Zeta Petroleum Limited

Report and Financial Statements

Year Ended 31 December 2008

ZETA PETROLEUM LIMITED

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

Page:

GENERAL INFORMATION

Directors

T W Osborne (Interim Chairman)
C C G Lewis (Chief Executive)
S P West

Company Secretary

B Hodges

Registered Office

1 Berkeley Street
London
W1J 8DJ
United Kingdom

Company Number

5560854

Auditor

Ernst & Young LLP
1 More London Place
London
SE1 2AF
United Kingdom

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2008

The directors present their report together with the audited financial statements for the year ended 31 December 2008.

Results and Dividends

The consolidated income statement is set out on page 8 and shows a loss for the year amounting to £2,853,000 (2007 – loss of £2,794,000 for the year restated). The directors do not recommend the payment of a dividend.

Principal Activities and Review of Operations

The principal activities of the Group are oil and gas exploration, development and production.

In January 2008 the Company completed a 2D seismic acquisition programme on the Duzce/Sakarya licences in Turkey with a total of 204km of 2D seismic data having been acquired. The acquired 2D seismic data was processed by a third party contractor during the period February 2008 to April 2008, and was interpreted in-house by the Company during the period May 2008 to July 2008. The total cost of the seismic programme was approximately US$2.3 million and under the terms of the Company's Duzce/Sakarya farm-out agreement the Company funded the total cost of this seismic programme.

On 27 February 2008 the Company signed an unconditional sale and purchase agreement ("SPA") with a third party for the sale of the Company's remaining 19.5% interest in the Bartin licences in Turkey. In accordance with the terms of the SPA, the consideration payable to the Company was an initial payment of US$1.2 million, a further payment of US$1.07 million should the buyer still hold an interest in the Bartin licences within twelve months of signing the SPA and a final payment of US$2.27 million should the buyer make a commercial discovery on the Bartin licences within three years of signing the SPA.

On 25 March 2008 the concession agreements for the Jimbolia and Padureni licences in Romania were fully ratified by the Romanian government ministries and were officially gazetted on 1 April 2008.

On 31 August 2008 the Company entered into a convertible loan agreement with GM Investment & Co Limited ("GMI") whereby GMI provided a facility of US$3.2 million repayable on or before 31 August 2010. Further details on the terms of the convertible loan are disclosed in Note 17 to the consolidated financial statements.

On 24 October 2008 the Company appointed Tristone Capital as advisor to the Company to investigate strategic options to fund the re-development of the Bobocu gas field and the continued exploration and appraisal activities of its portfolio in Romania and Turkey.

On 31 October 2008 the Duzce-1 exploration well commenced drilling on the Duzce/Sakarya licences in Turkey and was completed on 21 November 2008. During the drilling operation the well did not encounter any significant gas shows and the log interpretation did not show hydrocarbons across the target intervals. The total cost of the well was approximately US$2.2 million and under the terms of the Company's Duzce/Sakarya farm-out agreement the Company funded the total cost of this drilling programme. By funding the drilling of the Duzce-1 exploration well the Company has fulfilled all farm-in commitments on the Duzce/Sakarya licences to earn a 70% interest in the licences. In addition, the Duzce-1 exploration well satisfied the 2008 drilling commitment on the licences.

In October 2008 the Group lodged an application with the National Agency for Minerals and Resources, Romania to extend the boundary of the Bobocu licence. The Group was officially granted the extension to the boundary of the Bobocu licence on 17 December 2008.

On 5 December 2008 Jim Rutland, the Company's non-executive Chairman, sadly passed away. Jim was a great friend and colleague and a tremendous Chairman of the Company. Tim Osborne kindly agreed to act as non-executive Chairman until a new Chairman has been identified.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2008

The subsidiary undertakings principally affecting the profits or net assets of the Group are listed in Note 13 to the consolidated financial statements.

Principal Risks and Uncertainties

As an exploration, development and production company in the oil and gas industry the Company operates in an inherently risky sector and faces a large number of risks including:

Discovery Risk:	Risk that no economically producible oil or gas will be discovered or found to be present in the Group's exploration licence areas.
Capital Intensive Business:	The drilling of wells to discover whether there is oil or gas is a highly capital intensive business and will require the Company to raise capital in the future.
Natural Gas and Oil Price:	The Company's asset value and economic viability of its exploration projects depend on the price of natural gas and oil. The Company's ability to raise funds in the future is therefore likely to be sensitive to the price of natural gas and oil.
Environmental Regulations:	The Group's operations are subject to the environmental risks inherent in the oil and gas industry.

Post Balance Sheet Events

Post balance sheet events are disclosed in Note 26 to the consolidated financial statements.

Share Capital

Details of the Company's authorised and issued share capital as at 31 December 2008 and of shares issued during the year are set out in Note 19 to the consolidated financial statements.

Policy and Practice on Payment of Creditors

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers, providing that all trading terms and conditions have been complied with. The average creditor payment period for the year ended 31 December 2008 for the Company was 15.18 days.

Going Concern

The Group has implemented a series of cost cutting measures in 2009, including a significant reduction in discretionary capital expenditure and the closure of operations in Turkey (refer Note 26). Negotiations (which are in an advanced stage) over the sale of a proportion of the Bobocu gas field in Romania are taking place which, if successful, should generate sufficient proceeds to reduce the Group's debt and fund future working capital. Capital expenditure projects will only proceed to the extent that committed financing is fully secured.

As at 31 December 2008, the Group has available funds totalling £393,000 and additional access to US$500,000 being the undrawn component of the total convertible note facility of $3,200,000.

The Directors believe that the Group's current cash position and available credit facility, the cost cutting measures implemented within the business, together with the curtailment in discretionary capital spending, anticipated proceeds from the disposal of a proportion of the Bobocu gas field in Romania and other potential asset disposals, all provide sufficient cover to meet the Group's anticipated cash flow requirements. After performing detailed analyses, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2008

Directors and Directors' Interests

The directors who held office during the year were as follows:

	Date appointed	Date resigned
C C G Lewis	12 Sep 2005	-
S P West	12 Sep 2005	-
T W Osborne	31 Mar 2006	-
J A Rutland	25 May 2006	5 Dec 2008

The directors who held office at 31 December 2008 had the following interests in the ordinary shares of the Company according to the register of directors' interests:

	Class of Share	Interest at start of year	Interest at end of year
C C G Lewis	Ordinary	553,200	506,338
S P West[1]	Ordinary	419,000	419,000
T W Osborne	Ordinary	-	-

[1] S P West's interest is indirect as all the shares are owned by Cresthaven Investments Limited, a company in which S P West has an indirect beneficial interest.

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:

Date of grant	Number of options at start of year	Options granted during the year	Number of options at the end of the year	Exercise price	Date from which exercisable	Expiry date
C C G Lewis						
29.03.06	50,000	-	50,000	£2.8736	29.03.07	29.03.16
29.03.06	50,000	-	50,000	£2.8736	29.09.07	29.03.16
	100,000	-	100,000			
S P West						
29.03.06	50,000	-	50,000	£2.8736	29.03.07	29.03.16
29.03.06	50,000	-	50,000	£2.8736	29.09.07	29.03.16
	100,000	-	100,000			

Substantial Shareholders

The following parties had interests of greater than 3% of the issued share capital of the Company at 31 December 2008:

	Number of shares	% of issued ordinary share capital
GM Investment & Co Limited	849,844	31.07
C C G Lewis	506,338	18.51
S Pagel	422,793	15.46
Cresthaven Investments Limited[2]	419,000	15.32
WCI Overseas Oil & Gas LLC	191,400	7.00
AM2 (Bermuda) Limited	104,400	3.82

[2] Cresthaven Investments Limited is a company in which S P West has an indirect beneficial interest.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2008

Statement of Directors' Responsibilities

The directors are responsible for preparing the consolidated and company financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

The directors are required to prepare consolidated and company financial statements for each financial year which present fairly the financial position of the Group and Company, and the financial performance and cash flows of the Group and Company for the period. In preparing those financial statements the directors are required to:

- select suitable accounting policies in accordance with IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's and/or Company's financial position and performance; and
- state that the Group and Company have complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the consolidated and company financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement as to Disclosure of Information to Auditors

The directors who were members of the board at the time of approving the directors' report are listed on page 1. Having made inquiries of fellow directors and of the Company's auditors, each of these directors confirm that:

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Political and Charitable Contributions

The Group made no political contributions or donations to United Kingdom charities during the period.

By order of the Board

S P West
Director
28 July 2009

1 Berkeley Street
London W1J 8DJ
United Kingdom

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ZETA PETROLEUM LIMITED

We have audited the Group and parent company financial statements of Zeta Petroleum Limited for the year ended 31 December 2008 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated and Company Cash Flow Statements, the Consolidated and Company Statements of Changes in Equity and the related notes 1 to 26. 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 auditors' 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 consolidated and Company financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities on page 5.

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 consolidated and Company 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 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 the directors' report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies within it. 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 and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ZETA PETROLEUM LIMITED (CONTINUED)

Opinion

In our opinion:

- the consolidated and Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Company's affairs as at 31 December 2008 and of the loss of the Group for the year then ended;
- the consolidated and Company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Ernst & Young LLP

Ernst & Young LLP
Registered auditor
London
28 July 2009

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	2008 £'000	Restated 2007 £'000
Continuing operations			
Revenue	2	**598**	53
Cost of goods sold		**-**	(28)
Gross Profit		**598**	25
Exploration and evaluation expenses		**(2,198)**	(1,498)
Administrative expenses		**(1,168)**	(1,392)
Operating loss		**(2,768)**	(2,865)
Interest income	4	**54**	90
Financing costs	5	**(135)**	-
Loss before Taxation		**(2,849)**	(2,775)
Income tax	9	**(4)**	(19)
Loss for the year attributable to the equity holders		**(2,853)**	(2,794)
Loss per ordinary share – basic	10	**104.32p**	113.30p

CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2008

	Note	2008 £'000	Restated 2007 £'000
ASSETS			
Non-current assets			
Intangible assets	11	**732**	711
Property, plant & equipment	12	**17**	28
		749	739
Current assets			
Trade and other receivables	15	**379**	541
Prepayments and accrued income		**10**	9
Cash and cash equivalents	14	**393**	1,735
		782	2,285
Total assets		**1,531**	3,024
EQUITY AND LIABILITIES			
Equity attributable to equity holders			
Issued capital	19	**3**	3
Share premium	20	**6,008**	6,008
Share options reserve	21	**1,044**	606
Foreign currency translation reserve		**(282)**	5
Retained losses		**(7,201)**	(4,374)
Total equity		**(428)**	2,248
Non-current liabilities			
Interest-bearing loans & borrowings	17	**1,680**	-
Provision	18	**41**	37
		1,721	**37**
Current liabilities			
Trade and other payables	16	**238**	739
Total liabilities		**1,959**	776
Total equity and liabilities		**1,531**	3,024

Stephen West, Finance Director
28 July 2009

COMPANY BALANCE SHEET
AS AT 31 DECEMBER 2008

	Note	2008 £'000	Restated 2007 £'000
ASSETS			
Non-current assets			
Intangible assets	11	**1**	2
Property, plant & equipment	12	**14**	23
Investment in subsidiary	13	**1**	1
Other receivables		**3,080**	2,160
		3,096	2,186
Current assets			
Trade and other receivables	15	**37**	73
Prepayments and accrued income		**10**	8
Cash and cash equivalents	14	**383**	1,722
		430	1,803
Total assets		**3,526**	3,989
EQUITY AND LIABILITIES			
Equity attributable to equity holders			
Issued capital	19	**3**	3
Share premium	20	**6,008**	6,008
Share options reserve	21	**1,044**	606
Retained losses		**(5,462)**	(3,291)
Total equity		**1,593**	3,326
Non-current liabilities			
Interest-bearing loans & borrowings	17	**1,680**	-
Provision	18	**41**	37
		1,721	**37**
Current liabilities			
Trade and other payables	16	**212**	626
Total liabilities		**1,933**	663
Total equity and liabilities		**3,526**	3,989

Stephen West, Finance Director
28 July 2009

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2008

	Issued Capital £'000	Share Premium £'000	Share Options Reserve £'000	Foreign Currency Translation Reserve £'000	Retained Losses £'000	Total £'000
As at 1 January 2008	3	6,008	606	5	(4,337)	2,285
Prior period restatement	-	-	-	-	(37)	(37)
As at 1 January 2008 (restated)	3	6,008	606	5	(4,374)	2,248
Issue of share options	-	-	209	-	-	209
Convertible note options	-	-	255	-	-	255
Movement in reserve	-	-	-	(287)	-	(287)
Option write-back	-	-	(26)	-	26	-
Loss for the year	-	-	-	-	(2,853)	(2,853)
At 31 December 2008	**3**	**6,008**	**1,044**	**(282)**	**(7,201)**	**(428)**

COMPANY STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2008

	Issued Capital £'000	Share Premium £'000	Share Options Reserve £'000	Retained Losses £'000	Total £'000
As at 1 January 2008	3	6,008	606	(3,254)	3,363
Prior period restatement	-	-	-	(37)	(37)
As at 1 January 2008 (restated)	3	6,008	606	(3,291)	3,326
Issue of share options	-	-	209	-	209
Convertible note options	-	-	255	-	255
Movement in reserve	-	-	-	-	-
Option write-back	-	-	(26)	26	-
Loss for the year	-	-	-	(2,197)	(2,197)
At 31 December 2008	**3**	**6,008**	**1,044**	**(5,462)**	**1,593**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE PERIOD ENDED 31 DECEMBER 2007

	Issued Capital £'000	Share Premium £'000	Share Options Reserve £'000	Foreign Currency Translation Reserve £'000	Retained Losses £'000	Total £'000
As at 1 January 2007	2	3,910	337	-	(1,562)	2,687
Prior period restatement	-	-	-	-	(18)	(18)
As at 1 January 2007 (restated)	2	3,910	337	-	(1,580)	2,669
Issue of share capital	1	2,236	-	-	-	2,237
Transaction costs of issue of shares	-	(138)	-	-	-	(138)
Issue of share options	-	-	269	-	-	269
Movement in reserve	-	-	-	5	-	5
Loss for the year	-	-	-	-	(2,794)	(2,794)
At 31 December 2007	3	6,008	606	5	(4,374)	2,248

COMPANY STATEMENT OF CHANGES IN EQUITY
FOR THE PERIOD ENDED 31 DECEMBER 2007

	Issued Capital £'000	Share Premium £'000	Share Options Reserve £'000	Retained Losses £'000	Total £'000
As at 1 January 2007	2	3,910	337	(1,532)	2,717
Prior period restatement	-	-		(18)	(18)
As at 1 January 2007 (restated)	2	3,910	337	(1,550)	2,699
Issue of share capital	1	2,236	-	-	2,237
Transaction costs of issue of shares	-	(138)	-	-	(138)
Issue of share options	-	-	269	-	269
Loss for the year	-	-	-	(1,741)	(1,741)
At 31 December 2007	3	6,008	606	(3,291)	3,326

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	2008 £'000	2007 £'000
Operating activities			
Loss before tax from continuing operations		**(2,849)**	(2,775)
Adjustment to reconcile loss to net cash outflow from operating activities			
Non-cash:			
Depreciation	12	**17**	6
Amortisation	11	**102**	63
Borrowing costs amortised		**40**	-
Share based payments	21	**209**	269
Interest on convertible loan		**29**	-
Foreign exchange losses		**(409)**	-
Write-off of exploration and evaluation costs		**2,198**	1,498
Interest income	4	**(54)**	(90)
Licence sale proceeds		**(598)**	-
Working capital adjustments:			
Decrease/(increase) in trade and other receivables		**162**	(477)
(Increase)/decrease in prepayments and accrued income		**(1)**	75
(Decrease)/increase in trade and other payables		**(501)**	711
Net cash outflow from operating activities		**(1,655)**	(720)
Investing activities			
Purchase of property, plant and equipment	12	**(6)**	(26)
Purchase of intangible assets	11	**-**	(687)
Exploration and evaluation costs		**(2,198)**	(1,498)
Interest received	4	**54**	90
Licence sale proceeds		**598**	-
Net cash used in investing activities		**(1,552)**	(2,121)
Financing activities			
Proceeds from issue of shares		**-**	2,236
Transaction costs for issue of shares		**-**	(138)
Convertible note amounts drawn down		**1,865**	-
Net cash inflow from financing activities		**1,865**	2,098
Net decrease in cash and cash equivalents		**(1,342)**	(743)
Cash and cash equivalents at the beginning of the year	14	**1,735**	2,478
Cash and cash equivalents at the end of the year	14	**393**	1,735

COMPANY CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	2008 £'000	2007 £'000
Operating activities			
Loss before tax from continuing operations		**(2,193)**	(1,722)
Adjustments to reconcile loss to net cash outflow from operating activities			
Non-cash:			
Depreciation	12	**15**	5
Amortisation	11	**1**	9
Borrowing costs amortised		**40**	-
Share based payments	21	**209**	269
Interest on convertible loan		**29**	-
Foreign exchange losses		**(645)**	-
Write-off of exploration and evaluation costs		**1,997**	679
Interest income	4	**(19)**	(90)
Licence sale proceeds		**(598)**	-
Working capital adjustments:			
Decrease/(increase) in trade and other receivables		**36**	(27)
(Increase)/decrease in prepayments and accrued income		**(2)**	73
(Decrease)/increase in trade and other payables		**(414)**	600
Net cash outflow from operating activities		**(1,544)**	(204)
Investing activities			
Purchase of property, plant and equipment	12	**(6)**	(24)
Purchase of intangible assets		**-**	(1)
Exploration and evaluation costs		**(1,997)**	(679)
Interest received	4	**19**	90
Licence sale proceeds		**598**	-
Loans to subsidiary		**(274)**	(2,031)
Net cash used in investing activities		**(1,660)**	(2,645)
Financing activities			
Proceeds from issue of shares		**-**	2,236
Transaction costs for issue of shares		**-**	(138)
Convertible note amounts drawn down		**1,865**	-
Net cash inflow from financing activities		**1,865**	2,098
Net decrease in cash and cash equivalents		**(1,339)**	(751)
Cash and cash equivalents at the beginning of the year	14	**1,722**	2,473
Cash and cash equivalents at the end of the year	14	**383**	1,722

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1. Accounting policies

1.1 Authorisation of financial statements and statement of compliance with IFRSs

Zeta Petroleum Limited ("Zeta" or the "Company"), the ultimate parent of the Group, is a private company incorporated in England. The registered office and principal place of business is 1 Berkeley Street, London, W1J 8DJ. The principal activities of Zeta and its subsidiaries (the Group) are oil and gas exploration, development and production.

The Group's consolidated financial statements for the year ended 31 December 2008 were authorised for issue by the board of directors on 28 July 2009 and the balance sheets were signed on the Board's behalf by S P West.

The Group's consolidated financial statements and the Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The principal accounting policies adopted by the Group are set out below.

1.2 Basis of preparation

The consolidated financial statements of Zeta have been prepared on a historical cost basis. The consolidated financial statements are presented in British pounds and all values are rounded to the nearest thousand (£000) except when otherwise indicated.

1.3 Going concern

The Group has implemented a series of cost cutting measures in 2009, including a significant reduction in discretionary capital expenditure and the closure of operations in Turkey (refer Note 26). Negotiations (which are in an advanced stage) over the sale of a proportion of the Bobocu gas field in Romania are taking place which, if successful, should generate sufficient proceeds to reduce the Group's debt and fund future working capital. Capital expenditure projects will only proceed to the extent that committed financing is fully secured.

As at 31 December 2008, the Group has available funds totalling £393,000 and additional access to US$500,000 being the undrawn component of the total convertible note facility of $3,200,000.

The Directors believe that the Group's current cash position and available credit facility, the cost cutting measures implemented within the business, together with the curtailment in discretionary capital spending, anticipated proceeds from the disposal of a proportion of the Bobocu gas field in Romania and other potential asset disposals, all provide sufficient cover to meet the Group's anticipated cash flow requirements. After performing detailed analyses, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

1.4 Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

1.5 Basis of consolidation

The consolidated financial statements comprise the financial statements of Zeta and its subsidiaries as at 31 December 2008. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognised in assets, are eliminated in full.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

Zeta has used the exemption granted under s230(1)(b) of the Companies Act 1985 that allows for the non-disclosure of the Income Statement of the parent company. The after tax loss attributable to Zeta for the year ended 31 December 2008 was £2,197,000 (2007: £1,741,000).

1.6 Joint ventures

The Group has a number of contractual arrangements with other parties which represent joint ventures.

A joint venture is a contractual arrangement whereby the Group and the other parties undertake an economic activity that is subject to joint control.

Where a Group company undertakes its activities under joint venture arrangements, the Group's share of jointly and directly controlled assets and any liabilities incurred jointly with other ventures are recognised and classified according to their nature. The Group's share of joint venture expenses are recognised when it is probable that the economic benefits associated with the transactions will flow from the Group and their amounts can be measured reliably.

1.7 Foreign currencies

The consolidated financial statements are presented in British pounds, which is the Company's functional and presentational currency. Each entity in the Group translates foreign currency transactions into its functional currency at the rate of exchange prevailing at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange prevailing at the Balance Sheet date. Exchange differences arising are taken to the Income Statement.

The functional currency of the foreign subsidiary Zeta Petroleum (Romania) SRL is Romanian New Lei (RON). Zeta translates the subsidiary accounts into the presentational currency using the closing rate method for assets and liabilities, which are translated into British pounds at the rate of exchange prevailing at the Balance Sheet date, and the weighted average exchange rate for the period for Income Statement accounts. Exchange differences arising on the translation of net assets of the subsidiary are taken to reserves.

1.8 Intangible Assets

Oil and gas exploration assets

Zeta follows the successful efforts based accounting policy for oil and gas assets. The successful efforts method means that only costs which relate directly to the discovery and development of specific oil and gas reserves are capitalised.

Costs incurred prior to obtaining the legal rights to explore an area are expensed immediately to the Income Statement.

Expenditure incurred on the acquisition of a licence interest is initially capitalised on a licence by licence basis and amortised on a straight-line basis over the estimated period of exploration and, in the event that no future activity is planned, the remaining balance of licence acquisition costs is written off. Should a

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1.8 Intangible Assets *continued*

discovery be made, the amortisation would be suspended and the remaining costs aggregated with exploration expenditure on a field by field basis as properties awaiting approval for development. When development is approved, the relevant expenditure is transferred to tangible assets.

Exploration expenditure incurred in the process of determining exploration targets is capitalised initially within exploration assets and subsequently allocated to drilling activities. Exploration drilling costs are initially capitalised on a well by well basis until the success or otherwise of the well has been established. The success or failure of each exploration effort is judged on a well by well basis. Drilling costs are written off on completion of a well unless the results indicate that hydrocarbon reserves exist and there is a reasonable prospect that these reserves are commercial.

Following appraisal of successful exploration wells, if commercial reserves are established and technical feasibility for extraction demonstrated, then the related capitalised exploration costs are transferred into a single field cost centre within development/producing assets after testing for impairment. Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are written off to the Income Statement.

All costs incurred after the technical feasibility and commercial viability of producing hydrocarbons has been demonstrated are capitalised within development/producing assets on a field by field basis.

Subsequent expenditure is capitalised only where it either enhances the economic benefits of the development/producing assets or replaces part of the existing development/producing asset. Any costs remaining associated with the part replaced are expensed.

Software costs

Software costs are carried within intangible assets at cost, less any accumulated amortisation and accumulated impairment losses.

Amortisation is charged so as to write off the cost over the estimated useful lives (1 to 3 years) using the straight-line method.

1.9 Property, plant and equipment

Property, plant and equipment are carried at cost, less any accumulated depreciation and accumulated impairment losses. Cost includes purchase price and construction costs for qualifying assets and borrowing costs capitalised in accordance with the Group’s accounting policy. Depreciation of these assets commences when the assets are ready for their intended use.

Depreciation is charged so as to write off the cost, less estimated residual value, over their estimated useful lives using the straight-line method, for the following classes of assets: computer equipment (3 years) and other equipment (1 to 5 years).

The estimated useful lives of property, plant and equipment and their residual values are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the Income Statement for the relevant period.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1.10 Impairment of intangible assets and property, plant and equipment

At each balance sheet date, the Group reviews the carrying amounts of its intangible assets and property, plant and equipment to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets are grouped together as a cash-generating unit for impairment assessment purposes at the lowest level of their identifiable cash flows, where these are largely independent of the cash flows of the other Group assets. In the case of exploration assets this will normally be at a field by field level.

If any such indication of impairment exists the Group makes an estimate of the recoverable amount of the asset or cash generating unit. The recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of an individual asset or a cash-generating unit exceeds its recoverable amount, the asset/cash-generating unit is considered impaired and is written down to its recoverable amount. In accessing the value in use, the estimated future cash flows are adjusted for the risks specific to the asset/cash-generating unit and are discounted to their present value at a rate that reflects the current market indicators.

Where an impairment loss subsequently reverses, the carrying amount of the asset/cash-generating unit is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset/cash-generating unit in prior years. A reversal of an impairment loss is recognised as income immediately.

1.11 Impairment of financial assets

The Group assesses at each balance sheet date whether a financial asset is impaired and will recognise the impairment loss immediately through the income statement.

1.12 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and current balances with banks and similar institutions, which are readily convertible to known amounts of cash. Cash equivalents are short-term with an original maturity of less than 3 months, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

1.13 Trade and other receivables

Trade receivables are recognised and carried at the lower of their original invoiced value and recoverable amount. Other debtors are recognised and measured at nominal value.

1.14 Share-based payments

Share options

The Group issues equity-settled share-based payments to the directors and senior management ("Employee Share Options") and to its corporate finance advisers for assistance in raising private equity and to convertible loan providers ("Non-employee Share Options"). Equity-settled share-based payments are measured at fair value at the date of grant for Employee Share Options and the date of service for Non-employee Share Options. The fair value determined at the grant date or service date, as applicable, of the equity-settled share-based payments is expensed, with a corresponding credit to equity, on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. At each subsequent balance sheet date the Group calculates the estimated cumulative charge for each award having regard to any change in the number of options that are expected to vest and the expired portion of the vesting period. The change in this cumulative charge since the last balance sheet date is expensed with a corresponding credit being made to equity. Once an option vests, no further adjustment is made to the aggregate amount expensed. The fair value is calculated using the Black Scholes method. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability exercise restrictions and behavioural considerations. The market price used in the model is the issue price of Company shares at the last placement of shares immediately preceding the calculation date. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitation of the calculations used.

1.15 Taxation

Income tax expense represents the sum of the current tax payable and deferred tax.

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

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

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered. Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised based on tax rates and laws substantively enacted by the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1.15 Taxation *continued*

Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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

1.16 Financial liabilities

Initial recognition

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss or loans and borrowings. The Group determines the classification of its financial liabilities at initial recognition.

Financial liabilities are recognised initially at fair value and in the case of loans and borrowings, directly attributable transaction costs.

The Group's financial liabilities include trade and other payables as well as loans and borrowings.

Interest bearing loans and borrowings

Borrowings are initially recognised at the fair value of consideration received less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Borrowings denominated in a currency other than British Pounds are revalued through the profit and loss statement on a monthly basis.

1.17 Revenue recognition

Sales of oil and gas products are recognised when the significant risks and rewards of ownership have passed to the buyer and it can be reliably measured. Other services are recognised when the services have been performed. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales taxes or duty.

1.18 Interest Income

Revenue is recognised as interest accrued (using the effective interest method). Interest income is included in finance revenue in the income statement.

1.19 Share issue expenses and share premium account

Costs of share issues are written off against the premium arising on the issue of share capital.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1.20 Restatement of prior years comparatives

Adjustments have been made to the 2007 comparative numbers.

The adjustments have arisen due to revised judgements being made on the taxation of the Company's income for 2006 and 2007. The effects of the restatement on those financial statements are summarised below and there is no effect on 2008.

	2007 £'000	2006 £'000
Increase in tax expense	(19)	(18)
Decrease in profits	(19)	(18)
Increase in provisions	(37)	(18)
Decrease in equity	(37)	(18)

2. Revenue

For the year ended 31 December 2008 the revenue received is entirely attributable to the sale of the Bartin license in Turkey. For the year ended 31 December 2007 the revenue received is entirely attributable to other services provided by the Company to the joint venture operations in Turkey and Romania.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

3. Segment information

For the purposes of segmental information the primary segment reporting format is determined to be the business segment. The Group has one class of business, the exploration, development and production of oil and gas. No further disclosure is required in relation to primary segment reporting in this note as all the relevant disclosure is already detailed throughout the Group financial statements.

Secondary segment information is reported geographically. The Group's geographical segments are United Kingdom, Turkey and Romania.

Group revenue for the year ended 31 December 2008 is entirely attributable to the United Kingdom and Turkish geographical segments.

The following tables present expenditure and certain asset information regarding the Group's geographical segments for the year ended 31 December 2008:

Segment assets	**2008 £'000**	2007 £'000
United Kingdom	**441**	1,798
Turkey	**4**	32
Romania	**1,086**	1,194
	1,531	3,024

Capital expenditure	**2008 £'000**	2007 £'000
United Kingdom	**6**	24
Turkey	**1,997**	679
Romania	**201**	1,509
	2,204	2,212

4. Operating loss

Operating loss is stated after charging/(crediting):

	GROUP		**COMPANY**	
	2008 £'000	2007 £'000	**2008 £'000**	2007 £'000
Amortisation (note 11)	**102**	63	**1**	9
Depreciation (note 12)	**17**	6	**15**	5
Net foreign exchange differences	**(343)**	(80)	**(541)**	(11)
Interest income	**(54)**	(90)	**(19)**	(90)

5. Financing Costs

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Interest payable on loans	**29**	-	**29**	-
Other financing costs	**106**	-	**106**	-
Total financing costs	**135**	-	**135**	-

6. Auditors' remuneration

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Audit of the financial statements	**20**	20	**20**	20
	20	20	**20**	20

7. Employment costs

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Wages and salaries	**523**	313	**435**	305
Social security costs	**5l**	36	**51**	36
Share based payments arising from equity-settled share based payment transactions	**209**	227	**209**	227
	783	576	**695**	568

The weighted average number of employees (including executive directors) during the year was:

	GROUP		COMPANY	
	2008	2007	**2008**	2007
Management	**3**	3	**3**	2
Administration	**5**	1	**4**	1
	8	4	**7**	3

8. Remuneration of Directors

	2008	2007
Group and Company:	**£'000**	£'000
Basic salary and fees	**210**	172
Share based payments	**58**	175
	268	347

C. Lewis – Total Emoluments	**100**	81
S. West – Total Emoluments	**100**	81

Details of interests in share options for each director are set out in the Directors Report on page 4.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

9. Taxation

	2008	Restated 2007
Current income tax:	**£'000**	£'000
Current income tax charge	**4**	19

A reconciliation of the income tax expense applicable to the accounting loss before tax at the statutory income tax rate to the income tax expense at the Group's effective income tax rate is as follows:

	2008 **£'000**	Restated 2007 £'000
Accounting loss before tax	**(2,849)**	(2,775)
Expected tax credit at standard UK effective corporation tax of 28.5% (2007 – 30%)	**(812)**	(832)
Disallowed expenses and non-taxable income	**66**	77
Share options issued	**60**	81
Non-qualifying depreciation and amortisation	**87**	257
Effect of lower tax rates in Romania	**21**	18
Unrecognised tax losses	**583**	425
Effect of lower tax rate in the UK	**(1)**	(7)
Tax charge for the year	**4**	19

The Group has tax losses arising in the UK of £4,468,002 (2007: £2,518,743) that are available indefinitely for offset against future taxable profits of the companies in which these losses arose. In addition the Group has tax losses arising in Romania of £314,022 (2007: £144,487) that are eligible to be carried forward for five years. The Directors do not consider it appropriate to provide for any deferred tax asset on the basis that there are insufficient profits arising in the foreseeable future against which to offset the losses.

A deferred tax asset of £1,115,784 arising from share based payments has not been recognised in the consolidated financial statements on the basis that there will not be sufficient taxable profits for the temporary difference to be reversed in the foreseeable future.

The UK corporation tax rate decreased from 30% to 28% from 1 April 2008. This change will have no significant impact on deferred tax balances or foreseeable future tax profits/losses.

10. Loss per share

Basic loss per share is calculated on the loss for the year attributable to equity holders of the parent of £2,853,378 (2007: £2,793,793) and divided by the weighted average of 2,735,299 (2007: 2,465,743) ordinary shares.

The basic and diluted loss per share are the same as there are no dilutive effects on earnings as the effect of the exercise of share options would be to decrease the loss per share. Details of share options that could potentially dilute earnings per share in future years are set out in note 22.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

11. Intangible assets

GROUP	**Licence Acquisition Costs £'000**	**Exploration and Evaluation £'000**	**Software Costs £'000**	**Total £'000**
Cost:				
As at 1 January 2007	77	-	23	100
Additions	687	1,498	2	2,187
Unsuccessful exploration and evaluation	-	(1,498)	-	(1,498)
At 31 December 2007	764	-	25	789
Amortisation:				
As at 1 January 2007	(2)	-	(13)	(15)
Provided in the period (see note 4)	(53)	-	(10)	(63)
At 31 December 2007	(55)	-	(23)	(78)
Net book value at 31 December 2007	709	-	2	711
Cost:				
As at 1 January 2008	**764**	**-**	**25**	**789**
Additions	**-**	**2,198**	**-**	**2,198**
Unsuccessful exploration and evaluation	**-**	**(2,198)**	**-**	**(2,198)**
Effect of movement in foreign exchange	**146**	**-**	**-**	**146**
At 31 December 2008	**910**	**-**	**25**	**935**
Amortisation:				
As at 1 January 2008	**(55)**	**-**	**(23)**	**(78)**
Provided in the period (see note 4)	**(101)**	**-**	**(1)**	**(102)**
Effect of movement in foreign exchange	**(23)**	**-**	**-**	**(23)**
At 31 December 2008	**(179)**	**-**	**(24)**	**(203)**
Net book value at 31 December 2008	**731**	**-**	**1**	**732**

Acquisition of the Bobocu licence, Romania

On 15 January 2007 Zeta Petroleum (Romania) SRL acquired the Bobocu licence in Romania. This licence was ratified by the Romanian government on 19 December 2007. The carrying amount of this licence as at 31 December 2008 is £531,161. Amortisation will commence once the work programme enters the production phase and will be calculated on the basis of estimated remaining reserves.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

11. Intangible assets *continued*

COMPANY	**Exploration and Evaluation £'000**	**Software Costs £'000**	**Total £'000**
Cost:			
As at 1 January 2007	-	23	23
Additions	679	1	680
Unsuccessful exploration and evaluation	(679)	-	(679)
At 31 December 2007	-	24	24
Amortisation:			
As at 1 January 2007	-	(13)	(13)
Provided in the period (see note 4)	-	(9)	(9)
At 31 December 2007	-	(22)	(22)
Net book value at 31 December 2007	-	2	2
Cost:			
As at 1 January 2008	**-**	**24**	**24**
Additions	**1,997**	**-**	**1,997**
Unsuccessful exploration and evaluation	**(1,997)**	**-**	**(1,997)**
At 31 December 2008	**-**	**24**	**24**
Amortisation:			
As at 1 January 2008	**-**	**(22)**	**(22)**
Provided in the period (see note 4)	**-**	**(1)**	**(1)**
At 31 December 2008	**-**	**(23)**	**(23)**
Net book value at 31 December 2008	**-**	**1**	**1**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

12. Property, plant and equipment

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Cost:				
As at start of year	**39**	13	**33**	9
Additions	**6**	26	**6**	24
As at end of year	**45**	39	**39**	33
Depreciation:				
As at start of year	**(11)**	(5)	**(10)**	(5)
Provided in the year (see note 4)	**(17)**	(6)	**(15)**	(5)
As at end of year	**(28)**	(11)	**(25)**	(10)
Net book value at start of year	**28**	8	**23**	4
Net book value at end of year	**17**	28	**14**	23

13. Investment in subsidiary

	COMPANY	
	2008	2007
	£'000	£'000
Cost:		
As at start of year	**1**	1
Additions	**-**	-
As at end of year	**1**	1

The Company's only subsidiary is Zeta Petroleum (Romania) SRL, a Romanian incorporated company in which the Company holds 100% of the entire issued capital. The principal activity of Zeta Petroleum (Romania) SRL is exploration and production and the company operates in Romania.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

14. Cash and cash equivalents

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Cash at bank and on hand	**104**	244	**94**	231
Short-term deposits	**289**	1,491	**289**	1,491
As at end of year	**393**	1,735	**383**	1,722

Cash at bank earns interest at floating rates based on a discount to US$ / GBP LIBOR. Short-term deposits are made for varying periods of between one day and one month depending on the future cash requirements of the Group, and earn interest at the respective short-term deposit rates. The fair value of the Group's and Company's cash and cash equivalents is £393,218 (2007: £1,735,401) and £383,312 (2007: £1,722,229) respectively.

15. Trade and other receivables

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
VAT receivables	**356**	519	**14**	51
Other receivables	**23**	22	**23**	22
As at end of year	**379**	541	**37**	73

16. Trade and other payables

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Trade payables	**139**	128	**139**	129
Other taxes and social security costs	**16**	21	**16**	21
Accruals	**83**	590	**57**	476
As at end of year	**238**	739	**212**	626

17. Interest-bearing loans & borrowings

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Convertible Note	**1,680**	-	**1,680**	-

On 27 August 2008 Zeta Petroleum Limited signed a $3.2 million USD convertible loan agreement with GM Investment & Co Limited for the purposes of financing the drilling of the Duzce-1 well in Turkey and to fund working capital requirements.

Interest is charged monthly at 1 month USD LIBOR rate plus 4%. Drawn down amounts and interest are repayable when the facility expires on 31 August 2010. GM Investment & Co Limited has the option to convert the amount outstanding into ordinary shares in Zeta Petroleum Limited at a price of £7.22 per share at any point up until the date the facility expires.

Borrowing costs with an amortised cost of £255,000 as at 31 December 2008 have been netted off against this facility in accordance with IAS 39.

As at 31 December 2008 there were undrawn amounts of $500,000 USD on this facility.

18. Provisions

A provision is recognised in respect tax expenses which have arisen due to revised judgements being made on the taxation of the Company's income for 2006 and 2007.

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
As at start of year	**37**	18	**37**	18
Arising during the year	**4**	19	**4**	19
As at end of year	**41**	**37**	**41**	**37**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

19. Share capital

Group and Company:	2008 Number	2008 £'000	2007 Number	2007 £'000
Authorised:				
Ordinary shares of £0.001 each	**3,000,000**	**3**	3,000,000	3
Allotted, issued and fully paid:				
As at start of year	**2,735,299**	**3**	2,425,398	2
Issue of new shares for cash	**-**	**-**	309,901	1
As at end of year	**2,735,299**	**3**	2,735,299	3

20. Share premium

Group and Company:	2008 £'000	2007 £'000
As at start of year	**6,008**	3,910
Arising on shares issued for cash	**-**	2,236
Transaction costs for issue of shares	**-**	(138)
As at end of year	**6,008**	6,008

21. Share options reserve

Group and Company:	2008 £'000	2007 £'000
As at start of year	**606**	337
Charge for the year	**209**	269
Options associated with Convertible Note	**255**	-
Less : write-back of employee share options lapsed	**(26)**	-
As at end of year	**1,044**	606

The balance in the share options reserve relates to the fair value of the share options that have been expensed through the income statement in accordance with IFRS 2. During the year, 25,906 (2007: 47,541) share options were granted to directors and senior management (10,906 of which were exercisable at 31 December 2008).

22. Share Based Payments

The expense recognised for employee and non-employee services during the year is shown in the following table:

Group and Company:	**2008** **£'000**	2007 £'000
Expense arising from equity-settled share-based payment transactions	**209**	269
Expense arising from cash-settled share-based payment transactions	**-**	-
Total expense arising from share-based payment transactions	**209**	269

The share-based payment plans are described below. There have been no cancellations or modifications to any of the plans during 2008 or 2007.

During the year employees left service which resulted in 15,000 options lapsing where the employee leaving date was after vesting date and 17,422 options were cancelled where the employee leaving date was before vesting date.

Employee Plan

Under the Employee Plan ("EMP") share options are granted to directors and employees at the complete discretion of the Company. The exercise price of the options is determined by the Company at the date of the grant. Fifty percent (50%) of the options vest after twelve months and fifty percent (50%) vest after eighteen months.

The fair value of the options is determined using the Black Scholes method as stated in Note 1.14. The contractual life of each option granted is ten years. There are no cash settlement alternatives.

Options are settled when the Company receives a notice of exercise and cash proceeds from the optionholder equal to the aggregate exercise price of the options being exercised.

Non-Employee Plan

Under the Non-Employee Plan ("NEMP") share options are granted to non-employees at the complete discretion of the Company. The exercise price of the options is determined by the Company at the date of the grant. The options vest at the date of the grant.

The fair value of the options is determined using the Black Scholes method as stated in Note 1.14. The contractual life of each option granted ranges from three to seven years. There are no cash settlement alternatives.

Options are settled when the Company receives a notice of exercise and cash proceeds from the optionholder equal to the aggregate exercise price of the options being exercised.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

22. Share Based Payments *continued*

Group and Company:	**2008 Number**	**2008 WAEP[1]**	2007 Number	2007 WAEP[1]
Outstanding at the beginning of the year	**381,201**	**2.01**	316,269	1.61
Granted during the year	**25,906**	**5.34**	64,932	5.56
Lapsed during the year	**(15,000)**	**1.83**	-	-
Cancelled during the year	**(17,422)**	**5.79**	-	-
Outstanding at the end of the year	**374,685**	**2.16**	381,201	2.01
Exercisable at the end of the year	**352,186**	**2.00**	333,600	1.61

[1]weighted average exercise price

The weighted average remaining contractual life for the share options outstanding as at 31 December 2008 is 4.31 years (2007: 7.67 years). The weighted average fair value of options granted during the year was £5.34 (2007: £5.56). The range of exercise prices for options outstanding at the end of the year was £2.87 - £7.22 (2007: £2.87 - £7.22).

The following table lists the inputs to the models used for the two plans for the year ended 31 December 2008 and the period ended 31 December 2007:

	2008 (EMP)	**2008 (NEMP)**	2007 (EMP)	2007 (NEMP)
Expected volatility %	**60.86**	**60.86**	42.45	42.45
Risk-free interest rate %	**4.79**	**4.63**	4.99	4.78
Expected life of options (years)	**10**	**3**	10	3
Weighted average share price £	**7.22**	**7.22**	7.22	7.22
Model used	**Black Scholes**	**Black Scholes**	Black Scholes	Black Scholes

23. Financial instruments

The Group's and Company's principal financial instruments comprise cash and cash equivalents, short-term deposits and borrowings. The main purpose of these financial instruments is to finance the Group's operations. The Group has other financial instruments which mainly comprise trade payables which arise directly from its operations.

Exposure to currency and interest rate risks arise in the normal course of the Group's business.

Categories of financial assets and financial liabilities

		GROUP	
		2008	2007
	Note	**£'000**	£'000
Financial assets as fair value through profit or loss	14	**393**	1,735
Financial liabilities measured at amortised cost	17	**(1,680)**	-
Financial liabilities at fair value through profit or loss	16	**(238)**	(739)

Categories of financial assets and financial liabilities

		COMPANY	
		2008	2007
	Note	**£'000**	£'000
Financial assets as fair value through profit or loss	14	**383**	1,722
Financial liabilities measured at amortised cost	17	**(1,680)**	-
Financial liabilities at fair value through profit or loss	16	**(212)**	(626)

Interest rate risk

The Group and Company earn interest from bank deposits at floating rates.

The interest rate profile of the financial assets of the Group and Company as at the end of the year is as follows (excluding short-term assets and liabilities, non-interest bearing):

	GROUP		COMPANY	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Floating rate – within one year:				
<u>Financial Assets</u>				
Cash and cash equivalents	**393**	1,735	**383**	1,722
<u>Financial Liabilities</u>				
Interest bearing loans & borrowings	**1,680**	-	**1,680**	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

23. Financial instruments *continued*

Floating rate financial assets comprise cash deposits placed on money markets at call and cash at bank.

A one per cent increase/decrease in interest rates on the floating rate would decrease/increase the Group loss by £14,943 (2007: £17,354) and Company loss for the year by £15,042 (2007: £15,925). There is no impact on the Group's and Company's equity.

Foreign currency risk
The Group operates internationally and has monetary assets and liabilities in currencies other than the functional currency of the operating company involved.

The Group has a Convertible Note denominated in US dollars and has a foreign currency risk exposure to movements between the British pound and US dollar.
A ten per cent movement in the US dollar against the British Pound would increase/decrease the Group and Company loss by £188,752 (2007: nil). There is no impact on the Group and Company's equity.

The Group does not use foreign exchange contracts to hedge its currency risk.

Liquidity Risk
The Group and Company monitor liquidity risk on a monthly basis by maintaining cashflow summaries and forecasts extending out for a twelve month period. The Group and Company have no long term cash investments at balance date. In order to meet both overhead and operational cashflow obligations the Group and Company issues additional equity and Convertible Notes for cash, and divests interests in asset licenses in order to fund other areas of the business. Group and Company liabilities are payable on demand.

Fair values of financial assets and financial liabilities
Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are carried in the financial statements.

	2008 Carrying Value £'000	**2008 Fair Value £'000**	2007 Carrying Value £'000	2007 Fair Value £'000
Cash and cash equivalents	**393**	**393**	1,735	1,735
Borrowings	**(1,680)**	**(1,680)**	-	-
Trade and other payables	**(238)**	**(238)**	(739)	(739)

24. Capital commitments

There are no capital commitments outstanding that have not been disclosed in the Balance Sheet.

25. Capital management

The primary objective of the Group's capital management is to fund oil and gas exploration with a focus on central and eastern Europe and the Black Sea region. The Group aims to establish and maintain a balanced portfolio that includes development, appraisal and exploration stage assets.

The Group manages its capital commitments by raising funds through the issuance of ordinary shares in the parent company Zeta Petroleum Limited and divestment of licence interests.

Capital commitments involve the initial acquisition of licence interests that the Group believes has the potential to contain commercially viable oil and gas reserves and then the exploration and/or appraisal of these licences by following a work programme that achieves internally stated timelines as well as licence commitments imposed by local governments.

No changes were made in the objectives, policies or processes during the year ended 31 December 2008.

26. Post balance sheet events

On 24 April 2009 the Company signed a sale and purchase agreement ("SPA") for the sale of 87.5% of its interest in the Padureni licence in Romania. The Company is bound by a confidentiality clause in the SPA and is unable to disclose the consideration amount payable by the Purchaser.

Following a 2009 strategic review of the Company's assets it was decided to discontinue exploration work on the Duzce/Sakarya licences in Turkey and concentrate on maturing the Group's assets in Romania. Accordingly, on 15 May 2009 the Company gave notice to Lotus Petrol Limited (the Company's joint venture partner on the licences) that it was withdrawing from the Duzce/Sakarya licences. The Company no longer holds any licence interests in Turkey.