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**STERLING
ENERGY PLC**

175 1721

Report and Accounts 2002



Experience in Depth

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DEFINITIONS:

bcf billion cubic feet of gas
boe barrels of oil equivalent
bbls barrels of oil
bcfe billions of cubic feet gas equivalent
mmcf/d million cubic feet of gas per day
mmcfe/d millions of cubic feet of gas equivalent per day

ADVISORS

Brokers and financial advisers: Evolution Beeson Gregory
Main bankers: Barclays, Bank of Scotland, Hibernia National Bank
Auditors: Deloitte & Touche, London
Legal advisers: Ashurst Morris Crisp
Registrars: Capita Registrars

UK:

Sterling Energy plc
Mardall House
7-9 Vaughan Road
Harpenden, Herts
AL5 4HU

t: +44 (0)1582 462 121

f: +44 (0)1582 461 221

www.sterlingenergypic.com

USA:

Sterling Energy, Inc.
15425 North Freeway
Suite 180
Houston, Texas
TX77090

t: +1 281 875 4835

f: +1 281 875 0440

CHAIRMAN'S STATEMENT

Dear Shareholder,

As your Chairman since October 2002, I am pleased to report the successful transformation of your Company which is now a cash-generative business with a strong asset base and excellent development prospects.

While the annual results for the year to December 2002 include only two months of trading after the acquisition of Sterling Energy Ltd for £7.9 million, the results reflect an immediate impact of this transaction on the Company's fortunes. Losses for the year fell dramatically from £1.5 million in 2001 to £0.1 million in the current year and there was an increase in net assets from £0.5 million to £15 million. Trading during the first four months of this year is continuing to improve and the Company is now trading profitably.

The Company's proven and probable reserves have risen from virtually zero in January 2002 to the year end level of 17 bcfe. Net production rose from a negligible level in January 2002 to 4.4 mmcfe/d in April of this year.

We have recently entered into an active development phase and anticipate production by the year-end to climb significantly, exclusive of any new production brought in by acquisition.

Sterling currently has production interests in seven Gulf of Mexico gas fields covering 15 leases, together with minor production onshore USA and Canada. Approximately 95% of the Company's current production is from gas, at a time when prices have been at an historically high level.

Apart from the acquisition of Sterling Energy Ltd other key milestones have been achieved since the start of 2002. During the period the Company acquired:

- Westmount Resources, Inc. with small producing assets in the US.
- A 17.5% interest in the Galveston 303 licence: this acquisition has not only paid for itself already but has significant development upside which we hope to tap in the coming months.
- El Gordo/Sherman: These fields are presently producing revenues of approximately \$250,000 per month and have development upside which is presently being exploited.
- Eugene Island 268: The Company acquired 60% of this licence since the year-end, which has in excess of 4bcf of net proven and probable reserves with exploration upside.

**“A strong asset base
and excellent development
prospects”**

We also saw the successful drilling and hook up of the Gryphon #2 well on our High Island 52 acreage, in which the Company has a 7.63% royalty interest. The combined gross flow from these two wells is presently in excess of 35mmcfd. This success has led to a significant increase in the reserves attributable to the license and has improved the future development potential of the area in general.

HIGHLIGHTS

Transformation of the Company following acquisition of Sterling Energy Ltd in October 2002

Year-end reserve base increased to over 17 bcfe, and daily production up to 3.3 mmcfe/d

Book net assets up from £0.5 million to almost £15 million

Reduction of year end loss: cut to £0.1 million from £1.5 million in 2001

New projects on target for further early boost to revenues

Consolidation of management team with proven track record

Strong new institutional shareholder base

Strong US gas prices

STRATEGY

OUR STRATEGY IS BUILT AROUND THE PEOPLE IN STERLING – GOOD PEOPLE WITH RELEVANT EXPERIENCE WHO ADD VALUE.

Sterling has a first class team of oil & gas upstream experts with a strong technical and commercial capability. The oil & gas business is often referred to as the ultimate “risk” business – to be successful, any Company needs to understand and manage these risks. We believe we have assembled a team with the technical skills to find the oil & gas, together with the commercial and financial skills to translate the technical work into profit.

Our aim is to build a profitable oil & gas Company which has exciting exploration potential. We are looking to grow the Company both in size and value per share. To achieve this we are doing three things;

- Buying production with appraisal & development potential
- Acquiring low cost exploration licences with substantial upside
- Taking advantage of corporate opportunities which fit our profile

In addition to this we manage our existing production and exploration assets to extract maximum potential – this means working our projects up technically and financially, then deciding whether we want to spend the risk money ourselves or whether we want to “farm-out” on a promoted basis to an industry partner. Getting this risk reward balance right is the key to maximising the value of our assets.

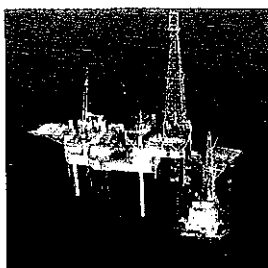
We also choose with great care the locations where we acquire assets, considering such questions as: Do we know much about the area? Can we compete? What data is available? What are the terms being offered? We seek to maximise synergies and value by building portfolios of assets in a limited number of core areas.

PRODUCTION

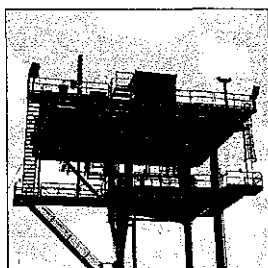
We have chosen the shallow water US Gulf of Mexico as the key location in which to develop our producing assets. We have worked there for over 15 years and know how to do business there. The main reasons for working in the Gulf are;

- project availability – there is a large turnover of projects which fit our requirements.
- politics – the area is very “safe”.
- infrastructure – is freely available unlike the N Sea.
- cost & speed – due to competition, drilling costs are significantly lower than many other places and projects can be brought onto production very fast.
- returns – good rates of return can be achieved on production and these can generally be improved by appraisal & development work.

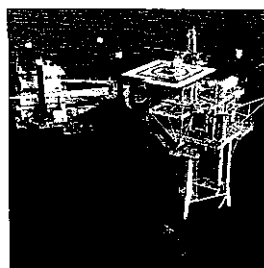
Over the last year, gas prices have been extremely volatile in the Gulf of Mexico and this has created opportunities which we are in a position to exploit. We believe this situation will persist for at least the next year or so.



Gryphon platform



El 268 platform



Gryphon platform

We are now looking forward to an exciting period for our Company with several of the Gulf of Mexico development projects coming to fruition. Over the next 18 months, we are planning a very active development programme with up to six wells scheduled for drilling or recompletion at a net cost of up to \$8 million. These will include Eugene Island 268, where a new platform was installed during May and a rig is presently on site, and El Gordo, where drilling of the number 4 well commenced in June. The Company is also planning to commence further work at High Island 52 and High Island 68.

The Company has, in addition, an exploration licence covering the Reed Bank area, offshore Philippines. Discoveries with potential reserves of up to 600 bcf were made during the 1970s and 1980s, and significant additional exploration potential exists within the licence. Sterling is currently reprocessing and reinterpreting seismic over the licence and studying the application of innovative gas-to-liquids technology to unlock these potentially commercial reserves.

In a period of international financial turmoil, the Company has also been in a position to raise £6.6 million cash through the placing of new shares in 2002, securing for itself a firm financial and institutional shareholder base. These financial resources and the new shareholder support have played a key role in enabling the Company to pursue its acquisition and development programme. We are pleased to welcome the new shareholders to our Company and thank them for their support at a time when so many, it would seem, had lost faith in the capital markets. We are particularly gratified by the strength of the institutional support we have received.

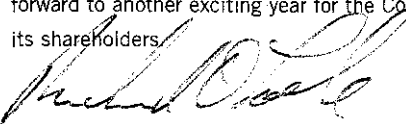
Underpinning this transformation has been the consolidation of the strong management team, who themselves own some 19% of the Company. I would like to express my appreciation for the dedication and effort of my fellow directors and Company staff that have worked hard to create this exciting opportunity for the Company and its shareholders.

OUTLOOK

The outlook for gas production in the US has rarely been better, with gas prices recently running in excess of \$5.50 per mcf, production declining, and consumption increasing. The gas futures market in the US allows us to lock in these advantageous prices for some of our gas production.

Consolidation within the oil industry has led to a high level of deal flow and I am confident that this will afford us the opportunity to maintain a rapid growth in both oil and gas reserves and shareholder value.

We are delighted that the implementation of our strategy of building a strong cash generative production base in the Gulf of Mexico complemented with selective international exploration prospects is rapidly taking shape. We look forward to another exciting year for the Company and its shareholders.



Richard O'Toole

24 June 2003

EXPLORATION

The key considerations for us here are potential upside and cost. We are looking for low entry cost projects where we can add technical value and bring in an industry partner to put up the drilling money. We are conscious of our size limitations and are careful to choose places where we can realistically compete. Our technical expertise is concentrated geographically so our initial focus is on these areas – S E Asia, Africa, Middle East, Eastern Europe and some other “hot” places. We will take on higher risk projects so long as they have the upside – our approach is to bring in larger companies to drill and they are only interested if the size is there – typically 50 million barrels or more.

As a small Company we also need to be flexible and to seize opportunities as they present themselves – if the project has outstanding technical and commercial potential we will review it.

Our aim is to build a portfolio of high potential exploration projects which are drilled by someone else while we retain part of the upside. The objective is to have a number of these wells drilled each year at minimal cost to the Company. Essentially we aim to roll the dice with someone else's stake money.

CORPORATE

Although buying and developing assets can take time, a relatively quick way to grow is through corporate acquisitions. This usually involves complex negotiations but can add significant steps in value. A key issue is finding companies where the assets fit or complement our existing portfolio.

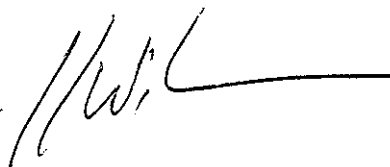
The economic turmoil of the last few years has created a number of interesting corporate opportunities. Cheap assets can be found this way and we are looking for them.

ENERGY PRICES

Overshadowing our plans and strategy for Sterling is the outlook for oil & gas prices. These have remained high. The fundamentals look strong for the sector but we are careful to develop our strategy and assets without relying on this continuing. This means being cautious about prices we input to our economic modelling and reducing the downside by selectively hedging our sales.

The performance of the Company is the only true measure of the success of the strategy. We believe our track record over the last year stands as an endorsement that we are on the right track.

H G Wilson
Chief Executive Officer



“ The performance of the Company is the only true measure of the success of the strategy ”

OPERATIONS REPORT

GULF OF MEXICO, USA

The Company has established an exciting portfolio of producing properties in the Gulf of Mexico, as a result of the acquisition of Sterling Energy last year, and supplemented by the addition of Galveston 303 in October 2002, plus the recently announced Eugene Island 268.

95 percent of the Company's reserves are gas, which has considerable appeal given a strategic view of the US gas market. Gas prices are currently at a sustained high and there is a clear trend of diminishing supply versus demand.

All of Sterling's properties are located in the shallow water shelf region where production, development and drilling costs are modest. All but one of our fields are in less than 60 ft of water.

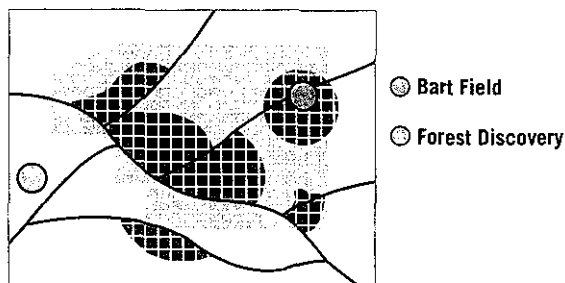
The properties have been targeted as fields that can be bought on the basis of the proven remaining reserves, but in areas where there is remaining development or exploration potential that has not been addressed or evaluated by previous owners.

Sterling has generally taken a controlling interest in the properties and brought in an operating partner such that we can control the direction and pace of evaluation and development activity without the overhead associated with being an offshore operator.

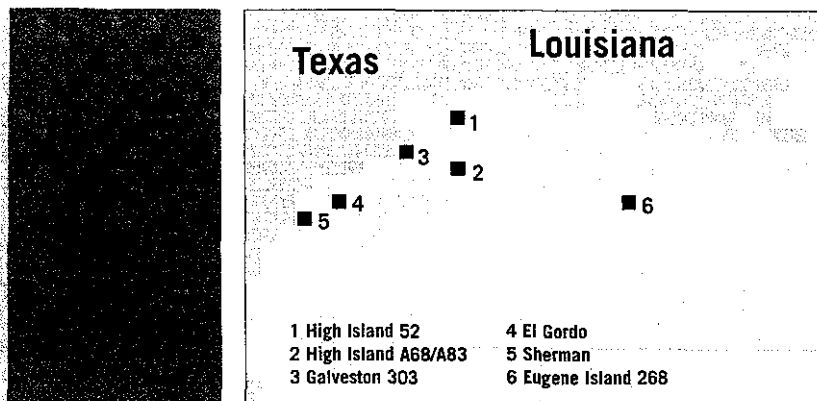
In January 2003 the Company hired Bob Munn as VP of its new Houston office. Bob has 23 years of experience the last 10 years of which has been spent working the offshore GOM, mostly with Amerada Hess where he reached the level of Division Explorationist, the top technical grade. Under his leadership, the Company is rapidly building a capacity to acquire, evaluate and eventually operate its expanding portfolio in the Gulf of Mexico.

HIGH ISLAND 52 FIELD

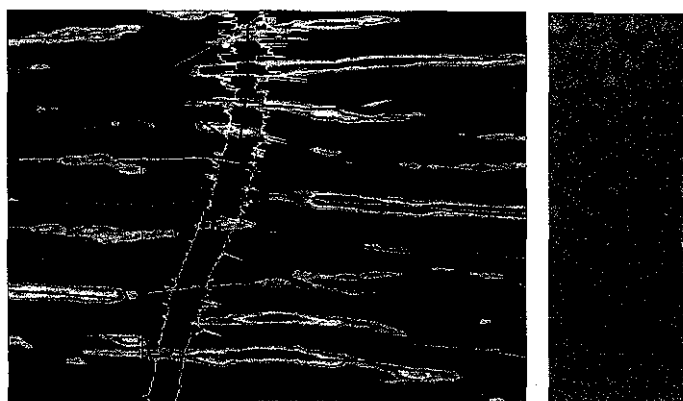
The High Island 52 Field was discovered in 1959 and has produced over 90 bcf to date. Despite the long history, there are still discoveries being made in the area. The field lies within the current trend of drilling for deep gas. In addition to the Gryphon discovery, Forest Oil have a discovery in the neighbouring High Island 53, which is expected to be tied back to the A platform with the benefit of delaying abandonment and generating significant processing fees.



HI 52 Field



Acerage holdings, Gulf of Mexico



Seismic section showing missing gas reservoir

Following acquisition of this property in 2000, Sterling was able to maintain production at a higher level than previously expected. Sterling was, perhaps surprisingly, the first owner to use 3D seismic to evaluate the field. Sterling farmed out the deep rights in the NE/4 to Gryphon Exploration who drilled the Bart discovery (see below) in 2001.

Following this success, the Company has worked up additional prospects and with new seismic reprocessing, to be paid for by a potential farm-in partner, we hope to be drilling further exploratory wells next year. We also have identified additional development potential which is scheduled to be drilled in 2003.

Production has been shut in recently pending recompletions and drilling which are scheduled in the coming months.

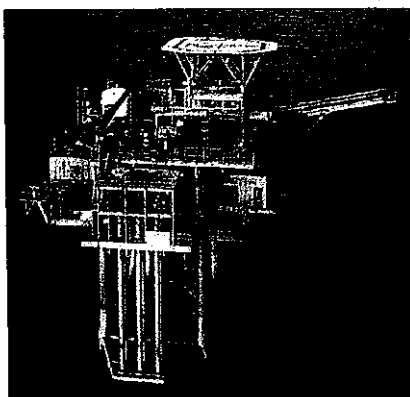
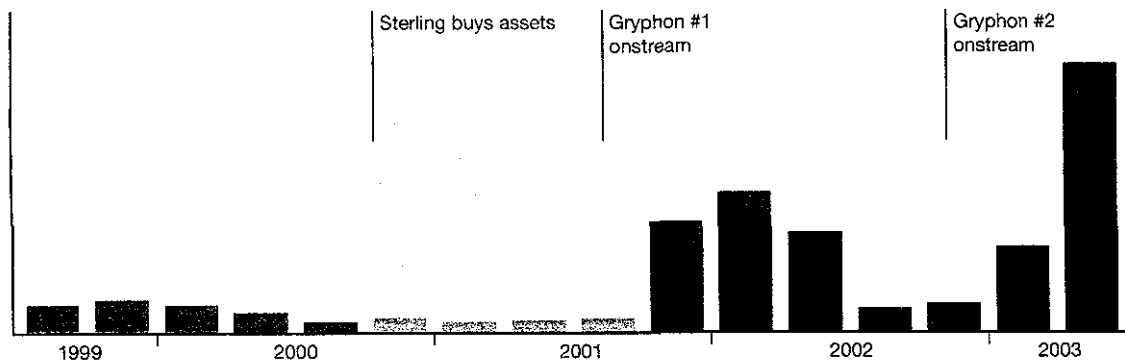
HIGH ISLAND 52- GRYPHON EXPLORATION BART DISCOVERY

2002 saw the drilling of the second well on the Bart discovery that was made in 2001. Sterling has an overriding royalty interest of 7.6% in this field. The #2 well confirmed the extent of the reservoir and was a significant improvement on the #1 well, with considerably improved reservoir thickness. The well was completed early in 2003 just in time to catch the wave of higher gas prices. Since February, production has been stable at 35 mmcfd from the two wells. This is 100% "profit", all costs having been paid by Gryphon Exploration and its partners.

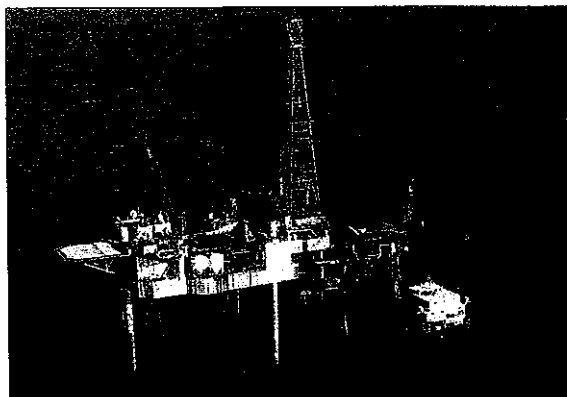
HIGH ISLAND A68/A83

These leases are very close to the end of their current producing life, and are subject of a detailed review of remaining potential. We expect to be completing this review shortly.

HIGH ISLAND ASSETS (gross gas production graph)



HI A68 platform



Gryphon platform



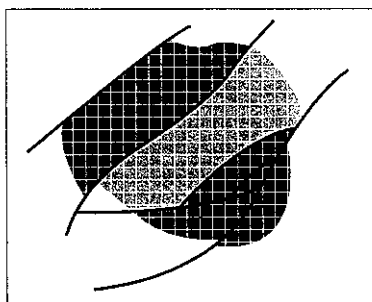
OPERATIONS REPORT (CONT'D)

EL GORDO

The El Gordo field was discovered in the 1970's and is one of the largest and oldest fields lying in Texas State waters. Sterling purchased a majority interest in this field in May 2002, and has worked closely with the operator to establish a programme of development drilling and recompletions which commenced in June 2003.

Beneath the main El Gordo sand (> 200 bcf produced to date) lie a series of fault blocks that have only been imaged by recent advances in 3D seismic quality. As a result we have been able to identify significant remaining potential that was not apparent to previous operators.

A sidetrack operation is underway to recover reserves from the deepest reservoir yet drilled on the field. A follow up programme is planned including a recompletion of an undepleted reservoir, and an infill well which could have reserves potentially as high as 40 bcf.



El Gordo field

- Proven reserves
- ⊗ Undrilled fault-blocks

SHERMAN FIELD

The Sherman field presently consists of only two producing wells but these have performed consistently since purchase as part of the same package that included El Gordo. Sterling plans to purchase seismic data later this year to evaluate the exploration potential in an area that although productive for many years has very few well penetrations below 7000 ft.

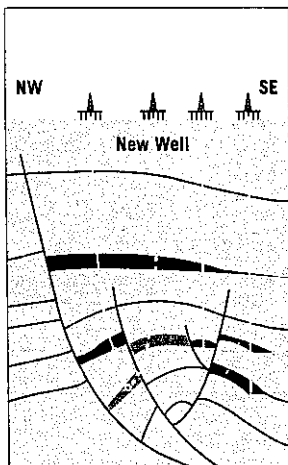
GALVESTON 303

This property was acquired in late 2002, and has considerable development potential, as well as exploration targets. The purchase achieved payout within only a few months, and production from the A platform continues at rates in excess of 3 mmcfde. Plans are under discussion with the operator for recompletion and drilling operations for 2003 and 2004.

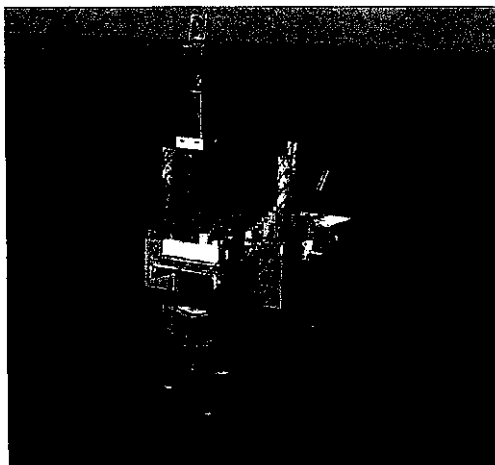
EUGENE ISLAND 268

As announced in April 2003 Sterling has taken a 60 percent working interest in this project which involves the development of a 1997 gas discovery that was deemed too small by previous owners. Gross reserves of 8.9 bcf have been certified and a platform was installed at the end of May 2003. Re-entry and completion operations are underway plus a pipeline to the nearby Unocal facility at EI 267. Total development costs are less than \$7 million, i.e. below \$1 per mcf, versus a current gas sales price in excess of \$5.50 per mcf.

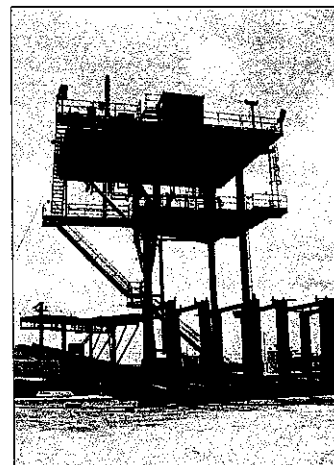
In addition there is offset drilling potential that will provide very cost effective reserves additions once the 3D seismic has been worked up fully over the coming months.



El Gordo cross section



El Gordo platform and drill rig



Eugene Island 268 platform

OTHER NORTH AMERICAN INTERESTS

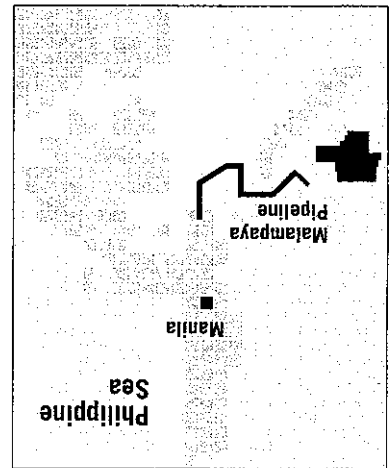
The Company maintains its long term holdings in Canada and the US, but will be looking to dispose of these less material interests in the coming year. The interests acquired through the acquisition of Westmount Resources Inc, which consist mostly of small royalties in fields located in the Gulf Coast area, have performed as expected.

INTERNATIONAL

The Company, led by our Exploration Manager Andrew Grose, has been actively developing and evaluating international exploration opportunities. In addition to the exploration license in the Philippines, applications are underway in several countries. The Company hopes to make announcements on the success of these applications as the year progresses.

REED BANK OFFSHORE PHILIPPINES

Sterling Energy was awarded GSEC 101 over Reed Bank, offshore Philippines, on 13th June 2002. The work programme includes seismic and engineering studies, and has a 24 month term which may be extended to conduct additional work. The Reed Bank concession lies about 200 kilometres southwest of the NW Palawan oil and gas province which includes the giant Malampaya gas field and several oil fields. It covers 10,360 km² (2.6 million acres) over several large shallow-water carbonate banks with water depths less than 100 metres.



Reed Bank Philippines

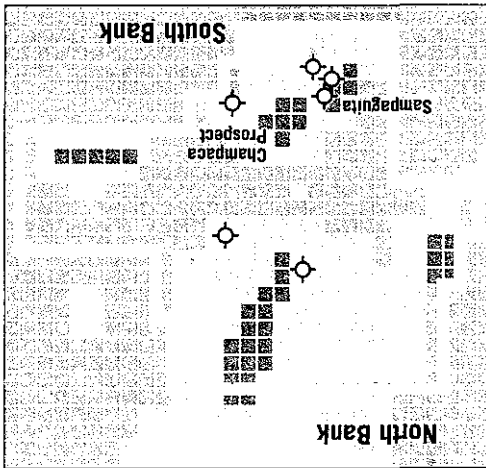
NW EUROPE INTERESTS

Recent advances in methanol production technology may make a methanol plant a viable economic solution for developing Reed Bank gas and Sterling is investigating this option as part of its committed work programme. In addition to the proven gas, GSEC 101 has significant exploration potential. Existing 2D seismic has identified several prospects, one of which, the Champaca Prospect, is a large amplitude anomaly lying close to Sampaguita, but with significantly greater reserves potential. Subject to the results of initial studies, Sterling plans to acquire a 3D seismic survey over Sampaguita and Champaca in 2004 with future exploration or development drilling expected to follow in 2005 or 2006.

The Company owns a 10 percent working interest in PEDL 71 in Yorkshire where seismic mapping has identified prospects which are currently being evaluated. The Company owns a 5 percent working interest in the Donkerbroek gas discovery onshore Holland.

N A Quinton

Operations and Technical Director



Reed Bank GSEC 101

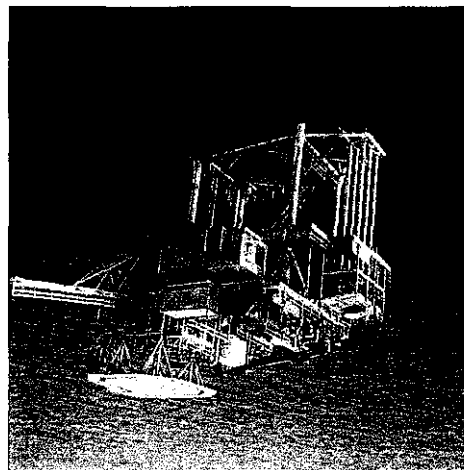
OPERATIONS (CONT'D)

PROVEN AND PROBABLE RESERVES SUMMARY

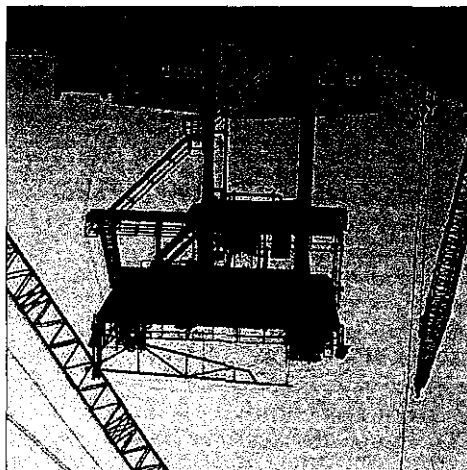
	Oil	Gas	Attributable reserves
1 January 2002 (1)	(000 barrels)	(million cubic ft)	(million cubic feet equivalent)
Corporate Acquisitions (2)	99	13,807	14,398
Upwards revision (3)	30	3,244	3,424
Production	-1	-240	-246
31 December 2002 (3)	128	16,841	17,606

NOTES:

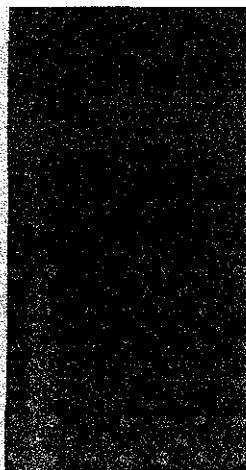
1. The reserves as at 1 January 2002 are estimated by the directors and relate only to the Canadian interests.
2. The reserves acquired under corporate acquisitions are based on:
 - evaluations by independent consulting engineers of the interests acquired through the takeover of Sterling Energy Limited in October 2002. Their published reserve estimates were effective as of the start of the year. These reserve estimates have been adjusted for production to the acquisition date;
 - reserves acquired through the purchase of an interest in Galveston 303 in October 2002;
 - directors estimates for the net reserves attributable to Westmount Resources, Inc at its date of acquisition in March 2002.
3. The year-end 2002 figures all relate to North America. The upward revisions and the Galveston reserves are based on reserve reports as at 31 December 2002, which have been prepared by independent consulting engineers. The upward revision is principally related to the Gryphon field following the successful number 2 well.



HI A68 platform



EI 268 platform under construction



DIRECTORS' BIOGRAPHIES

RICHARD O'TOOLE, 57

(Non-Executive Chairman)

Richard worked with GE in the USA for a number of years prior to becoming managing director of Estuary Fuels Ltd, an Irish oil importation and trading Company. From 1982 to 1987, he was managing director of Tusker Resources plc, an independent Irish oil Company, which built up a portfolio of international exploration assets in conjunction with international oil companies. He was the founder chairman of Kirkland Resources (Holdings) plc in 1987, which was sold in 1993. Richard was a founder of Endeavour Oil & Gas LP, whose assets were also sold, in 2000. He was appointed as a non-executive director of the Company in July 2001. Richard was a founding partner of Sterling LP, which fully owned Sterling Energy Limited ("SEL") until it was bought by the Company in October 2002, when he was appointed as Chairman. He is also chairman of the Nominations Committee.

HARRY WILSON, 50

(Chief Executive Officer)

Following graduation under a British Petroleum scholarship programme, Harry joined BP and worked for 17 years, initially as a geophysicist and subsequently as a senior exploration manager (in BP offices worldwide) and in corporate finance. In 1987, he set up an independent exploration and production Company - Kirkland Resources (Holdings) plc. In 1993 Kirkland AS was sold to a fully listed oil Company, later renamed Dragon Oil plc. In 1997 he co-established Endeavour Oil & Gas LP, and following a successful sale of Endeavour's US subsidiary in 2000 was a founding partner and chairman of Sterling LP. He was appointed as the sole executive of the Company in July 2001 and as Chief Executive Officer in October 2002 on the acquisition of SEL.

NIGEL QUINTON, 42

(Operations and Technical Director)

Nigel has 20 years oil industry experience. He worked at BP as a geophysicist, was responsible for discoveries in the Paris Basin and for regional work leading to its entry into Vietnam. In 1988 he left to join the Kirkland Group, and over the next seven years helped to build a portfolio of exploration acreage in SE Asia, resulting in discoveries in Thailand and the Philippines. At Hardy Oil and Gas plc he initiated a new overseas office and was General Manager in Pakistan and then, as General Manager UKCS, he farmed-in to Elf's 29/4d license, which resulted in the West Elgin discovery. In early 1999, he took over as Chief Executive of Endeavour Oil & Gas LP, whose Gulf of Mexico assets were sold in mid 2000, following which he was a founding partner and MD of Sterling LP. Nigel became an executive director in October 2002 with the takeover of SEL.

DR ELIZABETH BUTLER, 58

(Non-Executive Director)

Liz has spent over 20 years working in world financial markets. She has held senior posts in several international investment banks and is currently a strategic advisor on energy matters to WestLB AG. Prior to entering commercial life she gained a DPhil at Oxford University. She has also spent two periods working for BP Exploration, initially as a reservoir engineer and then as a consultant to the chief executive on projects relating to its reorganisation and restructuring. She became a director of the Company in 1992, was appointed as a non-executive in July 2001 and is chairman of the Remuneration Committee.

GRAEME THOMSON, FCA, 46

(Finance Director and Company Secretary)

Graeme has held a number of senior finance and management positions in quoted companies. In 1989 he co-led a management buy-in to AmBrit International plc, which was taken over in 1992. He then joined the Kirkland Group, which later became Dragon Oil plc, where he served as Finance Director and Company Secretary until April 1999. A founder partner of Endeavour and Sterling, he has most recently been assisting smaller unquoted and quoted companies, including Sterling LP and the Company, with their corporate finance, accounting, commercial and strategic affairs. He was appointed as a non-executive of the Company in July 2001 and as an executive in October 2002.

PETER WILDE, 49

(Non-Executive Director)

Peter graduated in law from the London School of Economics, and has spent most of his career managing and developing smaller companies, working in the oil sector for the last fifteen years. In 1989 was appointed Vice-President of Aviva Petroleum Inc., the Dallas based oil and gas independent, where his responsibilities particularly included corporate financial control and integration of acquisitions. He has been a director of the Company since its foundation in 1983, serving as a full time director from 1991 to 2001, firstly as Chief Operating Officer and latterly as Managing Director. Since July 2001 he has served as a Non-Executive Director and is chairman of the Audit Committee.

FINANCIAL REPORT AND OUTLOOK

ACQUISITIONS AND FUND RAISINGS

The year saw a transformation in the financial position of the Group. At the end of 2002 net assets had grown to £14.91 million from £0.47 million at the end of 2001 and net current assets had increased to £7.00 million (2001: £0.44 million). The emphasis during 2002 was on building a portfolio of cash flow generating assets and enhancing the working capital position of the Group, as well as investing in licences with potential for appraisal and drilling opportunities.

In early March 2002, the acquisition of Westmount Resources, Inc ("Westmount") for approximately £0.5 million was completed. The consideration for this transaction comprised the issue of 6.5 million shares at 4.5p, together with approximately £0.2 million in cash. This increased the net current assets of the Group by approximately £0.15 million and yielded an operating cash inflow in the 10 months since purchase of over £0.03 million.

net current assets

£0.4 million in 2001

to £7.0 million in 2002

The major highlight of the year was the acquisition of Sterling Energy Limited ("SEL") for approximately £7.9 million in mid October 2002. This was set out in a circular to shareholders dated 26 September 2002 and completed following an Extraordinary General Meeting ("the EGM"). This acquisition brought with it producing assets and new drilling prospects in the USA, as well as an experienced executive management team. The initial consideration at completion was 157 million ordinary shares, with a further 40 million expected to be issued by the end of 2003, subject to deduction for any agreed

warranty claims. The financial statements consolidate the results of SEL for the two and a half months since acquisition to the end of the year. During that time it contributed in excess of £0.5 million to turnover and approximately £0.2 million to gross profit. A coterminous placing and open offer at 4p per share was also completed in October. This resulted in the issue of approximately 60.4 million ordinary shares and raised approximately £1.8 million of cash after deducting the costs of the SEL purchase and this fund raising. The purchase of a 17.5% working interest in Galveston 303 licence offshore USA for a net consideration of approximately \$0.1 million (£0.06 million) was also completed in October. It adds further to the portfolio of drilling prospects. By year-end the incremental operating cash flows from this asset had exceeded the purchase price. As a result of these various purchases, offshore US production had increased to an average of approximately 3.3 million cubic feet of gas per day by December 2002. A further placing of 90.9 million shares at 5.5p in December raised approximately £4.75 million in cash, net of expenses. In conjunction with the other transactions described above, the issued share capital had therefore risen to approximately 353.8 million shares at the year-end (2001: 39.0 million). Since the 2002 year-end, the Group has acquired a 60% interest in the Eugene Island 268 lease in the Gulf of Mexico. Drilling commenced in late June 2003 and Sterling expects its total direct investment in this project in 2003 to be approximately US\$4.2 million (£2.63 million). In addition, also in June 2003, drilling started on the sidetrack on the El Gordo licence in the Gulf of Mexico, with Sterling Energy plc's share of costs budgeted at \$1.6 million (£1.0 million). In May 2003, approximately 20.7 million warrants to subscribe for ordinary shares at 6p were exercised, raising approximately £1.2 million in cash for working capital purposes.

PROFIT AND LOSS

Gross profit in 2002 improved to over £0.2 million (2001: £0.02 million), principally as a result of the company and asset acquisitions set out above. The non-recurring nature of the 2001 write down on exploration assets of £0.94 million and abortive acquisition costs of £0.3 million were the primary reasons for the reduction in the Group's operating loss, which fell from £1.48 million in 2001 to £0.078 million in 2002. After adjustment for net financial costs, the net loss for 2002 was £0.098 million (2001: loss of £1.49 million). Loss per share fell to 0.1p in 2002 from a loss of 6.7p in 2001.

CASH FLOW AND BALANCE SHEET

The Group's cash flow from operations moved from an outflow of £0.5 million in 2001 to an outflow of £1.10 million in 2002. However, this was more than compensated for by the proceeds from the share placings and the open offer, which resulted in a significant improvement in cash balances by the end of 2002 when they stood at £7.33 million (2001: £0.57 million), including £0.86 million of escrowed abandonment funds.

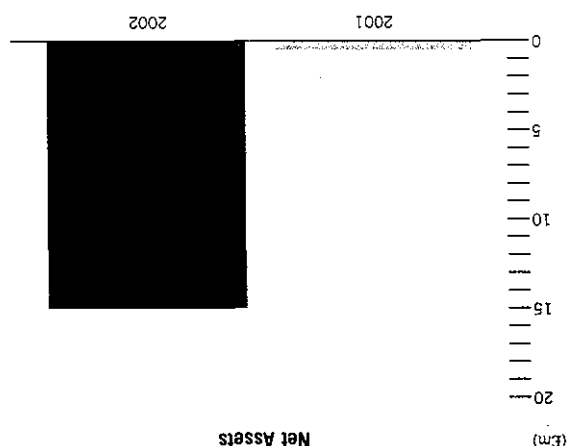
Net current assets improved to £7.00 million (2001: £0.44 million), whilst the effect of consolidating the net assets of Westmount and SEL at their fair value, of the various share issues and of the deferred shares expected to be issued in respect of the SEL acquisition, are the primary reasons for the increase in net assets from £0.47 million at the end of 2001 to £14.91 million at the end of 2002.

FINANCIAL OUTLOOK

With the increase in average production following the purchases made in late 2002, with the Gryphon 2 well commencing production in early 2003 and with strong gas futures prices in the US, the directors consider the outlook for the Group to be excellent. Although the impact of the current and planned drilling and production improvement programme will not become apparent until the second half of 2003, results for the first quarter were still significantly better than in the last quarter of 2002. The directors remain optimistic that, based on expected production levels, assuming good drilling results, with forward gas prices as indicated by the markets and taking into account hedging contracts entered into, 2003 results will show a continuing increase in profitability, leading to improved cash generated from operations. Existing working capital will enable the Group to invest further, not only in the producing operations but also internationally in early stage exploration projects where outstanding returns may be found.

Finance Director and Company Secretary

G P Thomson



DIRECTORS' REPORT

The directors have pleasure in presenting their annual report on the affairs of Sterling Energy plc ("the Company") and its subsidiaries ("the Group"), together with the financial statements and auditors' report for the year ended 31 December 2002.

CHANGE OF NAME

Following the passing of a Special Resolution at an EGM of shareholders held on 18 October 2002, the Company's name was changed from LEPCO plc to Sterling Energy plc effective from 23 October 2002.

PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the Group throughout the year was the exploration for and production of oil and gas. Following the EGM, the Company acquired the whole of the issued ordinary share capital of Sterling Energy Limited ("SEL") for a maximum consideration of £7.88 million, paid for by the issue of 197,000,000 ordinary shares at 4p each. Of the consideration, 157,000,000 initial consideration ordinary shares were issued and up to a further 40,000,000 deferred consideration ordinary shares are to be issued no later than 31 December 2003 less any reduction for any agreed warranty claims. The directors currently expect to issue all of these deferred consideration shares. The other activities of the Group, the significant developments during 2002 and the future prospects for the Group are reviewed in detail in the Chairman's statement and elsewhere in this annual report.

RESULTS AND DIVIDENDS

The Group made a loss after tax of £0.098 million during the year (2001 - loss after tax of £1.49 million). This leaves an accumulated Group deficit of £3.39 million (2001 - £3.29 million) to be carried forward as a balance on the Group profit and loss account. As a result of the accumulated deficit retained by the Company the directors cannot recommend the payment of a dividend (2001 - £nil).

CHANGES IN SHARE CAPITAL

Under an agreement dated 27 February 2002 and completed the following month, the Company purchased the whole of the issued share capital of Westmount Resources, Inc. for a consideration of approximately £0.5 million, part of which was satisfied by the issue of 6,500,000 new ordinary shares at 4.5p per share.

The major highlight of the year was the acquisition of Sterling Energy Limited for approximately £7.9 million in October 2002

A circular (the "Circular") to shareholders, dated 26 September 2002, set out details of the acquisition of Sterling Energy Limited, summarised above. The Circular also included details of a concurrent placing and open offer under which a total of 60,339,649 new ordinary shares were issued at 4p per share, raising approximately £1.8 million (after expenses). The enabling resolutions were all passed at the resulting EGM, at which time the authorised ordinary share capital was increased to £12.5 million. Also a result of the EGM, the Company repurchased for nominal consideration and cancelled all of its deferred shares. The carrying value of these shares of £0.891 million was recorded as a movement in the share premium account. On 23 December 2002 the Company issued 90,910,000 new ordinary shares at a price of 5.5p per share, to raise a total of £4.75 million net of expenses.

Subsequent to the year-end on 13 May 2003, the Company issued 20,726,152 new ordinary shares following the exercise of warrants which entitled holders to subscribe for new ordinary shares at 6p per share. This raised approximately £1.2 million for the Company.

DIRECTORS AND THEIR INTERESTS

The directors who served during the year, together with their beneficial interests in the issued share capital of the Company, were as follows:

Ordinary shares of 1p each			
	23 June	31 December	31 December
Dr. E.J. Butler**	329,550	329,550	213,800
R.A. O'Toole**	18,711,039	1,073,293	1,073,293
N.A. Quinton, appointed 18 October 2002 (see below)	14,977,469	1,120,571	-
G.P. Thomson	13,024,784	800,713	800,713
P.K. Wilde**	600,000	600,000	490,000
H.G. Wilson (see below)	23,149,544	2,374,430	2,374,430

*date of appointment if later

**non-executive director, member of the audit, remuneration and nominations committees

Beneficial shareholdings include the shareholdings of a director's spouse and infant children. Each of Mr Quinton, Mr O'Toole, Mr Thomson and Mr Wilson are deemed to be acting in concert, together with Mr R Brown who holds 200,000 ordinary shares, as a result of being partners in Sterling Energy Limited Partnership (formerly "SLP").

a shareholder of the Company via its general partner, Sterling Energy GP Limited ("SEGP"). Accordingly, in addition to the shareholdings shown above, each of these four directors was also deemed to be interested in 197,540,872 ordinary shares at 31 December 2002, principally being SEGP's shareholding at that date.

Subsequent to the year-end SLP distributed its shares to partners in specie resulting in the increase in interests set out above. Of the above interests at 23 June 2003, Mr Quinton's includes 6,947,295 ordinary shares held by QX Energy Limited, a Company wholly owned by him and his family, and Mr Wilson's includes 14,603,254 ordinary shares held by Rosalea Limited, a Company in which he has a 26% interest and is a director.

At 31 December 2002, the directors also had the following warrants or interests in warrants to subscribe for further shares at 6p each no later than 30 June 2003: 125,000 for Dr Butler, 1,664,799 for Mr O'Toole, 1,738,134 for Mr Quinton, 1,241,997 for Mr Thomson, 161,000 for Mr Wilde and 3,683,014 for Mr Wilson. All of these warrants or interests in warrants were disposed of on 13 May 2003 (see changes in share capital above).

None of the directors have any non-beneficial shareholdings.

None of the directors have contracts of employment with notice periods in excess of 12 months. Details of remuneration paid to the directors who served in the year are included in note 7 to the financial statements.

DIRECTORS' REPORT (CONT'D)

SHARE OPTION SCHEME

In July 2001, the shareholders voted in favour of a share option scheme ("the Scheme") entitling the directors, staff and others, to subscribe at a given subscription price for ordinary shares in the Company, with 2,650,000 options outstanding at the end of that year. Details of the options held by the directors and not exercised under the Scheme are in note 7 to the financial statements. As described in the Circular and following the passing of the EGM resolutions, an additional 23,650,000 options were granted to directors and staff during 2002 at a price of 4p per share with 10 year terms. At 31 December 2002, a total of 26,300,000 options were outstanding under the Scheme, all at prices of 4p, exercisable no later than 2011-2012. Since 1 January 2003, a further 9,000,000 options have been granted at an exercise price of 7p per share, exercisable between 2005 and 2013. Of these options 2,900,000 were granted to Mr Wilson, 1,900,000 to Mr Quinton, 1,700,000 to Mr Thomson, 1,250,000 to Mr O'Toole and the remainder to staff. The Scheme rule is that the number of share options outstanding should not exceed 10% of the issued share capital from time to time.

ENVIRONMENT, HEALTH AND SAFETY POLICY

The Group is fully committed to high standards of environment, health and safety management, whilst recognising that it is a non-operator on all of its producing interests.

SUPPLIER PAYMENT POLICY AND PRACTICE

The Company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensuring that suppliers are made aware of the terms of payment and abide by the terms of payment. At the year end the number of supplier days outstanding for the Company was 45 days (2001 - 65 days).

SUBSTANTIAL SHAREHOLDERS

Except for the holdings of ordinary shares listed below and the concert party noted above, the Company has not been notified by any person holding 3% or more of the 374,814,952 issued ordinary shares of 1p each of the Company at 23 June 2003:

Substantial shareholders

	Number	%
Harry Wilson, Chief Executive*	23,149,544	6.2
Richard O'Toole, Non-Executive Chairman*	18,711,039	5.0
Nigel Quinton, Operations and Technical Director*	14,977,469	4.0
Graeme Thomson, Finance Director and Company Secretary*	13,024,784	3.5

* See directors' interests in this report

NOTICE OF ANNUAL GENERAL MEETING ("AGM")

The notice of the AGM to be held on 23 July 2003 is set out on page 44, as well as a form of proxy which is enclosed. The ordinary business to be dealt with in Resolutions 1 to 5, includes the re-election of one third of directors (being Dr Butler and Mr Wilde), and the reappointment of Mr Quinton, who was appointed since the last AGM. Three other Resolutions are set out below, two of which are Special Resolutions.

Resolution number 6 deals with the disapplication of s95 of the Companies Act 1985 (the "Act"), which permits the directors to issue "headroom" shares up to a nominal value of £3,500,000. In addition to covering up to 40 million deferred consideration ordinary shares to be issued by the end of 2003, this covers any shares issued under the share option scheme (being a maximum of approximately 35.3 million ordinary shares based on the issued share capital at the end of 2002) and the exercise of remaining warrants (being up to approximately 4.0 million ordinary shares). This is intended to give the Company the flexibility to enter into transactions involving the issue of shares without requiring additional specific prior shareholder approval. The directors believe this is an appropriate level in light of the Company's stage of development and its plans. The net amount is an increase of approximately 35% over the level of headroom shares currently authorised whilst the issued share capital has increased by over 40% since the previous authority was taken. It is proposed that this authority should expire at the end of the 2005 AGM, unless otherwise amended before then.

Resolution number 7 deals with the implementation of an executive incentive bonus scheme based on the performance of the Group's producing oil and gas assets. This scheme was agreed in principle by the Remuneration Committee and was described in the Circular referred to previously. The detail of the scheme has now been agreed by the Remuneration Committee. Production royalty pools equivalent to a 2% over-riding royalty interest will be set-up subject to certain performance criteria such as a "hurdle rate" on the original investment made by the Group. This scheme is not only intended to incentivise the executive directors, who are expected to each receive 20% of the pools, but also to compensate them for the reduction in their salary and other remuneration accepted by them on this basis as part of the acquisition of SEL. This bonus scheme is also intended to provide appropriate incentives for senior personnel.

AUDITORS

Resolution number 8 deals with bringing the Company's Articles of Association up-to-date to comply with current best practice. In particular, the directors are proposing to permit shareholders to receive documents from the Company, such as the annual report and interim statement, in electronic form, as well as to vote in this way. The directors consider this to be consistent with recent trends in communicating with shareholders and in voting, as well as being cost-effective for the Company. A copy of the proposed Articles of Association, showing changes from the existing, will be available at the Company's registered office from the date of this Notice to the date of the AGM. During 2002, the Company's auditors, Arthur Andersen, ceased business. As a result, the directors appointed Deloitte & Touche as auditors to fill the casual vacancy. Deloitte & Touche has expressed their willingness to continue in office as auditors and Resolution 5 in the Notice of Annual General Meeting proposes their reappointment for the ensuing year. Deloitte & Touche has informed the directors that they are intending to transfer their business to a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000, to be known as Deloitte & Touche LLP. It is the current intention of the directors to use the Company's statutory power to give consent to the appointment of Deloitte & Touche being treated as extending to Deloitte & Touche LLP at the appropriate time.

By order of the Board,

[Signature]
B P Thomson, FCA

Company Secretary, Mardall House

7-9 Vaughan Road, Harpenden, Herts AL5 4HU

24 June 2003

CORPORATE GOVERNANCE

APPLICATION OF COMBINED CODE PRINCIPLES

The Directors are committed to maintaining the highest standards of corporate governance and this statement describes how the Principles of Good Governance set out in the Combined Code are applied.

THE BOARD OF DIRECTORS

At 31 December 2002, the Board comprised three

Executive Directors and three Non-Executive Directors.

Each of the Executive Directors has extensive knowledge of the oil and gas industry combined with general business

skills. All of the Directors bring independent judgement to

bear on issues of strategy, performance, resources, key

appointments and standards. There is a clear division of

responsibilities between the Chairman and the Chief

Executive. The Senior Independent Non-Executive Director

is Mr R O'Toole. The Board considers that all its Non-

Executive Directors are independent.

The Board meets regularly throughout the year and all

the necessary information is supplied to the Directors on

a timely basis to enable them to discharge their duties

effectively. The Directors have access to independent

professional advice, at the Group's expense, if and when

required. There is a formal schedule of matters reserved

for consideration by the Board and other matters are

delegated to Board Committees.

The Memorandum and Articles of Association require that

not less than one third of the Board must go forward for

reappointment at the Annual General Meeting (AGM) each

year, together with all new Directors appointed since the

previous AGM.

The Board has appointed the following subcommittees:

COMMUNICATIONS WITH SHAREHOLDERS

Communications with shareholders are given high priority

and there is regular dialogue with institutional investors,

as well as general presentations at the time of the release of

the annual and interim results. The Group issues its results

to individual shareholders and will also publish them on the

Company's website (www.sterlingenergyplc.com). Regular

updates to record news in relation to the Company are also

included on the website. Shareholders and other interested

parties can subscribe to receive news updates.

A business presentation is to be provided at the Company's

AGM and afterwards individual shareholders will be given

the opportunity to put questions to the Chairman and

the Board.

NOMINATIONS COMMITTEE

The members of this Committee are the three independent

Non-Executive Directors under the Chairmanship of Richard

O'Toole. The Nominations Committee considers the

composition of the Board and makes recommendations

on the appointment of new Directors.

REMUNERATION COMMITTEE

The members of the Committee are the three independent

Non-Executive Directors, under the Chairmanship of

Elizabeth Butler. The Committee determines the Group's

Executive Directors' remuneration. Non-Executive Directors'

fees are considered and agreed by the Board.

AUDIT COMMITTEE

This Committee comprises the three independent Non-

Executive Directors, under the Chairmanship of Peter Wilde.

It reviews the interim and annual financial statements,

internal control matters and the scope and effectiveness of

the external audit. The external auditors have unrestricted

access to the Chairman of the Audit Committee.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

United Kingdom Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group as at the end of the financial year and of the profit or loss of the Group for that year. After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, 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 Company and Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INTERNAL CONTROLS

In September 1999 the Turnbull Guidance (Internal Control: Guidance for Directors on the Combined Code) was published. The Directors acknowledge their responsibility for the Group's and the Company's systems of internal control, which are designed to safeguard the assets of the Group and to ensure the reliability of financial information for both internal use and external publication. The Group's internal control procedures include Board, technical and financial approval for all projects. All major expenditures require senior management approval at the appropriate stages of each transaction. Overall a regular reporting system covering both technical progress of projects and the state of the Group's financial affairs ensures control. The Board has put in place procedures for identifying, evaluating and managing any significant risks that face the Group.

Any systems of internal control can only provide reasonable, and not absolute, assurance that material financial irregularities will be detected or that the risk of failure to achieve business objectives is eliminated. The Directors, having reviewed the effectiveness of the system of internal financial, operational and compliance controls and risk management, consider that the system of internal control operated effectively throughout the financial year and up to the date the financial statements were signed.

COMPLIANCE WITH COMBINED CODE PROVISIONS

Throughout the year ended 31st December 2002, the Company has been in compliance with the provisions set out in Section 1 of the Combined Code on Corporate Governance issued by the Financial Services Authority.

CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2002

	2002	2001
Turnover	£000	£000
Existing operations	22	49
Acquisitions	566	-
	1(c),2	
Cost of sales	588	49
Existing operations	(13)	(24)
Acquisitions	(365)	-
Gross profit	(378)	(24)
Existing operations	9	25
Acquisitions	201	-
	210	25
Administrative expenses		
Amounts written off intangible fixed assets	3	(944)
Abortive acquisition and deal costs	3	(303)
Other		
Existing operations	(131)	(259)
Acquisitions	(157)	-
Operating (loss)/profit	(288)	(1,506)
Existing operations	(122)	(1,481)
Acquisitions	44	-
Investment income	(78)	(1,481)
4	22	13
Interest payable and similar charges	(42)	(25)
5	(98)	(1,493)
Loss on ordinary activities before taxation	(98)	(1,493)
Taxation	-	-
8		
Loss for the financial year	(98)	(1,493)
Loss per share (basic and diluted)	(0.1)p	(6.7)p
10		

The accompanying notes numbered 1 to 27 are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET

31 December 2002

	Notes	2002	2001
Fixed assets			
Intangible assets	11	4,096	26
Tangible assets	12	6,560	7
Current assets			
Debtors	14	673	20
Cash at bank and in hand	15	7,334	566
		8,007	586
Creditors: Amounts falling due within one year	16	(1,006)	(149)
Net current assets		7,001	437
Total assets less current liabilities		17,657	470
Creditors: Amounts falling due after one year	17	(808)	-
Provisions for liabilities and charges	18	(1,939)	-
Net assets		14,910	470
Capital and reserves			
Called-up share capital	19	3,538	1,282
Shares to be issued	19b	1,600	-
Share premium account	20	13,334	2,443
Currency translation reserve	20	(173)	36
Profit and loss account	20	(3,389)	(3,291)
Shareholders' funds		14,910	470
Shareholders' funds may be analysed as:			
Equity interests		14,910	(421)
Non-equity interests		-	891
		14,910	470

The accompanying notes numbered 1 to 27 are an integral part of these financial statements.

COMPANY BALANCE SHEET

31 December 2002

Notes	2002	2001
	£000	£000
Fixed assets		
Intangible assets	11	21
Investments	13	38
	8,412	8,430
Current assets		
Debtors	14	40
Cash at bank and in hand		547
	5,680	587
Creditors: Amounts falling due within one year	16	(133)
	6,875	454
Net current assets		
	6,735	513
Total assets less current liabilities, being net assets		
	15,165	15,165
Capital and reserves		
Called-up share capital	19	1,282
Shares to be issued	19b	-
	1,600	2,443
Share premium account	20	(3,212)
Profit and loss account	20	513
Shareholders' funds		
	15,165	15,165
Shareholders' funds may be analysed as:		
Equity interests		(378)
Non-equity interests		891
	15,165	513

Approved by the Board of Directors on 24 June 2003 and signed on its behalf by:

G.P. Thomson, FCA Director

H.G. Wilson Director

The accompanying notes numbered 1 to 27 are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2002

	2002	2001
Loss for the financial year	(98)	(1,493)
Currency translation adjustments	(209)	-
Total recognised losses relating to the year	(307)	(1,493)

RECONCILIATION OF MOVEMENTS IN GROUP SHAREHOLDERS' FUNDS

For the year ended 31 December 2002

	2002	2001
Loss for the financial year	(98)	(1,493)
Other recognised losses for the year	(209)	-
Shares issued (net of expenses)	13,147	1,063
Shares to be issued	1,600	-
Total movement in the year	14,440	(430)
Shareholders' funds at 1 January	470	900
Shareholders' funds at 31 December	14,910	470

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2002

	2002	2001
Net cash outflow from operations	23	(1,104)
Returns on investments and servicing of finance	24a	(3)
Capital expenditure	24a	(79)
Acquisitions	24a	405
Cash outflow before financing	24a	(781)
Financing	24a	6,574
Increase in cash	24b	5,793
		518

The accompanying notes numbered 1 to 27 are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2002

1 ACCOUNTING POLICIES

The principal accounting policies which, except for the adoption of FRS 19 in respect of deferred tax (see note 8), have all been applied consistently throughout the year and the preceding year, are set out below:

a) Basis of accounting

The financial statements are prepared under the historical cost convention, and in accordance with applicable United Kingdom accounting standards. The financial statements have also been prepared in accordance with the Statement of Recommended Practice "Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities" ("the SORP") published by the Institute of Petroleum on behalf of the UK Oil Industry Accounting Committee.

b) Consolidation

The Group financial statements consolidate the results of Sterling Energy plc and its subsidiary undertakings drawn up to 31 December annually. The results of subsidiaries acquired are consolidated for the periods from which control passed. Acquisitions are accounted for under the acquisition method with goodwill, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, being capitalised within intangible assets and amortised over its estimated useful economic life.

c) Turnover

Turnover represents the invoiced value of the Group's share of hydrocarbon production in the year.

d) Consortium accounting

The Group's exploration, development and production activities are generally conducted as co-licence in joint operations with other companies. The financial statements reflect the relevant proportions of production, capital expenditure and operating costs applicable to the Group's interests.

e) Oil and gas interests

The Group accounts for oil and gas exploration under the full cost basis as set out in the SORP. Licence acquisition costs, geographical and geophysical costs, costs of drilling exploration, appraisal and development wells, and an appropriate share of overheads (including appropriate directors' costs) are capitalised and accumulated in full cost pools within tangible fixed assets on a geographical basis. The Group's oil and gas assets are currently held in three cost pools, Western Europe, South East Asia and North America.

Costs relating to the exploration and appraisal of oil and gas interests, which the directors consider to be unevaluated, are initially held outside the cost pool as intangible fixed assets. These costs are reassessed at each year end and when there are indications of impairment or at the conclusion of an appraisal programme the related costs are transferred to the appropriate full cost pool within tangible fixed assets.

An impairment test is carried out at each balance sheet date to assess whether the net book value of the capitalised costs in each pool is covered by the associated recoverable amount, as outlined in FRS 11 "Impairment of Fixed Assets and Goodwill". Impairment losses are recognised in the profit and loss account.

Depletion is provided on balances held in each cost pool, plus the expected future costs to extract all commercial oil and gas reserves, using the unit of production method. Commercial oil and gas reserves are proven and probable oil and gas reserves as defined in the SORP. Depletion is not provided on interests held outside the cost pool.

f) Depreciation of other tangible fixed assets

Depreciation on other tangible fixed assets is provided at rates estimated to write off the cost, less estimated residual value, of each asset over its expected useful life as follows:

Computer equipment - 33% straight line

g) Decommissioning

Provision for decommissioning costs is recognised in accordance with Financial Reporting Standard No. 12 "Provisions, Contingent Liabilities and Contingent Assets". Provisions are recorded at the present value of the expenditures expected to be required to settle the Group's future obligations.

Provisions are reviewed at each balance sheet date to reflect the current best estimate of the cost at present value. The unwinding of the discount is reflected as a finance cost. A decommissioning asset is also established, since the future cost of decommissioning is regarded as part of the total investment to gain access to future economic benefits, and included in the relevant full cost pool. Depletion on this asset is calculated under the unit of production method based on estimated commercial reserves. Commercial reserves are net proven and probable oil and gas reserves, as defined in the SORP.

h) Foreign currencies

Transactions denominated in foreign currencies are translated into sterling at the rate of exchange ruling at the date of the transaction. Assets and liabilities in foreign currencies are translated into sterling at the rate of exchange ruling at the end of the financial year. All exchange differences are dealt with in the profit and loss account.

The results of overseas operations are translated at the closing rates of exchange during the period and their balance sheet at the rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets and results of overseas operations are dealt with through the statement of total recognised gains and losses.

i) Corporation tax

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

j) Investments

Fixed asset investments are shown at cost less provision for impairment.

k) Operating leases

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis.

l) Derivative financial instruments

The Group uses derivative financial instruments to manage its exposure to changes in prices of natural gas. These transactions are accounted for on an accruals basis.

2 SEGMENT INFORMATION

The Group operates in one business segment, the exploration for and production of oil and gas. The Group has interests in three geographical segments, Western Europe, North America and the South East Asia as follows:

	Western Europe**		North America		South East Asia		Group
Turnover*	2002	2001	2002	2001	2002	2001	2002 2001
	£000	£000	£000	£000	£000	£000	£000 £000
existing operations	-	-	22	49	-	-	22 49
acquisitions	-	-	566	-	-	-	566 -
(Loss)/profit before taxation	(135)	(1,490)	37	(3)	-	-	(98) (1,493)
Net assets***	4,611	453	10,264	17	35	-	14,910 470

* All turnover is sold to third parties within the segment of origin.

** Net assets for Western Europe are comprised principally of cash balances

*** Net assets exclude intra-group financing

3 LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION

	2002	2001
Loss on ordinary activities before taxation is stated after charging:	£000	£000
Depletion of tangible fixed assets	166	-
Depreciation of tangible fixed assets – owned assets	4	4
Amounts written off intangible fixed assets (see below)	-	944
Abortive acquisition and deal costs (see below)	-	303
Auditors' remuneration (see below):		
- audit fees	25	8
- non-audit assurance services	56	68
Operating lease rentals – land and buildings	11	18

Auditors' remuneration

The Group audit fee for 2001 was payable to Arthur Andersen, the former auditors to the Group, with the fee for 2002 payable to Deloitte & Touche. Non audit fees include £36,000 (2001 - £68,000) payable to Arthur Andersen, with the remainder payable to Deloitte & Touche.

The non-audit fees shown above for 2002 were recorded against the share premium account as they related to the placing and open offer described in note 19c. The non audit fees shown above for 2001 include £14,000 that was recorded against the share premium account as they related to an open offer during that year and £48,000 expensed as part of the abortive acquisition costs (see below).

All audit fees for both years were charged to the Company.

Amounts written off intangible fixed assets.
 The write off of £944,000 in 2001 arose in connection with a North Sea licence that was relinquished during 2002.
 Abortive acquisition and deal costs.
 The charge of £303,000 in 2001 represents costs incurred in connection with an aborted deal with DNO ASA.

4 INVESTMENT INCOME

Interest receivable and similar income	2002	2001
Interest receivable on restricted account (note 15)	4	13
	22	13

5 INTEREST PAYABLE AND SIMILAR CHARGES

Interest and fees arising on loans (see note 16)	2002	2001
Unwinding of discount on provisions for decommissioning (see note 18)	21	23
Other	2	25

6 EMPLOYEE INFORMATION

The average monthly number of employees (including executive directors (see note 7) during the year was 2 (2001 - 2).
 Due to the small size of the Company there is no formal classification of duties.
 Employee costs during the year (including executive directors) amounted to:

Wages and salaries	2002	2001
Social security costs	£000	£000
	132	175
	4	14
	136	189

Included within wages and salaries above is £23,000 (2001 - £nil) which has been capitalised. Included in wages and salaries in 2002 is a total of £nil relating to compensation for loss of office (2001 - £57,000). The Group does not provide pension arrangements for its directors or staff.

7 DIRECTORS' REMUNERATION

Aggregate remuneration

Directors' remuneration for the year comprised emoluments of £148,622 (2001 - £178,736), of which £nil (2001 - £51,322) relates to compensation for loss of office.

Directors' emoluments, all of which relate to basic salaries, fees and compensation for loss of office,

consist of the following:

Executive directors		2002	2001
H.G. Wilson		44,374	13,568
G.P. Thomson		25,269	2,710
N.A. Quinton		20,430	-
Non-executive directors			
R.A. O'Toole		12,875	2,710
P.K. Wilde		27,837	93,288
Dr E. J. Butler		17,837	46,235
P.J. Bassett (until 18 July 2001)		-	8,427
Prof. A. M. Lees (until 18 July 2001)		-	5,618
J.G. West (until 18 July 2001)		-	6,180
Aggregate emoluments		148,622	178,736

The services of Mr Wilson were charged by Park Holdings, a partnership in which he has a 50% interest and his wife has a 50% interest. The services of Mr Thomson were charged on a consultancy basis. The remuneration of Mr Quinton includes £9,613 charged by QX Energy Limited, a wholly owned family company in which he is a 25% shareholder, and £10,817 charged by QX Associates, a partnership in which he has a 50% interest. The services of J.G. West in 2001 were provided through Jimmy West Associates Limited. The amounts shown above for 2001 in respect of Dr. Butler and Mr. Wilde included £6,000 and £45,322 respectively as compensation for loss of office as executive directors.

The Company provides limited directors and officers liability insurance, at a cost of approximately £7,000 in 2002 (2001 - £5,000). This cost is not included in the above table.

Details of directors' interests in the shares of the Company are shown in the Directors' report and below. Details of other material transactions with the Group in which certain directors had an interest are provided in note 25.

Directors' and staff share options

Details of options to acquire ordinary shares in the Company are as follows:

	At 1 Jan 2002	Granted	At 31 Dec 2002
H.G. Wilson	700,000	4,300,000	5,000,000
Dr E.J. Butler	250,000	1,250,000	1,500,000
R.A. O'Toole	700,000	4,300,000	5,000,000
G.P. Thomson	700,000	4,300,000	5,000,000
P.K. Wilde	250,000	1,250,000	1,500,000
N.A. Quinton	-	5,000,000	5,000,000
Other grantees	50,000	3,250,000	3,300,000
	<u>2,650,000</u>	<u>23,650,000</u>	<u>26,300,000</u>

The share options at 1 January 2002 are exercisable at 4p at any date up to 24 July 2011. The share options granted in the year are exercisable at 4p at any time up to 18 October 2012. The mid-market price of the ordinary shares at 31 December 2002 was 7.0p (2001: 4.5p), and the range during the year was 3.6p to 7.5p (2001: 4p to 15p).

At 31 December 2002, the directors also held beneficial interests in warrants to subscribe for further shares, details of which are provided in the Directors' report.

9 TAXATION

There is no provision for current or deferred tax at 31 December 2002 (2001 - £nil). The difference between the current tax charge of Enil and the amount calculated by applying the applicable standard rate of tax is as follows:

	2002	2001
Group loss on ordinary activities before tax	£000	£000
	(98)	(1,493)
Tax on Group loss on ordinary activities at standard US (2001: UK) corporation tax rate of 35% (2001: 30%)	(34)	(448)
Effects of:		
Expenses not deductible for tax purposes	32	18
Capital allowances in excess of depreciation	(6)	(30)
Depletion and impairment of oil & gas properties	58	283
Other temporary differences	(18)	60
Adjustment for tax losses (see below)	(32)	117
Group current tax charge for the year	-	-

8 TAXATION (CONTINUED)

During 2002, the Group generated its results primarily in the US, subsequent to the acquisition of the Sterling Group (see note 22). Therefore the tax rate in the above reconciliation for 2002 is the standard rate for US corporation tax. The rate used for the 2001 comparatives is the UK rate, as the Group primarily generated its results in the UK during that year. A deferred tax asset of £918,438 (2001: £400,000), principally relating to tax losses, has not been recognised because these losses primarily relate to activities prior to the acquisition of the Sterling group and it is not certain whether these will be available to the Group for future offset against taxable profits. During the year the Group adopted FRS 19 ("Deferred tax"). The adoption of this standard had no material impact on the financial position of the Group.

9 LOSS ATTRIBUTABLE TO STERLING ENERGY PLC

The loss for the financial year dealt with in the accounts of Sterling Energy plc was £95,000 (2001 - loss of £1,694,000). As provided by s230 of the Companies Act 1985, no profit and loss account is presented in respect of Sterling Energy plc.

10 LOSS PER SHARE

The calculation of basic earnings per share is based on the loss for the financial year of £98,000 (2001 - loss of £1,493,000) and on 90,983,836 (2001 - 22,146,233) ordinary shares, being the weighted average number of ordinary shares in issue. Diluted earnings per share is the same as basic earnings per share in both years as the effect of potential ordinary shares is anti-dilutive.

11 INTANGIBLE FIXED ASSETS

Net book value	At 31 December 2001	At 31 December 2002
Company	21	18
Unvaluated	26	4,096
oil and gas	4,200	(163)
oil and gas	33	-
interests	-	-
£000		

Group net book value at 31 December 2002 comprises £4,037,000 for North America, £24,000 for Western Europe and £35,000 for South East Asia.

12 TANGIBLE FIXED ASSETS

Group	Oil and gas interests	Computer equipment	Total
£000	£000	£000	£000
Cost			
At 31 December 2001	51	-	51
Acquisition of subsidiary undertakings (note 22)	6,940	51	6,991
Additions	46	-	46
Currency translation adjustment	(318)	-	(318)
At 31 December 2002	6,719	51	6,770
Depreciation			
At 31 December 2001	44	-	44
Charge for the year	166	4	170
Currency translation adjustment	(4)	-	(4)
At 31 December 2002	206	4	210
Net book value			
At 31 December 2001	7	-	7
At 31 December 2002	6,513	47	6,560

The net book value of oil and gas interests at 31 December 2002 comprises £6,489,000 and £24,000 relating to the North America and Western Europe cost pools respectively.

13 FIXED ASSET INVESTMENTS

Company investment in subsidiaries	£000
Cost	
At 1 January 2002	38
Additions	8,374
At 31 December 2002	8,412

Included in cash at bank and in hand for the Group is an amount of approximately £858,000 (2001 - £nil) held in a restricted account to be used for the sole purpose of the payment of decommissioning costs on two US producing licences.

16 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2002	2001	2002	2001
Group			Company	
Bank loan (see below)	435	-	-	-
Trade creditors	233	89	44	86
Other taxation and social security	6	-	-	-
Other creditors	-	13	-	-
Accruals and deferred income	332	47	96	47
	<u>1,006</u>	<u>149</u>	<u>140</u>	<u>133</u>

Sterling Energy, Inc. has entered into a US\$10,000,000 revolving credit facility and mortgage with Hibernia National Bank in the USA (the "facility"). The amount that can be drawn under this facility is determined by a twice yearly borrowing base calculation which at the end of 2002 was \$2,750,000. At 31 December 2002, \$2,000,000 (£1,243,000) had been drawn down under this facility, of which \$700,000 (£435,000) was due in less than one year and the remaining \$1,300,000 (£808,000) was due between one and two years. In addition, a further \$175,000 (£109,000) was pledged under a letter of credit. The mortgage is secured by a floating charge over certain of the tangible net assets of Sterling Energy, Inc. and is non-recourse to the rest of the Group, although an intra-group loan of approximately £3.83 million is subordinated to the facility. Interest is payable at a margin over either the Eurodollar rate or the Wall Street Journal Prime Rate at the preference of Sterling Energy, Inc. The mortgage also includes certain financial and non-financial covenants.

17 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2002	2001
Group		
Bank loan (see note 16)	£000	£000
Between one and two years	<u>808</u>	<u>-</u>

18 PROVISIONS FOR LIABILITIES AND CHARGES

	2002	2001
Decommissioning		
At 1 January 2002	-	-
Acquisition of subsidiary undertakings (note 22)	1,994	
Unwinding of discount (note 5)	21	
Currency translation adjustment	(76)	
At 31 December 2002	<u>1,939</u>	

The amount shown above represents the estimated costs for decommissioning the Group's producing interests in North America, which are expected to occur between 2009 and 2016.

19 CALLED-UP SHARE CAPITAL

2002	2001
£000	£000
12,500	3,000
Called-up, allotted and fully paid	
1,250,000,000 ordinary shares of 1p each	
(2001 - 210,875,403 ordinary shares of 1p each	
and 9,902,733 deferred shares of 9p each)	
353,792,382 ordinary shares of 1p each	
(2001 - 39,042,733 ordinary shares of 1p each)	
Nil deferred shares (2001 - 9,902,733 deferred shares of 9p each) (see note e below)	
3,538	891
1,282	

Movements during the year were as follows:

- In March 2002, 6,500,000 ordinary shares with a nominal value of £65,000 were issued at 4.5p each, including a premium of 3.5p each, as part consideration for the cost of acquisition of Westmount Resources Inc. (see note 22a).
- In October 2002, a total of 157,000,000 ordinary shares with a nominal value of £1,570,000 were issued at 4p each, including a premium of 3p each, in connection with the purchase of SEL (see note 22b). Up to a further 40,000,000 ordinary shares will be issued no later than 31 December 2003, subject only to warranty claims settled by that date. The present expectation of the directors is that all of these ordinary shares will be issued and accordingly they have been recorded as a separate caption entitled "Shares to be issued" within capital and reserves at 4p per share.
- In October 2002, 60,339,649 ordinary shares with a nominal value of £603,396 were issued at 4p each, including a premium of 3p each, under a placing and open offer, as set out in a circular to shareholders dated 26 September 2002.
- In December 2002, 90,910,000 ordinary shares were issued at 5.5p each, including a premium of 4.5p each.
- In October 2002, the Company repurchased and then cancelled the whole of the 9,902,733 outstanding deferred shares (nominal value of 9p each) for a consideration of £1, which the Company retained. The carrying value of these shares of £891,245 was recorded as a movement in the share premium account. Non-equity shareholders' funds at 31 December 2001 related entirely to these shares, as their rights to participate in any surplus on a winding up were limited to a specific amount.
- Note 7 sets out the movements in share options during the year. In addition, a total of 24,755,000 warrants to subscribe for further ordinary shares on a one-for-one basis at 6p per share no later than 30 June 2003 were in issue at the year end, of which 20,726,152 have been subsequently exercised (see note 27).

20 RESERVES

Group			
Share premium account	Currency translation account	Profit and loss account	Total
£000	£000	£000	£000
At 31 December 2001	2,443	36	(3,291)
Premium on shares issued (see Note 19)	10,839	-	-
Expenses of share issues	(839)	-	-
Cancellation of deferred shares	891	-	-
Movement on currency translation reserve	-	(209)	-
Loss for the year	-	(98)	(98)
At 31 December 2002	13,334	(173)	(3,389)

Company

Share premium account	Profit and loss account	Total
£000	£000	£000
At 31 December 2001	2,443	(3,212)
Premium on shares issued in year	10,839	-
Expenses of share issues	(839)	-
Cancellation of deferred shares	891	-
Loss for the year	-	(95)
At 31 December 2002	13,334	(3,307)

21 FINANCIAL COMMITMENTS

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

Land and buildings	Land and buildings
2002	2001
£000	£000
Operating leases with an option to terminate between two and five years	52

Neither the Group nor the Company had any capital commitments at either year-end.

22 ACQUISITION OF SUBSIDIARY UNDERTAKINGS

a) Westmount Resources Inc.

On 7 March 2002, the Company purchased 100% of the issued share capital of Westmount Resources, Inc. ("Westmount") for a total consideration of £495,000.

The assets and liabilities at the date of acquisition and the total consideration are set out in the following table:

Assets	
Tangible fixed assets (see below)	149
Debtors	8
Cash at bank and in hand	343
	500
Liabilities	
Creditors	(1)
Provisions for liabilities and charges	(4)
	495
Net assets	
	495
Satisfied by:	
Issue of ordinary shares at fair value	293
Cash	202
	495

Included in tangible fixed assets is a fair value adjustment of £67,000, being the excess of the fair value of these assets at the date of acquisition over their book value. No other adjustments to book value were made.

Westmount's unaudited management accounts indicate that it earned a profit after tax of US\$28,000 (approximately £20,000) for the period from 1 July 2001, the beginning of its financial year, to its acquisition on 7 March 2002. In the period 8 March 2002 to 31 December 2002, Westmount contributed a loss after tax of £36,000 to the Group's overall results. However, the directors of the Company believe that it is not meaningful to make a direct comparison of the pre and post acquisition results of Westmount for the following reasons:

- Pre acquisition results include a non-recurring tax rebate of \$23,000 (approximately £16,500), and do not include a depletion charge for oil and gas interests.
- Post acquisition results include a charge of approximately £25,000 from a fellow subsidiary of the Company for administration support services (which is significantly in excess of the \$15,000 (approximately £10,500) charged by the parent Company of Westmount in the period prior to acquisition), and a £26,000 depletion charge.

The summarised profit and loss account of Westmount for the period 1 July 2001 to 7 March 2002, shown on the basis of the accounting policies of Westmount prior to the acquisition, is as follows:

US\$000	Turnover	39
(13)	Cost of Sales	26
	Gross profit	
(23)	Other operating expenses	
3	Operating profit	
4	Interest income	
7	Profit on ordinary activities before tax	
21	Tax on profit on ordinary activities	
28	Profit after tax	

There were no recognised gains and losses in the period other than the profit shown above.
Results for the year ended 30 June 2001 were not made available to the Group at the time of acquisition.

b) Sterling Energy Limited

On 18 October 2002, the Company completed the purchase of 100% of the issued ordinary share capital of Sterling Energy Limited (since renamed Sterling Energy (UK) Limited) for a total consideration of up to £7,880,000 payable wholly in ordinary shares. At that date, 157,000,000 ordinary shares were issued as the initial consideration shares and up to a further 40,000,000 ordinary shares will be issued no later than 31 December 2003 (see note 19b).
The assets and liabilities at the date of acquisition and the total consideration are set out in the following table:

	Book value	Fair value adjustments	Fair value
Assets	£000	£000	£000
Intangible fixed assets	-	4,200	4,200
Tangible fixed assets	5,752	1,090	6,842
Debtors	311	-	311
Cash at bank and in hand	1,092	-	1,092
	<u>7,155</u>	<u>5,290</u>	<u>12,445</u>
Liabilities			
Creditors	(1,283)	-	(1,283)
Provisions for liabilities and charges	(1,990)	-	(1,990)
Bank loan	(1,292)	-	(1,292)
Net assets	<u>2,590</u>	<u>5,290</u>	<u>7,880</u>
Satisfied by:			
Issue of ordinary shares at fair value			6,280
Shares to be issued			<u>1,600</u>
			<u>7,880</u>

The fair value adjustments to the fixed assets acquired were determined by the directors, having regard to reports by independent petroleum consulting engineers.

22 ACQUISITIONS OF SUBSIDIARY UNDERTAKINGS (CONT'D)

b) Sterling Energy Limited (continued)

From the date of acquisition on 18 October 2002 to 31 December 2002 Sterling Energy Limited and its subsidiaries contributed an operating profit of £78,000 to the Group and a profit of £37,000 to the Group's loss on ordinary activities before taxation.

The profit after tax of Sterling Energy Limited and its subsidiaries for the period from incorporation to 31 December 2001 was £105,000. For the period from 1 January to 17 October 2002 Sterling Energy Limited and its subsidiaries made a loss after tax of £689,000. The summarised profit and loss account for the period from 1 January to 17 October 2002, shown on the basis of the accounting policies of Sterling Energy Limited prior to the acquisition, were as follows:

£000	Turnover
1,254	Cost of Sales
(1,045)	Gross profit
209	Other operating expenses
(783)	Operating loss
(574)	Interest income
17	Interest payable
(132)	Loss on ordinary activities before and after tax
(689)	

There were no recognised gains and losses for the period other than the loss shown above.

23 RECONCILIATION OF OPERATING LOSS TO NET CASH OUTFLOW FROM OPERATIONS

2002	2001
£000	£000
(78)	(1,481)
170	4
-	944
(334)	10
(862)	70
(1,104)	(453)
Net cash outflow from operations	

24 NOTES TO THE CASH FLOW STATEMENT

2002
2001
£000
£000

Returns on investments and servicing of finance

Interest received 18 13

Interest paid (21) (12)

Net cash (outflow)/inflow (3) 1

Capital expenditure

Purchase of intangible fixed assets (33) -

Purchase of tangible fixed assets (46) (55)

Net cash outflow (79) (55)

Acquisitions (see note 22)

Purchase of subsidiary undertakings (202) -

Cash acquired with subsidiary undertakings* 607 -

Net cash inflow 405 -

* excluding restricted cash (see note 24b)

Financing

Issue of ordinary shares, net of expenses (see note 19 & 20) 6,574 775

New loans - 400

Repayment of loan - (150)

Net cash inflow 6,574 1,025

a) Gross cash flows

Companies acquired in the year contributed £1,162,000 to the Group's net operating cash outflows, paid £3,000 in respect of net returns on investment and servicing of finance, utilised £79,000 for capital expenditure and generated £nil in respect of net financing.

The Group also completed a material non cash transaction during the year, being the acquisition of Sterling Energy Limited (see notes 19b and 22b).

24 NOTES TO THE CASH FLOW STATEMENT (CONT'D)

b) Analysis and reconciliation of net funds

	1 Jan	2002	Cash flow	Acquisitions & disposals*	Exchange movement	31 Dec
Cash in hand and at bank**	566	566	5,793	-	117	6,476
Debt due after 1 year	-	-	-	(840)	32	(808)
Debt due within 1 year	-	-	-	(452)	17	(435)
Net funds (debt)	566	566	5,793	(1,292)	49	(1,243)
					166	5,233

* Excluding cash and overdrafts

** The cash balance at 31 December 2002 excludes £858,000 of restricted cash (2001 – nil)
as described further in note 15.

2002	£000	5,793	518
2001	£000	518	-
Increase in cash in the year			
Loans acquired with subsidiary undertakings		(1,292)	-
Translation difference		166	-
Movement in net funds in year		4,667	518
Net funds at 1 January		566	48
Net funds at 31 December		5,233	566

25 RELATED PARTY TRANSACTIONS

The following material related party transactions have taken place in the year:

- As set out in a circular to shareholders dated 26 September 2002, Mr O'Toole, Mr Quinton, Mr Thomson and Mr Wilson, who are directors of the Company, were also, directly or indirectly, partners in Sterling Energy Limited Partnership, which owned the whole of the issued share capital of Sterling Energy Limited ("SEL"). At a meeting of shareholders on 18 October 2002 the Company purchased 100% of SEL (see note 19b).
- SEL charged £38,000 to the Company for administration, accommodation and technical support prior to its acquisition by the Company.
- Certain other transactions with directors are disclosed in the directors report and in note 7.

26 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

This note provides the narrative and numerical disclosures required by FRS 13 "Derivatives and Other Financial Instruments: Disclosures". As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Objectives and policies

The Group's objective and policy is to use financial instruments to manage its risk profile commensurate with the complexity of its underlying operations. During the year, the Group's financial assets and liabilities consisted of

- Cash at bank and in hand (see note 15)
- Short term loan facility with Hibernia Bank (see notes 16 and 17)
- Short term gas commodity SWAP contracts

These are used to manage the working capital requirements of the Group. The main risks arising from the Group's operations are interest rate risk, gas price risk and foreign currency translation risk. The Group monitors risk on a regular basis and takes appropriate measures to ensure risks are managed in a controlled manner.

Interest rate risk

The Group's financial assets and liabilities accrue interest at prevailing floating rates in either the United States of America or the United Kingdom, as described further below. The Group does not currently use derivative instruments to manage its interest rate risk although it continues to monitor the need for such instruments on an ongoing basis.

Gas price risk

The Group uses natural gas hedging instruments to manage exposure to volatility in gas prices. At the end of 2002 it had entered into hedging transactions for a number of months in 2003 covering part of its projected production.

Foreign currency translation risk

The functional currency of the oil and gas producing activities of the Group is US\$ and of its management, services and treasury functions is £ sterling. Balances are held in US\$ to meet the immediate local operating or administrative needs. At the end of 2002 there were no material monetary liabilities or assets not denominated in the functional currency of the subsidiary involved, except for intra-group financings. The Group does not enter into derivative transactions to manage its foreign currency translation or transaction risk.

26 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (CONT'D)

Interest rate risk profile of financial assets and liabilities

Financial Assets

	2002	2001
Pounds sterling (£)	6,476	566
United States dollars (US\$)	858	-
At 31 December	7,334	566

At 31 December 2002 the Group's financial assets principally comprised of cash at bank and in hand under its control of £6,476,000 (2001 - £566,000), which forms the majority of its working capital. This balance relates to deposits placed with banking institutions that are available on demand or within seven days, which are principally denominated in pounds and which carry interest at prevailing United Kingdom deposit floating rates. The group's financial assets also include restricted cash balances denominated in US\$ of £858,000 (2001 - £nil) as disclosed in note 15 which bear interest at the prevailing US\$ bank floating rate.

Financial liabilities

At 31 December 2002 the Group's financial liabilities comprised a US\$10 million revolving credit loan facility. A summary of the loan facility available to the Group at 31 December 2002, including its maturity profile and interest rate profile, is set out in notes 16 and 17.

Fair values

The fair values of the Group's financial assets and liabilities at 31 December 2002 and 31 December 2001 are materially equivalent to their carrying value, save for forward gas SWAPS entered into for 2003 which, when compared to the forward market prices prevailing at the balance sheet date, represented a fair-value loss of US\$138,000 (2001 - US\$nil). The Group entered into no such forward sales during 2001.

27 POST BALANCE SHEET EVENTS

On 16 April 2003 the Group announced the purchase of a 60% interest in the Eugene Island 268 lease offshore Louisiana, USA. Sterling expects to invest approximately \$4.2 million (£2.63 million) in 2003 for its share of acquisition, drilling, completion, platform and other construction costs.

On 13 May 2003 the Company announced that a total of 20,726,152 warrants entitling holders to subscribe for new ordinary shares at 6p had been exercised. This raised cash proceeds of approximately £1.2 million.

INDEPENDENT AUDITORS' REPORT

to the Members of Sterling Energy plc

We have audited the financial statements of Sterling Energy plc (formerly LEPCO plc) for the year ended 31 December 2002 which comprise the profit and loss account, the balance sheets, the statement of total recognised gains and losses, the reconciliation of movements in Group shareholders' funds, the cash flow statement and the related notes 1 to 27. These financial statements have been prepared under the accounting policies set out therein. This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards. We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed. We read the directors' report and the other information contained in the annual report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information unless we specifically indicate in writing otherwise.

OPINION

We conducted our audit 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 financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

BASIS OF AUDIT OPINION

An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

24 June 2003
Chartered Accountants and Registered Auditors, London

Deloitte & Touche,

Deloitte & Touche

in accordance with the Companies Act 1985.

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2002 and of the loss of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of the Company will be held at the offices of Evolution Beeson Gregory Limited, The Registry, Royal Mint Court, London, EC3N 4LB at 11.00am on 23 July 2003 for the following purposes:

ORDINARY BUSINESS

1. To receive and adopt the financial statements for the year ended December 2002 and the Report of the Directors and Auditors thereon.
2. To re-elect Elizabeth Butler as a director.
3. To re-elect Peter Wilde as a director.
4. To re-appoint Nigel Quinton as a director.
5. To reappoint Deloitte & Touche as auditors of the Company and to authorise the Directors to fix their remuneration.

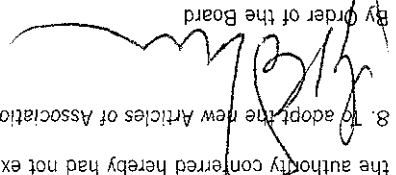
SPECIAL BUSINESS

To consider, and if thought fit, to pass the following resolutions of which number 6 will be proposed as an ordinary resolution and numbers 7 and 8 will be proposed as special resolutions:

6. To approve the Executive Incentive Plan.

7. THAT the Directors be and are hereby empowered pursuant to section 95 of the Companies Act 1985 (the "Act") in place of all existing powers given to the directors pursuant to such section 95 of the Act to allot equity securities (as defined in section 94 of the Act) for cash pursuant to the authority conferred upon them by Resolution No.2 passed at the extraordinary general meeting of the Company on 18 October 2002 as if section 89(1) of the Act did not apply to any such allotment PROVIDED THAT this power shall be limited to the allotment of equity securities up to an aggregate nominal value of £3,500,000 and that this power shall expire at the conclusion of the Annual General Meeting to be held in 2005 SAVE THAT the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

8. To adopt the new Articles of Association.


By Order of the Board
G.P. Thomson, Company Secretary

24 June 2003

Registered office: Mardall House, Vaughan Road, Harpenden, Hertfordshire AL5 4HU

Notes:

- (i) Shareholders are entitled to attend and vote at the annual general meeting and may appoint one or more proxies to so attend and, on a poll, vote instead of them. A proxy need not be a member of the Company.
- (ii) A form of proxy is enclosed with this document. To be valid, it must be returned to the Company's registrars, Capita Registrars, PO Box 25, Beckenham, Kent, BR3 4BR (if by post) or to 34 Beckenham Road, Beckenham, Kent BR3 4TU (if by hand), not later than 48 hours before the time of the annual general meeting.
- (iii) The completion and return by a member of a duly completed form of proxy will not preclude any such member from attending in person and voting at the annual general meeting.
- (iv) Pursuant to Regulation 4.1 of the Uncertified Securities Regulations 2001, only those shareholders registered in the register of members of the Company 48 hours before the meeting will be entitled to attend and vote at the annual general meeting in respect of the number of shares registered in their name at that time. Subsequent changes to the register will be disregarded in determining the right of any person to attend or vote at the annual general meeting.

UK:

Sterling Energy plc
Mardall House
7-9 Vaughan Road
Harpenden, Herts
AL5 4HU

t: +44 (0)1582 462 121

f: +44 (0)1582 461 221

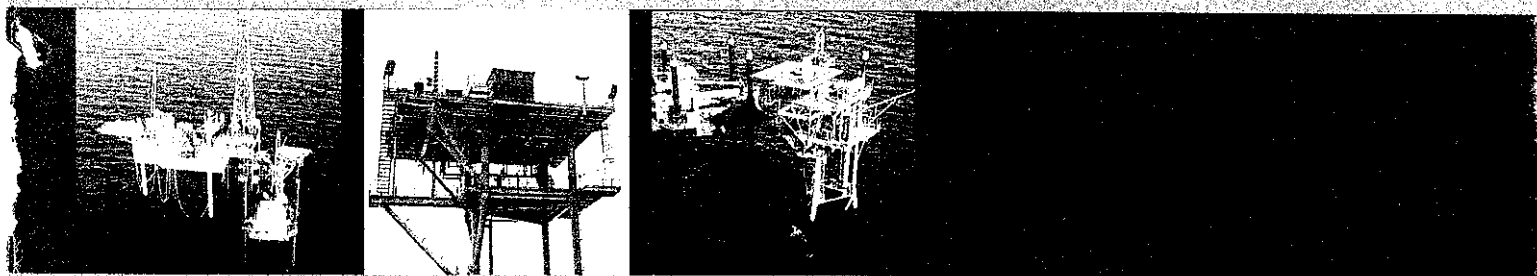
www.sterlingenergyplc.com

USA:

Sterling Energy, Inc.
15425 North Freeway
Suite 180
Houston, Texas
TX77090

t: +1 281 875 4835

f: +1 281 875 0440



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