited	UK	Ordinary	100%	Exploration for of oil and gas
Sterling Energy, Inc.*	USA	Ordinary	100%	Exploration for & production of oil and gas
Westmount Resources Inc.	USA	Ordinary	100%	Exploration for & production of oil and gas
Westmount Resources Limited	Jersey, C.I.	Ordinary	100%	Investment
Fusion Oil & Gas plc	UK	Ordinary	100%**	Investment holding company
Fusion Oil & Gas NL***	Australia	Ordinary	100%**	Exploration for oil and gas
Fusion Northwest Africa Holdings Limited***	Jersey, C.I.	Ordinary	100%**	Investment holding company
Fusion Mauritania A Limited ****	Jersey, C.I.	Ordinary	70.1%**	Exploration for oil and gas
Fusion Mauritania B Limited ****	Jersey, C.I.	Ordinary	70.1%**	Exploration for oil and gas
Fusion Cameroon Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Fusion Croix du Sud Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Fusion Cheval Marin Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Fusion Dome Flore Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Fusion Oil & Gas (Iris Marin) Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Fusion Oil & Gas (Themis Marin) Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Iris Marin Holdings Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas
Themis Marin Holdings Limited****	Jersey, C.I.	Ordinary	100%**	Exploration for oil and gas

* Held through Sterling Energy (UK) Limited

** After taking into account the conversion of 7% of shares held by minority shareholders of Fusion Oil & Gas plc subsequent to year-end (see note 21)

*** Held directly by Fusion Oil & Gas plc

**** Held directly or indirectly through Fusion Northwest Africa Holdings Limited

14. DEBTORS

	Group		Company	
	2003	2002	2003	2002
	£'000	£'000	£'000	£'000
Trade debtors	754	520	1	14
Amounts owed by subsidiary undertakings	-	-	7,477	1,148
Other debtors	300	33	65	25
Prepayments and accrued income	458	120	5	8
	1,512	673	7,548	1,195

15. CASH AT BANK AND IN HAND

Included in cash at bank and in hand for the Group is an amount of approximately £856,000 (2002 - £858,000) held in a restricted account to be used for the sole purpose of the payment of decommissioning costs on two US producing licences.

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2003	2002	2003	2002
	£'000	£'000	£'000	£'000
Bank loan (see below)	1,117	435	-	-
Trade creditors	671	233	62	44
Other taxation and social security	18	6	-	-
Other creditors	37	-	-	-
Accruals and deferred income	1,053	332	501	96
Deferred consideration (see note 23b)	2,704	-	2,704	-
	5,600	1,006	3,267	140

Sterling Energy, Inc. has entered into a US$10,000,000 revolving credit facility and mortgage with Hibernia National Bank in the USA (the "facility"). The amount that can be drawn under this facility is determined by a twice yearly borrowing base calculation which at the end of 2003 was $2,750,000. At 31 December 2003, $2,000,000 (£1,117,000) had been drawn down under this facility, all of which was due in less than one year (2002 - £435,000) and £nil was due between one and two years (2002 - £808,000). In addition, a further $175,000 (2002 - $175,000) is pledged under a letter of credit. The mortgage is secured by a floating charge over certain of the tangible net assets of Sterling Energy, Inc. and is non-recourse to the rest of the Group, although an intra-group loan of approximately £5.328 million (2002 - £3.83 million) is subordinated to the facility. Interest is payable at a margin over either the Eurodollar rate or the Wall Street Journal Prime Rate at the preference of Sterling Energy, Inc. The mortgage also includes certain financial and non-financial covenants.

17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group	
	2003	2002
Bank loan (see note 16)	£'000	£'000
Between one and two years	-	808

18. PROVISIONS FOR LIABILITIES AND CHARGES

	Group	
	2003	**2002**
	£'000	£'000
Decommissioning	2,412	1,939
Deferred tax	214	-
	2,626	1,939

Decommissioning

	2003
	£'000
At 1 January 2003	1,939
Adjustments to estimates	601
Unwinding of discount	73
Currency translation adjustment	(201)
At 31 December 2003	2,412

The amount shown above represents the estimated costs for decommissioning the Group's producing interests in North America, which are expected to occur between 2009 and 2017.

Deferred taxation

	2003
	£'000
At 1 January 2003	-
Charged to profit and loss account	228
Currency translation adjustment	(14)
At 31 December 2003	214

The provision at 31 December 2003 consists of the following:

	£'000
Accelerated capital allowances	1,023
Tax losses available	(809)
	214

A deferred tax asset of £1,536,956 (2002: £918,438), primarily related to tax losses carried forward, has not been recognised. This amount principally relates to the UK and Australia. The Australian asset (£568,194) has not been recognised as the losses principally relate to activities prior to the acquisition of Fusion and there is insufficient certainty that the Group can offset these losses against future taxable profits. The UK asset (£894,866) has not been recognised as there is insufficient certainty that future taxable profits will arise to offset the losses which give rise to this asset.

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19. CALLED UP EQUITY SHARE CAPITAL

	2003	2002
	£'000	£'000
Authorised:		
1,250,000,000 ordinary shares of 1p	12,500	12,500
Called up, allotted and fully paid:		
780,626,248 ordinary shares of 1p each		
(2002 - 353,792,382 ordinary shares of 1p each)	7,806	3,538

Movements during the year were as follows:

a. 24,683,108 new ordinary shares with a nominal value of £246,831 were issued from the exercise of warrants at 6p per share, before their expiry on 30 June 2003.

b. 82,500 new ordinary shares with a nominal value of £825 were issued to an employee at 6p per share as part of his employment agreement.

c. 71,375,000 new ordinary shares (the "Westmount shares") with a nominal value of £713,750 were issued at 11.5p per share, under an agreement dated 19 September 2003 and completed on 26 September 2003, under which the Company purchased the whole of the issued share capital of Westmount Resources Limited, whose assets principally comprised an approximately 20% interest in the ordinary share capital of Fusion Oil & Gas plc ("Fusion").

d. 90,909,090 new ordinary shares with a nominal value of £909,091 were issued on 1 October 2003 under a placing at a price of 11p per share. This placing raised a total of £10.0 million before expenses in order to provide funds to cover the expenses of this placing and to meet any costs and the maximum cash elements of making an offer to the shareholders of Fusion ("the Offer"), as described in a circular dated 1 October 2003.

e. 199,784,168 new ordinary shares with a nominal value of £1,997,842 were issued as partial satisfaction of the Offer, between the date it was declared unconditional on 10 December 2003 and the end of the year. The fair value of the shares at 10 December 2003 was 10.5p. In addition, acceptances for an additional 16,345,781 shares had also been received by year end, the fair value of £1,716,000 has been classified as "Shares to be issued" in the balance sheet. In conjunction with the Westmount shares, described in c. above, as of 31 December 2003 the Company either owned or had acceptances for approximately 93% of the issued ordinary share capital of Fusion. Since then these shares to be issued and a further 25,740,294 new ordinary shares have been issued and the compulsory purchase procedure has been completed, thereby acquiring all of the issued share capital of Fusion.

f. 40,000,000 new ordinary shares with a nominal value of £400,000 were issued on 31 December 2003 at 4p per share, being the final payment for the purchase of Sterling Energy Limited (now called Sterling Energy (UK) Limited) in October 2002. No warranty claims arose and accordingly the full number of shares arising under the agreement were issued. The fair value of these shares at 31 December 2002 of £1.6 million was classified as "Shares to be issued" in the prior year comparatives.

20. RESERVES

	Share premium account £'000	Currency translation account £'000	Profit and loss account £'000	Total account £'000
Group				
At 1 January 2003	13,334	(173)	(3,389)	9,772
Premium on shares issued	38,003	-	-	38,003
Expenses of share issues	(584)	-	-	(584)
Currency translation adjustments	-	(1,709)	-	(1,709)
Profit for the year	-	-	1,586	1,586
At 31 December 2003	50,753	(1,882)	(1,803)	47,068

	Share premium account £'000	Profit and loss account £'000	Total account £'000
Company			
At 1 January 2003	13,334	(3,307)	10,027
Premium on shares issued in year	38,003	-	38,003
Expenses of share issues	(584)	-	(584)
Loss for the year	-	(10)	(10)
At 31 December 2003	50,753	(3,317)	47,436

21. EQUITY MINORITY INTEREST

	£'000
At 1 January 2003	-
Acquisition of subsidiary undertaking (see note 23b)	11,571
At 31 December 2003	11,571

The above represents a 29.9% third party interest in the fair value of the entities that hold the Group's interests in Mauritania, Fusion Mauritania A Limited and Fusion Mauritania B Limited.

In addition there was deferred consideration of £2.7 million at 31 December 2003 relating to the 7% of shares in Fusion Oil & Gas plc still held by minority shareholders at that date, which is classified within creditors due within one year. The minority interest in the profit and loss account of £5,000 represents their share of the results of the group headed by Fusion in the period between 10 December and 31 December 2003.

22. FINANCIAL COMMITMENTS

Annual commitments under non-cancellable operating leases are as follows:

Group

	2003 £'000	2002 £'000
Land & buildings		
Operating leases with an option to terminate between two and five years	107	52

	2003 £'000	2002 £'000
Exploration expenditure commitments		
Due within one year	3,477	-
Due later than one year but within two years	1,017	-
	4,494	-

In acquiring its oil and gas interests the Group has pledged that various work programmes will be undertaken on each permit/interest. The exploration commitments above are an estimate of the cost of performing these work programmes. Commitments shown as due within one year include £3,217,000 of costs that it is anticipated will be met by Joint Venture Partners under farmout agreements currently under negotiation.

23. ACQUISITION OF SUBSIDIARY UNDERTAKINGS

(a) Westmount Resources Limited

On 19 September 2003, the Company announced that it had agreed to acquire Westmount Resources Limited ("Westmount"), a wholly owned subsidiary of Westmount Energy Limited. Westmount's assets consisted of 20,000,000 ordinary shares of 1p each in Fusion Oil and Gas plc and 500,000 partly paid ordinary shares in Fusion Oil and Gas NL, a wholly owned subsidiary of Fusion Oil and Gas plc. The consideration payable was 71,375,000 new ordinary shares of 1p each in the Company, comprising 70,000,0000 shares as payment for the 20,000,000 Fusion Oil and Gas plc shares with the balance of 1,375,000 shares being payment for the partly paid shares. The fair value of Sterling's shares at the date of acquisition was 11.5p.

The assets and liabilities of Westmount at the date of acquisition and the total consideration are set out in the following table:

	Book value £'000	Fair value adjustments £'000	Fair value £'000
Assets			
Investment in Fusion	1,027	7,186	8,213
Liabilities			
Creditors	(5)	-	(5)
Net assets	1,022	7,186	8,208
Satisfied by:			
Issue of ordinary shares at fair value			8,208

The fair value of consideration of £8.2 million shown above is included within the fair value of consideration in respect of the acquisition of Fusion of £39.5 million described in note 23(b) below.

Westmount's unaudited management accounts indicate that there was neither a profit nor loss incurred for the period from 1 July 2002 to the effective date of acquisition.

Results for the year ended 30 June 2002 were not made available to the Group at the time of the acquisition.

(b) Fusion Oil & Gas plc

On 12 September 2003, the Company announced that it had approached the board of Fusion with the possibility of an offer for the entire share capital of Fusion. A formal offer was made by the Company to the shareholders of Fusion on 1 October 2003 consisting of either 3.5 Sterling shares for each Fusion share, or 10p in cash and 2.5 Sterling shares for each Fusion share or an election for a higher cash amount. On 4 December 2003 the Company announced that it either owned or had received valid acceptances for approximately 51.37% of the issued Fusion shares. On 10 December 2003 the Company announced that its offer for the whole of the issued and to be issued share capital of Fusion had become unconditional in all respects. The mid-market share price of Sterling shares at that date was 10.5p and has been used to compute the fair value set out below.

The assets and liabilities of Fusion and its subsidiaries (the "Fusion group") at the date of acquisition and the total consideration are set out in the following table:

	Book value	Fair value adjustments	Fair value
	£'000	£'000	£'000
Assets			
Intangible fixed assets	11,579	34,218	45,797
Tangible fixed assets	208	-	208
Debtors	113	-	113
Cash at bank and in hand	5,238	-	5,238
	17,138	34,218	51,356
Liabilities			
Creditors	(247)	-	(247)
Minority interest	(1,741)	(9,830)	(11,571)
Net assets	15,150	24,388	39,538

Satisfied by:	
Issue of ordinary shares at fair value	29,185
Shares to be issued	1,716
Deferred consideration	2,709
Cash (including costs of the acquisition)	5,928
	39,538

23. ACQUISITION OF SUBSIDIARY UNDERTAKINGS (CONTINUED)

(b) Fusion Oil & Gas plc (continued)

The fair value adjustments to the fixed assets acquired were determined by the directors, having regard to reports by independent petroleum consulting engineers.

"Shares to be issued" represents the fair value of shares issued subsequent to year end but for which valid acceptances had been received by 31 December 2003. In conjunction with shares issued by that date, Sterling held an interest of 93% in Fusion at year end. The remaining 7% minority shareholders were acquired subsequent to year end for a combination of Sterling shares and cash. The fair value of this deferred consideration amounted to £2.7 million and has been recorded in creditors due within one year (see note 16).

From the effective date of acquisition on 10 December 2003 to 31 December 2003 the Fusion group contributed an operating loss of £26,000 to the Group and a loss of £17,000 to the Group's loss on ordinary activities before taxation.

The profit after tax of the Fusion group for the year to 30 June 2003 was £3,219,855 of which £636,856 is related to exceptional operating income and £4,235,663 related to the profit on the partial sale of a subsidiary undertaking. For the period from 1 July to 9 December 2003 the Fusion group made a loss after tax of £1,534,438.The summarised profit and loss account for the period from 1 July to 9 December 2003, shown on the basis of the accounting policies of Fusion prior to the acquisition, were as follows:

	1 July to 9 December 2003
	£'000
Turnover	-
Cost of sales	(147)
Gross loss	(147)
Other operating expenses	(1,574)
Operating loss	(1,721)
Interest income	4
Interest payable	-
Foreign exchange gains	183
Loss on ordinary activities before and after tax	(1,534)

There were no recognised gains and losses for the period other than the loss shown above.

(c) Other

During the year the Group acquired a 60% interest in the Eugene Island 268 lease offshore Louisiana. The consideration of £98,000 related to this asset transaction is included within additions to oil and gas interests in note 12.

24. RECONCILIATION OF OPERATING PROFIT/(LOSS) TO NET CASH INFLOW/(OUTFLOW) FROM OPERATIONS

	2003 £'000	2002 £'000
Operating profit/(loss)	1,704	(78)
Depreciation and depletion	1,384	170
Increase in debtors	(726)	(334)
Increase/(decrease) in creditors	978	(862)
Net cash inflow/(outflow) from operations	3,340	(1,104)

25. NOTES TO THE CASH FLOW STATEMENT

(a) Gross cash flows

	2003 £'000	2002 £'000
Returns on investments and servicing of finance		
Interest received	209	18
Interest paid	(41)	(21)
Net cash inflow/(outflow)	168	(3)
Capital expenditure		
Purchase of intangible fixed assets	(498)	(33)
Purchase of tangible fixed assets	(5,162)	(46)
Net cash outflow	(5,660)	(79)
Acquisitions (see note 23)		
Purchase of subsidiary undertakings	(5,928)	(202)
Cash acquired with subsidiary undertakings	5,238	607
Net cash (outflow)/inflow	(690)	405
Financing		
Issue of ordinary shares, net of expenses	10,925	6,574

Companies acquired in the year contributed £49,000 to the Group's net operating cash outflows, received £9,000 in respect of net returns on investment and servicing of finance, utilised £28,000 for capital expenditure and generated £nil in respect of net financing.

During 2003, the Group also completed material mainly non-cash transactions, being the acquisition of Westmount Resources Limited for shares and the acquisition of Fusion Oil and Gas plc principally for shares (see note 23).

25. NOTES TO THE CASH FLOW STATEMENT (CONTINUED)

(b) Analysis and reconciliation of net funds

Group	1 January 2003 £'000	Cash flow £'000	Other non-cash changes £'000	Exchange movement £'000	31 December 2003 £'000
Cash in hand and at bank*	6,476	8,083	-	(930)	13,629
Debt due after 1 year	(808)	-	726	82	-
Debt due within 1 year	(435)	-	(726)	44	(1,117)
Net funds (debt)	5,233	8,083	-	(804)	12,512

* The cash balance at 31 December 2003 excludes £ 856,000 of restricted cash (2002 – £858,000) as described further in note 15.

	2003	2002
	£'000	£'000
Increase in cash in the year	8,083	5,793
Translation difference	(804)	166
Loans acquired with subsidiary undertakings	-	(1,292)
Movement in net funds in year	7,279	4,667
Net funds at 1 January	5,233	566
Net funds at 31 December	12,512	5,233

26. POST BALANCE SHEET EVENTS

On 27 February 2004, the Company announced that it had concluded the acquisition of five producing gas fields in the Gulf of Mexico, USA from Osprey Petroleum Partners LP for $39.5 million in cash. The fields are located in shallow water, offshore Texas, in the Gulf of Mexico, and include the associated gas gathering system and onshore facilities. The consideration was paid in cash with an effective date of 1 November 2003 and was funded from a new bank loan facility from Hibernia National Bank of $27.5 million and from internal cash resources. The loan, which is repayable on or before 30 June 2006, contains a number of normal conditions such as a twice yearly borrowing base review and limitation on cash usage elsewhere in the Group and carries a current interest rate of 4.25%.

Included in other debtors at 31 December 2003, was an amount of £220,000 due for repayment by 10 April 2004 under an interest bearing loan secured by mortgages against a number of producing properties owned by the operator of certain of Sterling's producing assets. This loan was not repaid by the due date or as of the date of these financial statements. Also at the year-end a further £117,000 was owed to Sterling from the same entity for net production revenues, which are recorded within trade debtors and which has not yet been settled. As of the date of these financial statements the amount owed to the Group for net production revenues, based on estimates to the end of March 2004, had increased to approximately £350,000.

The directors have not made any provision in respect of the above debtors in the financial statements for a number of reasons, including the potential for initiating legal action to enforce the mortgages, currently under consideration by the Group, the value of the assets secured by the mortgages being estimated to be significantly in excess of the carrying value of the loan and the directors' understanding that the operator is progressing with a refinancing to improve its financial position. Action taken subsequent to the year end to limit the Group's financial exposure has included taking over operatorship of some of the fields and, since March, selling its share of production with payment made directly to itself.

In March 2004, 17,950,000 share options were issued to employees at 12.5p per share, all with an exercise period of no longer than 10 years from the date of grant and not exercisable within the first two years.

27. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

This note provides the narrative and numerical disclosures required by FRS 13 "Derivatives and Other Financial Instruments: Disclosures". As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

The Group's objective and policy is to use financial instruments to manage its risk profile commensurate with the complexity of its underlying operations.

During the year, the Group's financial assets and liabilities consisted of:

- Cash at bank and in hand (see note 15)
- Short term loan facility with Hibernia National Bank (see notes 16 and 17)
- Short term gas commodity swaps using forward sales contracts in the gas trading markets

These are used to manage the working capital requirements of the Group. The main risks arising from the Group's operations are interest rate risk, gas price risk and foreign currency translation risk. The Group monitors risk on a regular basis and takes appropriate measures to ensure risks are managed in a controlled manner.

27. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONTINUED)

Interest rate risk

The Group's financial assets and liabilities accrue interest at prevailing floating rates in either the United States of America or the United Kingdom, as described further below. The Group does not currently use derivative instruments to manage its interest rate risk although it continues to monitor the need for such instruments on an ongoing basis.

Gas price risk

The Group uses natural gas hedging instruments (forward sales) to manage exposure to volatility in gas prices. At the end of 2003 it had entered into hedging transactions for a number of months in 2004 covering part of its projected production.

Foreign currency translation risk

The functional currency of the oil and gas producing activities of the Group is US$ and of its management, services and treasury functions is £sterling. Balances are held in US$ and A$ to meet immediate local operating or administrative needs. At the end of 2003 there were no material monetary liabilities or assets not denominated in the functional currency of the subsidiary involved, except for intra-group financings. The Group does not enter into derivative transactions to manage its foreign currency translation or transaction risk.

Interest rate risk profile of financial assets and liabilities

Financial assets

	2003	2002
	£'000	£'000
Pounds sterling (£)	10,148	6,476
United States dollars (US$)	4,109	858
Other	228	-
At 31 December	14,485	7,334

At 31 December 2003 the Group's financial assets principally comprised cash at bank and in hand under its control of £13,629,000 (2002 - £6,476,000), which forms the majority of its working capital. This balance relates to deposits placed with banking institutions that are available on demand or within seven days, which are principally denominated in pounds sterling and which carry interest at prevailing United Kingdom deposit floating rates. The group's financial assets also include restricted cash balances denominated in US$ of £856,000 (2002 - £858,000) as disclosed in note 15 which bear interest at the prevailing US$ bank floating rate.

Financial liabilities

At 31 December 2003 the Group's financial liabilities comprised a US$10 million revolving credit loan facility. A summary of the loan facility available to the Group at 31 December 2003, including its maturity profile and interest rate profile, is set out in note 16.

Fair values

The fair values of the Group's financial assets and liabilities at 31 December 2003 and 31 December 2002 are materially equivalent to their carrying value, save for forward gas swaps entered into for 2004 which, when compared to the forward market prices prevailing at the balance sheet date, showed a fair value loss of US$95,000; £53,068 (2002 - US$138,000; £85,720).

Independent auditors' report

To the members of Sterling Energy plc

We have audited the financial statements of Sterling Energy plc for the year ended 31 December 2003 which comprise the consolidated profit and loss account, the balance sheets, the consolidated statement of total recognised gains and losses, the reconciliation of movements in Group shareholders' funds, the consolidated cash flow statement and the related notes 1 to 27. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We read the directors' report and the other information contained in the annual report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2003 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
30 April 2004