

Zeta Petroleum Limited

Report and Financial Statements

Year Ended 31 December 2009

ZETA PETROLEUM LIMITED

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

Page:

1	General information
2	Report of the directors
6	Independent auditor's report
8	Consolidated income statement
9	Consolidated statement of comprehensive income
10	Consolidated balance sheet
11	Company balance sheet
12	Consolidated and company statements of changes in equity
14	Consolidated cash flow statement
15	Company cash flow statement
16	Notes to the financial statements

ZETA PETROLEUM LIMITED

GENERAL INFORMATION

Directors

T W Osborne (Non-executive Chairman)

S P West (Executive Director)

R Gherghetta (Non-executive Director – *appointed 8 February 2010*)

P K Williams (Non-executive Director – *appointed 8 February 2010*)

Company Secretary

B Hodges

Registered Office

No.1 Minster Court

Mincing Lane

London

EC3R 7YL

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 2009

The directors present their report together with the audited financial statements for the year ended 31 December 2009.

Results and Dividends

The consolidated income statement is set out on page 8 and shows a loss for the year amounting to £1,336,000 (2008 – loss of £2,853,000). 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.

On 20 January 2009 the Romanian National Agency for Minerals and Resources (“NAMR”) officially granted an enlargement to the boundary of the Jimbolia Licence increasing the area of the licence from 8.5km² to 23.9km².

Following a strategic review of the Group’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. The primary reason for this decision was the ongoing commitment on the licences to drill a new well every six months. Accordingly, on 15 May 2009 the Company gave notice to the Company’s joint venture partner on the licences that it was withdrawing from the Duzce/Sakarya licences. The Group no longer holds any licence interests in Turkey.

On 22 April 2009 the Company signed a sale and purchase agreement (“SPA”) for the sale of 87.5% of its interest in the Padureni Licence to Expert Petroleum Limited. In accordance with the terms of the SPA, the Company was paid a cash amount representing reimbursement of previous costs and is fully carried on all future expenditure on the licence.

On 19 May 2009, a meeting was held with NAMR in Bucharest to provide an update on the Bobocu field evaluation and development plan, and to discuss the future work programme for the field. During this meeting the Company proposed that the committed work programme for 2009 be amended from a well work-over to a 3D seismic acquisition, which NAMR has accepted. This is to provide improved structural imaging of the field and better delineate structural compartments within the field, and thus enable the better selection of development well locations.

A farm-out process was launched in October 2009 to find a partner willing to fund two work-over wells on the Jimbolia Licence. This process was continuing at year end.

On 3 December 2009 C C G Lewis resigned as a director of the Company.

On 4 December 2009 an informal meeting of shareholders was held to consider different strategic proposals for the Group. At the end of the meeting an informal vote was held. Following the informal vote at the shareholders meeting a Directors Meeting was held on 15 December 2009 to consider, *inter alia*, the adoption of a strategic proposal in respect of the Company’s business going forward. It was resolved at this meeting to, *inter alia*, launch a fundraising in early January 2010 to raise funds of up to US\$2.5 million and to recommend to members of the Company that Peter Williams and Robert Gherghetta be appointed as non-executive directors of the Company.

On 7 December 2009 the Group was awarded three prospecting licences in the Moldavian Platform, Romania: the Falticeni prospecting licence (653km²), the Faurei prospecting licence (2,439km²) and the Vaslui prospecting licence (2,981km²). The prospecting licences are three year non-exclusive licences.

On 17 December 2009, NAMR granted the Group an extension to the deadline to complete the committed work programme (3D seismic survey) on the Bobocu field from 7 January 2010 to 30 June 2010. The 3D seismic acquisition was completed on 26 April 2010 and is now being processed.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2009

The subsidiary undertakings principally affecting the profits or net assets of the Group are listed in Note 14 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 28 to the consolidated financial statements.

Share Capital

Details of the Company's authorised and issued share capital as at 31 December 2009 are set out in Note 21 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 2009 for the Company was 26.38 days (2008: 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, the closure of operations in Turkey (refer Note 10) and a significant reduction in London working capital costs. On 5 February 2010 the Company issued 277,008 new ordinary shares to raise funds of £1 million to fund current committed capital expenditure projects and future working capital. On 5 May 2010 the Company extended its outstanding debt facility by two years to 31 August 2012. In addition, negotiations (which are in an advanced stage) over the part-sale of a proportion of the Jimbolia Licence in Romania are taking place which, if successful, should yield additional funds to be used towards future working capital. Capital expenditure projects will only proceed to the extent that committed financing is fully secured.

As at 31 December 2009, the Group had available funds totalling £179,293. Additional funds of £1 million were raised on 5 February 2010 by issuing new ordinary shares to existing shareholders and new investors.

The Directors believe that the Group's current cash position, 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 Jimbolia Licence 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.

ZETA PETROLEUM LIMITED

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2009

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	3 Dec 2009
S P West	12 Sep 2005	-
T W Osborne	31 Mar 2006	-

The directors who held office at 31 December 2009 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
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
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 2009:

	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 2009

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 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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
3 June 2010

No.1 Minster Court
Mincing Lane
EC3R 7YL
London
United Kingdom

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

We have audited the financial statements of Zeta Petroleum Limited for the year ended 31 December 2009 which comprise the Group and Parent Company Statement of Financial Position, the Group Statement of Comprehensive Income, the Group and Parent Company Cash Flow Statement and the Group and Parent Statement of Changes in Equity and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2009 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

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

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Paul Wallek (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

7 June 2010

ZETA PETROLEUM LIMITED**CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2009**

	Note	2009 £'000	2008 Restated £'000
Continuing operations			
Revenue	2	63	-
Cost of goods sold		(50)	-
		<hr/>	<hr/>
Gross Profit		13	-
Exploration and evaluation expenses		(45)	(201)
Administrative expenses		(1,193)	(1,106)
		<hr/>	<hr/>
Operating loss		(1,225)	(1,307)
Interest income	4	2	54
Financing costs	5	(225)	(135)
		<hr/>	<hr/>
Loss before Taxation from continuing operations		(1,448)	(1,388)
Income tax	9	-	(4)
		<hr/>	<hr/>
Loss for the year from continuing operations		(1,448)	(1,392)
Profit/(Loss) after tax from discontinued operations	10	112	(1,461)
		<hr/>	<hr/>
Loss for the year attributable to the equity holders		(1,336)	(2,853)
		<hr/>	<hr/>
Loss per ordinary share – basic	11	48.84p	104.32p
		<hr/>	<hr/>
Loss per ordinary share from continuing operations – basic	11	52.92p	50.89p
		<hr/>	<hr/>

ZETA PETROLEUM LIMITED

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
AS AT 31 DECEMBER 2009**

	Note	2009 £'000	2008 £'000
Loss for the year		(1,336)	(2,853)
Other comprehensive income:			
Share based payments		47	209
Convertible note options		7	255
Exchange differences on translation of foreign operations		256	(287)
Options lapsed/cancelled		(286)	(26)
Write-back of lapsed/cancelled options		286	26
		<hr/>	<hr/>
Total comprehensive income for the year		(1,026)	(2,676)
		<hr/>	<hr/>

ZETA PETROLEUM LIMITED

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2009

	Note	2009 £'000	2008 £'000
ASSETS			
Non-current assets			
Intangible assets	12	496	732
Property, plant & equipment	13	9	17
		<hr/>	<hr/>
		505	749
		<hr/>	<hr/>
Current assets			
Trade receivables	16	17	379
Prepayments and accrued income		5	10
Other receivables	17	25	-
Cash and cash equivalents	15	179	393
		<hr/>	<hr/>
		226	782
		<hr/>	<hr/>
Total assets		731	1,531
		<hr/>	<hr/>
EQUITY AND LIABILITIES			
Equity attributable to equity holders			
Issued capital	21	3	3
Share premium	22	6,008	6,008
Share options reserve	23	812	1,044
Foreign currency translation reserve		(26)	(282)
Retained losses		(8,251)	(7,201)
		<hr/>	<hr/>
Total equity		(1,454)	(428)
		<hr/>	<hr/>
Non-current liabilities			
Interest-bearing loans & borrowings	19	2,017	1,680
Provisions	20	41	41
		<hr/>	<hr/>
		2,058	1,721
		<hr/>	<hr/>
Current liabilities			
Trade and other payables	18	127	238
		<hr/>	<hr/>
Total liabilities		2,185	1,959
		<hr/>	<hr/>
Total equity and liabilities		731	1,531
		<hr/>	<hr/>

Stephen West, Finance Director
3 June 2010

ZETA PETROLEUM LIMITED

COMPANY BALANCE SHEET AS AT 31 DECEMBER 2009

	Note	2009 £'000	2008 £'000
ASSETS			
Non-current assets			
Intangible assets	12	-	1
Property, plant & equipment	13	6	14
Investment in subsidiary	14	1	1
Other receivables		2,719	3,080
		<hr/>	<hr/>
		2,726	3,096
Current assets			
Trade receivables	16	6	37
Prepayments and accrued income		4	10
Cash and cash equivalents	15	171	383
		<hr/>	<hr/>
		181	430
Total assets			
		<hr/>	<hr/>
		2,907	3,526
EQUITY AND LIABILITIES			
Equity attributable to equity holders			
Issued capital	21	3	3
Share premium	22	6,008	6,008
Share options reserve	23	812	1,044
Retained losses		(6,086)	(5,462)
		<hr/>	<hr/>
Total equity		737	1,593
Non-current liabilities			
Interest-bearing loans & borrowings	19	2,017	1,680
Provisions	20	41	41
		<hr/>	<hr/>
		2,058	1,721
Current liabilities			
Trade and other payables	18	112	212
		<hr/>	<hr/>
Total liabilities		2,170	1,933
Total equity and liabilities			
		<hr/>	<hr/>
		2,907	3,526

Stephen West, Finance Director
3 June 2010

ZETA PETROLEUM LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2009

	Issued Capital £'000	Share Premium £'000	Share Options Reserve £'000	Foreign Currency Translation Reserve £'000	Retained Losses £'000	Total £'000
As at 1 January 2009	3	6,008	1,044	(282)	(7,201)	(428)
Loss for the year	-	-	-	-	(1,336)	(1,336)
Other comprehensive income	-	-	(232)	256	286	310
At 31 December 2009	3	6,008	812	(26)	(8,251)	(1,454)

COMPANY STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2009

	Issued Capital £'000	Share Premium £'000	Share Options Reserve £'000	Retained Losses £'000	Total £'000
As at 1 January 2009	3	6,008	1,044	(5,462)	1,593
Loss for the year	-	-	-	(910)	(910)
Other comprehensive income	-	-	(232)	286	54
At 31 December 2009	3	6,008	812	(6,086)	737

ZETA PETROLEUM LIMITED**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
Loss for the year	-	-	-	-	(2,853)	(2,853)
Other comprehensive income	-	-	438	(287)	26	177
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
Loss for the year	-	-	-	(2,197)	(2,197)
Other comprehensive income	-	-	438	26	464
At 31 December 2008	3	6,008	1,044	(5,462)	1,593

ZETA PETROLEUM LIMITED

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	Note	2009 £'000	2008 £'000
Operating activities			
Loss before tax from continuing operations		(1,448)	(1,392)
Profit/(Loss) before tax for the year from discontinued operations		112	(1,461)
		<hr/>	<hr/>
Loss before tax		(1,336)	(2,853)
Adjustment to reconcile loss to net cash outflow from operating activities			
Depreciation	13	10	17
Amortisation	12	86	102
Borrowing costs amortised		115	40
Share based payments	24	47	209
Interest on convertible loan		88	29
Foreign exchange gains/(losses)		202	(409)
Write-off of exploration and evaluation costs		51	2,198
Interest income	4	(2)	(54)
Licence sale proceeds		(214)	(598)
Carrying value of licences		50	-
Working capital adjustments:			
Decrease in trade receivables		362	162
(Increase)/decrease in prepayments and accrued income		5	(1)
Increase in other receivables		(25)	-
Decrease in trade and other payables		(111)	(501)
		<hr/>	<hr/>
Net cash outflow from operating activities		(672)	(1,655)
		<hr/>	<hr/>
Investing activities			
Purchase of property, plant and equipment	13	(2)	(6)
Exploration and evaluation costs		(51)	(2,198)
Interest income	4	2	54
Licence sale proceeds		214	598
		<hr/>	<hr/>
Net cash used in investing activities		163	(1,552)
		<hr/>	<hr/>
Financing activities			
Convertible note amounts drawn down		295	1,865
		<hr/>	<hr/>
Net cash inflow from financing activities		295	1,865
		<hr/>	<hr/>
Net decrease in cash and cash equivalents		(214)	(1,342)
Cash and cash equivalents at the beginning of the year	15	393	1,735
		<hr/>	<hr/>
Cash and cash equivalents at the end of the year	15	179	393
		<hr/>	<hr/>

ZETA PETROLEUM LIMITED

COMPANY CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	Note	2009 £'000	2008 £'000
Operating activities			
Loss before tax from continuing operations		(1,022)	(732)
Profit/(Loss) before tax for the year from discontinued operations		112	(1,461)
		<hr/>	<hr/>
Loss before tax		(910)	(2,193)
Adjustments to reconcile loss to net cash outflow from operating activities			
Depreciation	13	8	15
Amortisation	12	1	1
Borrowing costs amortised		115	40
Share based payments	24	47	209
Interest on convertible loan		88	29
Expenses recharged		(141)	-
Foreign exchange gains/(losses)		131	(645)
Write-off of exploration and evaluation costs		6	1,997
Interest income	4	-	(19)
Licence sale proceeds		(151)	(598)
Working capital adjustments:			
Increase in trade receivables		31	36
(Increase)/decrease in prepayments and accrued income		6	(2)
Decrease in trade and other payables		(100)	(414)
		<hr/>	<hr/>
Net cash outflow from operating activities		(869)	(1,544)
		<hr/>	<hr/>
Investing activities			
Purchase of property, plant and equipment	13	-	(6)
Exploration and evaluation costs		(6)	(1,997)
Interest income	4	-	19
Licence sale proceeds		151	598
Disbursements of loans		217	(274)
		<hr/>	<hr/>
Net cash used in investing activities		362	(1,660)
		<hr/>	<hr/>
Financing activities			
Convertible note amounts drawn down		295	1,865
		<hr/>	<hr/>
Net cash inflow from financing activities		295	1,865
		<hr/>	<hr/>
Net decrease in cash and cash equivalents		(212)	(1,339)
Cash and cash equivalents at the beginning of the year	15	383	1,722
		<hr/>	<hr/>
Cash and cash equivalents at the end of the year	15	171	383
		<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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 No.1 Minster Court, Mincing Lane, London, EC3R 7YL. 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 2009 were authorised for issue by the board of directors on 3 June 2010 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, the closure of operations in Turkey (refer Note 10) and a significant reduction on London working capital costs. On 5 February 2010 the Company issued 277,008 new ordinary shares to raise funds of £1 million to fund current committed capital expenditure projects and future working capital. On 5 May 2010 the Company extended its outstanding debt facility by two years to 31 August 2012. In addition, negotiations (which are in an advanced stage) over the part-sale of a proportion of the Jimbolia Licence in Romania are taking place which, if successful, should yield some additional funds to be used towards future working capital. Capital expenditure projects will only proceed to the extent that committed financing is fully secured.

As at 31 December 2009, the Group had available funds totalling £179,293. Additional funds of £1 million were raised on 5 February 2010 by issuing new ordinary shares to existing shareholders and new investors.

The Directors believe that the Group’s current cash position, 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 Jimbolia Licence 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).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

1.5 Basis of consolidation

The consolidated financial statements comprise the financial statements of Zeta and its subsidiaries as at 31 December 2009. 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 s408 of the Companies Act 2006 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 2009 was £910,000 (2008: £2,197,000).

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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 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.

Capital costs are amortised to write off the cost over the length of the licences. Amortisation begins from the date that the licences are ratified by the Romanian Government. The amortisation periods for the active licences are: Bobocu 19/12/2007 – 19/12/2027; Jimbolia 25/03/2008 – 25/03/2028; Padureni 25/03/2008 – 25/03/2028.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

1.15 Taxation *continued*

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.

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 2009

2. Revenue

For the year ended 31 December 2009 the revenue received is attributable to Operator fees on the Duzce/Sayaka licence in Turkey, revenue received on the sale of 85% of the stake in the Padureni licence in Romania and a second instalment received for the sale of the Bartin licence in Turkey. For the year ended 31 December 2008 the revenue received is entirely attributable to the sale of the Bartin licence in Turkey.

Segment revenue	£'000	£'000
Turkey	156	598
Romania	63	-
	219	598

3. Segment information

The Group has one reportable segment, the exploration, development and production of oil and gas. No further disclosure is required in this note as all the relevant disclosure is already detailed throughout the Group financial statements.

The Group's geographical segments are United Kingdom, Turkey and Romania.

Group revenue for the year ended 31 December 2009 is entirely attributable to the Romania 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 2009:

Segment assets	2009 £'000	2008 £'000
United Kingdom	188	441
Turkey	-	4
Romania	543	1,086
	731	1,531

Capital expenditure	2009 £'000	2008 £'000
United Kingdom	-	6
Turkey	6	1,997
Romania	45	201
	51	2,204

ZETA PETROLEUM LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

4. Operating loss

Operating loss is stated after charging/(crediting):

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Amortisation (note 12)	86	102	1	1
Depreciation (note 13)	10	17	8	15
Net foreign exchange differences	224	(343)	116	(541)
Interest income	(2)	(54)	-	(19)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

5. Financing Costs

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Interest payable on loans	88	29	88	29
Other financing costs	137	106	137	106
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total financing costs	225	135	225	135
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

6. Auditors' remuneration

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Audit of the financial statements	23	20	23	20
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	23	20	23	20
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

7. Employment costs

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Wages and salaries	572	523	478	435
Social security costs	41	51	41	51
Share based payments arising from equity-settled share based payment transactions	47	209	47	209
	660	783	566	695

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

	GROUP		COMPANY	
	2009	2008	2009	2008
Management	2	3	2	3
Administration	3	5	2	4
	5	8	4	7

8. Remuneration of Directors

	2009	2008
Group and Company:	£'000	£'000
Basic salary and fees	248	210
Share based payments	-	58
	248	268
C. Lewis – Total Emoluments	145	100
S. West – Total Emoluments	103	100

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 2009

9. Taxation	2009	2008
<i>Current income tax:</i>	£'000	£'000
Current income tax charge	-	4

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:

	2009	2008
	£'000	£'000
Accounting loss before tax	(1,336)	(2,849)
Expected tax credit at standard UK effective corporation tax of 28% (2008 – 28.5%)	(374)	(812)
Disallowed expenses and non-taxable income	25	66
Share options issued	13	60
Non-qualifying depreciation and amortisation	39	87
Effect of lower tax rates in Romania	23	21
Unrecognised tax losses	274	583
Effect of lower tax rate in the UK	-	(1)
Tax charge for the year	-	4

The Group has tax losses arising in the UK of £5,338,588 (2008: £4,468,002) 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 £503,796 (2008: £314,022) 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 £67,356 (2008: £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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

10. Discontinued operations

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 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.

The results of Turkey operations for the year are presented below:

	2009	2008
	£'000	£'000
Revenue	156	598
Cost of goods sold	-	-
	<hr/>	<hr/>
Gross profit	156	598
Exploration and evaluation expenses	(6)	(1,997)
Administrative expenses	(38)	(62)
Income tax	-	-
	<hr/>	<hr/>
Profit/(Loss) after tax from discontinued operations	112	(1,461)
	<hr/>	<hr/>

The major classes of assets and liabilities of the Turkey operations as at 31 December are as follows:

	Note	2009	2008
		£'000	£'000
Assets			
Cash at bank and on hand	15	-	4
Other Receivables	16	5	-
		<hr/>	<hr/>
		5	4
		<hr/>	<hr/>
Liabilities			
Trade payables	18	-	(102)
Accruals	18	(34)	(37)
		<hr/>	<hr/>
		(34)	(139)
		<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

10. Discontinued operations *continued*

The net cash flows incurred by the Turkey operations are as follows:

	2009 £'000	2008 £'000
Operating	(5)	(1,803)
Investing	-	-
Financing	-	-
	<hr/>	<hr/>
Net cash outflow	(5)	(1,803)
	<hr/>	<hr/>
Profit (Loss) per ordinary share from discontinuing operations – basic	4.09p	(53.43p)
	<hr/>	<hr/>

11. Loss per share

	2009 £'000	2008 £'000
Loss for the year from continuing operations	(1,448)	(1,392)
Profit/(Loss) after tax from discontinued operations	112	(1,461)
	<hr/>	<hr/>
Loss for the year attributable to the equity holders	(1,336)	(2,853)
	<hr/>	<hr/>

Basic loss per share is calculated on the loss for the year attributable to equity holders of the parent of £1,336,000 (2008: £2,853,000) and divided by the weighted average of 2,735,299 (2008: 2,735,299) 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 24.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

12. Intangible assets

GROUP	Licence Acquisition Costs £'000	Exploration and Evaluation £'000	Software Costs £'000	Total £'000
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
Cost:				
As at 1 January 2009	910	-	25	935
Additions	-	51	-	51
Unsuccessful exploration and evaluation	-	(51)	-	(51)
Disposals	(58)	-	-	(58)
Effect of movement in foreign exchange	(117)	-	-	(117)
At 31 December 2009	735	-	25	760
Amortisation:				
As at 1 January 2009	(179)	-	(24)	(203)
Provided in the period (see note 4)	(85)	-	(1)	(86)
Write-back on disposal	3	-	-	3
Effect of movement in foreign exchange	22	-	-	22
At 31 December 2009	(239)	-	(25)	(264)
Net book value at 31 December 2009	496	-	-	496

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 2009 is £433,778. 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 2009

12. Intangible assets *continued*

COMPANY	Exploration and Evaluation £'000	Software Costs £'000	Total £'000
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
Cost:			
As at 1 January 2009	-	24	24
Additions	6	-	6
Unsuccessful exploration and evaluation	(6)	-	(6)
At 31 December 2009	-	24	24
Amortisation:			
As at 1 January 2009	-	(23)	(23)
Provided in the period (see note 4)	-	(1)	(1)
At 31 December 2009	-	(24)	(24)
Net book value at 31 December 2009	-	-	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

13. Property, plant and equipment

	GROUP		COMPANY	
	2009 £'000	2008 £'000	2009 £'000	2008 £'000
Cost:				
As at start of year	45	39	39	33
Additions	2	6	-	6
	<hr/>	<hr/>	<hr/>	<hr/>
As at end of year	47	45	39	39
	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:				
As at start of year	(28)	(11)	(25)	(10)
Provided in the year (see note 4)	(10)	(17)	(8)	(15)
	<hr/>	<hr/>	<hr/>	<hr/>
As at end of year	(38)	(28)	(33)	(25)
	<hr/>	<hr/>	<hr/>	<hr/>
Net book value at start of year	17	28	14	23
	<hr/>	<hr/>	<hr/>	<hr/>
Net book value at end of year	9	17	6	14
	<hr/>	<hr/>	<hr/>	<hr/>

14. Investment in subsidiary

	COMPANY	
	2009 £'000	2008 £'000
Cost:		
As at start of year	1	1
Additions	-	-
	<hr/>	<hr/>
As at end of year	1	1
	<hr/>	<hr/>

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 2009

15. Cash and cash equivalents

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Cash at bank and on hand	179	100	171	90
Short-term deposits	-	289	-	289
Cash at bank and on hand attributable to a discontinued operation (Note 10)	-	4	-	4
As at end of year	179	393	171	383

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 £179,000 (2008: £393,000) and £171,000 (2008: £383,000) respectively.

16. Trade receivables

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
VAT receivables	11	356	1	14
Other receivables	1	23	-	23
Other receivables attributable to a discontinued operation (Note 10)	5	-	5	-
As at end of year	17	379	6	37

17. Other receivables

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Loans to third parties	25	-	-	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

18. Trade and other payables

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Trade payables	47	41	47	41
Trade payables attributable to a discontinued operation (Note 10)	-	98	-	98
Other taxes and social security costs	9	16	8	16
Accruals	37	46	23	20
Accruals attributable to a discontinued operation (Note 10)	34	37	34	37
As at end of year	127	238	112	212

19. Interest-bearing loans & borrowings

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
Convertible Note	2,017	1,680	2,017	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. The final drawdown on the facility of \$500,000 was made on 6 August 2009.

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 2012. GM Investment & Co Limited has the option to convert the amount outstanding into ordinary shares in Zeta Petroleum Limited at a price of £3.61 per share at any point up until the date the facility expires. Borrowing costs with an amortised cost of £77,202 as at 31 December 2009 have been netted off against this facility in accordance with IAS 39.

20 Provisions

A provision is recognised in respect of tax expenses which have arisen due to judgements being made on the taxation of the Company's income for 2006 through 2009.

	GROUP		COMPANY	
	2009	2008	2009	2008
	£'000	£'000	£'000	£'000
As at start of year	41	37	41	37
Arising during the year	-	4	-	4
As at end of year	41	41	41	41

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

21. Share capital

Group and Company:	2009 Number	2009 £'000	2008 Number	2008 £'000
Authorised:				
Ordinary shares of £0.001 each	3,000,000	3	3,000,000	3
	<hr/>	<hr/>	<hr/>	<hr/>
Allotted, issued and fully paid:				
As at start of year	2,735,299	3	2,735,299	3
Issue of new shares for cash	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
As at end of year	2,735,299	3	2,735,299	3
	<hr/>	<hr/>	<hr/>	<hr/>

22. Share premium

Group and Company:	2009 £'000	2008 £'000
As at start of year	6,008	6,008
Arising on shares issued for cash	-	-
Transaction costs for issue of shares	-	-
	<hr/>	<hr/>
As at end of year	6,008	6,008
	<hr/>	<hr/>

23. Share options reserve

Group and Company:	2009 £'000	2008 £'000
As at start of year	1,044	606
Charge for the year	47	209
Options associated with Convertible Note	7	255
Less: write-back of employee share options lapsed	(286)	(26)
	<hr/>	<hr/>
As at end of year	812	1,044
	<hr/>	<hr/>

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 no share options were granted to directors and senior management (2008: 25,906).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

24. Share Based Payments

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

Group and Company:	2009 £'000	2008 £'000
Expense arising from equity-settled share-based payment transactions	47	209
Expense arising from cash-settled share-based payment transactions	-	-
	<hr/>	<hr/>
Total expense arising from share-based payment transactions	47	209
	<hr/>	<hr/>

The share-based payment plans are described below. There have been no cancellations or modifications to any of the plans during 2009 or 2008.

During the year employees left service which resulted in 53,865 options lapsing where the employee leaving date was after vesting date and 50,000 options were cancelled during the year.

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 option holder equal to the aggregate exercise price of the options being exercised.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

24. Share Based Payments *continued*

Group and Company:	2009 Number	2009 WAEP ¹	2008 Number	2008 WAEP ¹
Outstanding at the beginning of the year	374,685	2.16	381,201	2.01
Granted during the year	-	-	25,906	5.34
Lapsed during the year	(53,865)	3.65	(15,000)	1.83
Cancelled during the year	(50,000)	1.83	(17,422)	5.79
Outstanding at the end of the year	270,820	2.03	374,685	2.16
Exercisable at the end of the year	270,820	2.03	352,186	2.00
¹ weighted average exercise price				

The weighted average remaining contractual life for the share options outstanding as at 31 December 2009 is 5.00 years (2008: 4.31 years). The weighted average fair value of options granted during the year was £nil (2008: £5.34). The range of exercise prices for options outstanding at the end of the year was £2.87 - £7.22 (2008: £2.87 - £7.22).

The following table lists the inputs to the models used for the two plans for the year ended 31 December 2009 and the year ended 31 December 2008:

	2009 (EMP)	2009 (NEMP)	2008 (EMP)	2008 (NEMP)
Expected volatility %	-	-	60.86	60.86
Risk-free interest rate %	-	-	4.79	4.63
Expected life of options (years)	-	-	10	3
Weighted average share price £	-	-	7.22	7.22
Model used	Black Scholes	Black Scholes	Black Scholes	Black Scholes

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

25. 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

	Note	GROUP	
		2009 £'000	2008 £'000
Financial assets as fair value through profit or loss	15	179	393
Financial liabilities measured at amortised cost	19	(2,017)	(1,680)
Financial liabilities at fair value through profit or loss	18	(127)	(238)

Categories of financial assets and financial liabilities

	Note	COMPANY	
		2009 £'000	2008 £'000
Financial assets as fair value through profit or loss	15	171	383
Financial liabilities measured at amortised cost	19	(2,017)	(1,680)
Financial liabilities at fair value through profit or loss	18	(112)	(212)

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	
	2009 £'000	2008 £'000	2009 £'000	2008 £'000
Floating rate – within one year:				
<u>Financial Assets</u>				
Cash and cash equivalents	179	393	171	383
<u>Financial Liabilities</u>				
Interest bearing loans & borrowings	2,017	1,680	2,017	1,680

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

25. 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 £18,376 (2008: £14,943) and Company loss for the year by £18,459 (2008: £15,042). 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 £211,056 (2008: 188,752). 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.

	2009 Carrying Value £'000	2009 Fair Value £'000	2008 Carrying Value £'000	2008 Fair Value £'000
Cash and cash equivalents	179	179	393	393
Borrowings	(2,017)	(2,017)	(1,680)	(1,680)
Trade and other payables	(127)	(127)	(238)	(238)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

26. Capital commitments

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

27. 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. 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 2009.

28. Post balance sheet events

On 5 February 2010 the Company issued 277,008 new ordinary shares at a price of £3.61 per share to raise funds of £1 million to fund current committed capital expenditure projects and future working capital.

On 8 February 2010 P K Williams and R Gherghetta were appointed non-executive directors of the Company.

On 19 March 2010 the Romanian National Agency for Minerals and Resources granted the Group an extension to the deadline to complete the committed work programme on the Jimbolia Licence from 31 March 2010 to 30 September 2010.

On 27 March 2010 the Group commenced the acquisition of 50km² of 3D seismic over the Bobocu Licence. The 3D seismic survey was completed on 26 April 2010 and is now being processed. The primary focus of the 3D seismic is to enhance imaging of flow barriers on the Bobocu gas field, with a secondary focus of identifying bypassed gas.

In March 2010 the Group received and accepted (subject to contract) an offer to farm-in to the Jimbolia Licence. The terms of the offer are that Zeta will transfer a 50% working interest in the Jimbolia Licence to the farminee on the basis that a) the farminee will fund two work-over/sidetrack wells in the Jimbolia Licence up to a maximum cost of €1 million per well; b) the farminee will repay a proportion of the past costs incurred by the Group on the Jimbolia Licence; and c) the farminee will receive 100% of net revenues from oil production on the licence until 50% of the cost of the first work-over/sidetrack well is repaid to the farminee, and thereafter all net revenue will be split 50/50. Long form contracts are now being negotiated and are expected to be finalised and executed shortly.

On 5 May 2010 the Company extended the repayment date of its fully drawn US\$3.2 million convertible loan facility from 31 August 2010 to 31 August 2012. In consideration for the two year extension the Company agreed to reduce the conversion price of the convertible loan and the associated 50,000 share options from £7.22 to £3.61 (being the last share issue price). In addition, if any subsequent share issue occurs at a lower price than £3.61 during the term of the convertible loan, then the convertible loan and associated share options will be re-priced to the lower issue price.