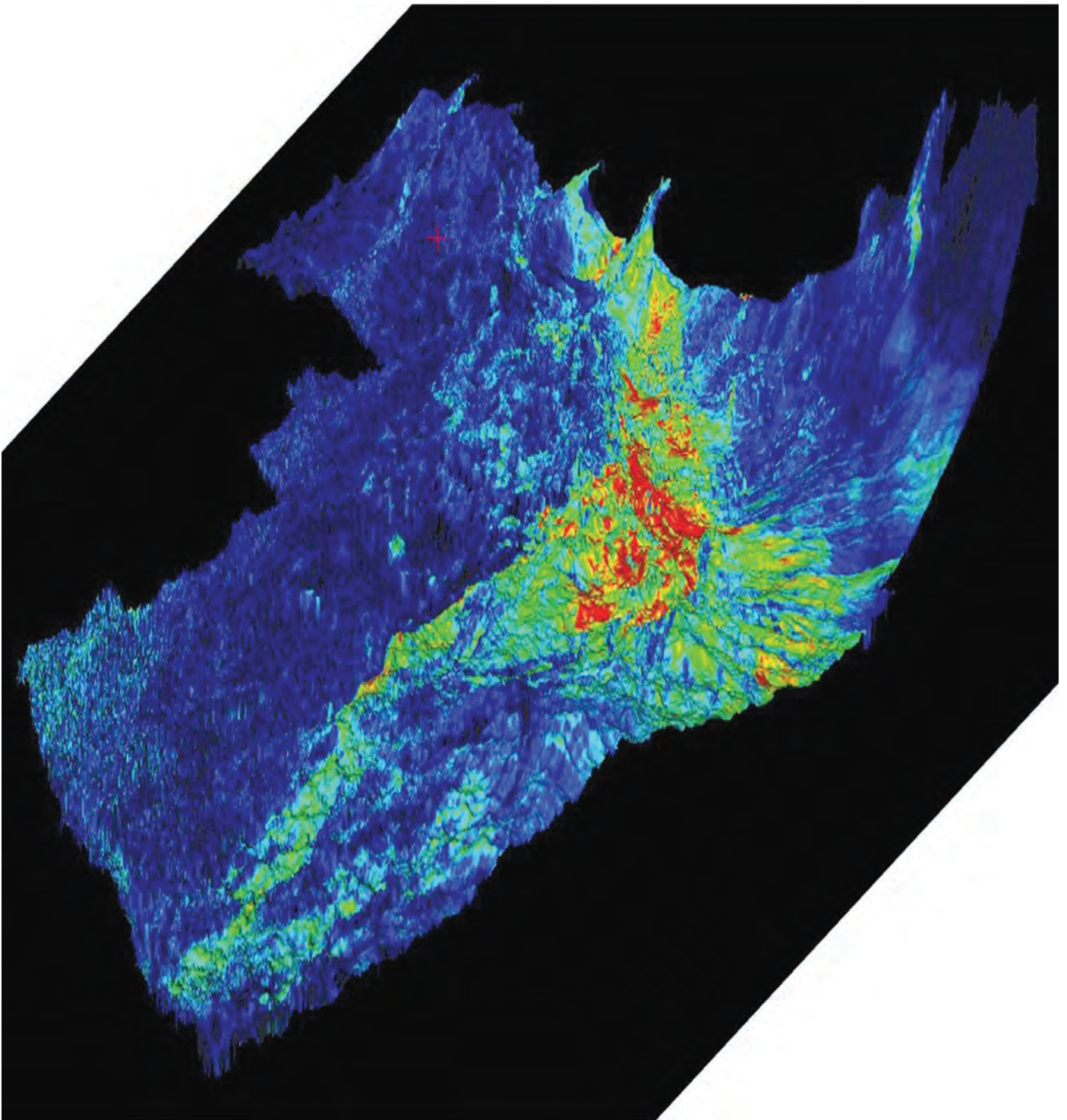


**REPORT AND FINANCIAL STATEMENTS 2011**



Sterling Energy Plc (“Sterling” or the “Company”) is an upstream oil and gas Company listed on AIM in London. Sterling is an experienced operator of international licences with a current focus on projects in Africa and the Middle East. Sterling has high potential projects in Cameroon, Madagascar and Kurdistan.

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## 2011 SUMMARY

- Completed farm-out of Ntem block, offshore Cameroon, to subsidiary of Murphy Oil Corporation; Sterling retains 50% interest and is carried for its share of all exploration expenditure during the current exploration period under the Ntem contract.
- Sangaw North-1 exploration well failed to find commercial hydrocarbons; secondary objectives within Sangaw North block are being evaluated.
- Received \$11.2 million of net cash flow from Chinguetti field operations during 2011 (2010: \$15.6 million).
- Cash resources as at 31 December 2011 \$115.8 million (2010: \$111.7 million).
- Company remains debt free.
- Strengthened technical team in support of New Ventures focus.

# CHAIRMAN'S STATEMENT

We believe Sterling's exploration portfolio contains a number of very prospective assets, a view supported by Murphy Oil Corporation when they chose, through a wholly-owned subsidiary, to farm-in to our Ntem licence in Cameroon. In exchange for a 50% interest they will fund all of the costs for Sterling's retained 50% interest during the remainder of the current exploration period of the licence. Murphy has a broad experience of drilling wells in deep water and they have become operator for the Ntem block. We look forward to when the boundary dispute between Cameroon and Equatorial Guinea is resolved and we can re-commence our exploration of the Ntem block.

The biggest disappointment for 2011 was the failure to discover commercial hydrocarbons in the Sangaw North-1 exploration well. However, our sub-surface specialists believe, based on all the available data, that there is potential for secondary objectives on the flanks of the main Sangaw structure. We plan to acquire 2D seismic this year to evaluate this potential.

In Madagascar progress on the Ampasindava and Ambilobe blocks remain stalled following the change of Government in March 2009. A 'roadmap' has been agreed between the current Government and their African neighbours for the holding of democratic elections during 2012, after which Sterling and ExxonMobil, our partner in Ampasindava block, will resume exploration activities.

Notwithstanding the merits of our existing projects, we recognise the need to broaden the portfolio, and we have the human and financial resources to achieve this. Our focus remains exploration. Our preferred method of entry is to secure a material working interest which, following a work programme to de-risk and/or value-add, we can farm down prior to major capital exposure. We have refreshed our new venture team with a new Exploration Director and several new sub-surface specialists who will complement the skills of our existing team. I look forward to reporting on our progress towards securing opportunities during 2012.

## **FINANCIAL**

The Company remains in a very strong financial position with cash resources of \$115.8 million at the end of 2011. Our approved work programme for 2012 is fully funded and we now have substantial funds available for new venture activity. During 2011, we held these very material funds to cover two possible eventualities: if the outcome of the Sangaw North-1 well had been more positive we would have funded our 53.33% working interest of an accelerated programme of seismic and an appraisal well, and prior to farming out 50% of the Ntem block to Murphy Cameroon Ntem Oil Co. Ltd we wished to be ready, if circumstances permitted force majeure to be lifted, to progress the drilling of an exploration well as required under the Ntem Contract. Sterling is now able to commit a much larger proportion of the cash reserves towards acquiring and progressing new ventures.

We remain pleased that the revenue from Chinguetti field operations in Mauritania provided positive cash flow during 2011 in excess of Sterling's administrative costs.

## **BOARD AND MANAGEMENT CHANGES**

During 2011, Dr. Jonathan Cooper, Sterling's Finance Director, and Mr. Andrew Grosse, Sterling's Exploration Director, resigned. I thank them both for their valuable contributions over the years and wish them well in their new endeavours.

Dr. Philip Frank was appointed Sterling's new Exploration Director on 3 October 2011. Philip has spent some 34 years in the E&P industry and already, in the few months he has been with Sterling, his experience as a successful explorer has greatly enhanced Sterling's new venture activity.

## **NOMINATED ADVISER AND BROKER**

On 16 December 2011, Sterling appointed Liberum Capital Limited as the Company's nominated adviser and broker. Liberum provides a wide range of services for its clients, including corporate finance advice, stock broker and research.

## **OUTLOOK FOR 2012 AND BEYOND**

Whilst we have no influence over the resolution of the border dispute between Cameroon and Equatorial Guinea, we are ready to commence the drilling programme to evaluate the large prospects, identified from 3D seismic, when force majeure can be lifted. We believe the Ntem block contains significant potential value waiting to be tested with the drill bit.

During 2012 one of our key objectives is to add to our portfolio of assets. Additions will be sought to broaden our exposure to opportunities in Africa and the Middle East. However, outstanding opportunities outside of these core areas will also be considered.

I would like to thank all Sterling's Directors and staff for their resilience during a disappointing 2011 and look forward to reporting progress with our existing projects and delivering new opportunities during 2012.

**Alastair Beardsall**

*Chairman*

19 March 2012

## CHIEF EXECUTIVE'S REVIEW

Sterling is an oil and gas company focused on exploration in Africa and the Middle East. The Company's strategy continues to be to add shareholder value through participation in the exploration drilling of large exploration prospects whilst retaining a material working interest. The Company's existing portfolio consists principally of large working interests in high materiality exploration licences acquired early in the exploration of an area. The Company has then advanced understanding of the exploration play through the acquisition of data and the application of technical studies, and reduced the exploration risk to a level that is commercially viable for the drilling of exploration wells. When appropriate the Company has introduced partners, generally through a farm-down process, to pay some, or all, of Sterling's share of the costs of exploration drilling operations.

The Company's exploration portfolio consists of highly prospective interests in three areas, Cameroon, Madagascar and Kurdistan. With this concentrated portfolio, the drilling of exploration wells is infrequent and the outcome of success or failure in any one well will greatly affect the longer term value of the Company (the average historical industry success rates for exploration wells worldwide is approximately one success for every five wells drilled). Success in any one exploration well has the potential for very large returns for shareholders and, by farming-down a proportion of our working interest in exchange for a third party to cover our share of the costs, the down side of our financial exposure is limited and success in any one exploration well has the potential for very large returns for shareholders.

During 2011, the Company made mixed progress in advancing exploration in two of its current areas, Kurdistan and Cameroon.

In Kurdistan, Sterling completed the drilling and testing of the Sangaw North-1 well. Following the farm-down of a 26.67% working interest to Addax, Sterling retained a large potential upside on success, for a cost to the Company of approximately \$11 million, being its working interest share of testing operations as all drilling costs were carried by Addax under the farm-out agreement. Unfortunately, testing operations demonstrated only small quantities of gas accompanied by water, making the main structure on the block non-commercial. Sterling has combined the well result with existing seismic data and exploration results in the area surrounding the block to develop a secondary play along the flanks of the main structure. The joint venture partnership plans to acquire additional 2D seismic in 2012 to confirm this play and, if this data is encouraging, may elect to drill an exploration well in 2013.

In Cameroon, Sterling has introduced Murphy Cameroon Ntem Oil Co. Ltd a wholly owned subsidiary of Murphy Oil Corporation, a successful deep-water operator, as a 50 per cent working interest partner and operator in the Company's deep water Ntem licence. Murphy paid to Sterling a contribution towards past costs and is committed to fully fund joint operations in relation to the current phase of exploration which includes the drilling of one exploration well. The block remains in force majeure due to a disagreement between the neighbouring Governments of Cameroon and Equatorial Guinea on their maritime border. When force majeure is lifted, fifteen months remain of the current phase of exploration in which to drill the planned exploration well.

Reprocessing of the existing 3D seismic that covers more than 66% of the Ntem licence, and subsequent interpretation, was also completed in 2011 and increased the Company's confidence in the four prospects within the licence. In the Company's best estimate each prospect has gross un-risked prospective resources of several hundred million barrels of recoverable oil.

In Madagascar, the Company has a material interest in the giant Sifaka prospect in the deep water Ampasindava licence in Madagascar. This prospect has been assessed by RISC, an independent sub-surface engineering consultancy, as having 1.2 billion barrels of gross un-risked prospective resource of recoverable oil.

However, progress towards drilling the Sifaka prospect was halted in 2009 when there was a change of Government in Madagascar by non-democratic means. In 2011, the incumbent Government and their African neighbours signed a 'roadmap' for the holding of democratic elections during 2012, after which Sterling and ExxonMobil, our partner in Ampasindava block, expect to resume exploration activities.

The Company also has an economic interest, approximately equivalent to 8 per cent, in production from the Chinguetti field in Mauritania and a minor royalty interest in the surrounding exploration acreage. Chinguetti is mature with no further development planned in the field. Gross oil production during 2011 averaged approximately 7,250 barrels per day. The rate of production decline has been reduced over the last 2 years, due to reservoir management and production optimisation activities. As a result of this improved production performance and outlook compared to previous predictions, the Company has in 2011 partially reversed a prior impairment of the asset by \$8.3 million and increased the net proved and probable reserves by 0.472 million barrels. Cash flow from our interests in Chinguetti currently covers the Company's administrative overhead costs and makes a contribution to the cost of operations. Whilst the cash flow from this project is significant, this asset is not material in comparison to the future potential of our other projects.

Sterling's exploration portfolio consists of highly prospective and material exploration projects in three emerging exploration areas. However, the largest scale projects, in Cameroon and Madagascar, are currently stalled operationally due to external factors not controlled by Sterling. Consequently, the planned exploration programme in existing assets during 2012 is relatively modest, consisting of the acquisition of 2D seismic data in the Sangaw North licence in Kurdistan and aeromagnetic data in the Ambilobe licence in Madagascar. Notwithstanding this situation, Sterling is ready to accelerate activities in both of these areas should the opportunity arise.

While the Company is confident these external factors will be resolved in due course, Sterling is, in the meantime, in a position to use its additional asset, a strong balance sheet with cash resources of \$115.8 million at 31 December 2011, to build on the existing portfolio in a manner consistent with the Company's strategy.

A material portion of the balance sheet cash has been held over the last two years for the eventualities of appraisal operations in Kurdistan and exploration drilling in Cameroon. Following the successful farm-out in Cameroon and unsuccessful exploration well in Kurdistan, this portion is now available for new ventures.

Sterling's technical and commercial team was re-structured during 2011 and continues to be strengthened. The Company is ready to progress our existing exploration projects as fast as allowed by external factors, and to identify and secure complementary exploration opportunities in 2012. The building of the exploration portfolio is a major focus of the Company during 2012 and we look forward to reporting to our shareholders on the progress we shall make in this regard.

**Angus MacAskill**  
*Chief Executive Officer*

19 March 2012



# OPERATIONS REVIEW

## CAMEROON

### **Ntem (WI 50%)**

The Ntem concession area is a deep water block situated in the southern Douala/Rio Muni Basin and lies adjacent to the northern maritime border of the Rio Muni province of Equatorial Guinea. Water depths range from 400m to 2,000m across the block. During the first term of the concession over 2,100km of 2D and 1,500km<sup>2</sup> of 3D seismic data were acquired. Additional seismic and gravity data were purchased.

This large block is undrilled and is well placed with respect to both Tertiary and Upper Cretaceous plays, which have both proved successful in West Africa. To the north of the block, Tertiary oil, gas and condensate discoveries made by Noble Energy commenced production in 2011, and further nearby discoveries are being appraised by Euroil (Bowleven).

During 2011, Sterling re-processed the 3D seismic data and interpretation of the improved data increased Sterling's confidence in the material exploration prospects previously identified in the block. The Company considers that four of these prospects are ready to drill and estimates that each has gross un-risked prospective recoverable resources of several hundred million barrels.

In November 2011 Sterling completed a farm-out agreement with Murphy Cameroon Ntem Oil Co. Ltd (Murphy), a wholly owned subsidiary of Murphy Oil Corporation under which Murphy was assigned a 50% working interest in, and operatorship of, the Ntem concession. Sterling retains a 50% non-operated working interest. As consideration, Murphy paid to Sterling a contribution towards past costs and is committed to fully fund joint operations in relation to the current phase of exploration.

Operations within the Ntem concession area are currently suspended under the force majeure provisions of the licence owing to an overlapping maritime border claim between Cameroon and Equatorial Guinea. The Company believes that both countries are actively working to resolve this issue and that the impact of the outcome will be either neutral or positive to the Company's position however, the possibility exists that the resolution could take longer than expected and that the outcome could have a negative effect on the Company's position.

When force majeure is lifted, there will be 15 months remaining in the current exploration period which includes the drilling of one exploration well. Having introduced an experienced deep water operator, the Company is now well placed for this operation when it occurs.

## MADAGASCAR

Sterling's Ambilobe and Ampasindava blocks are located in the Majunga and Ambilobe deep water basins, respectively, offshore north-west Madagascar. Exploration activity in these blocks continues to be delayed due to the political situation in the country following a change of Government by non-democratic methods in March 2009. The Government of Madagascar has not been recognised by the African Union or by the United Nations. In September 2011, the political parties in Madagascar agreed a process, prepared by the Southern African Development Community, leading to elections expected by the end of 2012.

During 2011, discussions have been undertaken with OMNIS, the state regulator, to prolong the current exploration period of both the Ambilobe and Ampasindava production sharing contracts. These discussions have been positive and an outcome is expected in 2012, however, the possibility exists that these licences will not be prolonged.

### **Ampasindava (WI 30%)**

The production sharing contract (PSC) for Ampasindava is in the third phase of the exploration period with a minimum work commitment of one exploration well. The large Sifaka prospect is ready to drill and has been independently estimated to contain gross un-risked best estimate prospective recoverable resources of 1.2 billion barrels (RISC Competent Persons Report, March 2008). ExxonMobil (WI 70%, Operator) and Sterling plan to drill this well once political stability is re-established.

Following the farm-in by ExxonMobil in 2005, Sterling's costs are carried up to a fixed amount. The cost to drill the Sifaka prospect is estimated to exceed the remaining carry and the Company may farm down the current working interest to cover these costs. It is currently unlikely that an exploration well will commence drilling before 2014.

#### **Ambilobe (WI 100% & Operator)**

The PSC for Ambilobe is in the second phase of the exploration period. All work commitments have been fulfilled by completing geological and geophysical studies and acquiring approximately 1,000km of 2D seismic. A number of large Cretaceous and Tertiary leads have been identified, located in both shallow and deep waters, which will require additional seismic data to develop into potential drillable prospects.

During 2011, an environmental impact assessment was undertaken in preparation for future exploration activities in the area. The Company plans to complete this study in 2012. The Company may undertake the acquisition of aeromagnetic data in 2012 to optimise the planning of subsequent seismic data acquisition.

### **KURDISTAN**

#### **Sangaw North PSC (WI 53.33% & Operator)**

The Sangaw North block lies in the foothills region of the Zagros fold belt, approximately 140km south east of Erbil, the capital of the Kurdistan region of Iraq.

The Sangaw North-1 exploration well, commenced in 2010 was drilled to a total depth of 4,190m into the Triassic aged Kurra Chine formation and in the current reporting period three flow tests were conducted across intervals between the Triassic aged Kurra Chine and the Cretaceous aged Kometan formations. Gas was produced, along with formation water, at rates that are not commercial and the well has been plugged and abandoned. Details of the three flow tests conducted in the current reporting period are as follows:

DST-3 tested an open-hole interval from 3,338m to 4,190m across the Jurassic Mus and Butmah formations and the Triassic Kurra Chine formation. The well flowed at a stabilised rate of approximately 4.6 million standard cubic feet of gas and 7,280 barrels of formation water per day during a 12 hour flow period through a 96/64ths inch choke with a wellhead pressure of 470 pounds per square inch. Analysis of gas samples, following the flow test, indicated that 53 per cent of the produced gas was hydrocarbon gas with the remainder comprising 46 per cent hydrogen sulphide and 1 per cent carbon dioxide.

DST-4 tested a 100m cased hole interval within the Jurassic aged Sargelu formation. Formation gas and water were observed in small quantities at surface but sustainable flow rates were not achieved.

DST-5 tested a 100m cased hole interval within the Cretaceous aged Kometan formation. The well flowed at a stabilised rate of approximately 0.4 million standard cubic feet of gas and 4,500 barrels of formation water per day during an 8 hour flow period through a 60/64ths inch choke with a wellhead pressure of 280 pounds per square inch. Analysis of gas samples, during the flow test, indicated approximately 83 per cent of the produced gas was hydrocarbon gas with the remainder comprising 10 per cent hydrogen sulphide and 7 per cent carbon dioxide.

The Sangaw North-1 exploration well tested the main structure within the block and was, unfortunately, unsuccessful. The Company has integrated the results of this well, along with exploration results in surrounding areas, into its geological interpretation of the block and believes that smaller, but nonetheless interesting, potential remains in an exploration play along the flanks of the main structure.

Following the identification of the remaining exploration potential, the joint venture partners entered the second sub-period of the exploration phase of the PSC in November 2011, with a duration of 2 years to November 2013. The work commitment for this period has been fulfilled by the drilling of the Sangaw North-1 well.



## OPERATIONS REVIEW – *continued*

The partnership plans to acquire 130km of 2D seismic data in 2012 to evaluate the identified exploration leads with the aim of preparing a prospect for drilling in 2013.

### **MAURITANIA**

#### **Chinguetti (Economic Interest via Funding and Royalty Agreements)**

Gross production continued to decline at the lower rate observed in 2010, reducing from 7,800 bopd in January to 6,800 bopd in December. The average production net to Sterling during 2011 was 629 bopd.

Sterling estimates that at the end of 2011, as a result of the lower observed decline rate, Chinguetti held a remaining 9.2 million barrels of gross proved and probable reserves (2P) that could be accessed with the existing wells. This is reflected in the upwards revision of Sterling's net 2P reserves to 0.664 million barrels.

No in-fill drilling or work-over activity took place on the Chinguetti field during 2011. A planned shutdown for maintenance of the floating production and storage facility was conducted over a 5 day period in November 2011.

In October 2011, the joint venture partners in PSC A and PSC B concluded agreements with the Mauritanian Government for the replacement of the offshore exploration areas within these PSC's with a new, single exploration PSC called C-10, operated by Tullow Oil Plc. The exploration programme in PSC C-10 is expected to include a minimum of 2 wells over the first 3 years. The existing Banda, Tevet and Tiof discoveries have been ring-fenced under their original PSC terms and extensions of up to 18 months were granted to allow appraisal and development activities to be completed. Petronas will continue to operate Chinguetti field.

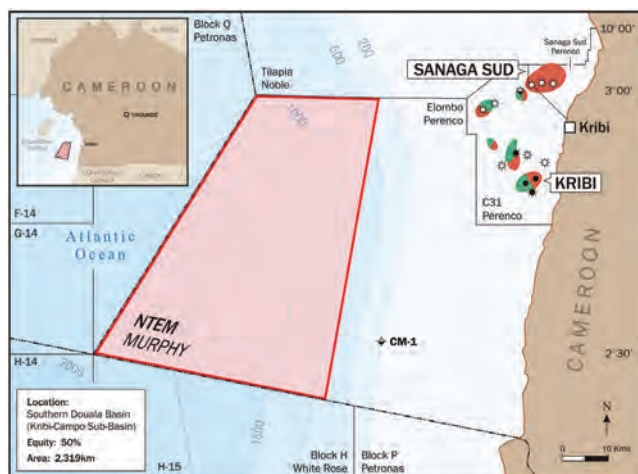
In the event of any commercial development of existing or future discoveries within these contract areas, Sterling will be entitled to revenue, but will not have any cost obligations, under its royalty interest agreements with Premier Oil.

**Philip Frank**

*Exploration Director*

19 March 2012

## CAMEROON – NTEM



### Contract Summary

Contract type	Concession
Contract signed	14 March 2001
Contract effective date	3 September 2002
Contract area	2,319 km <sup>2</sup>
Participants	
Murphy (Operator)	50%
Sterling	50%
Licence term remaining	In force majeure, minimum work and financial obligations are suspended
Current work period	15 months to run after the lifting of force majeure
Minimum work commitment	Drill 1 exploration well

a) Production Bonuses	<i>Average Production Rate</i>	<i>Bonus</i>
	50,000 bopd	\$1 Million
	100,000 bopd	\$5 Million
b) Proportional Royalty	<i>Annual Production Rate</i>	<i>State Entitlement</i>
	0-50,000 bopd	4.0%
	50-100,000 bopd	6.0%
	>100,000 bopd	10.0%

c) Corporation Tax 40% (on net profits)

d) Additional Petroleum Duty (APD), is calculated as a percentage of the profit subject to corporation tax and is paid in addition to the corporation tax. R factor is defined as the ratio of 'Accrued Net Income' and 'Accrued Investments':

R < 1.5, APD = 0%

1.5 < R < 2.5, APD = 10.0%

R > 2.5, APD = 20.0%

e) State may back in for a 10% participating interest in any development and production area

f) Production concession duration is 25 years, renewable for 10 years

### Overview

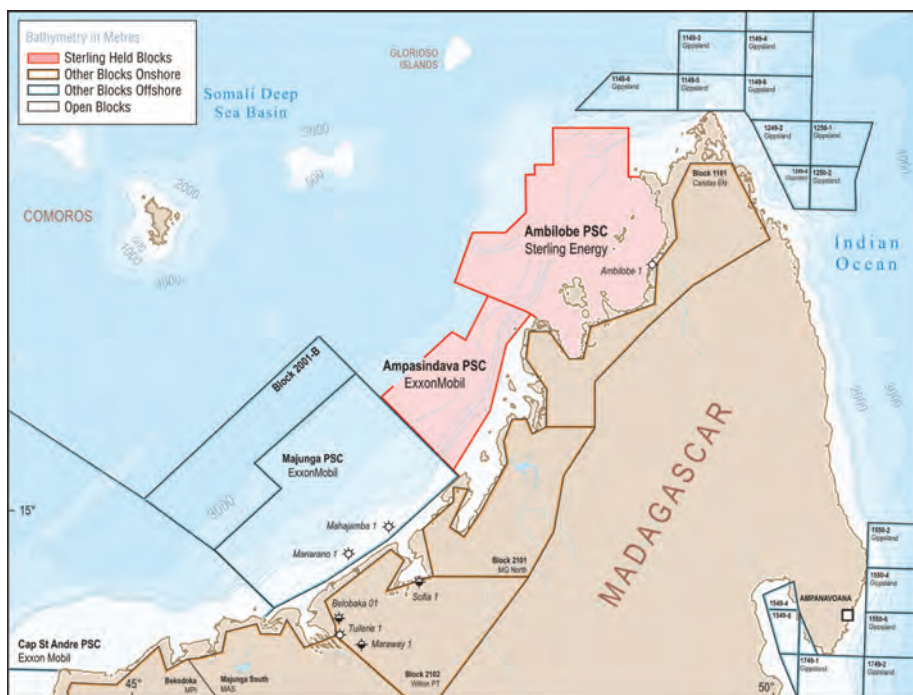
The Ntem concession is a deep water block situated in the southern Douala/Rio Muni Basin and lies adjacent to the northern maritime border of the Rio Muni province of Equatorial Guinea. Water depths range from 400m to 2,000m across the block.

During the first term of the concession over 2,100km of 2D and 1,500km<sup>2</sup> of 3D seismic data were acquired. Additional seismic and gravity data were also purchased. This large block is undrilled and is well placed with respect to both Tertiary and Upper Cretaceous plays.

The Ntem concession is currently in force majeure as a result of overlapping maritime border claims between Cameroon and Equatorial Guinea. Both countries are actively working to resolve this issue. When force majeure is lifted, there will be 15 months remaining in the current exploration period. The work commitment in this period is 1 exploration well.

In November 2011, Murphy Cameroon Ntem Oil Co., Ltd (Murphy), a wholly owned subsidiary of Murphy Oil Corporation, farmed into the block becoming a 50% working interest partner in, and operator of the Ntem concession. Sterling retains a 50% non-operated working interest and Sterling's share of costs for the remainder of the current exploration period will be paid by Murphy.

MADAGASCAR



**AMBILOBE**

**Contract Summary**

Contract type	PSC
Contract signed	15 July 2004
Effective start date	28 November 2004
Contract area	17,650 km <sup>2</sup>
Participants	
Sterling (Operator)	100%
Exploration term	8 year period with possible 2 year extension
Phase 2	End of Phase 2 under discussion
Phase 2 work commitment	Completed
Production term	25 year period with possible 5-10 year extension

**Overview**

The Ambilobe block is located in the Ambilobe basin, offshore Madagascar. Water depths across the block range from shoreline to 3,000m.

The Phase 1 and Phase 2 work programme commitments were fulfilled by conducting G&G studies, acquiring approximately 1,000km of new 2D seismic and processing more than 5,000km of new and vintage 2D seismic data.

In July 2005 Sterling farmed out 70% interest to ExxonMobil. 550km of new 2D seismic data were purchased and more than 5,500km of 2D data were reprocessed. A number of large leads in Cretaceous and Tertiary plays have been identified which will require additional seismic data to evaluate as potential drillable prospects.

In May 2008, Phase 2 of the exploration period was extended by 1 year. In early 2009 ExxonMobil withdrew from the PSC and their interest reverted to Sterling.

Discussions are ongoing to prolong Phase 2 of the licence which was scheduled to end in November 2010.

## AMPASINDAVA

### Contract Summary

Contract type	PSC
Contract signed	15 July 2004
Effective start date	28 November 2004
Contract area	7,379 km <sup>2</sup>
Participants	
Exxon Mobil (Operator)	70%
Sterling	30%
Exploration term	8 year period with possible 2 year extension
Phase 3	End of Phase 3 under discussion
Phase 3 work commitment	1 exploration well
Production term	25 year period with possible 5-10 year extension

### Overview

The Ampasindava block is located in the Majunga basin, offshore Madagascar. Water depths across the block range from 20m to 2,500m.

Sterling, as operator, fulfilled the Phase 1 and Phase 2 work programme commitments for the block by completing G&G studies and acquiring more than 3,000km of 2D seismic. In July 2005, Sterling farmed out the block to ExxonMobil. Following acquisition, processing and interpretation of the new 2D seismic data, Sterling transferred operatorship to ExxonMobil at the end of 2006.

In late 2007 the Sifaka prospect was selected as the first prospect for drilling and a site-survey was undertaken in 2008. In November 2008 the joint venture partners elected to enter Phase 3 of the exploration period which has a firm well commitment.

The Sifaka Prospect is located in the inboard portion of the Ampasindava block, in water depths of 500m to 1,800m. Sifaka is mapped as a very large, simple structure with the main reservoir target, Jurassic deep-water turbidite sandstones, expected to be encountered at approximately 3,000m below the seabed.

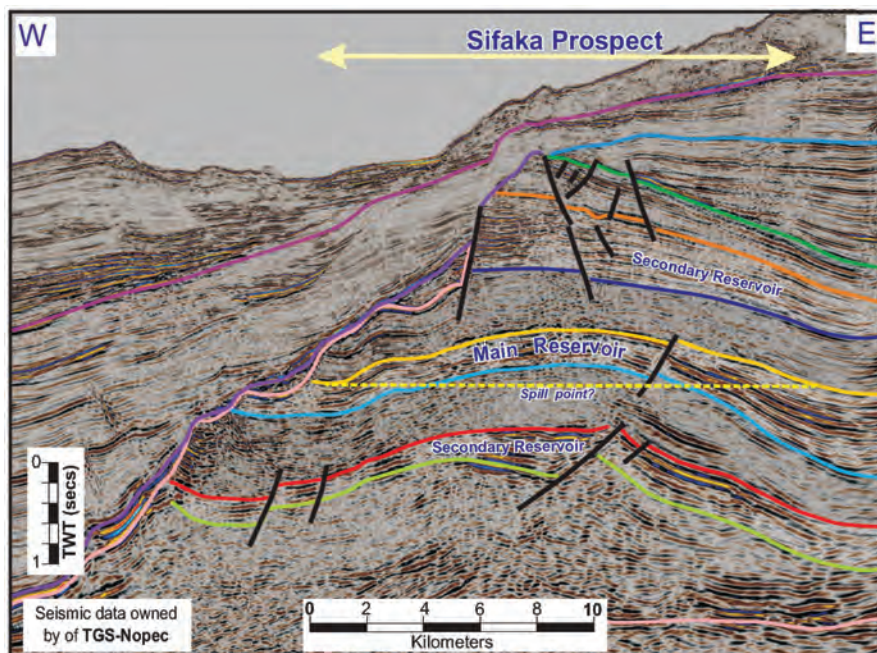
RISC (Competent Persons Report, March 2008) has estimated the gross (100%) un-risked prospective resources for the Sifaka prospect as follows:

Low Estimate	150 million bbl
Best Estimate	1.2 billion bbl
High Estimate	4.8 billion bbl

The drilling of the Sifaka prospect could be the first exploration well to test the deepwater potential of Madagascar.

Discussions are ongoing to prolong Phase 3 of the licence which was scheduled to end in November 2011.

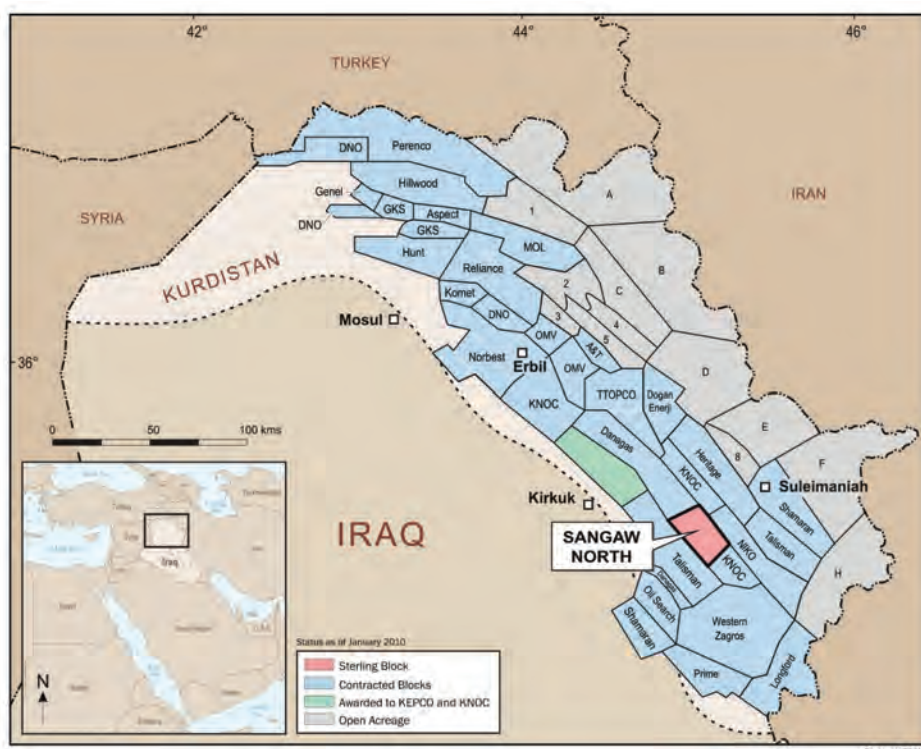
Sterling estimates that ExxonMobil's remaining carry at the beginning of 2012 is approximately \$37 million towards the gross cost of drilling.





# OPERATIONS REVIEW – continued

## KURDISTAN – SANGAW NORTH



### Contract Summary

Contract type	PSC
Contract signed	10 November 2007
Contract area	492 km <sup>2</sup>
Participants	
Sterling (Operator)	53.33% *
KNOCC	20%
Addax	26.67%
*If the KRG's back-in rights are fully exercised, then Sterling's working interest will reduce to 40%	
Exploration period expires	November 2013
1st Sub-period	3 years
1st Sub-period extension	1 year
2nd Sub-period	2 years
Summary of PSC terms	
Royalty	10%
Cost recovery (oil)	40% after royalty
Profit share (oil)	30%-15% sliding scale
Cost recovery (gas)	53% after royalty
Profit share (gas)	40%-20% sliding scale
Tax	Paid from state share of production

### Overview

The Sangaw North block lies in the foothills region of the Zagros fold belt, approximately 140km south east of Erbil, the capital of the Kurdistan region of Iraq. The block is located 50km southeast of the giant Kirkuk oil field and is on trend with both the Taq Taq oil discovery (90km) and the Chemchemical gas and condensate discovery (30km).

The Sangaw North PSC was awarded for an initial five-year term. The minimum work commitment for the 1st sub-period (November 2007 to November 2011 including a one year extension) of 200km of 2D seismic was fulfilled with the acquisition of 325 km of 2D seismic acquired in 2008/09.

In July 2011, Sterling completed the drilling and testing of the Sangaw North-1 exploration well, which fulfilled the minimum work commitment for the 2nd sub-period.

In November 2011, the joint venture partners entered the 2nd sub-period of exploration which runs to November 2013.

## RESERVES SUMMARY

	2011 Oil (000 bbl)	2011 Gas (mcf)	2011 Reserves (000 boe)	2010 Oil (000 bbl)	2010 Gas (mcf)	2010 Reserves (000 boe)
<b>Volumes of Proven plus Probable Reserves</b>						
At 1st January	<b>421</b>	–	<b>421</b>	340	–	340
Revision – Chinguetti <sup>(1-3)</sup>	<b>472</b>	–	<b>472</b>	320	–	320
Production	<b>(229)</b>	–	<b>(229)</b>	(239)	–	(239)
At 31st December	<b>664</b>	–	<b>664</b>	421	–	421

Notes:

- (1) The reserves stated are for Sterling's net interests in the Chinguetti field only and are based on Sterling's own assessment of reserves, as at 31 December 2011. Sterling's interest in the Chinguetti field is through its Funding Agreement and Royalty Agreements; Sterling does not have a direct equity participation in the Chinguetti field. The assessment was made in accordance with the definitions as set out on page 74.
- (2) Sterling has not booked reserves relating to other Mauritanian discoveries, on the basis that there are no approved development plans for these discoveries.
- (3) In accordance with the guidelines of the AIM Market of the London Stock Exchange, Dr. Philip Frank, Ph.D. Geology (1977), Exploration Director of Sterling Energy Plc, who has been involved in the oil industry for over 30 years, is the qualified person that has reviewed the assessment of reserves set out above.



## SCHEDULE OF INTERESTS

	Location	Size (km <sup>2</sup> )	Licence Name	Sterling Working Interest %	Sterling Net Revenue Interest %	Operated/ Non-operated
<b>Africa</b>						
Mauritania	Offshore	110	PSC A	n.a	Sliding scale royalty over 3%	Non-operated
	Offshore	403	PSC B	n.a	Sliding scale royalty over 6% (except 5.28% of the Chinguetti Field)	Non-operated
	Offshore	10,725	PSC C-10	n.a	Sliding scale royalty over 4% (average)	Non-operated
	Chinguetti	29	Funding Agreement with SMH	n.a	Economic interest for approximately 8% of Chinguetti project	Non-operated
Cameroon	Southern Douala Basin	2,319	Ntem	50% <sup>(1)</sup>		Non-operated
Madagascar	Offshore NW	17,650	Ambilobe <sup>(2)</sup>	100%		Operator
	Offshore NW	7,379	Ampasindava <sup>(2)</sup>	30% <sup>(3)</sup>		Non-operated
<b>Middle East</b>						
Iraq	Kurdistan	492	Sangaw North	53.33%		Operator

(1) Carried for the remainder of the current exploration period which includes the drilling of one exploration well.

(2) The current exploration period was due to end in November 2010. Sterling and Exxon are in discussions with OMNIS, the State oil Company of Madagascar, with regard to extending the current exploration periods of both licences.

(3) Carried for defined \$ amount.

# FINANCIAL REVIEW

## SELECTED FINANCIAL DATA

		2011	2010
Chinguetti production*	bopd	<b>629</b>	654
Year-end 2P reserves*	000 boe	<b>664</b>	421
Revenue	\$million	<b>19.1</b>	25.3
EBITDA*	\$million	<b>11.6</b>	11.3
Profit after tax	\$million	<b>18.4</b>	5.8
Net cash investment in oil & gas assets	\$million	<b>1.7</b>	12.2
Year-end cash (including partner funds)	\$million	<b>115.8</b>	111.7
Year-end debt*	\$million	<b>–</b>	–
Year-end net cash (including partner funds)	\$million	<b>115.8</b>	111.7
Average realised oil price (net of hedges)	\$/bbl	<b>108.57</b>	80.44
Total cash operating costs per boe (produced)	\$/boe	<b>34.03</b>	38.15
Year-end share price	Pence	<b>40</b>	84
Share price change*	%	<b>(53)</b>	(46)

\* Key performance indicators

## HIGHLIGHTS

- Group net profit of \$18.4 million in 2011 (2010 \$5.8 million);
- Cash balance at year-end of \$115.8 million (2010: \$111.7 million);
- Average 2011 Chinguetti production 629 bopd (2010: 654 bopd);
- Debt free throughout 2011.

## REVENUE AND COST OF SALES

2011 production averaged 629 bopd, including Royalty barrels, a decrease of 4% from the 654 bopd averaged in 2010. Currently, all of the Group's production is from the Chinguetti field and the Group's production was 597 bopd for the month of December 2011.

Group turnover was \$19.1 million (2010: \$25.3 million) on 176,345 barrels sold (2010: 315,000) with an average realised oil price of \$108.57 per bbl (2010: \$80.44 per bbl). Volumes lifted and sold during the year were down by 46% to 2.0 million barrels (2010: 3.7 million barrels), due mainly to timing differences on liftings of oil stored in facilities at the Chinguetti field.

## PROFIT FROM OPERATIONS

The 2011 profit from operations totalled \$16.3 million (2010: \$7.3 million).

During the year, an impairment reversal totalling \$8.3 million (2010: \$nil) on the Chinguetti asset has been recognised. This reversal of prior year impairments has been made following a review of decline rates by the operator, Petronas, who have extended their estimates of the economic field life. Sterling's own assessment of the asset's economic field life, although more conservative than that of the operator, is broadly in line with their assessment.

Chinguetti cost of sales totalled \$6.1 million (2010: \$13.6 million) averaging \$34.66/bbl (2010: \$43.11/bbl). The difference in the average cost per barrel is principally due to reductions in direct operating expenditures and reduced Royalty amortisation charges following the economic field life revision on the Chinguetti block.

Pre-licence exploration costs of \$1.3 million (2010: \$0.7 million) have been written off during the year.

## FINANCIAL REVIEW – *continued*

Administrative costs increased marginally during the year to \$3.7 million (2010: \$3.6 million). Included within this charge is \$1.9 million (2010: \$1.9 million) relating to share-based payment charges.

A portion of the Group's staff costs and associated overheads are recharged to the joint venture partners, expensed as pre-licence expenditure or capitalised where they are directly attributable to on-going capital projects. In 2011 this portion amounted to \$5.1 million (2010: \$6.8 million).

### **EBITDA AND NET PROFIT**

Group EBITDA (as defined within the Definitions and Glossary of Terms on page 75) totalled \$11.6 million (2010: \$11.3 million).

Net profit after tax totalled \$18.4 million (2010: profit \$5.8 million). The basic profit per share was \$0.08 per share (2010: \$0.03 per share).

Interest revenue and finance expenses were a net income of \$2.2 million (2010: net expense \$1.4 million) reflecting foreign exchange losses of \$0.1 million (2010: \$0.6 million) on GBP cash balances held at 31 December 2011 which are reported in US Dollars.

Non-cash finance income of \$1.9 million (2010: \$1.0 million) relates to the reduction of the decommissioning discount on the Chinguetti abandonment provision due to the improvements in the expected field life. Of this \$1.9 million, an expense of \$0.9 million (2010: \$1.0 million) relates to the unwinding of the decommissioning provision and an income of \$2.8 million (2010: \$nil) relates to adjustments made to the provision during the year following a review of the field's economic life by the operator (see note 1 on page 48 and note 5 on page 54).

Interest revenue was \$0.4 million (2010: \$0.2 million).

No dividend is proposed to be paid for the year ended 31 December 2011 (2010: \$nil).

### **CASH FLOW**

Net Group cash inflow generated from operating activities was \$5.6 million (2010: \$10.4 million).

Net cash investments in oil and gas assets totalled \$1.7 million (2010: \$12.2 million) primarily comprising of \$4.5 million invested in Kurdistan relating to testing costs on the Sangaw North-1 well, a net reduction of \$3.5 million in costs in Cameroon following the successful farm-out of the Ntem field (\$4.8 million cost reimbursement) and \$0.7 million invested in Madagascar. The Group's exploration drilling expenditure for Sangaw North-1 was carried by Addax, with Sterling paying its share of testing costs.

### **STATEMENT OF FINANCIAL POSITION**

Cash and cash equivalents were \$115.8 million at the year-end (2010: \$111.7 million) of which unrestricted funds of \$1.0 million (2010: \$10.1 million) was held on behalf of partners, leaving a cash balance of \$114.8 million (2010: \$101.6 million) available for Sterling's own use at 31 December 2011. At the end of 2011, net assets/total equity stood at \$116.1 million (2010: \$95.8 million), and non-current assets were \$31.3 million (2010: \$21.8 million). This increase was primarily as a result of investment in Kurdistan, the increase to the Chinguetti Funding Agreement and the increase to the Chinguetti Royalty Asset. Net current assets increased to \$105.1 million (2010: \$96.3 million).

The Group's Chinguetti decommissioning provision decreased during the year by \$1.9 million to \$20.1 million (2010: \$22.0 million) following a review of the field's economic life by the operator (see note 1 on page 48 and note 5 on page 54).

### **HEDGING**

During 2011 the Group did not have any oil and gas price derivatives in place (2010: no oil and gas price derivatives in place).

**CAUTIONARY STATEMENT**

This financial report contains certain forward-looking statements that are subject to the usual risk factors and uncertainties associated with the oil and gas exploration and production business. Whilst the Directors believe the expectation reflected herein to be reasonable in light of the information available up to the time of their approval of this report, the actual outcome may be materially different owing to factors either beyond the Group's control or otherwise within the Group's control but, for example, owing to a change of plan or strategy. Accordingly, no reliance may be placed on the forward-looking statements.

**Andrew Smith**  
*Financial Controller*

19 March 2012

**Angus MacAskill**  
*Chief Executive Officer*

19 March 2012

# CORPORATE RESPONSIBILITY

Sterling is committed to conducting its business in a responsible and sustainable way. Sterling recognises that it has corporate and social responsibilities to the local communities in the areas in which it operates, to its partners, to its employees and to its shareholders. In pursuing its business objectives it undertakes not to compromise its corporate or social responsibilities with any of these stakeholders.

## **BUSINESS INTEGRITY**

The highest ethical standards are the cornerstone of Sterling's business. Sterling is committed to conducting its business with integrity, honesty and fairness. All business activities are reviewed to ensure they meet these standards. Sterling also seeks to ensure that similar standards are applied by its business partners, contractors and suppliers. All members of staff are individually accountable for their actions to ensure they apply and maintain these standards.

Sterling is a member of TRACE International Inc., the anti-bribery association. The Directors have completed the TRACE training and assessment. Following the enactment of the UK Bribery Act on 1 July 2011, Sterling has adopted amended policies and guidelines to further reinforce the Company's anti-bribery procedures.

## **COMMUNITY RESPONSIBILITY**

Sterling is committed to being a good partner in the communities in which the Company operates. Engagement and dialogue with our local communities is essential in ensuring, where possible, projects benefit both the Company and the communities in which the project is located.

Throughout the year Sterling has continued to employ local staff and contractors at both its Suleimaniah office and operations on the Sangaw North block. Sterling has also continued to assist with basic infrastructure projects helping to provide water, electricity and schooling to local villages that would otherwise have been without these most basic amenities.

## **EMPLOYEES**

Sterling is committed to providing a workplace free of discrimination where all employees are afforded equal opportunities and are rewarded upon merit and ability. In the implementation of this policy Sterling is committed to ensuring that all employees are given contracts with clear and fair terms. Staff are offered access to relevant training and encouraged to join professional bodies to enhance knowledge, competence and career development.

Sterling is committed to achieving the highest possible standards of conduct, accountability and propriety and to a culture of openness in which employees can report legitimate concerns without fear of penalty or punishment. Sterling has a whistle blowing policy which empowers employees to be proactive, to stop or report any failure to comply with legal obligations or Sterling's regulations, dangers to health and safety, financial malpractice, damage to the environment, criminal offences and actions which are likely to harm the reputation of the Company. The whistle blowing policy allows employees to make anonymous reports directly to a non-executive Director.

## **HEALTH, SAFETY, ENVIRONMENT AND SECURITY ('HSES')**

It is an objective of Sterling that every individual is aware of his/her responsibility towards providing for a safe and secure working environment. HSES and social responsibility leadership are core competencies throughout Sterling's line management organisation. Sterling's HSES risks are managed in a systematic way by utilising procedures and appropriate training of staff, with the aim to reduce these risks to as low as is reasonably practical. Sterling ensures that appropriate emergency response systems are in place to reduce and mitigate the impact and losses of any incident and any residual risks and that it is in compliance with all relevant laws, regulations and industry standards.

Sterling maximises its influence with joint venture partners to share its HSES and social responsibility values. Contractors are required to demonstrate and deliver a credible HSES and social responsibility programme. In order to achieve continual improvement, Sterling is committed to reviewing its HSES and social responsibility performance each quarter.

Sterling is committed to minimising its impact on the environment in both field operations and within its offices. All staff share responsibility for monitoring and improving the performance of its environmental policies with the objective of reducing our impact on the environment on a year on year basis.

## BOARD OF DIRECTORS

### **Alastair Beardsall, executive Chairman, aged 58**

Alastair joined Sterling in September 2009. He has been involved in the oil industry for over 30 years. For the first 12 years Alastair worked on international assignments with Schlumberger, the oil-field services Company. From 1992 he began working for independent exploration and production operators, with increasing responsibility for specific exploration, development and production ventures.

Between September 2003 and October 2009, Alastair was Executive Chairman of Emerald Energy Plc during which time Emerald grew from a market capitalisation of less than £8 million to a size that allowed the Company to enter the FTSE 250 index in January 2009. In October 2009 Emerald was acquired by Sinochem Resources UK Limited, for £7.50 per share in a transaction that valued Emerald at £532 million.

### **Angus MacAskill, Chief Executive Officer, aged 52**

Angus joined Sterling as Chief Executive Officer in November 2010. His career in the oil and gas industry started in 1981 with 5 years at Schlumberger on assignments in Africa. Angus joined Mobil Oil and, during 10 years with the company, held a number of production, reservoir engineering and managerial posts in UK and Norway.

Since 1997, Angus has worked for a number of independent exploration and production companies, including Enterprise Oil and Elixir Petroleum, in commercial, managerial and executive positions of increasing responsibility.

Angus joined Emerald Energy in 2006 as Chief Operating Officer and in December of that year was appointed Chief Executive Officer. During the following three years, the company experienced material growth following exploration successes in its assets in South America and the Middle East, prior to being acquired by Sinochem in 2009.

### **Philip Frank, Exploration Director, aged 59**

Philip joined Sterling in October 2011 as Exploration Director. Following a PhD gained at Liverpool University, he started his oil industry career in 1977 with an 11 year spell in BP, initially as a North Sea rig geologist and finally as the group-wide Assistant Chief Geologist.

Since then he has held senior management positions in a range of UK-based independent exploration and production companies including Clyde, Monument and LASMO, and has gained extensive world-wide exploration experience with an emphasis on new venture generation.

Philip was closely involved with Emerald Energy from 2003 through to its acquisition in 2009. Initially in a consulting role and finally as Exploration Manager, he provided the exploration direction for the company's successes both in Colombia and in Syria.

### **Nicholas Clayton, non-executive Director, aged 48**

Nicholas was appointed a non-executive Director of Sterling in October 2009. Nicholas is chairman of the Audit Committee and a member of the Remuneration and Nomination Committees.

Nicholas has provided strategic and corporate finance advice to a number of public and private oil and gas companies since January 2007. Between August 2005 and December 2006 he was Global Co-Head of Oil and Gas Corporate Finance for Canaccord Adams. For the previous 5 years he held the position of Global Head of Oil and Gas Corporate Finance for Dresdner Kleinwort Benson, the investment bank, having previously been Global Head of Oil and Gas Research between 1997 and 2000. Nicholas began his career at BP having obtained a first class honours degree in Business Studies, sponsored by BP, from Portsmouth Polytechnic in 1985.

He is currently Chairman of Bridge Resources Corp., a Canadian listed Company with operations in the North Sea and North America. Nicholas also serves as a non-executive Director of Circle Oil Plc and provides strategic advice to Geopark, an AIM-listed Company operating in Chile and Argentina.



## BOARD OF DIRECTORS – *continued*

### **Keith Henry, non-executive Director, aged 67**

Keith was appointed a non-executive Director of Sterling in September 2009. He chairs the Remuneration Committee and is a member of the Audit and Nominations Committees.

He has over 35 years of international business experience in the development, ownership, design and construction of major facilities worldwide. He was with Brown & Root Limited for 23 years, the last five of which were as Chief Executive responsible for the Europe, Africa and FSU regions. From 1995 to 1999 he was Chief Executive of National Power Plc, and then Chief Executive of Kvaerner Engineering and Construction Ltd until June 2003.

Keith serves as Chairman of Regal Petroleum Plc and Mediterranean Oil and Gas Plc, as well as serving as a non-executive Director and advisor to a number of companies in the engineering, services and energy sectors. He is a Fellow of the Royal Academy of Engineering.

### **Malcolm Pattinson, non-executive Director, aged 68**

Malcolm is a geoscientist with 40 years of experience and joined Sterling in November 2010. Until 2001 he was the vice-president of exploration for Ranger Oil (which became CNR); and prior to this he was exploration vice-president for Hamilton Oil (which became BHP). From 2001 to 2006 Malcolm was a consultant for Tullow Oil.

Malcolm is an honorary life member and former chairman of the Petroleum Exploration Society of Great Britain, and was awarded the medal for outstanding achievement in 1996 by the Petroleum Group of the Geological Society. He is the chairman of GTO Limited and was formerly a Director of Aurelian Oil and Gas Plc.

# CORPORATE GOVERNANCE

## APPLICATION OF UK CORPORATE GOVERNANCE CODE PRINCIPLES

The Directors are mindful of their duties and responsibilities to all Shareholders and of their statutory duties under the Companies Act, the core duty of which is to act in good faith and in a way most likely to promote the success of the Company for the benefit of its members as a whole. As an AIM listed company, the Company is not required to comply with the UK Corporate Governance Code, however, the Directors are committed to maintaining the highest standards of corporate governance. This statement describes how the Company has applied the main and supporting principles of corporate governance set out in the UK Corporate Governance Code published by the Financial Reporting Council in June 2010 ("Code").

The Company has adhered to the provisions set out in the Code with the exception of the matters referred to below.

Provision D.1.3 Non-executive Directors ("NED") have been awarded share options under the NED Long Term Incentive Plan ("LTIP"). The NED LTIP rules and option awards were approved by shareholders, as required under the Code, at the December 2009 extraordinary general meeting. Future NED LTIP awards will be awarded subject to approval by shareholders. Under the NED LTIP rules, shares acquired by the exercise of options are not required to be held for at least one year after the non-executive Director leaves the Board as required under the Code. Notwithstanding the foregoing, the Board considers each of the non-executive Directors to be independent.

## THE BOARD OF DIRECTORS AND ITS COMMITTEES

### Board Composition, Operation and Independence

The Board currently comprises the executive Chairman, two executive Directors and three non-executive Directors. Each of the executive Directors has extensive knowledge of the oil and gas industry combined with general business and financial skills. All of the Directors bring independent judgement to bear on issues of strategy, performance, resources, key appointments and standards. The Board meets regularly throughout the year and all the necessary information is supplied to the Directors on a timely basis to enable them to discharge their duties effectively.

The Board is responsible to the Shareholders for the proper management of the Company. A Statement of Directors' Responsibilities in respect of the Financial Statements is set out on page 36.

The Board has a formal schedule of matters specifically reserved for its decision. These include strategic planning, business acquisitions or disposals, authorisation of major capital expenditure and material contractual arrangements, changes to the Group's capital structure, setting policies for the conduct of business, approval of budgets, remuneration policy of Directors and senior management, and taking on debt and approval of Financial Statements. Other matters are delegated to the Committees of the Board and executive Directors, supported by policies for reporting to the Board.

No new share options have been issued to non-executive Directors under the NED LTIP. In the opinion of the Board the NED LTIP aligns the objectives of the non-executive Directors with those of Shareholders. The NED LTIP is not subject to performance conditions for independence reasons.

Keith Henry is the Senior Independent Director. The Senior Independent Director is available to Shareholders if they have concerns which, through the normal channels of contact with the Chairman or CEO have not been resolved or for which such contact is inappropriate.

The Company maintains Directors' and Officers' liability insurance cover and provides the Directors with indemnity, the level of which is reviewed annually.

## Meetings and Attendance

The following table summarises the number of Board and committee meetings held during the year and the attendance record of the individual Directors:

	Board Meetings	Audit Committee	Remuneration Committee	Nominations Committee
<b>Number Meetings in year</b>	<b>8</b>	<b>2</b>	<b>3</b>	<b>1</b>
Alastair Beardsall	8	–	2*	–
Nicholas Clayton	8	2	3	1
Jonathan Cooper (resigned 18 October 2011)	7	–	–	–
Philip Frank (appointed 3 October 2011)	2	–	–	–
Andrew Grosse (resigned 3 October 2011)	6	–	–	–
Keith Henry	8	2	3	1
Angus MacAskill	8	–	–	1
Malcolm Pattinson	8	2	3	1

\*denotes attendance by invitation

## Induction and Training

New Directors, on their appointment to the Board, are briefed by the Board and management on the activities of the Group and its key business and financial risks, the Terms of Reference of the Board and its Committees, the list of Board reserved matters, and the latest financial information about the Group. The Chairman ensures that Directors update their skills, knowledge and familiarity with the Company to fulfil their roles on the Board and on Board Committees. On-going training is available as necessary and includes updates from the Company Secretary on changes to the AIM rules, the Code, requirements under the Companies Act and other regulatory matters. Directors may consult with the Company Secretary at any time on matters related to their role on the Board. All Directors have access to independent professional advice at the Company's expense.

## Evaluation of the Board's Performance

Performance evaluation takes place for individual Directors, the Board and its Committees and includes assessing the effectiveness of the Board as a whole. The evaluation of the performance of Directors is carried out using peer appraisal questionnaires which combine business and personal performance and includes discussions with the Senior Independent Director and the Senior Independent Director with the Chairman. Aspects of performance include attendance and participation at Board meetings, quality of involvement in Committees, commitment and effectiveness of their contribution to Board activities (including the AGM and shareholder communications), the adequacy of training and non-executive Directors' independence. The process is conducted and reviewed by the Senior Independent Director, on behalf of the Nomination Committee; the Company Secretary is advised of its completion. The performance of the Chairman is reviewed annually in a meeting of the non-executive Directors, led by the Senior Independent Director. This review takes into account the views of executive Directors.

## Retirement and Re-election

The Company's Articles of association require that any Director who has been a Director at the preceding two Annual General Meetings and who was not appointed or re-appointed by the Company, retire and stand for re-election. All new Directors appointed since the previous Annual General Meeting need to stand for election at the following Annual General Meeting.

## **SUB-COMMITTEES**

The Board has appointed the following sub-committees:

### **Audit Committee**

This Committee currently comprises Nicholas Clayton, Keith Henry and Malcolm Pattinson, under the Chairmanship of Nicholas Clayton. It reviews the interim and annual financial statements, internal control matters and the scope and effectiveness of the external audit. The external auditors have unrestricted access to the Chairman of the Audit Committee. Audit Committee meetings are also attended by the external auditor where appropriate and, by invitation, the Chairman, Chief Executive Officer, other Directors and senior management.

### **Audit Committee Report for 2011**

The Audit Committee met two times during the year. During these meetings the Audit Committee considered the following:

- the integrity of the financial statements and other formal announcements relating to the Group's financial performance and, in particular, reviewed the judgments that are contained within the financial statements;
- the Group's internal control and risk management policies and systems, and their effectiveness;
- Sterling's whistle blowing procedures to ensure that its employees are able to raise concerns, in confidence, about possible wrongdoing in financial reporting and other matters;
- the requirements for an internal audit function in the context of the Group's overall risk management system. The Committee is satisfied that the Group does not currently require an internal audit function, however, it will continue to monitor the situation;
- the Committee recommends that the Board presents the resolution to the shareholders at the 2012 AGM to reappoint BDO LLP as external auditors; and
- monitoring a policy on the engagement of the external auditors to supply non-audit services, taking into account relevant guidance regarding the provision of non-audit services by the external audit firm.

### **Nominations Committee**

The members of this Committee are currently Nicholas Clayton, Keith Henry and Malcolm Pattinson under the Chairmanship of Malcolm Pattinson. The Nominations Committee considers the composition of the Board and makes recommendations on the appointment of new Directors. The Nomination Committee also co-ordinates the performance evaluation of Directors and senior management and considers those candidates presenting themselves for election at the AGM.

### **Nominations Committee Report for 2011**

The Nomination Committee met one time during the year during 2011.

Philip Frank, Exploration Director, will offer himself for election at the AGM following his appointment on 3 October 2011. Alastair Beardsall, Chairman, will retire by rotation and offer himself for re-election at the AGM. Their biographical details, provided on page 19, demonstrate the range of experience and skill which each bring to Sterling. The Nominations Committee and the Board considers that their performance continues to be effective and that each Director has the necessary commitment to fulfil their respective roles.

### **Remuneration Committee**

The members of the Committee are Keith Henry, Nicholas Clayton and Malcolm Pattinson under the Chairmanship of Keith Henry. Further details on the roles and responsibilities of the Remuneration Committee are described in greater detail in the Report on Directors' Remuneration, set out in pages 25 to 29.

### **COMMUNICATIONS WITH SHAREHOLDERS**

The Board is accountable to the Company's shareholders and as such it is important for the Board to appreciate the aspirations of the shareholders and equally that the shareholders understand how the actions of the Board and short-term financial performance relate to the achievement of the Company's longer term goals.

The Board reports to the shareholders on its stewardship of the Company through the publication of interim and final results each year. Press releases are issued throughout the year and the Company maintains a website ([www.sterlingenergyplc.com](http://www.sterlingenergyplc.com)) on which press releases, corporate presentations and the annual report and accounts are available to view. Additionally this annual report contains extensive information about the Company's activities. Enquiries from individual shareholders on matters relating to the business of the Company are welcomed. Shareholders and other interested parties can subscribe to receive notification of news updates and other documents from the Company via email. In addition the executive Directors meet with major shareholders to discuss the progress of the Company.

The executive Chairman provides periodic feedback to the Board following meetings with shareholders. The Senior Independent Director also attends some shareholder meetings to ensure the Board is apprised of all feedback provided by such meetings.

The Annual General Meeting provides an opportunity for communication with all Shareholders and the Board encourages the Shareholders to attend and welcomes their participation. The Directors attend the Annual General Meeting and are available to answer questions. Details of resolutions to be proposed at the Annual General Meeting to be held on 19 April 2012 can be found in the notice of the meeting, on pages 79 to 83.

### **INTERNAL CONTROLS**

In September 1999 the Turnbull Guidance (Internal Control: Guidance for Directors on the Combined Code) was published, and revised in October 2005.

The Directors acknowledge their responsibility for establishing and maintaining the Group and the Company systems of internal control. These are designed to safeguard the assets of the Group and to ensure the reliability of financial information for both internal use and external publication.

The Group's internal control procedures include Board approval for all significant projects. All major expenditures require either senior management or Board approval at the appropriate stages of each transaction. A system of regular reporting covering both technical progress of projects and the state of the Group's financial affairs provides appropriate information to management to facilitate control. The Board reviews, identifies, evaluates and manages the significant risks that face the Group.

Any systems of internal control can only provide reasonable, and not absolute, assurance that material financial irregularities will be detected or that the risk of failure to achieve business objectives is eliminated. The Directors, having reviewed the effectiveness of the system of internal financial, operational and compliance controls and risk management, consider that the system of internal control operated effectively throughout the financial year and up to the date the financial statements were signed.

### **CONFLICTS OF INTEREST**

The Company has in place procedures for the disclosure and review of any conflicts, or potential conflicts of interest which the Directors may have and for the authorization of such conflicts by the Board. In deciding whether to authorize a conflict matter or a potential conflict the Directors must have regard to their general duties under the Companies Act 2006.

# REMUNERATION REPORT

## REMUNERATION COMMITTEE

The Remuneration Committee is comprised of Keith Henry, Nicholas Clayton and Malcolm Pattinson. Keith Henry is the Chairman of the Remuneration Committee. The Committee makes recommendations to the Board, within its agreed terms of reference, on the structure and overall remuneration package for executive Directors and reviews the remuneration for other senior employees. Non-executive Directors' fees are considered and agreed by the Board.

The Remuneration Committee is permitted to appoint independent advisors to assist in the determination of remuneration.

## REMUNERATION POLICY

The Company's policy on Directors' remuneration is that the overall remuneration package should be sufficiently competitive to attract, retain and motivate high quality executives capable of achieving the Group's objectives and thereby enhancing shareholder value. The package consists of salary, performance related bonus and share options awarded under the All Staff Long Term Incentive Plan, with the balance between these components being salaries at levels around the middle of the range of salaries for peer companies and material additional remuneration linked to performance and results adding materially to shareholder value. Sterling acknowledges the benefit of the executive Directors accepting appointments as non-executive Directors of other companies; if they accept more than two such appointments they are required to pass their fees for those appointments to the Company. The details of individual components of the executive remuneration package and service contracts are discussed below:

**Basic Salary and Benefits:** The salary and benefits are reviewed annually. Currently the Remuneration Committee uses remuneration data collected from published accounts and surveys of peer companies and does not use executive remuneration consultants. The Committee reviews this method on a regular basis.

**Performance Related Bonuses:** Performance bonuses are awarded to executive Directors by the Board, upon recommendations by the Remuneration Committee. Prior to each year the Remuneration Committee considers the levels of potential bonus payments and the corresponding set of objectives for which bonuses may be payable. Objectives are set to align the individuals' motivation with the longer term sustainable future of the Company. These objectives may not provide short term or easily measurable results. At the end of each year the Remuneration Committee considers if the objectives have been achieved as well as individual contribution to the performance of the Group. The maximum level of performance bonus is capped as a percentage of annual salary.

**Results Based Long Term Incentive Plans:** In 2009 the Company reviewed the existing share-based incentive schemes currently in place to motivate and incentivise its employees, and also took independent advice. Based on this review the Company proposed a new All Staff Long Term Incentive Plan as being the most effective way to deliver the incentives that the Board believes will continue to align the interests of the employees and shareholders. Shareholders approved this plan at the December EGM held on 22 December 2009.

With effect from 2009, awards are made in the form of options to acquire shares in the Company at the shares' nominal value. The All Staff LTIP is designed as a three year plan and the Company intends to grant annual awards in October each year based on the recommendations of the Remuneration Committee.

Awards are made on similar terms to non-executive Directors of the Company, under a separate plan the NED LTIP. Awards under the NED LTIP are made by the Board and are not subject to performance conditions for independence reasons.

**Pensions:** The Group operates a number of defined contribution pension schemes pursuant to which it contributes 10% per cent of pensionable salary per eligible member.

**Fees:** The fees for non-executive Directors are determined by the Board within the limits stipulated in the Articles of Association. The non-executive Directors are not involved in any discussions or decision about their own remuneration.



## REMUNERATION REPORT – continued

### SERVICE CONTRACTS

Each of the executive Directors has a service contract with the Company, details of which are as follows:

Director	Commencement of appointment	Date of current contract	Base annual salary	Notice period
Alastair Beardsall	8 September 2009	1 January 2011	*£80,000	6 months
Philip Frank	3 October 2011	3 October 2011	£225,000	6 months
Angus MacAskill	9 November 2010	9 November 2010	£263,800	6 months

\* As of 1 January 2011 contracted to devote 20% of his working time to the business of Sterling Energy Plc.

The salaries paid to the Directors are reviewed annually with the most recent salary review being implemented on 1 January 2012.

Non-executive Directors do not have service contracts, but instead each has a letter of appointment setting out the terms and conditions of their appointment, details of which are as follows:

Director	Commencement of appointment	Date of current contract	Base fees per annum
Nicholas Clayton	1 October 2009	1 October 2009	£30,000
Keith Henry	8 September 2009	8 September 2009	£30,000
Malcolm Pattinson	15 November 2010	15 November 2010	£30,000

Save for the fees outlined above and the share options awarded under the NED LTIP, the non-executive Directors are not entitled to any other benefits or arrangements.

Except as disclosed above, there are no service contracts or letters of appointment in force between any Director with the Company or the Group as at the date of this document.

The Company has granted an indemnity to its Directors (including subsidiary undertakings) under which the Company will, to the maximum extent possible, indemnify them against all costs, charges, losses and liabilities incurred by them in the performance of their duties.

The Company provides limited Directors' and Officers' liability insurance, at a cost of approximately \$26,000 in 2011 (2010 – \$68,000).

## DIRECTORS AND THEIR INTERESTS

### Directors' Remuneration and Share Options

#### Aggregate remuneration (audited)

	Fees and basic salary £	Compensation for loss of office £	Bonus £	Defined contribution pension £	Benefits in kind £	Total 2011 £	Total 2010 £
<b>Executive Directors</b>							
Alastair Beardsall	80,000	–	–	8,000	3,723	<b>91,723</b>	346,581
Jonathan Cooper (resigned 18 October 2011)	153,173	–	–	15,581	3,809	<b>172,563</b>	254,633
Philip Frank (appointed 3 October 2011)	56,250	–	–	5,625	35	<b>61,910</b>	–
Andrew Grosse (resigned 3 October 2011)	188,833	–	–	18,883	6,411	<b>214,127</b>	324,151
Angus MacAskill (appointed 9 November 2010)*	250,000	–	85,000	25,000	5,004	<b>365,004</b>	39,840
Graeme Thomson (resigned 22 December 2009)	–	–	–	–	–	–	326,537
<b>Non-executive Directors</b>							
Nicholas Clayton	30,000	–	–	–	–	<b>30,000</b>	30,000
Keith Henry	30,000	–	–	–	–	<b>30,000</b>	30,000
Malcolm Pattinson (appointed 15 November 2010)	30,000	–	–	–	–	<b>30,000</b>	3,885
Richard Stabbins (resigned 31 December 2010)	–	–	–	–	–	–	30,000
Aggregate remuneration 2011	<b>818,256</b>	–	<b>85,000</b>	<b>73,089</b>	<b>18,982</b>	<b>995,327</b>	–
Aggregate remuneration 2011 US\$	<b>1,311,665</b>	–	<b>136,255</b>	<b>117,162</b>	<b>30,429</b>	<b>1,595,511</b>	–
Aggregate remuneration 2010	881,052	185,753	202,250	103,328	13,244	–	1,385,627
Aggregate remuneration 2010 US\$	1,362,072	287,167	312,671	159,741	20,475	–	2,142,126

\* During the year a bonus equivalent to £85,000 was awarded to Angus MacAskill. Following the deduction of income tax obligations, the residual amount is to be satisfied by the issuance of 102,000 ordinary shares in Sterling Energy Plc with the restriction that they may not be traded for a period of at least 12 months from award.

Directors' interests in LTIP's are accounted for under IFRS 2 (Share-based payments), accounting charges in the period are detailed in note 25.

## REMUNERATION REPORT – continued

### Share Options (audited)

Details of options to acquire ordinary shares in the Company under the scheme approved in 2001 are as follows. The exercise price is shown in pence as this is the price at which the options are denominated under the scheme:

	1st January 2011	Granted	Lapsed	31st December 2011	Exercise price	Exercise period
Andrew Grosse	37,500	–	–	<b>37,500</b>	160p	Up to 18/10/2012
	37,500	–	(37,500)	–	500p	Up to 09/03/2014
	12,500	–	(12,500)	–	680p	Up to 28/01/2015
	37,500	–	(37,500)	–	960p	Up to 29/06/2016
<b>Total</b>	<b>125,000</b>	<b>–</b>	<b>(87,500)</b>	<b>37,500</b>		

### Directors' interests in Sterling Save As You Earn Option Scheme ('SAYE') (audited)

The Directors' interests in the SAYE scheme set up in 2008 are as follows:

	1st January 2011	Cancelled in year	31st December 2011	Option price	Earliest exercise date	Latest exercise date
Jonathan Cooper	10,101	(10,101)	–	95.04p	n/a	n/a
Andrew Grosse	10,101	–	<b>10,101</b>	95.04p	01/12/2011	01/06/2012
	<b>20,202</b>	<b>(10,101)</b>	<b>10,101</b>			

### Directors' interests in the Sterling 2007 Long Term Incentive Plan ('LTIP') (audited)

The Directors' interests in the 2007 LTIP are as follows:

	1st January 2011	Lapsed	Granted	Exercised	31st December 2011	Exercise price	Earliest exercise date*	Latest exercise date*
Jonathan Cooper	105,000	(52,500)	–	–	<b>52,500</b>	40p	03/11/2011	02/02/2012
Andrew Grosse	62,975	(10,000)	–	–	<b>52,975</b>	40p	03/11/2011	02/02/2012
	<b>167,975</b>	<b>(62,500)</b>	<b>–</b>	<b>–</b>	<b>105,475</b>			

\*If the Company is in a closed period the earliest and latest date of exercise may vary.

Jonathan Cooper and Andrew Grosse did not exercise any interests by the latest expiry date of 2 February 2012.

### All Staff Long-Term Incentive Plan (audited)

The Directors' interests in the All Staff LTIP are as follows:

	1st January 2011	Lapsed	Granted	Exercised	31st December 2011	Exercise price	Earliest exercise date	Latest exercise date
Alastair Beardsall**	1,125,000	–	–	–	<b>1,125,000</b>	40p	01/10/2012	30/09/2014
Jonathan Cooper	592,893	(592,893)	–	–	–	40p	n/a	n/a
Philip Frank	–	–	1,097,600	–	<b>1,097,600</b>	40p	01/10/2014	30/09/2016
Andrew Grosse	698,350	(698,350)	–	–	–	40p	n/a	n/a
Angus MacAskill	1,000,000	–	609,800	–	<b>1,609,800</b>	40p	01/10/2013	30/09/2015
	<b>3,416,243</b>	<b>(1,291,243)</b>	<b>1,707,400</b>	<b>–</b>	<b>3,832,400</b>			

\*\* In recognition of Alastair Beardsall's efforts in the fund raising and the September 2009 Placing, and as a means of retention, 50 per cent of the options awarded to him in 2009 will vest without performance criteria in October 2012, always provided he remains employed by the Company at that time.

### Non-executive Directors Long-Term Incentive Plan (audited)

The non-executive Directors' interests in the NED LTIP are as follows:

	1st January 2011	Lapsed	Granted	Exercised	31st December 2011	Exercise price	Earliest exercise date*	Latest exercise date*
Nicholas Clayton**	125,000	–	–	–	<b>125,000</b>	40p	01/10/2012	30/09/2014
Keith Henry**	125,000	–	–	–	<b>125,000</b>	40p	01/10/2012	30/09/2014
Malcolm Pattinson***	–	–	125,000	–	<b>125,000</b>	40p	01/01/2014	31/03/2015
Richard Stabbins (resigned 31 December 2010)	52,084	–	–	–	<b>52,084</b>	40p	03/11/2011	02/02/2012
	<b>302,084</b>	–	125,000	–	<b>427,084</b>			

\*If the Company is in a closed period the earliest and latest date of exercise may vary.

\*\* Approved by shareholders at the AGM held on 22 December 2009.

\*\*\* Approved by shareholders at the AGM held on 28 April 2011.

Richard Stabbins did not exercise any interests by the latest expiry date of 2 February 2012.

The rules of the LTIP schemes are summarised in note 25.

For and on behalf of the Board

**Keith Henry**

*Chairman, Remuneration Committee*

19 March 2012

# DIRECTORS' REPORT

The Directors present their annual report on the affairs of Sterling and its subsidiaries, together with the financial statements and auditors' report for the year ended 31 December 2011.

## PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the Group and Company throughout the year remained the exploration for and production of oil and gas in Africa and the Middle East. The significant developments during 2011 and the other activities of the Group, as well as the future strategy and prospects for the Group, are reviewed in detail in the Chairman's Statement, the Chief Executive's Review, the Operational Review and the Financial Review.

The Group operates through overseas branches and subsidiary undertakings as appropriate to the fiscal environment. Significant subsidiary undertakings of the Group are set out in note 15 to the financial statements.

The Group uses a number of key performance indicators (KPI's) to assess the business performance against strategy. These are net debt (\$), reserves (million boe), EBITDA (\$), production (bopd) and share price growth and analysis of the KPI's can be found in the Financial Review.

## RESULTS AND DIVIDENDS

The Group profit for the financial year was \$18.4 million (2010: profit of \$5.8 million). This leaves an accumulated Group retained deficit of \$411.1 million (2010: deficit \$431.4 million) to be carried forward. The Directors do not recommend the payment of a dividend (2010: nil).

## GOING CONCERN

The Group business activities, together with the factors likely to affect its future development, performance and position are set out in the Operations Review on pages 6 to 12. The financial position of the Group and Company, its cash flows and liquidity position are described in the Financial Review on page 16. In addition, note 24 to the financial statements include the Group's objectives, policies and processes for managing its capital financial risk: details of its financial instruments and its exposures to credit risk and liquidity risk.

The Group has sufficient cash resources for its working capital needs and its committed capital expenditure programme at least for the next 12 months. As a consequence, the Directors believe that both the Group and Company are well placed to manage their business risks successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

## CAPITAL STRUCTURE

Details of the issued share capital, together with details of the movements in the Company's issued share capital during the year, are shown in note 17 to the financial statements. The Company has one class of ordinary share which carries no right to fixed income. Each share carries the right to one vote at general meetings of the Company.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights. Details of the employee share schemes are set out in note 25.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

## DIRECTORS

The Directors who served during the year were as follows:

Mr. Alastair Beardsall  
Mr. Nicholas Clayton  
Dr. Jonathan Cooper (resigned 18 October 2011)  
Mr. Andrew Grosse (resigned 3 October 2011)  
Dr. Philip Frank (appointed 3 October 2011)  
Mr. Keith Henry  
Mr. Angus MacAskill  
Mr. Malcolm Pattinson

Biographical details of serving Directors can be found in the Board of Directors section of this report.

## DIRECTORS' ELECTION AND ROTATION

With regard to the appointment and replacement of the Directors, the Company is governed by its Articles of Association, the Code, the Companies Acts and related legislation. The powers of Directors are described in the Corporate Governance section.

In accordance with article 110 of the Company's Articles of Association Philip Frank offers himself for election at the forthcoming AGM on 19 April 2012.

In accordance with article 106 of the Company's Articles of Association Alastair Beardsall retires by rotation and offers himself for re-election at the forthcoming AGM.

## DIRECTORS' AND THEIR INTERESTS

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

Ordinary shares of 40p each	19-March 2012	31-December 2011	31-December 2010
Alastair Beardsall**	500,000	500,000	500,000
Nicholas Clayton*	132,500	132,500	132,500
Jonathan Cooper** (resigned 18 October 2011)	n/a	n/a	58,012
Philip Frank** (appointed 3 October 2011)	32,204	32,204	–
Andrew Grosse** (resigned 3 October 2011)	n/a	n/a	696,211
Keith Henry*	500,000	500,000	500,000
Angus MacAskill**	100,000	100,000	–
Malcolm Pattinson*	62,810	62,810	12,810

\* Non-executive Director, member of the Audit, Remuneration and Nominations Committees.

\*\* Executive Director.

Beneficial shareholdings include the shareholdings of a Director's spouse and infant children.



## DIRECTORS' REPORT – *continued*

### SUBSTANTIAL SHAREHOLDING

Except for the holdings of ordinary shares listed below, the Company has not been notified by or become aware of any persons holding 3% or more of the 219,389,020 issued ordinary shares of 40 pence each of the Company at 19 March 2012:

	Number	%
Waterford Finance and Investment Limited	65,384,217	29.80
Invesco Asset Management Limited	39,737,820	18.11
Mr. Denis O'Brien	16,190,443	7.38
Artemis Investment Management Limited	10,910,174	4.97

### SUPPLIER PAYMENT POLICY AND PRACTICE

The Company's and Group's policy is to settle terms of payment with suppliers when agreeing each transaction, ensuring that suppliers are made aware of the terms of payment and abide by them. At the 2011 year end, the number of supplier days outstanding for the Group was 37 days (2010: 69 days).

### CHARITABLE AND POLITICAL CONTRIBUTIONS

During the year the Group and Company made charitable donations of \$800 (2010: \$2,500), principally to local charities serving the communities in which the Group operates. No political contributions were made during the year (2010: \$nil).

### BUSINESS RISK

The Directors have identified the following current principal risks in relation to the Company's future performance. The relative importance of risks faced by the Company can, and is likely to change with progress in the Company's strategy and developments in the external business environment.

#### **Strategic:**

##### *Strategy risk*

The Company's strategy may not deliver the results expected by shareholders. The Directors regularly monitor the appropriateness of the strategy, taking into account both internal and external factors, and the progress in implementing the strategy, and modify the strategy as may be required based on results. Key elements of this process are annual business plans and strategy reviews, monthly reporting, and regular Board meetings.

The Board has identified the broadening of the exploration portfolio, using the existing financial resources of the Company, as an important element of the Company's strategy.

#### **Operational:**

##### *Exploration risk*

Exploration activities within the Company's licences may not result in a commercial discovery. Sterling is pursuing a growth strategy with a concentrated portfolio of exploration assets. The historic industry average exploration drilling success rate is approximately one success for every five wells. There is no certainty of success from the existing portfolio.

Sterling mitigates the exploration risk through the experience and expertise of the Company's specialists, the application of appropriate technology, and the selection of prospective exploration assets. The Company has an objective to acquire additional exploration assets, which will diversify exploration risk.

### *Health, Safety, Environment, and Security ('HSES') risk*

The Company conducts operations in countries in Africa and the Middle East. There is a risk of an HSES incident in these operations, with the potential to impact staff, contractors, communities, and the environment, and to have a negative impact on the Company's reputation. This risk is mitigated through the implementation of the Company's HSES management system, training of staff, and selection of contractors.

### **Financial:**

#### *Counterparty risk*

Sterling's cash resources may be negatively affected by failure of a counterparty. To mitigate this risk, the Company holds a large proportion of its cash reserves in US dollars on deposit with banks and institutions with a minimum credit rating of AA-. Additionally, the maximum amount that can be placed within any single financial institution is capped. The currency for most contracts, procurement, services and oil sales, is US dollars and therefore the Company believes it is not particularly exposed to large currency fluctuations. Furthermore, with substantial cash reserves the Company has no immediate requirement to raise new equity or debt and therefore is not exposed to the current uncertainty in the equity capital or debt markets.

### **External:**

#### *Country risk*

The Company's assets are located in non-OECD countries. Governments, regulations, and the security environment may change with a consequential effect on the Company's assets. The Company's assets in Cameroon and Madagascar are currently affected by country-specific situations.

In Cameroon, the Company holds a 50% working interest in the highly prospective Ntem block. The Governments of Cameroon and Equatorial Guinea are negotiating their joint maritime border, part of which runs concurrent with two of the Ntem block boundaries. The Company believes the final location of the maritime border will not impinge upon the Ntem area, however there is no certainty that, when agreement over the maritime border is reached, the Ntem acreage will remain as it is defined under the current licence agreement with the Cameroon Government.

The Company is in negotiations with OMNIS and the Government of Madagascar to prolong the Ampasindava and Ambilobe licences; the existing exploration phase of each licence ended in November 2010. The Company believes the discussions are progressing well and expects a positive outcome; however there is no certainty of a positive outcome.

Country risk is mitigated by monitoring the political, regulatory, and security environment within the countries in which Sterling holds assets, engaging in constructive discussions where and when appropriate, and introducing third-party expertise if this may assist in resolution of issues affecting the Company's assets.

The Company has an objective to acquire additional assets for the exploration portfolio, which may assist in diversifying country risk.

## DIRECTORS' REPORT – continued

In addition to the current principal risks identified above and general business risks, the Group's business is subject to risks inherent in oil and gas exploration, development and production activities. There are a number of potential risks and uncertainties which could have a material impact on the Group's long-term performance and could cause actual results to differ materially from expected and historical results. The Company has identified certain risks pertinent to its business including:

Category	Risk
Strategic and Economic	<ul style="list-style-type: none"> <li>Inappropriate or poorly conceived strategy and plans</li> <li>Failure to deliver on strategy and plans</li> <li>Business environment changes</li> <li>Significant competition</li> <li>Regulatory barriers to entry</li> <li>Operations in territories which are susceptible to political, fiscal and social instability</li> <li>Limited diversification</li> <li>Shareholder concentration</li> </ul>
Operational	<ul style="list-style-type: none"> <li>HSE incident or non-compliance under local rules and/or laws</li> <li>Poor field performance</li> <li>Failure to add value through exploration</li> <li>Licences, permits and/or approvals maybe difficult to sustain</li> <li>Reliance on other operators</li> <li>Delays in conducting work programmes</li> </ul>
Commercial	<ul style="list-style-type: none"> <li>Failure to access new opportunities</li> <li>Failure to maximise value from existing interests</li> <li>Loss of control of key assets</li> <li>Dissatisfied stakeholders</li> <li>Failure to negotiate optimal contract terms</li> <li>Reserve and production estimations are not exact determinations</li> <li>Regulatory compliance and legal</li> </ul>
Human Resources and Management Processes	<ul style="list-style-type: none"> <li>Failure to recruit and retain key personnel</li> <li>Human error or deliberate negative action</li> <li>Inadequate management processes</li> <li>Insufficient timely information available to the management and the Board</li> </ul>
Financial	<ul style="list-style-type: none"> <li>Restrictions in capital markets impacting available financial resource</li> <li>Oil or gas price volatility impacting both revenues and reserves</li> <li>Counterparty default</li> <li>Cost escalation and budget overruns</li> <li>Fiscal changes</li> <li>Operations under-insured</li> <li>Foreign currency risk</li> </ul>

The Directors regularly monitor such risks, using information obtained or developed from external and internal sources, and will take actions as appropriate to mitigate these. Effective risk mitigation may be critical to Sterling in achieving its strategic objectives and protecting its assets, personnel and reputation. The Company has developed a business management system, including a risk management process which identifies key business risks and measures to mitigate these risks and then implements such measures considered appropriate. Other significant elements of the business

management system include regular Board review of the business, defined process for preparation and approval of the annual work programme and budget, monthly management reporting, financial operating procedures, and HSES and anti-bribery management systems.

Sterling reviews its business risks and management systems on a regular basis and, through this process, the Directors have identified the principal risks. The Company manages some risks by maintaining a portfolio of projects and ensuring the Company is in compliance with the terms of all its agreements, through the application of appropriate policies and procedures implemented in the business management system, and via the recruitment and retention of a team of skilled and experience professionals.

### **FINANCIAL INSTRUMENTS**

Information about the use of financial instruments, the Group's policy and objectives for financial risk management is given in note 24 to the financial statements.

### **AUDITORS**

Each of the persons who are a Director at the date of approval of this Annual Report confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

BDO LLP has expressed its willingness to continue in office as auditors and a resolution to appoint BDO will be proposed at the forthcoming Annual General Meeting.

**Angus MacAskill**

*Director*

19 March 2012

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period. The Directors are also required to prepare financial statements in accordance with the rules of the London Stock Exchange for companies trading securities on the Alternative Investment Market.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the European Union, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the requirements of the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## **WEBSITE PUBLICATION**

The Directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the Company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the Company's website is the responsibility of the Directors. The Directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

## **DIRECTORS' RESPONSIBILITY STATEMENT**

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the annual report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

For and on behalf of the Board

**Angus MacAskill**

*Director*

19 March 2012

# INDEPENDENT AUDITORS' REPORT

We have audited the financial statements of Sterling Energy Plc for the year ended 31 December 2011 which comprise of the group statement of comprehensive income, the group and company statement of financial position, the group and company statement of changes in equity, the group and company statement of cash flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## **RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

As explained more fully in the Statement of Directors' Responsibilities, 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 and express an opinion on 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 (APB's) Ethical Standards for Auditors.

The Directors have chosen to comply with the requirements of the Listing Rules and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports Regulations) 2008 made under Section 421 of the Companies Act 2006 ("Schedule 8") with regard to the Directors' Remuneration Report as if the company is a quoted company included on the official list.

Our responsibility is to audit and express an opinion on that part of the Directors' Remuneration Report to be audited. Other than previously noted we are not responsible for auditing and expressing an opinion on the company's compliance with the requirements of the Listing Rules.

## **SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS**

A description of the scope of an audit of financial statements is provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm).

## **OPINION ON FINANCIAL STATEMENTS**

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2011 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and
- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

## **OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006**

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

## INDEPENDENT AUDITORS' REPORT – *continued*

### **MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

**Scott Knight** (senior statutory auditor)

For and on behalf of BDO LLP,

*statutory auditor*

London

United Kingdom

19 March 2012

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2011

	Note	31st December 2011 \$000	31st December 2010 \$000
Revenue	4	19,146	25,314
Cost of sales	6	(6,113)	(13,565)
<b>Gross profit</b>		<b>13,033</b>	11,749
Other administrative expenses		(3,728)	(3,649)
Reversal of impairment of oil and gas assets		8,269	–
Impairment of oil and gas assets		(33)	(152)
Pre-licence costs		(1,282)	(698)
<b>Total administrative expenses</b>		<b>3,226</b>	(4,499)
<b>Profit from operations</b>	5	<b>16,259</b>	7,250
Finance income	8	3,212	224
Finance expense	8	(1,051)	(1,629)
<b>Profit before tax</b>		<b>18,420</b>	5,845
Tax	9	–	–
<b>Profit for the year attributable to the owners of the parent</b>		<b>18,420</b>	5,845
<b>Other comprehensive income/(expense)</b>			
Currency translation adjustments		31	(127)
Revaluation of investments		–	(12)
Total other comprehensive income/(expense) for the year		31	(139)
<b>Total comprehensive income for the year attributable to the owners of the parent</b>		<b>18,451</b>	5,706
<b>Basic profit per share (USc)</b>	11	<b>8.40</b>	2.66
<b>Diluted profit per share (USc)</b>	11	<b>8.29</b>	2.65



# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2011

	Note	31st December 2011 \$000	31st December 2010 \$000
<b>Non-current assets</b>			
Intangible royalty assets	12	3,221	824
Intangible exploration and evaluation assets	13	22,455	20,793
Property, plant and equipment	14	5,643	175
		<b>31,319</b>	21,792
<b>Current assets</b>			
Inventories		2,872	901
Trade and other receivables	16	922	17,695
Cash and cash equivalents		115,826	111,679
		<b>119,620</b>	130,275
<b>Total assets</b>		<b>150,939</b>	152,067
<b>Equity</b>			
Share capital	17	148,589	148,573
Share premium		378,859	378,859
Currency translation reserve		(204)	(235)
Retained deficit		(411,103)	(431,380)
<b>Total equity</b>		<b>116,141</b>	95,817
<b>Non-current liabilities</b>			
Long-term provisions	20	20,297	22,231
		<b>20,297</b>	22,231
<b>Current liabilities</b>			
Trade and other payables	21	14,501	34,019
		<b>14,501</b>	34,019
<b>Total liabilities</b>		<b>34,798</b>	56,250
<b>Total equity and liabilities</b>		<b>150,939</b>	152,067

The financial statements of Sterling Energy Plc, registered number 1757721 were approved by the Board of Directors and authorised for issue on 19 March 2012.

Signed on behalf of the Board of Directors

Angus MacAskill  
Director

Alastair Beardsall  
Director

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2011

	Share capital \$000	Share premium \$000	Investment revaluation reserve \$000	Currency translation reserve \$000	Retained deficit*	Total \$000
At 1 January 2010	148,537	378,859	12	(108)	(439,161)	88,139
Profit for the year	–	–	–	–	5,845	5,845
Investment revaluation	–	–	(12)	–	–	(12)
Currency translation adjustments	–	–	–	(127)	–	(127)
Total comprehensive income for the year						
attributable to the owners of the parent	–	–	(12)	(127)	5,845	5,706
Issued share capital	36	–	–	–	–	36
Share option charge for the year	–	–	–	–	1,936	1,936
At 31 December 2010	148,573	378,859	–	(235)	(431,380)	95,817
Profit for the year	–	–	–	–	18,420	18,420
Currency translation adjustments	–	–	–	31	–	31
Total comprehensive income for the year						
attributable to the owners of the parent	–	–	–	31	18,420	18,451
Issued share capital	16	–	–	–	–	16
Share option charge for the year	–	–	–	–	1,857	1,857
<b>At 31 December 2011</b>	<b>148,589</b>	<b>378,859</b>	<b>–</b>	<b>(204)</b>	<b>(411,103)</b>	<b>116,141</b>

\* The share option reserve has been included within the retained deficit reserve.

# CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2011

	Note	31st December 2011 \$000	31st December 2010 \$000
<b>Operating activities</b>			
Cash generated from operations	23	5,573	10,446
<b>Net cash flow from operating activities</b>		<b>5,573</b>	<b>10,446</b>
<b>Investing activities</b>			
Interest received		365	224
Purchase of property, plant and equipment		(41)	(178)
Exploration and evaluation costs		(1,695)	(12,030)
Proceeds on disposal of available for sale assets		–	20
Proceeds on disposal of PPE		22	–
<b>Net cash used in investing activities</b>		<b>(1,349)</b>	<b>(11,964)</b>
<b>Financing activities</b>			
Net proceeds from issue of ordinary shares		16	36
<b>Net cash flow generated from financing activities</b>		<b>16</b>	<b>36</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>4,240</b>	<b>(1,482)</b>
<b>Cash and cash equivalents at beginning of year</b>		<b>111,679</b>	<b>113,859</b>
Effect of foreign exchange rate changes		(93)	(698)
<b>Cash and cash equivalents at end of year</b>		<b>115,826</b>	<b>111,679</b>

# COMPANY STATEMENT OF FINANCIAL POSITION

31 December 2011

	Note	31st December 2011 \$000	31st December 2010 \$000
<b>Non-current assets</b>			
Property, plant and equipment	14	5,602	15
Investments	15	105,740	223,137
		<b>111,342</b>	223,152
<b>Current assets</b>			
Inventories		2,872	901
Trade and other receivables	16	21,395	47,185
Cash and cash equivalents		114,831	100,936
		<b>139,098</b>	149,022
<b>Total assets</b>		<b>250,440</b>	372,174
<b>Equity</b>			
Share capital	17	148,589	148,573
Share premium		378,859	378,859
Retained deficit		(368,070)	(371,480)
<b>Total equity</b>		<b>159,378</b>	155,952
<b>Non-current liabilities</b>			
Long-term provisions	20a	20,144	22,032
		<b>20,144</b>	22,032
<b>Current liabilities</b>			
Trade and other payables	21	70,918	194,189
		<b>70,918</b>	194,189
<b>Total liabilities</b>		<b>91,062</b>	216,221
<b>Total equity and liabilities</b>		<b>250,440</b>	372,174

The financial statements of Sterling Energy Plc, registered number 1757721 were approved by the Board of Directors and authorised for issue on 19 March 2012.

Signed on behalf of the Board of Directors

Angus MacAskill  
Director

Alastair Beardsall  
Director

# COMPANY STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2011

	Share capital \$000	Share premium \$000	Retained deficit* \$000	Total \$000
At 1 January 2010	148,537	378,859	(381,565)	145,831
Total comprehensive income for the year	–	–	8,149	8,149
Issued share capital	–	–	–	36
Share option charge for the year	36	–	1,936	1,936
At 31 December 2010	148,573	378,859	(371,480)	155,952
Total comprehensive income for the year	–	–	1,553	1,553
Issued share capital	16	–	–	16
Share option charge for the year	–	–	1,857	1,857
<b>At 31 December 2011</b>	<b>148,589</b>	<b>378,859</b>	<b>(368,070)</b>	<b>159,378</b>

\* The share option reserve has been included within the retained deficit reserve.

# COMPANY STATEMENT OF CASH FLOWS

Year ended 31 December 2011

	Note	31st December 2011 \$000	31st December 2010 \$000
<b>Operating activities</b>			
Cash generated from/(used in) operations	23	<b>13,527</b>	(4,484)
<b>Net cash flow used in operating activities</b>		<b>13,527</b>	(4,484)
<b>Investing activities</b>			
Interest received		<b>365</b>	224
Proceeds on disposal of PPE		<b>22</b>	–
<b>Net cash generated from investing activities</b>		<b>387</b>	224
<b>Financing activities</b>			
Net proceeds from issue of ordinary shares		<b>16</b>	36
<b>Net cash flow generated from financing activities</b>		<b>16</b>	36
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>13,930</b>	(4,224)
<b>Cash and cash equivalents at beginning of year</b>		<b>100,936</b>	106,265
Effect of foreign exchange rate changes		<b>(35)</b>	(1,105)
<b>Cash and cash equivalents at end of year</b>		<b>114,831</b>	100,936

# NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2011

## 1. ACCOUNTING POLICIES

### a) General information

Sterling Energy Plc is a public Company incorporated in the United Kingdom under the UK Companies Act. The address of the registered office is 5 Chancery Lane, London, WC2A 1LG. The Company and the Group are engaged in the exploration for, and development and production of, oil and gas.

These financial statements are presented in US dollars as this is the currency in which the majority of the Group's revenues and expenditure are transacted and the functional currency of the Company.

### b) Basis of accounting and adoption of new and revised standards

(i) New and amended standards adopted by the Group:

The following new standards and amendments to standards are mandatory for the first time for the Group for financial year beginning 1 January 2011. Except as noted, the implementation of these standards is not expected to have a material effect on the Group.

Standard	Effective date	Impact on initial application
IAS 24 – Revised – Related Party Disclosures	1 January 2011	The structure of definition of a related party has been simplified and inconsistencies eliminated. Illustrative examples have also been added. The entities that are most likely to be affected are those that are part of a group that includes both subsidiaries and associates, and entities with shareholders that are involved with other entities.
Improvements to IFRSs (2010)	Generally 1 January 2011	The improvements in this Amendment clarify the requirements of IFRSs and eliminate inconsistencies within and between Standards. The improvements did not have any impact on the current or prior years' financial statements.

No other IFRS issued and adopted but not yet effective are expected to have an impact on the Group's financial statements.

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 1. ACCOUNTING POLICIES – *continued*

- (ii) Standards, amendments and interpretations, which are effective for reporting periods beginning after the date of these financial statements which have not been adopted early:

Standard	Description	Effective date
IFRS 7	Amendment disclosure of information in respect of transferred financial assets not derecognised	1 July 2012
IFRS 1	Amendment of fixed date of transition to IFRSs'	1 July 2011
IAS 12	Deferred Tax: Recovery of Underlying Assets	1 January 2012
IAS 1	Presentation of Items of Other Comprehensive Income	1 July 2012
IFRS 9	Financial Instruments	1 January 2013
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 27	Separate Financial Statements	1 January 2013
IAS 28	Investments in Associates and Joint Ventures	1 January 2013
IAS 19	Employee Benefits	1 January 2013
IFRS 7	Amendment disclosure, offsetting financial assets and financial liabilities.	1 January 2013
IAS 32	Amendment offsetting financial assets and financial liabilities.	1 January 2014

The Group has not yet assessed the impact of IFRS 9. Amendments and interpretations are not expected to materially affect the Group's reporting or reported numbers.

#### c) Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Directors' Report.

#### d) Basis of consolidation

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

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

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

As a consolidated Group statement of comprehensive income and expense is published, a separate statement of comprehensive income and expense for the parent Company has not been published in accordance with section 408 of the Companies Act 2006.

**1. ACCOUNTING POLICIES – continued**

Jointly controlled operations are arrangements in which the Group holds an interest on a long term basis which are jointly controlled by the Group and one or more ventures under a contractual arrangement. The Group's exploration, development and production activities are sometimes conducted jointly with other companies in this way. Since these arrangements do not constitute entities in their own right, the consolidated financial statements reflect the relevant proportion of costs, revenues, assets and liabilities applicable to the Group's interests.

**e) Revenue**

Sales of oil and gas are recognised, net of any sales taxes when goods are delivered or the title has passed to the customer. Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable. Royalties and tariff income are recognised as earned on an entitlement basis. Dividend revenue from investments is recognised when the shareholders' rights to receive payment have been established.

**f) Oil and gas interests**

**Exploration and evaluation assets**

The Group accounts for oil and gas exploration under the full cost method having regard to the requirements of IFRS 6 Exploration for and Evaluation of Mineral Resources. E&E costs are initially capitalised within intangible assets. Such E&E costs include licence acquisition costs, geological and geophysical costs, costs of drilling exploration and appraisal wells, and an appropriate share of overheads. E&E costs are capitalised and accumulated in cost pools which are not larger than a segment. Expenditures incurred before the Group has obtained the legal rights to explore a specific area are expensed in the year that they are incurred.

Costs relating to the exploration and evaluation of oil and gas interests are carried forward until the existence or otherwise of commercial reserves has been determined.

If commercial reserves have been discovered, the related E&E assets are assessed for impairment and the resultant carrying value is then reclassified as oil and gas assets within property, plant and equipment, on a cost pool by cost pool basis.

E&E assets that are determined not to have resulted in the discovery of commercial reserves remain capitalised as intangible E&E assets at cost, subject to the relevant cost pool meeting an impairment test as set out below.

Under the full cost method, impairment tests on E&E assets are conducted on an individual cost pool basis, including any development or producing assets, when facts and circumstances suggest that the carrying amount in the pool may exceed its recoverable amount. Such indicators include the point at which a determination is made as to whether or not commercial reserves exist. The E&E assets are tested for impairment together with all development and production assets associated with that cost pool, as a single cash-generating unit. The aggregate carrying value is compared against the expected recoverable amount of the cost pool, generally by reference to the present value of the future cash flows expected to be delivered from production of commercial reserves. Where the E&E assets to be tested fall outside the scope of any established cost pool, there will generally be no commercial reserves and if the E&E is determined as unsuccessful the E&E assets concerned will be written off in full. Any impairment loss is separately recognised within the statement of comprehensive income.

Impaired assets are reviewed annually to determine whether any substantial change to their fair value amounts previously impaired would require reversal.

A previously recognised impairment loss is reversed if the recoverable amount increases as a result of a change in the estimates used to determine the recoverable amount, but not to an amount higher than the carrying amount that would have been determined (net of depletion or amortisation) had no impairment loss been



## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 1. **ACCOUNTING POLICIES** – *continued*

recognised in prior periods. Reversal of impairments and impairment charges are credited/(charged) to a separate line item under total costs in the Consolidated Income Statement.

Refer to note 5 for detailed disclosure of the results of impairments and impairment reviews performed.

#### **Development and production assets**

Development and production assets are generally accumulated on a field-by-field basis and include the cost of developing the commercial reserves discovered and bringing them into production, together with the E&E expenditures, incurred in finding commercial reserves, transferred from intangible E&E assets as outlined above, which constitutes a single cash generating unit. Depletion is provided for on a cash-generating unit basis on a unit of production basis over the life of the proven and probable commercial reserves taking into account the expected future costs to extract all such reserves.

An impairment test is performed on an individual cash-generating unit whenever events and circumstances indicate that the carrying value of an asset may exceed its recoverable amount.

The recoverable amount is assessed as the present value of the future cash flows expected to be derived from production of commercial reserves.

The cash-generating unit basis is generally the field, however, oil and gas assets, including infrastructure assets, may be accounted for on an aggregated basis where such assets are economically inter-dependent.

#### **Property, plant and equipment assets other than oil and gas assets**

Property, plant and equipment other than oil and gas assets are stated at cost, less accumulated depreciation, and any provision for impairment. Depreciation 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**

Provisions for decommissioning costs are recognised in accordance with IAS 37 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 reporting date to reflect the current best estimate of the cost at present value. The unwinding of the discount is reflected as a finance expense. 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 as part of the cost of the relevant development and production asset. Depletion on this asset is calculated under the unit of production method based on commercial reserves.

### **h) Intangible royalty interests**

The carrying value of each individual royalty interest is initially stated at cost, and amortised on the unit of production basis relative to the underlying asset and assessed individually for impairment when there is an indication that an impairment event may have occurred.

### **i) Foreign currencies**

The US dollar is the functional and reporting currency of the Company and the reporting currency of the Group. Transactions denominated in other currencies are translated into US dollar at the rate of exchange ruling at the date of the transaction. Assets and liabilities in other currencies are translated into US dollars at the rate of

**1. ACCOUNTING POLICIES – continued**

exchange ruling at the reporting date. All exchange differences arising from such translations are dealt with in current year comprehensive income.

The results of entities with a functional currency other than the US dollar are translated at the average rates of exchange during the period and their statement of financial position at the rates ruling at the reporting date. Exchange differences arising on translation of the opening net assets and on translation of the results of such entities are dealt with through the currency translation reserve.

**j) Taxation**

**Current tax**

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

**Deferred tax**

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

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

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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

**k) Investments (Company)**

Investments are recognised and derecognised on a trade date where a purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at cost, including transaction costs.

Non-current investments in subsidiary undertakings are shown in the Company's Statement of Financial Position at cost less any provision for permanent diminution of value.

**l) Operating leases**

Rentals under operating leases are charged on a straight-line basis over the lease term.

# NOTES TO THE FINANCIAL STATEMENTS – *continued*

## 1. ACCOUNTING POLICIES – *continued*

### m) Financial instruments

The Group has the following Financial Instruments, all financial assets are loans and receivables. There are no other categories of financial asset.

#### Trade receivables

Trade receivables are measured at amortised cost, unless the effect of the time value of money is immaterial. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired.

#### Cash and cash equivalents

Cash and cash equivalents comprise demand deposits, and other short term highly liquid investments, with an original maturity of less than 3 months, and are readily convertible to a known amount of cash and are subject to an insignificant risk of change in value.

The Group has the following financial liabilities, all are classified as held at amortised cost. The Group holds no other categories of financial liability.

#### Trade payables

Trade payables are stated at their amortised cost.

#### Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the asset of the Group after deducting all of its liabilities. Equity instruments issued by the Company are recorded at the proceeds received net of direct issue costs.

### n) Pension costs

The Group operates a number of defined contribution pension schemes. The amount charged to the Statement of Comprehensive Income for these schemes is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the Statement of Financial Position.

### o) Share-based payments

The Company and Group have applied the requirements of IFRS 2 Share-based payments. The Company issues equity share-based payments to certain employees. The fair value of these awards has been determined at the date of the grant of the award allowing for the effect of any market-based performance conditions. This fair value, adjusted by the estimate of the number of awards that will eventually vest as a result of non-market conditions, is expensed uniformly over the vesting period.

The fair values are calculated using an option pricing model with suitable modifications to allow for employee turnover before vesting and early exercise. The inputs to the model include: the share price at the date of grant; exercise price; expected volatility; expected dividends; risk-free rate of interest; and patterns of exercise of the plan participants.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the Consolidated Statement of Comprehensive Income over the remaining vesting period.

## **1. ACCOUNTING POLICIES – continued**

### **p) Over/(under) lift**

Lifting or off take arrangements for oil and gas produced in certain of the Group's operations are such that each participant may not receive and sell its precise share of the overall production in each period. The resulting imbalance between cumulative entitlement and cumulative liftings is 'underlift' or 'overlift'. Underlifts are valued at the lower of cost and net realisable value and overlifts are valued at market value. Adjustments are made to cost of sales and balances included within receivables and payables as appropriate.

### **q) Inventories**

The Group's share of any material and equipment inventories is accounted for at the lower of cost and net realisable value. Net realisable value is the estimated selling price less the estimated costs of completion and the estimated costs necessary to make the sale. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

### **r) Provisions**

Provisions are recognised when the Group has a present obligation as a result of a past event and it is probable that the Group would be required to settle that obligation. Provisions are measured at the management's best estimate of the expenditure required to settle the obligation at the reporting date, and are discounted to present value where the effect is material.

### **s) Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision makers. The chief operating decision makers have been identified as the executive Board members.

The operating results of each of the geographical segments are regularly reviewed by the Group's chief operating decision makers in order to make decisions about the allocation of resources and to assess their performance. Africa has exploration and development activities, the Middle East has exploration activities and the United Kingdom office is an administrative cost centre.

## **2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY**

In the application of the Group's accounting policies, which are described in note 1, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

### 2. **CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY** – *continued*

#### **Commercial reserves**

Commercial reserves are proven and probable oil and gas reserves, calculated on an entitlement basis. Estimates of commercial reserves underpin the calculation of depletion and amortisation on a unit of production basis. Estimates of commercial reserves include estimates of the amount of oil and gas in place, assumptions about reservoir performance over the life of the field and assumptions about commercial factors which, in turn, will be affected by the future oil and gas price.

#### **Impairment of assets**

Management is required to assess the oil and gas assets for indicators of impairment. The carrying value of oil and gas assets is disclosed in notes 12, 13 and 14. The carrying value of related investments in the Company statement of financial position is disclosed in note 15. As part of this assessment, management has carried out an impairment test on the Chinguetti oil and gas assets within property, plant and equipment. This test compares the carrying value at the reporting date with the expected discounted cash flows from the relevant projects.

For the discounted cash flows to be calculated, management has used a production profile based on its best estimate of proven and probable reserves and a range of assumptions including a 10% pre-tax discount rate and an internally estimated oil price profile. Exploration and evaluation assets are subject to a separate review for indicators of impairment, by reference to the impairment indicators set out in IFRS 6, which is inherently judgemental.

#### **Decommissioning**

The Group has obligations in respect of decommissioning in Mauritania. The extent to which a provision is recognised depends on the legal requirements at the date of decommissioning, the estimated costs and timing of the work and the discount rate applied. Decommissioning estimates for the Chinguetti field are based on a range of operator estimates which are currently under further review by the operator and the Chinguetti partners. Sterling believes the field could be abandoned earlier than originally planned and allowance has been made for this in the calculation of the obligation.

#### **Fair values**

The determination of the fair values of oil and gas properties, particularly exploration and evaluation assets and royalty assets, requires the use of estimates similar to those described above.

#### **Share-based payments**

Management is required to make assumptions in respect of the inputs used to calculate the fair value of share-based payment arrangements. Details of these can be found in note 25.

### 3. **OPERATING SEGMENTS**

The Group's two operating segments are its Africa and Middle East segments. The UK corporate office is a technical and administrative cost centre. The operating results of each of these segments are regularly reviewed by the Group's executive Directors and senior management in order to make decisions about the allocation of resources and to assess their performance.

The accounting policies of these segments are in line with those set out in note 1.

### 3. OPERATING SEGMENTS – *continued*

The following tables present revenue, profit and certain asset and liability information regarding the Group's operating segments for the year ended 31 December 2011, and for the year ended 31 December 2010.

	Corporate		Africa		Middle East		Total	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000	2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Other segment information</b>								
<i>Capital additions</i>								
Property, plant and equipment	41	178	–	–	–	–	41	178
Exploration and evaluation	–	–	(2,786)	3,045	4,481	8,985	1,695	12,030
Depreciation & amortisation	(160)	(299)	(267)	(1,003)	–	–	(427)	(1,302)
Impairment reversal	–	–	8,269	–	–	–	8,269	–
Impairment provision	–	–	(33)	(152)	–	–	(33)	(152)
<b>Segment Assets and Liabilities</b>								
Non-current assets*	41	159	17,432	12,268	13,846	9,365	31,319	21,792
Segment assets**	115,300	102,004	3,297	7,841	1,023	20,430	119,620	130,275
Segment liabilities***	(994)	(1,873)	(33,088)	(34,692)	(716)	(19,685)	(34,798)	(56,250)

Revenue from continuing operations includes amounts of \$17.5 million from one single customer (2010: \$24.0 million). (100% external).

\* Segment non-current assets include \$6.0 million in Cameroon (2010: \$9.4 million), \$13.8 million in Kurdistan (2010: \$9.4 million) and \$8.8 million in Mauritania (2010: nil).

\*\* Carrying amounts of segment assets exclude investments in subsidiaries.

\*\*\* Carrying amounts of segment liabilities exclude intra-group financing.

	Africa		Middle East		Total	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Statement of comprehensive income</b>						
Revenue	19,146	25,314	–	–	19,146	25,314
Cost of sales	(6,113)	(13,565)	–	–	(6,113)	(13,565)
<b>Gross profit</b>	<b>13,033</b>	<b>11,749</b>	<b>–</b>	<b>–</b>	<b>13,033</b>	<b>11,749</b>
Impairment reversal	8,269	–	–	–	8,269	–
Impairment provision	(33)	(152)	–	–	(33)	(152)
Pre-licence costs	(1,282)	(698)	–	–	(1,282)	(698)
<b>Segment result</b>	<b>19,987</b>	<b>10,899</b>	<b>–</b>	<b>–</b>	<b>19,987</b>	<b>10,899</b>
Unallocated corporate expenses					(3,728)	(3,649)
<b>Profit from operations</b>					<b>16,259</b>	<b>7,250</b>
Finance income					3,212	224
Finance expense					(1,051)	(1,629)
<b>Profit before tax</b>					<b>18,420</b>	<b>5,845</b>
Tax					–	–
<b>Profit attributable to owners of the parent</b>					<b>18,420</b>	<b>5,845</b>

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 4. REVENUE

	Total	
	2011 \$000	2010 \$000
Revenue from the sale of oil and gas	17,509	23,978
Royalty income	1,637	1,336
<b>Total operating revenue</b>	<b>19,146</b>	<b>25,314</b>

### 5. PROFIT FROM OPERATIONS

Profit from operations is stated after charging/(crediting):

	Note	Total	
		2011 \$000	2010 \$000
Staff costs	7	4,554	5,772
Share-based payments	7	1,857	1,936
Impairment reversal		(8,269)	–
Impairment expense		33	152
Depreciation of other non-current assets	14	161	308

#### An analysis of auditor's remuneration is as follows:

Fees payable to the Group's auditors for the audit of the

Group's annual accounts	70	62
Audit of the Company's subsidiaries pursuant to legislation	32	31
<b>Total audit fees</b>	<b>102</b>	<b>93</b>
Tax advisory services to previous auditors	37	36
<b>Total non audit fees</b>	<b>37</b>	<b>36</b>

During the year the Company reversed impairments totalling \$8.269 million in accordance with IAS 36 "Impairment of Assets" following a review by the operator of forecast field life estimations on the Chinguetti field in Mauritania. This review resulted in an extension of the economic field life to better reflect decline rates that have been regressing less aggressively than originally prognosed. Of the \$8.269 million, \$5.606 million relates to reversals of prior period impairment losses on the Chinguetti Funding Agreement and \$2.663 million to reversals of prior period impairment losses on the Chinguetti Intangible Royalty Asset.

Impairment reversals have been determined by estimating the value in use and resulted in an increase in field reserves of 0.472 million barrels of oil (Reserves Summary page 13). In calculating this impairment, management used a range of assumptions, including a long-term oil price of \$85 per barrel and a 10% pre-tax discount rate.

### 6. COST OF SALES

	2011 \$000	2010 \$000
Amortisation of intangible royalty asset	266	994
Operating costs	7,814	9,105
(Under)/over lift of product entitlement	(1,967)	3,466
	<b>6,113</b>	<b>13,565</b>

## 7. EMPLOYEE INFORMATION

The average monthly number of employees of the Group (including executive Directors) was:

	2011	2010
Africa & Middle East	17	20
Corporate support staff	14	14
	<b>31</b>	<b>34</b>

Group employee costs during the year (including executive Directors) amounted to:

	2011 \$000	2010 \$000
Wages and salaries	3,831	4,912
Social security costs	426	497
Other pension costs	297	363
Share-based payments	1,857	1,936
	<b>6,411</b>	<b>7,708</b>

Key management personnel include Directors who have been paid \$1.600 million (2010: \$2.142 million), see Remuneration Report for additional detail.

A portion of the Group's staff costs and associated overheads are recharged to the joint venture partners, expensed as pre-licence expenditure or capitalised where they are directly attributable to on-going capital projects. In 2011 this portion amounted to \$5.140 million (2010: \$6.807 million).

## 8. FINANCE INCOME AND FINANCE EXPENSE

	2011 \$000	2010 \$000
<b>Finance income:</b>		
Interest revenue on short-term deposits	365	224
Revisions to discount on decommissioning provision in year	2,847	–
	<b>3,212</b>	<b>224</b>
<b>Finance expense:</b>		
Interest on bank loans and bank charges	10	14
Unwinding of discount on decommissioning provision	959	1,045
Unwinding of discount on production royalty bonus provision	21	19
Exchange differences	61	551
	<b>1,051</b>	<b>1,629</b>



## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 9. TAXATION

The difference between the tax credit of \$nil (2010: \$nil) and the amount calculated by applying the applicable standard rate of tax is as follows:

	Total	
	2011 \$000	2010 \$000
Profit before tax	<b>18,420</b>	5,845
Tax on profit on ordinary activities at standard UK corporation tax rate of 26.5% (2010: 28%)	<b>4,881</b>	1,637
<b>Effects of:</b>		
Expenses not deductible for tax purposes	<b>(2,117)</b>	866
Capital allowances in excess of depreciation	<b>(2,981)</b>	(3,644)
Other temporary differences	–	(25)
Adjustment for tax losses	<b>217</b>	1,166
Tax charge for the year	–	–

### 10. PROFIT ATTRIBUTABLE TO THE COMPANY

The profit for the financial year dealt within the Company accounts of Sterling Energy Plc was \$1.553 million (2010: profit of \$8.149 million). As provided by s408 of the Companies Act 2006, no individual statement of comprehensive income and expense is provided in respect of the Company.

### 11. EARNINGS PER SHARE

The calculation of basic profit per share is based on the Group consolidated profit for the financial year of \$18.420 million (2010: profit \$5.845 million) and on 219,382,869 (2010: 219,332,806) ordinary shares, being the weighted average number of ordinary shares in issue. For the year ended 31 December 2011, the basic earnings per share were 8.40 US¢ per share (2010: profit 2.66 US¢ per share).

For the year ended 31 December 2011, the fully diluted earnings per share were 8.29 US¢ per share (2010: 2.65 US¢ per share). This is computed based on 222,292,291 (2010: 220,865,039) ordinary shares, being the total used for the computation of the basic earnings per share as adjusted in assuming the exercise of 2,909,000 of the 8,844,000 options granted or approved for grant as at 31 December 2011 (see note 25 on page 68).

### 12. INTANGIBLE ROYALTY ASSETS

	Group \$000
Net book value at 31 December 2009 and 1 January 2010	1,818
Amortisation charge for the year	(994)
Net book value at 31 December 2010	824
Impairment reversal	2,663
Amortisation charge for the year	(266)
<b>Net book value at 31 December 2011</b>	<b>3,221</b>

Group net book value at 31 December 2011 comprises the value of rights to future royalties in respect of the Group's agreements covering licences PSC A and PSC B in Mauritania. The value of these royalty interests is

## 12. INTANGIBLE ROYALTY ASSETS – *continued*

dependent upon future oil and gas prices and the development and production of the underlying oil and gas reserves.

An impairment assessment and any subsequent charge are calculated on an individual royalty interest basis. Future recoverable amounts are estimated by management based on the present value of future cash flows expected to be derived from the production of commercial reserves in these licences and are compared against the carrying value of these assets.

During the year impairment losses recognised in prior periods totalling \$2.664 million have been reversed on the Chinguetti asset. Details of impairment losses can be found in note 1 on page 48 and note 5 on page 54.

## 13. INTANGIBLE EXPLORATION AND EVALUATION (E&E) ASSETS

	<b>Group \$000</b>
Net book value at 31 December 2009 and 1 January 2010	8,957
Additions during the year	12,030
Impairment charge for the year	(194)
Net book value at 31 December 2010	20,793
Additions during the year	6,474
Reimbursement of back costs on farm-out	(4,779)
Impairment charge for the year	(33)
<b>Net book value at 31 December 2011</b>	<b>22,455</b>

The amount for intangible exploration and evaluation assets represents investments in respect of exploration licences (see note 1f). Impairment tests on E&E assets are conducted on an individual cost pool basis when facts and circumstances suggest that the carrying amount in the pool may exceed its recoverable amount. The impairment recorded above relates to assets held in the Africa pool of \$0.04 million (2010: \$0.2 million) where the estimated recoverable amount of the property, plant and equipment and E&E in the pool was insufficient to cover the carrying amount.

During the year the Group successfully completed a farm-out of the Ntem block. As part of the farm-out agreement Sterling received \$4.8 million of costs previously incurred on this block (see financial review page 16).

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 14. PROPERTY, PLANT AND EQUIPMENT

Group	Oil and Gas assets \$000	Computer and office equipment \$000	Total \$000
<b>Cost</b>			
At 31 December 2009 and 1 January 2010	185,871	2,771	188,642
Additions during the year	–	178	178
Adjustments during the year	(42)	–	(42)
At 31 December 2010	185,829	2,949	188,778
Additions during the year	–	41	41
Disposals in the year	–	(26)	(26)
Adjustments during the year	(4)	–	(4)
<b>At 31 December 2011</b>	<b>185,825</b>	<b>2,964</b>	<b>188,789</b>
<b>Accumulated depreciation and impairment</b>			
At 31 December 2009 and 1 January 2010	(185,871)	(2,466)	(188,337)
Charge for the year	–	(308)	(308)
Impairment reversal for the year	42	–	42
At 31 December 2010	(185,829)	(2,774)	(188,603)
Charge for the year	–	(161)	(161)
Disposals in the year	–	12	12
Impairment reversal for the year	5,606	–	5,606
<b>At 31 December 2011</b>	<b>(180,223)</b>	<b>(2,923)</b>	<b>(183,146)</b>
<b>Net book value at 31 December 2011</b>	<b>5,602</b>	<b>41</b>	<b>5,643</b>
Net book value at 31 December 2010	–	175	175
Net book value at 31 December 2009	–	305	305

14. **PROPERTY, PLANT AND EQUIPMENT** – *continued*

Company	Oil and Gas assets \$000	Computer and office equipment \$000	Total \$000
<b>Cost</b>			
At 31 December 2009 and 1 January 2010	185,871	176	186,047
Adjustments during the year	(42)	–	(42)
At 31 December 2010	185,829	176	186,005
Adjustments during the year	(4)	–	(4)
Disposals in the year	–	(26)	(26)
<b>At 31 December 2011</b>	<b>185,825</b>	<b>150</b>	<b>185,975</b>
<b>Accumulated depreciation and impairment</b>			
At 31 December 2009 and 1 January 2010	(185,871)	(151)	(186,022)
Charge for the year	–	(10)	(10)
Impairment reversal for the year	42	–	42
At 31 December 2010	(185,829)	(161)	(185,990)
Charge for the year	–	(1)	(1)
Disposals in the year	–	12	12
Impairment reversal for the year	5,606	–	5,606
<b>At 31 December 2011</b>	<b>(180,223)</b>	<b>(150)</b>	<b>(180,373)</b>
<b>Net book value at 31 December 2011</b>	<b>5,602</b>	<b>–</b>	<b>5,602</b>
Net book value at 31 December 2010	–	15	15
Net book value at 31 December 2009	–	25	25

During the year impairment losses recognised in prior periods totalling \$5.606 million have been reversed on the Chinguetti asset. Details of impairment losses can be found in note 1 on page 48 and note 5 on page 54.

15. **INVESTMENT IN SUBSIDIARIES**

	Company \$000
<b>Cost</b>	
At 1 January 2010	221,386
Additions during the year	1,751
At 31 December 2010	223,137
Additions during the year	1,539
Disposals during the year on liquidation of subsidiary undertakings	(118,936)
<b>At 31 December 2011</b>	<b>105,740</b>

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 15. INVESTMENT IN SUBSIDIARIES – *continued*

The principal subsidiary undertakings at the year-end are as follows (these undertakings are included on consolidation):

	Country of incorporation	Class of shares held	Proportion of voting rights held #	Nature of business
Sterling Energy (UK) Limited *	United Kingdom	Ordinary	100%	Exploration for oil and gas
Sterling Energy (International) Limited **	United Kingdom	Ordinary	100%	Exploration for oil and gas
Sterling Northwest Africa Holdings Limited *	Jersey, CI	Ordinary	100%	Exploration for oil and gas
Sterling Cameroon Holdings Limited ***	Jersey, CI	Ordinary	100%	Investment holding company
Sterling Cameroon Limited ***	Jersey, CI	Ordinary	100%	Exploration for oil and gas

\* Held directly by the Company, Sterling Energy Plc

\*\* Held directly by Sterling Energy (UK) Limited

\*\*\* Held directly or indirectly through Sterling Northwest Africa Limited

# 2011 and 2010

During the year the Company voluntarily liquidated Sterling Energy (Mauritania) Limited and Sterling Oil Ltd. The carrying value of these subsidiaries at the date of disposal was \$118.936 million. The net loss on the disposal of these subsidiaries totalled \$16.561 million.

### 16. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Trade receivables	428	6,945	21	6,557
Amounts owed by subsidiary undertakings	–	–	21,308	40,541
Other receivables	51	212	13	41
Amounts due from joint venture partners	46	10,122	–	–
Prepayments and accrued income	397	416	53	46
	<b>922</b>	<b>17,695</b>	<b>21,395</b>	<b>47,185</b>

The Directors consider that the carrying amount of trade and other receivables approximates their fair value.

### 17. SHARE CAPITAL

	2011 \$000	2010 \$000
<b>Authorised, called up, allotted and fully paid</b>		
219,389,020 (2010: 219,363,506) ordinary shares of 40p	<b>148,589</b>	148,573

Movements during the year included:

- Issue of 25,514 Ordinary Shares of 40 pence to a former employee on 29 March 2011.

## 18. RESERVES

Reserves within equity are as follows:

### Share capital

Amounts subscribed for share capital at nominal value.

### Share premium account

The share premium account represents the amounts received by the Company on the issue of its shares which were in excess of the nominal value of the shares.

### Investment revaluation reserve

Gains/losses arising on the revaluation of the Group's investments that are classified as available-for-sale.

### Currency translation reserve

The foreign currency translation reserve includes movements that relate to the retranslation of the subsidiaries whose functional currencies are not the US\$.

### Retained deficit

Cumulative net gains and losses recognised in the Statement of Comprehensive Income less any amounts reflected directly in other reserves.

## 19. DEFERRED TAX

At the reporting date the Group had an unrecognised deferred tax asset of \$21.490 million (2010: \$22.190 million) relating primarily to unused tax losses and unutilised capital allowances. No deferred tax asset has been recognised due to the uncertainty of future profit streams against which these losses could be utilised. At the reporting date the Company had an unrecognised deferred tax asset of \$21.273 million (2010: \$21.919 million) relating primarily to unused losses and unutilised capital allowances.

## 20. LONG-TERM PROVISIONS

	2011 \$000	2010 \$000
<b>Group</b>		
Decommissioning provision (a)	20,144	22,032
2003 Production royalty bonus scheme (b)	153	199
	<b>20,297</b>	22,231

### a) Decommissioning provisions

	2011 \$000	2010 \$000
<b>Group</b>		
At 1 January	22,032	20,987
Revisions in year	(2,847)	–
Unwinding of discount	959	1,045
	<b>20,144</b>	22,032

The amounts shown above for Africa represent the estimated costs for decommissioning the Group's producing interests in respect of its economic interest in the Chinguetti field in Mauritania.

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 20. LONG-TERM PROVISIONS – *continued*

The Company amount of \$20.144 million (2010: \$22.032 million) in Africa represents the amount provided within the Company for future decommissioning expenditure.

During the year the economic field life was extended following a review by the operator of decline rate performance. The extension of field life has resulted in a revision to the provision during the year of \$2.847 million. Full details of impairment losses and reversals can be found in note 1 on page 48 and note 5 on page 54.

#### b) 2003 Production royalty bonus scheme

	2011 \$000	2010 \$000
<b>Group</b>		
At 1 January	<b>199</b>	251
Unwinding of discount	<b>21</b>	19
Transferred to current liabilities	<b>(69)</b>	(63)
Foreign exchange movements	<b>2</b>	(8)
	<b>153</b>	199

This scheme was intended to reward key persons for the successful performance of certain assets after financial thresholds had been reached for the period since listing in 2002. The scheme was terminated in 2007 and replaced by the LTIP scheme ('2007 LTIP', and the 'All Staff LTIP', see note 25) and no further sums will accrue. The Company has the option to require the one remaining beneficiary to subscribe for new ordinary shares for the net amount arising after tax and national insurance from 2008 onwards.

### 21. TRADE AND OTHER PAYABLES

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Trade payables	<b>962</b>	14,696	<b>6</b>	81
Amounts owed to subsidiary undertakings	–	–	<b>58,570</b>	181,656
Amounts advanced from joint venture partners	<b>205</b>	92	–	–
Accruals	<b>13,334</b>	19,231	<b>12,342</b>	12,452
	<b>14,501</b>	34,019	<b>70,918</b>	194,189

The Directors consider that the carrying amount of trade and other payables approximates their fair value.

### 22. OPERATING LEASES AND CAPITAL COMMITMENTS

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Minimum lease payments under operating leases recognised as an expense in the year	<b>4,447</b>	4,598	<b>3,383</b>	3,594



## 22. OPERATING LEASES AND CAPITAL COMMITMENTS – *continued*

At the reporting date outstanding commitments for minimum operating leases payments fall due as follows:

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Within one year	4,395	4,401	3,378	3,373
In the second to fifth year inclusive	696	7,970	490	6,738
After five years	–	–	–	–
	<b>5,091</b>	12,371	<b>3,868</b>	10,111

Operating lease payments represent the Group's share of rentals for an FPSO (Floating Production Storage and Offtake) vessel in Mauritania and rentals payable for certain of its office properties. The current FPSO lease is due to expire in 2013 at which point the Joint Venture Partners have an option to extend the contract for a further period of time.

Included within the \$5.091 million is \$3.378 million and \$0.490 million payable on the FPSO within one year and two to five respectively.

## 23. CASH FLOWS FROM OPERATING ACTIVITIES

	2011 \$000	2010 \$000
<b>Group</b>		
<b>Operating activities:</b>		
Profit before tax	18,420	5,845
Finance income and gains	(3,212)	(224)
Finance expense and losses	1,041	1,615
Depletion and amortisation	427	1,302
Impairment reversal	(8,269)	–
Impairment expense	33	152
Gain on disposal of property, plant and equipment	(8)	(8)
Gain on disposal of available for sale assets	–	(14)
Share-based payment charge	1,857	1,936
Operating cash flow prior to working capital movements	10,289	10,604
(Increase)/decrease in inventories	(1,971)	3,466
Decrease/(increase) in trade and other receivables	16,773	(15,117)
(Decrease)/increase in trade and other payables	(19,518)	11,493
	<b>5,573</b>	10,446

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 23. CASH FLOWS FROM OPERATING ACTIVITIES – *continued*

	2011 \$000	2010 \$000
<b>Company</b>		
<b>Operating activities:</b>		
Profit before tax	1,553	8,149
Finance income and gains	(3,212)	(224)
Finance expense and losses	996	1,962
Depletion and amortisation	1	9
Impairment reversal	(5,605)	(42)
Net movement in investments	(1,539)	–
Disposal of investments	16,569	–
Gain on disposal of property, plant and equipment	(8)	(8)
Share-based payment charge	1,857	1,936
Operating cash flow prior to working capital movements	10,612	11,782
(Increase)/decrease in inventories	(1,971)	3,466
Decrease/(increase) in trade and other receivables	25,790	(17,967)
Decrease in trade and other payables	(20,904)	(1,765)
	<b>13,527</b>	<b>(4,484)</b>

### 24. FINANCIAL INSTRUMENTS

#### Capital risk management and liquidity risk

The Group and Company is not subject to externally imposed capital requirements. The capital structure of the Group and Company consists of cash and cash equivalents held for working capital purposes and equity attributable to the equity holders of the parent, comprising issued capital, reserves and retained deficit as disclosed in the statement of changes in equity. The Group and Company uses cash flow models and budgets, which are regularly updated, to monitor liquidity risk.

#### Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each material class of financial asset, financial liability and equity instrument are disclosed in note 1 to the financial statements.

Due to the short term nature of these assets and liabilities such values approximate their fair values at 31 December 2011 and 31 December 2010.

	Carrying amount/Fair value	
	2011 \$000	2010 \$000
<b>Group</b>		
<b>Financial assets (classified as loans and receivables)</b>		
Cash and cash equivalents	115,826	111,679
Trade and other receivables	525	17,279
<b>Total</b>	<b>116,351</b>	<b>128,958</b>

## 24. FINANCIAL INSTRUMENTS – *continued*

Group	Carrying amount/Fair value	
	2011 \$000	2010 \$000
<b>Financial liabilities at amortised cost</b>		
Trade and other payables	14,501	34,019
<b>Total</b>	<b>14,501</b>	<b>34,019</b>
<hr/>		
Company	Carrying amount/Fair value	
	2011 \$000	2010 \$000
<b>Financial assets (classified as loans and receivables)</b>		
Cash and cash equivalents	114,831	100,936
Trade and other receivables	21,342	47,139
<b>Total</b>	<b>136,173</b>	<b>148,075</b>
<hr/>		
<b>Financial liabilities at amortised cost</b>		
Trade and other payables	70,918	194,189
<b>Total</b>	<b>70,918</b>	<b>194,189</b>

### Financial risk management objectives

The Group's and Company's objective and policy is to use financial instruments to manage the risk profile of its underlying operations. The Group continually monitors financial risk including oil and gas price risk, interest rate risk, equity price risk, currency translation risk and liquidity risk and takes appropriate measures to ensure such risks are managed in a controlled manner including, where appropriate, through the use of financial derivatives. The Group and Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

### Interest rate risk management

The Group and Company does not have any outstanding borrowings and hence, the Group and Company is only exposed to interest rate risk on its short term cash deposits.

### Interest rate sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to interest rates for derivative and non-derivative instruments at the reporting date and assuming the amount of the balances at the reporting date were outstanding for the whole year.

A 100 basis point change represents management's estimate of a possible change in interest rates at the reporting date. If interest rates had been 100 basis points higher and all other variables were held constant the Group's profits and equity would be impacted as follows:

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 24. FINANCIAL INSTRUMENTS – *continued*

	Group Increase		Company Increase	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Cash and cash equivalents	<b>1,158</b>	1,117	<b>1,148</b>	1,009
	<b>1,158</b>	1,117	<b>1,148</b>	1,009

#### Foreign currency translation risk

The Group's and Company's reporting currency is the US dollar; being the currency in which the majority of the Group's revenue and expenditure is transacted. The US dollar is the functional currency of the Company and the majority of its subsidiaries. Less material elements of its management, services and treasury functions are transacted in pounds sterling. The majority of balances are held in US dollars with transfers to pounds sterling and other local currencies as required to meet local needs. The Group does not enter into derivative transactions to manage its foreign currency translation or transaction risk.

The Group and Company's foreign currency translation risk is as follows:

#### Financial assets

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Cash and cash equivalents</b>				
Cash and cash equivalents held in US\$	<b>101,671</b>	111,679	<b>100,862</b>	100,936
Cash and cash equivalents held in GBP	<b>14,155</b>	–	<b>13,969</b>	–
	<b>115,826</b>	111,679	<b>114,831</b>	100,936

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Trade and other receivables</b>				
Trade and other receivables held in US\$	<b>469</b>	17,210	<b>13,693</b>	43,624
Trade and other receivables held in GBP	<b>56</b>	69	<b>7,649</b>	3,515
	<b>525</b>	17,279	<b>21,342</b>	47,139

#### Financial Liabilities

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
<b>Trade and other payables</b>				
Trade and other payables held in US\$	<b>13,763</b>	32,276	<b>65,676</b>	189,190
Trade and other payables held in GBP	<b>738</b>	1,743	<b>5,242</b>	4,999
	<b>14,501</b>	34,019	<b>70,918</b>	194,189

## 24. FINANCIAL INSTRUMENTS – continued

### Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group or Company. The Group and Company reviews the credit risk of the entities that it sells its products to or that it enters into contractual arrangements with and will obtain guarantees and commercial letters of credit as may be considered necessary where risks are significant to the Group or Company. The Group's and Company's business is diversified in terms of both region and the number of counter-parties and the Group and Company does not have significant exposure to any single counter-party or Group and Company of counter-parties with similar characteristics.

In relation to its cash and cash equivalents, the Group has to manage its currency exposures and the credit risk associated with the credit quality of the financial institutions in which the Group maintains its cash resources. At the year-end the Group held approximately 88% (2010: 83%) of its cash in US dollars. At the year-end the Group held the majority of its balances with AA- and A+ Standard & Poors rated institutions. The Group continues to monitor its treasury management to ensure an appropriate balance of the safety of funds and maximisation of yield.

None of the other trade and other receivables had been impaired. Trade and other receivables are non-interest bearing. The Group does not hold any collateral as security and the Group does not hold any significant provision in the impairment account for trade and other receivables as they relate to customers with no default history.

### Liquidity and interest rate tables

The following tables detail the remaining contractual maturity for the non-derivative financial assets and liabilities of the Group and Company. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows including rates for loan liabilities and cash deposits on actual contractual arrangements. The weighted average interest rate used in 2011 is nil (2010: nil).

Group	Less than six months \$000	Six months to one year \$000	One to six years \$000	Total \$000	Interest \$000	Principal \$000
<b>2011</b>						
Trade payables	1,167	–	–	1,167	–	–
2010						
Trade payables	14,788	–	–	14,788	–	–
Company	Less than six months \$000	Six months to one year \$000	One to six years \$000	Total \$000	Interest \$000	Principal \$000
<b>2011</b>						
Trade payables	6	–	–	6	–	–
2010						
Trade payables	81	–	–	81	–	–

### 24. FINANCIAL INSTRUMENTS – *continued*

#### Upside sharing agreement

##### *Fair value measurement at 31 December 2011*

Following the sale of Sterling's U.S. operations to Atinum E&P Inc. ("Atinum") in 2009 the Company holds a three year 'upside sharing agreement', under which the Company is entitled to a 40% share of the annual excess net production proceeds, net of certain costs, if Atinum's average realised oil price exceeds \$90 bbl and/or the realised gas price exceeds \$9 mcf in 2010–2012.

The Company has modelled the value of each of the embedded derivatives (for oil and gas production) using a DCF model at a wide range of oil and gas prices. Each commodity price (at a given point in the future) is calculated using this statistical distribution. The DCF model takes account of production profiles, appropriate discount factors and costs, hedges and other contractual terms.

The probabilities are calculated using a normal distribution whose mean represents the most likely price at the future point and whose standard deviation is related to the volatility of the commodity price. An examination of historical prices for a given time period is analysed to determine the standard deviation and therefore the volatility.

A futures curve is used to establish the market's latest expectation of the commodity price in the future and therefore a mean for the distribution curve. Commodity prices are affected by a large number of variables and for this reason it has been considered appropriate to calculate the probability using a normal distribution.

The upside sharing agreement fair value valuation is based on inputs where there is no observable market data to accurately assess the outcome of the agreement.

At 31 December 2011 the value of the upside sharing agreement was \$nil (31 December 2010: \$nil). The Group has no financial obligation in respect of this agreement.

### 25. SHARE-BASED PAYMENTS

The Group recognised a total expense, within administration costs, in respect of share-based payments under equity-settled share option plans of \$1,857,000 (2010: \$1,936,000). The Company recognised a total expense, within administration costs, in respect of share-based payments under equity-settled share option plans of \$215,000 (2010: \$184,000).

In 2009 the Company reviewed the existing share-based incentive schemes currently in place to motivate and incentivise its employees. The Company also took independent advice to support its review. Based on this, the Company proposed a new All Staff Long Term Incentive Plan as being the most effective way to deliver the incentives that the Board believes will continue to align the interests of the employees and shareholders. Shareholders approved this plan at the December EGM held on 22 December 2009.

With effect from 2009, all further awards are made under the All Staff Long Term Incentive Plan. Awards are made on similar terms to non-executive Directors of the Company, under a separate plan the NED Long Term Incentive Plan.

## 25. SHARE-BASED PAYMENTS – *continued*

### Share options (2002–2007)

Movements during the year on share options were as follows:

	2011 Number of share options	2011 Weighted average exercise price (pence)	2010 Number of share options	2010 Weighted average exercise price (pence)
Outstanding at the beginning of period	<b>1,125,625</b>	<b>337</b>	1,248,125	397
Forfeited during the period	<b>(326,250)</b>	<b>553</b>	(122,500)	816
Exercised during the period	–	–	–	–
Outstanding at the end of the year	<b>799,375</b>	<b>266</b>	1,125,625	337
Exercisable at the end of the year	<b>799,375</b>	<b>266</b>	1,125,625	337

For all options the Group plan provides for a grant price equal to the average quoted market price of the Company's shares on the date of grant. All options are equity settled.

The vesting period for all options is generally two years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Furthermore, some options are forfeited if the employee leaves the Group before the options vest.

The range of exercise prices for options outstanding at the end of the year was:

Year of grant:	2011 Weighted average exercise price (pence)	2011 Number	2010 Number
2001	n/a	–	58,750
2002	<b>160</b>	<b>503,750</b>	546,250
2003	<b>280</b>	<b>193,750</b>	193,750
2004	<b>500</b>	<b>14,375</b>	83,125
2005	<b>681</b>	<b>27,500</b>	100,000
2006	<b>922</b>	<b>47,500</b>	131,250
2007	<b>620</b>	<b>12,500</b>	12,500

No share options were exercised during 2011 (2010: nil). The options outstanding at the end of the year have a weighted average contractual life of 1.18 years (2010: 2.51 years). The cost of share options is spread over the vesting period of two years. The weighted average fair value of options granted during the period was nil pence (2010: nil). Some of the options lapse if the employee leaves the Company.

No further awards were made under this share option scheme post the introduction of the 2007 LTIPs.

#### 2007 Long Term Incentive Plan ("2007 LTIP")

Following the introduction, and approval by shareholders of the All Staff Long Term Incentive Plan ('All Staff LTIP') in 2009, no further awards or grants have been made under the 2007 LTIP, subsisting awards and grants will remain in place and the scheme will be allowed to time lapse.

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 25. SHARE-BASED PAYMENTS – *continued*

Movement during the year on share options were as follows:

	2011 Number of share options	2010 Number of share options
Outstanding at the beginning of period	910,240	1,263,282
Exercised during the period	(25,513)	(53,881)
Lapsed during the period	(467,399)	(299,161)
Outstanding at the end of the year	417,328	910,240
Exercisable at the end of the year	417,328	174,558

The nominal cost options outstanding at the end of the year have a weighted average remaining contractual life of nil years (2010: 0.89 years). The cost of these shares is spread over the vesting period of 3 years (2010: 3 years).

The actual number of shares that will be finally awarded out of the maximum number stated above under the 2007 LTIP, or alternative cash settlement at the parent Company's option, will depend upon the achievement of performance criteria measured over a vesting period of three years for each award.

Up to 50% of the nominal cost options will vest based on a comparison of the total shareholder return ("TSR") of the parent Company as measured against a comparator group of companies ("the First Performance Condition"). The TSR of each Company with the comparator group will be statistically ranked.

The number of options that ultimately vest is based on the Company's relative ranking as follows:

#### TSR compared to comparator group

Below Median	25.0%
Median to Upper Quartile	32.5%
Upper Quartile to Upper Decile	42.5%
Above Upper Decile	50.0%

Up to the other 50% of the nominal cost options will vest based on the share price growth of the Company's shares at the date of grant or at the amendment date for options granted before the amendment date ("the Second Performance Condition") as follows:

#### Share price growth %

Below 50%	25.0%
50% – 75%	30.0%
75% – 100%	35.0%
100% – 125%	40.0%
125% – 150%	45.0%
above 150%	50.0%

The 2007 LTIP options exercised during the year were for good leavers whose awards were pro-rated under the scheme rules and were subject to certain performance criteria.

The Company used the inputs noted below to measure the fair values of the old and new nominal cost options. These fair values were calculated using modified binomial option pricing models. Expected volatility was



## 25. SHARE-BASED PAYMENTS – *continued*

estimated by calculating the historical volatility of the Company's share price over the three years preceding the grant of the 2007 LTIP options.

For the options that are subject to the First Performance Condition, a weighted expected percentage of options vesting were applied. This was estimated based on the Company's historical TSR performance against the comparator Group on a quarterly basis from 2000 to 2009.

### All Staff Long Term Incentive Plan ("All Staff LTIP")

In accordance with the approved All Staff LTIP, the Group has granted options to its staff and executive Directors to acquire shares in the Company.

The movement during the year on the share options were as follows:

	2011		2010	
	Number of Share options	Exercise price (pence)	Number of Share options	Exercise price (pence)
Outstanding at the beginning of the year	<b>5,282,777</b>	<b>40</b>	3,143,088	40
Granted during the period	<b>3,952,150</b>	<b>40</b>	2,367,989	40
Forfeited during the period	<b>(1,880,059)</b>	<b>40</b>	(228,300)	40
Outstanding at the end of the year	<b>7,354,868</b>	<b>40</b>	5,282,777	40
Exercisable at the end of the year	–	–	–	–

All options are equity settled. The vesting period is three years. If the options remain unexercised after a period of five years from the date of grant, the options expire. Options are forfeited if the employee leaves the Group before the options vest or are exercised.

The options outstanding at the year-end have a contractual life of 4.10 years (2010: 4.19 years). The cost of the options is spread over the vesting period of three years. The fair value of the options granted during the year was 8.96 pence (2010: 31.24 pence).

If the Sterling Energy share price ("SESP") under-performs the Index performance by 10% or more, then no share options will be earned and the share options will lapse.

If the SESP performance is between matching the Index and under-performing by 10%, the amount of the share options that will be earned will be determined by extrapolating on a 2.5:1 straight line basis.

If the SESP performance matches the Index performance, then 25% of the share options will be earned.

If the SESP performance is between matching the Index and out-performing by 50%, the amount of the share options that will be earned will be determined by extrapolating on a 1.5:1 straight line basis.

If the SESP out performs the Index performance by 50% or more, then 100% of the share options will be earned.

All performance measures are defined as being the absolute share price performance or absolute index performance, and not the performance relative to each other.

## NOTES TO THE FINANCIAL STATEMENTS – *continued*

### 25. SHARE-BASED PAYMENTS – *continued*

Fair values were measured by use of a modified binomial model. The inputs to the basic binomial model were as follows:

	2011	2010
Share price (pence)	40	68
Exercise price (pence)	40	40
Expected volatility at time of grant	79.77%	85.21%
Expected life (years)	3	3
Risk free rate (%)	0.81%	0.75%
Expected dividends	Nil	Nil

Expected volatility for grants in the year was estimated by calculating the historical volatility of the Company's share price over the period 23 December 2009 to 30 September 2011 (2010: over the period 23 December 2009 to 30 September 2010). The Company has overlaid a normal distribution for the FTSE350 condition to assess a range of possible outcomes.

The Company has then compared the SESP performance against the range of Index performance to estimate the vested proportions of share options in accordance with the scheme rules. Weighting factors based on probabilities under the normal distribution are then applied to the range of share option values to calculate a weighted-average share option value.

#### Non-executive Directors Long Term Incentive Plan ('NED LTIP')

In accordance with the approved NED LTIP, the Group has granted options to its non-executive Directors to acquire shares in the company.

The movement during the year on the share options was as follows:

	2011		2010	
	Number of Share options	Exercise price (pence)	Number of Share options	Exercise price (pence)
Outstanding at the beginning of the year	302,084	40	375,000	40
Granted during the period	125,000	40	–	–
Lapsed during the period	–	–	(72,916)	–
Outstanding at the end of the year	427,084	40	302,084	40
Exercisable at the end of the year	–	–	–	–

All options are equity settled. The vesting period is three years. If the options remain unexercised after a period of five years from the date of grant, the options expire.

Furthermore, options are forfeited if the employee leaves the Group before the options vest or are exercised. The options outstanding at the year-end have a contractual life of 3.20 years (2010: 4.00 years). The cost of the options is spread over the vesting period of three years. The fair value of the options granted during the year was n/a (2010: n/a pence).

No performance criteria are attached to the outstanding options, other than the requirement that the holders must remain employed by the Group when the options are exercised, unless employment is terminated on death, or as a good leaver.

Fair values were measured by use of a binomial model, using the same inputs as the basic (pre-modified) model for the All Staff Long Term Incentive Plan above.

## 26. RELATED PARTY TRANSACTIONS

Details of Directors' remuneration, which comprise key management personnel, are provided below:

	Group		Company	
	2011 \$000	2010 \$000	2011 \$000	2010 \$000
Short-term employee benefits	<b>1,482</b>	1,695	<b>144</b>	145
Compensation for loss of office	–	287	–	–
Defined contribution pension	<b>117</b>	160	–	–
Share-based payments	<b>1,089</b>	1,238	<b>255</b>	144
	<b>2,688</b>	3,380	<b>399</b>	289

Further information on Directors' remuneration is detailed in the Remuneration Report, on pages 25 to 29.

## 27. SUBSEQUENT EVENTS

There have been no events subsequent to the reporting date that require disclosure.

# DEFINITIONS AND GLOSSARY OF TERMS

Year ended 31 December 2011

\$	US dollars
2006 Act	The Companies Act 2006, as amended
2007 LTIP	the 2007 Long Term Incentive Plan
1P	Proven reserves or in-place quantities depending on the context
2D	two dimensional
2P	the sum of Proven and Probable reserves or in-place quantities depending on the context
3D	three dimensional
3P	the sum of Proven, Probable and Possible reserves or in-place quantities depending on the context
AIM	Alternative Investment Market of the London Stock Exchange
All Staff LTIP	the All Staff Long-Term Incentive Plan adopted in 2009
AGM	Annual General Meeting
API gravity	an American Petroleum Institute scale for crude oil density
Articles	the Articles of Association of the Company
bbl	barrel, equivalent to 42 US gallons of fluid
bbl/d	barrel per day
bopd	barrel of oil per day
boe	barrel of oil equivalent, a measure of the gas component converted into its equivalence in barrels of oil
boepd	barrel of oil equivalent per day
bcf	billion cubic feet of gas
Board	the Board of Directors of the Company
C	Celsius
Capex	capital expenditure
CGR	condensate gas ratio
Code or City Code	The City Code on Takeovers and Mergers
Combined Code	the Combined Code on Corporate Governance. Now superseded by the UK Corporate Governance Code (see below)
Companies Act	the Companies Act (as amended 2006)
Company or Sterling	Sterling Energy Plc
Contingent Resources	those quantities of petroleum estimated, as at a given date, to be potentially recoverable from known accumulations by application of development projects but which are not currently considered to be commercially recoverable due to one or more contingencies, Contingent Resources are a class of discovered recoverable resources
COS	chance of success
CPF	central production facility
Darcy	unit of permeability

Deg	degrees
Directors	the Directors of the Company
DST	drill stem test, a method of flow testing a well
E&E	exploration and evaluation assets
EBITDA	earnings before interest, taxation, depreciation, depletion and amortisation, impairment, share-based payments and pre-licence expenditure
EMV	expected monetary value
EPF	early production facility
ESP	electric submersible pump
EUR	economic ultimate recovery
farm-in & farm-out	a transaction under which one party (farm-out party) transfers part of its interest to a contract to another party (farm-in party) in exchange for a consideration which may comprise the obligation to pay for some of the farm-out party costs relating to the contract and a cash sum for past costs incurred by the farm-out party
FDP	field development plan
FPSO	Floating, Production, Storage and Offloading vessel
FSA	the Financial Services Authority of the United Kingdom
G&G	geological and geophysical
GBP	pounds sterling
GIIP	gas initially in place
GOC	gas oil contact
GOR	gas oil ratio
GWC	gas water contact
Group	the Company and its subsidiary undertakings
H <sub>2</sub> S	hydrogen sulphide
HMRC	Her Majesty's Revenue and Customs
HSES	Health, Safety, Environment and Security
hydrocarbons	organic compounds of carbon and hydrogen
km	kilometre(s)
km <sup>2</sup>	square kilometre(s)
KRG	Kurdistan Regional Government of Iraq
lead	indication of a possible exploration prospect
London Stock Exchange or LSE	London Stock Exchange Plc
m	metre(s)
mmbbl	million barrels
mmstb	million barrels of oil at stock tank conditions

## DEFINITIONS AND GLOSSARY OF TERMS – *continued*

Year ended 31 December 2011

mmbobe	million barrels of oil equivalent
mmcf	million cubic feet of gas
mmcfg/d	million cubic feet of gas per day
mmcfge/d	million cubic feet of gas equivalent per day
mmscf/d	million cubic feet at standard pressure and temperature per day
mss	metres sub-sea
mTVDss	metres true vertical depth sub-sea
NED LTIP	non-executive Director Long Term Incentive Plan adopted in 2009
NPV	net present value of a series of cash-flows
OECD	Organisation for Economic Cooperation and Development
Opex	operating expenditure
Ordinary Shares	Sterling ordinary shares of 40 pence each
OWC	oil water contact
P90, P50, P10	90%, 50% and 10% probabilities respectively that the stated quantities will be equalled or exceeded. The P90, P50 and P10 quantities correspond to the Proved (1P), Proved + Probable (2P) and Proved + Probable + Possible (3P) confidence levels respectively
Panel or Takeover Panel	The Panel on Takeovers and Mergers
Petroleum	oil, gas, condensate and natural gas liquids
Petronas	PC Mauritania I PTY LTD
PP&E	Property, Plant & Equipment
PRMS	Petroleum resource Management System as issued in March 2007 by the Society of Petroleum Engineers et al
Prospect	a potential sub-surface accumulation of hydrocarbons which has been identified but not drilled
Prospective Resources	those quantities of petroleum which are estimated, as at a given date, to be potentially recoverable from undiscovered accumulations
psi(a)	pounds per square inch (absolute)
PSC	production sharing contract
Reserves	reserves are those quantities of petroleum anticipated to be commercially recoverable by application of development projects to known accumulations from a given date forward under defined conditions. Reserves must satisfy four criteria; they must be discovered, recoverable, commercial and remaining based on the development projects applied. Reserves are further categorised in accordance with the level of certainty associated with the estimates and may be sub-classified based on project maturity and/or characterised by development and production status
Reservoir	a porous and permeable rock capable of containing fluids
RF	recovery factor

RI	royalty interest
RISC	RISC (UK) Limited of Golden Cross House, 8 Duncannon Street, London WC2N 4JF
Scf	standard cubic feet of gas (measured at 60 degree Fahrenheit and 14.7 psia)
Seismic	data, obtained using a sound source and receiver, that is processed to provide a representation of a vertical cross-section through the subsurface layers
SESP	Sterling Energy share price
Shares	40p Ordinary Shares
Shareholders	Ordinary shareholders of 40p each in the Company
SMH	Societe Mauritanienne Des Hydrocarbures
spud	to commence drilling a well
sq km	square kilometre
sq mi	square mile
stb	stock tank barrel (measured at 60 degrees Fahrenheit and 14.7 psia)
STOIP	Stock tank oil initially in place
Subsidiary	a subsidiary undertaking as defined in the 2006 Act
Water-cut	that per centage of total fluid production that is water
Working Interest or WI	a Company's equity interest in a project before reduction for royalties or production share owed to others under the applicable fiscal terms
Tcf	trillion cubic feet of gas
TEA	technical evaluation agreement
TD	total depth
TVD	true vertical depth
United Kingdom or UK	the United Kingdom of Great Britain and Northern Ireland
UK Corporate Governance Code Or Code	Formerly the Combined Code, sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders
United States or US	the United States of America

# PROFESSIONAL ADVISERS

## **Nominated Advisors**

Liberum Capital Limited  
Ropemaker Place, Level 12  
25 Ropemaker Street  
London  
EL2Y 9LY

## **Corporate Brokers**

Liberum Capital Limited  
Ropemaker Place, Level 12  
25 Ropemaker Street  
London  
EL2Y 9LY

## **Corporate Bankers**

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HSBC  
165 Fleet Street  
London  
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## **Legal**

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## **Auditors**

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## **Registered Office**

5 Chancery Lane  
London  
WC2A 1LG



# ANNUAL GENERAL MEETING

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to what action to take, you should consult your stockbroker, solicitor, accountant or other appropriate independent professional adviser authorised under the Financial Services and Markets Act 2000. If you have sold or otherwise transferred all your shares in Sterling Energy Plc, please forward this document and the accompanying Form of Proxy to the person through whom the sale or transfer was effected, for transmission to the purchaser or transferee.**

Information relating to the appointment of a proxy may be found in the notes appended to this notice of Annual General Meeting.

## **STERLING ENERGY PLC (the "Company")**

### **NOTICE OF ANNUAL GENERAL MEETING**

Notice is hereby given that the Annual General Meeting of Sterling Energy Plc will be held at Ashurst LLP, Broadwalk House, 5 Appold Street, London, EC2A 2HA on 19 April 2012, at 11.00 a.m. to consider and, if thought fit to pass, the following resolutions. Resolution 8 shall be proposed as a special resolution and all other resolutions shall be proposed as ordinary resolutions.

#### **ORDINARY RESOLUTIONS**

1. To receive and adopt the Accounts for the financial year ended 31 December 2011, together with the reports of the Directors and auditors thereon. **(Resolution 1)**
2. To approve the Remuneration Report contained in the Accounts for the financial year ended 31 December 2011. **(Resolution 2)**
3. To re-appoint BDO LLP as auditors of the Company. **(Resolution 3)**
4. To authorise the Directors to set the remuneration of the auditors. **(Resolution 4)**
5. In accordance with article 106 of the Company's Articles of Association, to re-elect Alastair Beardsall, who retires by rotation, as a Director of the Company. **(Resolution 5)**
6. In accordance with article 110 of the Company's Articles of Association, to elect Philip Frank as a Director of the Company (appointed since the last Annual General Meeting). **(Resolution 6)**
7. That the Directors be generally and unconditionally authorised for the purposes of section 551 of the Companies Act 2006 (the "Act"), to exercise all the powers of the Company to allot shares and grant rights to subscribe for, or convert any security into, shares:
  - (a) up to an aggregate nominal amount (within the meaning of section 551(3) and (6) of the Act) of £29,251,869 (such amount to be reduced by the nominal amount allotted or granted under (b) below in excess of such sum); and
  - (b) comprising equity securities (as defined in section 560 of the Act) up to an aggregate nominal amount (within the meaning of Section 551(3) and (6) of the Act) of £58,503,739 (such amount to be reduced by any allotments or grants made under (a) above) in connection with or pursuant to an offer or invitation by way of a rights issue in favour of holders of ordinary shares in proportion (as nearly as practicable) to the respective number of ordinary shares held by them on the record date for such allotment (and holders of any other class of equity securities entitled to participate therein or if the Directors consider it necessary, as permitted by the rights of those securities), but subject to such exclusions or other arrangements as the Directors may consider necessary or appropriate to deal with fractional entitlements, treasury shares, record dates or legal, regulatory or practical difficulties which

## ANNUAL GENERAL MEETING – *continued*

may arise under the laws of, or the requirements of any regulatory body or stock exchange in any territory or any other matter whatsoever,

these authorities to expire at the conclusion of the next Annual General Meeting of the Company (or if earlier on 30 June 2013), (save that the Company may before such expiry make any offer or agreement which would or might require shares to be allotted or rights to be granted, after such expiry and the Directors may allot shares, or grant rights to subscribe for or to convert any security into shares, in pursuance of any such offer or agreement as if the authorities conferred hereby had not expired). **(Resolution 7)**

### SPECIAL RESOLUTION

8. That subject to the passing of Resolution 7, the Directors be given power pursuant to section 570(1) and 573 of the Companies Act 2006 (the “Act”) to:

- (a) allot equity securities (as defined in section 560 of the Act) of the Company for cash pursuant to the authority conferred by that resolution; and
- (b) sell ordinary shares (as defined in section 560(1) of the Act) held by the Company as treasury shares for cash,

as if section 561 of the Act did not apply to any such allotment or sale, provided that this power shall be limited to the allotment of equity securities for cash and the sale of treasury shares:

- (i) in connection with or pursuant to an offer or invitation to acquire equity securities (but in the case of the authority granted under Resolution 7(b), by way of a rights issue only) in favour of holders of ordinary shares in proportion (as nearly as practicable) to the respective number of ordinary shares held by them on the record date for such allotment or sale but subject to such exclusions or other arrangements as the Directors may consider necessary or appropriate to deal with fractional entitlements, treasury shares, record dates or legal regulatory or practical difficulties which may arise under the laws or the requirements of any regulatory body or stock exchange in any territory or any other matter whatsoever; and
- (ii) in the case of the authority granted under Resolution 7(a) above (or in the case of any transfer of treasury shares), and otherwise than pursuant to paragraph (i) of this resolution, up to an aggregate nominal amount of £4,387,780,

and shall expire at the conclusion of the next Annual General Meeting of the Company (or, if earlier, on 30 June 2013), save that the Company may before such expiry make any offer or agreement which would or might require equity securities to be allotted, or treasury shares to be sold, after such expiry and the Directors may allot equity securities, or sell treasury shares in pursuance of any such offer or agreement as if the power conferred hereby had not expired. **(Resolution 8)**

*By Order of The Board*  
Michelle Churchward  
COMPANY SECRETARY  
19 March 2012

*Registered Office:*  
Sterling Energy Plc  
5 Chancery Lane  
London  
WC2A 1LG

# EXPLANATORY NOTES TO THE RESOLUTIONS

*The following explanatory information is provided by way of background to the business of the meeting:*

## **Resolution 2**

This resolution is to approve the Directors' Remuneration Report for the financial year ended 31 December 2011. You can find the report on pages 25 to 29 of the Annual Report 2011.

## **Resolution 6**

Biographical details of the Director standing for election (Philip Frank) appear on page 19 of the Annual Report 2011.

## **Resolution 7**

Your Directors may allot shares and grant rights to subscribe for, or convert any security into, shares only if authorised to do so by shareholders. The authority granted at the last Annual General Meeting is due to expire at this year's Annual General Meeting. Accordingly, Resolution 7 will be proposed as an ordinary resolution to grant new authorities to allot shares and grant rights to subscribe for, or convert any security into, shares (a) up to an aggregate nominal amount of £29,251,869 and (b) in connection with a rights issue up to an aggregate nominal amount (when added to allotments under part (a) of the resolution) of £58,503,739.

These amounts represent approximately one third and approximately two thirds respectively of the total issued ordinary share capital of the Company at 23 March 2012, in accordance with current guidelines of the Association of British Insurers (the "ABI") insofar as they affect the Company. If given, these authorities will expire at the next Annual General Meeting of the Company or on 30 June 2013, whichever is the earlier. Your Directors have no present intention of issuing shares pursuant to this authority.

## **Resolution 8**

Your Directors also require additional authority from shareholders to allot equity securities or sell treasury shares where they propose to do so for cash and otherwise than to existing shareholders pro rata to their holdings. The authority granted at the last Annual General Meeting is due to expire at this year's Annual General Meeting. Accordingly, Resolution 8 will be proposed as a special resolution to grant such authority. Apart from offers or invitations in proportion to the respective number of shares held, the authority will be limited to the allotment of equity securities and sales of treasury shares for cash up to an aggregate nominal value of £4,387,780 (being five per cent of the Company's issued ordinary share capital at 23 March 2012). If given, this authority will expire at the next Annual General Meeting of the Company or on 30 June 2013, whichever is the earlier. Your Directors do not have any present intention of exercising this authority, but consider it desirable to have the flexibility to use it should opportunities arise. Your Directors will have due regard to institutional guidelines in relation to any exercise of this authority, in particular, the requirement for advance consultation and explanation before making any non pre-emptive cash issue pursuant to this resolution which exceeds 7.5% of the Company's issued share capital in any rolling 3 year period.

## **Recommendation**

Your Directors believe that all the proposed resolutions to be considered at the Annual General Meeting as set out in this document are in the best interests of the Company and its shareholders as a whole. Accordingly, your Directors unanimously recommend that you vote in favour of them as they intend to do in respect of their own beneficial holdings.

### NOTES:

#### 1. Appointment of a proxy

Only holders of ordinary shares are entitled to attend and vote at this meeting.

A member is entitled to appoint another person as their proxy to exercise all or any of their rights to attend to speak and to vote at the Annual General Meeting. A member may appoint more than one proxy in relation to the meeting, provided that each proxy is appointed to exercise the rights attached to a different share or shares held by them. A proxy need not be a member of the Company. A Form of Proxy for the Annual General Meeting is enclosed and should be completed and returned so as to reach the Company's registrar, Capita Registrars, PXS, 34 Beckenham Road, Beckenham, Kent, BR3 4TU by hand, post or courier (during normal business hours only), not later than 48 hours before the time of the Annual General Meeting. Completion of a Form of Proxy or any CREST Proxy Instruction will not preclude a member attending and voting in person at the meeting.

Alternatively, you can register your proxy vote electronically by means of a website provided by the Company's registrar ([www.capitashareportal.com](http://www.capitashareportal.com)), where full instructions are provided. In order to register your vote on-line you will need to enter the Investor Code which is given in the enclosed Form of Proxy. This website can only be used for the purpose stated above, not for sending any other document or information.

#### 2. CREST electronic proxies

Alternatively, if you are a member of CREST, you may register the appointment of a proxy by using the CREST electronic proxy appointment service.

CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so for this Annual General Meeting and any adjournment(s) thereof by using the procedures described in the CREST Manual subject to the provisions of the Company's Articles of Association. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications and must contain the information required for such instructions, as described in the CREST Manual (available via [www.euroclear.com/CREST](http://www.euroclear.com/CREST)). The message, regardless of whether it constitutes the appointment of a proxy or an amendment to the instruction given to a previously appointed proxy, must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10) by no later than 48 hours before the start of the Annual General Meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

CREST members and, where applicable, their CREST sponsors or voting service providers should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and,

where applicable, their CREST sponsors or voting service provider(s) are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

### **3. Documents on display**

There will be available for inspection at the registered office of the Company during normal business hours from the date of this notice until the time of the Annual General Meeting and at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting:

- (a) copies of service agreements under which Directors of the Company are employed, and copies of the terms and conditions of appointment of non-executive Directors; and
- (b) the Company's Articles of Association.

### **4. Right to attend and vote**

Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that in order to have the right to attend and vote at the Annual General Meeting (and also for the purpose of determining how many votes a person entitled to attend and vote may cast), only those persons who have their name entered in the register of members' of the Company at 6:00 p.m. on 17 April 2012 or, in the event of any adjournment, by 6:00 p.m. on the date which is two days before the day of the adjourned meeting. Changes to entries on the register after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

### **5. Corporate members**

Any corporate which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that they do not do so in relation to the same shares.

### **6. Electronic Communication**

You may not use any electronic address (within the meaning of section 333(4) of the Companies Act 2006) provided in this notice (or in any related documents including the proxy form) to communicate with the Company for any purposes other than those expressly stated.

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