Regal Petroleum plc

Annual Report and Accounts 2006

Regal Petroleum plc is an independent oil and gas exploration and production group based in the United Kingdom. The Group is focused on the exploration, development and production of oil and gas assets in Ukraine, Romania, Egypt, Greece and Liberia.

Highlights

The legal dispute over our licences in Ukraine was successfully resolved by the Supreme Court of Ukraine

The Egyptian ERB concession was farmed out to Apache with a work programme of 3D seismic and two wells

Over 800km of 2D seismic were acquired in the Barlad concession in Romania and several prospects identified for drilling

Realised prices for gas in Ukraine increased by over 40% from January 2006 to January 2007

A Joint Venture was signed with Aurelian to jointly explore the Suceava concession in Romania

Dormant Ukrainian production well SV-10 was successfully reinstated and tested at commercial rates

169MMboe

Ukraine audited 2P reserves

Chairman's Statement

The Company continues to focus its resources on assets in Eastern Europe and on value creation through both exploration and field development. Our strategic proposition remains unchanged; however, our ability to achieve our goals has been greatly enhanced in the past year.

The last year was a key period for the Company following the legal challenge to its major assets in Ukraine. Those legal proceedings were successfully concluded by year end when the Supreme Court of Ukraine endorsed Regal's title to 20 year production licenses. The Company has now embarked on a strategy that we believe will maximise value from its exciting portfolio of production and exploration assets.

The year also saw some notable developments including establishing new joint ventures in both Egypt and Romania to spread risk whilst simultaneously allowing us to deploy our capital on the production and field development activities underway in Ukraine. We have also rebuilt our senior management team to ensure the right skills and relevant experience are available within the Company for the longer term future. We will continue to employ joint ventures and have engaged Tristone Capital as advisors to assist us in finding a partner for our Ukrainian assets during 2007.

Ukraine

We entered the year with concerns over our title to the key Mekhediviska/Golotvschinska (MEX-GOL) and Svyrydivske (SV) production licences granted to Regal in July 2004 due to a legal dispute which arose in 2005 between our previous joint venture partner Chernihivnaftagasgeologia (CNGG) and the Ministry of Environmental Protection (MEP). To assist us in the process of managing the legal and strategic aspects of our business in Ukraine we appointed a new legal team and on their recommendation a strategic partner, Alberry Limited (Alberry), was introduced to support Regal on a success fee basis.

The dispute over the validity of the licences was finally resolved in December 2006 when the Supreme Court of Ukraine dismissed all claims brought by CNGG. The Court thereby affirmed the validity of the 20 year licences granted to Regal.

During the year, as a result of the ongoing litigation, the MEX-GOL and SV field pilot production facilities were shut-in twice. Uninterrupted production, however, recommenced in August 2006 and through to the year end, average daily production from the five Regal wells was 3.85 million standard cubic feet of gas and 447 barrels of condensate. Free cash flow was generated from these operations and was partially repatriated to the UK. Upper limits on gas prices set by the Ukrainian Government rose from $2.37 per thousand cubic feet in January 2006 to $3.07 per thousand cubic feet by year end. A further significant upward revision to $4.03 per thousand cubic feet occurred in early 2007 as Russia progressively seeks to eliminate the discount paid by Ukraine for imported gas. This trend of increasing prices appears set to continue in the coming years and underpins value in our field development operations.

To accelerate the development of the fields it was decided to acquire 3D seismic data over the MEX-GOL field and, if successful, to extend the survey over the SV field in subsequent years. Mobilisation of the Ukrgeofizika crew was under way at year end and the survey was successfully completed in May 2007.

Additionally, we were able to re-open the SV-10 well and after coiled tubing conveyed nitrogen lift, we obtained a stable and commercial flow rate which has been tied in to the existing facilities. We also expect to recommence drilling on the delayed development plan as soon as the required rig can be refurbished and a commercial contract agreed.

Egypt

Regal acquired a 100% interest in a prospective onshore concession, East Ras Budran, in the Gulf of Suez in 2004. In 2006 Regal sought a joint venture partner and in October farmed-out the concession to Apache Khalda Corporation LDC (Apache) who entered the partnership with a 75% working interest and returned to Regal back costs totalling $4.85 million. Apache immediately acquired an aeromagnetic survey and have subsequently acquired an extensive new 3D seismic survey. Two exploration wells are committed in the concession. Apache, as operator, will drill those in 2007, with the first commencing in June.

Romania

The Company holds two large under-explored licences in Romania where there is considered to be good potential to find gas accumulations. In September 2006 we concluded a 50% farm-out with Aurelian Oil and Gas plc (Aurelian) on the northern, Suceava block, under which Aurelian agreed to carry Regal on a 2D seismic programme and an exploration well. Their 2D seismic (totalling 160km) has been completed and drilling of a well is planned for July 2007. In the Barlad block, where Regal maintains a 100% working interest, an additional 800km of 2D seismic was acquired and interpreted. Using the new seismic data drilling locations have been defined for two wells which are scheduled to commence in late third quarter 2007.

Greece

Throughout the year the status quo has been maintained on the Company's Greek interests. Kavala Oil S.A. (Kavala Oil) has been operated by local management and the Workers Union and Regal has neither invested nor received any dividend on its previous investments. In the second half of the year active approaches were made to potential buyers with a view to Regal divesting its holding in Eurotech S.A. (Eurotech), the Kavala holding company. Sales discussions

were not concluded by year end and are ongoing in 2007; however, I remain confident that a partner for the Regal position can be found.

Financial

Regal posted a consolidated loss of $109.2 million in 2006 which reflects exceptional non-cash charges resulting from the agreement with Alberry to assist in securing the validity of the Ukranian licences ($48.9 million) and $43.7 million reflecting the impairment of the Greek assets carried as an investment.

Turnover from sales of gas and condensate in Ukraine was $10.9 million (2005: $13.9 million) down due largely to the shut-ins associated with the legal dispute, although partially offset by higher commodity prices. Over the year the Company received an average price of $105 per thousand cubic metres ($2.95 per Mcf) for gas and $53 per barrel for condensate.

Net cash outflow from operating activities for the year was $11.8 million (2005: outflow $30.5 million) and at the end of 2006 the Group had no long-term borrowings and cash balances of $13.0 million (2005: $34.9 million). This places the Company in a secure position going forward with various options available for future financing.

Management

During the year, with the support of our shareholders, we have had a number of management and Board changes. The result is that we have simplified and strengthened our management approach. We have been successful in appointing a new CEO, Neil Ritson, who has a wealth of industry experience and have appointed a new COO, David Scott. Early in 2007, we also appointed a new CFO, Gordon Stein.

Outlook for 2007

The year ahead is set to be a critical one in terms of short-term value creation within the Company. Our focus will be on four key areas: the ongoing field development operations in Ukraine which we hope will lead to a reserves update in the fourth quarter; the search for a joint venture partner to work with us to accelerate the Ukrainian development project; a significant exploration programme with the drilling of five wells in Romania and Egypt; and finally the continued process of strengthening corporate governance with the probable addition of new Board members and advisors; a process which commenced with the appointment of Mirabaud Securities as joint broker in February 2007.

The developments in 2006 have paved the way for a bright future for Regal. We hold excellent assets and have a strong and experienced management team, which together can drive future value creation. I would like to thank the shareholders, the Board and the staff for their ongoing support.

Francesco Scolaro
Chairman

Operational Review

Licence Areas

Regal Petroleum has interests in five countries – Ukraine, Romania, Egypt, Greece and Liberia.

Ukraine

Regal is the operator of two significantly under-developed gas and condensate fields located in the prolific Dneiper-Donets basin in the north-east of Ukraine. Regal received irrevocable confirmation from the Supreme Court in December 2006 of the validity of its Ukrainian licences and is actively seeking a strategic partner to assist in the acceleration of full field development, which will be implemented using modern technology, to significantly boost production.

Romania

Regal has continued to progress the exploration of its two large onshore licences in north-eastern Romania. Additional seismic data has been acquired in both the Barlad and Suceava blocks and a number of well locations have been selected for drilling in 2007. During 2006 Regal farmed-out a 50% working interest in the Suceava block to Aurelian who have now assumed operatorship. Regal retains a 100% working interest and operatorship in the Barlad block.

Egypt

During 2006 Regal continued to progress exploration in the East Ras Budran Concession with preparation for an initial well. The Company entered into a joint venture in October 2006 with Apache. Regal, in conjunction with Apache, is undertaking an active exploration campaign in 2007 involving both 3D seismic and drilling.

Greece

Through its wholly owned Greek subsidiary, Eurotech, Regal owns a 95% economic interest in Kavala Oil which operates the Prinos Field and associated infrastructure in the northern Aegean Sea. Production continued throughout 2006, however, Regal exercised no direct management control which was passed to local management in 2005.

Liberia

Regal has signed production sharing contracts (PSCs) for two offshore blocks in the Republic of Liberia with partner European Hydrocarbons Limited. Regal holds a 25% working interest. These contracts have not yet been ratified by the Liberian Government.

Operational Review

Ukraine

Regal is the operator of two significantly under-developed gas and condensate fields located in the prolific Dneiper-Donets basin. Regal received irrevocable confirmation from the Supreme Court in December 2006 of the validity of its Ukrainian licences and is actively seeking a strategic partner to assist in the acceleration of full field development and to significantly boost production.

Licences

Regal holds a 100% interest in and is operator of the Mekhediviska-Golotvschinska (MEX-GOL) and Svyrydivske (SV) licences, onshore Ukraine. The 20 year production licences, for which royalties and taxes are payable to the State, cover a combined area of 269 square kilometres and contain two large, commercial gas condensate accumulations. Although the two licences are formally classified as separate fields, the individual gas condensate reservoirs extend across the MEX-GOL and SV licence boundaries.

In August 1999, after several years of reviewing potential assets in Ukraine, Regal signed a Joint Venture Agreement with the State-owned drilling and exploration company Chernihivnaftagasgeologia (CNGG) to jointly explore, appraise and create pilot production from the MEX-GOL and SV fields. Regal held a 75% working interest in this Joint Venture (JV) and was operator. During this phase Regal drilled two additional wells, re-interpreted the existing 2D seismic data, worked over several existing wells and constructed the Yachniki gas gathering and export infrastructure.

When the exploration licences expired in June 2004, Regal applied for a production licence over the combined MEX-GOL field and, separately, over the SV field. These licences were granted to Regal in July 2004 and are valid for the recovery of commercial reserves from the fields, with an initial term set at 20 years.

In September 2005 CNGG filed a case with the Kiev Commercial Court citing its parent organisation, the Ministry of Environmental Protection (MEP), as being in breach of certain requirements in the granting of the production licences to Regal. After two years of legal proceedings the Supreme Court of Ukraine finally found in favour of the MEP, thereby confirming Regal's title to the MEX-GOL and SV licences. The decision of the Supreme Court cannot be further appealed.
Due to the legal action pursued by CNGG, the asset was effectively in force majeure during much of 2006 until the final resolution of the legal dispute.

Within the Company's licences, a Ukrainian State Company, Ukrnafta, owns six wells and remunerates Regal for the use of its production licences through a JV which attributes 7% of net revenue to Regal.

Technical

The two fields, MEX-GOL and SV, are located approximately 180km east of Kiev in the north-east of Ukraine, within the prolific Dnieper-Donets sedimentary basin which contains about 90% of all Ukrainian gas and condensate production.

The MEX-GOL and SV fields contain 11 mapped gas bearing horizons in the Lower Carboniferous, ranging in depth from 4,700 metres to 6,000 metres. The oldest rocks penetrated to date belong to the Lower Carboniferous Tournaisian formation which consists of interbedded limestone, shale and sandstone with a combined gross thickness of approximately 1,000 metres. Three gas bearing zones have been identified in the Tournaisian, however, due to local rig limitations only five wells have penetrated this horizon, which lies at depths of more than 5,700 metres. The available data suggests these zones contain dry gas within low porosity sandstone reservoirs, while the trapping mechanism appears to be a combination of stratigraphic, structural and fault seals. The Tournaisian could be a source of potential reserves upside since these reservoirs have not been included in the 2P reserves.

The MEX-GOL-SV field area is covered by a grid of 2D seismic data totalling in excess of 800km. The data was acquired by the State geophysical company, Ukrgeofizika, from the 1960s until 1995. This existing seismic data has been combined with the extensive well data over the field to define the field structure.

Given the variable nature of the reservoir and the likelihood that it may be possible to image areas of better reservoir development, Regal commenced the acquisition of a 100km^2 3D seismic survey over the MEX-GOL licence area in January 2007. These data are expected to yield detailed fault configurations and some reservoir scale information in addition to improved structural definition. The field acquisition was completed in May 2007 and once processed by Ukrgeofizika the data is expected to be available for interpretation in the third quarter 2007, leading to a new reserves determination in late 2007. It is planned that a similar survey will also be acquired over the SV licence area in 2008.

Production

Gas and condensate from Regal's wells in the MEX-GOL and SV fields is sent to the Regal-owned Yachniki processing facilities. After treatment, gas is exported via a Company-owned high capacity export line which connects to the Majestral international export pipeline. Condensate is evacuated by road tanker and sold to the local market.

Production in the MEX-GOL and SV fields was adversely affected by the licence litigation in 2006, with two field closures during the year; one from 1 February to 16 March and the second from 6 May to 31 July (a total of 131 days). The average daily production between 1 August and 31 December 2006 was 3.85 MMcf of gas and 447 bbls of condensate, totalling 1,134 boepd.

As part of a planned campaign to reactivate dormant wells and increase production from existing wells, the SV-10 well on the SV field was nitrogen lifted using coiled tubing in early October 2006 and placed on production test in mid November 2006 until February 2007 during which time average flow rates of approximately 46,000 m^3d of gas (1.62 MMcfd) and 8.5 m^3d (50 bopd) of condensate were achieved. Permanent production from the SV-10 well was established in late May 2007 after the construction of a 4km pipeline to connect the well to the Yachniki gas gathering facility. The additional production from SV-10 is forecast to increase the daily volume by some 25% in the second half of 2007.

Development

The MEX-GOL and SV fields are in the very early stages of development based on the existing field development plans which were approved by the relevant Ukrainian State authorities in 2005. These development plans include the drilling of new vertical production wells (11 in MEX-GOL, 6 in SV) and the installation of additional processing facilities. Although the production licences presently extend to mid 2024 there is potential to extend the licences to recover any remaining reserves.

To date only a fraction of the expected gas-initially-in-place in the fields has been developed through the existing production wells. Building on the results and experience of operating the current development, Regal has prepared a conceptual field development plan to target the large remaining in-place volumes.

The new conceptual development plan anticipates development by vertical, deviated and multi-lateral wells, using modern proven drilling and production technologies and practices based upon a sub-surface model which will draw upon the new 3D seismic data. The conceptual plan envisages the drilling of

Operational Review

Ukraine

70 wells reaching production rates in excess of 240 MMcfd of gas and 8,800 bopd of condensate in 2016.

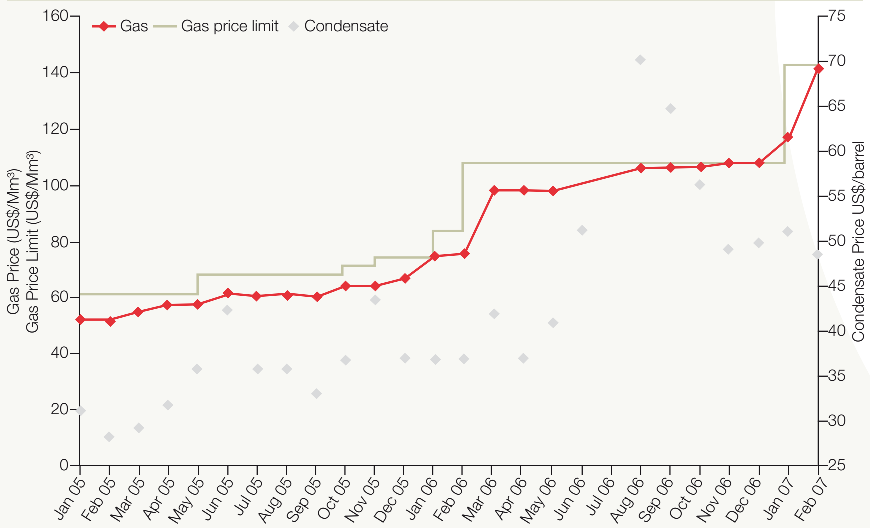
The new plan also includes a second gas gathering station to be constructed for the SV field as well as five infield manifolds and up to 350km of flowlines. It is the intention to continue to refine this plan and submit a revised Field Development Plan to the Ukrainian authorities in late 2007/early 2008.

Gas Marketing

Gas and condensate is currently sold in the Ukrainian domestic market where gas prices continue to increase and where prices are anticipated to converge with European border prices within the next five years. The present consensus is that European border prices will be in the range US$220-260/Mm³ when convergence occurs. During the second half of 2006, Regal realised an average sales price of US$3.05/Mcf (US$107.7/Mm³) for gas and US$57.34/bbl for condensate.

The chart below shows a continuous increase in realised domestic gas prices over the last two years. The Ukrainian Government-imposed gas price limits are also illustrated. The price cap at the end of May 2007 was $142.57/Mm³ (net of VAT).

MEX-GOL-SV Historic Gas and Condensate Prices Achieved (net of VAT)



Reserves

During the course of its involvement in the licence areas, Regal has undertaken a number of independent reserve audits on the fields. In each of these audits, the two licence areas have been taken as one subsurface accumulation. It should be noted that in these audits, reserves have been categorised as either proven and/or probable, no possible reserves have been attributed at this stage. It is considered likely that significant volumes of possible reserves would be assigned to the fields if a determination was undertaken. The most recent reserves audit was conducted by Ryder Scott in 2005 and is the basis for the Company's present published Ukrainian proven and probable (2P) reserves of approximately 169 MMboe.

Proven and probable reserves (2P)

	Gas MMcf	Condensate Mbbls	Total Mboe
As at 1 January 2006	811,314	25,110	169,671
Production	(914)	(101)	(261)
As at 31 December 2006	810,400	25,009	169,410

Operations

In 2003 Regal built new gas processing facilities designed to process sweet gas and hydrocarbon liquids at MEX-GOL with an initial plant capacity of 450,000 m³d of gas and 60 m³d of condensate. In May 2005 the plant was expanded to incorporate additional gas and condensate handling and the current capacity and production levels are summarised in the table below.

Regal Yachniki Gas Processing Facility – Capacity and Production

Gas processing capacity	700,000 m³d
Condensate processing capacity	200 m³d
Condensate storage	1,000 m³
April 2007 production from Regal wells	120,000 m³d of gas 50 m³d of condensate
Gas export capacity	1,500,000 m³d

169MMboe

Ukraine audited 2P reserves
per Ryder Scott

Regal has approximately 80 staff based at its Yachniki operating base, MEX-GOL production facility and well sites. There is a Ukrainian head office in Kiev where the Director General for Regal Ukraine is based along with a small number of additional staff, whilst the head office accounting staff are currently based in Chernigiv.

Forward Plan

The Company is committed to realising the full potential of the reserves in its Ukrainian assets and in early 2007 appointed Tristone Capital to seek a strategic partner to assist in the acceleration of full field development. It is envisaged that a strategic partner will take an interest in the region of 50%, with the possibility that the partner will participate in the operatorship of the fields. The partial divestment plan involves a targeted approach to pre-qualified potential partners and this process began in April 2007.

Whilst it is hoped that the full field development will commence in early 2008, the Company plans to spud a new well (MEX-103) in August 2007 using a CNGG rig as the start of a new phase of field expansion.

If the partial divestment process is successful the Company will fund its share of the full field development from a mixture of funds raised from the partial divestment, development costs carried by the new partner or from debt raised from banks and financial institutions based on future cash flows. Should an appropriate partner not be found the full field development is intended to be financed through a combination of debt, equity and reinvestment of free cash flow.

Operational Review

Romania

Regal has continued to progress the exploration of its two large onshore licences in north-eastern Romania. Additional seismic data has been acquired in both the Barlad and Suceava blocks and a number of well locations have been selected for drilling in 2007. During 2006 Regal farmed-out a 50% working interest in the Suceava block to Aurelian who have now assumed operatorship. Regal retains a 100% working interest and operatorship in the Barlad block.

Licences

The Suceava block is a 4,103 square kilometre exploration licence which lies east of the Carpathian Mountains and is located exclusively on the Moldavia Platform. The licence was granted in 2004 and has a potential 30 year term. The commitments for the first exploration term of 1,000km of 2D seismic and two exploration wells (SE-1 and RSD-1) have been fulfilled. A protocol with the Romanian authorities has been signed for a second exploration term, until 2009, and the work programme obligations are under discussion.

In September 2006 Regal farmed-out a 50% working interest in the Suceava block to Aurelian in return for their acquiring 160km of 2D seismic and the drilling of one exploration well at their sole cost. The 2D seismic has been acquired and the 'earn-in' well is planned for mid-year 2007.

The Barlad block covers an area of 6,285 square kilometres and is located immediately south of the Suceava block. The award was ratified in 2005 and by the end of 2006 all seismic commitments (1,000km) had been fulfilled. This block is situated within the Moldavia Platform and a less well explored geological zone known as the Barlad Depression. The licence has a potential 30 year term. The drilling of two wells in 2007 will conclude the commitments for the first exploration term which expires in 2008.

Regal continues to hold 100% working interest in the Barlad licence and to operate through its wholly owned Romanian subsidiary based in Bucharest. The Company has indicated a willingness to share the risk of further exploration with a joint venture partner in a farm-out, but at this time a suitable partner has not been found. Regal intends to continue to pursue exploration within the licence given the relatively low cost associated with the drilling of wells.

Technical and Operations

The two licence blocks lie adjacent to each other to the east of the Carpathian Mountains in the area broadly known as the Moldavia Platform. Gas and gas/condensate fields in this part of Romania have reserves commonly in the range 10 to 50 billion cubic feet, however, the Roman gas field, which lies 10km west of Barlad, has quoted reserves in excess of 300 billion cubic feet.

In early 2006 the main activity on the Suceava block was the interpretation of the results of the earlier RSD-1 well drilled to a depth of 1,248 metres and completed in November 2005. Preparations for a further campaign of 2D seismic acquisition were commenced and transferred to Aurelian in September 2006. Aurelian subsequently acquired 161km of 2D seismic data, completing field operations in late November 2006.

After ratification of the Barlad block Regal acquired 200km of new 2D seismic data and reprocessed some 800km of existing data previously acquired by the Romanian State oil company. These data were integrated and the decision was made to acquire further 2D

10,388km^2

Total exploration licence area

seismic data to improve prospect definition in the Barlad Depression and to explore the northern portion of the block where no seismic data had so far been acquired. As a result, in 2006, Regal acquired a further 803km of 2D seismic data which was processed and fully interpreted by year end. This seismic, along with the earlier data, has led to the definition of over 10 leads of which several have been matured as potential drilling targets. These leads are potential gas accumulations in the shallow Sarmatian formation and the immediately underlying Eocene formation. The drilling of two of these leads; RBN-3 and RBN-4, to a depth of approximately 1,200 metres and 900 metres respectively, is envisaged for late third quarter 2007. Regal's best estimate of prospective resources in these two leads totals 90 billion cubic feet.

Any discovery of commercial quantities of gas in the Suceava and Barlad blocks can be rapidly tied in to existing local gas infrastructure.

Forward Plan

Regal expects that three wells will be drilled in 2007, one in the Suceava block and two in the Barlad block. Each of these wells will test independent shallow gas prospects on the Moldavian Platform. The dry hole cost of each well in the Barlad licence is estimated to be around $1.5 million. The Suceava well will be drilled at Aurelian's sole cost in accordance with the farm-out agreement.

Following completion of the planned drilling, the Company will review future activity and define a new work programme to further pursue the exploration and development potential within the licences. The acquisition of both 2D and 3D seismic and the drilling of further wells will be actively considered.

Operational Review

Egypt

During 2006 Regal continued to progress exploration of the East Ras Budran Concession with preparation for an initial well. The Company entered into a joint venture in October 2006 with Apache. Regal, in conjunction with Apache, is undertaking an active exploration campaign in 2007 involving both 3D seismic and drilling.

Licence

The East Ras Budran concession is a 521 square kilometre exploration concession wholly onshore on the Sinai Peninsula in Egypt. Regal acquired the concession rights in December 2004. The concession agreement provides for exploration in the East Ras Budran area for an initial period of three years (ending in September 2007) with the right to extend this for a further four years. The concession can be converted to a production licence if commercial hydrocarbons are found and plans for development submitted and approved by the Egyptian authorities.

In October 2006 Regal farmed-out a 75% working interest in the East Ras Budran concession to Apache in return for their paying $4.85 million, a sum equivalent to the proportional costs expended by Regal on the concession. Under the terms of the farm-out, Apache agreed to participate in a US$12 million exploration programme. Following completion of the farm-out Apache assumed the role of operator and initiated the exploration work programme including, an aeromagnetic survey, the acquisition of 100km^2 of 3D seismic and two exploration wells which will be funded according to the working interests (75% Apache; 25% Regal).

The 3D seismic was subsequently acquired in early 2007 and the exploration wells are due to commence in mid-2007.

Technical and Operations

The East Ras Budran concession is prospective mainly for pre-Miocene reservoirs which contain oil in several large discoveries adjacent to the concession. These nearby fields are large and include the 270 MMbbls Ras Budran field and the 1 billion barrel October field which are 4km and 15km away respectively. The Nubian D and C (Paleozoic) and the Nubian A (Lower Cretaceous to Cenomanian) sandstones are the most prolific regional reservoirs. Additional potential has also been identified in the shallower Thebes limestone (Eocene) which also constitutes a secondary source rock.

In early 2006, Regal's main activity in Egypt related to the planning and preparation for an initial exploration well. In order to reduce the technical risk on the selection of a drilling location, Regal tendered for a 3D seismic acquisition programme. Preparations for this seismic campaign were transferred to Apache in the fourth quarter. Apache subsequently acquired approximately 100km^2 of 3D seismic, completing field operations in early March 2007. In addition to the 3D seismic survey, an aeromagnetic survey covering some 500km^2 of the Baba Plain was undertaken to assist in finalising the location of future exploration wells.

The concession area includes the production facilities for the Ras Budran offshore oil field, which due to production decline are currently significantly under-utilised. Any discovery of commercial quantities of hydrocarbons in the East Ras Budran concession could therefore be rapidly tied in to these existing treatment and export facilities. This would substantially reduce the economic threshold of commerciality of any development.

Forward Plan

In accordance with the farm-out agreement with Apache, it is planned to drill two back-to-back wells in 2007. The drilling of these wells will satisfy the conditions of the initial three year period of exploration stipulated in the concession agreement. Both rig slots have been secured and the first well is expected to spud in late quarter two following the arrival of a Precision Drilling International rig which is under contract with Apache for two years. The dry hole costs of wells in the East Ras Budran concession are estimated to average $4.5 million.

The first well is planned to explore reservoirs in the Thebes formation (3,600m) and targets a trap Regal estimates to contain prospective resources in the range of 5 to 50 MMbbls. The location for the second well will be determined once the results of the 3D seismic survey and other data have been fully interpreted.

Following the completion of the planned drilling the Company, with Apache, will review future activity and define a new work programme to further pursue the exploration and development potential within this concession and any adjacent open acreage.

Operational Review

Greece

Through its wholly owned Greek subsidiary, Eurotech, Regal owns a 95% economic interest in Kavala Oil which operates the Prinos Field and associated infrastructure in the North Aegean Sea.

Licence
Kavala Oil was created by special Law 2779 and has rights to produce the Prinos and South Kavala fields through facilities owned by the Greek State. Regal, through Eurotech, owns a 95% economic interest in Kavala Oil. In 2005 following a period of production decline and industrial unrest it was agreed to hand over management of Kavala Oil to local management and the Workers Association. That situation persists today.

Technical
The Prinos field was discovered in 1973 and has produced approximately 104MMbbls of sour crude. Adjacent discoveries, Prinos North and Epsilon, hold estimated proven and probable reserves of 15MMbbls (McDaniels & Associates Consultants Ltd, 2005). During 2004 and 2005 Regal drilled the Kallarachi 1 and 2 exploration wells, however, despite the presence of hydrocarbons, Regal determined the Kallarachi structure could not be economically developed.

Reserves
The table below details estimated reserves as audited by McDaniels in September 2005.

Proven and probable reserves (2P)

	Condensate Mbbl	Crude oil Mbbl	Total Mboe
As at 1 January 2006	3,881	17,036	20,917
Estimated production	–	(730)	(730)
As at 31 December 2006	3,881	16,306	20,187

Forward Plan
Due to the continuing difficulties faced by Regal in realising the full potential of the assets operated by Kavala Oil the Company has taken the strategic decision to seek a buyer for its shareholding in Eurotech. Discussions with a number of potential buyers were conducted through the latter part of 2006 and are continuing in 2007.

Liberia

Regal has signed production sharing contracts for two offshore blocks in the Republic of Liberia with partner European Hydrocarbons Limited. These contracts have not yet been ratified by the Liberian Government.

Licence
Through a Liberian Government tender process Regal was awarded, jointly with European Hydrocarbons Limited, production sharing contracts (PSCs) for two concessions, Block 8 and Block 9. Regal holds a working interest of 25%.

The PSCs were signed in June 2005 by the National Oil Company of Liberia. Following the election of a new government in democratic elections in late 2005 a due diligence process for all government contracts was initiated under the scrutiny of the international community. Some elements of the model PSC were reopened for further discussion with all operators awarded PSCs in 2005. Regal has collaborated in this process and has indicated its willingness to modify some terms of the agreements to bring them broadly in line with international best practice. Other terms have not as yet been concluded.

At the end of 2006 the two PSCs continued to be discussed, and no timetable has been agreed for their possible ratification.

Technical
The two blocks are of frontier offshore acreage and cover a combined area of 7,200 square kilometres. Water depths range from 200 metres to over 3,000 metres at the deepest point.

As a condition of the award, regional speculative 2D seismic data was acquired at a gross cost of $960,000 and has been fully interpreted. Hydrocarbon plays and leads have been identified which require more detailed data collection and analysis.

Forward Plan
Liberia has no indigenous oil and gas production and the Liberian offshore is one of the remaining untested portions of the West African margin. Regal plans to seek to conclude negotiations on the PSCs and commence seismic operations when conditions are agreed.

Financial Review

Overview
The financial performance of the Group in 2006 was detrimentally impacted by the legal actions in Ukraine and by the continuing lack of operational control throughout the year in Greece. As a result, the Group was required to post two exceptional non-cash charges totalling $92.6 million in 2006 for Ukraine and Greece which contributed significantly towards the $109.2 million loss for the year; $48.9 million related to an exceptional charge resulting from the agreement with Alberry to assist in securing the validity of the Ukraine licences and $43.7 million was attributable to the impairment in the value of the Group's investment in Greece. In taking these actions in 2006, however, the Group is in a much stronger position to deliver shareholder value from its Ukrainian, Romanian and Egyptian assets in 2007 and beyond.

Despite its problems in Ukraine and Greece, the Group continued to invest in its asset portfolio in 2006, increasing its fixed asset position throughout the year by $16.1 million, offset by $4.2 million received from Apache as a proportionate reimbursement of capitalised back-costs from the Egyptian farm-out. This programme of investment in 2006 has provided a solid platform for the five well drilling campaign in Romania and Egypt which is due to commence in mid 2007.

Turnover
The Group's turnover for the year was adversely affected by the legal issues in Ukraine which resulted in two production shutdown periods in the year totalling 131 days. Turnover for the year generated from the sale of gas and condensate production from wells MEX-102, MEX-3, SV-10, GOL-2 and GOL-1 in Ukraine was down from $13.9 million in 2005 to $10.9 million in 2006 due largely to the shut-ins associated with the legal dispute, although partially offset by higher commodity prices. Included in turnover for 2005 was $23.4 million relating to the sale of oil and sulphur production from Kavala Oil in Greece. The results for Kavala Oil for the 2006 year have not been consolidated in the Group's financial statements as the Group's interest in Kavala Oil is treated as an investment, the value of which has been fully impaired at the end of 2006.

All gas and condensate production in Ukraine was sold locally at an average price of $105 per thousand cubic metres of gas and $53 per barrel of condensate over the year.

Cash Flow
Net cash outflow from operating activities totalled $11.8 million (2005: outflow $30.5 million). The capital expenditure outflow of $11.8 million (2005: $41.7 million) relates to development and exploration expenditure across the Group.

As at 31 December 2006, the Group had total cash balances of $13.0 million (2005: $34.9 million). The Group, at 31 December 2006, had no long-term bank debt.

Financial Risk
The main financial risks Regal are exposed to are resource price, exchange rate, counterparty and liquidity risks in its Group operations. Wherever possible the Group attempts to minimise the impact of such risks. The farm-out campaigns in Romania and Egypt in 2006 were, for example, undertaken to reduce the portfolio risk within the Group.

To minimise exchange rate risks, Regal attempts to match currency receipts and payments wherever possible. Regal also seeks to retain sufficient liquidity, either in the form of cash or maturing deposits, to manage the Group's ongoing activities.

During the year the Group recognised foreign exchange gains of $0.5 million in the profit and loss account as well as a $4.3 million movement in the foreign exchange reserve. This is attributable to currency fluctuations during the year.

Funding Position
The Company will fund its share of field developments from a mixture of funds raised from the potential partial divestment of Ukraine, development carries by the new partner from that partial divestment, cash flows generated from production, or from debt raised from banks or financial institutions based on future cash flows. The Company continues to examine all potential funding options and has been in active discussions with some major banks in this regard in 2007.

Contingent Liabilities
As the licence litigation in Ukraine has been finalised by the Ukraine Supreme Court, the Group no longer recognises a contingent liability in this respect.

Summary
The Company is committed to realising the full potential of its assets. This means instigating development work on its licences with proved and probable reserves and raising funds by either selling down a percentage interest or using financial instruments based on future cash flows. With the resolution of the legal title issue in Ukraine, and with the support of new partners in Romania and Egypt, the Company is in a much stronger financial position going into 2007 than was the case at the start of 2006. This enhanced platform will enable the Group to seek to optimise its asset portfolio in 2007 and beyond through a focused programme of investment to significantly improve shareholder value and returns.

G B Stein
Chief Financial Officer

Board of Directors and Senior Management

Francesco Scolaro
Non-Executive Chairman
Mr Scolaro was appointed as Non-Executive Chairman in October 2006, having previously served as a Non-Executive Director. He was educated as a lawyer and has actively pursued a career as an investor in publicly quoted companies in the resource, leisure and property sector.

Neil Ritson
Chief Executive Officer
Mr Ritson has had a lengthy and broad international career as an executive in the oil and gas industry. Mr Ritson spent 22 years with BP moving through senior technical roles into executive management. His roles within BP included International Chief Geophysicist, Business Unit Manager for BP Norway and Vice President Exploration for BP Alaska. In 1999 Mr Ritson joined Burlington Resources Inc becoming Vice President, London Division and subsequently being appointed Vice President, International Business. Mr Ritson was appointed Chief Executive Officer in October 2006, having previously served as a Non-Executive Director.

Lord Anthony St John of Bletso
Non-Executive Director
Lord St John is the longest serving member of the Board. A qualified solicitor, Lord St John is a Crossbench Member of the House of Lords and a Member of the House of Lords European Union Sub-committee B on Trade, Finance and Foreign Affairs. He is currently retained as a consultant to Merrill Lynch, specialising in parliamentary liaison and emerging markets. In addition, Lord St John serves as the Chairman of Estate and General and Chairman of the Governing Board of Certification International.

Gordon Stein
Chief Financial Officer
Mr Stein has over 17 years experience in the upstream oil and gas sector both in the UK and internationally. His experience includes senior finance and operational management positions with BG, Centrica, Monument Oil & Gas and LASMO. Between 2001 and 2005 Mr Stein was a founder and Finance Director of Acorn Oil & Gas. From 2005 Mr Stein was a founder and Head of Finance & Company Secretary with Fairfield Energy, an upstream oil company focused on the North Sea.

David Scott
Chief Operating Officer
With over 25 years experience in operational management in the oil and gas industry Mr Scott was appointed Chief Operating Officer in October 2006. Trained in mechanical engineering, Mr Scott's career started with Conoco working within drilling and engineering roles for nine years before joining Enterprise Oil. He then spent time with Hardy Oil & Gas before joining Burlington Resources, where he remained for eight years, leading to a position of General Manager Drilling & Production.

Christopher Phillips
Company Secretary & General Counsel
Mr Phillips is a solicitor with over 19 years experience in corporate and resources law. He is qualified in both England and Australia, having worked for some years in each jurisdiction. Mr Phillips specialises in corporate finance, mergers and acquisitions, and natural resources projects.

Financial Contents

Corporate Governance Statement

Companies on the Alternative Investment Market of the London Stock Exchange are not required to comply with the Combined Code and due to its size the Company is not in full compliance.

The Board

The Board of the Company consists of one executive director and two non-executive directors. The composition of the Board ensures that no one individual dominates the decision making process.

The Board is responsible to the shareholders for setting the direction of the Company through the establishment of strategic objectives and key policies. The Board meets on a regular basis and considers issues of strategic direction, approves major capital expenditure, appoints and monitors senior management and any other matters having a material effect on the Company. Presentations are made to the Board by senior management on the activities of operations and both executive and non-executive directors undertake regular visits to operations.

All directors have access to management, including the Chief Financial Officer and the Company Secretary, and to such information as is needed to carry out their duties and responsibilities fully and effectively.

Furthermore, all directors are entitled to seek independent professional advice concerning the affairs of the Company at its expense. All directors are subject to election by shareholders at the first opportunity following their appointment. In addition, directors will retire by rotation and stand for re-election by shareholders at least once every three years in accordance with the Company's articles of association.

The non-executive directors are interested in ordinary shares and hold options in respect to ordinary shares. The Company does not consider that these interests, which serve to align their interests with shareholders generally, adversely affect their independence as non-executive directors.

Remuneration Committee

The Remuneration Committee, comprising solely of independent non-executive directors, is responsible for establishing and developing the Company's general policy on executive and senior management remuneration and determining specific remuneration packages for executive directors.

The Remuneration Committee presently comprises: Lord St John of Bletso and F Scolaro.

Audit Committee

The Audit Committee, comprising solely of independent non-executive directors meets not less than twice a year and considers the Company's financial reporting (including accounting policies) and internal financial controls. Meetings are normally attended, by invitation, by the Chief Financial Officer and a representative of the auditors.

The Audit Committee presently comprises: Lord St John of Bletso and F Scolaro.

Nomination Committee

The directors do not consider that, given the size of the Board, it is appropriate to have a Nomination Committee. The appropriateness of such a committee will, however, be kept under regular review by the Company.

Internal Controls

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

Internal controls and business risks were monitored in the course of 2006 through regular Board meetings.

Communication with Shareholders

The Board recognises that it is accountable to shareholders for the performance and activities of the Group.

The fifth annual meeting of the Company will provide an opportunity for the directors to present to the shareholders a report on current operations and developments and enable the shareholders to express their views about the Company's business.

The annual report, together with other information about the Group is available on the Group's internet website at www.regalpetroleum.co.uk.

Going Concern

The Board is required to assess whether the Group has adequate resources to continue operations for the foreseeable future. The directors are satisfied that the Company and the Group will continue in operational existence for the foreseeable future (being a period of at least 12 months from the date of this report), for this reason the directors have adopted the going concern basis for preparing the financial statements.

Directors' Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2006.

Principal Activities
The principal activities of the Group are oil and gas exploration, development and production. The Group has its head office in London and has oil and gas interests in Ukraine, Romania, Egypt, Greece and Liberia. The subsidiary undertakings principally affecting the profits or net assets of the Group are listed in Note 14 to the accounts.

Proposed Dividend
The directors do not recommend the payment of a dividend.

Business Review
The business of oil and gas exploration and production involves a high degree of risk that a combination of experience, knowledge and careful evaluation may not be able to fully mitigate. Principal non financial risks and uncertainties facing the Group include, but are not limited to:

- delays in construction and drilling projects which may result in the Group's projected target dates for production being delayed or further capital being required;
- the political situation in Ukraine exposes the Group to economic uncertainties, including but not limited to, changes in energy policies, regulations, taxation and the operation of foreign owned businesses;
- no assurance exists that during exploration, for example in Egypt and Romania, oil or gas will be discovered and that, if discovered, it will be economically viable to recover.

The Group's financial risk management policies are detailed in the Financial Review.

Details of the Group's 2006 operations, review of strategic performance and key performance indicators are included in the Operational Review and the Chairman's Statement.

Policy and Practice on Payment of Creditors
The Company's policy on payment of creditors for the year following that covered by this report is to settle all amounts with its creditors on a timely basis taking account of the credit period given by each supplier.

The Company's average number of days purchases included within trade creditors at the year end was 19 (2005: 40).

Post Balance Sheet Events
In the directors' opinion no post balance sheet events have occurred that require disclosure.

Directors and Directors' Interests
The directors who held office during the year were as follows:

	Date appointed	Date resigned
F Scolaro	15 June 2006	–
N Ritson	25 July 2006	–
R S C Phillips	–	–
Lord St John of Bletso	–	–
P Morgan	3 March 2006	10 July 2006
M Byrnes	5 April 2006	5 May 2006
Sir P Heap	–	3 March 2006
Dr R W Gaisford	–	3 March 2006
R F P Hardman	–	3 March 2006

The directors who held office at the end of the financial year had the following interests in the ordinary shares of the Company according to the register of directors' interests:

	Class of share	Interest at end of year	Interest at start of year or date of appointment
F Scolaro	Ordinary	1,994,080	4,753,870
N Ritson	Ordinary	–	–
R S C Phillips	Ordinary	4,472	4,472
Lord St John of Bletso	Ordinary	6,500	6,500

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

According to the register of directors' interests, no rights to subscribe for shares in or debentures of Group companies were granted to any of the directors or their immediate families, or exercised by them, during the financial year except as indicated below:

	At start of year	Number of options during the year Granted	Relinquished	Lapsed	At end of year	Exercise price £	Date from which exercisable	Expiry date
R S C Phillips	500,000	–	–	–	500,000	0.600	14.12.2005	13.12.2014
	250,000	–	(250,000)	–	–	2.000	–	–
	–	250,000	–	–	250,000	0.853	22.12.2006	25.04.2015
Lord St John of Bletso	500,000	–	–	–	500,000	0.835	15.06.2005	14.06.2014
	–	250,000	–	–	250,000	0.875	24.10.2006	23.04.2015
P Morgan	–	500,000	–	(500,000)	–	0.875	–	–
	–	500,000	–	(500,000)	–	0.875	–	–
	–	500,000	–	(500,000)	–	0.875	–	–
	–	500,000	–	(500,000)	–	0.875	–	–
Sir P Heap	250,000	–	–	(250,000)	–	0.600	–	–
Dr R W Gaisford	1,000,000	–	–	(1,000,000)	–	0.600	–	–
	250,000	–	–	(250,000)	–	2.000	–	–
	250,000	–	–	(250,000)	–	3.000	–	–
	250,000	–	–	(250,000)	–	4.000	–	–
	250,000	–	–	(250,000)	–	5.000	–	–
	–	500,000	–	–	500,000	0.600	24.04.2006	02.03.2008
R F P Hardman	200,000	–	–	(200,000)	–	0.600	–	–
	200,000	–	–	(200,000)	–	2.000	–	–
	200,000	–	–	(200,000)	–	3.000	–	–
	150,000	–	–	(150,000)	–	4.000	–	–

Substantial Shareholders

The following parties had interests of greater than 3% of the issued share capital of the Company at 31 December 2006:

Substantial Shareholder	Number of shares	% of issued ordinary share capital
C. A. Fiduciary Services Limited	23,377,387	18.19
Henderson Global Investors	14,426,188	11.23
Blackrock Investment Management	11,587,476	9.02
Dresdner Kleinwort Wasserstein	7,871,168	6.13
Capital International	7,817,000	6.08
Credit Agricole Indoseuz Cheuvreux	5,675,939	4.42
Artemis Investment Management	5,375,209	4.18
Man Financial (SL)	4,833,041	3.76

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and 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 Group and to prevent and detect fraud and other irregularities.

Directors' Report continued

Statement of Disclosure to Auditor

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are not informed. The directors have taken all steps required to make themselves aware of any relevant audit information and to establish that the Company's auditors are informed of that information.

Political and Charitable Contributions

During the year the Group made charitable donations of $1,380 (2005: $nil). These donations were made in sponsorship of employee charity efforts.

Auditors

On 30 April 2007 the Company's auditors UHY Hacker Young, transferred their business to a limited liability partnership, UHY Hacker Young LLP (the LLP) and the office of auditor has passed to the LLP. In accordance with section 385 of the Companies Act 1985, a resolution proposing UHY Hacker Young LLP be reappointed as auditors of the Company will be put to the Annual General Meeting.

By Order of the Board

N Ritson
Director

11 Berkeley Street
London W1J 8DS
United Kingdom

22 June 2007

Report of the Independent Auditor to the Members of Regal Petroleum plc

We have audited the Group and parent company financial statements (the 'financial statements') of Regal Petroleum plc for the year ended 31 December 2006 which comprise the Group profit and loss account, the Group and Company balance sheets, the Group cash flow statement, the Group statement of total recognised gains and losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report, and consider whether it is consistent with the audited financial statements. This other information comprises the Chairman's statement, the operational review, the financial review, the corporate governance statement and the Directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of Audit Opinion

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

We planned 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. However, the evidence available to us was limited in relation to the comparatives in the current year's financial statements which are derived from the financial statements for the year ended 31 December 2005. In respect of the financial statements for that year, the evidence available to us in respect of the results of Kavala Oil S.A. ('Kavala') included in the consolidated profit and loss account to the date of loss of control was limited, in that we did not have access to the accounting records of Kavala or to the audit working papers of Kavala's auditor SOL S.A., Certified Public Accountants Auditors, nor did SOL S.A. provide information or explanations in response to our requests.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Qualified Opinion Arising from Limitation in Audit Scope in Respect of the Comparatives

Except for the financial effects on the comparatives of such adjustments, if any, as might have been determined to be necessary had we received the information and explanations we required concerning the results of Kavala Oil S.A. included in the comparative consolidated profit and loss account to the date of loss of control, in our opinion:

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

UHY Hacker Young LLP
Registered Auditors
Chartered Accountants
22 June 2007

Consolidated Profit and Loss Account
for the year ended 31 December 2006

	Note	2006 $000	2005 as restated $000
Group turnover	2	10,845	37,255
Cost of sales	3	(8,306)	(38,505)
Gross profit/(loss)		2,539	(1,250)
Normal administrative expenses	3	(14,765)	(30,228)
Exceptional administrative expenses	4	(54,801)	–
Total administrative expenses		(69,566)	(30,228)
Other operating income		861	1,083
Group operating loss		(66,166)	(30,395)
Impairment of investment	5	(43,700)	–
Loss on deconsolidation of excluded subsidiary		–	(53,477)
Loss on sale of fixed assets		–	(113)
Interest receivable and similar income		1,183	1,115
Interest payable and similar charges	8	(2)	(145)
Loss on ordinary activities before taxation		(108,685)	(83,015)
Tax on profit on ordinary activities	9	(491)	(1,213)
Loss on ordinary activities after taxation		(109,176)	(84,228)
Retained loss for the financial year		(109,176)	(84,228)
Loss per ordinary share (cents)			
Basic	11	(85.0c)	(68.9c)

The profit and loss account has been prepared on the basis that all operations are continuing operations.

Consolidated Balance Sheet
at 31 December 2006

	Note	2006 $000	2005 as restated $000
Fixed assets			
Intangible assets	12	**26,867**	14,731
Tangible assets	13	**29,761**	29,356
Investments	14	**–**	43,700
		56,628	87,787
Current assets			
Stocks	15	**37**	38
Debtors	16	**3,368**	4,995
Investments	17	**–**	136
Cash at bank and in hand		**13,048**	34,796
		16,453	39,965
Creditors: amounts falling due within one year	18	**(2,171)**	(2,267)
Net current assets		**14,282**	37,698
Total assets less current liabilities		**70,910**	125,485
Provisions for liabilities and charges	19	**(950)**	(196)
Net assets		**69,960**	125,289
Capital and reserves			
Called up share capital	20	**10,934**	10,934
Share premium account	21	**217,640**	217,640
Other reserves	21	**10,644**	6,073
Equity reserve	21	**49,049**	–
Profit and loss account	21	**(218,307)**	(109,358)
Shareholders' funds – equity		**69,960**	125,289

These financial statements were approved by the Board of Directors on 22 June 2007 and were signed on its behalf by:

N Ritson
Director

Company Balance Sheet
at 31 December 2006

	Note	2006 $000	2005 as restated $000
Fixed assets			
Intangible assets	12	6,150	–
Tangible assets	13	601	2,551
Investments	14	46,939	71,672
		53,690	74,223
Current assets			
Debtors	16	1,087	1,324
Investments	17	–	121
Cash at bank and in hand		11,215	31,160
		12,302	32,605
Creditors: amounts falling due within one year	18	(962)	(868)
Net current assets		11,340	31,737
Total assets less current liabilities		65,030	105,960
Provisions for liabilities and charges	19	(745)	–
Net assets		64,285	105,960
Capital and reserves			
Called up share capital	20	10,934	10,934
Share premium account	21	217,640	217,640
Share option reserve	21	2,031	1,791
Equity reserve	21	49,049	–
Profit and loss account	21	(215,369)	(124,405)
Shareholders' funds – equity		64,285	105,960

These financial statements were approved by the Board of Directors on 22 June 2007 and were signed on its behalf by:

N Ritson
Director

Consolidated Cash Flow Statement

for the year ended 31 December 2006

	Note	2006 $000	2005 $000
Net cash flow from operating activities	23	**(11,840)**	(30,470)
Returns on investments and servicing of finance	24	**1,181**	970
Taxation		**(491)**	(1,227)
Capital expenditure and financial investment	24	**(11,831)**	(41,681)
Acquisitions and disposals	24	**–**	(1,854)
Cash outflow before management of liquid resources and financing		**(22,981)**	(74,262)
Management of liquid resources	24	**20**	3,113
Financing	24	**64**	83,578
(Decrease)/increase in cash in the period		**(22,897)**	12,429
Reconciliation of net cash flow to movement in net funds	25		
(Decrease)/increase in cash in the period		**(22,897)**	12,429
Cash inflow from increase in funds and lease financing		**16**	1,064
Cash outflow from increase in liquid resources		**(20)**	(3,113)
Change in net funds resulting from cash flows		**(22,901)**	10,380
Translation differences		**1,149**	(3,276)
Other non-cash movements		**(116)**	589
Movement in net funds in the period		**(21,868)**	7,693
Net funds at the start of the period		**34,916**	27,223
Net funds at the end of the period		**13,048**	34,916

Consolidated Statement of Total Recognised Gains and Losses

for the year ended 31 December 2006

	2006 $000	2005 as restated $000
Loss for the financial year	**(109,176)**	(84,228)
Gross exchange differences on the retranslation of net investments	**(4,331)**	(1,606)
Total recognised gains and losses relating to the financial year	**(113,507)**	(85,834)
Prior year adjustment*	**(1,791)**	
Total recognised gains and losses since the last annual report	**(115,298)**	

Reconciliations of Movements in Shareholders' Funds

for the year ended 31 December 2006

	Group		Company	
	2006 $000	2005 $000	2006 $000	2005 $000
Loss for the financial year	**(109,176)**	(82,564)	**(91,191)**	(114,905)
Prior year adjustment*	**–**	(1,664)	**–**	(1,664)
Restated loss for the financial year	**(109,176)**	(84,228)	**(91,191)**	(116,569)
Credits to equity in respect of share based payments recognised in the profit and loss account	**49,436**	–	**49,436**	–
Other recognised gains and losses relating to the year (net)	**4,411**	(1,606)	**80**	–
New share capital subscribed (net of issue costs)	**–**	84,642	**–**	84,642
Prior year adjustment to reserves	**–**	1,664	**–**	1,664
Net (deficit)/addition to shareholders' funds	**(55,329)**	472	**(41,675)**	(30,263)
Opening shareholders' funds	**125,289**	124,817	**105,960**	136,223
Closing shareholders' funds	**69,960**	125,289	**64,285**	105,960

*Restated for the adoption of FRS 20 Share-Based Payments.

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 Group'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. The Group's financial statements fall within the scope of the United Kingdom Oil Industry Accounting Committee's Statement of Recommended Practice (SORP) 'Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities' and have been prepared in accordance with the provisions thereof.

The Group intends to adopt International Financial Reporting Standards from 1 January 2007.

Basis of Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiary undertakings made up to 31 December 2006. The acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

In accordance with Financial Reporting Standard 2 'Subsidiary undertakings', subsidiary undertakings are excluded from consolidation if severe long-term restrictions substantially hinder the exercise of the parent undertaking's rights over the subsidiary undertaking's assets or management.

Where a group company is party to a joint arrangement, which is not an entity that company accounts directly for its part of the income and expenditure, assets, liabilities and cash flows, such arrangements are reported in the consolidated financial statements on the same basis.

Under section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account.

Corporate Restructuring

During 2002 the Group carried out a corporate restructuring including the introduction of a new holding company. The corporate restructure was accounted for as a merger in accordance with Financial Reporting Standard 6 'Acquisitions and Mergers.' The balance of the merger reserve is disclosed in Note 21.

Reserves

Proven and probable oil and gas reserves are estimated quantities of commercially producible hydrocarbons which the existing geological, geophysical and engineering data show to be recoverable in future years from known reservoirs. The proven and probable reserves included herein conform to the definition approved by the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC).

Oil and Gas Assets

The Group follows the 'full cost' method of accounting for the costs associated with exploration, appraisal, development and production of oil and gas reserves. The Group's evaluated oil and gas assets are held in separately designated geographical cost pools. The costs of acquisition of property (including rights and concessions), geological and geophysical costs, cost of field production facilities, pipelines and plant and equipment are classified as tangible fixed assets if they relate to proved and probable oil and gas properties.

All costs associated with property acquisition, exploration and development are capitalised regardless of whether they result in commercial discoveries or not. Producing oil and gas assets are depleted by pool on a unit of production method in the proportion of actual production for the period to the total remaining commercial reserves. Reserves are those estimated at the end of the period plus production during the period. For depletion purposes only, the cost base includes costs of capital assets and anticipated future development expenditure. Pre-licence acquisition, exploration and appraisal costs of individual licence interests are held outside cost pools until the existence, or otherwise of, commercial reserves is established. These costs remain undepreciated as intangible exploration and development costs until this determination is made. When a positive determination is made the cost is transferred to a cost pool and depreciated. If the area of interest is determined to be non-commercial the cost is written off.

Other Fixed Assets and Depreciation

Depreciation is provided to write off the cost, less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Fixtures, fittings and equipment	20–25% per annum straight line
Motor vehicles	20–25% per annum straight line
Plant and machinery	8–25% per annum straight line
Exploration, evaluation and development costs	depreciated on a unit of production basis

Notes continued

Forming part of the financial statements

1 Accounting Policies continued

Impairment Testing

As at the year end, ceiling tests were performed in accordance with Financial Reporting Standard 11: 'Impairment of Fixed Assets and Goodwill'. Other than the impairment of the carrying value of the King Alexander Rig (see note 13) and the carrying amount of the investment in Kavala Oil S.A. (see note 14) the results indicate that there has been no impairment and that the carrying value of fixed assets is appropriate. The assumptions made by the directors in performing the tests were:

IPE Brent Oil price: $48 per barrel
Condensate price: $283 per cubic metre
Gas price: $130 per thousand cubic metres
Exchange rate: €/$1.31
Inflation rate: 1–2%
Discount rate: 10%

Fixed Asset Investments

Subsidiary undertakings that have been excluded from consolidation because of severe long-term restrictions are treated as fixed asset investments. The impairment of the fixed asset investment has been carried out in accordance with Financial Reporting Standard 11: 'Impairment of Fixed Assets and Goodwill', as above.

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 contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

The assets and liabilities, and profit and loss accounts of overseas subsidiary undertakings are translated at the closing exchange rates. Gains and losses arising on these translations are taken to reserves, net of exchange differences arising on related foreign currency borrowings.

Post Retirement Benefits

The Group operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the Group in an independently administered fund. The amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.

Stocks

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

Taxation

The charge for taxation is based on the result for the year and takes into account 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 Financial Reporting Standard 19 'Deferred Tax'.

Turnover

Turnover represents amounts invoiced in respect of sales of oil and gas exclusive of indirect taxes and excise duties and is recognised on delivery of product.

Merger Accounting

Where merger accounting is used, the investment is recorded in the Company's balance sheet at the nominal value of the shares issued together with the fair value of any additional consideration paid.

Any difference between the nominal value of the shares acquired by the Company and those issued by the Company to acquire them is taken to reserves.

Decommissioning Costs

Where there is a material liability for the removal of production facilities and site restoration at the end of the production life for a field, the Group recognises the provision under the basis set out in Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets'.

Cash and Liquid Resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand. Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise term deposits of less than one year (other than cash) and investments in money market managed funds.

Included in cash and liquid resources are amounts relating to financial guarantees entered into by the Group to collaterise future commitments as per normal business procedure.

1 Accounting Policies continued

Financial Instruments

The Group uses derivative financial instruments to reduce its exposure to fluctuations in movements in oil and gas prices. Premiums paid to enter into such derivative financial instruments are charged to the profit and loss account over the period of the hedge. Payments and receipts arising under the financial instruments are recognised in the profit and loss account in the same periods as the hedged transactions.

The Group does not hold or issue derivative financial instruments for speculative purposes and it is the Group's policy that no trading in financial instruments shall be undertaken.

Leases

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Accounting for Employee Stock Ownership Plan Trusts

UITF Abstract 38 standard requires the assets and liabilities of the Group's Employee Stock Ownership Plan (ESOP) trust to be recognised in the Group's financial statements where there is de-facto control of those assets and liabilities. The Company's own shares held by the ESOP trust are deducted from shareholders' funds until they vest unconditionally with employees.

Share-Based Payments

The Group has applied the requirements of FRS 20 Share-Based Payments. In accordance with the transitional provisions of that standard, only those awards that were granted after 7 November 2002, and had not vested at 1 January 2005, are included.

All share based awards of the Group to date have been equity settled as defined by FRS 20. The fair value of these awards has been determined at the date of grant of the award allowing for the effect of any market-based performance conditions. This fair value, adjusted by the Group's estimate of the number of awards that will eventually vest as a result of non-market conditions, is expensed uniformly over the vesting period.

The fair values were calculated using a binomial option pricing model with suitable modifications to allow for employee turnover after vesting and early exercise. Where necessary this model was supplemented with a Monte Carlo model. The inputs to the model include: the share price at date of grant; exercise price; expected volatility; expected dividends; risk free rate of interest; and patterns of exercise of the plan participants.

Share Options

In accordance with Urgent Issues Task Force Abstract 25 – National Insurance contributions on share option gains (UITF 25) the Company provides in full for the employer's national insurance liability estimated to arise on the future exercise of share options granted.

2 Segmental Information

The table below sets out information for each of the Group's industry segments and geographic areas of operation.

	Ukraine		United Kingdom		Romania		Egypt		Greece		Total	
	2006	2005	**2006**	2005 as restated	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005 as restated
	$000	$000	**$000**	$000	**$000**	$000	**$000**	$000	**$000**	$000	**$000**	$000
Turnover												
Oil sales	**–**	–	**–**	–	**–**	–	**–**	–	**–**	22,762	**–**	22,762
Gas sales	**4,838**	7,688	**–**	–	**–**	–	**–**	–	**–**	–	**4,838**	7,688
Condensate sales	**6,007**	6,202	**–**	–	**–**	–	**–**	–	**–**	–	**6,007**	6,202
Sulphur sales	**–**	–	**–**	–	**–**	–	**–**	–	**–**	580	**–**	580
Other	**–**	–	**–**	–	**–**	–	**–**	–	**–**	23	**–**	23
Total sales (and sales to third parties)	**10,845**	13,890	**–**	–	**–**	–	**–**	–	**–**	23,365	**10,845**	37,255
Group operating profit/(loss)	**1,225**	2,036	**(66,930)**	(23,312)	**(480)**	(1,446)	**151**	(365)	**(132)**	(7,308)	**(66,166)**	(30,395)
Net assets	**30,712**	30,979	**16,966**	34,178	**21,641**	13,430	**606**	2,927	**35**	43,775	**69,960**	125,289

There are no inter-segment sales within the Group and all products are sold in the geographical region in which they are produced.

Notes continued

Forming part of the financial statements

3 Loss on Ordinary Activities Before Taxation

		2006 $000	2005 $000
Loss on ordinary activities before taxation is stated after charging/(crediting)			
Auditors' remuneration:			
Group	– audit	**170**	313
	– fees paid to the auditors and their associates in respect of other services	**74**	229
Company	– audit	**89**	275
Depreciation and other amounts written off tangible fixed assets		**1,041**	7,626
Impairment of fixed assets		**1,935**	7,214
Hire of plant and machinery – rentals payable under operating leases		**–**	3,649
Defined pension contributions		**180**	207
Foreign exchange differences		**(550)**	10,632

4 Ukrainian Settlement Costs

As approved by shareholders at the Extraordinary General Meeting held by the Group on 6 September 2006, Alberry Limited (Alberry) a company registered in the British Virgin Islands subscribed for 15% of the increased ordinary shares in Regal Petroleum Corporation Limited (RPC), a subsidiary of the Group, for a cash consideration of £100,000 and committed to provide assistance in relation to securing the licences of the Group's Ukrainian assets. Should Alberry be successful in securing the licences, the Group committed to repurchase the shares for a consideration of $50,901,300, payable in cash or by the new issue of ordinary shares in Regal Petroleum plc at the Group's discretion, to a limit of 29.9% of the increased ordinary share capital of Regal Petroleum plc.

On 12 December 2006 the Supreme Court of Ukraine affirmed the validity of the Ukrainian production licences thus fulfilling the terms of the agreement. As such (and in accordance with FRS 20) a provision has been made for the liability due in return for the services performed.

Due to the transient nature of Alberry's investment in RPC, the disposal of the 15% of the increased ordinary shares in RPC has not been accounted for as a disposal in the Group's consolidated financial statements.

The Company also engaged a number of external consulting firms on a success based fee structure to assist it in securing the validity of the licences. Costs relating to these engagements have been included in exceptional administrative expenses.

	2006 $000
Net consultancy charge	**54,801**

5 Impairment of Investment

	2006 $000
Impairment of investment in Kavala Oil S.A. (refer note 14)	**43,700**

6 Remuneration of Directors

	2006 $000	2005 $000
Directors' emoluments	**1,480**	1,275

The emoluments of the individual directors were as follows:

	Basic salary and fees 2006 $000	Benefits in in kind 2006 $000	Aggregate emoluments 2006 $000	Pension contributions 2006 $000	**Total emoluments 2006 $000**	Total emoluments 2005 $000
F Scolaro	44	–	44	–	**44**	–
N Ritson	83	1	84	10	**94**	–
R S C Phillips	331	9	340	39	**379**	320
Lord St John of Bletso	51	–	51	–	**51**	27
P Morgan	508	–	508	–	**508**	–
Sir P Heap	50	–	50	–	**50**	64
Dr R W Gaisford	307	1	308	8	**316**	299
R F P Hardman	37	1	38	–	**38**	121
V F Timis	–	–	–	–	**–**	430
W H Humphries	–	–	–	–	**–**	14
	1,411	12	1,423	57	**1,480**	1,275

6 Remuneration of Directors continued

In addition to the above the following remuneration was granted during the year:
F Scolaro received $74,870 in consulting fees in recognition of additional services performed.
N Ritson received $101,669 in consulting fees in recognition of services performed prior to becoming an executive director.

Included in the above, the following amounts were paid as compensation in respect of loss of office:

Dr R W Gaisford	$230,000
Sir P Heap	$ 30,000

In addition, Dr R W Gaisford received 500,000 options exercisable at 60p (as disclosed in the Directors' Report).
No directors exercised share options during the year (2005: nil).

7 Staff Numbers and Costs

The average number of employees on a full time equivalent basis during the year was as follows:

	Number of employees	
	2006	2005
Full time	**106**	287

The aggregate payroll costs of these persons were as follows:

	2006 $000	2005 as restated $000
Wages and salaries	**3,355**	13,782
Social security costs	**399**	2,316
Other pension costs	**340**	807
Share option charge	**387**	1,664
Provision for national insurance on share options	**745**	–
	5,226	18,569

8 Interest Payable and Similar Charges

	2006 $000	2005 $000
On bank loans and overdrafts	**2**	145

9 Taxation

Analysis of charge in period

	2006 $000	2005 $000
Foreign tax		
Current tax on income for the period	**491**	1,213
Tax on profit on ordinary activities	**491**	1,213

Factors Affecting the Tax Charge for the Current Period

The current tax charge for the period is higher than the standard rate of corporation tax in the UK 30% (2005: 30%). The differences are explained below.

	2006 $000	2005 as restated $000
Current tax reconciliation		
Loss on ordinary activities before tax	**(108,685)**	(83,015)
Current tax credit at 30% (2005: 30%)	**(32,605)**	(24,905)
Effects of:		
Disallowed expenses and non taxable income	**28,305**	2,876
Foreign tax calculation differences	**(73)**	8,577
Capital allowances for period in excess of depreciation	**–**	(5,575)
Depreciation for period in excess of capital allowances	**549**	–
Other timing differences	**(526)**	203
Loss on deconsolidation of excluded subsidiary	**–**	16,043
Utilisation of tax losses	**4,841**	3,994
Total current tax charge (see above)	**491**	1,213

Notes continued

Forming part of the financial statements

9 Taxation continued

Factors Affecting Future Tax Charge

The directors do not consider it appropriate to provide for any deferred tax asset to reflect the potential benefit arising from timing differences at 31 December 2006. At 31 December 2006 there were unprovided deferred tax assets in respect of estimated tax losses carried forward of up to $30.0 million (2005 restated: $16.3 million). The Group has also not recognised a deferred tax asset for the same reason in respect of the excess of book depreciation allowances over tax depreciation of approximately $2.5 million (2005: $2.0 million) and other differences amounting to $0.6 million (2005: $0.5 million). Deferred tax assets relate primarily to the UK.

10 Loss for the Financial Year

The Company has taken advantage of the exemption allowed under section 230 of the Companies Act 1985 and has not presented its own profit and loss account in these financial statements. The Group loss for the period includes a parent company loss after tax of $91,191,000 for the year ended 31 December 2006 (2005 restated: $116,569,000).

11 Loss Per Share

Basic loss per share of 85.0 cents (2005 restated: 68.9 cents) is based upon losses of $109,176,000 (2005 restated: $84,228,000) and 128,447,423 (2005: 122,323,864) ordinary shares being the weighted average number of shares in issue excluding the nil (2005: 69,325) shares held by the Group's ESOP trust. As the exercise of options would be anti-dilutive no diluted earnings per share figure has been provided.

The 2005 loss per share for ongoing operations has also been restated to 19.7 cents. This excludes the results of Kavala Oil S.A. and is based upon restated losses of $24,133,000 and the number of ordinary shares as above.

These losses may be reconciled as follows:

	2006 $000	2006 $000	2005 $000	2005 as restated $000
Loss attributable to shareholders		(109,176)		(84,228)
Items not relating to ongoing operations:				
Excluded subsidiary operations:				
Operating loss	–		(6,631)	
Interest receivable	–		13	
		–		6,618
Loss on deconsolidation of excluded subsidiary		–		53,477
Loss relating to ongoing operations attributable to shareholders		(109,176)		(24,133)

12 Intangible Fixed Assets

	2006				2005			
Exploration and development costs	**United Kingdom $000**	**Romania $000**	**Egypt $000**	**Total $000**	United Kingdom $000	Romania $000	Egypt $000	Total $000
Group								
Cost								
At beginning of year	**287**	**11,692**	**2,752**	**14,731**	129	5,442	612	6,183
Additions	**6,184**	**5,631**	**2,285**	**14,100**	287	6,408	2,140	8,835
Disposals (i)	**–**	**–**	**(4,202)**	**(4,202)**	(129)	–	–	(129)
Transfer from tangible fixed assets	**–**	**–**	**–**	**–**	–	325	–	325
Impairment of fixed assets	**(321)**	**–**	**–**	**(321)**	–	–	–	–
Effect of movement in foreign exchange	**–**	**2,559**	**–**	**2,559**	–	(483)	–	(483)
At end of year	**6,150**	**19,882**	**835**	**26,867**	287	11,692	2,752	14,731
Amortisation								
At beginning of year	**–**	**–**	**–**	**–**	–	–	–	–
At end of year	**–**	**–**	**–**	**–**	–	–	–	–
Net book value								
At 31 December	**6,150**	**19,882**	**835**	**26,867**	287	11,692	2,752	14,731

(i) On 5 October 2006 the Group entered into a joint venture agreement with Apache Khalda Corporation LDC (Apache) in respect of the Group's 100% interest in the East Ras Budran Concession in Egypt. Apache has agreed a farm-in for a 75% interest in the Concession upon Apache paying $4,202,000 to the Group representing a proportionate reimbursement of the capitalised back costs previously treated as intangible fixed assets. In addition, Apache paid $642,000 to the Group as a proportionate reimbursement of expenditure that had been previously charged to the profit and loss account in prior years. This amount has been credited to the Group's profit and loss account in 2006.

In addition to the above, the Group has also entered into a joint venture agreement with Aurelian Oil & Gas plc (Aurelian) in respect of the Group's Suceava Concession in Romania. The Group has agreed to reduce its previously held 100% interest in the Concession to 50% upon Aurelian acquiring 150km of new 2D seismic and drilling one exploration well at no additional cost to Regal. It is budgeted that this programme will cost Aurelian $2.6 million to complete. The agreement has had no effect on the financial results presented.

12 Intangible Fixed Assets continued

Exploration and development costs	2006 $000	2005 $000
Company		
Cost		
At beginning of year	–	–
Additions	6,471	–
Impairment of fixed assets	(321)	–
At end of year	6,150	–
Amortisation		
At beginning of year	–	–
At end of year	–	–
Net book value		
At 31 December	6,150	–

13 Tangible Fixed Assets

	2006			2005			
	Exploration and development costs Ukraine $000	Other fixed assets $000	Total $000	Exploration and development costs Ukraine $000	Exploration and development costs Greece $000	Other fixed assets $000	Total $000
Group							
Cost							
At beginning of year	28,521	3,896	32,417	18,810	93,170	22,359	134,339
Additions	1,830	146	1,976	8,745	30,739	2,197	41,681
Disposals	–	(157)	(157)	–	–	(319)	(319)
Transfer to intangible fixed assets	–	–	–	–	–	(325)	(325)
Effect of movement in foreign exchange	1,226	28	1,254	966	(12,736)	(1,298)	(13,068)
Impairment of fixed assets*	–	(1,873)	(1,873)	–	–	(8,018)	(8,018)
Deconsolidation of excluded subsidiary	–	–	–	–	(111,173)	(10,700)	(121,873)
At end of year	31,577	2,040	33,617	28,521	–	3,896	32,417
Depreciation							
At beginning of year	1,910	1,151	3,061	851	33,329	2,282	36,462
Charge for year	557	484	1,041	1,015	4,179	2,432	7,626
On disposals	–	(83)	(83)	–	–	(206)	(206)
Effect of movement in foreign exchange	82	14	96	44	(4,242)	(209)	(4,407)
Impairment of fixed assets	–	(259)	(259)	–	–	(804)	(804)
Deconsolidation of excluded subsidiary	–	–	–	–	(33,266)	(2,344)	(35,610)
At end of year	2,549	1,307	3,856	1,910	–	1,151	3,061
Net book value							
At 31 December	29,028	733	29,761	26,611	–	2,745	29,356

* In accordance with Financial Reporting Standard 11: 'Impairment of Fixed Assets and Goodwill', the directors consider the valuation of the King Alexander rig to be impaired as at 31 December 2006. Access to the rig has been denied to the Group by the management of Kavala Oil S.A. and therefore the directors consider the net realisable value and value in use of the asset to be $nil.

Other fixed assets include fixtures, fittings and equipment, motor vehicles and plant and machinery.

Notes continued

Forming part of the financial statements

13 Tangible Fixed Assets continued

Other fixed assets	2006 $000	2005 $000
Company		
Cost		
At beginning of year	**2,919**	10,853
Additions	**19**	273
Disposals	**(6)**	(189)
Impairment of fixed assets*	**(1,873)**	(8,018)
At end of year	**1,059**	2,919
Depreciation		
At beginning of year	**368**	587
Charge for year	**350**	683
On disposals	**(1)**	(76)
Effect of movement in foreign exchange	**–**	(22)
Impairment of fixed assets	**(259)**	(804)
At end of year	**458**	368
Net book value		
At 31 December	**601**	2,551

* In accordance with Financial Reporting Standard 11: 'Impairment of Fixed Assets and Goodwill', the directors consider the valuation of the King Alexander rig to be impaired as at 31 December 2006. Access to the rig has been denied to the Group by the management of Kavala Oil S.A. and therefore the directors consider the net realisable value and value in use of the asset to be $nil.

Other fixed assets include fixtures, fittings and equipment, motor vehicles and plant and machinery.

14 Fixed Asset Investments

In September 2005 the Group issued a press release stating that due to recent industrial unrest, it had been agreed with the Union at Kavala Oil S.A. that Greek operational and economic management be undertaken by local management with the assistance of the unionised workforce. The operational and economic management continued to be undertaken by local management throughout 2006. Due to the continued severe long-term restrictions that this agreement imposes, the directors consider that the inclusion of the results of Kavala Oil S.A. in the Group's financial statements would be misleading. Therefore in accordance with Financial Reporting Standard 2, the Group has not consolidated its interest in the Greek operations from September 2005. We believe that the reclassification correctly represents the Group's position as the majority shareholder.
The investment in Kavala Oil S.A. is treated as a fixed asset investment in the Group's financial statements and carried at the directors' valuation.

The profit for the year ended 31 December 2006 which has been reported in the independently audited financial statements of Kavala Oil S.A. is €79,271,230 (2005: €31,531,866 loss). Included in this profit are exceptional items relating to Kavala Oil S.A. writing-off historical amounts totalling €80,873,126 owed to its parent company. The carried forward losses at 31 December 2006 of Kavala Oil S.A. total €9,241,961 (2005: €88,304,000). The aggregate capital and reserves of Kavala Oil S.A. reported at 31 December 2006 is a surplus of €1,596,241 (2005: €77,465,798 deficit).

	2006 $000	2005 $000
Group		
Investment in Kavala Oil S.A.	**–**	43,700

In accordance with Financial Reporting Standard 11: 'Impairment of Fixed Assets and Goodwill', the directors consider the valuation of the investment in Kavala Oil S.A. to be impaired as at 31 December 2006.This has resulted in the carrying value of the asset being adjusted to reflect the directors' revised valuation. In arriving at the valuation the directors have concluded that the long-term restriction referred to above is likely to continue and therefore the Company will not be allowed to instigate a development programme to extract the reserves in a cost effective manner.

	Shares in Group undertakings $000	Loans to Group undertakings $000	Total $000
Company			
Cost			
At beginning of year	28,016	43,656	71,672
Additions	–	715	715
Provision	–	(14,787)	(14,787)
Impairment	(10,661)	–	(10,661)
At end of year	**17,355**	**29,584**	**46,939**

14 Fixed Asset Investments continued

In accordance with Financial Reporting Standard 11: 'Impairment of Fixed Assets and Goodwill', the directors consider the valuation of the Company's investment in Eurotech S.A. to be impaired as at 31 December 2006.This has resulted in the carrying value of the asset being adjusted to reflect the directors' revised valuation. In arriving at the valuation the directors have concluded that as the intermediary holding company for the Group's interest in Kavala Oil S.A., Eurotech S.A.'s investment in Kavala Oil S.A. is impaired (see above) to $nil. As Eurotech S.A. has no other material assets, the directors conclude the Company's investment in Eurotech S.A. to be impaired as at 31 December 2006 to $nil.

The undertakings in which the Group's interest at the year end is more than 20% are as follows:

Subsidiary undertakings	Country of incorporation	Principal activity	Percentage of shares held
Regal Petroleum (Jersey) Limited	Jersey	Holding company	100%
Regal Petroleum Corporation Limited	Jersey	Oil and Natural Gas Extraction	85%
Regal Petroleum Ukraine Limited	Ukraine	Service Company	85%
Eurotech S.A.	Greece	Holding Company	100%
Kavala Oil S.A.	Greece	Oil and Natural Gas Extraction	95%
Regal Romania SRL	Romania	Oil and Natural Gas Extraction	100%
Regal Hellas S.A.	Greece	Dormant	100%
Regal Energy Limited	United Kingdom	Dormant	50%
Regal Egypt Limited	United Kingdom	Oil and Natural Gas Extraction	100%
Regal Group Services Limited	United Kingdom	Service Company	100%
Regal Liberia Limited	United Kingdom	Dormant	100%

The parent company holds direct interests in the above except for:

- The indirect interest of 95% of the share capital of Kavala Oil S.A. which is controlled through its 100% ownership of Eurotech S.A. which in turn owns 95% of the issued capital of Kavala Oil S.A.. Eurotech S.A.'s equity interest in Kavala Oil S.A. gives the company a 67% voting interest. The remaining 33% voting interest is retained by The Kavala Petroleum Employees Investment – Management Association.
- The indirect interest of 85% of the share capital of Regal Petroleum Corporation Limited and Regal Petroleum Ukraine Limited are controlled through its 100% ownership of Regal Petroleum (Jersey) Limited.

15 Stocks

	Group	
	2006 $000	2005 $000
Finished goods and goods for resale	**37**	38

In the opinion of the directors, there is no material difference between the cost of stock included in the accounts and its replacement cost.

16 Debtors

	Group		Company	
	2006 $000	2005 $000	**2006 $000**	2005 $000
Trade debtors	**1,139**	3,482	**43**	595
Amounts owed by Group undertakings	**–**	–	**332**	332
Prepayments and accrued income	**321**	217	**318**	216
Other debtors	**1,908**	1,296	**394**	181
	3,368	4,995	**1,087**	1,324

17 Investments (held as current assets)

	Group		Company	
	2006 $000	2005 $000	**2006 $000**	2005 $000
Other investments	**–**	136	**–**	121

18 Creditors: Amounts Falling Due Within One Year

	Group		Company	
	2006 $000	2005 $000	**2006 $000**	2005 $000
Bank loans and overdrafts	**–**	16	–	–
Trade creditors	**1,014**	1,428	135	294
Taxation and social security	**583**	546	160	282
Accruals and deferred income	**574**	277	667	292
	2,171	2,267	962	868

Notes continued

Forming part of the financial statements

19 Provisions for Liabilities and Charges

	Provision for national insurance on share options $000	Provision for decommissioning $000	Total $000
Group			
At beginning of year	–	196	196
Amounts provided	745	–	745
Effect of movement in foreign exchange	–	9	9
At end of year	**745**	**205**	**950**

At 31 December 2006 a provision for $204,673 (2005: $196,238) has been recognised for decommissioning costs. These costs relate to the estimated liability for the removal of the Ukraine production facilities and site restoration at the end of the production life. These costs are expected to be incurred between 2009 and 2024.

	Provision for national insurance on share options $000
Company	
At beginning of year	–
Amounts provided	745
At end of year	**745**

20 Called Up Share Capital

	2006 $000	2005 $000
Authorised		
Equity: 300,000,000 (2005: 200,000,000) ordinary shares of 5 pence each (approximately 9 cents each)	**27,405**	17,905
Allotted, called up and fully paid		
Equity: 128,508,201 (2005: 128,508,201) ordinary shares of 5 pence each (approximately 9 cents each)	**10,934**	10,934

The directors held the following options to subscribe for shares in the Company:

	Class of share	At end of year	At beginning of year or date of appointment
R S C Phillips	Ordinary	750,000	750,000
Lord St John of Bletso	Ordinary	750,000	500,000

The above options are held under share option schemes and are exercisable by 2015 at prices ranging between 60 pence and 87.5 pence.

Share Option Scheme

The only share option plan operated during the year was the 2004 share option plan. Options granted under the 2004 share option plan normally only become exercisable following the first anniversary of the date of grant if the performance condition has been met. In addition to the share option plan, the Company holds agreements with three individuals granting the right to subscribe for shares in the Company.

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the year.

	2006 Number	2006 WAEP £	2005 Number	2005 WAEP £
Outstanding at beginning of year	**6,390,000**	**1.497**	250,000	3.530
Granted during the year	**4,330,000**	**0.832**	6,140,000	1.414
Exercised during the year	**(69,325)**	**0.600**	–	–
Expired during the year	**(7,425,675)**	**1.380**	–	–
Outstanding at end of year	**3,225,000**	**0.892**	6,390,000	1.497
Exercisable at end of year	**3,085,000**	**1.044**	1,310,000	1.020

The weighted average share price at exercise for options exercised in 2006 was 60 pence.

Options outstanding at 31 December 2006 had exercise prices of 41.6 pence to 360 pence and remaining contractual life of one to 10 years.

20 Called Up Share Capital continued

The principal inputs to the options valuation model were:

Risk free interest rate	4.5% p.a.
Expected volatility	60–117% p.a.
Dividend yield	0% p.a.
Employee turnover	From 0%–10% p.a. depending on seniority
Early exercise	At rates dependent upon seniority and potential gain from exercise

The fair values and expected lives of the options valued in accordance with FRS 20 were:

	Weighted average fair value £	Weighted average expected life from grant date Years
2005	0.304	1.96
2006	**0.357**	**1.29**

The Company recognised a total expense of $387,000 (2005: $1,664,000) in respect of the share option valuation.

21 Share Premium and Reserves

	Share capital $000	Share premium account $000	Equity share option reserve $000	Shares to be issued $000	Merger reserve $000	Capital Contri-bution $000	Foreign exchange reserve $000	Profit and loss account $000	Total $000
Group									
At beginning of year	10,934	217,640	–	–	(3,204)	7,477	9	(107,567)	125,289
Prior year adjustment – FRS 20 Share option charge (i)	–	–	1,791	–	–	–	–	(1,791)	–
At beginning of year as restated	10,934	217,640	1,791	–	(3,204)	7,477	9	(109,358)	125,289
Retained loss for the year	–	–	–	–	–	–	–	(109,176)	(109,176)
Current year FRS 20 charge	–	–	387	49,049	–	–	–	–	49,436
Cost of shares vesting	–	–	–	–	–	–	–	80	80
Exchange differences (ii)	–	–	–	–	–	–	4,331	–	4,331
Transfer for options exercised or expired	–	–	(147)	–	–	–	–	147	–
At end of year	**10,934**	**217,640**	**2,031**	**49,049**	**(3,204)**	**7,477**	**4,340**	**(218,307)**	**69,960**
Company									
At beginning of year	10,934	217,640	–	–	–	–	–	(122,614)	105,960
Prior year adjustment – FRS 20 Share option charge (i)	–	–	1,791	–	–	–	–	(1,791)	–
At beginning of year as restated	10,934	217,640	1,791	–	–	–	–	(124,405)	105,960
Retained loss for the year	–	–	–	–	–	–	–	(91,191)	(91,191)
Current year FRS 20 charge	–	–	387	49,049	–	–	–	–	49,436
Cost of shares vesting	–	–	–	–	–	–	–	80	80
Transfer for options exercised or expired	–	–	(147)	–	–	–	–	147	–
At end of year	**10,934**	**217,640**	**2,031**	**49,049**	**–**	**–**	**–**	**(215,369)**	**64,285**

A number of Regal Petroleum plc ordinary shares were previously held in an Employee Share Ownership Trust (ESOT). These shares were held by the ESOT to meet awards made under a number of employee share plans. At 31 December 2006 the ESOT held no Regal Petroleum plc ordinary shares (2005: 69,325). At 31 December 2006 the market value of these shares was $nil (2005: $139,750).

Notes continued
Forming part of the financial statements

21 Share Premium and Reserves continued
(i) Equity Share Option Reserve
The balance held in the equity share option reserve relates to the fair value of the share options that have been expensed through the profit and loss account less any amounts that have been credited back since the adoption of FRS 20.

(ii) Foreign Exchange Reserve
Exchange reserve movement for the year attributable to currency fluctuations.

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

	2006 Land and buildings $000	2005 Land and buildings $000
Group		
Operating leases which expire:		
Within one year	–	382
In the second to fifth years inclusive	432	127
	432	509

The following commitments were held as at 31 December 2006:

- The Group has committed to 25% of the total agreed exploration plan expenditure in its joint venture interest in the East Ras Budran concession in Egypt. The Group's portion of this cost is expected to be $3.4 million.
- The Group has signed a contract with Ukrainian State Enterprise – Ukrgeofizika to undertake a 3D seismic survey over the producing area of the MEX-GOL field in Ukraine. The survey is anticipated to cost $2.5 million to acquire. An initial payment of $0.6 million had been made as at 31 December 2006.

In addition, while no contractual commitment existed as at 31 December 2006, the Group's Romanian subsidiary expects to drill two wells in 2007 in order to fulfil its commitment in the Company's Barlad licence area. The wells are expected to cost approximately $3.0 million in aggregate.

	2006 Land and buildings $000	2005 Land and buildings $000
Company		
Operating leases which expire:		
Within one year	–	382
In the second to fifth years inclusive	432	127
	432	509

23 Reconciliation of Operating Loss to Operating Cash Flow

	2006 $000	2005 as restated $000
Operating loss	(66,166)	(30,395)
Depreciation, amortisation and impairment charges	2,977	14,840
Exchange differences	(343)	771
Movement in provisions	754	276
Decrease/(increase) in stocks	1	(4,522)
Decrease/(increase) in debtors	1,580	(887)
Decrease in creditors	(195)	(12,310)
Current asset investment	116	93
Share option charge	387	1,664
Exceptional share based payment charge	49,049	–
Net cash outflow from operating activities	(11,840)	(30,470)

24 Analysis of Cash Flows

	2006 $000	2006 $000	2005 $000	2005 $000
Returns on investment and servicing of finance				
Interest received	**1,183**		1,115	
Interest paid	**(2)**		(145)	
		1,181		970
Capital expenditure and financial investment				
Purchase of tangible and intangible fixed assets	**(16,076)**		(41,681)	
Sale of intangible assets	**4,245**		–	
		(11,831)		(41,681)
Acquisitions and disposals				
Deconsolidation of subsidiary undertaking	**–**		(669)	
Purchase of subsidiary undertaking	**–**		(1,185)	
		–		(1,854)
Management of liquid resources				
Disposal of current non-listed investments	**–**		3,000	
Decrease in monies on deposit	**20**		113	
		20		3,113
Financing				
Funds received in connection to the exercise of share options	**80**		–	
Issue of ordinary share capital	**–**		84,642	
Debt due within one year:				
Decrease in short-term borrowing	**(16)**		(1,064)	
		64		83,578

25 Analysis of Net Funds

	At beginning of year $000	Cash flow $000	Other non-cash movements $000	Exchange movement $000	At end of year $000
Cash in hand, at bank	34,796	(22,897)	–	1,149	13,048
Overdrafts	(16)	16	–	–	–
Current asset investments	136	(20)	(116)	–	–
Total	**34,916**	**(22,901)**	**(116)**	**1,149**	**13,048**

26 Financial Instruments

The Group's financial instruments comprise loans, short-term investments, cash and various items such as debtors and creditors that arise directly from its operations. The Group has bank accounts denominated in British pounds, Egyptian pounds, US dollars, Euros, Ukraine hryvnia and Romanian lei. As at 31 December 2006 the Group does not have any long-term borrowings (2005: $nil). The main future risks arising from the Group's financial instruments are currently currency risk and liquidity risk.

Short-term Debtors and Creditors

Short-term debtors and creditors have been excluded from all the following disclosures other than the currency risk disclosures. The fair value of short-term debtors and creditors approximates to the carrying value because of their short maturity. In accordance with Financial Reporting Standard 13 'Derivatives and Other Financial Instruments', deferred tax has been excluded from the following disclosures.

Currency Risk

The main functional currency of the Group is US dollars. The following analysis of net monetary assets and liabilities shows the Group's currency exposures. Exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of operations.

	2006 $000	2005 $000
Currency		
British pounds	**761**	1,319
Egyptian pounds	**22**	(1)
Euros	**838**	4,168
Ukraine hryvnia	**1,856**	4,439
Romanian lei	**1,487**	1,333
	4,964	11,258

Notes continued

Forming part of the financial statements

26 Financial Instruments continued

Liquidity Risk

The Group's objective throughout the year has been to ensure continuity of funding. Operations to date have primarily been financed through capital contributions, the issue of share capital prior to January 2006, revenue from Ukraine operations and proceeds received as a result of the joint venture in Egypt from which 75% of back costs were reimbursed.

Interest Rate Risk Profile of Financial Liabilities

The interest rate profile of the financial liabilities of the Group as at 31 December 2006 was:

	2006			2005		
Currency	Total financial liabilities $000	Floating rate financial liabilities $000	Fixed rate financial liabilities $000	Total financial liabilities $000	Floating rate financial liabilities $000	Fixed rate financial liabilities $000
Euros	–	–	–	16	16	–
Total	**–**	**–**	**–**	**16**	**16**	**–**

All the Group's creditors falling due within one year (other than bank borrowings) are excluded from the above tables either due to the exclusion of short-term items or because they do not meet the definition of financial liabilities. There are no material financial liabilities on which interest is not paid. The floating rate financial liabilities comprise bank borrowings bearing interest rates fixed in advance for various periods up to 12 months by reference to the London Interbank Offered Rate (LIBOR) for that time period.

	2006 Fixed rate financial liabilities		2005 Fixed rate financial liabilities	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Euros	n/a	n/a	n/a	n/a
Weighted average	**n/a**	**n/a**	**n/a**	**n/a**

Interest Rate Risk Profile of Financial Assets

The Group had the following financial assets as at 31 December 2006:

	2006			2005		
	Total $000	Floating rate financial assets $000	Fixed rate financial assets $000	Total $000	Floating rate financial assets $000	Fixed rate financial assets $000
Currency						
British pounds	924	924	–	1,483	1,483	–
US dollar	9,939	9,939	–	26,140	26,140	–
Egyptian pounds	26	26	–	79	79	–
Euros	808	808	–	4,154	4,154	–
Ukraine hryvnia	1,343	1,343	–	2,237	2,237	–
Romanian lei	8	8	–	703	703	–
Total	**13,048**	**13,048**	**–**	34,796	34,796	–

The cash deposits comprise deposits placed in money market funds.

Maturity of Financial Liabilities

The maturity profile of the Group's financial liabilities, other than short-term creditors and accruals, was as follows:

	2006 $000	2005 $000
In one year or less	–	16
In more than five years	–	–
Total	**–**	**16**

Borrowing Facilities

The Group has certain borrowing facilities available to it. The undrawn facilities available at 31 December 2006 in respect of which all conditions precedent have been met at that date amount to $nil (2005: $nil).

	2006			2005		
	Total $000	Drawn $000	Undrawn $000	Total $000	Drawn $000	Undrawn $000
Facility						
Overdraft facility	–	–	–	16	16	–
Total	**–**	**–**	**–**	**16**	**16**	**–**

Bank borrowing facilities are normally reaffirmed by the banks annually although they can theoretically be withdrawn at any time.

26 Financial Instruments continued

Fair Value of Financial Assets and Liabilities

The fair value of all financial instruments is not materially different from the book value.

27 Related Party Disclosures

Goods and services to the value of $63,968 (2005: $11,187) were paid for by the Group on behalf of Sierra Leone Diamond Company Limited in the form of a debtor. Sierra Leone Diamond Company Limited is a diamond exploration company in which Mr F Scolaro (current non-executive Chairman) is a current non-executive Director. The amount of $22,600 (2005: $nil) was owed to the Group at the end of the year. All amounts outstanding at year end were fully repaid during 2007.

During the year, services to the value of $467,102 (2005: $nil) were provided by Mionex International Limited to the Group. Mionex International Limited is a company in which Mr F Scolaro (current non-executive Chairman) has a minority shareholding.

The Company made no provisions for loans or debtor balances due from Kavala Oil S.A. during the year (2005: $96,931,495).

Notes

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Glossary

boepd
barrels of oil equivalent per day

km
kilometres

km²
square kilometres

m³d
cubic metres per day

Mm³
thousand cubic metres

$
United States Dollars

bbls
barrels

bopd
barrels per day

Mbbls
thousand barrels

MMbbls
million barrels

Mboe
thousand barrels of oil equivalent

MMboe
million barrels of oil equivalent

Mcf
thousand cubic feet

MMcf
million cubic feet

MMscfd
million standard cubic feet of gas per day

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