

# EMPYREAN ENERGY PLC

Company Number: 05387837

**ANNUAL REPORT AND ACCOUNTS**  
For the period 1 April 2009 to 31 March 2010



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## COMPANY INFORMATION

Directors	Patrick Cross (Non-Executive Chairman) Thomas Kelly (Commercial Director) Frank Brophy (Technical Director) John Laycock (Finance Director)
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Auditors	Chapman Davis LLP 2 Chapel Court London SE1 1HH
Nominated Adviser and Broker	Astaire Securities Plc 30 Old Broad Street London EC2N 1HT
Solicitors	Kerman & Co LLP 200 Strand London WC2R 1DJ
Registrars	Capita Registrars Bourne House 34 Beckenham Road Beckenham, Kent BR3 4TU

## **CHAIRMAN'S STATEMENT**

As the fifth anniversary of Empyrean Energy plc ("Empyrean" or "Company") listing on AIM approaches, I am pleased to report that the Company is very well positioned to grow and capitalise on both its exploration and production development opportunities

In an eventful and very busy year operationally, with a slowly improving economic climate and increasing confidence among the investing community, the Company has been able to raise the necessary development capital needed to maintain the great momentum being generated at the Sugarloaf Project and also participate in a number of new projects

The Sugarloaf Project is now attracting a great deal of interest with the Austin Chalk and recently favoured Eagle Ford Shale play delivering very good results as drilling and completion techniques are optimised

In June 2009, in difficult market conditions, the Company raised £1.54 million in two placings, which as reported at the 2009 AGM, enabled us to secure a 10% share of the Riverbend project, as well as providing additional working capital. This was a key development for Empyrean, securing both participation in an exciting high leverage project and a relationship with Krescent Energy Company, LLC ("Krescent")

Empyrean has since participated in two further projects with Krescent, with Hercules showing potential and nearing production testing with a pipeline in the process of being connected to the well

In April 2010 the Company raised a further £3.6m, which will contribute to the further development of the Riverbend, Hercules and Sugarloaf projects in Texas, USA, the Eagle Oil project in California, USA and for general working capital

These raisings have put Empyrean on firmer ground in order to meet our current exploration and development objectives, and the high level of operational activity anticipated moving forward

In September 2009 Empyrean participated in the farm out by Texas Crude Energy Inc of the Block B Sugarloaf Project to Hilcorp Energy Company ("Hilcorp"), the fourth largest private E&P company in the USA. We envisaged the deal would generate development momentum at Sugarloaf and rapidly unlock its potential through active management of the field. It has proved a great success

For Empyrean, the farm-in by an established and substantial company of Hilcorp's size represented a significant endorsement of the potential of this gas and condensate asset. Hilcorp has considerable operating experience in onshore USA operations, and the deal provided for Empyrean to be free-carried for the drilling, completion and tie in of up to 3 new horizontal wells and the stimulation of the three existing Sugarloaf horizontal wells

Hilcorp has moved rapidly to drill three new wells, and the first two, Easley and Morgan, are already producing. The third, Rancho Grande, was drilled in only eighteen days and will be production tested shortly. With these successful results at the Sugarloaf Project, we are expecting that Hilcorp will continue to scale up the development of the field

## **CHAIRMAN'S STATEMENT CONTINUED**

In a separate exciting development, the Eagle Oil Pool Development Project has emerged from limbo with a new operator, of which Empryan owns a 48.5% share. Exploration activity adjacent to the Eagle Oil Pool Development Project is being monitored closely and Empryan is working closely with the new operator to optimise the forward plan.

In closing I would like to point out that during the short five years since we listed on AIM, Empryan has secured a substantial portfolio of projects, and has participated in the drilling of 22 wells – a very high level of activity for a junior with limited funds. Of these, 15 wells have either produced or are currently in production.

We look forward to an equally exciting and busy 12 months ahead and despite the many challenges we aim to progressively convert technical success into commercial success.

*Patrick H. Cross*

**Patrick Cross**  
**Chairman**  
**27 May 2010**

## **OPERATIONAL REVIEW**

Empyrean has focused solely on its USA assets during the past 12 months. It is at present participating in five projects. These are the Sugarloaf Hosston Project (Blocks A and B), the Eagle Oil Pool Development Project, the Riverbend Project and the Hercules Project.

Recent highly encouraging results at the Sugarloaf Project have indicated a diminution of risk as drilling and fracking techniques ameliorate. These results will inevitably result in increased drilling intensity and expenditure obligations in the future. Pursuit of the prolific Austin Chalk and Eagle Ford Shale reservoirs has therefore, for the time being, become the main focus of interest, having produced the results, and thereby ensuring continuation of long term potential and economic reward.

An additional and entirely separate Austin Chalk Project, being the Riverbend Project located onshore Texas in the Tyler and Jasper counties, was entered into by Empyrean with Krescent Energy Company, LLC ("Krescent") on 1 June 2009. This project lies south of the prolific Brookeland Field and has an estimated potential of 800 billion cubic feet of gas equivalent. In December 2009, Empyrean added the Hercules and Aquarius Prospects to its agenda with Krescent. These were smaller and less expensive plays which focused on the Wilcox Formation reservoir sands.

Among other projects, the Eagle Oil Pool Development Project onshore California remains intact, although activity has been limited during the last 12 months. This has been due to the normal re-adjustments encountered during a change in operatorship. It is anticipated that appraisal of the oil accumulation, in addition to exploration of additional plays, will be rejuvenated in the second half of 2010 as drilling activity in the area accelerates.

The second phase Margarita Project, located onshore Gulf Coast Texas, has virtually terminated with only one well, Dona Carlotta, producing small amounts of gas intermittently in order to maintain the land tenure.

Finally, the German project at Glantal has been abandoned. The challenges of the Austin Chalk and Eagle Ford Shale Projects in the USA incur far less risk. On 4 May 2010 Empyrean announced that it would not be applying for either an extension of the existing permit or a new permit.

In the following, a summary is given of all the operational activity in which Empyrean has been involved over the last 12 months.

### **Sugarloaf Hosston Project (Empyrean Interest: 3-9% after farmout)**

This project comprises Blocks A and B in which the Austin Chalk and Eagle Ford Shale are the primary reservoir targets. The blocks fall within the boundaries of the regional Sugarkane Gas Field. The field is condensate-rich and is ideally located in terms of the gas-liquid window, and this fact impacts significantly on the well economics.

## OPERATIONAL REVIEW CONTINUED

### Block A

Empyrean retains a 7.5% share in 4 Block A wells which at present are in various stages of gas and condensate production. These are TCEI JV A-1 well, TCEI JV A-3 well, TCEI JV A-4 well and TCEI JV A-5 well.

The fifth well, TCEI JV A-2, which for most of its life had been used for monitoring purposes by the operator Conoco Philips, has been suspended indefinitely and is unlikely ever to be placed on production, having fallen short of expectations.

### Block B

On 21 September 2009, Empyrean announced that Texas Crude Energy Inc ("TCEI"), the operator of Block B, had been successful in farming out Block B to Hilcorp Energy Company ("Hilcorp"), the fourth largest private exploration & petroleum company in the USA.

The terms of the farmout meant that Empyrean would be free carried for the drilling, completion and tie in of 3 new horizontal wells and the (re) stimulation of the 3 existing Sugarloaf horizontal wells in Block B. The programme has a series of deadlines over the 20 months from the commencement of the farmout, and no interest will be earned unless the agreed work programme is completed. The farmin partner will earn an interest incrementally, up to a maximum of 50%.

### New Farmout Wells

The 3 new wells being the Easley-1H well, Morgan-1H well and Rancho Grande 168-1 well have all been successfully drilled by Hilcorp since it took charge of the operatorship from TCEI in February 2010.

#### - Easley- 1H

This first well to be drilled under the farmout agreement is located approximately 2 km to the northeast of the Weston-1H well. It was spudded on 21 January 2010 and reached a total depth of 15,593 ft on 3 March 2010.

After a production casing string was run and cemented, a 10 stage fracture stimulation was performed over approximately 2,750 ft of horizontal section. This operation was completed on 30 April 2010 and production to sales commenced the following day.

Well production stabilised relatively quickly and on 5 May 2010 Empyrean announced an Initial Production rate of 6.81 million standard cubic feet of gas per day ("mmscfpd") of gas and 780 barrels of condensate per day ("bcpd"). This equates to **17.9 million standard cubic feet of gas equivalent ("mmscfepd")** based on a 12.1 conversion factor.

#### - Morgan-1H

The second well of the three farmout wells spudded on 26 February 2010 and is located approximately 5km northwest of Easley-1H. It reached a total depth of 17,015 ft in less than 30 days on 25 March 2010.

## **OPERATIONAL REVIEW CONTINUED**

### **- Morgan-1H continued..**

Production casing was run across approximately 5,000 ft of the reservoir section, which was then subjected to a 17 stage fracing operation on 16 April 2010. This was completed successfully in 11 days.

On 5 May 2010 Empryan announced an Initial Production rate of 5.16 mmscfpd of gas and 2,046 bcpd equating to **31 mmscfepd**.

### **- Rancho Grande 168-1**

This is the third and final well of the farmout agreement is located approximately 8 km southwest of Morgan-1H. It spudded on 26 March 2010 and reached a total depth of 16,957 ft in the remarkable time of 18 days on 12 April 2010. The horizontal lateral is approximately 5,000 ft.

The well will be fraced, as in the previous 2 wells, and brought on production immediately afterwards.

## **Re-Stimulation of Existing Wells**

As part of the farmout agreement, Hilcorp was also obliged to re-enter, re-fracc and bring on production the 3 wells already drilled by TCEI, namely Kowalik-1H well, Kennedy-1H well and the Weston-1H well.

### **- Kowalik-1H**

Original testing operations commenced on 3 November 2008. The production profile had not been continuous and on 5 October 2009 the well was shut-in. Hilcorp commenced fracc stimulation on 28 December 2009.

The fracing operation was divided into 4 phases targeting the horizontal 3,800 ft of slotted liner. During the fourth phase, a sudden pressure drop during the pumping of fracc fluids necessitated the suspension of operations.

Hilcorp decided to run a tie back string of 4.5 inch casing to isolate the suspected leak in the 7 inch casing. During the final stages of retrieving the slim drill pipe used, a section parted 700 ft below the surface and consequent fishing operations were unsuccessful.

It was decided to suspend operations at Kowalik-1H to minimize the effect on the remaining obligations and programme of the farmout agreement.

### **- Kennedy -1H**

The previous operator TCEI, was only partially successful with the fracing carried out in May 2008. At the time, it was estimated by TCEI that production was coming from only 17 ft of perforations in the bottom section of the 600 ft horizontal interval. After several interruptions, production to market resumed on 2 October 2008, at the modest rate of 20,000 cfgpd and 60 bcpd.

## OPERATIONAL REVIEW CONTINUED

### - Kennedy -1H Continued. .

Although these rates were below expectations, the fact that production came from the "middle" pay zone of the Austin chalk (referred to as the upper part of the Eagle Ford Shale by some authors) was a positive sign for recoverable reserve considerations

Hilcorp adopted a different approach in its fracing design. The original plan was to fracc the full 4,000 ft of the cemented horizontal liner in 14 separate stages. This was modified to 8 separate stages over 2,200ft. Fracc operations commenced on 18 January 2010 and the well commenced unloading fluids on 28 January 2010.

The well has been on continuous production since 29 January 2010. During the first 6 hours the well flowed at a rate of 4.39 mmcf/gpd and 1,132 bcpd, which corresponds to a gas equivalent production of **19.1 mmcf/gpd.**

The initial 30 and 60 day production rates were **11.7 mmcf/gpd** and **9.26 mmcf/gpd.**

### - Weston -1H

Weston-1H is located 1.5 km to the east of Kennedy-1H and reached total depth on 13 February 2009. Operations were suspended until the resumption of activity by Hilcorp on 4 February 2010 when it commenced fracing operations. Weston-1H had neither been fraced nor tested previously.

The operation involved fracing the entire 3,000 ft of horizontal section in the "Upper" Austin Chalk. It was carried out in 13 separate stages with an isolation plug set between each stage interval.

During the first 5 days the average production rate measured 5.68 mmcf/gpd and 414 bcpd equating to **12.1 mmcf/gpd.**

The initial 60 day average production rate was **11.4 mmcf/gpd.**

## Riverbend Project, Texas USA (Empyrean Interest: 10%)

Empyrean announced on 1 June 2009 that it had entered into a Participating Agreement with Krescent Energy Partners 11, LP of Houston Texas ("Krescent") to acquire a 10% working interest in Krescent's Riverbend Project. The primary objective is the Austin Chalk, and the area is ideally located being just south of the prolific Brookeland Field.

The project area covers approximately 40,000 acres under lease or exclusive option and an area of mutual interest of 50,000 acres, all of which are located in the Tyler and Jasper Counties.

Anadarko Petroleum Corporation and Ergon Oil and Gas drilling north and west of the project area have both had spectacular results using the dual lateral completion procedure to exploit the Austin Chalk fractured reservoirs.

## **OPERATIONAL REVIEW CONTINUED**

### **Riverbend Project, Texas USA (Empyrean Interest: 10%) Continued ..**

When Krescent commenced its operations in July 2008 with the drilling of Quinn 3-H, it encountered higher than normal bottom hole pressures when entering the Austin Chalk "B" zone pay. After penetrating approximately 1,000 ft of horizontal hole, with attendant impressive gas shows in the form of flares as high as 80 ft, a blowout occurred causing the operator to temporarily abandon the well and seek a larger rig with greater pump capacity.

Under the terms of the Participating Agreement, Empyrean Energy Plc earns its 10% interest by reimbursing 10% of the land costs and 10% of the original cost estimate of Quinn 3-H. It then pays 10% of the cost to re-enter, drill and complete the horizontal section of the well.

The Quinn 3-H well was re-entered on 2 September 2009. After some remedial work on the casing was completed, the new horizontal hole was successfully drilled to total depth of 16,641 ft. Numerous fracture zones and surface flares were encountered during the drilling.

Testing of the well commenced on 1 Jan 2010 and initial flow rates varied between 13-15 mmscf/gpd over a 32 hour period. The flow was suddenly restricted by extraneous debris blocking the well bore. It was immediately shut-in to enable the operator to decide on what remedial action should be taken to facilitate resumption of uninhibited flow to sales.

The well was cleaned to 16,450 ft, but a fish consisting of 14 ft of work string plus milling assembly became lodged in the bottom of the lateral hole. The fish was later found to have been forced by high pressure up the hole to a point near the top of the 3 inch liner hanger at 14,184 ft. Initial attempts to mill the fish and pump fluids past the fish were both unsuccessful.

A later second attempt to retrieve the fish, which involved 7 separate runs, was also unsuccessful. On 20 May 2010 it was decided to abandon these efforts, plug off the high pressured Austin Chalk, and continue up the vertical hole to assess the hydrocarbon shows encountered while drilling the secondary objective, the Saratoga Formation.

A second well to test the primary high pressured Austin Chalk target is nearing preparation and will spud in shortly.

### **Hercules Project, Texas USA (Empyrean Interest: 10%)**

Empyrean announced on 10 December 2010 that it had entered into a Participating Agreement with Krescent to drill the Hercules Prospect. The prospect is well-located in Tyler County onshore Texas and lies just north of the Thevenins Creek and Highbaugh gas fields.

The primary objective is the Upper Wilcox Formation, in particular the so-called "10,350 ft sand". This stratigraphic level shows a well defined amplitude versus offset (AVO) anomaly which conforms with the time structure, an often sure indication that a hydrocarbon accumulation exists. Pre-drill volumetric calculations gave mean recoverable reserves of 17.8 billion cubic feet and 356,000 barrels of oil.

Under the terms of the agreement Empyrean earns a 10% working interest by paying 13.33% of the drilling costs (turnkey) and completion.

## OPERATIONAL REVIEW CONTINUED

### Hercules Project, Texas USA (Empyrean Interest: 10%) Continued...

#### - BP America A-740#1

This well has been designed to test the Hercules Prospect. It spudded on 20 February 2010 and reached a total depth of 10,416 ft on 2 March 10.

Production casing was set and a short flow test of gas was conducted, confirming positive log analysis and the encouraging shows encountered while drilling. The well has since been shut in to enable connection to a sales line, after which the well will be flowed for an extended period to determine stabilized flow rates.

### Aquarius Project, Texas USA (Empyrean Interest: 10%)

This agreement with Krescent was announced by Empyrean on 5 December 2009. The conditions and objective are the same as those of the Hercules Project.

#### - McMillan WMRU A-415 #1

This second Wilcox well tested the Aquarius Prospect which, like Hercules, relied on the correct identification of an AVO anomaly and other geological requisites to ensure its structural integrity.

The well spudded on 6 March 2010 and reached a total depth of 9,416 ft on 14 March 2010. Electric log analysis confirmed the well site observations that the Wilcox sands in this well were unlikely to produce hydrocarbons and the well was consequently plugged and abandoned.



FJ Brophy BSc (Hons)  
Technical Director  
Empyrean Energy Plc  
27 May 2010

## **DIRECTORS' REPORT**

The Directors are pleased to present their report on the affairs of the Company, together with the audited financial statements for the period 1 April 2009 to 31 March 2010

### **Principal Activities and Business Review**

The principal activities of the Company are energy resource exploration and project development in geopolitically stable environments. The developments during the period are detailed in the Chairman's Statement and Operational Review.

### **Principal Risks and Uncertainties**

The Company's activities are carried out principally in North America and Europe. Risk assessment and evaluation is an essential part of the Company's planning and an important aspect of the Company's internal control system. The principal risks and uncertainties are considered to be the following:

#### Exploration, Development and Production Risks

Exploration and development activities may be delayed or adversely affected by factors outside the Company's control, in particular, climatic conditions, performance of joint venture partners or suppliers, availability, delays or failures in commissioning or installing plant and equipment, unknown geological conditions resulting in uneconomic or dry wells, remoteness of location, failure to achieve estimate capital costs, operating costs, reserves, recovery and production levels, actions of host governments or other regulatory authorities.

#### Commodity Risk

The demand for, and pricing of, oil and gas is dependent on global and local supply and demand, weather conditions, availability of alternative fuels, actions of governments or cartels and general economic and political developments.

#### Currency Risk

Although the reporting currency is Sterling (£GBP), the currency most commonly used in the pricing of petroleum commodities and for significant exploration and production costs is US dollar (\$USD), thus creating currency exposure.

#### General and Economic Risk

As a consequence of activities in different parts of the world the Company may be subject to political, economic and other uncertainties both locally and internationally, including but not limited to inflation, interest rates, market sentiments, equity and financing market conditions.

#### Financing Risk

Future investment is dependant on having sufficient funds to enable the exploration or development of projects, whether through debt or equity funding.

#### Market Risk

Securing sufficient and profitable sales contracts to support operations is a key business risk.

## DIRECTORS' REPORT CONTINUED

### Key Performance Indicators

The current business of the Company is fundamentally exploration, together with development and initial production with focus on the successful delivery of investment to enable the Company to progress to a larger operational business. The Company intends to provide detailed analysis and comparison of production, cash flows from operations, operating costs per barrel of oil equivalent and realised oil and gas prices per barrel in the 2010 Annual Report.

### Financial Review

The loss for the year on ordinary activities of the Company after taxation amounted to £4,266,000 (2009 £1,494,000).

The Company generated a turnover of £310,000 (2009 £724,000) from oil and gas sales derived from its Sugarloaf and Margarita prospects in Texas. This was offset by cost of sales of £800,000 (2009 £646,000) which includes amortisation of the oil and gas properties.

The Company incurred administrative expenses of £540,000 (2009 £754,000), which is exclusive of exploration expenditure impairment write off totalling £3,237,000 (2009 £168,000).

Net exploration costs for the year of £2,418,000 (2009 £5,531,000) have been capitalised.

Continued production success at the Sugarloaf prospects resulted in oil and gas properties of £594,000 (2009 £6,973,000) being re-classified from exploration expenditure.

### Dividends

The Directors do not propose the payment of a dividend.

### Directors and Directors' Interests

The Directors who served during the year to 31 March 2010 had, at that time, the following beneficial interests in the securities of the Company:

	31 March 2010		31 March 2009	
	Number of ordinary shares	Number of options over ordinary shares	Number of ordinary shares	Number of options over ordinary shares
Patrick Cross	540,000	400,000	340,000	600,000
Thomas Kelly	8,500,000	3,800,000	4,500,000	4,800,000
Frank Brophy	1,166,666	3,000,000	1,000,000	4,000,000
John Laycock (appointed 20/08/08)	200,000	-	-	200,000

Other than those items disclosed above, there have been no changes in Directors' interests since the year-end. For further details on options held by Directors, refer to Note 5 of the Financial Statements.

## DIRECTORS' REPORT CONTINUED

### Directors' Remuneration

The Company's policy on remuneration of directors is to attract, retain and motivate the best people, recognising they are key to the ongoing success of the business, but to avoid paying more than is necessary for that service

Details of the Directors' emoluments and of payments made for professional services rendered are set out in Note 5 to the Financial Statements

### Employment Policies

The Company is committed to promoting policies which ensure that high calibre employees are attracted, retained and motivated, to ensure the ongoing success of the business. Employees and those who seek to work within the Company are treated equally regardless of sex, marital status, creed, colour, race or ethnic origin

### Insurance

The Company maintains liability insurance for the Directors and officers of the Company

### Substantial shareholdings

On 18 May 2010 the following were registered as being interested in 3% or more of the Company's ordinary share capital, inclusive of Directors holdings above 3%

	18 May 2010	
	Ordinary shares of £0.002 each	% of issued share capital
TD Waterhouse Investor Services	23,477,239	19.21%
Barclays Stockbrokers Limited	17,490,223	14.31%
HSDL Nominees Limited	13,793,599	11.29%
LR Nominees Limited	10,758,021	8.80%
Thomas Kelly	8,500,000	6.95%
James Capel (Nominees) Limited	5,694,204	4.66%
Pershing Nominees Limited	5,594,167	4.58%

### Share Capital

Information relating to shares issued during the period is given in Note 14 to the Financial Statements

### Charitable and Political Donations

During the period there were no charitable or political donations

## **DIRECTORS' REPORT CONTINUED**

### **Treasury Policy**

The Company finances its operations through equity investment and holds its cash as a liquid resource to fund the Company's financial commitments. Decisions regarding the management of these assets are approved by the Board.

### **Payment of Suppliers**

The Company's policy is to settle terms of payment with suppliers when agreeing terms of business, to ensure that suppliers are aware of the terms of payment and to abide by them. It is usual for suppliers to be paid within 28 days of receipt of invoice.

### **Post Balance Sheet Events**

Material post balance sheet events are set out in Note 18 to the Financial Statements.

### **Going Concern**

The Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing its financial statements.

### **Auditors**

The Auditors, Chapman Davis LLP, have indicated their willingness to continue in office and a resolution that they be reappointed will be proposed at the Annual General Meeting.


### **Control Procedures**

The Board has approved financial budgets and cash forecasts. In addition, it has implemented procedures to ensure compliance with accounting standards and effective reporting.

### **Environment, Health and Safety**

The Company is committed to conducting its operations in a responsible manner that protects the health and safety of employees, contractors and the public and minimises the impact on the environment. To accomplish this the Company is committed to ensuring compliance with all applicable legislation and standards, ensure an effective management team is in place and that all personnel and contractors are aware of their health, safety and environmental responsibilities, creation of a safe and healthy working environment, identify, evaluate and control the risks and impact associated with all company activities, monitor, evaluate and report health, safety and environmental performance, seek to achieve continuous improvement in health, safety and environmental performance.

By order of the Board



**Thomas Kelly**  
Commercial Director  
27 May 2010  
Company number 05387837

## **CORPORATE GOVERNANCE REPORT**

The Directors are committed to maintaining high standards of corporate governance. The Directors have established procedures, so far as is practicable, given the Company's size, to comply with the Combined Code as modified by the recommendations of the Quoted Companies Alliance. The Company has adopted and operates a share dealing code for directors and senior employees on substantially the same terms as the Model Code appended to the Listing Rules of the UK Listing Authority.

### The Board

The Board meets regularly throughout the year. To enable the Board to perform its duties, each of the Directors has full access to all relevant information and to the services of the Company Secretary. If necessary the non-executive directors may take independent professional advice at the Company's expense. The Board currently includes two executive directors and two non-executive directors. The Board has delegated specific responsibilities to the committees described below.

### The Audit Committee

The Audit Committee comprises Patrick Cross and John Laycock, and is chaired by John Laycock. During the year the Audit Committee met twice. The committee reviews the Company's annual and interim financial statements before submission to the Board for approval. The committee also reviews regular reports from management and the external auditors on accounting and internal control matters. When appropriate, the committee monitors the progress of action taken in relation to such matters. The committee also recommends the appointment of, and reviews the fees of, the external auditors.

### The Remuneration Committee

The Remuneration Committee is made up of Patrick Cross and John Laycock, and is chaired by John Laycock. The Remuneration Committee met once during the period ended 31 March 2010. It is responsible for reviewing the performance of the Executive Directors and for setting the scale and structure of their remuneration, paying due regard to the interests of shareholders as a whole and the performance of the Company.

### Internal Control

The Board is responsible for the Company's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board has established a continuous process for identifying, evaluating and managing the Company's significant risks. This process involves the monitoring of all controls including financial, operational and compliance controls and risk management. It is based principally on reviewing reports from senior management and professional advisors to ensure any significant weaknesses are promptly remedied and to indicate a need for more extensive monitoring.

### Relationship with Shareholders

The Board attaches a high importance to maintaining good relationships with shareholders and seeks to keep the fully updated on the Company's performance, strategy and management. In addition the Board welcomes as many shareholders as possible to attend its general meeting and encourages open discussion after formal proceedings.

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law in the United Kingdom requires the Directors to prepare financial statements for each financial year which 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 those financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business,
- so far as each director is aware, there is no relevant audit information of which the Company's auditors are unaware, and the directors have taken all the steps that they ought to have taken as directors' in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

The Directors are responsible for keeping proper accounting records, for safeguarding the assets of the company and for taking reasonable steps for the prevention and detection of fraud and other irregularities. They are also responsible for ensuring that the annual report includes information required by the AIM Listing Rules and comply with the Companies Act 2006

The maintenance and integrity of the Company's website is the responsibility of the Directors. Work carried out by the auditors does not involve consideration of these matters and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions

In so far as each of the directors is aware

- there is no relevant audit information of which the Company's auditors are unaware, and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information



**Thomas Kelly**  
**Commercial Director**  
**27 May 2010**

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF EMPYREAN ENERGY PLC**

We have audited the financial statements of Empyrean Energy Plc for the year ended 31<sup>st</sup> March 2010 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Equity and the related notes 1 to 18. 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 sections 495 and 496 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 auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 17, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the 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**

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 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 financial statements

- give a true and fair view of the state of the company's affairs as at 31<sup>st</sup> March 2010 and of the loss 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

### **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion

- the information given in the Director's Report for the financial year for which the financial statements are prepared is consistent with the 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:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements 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.



*Rowan J Palmer (Senior statutory auditor)  
For and on behalf of Chapman Davis LLP, Statutory Auditor*

*Chartered Accountants  
Chapman Davis LLP  
2 Chapel Court  
London SE1 1HH*

27th May 2010

**STATEMENT OF COMPREHENSIVE INCOME  
for the year ended 31 March 2010**

	Notes	2010 £'000	2009 £'000
Revenue		310	724
<b>Cost of Sales</b>			
Operating costs (excludes oil and gas and exploration expenditure impairment)		(42)	(35)
Amortisation - oil and gas properties	9	(758)	(611)
Total cost of sales		(800)	(646)
<b>Gross Profit / (Loss)</b>		(490)	78
<b>Expenditure</b>			
General and administrative expenses		(540)	(754)
Share based payments (directors & employees)	4	-	(332)
Share based payments (consultants)		-	(72)
Exploration expenditure impairment	8	(3,237)	(168)
Oil and gas properties impairment	9	-	(300)
Total expenditure		(3,777)	(1,626)
<b>Operating Loss</b>	2	(4,267)	(1,548)
Interest received	3	1	54
<b>Loss on ordinary activities before taxation</b>		(4,266)	(1,494)
Taxation on loss on ordinary activities	6	-	-
<b>Loss for the financial year</b>		(4,266)	(1,494)
<b>Total comprehensive loss for the year</b>		(4,266)	(1,494)
<b>Attributable to</b>			
Equity shareholders of the Company		(4,266)	(1,494)
Loss per share (expressed in pence)			
- Basic	7	(3 65)p	(2 53)p

A separate Statement of Recognised Income and Expense is not required

All financial results presented are from continued operations

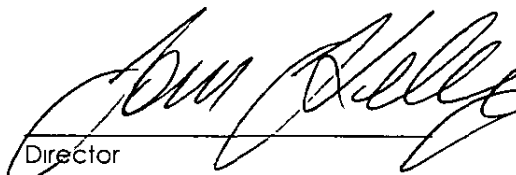
The accompanying accounting policies and notes form an integral part of these financial statements

**STATEMENT OF FINANCIAL POSITION**  
**as at 31 March 2010**

	Notes	2010 £'000	2009 £'000
<b>Assets</b>			
<b>Non-current assets</b>			
Intangible assets	8	6,217	7,630
Oil and gas properties	9	6,320	6,436
Plant and equipment	10	-	1
		<b>12,537</b>	<b>14,067</b>
<b>Current assets</b>			
Trade and other receivables	11	33	413
Cash and cash equivalents		254	291
		<b>287</b>	<b>704</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	12	(34)	(43)
		<b>(34)</b>	<b>(43)</b>
<b>Net current assets</b>		<b>253</b>	<b>661</b>
<b>Net assets</b>		<b>12,790</b>	<b>14,728</b>
<b>Shareholders' equity</b>			
Share capital	14	244	132
Share premium		19,862	17,621
Share based payments reserve		662	975
Retained loss		(7,978)	(4,000)
<b>Total equity</b>		<b>12,790</b>	<b>14,728</b>

The Financial Statements on pages 20 to 37 were approved by the Board of Directors on 27 May 2010 and were signed on its behalf by

Patrick H. Cross  
 Chairman

  
 Director

The accompanying accounting policies and notes form an integral part of these financial statements

**STATEMENT OF CASH FLOWS**  
**for the year ended 31 March 2010**

	Notes	2010 £'000	2009 £'000
<b>Net cash inflow / (outflow) from operating activities</b>	13	(203)	122
<b>Return on Investments</b>			
Interest received		1	54
Net cash inflow from returns on investments		1	54
<b>Capital expenditure</b>			
Purchase of tangible fixed assets		(44)	(1)
Purchase of intangible fixed assets		(2,119)	(6,072)
Net cash outflow for capital expenditure		(2,163)	(6,073)
<b>Financing</b>			
Issue of ordinary share capital		2,456	4,985
Expenses relating to share issues		(128)	(307)
Net cash inflow from financing		2,328	4,678
<b>Decrease in net cash</b>		(37)	(1,219)
Cash and cash equivalents at the start of the year		291	1,510
<b>Cash and cash equivalents at end of the year</b>		254	291

The accompanying notes and accounting policies form an integral part of these financial statements

**STATEMENT OF CHANGES IN EQUITY**  
**For the year ended 31 March 2010**

	Share capital account	Share premium reserve	Share based payment reserve	Retained loss	Total equity
	£'000	£'000	£'000	£'000	£'000
<b>Balance at 31 March 2008</b>	<b>101</b>	<b>12,816</b>	<b>770</b>	<b>(2,633)</b>	<b>11,054</b>
Share capital issued	30	5,040	-	-	5,070
Cost of shares issued	-	(306)	-	-	(306)
Share based payments	1	71	332	-	404
Share based payments reversal	-	-	(127)	127	-
Comprehensive loss for the year	-	-	-	(1,494)	(1,494)
<b>Balance at 31 March 2009</b>	<b>132</b>	<b>17,621</b>	<b>975</b>	<b>(4,000)</b>	<b>14,728</b>
Share capital issued	112	2,344	-	-	2,456
Cost of shares issued	-	(128)	-	-	(128)
Share based payments reversal	-	25	(313)	288	-
Comprehensive loss for the year	-	-	-	(4,266)	(4,266)
<b>Balance at 31 March 2010</b>	<b>244</b>	<b>19,862</b>	<b>662</b>	<b>(7,978)</b>	<b>12,790</b>

The accompanying accounting policies and notes form an integral part of these financial statements

## **STATEMENT OF ACCOUNTING POLICIES for the year ended 31 March 2010**

The financial statements of Empyrean Energy Plc for the year ended 31 March 2010 were authorised for issue by the Board on 27 May 2010 and the Statement of Financial Position signed on the Board's behalf by Mr Patrick Cross and Mr Thomas Kelly

The Company's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. The principal accounting policies are summarised below. They have all been applied consistently throughout the year.

The financial report is presented in Sterling and all values are shown in pounds (£)

### **Basis of accounting**

These financial statements have been prepared under the historical cost convention, modified for certain items carried at fair value, in accordance with International Financial Reporting Standards and International Financial Reporting Interpretations Committee ("IFRIC") and with the Companies Act 2006.

### **Going concern**

The financial statements have been prepared on a going concern basis.

### **Revenue Recognition**

Net revenues from crude oil and natural gas sales are recognised when the oil and gas has been lifted and payment received from a third-party purchaser. The Company uses the entitlement method to account for its revenue from sales of condensate and gas production, which is presented in the accounts as net of production expenditure incurred prior to the product receipt by a third-party purchaser.

### **Finance Revenue**

Finance Revenue is recognised as interest accrues.

### **Cash and cash equivalents**

Cash and short-term deposits in the Statement of Financial Position comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purposes of the Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

### **Trade and other receivables**

Trade receivables, which generally have 30 day terms, are recognised and carried at original invoice amount less any allowance for any uncollectible amounts.

### **Deferred tax**

Current tax assets and liabilities for the current and prior periods are measured as the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted by the end of financial year date.

**STATEMENT OF ACCOUNTING POLICIES CONTINUED**  
**for the year ended 31 March 2010**

**Deferred tax continued...**

No deferred tax asset has been recognised because there is insufficient evidence of the timing of suitable future profits against which they can be recovered

**Foreign currencies**

Transactions denominated in foreign currencies are translated into sterling at contracted rates or, where no contract exists, at average monthly rates. Monetary assets and liabilities denominated in foreign currencies which are held at the year-end are translated into sterling at year-end exchange rates. Exchange differences on monetary items are taken to the Statement of Comprehensive Income.

**Trade and other payables**

Trade payables and other payables are carried at amortised cost and represent liabilities for goods and services provided to the company prior to the end of the financial year that are unpaid and arise when the company becomes obliged to make future payments in respect of the purchase of these goods and services.

**Tangible fixed assets**

Tangible fixed assets are included in the Statement of Financial Position at cost, less accumulated depreciation and any provision for impairment. Tangible fixed assets are depreciated on a straight line basis at rates sufficient to write off the cost, less estimated residual values, of individual assets over their estimated useful lives.

Office systems, equipment and furniture 2.5 - 6 years

**Intangible Fixed Assets**

**- exploration and development expenditure**

Exploration, evaluation and development expenditure incurred is accumulated in respect of each identifiable area of interest. Restoration, rehabilitation and environmental costs necessitated by exploration and evaluation activities are expensed as incurred and treated as exploration and evaluation expenditure.

These costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves. Accumulated costs in relation to an abandoned area are written off in full against the profit in the year in which the decision to abandon the area is made.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward the exploration and development costs in relation to that area of interest.

**STATEMENT OF ACCOUNTING POLICIES CONTINUED**  
**for the year ended 31 March 2010**

**Intangible Fixed Assets Continued...**

**- oil and gas properties**

Investments in unevaluated properties and development projects are not reclassified from exploration and development expenditure to oil and gas properties, until commercial production associated with the projects can be determined or until impairment occurs. The capitalised costs of intangible oil and gas assets are subject to amortisation when they are determined to have commercial production, at which point the capitalised costs plus the estimated future costs to develop the underlying commercial reserves are amortised using the unit-of-production method using total estimated reserves.

**Judgements and estimates**

The Group makes judgements and assumptions concerning the future that impact the application of policies and reported amounts. The resulting accounting estimates calculated using these judgements and assumptions will, by definition, seldom equal the related actual results but are based on historical experience and expectations of future events. The judgements and key sources of estimation uncertainty that have a significant effect on the amounts recognised in the financial statements are discussed below.

**- impairment of assets**

Financial and non-financial assets are subject to impairment reviews based on whether current or future events and circumstances suggest that their recoverable amount may be less than their carrying value. Recoverable amount is based on a calculation of expected future cash flows which includes management assumptions and estimates of future performance.

**- share-based payments**

Certain Directors of the Company receive remuneration in the form of equity-settled share-based payment transactions, whereby services are rendered in exchange for rights over shares ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using the Black-Scholes pricing model.

The cost of equity-settled transactions with parties other than employees is measured at the fair value of the services received at the date of receipt, with a corresponding increase in equity.

**Financial instruments**

The Company's financial assets consist of current account or short-term deposits at variable interest rates, loans and other receivables. Any interest earned is accrued and classified as interest. Trade and other receivables are stated at cost. The Company's financial liabilities consist of trade and other payables. All are non-derivative assets. The trade and other payables are stated at cost.

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 March 2010**

**1. Turnover and Segmental Analysis**

The primary segmental reporting format is determined to be the geographical segment according to the location of the asset. The Directors consider the Company to have a single business being the exploration for, development and production of oil and gas properties.

There are three geographical segments being Continental Europe and North America which are involved in the exploration for, development and production of oil and gas properties, and the United Kingdom which is where the registered office is located.

	UK (£'000)	Continental Europe (£'000)	North America (£'000)	Total (£'000)
<b>2010</b>				
Oil and gas revenue	-	-	310	310
Cost of sales	-	-	(800)	(800)
<b>Gross Profit</b>	-	-	<b>(490)</b>	<b>(490)</b>
<b>Interest Received</b>	<b>1</b>	-	-	<b>1</b>
General and administrative	(540)	-	-	(540)
Exploration expenditure impairment	-	(2,794)	(443)	(3,237)
<b>Operating Expenses</b>	<b>(540)</b>	<b>(2,794)</b>	<b>(443)</b>	<b>(3,777)</b>
<b>Loss on Ordinary Activities (before tax)</b>	<b>(539)</b>	<b>(2,794)</b>	<b>(933)</b>	<b>(4,266)</b>
Exploration expenditure	-	-	6,320	6,320
Oil and gas properties	-	-	6,217	6,217
	-	-	<b>12,537</b>	<b>12,537</b>

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
for the year ended 31 March 2010

**1 Turnover and Segmental Analysis Continued.**

	UK (£'000)	Continental Europe (£'000)	North America (£'000)	Total (£'000)
<b>2009</b>				
Oil and gas revenue	-	-	724	724
Cost of sales	-	-	(646)	(646)
<b>Gross Profit</b>	-	-	<b>78</b>	<b>78</b>
<b>Interest Received</b>	<b>54</b>	-	-	<b>54</b>
General and administrative	(754)	-	-	(754)
Share based payments	(404)	-	-	(404)
Exploration expenditure impairment	-	-	(168)	(168)
Oil and gas properties impairment	-	-	(300)	(300)
<b>Operating Expenses</b>	<b>(1,158)</b>	-	<b>(468)</b>	<b>(1,626)</b>
<b>Loss on Ordinary Activities (before tax)</b>	<b>(1,104)</b>	-	<b>(390)</b>	<b>(1,494)</b>
Exploration expenditure	-	2,793	4,837	7,630
Oil and gas properties	-	-	6,436	6,436
	-	<b>2,793</b>	<b>11,273</b>	<b>14,066</b>

**2. Operating Loss**

The operating loss is stated after charging

	2010 £'000	2009 £'000
Auditors' remuneration – audit services	15	13
– other services	6	6
Depreciation (Note 10)	-	1
Amortisation Exploration Expenditure (Note 9)	758	611
Exploration Expenditure Impairment (Note 8)	3,777	168
Oil and Gas Properties Impairment (Note 9)	-	300
Directors' emoluments (Note 5)	244	255
Directors' share based payments (Note 5)	-	297

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**3 Interest Receivable**

	2010 £'000	2009 £'000
Bank interest received	1	54

**4 Staff Costs (including Directors)**

The Company had no employees during the year, other than Directors

	2010 £'000	2009 £'000
Equity settled share based payments (directors & employees)	-	332

The Company's equity-settled share based payments comprise incentive options granted to the Company's Directors

No options were issued to Directors or Employees during the year ended 31 March 2010

In addition 2,200,000 options exercisable at 50 pence expired on 20 October 2009, resulting in a write back of £287,568 to equity

**5 Directors' Emoluments**

	Fees and Salary Paid		Other Payments		Options Issued	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000	2010 £'000	2009 £'000
<b>Non-Executive Directors.</b>						
Patrick Cross	38	35	-	-	-	26
John Laycock (Appointed 20/08/08)	6	20	-	-	-	3
<b>Executive Directors:</b>						
Frank Brophy <sup>(1)</sup>	100	100	-	-	-	129
Thomas Kelly <sup>(2)</sup>	100	100	51	-	-	139
<b>Total</b>	<b>244</b>	<b>255</b>	<b>51</b>	<b>-</b>	<b>-</b>	<b>297</b>

<sup>(1)</sup> Services provided by F J Brophy Pty Ltd

<sup>(2)</sup> Services provided by Apnea Holdings Pty Ltd

No pension benefits are provided for any Director

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**5 Directors' Emoluments Continued...**

**Directors' Share Options**

The terms of the share option interests of Directors in office during the year ended 31 March 2010 were as follows

	Grant Date	Options held 31 Mar 09	Options exercised during year	Options expired during year	Options held 31 Mar 10	Exercise Price (£)	Expiry
Patrick Cross	28/06/07	200,000			200,000	£0 50	28/06/10
	27/02/08	100,000			100,000	£0 25	27/02/11
	26/06/08	100,000			100,000	£0 25	27/02/11
	31/03/09	200,000	(200,000)		-	£0 04	31/03/12
Thomas Kelly	20/10/06	1,000,000		(1,000,000)	-	£0 50	20/10/09
	28/06/07	1,000,000			1,000,000	£0 50	28/06/10
	27/02/08	500,000			500,000	£0 25	27/02/11
	26/06/08	500,000			500,000	£0 25	27/02/11
	31/03/09	1,800,000			1,800,000	£0 04	31/03/12
Frank Brophy	20/10/06	1,000,000		(1,000,000)	-	£0 50	20/10/09
	28/06/07	1,000,000			1,000,000	£0 50	28/06/10
	27/02/08	500,000			500,000	£0 25	27/02/11
	26/06/08	500,000			500,000	£0 25	27/02/11
	31/03/09	1,000,000			1,000,000	£0 04	31/03/12
John Laycock	31/03/09	200,000	(200,000)		-	£0 04	31/03/12
		9,600,000	(400,000)	(2,000,000)	7,200,000		

**6 Taxation**

	2010 £'000	2009 £'000
<b>Current year taxation</b>		
UK corporation tax at 28% (2009 28%) on profits for year	-	-
<b>Factors affecting the tax charge for the year</b>		
Loss on ordinary activities before tax	(4,266)	(1,494)
Loss on ordinary activities at the UK standard rate of 28%	(1,994)	(418)
Effect of tax benefit of loss carried forward	1,994	418
Current year taxation	-	-

No deferred tax asset has been recognised because there is insufficient evidence of the timing of suitable future profits against which they can be recovered

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**6 Taxation Continued .**

Tax losses of approximately £6,056,000 (2009 £2,548,000) are available to be claimed going forward, which are inclusive of the exploration expenditure and oil & gas properties impairment total write off of £3,237,000 (2009 £1,298,000)

**7. Loss Per Share**

The basic loss per share is derived by dividing the loss for the year attributable to ordinary shareholders by the weighted average number of shares in issue

	<b>2010</b>	<b>2009</b>
Loss for the year	£4,266,000	£1,494,000
Weighted average number of Ordinary shares of £0.002 in issue	116,865,556	58,847,344
Loss per share – basic (pence)	3.65	2.53
Weighted average number of Ordinary shares of £0.002 in issue inclusive of outstanding options	125,065,556	65,650,213

As the inclusion of the potential ordinary shares would result in a decrease in the loss per share they are considered to be anti-dilutive and, as such, a diluted loss per share is not included

**8 Intangible Assets**

**Exploration expenditure**

	<b>2010</b>	<b>2009</b>
	<b>£'000</b>	<b>£'000</b>
<b>Cost</b>		
Balance brought forward	7,630	9,240
Additions	2,418	5,531
At 31 March	<u>10,048</u>	<u>14,771</u>
Reclassified - Oil and Gas Properties	(594)	(6,973)
Exploration Expenditure Impairment <sup>(1)</sup>	<u>(3,237)</u>	<u>(168)</u>
	(3,831)	(7,141)
<b>Net Book Value</b>		
At 31 March	<u><b>6,217</b></u>	<u><b>7,630</b></u>

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**8 Intangible Assets Continued**

(1) During the period ended 31 March 2010, exploration expenditure of £3,237,000 (2009 £168,000) was written off due to impairment. The impairment primarily relates to the Glantal well, Germany which resulted in £2,794,000 of exploration impairment after the decision was made not to apply for an extension of the permit over this prospect. In addition £356,000 and £87,000 was written down for the Sugarloaf Prospects TCEI JV A-2 well and the Krescent Joint Venture Aquarus well respectively, as both wells were plugged and abandoned during the period.

**Exploration expenditure by project area (£'000)**

Project Group / Area of Interest	Cost at 31 March 09	Additions	Written Off	Reclassified as Oil & Gas Property	Net Book Value at 31 March 10
<b>Germany</b>					
Glantal	2,793	1	(2,794)	-	-
<b>USA</b>					
Eagle Oil	2,739	28	-	-	2,767
Sugarloaf Hosston	2,098	470	(356)	(594)	1,618
Krescent	-	1,919	(87)	-	1,832
<b>Total</b>	<b>7,630</b>	<b>2,418</b>	<b>(3,237)</b>	<b>(594)</b>	<b>6,217</b>

**Summary of Exploration Wells at 31 March 2010**

Project Group / Area of Interest	Name of Exploration Wells
Eagle Oil	Eagle North-1 well
Sugarloaf Hosston	Sugarloaf #1 well
	Weston #1 well (1)
Krescent – Riverbend Project	Quinn 3-H well
Krescent – Hercules Project	BP America A-740#1 well

(1) As announced on 24 February 2010, the Weston well commenced flowing gas and condensate to sales. Under the Company's policy, this exploration well will be reclassified as an oil and gas property once revenue is received by the Company.

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**9 Oil and Gas Properties**

	<b>2010</b> <b>£'000</b>	<b>2009</b> <b>£'000</b>
<b>Net Book Value</b>		
Balance brought forward	6,436	374
Reclassification of exploration costs (Note 8)	594	6,973
Additions	48	-
Oil and Gas Properties Impairment	-	(300)
Amortisation	(758)	(611)
At 31 March	<b>6,320</b>	<b>6,436</b>

**Summary of Oil and Gas Properties at 31 March 2010**

Project Group / Area of Interest	Name of Production Wells
Sugarloaf Hosston	TCEI JV Block A-1 well
	TCEI JV Block A-3 well
	TCEI JV Block A-4 well
	TCEI JV Block A-5 well
	Kennedy#1 well
	Kowalik#1H well

**10 Plant and Equipment**

**Office Equipment**

	<b>2010</b> <b>£'000</b>	<b>2009</b> <b>£'000</b>
<b>Cost</b>		
Balance brought forward	1	12
Additions	-	1
Disposal	(1)	(11)
At 31 March	<b>-</b>	<b>2</b>
<b>Depreciation</b>		
Balance brought forward	1	11
Charge for the year	-	1
Disposals	(1)	(11)
At 31 March	<b>-</b>	<b>1</b>
<b>Net Book Value</b>		
At 31 March	<b>-</b>	<b>1</b>

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**11 Trade and Other Receivables**

	<b>2010</b> <b>£'000</b>	<b>2009</b> <b>£'000</b>
Trade and other receivable	-	6
Prepayments	22	402
VAT receivables	11	5
	<hr/>	<hr/>
Total Receivables	<b>33</b>	<b>413</b>

**12 Trade and Other Payables**

	<b>2010</b> <b>£'000</b>	<b>2009</b> <b>£'000</b>
Trade and other payables	13	28
Accruals	21	15
	<hr/>	<hr/>
Total Payables	<b>34</b>	<b>43</b>

**13 Reconciliation of Operating Loss to Operating Cash Flows**

	<b>2010</b> <b>£'000</b>	<b>2009</b> <b>£'000</b>
Operating loss	(4,267)	(1,494)
Increase in receivables	-	(40)
Decrease / (increase) in prepayments	78	(8)
Increase / (decrease) in accrued liabilities	6	(24)
Share based payments – directors & employees	-	332
Share based payments – consultants	-	72
Depreciation	-	1
Oil and gas properties amortisation	758	611
Exploration expenditure impairment	3,237	168
Oil and gas properties impairment	-	300
Increase / (decrease) in accounts payable	(15)	14
	<hr/>	<hr/>
Net cash outflow from operating activities	<b>203</b>	<b>122</b>

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**14 Called Up Share Capital**

The authorised share capital of the Company and the called up and fully paid amounts at 31 March 2010 were as follows -

	2010	2009
<b>Authorised</b>		
1,000,000,000 ordinary shares of 0.2p each	2,000,000	2,000,000
<b>Issued and fully paid</b>		
122,224,460 (2009 66,157,792) ordinary shares of 0.2p each	244,449	132,316

On 2 April 2009, 30,000,001 fully paid ordinary shares of 0.2p each were placed for cash at a price of £0.03 per share

On 4 June 2009, 13,600,000 fully paid ordinary shares of 0.2p each were placed for cash at a price of £0.06 per share

On 18 June 2009, a further 12,066,667 fully paid ordinary shares of 0.2p each were placed for cash at a price of £0.06 per share

On 10 July 2009, 100,000 fully paid ordinary shares of 0.2p each were issued pursuant to an exercise of options by a director, at an exercise price of £0.04 per share

On 15 March 2010, 300,000 fully paid ordinary shares of 0.2p each were issued pursuant to an exercise of options by two directors, at an exercise price of £0.04 per share

**Share Options**

The following equity instruments have been issued by the Company and have not been exercised at 31 March 2010

	Number options	Exercise Price	Vesting Date	Expiry Date	Value per option (pence)
Incentive options	2,450,000	50 pence	28/06/07	28/06/10	11.16
Incentive options	1,225,000	25 pence	26/06/08	27/02/11	5.07
Incentive options	1,225,000	25 pence	27/02/08	27/02/11	23.21
Incentive options	3,700,000	4 pence	31/03/09	31/03/12	1.30
<b>TOTAL</b>	<b>8,600,000</b>				

No options were issued during the year ended 31 March 2010

**15 Commitments**

As at 31 March 2010, the Company had no material capital commitments

## **NOTES TO THE FINANCIAL STATEMENTS CONTINUED**

### **for the year ended 31 March 2010**

#### **16 Related Party Transactions**

On 31 March 2010 the Company entered into a loan facility agreement for £250,000 with Apnea Holdings Pty Ltd, a company associated with Director Thomas Kelly

The unsecured Loan facility is available for 6 months from 31 March 2010 and can be drawn down by the Company as required and will be due for repayment by 31 December 2010. Interest is payable on drawn down funds at a rate of 9% per annum, accruing daily and payable on the repayment date.

In the event of an equity capital raising between 31 March 2010 and 31 December 2010, the loan facility, in proportion to the amount drawn down and not repaid together with any accrued interest, becomes either repayable or convertible at the lender's discretion at any time prior to the repayment date. The loan would be convertible at the placing price of the fundraising.

Should no capital raising take place before 31 December 2010, the loan facility will automatically convert to shares in the Company at a conversion rate of 15% discount to the preceding four week average share price of the issued shares.

At the date of this report, no drawdown's had been made against the facility.

Other than those disclosed above and in Note 5 there were no other related party transactions during the year.

#### **17 Financial instruments**

The Board of Directors determine, as required, the degree to which it is appropriate to use financial instruments to mitigate risk. Current the Company's principal financial instruments comprise cash. Together with the issue of equity share capital, the main purpose of these is to finance the Company's operations. The Company has other financial instruments such as short-term receivables and payables which arise directly from normal trading.

The Company has not entered into any derivative or other hedging instruments.

The main risk affecting the groups financial instruments are interest rate risk, foreign currency risk and liquidity risk, which are discussed below.

Throughout the period ending 31 March 2010 no trading in financial instruments was undertaken.

There is no material difference between the book value and fair value of the Company cash balances, short-term receivables and payables.

##### **Interest rate risk**

The Company finances its operations through the use of cash deposits at variable rates of interest for a variety of short-term periods, depending on cash requirements. These rates are reviewed regularly and the best rate obtained in the context of the Company's needs.

Short-term receivables and payables are not exposed to interest rate risk.

**NOTES TO THE FINANCIAL STATEMENTS CONTINUED**  
**for the year ended 31 March 2010**

**17 Financial instruments Continued .**

**Currency risk**

The Company has potential currency exposures in respect of items denominated in foreign currencies comprising transactional exposure in respect of operating costs and capital expenditure incurred in currencies other than the functional currency of operations

At times the Company may hold cash deposits in foreign currency to meet needs of commitments required for international operations

**Liquidity risk**

The Company's policy throughout the year has been to ensure that it has adequate liquidity by careful management of its working capital. Amount held at bank amounted to £ 254,000 (2009: £291,000)

**Capital**

In managing its capital, the Company's primary objective is to maintain a sufficient funding base to enable the Company to meet its working capital and strategic investment needs. In making decisions to adjust its capital structure to achieve these aims, through new share issues, the Company considers not only its short-term position but also its long-term operational and strategic objectives

**18 Post Balance Sheet Date Events**

On 16 April 2010 and on 23 April 2010, the Company allotted 17,250,000 and 7,750,000 ordinary shares respectively pursuant to a placement which raised £1,500,000 as announced on 9 April 2010. The proceeds from the placing will contribute towards further development at the Riverbend, Hercules and Sugarloaf project in Texas, USA and the Eagle Oil project in California and for general working capital.

On 21 April 2010, the Company allotted 35,000,000 ordinary shares pursuant to a placement which raised £2,100,000 as announced on 14 April 2010. The proceeds from the placing will contribute towards further development at the Riverbend, Hercules and Sugarloaf project in Texas, USA and the Eagle Oil project in California and for general working capital.