Gulfsands Petroleum

ANNUAL REPORT & ACCOUNTS 2004

CORPORATE PROFILE

Gulfsands Petroleum PLC is an independent oil and gas exploration, development and production group based in Houston, Texas. Gulfsands has development, exploitation and exploration projects in the USA (offshore Gulf of Mexico and onshore Gulf Coast) and the Syrian Arab Republic and has a signed memorandum of understanding relating to a large project in Iraq.

Ordinary shares of the Company trade on the Alternative Investment Market ("AIM") of the London Stock Exchange under the symbol GPX.

TABLE OF CONTENTS

ANNUAL MEETING

The Annual Meeting of Shareholders will take place 11:00 A.M. on Friday, 5 August 2005 at the offices of College Hill Associates Limited located at 78 Cannon Street in London, England. All shareholders are welcome to attend. If unable to attend, shareholders are encouraged to fill out the form of proxy and return it to Computershare Investor Services PLC.

Eugene Island 32 Facilities

Block 26, Syria

Offshore Rig

HIGHLIGHTS

- Northstar Gulfsands, owned 52.6% by the Group, acquired a large package of producing properties in the U.S. Gulf of Mexico.
- Proved and probable reserves within Northstar Gulfsands LLC, of which Gulfsands owns 52.6%, increased significantly to 4.7 million barrels of oil ("mmbbls") and 29.2 billion cubic feet of natural gas ("bcf") as of 1 November 2004 (2003: 2.4 mmbbls and 5.4 bcf).
- Gulf of Mexico net working interest production within Northstar Gulfsands increased from approximately 1,000 barrels of oil equivalent per day (boepd) in 2003 to 5,000-6,000 boepd by year end 2004.
- Net income increased to $1,622,000 (2003: loss of $2,437,000) primarily as a result of increased production in the Gulf of Mexico.
- Turnover increased to $33,056,000 (2003: $6,852,000)
- Operating profit increased to $8,862,000 (2003: loss of $371,000)
- Cash flow from operating activities increased to $14,802,000 (2003: $3,134,000)
- Darcy Energy, owned 75% by Gulfsands, participated at a 25% working interest in a successful gas well in an onshore Texas gas re-development known as Emily Hawes. First production is expected to commence early in the third quarter of 2005.

Since the year end, Gulfsands has:

- increased its ownership in Block 26, Syria from 20% to 50% and became the operator.
- participated in a new gas discovery on Eugene Island Block 83 in the Gulf of Mexico through its 52.6% ownership in Northstar Gulfsands LLC, whereby Northstar Gulfsands LLC owns a 10% working interest in the well.
- signed a Memorandum of Understanding on the Misan Gas Project in Iraq and increased its interest to 100%.
- completed an Initial Public Offering on the Alternative Investment Market of the London Stock Exchange raising approximately $57 million after expenses.

CHAIRMAN'S REPORT TO SHAREHOLDERS

The year ending 31 December 2004 was a landmark year for the Group. We made pleasing progress financially, operationally and strategically. Turnover increased significantly, the Group retained its first annual profit and there was significant increase in oil and gas reserves.

USA

During the year, Northstar Gulfsands LLC, a subsidiary company owned 52.6% by Gulfsands, closed acquisitions in the USA Gulf of Mexico that doubled oil reserves and increased natural gas reserves over five-fold bringing the total number of fields in the Gulf in which Northstar Gulfsands owns an interest to 39 fields, with 8 of these fields operated by Northstar Gulfsands. This expansion of reserves, interests and operations at very competitive cost was the source of large growth in asset value for the Group during 2004.

As a result, net production to Northstar Gulfsands increased from approximately 1,000 barrels of oil equivalent per day to 5,000-6,000 barrels of oil equivalent per day, resulting in large increases in both turnover and net profit for the Group. The Group's financial performance was also helped by very strong oil and gas prices during this period.

During 2004, the Group also established a subsidiary company, Darcy Energy, to conduct onshore USA Gulf Coast field re-development and exploration. Darcy acquired interests in two onshore projects during the year and participated in its first well in the Emily Hawes Field on Matagorda Island. The Group expects its first onshore production from these activities to commence during the third quarter of 2005, and is actively reviewing additional re-development and exploration projects for acquisition.

Syria

Subsequent to the end of 2004, the Group capitalized on an opportunity to increase its interest in Block 26, located in northeast Syria, by purchasing Devon Syria Ltd., holder of 80% interest in Block 26, following a corporate decision by Devon to exit Syria. The Group has identified some 27 leads and prospects in the Block with aggregated potential exceeding 1 billion barrels of recoverable oil reserves. Concurrent with the acquisition of the Devon interest, the Group farmed-out a 50% interest in the Block to SoyuzNefteGas, a private Russian oil and gas company. Gulfsands is now the operator of Block 26 and is actively conducting the work program of seismic acquisition and expects to drill the first exploration well in the Block by early 2006.

Iraq

In Iraq, the Group completed a Feasibility Study for the Misan Gas Project in August 2004 and presented the final results to the Iraqi Oil Ministry in October 2004. The Misan Gas Project is a midstream project that gathers gas that is currently being flared at the oil fields in Southern Iraq, brings the gas to a central processing plant to clean it of impurities and remove the light hydrocarbon liquid fraction (Natural Gas Liquids), and then transmits the natural gas for further distribution and use in Iraq. The extracted hydrocarbon liquids are then transmitted to a southern port for storage, offloading and export. The Group signed a Memorandum of Understanding with the Iraqi Oil Ministry on 5 January 2005 to continue cooperation on this project and to begin discussion of a definitive contract during 2005. In May, Gulfsands increased its interest in the Misan Gas Project to 100%.

AIM Listing

The directors of the Group decided in 2004 to list its business on the London Stock Exchange (AIM market) and began formalities to implement this resolution during the second half of the year. This process was completed in early April 2005 when Gulfsands Petroleum PLC's shares began trading in London. The Group placed approximately $57 million of new equity (net of expenses) at 130 pence per share. These new funds will enable the Group to re-structure the financing in Northstar Gulfsands, conduct active exploration programs in the Gulf of Mexico and Syria, and continue its business development activity in Iraq and in particular the Misan Gas Project.

Outlook

In summary, 2004 was a very active and successful year for Gulfsands, resulting in significant increase in oil and gas reserves, turnover of $33 million and a net profit for the year. In addition the Group's activities in the Gulf of Mexico, Syria and Iraq continue to provide significant potential for expansion during 2005 and beyond.

John P. Dorrier
Chairman
June 15, 2005

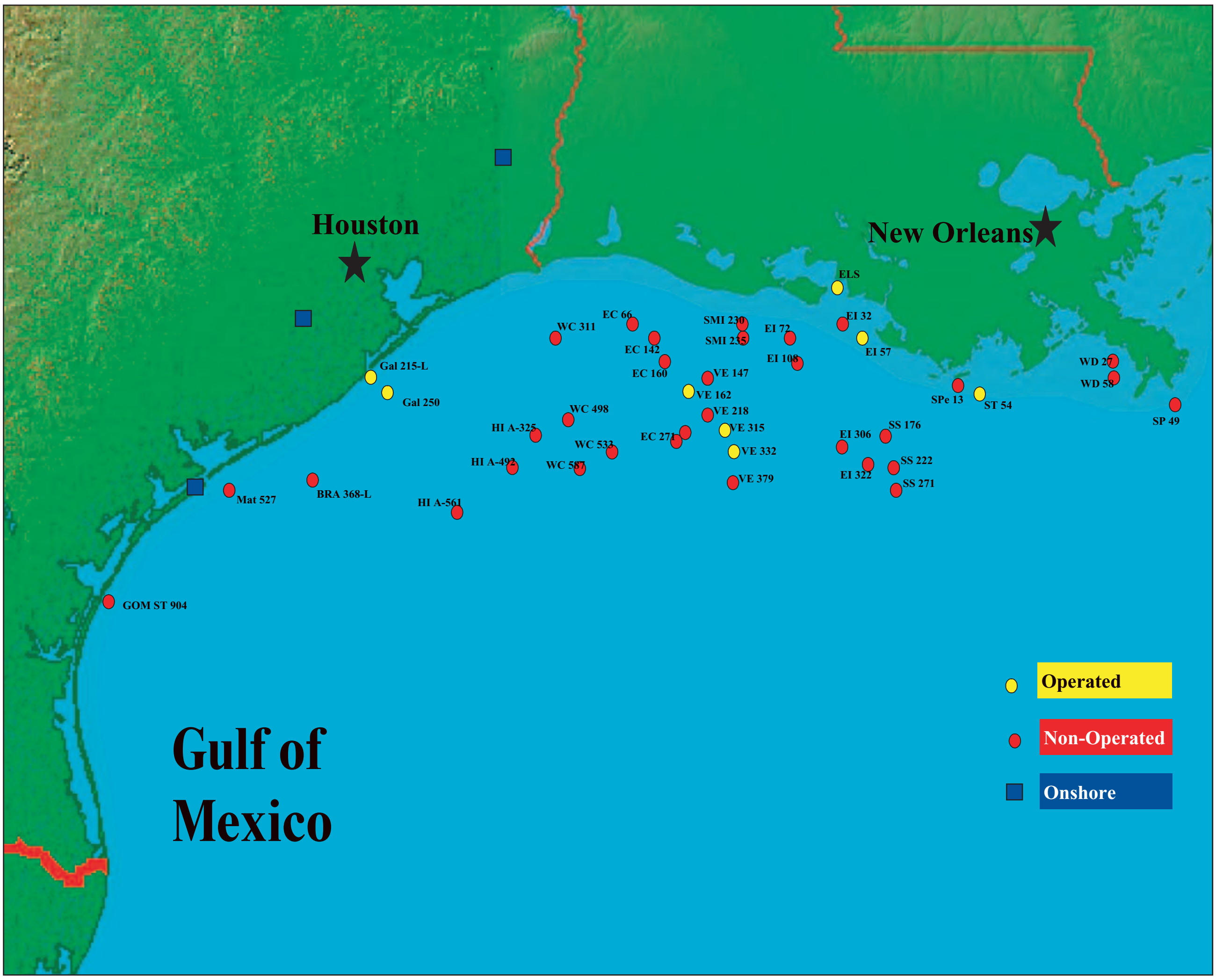
Gulfsands Petroleum PLC did not acquire the share capital of Gulfsands Petroleum Ltd. until after 31 December 2004, therefore the results presented are the results of Gulfsands Petroleum Ltd. and its subsidiaries for the year ended 31 December 2004.

REVIEW OF OPERATIONS

GULF OF MEXICO, USA

In the USA Gulf of Mexico, Gulfsands operates through Northstar Gulfsands L.L.C. (“Northstar Gulfsands”), an oil and gas producing company owned 52.6% by Gulfsands and managed by both Gulfsands and Northstar Interests, L.C. Northstar Gulfsands owns interests in 39 producing oil and gas fields offshore Texas and Louisiana and operates 8 of those fields. Northstar Gulfsands’ working interests in the various fields range from 2.675% to 100% and it works with a number of partners in the fields, 11 exploration and/or development wells and carry out 15 to 20 recompletions and/or workovers.

Northstar Gulfsands has acquired 3D seismic data over part of its acreage in the Gulf of Mexico to exploit further the prospect potential of its 58 offshore Gulf of Mexico Blocks. Northstar Gulfsands has also entered into agreements with a number of Houston-based Gulf of Mexico exploration and production companies whereby Northstar Gulfsands has acquired rights of participation in new drilling opportunities.



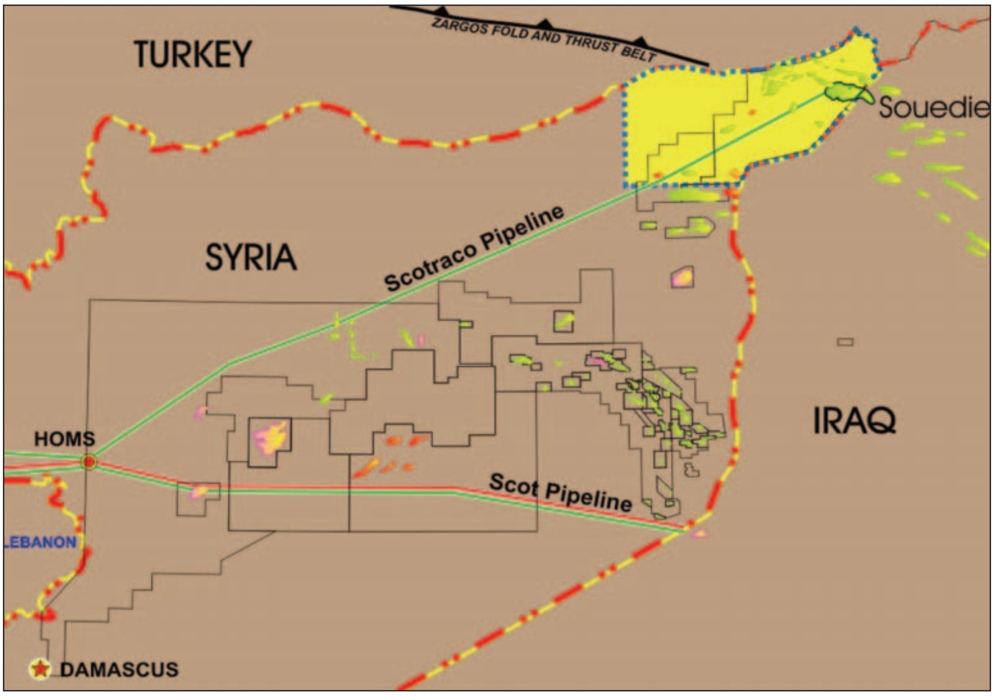
including Unocal, Devon Energy, Sterling Energy and El Paso.

A review of Northstar Gulfsands’ assets in the Gulf of Mexico has been carried out by an independent engineering firm. The report shows that, as at 1 November 2004, Northstar Gulfsands had proved and probable reserves of 4.7 million barrels of oil and some 29.2 billion cubic feet of natural gas.

Northstar Gulfsands has an active program of field study, field re-development, ownership consolidation and acquisitions, and exploratory drilling. In 2005, Northstar Gulfsands may participate in up to

BLOCK 26, SYRIA

Between 1999 and 2003, Gulfsands and Devon Energy, a large US-based independent oil and gas producer, acted jointly to acquire projects in the Middle East. The parties carried out technical and economic evaluations for a series of large oil fields in the latter stages of primary development and production, where they considered that the application of modern, integrated petroleum technologies and new capital investment could result in a significant increase in oil production levels and reserve recoveries. These studies also identified new exploitation



mean resource potential exceeding 1 billion barrels of recoverable oil as determined by an independent oil and gas reserves engineering consulting firm. This independent review of Block 26 determined that the mean risked resources net to Gulfsands was 29.45 million barrels of recoverable oil at a 20% working interest, or 147.25 million barrels of mean risked resource barrels net to the entire Block. Following the acquisition of an additional 30% working interest the mean risked resources net to Gulfsands has increased to 73.625 million barrels of recoverable oil.

and exploration prospects near producing fields that have established production and transportation infrastructures.

In May 2003, Gulfsands and Devon Energy successfully acquired the right to explore Block 26 in northeast Syria. Block 26 covers an area of approximately 11,000 square kilometres, and surrounds areas which currently produce over 100,000 barrels of oil per day from existing fields, including the Souedie Field, the largest known oil field in Syria. Gulfsands owned a 20% working interest in Block 26, but in May 2005 Gulfsands acquired an 80% working interest in Block 26 from Devon Energy. Also, in May 2005 Gulfsands farmed out a 50% working interest in the Block to SoyuzNefteGas following the transaction with Devon Energy. The new Block 26 ownership structure has Gulfsands as operator with a 50% working interest and SoyuzNefteGas with the remaining 50% working interest.

Primary production from these fields is from mid-Cretaceous aged limestone reservoirs that produce medium gravity (20º-26º API gravity) crude oil with a high sulfur content. This oil is then processed and transported to the Syrian coast for export through existing pipeline infrastructure. There is also an undeveloped discovery of light oil in a Paleozoic reservoir within Block 26. The minimum work programme for Block 26 includes the reprocessing of existing seismic data, the acquisition of at least 500 kilometres of new seismic data and the drilling of four wells, two of which will be drilled to test Paleozoic-age reservoirs.

The Group is planning the acquisition of an extensive 2D seismic programme during the third quarter of 2005 and the drilling of the first well by early 2006.

Gulfsands has identified 27 exploitation and exploration prospects and leads with an aggregate

MISAN GAS PROJECT, IRAQ

Gulfsands has been conducting business development activities in Iraq since 2003 and has formed a subsidiary for its operations in Iraq as well as opened an office in Baghdad.

In August 2004, with the approval and cooperation of the Iraqi Ministry of Oil, Gulfsands completed a conceptual feasibility study for the Misan Gas Project in southern Iraq with ABB Lummus Global Inc. acting as the primary subcontractor for the work. The Group formally presented the results of the study to the Iraqi Oil Ministry in October 2004 and, on 5 January 2005, a Memorandum of Understanding was signed between Gulfsands and the Iraqi Ministry of Oil providing for Gulfsands to carry out a feasibility study for the design, building, operation and transfer of the Misan Gas Project and prepare an updated economic evaluation of the project. The Group has drafted a definitive contract which is being negotiated with the Oil Ministry. The project is a private initiative and would not be a part of any contracts in Iraq directly funded by the US government.

The Misan Gas Project, of which Gulfsands owned an 85% in a joint venture with a Russian partner as of 31 December 2004, involves the engineering, design, procurement, construction and operation of an associated natural gas gathering system, a natural gas liquids plant and gas and natural gas liquids transmission pipelines in southern Iraq. The natural gas is currently produced as a by-product of oil production from existing fields and is being flared (burned) on the sites of the various oil production facilities for the fields. In 2005 Gulfsands increased its interest to 100% in the Misan Gas Project.

The Group's initial analysis indicates that the Misan Gas Project will be built in two phases over a 5 year period. The first phase will consist of a gas gathering system and natural gas liquids processing train for 225 million cubic feet per day of natural gas and transmission pipelines for both the processed natural gas and the extracted natural gas liquids. The second phase will also consist of 225 million cubic feet per day of natural gas inlet together with the necessary additional gas gathering system.

At total capacity of 450 million cubic feet per day of natural gas, the natural gas liquids plant should produce approximately 46,600 barrels of natural gas liquids per day and approximately 338 million cubic feet per day of dry, sweet natural gas. It is expected that the dry gas stream will be delivered into the Iraqi main gas trunkline in An Nasiriyah while the natural gas liquids stream will be retained by Gulfsands for export and sale.

It is estimated that the Misan Gas Project will produce in excess of 2.6 trillion cubic feet of dry, sweet natural gas and over 350 million barrels of recoverable natural gas liquids over its life.

The capital cost of the Misan Gas Project is estimated between \$750-\$900 million depending on the cost of steel and the quantity of capital repairs and upgrades to existing facilities for storage and offloading. This project is intended to be financed predominantly by project debt finance.

ONSHORE GULF COAST, USA

During 2004 Gulfsands formed Darcy Energy LLC with a Houston based oil and gas exploration company to explore for and acquire properties in producing basins within the onshore USA. Gulfsands owned a 70% interest in Darcy Energy LLC at 31 December 2004 but has since increased its ownership to 75%.

The Group believes that there are numerous opportunities to pursue in the exploration and redevelopment of small to medium sized, low risk opportunities that are available in the USA. With domestic natural gas and oil prices near historic highs and increasing demand for fuel and electricity generation, the Group believes that the onshore USA offers significant opportunities to build long term value and cash flows for Gulfsands.

In the fourth quarter of 2004 Darcy Energy LLC participated in the drilling of the first sidetrack well in its Emily Hawes Field project, on Matagorda Island, Calhoun County, Texas. The three wells previously drilled in the Emily Hawes Field produced approximately 1.7 billion cubic feet of natural bas from multiple Basal Miocene Sands, before being shut in over 15 years ago. This new well encountered several potential pay sands in the Basal Miocene formation after being drilled to a measured depth of 6,725 feet. Darcy Energy LLC expects to initiate gas production during the third quarter of 2005. Darcy Energy LLC has a 25% working interest in the acreage.

In Fort Bend County, Texas, Darcy Energy LLC has a 37.5% working interest in the development of low risk oil reserves within the Barb Mag oil field. This field was discovered during the 1950's and was developed and produced prior to the use of extensive 3D seismic data. The interpretation of modern 3D seismic data over the field has uncovered the potential for oil remaining within 2 undrilled fault blocks. In addition, a secondary, deeper, target at approximately 9,000 feet that has the potential for up to 1.2 billion cubic feet of natural gas has been identified. The deeper target is a seismic amplitude anomaly of approximately 40 acres that appears to be analogous to adjacent, yet separate, natural gas production. The first well is expected to be drilled during the third quarter of 2005.

BOARD OF DIRECTORS

The Board of Directors for Gulfsands Petroleum PLC is comprised of the following individuals:

John Dorrier,
Chairman

Mr. Dorrier founded Gulfsands in 1997. He holds Bachelor of Science degrees in Physics and Geophysics from University of Utah (magna cum laude), and during 1975 to 1997, held a series of technical and executive positions with Mobil, Amoco, The Anschutz Corporation, BHP Petroleum and Seven Seas Petroleum. For BHP, Mr. Dorrier served as Regional Manager, Gulf Basin (Houston, 1987-90), Vice President and General Manager Europe, Africa and Middle East (London, 1990-94) and Vice President Exploration, Americas (Houston, 1994). At Seven Seas Petroleum, Mr. Dorrier was Executive Vice President from 1995-1997. In these positions, Mr. Dorrier originated and participated in successful exploration and production projects in North and South America, Australia, Africa and the Middle East.

David DeCort,
Executive Director

Mr. DeCort, a Certified Public Accountant, has over 25 years oil industry experience in finance and accounting within the USA, Canada, Syria, Indonesia, Colombia, Turkey, Australia, Argentina, Papua New Guinea and Nigeria. Mr. DeCort was formerly the Chief Financial Officer of Seven Seas Petroleum (1995-97) and the Treasurer and Controller for the Huffco Group (1990-95), an independent oil and gas company. Mr. DeCort also held various managerial accounting and auditing positions with large US-based oil companies with operations both domestically and internationally. Mr. DeCort joined Gulfsands in 1997.

Mahdi Sajjad,
Executive Director

Educated in the United Kingdom, Mr. Sajjad worked from 1981-1988 with a consortium of British companies marketing products and engineering services in the Middle East and Africa. In 1988, Mr. Sajjad joined International Development Corporation in Dubai as a Senior Executive and later as Managing Director whilst also serving during the same period through to 1995 as a Director of Oil & Minerals Development Corporation. Mr. Sajjad has also established as a founder shareholder and financier, a number of companies with interests in the Middle East in different industry sectors but with particular emphasis on the energy and mining sectors. Mr. Sajjad joined Gulfsands in 1998.

Charles Stonehill,
Non-executive Director

Mr. Stonehill has over 25 years experience in the investment banking industry. Most recently, between 2002 and 2004, he was Managing Director of Lazard Freres in New York, Head of the Global Capital Markets Division and a member of that firm's Executive Committee. From 1997 to 2002, he was Managing Director of Credit Suisse First Boston, Head of Investment Banking for the Americas, and a member of that firm's Operating Committee. Mr. Stonehill has also worked at Morgan Stanley (1984-97) and JP Morgan (1978-84). Mr. Stonehill was appointed a Director of Gulfsands in 2005.

Malcolm Butler,
Non-executive Director

Dr. Butler holds Bachelor of Science and Ph. D degrees in Geology from the Universities of Wales and Bristol. He has worked in exploration and management positions in the international oil business for over 30 years, including experience in Europe, North and South America, Russia, North and West Africa and the Far East. Dr. Butler has been Managing Director of Industrial Scotland Energy plc and founded Brabant Resources plc in 1986. Following the acquisition of Brabank by Energy Development (EDC), of Houston, Dr. Butler was appointed President and Chief Executive Officer of EDC, which was one of the largest independent operators in the Gulf of Mexico. EDC was sold to Noble Energy in 1996 for $780 million. Between 1998 and 2003 Dr. Butler was an Advisory Director to HSBC Investment Bank in London, where he took responsibility for oil and gas corporate finance and also established an energy technology group. Since 2003 he has acted as a consultant on energy matters to Seymour Pierce Limited, while continuing to advise his own corporate clients in international oil and gas and running GeoSolutions Limited, a small North Sea exploration company. Dr. Butler was appointed a Director of Gulfsands in 2005.

GULFSANDS PETROLEUM LTD.
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2004

GULFSANDS PETROLEUM LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2004

CONTENTS

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Independent Auditors' Report

To The Shareholders of
Gulfsands Petroleum plc London
United Kingdom

We have audited the consolidated financial statements of Gulfsands Petroleum Ltd. (the "Company") and its subsidiaries (the "Group") for the years ended 31 December 2004 and 2003, which comprise the consolidated profit and loss account, the consolidated balance sheets, the consolidated statements of cash flow, the consolidated statement of total recognised gains and losses and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

This report is made solely to Gulfsands Petroleum plc's shareholders, as a body, and the financial information is prepared under the historical cost convention in accordance with applicable UK accounting standards and with the provisions of the Companies Act 1985 that would apply if these were statutory financial statements, except that consolidated figures only have been presented. Our audit work has been undertaken so that we might state to Gulfsands Petroleum plc's shareholders those matters that we would be required to state to them in an auditors' report of statutory financial statements and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Gulfsands Petroleum plc and Gulfsands Petroleum plc's shareholders as a body, for our audit work, for this report, or for the opinion we have formed.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of the consolidated financial statements under the historical cost convention in accordance with applicable UK accounting standards and with the provisions of the Companies Act 1985 that would apply if these were statutory financial statements, except that consolidated figures only have been presented. Our responsibility is to audit the consolidated financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards that would apply if these were statutory financial statements.

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements been properly prepared in accordance with the provisions of the Companies Act 1985 that would apply if these were statutory financial statements, except that consolidated figures only have been presented. We also 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 transactions with the Company and other members of the Group is not disclosed.

Basis of opinion

We conducted our audits in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audits 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 consolidated 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 consolidated financial statements.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2004 and 2003, and of the profit and loss of the group for the years then ended; and the consolidated financial statements have been properly prepared in accordance with the provisions of the Companies Act 1985 that would apply if these were statutory financial statements, except that consolidated figures only have been presented.

UHY Mann Frankfort Stein & Lipp CPAs, LLP

Houston, Texas USA
13 June 2005

GULFSANDS PETROLEUM LTD. AND SUBSIDIARIES

1. Consolidated Profit and Loss Account

	Notes	Years Ended 31 December 2004	2003
		US$'000 except per share amounts	
Turnover	4.1(i)	33,056	6,852
Cost of sales		(19,485)	(3,954)
Write down of oil and gas properties	4.2(i)	—	(900)
Gross profit		13,571	1,998
General and administrative expenses		(4,602)	(2,262)
Write down of goodwill	4.9	(107)	(107)
Administrative expenses		(4,709)	(2,369)
Operating profit (loss)		8,862	(371)
Investment Loss	4.2(ii)	(675)	—
Interest receivable	4.4	143	28
Interest payable	4.5	(3,477)	(1,459)
Accretion of net present value of decommissioning provision		(1,352)	(327)
Profit (loss) on ordinary activities before taxation	4.6	3,501	(2,129)
Tax on profit (loss) on ordinary activities	4.7	1,038	—
Profit (loss) on ordinary activities after taxation		4,539	(2,129)
Minority interests	4.18	(2,917)	(308)
RETAINED PROFIT (LOSS)		1,622	(2,437)
Basic earnings (loss) per share	4.8	0.33	(0.50)
Diluted earnings (loss) per share	4.8	0.20	(0.50)

Consolidated Statement of Total Recognised Gains and Losses

		Years Ended 31 December 2004	2003
		US$'000	US$'000
Profit (loss) for the period		1,622	(2,437)
Unrealised gains (losses) on investments	4.2(ii)	212	(212)
Total recognized gains (losses) relating to the period		**1,834**	**(2,649)**

The notes in section 4 form part of these consolidated financial statements.

2. Consolidated Balance Sheets

	Notes	31 December 2004 US$'000	31 December 2003 US$'000
Fixed assets			
Tangible fixed assets	4.10	56,038	21,833
Intangible fixed assets	4.9	2,629	1,842
Investments	4.2(ii)	—	463
		58,667	24,138
Current assets			
Debtors: amounts falling due within one year	4.12	9,001	3,132
Cash at bank and in hand	4.1(n)	19,579	7,599
		28,580	10,731
Creditors: amounts falling due within one year	4.13	(18,688)	(3,382)
Net current assets		9,892	7,349
Total assets less current liabilities		68,559	31,487
Debtors: amounts falling due after one year	4.12	1,748	—
Creditors: amounts falling due after more than one year	4.14	(29,947)	(11,826)
Provision for liabilities and charges	4.16	(16,427)	(2,889)
Equity minority interests	4.18	(7,873)	(2,546)
NET ASSETS		**16,060**	**14,226**
Share capital	4.20	7	7
Share premium account	4.20	17,448	17,448
Revaluation reserve	4.2(ii)	—	(212)
Profit and loss account	4.20	(1,395)	(3,017)
SHAREHOLDERS' FUNDS		**16,060**	**14,226**

The notes in section 4 form part of these consolidated financial statements.

Approved by the Board of Directors of Gulfsands Petroleum Ltd. on 13 June 2005:

John P. Dorrier

David F. DeCort

3. Consolidated Statements of Cash Flows

	Notes	Years Ended 31 December 2004 US$'000	2003 US$'000
Net cash inflow from operating activities	4.22	14,802	3,134
Interest received	4.4	143	28
Interest paid	4.5	(2,916)	(1,354)
Net cash outflow from returns on investments and servicing of finance		(2,773)	(1,326)
Capital expenditure			
Payments to acquire tangible fixed assets	4.10	(22,912)	(19,864)
Payments to acquire intangible fixed assets	4.9	(895)	(1,209)
Net cash outflow from capital expenditure		(23,807)	(21,073)
Financing			
Issues of ordinary share capital	4.20	1,187	10,488
Contributions in subsidiary undertaking	4.18	160	750
Issue costs of share capital		—	(521)
Receipts from new loans	4.24	35,236	14,134
Repayment of loans	4.24	(12,825)	(1,646)
Net cash inflow from financing		23,758	23,205
Increase in cash		11,980	3,940
Cash at bank and in hand, beginning of year		7,599	3,659
Cash at bank and in hand, end of year		19,579	7,599
Non-cash investing and financing			
Non-cash capital contributions in subsidiary undertaking		2,250	—
Provision for decommissioning		17,000	2,562
Receipt of investment for oil and gas properties		—	675

The notes in section 4 form part of these consolidated financial statements.

4. Notes to the Consolidated Accounts

4.1 Accounting policies

The accounting policies, which have been consistently applied for all periods covered by this report, are set out below:

(a) Basis of preparation

The financial information is prepared under the historical cost convention in accordance with applicable UK accounting standards and with the provisions of the Companies Act 1985 that would apply if these were statutory financial statements, except that consolidated figures only have been presented.

(b) Accounting standards

In addition to the requirements of UK accounting standards, the accounting for oil and gas exploration and production activities is guided by the Statement of Recommended Practice (SORP) "Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities", issued by the UK Oil Industry Accounting Committee on 7 June 2001. The financial information has been prepared in accordance with the provisions of the SORP.

(c) Basis of consolidation

The financial information consolidates the results of Gulfsands Petroleum Ltd. and its subsidiary undertakings (see note 4.11) (the "Company"). The results of subsidiaries acquired or sold are consolidated for the periods from or to the date control passed. Acquisitions are accounted for under the acquisition method, under which purchase consideration is allocated to the assets and liabilities on the basis of fair value at the date of acquisition.

The Company's consolidated statements include the accounts of undertakings when the Company has the power to exercise, or actually exercises, dominant influence or control over the undertaking.

(d) Reporting currency

The financial information is presented in U.S. dollars. The Company's operations and the majority of all costs associated with foreign operations are paid in U.S. dollars and not the local currency of the operations; therefore, the reporting and functional currency is the U.S. dollar. Gains and losses from foreign currency transactions, if any, are recognised in current profit or loss for the period.

(e) Oil and gas properties

The Group follows the full cost method of accounting for oil and gas properties under which expenditure on pre-license, license acquisition, exploration, appraisal and development activities is capitalised. All capitalised exploration and development expenditures are recorded within an appropriate cost pool within tangible fixed assets, except that certain exploration and appraisal costs may be held outside a cost pool pending determination of commercial reserves, within intangible fixed assets. The Group has three cost pools: USA, Colombia, and Syria. The Group's definition of commercial reserves is proven and probable reserves.

Pre-license acquisition, exploration and appraisal costs of individual license interests held outside a cost pool remain un-depreciated pending determination but subject to there being no evidence of impairment. When a decision to develop an oil and gas property has been taken, or if there is evidence of impairment in value, the costs are transferred to the appropriate cost pool within tangible fixed assets.

Costs carried within each pool are depreciated on a unit of production basis using the ratio of oil and gas production in the period to the estimated quantity of commercial reserves at the end of the period plus production in the period. Costs in the unit of production calculation include the net book value of capitalised costs plus estimated future development costs. Changes in estimates of commercial reserves or future development costs are dealt with prospectively.

When events or changes in circumstances indicate that the carrying amount of expenditure within a cost pool may not be recoverable from future net revenues from oil and gas reserves attributable to that pool, a comparison between the net book value of the cost pool and the discounted future cash flows from that cost pool is undertaken. To the extent that the carrying amount exceeds the recoverable amount, the pool is written down to its recoverable amount and charged as additional depreciation.

(f) Decommissioning

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

(g) Other tangible fixed assets

Other tangible fixed assets are stated at cost less depreciation and any provision for impairment. Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of assets on a straight-line basis over their estimated useful lives, generally 3 years.

The carrying values of other tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

(h) Debt

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the period and reduced by payments made in the period.

Finance costs of debt are recognised in the profit and loss account over the term of the debt instrument at a constant rate on the carrying amount.

(i) Revenue recognition

Oil sales revenue represents amounts invoiced (exclusive of sales related taxes) for the Group's share of oil and gas sales in the period, in addition to realised gains and losses from hedging activities (see 4.1(l)).

(j) Operating leases

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term.

(k) Taxation

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

The liability method is used in accounting for deferred income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The realisability of deferred tax assets are evaluated annually and a valuation allowance is provided if it is more likely than not that the deferred tax asset will not give rise to future benefits in the Company's tax returns.

(l) Derivative financial instruments

The Company uses forward crude oil and gas sales contracts and swaps to reduce exposure to fluctuations in the price of crude oil and natural gas in order to reduce the volatility of the cash flows of the Company to preserve the Company's ability to service its bank debt. Contracts are only entered into to hedge physical positions related to the Company's crude oil and natural gas production and are, accordingly, accounted for as hedge transactions. The gain or loss arising on these instruments is deferred and recognised only when the hedged transaction occurs. The Company does not hold or issue derivative financial instruments for speculative purposes.

(m) Share based compensation

The Company accounts for share based compensation using the intrinsic value method. Under the intrinsic value method the amount recognised is the difference between the fair value of the shares at the date of grant and the amount of consideration to be received for the shares. The amount initially recognised is allocated over the periods to which the employee's performance relates.

(n) Cash at bank and in hand

The Company considers cash in hand and deposits repayable on demand with any qualifying financial institution, less overdrafts from any qualifying financial institution repayable on demand as cash at bank and in hand. Deposits are repayable on demand if they can be withdrawn at any time without notice and without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed. Cash at bank and in hand includes cash in hand and deposits denominated in foreign currencies.

The Company has classified as Cash at bank and in hand certain deposits that are not available for use in its operations. At 31 December 2004, the Company incurred a commitment as part of a credit facility to escrow funds for its future decommissioning provision associated with its oil and gas properties at an estimated cost of $25,000,000. At 31 December 2004, the Company had escrowed approximately $16,000,000 of cash for use in the settlement of its decommissioning provision (see note 4.16).

4.2 Exceptional items

Exceptional items have been recognised in the financial information, as summarised below.

(i) Write down in Colombia oil and gas properties

The Company was the operator and 60% working interest owner of an association contract in Colombia, South America. However, in March 2004 this property known as the Alborada Association Contract was relinquished back to the government of Colombia and an impairment of $900,000 was recognised in the consolidated profit and loss account for the year ended 31 December 2003.

(ii) Energulf

The Company entered into a participation agreement with Energulf Resources, Inc. for the purpose of exploration and development of certain oil and gas properties in Colombia in September 2003. In exchange for a 25% ownership interest in the related oil and gas properties and the issuance of 150,000 ordinary share purchase warrants in the Company, Energulf issued the Company 2,000,000 ordinary shares of Energulf bearing an initial cost basis of $675,000. These available for sale securities were recorded at fair value with the change in fair value recorded as a component of revaluation reserve. As of 31 December 2003 the securities were valued at $463,000 with a revaluation reserve (unrealised loss) of $212,000.

During September 2004, the Company and Energulf entered into a mutual release agreement as a result of the relinquishment of the Alborada Association Contract in Colombia (as noted above). The Company released and returned the 2,000,000 Energulf shares in exchange for the release and return of the original certificates of the Company's 150,000 purchase warrants issued to Energulf in the prior year. The Company recognised a total realised loss from the ordinary shares disposition in the amount of $675,000, the initial cost basis of the shares at the time of issuance.

(iii) Share based compensation

The Company recorded compensation expense of $1,080,000 in 2003 for share options initially granted in 1998. The compensation expense in 2003 related to the extension of the 1998 options in 2003 which was considered a new issuance of share options (see note 4.3).

4.3 Staff costs, Directors' remuneration and interests

The average monthly number of employees (including executive directors) was as follows for the years ended 31 December:

	2004 Number	2003 Number
Gulfsands Petroleum		
Management	3	3
Northstar Gulfsands, LLC		
Management	4	4
Land Services	1	1
Accounting Services	2	—

Directors' remuneration

The total amounts for remuneration of the Directors for the two years ended 31 December 2004 and 2003 were as follows:

	2004 US$'000	2003 US$'000
Gulfsands Petroleum		
Wages and salaries	521	439
Bonus	149	225
Social security and Medicare costs	18	17
Life Insurance	34	2
Benefits in Kind	30	8
Total Remuneration	752	691

At 1 November 2004 John Dorrier and David DeCort were provided with a Non-Qualified Retirement Plan in which the Company funds $100,000 per annum each.

Directors' emoluments

An analysis of emoluments by Director is as follows:

	Year Ended 31 December 2003			
	Salaries	**Bonus**	**Benefits in Kind**	**Total**
	US$'000	**US$'000**	**US$'000**	**US$'000**
Executive Directors				
John Dorrier	158	85	5	248
David DeCort	131	70	3	204
Mahdi Sajjad	150	70	—	220
	439	225	8	672

	Year ended 31 December 2004			
	Salaries	**Bonus**	**Benefits in Kind**	**Total**
	US$'000	**US$'000**	**US$'000**	**US$'000**
Executive Directors				
John Dorrier	180	60	17	257
David DeCort	150	54	13	217
Mahdi Sajjad	191	35	—	226
	521	149	30	700

Directors' interests in shares and debentures

The interests of the Directors who held office at 31 December 2004 required to be disclosed under Schedule of the Companies Act 1985 that would apply if these were statutory financial statements, all of which were beneficial, were as follows:

(i) Issued share capital

The following Directors held direct interests in the ordinary shares of the Company.

	At 31 December	
	2004	**2003**
	Number	**Number**
John Dorrier(1)	955,000	1,000,000
David DeCort	487,500	487,500
Mahdi Sajjad(2)	—	—

(1) During 2004, 45,000 ordinary shares were gifted by John Dorrier.

(2) Nordman Continental S.A. ("Nordman") was the registered owner of 802,500 ordinary shares at 31 December 2004 and 2003. Nordman is owned by the IT — 5483 Trust, Grand Cayman, which is a discretionary trust, the trustees of which are Shelter Trust Anstalt Liechtenstein. Mr. Mahdi Sajjad's children, one of whom is under 18, are potential beneficiaries under the Trust.

(ii) Share options

Share options have been granted under the Group's 1998 Stock Option Plan (the "Plan"). Pursuant to the Plan, 2,000,000 options were authorised for issuance. The options granted are not subject to vesting requirements and expire five years from their date of grant. Under the Plan, the option price equals the fair market value of the share on the date of initial grant. The market price of the options granted was equal to the private placement price of the most recent offering of the Company's ordinary shares prior to date of grant.

The Board of Directors is responsible for administering the Plan, determining the terms upon which options may be granted, prescribing, amending and rescinding such interpretations and determinations and granting options.

Compensation expense of $1,080,000 was recorded in 2003 for share options granted; the compensation expense in 2003 relates to the extension of the 25 November 1998 options on 25 November 2003 which causes the share option to be remeasured as of the extension date. The options held by Directors (all fully vested) are exercisable between the following dates:

(a) 25 November 1998 (as extended on 25 November 2003) and 25 November 2008

(b) 2 August 2001 and 2 August 2006

(c) 1 January 2003 and 1 January 2008

(d) 17 October 2003 and 17 October 2008

(e) 25 May 2000 and 25 May 2005

	Exercise Price	At 1 January 2003	Granted During the Years Ended 31 December 2004	2003	Total
John Dorrier	(a) US $1.00	170,000	—	—	170,000
	(b) US $2.00	170,000	—	—	170,000
	(c) US $3.75	—	—	80,000	80,000
	(d) US $5.00	—	—	130,000	130,000
		340,000	—	210,000	550,000
David DeCort	(a) US $1.00	100,000	—	—	100,000
	(b) US $2.00	100,000	—	—	100,000
	(c) US $3.75	—	—	65,000	65,000
	(d) US $5.00	—	—	100,000	100,000
		200,000	—	165,000	365,000
David Cowan	(e) US $1.72	25,000	—	—	25,000
	(b) US $2.00	25,000	—	—	25,000
	(d) US $5.00	—	—	20,000	20,000
		50,000	—	20,000	70,000

In addition Nordman (see note 4.3(i) above) has been granted options as follows:

Nordman Continental S.A.	(e) US $1.72	50,000	—	—	50,000
	(b) US $2.00	150,000	—	—	150,000
	(c) US $3.75	—	—	65,000	65,000
	(d) US $5.00	—	—	100,000	100,000
		200,000	—	165,000	365,000

4.4 Investment income (loss) and interest receivable

	Years Ended 31 December	
	2004	2003
	US$'000	US$'000
Bank interest receivable	143	28
Investment loss	(675)	—

4.5 Interest payable and similar charges

	Years Ended 31 December	
	2004	2003
	US$'000	US$'000
Debt Amortisation	424	106
Interest expense — Loans	3,053	1,347
Interest expense — Other	—	6
	3,477	1,459

4.6 Profit (loss) on ordinary activities before taxation

This is stated after charging:

	Years Ended 31 December	
	2004	2003
	US$'000	US$'000
Auditors' remuneration:		
— Audit services	87	13
— Non-audit services	31	2
Depreciation on owned tangible fixed assets	7,958	754
Depreciation and impairment on intangible assets	1	905
Write down of goodwill	107	107
Operating lease rentals:		
— buildings	122	33
— auto and equipment	42	10

The auditors for the two years ended 31 December 2004 and 2003 were UHY Mann Frankfort Stein & Lipp CPAs, LLP. Non-audit services charged to the profit and loss account for the two years ended 31 December 2004 and 2003 related to tax advice and services.

4.7 Tax on profit (loss) on ordinary activities

The income tax benefit for the year ended 31 December 2004 was $1,038,000. Income tax expense for the years ended 31 December 2003 was not significant. The income tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	Years Ended 31 December	
	2004	2003
	US$'000	US$'000
Deferred tax assets:		
Net operating loss and capital loss carry forwards	1,707	1,871
Deferred tax liabilities:		
Basis differences in oil and gas properties and property and equipment	(669)	(483)
Total gross deferred tax assets	1,038	1,388
Less: valuation allowance	—	(1,388)
Net deferred tax assets	1,038	—

Deferred tax assets had not been recognised on the grounds that there was insufficient evidence at the time of sufficient future taxable profits in the foreseeable future to enable the amounts to be recovered. As a result, the valuation allowance for 31 December 2003 reduced the deferred tax assets to $0. As of 31 December 2004, a deferred tax asset was recognised in the amount of $1,038,000 as there was sufficient evidence that there would be sufficient future taxable profits to enable the amounts to be recovered.

The effective tax rates applicable to continuing operations are as follows:

	Years Ended 31 December	
	2004	2003
Expected tax rate	34%	(34)%
State taxes, net of federal benefit	—	—
Expenses not deductible for tax purposes	9%	—
Net operating loss and capital loss	(53)%	—
Basis differences in oil and gas properties and property and equipment	(7)%	—
Valuation allowance recognised in earnings	—	34%
Income not taxable for tax purposes	(13)%	—
	(30)%	0%

For federal tax purposes, the Company has a net operating loss carry forward ("NOL") of approximately $5.0 million and $0 for the years ended 31 December 2004 and 2003, respectively. These NOL's must be utilised between 2005 and 2023.

4.8 Earnings per ordinary share

The calculation of basic and diluted earnings per ordinary share is based on the following profits (losses) and numbers of shares:

	Years ended 31 December	
	2004	2003
	US$'000 except per share amounts	US$'000 except per share amounts
Profit (loss):		
Profit (loss)	1,622	(2,437)
Basic earnings (loss) per share	0.33	(0.50)
Diluted earnings (loss) per share	0.20	(0.50)

	2004	2003
	Number	Number
Weighted average number of shares:		
For basic earnings per share	4,935,000	4,893,000
Effect of dilutive potential ordinary shares		
Convertible preferred shares	2,119,000	—
Options	585,000	—
Warrants	373,000	—
For diluted earnings per share	8,012,000	4,893,000

The calculation of basic earnings per share is based on the profit attributable to ordinary shareholders and the weighted average number of ordinary shares in issue during the period. Diluted earnings per share is calculated by adjusting the profit measure and the weighted average number of ordinary shares in issue on the assumption of conversion of all dilutive potential ordinary shares.

4.9 Intangible fixed assets

(i) Oil and gas properties — unevaluated costs

	Colombia US$'000	Syria US$'000	USA US$'000	Total US$'000
Cost and net book value:				
At 1 January 2003	821	—	154	975
Additions	754	449	—	1,203
Impairment	(900)	—	—	(900)
Disposals	(675)	—	—	(675)
Transfer to tangible fixed assets	—	—	(154)	(154)
At 31 December 2003	—	449	—	449
At 1 January 2004	—	449	—	449
Additions	—	890	—	890
Transfer to tangible fixed assets	—	—	—	—
At 31 December 2004	—	1,339	—	1,339

(ii) Goodwill

Cost and net book value:	
At 1 January 2003	1,500
Goodwill written off	(107)
At 31 December 2003	1,393
At 1 January 2004	1,393
Goodwill written off	(107)
At 31 December 2004	1,286

(iii) Computer Software

Cost and net book value:	
At 1 January 2003	—
Additions	5
Depreciation charge for the year	(5)
At 31 December 2003	—
At 1 January 2004	—
Additions	5
Depreciation charge for the period	(1)
At 31 December 2004	4

4.10 Tangible fixed assets

	Oil and Gas Properties US$'000	Fixed Assets US$'000	Total US$'000
Cost:			
At 1 January 2003	—	31	31
Additions	22,579	1	22,580
At 31 December 2003	22,579	32	22,611
Accumulated depreciation:			
At 1 January 2003	—	(24)	(24)
Charge for the year	(749)	(5)	(754)
At 31 December 2003	(749)	(29)	(778)
Net book value at 31 December 2003	**21,830**	**3**	**21,833**
Cost:			
At 1 January 2004	22,579	32	22,611
Additions	42,134	29	42,163
Disposals	—	—	—
At 31 December 2004	64,713	61	64,774
Accumulated depreciation:			
At 1 January 2004	(749)	(29)	(778)
Charge for the period	(7,953)	(5)	(7,958)
At 31 December 2004	(8,702)	(34)	(8,736)
Net book value at 31 December 2004	**56,011**	**27**	**56,038**

4.11 Investments

(i) Principal Group investments

The Company has investments in the following subsidiary undertakings which principally affected the results or net assets of the Group. All investments are in ordinary shares and are indirectly owned by the Company unless otherwise stated:

Name of Company	Proportion of Voting Shares at 31 December 2004	Nature of Business	Country of Incorporation
Gulfsands Petroleum Holdings Ltd. ("GPH")	100%	Holding company	Cayman Islands
Gulfsands Petroleum Colombia Ltd. ("GPC")	100%	Operating company	Cayman Islands
Gulfsands Petroleum Syria Ltd. ("GPS")	100%	Operating company	Cayman Islands
Gulfsands Petroleum Iraq Ltd. ("GPI")	100%	Operating company	Cayman Islands
Gulfsands Petroleum USA, Inc. ("GP USA")	100%	Operating company	US
Northstar Gulfsands, LLC ("NG")	52.6%	Operating company	US
Darcy Energy LLC ("Darcy")	70%	Operating company	US

Formation of Northstar Gulfsands, LLC

During 2002, the Company's subsidiary, GP USA, formed a limited liability company, Northstar Gulfsands LLC ("NG"), jointly with another U.S. company, Northstar Interests, LC ("Northstar"), for the purpose of acquiring oil and gas producing properties within the Outer Continental Shelf of the United States in the Gulf of Mexico. GP USA agreed to fund $3,000,000 for a 50% ownership interest in NG while Northstar pledged its oil and gas properties to secure the loan for the acquisition of an offshore Gulf of Mexico producing field known as Eugene Island 32, which resulted in a write-off to pre-acquisition reserves of $3,000,000; however, no amount of goodwill was attributed to minority interests but goodwill of $1,500,000 was recognised in the consolidated balance sheets upon consolidation. The Company consolidated NG into the consolidated financial statements on the basis of dominant influence over NG. The Company determined that dominant influence over NG occurred primarily due to its increased ownership to 52.6% as of 31 December 2004 (GP USA's ownership interest in NG was 50% from inception in 2002 until 31 December 2004, see note 4.27). The financial statements of NG are as follows:

NG PROFIT AND LOSS ACCOUNTS

	Years Ended 31 December	
	2004	2003
	US$'000	US$'000
Turnover	33,033	6,799
Cost of sales	(19,364)	(3,194)
Gross profit	**13,669**	**3,605**
General and administrative expenses	(3,028)	(254)
Interest receivable	27	—
Interest payable	(3,477)	(1,460)
Accretion of net present value of decommissioning provision	(1,352)	(1,081)
Retained profit for the period	**5,839**	**810**

NG BALANCE SHEETS

	At 31 December	
	2004	2003
	US$'000	US$'000
Fixed assets		
Tangible fixed assets	54,522	21,320
Intangible fixed assets	4	—
Current assets		
Debtors: amounts falling due within one year	7,867	1,031
Cash at bank and in hand	18,427	769
Creditors: amounts falling due within one year	(18,392)	(3,031)
Net current assets	7,902	(1,231)
Total assets less current liabilities	62,428	20,089
Debtors: amounts falling due after one year	1,748	—
Creditors: amounts falling due after more than one year	(29,947)	(11,826)
Provision for liabilities and charges	(16,427)	(2,889)
Net assets	**17,802**	**5,374**
Partners capital	11,176	4,587
Profit and loss account	6,626	787
Equity shareholders' funds	**17,802**	**5,374**

Formation of Darcy Energy LLC

In June 2004, the Company's subsidiary, GP USA, formed a limited liability company, Darcy Energy LLC jointly with another U.S. company, Bazmo Exploration LLC ("Bazmo") for the purpose of exploration and production of onshore oil and gas producing properties in the United States. GP USA agreed to fund $350,000 for a 66.67% ownership interest in Darcy while Bazmo agreed to contribute $175,000 of expenditures for a 33.33% ownership interest. In December 2004, GP USA's ownership interest in Darcy increased to 70% due to an additional capital contribution made by GP USA.

4.12 Debtors

	At 31 December	
	2004	2003
	US$'000	US$'000
Trade debtors	6,918	1,047
Other debtors	85	815
Underlift	1,748	—
Prepayments and accrued income	960	20
Deferred tax asset	1,038	—
Called up share capital not paid	—	1,250
	10,749	3,132

Underlift at 31 December 2004 represents underlift acquired as a result of the acquisition of oil and gas properties in May 2004. In accordance with FRS 5, underlift represents a right to future economic benefit (through entitlement to receive equivalent future production) which constitutes an asset.

4.13 Creditors: amounts falling due within one year

	At 31 December	
	2004	2003
	US$'000	US$'000
Borrowings — accrued interest (see note 4.15)	369	160
Borrowings — principal (see note 4.15)	5,250	767
Provision for liabilities and charges (see note 4.16)	4,814	—
Trade creditors	6,180	2,290
Other creditors	2,075	165
	18,688	3,382

4.14 Creditors: amounts falling after more than one year

	At 31 December	
	2004	2003
	US$'000	US$'000
Borrowings (see note 4.15)	29,947	11,826

4.15 Borrowings

	At 31 December	
	2004	2003
	US$'000	US$'000
Macquarie Line of Credit Facility — 12.5% 2005		
Amounts falling due:		
In one year or less	—	383
In more than one year but not more than five years	—	5,913
Petrobridge Line of Credit Facility — 12.5% 2005		
Amounts falling due:		
In one year or less	—	384
In more than one year but not more than five years	—	5,913
Petrobridge Line of Credit Facility — 12% 2007		
Amounts falling due:		
In one year or less	5,250	—
In more than one year but not more than five years	29,947	—

Petrobridge Line of Credit Facility 12% 2007

In May 2004, in conjunction with the acquisition of certain oil and gas properties, the Line of Credit Facility 12% 2007 is available to the Company's subsidiary, Northstar Gulfsands, LLC ("NG"), by Petrobridge Investment Management, LLC. The credit agreement is non-recourse to the Company. Interest is payable monthly at a fixed rate of 12% of the outstanding balance for the life of the facility. Repayment of principal will be paid at interim periods only if there is a residual balance in the lockbox account of NG, and the total amount of the outstanding balance is due May 2007.

Initial proceeds of approximately $29 million under this new facility were used to (i) refinance existing debt incurred pursuant to the existing credit facility, which was terminated in May 2004 for approximately $12.8 million, (ii) pay costs related to the acquisition of interests in oil and gas properties in the aggregate amount of approximately $12.2 million, (iii) pay costs of approximately $0.9 million with respect to closing costs of the credit agreement and (iv) settle swap agreements for approximately $3.1 million. In November 2004, NG paid Petrobridge $500,000 of origination fees and $122,000 commitment fees to extend the line of credit (see note 4.15) an additional $8.1 million. NG also agreed to grant the lender an additional 1% warrant membership interest of NG. In November and December 2004, NG borrowed a total of $7.5 million of the additional credit line to pay for capital expenditures, final settlement costs for the May 2004 property acquisition, and to make bond payments related to decommissioning.

The interest rate on borrowings under the credit agreement is based on the applicable rate, which is defined as twelve percent (12%) per annum. NG also pays (i) a commitment fee equal to 1.5% per annum for all amounts committed to be loaned to NG and for which NG paid $460,000 with respect to the initial commitment, (ii) a semi-annual agency or engineering fee of $15,000 in connection with the delivery of each reserve report to one lender, beginning with the 1 July 2004 reserve report and (iii) a credit support fee to the administrative agent, in advance as of the date of the credit agreement and on the first business day of each month so long as a guaranty agreement between the lenders and an insurance company and this credit agreement are in effect, equal to six percent (6%) of the maximum amount guaranteed under the guaranty agreement, to support NG's surety bond arrangements. The borrowings under the credit agreement are secured by a first priority lien on substantially all of the accounts receivable of NG, oil and gas properties, other supporting property and equipment, and a conveyance of an overriding royalty interest of 4% in any oil and gas properties. The credit agreement establishes a lockbox interest-bearing account under the administrative agent's control with a bank to which all cash receipts to be received by NG shall be deposited and from which all disbursements for expenditures of NG shall be made. Principal is payable monthly by an amount equal to 100% of the residual balance in the lockbox interest-bearing account. Interest is payable monthly regardless of whether or not funds are available from the lockbox interest-bearing account. The credit agreement terminates May 2007, unless terminated earlier by NG. NG may prepay all or any portion of outstanding debt without premium or penalty; however, any voluntary or mandatory payments or prepayments may not be re-borrowed.

The credit agreement contains customary covenants and restrictions on NG's ability to issue additional debt or engage in certain activities and certain affirmative covenants, including, but not limited to, reporting requirements. In addition, the credit agreement specifies that NG must maintain a total debt to EBITDA, as defined, of less than 2:1, a ratio of EBITDA to interest and rent expense greater than 3:1, a current ratio greater than 1:1, a ratio of proved developed producing reserves to total debt greater than 1:1 and a ratio of total proved reserves to total debt greater than 2:1. At 31 December 2004 and 2003, NG was not in compliance with certain of these covenants, which constituted events of default; however, NG received waivers for non-compliance from the lender. The credit agreement also contains events of default customary for credit agreements of this type, including failure to pay interest or principal when due. In the event of default and during the continuation thereof, borrowings under the credit agreement will bear interest, at the option of the lender, at the rate of 14% per annum.

Macquarie/Petrobridge Line of Credit Facility 12.5% 2005

NG was charged an additional 1.5% (14% total interest) on the total loan balance to guarantee a note payable to Unocal in the amount of $1,500,000. The interest rate would revert back to 12.5% once the $1,500,000 note was repaid, which occurred in December 2003. The Macquarie/Petrobridge Line of Credit Facility 12.5% 2005 was refinanced by the above mentioned Petrobridge Credit Facility in May 2004. No amount was outstanding at 31 December 2004.

4.16 Provisions for liabilities and charges

The provision for decommissioning relates to the expected future costs of plugging and abandoning the oil and gas properties held by NG. At 31 December 2004 the oil and gas properties have estimated plugging and abandonment dates between 2005 and 2017. The portion of the provision for decommissioning expected to be settled in 2005 (the oil and gas properties have plugging and abandonment dates in 2005) totaling approximately $4,814,000 is included in creditors: amounts falling due within one year (see note 4.13) and the remainder totaling approximately $16,427,000 is included in provision for liabilities and charges in the consolidated balance sheets at 31 December 2004.

The provision for decommissioning is as follows:

	US$'000
At 1 January 2004	2,889
Additions	17,000
Current year accretion of net present value of decommissioning provision	1,352
At 31 December 2004	21,241
Less: current portion (classified within creditors: amounts falling due within one year)	(4,814)
	16,427

4.17 Obligations under operating leases

At 31 December 2003, the Company was committed to the following payments during the next year under non-cancelable operating leases:

	Land and Buildings US$'000	Plant and Property US$'000
Operating Leases which expire:		
Within one year	44	31
In the second to fifth years inclusive	95	85
Over five years	—	—

At 31 December 2004, the Company was committed to the following payments during the next year under non-cancelable operating leases:

	Land and Buildings US$'000	Plant and Property US$'000
Operating Leases which expire:		
Within one year	252	41
In the second to fifth years inclusive	341	68
Over five years	—	—

4.18 Equity minority interests

	US$'000
At 1 January 2003	1,488
Profit on ordinary activities after taxation	308
Contributions	750
At 31 December 2003	2,546
At 1 January 2004	2,546
Profit on ordinary activities after taxation	2,917
Contributions	2,410
At 31 December 2004	7,873

4.19 Share capital

	At 31 December 2004	At 31 December 2003
	Number	Number
Authorised:		
Ordinary Shares (par value \$.001 per share)	50,000,000	50,000,000
Preferred Shares (par value \$.001 per share)	50,000,000	50,000,000
	100,000,000	100,000,000
	US\$'000	US\$'000
Ordinary Shares (par value \$.001 per share)	50	50
Preferred Shares (par value \$.001 per share)	50	50
	Number	Number
Allotted, called-up and fully paid:		
Ordinary Shares (par value \$.001 per share)	4,935,000	4,935,000
Preferred Shares (par value \$.001 per share)	2,160,000	1,910,000
	7,095,000	6,845,000
	US\$'000	US\$'000
Ordinary Shares (par value \$.001 per share)	5	5
Preferred Shares (par value \$.001 per share)	2	2

4.20 Share capital and reserves

	Share Capital	Share Premium Account	Reval. Reserve	Profit and Loss Account	Total
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
At 1 January 2003	5	6,130	—	(580)	5,555
Contributions	—	—	—	—	—
Retained profit for the year	—	—	—	(2,437)	(2,437)
Revaluation	—	—	(212)	—	(212)
Shares issued in the year	2	11,318	—	—	11,320
At 31 December 2003	7	17,448	(212)	(3,017)	14,226
At 1 January 2004	7	17,448	(212)	(3,017)	14,226
Contributions	—	—	—	—	—
Retained profit for the year	—	—	—	1,622	1,622
Revaluation	—	—	212	—	212
Shares issued in the year	—	—	—	—	—
At 31 December 2004	7	17,448	—	(1,395)	16,060

4.21 Reconciliation of movements in shareholders' funds

	At 31 December 2004 US$'000	At 31 December 2003 US$'000
Profit for the financial period	1,622	(2,437)
Revaluation	212	(212)
Shares issued during the period	—	11,320
Net additions to shareholders' funds	1,834	8,671
Opening shareholders' funds	14,226	5,555
Closing shareholders' funds	16,060	14,226

4.22 Reconciliation of operating profit (loss) to net cash inflow (outflow) from operating activities

	Years Ended 31 December 2004 US$'000	Years Ended 31 December 2003 US$'000
Operating profit (loss)	8,862	(371)
Depreciation	7,959	761
Write down to carrying value of Colombia oil and gas assets	—	900
Goodwill written off	107	107
Increase in debtors excluding deferred tax assets	(7,828)	(1,754)
Increase in creditors, excluding provision for liabilities and charges (see note 4.13)	5,702	2,411
Non-cash compensation from extending share option lives	—	1,080
Net cash inflow from operating activities	14,802	3,134

4.23 Analysis of changes in net debt (US$'000)

	At 1 Jan 2003	Net Cash Flows	Non-Cash Movements	At 31 Dec 2003
Cash at bank and in hand	3,659	3,940	—	7,599
Overdrafts	—	—	—	—
Net cash	3,659	3,940	—	7,599
Debt due after one year	—	(11,720)	(106)	(11,826)
Debt due within one year	—	(767)	—	(767)
Net debt	3,659	(8,547)	(106)	(4,994)

	At 1 Jan 2004	Net Cash Flows	Non-Cash Movements	At 31 Dec 2004
Cash at bank and in hand	7,599	11,980	—	19,579
Overdrafts	—	—	—	—
Net cash	7,599	11,980	—	19.579
Debt due after one year	(11,826)	(17,929)	(192)	(29,947)
Debt due within one year	(767)	(4,483)	—	(5,250)
Net debt	(4,994)	(10,432)	(192)	(15,618)

4.24 Reconciliation of net cash flow to movements in net debt

	Years Ended 31 December	
	2004	2003
	US$'000	US$'000
Increase in cash in the period	11,980	3,940
Cash inflow from increase in debt	(22,412)	(12,487)
Change in net debt resulting from cash flows	(10,432)	(8,547)
Amortisation Expense	(192)	(106)
Movement in net debt	(10,624)	(8,653)
Opening net funds (debt)	(4,994)	3,659
Closing net debt	(15,618)	(4,994)

4.25 Capital commitments

There are no obligations or contracts outstanding in relation to ongoing projects not provided for in the financial statements at 31 December 2004.

4.26 Contingent liabilities

Due to the nature of the Company's business, some contamination of the real estate property owned or leased by the Company is possible. Environmental site assessments of the property would be necessary to adequately determine remediation costs, if any. Management of the Company does not consider the amounts that would result from any environmental site assessments to be significant to the financial position or results of operations of the Company. Accordingly, no provision for potential remediation costs is reflected in the accompanying financial statements.

4.27 Related party transactions

Notes Receivable from Northstar Interests, LC

In November 2004, the Company received a note receivable from Northstar in the amount of $250,000 bearing no interest. The principal amount of the note was due on or before 31 December 2004. If the payment was not received by the Company by 31 December 2004, then the Company would assume .65% out of the 50% membership interest currently held by Northstar in NG. In 2003, the Company received a note receivable from Northstar in the amount of $750,000 bearing interest at 10% per annum. The principal amount of the note was due on or before 31 December 2004. If the payment was not received by the Company by 31 December 2004, then the Company would assume 1.95% of Northstar Interests, LC's 50% interest in NG. Northstar did not pay either of the outstanding notes by 31 December 2004, therefore, the Company assumed a total of 2.6% additional membership interest in NG, resulting in a total 52.6% interest in NG.

4.28 Derivatives and financial instruments

The Company has exposure to changes in oil and gas prices. The Company utilises derivative financial instruments to reduce exposure to market risks resulting from fluctuations in oil and gas prices in order to reduce the volatility of the cash flows of the Company to preserve the Company's ability to service its bank debt.

NG has entered into forward swap contracts as of 31 December 2004 and 2003. The counter-parties to the contracts are non-related third parties. The contracts settle monthly and are scheduled to coincide with either oil production equivalent to barrels ("bbl") per month or gas production equivalent to volumes in millions of British thermal units ("MMbtu") per month. The contracts represent agreements between NG and the counter-parties to exchange cash based on a designated price. Prices are referenced to oil or natural gas futures contracts traded on either the Houston Ship Channel/Beaumont, Texas index or on the New York

Mercantile Exchange ("NYMEX") index. Cash settlement occurs monthly based on the floating price. The Company accounts for any realised gains and losses from the contracts as adjustments to turnover in the period of the settlement.

	US$'000
Unrecognised losses at 1 January 2003	—
Gains and losses arising in the period that were not recognised in the period	1,317
Unrecognised losses at 31 December 2003	1,317
Unrecognised losses at 1 January 2004	1,317
Gains and losses arising in previous years that were recognised in the period	(1,317)
Gains and losses arising in the period that were not recognised in the period	2,719
Unrecognised losses at 31 December 2004	2,719

4.29 Contingent right to allotment of shares

	Years Ended 31 December	
	2004	2003
	Number	Number
Authorised:		
Share Warrants	685,000	835,000

As of 31 December 2004, the Company has issued and outstanding 685,000 warrants for the purchase of its ordinary shares. The Company has reserved an equal number of ordinary shares for issuance upon the exercise of its outstanding warrants. Warrants issued by the Company do not confer upon the holders thereof any voting or other rights of a shareholder of the Company. The Company has granted warrants in connection with certain of its participation agreements and equity financings. Such warrants were valued based on the estimated fair market value of the stock at the date of issuance. The terms of the warrants outstanding at 31 December 2004 include warrants that expire one year following the date the ordinary shares become listed on a stock exchange or automated dealer quotation system. Each warrant entitles the holder thereof to purchase one share of the Company's ordinary shares. Prices at which the warrants are exercisable range from $2.15 to $2.50 per share with a weighted average exercise price of $2.28 per share at 31 December 2004.

In December 2004, the Company and the shareholders entered into an agreement to exercise the warrants prior to or on the date of the ordinary shares became listed on a stock exchange (see note 4.30).

As of 31 December 2003, the Company had issued and outstanding 150,000 warrants for the purchase of its ordinary shares to Energulf in accordance with the terms of an exploration and development participation agreement for oil and gas properties (see note 4.2(ii)). These warrants had an exercise price of $6.00 per share that expired in June 2004. The expiration on the warrants were extended an additional two months, after which expired in August 2004.

4.30 Events since the balance sheet date

Darcy Energy LLC

GP USA's ownership interest in Darcy increased from 70% to 75% due to additional capital contributions made by the Company.

Acquisitions

The Company acquired all of the capital stock of Devon Syria, Ltd on 27 May 2005. The sole asset of Devon Syria, Ltd was an 80% working interest in the Production Sharing contract for Block 26 in Syria in which Gulfsands Petroleum plc previously owned a 20% working interest. The Company farmed out a 50%

working interest in Block 26 to SoyuzNefteGas. As a result of the acquisition, the Company became the operator of the Block 26 property.

In June 2005, GPI, following the expiration of the initial twelve month period of a joint venture with Ronexim (a private Russian company), acquired Ronexim's 15% interest in the Misan Gas Project and in connection therewith provided Ronexim $225,000. A further $250,000 will be paid upon signing a definitive agreement and upon execution of this agreement the Company will grant 75,000 share options of Gulfsands Petroleum plc shares. The Company now holds 100% of the project.

Warrants

In January 2005, 125,000 and 290,000 of the outstanding warrants were converted to ordinary shares at an exercise price of $2.50 and $2.15 per share, respectively. During March and April 2005, the remaining 125,000 and 145,000 warrants were exercised, at exercise prices of $2.50 and $2.15 respectively.

Share for share exchange

During February, March and April 2005, the entire issued share capital of the Company was acquired by Gulfsands Petroleum plc by way of a number of share for share exchange agreements. In April 2005, Gulfsands Petroleum plc floated on the AIM market of London Stock Exchange plc.

4.31 Ultimate controlling party

Gulfsands Petroleum plc, incorporated in the United Kingdom, is the single controlling party of the Company. Ultimate control is exercised by the shareholders of Gulfsands Petroleum plc.

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Mahdi Sajjad
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