# Gulfsands Petroleum plc
# Annual report and accounts
# For the year ended 31 December 2011

**Registered number:** **05302880 (England & Wales)**

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**Description**

Gulfsands Petroleum plc is an independent oil and gas exploration and production company, incorporated in the United Kingdom, whose shares are traded on the Alternative Investment Market ("AIM") of the London Stock Exchange (symbol : GPX).

The Group's major focus is on the Middle East and North Africa where it has oil exploration and development projects in the Syrian Arab Republic (currently suspended owing to sanctions), and oil exploration projects in Tunisia. Gulfsands also produces oil and gas from a portfolio of properties in the USA, offshore Gulf of Mexico.

**Annual General Meeting**

The Annual General Meeting of shareholders will take place at 11am on Wednesday 30 May 2012 at the offices of Buchanan Communications, 3rd Floor, 107 Cheapside, London, EC2V 6DA. All shareholders are welcome to attend. If unable to attend, shareholders are encouraged to fill out the form of proxy and return it to our registrars, Capita IRG.

As a consequence of the sanctions imposed on Syria by the EU, the Group declared force majeure in December 2011 on its PSC in Syria. This has had a significant impact on the financial statements, as explained in detail, herein.

## HIGHLIGHTS

### Financial

- Profit after tax up by 23% to $55.1 million (2010: $44.7 million)
- Cash from operating activities up by 34% to $94.3 million (2010: $70.2 million)
- Further part-disposal of US business realising aggregate cash of $11.0 million
- Free cash balances at year-end of $124.2 million (2010: $80.6 million)

### Operations

- Group working interest production down by 17% to 8,542 boepd (2010: 10,308 boepd)
- Group 2P working interest reserves up by 34% to 76.3 mmboe (2010: 56.9 mmboe) of which 74.5 mmboe (2010: 53.6 mmboe) relates to its PSC in Syria
- Group 2C risked contingent resources of 13.0 mmboe
- Six exploration wells drilled in Block 26, Syria resulting in three discoveries
- Potentially commercial onshore oil discovery in Tunisia

### 2012 Objectives

- Maintain presence in Syria
- Consolidate position in Tunisia
- Build another viable non-Syrian business
- Complete disposal of US business

**Chairman's Statement**

Dear Shareholder,

Introductory remarks

The year ended 31 December 2011 was overshadowed by the crisis in Syria, a crisis the severity of which few could have predicted a little more than twelve months ago.

At the time of writing the crisis continues unabated and it is impossible to predict with any degree of confidence how or when it will reach a final resolution. The scale of the humanitarian tragedy has rightly dominated the media and public debate and resonates with all of us. Underlying that tragedy is an evolving political and economic conundrum of immense complexity. It is against this backdrop that we as a Company must seek to preserve the value we have built in our Syrian assets and operations, for the long term benefit of both our shareholders and the people of Syria.

Declaration of force majeure

As a result of the progressive tightening of EU Sanctions, the Company declared *force majeure* under our Production Sharing Contract ("PSC") on 11 December 2011. We have since that date ceased to be involved in production or exploration activities, one key consequence of which is that currently and for the foreseeable future we can expect to receive no revenue from our principal asset. It is, perhaps, worth noting as an aside that at the date of ceasing our operational involvement we had experienced no security issues in our fields in the north east of Syria, an interesting reflection of just how localised the troubles in that country remain.

A summary of the EU Sanctions and the measures we have taken to comply is set forth later in this report in the section entitled "Sanctions Compliance". No useful purpose is served by my elaborating further, save to say that your Board has acted at all times and continues to act on the basis of international and local legal advice and has been at pains to keep HM Treasury properly and timely informed of our actions. We have also been, and remain, in regular communication with other international oil companies with assets and operations in Syria, who have of course to deal with the same set of issues.

I have made the point often enough but it bears repeating, that this Company has no political affiliations or agendas. Our goal is to be a good corporate citizen in all countries and markets in which we operate, to comply with the letter and spirit of our contractual obligations and to obey fully all pertinent laws and regulations. Circumstances such as the present certainly test those intentions to the full.

Our key objectives and near term strategy for Syria

Subject to our overriding legal obligations, your Board has two specific objectives.

First, to the fullest extent within our power, we seek to ensure the safety and well-being of our staff. Not least of the ways in which we are going about this is to continue to employ our local staff in Damascus and to find useful work for them to do during this period of enforced operational "downtime".

Secondly, we seek to preserve value for our shareholders.

Our legal advice with respect to our declaration of *force majeure* is that the declaration is valid both as a matter of international law and within the terms of the PSC and as such, the Company's

continuing legal right to its Syrian assets is protected. The PSC also provides legal remedies in the eventuality that the Syrian state, for reasons of national policy, elects to continue to produce oil from the Khurbet East and Yousefieh fields using its own human and technical resources. These remedies include payment for our share of oil produced during the period of force majeure, international arbitration of any matters which cannot be otherwise resolved and, in a final analysis, legal proceedings.

On a more pragmatic level, again subject to the Company's overriding legal obligations, we have sought to continue to maintain good working level relations with the Oil Ministry and with General Petroleum Corporation, the state oil company which is our partner under the PSC.

We are also continuing, where it makes sense to do so and we are confident of making a meaningful contribution to the well-being of the communities amongst whom we operate, to make funding available for high impact Corporate Social Responsibility initiatives.

As a Board, we are convinced that maintaining this balanced approach to a bewilderingly complicated and constantly evolving situation is the best possible way to seek to preserve our position in Syria for when sanctions are eventually lifted.

The damage done to the Company by the events of the past twelve months is plain to see in our share price and in the exodus of many institutions from our share register. However, the position is far from hopeless and your Board remains resolute.

Financial reporting implications

One immediate consequence of our declaration of *force majeure* which does merit an explanation is its impact on the Group's financial reporting. This is a highly technical subject but the simplified explanation is as follows.

Pursuant to the PSC, the Group holds its interest in its Syrian oil and gas production assets through a joint venture which is administered through a company, Dijla Petroleum Company ("DPC"), in which the Syrian State is a 50% shareholder. In accordance with International Financial Reporting Standards ("IFRS"), the Group has in prior periods proportionally consolidated the assets and liabilities of the joint venture.

Now that DPC has been declared a "designated entity" under the EU Sanctions and the Group is precluded (temporarily but indefinitely) from any involvement in its affairs, the Group has for the time being lost its ability to control the deployment and utilisation of its production assets. Despite this being what we anticipate to be a temporary state of affairs and despite the fundamental protections afforded by the PSC, IFRS mandates that the Company now cease proportionate consolidation. Instead, the Group is required to account for its Syrian production assets in the Balance Sheet as an investment and we have disclosed these operations separately in the Income Statement as a "Suspended Activity". As such, the Directors are required to attribute to such investment a highly judgemental "Fair Value" which has been referenced, as a practical matter, to the Company's current market capitalisation (as adjusted for its substantial net cash balance). More detailed reference to these concepts will be found in the Financial Review and in the detailed notes to the Financial Statements

The IFRS requirement to deconsolidate our Syrian operations is mandatory as a matter of International Accounting Standards and the Board has no discretion or flexibility in the matter.

For the avoidance of doubt, your Board does not regard the current market capitalisation of the Company as an accurate reflection of its long term potential value and we have no present intention of seeking to dispose of our Syrian assets.

The "political risk" inherent in an investment in Gulfsands Petroleum is a matter for each individual shareholder or prospective shareholder to quantify. For its own part, your Board remains determined to do all in its power to ensure that the present hiatus in the Group's ability to exploit its Syrian assets is in due course reversed.

Achievements in 2011

As described more fully in the Chief Executive's Report and in the Operations Review, the operating performance of our Syrian assets until the disruption began in mid-2011, the 40% underlying increase in our year–end 2P reserves (34% net of production) and our recent successes in exploration drilling are most encouraging for the long term. Furthermore, the strength of our balance sheet and our net cash balance of close to $125 million, coupled with strong technical and management competence, render us well-equipped both to withstand a long period of uncertainty in Syria and to pursue attractive opportunities in other markets.

Directors' incentive compensation

Your Board is acutely conscious of the severely adverse impact of the Syrian situation upon the Company's share price. Although this situation is quite clearly beyond our control, we feel it is inappropriate in the circumstances that Directors receive incentive compensation that would otherwise be payable in respect of the year ended 31 December. Accordingly, cash bonus payments due to Directors in respect of their 2011 performance and contribution will be deferred and will not become payable until the Company is once again receiving payment for production from its Syrian interests. Furthermore, no awards will be made pursuant to the Company's Executive Share Option Plan in respect of 2011 performance and contribution.

Concluding remarks

I have two sets of thanks to offer. First, to our 50% working interest partners Sinochem, who have been and continue to be strong and loyal supporters and collaborators throughout this most difficult period. Secondly, to our Chief Financial Officer, Andrew Rose, who will be leaving the Company shortly to pursue other interests. He has made a sterling contribution over the past three and a half years and leaves to his eventual successor a first-class financial reporting platform.

In conclusion, we can but hope that the coming months will bring some respite from the present acute difficulties in Syria, most importantly for the population but also for the Company and its shareholders. In the interim, we are leaving no stone unturned in our continuing efforts to find attractive opportunities to deploy our financial and technical firepower into "fast track" geographical diversification.

Yours sincerely

Andrew West

Chairman

**2 April 2012**

## Key Performance Indicators

Key Performance Indicators ("KPIs") provide a means of measuring our progress in delivering our strategic objectives and creating shareholder value. The KPIs mentioned below are inclusive of the Syria production assets, which are currently suspended and, as such, are expected to alter significantly during 2012. The KPIs do not reflect suspended operations and are therefore not necessarily GAAP measures.

| | | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| **Financial Key Performance Indicators** | | | | |
| **Working interest production** | mmboe | 3.1 | 3.8 | 2.7 |
| Description: | reduction % | -18% | | |
| The key driver of cash generation. The working interest measure is preferred to entitlement production because the latter is impacted by the terms of production sharing agreements so is not representative of underlying operational performance | | | | |
| Outlook: This measure is expected to drop significantly as sanctions against the Syria oil industry have continued into 2012 | | | | |
| **Lifting cost per barrel (working interest)** | $/boe | 4.3 | 4.7 | 6.9 |
| Description: | reduction % | -8% | | |
| The key measure of operating efficiency. Calculated as cost of sales excluding depreciation, impairment charges, dry hole costs, decommissioning costs and hurricane repair costs, divided by working interest production | | | | |
| Outlook: Expected to increase in 2012 without the benefit of the Group's production from low cost operations in Syria | | | | |
| **Cash flow available for exploration** | $MM | 78.9 | 47.7 | 22.6 |
| Description: | growth % | 65% | | |
| Calculated as net cash provided by operating activities, less net cash used in investing activities but excluding exploration and evaluation expenditure. This gives a measure of the cash flow available to the Group for exploration after investment in the development of its existing reserves, purchase of other fixed assets and payment of decommissioning costs | | | | |
| Outlook: Likely to be negative in 2012 as the Group will not be benefiting from Syrian production | | | | |
| **Earnings per share** | US cents | 45.5 | 35.9 | 23.4 |
| Description: | growth % | 27% | | |
| The standard measure of profit attributable to shareholders calculated on a diluted basis assuming the exercise of outstanding options | | | | |
| Outlook: Expected to fall significantly in 2012 | | | | |
| **Underlying reserves growth** | % | 40% | 20% | 32% |
| Description: | 3 year average growth % | 31% | | |
| The growth in proved and probable working interest reserves over the year after adding back production in that year | | | | |
| Outlook: The Group targets to at least replace the year's production with new reserves | | | | |
| **Non-financial KPIs** | | | | |
| **Lost time incidents** | Number | Nil | Nil | Nil |
| Description: | | | | |
| The number of incidents during the year which resulted in a loss of working time | | | | |

**Chief Executive's Report**

As a consequence of the Group's principal assets being held in Syria, the Syrian crisis that began in early 2011 has had a profound impact on our business. During the year a progressive tightening of European Union sanctions took place, some of which specifically targeted the oil industry. This eventually resulted in the Group, on 1 December 2011, ceasing all exploration, development and production operations in Syria. Until recently, the Syrian Government's General Petroleum Corporation ("GPC") continued to produce oil from our fields via the Block 26 joint venture operating company, Dijla Petroleum Company ("DPC"), but at a significantly reduced rate compared to pre-crisis levels. The personal and professional toll on our Syrian staff has been very significant and we remain committed to ensure that they are adequately cared for from both a humanitarian and safety perspective. As a result we intend to retain substantially all local staff throughout this difficult period. We believe the situation in Syria will be resolved in due course at which time the Company will be able to resume operations. In the interim, it is our intention to maintain our presence in Syria in full compliance with the European Union sanctions.

Despite the well publicised troubles in certain areas of the country during the year, there have been no incidents, disruptions to our activities or employees injured in Syria, either in the field or in our Damascus office. A detailed emergency response plan to evacuate expatriate employees was put in place early in the year, but has not been activated to date. We are pleased to report that our excellent operational health and safety record remains intact with no significant incidents reported.

Notwithstanding the difficult operating environment in Syria, the results of the Group have been favourable. Net profit increased by 23%, cash flow from operating activities was up by 34% and a $43.6 million increase was achieved in our year-end net cash balance to $124.2 million. All the increase in net profit and cash flow was derived from Syria. Working interest production in Syria was 8,133 bopd compared with 9,165 bopd in 2010, but this reduction was as a result of the government-imposed shut-in of production from our fields following the first round of sanctions against the Syrian oil trade on 2 September. Gross production from the Khurbet East and Yousefieh fields had reached an average of just over 24,000 bopd in August, which was our year-end target. Had production been allowed to continue at this rate, our working interest production would have exceeded 2010 by a significant margin. Both fields continued to perform extremely well with minimal pressure decline and minimal water production. Four development wells, three of which were designed as delineation wells, have provided improved confidence in the extent and quality of the reservoirs with positive implications for reserves.

Indeed, our investment programmes have continued to significantly expand our reserves and resources base. Oil and gas proved and probable ("2P") working interest reserves increased by an underlying 40% to 76.3 mmboe and, in addition, for the first time, proved and probable working interest risked contingent resources ("2C") of 13.0 mmboe have also been booked. All reserve additions were derived in Syria from reservoirs at Khurbet East and Yousefieh fields, with the vast majority from the producing Massive Formation. Our ability to crystallise value from the Syrian portion of our 2P reserves (74.5 mmboe) is dependent on the Syrian situation, as discussed elsewhere in this report.

Oil and gas discovered in 2011 at Khurbet East in the deeper Triassic Butmah and Kurrachine Dolomite Formations has also been booked as reserves (2P working interest of 9.3 mmboe). This oil

is lighter (34° API) than the oil being produced from the Massive Formation reservoirs and is interpreted to be an oil-leg of the gas accumulation previously discovered in the original Khurbet East-1 discovery well. Government approval to commercialise the oil and gas in the Butmah Formation was received in December. As a result of obtaining this approval, the Company is able for the first time to book oil and gas reserves for the Khurbet East Triassic Kurrachine Dolomite Formation (also originally discovered by the Khurbet East-1 well). A strong demand for gas exists within Syria and indications are that commercialisation of the Triassic Formations can be progressed with favourable terms consistent with those defined within the Block 26 Production Sharing Contract.

Seven exploration wells were drilled during the year resulting in four oil discoveries, three of which were in Syria and one in Tunisia. In addition to the Butmah discovery discussed above, the two other oil discoveries in Syria were located adjacent to and east of the Yousefieh field. The most notable of these was the Al Khairat discovery which is assessed to hold net proved and probable working interest contingent resources of 12 mmbbl. A number of attractive ready-to-drill prospects have been identified in Block 26 within the 3D seismic area with estimated risked mean resources of 76 mmboe. Our exploration success rate to date in Block 26 is a robust one in three. In Tunisia, oil was recovered in fluid samples at Sidi Dhaher-1, an onshore exploration well drilled in September. Although an oil column has been interpreted from wireline logs, the commercial significance of oil discovered has yet to be established, with a production test planned later this month.

In the US, a second package of assets was divested during the year realising cash of some $11 million after release of restricted cash balances. Preparations are underway to sell substantially all of the remaining US assets in the first half of 2012.

Our objectives for 2012 are to consolidate our position in Tunisia and build a viable non-Syrian leg to the business within the capacity of the Group's financial resources. The foundations of success are already in place: significant financial resources, highly competent human and technical resources and the credibility of having built a successful exploration and production operation in a relatively short period of time. We are aware of numerous opportunities to acquire both exploration acreage and prospective production at an attractive cost of entry. Several such opportunities are currently being evaluated. In all cases, the emphasis is upon cash preservation, the ability to fast-track production and the opportunity to maximise the Company's operational strengths and experience. This promises to be an exciting period for the Group, as we utilise and apply our proven strengths to establish a stronger base from which to build future value for shareholders.

Richard Malcolm

**Chief Executive Officer**

2 April 2012

## Objectives & Outcomes: 2011/12

### 2011 Objectives

| Objective | Outcome |
|---|---|
| | |
| Syria | |
| Drill five development wells and six exploration wells | Achieved |
| Increase gross field production to 24,000 bopd by year-end | Achieved |
| Acquire at least one new block | Not achieved |
| Award Central Production Facility EPC contract | Achieved |
| | |
| Tunisia | |
| Complete study into commercial development of offshore resources | Not achieved |
| Drill at least one exploration well onshore | Achieved |
| | |
| Other | |
| Complete the divestment of US assets | Not achieved |
| Capture a material new project in Iraq | Not achieved |

### 2012 Objectives

| Syria |
|---|
| Maintain presence in Syria in full compliance with EU sanctions |
| |
| Tunisia |
| Establish offshore potential for a commercial hydrocarbon development |
| Subject to successful testing at Sidi Dhaher-1, conduct appraisal programme |
| Acquire at least one new block |
| Other |
| Build new leg to the business within the Group’s financial capacity |
| Complete the divestment of the US assets |

## Operations Review

### SYRIA

Gulfsands is the operator of the Block 26 Production Sharing Contract with a 50% working interest. The contract is currently in force majeure as a result of the EU sanctions against Syria.

Description

Gulfsands is the operator of the Block 26 Production Sharing Contract ("PSC") with a 50% working interest: the other 50% interest is held by Sinochem. Block 26 covers an area of 5,414 km². The PSC grants rights to explore, develop and produce from all depths outside the existing field areas and from the deeper stratigraphic levels only within the pre-existing discovered field areas. The final exploration period of the PSC expires in August 2012.

There are two producing oil fields of Cretaceous age within the PSC area, Khurbet East and Yousefieh. In addition, two further oil and gas discoveries of Triassic age lie beneath the Cretaceous oil producing reservoir in the Khurbet East field, within the Butmah and Kurrachine Dolomite Formations, for which development approval has been granted.

The development and operation of these fields is being undertaken by Dijla Petroleum Company ("DPC"), a joint operating company formed between Gulfsands, Sinochem and the General Petroleum Corporation ("GPC") for this purpose, to which staff of both Gulfsands and GPC have been seconded. Since the imposition of sanctions against GPC on 1 December 2011, which led to the subsequent declaration of force majeure under the PSC, Gulfsands has had no involvement with the operations of DPC and Gulfsands staff seconded to DPC have been withdrawn, leaving DPC to be run by its GPC secondees.

The Khurbet East field was discovered in June 2007, and commercial development approval was granted in February 2008 for the Cretaceous "Massive" and Triassic Kurrachine Dolomite Formations. Oil production from the Cretaceous Massive Formation commenced in July 2008. The Yousefieh field was discovered in November 2008, commercial development approval was granted in January 2010, and oil production commenced in April 2010, also from the Cretaceous "Massive" Formation. The original discovery well at Yousefieh is located approximately three km away from the Early Production Facility ("EPF") at Khurbet East. The development and production period for the Khurbet East Cretaceous Massive and Triassic Kurrachine Dolomite Formations expires in February 2033, and that for the Yousefieh field in January 2035, but each may be extended for a further 10 years at the Contractor's option.

The crude oil currently being produced from Khurbet East has an API gravity of approximately 25°, slightly lighter than that of the area benchmark "Syrian Heavy" crude oil. Oil produced from Yousefieh is similar to that from Khurbet East, with an API gravity of 23-24°. The oil is transported via pipeline to the SPC-operated gathering facilities located some 30 km away at Tel Addas. There it is blended with the Syrian Heavy crude oil, and transported to the Mediterranean port of Tartous

using SPC's oil handling infrastructure.

Approval for the development of the Khurbet East Triassic Butmah oil and gas field was granted in December 2011. Oil from the Triassic Formations in Khurbet East has been sampled and has been found to be lighter than that produced from the Cretaceous Formation, with an API gravity of 34-35°, and it contains a higher gas content. In addition, small amounts of condensate have been recovered from the gas cap in the Butmah Formation. The construction of sour gas sweetening and export facilities at Khurbet East is planned to enable commercial production of hydrocarbons both from the Butmah and also from the Triassic Kurrachine Dolomite Formations. The development and production period for the Khurbet East Triassic Butmah Formation expires in December 2036, but may be extended for a further 10 years at the Contractor's option.

Operations

*Production*

Gross oil production from Block 26 increased from an average 20,600 bopd in January 2011 to just over 24,000 bopd in August. However following the imposition on 2 September 2011 of EU sanctions against the import or transportation of Syrian crude oil or petroleum products, which severely curtailed Syria's ability to export its oil, GPC instructed Gulfsands to reduce its production. As a result gross production fell to an average of approximately 14,500 bopd in September, 6,000 bopd in October, and 4,800 bopd in November. Production was completely shut-in during March 2012, compared with 14 wells on production in August. For the full year, gross production averaged 16,628 bopd compared with 18,330 bopd in 2010. Of the 2011 total, 14,775 bopd came from Khurbet East and 1,853 bopd from Yousefieh field. Production since 1 December 2011, being the date of imposition of sanctions against GPC, has been estimated in order to produce these full year figures.

The Khurbet East Cretaceous Massive oil reservoir has continued to perform impressively: based on results to the end of August (the last full month before production cuts were imposed) the reservoir pressure had declined by less that 1% since the start of production in July 2008, and the field water cut was well below 1% by volume. As at the end of November, cumulative production from Khurbet East since inception stood at 17.6 million barrels.

With the shut-in of the Yousefieh field in September the opportunity was taken to conduct a long-term pressure build-up survey. This found that the bottom-hole pressures for the production wells recovered rapidly during the shut-in period to an average pressure less than 1% below the initial pressure of the field measured prior to first oil in April 2010, signifying the likely presence of a large regional aquifer within the Massive just as for Khurbet East.

*Development wells*

During the year four Massive development wells were drilled: two each on Khurbet East and Yousefieh. Three of the wells were designed as delineation wells and the fourth was designed as a production well.

On Khurbet East, KHE-19 (completed in July) was aimed at delineating the north-west flank of the field. The original vertical well encountered the Massive reservoir section outside the limits of the

field and so the well was side-tracked horizontally back in a south-easterly direction. A gross horizontal reservoir section of 67 metres was drilled and the well flowed 5,516 bopd with a 48/64" choke on test, the highest flow rate achieved from any well on Block 26 to date. KHE-20 (completed in September) was another vertical delineation well, on the north flank to the east of KHE-19. It encountered a net oil column of 30 m, with average oil saturation of 82%, and flowed 1,897 bopd with a 48/64" choke on test.

On Yousefieh, YOU-7 (completed in June) was drilled to delineate the northern flank of the field. It encountered a net oil column of approximately 27 m and flowed on test at a rate of 528 bopd with a 2" choke under nitrogen lift. It is likely that the well will require artificial lift facilities, and possibly acid stimulation, to produce at a satisfactory rate on a continuous basis. YOU-8H (completed in November 2011) was a development well drilled horizontally to target recoverable volumes on the south flank of the field: the well intersected good quality reservoir and penetrated 256 m of net oil pay.

*Facilities*

Work on the Central Production Facility at Khurbet East, contracted to Saipem, was suspended in December after Saipem declared force majeure under their contract as a result of EU sanctions. The project was still at design stage, having been delayed already owing to the deteriorating situation in Syria. A new oil processing substation was constructed at Khurbet East, which increased the production capacity for Block 26 as a whole by 3,000 bopd to 24,000 bopd with effect from the beginning of August.

*Exploration Programme*

Six exploration and appraisal wells were drilled in 2011, three of which were oil discoveries: the Triassic Butmah discovery within the Khurbet East field, Yousefieh East and Al Khairat. In addition a successful appraisal well was drilled to appraise the Triassic Butmah discovery.

The Butmah discovery was made in May by the KHE-101 well, which targeted the Triassic Butmah and Kurrachine Dolomite Formations beneath the Khurbet East field, and encountered a gross vertical oil column of 69 m with a net to gross ratio of approximately 35% and average porosity of 21%. An open hole drill stem test ("DST") on this section achieved a stabilized flow rate of 447 bopd of 34° API oil plus associated gas. In the deeper Kurrachine Dolomite reservoir, however, although a 6 m net oil column was assessed, an open hole DST recovered only minor amounts of oil, gas and formation water, which was believed to be due to the presence of relatively few natural fractures in this area of the reservoir. An application for commercial development of the Triassic Butmah was subsequently submitted to the Syrian authorities and approval was granted in December.

The KHE-102 Butmah appraisal well was spudded in October on the northern flank of the field. An open hole DST conducted in January 2012 over a 48 m interval in the Butmah section flowed wet gas at a rate of 10.7 mmcfd with a 32/64" choke, with associated 524 bopd of 58° API condensate and with no formation water. The results were interpreted as signifying an oil reservoir with an overlying gas cap which also contains small volumes of condensate. Again however, the Kurrachine Dolomite section failed to flow oil in an open hole DST.

The Abu Ghazal exploration well, targeting multiple Cretaceous and Triassic objectives, which completed drilling and testing in May, encountered hydrocarbon columns in the Triassic aged

Butmah and Kurrachine Formations but only recovered small sub-commercial quantities of viscous heavy oil.

The Safa exploration well, targeting a Cretaceous age prospect on trend with the Khurbet East field, which completed drilling and testing in August, encountered non-commercial heavy oil and was plugged and abandoned.

On the other hand the Yousefieh East exploration well, which also completed drilling and testing in August, encountered a commercial oil column of 12.8 m net, and produced some 250 bopd of 20° API oil on test with no associated water. It is interpreted to represent an eastern flank extension of the Yousefieh field (falling with the Yousefieh Development License Area ("DLA") and is likely to require acid stimulation and the installation of artificial lift facilities, in due course, in order to be placed on production.

The Wardieh exploration well, which completed drilling and testing in September, targeted a combined structural and stratigraphic trap in formations of Cretaceous age. While drilling it encountered a zone of live asphaltic hydrocarbons overlying a porous reservoir zone, the combination of which caused the well to be plugged and abandoned for safety reasons within 271 m of its planned total depth. A comprehensive geological and operational review of the well is being undertaken.

Finally, the Al Khairat exploration well, located 3.5 km south-east of Yousefieh East, which completed drilling and testing in December, found a 29 m net oil column in the Cretaceous Massive Formation. When tested open hole over a 26 m interval with a 2" choke and under nitrogen lift it flowed 1,826 bopd of 22° API oil. Al Khairat is located outside the Yousefieh field DLA, but no application for commercial development approval has been made because of EU sanctions.

The 3D seismic data acquired in 2010 over a 1060 $km^2$ area was processed in H1 2011 and has now been interpreted. A reprocessing project was undertaken to merge the 2009 and 2010 vintages of 3D into one consistent volume and this was completed in Q4 2011. The acquisition of a further 250 $km^2$ of 3D data commenced in Q3 2011 around the Maghlouja prospect, however owing to the situation in-country the seismic contractor declared force majeure on the contract.

Plans for 2012

Following the declaration of force majeure on its PSC in December the Group no longer has any involvement in the operation of producing fields, or the development of discoveries, on Block 26, and no longer seconds staff, or supplies technical assistance, to DPC.

Gulfsands announced in early February 2012 that it had decided to cease all further exploration in Syria in light of the effect of the EU sanctions and the effect these were having on the procurement of essential goods and services for exploration operations. It is the intention that local staff will be engaged, for the time being at least, in conducting internal studies and analysing potential exploration prospects with a view to being in a position to resume exploration activity as and when sanctions are lifted, on the assumption that an extension in the exploration period (which is currently due to expire in August 2012) can be negotiated with the Syrian authorities to replace that lost due to the sanctions.

**TUNISIA**

Description

Gulfsands has non-operated working interests in two exploration permits in Tunisia (the Chorbane and Kerkouane Permits) and one exploration permit in Southern Italy (G.R15.PU) as a result of a farm-in in May 2010. The operator of all three permits is ADX Energy Ltd, an Australia based independent E&P company. During 2011, the Company completed the farm-in obligation for the Chorbane Permit with the drilling of the Sidi Dhaher-1 (SDHR-1) exploration well.

*Kerkouane Permit - Offshore Tunisia (Gulfsands : 30%)*
*G.R15.PU (Pantelleria) Permit - Offshore Italy (Gulfsands : 30%)*

The Kerkouane Permit is located offshore north east of Tunisia and G.R15.PU is located offshore the island of Pantelleria south west of Sicily in Italian waters. The two permits are contiguous and comprise a total area of approximately 3,700 $km^2$. The Kerkouane exploration permit has been extended to February 2014 while the G.R15.PU permit remains suspended pending application to the Italian government for the permit to be reactivated. The Kerkouane block is governed by a Tunisian PSC, whilst the Pantelleria block is governed by an Italian tax/royalty structure.

The Kerkouane Permit contains the Dougga gas/condensate discovery made by Shell in 1981, which is estimated to comprise mean raw GIIP of 618 bcf. 640 $km^2$ of 3D seismic was acquired in 2010. The Lambouka-1 well was drilled in 2010. Although wireline logs indicated the presence of gas and possibly condensate, it was not possible to safely recover fluid samples or pressure data from the formation, and the well was suspended.

*Chorbane Permit - Onshore Tunisia(Gulfsands : 40%)*

The Chorbane Permit is located in central Tunisia and covers an area of 2,428 $km^2$. The permit is surrounded by several producing oil fields and extensive oil & gas infrastructure. A number of prospects and leads have been indentified within the permit, the most prospective being a large tilted fault block ("Sidi Daher") where a potential oil discovery was made in September 2011 . The current exploration term is set to expire in July 2012, but may be extended for a further three years.

Operations

*Kerkouane*

During 2011, the Kerkouane Joint Venture took advantage of the presence of a seismic vessel that was acquiring data in an adjacent permit, and undertook a small 2D seismic programme to further evaluate a mapped exploration lead in the vicinity of the previously drilled Kerkouane-1 well. The processed data were scheduled for delivery in early 2012.

Geological and geophysical studies were undertaken, incorporating the results of the Lambouka-1 well into the regional geological framework.  A number of attractive leads have been identified, the most promising of which is the West Dougga structure.  West Dougga is a fault-supported four way dip closure with both Tertiary and Cretaceous aged reservoir targets.

The Joint Venture is also currently in discussions with the authorities in Tunisia regarding potential fiscal options for progressing the development of the existing Dougga gas/condensate discovery.

*Chorbane*

The Sidi Dhaher-1 exploration well was spudded in late August, following substantial delays in deploying the rig to site because of the need to agree the logistics and secure the safe passage of the rig and its crew in the aftermath of the Tunisian revolution. The well was drilled to a depth of 2,011 m MD and wire-line logs acquired over a 1,012 m interval. Formation pressure measurements indicated the presence of a possible oil column commencing at a depth of 1,156 m MD within a late Cretaceous aged reservoir, and wireline fluid samples recovered yielded a mix of drilling mud filtrate and movable oil. The well was suspended pending testing and the rig released. A suitable test rig was secured in early 2012, and testing of the potential pay zone will commence imminently.

Plans for 2012

In the event of a commercial oil flow from the Sidi Dhaher-1 well, the Chorbane Joint Venture will move forward with rapid appraisal of the feature with the objective of early commercialisation of the field.  The likeliest scenarios involve immediate application for an extended well test period of at least 90 days duration in order to obtain production and reservoir performance information, acquisition and processing of 3D seismic data and drilling at least one appraisal well.

At a minimum, the Sidi Dhaher-1 well demonstrated the existence of a working petroleum system on the western portion of the permit, reducing the exploration risk of follow-up prospects. Geological and geophysical studies and seismic data reprocessing will be undertaken to further evaluate the exploration potential of the block.

In the Kerkouane permit, pending satisfactory resolution of the discussions regarding the fiscal terms, plans for the first Dougga appraisal well will be put in place and drilling could commence as early as late 2012.

**USA**

Description

Gulfsands owns a small portfolio of non-operated oil & gas properties in the Gulf of Mexico, in the shallow "shelf" region offshore Texas and Louisiana. These comprise interests in 14 leases containing nine producing fields. Gulfsands also has a small interest in one onshore oil & gas field in Texas.

The assets are relatively mature, are deemed to be non-core and are in the process of being sold. Proved & Probable reserves at year-end 2011 amounted to 1.7 million boe on a working interest basis (1.4 million boe on a net revenue interest basis), comprised 60% of oil and 40% of gas.

Operations

Production on a working interest basis, including Natural Gas Liquids ("NGLs"), averaged 410 boepd in 2011, compared with 1,143 boepd in 2010. The composition of this production was 51% oil, 43% gas and 6% NGLs. After tax and royalties, net interest production in 2011 was 323 boepd.

However the year-on-year comparison is distorted by the sale of a package of properties constituting in total 1.1 mmboe of 2P working interest reserves, which completed in late September 2011: the production from these properties was excluded from the reported total as from the 1 June 2011 effective date of the transaction. In September 2011, the month in which the sale was closed, working interest production from these sold properties was 322 boepd.

Production in December 2011 was 337 boepd (working interest basis), comprising 37% oil, 59% gas and 4% NGLs.

At Eugene Island 32, Gulfsands participated in the reprocessing of 3D data to optimize further field development and identify new drill opportunities anticipated to be conducted during 2012. During early 2011 it was determined that the EI32 "A" Platform, a major structure supporting the living quarters for the EI32 Field, required significant repair or replacement. Instead of replacing the platform, Gulfsands and its partners received regulatory approval to undertake major repairs to the EI32 "A" Platform, yielding significant cost savings to the joint venture. This work has now been completed. At West Cameron 310 a major rig work-over of the #1 well was successfully completed and the well has been returned to production. The Ship Shoal 271 Field was returned to production in September after being shut-in all year due to third party pipeline issues. Several significant decommissioning projects were completed, including HI A-471, Matagorda 555 and Eugene Island 97.

Sale of Interests

Portfolio divestment continued during 2011 with the completion of the sale of a second package of assets in September for $6.0 million (prior to closing adjustments). The previous such sale had been signed in late 2010 and completed in H1 2011 (see Financial Review). The 2011 sale removed a significant forward liability provision relating to the decommissioning of the properties in question, resulting in the release to Gulfsands of $4.2 million of cash held as collateral for abandonment bonds. When combined with the release of escrow funds associated with the completion of the

plugging and abandonment projects, a total approximately $11.1 million in restricted funds were released during 2011.

Plans for 2012

Gulfsands intends to divest the remaining Gulf of Mexico assets in 2012, subject of course to being able to negotiate appropriate commercial terms.

**Reserves and Contingent Resources**

The Group's reserves and contingent resources at 31 December 2011 are based on estimates made by management and reviewed by independent petroleum engineers. For the Syrian and Tunisian assets the review was performed by Senergy (2010 Syria: Senergy, 2010 Tunisia: n/a), and for the USA by Netherland, Sewell & Associates, Inc ("NSAI") (2010: NSAI).

*Reserves*

The reserves are categorized into Proved, Probable and Possible reserves in accordance with the 2007 Petroleum Resources Management classification system of the Society of Petroleum Engineers ("SPE"). Definitions for Proved, Probable and Possible reserves are contained in the Glossary.

Working interest reserves in Syria represent the proportion, attributable to the Group's 50% participating interest, of forecast future hydrocarbon production during the economic life of the Block 26 PSC, including the share of that production attributable to General Petroleum Corporation ("GPC"). In assessing the reserves it has been assumed that:

(a) the force majeure condition is lifted with effect from 1 January 2013 and Gulfsands resumes its role as operator

(b) all Gulfsands' rights under the PSC are preserved and no change is made to the economic terms thereof, and

(c) the option is exercised to extend the development period of each field for a further 10 years after its initial 25 year development period has expired.

It should be noted that these assumptions are highly subjective and their outcome is impacted by events beyond the Group's control, including the timing and circumstances of the eventual lifting of the EU sanctions against Syria and the actions of any new government in Syria which may ultimately replace the one currently in power.

Working interest reserves in the USA represent the proportion, attributable to the Group's participating interests, of forecast future hydrocarbon production during the economic life of the properties in question, before deduction of state production taxes and overriding royalty interests. Working interest reserves have been derived from the net revenue interest reserves data contained in the NSAI report, by grossing up for the percentage production tax and royalty "burden" applicable to each property. The reserves-weighted average burden at 31 December 2011 was 20%.

Entitlement reserves in Syria represent the Group's estimated share of working interest reserves after deducting the share of forecast future production attributable to GPC. This proportion is impacted by assumptions as to future development expenditure and future oil prices. For the calculation as at 31 December 2011 the average price of Brent crude was assumed to be $100/bbl in 2012/3, $95/bbl in 2014 and constant $90/bbl thereafter.

Entitlement reserves in the USA represent the Group's estimated net revenue interest reserves after deduction of the equivalent share of hydrocarbon production attributable to state production taxes and overriding royalty interests.

*Contingent Resources*

Contingent Resources are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations by the application of development projects, but are not currently considered to be commercially recoverable due to one or more contingencies. Contingent Resources are further categorised by the SPE into 1C, 2C and 3C according to the level of uncertainty associated with the estimates: these categories correspond broadly to the Proved, Proved & Probable, and Proved, Probable & Possible categorisations for Reserves.

### Working Interest Basis

| | Syria | | USA | | Group Total | | |
|---|---|---|---|---|---|---|---|
| | Oil [1] | Gas | Oil [1] | Gas | Oil [1] | Gas | Oil & Gas [2] |
| | mmbbl | bcf | mmbbl | bcf | mmbbl | bcf | mmboe |
| **As at 31 December 2011** | | | | | | | |
| Proved | 38.9 | 12.5 | 0.8 | 3.0 | 39.7 | 15.5 | 42.3 |
| Probable | 30.2 | 20.0 | 0.2 | 1.0 | 30.4 | 21.0 | 33.9 |
| **Proved & Probable** | 69.1 | 32.5 | 1.0 | 4.0 | 70.2 | 36.6 | 76.3 |
| Possible | 43.7 | 36.3 | 0.1 | 0.9 | 43.8 | 37.2 | 50.0 |
| Proved, Probable & Possible | 112.8 | 68.8 | 1.2 | 4.9 | 114.0 | 73.7 | 126.3 |
| | | | | | | | |
| **Movements in Proved & Probable reserves during year** | | | | | | | |
| At 31 December 2010 | 53.6 | 0.0 | 1.9 | 8.0 | 55.5 | 8.0 | 56.9 |
| Discoveries and additions | 5.8 | 30.4 | 0.0 | 0.0 | 5.8 | 30.4 | 10.9 |
| Disposals | 0.0 | 0.0 | (0.7) | (2.8) | (0.7) | (2.8) | (1.1) |
| Revisions | 12.7 | 2.2 | (0.1) | (0.8) | 12.6 | 1.3 | 12.8 |
| Less Production | (3.0) | 0.0 | (0.1) | (0.4) | (3.1) | (0.4) | (3.2) |
| **At 31 December 2011** | 69.1 | 32.5 | 1.0 | 4.0 | 70.2 | 36.6 | 76.3 |

### Entitlement Basis

| | Syria | | USA | | Group Total | | |
|---|---|---|---|---|---|---|---|
| | Oil [1] | Gas | Oil [1] | Gas | Oil [1] | Gas | Oil & Gas [2] |
| | mmbbl | bcf | mmbbl | bcf | mmbbl | bcf | mmboe |
| **As at 31 December 2011** | | | | | | | |
| Proved | 17.5 | 6.9 | 0.7 | 2.3 | 18.2 | 9.2 | 19.7 |
| Probable | 12.8 | 10.4 | 0.2 | 0.8 | 13.0 | 11.2 | 14.8 |
| **Proved & Probable** | 30.2 | 17.3 | 0.9 | 3.1 | 31.1 | 20.4 | 34.5 |
| Possible | 14.8 | 16.9 | 0.1 | 0.7 | 14.9 | 17.5 | 17.8 |
| Proved, Probable & Possible | 45.0 | 34.2 | 0.9 | 3.8 | 46.0 | 37.9 | 52.3 |
| | | | | | | | |
| **Movements in Proved & Probable reserves during year** | | | | | | | |
| At 31 December 2010 | 19.9 | 0.0 | 1.5 | 6.1 | 21.4 | 6.1 | 22.4 |
| Discoveries and additions | 3.0 | 16.1 | 0.0 | 0.0 | 3.0 | 16.1 | 5.6 |
| Disposals | 0.0 | 0.0 | (0.5) | (2.1) | (0.5) | (2.1) | (0.8) |
| Revisions | 8.6 | 1.2 | (0.1) | (0.6) | 8.5 | 0.5 | 8.6 |
| Less Production | (1.2) | 0.0 | (0.1) | (0.3) | (1.2) | (0.3) | (1.3) |
| **At 31 December 2011** | 30.2 | 17.3 | 0.9 | 3.1 | 31.1 | 20.4 | 34.5 |

1: "Oil" includes condensate and NGLs

2: Gas is converted to mmboe at the conversion factor 1 bcf = 0.1667 mmboe

NB: Certain figures may not add up due to roundings.

## Summary of Contingent Resources

### Unrisked Working Interest Basis

| Syria Block 26 | Constituent | 1C | 2C | 3C | Risk Factor |
|---|---|---|---|---|---|
| Al Khairat Discovery (Working Interest 50%) | Oil, mmbbl | 3.0 | 12.0 | 45.7 | 76% |

| Tunisia Kerkouane Permit | Constituent | 1C | 2C | 3C | Risk Factor |
|---|---|---|---|---|---|
| Dougga Discovery (Working Interest 30%)* | Sales Gas, bcf | 15.9 | 44.1 | 96.0 | 21% |
| | Condensate, mmbbl | 2.1 | 5.8 | 12.5 | |
| | LPG, mmbbl | 0.7 | 1.8 | 4.0 | |
| | Total, mmboe | 5.3 | 14.6 | 31.8 | |

| Tunisia Chorbane Permit | Constituent | 1C | 2C | 3C | Risk Factor |
|---|---|---|---|---|---|
| Sidi Dhaher Discovery (Working Interest 40%) | Oil, mmbbl | 0.3 | 2.4 | 18.8 | 33% |

### Risked Working Interest Basis

| | | 1C | 2C | 3C |
|---|---|---|---|---|
| Syria Block 26 | mmboe | 2.3 | 9.1 | 34.7 |
| Tunisia Kerkouane* | mmboe | 1.1 | 3.1 | 6.7 |
| Tunisia Chorbane | mmboe | 0.1 | 0.8 | 6.2 |
| **Total** | **mmboe** | **3.5** | **13.0** | **47.6** |

* Based on calculations by TRACS International Consultancy April 2011 but incorporating Gulfsands own risk assessment. Conversion factors: 1 bbl LPG = 0.674 boe, 1 bcf = 0.1724 mmboe

NB: Certain figures may not add up due to roundings.

## Financial Review

## Selected operational and financial data

| | 2011 | | | | |
|---|---|---|---|---|---|
| | Syrian operations | All other business units | Pro forma total | Adjustment for suspended operations [2] | Total per financial statements |
| | | | mmboe | | |
| Production: working interest | 3.0 | 0.1 | 3.1 | (3.0) | 0.1 |
| Production: entitlement interest | 1.2 | 0.1 | 1.3 | (1.2) | 0.1 |
| | | | $MM | | |
| Revenue | 117.0 | 7.9 | 124.9 | (117.0) | 7.9 |
| Total cost of sales | (15.9) | (10.3) | (26.2) | 15.9 | (10.3) |
| Gross profit / (loss) | 101.1 | (2.4) | 98.7 | (101.1) | (2.4) |
| Total administrative expenses | (9.6) | (16.4) | (26.0) | 2.3 | (23.7) |
| Exploration costs written off | (8.8) | (13.7) | (22.5) | - | (22.5) |
| Impairment on Syrian E&E assets | (10.0) | - | (10.0) | - | (10.0) |
| Profit on sale of O&G properties | - | 6.6 | 6.6 | - | 6.6 |
| Operating profit / (loss) | 72.7 | (25.9) | 46.8 | (98.8) | (52.0) |
| Discount expense and net interest | - | (0.4) | (0.4) | - | (0.4) |
| Profit / (loss) before tax | 72.7 | (26.3) | 46.4 | (98.8) | (52.4) |
| Profit from suspended operations | | | | 98.8 | 98.8 |
| Profit on deconsolidation of DPC | | | | | 8.7 |
| Profit before tax per financial statements | | | | | 55.1 |
| Adjusted underlying profit / (loss) [1] | 102.2 | (12.3) | 89.9 | (108.9) | (19.0) |
| Net cash provided by operating activities [3] | 104.2 | (9.9) | 94.3 | (104.2) | (9.9) |
| Capital expenditure [3] | (39.4) | (6.1) | (45.5) | 39.4 | (6.1) |
| Decommissioning costs (net of escrow cash released) | - | 7.1 | 7.1 | - | 7.1 |
| Group cash balance | | | | | 124.2 |

[1] Defined as profit before depeletion, depreciation, impairment, exploration write offs, profit on asset disposals, share based payment charges, interest and tax

[2] Production activities in Syria

[3] The cash flow figures in the Financial Statements are not adjusted for the Syrian suspended operations but the analysis is included here for completeness

| | Syrian operations | All other business units | Pro forma total | Adjustment for suspended operations [2] | Total per financial statements |
|---|---|---|---|---|---|
| | | | **2010** | | |
| | | | mmboe | | |
| Production: working interest | 3.3 | 0.4 | 3.7 | (3.3) | 0.4 |
| Production: entitlement interest | 1.3 | 0.3 | 1.6 | (1.3) | 0.3 |
| | | | $MM | | |
| Revenue | 99.0 | 16.6 | 115.6 | (99.0) | 16.6 |
| Total cost of sales | (17.8) | (21.1) | (38.9) | 15.0 | (23.9) |
| Gross profit / (loss) | 81.2 | (4.5) | 76.7 | (84.0) | (7.3) |
| Total administrative expenses | (11.8) | (15.8) | (27.6) | 2.2 | (25.4) |
| Exploration costs written off | (5.5) | - | (5.5) | - | (5.5) |
| Hurricane repairs | - | 0.8 | 0.8 | - | 0.8 |
| Profit on sale of O&G properties | - | 1.1 | 1.1 | - | 1.1 |
| Operating profit / (loss) | 63.9 | (18.3) | 45.6 | (81.8) | (36.2) |
| Discount expense and net interest | - | (0.9) | (0.9) | - | (0.9) |
| Profit / (loss) before tax | 63.9 | (19.2) | 44.7 | (81.8) | (37.1) |
| Profit from suspended operations | | | | 81.8 | 81.8 |
| Profit before tax per financial statements | | | | | 44.7 |
| Adjusted underlying profit / (loss) [1] | 81.3 | (7.4) | 73.9 | (93.4) | (20.6) |
| Net cash provided by operating activities [3] | 67.3 | 2.9 | 70.2 | (67.3) | 2.9 |
| Capital expenditure [3] | (24.2) | (19.2) | (43.4) | 24.2 | (19.2) |
| Decommissioning costs (net of escrow cash released) | - | (4.7) | (4.7) | - | (4.7) |
| Group cash balance | | | | | 80.6 |

[1] Defined as profit before depeletion, depreciation, impairment, exploration write offs, profit on asset disposals, share based payment charges,

[2] Production activities in Syria

[3] The cash flow figures in the Financial Statements are not adjusted for the Syrian suspended operations but the analysis is included here for completeness

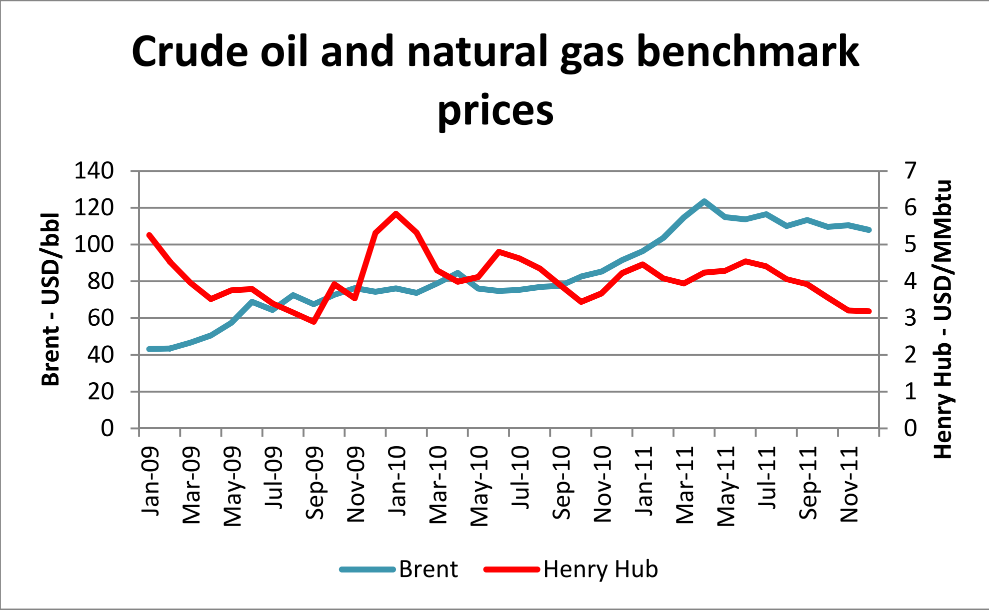
## Production and sales prices (excluding NGLs)

### Production and sales prices (excluding NGLs)

| | Working interest production | | Entitlement production | | Average sales price | | Premium / (discount) to Brent | Premium / (discount) to Henry Hub |
|---|---|---|---|---|---|---|---|---|
| | Oil | Gas | Oil | Gas | Oil | Gas | | |
| | bopd | mcf/d | bopd | mcf/d | $/bbl | $/mcf | $/bbl | $/mcf |
| **Year ended 31 December 2011** | | | | | | | | |
| **Syria** | **8,133** | **-** | **3,171** | **-** | **101.1** | **-** | **(10.1)** | **N/A** |
| **USA** | **208** | **1,066** | **168** | **824** | **103.0** | **4.0** | **(8.2)** | **0.0** |
| **Total** | **8,341** | **1,066** | **3,339** | **824** | | | | |
| Year ended 31 December 2010 | | | | | | | | |
| Syria | 9,165 | - | 3,636 | - | 74.6 | - | (4.9) | N/A |
| USA | 479 | 3,613 | 379 | 2,727 | 76.5 | 5.1 | (2.9) | 0.8 |
| Total | 9,644 | 3,613 | 4,015 | 2,727 | | | | |

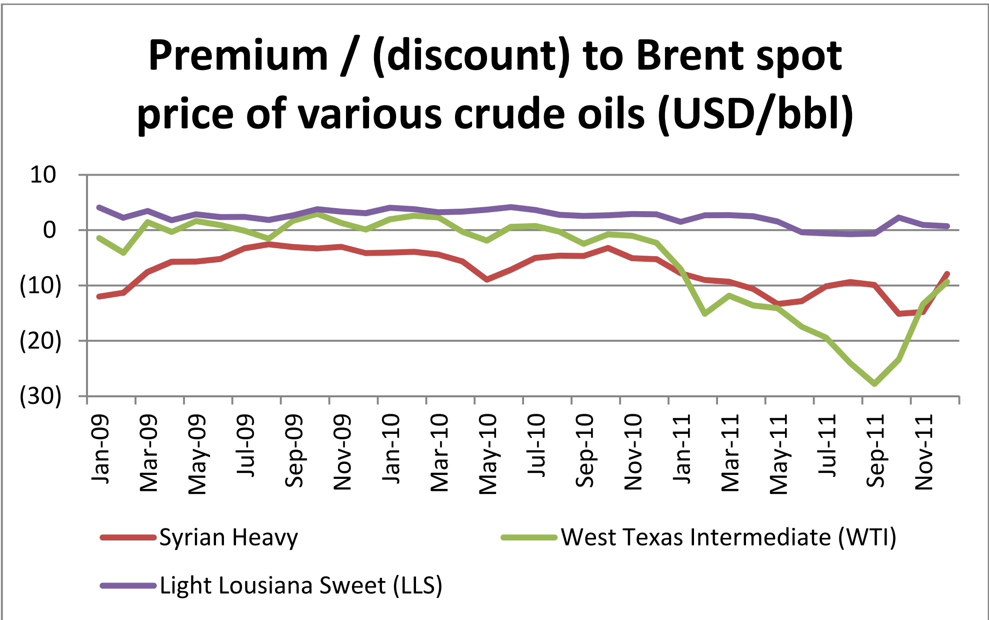
## Market conditions

Brent crude prices rose during the year from an initial price of approximately $93/bbl towards a peak of $127/bbl in May before closing the year at $108/bbl. The index averaged approximately $111/bbl against $79/bbl in 2010.




WTI has traded at a substantial discount to Brent averaging $16/bbl with a peak discount of approximately $28/bbl in September 2011. The majority of the production from the Group's US assets is linked to the price of WTI with an adjustment to reflect the price of Light Louisiana Sweet which more closely tracks Brent crude prices. The Group's gas production in the US is linked most closely to Henry Hub prices which have traded in the range $2.8/mcf to $4.9/mcf with an average price of $4.0/mcf during 2011.

The Group receives a price for its Syrian production corresponding to the export price of Syrian Heavy Crude. The price of Syrian Heavy is not a widely published crude oil benchmark and prices are established by the Syrian government based on non-public trading arrangements. The discount of Syrian Heavy to Brent fluctuated between $5/bbl and $15/bbl during the year averaging $11/bbl (2010: $5/bbl).



*Accounting treatment of Syria*

As described in note 6 to the Financial Statements and in the section on Sanctions Compliance the Group considers that it has temporarily lost the ability to manage, control or participate in the operations of Dijla Petroleum Company, the entity established in Syria, pursuant to the PSC, to administer the Syrian oil and gas production assets, and to benefit (in conjunction with the rights granted by the PSC itself) from the production from its fields in Block 26, Syria ("DPC"). In accordance with International Financial Reporting Standards ("IFRS") the Group is required to account for these suspended operations as though DPC was disposed of and the operations in Syria were discontinued. The Group's share of the net assets and liabilities of DPC, which had been proportionally consolidated, have therefore been derecognised as at 1 December 2011, the date on which the EU listed General Petroleum Corporation ("GPC") as an entity subject to an asset freeze and the results of the now suspended operations for both 2011 and 2010 have been shown separately at the bottom of the Income Statement. In accordance with IAS 39 "Financial Instruments: Recognition and Measurement" the Group has then recognised a fair value for its net investment in DPC. This value reflects a subjective assessment of the financial consequences of the EU sanctions on the Group's interest in DPC and is not, nor is it intended to be, an estimate of the Directors' view of the long-term value of its Syrian operations once the present situation in Syria is resolved.

As part of the deconsolidation process the Group has effectively impaired its share of outstanding crude oil receivables from production in Block 26 and has also recorded an impairment loss on its remaining exploration & evaluation assets in Syria. The impairment of the exploration & evaluation assets is not related to geological conditions but is as a direct result of it becoming illegal for an EU entity to provide economic resources to GPC and therefore it is presently unclear whether the Group will be able to pursue commercial development applications for successful discoveries, including Al Khairat, in the manner contemplated by the PSC.

Unless stated otherwise, the discussion below is based upon the pro forma figures as if the suspended Syrian operations of DPC had not been deconsolidated, as this is considered to be more reflective of the performance of the Group during the period (see "Selected operational and financial data" and note 7).

*Group*

*Income Statement*

The Group reported a net profit after tax in 2011 of $55.1 million (2010: $44.7 million). The profit for 2011 is stated after including a net $1.3 million of exceptional costs comprising the impairment of exploration and evaluation assets in Syria ($10.0 million) less an accounting gain of $8.7 million on deconsolidation of DPC (see note 6).

Excluding all Syrian operations, the loss for the period was $26.3 million (2010: $19.2 million). The principal reason for the increased loss is the write off of the Lambouka-1 well, offshore Tunisia ($13.8 million) partially offset by increased gains on US asset disposals of $5.5 million.

Adding back suspended activities, the underlying profit before depletion, impairment, write off of unsuccessful exploration efforts, profits on asset disposals, share based payment charges, interest and taxation was $89.9 million (2010: $73.9 million). The increase of $16.0 million was attributable

primarily to higher revenues ($9.3 million), reduced cost of sales ($5.6 million) and lower general administrative expenditure ($2.3 million) partially offset by higher foreign exchange losses ($0.5 million). Further details of this are provided in the commentary below.

Revenues from sales of hydrocarbons increased by 8% to $124.9 million (2010: $115.6 million). The Group's entitlement production, including NGLs, dropped by 23% from 4,525 boepd to 3,494 boepd due to a combination of decreased production in Syria and asset sales in the USA. The reduction in entitlement production was more than offset by increased average realised oil prices. In 2011 the average price achieved for the Group's crude oil sales was $101.2 /bbl (2010: $74.8/bbl), an increase of 35%. Revenue was 95% from crude oil (2010: 89%) 4% from gas (2010: 10%) and approximately 1% (2010: 1%) from NGLs.

Depletion charges dropped to $13.8 million (2010: $17.0 million) in line with the fall in entitlement production. Impairment charges fell to $0.1 million (2010: $3.8 million), all relating to the Group's US operations. Other cost of sales fell 31% to $12.4 million (2010: $18.0 million).

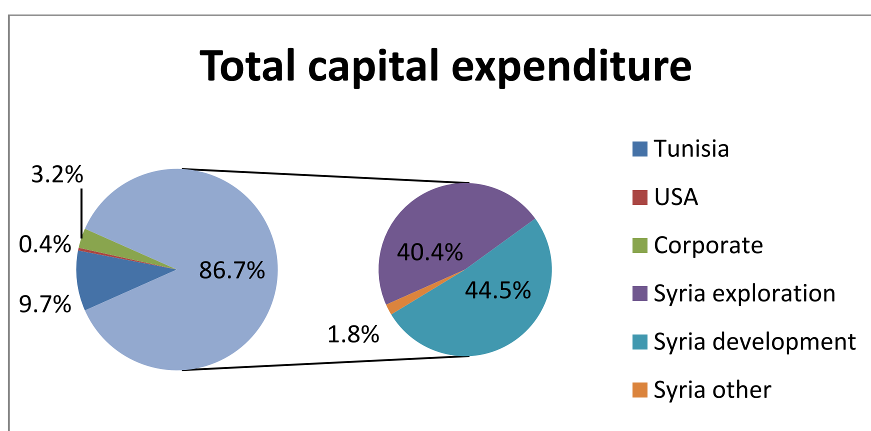
Administrative expenses (including depreciation) decreased to $26.1 million (2010: $27.7 million) principally due to reduced expenditure in Syria.

Costs of unsuccessful exploration & evaluation efforts of $22.5 million (2010: $5.5 million) were written off in respect of the Lambouka-1 (Tunisia), Safa-1 and Abu Ghazal-1 (Syria) wells and associated seismic costs. An additional impairment charge of $10.0 million (2010: nil) was incurred against the remaining exploration & evaluation assets in Syria given that it is presently unclear whether the Group will be able to pursue further applications for commercial development in the manner contemplated by the PSC.

The divestment of a further package of Gulf of Mexico assets generated a profit on disposal of $6.6 million (2010: $1.1 million). An accounting profit of $8.7 million has been recognised in respect of the deconsolidation of DPC which has been brought back into the Group accounts as an investment with a fair value, given the current exceptional circumstances in Syria, of $102.0 million.

*Cash Flow*

Cash generated by operations increased by 35% to $94.0 million (2010: $69.6 million) of which $3.0 million was generated from a reduction in working capital (2010: $6.5 million consumed). $22.9 million (2010: $25.5 million) was expended on exploration and evaluation activities and $20.5 million (2010: $16.3 million) on oil & gas development assets. $2.2 million was spent on other tangible assets and software (2010: $1.1 million).



The Group paid $5.1 million to decommission assets in the Gulf of Mexico (2010: $2.5 million) which was offset by releases from restricted cash balances of $11.2 million (2010: $3.2 million increase in balances). The substantial release from restricted cash is principally related to the disposals of assets and the associated decommissioning provisions. The disposal of properties in the Gulf of Mexico generated $10.4 million (2010: $1.1 million) excluding movements in associated restricted cash balances part of which arose from the asset sale agreed in late 2010.

The deconsolidation of DPC referred to above led to a net reduction in cash from investing activities of $9.3 million, comprised of working capital adjustments of $7.6 million, further payments on behalf of the production activities of $1.1 million and cash within DPC at the time of deconsolidation of $0.6 million.

The exercise of options, less cash paid to buy back options issued, contributed $0.6 million (2010: $0.8 million) and $13.0 million (2010: nil) was used to fund a share buyback programme.

The resultant net increase in cash during the period was $43.6 million (2010: $23.0 million).

As the Group has been unable to exploit its Syrian assets since the declaration of force majeure in December 2011 it is anticipated that the Group will consume cash at the operating level during 2012 but the cash used in investing activities for its current operations will be substantially reduced. The cash balance held is sufficient to fund the Group's current operations under all reasonably foreseeable circumstances for substantially longer than the twelve months following the date of this report.

*Financial position*

Despite the challenges provided by the situation in Syria, the Group remains in a strong financial position. At 31 December 2011 the Group had cash balances of $124.2 million (2010: $80.6 million) of which $111.8 million ($68.9 million) was denominated in US Dollars and held in money market funds through UK regulated financial institutions.

The deconsolidation of DPC has had a substantial impact on the shape of the Group's balance sheet. At 30 November 2011 the Group derecognised $60.2 million of non-current assets, $37.2 million of current assets and $4.1 million of liabilities. IFRS requires the fair value of DPC to be reinstated on the balance sheet at fair value as an investment. The Group has recorded an estimate of fair value of $102.0 million for these assets taking into account the current exceptional circumstances in Syria and the consequential difficulty of predicting the timing of future activities in the country. This valuation is based upon the entitlement reserves at 31 December 2011 discounted at a rate of 15% per annum and then the net present value is reduced further by 80% to reflect other risks of investments in the Syrian oil and gas sector at this time. In deriving the figure of 80% which is highly subjective we have assumed, inter alia, a long term Brent oil price assumption of $90/bbl, a delay to resumption of oil production in Syria, deferred revenue receipts for a period after resumption of production, potential further costs associated with restarting operations and the possibility of a change to the terms of the PSC or even expropriation.

The valuation was also reviewed by reference to the market capitalisation of the Company which provided a higher valuation despite the current depressed share price.

Long-term and short-term financial assets have reduced from $9.6 million and $5.6 million respectively to $4.0 million (all long-term) as the Group has continued its property disposal

programme in the Gulf of Mexico. Assets classified as held for sale at 31 December 2010 of $12.7 million and the associated liabilities of $8.6 million were realised during the year. Following the US asset sales the provision for decommissioning held by the Group has also reduced from $28.2 million ($20.7 million long-term, $7.5 million short-term) to $14.7 million long-term and $2.1 million short-term.

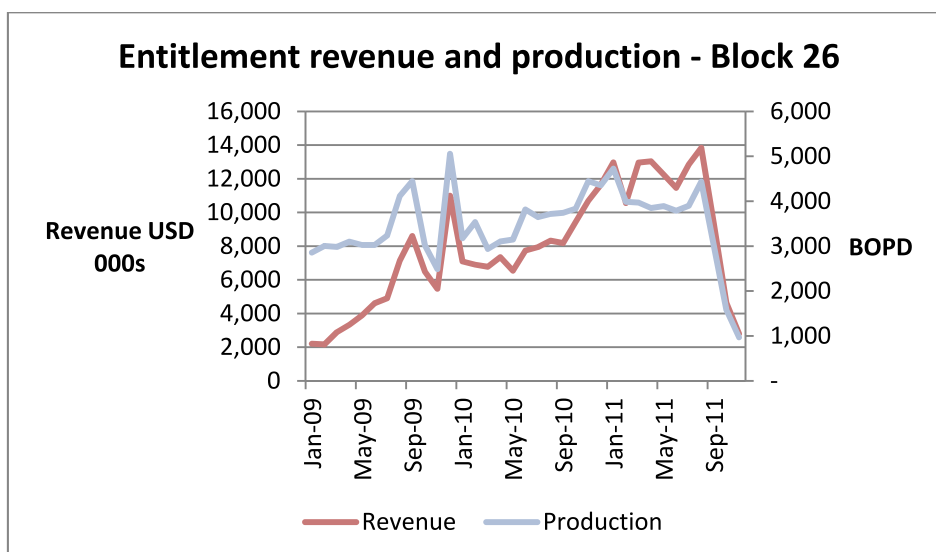
*Unit revenues and costs (per boe of working interest production)*

| | SYRIA | | USA | |
|---|---|---|---|---|
| | **2011 $/boe** | 2010 $/boe | **2011 $/boe** | 2010 $/boe |
| Gross revenue | **101.1** | 74.6 | **67.1** | 51.1 |
| Less royalties and production share | **(61.7)** | (45.0) | **(14.2)** | (11.4) |
| Net revenue | **39.4** | 29.6 | **52.9** | 39.8 |
| Production and transport cost | **(2.0)** | (1.9) | **(42.7)** | (27.7) |
| Operating cash flow | **37.4** | 27.7 | **10.2** | 12.1 |
| Depletion | **(3.3)** | (3.4) | **(26.0)** | (13.6) |
| Decommissioning accrual | **-** | - | **(4.3)** | (2.7) |
| Operating profit / (loss) before G&A | **34.1** | 24.3 | **(20.0)** | (4.2) |

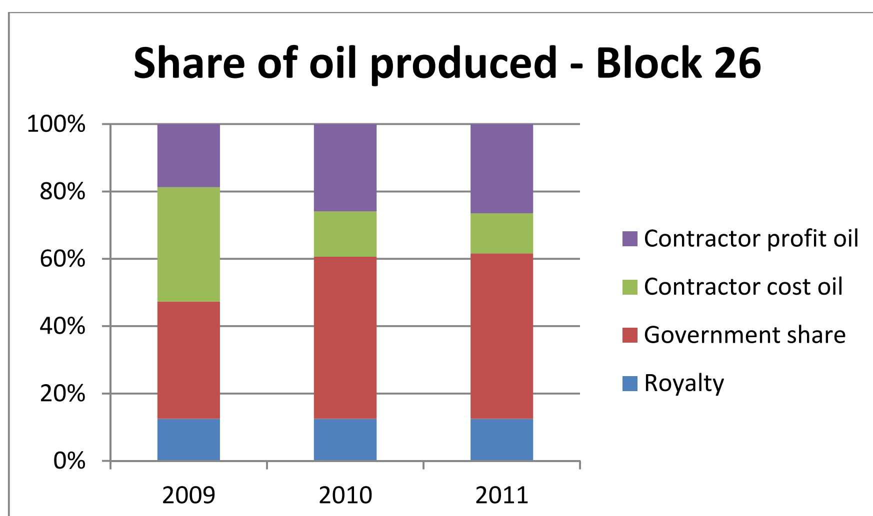
Syria

Notwithstanding the disclosure of the results required by IFRS, which separates the suspended DPC operations from our exploration activities, the following discussion treats Syria as one business stream as this is how it is reported to management (see "Selected operational and financial data" and note 7).

*Income Statement*




Working interest production from Block 26 averaged 8,133 bopd (2010: 9,165 bopd). The reduction in volumes is directly attributable to the enforced reduction in production following the ban on Syrian oil exports and, from 1 December 2011, the derecognition of volumes produced by DPC. Entitlement production was 3,171 bopd (2010: 3,636 bopd). The royalty and government share was 61% (2010: 60%).




The weighted average sales price achieved during the year was $102.3/bbl, a discount to the average Brent price of $8.9/bbl (2010: $74.6/bbl with a discount of $4.9/bbl).

Cost of sales decreased from $17.7 million to $15.9 million. The major component within cost of sales is depletion which averaged $8.5 per entitlement barrel, unchanged from 2010. Other costs of sales amounted to $6.0 million (2010: $6.4 million). A reduction of transportation tariffs of $1.3 million was offset by an increase in rental and maintenance costs of production facilities of $0.5 million and an increase in studies and data gathering costs of $0.4 million. The average production cost per working interest barrel (excluding depletion and transportation) was $1.1/bbl (2010: $0.7/bbl).

The Group wrote off $8.8 million (2010: $5.5 million) in relation to two unsuccessful exploration wells and associated 3D seismic costs.

Administrative expenses including depreciation and amortisation were $9.6 million (2010: $11.8 million). The reduction in administrative expenses was principally attributable to certain one-off compliance costs incurred in 2010 of $2.3 million and a reduction in professional fees.

The net profit from the Syrian operations before adjustments relating to the impairment of exploration and evaluation assets following the imposition of sanctions, interest and taxation amounted to $82.7 million (2010: $63.9 million).

One off costs associated with the imposition of EU sanctions against the Syrian oil industry amounted to $1.3 million in 2011 comprising the impairment of exploration and evaluation assets of $10.0 million and a net accounting gain on the deconsolidation of the Group's production assets and reinstatement at fair value, taking into account the current exceptional circumstances in Syria and the consequential difficulty of predicting the timing of future activities in the country, of $8.7 million. The resultant net profit contribution to the Group from Syrian operations amounted to $81.4 million (2010: $63.9 million).

*Cash Flow*

Cash generated by Syrian operations amounted to $104.2 million (2010: $67.3 million). Cash received from oil sales increased to $114.1 million (2010: $90.3 million) principally as a result of an increased oil price during the year. The Group delayed payment of certain suppliers over period end whilst it reviewed the implications of the imposition of sanctions, resulting in a reduction of cash payments for operations from $23.0 million to $9.9 million.

Capital expenditure amounted to $39.4 million (2010: $24.2 million) including development and inventory expenditure of $20.2 million (2010: $13.0 million) and exploration expenditure of $18.5 million (2010: $9.6 million).

Net cash inflows before financing activities amounted to $64.8 million (2010: $42.8 million). $90.0 million (2010: $30.0 million) was paid to the holding company as dividends. All other funding of the Syrian operations is provided in proportionate shares by the Group and its joint venture partner, Emerald Energy plc, by way of non-interest bearing loans.

Tunisia

*Income Statement*

Tunisian operations made a loss of $13.8 million (2010: $0.3 million) which was almost entirely due to the write off of the Lambouka exploration well. Although gas was discovered uncertainty remains as to the nature of this gas and the viability of its commercialisation. The majority of the borehole is deemed unusable for future operations and in accordance with the Group's successful efforts accounting policy the carrying value has been written off.

*Cash Flow*

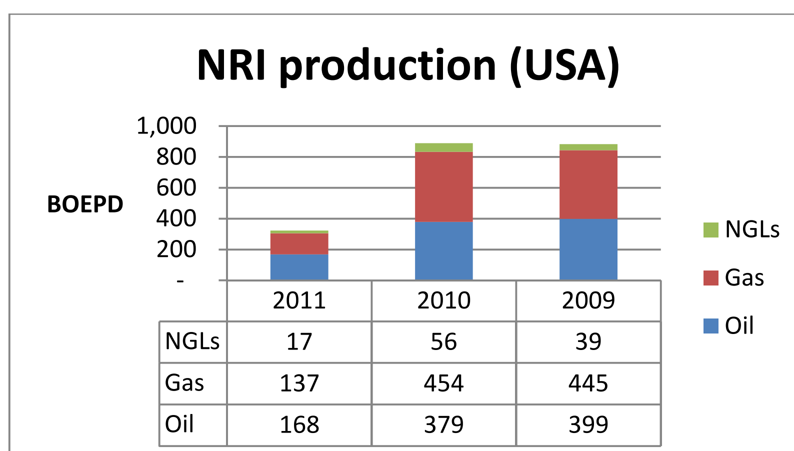
During the year $4.4 million (2010: $2.1 million) was spent on exploration activities, principally in the Chorbane block where the Sidi Dhaher-1 well discovered a potential hydrocarbon column. The well will be tested during H1 2012 and at 31 December 2011 $3.9 million, being the Group's share of the cost of Sidi Dhaher-1 well, is included in exploration and evaluation assets.

USA

*Income Statement*

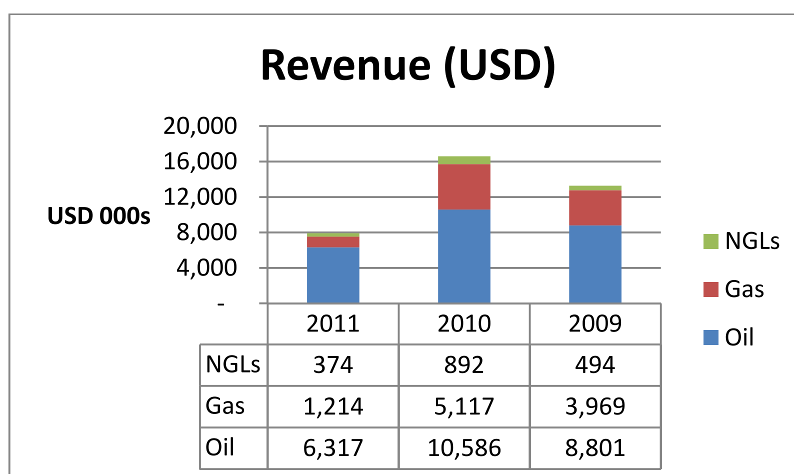
Production for the year from offshore USA assets averaged 323 boepd on a net revenue interest ("NRI") basis (2010: 889 boepd), a total reduction of 566 boepd. Disposals of assets with effective dates of 1 May 2010 and 1 June 2011 accounted for approximately 370 boepd of this reduction.

The NRI production comprised 52% oil (168 bopd), 43% gas (824 mcf/d) and 5% NGLs (728 galls/d). The corresponding figures for 2010 were 43% oil (479 bopd), 51% gas (2,726 mcf/d) and 6% NGLs (2,341 galls/d).




| | 2011 | 2010 | 2009 |
|---|---|---|---|
| NGLs | 17 | 56 | 39 |
| Gas | 137 | 454 | 445 |
| Oil | 168 | 379 | 399 |

Average sales prices were $103.0/bbl for oil (2010: $76.5/bbl), $4.0/mcf for gas (2010: $5.1/mcf) and $1.4/gall for NGLs ($1.0/gall). The majority of the Group's production from offshore Gulf of Mexico is sold through contracts with prices linked to a combination of indices comprising West Texas Intermediate and a pricing differential based on Light Louisiana Sweet ("LLS") and then adjusted for transportation tariffs. During 2011 the average of the WTI and LLS differential averaged $108.1/bbl.




| | 2011 | 2010 | 2009 |
|---|---|---|---|
| NGLs | 374 | 892 | 494 |
| Gas | 1,214 | 5,117 | 3,969 |
| Oil | 6,317 | 10,586 | 8,801 |

Depletion during the year was $3.9 million ($32.9/boe on an NRI basis) compared to $5.7 million ($17.5/boe) during 2010. The depletion charge is calculated asset by asset and is substantially affected by changes to the production mix and decommissioning estimates. The average depletion rate of the Group's remaining assets at 31 December 2011 is approximately $13.8 per boe on an NRI basis. Impairment charges of $0.1 million (2010: $3.8 million) were incurred, principally against assets disposed.

Other costs of sales of $6.4 million (2010: $11.6 million) included repair and workover costs of $3.0 million (2010: $1.5 million) and decommissioning costs in excess of provisions of $1.1 million (2010: $2.0 million). Excluding maintenance and repair costs, underlying lease operating expenses amounted to an average of approximately $16.5/boe on a working interest basis ($20.5/boe).

Administrative costs amounted to $2.8 million (2010: $3.1 million). Interest payable to Group undertakings was $4.4 million (2010: $4.3 million) and amortisation of the decommissioning provision amounted to $0.6 million (2010: $1.1 million).

*Cash Flow*

The net cash inflow from US operations was $0.9 million (2010: $2.3 million). Included in the net cash inflow from operations was expenditure of $3.0 million (2010: $1.5 million) on repairs to assets.

Development expenditure reduced considerably to $0.2 million (2101: $3.2 million) and $5.1 million (2010: $2.5 million) was spent on decommissioning assets.

During the period the Group disposed of a package of assets with an effective date of 1 June 2011 for a consideration of $6.0 million (prior to closing working capital adjustments) as part of the ongoing property portfolio rationalisation and a further $4.4 million was received from the sale of the Group's interests in Eugene Island 57/58, Vermilion 379 and South Pelto 13 announced during 2010. The purchasers of these assets assumed all future abandonment obligations allowing the Group to release $11.2 million from escrow accounts.

Financial risk management

The financial risks concerning the Group comprise pricing risk, currency risk, liquidity risk and access to capital.

Pricing risk arises because all of the Group's oil and gas production is sold under short term pricing arrangements and so the Group is exposed to movements in oil and gas prices. To date this exposure has not been hedged since the Board has taken the view that the Group's cash flow has been sufficient to bear any reasonably foreseeable downturn in prices without affecting our core business. However this policy is kept under frequent review.

Currency risk arises because the Group's sales are denominated in US Dollars but a proportion of its expenses are in Euro and Sterling (head office costs). The risk is mitigated by retaining a proportion of our cash resources in these currencies.

Liquidity risk concerns the Group's ability to access funds to meet its obligations as they fall due. Our policy is to maintain sufficient cash balances and readily realisable investments for this purpose, given that the Group has no bank lines of credit available to it. Sums in excess of what is needed to meet near-term obligations are invested in a money market fund which holds a diverse portfolio of short-term financial instruments rated A1 or better, resulting in a greater spread of risk and an improved return compared with what we would otherwise be able to achieve.

Access to capital depends on conditions prevailing in the equity market for independent E&P companies generally and the sentiment among the Group's shareholders in particular but the Group has sufficient resources to finance its current operations for the foreseeable future until the resumption of operations in Syria.

Andrew Rose

**Chief Financial Officer**

2 April 2012

**Sanctions Compliance**

During 2011 the European Union ("EU") imposed progressively tighter sanctions on Syria, which targeted, inter alia, the country's oil industry. The following describes the impact of those sanctions, and the measures taken by the Group to comply therewith.

Summary of Legislation

*USA*

The USA has since the 2003 Syria Accountability and Lebanese Sovereignty Restoration Act had measures in place against Syria, to prohibit the export of certain goods and to block the property of certain persons. Whilst these measures did not impact Gulfsands directly, Mr Rami Makhlouf, with whom Gulfsands had had a relationship since the time of its entry into Syria in 2000, was in 2008 designated by the US Treasury Department's Office of Foreign Asset Control ("OFAC") as a Specially Designated National pursuant to this legislation.

*EU*

On 9 May 2011, the EU Council adopted Regulation 442/2011 which, inter alia, froze the assets held or controlled by certain individuals and entities. Among the individuals in question was Mr Rami Makhlouf. The provision of funds or economic resources, directly or indirectly, to those on this list was prohibited.

Subsequently by virtue of several further Regulations between May and December 2011 additional persons and entities were added to the list of those subject to the asset freeze. These included President Bashar Al-Assad, other members of his family, and certain relatives of Mr Rami Makhlouf and entities controlled or beneficially owned by him and his family (the "Makhlouf Interests").

On 2 September 2011 the EU Council adopted Regulation 878/2011 which prohibited the import into the EU of crude oil or petroleum products originating in Syria, the transportation of such crude oil or petroleum products, or the provision of financing or insurance for such activities.

On 23 September 2011 the EU Council adopted Regulation 950/2011 which prohibited the granting of any loan or credit to a Syrian person or entity engaged in the exploration, production or refining of crude oil, the acquisition or extension of a participation in any such entity, or the creation of a joint venture with such person or entity. These prohibitions were however without prejudice to the fulfilment of obligations arising under contracts concluded prior to the date of the Regulation.

On 1 December 2011 an EU Council Decision significantly increased the sanctions against the oil industry in Syria: although the associated EU regulation (Regulation 36/2012) was not adopted until 18 January 2012 certain aspects of the decision became effective immediately. The additional measures prohibited, inter alia, the supply to any Syrian person or entity of key equipment or technology used in exploration or production of crude oil and natural gas, or technical assistance related to such equipment or technology. These prohibitions were however without prejudice to the fulfilment of obligations arising under contracts concluded prior to the date of the Regulation.

Furthermore the 1 December 2011 EU Council Decision added General Petroleum Corporation ("GPC") to the asset freeze list: GPC is the party to the Block 26 PSC and a 50% shareholder in Dijla Petroleum Company ("DPC"). On 23 January 2012 by EU Regulation 55/2012 further persons and

entities were added to the list of those subject to the asset freeze. These included DPC, the Group's joint operating company formed for the purpose of exploiting the discovered oil & gas in Block 26.

Relationship with Makhlouf Interests

A full disclosure of the extent of the Group's relationship with Mr Makhlouf and certain corporate entities in which Mr Makhlouf and other members of his family (collectively the "Makhlouf interests") are involved was made in August 2011, and a copy of the press release may be found on Gulfsands' website www.gulfsands.com. The following summarises the contents of that disclosure.

Since the time of its first entry into Syria the Group has had constructive arms length commercial relationships with certain Makhlouf Interests, all of which have been properly documented and disclosed. These comprise:

- the rental of office premises in Damascus from a company beneficially owned by Makhlouf Interests;
- a services agreement with Ramak, a company beneficially owned by Makhlouf Interests, which was engaged to provide assistance to the original joint venture partners in identifying and evaluating E&P opportunities in Syria and since 2000 has provided various support and administrative services to the Block 26 joint venture. Under this agreement Ramak was entitled to an annual fee of less than $250,000 plus a 2.5% net profit interest in the entitlement production attributable to the joint venture.

In addition Al Mashrek Global Invest, a company beneficially owned by Makhlouf Interests, currently owns 7.0 million shares in the company representing 5.9% of the total issued share capital of the company (excluding shares held in treasury).

Compliance Measures Taken

Gulfsands has from the outset taken extensive legal advice to ensure full compliance with the relevant sanctions.

Immediately after the 9 May EU regulation all payments to the Makhlouf interests under the existing commercial agreements were suspended, and additionally all voting, dividend and transfer rights pertaining to the shares in Gulfsands held by Al Mashrek Global Invest were suspended.

Following the EU Council Decision of 1 December, after taking legal advice and obtaining the agreement of Emerald Energy (a subsidiary of Sinochem and its 50% working interest partner), Gulfsands on 11 December declared force majeure under the PSC on the grounds that it could no longer comply with its obligations while remaining compliant with UK law.

With effect from 1 December Gulfsands has:

- ceased to provide assistance to DPC in the form of seconded staff or indeed have any involvement with the day to day operations of DPC
- recused itself from decisions taken by the DPC board
- not submitted invoices for the Joint Venture's entitlement share of oil production
- exercised strict control over payment of outstanding invoices to ensure that (a) no payments were made to persons or entities who are included on the list of those subject to the asset

freeze and (b) no payment was made which would constitute a transfer of economic resources to GPC or DPC

- ceased (with effect from the 18 January being the date of adoption of EU Regulation 36/2012) to enter into new contracts for the procurement of oil & gas related goods or services into Syria, or for associated technical assistance.

The Group has now ceased all exploration, as well as production, activity in Syria but is intending to retain a place of business in the country, and for the time being at least, to retain the services of the majority of its local staff.

**Principal Risks and Uncertainties**

The Board places a high priority on managing and mitigating risk. The Risk Committee comprising, inter alia, the Chief Executive and Chief Financial Officer has responsibility for the management of risk in all its forms throughout the Group, under the oversight of the Audit Committee.

A comprehensive assessment of risks facing the Group is undertaken annually using a matrix approach which assesses each risk in terms of its impact on both the financial statements and the value of the business, the probability of occurrence, perceived shareholder tolerance and the cost of mitigation. The conclusions are reviewed by the Board. The risk matrix is updated as required during the year.

Principal risks and uncertainties

Since early 2011 the principal risk and uncertainty facing Gulfsands has been the impact of the growing pro-democracy movement throughout the Middle East, now known collectively as the Arab Spring, which began in Tunisia in December 2010 and which started to gather pace in Syria in Q1 2011. From early on Gulfsands began to evaluate possible scenarios for the Syrian crisis and put in place contingency plans. These comprised, inter alia, security measures to protect the office in Damascus and the field installations, evacuation plans for expatriates, and investigating alternative suppliers of goods and services to our Syrian business in case existing suppliers became reluctant to deal with the Group. Where suppliers, consultants and other third parties proved reluctant to travel to Damascus on security grounds meetings were organized in Beirut instead.

Ultimately however, the impact of the progressive imposition of EU sanctions against Syria, and against its oil industry in particular, proved impossible to mitigate, leading eventually to the declaration of force majeure on our Block 26 PSC on 11 December 2011.

The situation in Syria continues to be grave, with no visible sign of any impending resolution to the crisis. It is impossible to predict with any confidence how the situation may resolve itself and over what timescale. Once sanctions are lifted the risk remains that Gulfsands may not be able to resume operatorship of the Block 26 PSC without any disruption or amendment to the terms of our PSC. There is a risk that the government may elect to re-negotiate the terms of the PSCs of international oil companies with operations in Syria, or may attempt to put existing licensed blocks out for re-tender. Whilst, in the case of Gulfsands at least, either of such actions would amount to a breach of the terms of our PSC, the possibility of such an outcome cannot be discounted.

Annual Risk Review

The last annual risk review was carried out in November 2011, after the EU sanctions of 2 September which banned the import or transportation of Syrian crude, but before the imposition on 1 December of sanctions which specifically targeted the oil & gas industry in Syria. In that review the following principal risks and uncertainties were identified:

| Risk | Mitigation |
|---|---|
| **Supply Chain**<br>The risk that suppliers would cease to trade with our Syrian business because of the local situation | Suppliers were contacted to assess their position. Alternative supply relationships were established where appropriate. A regular dialogue was maintained at high level with Saipem, lead contractor on the central production facility contract. The use of US Dollars to settle invoices was avoided because of perceived money transfer risks. |
| **Further Sanctions**<br>The risk of further sanctions being imposed which directly targeted the oil industry in Syria | This turned out to be the case within weeks of the review, and the risk was obviously impossible to mitigate in advance. |
| **Civil war**<br>The risk of the situation in Syria descending into civil war | Evacuation plans for expatriate staff were put in place, and security measures around the Damascus office and field installations were increased. Contingency plans were made to shut in production and suspend operations should the need arise. |
| **Change in government**<br>The risk of a new government taking power in Syria that is less well disposed towards international oil companies | Gulfsands has been at pains over the years to develop good relations with the Oil Ministry, GPC, and other governmental bodies in Syria. In the event of a change in government there can be no assurance that these relationships would continue to have any currency, and there are no practical ways to mitigate this risk. |
| **Attracting and retaining staff**<br>The risk that key staff leave because of the current situation and that recruiting new staff is difficult | Discussions have been held with all key staff, both in Syria and in London, to address their concerns and provide reassurance as far as possible. It has been emphasized to all Syrian staff that the Group intends to retain a presence in-country throughout the crisis. |
| **Viable growth opportunities**<br>The risk that insufficient viable growth opportunities with the right risk/reward mix can be found | The risk profile of the MENA region increased significantly in 2011, but the reluctance of the capital markets to fund investment in the region offers opportunities for corporates with investable cash. Screening of opportunities, both within the MENA region and elsewhere, has been stepped up significantly. |

The review also indentified, analysed and recommended (where appropriate) mitigation measures for a number of secondary risks including:

- the impact of a major fall in oil prices
- exploration subsurface risk
- liquidity and access to capital
- Bribery Act compliance
- information technology risks, including hacking, viruses, cyber attack and loss of confidential data

**Board of Directors**

**Andrew West**
**Non-Executive Chairman**

Andrew West (54) has been Chairman of Gulfsands since July 2006. An investment banker specialising in mergers and acquisitions by career, he has worked for Smith Barney (1981-85), Lehman Brothers (1985–90), Guinness Mahon (1990–97) and from 1997 to 1999 was Managing Director of Strand Partners, a privately owned investment banking firm specialising *inter alia* in energy and natural resources. Since 1999 he has run his own consultancy practice. He is currently a non-executive director of or adviser to numerous companies, both public and private, and has had considerable experience as both a financial adviser and a non-executive director in the oil and gas sector

**Richard Malcolm**
**Chief Executive**

Ric Malcolm (59) joined Gulfsands as Chief Executive in October 2008. A professional geoscientist with over 30 years of oil and gas experience, he began his career as a Petroleum Geologist with Woodside in Australia. He then spent 10 years with Ampolex, an Australian independent E&P company, latterly as Exploration Manager, followed by three years with Mobil as Manager for Papua New Guinea. In 1999 he joined OMV as Exploration Manager for Australia and New Zealand, going on to become Exploration Manager in Libya, General Manager in Norway and finally in 2006 Managing Director for OMV UK.

**Mahdi Sajjad**
**Executive Director and President**

Mahdi Sajjad (53) is an Iraqi national who was educated in the UK, and was one of the founders of Gulfsands in 1998. Having worked from 1981–88 with a consortium of British engineering companies in the Middle East and Africa, in 1988 he joined International Development Corporation in Dubai where he became Managing Director. From 1988 – 95 he was also a director of Oil & Minerals Development Corporation in Dubai. He has also established a number of companies with interests in the Middle East in different industry sectors but with particular emphasis on the energy and mining sectors.

**Ken Judge**
**Director of Corporate Development & Communications**

Ken Judge (56) joined the Board in 2006 as a Non-Executive Director, becoming an executive Director in 2008. A former corporate lawyer in Australia, he has held numerous public company directorships and has been engaged in the establishment or corporate development of oil and gas, mining and technology companies in the United Kingdom, Middle East, USA, Australia, Europe, Canada, Latin America and South East Asia.

**David Cowan**
**Non-Executive Director**

David Cowan (56) has been a Director of Gulfsands since 2006. A practicing solicitor, he is a partner with McMillan LLP based in Vancouver, Canada, and practices primarily in the area of corporate and securities law. He represents numerous publicly traded companies and has been involved in the drafting of British Columbia's securities legislation. He is a past Chairman of both the Securities and Natural Resources subsections of the British Columbia branch of the Canadian Bar Association, and the National Natural Resources subsection of the Canadian Bar Association. His specific Middle East experience includes ventures in Syria, Iraq and Algeria.

In addition to the Directors whose biographies are shown above, Andrew Rose served as Chief Financial Officer throughout the year and to the date of this report.

## Corporate Social Responsibility

2011 saw the introduction of a number of important regulatory changes that caused Gulfsands to review and update our policies and procedures to ensure our employees and consultants are properly prepared to meet the new regulatory environment introduced with the UK's Bribery Act and respond to the impact of the EU's sanctions on Syria.

The Company is committed to ensuring that our business conduct reflects high standards of corporate social responsibility ("CSR") and corporate governance across the entire Group and in all the countries in which we operate and we are satisfied that our Company has the systems and controls and our employees and consultants have been suitably trained to ensure that we can be confident of our continued compliance with the stringent compliance obligations introduced with the passing of the Bribery Act and the EU's sanctions on Syria.

Responding on a timely basis to the EU's progressive introduction of sanctions during the course of 2011 presented our local staff with a number of Health, Safety and Environment ("HSE") challenges as firstly oil production operations were reduced and then, finally, the Company was obliged to withdraw completely from any involvement in those activities. The Company safely and efficiently responded to these challenges without incident and there have been no reported safety or security incidents since General Petroleum Corporation personnel were handed control of our oil fields and facilities in Block 26.

Notwithstanding these operating restrictions, we continued to support our CSR initiatives with a level of financial assistance and range of activities consistent with those undertaken in prior years, reflecting the importance our organisation attributes to these initiatives. We are very pleased to have the full backing and encouragement of our partners in Block 26, China's Sinochem Corporation, for these initiatives and this has ensured that the important work of these local charities and communities was able to continue during 2011 with only limited disruption to previously agreed plans.

### Supporting local communities and charitable causes

During 2011 Gulfsands maintained the level and scope of its financial and logistical support for the local communities and social and charitable organisations with which we worked, in a manner consistent with our activities during 2010. Gulfsands continues to direct these efforts towards supporting programmes that aim to improve the health, welfare and prospects of children, women and the disadvantaged members of society and especially for people living within the north east region of Syria where our operations are based.

Building on our 2010 programme to fund the installation of facilities at three elementary schools in villages local to our operations at the Khurbet East and Yousefieh oil fields that included the provision of internet access and approximately fifty computers, peripherals and supplies as well as the refurbishment of dedicated class rooms and programmes to train teaching staff, we expanded

access to training programmes at these facilities to include the parents of students attending these schools.

Our support for the establishment of Information Technology training programmes at a number of schools in Al Qamishli has become an important part of local efforts to modernise the education curriculum and develop technical skills that can help reduce local unemployment levels.

We have continued to focus much of our CSR investment in supporting projects that are specifically directed at providing women and young and disadvantaged people with access to education and the development of the skills to create self-sustaining micro-businesses especially in rural communities where these programmes have proved very popular and effective in reducing poverty levels. During 2011 we again provided meaningful financial and logistical support for organisations that are working to provide access to education and educational infrastructure such as mobile libraries, micro finance and technical and mentoring assistance for the development of micro-businesses.

The organisations supported by Gulfsands are all heavily dependent upon the dedication of volunteers, including, we are proud to acknowledge, volunteers from within our organisation. The financial support provided by Gulfsands when combined with the tremendous energy and application shown by these well organised groups of volunteers has continued to show outstanding results such as demonstrated by the continued remarkable achievements of the **BASMA** (Children with Cancer) organisation to which Gulfsands again provided substantial assistance.

The **BASMA** sponsored paediatric oncology unit at the Al Buruni University Hospital in Damascus, which remains Syria's first and only dedicated paediatric oncology unit, was further expanded during 2011 to significantly increase the capacity of the unit to treat in-bed and outpatients at the hospital.

This facility has helped local doctors meaningfully reduce paediatric oncology mortality rates in Syria as a result of them having access to the high quality medical support and treatment available at this specialist hospital unit. Gulfsands also continued its programme to fund specialised Oncology treatments and pharmaceuticals at this unit and at the upgraded Haematology and Oncology unit at the larger Children's Hospital in Damascus and, as a consequence, a large number of families from across the country travel to Damascus to accompany their children while they are treated at these facilities. The astonishing results achieved at these facilities demonstrate the extraordinary effectiveness of this joint public, corporate and volunteer initiative.

During 2011 Gulfsands worked with **BANA** (the Syrian institute for the Blind) to complete the construction of a facility and equipment for a computer based Braille teaching programme and the construction and population of a digital audio library at the Damascus headquarters of **BANA**. Both these facilities and the programmes they facilitate are unique in Syria.

Gulfsands has also furthered its support for **AAMAL**, the Syrian Organisation for the Disabled, the **Syrian Association for Autistic Children** which provides teaching and support facilities for children with learning difficulties, and the **Light and Flowers Centre for Cerebral Palsy.** We expect to continue support for these worthwhile organisations during the current year.

Finally, while the recent unrest in Syria made field work difficult during the summer months of 2011, Gulfsands nevertheless provided funding for ongoing carbon dating and forensic work on discoveries made during the archaeological excavation of an ancient **Urkesh Palace at the Tell Mozan site near to Block 26** in north east Syria being carried out by the **International Institute for Mesopotamian Area Studies (”IIMAS”)**. This world renowned excavation follows the discovery of this extraordinary Urkesh Palace believed to have been the original home of the Hurrian Kings of Syria and built in circa 2250BC.

The excavation of this famous archaeological site is carried out under the guidance of Professor Giorgio Giorgio Buccellati, Director, Mesopotamian Lab, Cotsen Institute of Archaeology, UCLA and Professor Emeritus, Department of Near Eastern Languages and Cultures, UCLA. Professor Buccellati and his teams have now partially excavated one of the most important archaeological sites in Syrian and Middle Eastern history. Further details about this important work and the **Gulfsands Urkesh Exploration Fund** can be viewed at www.urkesh.org.

Gulfsands is widely recognised for its commitment to supporting the communities in which we operate, whether in the remote north east of Syria or central Damascus. We are proud of our achievements but humbled by the enormous support we receive from the large numbers of committed volunteers working within the organisations with which we are involved and who are simply motivated to assist those less fortunate in society than themselves.

Notwithstanding recent events in the Middle East it remains the Company’s ambition to continue working with well-run non-government organisations pursuing worthy social objectives in the countries in which we operate. We expect this work to continue to be an important point of reference for our organisation when pursuing new business opportunities in Syria, Iraq, Tunisia and elsewhere in the MENA region and with the continued support of our shareholders and partners, Sinochem Corporation, we expect to further build on our present record during the coming year.

The Directors present their report together with the audited financial statements of Gulfsands Petroleum plc and its subsidiary undertakings ("the Group" or "the Company" or "Gulfsands") for the year ended 31 December 2011.

**Principal activity**

The Group was established in October 1997. The Company was incorporated in England on 2 December 2004 as a public company limited by shares, and became the parent company of the Group in March 2005 as a result of a corporate reorganisation. In April 2005 the Company was listed on the Alternative Investment Market ("AIM") of the London Stock Exchange.

The Group's principal activity is that of oil and gas production, exploration and development. The Group has development and exploration projects in the Syrian Arab Republic which are currently suspended, exploration projects onshore and offshore Tunisia and a non-operated portfolio of producing oil and gas properties in the USA (offshore Gulf of Mexico and onshore Gulf Coast).

**Review of the business and future prospects**

The Group is required by the Companies Act 2006 to set out in this report a review of the business for the year ended 31 December 2011. A full review of the Group's operations, performance and prospects is set out in the following sections of this report:


| | Pages |
|---|---|
| The Chairman's Statement | 4-6 |
| The Chief Executive's Report | 8-9 |
| The Operations Review | 11-18 |
| The Financial Review | 22-32 |
| The Corporate Social Responsibility Review | 40-42 |
| The Directors' Remuneration Report | 50-52 |


**Key performance indicators**

The Directors have adopted certain financial and non-financial Key Performance Indicators ("KPIs") with which to measure performance of the Group during the current and future financial years. Definitions of these KPIs plus the outcome for the year are contained in the section "Key Performance Indicators" on page 7.

## Results and dividends

The Group made a profit after taxation for the year ended 31 December 2011 of $55.1 million (2010: $44.7 million). The Directors do not recommend payment of a dividend.

## Group structure and changes in share capital

In December 2011 the Company lost joint control of Dijla Petroleum Company and has deconsolidated its related Syrian production assets in its Financial Statements. Details are included in note 6 to the financial statements. Other than this there were no changes in the Group structure during the year. Details of movements in the Company's share capital during the year are set out in note 22 to the Consolidated Financial Statements.

## Directors and their interests

The Directors who served during the year and their interests in the Company's shares were as follows:

| | **At 31 December 2011** | | At 31 December 2010 | |
|---|---|---|---|---|
| | **Number of ordinary shares** | **Number of share options** | Number of ordinary shares | Number of share options |
| A T West | **122,664** | **1,000,000** | - | 1,200,000 |
| M Sajjad [1] | **8,655,268** | **1,750,000** | 8,655,268 | 1,500,000 |
| R Malcolm | **150,000** | **2,100,000** | 150,000 | 1,850,000 |
| A Rose | **600,000** | **1,275,000** | 600,000 | 1,100,000 |
| K Judge [2] | **2,616,750** | **1,050,000** | 3,966,750 | 1,300,000 |
| D Cowan | **491,750** | **400,000** | 441,750 | 525,000 |

(1) The interest for Mr Sajjad disclosed above includes shares held by Nordman Continental S.A., a company owned by a trust of which Mr Sajjad's children are potential beneficiaries.
(2) The interest for Mr Judge disclosed above includes shares held by Hamilton Capital Partners Limited, an associated company of Mr Judge.

## Issue of share options and restricted shares

Details of share options and restricted shares issued, exercised and cash settled during the year ended 31 December 2011 are set out in note 22 to the Consolidated Financial Statements.

## Directors' interests in transactions

Details of transactions with Directors for the year ended 31 December 2011 are set out in note 28 to the Consolidated Financial Statements.

The Company maintains directors' and officers' liability insurance cover, the level of which is reviewed on a regular basis.

**Internal controls**

The Board is responsible for identifying and evaluating the major business risks faced by the Group and for determining and monitoring the appropriate course of action to manage these risks. Further information relating to the Group's corporate governance policies is shown on pages 48-49.

**Substantial shareholders**

The Company has been notified, in accordance with Chapter 5 of the FSA's Disclosure and Transparency Rules, of the following voting interests in its ordinary shares as at 28 March 2012 of 3% shareholders and above:

| Name | Number of shares | % of shares in issue |
|---|---|---|
| Waterford Finance & Investment Limited | 21,534,737 | 17.7% |
| Schroder Investment Management | 19,932,672 | 16.3% |
| Abdul Rahman Mohdabdullah Kayed | 11,500,000 | 9.4% |
| Nordman Continental S.A. (1) | 8,655,268 | 7.1% |
| Al-Mashrek Global Invest Ltd (2) | 7,000,000 | 5.7% |
| Soyuzneftegas Capital Limited | 5,969,298 | 4.9% |
| Hugh Sloan | 5,005,800 | 4.1% |
| Norges Bank | 4,700,000 | 3.9% |
| Shares held in Treasury by the Company (3) | 4,245,681 | 3.4% |

(1) Nordman Continental S.A. is owned by discretionary trusts of which Mr Sajjad's children are potential beneficiaries.
(2) Voting rights currently suspended
(3) Not eligible for voting rights

**Principal risks and uncertainties facing the Group**

The business of oil and gas exploration involves a high degree of risk which a combination of experience, knowledge and careful evaluation may not be able to prevent. The Board has established a process for identifying and evaluating the principal risks and uncertainties facing the Group and a summary of these risks and uncertainties, together with measures taken to mitigate them, is contained on pages 36-37.

There are also significant risks arising due to the sanctions imposed on the Syrian oil and gas sector by the EU which are extensively described in the Chairman's letter, the Chief Executive's Report and the Financial Review.

**Suppliers' payments policy**

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers, provided that all trading terms and conditions have been complied with. The Company's average creditors' payment period at 31 December 2011 was 11 days.

**Financial risk management objectives and policies**

Gulfsands' approach to financial risk management is described in the Financial Review on pages 22-32 and in the Principal Risks and Uncertainties section on pages 36-37. Further disclosure is made in

note 27 to the Consolidated Financial Statements and note 16 to the Company Financial Statements including the Group and Company's exposure to price, credit, liquidity and currency risk.

**Political and charitable donations**

There were no political contributions made by the Group during the years ended 31 December 2011 and 2010. The Group has a policy of making social contributions in its areas of operations where it will impact directly in the local communities. Further details are included in the Corporate Social Responsibility Report on pages 40-42. Approximately $347,000 was provided to community programmes undertaken in Syria during 2011 (2010: $543,000) and a further $15,000 (2010: $184,000) was donated to other charitable causes outside Syria.

**Annual General Meeting**

The Company's Annual General Meeting will be held on Wednesday 30 May 2012 at 11 am. The Notice of the Meeting, which sets out the resolutions to be proposed, accompanies this Annual Report and Financial Statements.

**Going concern**

The Group's business activities, financial performance, financial position and risks are set out in the Operations Review and the Financial Review. The financial position of the Group, its cash flows, liquidity position and resources are detailed in these reviews and further details are included in the Consolidated Financial Statements. The Group has significant cash resources, no debt and, based on current predictions of expenditure, anticipates that it will have sufficient resources available to meet all committed expenditure for substantially longer than twelve months from the date of this report. After making appropriate enquiries and examining those areas which could give rise to financial exposure the Directors are satisfied that the Group and Company has adequate resources to continue its operations for the foreseeable future, despite the current uncertain economic environment. For this reason the Directors continue to adopt the going concern basis in preparing the financial statements.

**Information to shareholders**

The Group has its own website (www.gulfsands.com) for the purposes of improving information flow to shareholders and potential investors.

**Statement of Directors' Responsibilities**

The Directors are responsible for preparing the financial statements in accordance with applicable laws and International Financial Reporting Standards ("IFRSs") as adopted by the European Union.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Group for that year. In preparing those financial statements, the Directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors confirm that the Financial Statements comply with the above requirements.

The Directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the United Kingdom governing the preparation and the dissemination of financial statements may differ from legislation in other jurisdictions.

**Statement of disclosure to the auditors**

So far as the Directors, at the time of approval of their report, are aware:

- there is no relevant audit information of which the Company's auditors are unaware; and
- each Director has taken steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

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

**Auditors**

A resolution to reappoint Deloitte LLP as auditors and that the Directors be authorised to fix their remuneration will be put to shareholders at the Annual General Meeting.

By order of the Board

Richard Malcolm

**Chief Executive Officer**

Andrew Rose

**Chief Financial Officer**

2 April 2012

**Directors' Corporate Governance Report for the year ended 31 December 2011**

Gulfsands Petroleum plc is committed to meeting high standards of corporate governance. The Directors are committed to maintaining throughout the Group the highest standards of business conduct and ethics, as well as full compliance with all applicable government laws, rules and regulations (including the UK Bribery Act, which came into effect in 2011). The Group is also committed to prompt and comprehensive corporate reporting and disclosure.

The Board of Directors holds scheduled Board Meetings approximately six times per year plus such other ad-hoc meetings as are deemed necessary to deal with urgent business matters.

The Company has established subcommittees of the Board, comprising an Audit Committee, a Remuneration Committee and a Risk Committee, each of which has its own written terms of reference. A copy of these terms of reference is available on the Company's website. A detailed schedule of matters reserved to the Board is in place.

The Company has a Code of Business Conduct and Ethics, which was amended during the year in light of the UK Bribery Act, and an Employee Handbook containing all Group policies and procedures. These include, inter alia, a Whistleblower Policy.

**Audit Committee**

The Audit Committee meets at least three times each year to discuss the review of the Interim Financial Statements, to agree the plan for the audit of the year-end Financial Statements and to review the outcome of that audit. For the annual results the independent auditors are invited to discuss the conclusions arising from their audit and their assessment of the Group's internal controls. The Audit Committee also reviews annually, in detail, the risks and uncertainties facing the Group prior to the submission of the annual risk report to the Board. The Chairman of the Audit Committee is Andrew West and the other participating members of the committee are David Cowan and Kenneth Judge.

The activities of the Audit Committee are governed by terms of reference which cover its mandate, its composition, the independence and expertise of the members, frequency of meetings, and its responsibilities which include oversight of the external audit function, risk management, internal controls, financial reporting, and the provision by the auditors of non-audit services. The Audit Committee has the power to engage such external advisers as it deems necessary to discharge its responsibilities.

**Remuneration Committee**

The Remuneration Committee meets at least once per year and is responsible for setting the remuneration of the Board of Directors, including share incentive plan awards, and for establishing guidelines for the remuneration of staff in general, with closer scrutiny of the remuneration of senior management. The Chairman of the Remuneration Committee is David Cowan and the other participating member is Andrew West.

**Risk Committee**

The mandate of the Risk Committee is to review on an ongoing basis the risks facing the Group, their potential impact, the strategies available to mitigate those risks and the costs of such mitigation. The remit of the committee also includes oversight of the Group's system of internal controls and its policies and procedures, including those pertaining to conduct of business, health and safety, and environment. The Risk Committee is comprised of senior members of Executive Management, including the Chief Executive, the Chief Financial Officer and the Group Vice President, Engineering and Projects. It reports to the Audit Committee pursuant to the latter's responsibility for oversight of risk management and internal controls in the Group.

**Code of Business Conduct and Ethics**

The Code of Business Conduct and Ethics sets out the Group's policy in relation to the payment of bribes (including facilitation payments), conflicts of interest, gifts and hospitality, charitable and political donations, and business relationships generally (including the promotion of fair competition).

The Code states clearly that the direct or indirect offer or payment of bribes in any form is unacceptable, as is the solicitation or receipt of bribes from others, and that the payment of money or the provision of gifts or services to public officials in order to influence them in any decision concerning the Group is strictly prohibited.

**Employee Handbook**

The Employee Handbook contains the Group's policies and procedures governing such matters as the workplace environment (including non-discrimination, harassment, substance abuse, and employment of family members), grievance and disciplinary procedures, maternity and paternity leave, corporate disclosure, share dealing, health & safety and information technology. It also includes the Whistleblower Policy.

**Whistleblower Policy**

The Whistleblower Policy provides a confidential and anonymous means whereby persons can report any matter relating to the Group which, in the view of the complainant, is illegal, unethical, contrary to the policies of the Group or in some other manner not right or proper.

**Health, Safety & Environment Policy**

A primary goal of the Group is the protection of Health, Safety and Environment ("HSE"). This policy, whose implementation is overseen by the Chief Executive Officer, governs the Group's operations and is specifically designed to:

- comply with relevant HSE legislation, regulations and other requirements;
- maintain and develop systems to identify, assess, monitor, review and control HSE issues;
- set HSE objectives and targets;
- implement mechanisms to communicate with and to obtain input from employees, contractors, partners and associates;
- coordinate HSE policy, including the HSE management systems of contractors, to provide a unified system to guide operations; and
- institute a site-specific Emergency Response Procedure ("ERP") so that immediate actions are taken, without delay, to minimise danger to personnel, the environment and property. ERPs will be rehearsed prior to commencing operations to ensure that personnel make the appropriate responses in the event of emergency.

**Directors' Remuneration report for the year ended 31 December 2011**

This report has been prepared having regard to Schedule 8 to the Accounting Regulations under the Companies Act 2006, which requires the Auditors to report to a company's shareholders on the auditable part of the Directors' Remuneration Report and to state whether in their opinion that part of the report has been properly prepared. The report has therefore been divided into separate sections for audited and unaudited information.

The report has been prepared by the Remuneration Committee and has been approved by the Board for submission to shareholders. The Chairman of the Remuneration Committee is David Cowan and the other participating member is Andrew West.

**Unaudited Information**

Remuneration Policy

The policy of the Group is to remunerate Directors and employees by a combination of salary, discretionary bonus and share-based awards. Bands are established for Directors and the various different seniority levels of employee which define the range of potential bonus and share-based awards relative to the Director's or employee's salary, and awards are generally made annually. The level of award within the applicable band is determined by a combination of the Group's performance and the assessment of the individual's performance during the previous year, together with an assessment of the relative importance of that employee to the Group. Formal assessments are made annually of each employee's performance and goals set for the coming year. Bonuses are entirely discretionary (not subject to performance conditions) and are paid in cash.

There are two share-based plans in operation, a Share Option Plan and a Restricted Share Plan. The Share Option Plan is reserved for the Executive Directors and certain members of senior management. The majority of employees receive awards under the Restricted Share Plan. Substantially all awards made since 2009 have had a vesting period of two years: the majority of awards made prior to 2009 have no vesting period. Neither plan contains performance conditions.

The Group's current remuneration policy was established in 2009 and was reviewed in early 2011 by Hewitt New Bridge Street, external specialist remuneration consultants. The policy as regards Directors' remuneration is that variable remuneration, including on-target bonuses and the value of share-based awards, shall comprise in the region of 50% of Directors' aggregate remuneration. A detailed benchmarking exercise was undertaken by the same consultants in early 2011 to compare the remuneration of each Director with that of their equivalent peers among London-listed independent oil & gas companies and other companies of similar size. A less detailed benchmarking exercise was undertaken at the same time for other staff using external databases for remuneration in the oil & gas industry. No similar exercise has been undertaken since then.

The Group provides life assurance cover for all staff outside Syria and medical insurance cover for substantially all staff. Stakeholder pension arrangements were put in place in early 2011 for the Company's staff but there is no Company pension scheme and the Company does not make any contribution to individual employee pension schemes.

Directors' incentive compensation

Your Board is acutely conscious of the severely adverse impact of the Syrian situation upon the Company's share price. Although this situation is quite clearly beyond our control, we feel it is inappropriate in the circumstances that Directors receive incentive compensation that would otherwise be payable with reference to the year ended 31 December 2011. Accordingly, cash bonus payments due to Directors with reference to 2011 performance will be deferred and will not become payable until the Company is once again receiving payment for production from its Syrian interests. Furthermore, no awards will be made pursuant to the Company's Executive Share Option Plan in respect of 2011 performance and contribution.

**Audited Information**

Remuneration of Directors

The remuneration of the Directors for the year ended 31 December 2011 was as follows:

| | Annual remuneration ($'000) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Salary and fees | | Bonuses | | Benefits in kind | | Total | |
| | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 |
| A West | **241** | 232 | **-** | - | **-** | - | **241** | 232 |
| M Sajjad | **629** | 670 | **641** | 336 | **-** | 27 | **1,270** | 1,033 |
| R Malcolm | **562** | 534 | **508** | 149 | **7** | 3 | **1,077** | 686 |
| A Rose | **441** | 447 | **400** | 150 | **13** | 12 | **854** | 609 |
| K Judge [1] | **382** | 552 | **269** | 187 | **-** | - | **651** | 739 |
| D Cowan [2] | **80** | 61 | **-** | - | **-** | - | **80** | 61 |
| | **2,335** | 2,496 | **1,818** | 822 | **20** | 42 | **4,173** | 3,360 |

(1) Paid to Hamilton Capital Partners Limited, a company with which Mr Judge is associated. Included in the fees paid during 2010 is an amount of $187,000 in respect of fees paid to Hamilton Capital Partners Limited for services provided in prior periods.

(2) Non-executive director

In addition to the remuneration shown above the Group incurred share based payment charges of $1,632,000 (2010: $1,529,000) in respect of the above named Directors.

Share options

The interests of the Directors in options over the Company's shares are set out in the table below:

| | Number of options | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | At 1 January 2011 | Granted | Exercised | At 31 December 2011 | Exercise price (£) | Market price at date of exercise (£) | Gain on exercise of options ($'000) | Date from which exerciseable | Expiry date |
| A West | 125,000 | | (125,000) | - | 1.45 | 3.10 | 334 | 14/02/2006 | 13/02/2011 |
| | 75,000 | | (75,000) | - | 1.04 | 3.10 | 250 | 25/07/2006 | 24/07/2011 |
| | 1,000,000 | | | 1,000,000 | 1.88 | | | 13/05/2008 | 12/05/2013 |
| M Sajjad [1] | 1,000,000 | | | 1,000,000 | 1.88 | | | 13/05/2008 | 12/05/2013 |
| | 250,000 | | | 250,000 | 3.20 | | | 04/05/2011 | 03/05/2015 |
| | 250,000 | | | 250,000 | 3.20 | | | 04/05/2012 | 03/05/2015 |
| | - | 250,000 | | 250,000 | 2.35 | | | 03/06/2012 | 02/06/2016 |
| R Malcolm | 600,000 | | | 600,000 | 1.86 | | | 15/10/2008 | 14/10/2013 |
| | 375,000 | | | 375,000 | 1.86 | | | 15/10/2009 | 14/10/2013 |
| | 375,000 | | | 375,000 | 1.86 | | | 15/10/2010 | 14/10/2013 |
| | 250,000 | | | 250,000 | 3.20 | | | 04/05/2011 | 03/05/2015 |
| | 250,000 | | | 250,000 | 3.20 | | | 04/05/2012 | 03/05/2015 |
| | - | 250,000 | | 250,000 | 2.35 | | | 03/06/2012 | 02/06/2016 |
| A Rose | 300,000 | | | 300,000 | 1.80 | | | 08/05/2008 | 07/05/2013 |
| | 250,000 | | | 250,000 | 1.80 | | | 08/05/2009 | 07/05/2013 |
| | 250,000 | | | 250,000 | 1.80 | | | 08/05/2010 | 07/05/2013 |
| | 150,000 | | | 150,000 | 3.20 | | | 04/05/2011 | 03/05/2015 |
| | 150,000 | | | 150,000 | 3.20 | | | 04/05/2012 | 03/05/2015 |
| | - | 175,000 | | 175,000 | 2.35 | | | 03/06/2012 | 02/06/2016 |
| K Judge | 400,000 | | (400,000) | - | 0.96 | 1.91 | 603 | 18/10/2006 | 17/10/2011 |
| | 600,000 | | | 600,000 | 1.88 | | | 13/05/2008 | 12/05/2013 |
| | 150,000 | | | 150,000 | 3.20 | | | 04/05/2011 | 03/05/2015 |
| | 150,000 | | | 150,000 | 3.20 | | | 04/05/2012 | 03/05/2015 |
| | - | 150,000 | | 150,000 | 2.35 | | | 03/06/2012 | 02/06/2016 |
| D Cowan | 125,000 | | (125,000) | - | 1.45 | 3.07 | 327 | 14/02/2006 | 13/02/2011 |
| | 400,000 | | | 400,000 | 1.88 | | | 13/05/2008 | 12/05/2013 |

(1) Share option details shown above include options granted to Nordman Continental S.A., a company owned by discretionary trusts of which Mr Sajjad's children are potential beneficiaries.

This report was approved by the Board of Directors on 2 April 2012.

David Cowan

Chairman of the Remuneration Committee

2 April 2012

**Independent Auditors' Report to the shareholders of Gulfsands Petroleum plc**

We have audited the financial statements of Gulfsands Petroleum plc for the year ended 31 December 2011 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity and the Consolidated and Company Cash Flow Statements, and the related notes 1 to 28 of the Consolidated Financial Statements and notes 1 to 17 of the Company Financial Statements. 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 and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

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

**Respective responsibilities of Directors and Auditor**

As explained more fully in the Statement of Directors' Responsibilities in the Directors' Report, 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 Ethical Standards for Auditors.

**Scope of the audit of the Financial Statements**

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Opinion on Financial Statements**

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2011 and of the Group's profit for the year then ended;
- the Consolidated Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union;

- the 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; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

**Emphasis of matter – fair value of the Group's producing operations in Syria**
In forming our opinion on the Consolidated Financial Statements for the year ended 31 December 2011, which is not qualified, we have considered the adequacy of the disclosures made in note 6 to the Financial Statements concerning the valuation of the Group's producing operations in Syria. The Group ceased to exercise either joint control or significant influence over its Syrian producing operations following the imposition of additional EU sanctions on 1 December 2011, which prevent the Group from being involved in the management of these operations. Accordingly, the Group no longer consolidates its share of the Syrian assets and liabilities and instead holds an investment on the balance sheet at $102.0 million, being the Directors' best estimate of its fair value. As highlighted in note 6, there is significant uncertainty in the valuation of $102.0 million due to the unknown duration of the sanctions and the eventual outcome of events in Syria.

**Opinion on other matter prescribed by the Companies Act 2006**
In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

**Matters on which we are required to report by exception**
We have nothing to report in respect of the following 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.

**Other matters**
In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the provisions of the Companies Act 2006 that would have applied were the company a quoted company.

David Paterson (Senior Statutory Auditor)

for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom

2 April 2012

## Consolidated Income Statement
## For the year ended 31 December 2011

| | Notes | **2011** | 2010 |
|---|---|---|---|
| | | **$' 000** | $' 000 |
| **Continuing operations** | | | |
| **Revenue** | 7 | **7,907** | 16,595 |
| **Cost of sales** | | | |
| Depletion | 14 | **(3,883)** | (5,689) |
| Impairment | 14 | **(64)** | (3,820) |
| Other cost of sales | | **(6,382)** | (14,379) |
| Total cost of sales | | **(10,329)** | (23,888) |
| **Gross loss** | | **(2,422)** | (7,293) |
| General administrative expenses | | **(19,745)** | (21,967) |
| Foreign exchange losses | | **(1,458)** | (968) |
| Share based payments | 8 | **(2,522)** | (2,533) |
| Total administrative expenses | | **(23,725)** | (25,468) |
| Exploration costs written off | 15 | **(22,547)** | (5,498) |
| Impairment provision on Syrian exploration activities | 15 | **(9,997)** | - |
| Other operating income - hurricane repairs | 9 | **-** | 816 |
| Profit on disposal of oil and gas properties | 14 | **6,628** | 1,137 |
| **Operating loss** | 10 | **(52,063)** | (36,306) |
| Discount expense on decommissioning provision | 21 | **(638)** | (1,113) |
| Net interest income | 11 | **270** | 228 |
| **Loss before taxation from continuing activities** | | **(52,431)** | (37,191) |
| Taxation credit | 12 | **31** | 18 |
| Profit for the year from suspended Syrian activities | 6 | **107,476** | 81,843 |
| **Profit for the year - attributable to owners of the Parent Company** | | **55,076** | 44,670 |
| **Loss per share from continuing operations (cents):** | | | |
| **Basic** | 13 | **(43.30)** | (30.69) |
| **Diluted** | 13 | **(43.30)** | (30.69) |
| **Earnings per share from continuing operations and Syrian activities (cents):** | | | |
| **Basic** | 13 | **45.51** | 36.88 |
| **Diluted** | 13 | **44.80** | 35.88 |

There are no items of comprehensive income not included in the Income Statement.

**Consolidated Balance Sheet**
**As at 31 December 2011**

| | Notes | 2011<br>$' 000 | 2010<br>$' 000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 14 | 14,229 | 63,878 |
| Intangible assets | 15 | 8,457 | 30,958 |
| Long-term financial assets | 18 | 3,965 | 9,603 |
| Investments | 16 | 102,000 | - |
| | | 128,651 | 104,439 |
| **Current assets** | | | |
| Inventory - materials | | 2,870 | 4,002 |
| Trade and other receivables | 17 | 5,347 | 35,559 |
| Cash and cash equivalents | 18 | 124,240 | 80,625 |
| Short-term financial assets | 18 | - | 5,576 |
| Assets classified as held for sale | 14 | - | 12,711 |
| | | 132,457 | 138,473 |
| **Total assets** | | 261,108 | 242,912 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 19 | 16,038 | 23,126 |
| Provision for decommissioning | 21 | 2,135 | 7,473 |
| Liabilities associated with assets held for sale | 14 | - | 8,623 |
| | | 18,173 | 39,222 |
| **Non-current liabilities** | | | |
| Provision for decommissioning | 21 | 14,748 | 20,683 |
| **Total liabilities** | | 32,921 | 59,905 |
| **Net assets** | | 228,187 | 183,007 |
| **Equity** | | | |
| **Capital and reserves attributable to equity holders** | | | |
| Share capital | 22 | 13,131 | 13,093 |
| Share premium | | 105,926 | 105,025 |
| Share-based payments reserve | | 18,506 | 16,318 |
| Merger reserve | | 11,709 | 11,709 |
| Retained profit | | 78,915 | 36,862 |
| **Total equity** | | 228,187 | 183,007 |

These Financial Statements were approved by the Board of Directors on 2 April 2012 and signed on its behalf by:

Richard Malcolm
**Chief Executive Officer**

Andrew Rose
**Chief Financial Officer**

**Consolidated Statement of Changes in Equity**
**For the year ended 31 December 2011**

| | Share capital $'000 | Share premium $'000 | Share based payments reserve $'000 | Merger reserve $'000 | Retained profit / (loss) $'000 | Total equity $'000 |
|---|---|---|---|---|---|---|
| **Year ended 31 December 2011** | | | | | | |
| At 1 January 2011 | 13,093 | 105,025 | 16,318 | 11,709 | 36,862 | 183,007 |
| Options exercised | 38 | 901 | - | - | - | 939 |
| Purchase of own shares | - | - | - | - | (13,023) | (13,023) |
| Share-based payment charge | - | - | 2,523 | - | - | 2,523 |
| Payments made in lieu of option exercise | - | - | (335) | - | - | (335) |
| Profit for 2011 | - | - | - | - | 55,076 | 55,076 |
| At 31 December 2011 | 13,131 | 105,926 | 18,506 | 11,709 | 78,915 | 228,187 |
| **Year ended 31 December 2010** | | | | | | |
| At 1 January 2010 | 12,971 | 101,929 | 15,429 | 11,709 | (7,808) | 134,230 |
| Options exercised | 122 | 3,096 | - | - | - | 3,218 |
| Share-based payment charge | - | - | 2,359 | - | - | 2,359 |
| Payments made in lieu of option exercise | - | - | (1,470) | - | - | (1,470) |
| Profit for 2010 | - | - | - | - | 44,670 | 44,670 |
| At 31 December 2010 | 13,093 | 105,025 | 16,318 | 11,709 | 36,862 | 183,007 |

The merger reserve arose on the acquisition of Gulfsands Petroleum Ltd and its subsidiaries by the Company by way of share-for-share exchange in April 2005, in conjunction with the flotation of the Company on the Alternative Investment Market of the London Stock Exchange.

## Consolidated Cash Flow Statement
## For the year ended 31 December 2011

| | *Notes* | **2011** **$' 000** | 2010 $' 000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Operating loss from continuing operations | | **(52,063)** | (36,306) |
| Operating profit from suspended Syrian activities | 6 | **98,774** | 81,842 |
| **Total operating profit** | | **46,711** | 45,537 |
| Depreciation, depletion and amortisation | 14 & 15 | **14,665** | 17,725 |
| Impairment charge | 14 | **64** | 3,820 |
| Exploration costs written off | 15 | **22,547** | 5,498 |
| Impairment provision on Syrian exploration activities | 15 | **9,997** | - |
| Decommissioning costs in excess of provision | 21 | **1,100** | 2,048 |
| Share-based payment charge | 8 | **2,522** | 2,533 |
| Profit on disposal of assets | 14 | **(6,628)** | (1,137) |
| Decrease / (increase) in receivables | | **2,655** | (12,049) |
| Increase in payables | | **359** | 5,587 |
| **Net cash provided by operations** | | **93,992** | 69,562 |
| Interest received | | **270** | 228 |
| Taxation recovered | | **55** | 402 |
| **Net cash provided by operating activities** | | **94,317** | 70,192 |
| **Investing activities** | | | |
| Exploration and evaluation expenditure | | **(22,887)** | (25,502) |
| Oil and gas properties expenditure | | **(20,521)** | (16,305) |
| (Decrease) / increase in inventory | | **159** | (488) |
| Disposal of oil and gas assets | | **10,403** | 1,100 |
| Other capital expenditures | | **(2,228)** | (1,096) |
| Change in restricted cash balances | 18 | **11,212** | (3,189) |
| Decommissioning costs paid | | **(5,082)** | (2,544) |
| Movements in balances due to or from oil and gas partnerships | | **(1,092)** | - |
| Net working capital adjustment in respect of Syrian production activities | | **(7,610)** | - |
| Cash derecognised in respect of Syrian production activities | 6 | **(637)** | - |
| **Net cash used in investing activities** | | **(38,283)** | (48,024) |
| **Financing activities** | | | |
| Cash proceeds from issue of shares | | **939** | 3,218 |
| Purchase of own shares | | **(13,023)** | - |
| Payments made in lieu of options exercised | | **(335)** | (1,470) |
| Other payments in connection with options issued | | **-** | (914) |
| **Net cash (used in) / provided by financing activities** | | **(12,419)** | 834 |
| **Increase in cash and cash equivalents** | | **43,615** | 23,002 |
| Cash and cash equivalents at beginning of period | | **80,625** | 57,623 |
| Cash and cash equivalents at end of period | 18 | **124,240** | 80,625 |

## 1. Authorisation of financial statements and statement of compliance with IFRSs

Gulfsands Petroleum plc is a public limited company listed on the Alternative Investment Market ("AIM") of the London Stock Exchange and incorporated in the United Kingdom. The principal activities of the Company and its subsidiaries ("the Group") are that of oil and gas production, exploration and development.

The Consolidated Financial Statements for the year ended 31 December 2011 were authorised for issue by the Board of Directors on 2 April 2012 and the balance sheets were signed on the Board's behalf by Richard Malcolm and Andrew Rose.

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. The principal accounting policies adopted are set out in note 3 below.

## 2. Adoption of International Financial Reporting Standards

The Consolidated Financial Statements for the year ended 31 December 2011 and for the comparative year ended 31 December 2010 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and IFRIC (International Financial Reporting Interpretations Committee) interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

## 3. Significant accounting policies

### 3.1 Basis of preparation and accounting standards

The Group's significant accounting policies used in the preparation of the financial statements are set out below.

The financial statements have been prepared in accordance with applicable International Financial Reporting Standards as adopted by the European Union and, except for share-based payments and the valuation of available-for-sale investments, under the historical cost convention. They have also been prepared on the going concern basis of accounting, for the reasons set out in the "Going concern" section of the Directors Report.

These financial statements consolidate the accounts of Gulfsands Petroleum plc and all its subsidiary undertakings drawn up to 31 December each year.

In the Consolidated Financial Statements, merged subsidiary undertakings are treated as if they had always been a member of the Group. The results of such subsidiaries are included for the whole year in the year they join the Group.

### 3.2 Basis of consolidation

Intra-group sales, profits and balances are eliminated fully on consolidation.

The results of other subsidiaries acquired or sold are consolidated for the periods from or to the date when control passed. Acquisitions are accounted for under the purchase method, under which purchase consideration is allocated to the assets and liabilities on the basis of fair value at the date of acquisition.

The Consolidated Financial Statements include the accounts of subsidiary undertakings when the Company has the power to exercise, or actually exercises, dominant influence or control over the undertaking.

The Group is engaged in oil and gas exploration, development and production through incorporated and unincorporated joint ventures (together "Jointly Controlled Entities"). The Group accounts for its share of the results and net assets of these Jointly Controlled Entities using the proportional consolidation method.

When the Group loses control or joint control of a subsidiary or joint venture, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary or joint venture and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary or joint venture are accounted for in the same manner as would be required if the relevant assets or liabilities are disposed of. The fair value of any investment retained in the former subsidiary or joint venture at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 "Financial Instruments: Recognition and Measurement" or, where applicable, the costs on initial recognition of an investment in an associate or jointly controlled entity.

### 3.3 Reporting currency

These financial statements are presented in US Dollars. The majority of all costs associated with foreign operations are denominated in US Dollars and not the local currency of the operations. Therefore the presentational and functional currency of the Group, and the functional currency of all subsidiaries, is the US Dollar. Gains and losses from foreign currency transactions, if any, are recognised in the income statement for the year. The effective exchange rate to the Pound Sterling at 31 December 2011 was £1: US $1.57 (2010 – £1: US $1.55).

### 3.4 Oil and gas assets

The Group applies the requirements of IFRS 6 "Exploration for and Evaluation of Mineral Resources" and where additional guidance is needed IAS 16 "Property, Plant and Equipment" and IAS 36 "Impairment of Assets" noting that several items in the latter two standards are exempted for assets at the exploration and evaluation stage due to the application of IFRS 6. Set out below is our interpretation of the principles set out in IFRS 6 and other IFRSs.

There are two categories of oil and gas assets, exploration and evaluation assets which are included in Intangible assets, and development and production assets which are included in Property, plant and equipment.

***Oil and gas assets: exploration and evaluation***

*Recognition and measurement*

The Group follows the successful efforts method of accounting whereby costs for unsuccessful exploration and development activities are expensed. All licence acquisition, exploration and evaluation costs are initially capitalised as intangible fixed assets in cost centres by field or exploration area, as appropriate, pending determination of commerciality of the relevant property. Directly attributable administration costs are capitalised insofar as they relate to specific exploration activities. Pre-licence costs and general exploration costs not directly attributable to any particular licence or prospect are expensed as incurred.

Exploration and evaluation ("E&E") assets relating to each exploration license/prospect are not amortised but 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 on a cash generating unit basis as set out below and any impairment loss is recognised in the income statement. The carrying value of the E&E assets, after any impairment loss, is then reclassified as development and production assets in property, plant and equipment. Costs of unsuccessful exploration efforts are expensed at the time that a determination is made that the exploration has failed to locate commercially recoverable hydrocarbons.

*Impairment*

Non-current assets are assessed for impairment on a cash generating unit basis when facts and circumstances suggest that the carrying amount may exceed its recoverable amount. Such triggering events in respect of E&E assets include the point at which determination is made as to whether commercial reserves exist.

Where there has been an indication of a possible impairment, management assess the recoverability of the carrying value of the cash generating unit by comparison with the estimated discounted future net cash flows based on management's expectation of the future production, hydrocarbon prices and costs. Any identified impairment is charged to the Income Statement.

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

***Oil and gas assets: development and production***

Tangible oil and gas assets are grouped into a cash generating unit or groups of units for purposes of impairment testing and for depreciating the development and production assets. A cash generating unit is the smallest unit that does not have inter-related revenues and may be a well, field, area, block, region or other defined area as appropriate. Inter-relationships can be measured by oil and gas production agreements, geological analysis, or other documentation showing such relationships. The only limitation in the size of a cash generating unit is that it cannot be larger than an operating segment of the Group.

*Recognition and measurement*

Development and production assets are accumulated on a cash generating unit basis and represent the cost of developing the commercial reserves discovered and bringing them into production,

together with the E&E expenditures incurred in finding commercial reserves transferred from intangible E&E assets.

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

*Depletion of producing assets*
Expenditure within each cash generating unit is depleted by a unit of production method using the ratio of oil and gas production in the year compared to the estimated quantity of commercial reserves at the beginning of the year. Costs used in the unit of production calculation comprise the net book value of capitalised costs plus the estimated future field development costs for proved and probable reserves. Changes in estimates of commercial reserves or future development costs are dealt with prospectively.

*Impairment*
An impairment test is performed whenever events and circumstances arising during the development or production phase indicate that the carrying value of a development or production asset may exceed its recoverable amount. The aggregate carrying value is compared against the recoverable amount of the cash generating unit, generally by reference to the present value of the future net cash flows expected to be derived from production of commercial reserves.

**3.5 Decommissioning**

Where a material liability for the removal of production facilities and site restoration at the end of the productive life of a field exists, a provision for decommissioning is recognised. The amount recognised is the present value of estimated future expenditure determined in accordance with local conditions and requirements. A fixed asset of an amount equivalent to the provision is also created (included in development and production assets) and depleted on a unit of production basis. Changes in estimates are recognised prospectively, with corresponding adjustments to the provision and the associated fixed asset.

**3.6 Definition of reserves**

The Group's definition of reserves is in accordance and consistent with the 2007 Petroleum Resources Management System, as prepared by the Oil and Gas Reserves Committee of the Society of Petroleum Engineers ("SPE") and reviewed and jointly sponsored by the World Petroleum Council ("WPC"), the American Association of Petroleum Geologists and the Society of Petroleum Evaluation Engineers. The estimation of Proved (1P), Proved plus Probable (2P) and Proved plus Probable plus Possible (3P) commercially recoverable reserves are performed utilising relevant geological, geophysical and engineering data and with reference to the use of the probabilistic methodology as approved by SPE / WPC. The reserves are verified by a certified independent expert.

Proved plus Probable (2P) entitlement reserves are utilised as the basis for the Group's calculations of depletion and impairment as these represent the Group's estimate of the most likely commercially recoverable reserves as per the approved probabilistic methodology.

### 3.7 Property, plant and equipment 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 charged so as to write off the cost, less estimated residual value, of assets on a straight-line basis over their useful lives of between two and five years. Freehold land is not depreciated.

### 3.8 Intangible assets other than oil and gas assets

Intangible assets other than oil and gas assets are stated at cost less accumulated amortisation and any provision for impairment. Amortisation is charged so as to write off the cost, less estimated residual value, of assets on a straight-line basis over their useful lives of between two and five years. Amortisation is included with depreciation and classified as cost of sales or administrative expenses as appropriate. No intangible assets other than oil and gas assets have indefinite lives.

### 3.9 Revenue recognition

Sales revenue represents amounts invoiced exclusive of sales-related taxes and royalties for the Group's share of hydrocarbon sales in the year. Hydrocarbon sales are recognised when goods are delivered and title has passed. No allowance is made for the Group's share of future revenues from costs incurred to date that have yet to be allowed for cost recovery purposes.

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

### 3.10 Operating leases

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

### 3.11 Taxation

Current tax, including UK corporation tax and overseas tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted, or substantively enacted, tax rates and laws that will be in effect when the differences are expected to reverse. The recoverability of deferred tax assets is evaluated annually and an impairment provision is made if it is more likely than not that the deferred tax asset will not give rise to future benefits in the Group's tax returns.

### 3.12 Derivative financial instruments

The Group has in previous periods entered into regular forward-dated foreign exchange transactions as a means of reducing the exposure of the Group to exchange rate differences. These transactions were normally of a duration of less than two weeks and the amounts sold forward approximated to the monthly hydrocarbon invoicing for the Group's Syrian operations. No forward or derivative financial instruments have been entered into since September 2011.

The Group does not enter into derivative contracts in respect of its exposure to fluctuations in the price of oil and gas.

**3.13 Share-based payments**

The Company has made equity-settled share-based payments to certain employees and directors by way of issues of share options. The fair value of these payments is calculated at grant date by the Company using the Black-Scholes option pricing model excluding the effect of non market-based vesting conditions. The expense is recognised on a straight-line basis over the period from the date of award to the date of vesting, based on the Company's best estimate of the number of options that will eventually vest. At each balance sheet date, the Company revises its estimates of the number of options expected to vest as a result of the effect of non market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the share-based payments reserve.

**3.14 Cash and cash equivalents**

Cash and cash equivalents are carried in the Balance Sheet at cost and comprise cash in hand and deposits repayable on demand by banks and other short term investments with original maturities of three months or less. Balances held in bank accounts subject to escrow agreements as collateral for performance bonds issued are excluded from cash and cash equivalents and are shown as long term financial assets.

**3.15 Foreign currency**

Foreign currency transactions of individual companies within the Group are translated to the functional and reporting currency of US Dollars at the rates prevailing when the transactions occurred. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date. All differences are taken to the Income Statement.

**3.16 Inventories**

Inventories comprise materials and equipment, which are stated at the lower of cost and net realisable value. Cost includes all costs incurred in bringing the materials and equipment to its present condition and location.

**3.17 Trade receivables**

Trade receivables are carried at original invoice amounts less any provision made for impairment of receivables. A provision for impairment of trade receivables is made when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the debt.

**3.18 Trade payables**

Trade payables are not interest-bearing and are stated at their nominal values.

**3.19 Equity instruments**

Equity instruments issued by the Company, being any instruments with a residual interest in the assets of the Company after deducting all its liabilities, are recorded at the proceeds received, net of direct issue costs.

### 3.20 Available-for-sale financial assets

Available-for-sale ("AFS") financial assets are stated at fair value. Fair value is determined in the manner described in notes 6 and 27. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve with the exception of impairment losses which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is reclassified to profit or loss.

## 4. New IFRS standards and interpretations

The Financial Statements have been prepared after adopting a number of new and revised pronouncements from the IASB, including amendments to IFRS 3 (Business Combinations), IFRS 7 (Financial Instruments: Disclosures) and IAS 24 (Related Party Disclosures). However, these have had no effect on either the reported results and financial position or the presentation or disclosure within these financial statements.

The following pronouncements from the IASB will become effective for future financial reporting periods and have not yet been adopted by the Group.

IAS 12 (Amended 2010) – Income Taxes
The amendment will be effective for financial years starting on or after January 1 2012.

IFRS 9 – Financial Instruments: Classification and Measurement
The standard is effective for annual periods beginning on or after 1 January 2013.
The standard introduces a new classification and measurement regime for financial assets including "available-for-sale" assets.

IFRS 10 – Consolidated Financial Statements
The standard is effective for annual periods beginning on or after 1 January 2013.
The standard supersedes IAS 27 - Consolidated and Separate Financial Statements and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

IFRS 11 – Joint Ventures/Joint arrangements
The standard is effective for annual periods beginning on or after 1 January 2013.
The standard supersedes IAS 31 Interest in Joint Ventures and establishes the principles for financial reporting by parties to a joint arrangement.

IFRS 12 – Disclosures of Interests in Other Entities
The standard is effective for annual periods beginning on or after 1 January 2013.
The standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.

IFRS 13 – Fair value measurement
The standard is effective for annual periods beginning on or after 1 January 2013.
The standard sets out in a single IFRS a framework for measuring fair value and required disclosures about fair value measurement.

Amendments to IAS 1 Presentation of Items of Other Comprehensive Income
The amendments aim is to improve consistency and clarity of the presentation of items of other comprehensive income statement properties.

IAS 19 – Employee Benefits
The standard is effective for annual periods beginning on or after 1 January 2013.
The revised standard prescribes the accounting and disclosure for employee benefits allowing users to make better assessment on the characteristics of a company's defined benefit plans.

The Directors do not anticipate that the adoption of these standards and interpretations will have a material effect on the reported income or net assets of the Group or Company.

## 5. Critical accounting estimates and assumptions

In the process of applying the Group's accounting policies, which are set out in note 3, the Directors have made the following judgements and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

*a) Fair value of the Group's investment in Dijla Petroleum Company ("DPC")*

The Group's investment in DPC, the entity established in Syria, pursuant to the PSC, to administer the Group's Syrian oil and gas production assets (and which is considered to also include the related rights to production under the PSC), is recorded as an available-for-sale investment at an estimate of fair value taking into account the current exceptional circumstances in Syria and the consequential difficulty of predicting the timing of future activities in Syria. Due to the unknown duration of EU sanctions in force against Syria and uncertainty over the eventual outcome of events in the country, the calculation of fair value is highly subjective and subject to material change in future periods, as described further in note 6.

*b) Intangible oil and gas exploration and evaluation assets*

Costs capitalised as intangible assets are assessed for impairment when circumstances suggest that the carrying value may exceed its recoverable value. This assessment involves judgement as to the (i) likely commerciality of the assets, and (ii) future revenues and costs pertaining and the discount rate to be applied for the purpose of deriving a recoverable value. Additional judgements apply to the Group's exploration and evaluation assets affected by sanctions in Syria.

*c) Decommissioning*

The Group has decommissioning obligations in respect of its producing interests in the Gulf of Mexico and its exploration well offshore Tunisia. The full extent to which the provision is required depends on the legal requirements at the time of decommissioning, the costs and timing of any decommissioning works and the discount rate applied to such costs. The Group received a report from external specialist decommissioning experts regarding the cost of future works in the Gulf of Mexico during 2011 and has prepared an internal estimate of the work required offshore Tunisia. The timing of the decommissioning works is inherently uncertain and depends upon the determination of the end of commercial production. The Group has utilised the expected useful lives in the year-end reserves report for the Gulf of Mexico to estimate the timing of associated decommissioning liabilities.

A risk free interest rate of 3% (2010: 4%) has been used to discount the expected costs of decommissioning. A decrease in the discount rate utilised to 2% per annum would increase the total

value of the decommissioning provision by $1.3 million. An increase in the discount rate to 4% would decrease the decommissioning provision by $1.1 million.

*d) Oil and gas development and production assets and reserves*

Oil and gas development and production assets held in property, plant and equipment are depleted on a unit of production basis calculated by reference to Proved and Probable ("2P") reserves. The Group's 2P reserves take the estimated future cost of developing and extracting those reserves into account.

Future forecast capital expenditure associated with developing Proved and Probable reserves is included in the cost base for the purposes of calculating depletion charges. 2P reserves are determined using estimates of oil and gas in place, recovery factors and future oil and gas prices. A long-term oil price of $90/bbl (2010: $80/bbl) and a long term gas price of $4.50/mcf (2010: $6.00/mcf) have been used in determining the commercial reserves. The carrying amount of oil and gas assets therefore depends upon a number of estimates at year-end.

The level of 2P reserves is also a key determinant in assessing whether the carrying value of any of the Group's oil and gas assets has been impaired.

The carrying amount of oil and gas development and production assets is shown in note 14.

An increase in the forecast long-term oil price of $10/bbl would reduce the 2P entitlement reserves in Syria by approximately 0.7mmboe. A $10/bbl reduction in the forecast long-term oil price would increase 2P entitlement reserves in Syria by approximately 0.8mmboe. There would be no significant impact on the reserves, depletion charge or impairment attributable to the USA under either scenario.

An increase in the forecast future capital expenditure for Syria of $50 million (gross) would increase the Group's entitlement reserves by 0.2mmboe. An increase of 50% in the forecast future expenditure in the USA would increase the depletion charge for 2011 by $0.6 million but have no material impact on entitlement reserves.

**6. Effect of sanctions applied to the Group's operations in the Syrian Arab Republic**

The Group is party to a Production Sharing Contract ("PSC") for the exploitation of hydrocarbon production in Block 26 in Syria. Pursuant to the PSC the Group operates its Syrian oil and gas production assets through a joint venture administered by Dijla Petroleum Company in which the Group has a 25% equity interest. The Group lost control of DPC on 1 December 2011 following the publication of European Union Council Decision 2011/782/CFSP which significantly increased sanctions against the oil industry in Syria. For the purposes of EU sanctions, DPC is considered to be controlled by General Petroleum Corporation.

The Group has followed the guidance in International Accounting Standard 31 "Interests in Joint Ventures" and has derecognised its share of the assets and liabilities of DPC from 1 December 2011. Until 1 December 2011 DPC had been proportionally consolidated, as explained in note 16 to the Financial Statements. Subsequent to this date the Group's interest in DPC has been recognised as an available-for-sale investment, at an estimate of fair value as given the current exceptional circumstances in Syria the Group has neither joint control nor significant influence over the financial and operating policy decisions of the entity.

The Group's share of the results of DPC up to 1 December 2011, which have been included in the Consolidated Income Statement, together with the accounting gain recognised at the date of de-recognition, were as follows:

| | **Period ended 30 November 2011 $' 000** | Year ended 31 December 2010 $' 000 |
|---|---|---|
| Revenue | **117,041** | 98,983 |
| Expenses | **(18,268)** | (17,140) |
| Profit before taxation and net profit attributable to suspended activities | **98,774** | 81,843 |
| Profit on derecognition of DPC (see below) | **8,702** | - |
| Profit for the year from suspended activities | **107,476** | 81,843 |

The results of these suspended activities have been treated as 'discontinued operations' in the Income Statement as required by IFRS5 "Non-Current Assets Held for Sale and Discontinued Operations".

On 1 December 2011 the Group's ability to exercise joint control over its Syrian interests ceased. In the period ended 30 November 2011, the revenue arising from this production amounted to $117.0 million (2010: $99.0 million). The cash inflows associated with these revenues amounted to $114.1 million (2010: $90.3 million).

During the year, suspended Syrian operations consumed $12.8 million (2010: $24.5 million) of cash in operating activities and paid $21.0 million (2010: $14.1 million) for investing activities. This cash was provided by entities within the Group.

As noted above, a gain of $8.7 million arose on the loss of joint control of DPC, being an estimate of the fair value of the remaining investment, taking into consideration the current exceptional circumstances in Syria and the consequential difficulty of predicting the timing of future activities in the country, less the carrying amount of the Group's share of the net assets of DPC at the date of loss of joint control. This is summarised below:

| | As at 30 November 2011 $' 000 |
|---|---|
| Property, plant & equipment | 59,959 |
| Intangible assets | 226 |
| Restricted cash | 2 |
| Inventories | 1,699 |
| Trade and other receivables | 34,851 |
| Bank and cash balances | 637 |
| Trade and other payables | (4,076) |
| Net assets derecognised | 93,298 |
| Fair value of investment in DPC | 102,000 |
| Accounting gain on loss of control | 8,702 |

Further details of the overall contribution of Syria to the Group's results for the year, including the exploration activities that were not directly caught by the EU sanctions, is provided in note 7.

The fair value of the investment in DPC has been calculated based upon estimated future cash flows that could be generated from the entitlement reserves at 31 December 2011 discounted at a rate of 15% per annum and then the net present value is reduced further by 80% to reflect a market view of other risks of investments in the Syrian oil and gas sector at the current time. It has also been referenced, as a practical matter, to the Group's year-end market capitalisation (as adjusted for its substantial net cash balance).

The fair value included within the Group's investments reflects an estimate of fair value taking into account the current exceptional circumstances in Syria and the consequential difficulty of predicting the timing of future activities in the country as a consequence of the impact of the EU's sanctions and is not necessarily reflective of the value of the Group's investments in its Syrian operations over the long-term.

In deriving the figure of 80% the Directors have assumed, inter alia, a delay to resumption of oil production in Syria, deferred revenue receipts for a period after resumption of production, potential further costs associated with restarting operations and the possibility of a change to the terms of the PSC or even expropriation. There is a high degree of subjectivity inherent in the valuation due to the unknown duration of the sanctions and the eventual outcome of events in Syria. Accordingly it may change materially in future periods depending on a wide range of factors.

## 7. Total revenue and segmental information

The total revenue of the Group, as defined by IAS 18, for 2011 was $125,219,000 (2010: $115,825,000) comprising sales of hydrocarbons and incidental income of $124,948,000 (2010: $115,578,000) and interest income of $271,000 (2010: $247,000).

For management purposes, the Group operates in three geographical areas, Syria, Tunisia and the US. All segments are involved with production and exploration of oil and gas. As discussed in note 6, the Group has lost control of its production activities in Syria and these are separately disclosed in the analysis below.

The Group revenue and results for the year are analysed by reportable segment as follows:

| | Year ended 31 December 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Syria exploration activities | Syria production activities | Tunisia | USA | Other | Total |
| | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 |
| Revenues from external parties | - | 117,041 | - | 7,907 | - | 124,948 |
| Inter-segment and other income | - | - | - | - | 2,809 | 2,809 |
| Total segment revenue | - | 117,041 | - | 7,907 | 2,809 | 127,757 |
| Depletion charges | - | (9,875) | - | (3,883) | - | (13,758) |
| Impairment | - | - | - | (64) | - | (64) |
| Other cost of sales | - | (6,001) | - | (6,382) | - | (12,383) |
| General administrative expenses before depreciation | (4,387) | (1,760) | - | (2,354) | (12,729) | (21,229) |
| Inter-segment administrative expense | (1,825) | (367) | (26) | (389) | (202) | (2,809) |
| Depreciation and amortisation | (462) | (265) | - | (17) | (163) | (907) |
| Foreign exchange gains / (losses) | (513) | - | 1 | - | (946) | (1,458) |
| Share-based payments | - | - | - | - | (2,522) | (2,522) |
| Exploration costs written off | (8,788) | - | (13,759) | - | - | (22,547) |
| Impairment provision on Syrian exploration activities | (9,997) | - | - | - | - | (9,997) |
| Profit on disposal of oil and gas properties | - | - | - | 6,628 | - | 6,628 |
| Profit / (loss) before interest and taxation | (25,972) | 98,774 | (13,784) | 1,446 | (13,753) | 46,711 |
| Interest expense and unwinding of discount | - | - | - | (638) | - | (638) |
| Interest income from external parties | 9 | - | - | 4 | 257 | 270 |
| Inter-segment interest | - | - | - | (4,365) | 4,365 | - |
| Taxation | - | - | - | - | 31 | 31 |
| Attributable to suspended operations | - | (98,774) | - | - | - | (98,774) |
| Loss for the year from continuing operations | (25,963) | - | (13,784) | (3,553) | (9,100) | (52,400) |
| Profit for the year from suspended operations | - | 98,774 | - | - | - | 98,774 |
| Profit on derecognition of Dijla Petroleum Company | - | 8,702 | - | - | - | 8,702 |
| Profit / (loss) for the year attributable to owners of the Company | (25,963) | 107,476 | (13,784) | (3,553) | (9,100) | 55,076 |

| | Year ended 31 December 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Syria exploration activities | Syria production activities | Tunisia | USA | Other | Total |
| | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 |
| Revenues from external parties | - | 98,983 | - | 16,595 | - | 115,578 |
| Inter-segment and other income | - | - | - | 201 | 2,739 | 2,940 |
| Total segment revenue | - | 98,983 | - | 16,796 | 2,739 | 118,518 |
| Depletion charges | - | (11,353) | - | (5,689) | - | (17,042) |
| Impairment | - | - | - | (3,820) | - | (3,820) |
| Other cost of sales | (2,820) | (3,575) | - | (11,561) | 2 | (17,954) |
| General administrative expenses before depreciation | (6,605) | (2,006) | (264) | (3,106) | (11,515) | (23,496) |
| Inter-segment administrative expense | (2,693) | - | (16) | (30) | (201) | (2,940) |
| Depreciation and amortisation | (294) | (207) | - | (17) | (165) | (683) |
| Foreign exchange losses | (7) | - | - | - | (961) | (968) |
| Share-based payments | - | - | - | - | (2,533) | (2,533) |
| Exploration costs written off | (5,498) | - | - | - | - | (5,498) |
| Hurricane repairs | - | - | - | 816 | - | 816 |
| Profit on disposal of oil and gas properties | - | - | - | 1,137 | - | 1,137 |
| Profit / (loss) before interest and taxation | (17,917) | 81,842 | (280) | (5,474) | (12,634) | 45,537 |
| Interest expense and unwinding of discount | - | - | - | (1,116) | (16) | (1,132) |
| Interest income from external parties | 9 | - | - | (14) | 252 | 247 |
| Inter-segment interest | - | - | - | (4,267) | 4,267 | - |
| Taxation | - | - | - | 19 | (1) | 18 |
| Attributable to suspended operations | - | (81,842) | - | - | - | (81,842) |
| Loss for the year from continuing operations | (17,908) | - | (280) | (10,852) | (8,132) | (37,172) |
| Profit for the year from suspended operations | - | 81,842 | - | - | - | 81,842 |
| Profit / (loss) for the year attributable to owners of the Company | (17,908) | 81,842 | (280) | (10,852) | (8,132) | 44,670 |

Central costs have not been apportioned to the reportable segments and are included within “Other” above.

All external revenues are derived from production in, and sales to, the segments above. See the credit risk section of note 27 for details on major customers.

The segment assets and liabilities as at 31 December and the segment capital expenditure during the year ended 31 December were as follows:

| | At 31 December 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Syria exploration activities | Syria production activities | Tunisia | USA | Other | Total |
| | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 |
| Assets | **11,990** | **102,000** | **6,869** | **19,527** | **120,722** | **261,108** |
| Liabilities | **(14,468)** | **-** | **(1,000)** | **(16,832)** | **(621)** | **(32,921)** |
| Inter-segment balances | **(8,934)** | **-** | **(19,934)** | **(7,532)** | **36,400** | **-** |
| | | | | | | |
| Exploration and evaluation expenditure | **17,592** | **-** | **4,657** | **-** | **-** | **22,249** |
| All other additions to non-current assets | **494** | **18,835** | **-** | **2,117** | **1,116** | **22,562** |
| | | | | | | |
| Total capital expenditure during period | **18,086** | **18,835** | **4,657** | **2,117** | **1,116** | **44,811** |

| | At 31 December 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Syria exploration activities | Syria production activities | Tunisia | USA | Other | Total |
| | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 | $' 000 |
| Assets | 66,542 | 46,140 | 15,971 | 41,780 | 72,479 | 242,912 |
| Liabilities | (10,906) | (9,213) | (1,932) | (28,607) | (9,247) | (59,905) |
| Inter-segment balances | 26,047 | (41,233) | (16,208) | (56,249) | 87,643 | - |
| | | | | | | |
| Exploration and evaluation expenditure | 13,044 | - | 15,971 | - | - | 29,015 |
| All other additions to non-current assets | 491 | 13,752 | - | 5,876 | 356 | 20,475 |
| | | | | | | |
| Total capital expenditure during period | 13,535 | 13,752 | 15,971 | 5,876 | 356 | 49,490 |

Transactions between segments include management fees and are charged at estimated prevailing market prices.

## 8. Share-based payments

The Group operates two share-based remuneration plans issuing options and restricted shares. Options are issued to directors and certain senior management personnel. Restricted shares are available to other staff.

Options are issued with an exercise price equivalent to the underlying share price averaged over a period immediately prior to the date of grant, or such other higher exercise price as the Remuneration Committee may determine. Restricted shares are issued with an exercise price equivalent to the par value of the shares. Both options and restricted shares will usually have a deferred vesting period and a maximum validity period of five years.

The share-based payment charge for the period is based upon the requirements of IFRS 2 regarding share-based payments. For this purpose, the weighted average estimated fair value of the share options and restricted shares granted was calculated using a Black-Scholes option pricing model. The expected average life of options and restricted shares was assumed to be four years. No dividends were factored into the model. Volatility has been estimated based on the historical volatility of the underlying shares.

The fair value of options and restricted shares issued in 2011 was $2,252,000 (2010: $3,915,000). Details of grants made during the year and assumptions included in the calculation of the charge to the income statement are as follows:

| Grant date | Years options or restricted shares vest | Stock price at date of grant (£) | Exercise price (£) | Number of options or restricted shares issued | Risk free interest rate | Volatility |
|---|---|---|---|---|---|---|
| 03/06/2011 | 2012 & 2013 | 2.47 | 2.35 | 825,000 | 2.0% | 36.4% |
| 03/06/2011 | 2012 & 2013 | 2.47 | 2.35 | 196,000 | 1.9% | 36.4% |
| 03/06/2011 | 2012 & 2013 | 2.47 | 0.06 | 31,320 | 1.9% | 36.4% |

The estimated fair value of options and restricted shares with a deferred vesting period is charged to the Income Statement over the vesting period of the options concerned. The estimated fair value of options and restricted shares exercisable immediately is expensed at the time of issuance of the award. Further details are provided in note 22.

## 9. Hurricane repairs

In 2008 Hurricanes Gustav and Ike caused damage to several of the Group's oil and gas properties and supporting infrastructure in the Gulf of Mexico. During 2009 a charge was made in the accounts for the estimated full amount of any damage notified by the operators less insurance claim refunds that the Directors were satisfied were virtually certain to be recoverable. The Income Statement in 2010 reflects a write back of certain estimates of costs from operators that were not incurred and an increased insurance recovery. The insurance proceeds were received during 2010. The amount credited to the Income Statement in the year end 31 December 2010 was $816,000.

## 10. Operating loss

The Group’s operating loss, including its suspended Syrian activities, is stated after charging / (crediting):

| | 2011 | 2010 |
|---|---|---|
| | $' 000 | $' 000 |
| Foreign exchange loss | **1,458** | 968 |
| Share based payment charges (note 8) | **2,522** | 2,533 |
| Hurricane repairs (note 9) | **-** | (816) |
| Depletion of oil and gas properties (note 14) | **13,758** | 17,042 |
| Depreciation and amortisation of other assets (notes 14 & 15) | **907** | 684 |
| Impairment of development and production assets (note 14) | **64** | 3,820 |
| Exploration expenditure written off (note 15) | **22,547** | 5,498 |
| Impairment provision on exploration assets (note 15) | **9,997** | - |
| Staff costs excluding share-based payments (note 23) | **11,128** | 8,277 |
| Operating lease rentals: | | |
| Buildings | **1,102** | 1,113 |
| Vehicles and equipment | **5,487** | 5,467 |
| Profit on sale of assets | **(6,628)** | (1,137) |

The operating lease rentals shown for 2011 include $5,465,000 (2010: $4,019,000) in respect of the hire of drilling rigs and operating staff.

Details of the auditors’ remuneration is set out in the table below:

| | 2011 | 2010 |
|---|---|---|
| | $' 000 | $' 000 |
| Fees payable to the Company's auditors for the audit of: | | |
| the Company's annual accounts | **234** | 233 |
| the Company's subsidiaries | **61** | 24 |
| the Company's joint ventures | **-** | 26 |
| Total audit fees | **295** | 283 |
| Audit related assurance services | **83** | 55 |
| Taxation compliance services | **71** | 61 |
| Other taxation advisory services | **143** | 25 |
| Other services | **42** | - |
| Total non-audit fees | **339** | 141 |

## 11. Net Interest receivable

| | 2011 $' 000 | 2010 $' 000 |
|---|---|---|
| Short-term bank deposit interest | **271** | 247 |
| Overdraft and similar interest charges | **(1)** | (19) |
| | **270** | 228 |

## 12. Taxation credit

| | 2011 $' 000 | 2010 $' 000 |
|---|---|---|
| Current Corporation Tax: | | |
| UK Corporation Tax | 31 | - |
| Overseas Corporation Tax | - | 18 |
| Total (credit) / charge | 31 | 18 |

The Group's effective tax rate differs from the theoretical amount that would arise using the UK domestic corporation tax rate applicable to profits of the consolidated companies as follows:

| | 2011 $' 000 | 2010 $' 000 |
|---|---|---|
| Loss before tax from continuing operations | **(52,431)** | (37,191) |
| Profit before tax from suspended Syrian operations | **107,476** | 81,843 |
| Total profit before tax | **55,045** | 44,652 |
| Tax calculated at domestic rate of 26.5% (2010: 28%) | **14,587** | 12,503 |
| Effects of: | | |
| Expenses not deductible for taxation purposes | **23** | 32 |
| Share based payments | **261** | (512) |
| Tax losses for which no deferred taxation asset was recognised | **6,870** | 6,914 |
| Effect of prior period adjustment | **(262)** | (702) |
| Impact of local tax rates | **(21,620)** | (18,383) |
| Other tax adjustments | **110** | 129 |
| | **(31)** | (18) |

The Group's tax liability in Syria is settled on its behalf by the General Petroleum Corporation out of the latter's share of royalties and profit oil and, as such, is not reflected in the Group's tax charge for the year.

## 13. Earnings per share

The basic and diluted earnings per share have been calculated using the earnings for the year ended 31 December 2011 of $55,076,000 (2010: $44,670,000). The basic earnings per share was calculated using a weighted average number of shares in issue less treasury shares held, of 121,028,071 (2010: 121,116,459). The weighted average number of ordinary shares, allowing for the exercise of share options, for the purposes of calculating the diluted earnings per share was 122,943,300 (2010: 124,513,383).

The loss per share from continuing operations is calculated before profits attributable to suspended Syrian activities. In 2011 this loss from continuing activities amounted to $52,400,000 (2010: $37,173,000). As this is a loss, the impact of share options is anti-dilutive and hence, basic and diluted loss per share from continuing operations are the same.

## 14. Property, plant and equipment

| | Oil and gas properties | | | |
|---|---|---|---|---|
| | Syria | USA | Other fixed assets | Total |
| | $' 000 | $' 000 | $' 000 | $' 000 |
| ***Cost:*** | | | | |
| At 1 January 2010 | 47,820 | 85,234 | 1,301 | 134,355 |
| Additions | 13,099 | 5,847 | 872 | 19,818 |
| Disposals | - | (4,255) | - | (4,255) |
| Transfer to Disposal Group | - | (23,997) | - | (23,997) |
| At 1 January 2011 | 60,919 | 62,829 | 2,173 | 125,921 |
| Additions | 18,604 | 2,117 | 414 | 21,135 |
| Disposals | - | (23,679) | - | (23,679) |
| Transfer from intangible assets | 13,077 | - | - | 13,077 |
| Loss of control of DPC | (92,600) | - | (791) | (93,391) |
| At 31 December 2011 | - | 41,267 | 1,796 | 43,063 |
| ***Accumulated depreciation and depletion:*** | | | | |
| At 1 January 2010 | (12,058) | (31,331) | (641) | (44,030) |
| Charge for 2010 | (11,353) | (5,689) | (377) | (17,419) |
| Disposals | - | 1,033 | - | 1,033 |
| Transfer to Disposal Group | - | 7,424 | - | 7,424 |
| At 1 January 2011 | (23,411) | (28,563) | (1,018) | (52,992) |
| Charge for 2011 | (9,875) | (3,883) | (577) | (14,335) |
| Disposals | - | 10,703 | - | 10,703 |
| Loss of control of DPC | 33,286 | - | 325 | 33,611 |
| At 31 December 2011 | - | (21,743) | (1,270) | (23,013) |
| ***Accumulated impairment:*** | | | | |
| At 1 January 2010 | - | (13,800) | - | (13,800) |
| Impairment charge for 2010 | - | (3,820) | - | (3,820) |
| Disposals | - | 3,222 | - | 3,222 |
| Transfer to Disposal Group | - | 5,347 | - | 5,347 |
| At 1 January 2011 | - | (9,051) | - | (9,051) |
| Impairment charge for 2011 | - | (64) | - | (64) |
| Disposals | - | 3,294 | - | 3,294 |
| At 31 December 2011 | - | (5,821) | - | (5,821) |
| **Net book value at 31 December 2011** | **-** | **13,703** | **526** | **14,229** |
| Net book value at 31 December 2010 | 37,508 | 25,215 | 1,155 | 63,878 |

Disposals during 2011 represents the sale of a package of assets in the Gulf of Mexico. The total proceeds were $6.6 million and the associated decommissioning provision was $10.0 million. A further $4.2 million was received during the year in respect of a further package of assets in the Gulf of Mexico that was classified as held for sale at 31 December 2010. These two disposals of assets resulted in a release of funds from restricted cash balances which, including releases of funds following decommissioning of assets that were not sold, amounted to $11.2 million. A net profit on disposal of $6.6 million has been recorded upon these transactions.

Included in the 2011 depletion charge for the US oil and gas properties is a credit of $1,147,000 (2010: charge of $2,397,000) related to properties substantially depleted in prior years. These depletion adjustments occur where revisions to decommissioning estimates have been made to properties with very short useful lives.

The impairment charge for 2010 includes $2,918,000 in respect of a package of assets that was disposed of with an effective date of 1 May 2010. These assets were written down to the agreed selling price. Other impairment charges related to provisions against the Group's carrying values of its USA producing assets, following a review of reserves at the year end.

Impairment for those assets not held for sale has been assessed, based on a value in use calculation, and using a pre-tax discount rate of 6% (2010: 6%), a long-term Brent crude oil price of $90/bbl (2010: $80/bbl) and a long term gas price of $4.50/mcf (2010: $6.00/mcf). In determining the appropriate discount rate to be used consideration is given to the risk directly incorporated in the underlying cash flow forecasts.

## 15. Intangible assets

| | Exploration and evaluation assets | | Computer software | Total |
|---|---|---|---|---|
| | Syria | Tunisia | | |
| | $' 000 | $' 000 | $' 000 | $' 000 |
| ***Cost:*** | | | | |
| At 1 January 2010 | 6,724 | - | 579 | 7,303 |
| Additions | 13,044 | 15,971 | 657 | 29,672 |
| Exploration expenditure written off | (5,498) | - | - | (5,498) |
| At 1 January 2011 | 14,270 | 15,971 | 1,236 | 31,477 |
| Additions | 17,592 | 4,657 | 1,427 | 23,676 |
| Exploration expenditure written off | (8,788) | (13,759) | - | (22,547) |
| Transfer to property, plant & equipment | (13,077) | - | - | (13,077) |
| Loss of control of DPC (note 6) | - | - | (528) | (528) |
| At 31 December 2011 | 9,997 | 6,869 | 2,135 | 19,001 |
| ***Accumulated amortisation:*** | | | | |
| At 1 January 2010 | - | - | (212) | (212) |
| Charge for 2010 | - | - | (307) | (307) |
| At 1 January 2011 | - | - | (519) | (519) |
| Charge for 2011 | - | - | (330) | (330) |
| Loss of control of DPC (note 6) | - | - | 302 | 302 |
| At 31 December 2011 | - | - | (547) | (547) |
| ***Accumulated impairment:*** | | | | |
| At 1 January 2011 | - | - | - | - |
| Impairment provision for 2011 | (9,997) | - | - | (9,997) |
| At 31 December 2011 | (9,997) | - | - | (9,997) |
| **Net book value at 31 December 2011** | **-** | **6,869** | **1,588** | **8,457** |
| Net book value at 31 December 2010 | 14,270 | 15,971 | 717 | 30,958 |

The accumulated costs of E&E assets in Syria represent $9,997,000 in respect of the Group's share of the drilling costs of the Al Khairat, Twaiba and Wardieh wells and certain 3D seismic surveys. The Al Khairat well was successfully tested but commercial development approval is yet to be granted by the Syrian Arab Republic. The Twaiba and Wardieh wells are still under evaluation.

Although the Group retains joint control over its Syrian exploration activities an impairment test was conducted following the imposition of EU sanctions against the oil industry in Syria. The carrying value of all E&E assets in Syria has been impaired to nil as it is presently unclear whether the Group will be able to apply for commercial development approval in the manner contemplated by the Production Sharing Contract. In 2011 the Group announced a discovery in the Khurbet East 101 well and the costs of this well plus the appraisal well drilled at Khurbet East 102 were transferred to property, plant & equipment following the granting of a commercial development licence. Wells

drilled at Abu Ghazal and Safa were deemed non-commercial and the costs of $8,788,000 have been written off.

In 2011 the Group reviewed the results of the Lambouka well, offshore Tunisia and wrote off exploration costs of $13,759,000. At 31 December 2011 the Tunisian E&E assets represent the costs invoiced to date by the operator of the Sidi Dhaher well plus seismic acquisition and processing for both the onshore and offshore Tunisian assets.

## 16. Investments

The Company's investments in subsidiary undertakings are shown below. All investments are in ordinary shares and are directly or indirectly owned by the Company as stated below:

| Name of Company | Proportion of voting shares at 31 December 2011 | Nature of business | Country of incorporation |
|---|---|---|---|
| *Directly held by the Company:* | | | |
| Gulfsands Petroleum Ltd | 100% | Holding company | Cayman Islands |
| *Indirectly held by the Company:* | | | |
| Gulfsands Petroleum Holdings | 100% | Holding company | Cayman Islands |
| Gulfsands Petroleum Levant Ltd | 100% | Oil & gas exploration | Cayman Islands |
| Gulfsands Petroleum Iraq Ltd | 100% | Oil & gas exploration | Cayman Islands |
| Gulfsands Petroleum Tunisia Ltd. | 100% | Oil & gas exploration | Cayman Islands |
| Gulfsands Petroleum USA, Inc. | 100% | Oil & gas exploration | US |
| Darcy Energy LLC | 100% | Oil & gas exploration | US |

On 16 June 2011 Gulfsands Petroleum Syria Limited changed its name to Gulfsands Petroleum Levant Limited. Gulfsands Petroleum Levant Limited owns a 50% interest in a contractor group that has been exploring for hydrocarbons in Block 26 in Syria prior to the imposition of EU sanctions against the Syrian oil industry. The results and net assets of the contractor group are proportionally consolidated within the Group accounts.

Gulfsands Petroleum Levant Limited owns 25% of the voting shares in Dijla Petroleum Company ("Dijla"), a company incorporated in Syria. Dijla is a joint venture undertaking between the General Petroleum Corporation and the other parties participating in the production of hydrocarbons from Block 26 in Syria. Dijla is responsible for administering these production operations and, as such, all its costs are ultimately borne equally between the Group and its joint venture partner, Emerald Energy plc. Further information on the status of the Syrian producing operations is provided in note 6.

## 17. Trade and other receivables

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Trade receivables | **-** | 23,119 |
| Underlift | **520** | 452 |
| Corporation tax recoverable | **-** | 55 |
| Prepayments and accrued income | **2,023** | 3,405 |
| Advances on contracts | **-** | 6,252 |
| Amounts due from oil and gas partnerships | **2,804** | 2,276 |
| | **5,347** | 35,559 |

At 31 December 2011 the Group was owed $25,332,000 by the government of the Syrian Arab Republic relating to oil delivered during the period August to November 2011. The total amount invoiced was $31,232,000 and to date an amount of $5,900,000 has been paid. The government of the Syrian Arab Republic has acknowledged the debt. This asset has been effectively impaired as part of the deconsolidation of the Group's Syrian producing operations, described in note 6.

Underlift at 31 December 2011 and 2010 represents the rights to gas revenue receivable as a result of the acquisition of oil and gas properties in the Gulf of Mexico in May 2004. Underlift represents a right to future economic benefits (through entitlement to receive equivalent future production), which constitutes an asset of which the timing of recovery is uncertain. During the year ended 31 December 2011 certain underlift balances were sold to external parties.

Advances on contracts represent the total amount invoiced by contractors on long-term projects in excess of the value of work completed at the balance sheet date. At 31 December 2010 this balance related entirely to the contract for the construction of the CPF and accordingly there is no corresponding balance in 2011 following the Syrian deconsolidation referred to above.

Amounts due from oil and gas partnerships represents amounts owed from its joint venture partners.

## 18. Cash and cash equivalents

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Cash at bank and in hand | **124,240** | 80,625 |
| Restricted cash balances | **3,965** | 15,179 |
| | **128,205** | 95,804 |
| | | |
| Included in long term financial assets | **3,965** | 9,603 |
| Included in short term financial assets | **-** | 5,576 |
| | | |
| Total cash and cash equivalents | **124,240** | 80,625 |

The restricted cash balances include amounts held in escrow to cover decommissioning expenditures under the requirements of the regulatory authorities that manage the oil and gas and

other mineral resources in the Gulf of Mexico and an amount held in escrow to secure a line of credit for forward foreign currency trading.

## 19. Trade and other payables

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Trade payables | **494** | 10,799 |
| Accruals and other payables | **15,544** | 12,296 |
| UK Corporation tax payable | **-** | 31 |
| | **16,038** | 23,126 |

## 20. Deferred tax assets / (liabilities)

The tax effect of amounts for which no deferred tax asset has been recognised is as follows:

| | **2011** | **2010** |
|---|---|---|
| | **$' 000** | **$' 000** |
| DD&A and impairment (less than) / in excess of tax allowances | **(248)** | **5,275** |
| Other short term temporary differences | **4,148** | **2,330** |
| Tax losses carried forward | **15,036** | **14,844** |
| Unprovided deferred tax asset | **(18,935)** | **(22,449)** |
| Deferred tax asset / (liability) at 31 December | - | - |

$22 million (2010: $27 million) of the Group's unutilised tax losses have expiry dates between 2024 and 2032. The remaining tax losses of the Group have no expiry date.

Deferred tax assets are not provided where the Group does not consider it probable that sufficient future taxable profits will be made to offset the deductions represented by those deferred tax assets. In performing this calculation the Group considers deferred tax balances relating to each tax authority separately.

## 21. Provision for decommissioning

The provision for decommissioning relates to the expected present value of costs of plugging and abandoning the exploration and development assets held by Gulfsands Petroleum Tunisia Limited, Gulfsands Petroleum USA, Inc and Darcy Energy LLC. The provision for decommissioning is estimated after taking account of inflation, years to abandonment and an appropriate discount rate. At 31 December 2011, the oil and gas properties had estimated plugging and abandonment dates between 2012 and 2027.

Actual decommissioning costs will ultimately depend upon future market prices for the decommissioning work required, which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices,

which are inherently uncertain.

The actual amounts paid for decommissioning may ultimately vary significantly from the provision at 31 December 2011 requiring potentially material adjustments to the carrying value of the obligations.

The movement in the provision for decommissioning was as follows:

| | $' 000 |
|---|---|
| At 1 January 2010 | 31,620 |
| Changes in estimates | 2,436 |
| Additions | 662 |
| Transfer to disposal group | (7,027) |
| Costs in excess of provision | 2,048 |
| Decommissioning expenses | (2,697) |
| Discount expense | 1,114 |
| At 31 December 2010 | 28,156 |
| Current portion | 7,473 |
| Non-current portion | 20,683 |
| At 1 January 2011 | 28,156 |
| Changes in estimates | 1,917 |
| Disposals | (9,999) |
| Costs in excess of provision | 1,100 |
| Decommissioning expenses | (4,929) |
| Discount expense | 638 |
| At 31 December 2011 | 16,883 |
| Current portion | 2,135 |
| Non-current portion | 14,748 |

## 22. Share capital

### Group and Company

| | 2011 Number | 2010 Number |
|---|---|---|
| *Authorised:* | | |
| Ordinary shares of 5.714 pence each | **175,000,000** | 175,000,000 |

| | 2011 $' 000 | 2010 $' 000 |
|---|---|---|
| *Allotted, called up and fully paid:* | | |
| 122,389,500 (2010: 121,577,500) ordinary shares of 5.714 pence each | **13,131** | 13,093 |

The movements in share capital and share options were:

| | Number of ordinary shares | Number of share options | Number of restricted shares | Weighted average price of options £ |
|---|---|---|---|---|
| At 31 December 2010 | 121,577,500 | 8,585,000 | 230,835 | 2.05 |
| Share options and restricted shares exercised for cash | 812,000 | (800,000) | (12,000) | 1.21 |
| Share options and restricted shares cash settled | | - | (25,000) | - |
| Share options and restricted shares issued | - | 1,021,000 | 31,320 | 2.35 |
| At 31 December 2011 | 122,389,500 | 8,806,000 | 225,155 | 2.17 |

During the year the Group implemented a share buy-back programme. A total of $13,023,000 was expended on this programme and 4,645,681 shares were repurchased to be held in Treasury. 400,000 shares were allotted in October 2011 to satisfy the exercise of share options and the net number of shares held in Treasury at 31 December 2011 amounted to 4,245,681.

In 2010 a Restricted Share Plan (“RSP”) was established to complement the existing Share Option Plan. Under the RSP restricted (deferred) shares are awarded at par value to employees. Other than the lower exercise price the restricted shares operate in the same manner as the ordinary share options.

The detail of the share options and restricted shares outstanding at 31 December 2011 are as follows:

| Exercise period | Year options or restricted shares vest | Weighted average exercise price of options (£) | Number of options | Number of restricted shares |
|---|---|---|---|---|
| 19 February 2007 - 3 June 2012 | 2007 | £1.02 | 95,000 | |
| 8 May 2008 - 8 December 2013 | 2008 | £1.87 | 4,365,000 | |
| 8 May 2009 - 27 November 2013 | 2009 | £1.82 | 675,000 | |
| 9 February 2009 - 10 June 2014 | 2009 | £1.87 | 135,000 | |
| 8 May 2010 - 27 November 2013 | 2010 | £1.82 | 675,000 | |
| 16 February 2010 - 10 June 2014 | 2010 | £1.88 | 72,500 | |
| 16 February 2011 - 15 February 2014 | 2011 | £1.86 | 62,500 | |
| 4 May 2011 - 3 May 2015 | 2011 | £3.20 | 852,500 | |
| 4 May 2012 - 3 May 2015 | 2012 | £3.20 | 852,500 | |
| 3 June 2012 - 2 June 2016 | 2012 | £2.35 | 510,500 | |
| 3 June 2013 - 2 June 2016 | 2013 | £2.35 | 510,500 | |
| 4 May 2011 - 3 November 2015 | 2011 | | | 121,918 |
| 4 May 2012 - 3 November 2015 | 2012 | | | 71,917 |
| 3 June 2012 - 2 June 2016 | 2012 | | | 15,661 |
| 3 June 2013 - 2 June 2016 | 2013 | | | 15,659 |
| | | £2.05 | 8,806,000 | 225,155 |

All restricted shares have an exercise price of £0.06 per restricted share

Options are exercisable at prices from £1.02 to £3.20 per share and had a weighted estimated remaining contractual life of 2.0 years at 31 December 2011. The weighted remaining contractual life of the restricted shares is approximately 3.5 years.

Of the total outstanding options at 31 December 2011, the options granted to the Directors numbered 7,575,000 (2010: 7,475,000) and those granted to other staff numbered 1,156,000 (2010: 1,035,000). The remaining 75,000 (2010: 75,000) were granted to ex-employees and ex-Directors or consultants who are currently involved with or have performed work for the Group. All restricted shares outstanding were granted to non-directors employed by the Group.

The average share price during 2011 was £2.43. The highest share price during the year was £4.03 and the lowest price was £1.41.

## 23. Staff costs

The aggregate payroll costs of staff and Directors were as follows:

| | **2011**<br>**$' 000** | 2010<br>$' 000 |
|---|---|---|
| Wages and salaries | **9,434** | 6,948 |
| Social security costs | **1,143** | 740 |
| Share-based payment charges | **2,522** | 2,533 |
| Other benefits in kind | **551** | 589 |
| | **13,650** | 10,810 |

The average monthly number of persons employed by the Group, including Directors was as follows:

| | **2011**<br>**$' 000** | 2010<br>$' 000 |
|---|---|---|
| Operational and technical | **19** | 27 |
| Administrative | **29** | 16 |
| | **48** | 43 |

Staff numbers and costs recorded above include the Group's proportionate share of staff employed by jointly controlled entities.

Details of the remuneration of Directors are included in the Directors' Remuneration Report on pages 50-52. No employees other than Directors are determined to be key management personnel.

## 24. Obligations under operating leases

At the end of the year the Group had commitments for future minimum lease payments under non-cancellable operating leases as follows:

| | **2011** | | 2010 | |
|---|---|---|---|---|
| | **Land & Buildings** | **Other** | Land & Buildings | Other |
| | **$' 000** | **$' 000** | $' 000 | $' 000 |
| Amounts payable on leases: | | | | |
| Within one year | **1,060** | **12** | 857 | 720 |
| In two to five years | **156** | **-** | 499 | 24 |
| After more than five years | **-** | **-** | - | - |
| | **1,216** | **12** | 1,356 | 744 |

Included in amounts payable on leases for land and buildings falling due within one year is an amount of $444,000 in respect of the Group's offices in Damascus. The current lease expires in November 2012. Payment of amounts due under this contract are suspended due to the receiving party being an entity subject to an asset freeze under EU Syria sanctions legislation.

In addition to the items mentioned above the Group had a non-cancellable lease for the provision of an oil rig and ancillary services. At 31 December 2011 the Group had no obligation to make further payments under this contract. The lease was terminated in January 2012.

## 25. Commitments

At 31 December 2011 all exploration expenditure and work programme commitments pertaining to the current exploration period (ending August 2012) in Block 26 in Syria had been satisfied in full.

At 31 December 2011 the minimum work commitments in respect of the Kerkouane and Chorbane permits in Tunisia had been fulfilled.

In December 2010 the Dijla Petroleum Company ("DPC") signed a contract with Saipem S.p.A for the construction of a central processing facility to be installed at the Khurbet East Field on Block 26, Syria. The total contract cost is denominated in Euro and the Group's share of the current approved value is approximately $65 million. The Group has not recognised a commitment in respect of this amount as the operations of DPC are no longer included within the consolidated results of the group. On 19 December 2011 Saipem S.p.A issued notice of force majeure and the contract is currently suspended.

There were no other material obligations or contracts outstanding in relation to ongoing projects not provided for at 31 December 2011 or 2010.

## 26. Contingent liabilities

Due to the nature of the Group's business, some contamination of the property owned or leased by the Group is possible. Environmental site assessments of the property would be necessary to adequately determine remediation costs, if any. The Directors do not consider the amounts that would result from any environmental site assessments to be significant to the financial position or results of operations of the Group. Accordingly, except for the provision made against decommissioning costs (note 21), no further provision for potential remediation costs is required.

The Group has entered into a Production Sharing Contract with the government of the Syrian Arab Republic under which it is responsible for bearing 50% of the costs and expenses of all operations in the Block 26 area, Syria. As discussed in note 6, a notice of force majeure was issued to the General Petroleum Corporation ("GPC") in December 2011 after which the GPC has continued to operate the fields through Dijla Petroleum Company ("DPC"). It is anticipated that once sanctions are lifted and the Group is able to legally resume operations DPC will seek to reclaim costs incurred during the pendency of the force majeure period. At 31 December 2011 the Group could not reliably estimate these costs but does not believe them to be significant.

## 27. Financial instruments, derivatives and capital management

*Risk assessment*
The Group's oil and gas activities are subject to a range of financial risks, as described below, which can significantly impact its performance.

*Liquidity risk*
At the end of the year the Group had cash in hand of $124.2 million, and further bank balances of $4.0 million held in escrow to cover expected decommissioning liabilities and other obligations.

Cash forecasts identifying the liquidity requirements of the Group are produced frequently. These are reviewed regularly by management and the Board to ensure that sufficient financial headroom exists for at least 12 months. At present the Group has no loan facilities in place and has no obvious need for such facilities based upon its current projects in hand and its available cash resources. However this position will continually be reviewed in the light of developments with existing projects and new project opportunities as they arise.

*Currency risk*
The Group has currency exposure arising from transactions denominated in currencies other than the functional currency of the Company and all its subsidiaries, US Dollars. These transactions relate predominantly to certain costs of its Syrian operations which are denominated in Syrian Pounds and Euro, and its head office costs which are denominated in Pounds Sterling.

Although sales of crude oil by the Group's Syrian operations have been invoiced in US Dollars payment has previously been made in Euro or Syrian Pounds according to the exchange rates pertaining between US Dollars and these currencies shortly before the payment is made. The Group manages any further risk through the use of short-term foreign currency forward contracts of not more than two weeks duration. Each contract is entered into with the aim of exactly covering any foreign currency risk on Euro receivables. There was no significant exposure to forward exchange contracts in place as at 31 December 2011 or 2010.

Costs incurred in Euro in the Syrian operations are recoverable under the terms of the Production Sharing Contract, subject to the sanctions, at the rate of exchange between US Dollars and Euro at the date of payment.

The Group maintains part of its cash balances in Pounds Sterling to defray head office costs.

The following table demonstrates the sensitivity to changes in the US Dollar exchange rate, with all other variables held constant, on the Group's profit before tax and the Group's equity:

| | Change in US Dollar rate | Effect on profit before tax $ 000 |
|---|---|---|
| **2011** | **(+ or -) 5%** | **423** |
| 2010 | (+ or -) 5% | 260 |

*Credit risk*
In the USA the Group trades only with a small number of recognised, creditworthy third parties. The Group manages the exposures to credit risk by performing credit evaluations on such of their major customers as require credit.

In Syria, the Group's share of crude oil has previously been sold to the Oil Marketing Bureau of the Government of the Syrian Arab Republic. The Group has yet to receive payment for oil sales for the period from August 2011 to November 2011 amounting to $26.2 million. Although the resultant debtor has been acknowledged by the government of the Syrian Arab Republic the ultimate recoverability of this amount is subject to a high degree of uncertainty and the Group has impaired the outstanding amount in full.

*Capital risk management*
The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may return capital to shareholders, issue new shares or sell assets to reduce debt.

The Group considers capital to be its equity reserves. At the current stage of the Group's life cycle, the Group's objective in managing its capital is to ensure funds raised meet the exploration expenditure commitments.

The Group ensures it is meeting its objectives by reviewing its KPIs and other management information to ensure its activities are progressing in line with expectations, controlling costs and placing unused funds on deposit to conserve resources and increase returns on surplus cash held.

*Financial assets*
The Group's financial assets consist of long term financial assets, its available-for-sale investment in DPC, cash at bank and receivables. The interest rate profile at 31 December for these assets at US dollar equivalents was as follows:

| | Financial assets on which interest is earned<br>$ 000 | Financial assets on which no interest is earned<br>$ 000 | Total<br>$ 000 |
|---|---|---|---|
| **2011** | | | |
| US Dollar | **118,122** | **107,384** | **225,506** |
| UK Sterling | **2** | **890** | **892** |
| Euro | **5,544** | **1,044** | **6,588** |
| Syrian Pounds | **750** | **1,891** | **2,641** |
| | **124,418** | **111,209** | **235,627** |
| | | | |
| 2010 | | | |
| US Dollar | 72,869 | 26,736 | 99,605 |
| UK Sterling | 794 | 956 | 1,750 |
| Euro | 257 | 19,746 | 20,003 |
| Syrian Pounds | - | 348 | 348 |
| | 73,920 | 47,786 | 121,706 |

The UK Sterling, Euro and Syrian Pound assets principally comprise cash on hand, cash in instant access accounts and short term money market deposits. The US Dollar assets represent an available-for-sale investment, cash on call accounts, money market accounts, and short term receivables. The Group earned interest on its interest bearing financial assets at rates between 0.01% and 1.0%. All financial assets, except the investment in DPC, are considered to be immediately available to turn into cash on demand.

At 31 December 2010 there was an amount of €6.7 million ($9.0 million) included in the Euro denominated financial assets on which no interest is earned which was subject to a short term forward exchange contract entered into on 31 December 2010 which matured on 11 January 2011. There was no similar amount at 31 December 2011.

In the current economic climate with exceptionally low interest rates, the Group is not sensitive to fluctuations in the interest rate received on bank and money market deposits and accordingly no sensitivity analysis is published.

Included in financial assets on which no interest is earned at 31 December 2010 was an amount of $25,332,000 of trade receivables. This amount was due from the Government of the Syrian Arab Republic in respect of oil sales in Syria. The receivable at 31 December 2011 is acknowledged by General Petroleum Corporation of the Syrian Arab Republic but due to the ongoing sanctions against the country's oil industry the payment of this amount has been delayed and, taking into account the current exceptional circumstances in Syria and the consequential difficulty of predicting the timing of future payment, has been fully impaired. The receivable from the Syrian Arab Republic at 31 December 2010 was paid during January and February 2011. The remaining trade receivables consist of amounts receivable from various counter-parties where the Group considers the credit risk to be low. This risk is monitored by the Group.

*Financial liabilities*

The Group's financial liabilities consist of short term payables. None of these liabilities bear interest to external parties.

At 31 December financial liabilities are classified as shown below:

| | Financial liabilities on which no interest is charged $ 000 |
|---|---|
| **2011** | |
| US Dollar | **16,469** |
| UK Sterling | **109** |
| Euro | **412** |
| Syrian Pounds | **1,146** |
| | **18,136** |
| | |
| 2010 | |
| US Dollar | 15,198 |
| UK Sterling | 528 |
| Euro | 6,791 |
| Syrian Pounds | 574 |
| | 23,091 |

The Group's short term liabilities are considered to be payable on demand.

*Commodity derivatives*

The Group sells its hydrocarbon production on the spot market and has exposure to changes in oil and gas prices. The Directors consider the Group has the financial strength to withstand such changes under all reasonable prognoses and, accordingly, no commodity derivative contracts are currently outstanding. The potential future use of derivatives will be kept under review should the Group feel that the exposure to commodity price risk significantly impacts the liquidity risk of the Group. The Group incurred no expense in respect of oil and gas price derivatives in 2011 or 2010.

*Fair values*

The Group has an available-for-sale financial asset valued by the directors at $102.0 million as described further below. At 31 December 2011 and 2010, the Directors considered the fair values and book values of the Group's other financial assets and liabilities to be materially the same.

*Available-for-sale financial assets*

The available-for-sale asset comprises the Group's investment in DPC and has been valued by the Directors at an internal estimate of fair value at the balance sheet date taking into consideration the current exceptional circumstances in Syria.

Upon deconsolidation of this interest, IFRS requires the fair value of any remaining investment to be reinstated on the balance sheet as an investment. This investment is classified as an "available-for-sale" financial asset although it is not the Group's intention to dispose of the asset in the foreseeable future.

The Group has recognised a fair value of $102.0 million for the investment. As described in more detail in note 6, this valuation is substantially different from the potential long-term value of the asset. It is based upon the entitlement reserves at 31 December 2011 discounted at a rate of 15% per annum and then the net present value is reduced further by 80% to reflect a current market view of other risks of investments in the Syrian oil and gas sector. In deriving the figure of 80% we have assumed, inter alia, a long term Brent oil price assumption of $90/bbl, a delay to resumption of oil production in Syria, deferred revenue receipts for a period after resumption of production, potential further costs associated with restarting operations and the possibility of a change to the terms of the PSC or even expropriation. The valuation represents a level 3 measurement basis as defined by IFRS 7.

The following table sets out the impact that changes in the key variables would have on the carrying value of this asset:

| | Change | Change in carrying value of investment<br>$' 000 | Change in equity<br>$' 000 |
|---|---|---|---|
| Increase in forecast capital expenditure | **5%** | **(1,052)** | **(1,052)** |
| Decrease in long term commodity prices | **5%** | **(4,624)** | **(4,624)** |
| Increase in forecast operating expenditure | **5%** | **(682)** | **(682)** |
| Change in discount rate to 10% | **5%** | **21,555** | **21,555** |
| Change in discount rate to 20% | **5%** | **(31,984)** | **(31,984)** |
| Change in the Syrian oil and gas sector risk to 50% | **30%** | **153,000** | **153,000** |
| Change in the Syrian oil and gas sector risk to 90% | **10%** | **(51,000)** | **(51,000)** |
| Expropriation of the asset | **n.a.** | **(102,000)** | **(152,000)** |

## 28. Related party transactions and key management

Key management of the Group are considered to be the Directors of the Company. There were no transactions with Directors, other than interests in shares and their remuneration and share options as disclosed in the Directors' Remuneration Report on pages 50-52.

The remuneration of Directors is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'.

| | 2011 | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Short-term employee benefits | **4,173** | 3,360 |
| Share-based payments | **1,632** | 1,529 |
| | **5,805** | 4,889 |

In 2011 the Group paid $31,000 (2010: $30,000) to Hamilton Capital Partners Limited, a company associated with Mr Judge, for London office representative costs.

There were no other related party transactions of the Group during the years ended 31 December 2011 or 2010.

# Parent Company Financial Statements

## Company Balance Sheet
## As at 31 December 2011

| | Notes | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 7 | 30 | 107 |
| Intangible assets | 8 | 1,437 | 393 |
| Long-term financial assets | 11 | 1,000 | 1,000 |
| Investments in and loans to subsidiaries | 9 | 12,238 | 35,161 |
| | | 14,705 | 36,661 |
| **Current assets** | | | |
| Trade and other receivables | 10 | 29,808 | 70,273 |
| Cash and cash equivalents | 11 | 114,819 | 68,901 |
| | | 144,627 | 139,174 |
| **Total assets** | | 159,332 | 175,835 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 12 | 2,722 | 71,482 |
| **Total Liabilities** | | 2,722 | 71,482 |
| **Net assets** | | 156,610 | 104,353 |
| **Equity** | | | |
| **Capital and reserves attributable to equity holders** | | | |
| Share capital | 14 | 13,131 | 13,093 |
| Share premium | | 105,926 | 105,025 |
| Share-based payments reserve | | 18,506 | 16,318 |
| Retained profit / (loss) | | 19,047 | (30,083) |
| **Total equity** | | 156,610 | 104,353 |

The Financial Statements of Gulfsands Petroleum Plc (registered number: 05302880) were approved by the Board of Directors on 2 April 2012 and signed on its behalf by:

Richard Malcolm
**Chief Executive Officer**

Andrew Rose
**Chief Financial Officer**

**Company Statement of Changes in Equity**
**For the year ended 31 December 2011**

| | Share capital $'000 | Share premium $'000 | Share-based payments reserve $'000 | Retained profit / (loss) $'000 | Total equity $'000 |
|---|---|---|---|---|---|
| **Year ended 31 December 2011** | | | | | |
| At 1 January 2011 | 13,093 | 105,025 | 16,318 | (30,083) | 104,353 |
| Options exercised | 38 | 901 | - | - | 939 |
| Purchase of own shares | - | - | - | (13,023) | (13,023) |
| Share-based payment charge | - | - | 2,523 | - | 2,523 |
| Payments made in lieu of option exercise | - | - | (335) | - | (335) |
| Profit for 2011 | - | - | - | 62,153 | 62,153 |
| At 31 December 2011 | 13,131 | 105,926 | 18,506 | 19,047 | 156,610 |
| **Year ended 31 December 2010** | | | | | |
| At 1 January 2010 | 12,971 | 101,929 | 15,429 | (21,330) | 108,999 |
| Options exercised | 122 | 3,096 | - | - | 3,218 |
| Share-based payment charge | - | - | 2,359 | - | 2,359 |
| Payments made in lieu of option exercise | - | - | (1,470) | - | (1,470) |
| Loss for 2010 | - | - | - | (8,753) | (8,753) |
| At 31 December 2010 | 13,093 | 105,025 | 16,318 | (30,083) | 104,353 |

**Company Cash Flow Statement**
**For the year ended 31 December 2011**

| | *Notes* | **2011 $' 000** | 2010 $' 000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Operating loss | | **(13,514)** | (11,481) |
| Depreciation and amortisation | 7 & 8 | **148** | 159 |
| Share-based payment charge | | **2,522** | 2,533 |
| Decrease / (increase) in receivables | | **62** | (99) |
| Decrease in payables | | **(250)** | (767) |
| **Net cash provided by / (used in) operations** | | **(11,032)** | (9,655) |
| Interest received | | **4,622** | 4,503 |
| Taxation received | | **-** | 385 |
| **Net cash provided by / (used in) operating activities** | | **(6,410)** | (4,767) |
| **Investing activities** | | | |
| Capital expenditure | | **(1,446)** | (33) |
| Change in long-term financial assets | 11 | **-** | (1,000) |
| Loans to subsidiaries | | **(23,807)** | (851) |
| **Net cash used in investing activties** | | **(25,253)** | (1,884) |
| **Financing activities** | | | |
| Cash proceeds from issue of shares | | **939** | 3,218 |
| Payments made in lieu of options exercised | | **(335)** | (1,470) |
| Purchase of own shares | | **(13,023)** | - |
| Payments in connection with options issued | | **-** | (174) |
| Dividend received | | **90,000** | 28,400 |
| **Net cash provided by financing activities** | | **77,581** | 29,974 |
| **Increase in cash and cash equivalents** | | **45,918** | 23,323 |
| Cash and cash equivalents at beginning of period | | **68,901** | 45,578 |
| Cash and cash equivalents at end of period | 11 | **114,819** | 68,901 |

**Notes to the Parent Company Financial Statements for the year ended 31 December 2011**

## 1. Authorisation of Financial Statements and statement of compliance with IFRSs

Gulfsands Petroleum plc is a public limited company listed on the Alternative Investment Market ("AIM") of the London Stock Exchange and incorporated in the United Kingdom. The principal activitiy of the Company is that of provision of services to its subsidiaries which are engaged in oil and gas production, exploration and development activities.

The Company's Financial Statements for the year ended 31 December 2011 were authorised for issue by the Board of Directors on 2 April 2012 and the balance sheet was signed on the Board's behalf by Richard Malcolm and Andrew Rose.

The Company's Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. The principal accounting policies adopted are set out in note 3 below.

The risks faced by the Company include those related to EU sanctions, described in note 6 to the Consolidated Financial Statements.

## 2. Adoption of International Financial Reporting Standards

The Company's Financial Statements for the year ended 31 December 2011 and for the comparative year ended 31 December 2010 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and IFRIC (International Financial Reporting Interpretations Committee) interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

See note 4 to the Consolidated Financial Statements for details of new IFRSs and interpretations.

## 3. Significant accounting policies

### 3.1 Basis of preparation and accounting standards

The Company's significant accounting policies used in the preparation of the Company Financial Statements are set out below.

The Financial Statements have been prepared in accordance with applicable International Financial Reporting Standards as adopted by the European Union and, except for share-based payments, under the historical cost convention. They have also been prepared on the going concern basis of accounting, for the reasons set out in the "Going concern" section of the Directors' Report.

### 3.2 Reporting currency

These Financial Statements are presented in US Dollars. The Company's operations and the majority of all costs associated with foreign operations are paid in US Dollars and all loan balances with subsidiary undertakings are denominated in US Dollars. Therefore the presentational and functional currency of the Company is the US Dollar. Gains and losses from foreign currency transactions, if any, are recognised in the Income Statement for the year. The effective exchange rate to the Pound Sterling at 31 December 2011 was £1: US $1.57 (2010 – £1: US $1.55).

### 3.3 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any provision for impairment. Depreciation is charged so as to write off the cost, less estimated residual value, of assets on a straight-line basis over their useful lives of between two and five years.

### 3.4 Intangible assets

Intangible assets are stated at cost less accumulated amortisation and any provision for impairment. Amortisation is charged so as to write off the cost, less estimated residual value, of assets on a straight-line basis over their useful lives of between two and five years. Amortisation is included with depreciation and classified as administrative expenses. No intangible assets have indefinite lives.

### 3.5 Revenue recognition

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

### 3.6 Operating leases

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

### 3.7 Taxation

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted, or substantively enacted, tax rates and laws that will be in effect when the differences are expected to reverse. The recoverability of deferred tax assets is evaluated annually and an impairment provision is provided if it is more likely than not that the deferred tax asset will not give rise to future benefits in the Company's tax returns.

### 3.8 Derivative financial instruments

The Company enters into regular forward dated foreign exchange transactions as a means of reducing its exposure to exchange rate differences. These transactions are normally of a duration of less than two weeks and the amounts sold forward approximates to the anticipated monthly receipts from the Company's Syrian subsidiary.

### 3.9 Share-based payments

The Company has made equity-settled share-based payments to certain employees and directors by way of issues of share options. The fair value of these payments is calculated at grant date by the Company using the Black-Scholes option pricing model excluding the effect of non market-based vesting conditions. The expense is recognised on a straight-line basis over the period from the date of award to the date of vesting, based on the Company's best estimate of the number of options that will eventually vest. At each balance sheet date, the Company revises its estimates of the number of options expected to vest as a result of the effect of non market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in profit or

loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the share-based payments reserve.

**3.10 Cash and cash equivalents**

Cash and cash equivalents are carried in the balance sheet at cost and comprise cash in hand and deposits repayable on demand by banks and other short-term investments with original maturities of three months or less. Balances held in bank accounts subject to escrow agreements as collateral for performance bonds issued are excluded from cash and cash equivalents and are shown as long-term financial assets.

**3.11 Foreign currency**

Foreign currency transactions are translated to the functional and reporting currency of US Dollars at the rates prevailing when the transactions occurred. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date. All differences are taken to the Income statement.

**3.11 Investments**

The Company's investments in subsidiary companies are included in the Company Balance Sheet at cost, less provision for any impairment.

**3.12 Trade receivables**

Trade receivables are carried at original invoice amounts less any provision made for impairment of receivables. A provision for impairment of trade receivables is made when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the debt.

**3.13 Trade payables**

Trade payables are not interest-bearing and are stated at their nominal values.

**3.14 Equity instruments**

Equity instruments issued by the Company, being any instruments with a residual interest in the assets of the Company after deducting all its liabilities, are recorded at the proceeds received, net of direct issue costs.

**4. Income statement and total revenue**

No individual Income Statement is presented in respect of the Company as permitted by section 408 of the Companies Act 2006. The Company's profit for the year was $62,153,000 (2010: loss of $8,753,000). The total revenue of the Company, as defined by IAS 18, for 2011 was $7,431,000 (2010: $7,259,000) comprising management fees of $2,809,000 (2010: $2,739,000) and interest income of $4,622,000 (2010: $4,520,000).

The Company operates in one segment, that of the provision of services to group undertakings, and in one geographical area, the United Kingdom.

**5. Share-based payments**

See note 8 within the financial statements of the Group.

## 6. Earnings per share

No earnings per share information is shown as the Company is not required to present an Income Statement.

## 7. Property, plant and equipment

| | Office equipment, fixtures and fittings $' 000 |
|---|---|
| ***Cost:*** | |
| At 1 January 2010 | 298 |
| Additions | 12 |
| At 1 January 2011 | 310 |
| Additions | 22 |
| At 31 December 2011 | 332 |
| ***Accumulated depreciation:*** | |
| At 1 January 2010 | (102) |
| Charge for 2010 | (101) |
| At 1 January 2011 | (203) |
| Charge for 2011 | (99) |
| At 31 December 2011 | (302) |
| **Net book value at 31 December 2011** | **30** |
| Net book value at 31 December 2010 | 107 |

## 8. Intangible assets

| | Computer software $' 000 |
|---|---|
| ***Cost:*** | |
| At 1 January 2010 | 173 |
| Additions | 330 |
| At 1 January 2011 | 503 |
| Additions | 1,093 |
| At 31 December 2011 | 1,596 |
| ***Accumulated amortisation:*** | |
| At 1 January 2010 | (52) |
| Amortisation charge for 2010 | (58) |
| At 1 January 2011 | (110) |
| Amortisation charge for 2011 | (49) |
| At 31 December 2011 | (159) |
| **Net book value at 31 December 2011** | **1,437** |
| Net book value at 31 December 2010 | 393 |

## 9. Investments

The Company's fixed asset investment of $7,306,000 represents the historic cost of acquisition of the entire share capital of Gulfsands Petroleum Ltd. by means of a share for share exchange in 2005, less any required provision for impairment.

Loans to subsidiary undertakings comprise a revolving loan from the Company to Gulfsands Petroleum USA, Inc. for $46,039,000 (2010: $56,262,000) including accrued interest of $8,347,000 which is included within trade and other receivables. Interest is charged at 8.5% per annum on the outstanding principal and is payable in full on 31 December annually. The principal balance may be paid in part or in full at anytime with no penalty. On 1 January 2015 the loan converts to a term loan and the payments will be made in four instalments over the next three years.

A total impairment provision of $32,760,000 (2010: $28,407,000) has been recognised against the carrying value of this loan in the Company's Financial Statements. This provision writes down the value of the loan to Gulfsands Petroleum USA, Inc. to the amount expected to be realisable after the anticipated disposal of the Company's assets in the Gulf of Mexico. The impairment follows the change of classification of the Gulf of Mexico assets from being valued at their expected value in use

to their fair value less costs to sell. The fair value less costs to sell has been estimated following discussions with external specialist transaction advisors retained by the Group.

The Company's investments in subsidiary undertakings are shown below. All investments are in ordinary shares and are directly or indirectly owned by the Company as stated below:

| *Name of Company* | *Proportion of voting shares at 31 December 2011* | *Nature of business* | *Country of Incorporation* |
|---|---|---|---|
| *Directly held by the Company:* | | | |
| Gulfsands Petroleum Ltd | 100% | Holding company | Cayman Islands |
| *Indirectly held by the Company:* | | | |
| Gulfsands Petroleum Holdings | 100% | Holding company | Cayman Islands |
| Gulfsands Petroleum Levant Ltd | 100% | Oil & gas exploration | Cayman Islands |
| Gulfsands Petroleum Iraq Ltd | 100% | Oil & gas exploration | Cayman Islands |
| Gulfsands Petroleum Tunisia Ltd | 100% | Oil & gas exploration | Cayman Islands |
| Gulfsands Petroleum USA, Inc. | 100% | Oil & gas exploration | US |
| Darcy Energy LLC | 100% | Oil & gas exploration | US |

On 16 June 2011 Gulfsands Petroleum Syria Limited changed its name to Gulfsands Petroleum Levant Limited. Gulfsands Petroleum Levant Limited owns a 50% interest in a contractor group that has been exploring for hydrocarbons in Block 26 in Syria prior to the imposition of EU sanctions against the Syrian oil industry.

## 10. Trade and other receivables

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Prepayments and accrued income | **246** | 308 |
| Amounts due from subsidiaries (note 16) | **29,562** | 69,965 |
| | **29,808** | 70,273 |

## 11. Cash and cash equivalents

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Cash at bank and in hand | **114,819** | 68,901 |
| Restricted cash balances | **1,000** | 1,000 |
| | **115,819** | 69,901 |
| Included in long term financial assets | **1,000** | 1,000 |
| Total cash and cash equivalents | **114,819** | 68,901 |

The restricted cash balance represents an amount held in escrow to secure a line of credit for forward foreign currency trading.

## 12. Trade and other payables

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Trade payables | **218** | 517 |
| Accruals and other payables | **126** | 72 |
| UK Corporation tax payable | **-** | 31 |
| Amounts due to subsidiaries | **2,378** | 70,862 |
| | **2,722** | 71,482 |

## 13. Deferred tax assets / (liabilities)

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Tax losses carried forward | **7,247** | 5,489 |
| Unprovided deferred tax asset | **(7,247)** | (5,489) |
| Deferred tax asset / (liability) at 31 December | **-** | - |

The tax effect of amounts for which no deferred tax asset has been recognised is as follows:

| | **2011** | 2010 |
|---|---|---|
| | **$' 000** | $' 000 |
| Unutilised tax losses | 7,247 | 5,489 |
| Other short-term temporary differences | - | - |
| | 7,247 | 5,489 |

The tax losses of the Company have no expiry date.

Deferred tax assets are not provided where the Company does not consider it probable that sufficient future taxable profits will be made to offset the deductions represented by those deferred tax assets.

## 14. Share capital

See note 22 within the Financial Statements of the Group.

## 15. Obligations under operating leases

At the end of the year the Company had commitments for future minimum lease payments under non-cancellable operating leases in respect of land and buildings of $390,000 (2010: $399,000) within one year and $62,000 (2010: $499,000) between two and five years. This lease is due to expire in 2013.

## 16. Financial instruments, derivatives and capital management of the Company

The financial risks of the Company are principally in respect of balances held in bank accounts and on deposit, and balances owed to, or owed by, subsidiary undertakings. Balances owed to or owed by subsidiary undertakings are all denominated in US Dollars. Other risks are managed on a unified basis with the Group and a full disclosure of these risks is made in note 27 of the Group's Financial Statements.

The exposure of the Company to interest rate and currency movements is not significant.

A summary of the financial assets and financial liabilities of the Company is set out below:

| | Financial assets on which interest is earned $' 000 | Financial assets on which no interest is earned $' 000 | Total $' 000 |
|---|---|---|---|
| **2011** | | | |
| US Dollar | **116,731** | **38,307** | **155,038** |
| UK Sterling | **1** | **707** | **708** |
| Euro | **-** | **2,119** | **2,119** |
| | **116,732** | **41,133** | **157,865** |
| 2010 | | | |
| US Dollar | 90,415 | 74,025 | 164,440 |
| UK Sterling | 794 | 921 | 1,715 |
| Euro | - | 1,565 | 1,565 |
| | 91,209 | 76,511 | 167,720 |

| | Financial liabilities on which no interest is charged $ 000 |
|---|---|
| **2011** | |
| US Dollar | **2,658** |
| UK Sterling | **64** |
| | **2,722** |
| 2010 | |
| US Dollar | 70,862 |
| UK Sterling | 517 |
| | 71,379 |

The Company has impaired balances owed from subsidiary undertakings totalling $47.4 million ($28.4 million) in respect of activities in the Gulf of Mexico ($32.8 million), Syria ($9.7 million) and Iraq ($4.9 million). In 2010 this provision related exclusively to its Gulf of Mexico activities.

## 17. Related party transactions and key management

Key management of the Company are considered to be the Directors of the Company. There were no transactions with Directors, other than interests in shares and their remuneration and share options as disclosed in the Directors' Remuneration Report on pages 50-52.

The remuneration of Directors is set out in note 28 to the Financial Statements of the Group.

The Company traded with various undertakings within the same Group during the years ended 31 December 2011 and 2010. A summary of the transactions and outstanding balances at the year end is set out below.

**Balances owed by / (owed to) related parties**

| Name of related party | Nature of relationship | Commercial terms | **2011 $'000 s** | 2010 $'000 s |
|---|---|---|---|---|
| Gulfsands Petroleum USA, Inc. | Subsidiary | Interest rate 8% per annum | **46,040** | 56,262 |
| | | Asset impairment | **(32,760)** | (28,407) |
| Gulfsands Petroleum Tunisia Limited | Subsidiary | Non-interest bearing | **20,655** | 16,208 |
| Gulfsands Petroleum Levant Limited | Subsidiary | Non-interest bearing | **9,683** | 48,291 |
| | | Non-interest bearing | **-** | (68,507) |
| | | Impairment | **(9,683)** | - |
| All other subsidiary undertakings | Subsidiary | Non-interest bearing | **2,609** | 4,007 |
| | | Impairment | **(4,939)** | - |
| Dijla Petroleum Company | Previously proportionately consolidated | Non-interest bearing | **511** | - |

**Services recharged to related parties**

| Name of related party | Nature of relationship | Commercial terms | **2011 $'000 s** | 2010 $'000 s |
|---|---|---|---|---|
| Gulfsands Petroleum USA, Inc. | Subsidiary | All materials and services recharged at cost. Labour recharged at marked up amounts | **389** | 30 |
| Gulfsands Petroleum Tunisia Limited | Subsidiary | | **26** | 16 |
| Gulfsands Petroleum Levant Limited | Subsidiary | | **1,099** | 1,729 |
| Gulfsands Petroleum Iraq Limited | Subsidiary | | **202** | 184 |
| Dijla Petroleum Company | Previously proportionately consolidated | | **367** | - |
| Gulfsands Petroleum Levant Limited | Subsidiary | Management fee | **726** | 780 |

**Services recharged by related parties**

| Name of related party | Nature of relationship | Commercial terms | **2011 $'000 s** | 2010 $'000 s |
|---|---|---|---|---|
| Gulfsands Petroleum USA, Inc. | Subsidiary | Marked up amount | **-** | 201 |

# Five Year Summary

| | | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| Production | | | | | | |
| Production - Working Interest | mmboe | 3.1 | 3.8 | 2.7 | 1.2 | 0.8 |
| Production - Entitlement | mmboe | 1.3 | 1.7 | 1.6 | 0.8 | 0.7 |
| | | | | | | |
| Summary income statement | | | | | | |
| Revenue | $MM | 124.9 | 115.6 | 84.4 | 53.6 | 37.3 |
| Operating profit / (loss) | $MM | 56.7 | 45.5 | 29.0 | (6.6) | (4.7) |
| Net profit / (loss) to shareholders | $MM | 55.1 | 44.7 | 28.3 | (5.1) | (7.9) |
| Basic earnings / (loss) per share | US cents | 45.14 | 36.88 | 23.68 | (4.45) | (7.40) |
| | | | | | | |
| Summary cash flow statement | | | | | | |
| Net cash from operating activities | $MM | 94.3 | 70.2 | 43.5 | 20.0 | 2.7 |
| Net cash used in investing activities | $MM | (38.3) | (48.0) | (26.3) | (21.7) | (21.5) |
| Net cash from financing activities | $MM | (12.4) | 0.8 | 3.6 | 20.0 | 23.6 |
| Net increase in cash and cash equivalents | $MM | 43.6 | 23.0 | 20.8 | 18.3 | 4.7 |
| | | | | | | |
| Summary balance sheet | | | | | | |
| Total assets | $MM | 261.1 | 242.9 | 179.3 | 138.8 | 110.3 |
| Shareholders equity | $MM | 228.2 | 183.0 | 134.2 | 101.3 | 73.9 |
| Cash and cash equivalents less debt | $MM | 124.2 | 80.6 | 57.6 | 36.8 | 18.5 |

All amounts shown above include the results of the Group's Syrian operations which are required to be treated as discontinued by IFRS and are therefore non-GAAP measures.

The figures for 2007 to 2009 shown above have been restated since publication of original financial statements

# Gulfsands Petroleum plc

## Glossary of Terms

| Term | Definition |
|---|---|
| 2D seismic | Seismic data, obtained using a sound source and receivers placed in a straight line on the surface of the earth, that is processed to provide a graphic representation of a vertical cross-section through the subsurface rock layers (“seismic line”). In a 2D seismic survey, several seismic lines are recorded and the cross-sections are interpolated to yield subsurface maps on which exploration prospects can be delineated |
| 2P | Proved and Probable reserves |
| 3D seismic | In a 3D seismic survey, multiple closely spaced seismic lines are recorded and the high density of cross sections are interpolated to yield detailed subsurface maps on which exploration prospects can be delineated |
| Appraisal well | An appraisal well is drilled to assess the characteristics (e.g. flow rate) of a proved oil and gas accumulation |
| bbl | Barrel of oil |
| bcf | Billion cubic feet of gas |
| bfpd | Barrels of fluid per day |
| boe | Barrels of oil equivalent where the gas component is converted into an equivalent amount of oil using a conversion rate of 6mcf to one barrel of oil |
| boepd | Barrels of oil equivalent per day |
| bopd | Barrels of oil per day |
| CPF | Central production facility |
| CSR | Corporate Social Responsibility |
| Development well | A development well is drilled within the proved area of an oil or gas reservoir to the depth of the stratigraphic horizon known to be productive. |
| DPC | Dijla Petroleum Company, a corporate entity established in Syria pursuant to the Block 26 PSC. DPC is considered to represent both the Group’s legal interest in Dijla Petroleum Company and the associated rights to oil and gas production assets in Syria granted by the PSC |
| E&P | Exploration and production |
| EPF | Early production facility |
| Exploration well | An exploration well is drilled to find and produce oil or gas in an unproved area, to find a reservoir in a field previously found to be productive of oil or gas in another reservoir, or to extend a known reservoir |
| Force Majeure | Force Majeure is defined in the PSC as a circumstance beyond the Group’s reasonable control which may result in the Group being unable to fulfil its obligations under the PSC. Examples of force majeure include Government law, order or regulation, insurrection, riot, war, strikes and other labour disturbances, fire and flood or any “act of God”. The non-performance of obligations under the PSC is excused if the reason is because of a force majeure event. The PSC contains certain provisions to protect the interests of the Group in the case of “force majeure” being declared |
| HSE | Health, Safety and Environment |
| GIIP | Gas Initially-in-place |
| GPC | General Petroleum Corporation |
| $Km^2$ | Square kilometres |
| KPI | Key Performance Indicators |
| mcf | Thousand cubic feet of gas |
| mcf/d | Thousand cubic feet of gas per day |
| MENA | Middle East and North Africa |
| mmbbl | Millions of barrels of oil |
| mmboe | Millions of barrels of oil equivalent |
| mmcf/d | Millions of cubic feet of gas per day |
| mmstb | Millions of stock tank barrels |
| NGLs | Natural Gas Liquids |
| NGO | Non-governmental organisation |

| | |
|---|---|
| NRI | Net revenue interest |
| OMB | The Oil Marketing Bureau of the Government of the Syrian Arab Republic |
| P+P | Proved and Probable reserves |
| Possible reserves | Possible reserves are those additional reserves which analysis of geological and engineering data suggests are less likely to be recoverable than Probable reserves. The total quantities ultimately recovered from the project have a low probability to exceed the sum of Proved plus Probable plus Possible (3P) reserves, which is equivalent to the high estimate scenario. In this context, when probabilistic methods are used, there should be more than a 10% probability that the quantities actually recovered will equal or exceed the 3P estimate |
| Probable reserves | Probable reserves are those unproved reserves which analysis of geological and engineering data suggests are more likely than not to be recoverable. In this context, when probabilistic methods are used, there should be more than a 50% probability that the quantities actually recovered will equal or exceed the sum of estimated Proved plus Probable reserves |
| Proved reserves | Proved reserves are those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty (normally over 90% if measured on a probabilistic basis) to be commercially recoverable, from a given date forward, from known reservoirs and under defined economic conditions, operating methods, and government regulations |
| PSC | Production Sharing Contract |
| psi | Pounds per square inch (pressure) |
| SPC | Syrian Petroleum Company |
| SPE | Society of Petroleum Engineers |
| Stock tank barrel | A barrel of oil measured at standard temperature (60$^{o}$F) and pressure (14.7 psi) |
| STOIIP | Stock Tank Oil Initially-in-place |
| WI | Working interest |
| WPC | World Petroleum Congress |
| WTI | West Texas Intermediate (crude) |

# Gulfsands Petroleum plc

## Corporate information

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### STOCK EXCHANGE LISTING

AIM market of London Stock Exchange
Symbol : GPX