2006
Annual Report & Accounts

Borders & Southern Petroleum plc

The company is UK based and engaged in the exploration of hydrocarbons. The company's shares are listed on the Alternative Investment Market of the London Stock Exchange (AIM).

Contents

Front cover: Volunteer Beach, Falkland Islands

Highlights

- Borders & Southern has completed the processing and interpretation of its Falkland Islands 2D seismic data
- The Company has commissioned and completed numerous technical studies aimed at technical risk reduction
- A new fold belt play located to the south of the Falkland Islands has been defined, the heart of which is contained within the Company's 100% owned licensed area
- The size of the Company's lead inventory has increased significantly, and contains numerous structures capable of holding giant oil or gas accumulations
- The Company is currently assessing the design and cost of a focused 3D seismic acquisition programme aimed at further risk reduction prior to drilling
- The management team is actively seeking to add new projects to its portfolio that are consistent with its strategy and meet its stringent screening criteria
- Cash balance as at 31 December 2006 was £9.47 million

In the last 18 months the Company has made significant progress towards its objective of building a successful exploration and production business.

Chairman's Statement

During this period the Company has completed the processing and interpretation of the Falkland Islands 2D seismic data and commissioned a number of specialist studies all aimed at reducing the technical exploration risk.

The results of the technical work have confirmed our belief that an excellent fold belt play exists to the south of the Falkland Islands. The work also confirmed the scale of the opportunity, with numerous structural leads mapped, seven of which exceed 50 square kilometres in size. These structures are potentially capable of holding very large volumes of hydrocarbons.

The evaluation has produced far better results than expected at the outset and the Company has been fortunate to find that its acreage (in which we hold a 100% interest) contains the majority of the play fairway.

The management team's strategy from the outset was to attract large Independent and major oil companies as partners in the projects that we pursue. The challenge is to determine the right time to bring in such partners by way of a farmout. We need to optimise the commercial terms of any agreement whilst reducing the technical risk enough to attract the partner.

In order to understand how major oil and gas companies would perceive the current risk profile of Borders & Southern's licensed acreage, the Company invited a very limited number of companies to review the data, with a view to them potentially becoming a joint venture partner. We did not believe it appropriate to launch a full farmout campaign at this time.

The selected small number of companies took up our invitation and made multiple visits to our offices to review the data. Discussions with some of these potential partners are ongoing.

In the meantime, in order to maintain the pace of exploration the Company is currently evaluating the best way to further reduce the technical risk. One option being considered is a focused 3D seismic survey. Therefore the Company is working with consultants on 3D survey design and assessing how much data is required to deliver a significant risk reduction and how much it will cost. If we proceed with 3D seismic acquisition then it is likely to occur in the last quarter of 2007 at the start of the Austral summer season.

Ultimately, of course, we want to drill our Falkland Islands prospects as soon as practical. The objective is to align the drilling programme with other licence holders in the Falkland Islands region so that we can take advantage of the cost benefits of a combined drilling programme. Discussions with these licence holders are ongoing. However, if a joint venture partner is brought into our acreage, the incoming partner is likely to assume operatorship of our licences and will accordingly seek input into the timing of exploration drilling.

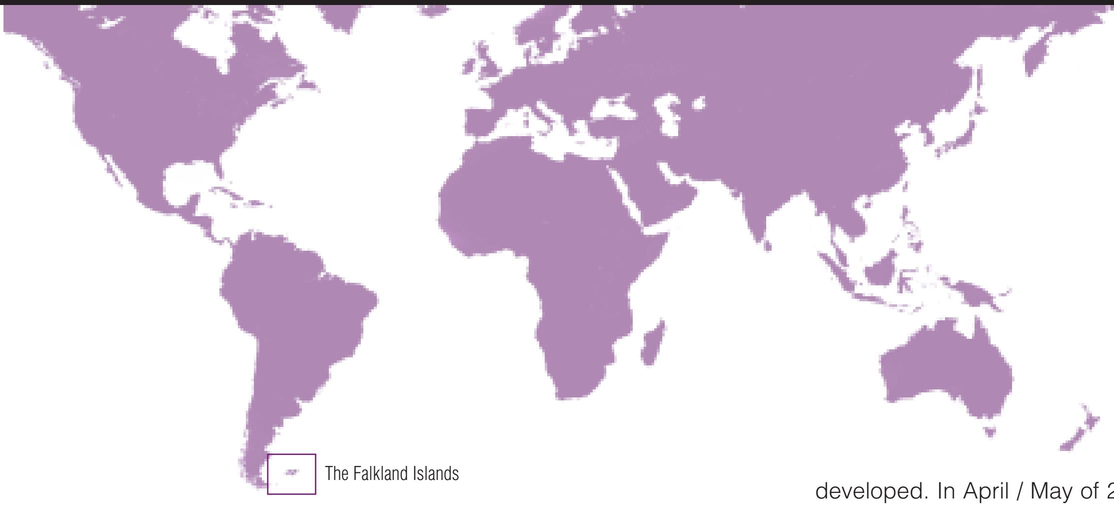
In addition to progressing the evaluation of the Falkland Islands licences the management team has been assessing opportunities in other regions with the intention of adding new licences to the Company's portfolio. Applying strict screening criteria, the Company has been and will continue to be very selective when considering new licences. Borders & Southern will ensure that any additions to the exploration portfolio will be consistent with our strategy and at least equal in quality to those assets in our current portfolio.

Exploration in frontier regions is always challenging. However the potential rewards are great. Borders & Southern's current portfolio holds the potential to discover and prove up significant volumes of hydrocarbons. We will continue to progress towards testing this potential.

HARRY DOBSON
Chairman

In November 2004 Borders & Southern gained licences to explore in nearly 20,000 square kilometres of the territorial waters of the Falkland Islands. This acreage is located in the untested South Falkland Basin.

Chief Executive's Review



FALKLAND ISLANDS EVALUATION

The Company's specific objective was to investigate the presence of a fold belt play to the south of the Falkland Islands, the offshore continuation of the Andes Mountain trend. Throughout the South American continent, from Venezuela in the north through Colombia, Peru, Bolivia and Argentina, fold belts provide one of the most successful hydrocarbon plays.

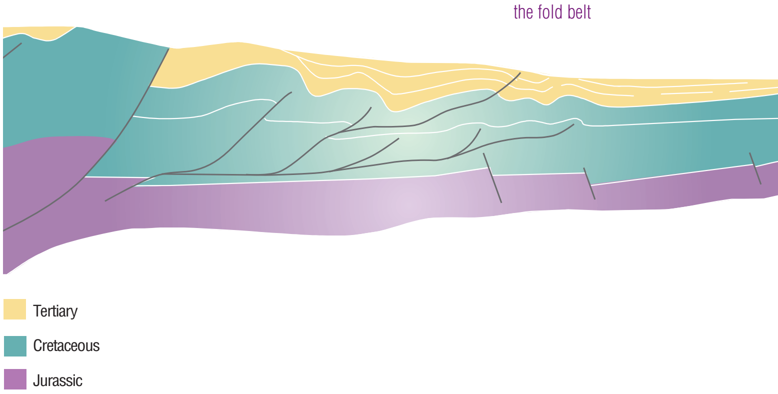
Fold belts usually contain numerous, simple geological structures suitable for trapping hydrocarbons. Providing there are good reservoir rocks and working source systems then fold belts can contain prolific hydrocarbon provinces. Individual structures can contain billion barrel oil fields or multi-tcf gas accumulations. Examples of such giant fields include: El Furrial (Venezuela), Cusiana (Colombia) and the San Martin / Cashiriari structures (Peru).

Prior to our exploration programme in the South Falkland Basin there had been only limited evaluation of the fold belt play. Hints that a play could exist were seen on legacy regional seismic data from 1992. However, this data is insufficient to define where the play might best be developed. In April / May of 2005 we acquired 2862 kilometres of new 2D seismic data. Onboard processing allowed us to confirm that the play existed and enabled us to refine the survey during acquisition in order to cover the most interesting structures. This is why there is a higher density of seismic lines in the west of the licensed area.

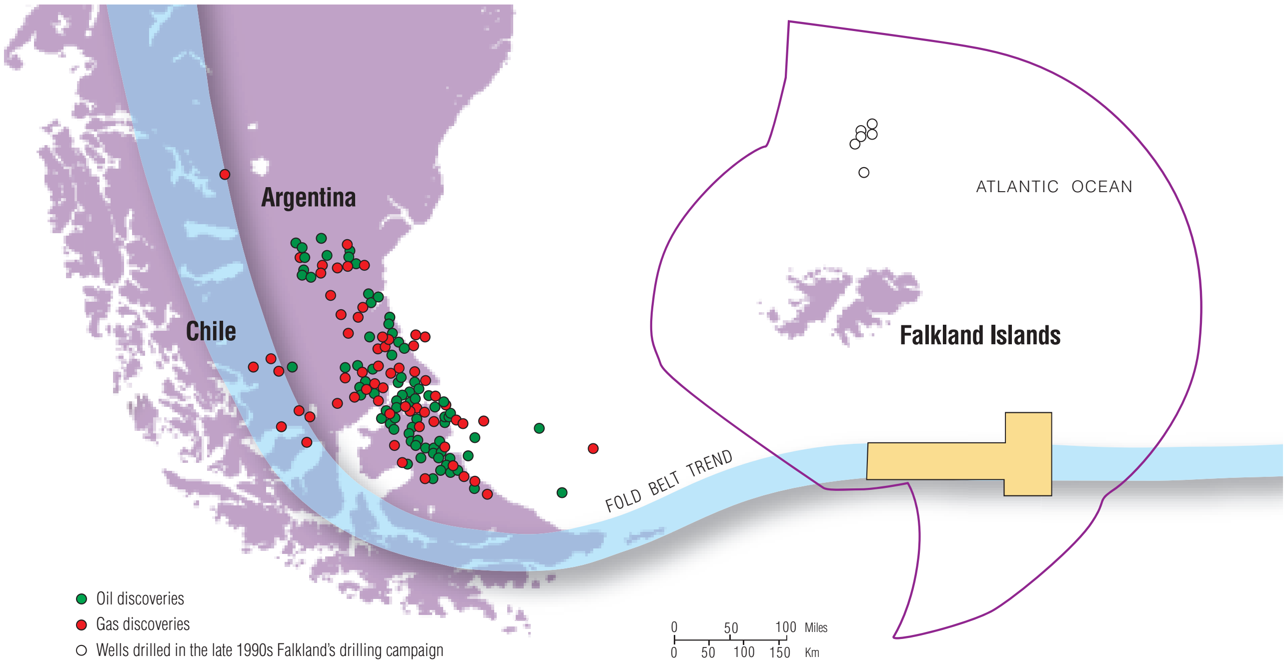
There have been no exploration wells drilled in the basin. Calibration of the seismic data, necessary for interpretation, comes from Deep Sea Drilling Project (DSDP) wells located to the east of the Falklands on the Maurice Ewing Bank and from exploration wells located in the Malvinas Basin to the west. These wells provide critical stratigraphic information and demonstrate the presence of a high quality, organic rich Cretaceous / Jurassic aged marine source rock.

Previous exploration drilling in the contiguous Malvinas basin during the early 1980s resulted in several sub-commercial discoveries. Oil flow rates in excess of 3000 bopd have been reported. Importantly the oil has been typed to source rocks in the same stratigraphic interval

Typical north-south cross-section through the fold belt



Regional map illustrating the location of Borders & Southern's licences in the untested basin to the south of the Falkland Islands



as the source rocks cored in the DSDP wells. Similar aged organic rich shales are also recorded onshore South America, on the Antarctic Peninsula, in the Weddell Sea, and off the west coast of South Africa. This gives a high degree of confidence that this is a regional source rock which will be present within Borders & Southern's licensed acreage.

Indirect evidence that source rocks are present and generating hydrocarbons within the licences come from a clearly defined bottom simulation reflector, interpreted to represent gas hydrates. There are also many seismic amplitude and AVO anomalies within geologically sensible trapping configurations that might be indicative of hydrocarbons.

Borders & Southern's regional work has demonstrated that Upper Cretaceous / Tertiary sands are likely to have been derived from the Falklands Massif to the north of the Company's acreage. Mapped canyons and channels indicate a north south sediment transport direction.

The nearest outcrop to the licensed area is Beauchene Island, located almost midway between the northern limit of the acreage and the main Falkland Islands. The geology of Beauchene Island is comprised of quartzitic sandstones and quartzites, interpreted to be of Devonian age by analogy to the quartzites of the Port Stephens and Port Stanley Formations on the main Falkland Islands. Erosion of these sandstones and quartzites would provide excellent reservoirs in the contract area.

Several prospective play fairways have been identified and mapped, but the main targets are Late Cretaceous / Tertiary sands within large anticlinal closures. Additional stratigraphic plays also occur within this stratigraphic interval. Subsidiary plays include Lower Cretaceous sands within tilted fault blocks. This is similar to the proven play of the Malvinas Basin.

2D SEISMIC INTERPRETATION

Detailed mapping of our new 2D seismic data has revealed numerous structural leads. These comprise four-way dip anticlinal closures, three-way dip thrust fault closed structures, and tilted fault blocks. Many of these structures are large. Seven leads have a mapped area of closure over 50 sq km, with one structure exceeding 130 sq km. Significantly these structures display vertical closure in excess of 2 km which allows the possibility of stacked reservoirs, providing multiple targets within the same prospect.

During the last 12 months we have undertaken a rigorous technical evaluation. This started with a regional play fairway analysis taking in the whole of the South and East Falkland Basins. Once the new data had been acquired, we focused on the licensed area, and brought in specialist help for specific projects, using experienced industry consultants and experts from British universities.

Projects have included geochemical and thermal modelling, structural modelling and restoration, seismic AVO analysis, seismic reprocessing, seismic facies analysis, and lead specific mapping. All of these studies have been brought together to help reduce the exploration risks.

In addition to the technical studies we have commissioned independent analysis of the operating environment and economics. The environment conditions are described as similar to the West of Shetlands in the UK, challenging but certainly within the capability of industry practice. Due to the water depths of between 1500 and 2000 metres it is likely that a drill ship or a high specification semi-submersible will be required for an exploration well. Again, we will be using standard oil industry technology and the oil industry is already exploring in water depths out to 3000 metres.

Critically, the minimum field size required for a commercial development has been investigated. This was found to be around 100 million barrels, assuming an oil price in excess of $34 per barrel. In the exploration success case, these volumes should be easily achievable given the size of mapped structures.

A discovery would be developed using standard technology involving a Floating Production Storage Offloading system whereby the crude oil is shipped direct to market without the need for significant onshore infrastructure.

NEXT STEPS

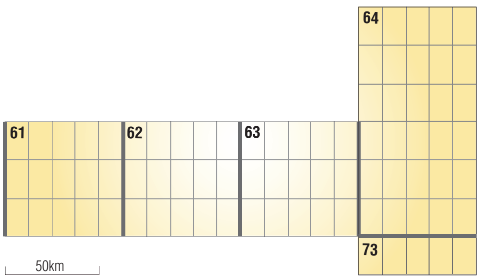
All the technical and commercial work we have undertaken to date has reinforced our view that we have an excellent position in the South Falklands Basin worthy of exploration drilling.

In order to progress further we are currently evaluating additional work programme options. One such option is 3D seismic acquisition. New 3D data would allow the Company to have greater confidence in the reservoir distribution across the large structures and to better site

exploration wells. It may also provide direct hydrocarbon indicators such as flat spots and amplitude anomalies conforming to the mapped structure thereby significantly reducing the technical risks.

LICENCE	AREA	INTEREST
PL 018 Quad 61 Blocks 16 to 30	3,668 sq km	100% Operator
PL 019 Quad 62 Blocks 16 to 30	3,668 sq km	100% Operator
PL 020 Quad 63 Blocks 16 to 30	3,668 sq km	100% Operator
PL 021 Quad 64 Blocks 1 to 30	7,381 sq km	100% Operator
PL 022 Quad 73 Block 1 to 5	1,213 sq km	100% Operator

OUR ACREAGE IN THE SOUTH FALKLAND BASIN



STRATEGY

The Company's strategy is to build a portfolio of up to five exploration projects in frontier basins, areas in which a prolific petroleum system has yet to be defined. As frontier exploration has a higher technical risk profile than exploration in mature basins, the scale of opportunity and the potential rewards will need to be very large.

One overriding technical constraint to the screening is the focus on basins where there is a high degree of confidence of a working source system, through either direct (oil flow in wells) or indirect technical evidence (direct hydrocarbon indicators from seismic or seeps).

The Company will seek to minimise the exploration risk through high quality technical work and the application of leading edge technologies.

We hope to secure large tracts of our targeted play fairways so that if the drilling of the first prospect is successful then there would be plenty of remaining potential. The Company will also target those play fairways that contain individual prospects of significant size.

In contrast to the relatively high technical risks, the Company intends to focus on countries where political and commercial risks are considered to be relatively low.

The Company sees its role in the industry as one where it generates ideas, secures the acreage, funds the early stage of exploration with the acquisition of 2D and/or 3D seismic data and thereby takes out significant exploration

risk from the opportunity prior to attracting the larger companies to help fund the drilling campaigns.

Despite the sustained high price of oil and increased pressure of reserve replacement, the industry majors are still relatively risk averse and are not pursuing frontier opportunities. This provides an excellent opportunity for technically proficient small companies like Borders & Southern for early entry and risk-reduction exploration work prior to farming out.

NEW OPPORTUNITIES

With the price of oil still relatively high, the competition for acreage is fierce, particularly in proven and emerging petroleum basins. As the Company screens opportunities it needs to ensure the quality is as good as its existing project and also that it focuses on projects that would appeal to the larger companies. During the last 18 months we have screened a number of opportunities, but as yet have not secured a second project. The Company will continue to take time in order to bring the right projects into the portfolio.

During the last year we were pleased to welcome Bruce Farrer into the Company. Bruce trained as a geologist and joins us from BHP Billiton where he has worked for the last 15 years in various technical and project management roles. He brings significant operational and evaluation expertise to the Company based on his experience of exploration and development projects in Europe, North and West Africa and the Caribbean.

INDUSTRY OUTLOOK

During the last 18 months the price of oil increased to over $75 per barrel (July/August 2006) before falling back to levels around $60 per barrel. This is still very high when looking at a five-year trend as the early part of the decade was characterised by prices around the $30 per barrel level. Whilst some weakening of the price might occur many commentators believe that it is unlikely that oil prices will return to these levels in the short to medium term.

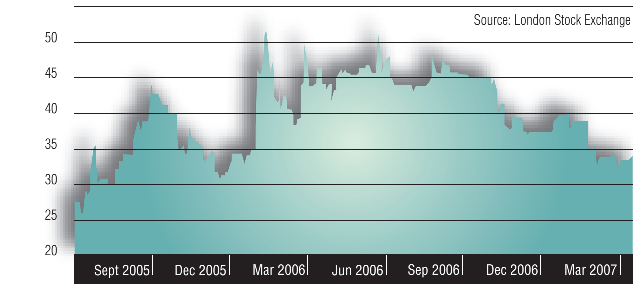
Bruce Farrer, Business Development Manager

The impact of high oil prices on our business is two fold. Firstly, there is increased competition for acreage, particularly in the proven hydrocarbon basins. Secondly, due to the increased exploration, appraisal, and development activity there is a higher demand for services, such as seismic and drilling contractors, which flows through to both costs and availability.

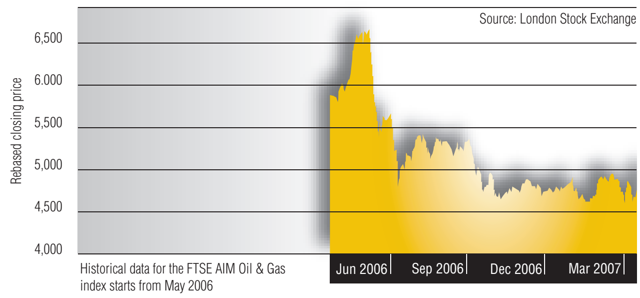
HOWARD OBEE
Chief Executive Officer

Financial Review

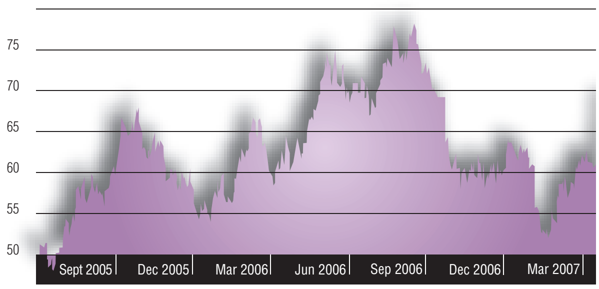
BORDERS & SOUTHERN SHARE PRICE (p)



FTSE AIM ALL SHARE INDEX - OIL & GAS



BRENT CRUDE OIL $/BARREL



During the period under review, the Company did not incur any significant capital expenditures, with interest from the cash deposits offsetting the majority of the Company's costs.

The cash balances at the beginning and end of the period were as follows:

	£ million
Cash at 1 July 2005	£10.42
Less:	
Overheads and working capital (net of interest)	£0.95
Cash at 31 December 2006	£9.47

The cash at 31 December 2006 was held in pounds sterling and US dollars in either current accounts or short- term cash deposits. It is the Company's intention to continue to hold this cash on current or short-term deposits until required and to potentially convert further pounds sterling into US dollars at times when the exchange rate is favourable.

The Company has sufficient funds to finance current exploration expenditure commitments and to cover general overheads for the next financial year.

PETER FLEMING

Finance Director

Board of Directors

NUMBER OF BOARD MEETINGS	5
Attendance:	
Harry Dobson	4
Howard Obee	5
Peter Fleming	5
Steven Posford	5
Nigel Hurst-Brown	5

DAVID HARRY WILLIAMSON DOBSON

(Non-executive Chairman) age 59. Harry Dobson is a former investment banker and senior partner of Yorkton Securities. He currently engages in various merchant banking and venture capital activities in North America and Europe, and has acted as Chairman of a number of resource companies (including American Pacific Mining Company Inc. and Lytton Minerals Limited). He is currently the Chairman of Kirkland Lake Gold Inc. (a Toronto Stock Exchange and AIM quoted Company) and Rambler Metals and Mining plc (an AIM quoted Company). He is experienced in the organisation and funding of resource projects, including those located in inaccessible locations.

HOWARD KEVIN OBEE

(Chief Executive) age 47. Howard Obee was appointed Chief Executive when the Company was incorporated in June 2004. He has a PhD in structural geology from Imperial College, and has spent 20 years in the oil industry, initially with BP (1985-1992), and subsequently with BHP Billiton (1992-2004). He trained as an exploration geologist, but has been appointed to various technical and commercial roles, incorporating exploration, new ventures, strategic planning, and business development. His most recent roles for BHP Billiton were West Africa Asset Team Leader, and Exploration Manager, London. He has experience of executing seismic and drilling programmes in frontier basins, including those in deep water.

PETER WILLIAM FLEMING

(Finance Director) age 45. Peter Fleming has over 12 years of upstream oil and gas experience, the majority of which was gained at BHP Billiton both in London and Melbourne. Whilst at BHP Billiton, Peter held senior positions in exploration and business development, investment evaluation, acquisitions and disposals and strategic planning. Prior to joining BHP Billiton, he worked for Bridge Oil and Banque Indosuez. He holds Masters degrees in Business Administration and Finance.

STEPHEN JAMES DOUGLAS POSFORD

(Non-executive Director) age 60. Stephen Posford was a partner of stockbrokers W.Greenwell and Co. In 1986, he became Managing Director of Greenwell Montagu Gilt Edged, and in 1989 moved to Salomon Brothers to head up their proprietary trading department in London. He then became Salomon Brothers European CEO before retiring in 1996.

CHRISTOPHER NIGEL HURST-BROWN

(Non-executive Director) age 55. Since qualifying as a Chartered Accountant, Nigel Hurst-Brown has pursued a career in fund management. From 1986-1990 he was Chairman of Lloyd's Investment Managers. In 1990 he moved to Mercury Asset Management as a main board Director and following Mercury's acquisition by Merrill Lynch in 1997 became a Managing Director of Merrill Lynch Investment Managers. Currently he is Chief Executive of Hotchkis and Wiley (UK) Limited and a member of the Executive Committee of its US parent Hotchkis and Wiley Capital Management LLC.

From left to right:
Peter William Fleming
Howard Kevin Obee
David Harry Williamson Dobson
Stephen James Douglas Posford
Christopher Nigel Hurst-Brown

Directors' Report

The Directors present their report and the audited consolidated financial statements for the 18 month period ended 31 December 2006.

PRINCIPAL ACTIVITY

The principal activity of the Group is the exploration for oil and gas.

The comparative figures cover the period from the date of the Company's incorporation, 8 June 2004 to 30 June 2005.

RESULTS AND DIVIDENDS

The Group profit and loss account is set out on page 22 and shows the result for the period.

The Directors do not recommend the payment of a dividend.

REVIEW OF BUSINESS AND FUTURE DEVELOPMENTS

On 18th October 2005 the Company's sole subsidiary, Borders & Southern Falklands Islands Limited, was incorporated. It is owned 100% by Borders & Southern Petroleum Plc.

Whilst the Company made a loss during the period, the Directors are comfortable with the Company's financial position at period end. Further details and a review on the operations of the Group are contained in the Chairman's Statement, Chief Executive's Review and Financial Review on pages 2 to 11.

POST BALANCE SHEET EVENTS

No events have occurred since the period end which require reporting or disclosing in the financial statements.

CHARITABLE AND POLITICAL DONATIONS

There were no political or charitable contributions made by the Company or the Group during the period.

HEALTH, SAFETY AND ENVIRONMENT

The Group has an overriding commitment to health, safety and environmental responsibility. The Group works closely with host governments and communities in the countries in which it operates, together with its contractors and partners, to ensure internationally recognised standards are implemented and maintained along with compliance to local legislation.

The Group's exploration activities are subject to the relevant environmental protection acts. The Group closely monitors its activities to ensure to the best of its knowledge there is no potential for the breach of such regulations. There have been no convictions in relation to breaches of these Acts recorded against the group during the reporting period.

CREDITOR PAYMENT POLICY

It is the Group's policy to settle the terms of payment with suppliers when agreeing the terms of the transaction, to ensure that suppliers are aware of these terms and to abide by them.

The amounts owed to the Company and Group's trade creditors at the year end represented 23 days (2005: 66 days) as a proportion of the total amounts invoiced by suppliers during the year.

FINANCIAL INSTRUMENTS

Details of the use of financial instruments by the Company and its subsidiary undertaking are contained in note 25 of the financial statements.

DIRECTORS AND THEIR INTERESTS

The beneficial and other interests of the Directors and their families in the share capital at the beginning of the period or the date of their appointment to the board, whichever is earlier, and at 31 December 2006, were as follows:

	At 31 December 2006	At 1 July 2005
David Harry Williamson Dobson	25,000,000	25,000,000
Stephen James Douglas Posford	25,000,000	25,000,000
Howard Kevin Obee	10,000,000	10,000,000
Peter William Fleming	2,200,000	2,200,000
Christopher Nigel Hurst-Brown	1,000,000	1,000,000

The ordinary shares in which Mr D H W Dobson is interested in are held by the Zila Corporation, a company owned by the Whitmill Trust Company Limited, as trustee of The Lotus Trust of which he is a beneficiary.

DIRECTORS SHARE OPTIONS

	Number of options granted during the period (and held at end of period)	Fair value of options	Exercise price	Vesting period
Howard Kevin Obee	50,000	21p	48p	3 years
Peter William Fleming	50,000	21p	48p	3 years

SUBSTANTIAL SHAREHOLDERS

At 13 April 2007 the following had notified the Company of disclosable interests in 3% or more of the nominal value of the Company's shares carrying voting rights:

	Number of ordinary shares	% of share capital
Stephen James Douglas Posford	25,000,000	19.58
Zila Corporation Limited	25,000,000	19.58
Lansdowne Partners Limited Partnership	11,125,000	8.71
Howard Kevin Obee	10,000,000	7.83
Morgan Stanley Securities Limited	6,756,250	5.29
Artemis UK Smaller Companies	6,260,000	4.9
Merrill Lynch & Co Inc	4,200,000	3.29
F & C Inv Funds ICVCII UK Dynamic Fund	4,200,000	3.29

DIRECTORS' RESPONSIBILITIES

Directors are required by company law to prepare financial statements which give a true and fair view of the state of affairs of the Company and the Group at the end of the financial period and of the profit or loss of the Company and the Group for the period ending on that date. In preparing those financial statements, Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the Group and to prevent and detect fraud and other irregularities.

Financial statements are published on the Group’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 Group’s website is the responsibility of the Directors. The Directors’ responsibility also extends to the ongoing integrity of the financial statements therein.

All of the current directors have taken all the steps that they ought to have taken to make themselves aware of any information needed by the Company's auditors for the purposes of their audit and to establish that the auditors are aware of that information. The Directors are not aware of any relevant audit information of which the auditors are unaware.

AUDITORS

BDO Stoy Hayward LLP have expressed their willingness to continue in office and a resolution to reappoint them will be proposed at the Annual General Meeting.

By order of the board

WILLIAM JOHN WALTON SLACK

Company Secretary

16 April 2007

Audit Committee Report

The Board has established an Audit Committee comprising Mr Hurst-Brown (Chairman), Mr Dobson and Mr Posford, all Non-executive Directors.

The Audit Committee meets at least biannually and is responsible for:

- The integrity of the financial statements and related disclosures, based on adequate books, records and internal controls and selection and consistent application of appropriate accounting policies;
- The appropriateness of the internal financial controls;
- The independent auditors' qualifications, independence, and performance; and
- The compliance with legal and regulatory requirements.

Remuneration Committee Report

The Board has established a Remuneration Committee comprising Mr Dobson (Chairman), Mr Hurst-Brown and Mr Posford, all Non-executive Directors.

The Remuneration Committee meets at least annually and is responsible for:

- Reviewing the performance of the CEO and other Executive Directors and senior management of the Company and determines their remuneration and the basis of their service agreements with due regard to the interests of shareholders;
- The payment of any bonuses to the CEO, other Executive Directors and senior management; and
- Making recommendations to the Board with respect to equity-based incentive plans and to act as a preparatory body for the Board of Directors in the management of any company award and option plans

DIRECTORS' REMUNERATION AND SERVICE CONTRACTS

On 18 May 2005, all of the Company's Directors entered into a service agreement with the Company.

The remuneration of the Directors for the 18 month period from 1 July 2005 to 31 December 2006 was as follows:

	Basic Salary £
David Harry Williamson Dobson	–
Stephen James Douglas Posford	–
Howard Kevin Obee	106,665
Christopher Nigel Hurst-Brown	–
Peter William Fleming	31,670

PENSIONS

The Group does not operate a pension scheme for its Directors or employees.

Whilst the Company is not required to present a Directors' Remuneration Report as it is not subject to the Listing Rules of the Financial Services Authority nor the requirements of the Directors' Remuneration Report Regulations 2002; it has disclosed here certain information about the Directors' policies and emoluments.

Auditor's Report

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BORDERS & SOUTHERN PETROLEUM PLC

We have audited the Group and parent company financial statements (the "financial statements") of Borders & Southern Petroleum Plc for the period ended 31 December 2006, which comprise the Group profit and loss account, the Group and parent balance sheets, the Group cash flow statement and the related notes. These financial statements have been prepared in accordance with the accounting policies set out therein.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

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

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

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Highlights Report, the Chairman's Statement, the Chief Executive's Review, the Financial Review, Board of Directors' Report, Audit Committee's Report, Remuneration Report and the Corporate Directory. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

BASIS OF OPINION

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

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

OPINION

In our opinion:

- the Group financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's affairs as at 31 December 2006 and of its loss for the period then ended; and
- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2006
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

BDO STOY HAYWARD LLP
Chartered Accountants & Registered Auditors

16 April 2007

Financial Statements

for the Period from 1 July 2005
to 31 December 2006

Consolidated Profit & Loss Account

	Note	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Turnover		–	–
Administrative expenses		(1,176,389)	(204,785)
Operating loss	2	(1,176,389)	(204,785)
Other interest receivable and similar income		649,365	63,539
Loss on ordinary activities before and after taxation		(527,024)	(141,246)
Loss for the financial period		(527,024)	(141,246)
Loss per share – basic and diluted (see note 3)		(0.39p)	(0.26p)

All amounts for both periods relate to continuing activities.
The Group has no recognised gains or losses for the period other than the results above.

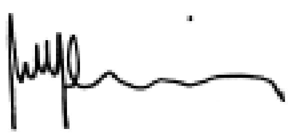
The notes on pages 26 to 35 form an integral part of these financial statements.

Consolidated Balance Sheet

	Note	31 December 2006 £	£	30 June 2005 £	£
Fixed assets					
Intangible assets	9		1,637,066		1,497,668
Tangible assets	10		10,144		14,965
			1,647,210		1,512,633
Current assets					
Debtors	12	135,731		142,790	
Cash at bank and in hand		9,468,174		10,416,100	
		9,603,905		10,558,890	
Creditors: Amounts falling due within one year	13	(65,804)		(331,546)	
Net current assets			9,538,101		10,227,344
Total assets less current liabilities			11,185,311		11,739,977
Provisions for liabilities	14		–		(42,955)
Net assets			11,185,311		11,697,022
Capital and reserves					
Called up share capital	15		1,276,875		1,276,875
Share premium reserve	18		10,561,393		10,561,393
Other reserves	18		15,313		–
Profit and loss reserve	18		(668,270)		(141,246)
Equity shareholders' funds	17		11,185,311		11,697,022

The financial statements were approved by the Board of Directors and authorised for issue on 16 April 2007.

HOWARD KEVIN OBEE
Director



PETER WILLIAM FLEMING
Director

The notes on pages 26 to 35 form an integral part of these financial statements.

Company Balance Sheet

	Note	31 December 2006 £	31 December 2006 £	30 June 2005 £	30 June 2005 £
Fixed assets					
Intangible assets	9		1,637,066		1,497,668
Tangible assets	10		10,144		14,965
Investments	11		1		–
			1,647,211		1,512,633
Current assets					
Debtors	12	156,758		142,790	
Cash at bank and in hand		9,468,174		10,416,100	
		9,624,932		10,558,890	
Creditors: Amounts falling due within one year	13	(60,804)		(331,546)	
Net current assets			9,564,128		10,227,344
Total assets less current liabilities			11,211,339		11,739,977
Provisions for liabilities	14		–		(42,955)
Net assets			11,211,339		11,697,022
Capital and reserves					
Called up share capital	15		1,276,875		1,276,875
Share premium reserve	18		10,561,393		10,561,393
Other reserves	18		15,313		–
Profit and loss reserve	18		(642,242)		(141,246)
Equity shareholders' funds	17		11,211,339		11,697,022

The financial statements were approved by the Board of Directors and authorised for issue on 16 April 2007.

HOWARD KEVIN OBEE
Director

PETER WILLIAM FLEMING
Director

The notes on pages 26 to 35 form an integral part of these financial statements.

Consolidated Cash Flow Statement

	Note	31 December 2006 £	31 December 2006 £	30 June 2005 £	30 June 2005 £
Net cash flow from operating activities	19		(1,456,917)		(140,147)
Returns on investment and servicing of finance			654,221		63,539
Capital expenditure and financial investment					
Purchase of intangible fixed assets		(139,398)		(1,326,875)	
Purchase of tangible fixed assets		(5,832)		(18,685)	
			(145,230)		(1,345,560)
Cash outflow before management of liquid resources and financing			(947,926)		(1,422,168)
Financing					
Issue of shares (net of issue costs of £804,232)		–		11,838,268	
Change in cash on deposit		928,867		(10,000,000)	
			928,867		1,838,268
Net cash flow			(19,059)		416,100

Reconciliation of Net Cash Flow to Movement in Net Debt

	31 December 2006 £	30 June 2005 £
(Decrease)/increase in cash in the period	(19,059)	416,100
Change in short term deposits	(928,867)	10,000,000
Change in net debt resulting from cash flows	(947,926)	10,416,100
Net funds at the start of the period	10,416,100	–
Net funds at the end of the period	9,468,174	10,416,100

The notes on pages 26 to 35 form an integral part of these financial statements.

Notes to the Financial Statements

1. ACCOUNTING POLICIES

Basis of preparation

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

In preparing these financial statements, the Group has adopted FRS20 'share-based payment' for the first time. The impact for the current period is to increase the loss by £15,335. There is no change in net assets. There is no impact on the prior period as there were no share-based payments in existence. Further details are given in note 16.

The consolidated financial statements include the financial statements of the Company and its subsidiary undertaking made up to 31 December 2006. The acquisitions method of accounting has been adopted. Under this method, the result of the subsidiary undertaking acquired in the period is included in the consolidated profit and loss account from the date of acquisition.

Under section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account. Its loss for the financial period was £500,996 (2005 – £141,246).

Turnover

At the end of the period the Group had not commenced commercial production from its exploration sites and therefore has no turnover in the period.

Depreciation

Depreciation is provided on tangible fixed assets so as to write off the cost or valuation, less any estimated residual value, over their expected useful economic life as follows:

Office equipment	33⅓%

Assets are depreciated from the date of acquisition, and on a straight line basis.

Exploration and evaluation expenditure

The Group has adopted the full cost accounting policy for expenditure on oil and gas projects. All costs associated with oil exploration are capitalised on a project-by-project basis, pending determination of feasibility of the project. Costs incurred include appropriate technical and administrative expenses but not general overheads. If an exploration project is successful, the related expenditures will be transferred to tangible fixed assets and amortised over the estimated life of the commercial reserves. Where a licence is relinquished, a project is abandoned, or is considered to be of no further value to the Group the related costs are written off. All capitalised costs are reviewed annually against the underlying value of oil and gas reserves, unless the expenditure relates to an area where it is too early to make a decision about the value of the assets.

Impairment tests

When there is an indication that the value of an asset may be impaired, the net amount at which the asset is recorded is assessed for recoverability against the discounted future estimated net cash flows expected to be generated from the estimated remaining commercial reserves. The assessment is made on the basis of future oil prices, exchange rate and cost levels as forecast at the balance sheet date. A provision is made by way of an additional depreciation charge, where the carrying value of the asset exceeds the discounted future net cash flows to be derived from its estimated remaining commercial reserves.

Foreign currencies

Profit and loss account transactions in foreign currencies are translated into sterling at the exchange rate ruling at the date of the transaction. Assets and liabilities denominated in foreign currencies are translated into sterling at the closing rates at the balance sheet date and the exchange differences are included in the profit and loss account.

Operating leases

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term.

Share based incentives

In accordance with Financial Reporting Standard 20 the fair value of equity-settled share-based payments to Directors and employees is determined at the date of grant and is expensed over the vesting period. Fair value is measured by a Black-Scholes-Merton pricing model.

Financial instruments

In relation to the disclosures made in Note 25:

- Other than the information about the Group's exposure to foreign exchange risk, short-term debtors and creditors have been excluded from the financial instrument disclosures in note 25.
- The Group does not hold or issue derivative financial instruments for trading purposes; and
- Forward exchange contracts are used to fix the exchange rate of committed and anticipated foreign currency transactions. Gains and losses arising on such hedges are not recognised until until the transaction occurs.

The Group has not made use of any derivative financial instruments in the period.

Deferred taxation

Deferred tax is provided in full on timing differences which represent a liability at the balance sheet date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income or expenditure in tax computations in periods different from those in which they are included in the financial statements. Deferred tax balances are not discounted.

Liquid resources

For the purpose of the cash flow statement, liquid resources are defined as current asset investments and short-term deposits, held on a rolling monthly basis.

2. OPERATING LOSS

Operating loss is stated after charging:

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Exploration and evaluation expenditure	144,422	16,667
Auditors' remuneration – audit services		
Company	15,000	12,500
Group	17,500	12,500
Auditors' remuneration – non audit services		
Company – taxation	3,000	5,500
Group – taxation	3,000	5,500
Exchange differences	392,486	–
Depreciation of owned tangible fixed assets	10,653	3,720
Hire of other assets – operating leases	102,284	21,150
Equity settled share-based payment	15,335	–

3. EARNINGS/(LOSS) PER SHARE

The calculation of the basic loss per share is based on the loss attributable to ordinary shareholders divided by the weighted average number of shares in issue during the period. The loss for the financial period for the Group was £527,024 (2005 – £141,246) and the average number of shares in issue for the year was 127,687,500 (2005 – 55,413,437). The effect of the share options in issue is anti-dilutive (see note 16 for details of share options).

4. SEGMENTAL ANALYSIS

For the purpose of segmental information the operations of the Group consist of one class of business, the exploration for hydrocarbons.

During the period the Group's exploration and evaluation activities took place outside the UK, substantially in the Falkland Islands. These costs are capitalised, where appropriate, in accordance with the accounting policies as set out in note 1 above.

The operating loss of the Group is analysed as follows:

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
United Kingdom	1,031,967	204,785
Falkland Islands	21,028	–
Worldwide (excluding UK and Falkland Islands)	123,394	–
	1,176,389	204,785

4. SEGMENTAL ANALYSIS continued

Net assets are analysed as follows:

	Group		Company	
	31 December 2006 £	30 June 2005 £	31 December 2006 £	30 June 2005 £
United Kingdom	9,527,511	10,363,420	9,553,539	10,363,420
Falkland Islands	1,657,800	1,333,582	1,657,800	1,333,582
	11,185,311	11,697,002	11,211,339	11,697,002

5. EMPLOYEES (INCLUDING DIRECTORS)

The aggregate payroll costs of the Group and Company's employees and Directors were as follows:

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Wages and salaries	233,302	36,744
Social security	27,884	3,216
Share-based payment	15,313	–
	276,499	39,960

The average number of employees (including Directors) employed during the period by the Company was 6 (2005 – 4) and for the Group was 6 (2005 – 4).

The Group granted to Directors and staff of Borders and Southern Petroleum Plc, for nil consideration, share options with a total fair value of £105,457 (2005 – £nil), of which £15,313 (2005 – £nil) has been expensed during the year.

6. DIRECTORS' EMOLUMENTS

The Directors' emoluments for the period are as follows:

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Directors' remuneration	138,335	35,000

The Group granted to two Directors of Borders and Southern Petroleum Plc, for nil consideration, 50,000 share options each, with a total fair value of £21,091. Of this amount £3,063 has been expensed during the year.

7. INTEREST RECEIVABLE

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Bank interest	649,365	63,539

8. TAXATION ON LOSS ON ORDINARY ACTIVITIES

Analysis of current period tax charge

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Taxation on loss on ordinary activities	–	–

Factors affecting current period tax charge

The tax assessed on the loss on ordinary activities for the period is higher than the standard rate of corporation tax in the UK of 30.00% (8 June 2004 to 30 June 2005 – 30.00%).

The differences are reconciled below:

	18 months ended 31 December 2006 £	8 June 2004 to 30 June 2005 £
Loss on ordinary activities before and after taxation	(527,024)	(141,246)
Standard rate corporation tax charge	(158,107)	(42,374)
Expenses not deductible for tax purposes	6,227	830
Depreciation in excess of capital allownces	1,320	(1,682)
Unutilised tax losses carried forward	150,560	43,226
Total current tax for the period	–	–

Factors that may affect future tax charges

The Group has a deferred tax asset of £193,786 (2005 – £43,226) in respect of unrelieved tax losses of £645,953 at 31 December 2006 (2005 – £144,085), and a deferred tax liability of £371 in respect of accelerated capital allowances (2005- £1,682). The net deferred tax asset has not been recognised in the financial statements as the transfer of economic benefit is uncertain.

9. INTANGIBLE FIXED ASSETS

Group and Company

	Exploration and evaluation costs £
Cost	
As at 1 July 2005	1,497,668
Additions	139,398
As at 31 December 2006	1,637,066
Net book value	
As at 31 December 2006	1,637,066
As at 30 June 2005	1,497,668

10. TANGIBLE FIXED ASSETS

Group and Company

	Office equipment £
Cost	
As at 1 July 2005	18,685
Additions	5,832
As at 31 December 2006	24,517
Depreciation	
As at 1 July 2005	3,720
Charge for the period	10,653
As at 31 December 2006	14,373
Net book value	
As at 31 December 2006	10,144
As at 30 June 2005	14,965

11. INVESTMENTS HELD AS FIXED ASSETS

Company

Group shares

	31 December 2006 £	30 June 2005 £
Cost		
Additions	1	–
Net book value		
As at 31 December 2006	1	–

The Company owns the one ordinary £1 subscriber share, being 100% of the issued share capital, in Borders and Southern Falkland Islands Limited. The Company was incorporated in England on 18 October 2005 and its principal activity is oil and gas exploration.

12. DEBTORS

	Group		Company	
	31 December 2006 £	30 June 2005 £	31 December 2006 £	30 June 2005 £
Amounts owed by group undertakings	–	–	21,027	–
Other debtors	32,939	62,166	32,939	62,166
Prepayments and accrued income	102,792	80,624	102,792	80,624
	135,731	142,790	156,758	142,790

All amounts shown under debtors fall due for payment within one year.

13. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	31 December 2006 £	30 June 2005 £	31 December 2006 £	30 June 2005 £
Trade creditors	28,436	167,735	28,436	167,735
Social security and other taxes	–	10,198	–	10,198
Other creditors	1,367	29,831	1,367	29,831
Accruals and deferred income	36,001	123,782	31,001	123,782
	65,804	331,546	60,804	331,546

14. PROVISION FOR LIABILITIES

Group and Company

	31 December 2006 £	30 June 2005 £
Demobilisation costs:		
Provision brought forward	42,955	–
(Released)/provided for in the period	(42,955)	42,955
Provision carried forward	–	42,955

The Company was obliged to pay for seismic demobilisation costs to a pre-agreed sum and this was paid during the period.

15. SHARE CAPITAL

	31 December 2006 £	30 June 2005 £
Authorised		
750,000,000 Ordinary shares of 1 pence each	7,500,000	7,500,000
Allotted, called up and fully paid		
127,687,500 Ordinary shares of 1 pence each	1,276,875	1,276,875

16. SHARE-BASED PAYMENT

On 25th July 2006, the Group granted 500,000 share options to two of its Directors and one other employee of Borders and Southern Petroleum Plc, for nil consideration. The options will be cancelled if the Director/employee leaves the Company. There were no other options at the start of the period and those options granted in the period were outstanding at the balance sheet date. The vesting period is three years.

The fair value of each option granted during the year was 21p. The following information is relevant in the determination of the fair value of the options granted during the period, and outstanding at the end of the period, under the equity-settled share based remuneration scheme operated by the Company.

16. SHARE-BASED PAYMENT continued

	31 December 2006
Equity-settled scheme	
Option pricing model used	Black-Scholes
Weighted average share price at grant date	48p
Exercise price	48p
Weighted average contractual life (days)	1,460
Expected volatility	50%
Expected dividend growth rate	0%
Risk-free interest rate	4.72%
Share-based remuneration expense for the period in respect of the equity-settled scheme (note 5)	£15,313

The volatility assumption measured at the standard deviation of expected share price returns is based on a statistical analysis of daily share prices over the last 21 months.

17. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Group		Company	
	31 December 2006 £	30 June 2005 £	31 December 2006 £	30 June 2005 £
Loss for the period	(527,024)	(141,246)	(500,996)	(141,246)
Share-based payment for the period	15,313	–	15,313	–
New share capital subscribed	–	11,838,268	–	11,838,268
Net (reduction)/addition to shareholders' funds	(511,711)	11,697,022	(485,683)	11,697,022
Opening equity shareholders' funds	11,697,022	–	11,697,022	–
Closing equity shareholders' funds	11,185,311	11,697,022	11,211,339	11,697,022

18. RESERVES

Group

	Share premium reserve £	Other reserves £	Profit and loss reserve £	Total £
Balance at 1 July 2005	10,561,393	–	(141,246)	10,420,147
Share-based payment	–	15,313	–	15,313
Loss for the period	–	–	(527,024)	(527,024)
Balance at 31 December 2006	10,561,393	15,313	(668,270)	9,908,436

Company

	Share premium reserve £	Other reserves £	Profit and loss reserve £	Total £
Balance at 1 July 2005	10,561,393	–	(141,246)	10,420,147
Share-based payment	–	15,313	–	15,313
Loss for the period	–	–	(500,996)	(500,996)
Balance at 31 December 2006	10,561,393	15,313	(642,242)	9,934,464

19. RECONCILIATION OF OPERATING LOSS TO OPERATING CASH FLOWS

	31 December 2006 £	30 June 2005 £
Operating loss	(1,176,389)	(204,785)
Depreciation of tangible fixed assets	10,653	3,720
Decrease/(increase) in debtors	2,203	(142,790)
(Decrease)/increase in creditors	(265,742)	160,753
(Decrease)/increase in provisions	(42,955)	42,955
Issue of share options	15,313	–
Net cash outflow from operating activities	(1,456,917)	(140,147)

20. ANALYSIS OF CHANGES IN NET FUNDS

	At start of period £	Cash flow £	At end of period £
Cash at bank	416,100	(19,059)	397,041
Short term deposit	10,000,000	(928,867)	9,071,133
Total	10,416,100	(947,926)	9,468,174

21. CONTROLLING ENTITY

So far as the Directors are aware there are not any persons who, directly or indirectly could exercise control over the Group.

22. RELATED PARTY TRANSACTIONS

During the year Borders & Southern Petroleum Plc paid expenses of £21,028 on behalf of Borders & Southern Falkland Islands Limited. This amount was due from the subsidiary at the balance sheet date, and has been set against the £1 unpaid share capital due from Borders & Southern Petroleum Plc to the subsidiary.

23. OPERATING LEASE COMMITMENTS

As at 31 December 2006 the Group and Company had annual commitments under non-cancellable operating leases as follows:

	Land and Buildings	
	31 December 2006 £	30 June 2005 £
Within one year	57,300	21,810

24. CONTINGENT LIABILITIES

The Group and Company had no contingent liabilities at 31 December 2006.

25. FINANCIAL INSTRUMENTS

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

The main risks arising from the Group's operations are interest rate risk and foreign currency translation risk. The Group monitors risk on a regular basis and takes appropriate measures to ensure risks are managed in a controlled manner.

a) Interest rate risk

The Group's financial assets and liabilities accrue interest at prevailing floating rates in the United Kingdom or at pre-arranged fixed rates, as described further below. The Group does not currently use derivative instruments to manage its interest rate risk.

b) Foreign currency translation risk

The operational currency of the oil and gas exploration and evaluation activities of the Group is USD dollars, services and treasury functions is pound sterling. Balances are held in £ sterling and USD dollars are purchased when required and used to meet exploration and evaluation needs.

Interest rate risk profile of financial assets of the Group:

	£
Held in pounds sterling	6,197,041
Pound sterling equivalent of amounts held in US dollars	3,271,133

At 31 December 2006 the Company held cash at bank and in deposits under its control of £9,468,174 (2005 – £10,416,100), which forms the majority of the Group's working capital. Of this £397,041 (2005 – £416,100) relates to deposits placed with banking institutions that are available on demand which carry interest at prevailing United Kingdom deposit floating rates. The balance represents restricted deposits of £9,071,133 (2005 – £10,000,000) with weighted average fixed interest rate of 4.613% for three months.

Fair values

The fair values of the Group's financial assets and liabilities at 31 December 2006 are materially equivalent to their carrying value as disclosed in the balance sheet and related notes.

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