Star Energy UK Onshore Limited

Directors' report and financial statements

Registered Number: 1021095

31 December 2003

Contents

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2003.

Principal activities

The principal activities of the company are that of crude oil exploration, development and production and electricity generation.

Business review

The company made a retained profit for the year of £200,000 (2002: £1,917,000). No dividend is proposed for the year and the profit is transferred to reserves giving an accumulated deficit carried forward at 31 December 2003 of £3,364,000 (2002: £3,564,000).

Directors and directors' interests

The following directors held office during the year:

RT McKie
R Wessel
C Judd
MJ Horgan
MV Garland
A Fernando (appointed 12th December 2003)
RG Pearson

The interests in group companies of R Wessel, C Judd, MJ Hogan, MV Garland and A Fernando are disclosed in the directors' report of the parent company.

None of the other directors who held office at the end of the financial year had any disclosable interest in the shares of the company.

According to the register of directors' interests, no rights to subscribe for shares in or debentures of the company or any other group company were granted to any of the directors or their immediate families, or exercised by them, during the financial year.

Directors' report *(continued)*

Auditors

In accordance with the Companies Act 1985, a resolution for the re-appointment of KPMG LLP as auditors of the company will be placed at the Annual General Meeting.

By order of the board

Colin Judd
Director

Kempson House
Camomile Street
London
EC3A 7AN
5 May 2004

Statement of directors' responsibilities

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 of the profit or loss for that year. In preparing those financial statements, the directors are required to:

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

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

KPMG

KPMG LLP
8 Salisbury Square
London
EC4Y 8BB
United Kingdom

Report of the independent auditors to the members of Star Energy UK Onshore Limited

We have audited the financial statements on pages 5 to 18.

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

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 3, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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

Basis of audit opinion

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

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

Opinion

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

KPMG LLP
KPMG LLP
Chartered Accountants
Registered Auditor
London

5 May 2004

Profit and loss account
for the year ended 31 December 2003

	Note	2003 £000	2002 £000
Turnover	*1*	9,990	9,734
Operating costs		(5,432)	(5,579)
Depletion		(2,618)	(2,714)
Gross profit		1,940	1,441
Administrative expenses		(984)	(815)
Other operating income/(charges)		-	-
Operating profit	*2*	956	626
Profit on sale of fixed assets		-	8
Profit on ordinary activities before interest		956	634
Interest receivable and similar income	*5*	-	9
Interest payable and similar charges	*6*	(414)	(488)
Profit on ordinary activities before taxation		542	155
Tax (charge)/ credit on profit on ordinary activities	*7*	(342)	1,762
Retained profit for the year	*15*	200	1,917

All gains and losses arising during the year have been recognised in the profit and loss account and derive from continuing operations of the company. These comprise all gains and losses arising since the last annual report.

The notes on pages 8 to 18 form an integral part of these accounts.

Balance sheet
at 31 December 2003

	Note	2003 £000	2003 £000	2002 £000	2002 £000
Fixed assets					
Tangible assets	8		17,030		19,656
Current assets					
Stocks		123		181	
Debtors	9	8,650		7,786	
Cash at bank and in hand		20		67	
		8,793		8,034	
Creditors: amounts falling due within one year	10	(5,494)		(6,918)	
Net current assets			3,299		1,116
Total assets less current liabilities			20,329		20,772
Creditors: amounts falling due after more than one year	11		(1,330)		(2,205)
Provisions for liabilities and charges	13		(2,103)		(1,871)
Net assets			16,896		16,696
Capital and reserves					
Called up share capital	14		4,357		4,357
Share premium account	15		14,900		14,900
Other reserves	15		1,003		1,003
Profit and loss account deficit	15		(3,364)		(3,564)
Equity shareholders' funds			16,896		16,696

These financial statements were approved by the board of directors on 5 May 2004 and were signed on its behalf by:

Colin Judd
Director

The notes on pages 8 to 18 form an integral part of these accounts.

Reconciliation of movements in shareholders' funds
for the year ended 31 December 2003

	2003 £000	2002 £000
Profit for the financial year	200	1,917
Opening shareholders' funds	16,696	14,779
Closing shareholders' funds	16,896	16,696

The notes on pages 8 to 18 form an integral part of these accounts.

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules, and in accordance with Statement of Recommended Practice: Oil and Gas companies.

Under *Financial Reporting Standard 1(Revised 1996):Cash Flow Statements* (FRS 1) the company is exempt from the requirement to prepare a cash flow statement on the grounds that its parent undertaking includes the company in its own published consolidated financial statements.

As the company is a wholly owned subsidiary of Star Energy Limited which is incorporated in the UK, the company has taken advantage of the exemption contained in *FRS 8:Related party disclosures* and has therefore not disclosed transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties).

Decommissioning provision and asset

Licensees have an obligation to restore producing fields to a condition acceptable to the relevant authorities at the end of their commercial lives. Under *FRS 12:Provisions, Contingent Liabilities and Contingent Assets*, the discounted present value of this future cost has been provided for and capitalised within the respective cost pool. The capitalised cost is amortised through the cost pool on a unit of production basis and the increase in the net present value of the future cost (the unwinding of the discount) is included within interest payable and other similar charges.

Tangible fixed assets

The company follows the full cost method of accounting for oil and gas operations. Under this method all expenditure in connection with the acquisition, exploration, appraisal and development of oil and gas assets, including interest payable, exchange differences incurred on borrowing in respect of development projects and direct overheads are capitalised and accumulated in full cost pools on a geographical basis.

The costs of undeveloped acreage and exploration assets are excluded from the capitalised cost pool to be depleted, pending determination of the recoverable reserves attributable to such assets. Any impairment in the value of the cost pool is charged through the profit and loss account as additional depletion where it is considered that a permanent impairment of the asset value has occurred.

Proceeds from the disposal of oil and gas assets are credited against the relevant pool. Any overall surplus arising in the cost pool is credited to the profit and loss account.

Notes *(continued)*

1 Accounting policies *(continued)*

Depletion and depreciation

Capitalised expenditure within each separate cost pool is depleted on a unit of production basis. The depletion charge is based on estimates of proven and probable reserves.

Other tangible fixed assets are stated at historical cost or valuation, net of depreciation and any provision for impairment. Depreciation is calculated on all other tangible fixed assets, other than freehold land, on a straight-line basis at rates calculated to write off the cost or valuation of those assets, less estimated residual value, over its expected useful life of between 3 and 20 years.

Ceiling tests

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

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet. Exchange gains or losses on translation are included in the profit and loss account except for those incurred on borrowings in respect of development projects which are capitalised as part of the cost of the assets.

Stocks

Stocks of crude oil are stated at lower of cost and net realisable value.

Leases

Operating leases and the corresponding rental charges are charged to the profit and loss account on a straight-line basis over the life of the lease.

Assets under finance leases are included under tangible fixed assets at their capital value and depreciated over their useful lives. Lease payments consist of capital and finance charge elements, and the finance charge element is charged to the profit and loss account.

Post-retirement benefits

The company operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. The amount charged against profits represents the contributions payable to the scheme in respect of the accounting period.

Notes *(continued)*

1 Accounting policies *(continued)*

Taxation

The charge for taxation is based on the result for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Turnover

Turnover is derived from sales of oil to third party customers and from electricity sales. All turnover is derived from UK based operations. Forward contracts are sometimes used by the company to hedge the price at which oil is sold. In such circumstances turnover is recorded at the actual hedged amount.

2 Operating profit

	2003	2002
	£000	£000
Operating profit is stated after charging:		
Auditors' remuneration:		
Audit	27	29
Fees paid to the auditor in respect of other services	7	-
Depletion, depreciation and other amounts written off tangible fixed assets:		
Oil and gas assets	2,618	2,714
Other fixed assets – owned	23	35
Other fixed assets – leased	9	9

3 Remuneration of directors

	2003	2002
	£000	£000
Directors' emoluments	172	179
Compensation for loss of office	-	76
Company contributions to money purchase pension schemes	19	29
	191	284

	Number of directors	
	2003	2002
Retirement benefits are accruing to the following number of directors under:		
Money purchase schemes	2	2

The amount of emoluments paid to the highest paid director were £96,600 (2002: £87,860) and company contributions to money purchase pension schemes paid to the highest paid director were £8,558 (2002: £8,150).

The above remuneration relates to payments made by Star Energy UK Onshore Limited. The total remuneration paid to Group directors is disclosed in the Star Energy Limited consolidated accounts.

Notes *(continued)*

4 Staff numbers and costs

The average number of persons employed by the company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2003	2002
Technical	29	30
Administration	7	6
	36	36

The aggregate payroll costs of these persons were as follows:

	2003	2002
	£000	£000
Wages and salaries	1,134	1,137
Social security costs	124	119
Other pension costs	111	113
	1,369	1,369

5 Interest receivable and similar income

	2003	2002
	£000	£000
Bank interest receivable	-	9

6 Interest payable and similar charges

	2003	2002
	£000	£000
On bank loans and overdrafts	2	1
Finance charges payable in respect of finance leases and hire purchase contracts	181	213
Unwinding of discount on decommissioning provision	231	274
	414	488

Notes *(continued)*

7 Taxation

Due to the availability of tax losses and capital allowances in excess of depreciation there was no current UK corporation tax charge arising from the company's activities for the year ended 31 December 2003.

Analysis of tax credit in period

	2003	2002
	£000	£000
Deferred tax (charge)/ credit:		
Origination/reversal of timing differences	(325)	1.762
Adjustment in respect of prior periods	(17)	-
Tax (charge)/credit on profit on ordinary activities	(342)	1.762

Factors affecting the current tax charge for the current period

The assessed tax charge for the period is lower than the standard rate of corporation tax in the UK 40% (2002: 37.1%). The differences are explained below.

	2003	2002
	£000	£000
Current tax reconciliation		
Profit on ordinary activities before tax	542	155
Profit on ordinary activities at standard rate of corporation tax 40 % (2002: 37.1 %)	(217)	(57)
Effects of:		
Expenses not deductible for tax purposes	(95)	(125)
Capital allowances in excess of depreciation	(89)	1.210
Losses utilised/(generated)	267	(1.055)
Utilisation of tax losses	128	-
Interest not allowed for Supplementary Charge	(3)	(16)
Rate difference	9	43
Total current tax charge (see above)	-	-

Factors that may affect future tax charges

The future tax charge is likely to be dependent on the generation of profits from oil and gas activities which will enable the company to utilise brought forward tax losses.

Notes *(continued)*

7 Taxation *(continued)*

Deferred tax asset	**2003**	2002
	£000	£000
At beginning of year	3,136	1,374
Profit and loss (charge)/ credit for the year	(342)	1,762
At end of year	2,794	3,136

Deferred tax asset/(liability)

	2003	2002
	£000	£000
Accelerated capital allowances	(1,854)	(1,778)
Trade losses – Ring Fenced	2,737	3,119
Trade losses – Supplementary Charge	207	993
Trade losses – Non Ring Fence	863	90
Abandonment provision	841	689
Short term timing differences	-	23
	2,794	3,136

At 31 December 2003 a deferred tax asset of £3,807,000 arising in relation to brought forward trading losses has been recognised based on business projections of future profits.

At 31 December 2003 a deferred tax asset of £566,000 arising in relation to brought forward capital losses has not been recognised in the balance sheet. This would be recognised if the realisation of capital gains could be foreseen for the purposes of FRS19.

Notes *(continued)*

8 Tangible fixed assets

	UK Onshore pool £000	Other fixed assets £000	Total £000
Cost			
At beginning of year	57,866	460	58,326
Transfers	(239)	-	(239)
Additions	388	-	388
Disposals and credits to cost pool	(125)	(20)	(145)
Reassessment of abandonment liabilities	-	-	-
At end of year	57,890	440	58,330
Depreciation			
At beginning of year	38,443	227	38,670
Charge for year	2,618	32	2,650
Disposals	-	(20)	(20)
At end of year	41,061	239	41,300
Net book value			
At 31 December 2003	16,829	201	17,030
At 31 December 2002	19,423	233	19,656

Other fixed assets includes net book values of £173,378 (2002: £182,858) relating to land and buildings, £864 (2002: £1,079) relating to motor vehicles, and £27,821 (2002: £48,741) relating to fixtures, fittings, tools and equipment.

Included within the net book value of UK Onshore asset pool is £2,184,257 (2002: £2,777,172) relating to gas turbines.

Included in the total net book value of fixed assets is £2,344,635 (2002: £2,947,031) in respect of assets held under finance leases and similar hire purchase contracts. Depreciation for the year on these assets was £602.396 (2002: £507,623).

Transfers of £239,000 relate to costs incurred in respect of the gas storage project at 31 December 2002. These amounts have now been transferred to Star Energy HG Gas Storage Limited and settled through inter-company.

Disposals and credits to cost pool in 2003 include £125,000 of insurance receipts in relation to costs previously capitalised.

Included in the cost of tangible fixed assets is £42,745 (2002: £48,438) in respect of capitalised interest cost.

Notes *(continued)*

8 Tangible fixed assets *(continued)*

In accordance with *FRS11: 'Impairment of Fixed Assets and Goodwill'*, the directors reassessed the carrying value of assets contained within the UK Onshore pool. The assumptions made by the directors in performing the tests were:

	2003	2002
Oil price	**$25.00 per bbl to 2007 Inflated thereafter**	$20.00-$25.00 per bbl
Electricity price	**£19.55 per MWhr**	£16.76-£20 per MWhr
Exchange rate	**$/£1.65-$/£1.85**	$/£1.60
Inflation rate	**3.5%**	3%
Discount rate	**10%**	10%

9 Debtors

	2003 £000	2002 £000
Trade debtors	732	956
Amounts owed by group undertakings	3.772	2.358
Deferred tax assets	2.794	3.136
Other debtors	759	827
Prepayments and accrued income	593	509
	8.650	7.786

Included in other debtors are amounts due from Joint Ventures totalling £464,000 (2002: £595,000) in respect of VAT, time writing and short term financing.

Amount of debtors falling due after more than one year: £Nil (2002: £Nil).

10 Creditors: amounts falling due within one year

	2003 £000	2002 £000
Bank overdrafts	2	-
Obligations under finance leases and hire purchase contracts	874	809
Trade creditors	423	1.107
Amounts owed to group undertakings	4.004	4.199
Other creditors	108	123
Taxation and social security	36	35
Accruals and deferred income	47	645
	5.494	6.918

Notes *(continued)*

11 Creditors: amounts falling due after more than one year

	2003	2002
	£000	£000
Obligations under finance leases and hire purchase contracts	1,330	2,205

12 Obligations under finance leases and hire purchase contracts

	2003	2002
	£000	£000
Amounts payable:		
Within one year	874	809
In second to fifth years inclusive	1,330	874
In more than five years	-	1,331
	2,204	3,014

13 Provisions for liabilities and charges

Decommissioning provision	**2003**	2002
	£000	£000
At beginning of year	1,871	1,327
Charge for the year:		
Additional amounts provided	-	270
Unwinding of the discount	90	274
Effect of change in timing of abandonment	142	-
At end of year	2,103	1,871

Provision has been made for the discounted future cost of restoring producing fields to a condition acceptable to the relevant authorities.

14 Called up share capital

	2003	2002
	£000	£000
Authorised		
Equity: 87,144,893 ordinary shares of 5p each	4,357	4,357
Allotted, called up and fully paid		
Equity: 87,144,893 ordinary shares of 5p each	4,357	4,357

Notes *(continued)*

15 Share premium and reserves

	Share premium account £000	Other reserves £000	Profit and loss account £000
At beginning of year	14,900	1.003	(3.564)
Retained profit for the year	-	-	200
At end of year	14.900	1.003	(3.364)

16 Operating lease commitments

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

	2003 £000 Land and buildings	2002 £000 Land and buildings
Operating leases which expire		
Within one year	-	-
In the second to fifth years inclusive	98	83
After more than five years	-	-
Total operating lease commitments	98	83

Star Energy Limited pays these lease amounts on behalf of Star Energy UK Onshore Limited.

17 Commitments

Capital commitments at the end of the financial year for which no provision has been made, are as follows:

	2003 £000	2002 £000
Oil and gas expenditure – contracted	-	10

18 Pension scheme

The company operates a defined contribution pension scheme. The pension cost charge for the period represents contributions payable by the company to the fund and amounted to £111,113 (2002: £113,220).

There were no prepaid contributions at the end of the financial year.

Notes *(continued)*

19 Ultimate parent company

The company is a subsidiary undertaking of Star Energy Limited, its immediate parent company, which is incorporated in England and Wales.

The ultimate controlling party is European Acquisition Capital Limited, which owns the majority of the voting rights in Star Energy Limited.

The largest group in which the results of the company are consolidated is that headed by Star Energy Limited. The consolidated accounts of the group are available to the public.

The registered office of Star Energy Limited is:

Norton Rose
Kempson House
35-37 Camomile Street
London
EC3A 7AN

20 *Post balance sheet event*

On 5 May 2004, a Reorganisation Agreement was entered into with the purpose of interposing a new holding company to hold the entire issued share capital of Star Energy Limited, the immediate parent undertaking of Star Energy UK Onshore Limited as at 31 December 2003.

As part of this reorganisation, all the shares of Star Energy Limited were transferred to the new holding company, Star Energy Group plc, in a share for share exchange.

On 5 May 2004, a new senior corporate secured credit facility agreement was signed between ABN AMRO acting as an agent and Star Energy Group plc (the ultimate parent undertaking of Star Energy Limited from 4 May 2004), Star Energy Limited, Star Energy UK Onshore Limited, Star Energy (East Midlands) Limited and Star Energy HG Gas Storage Limited acting as guarantors. Under the facility agreement a term loan facility was provided for a total amount of £57.5 million with half yearly repayments starting on 30 June 2006.