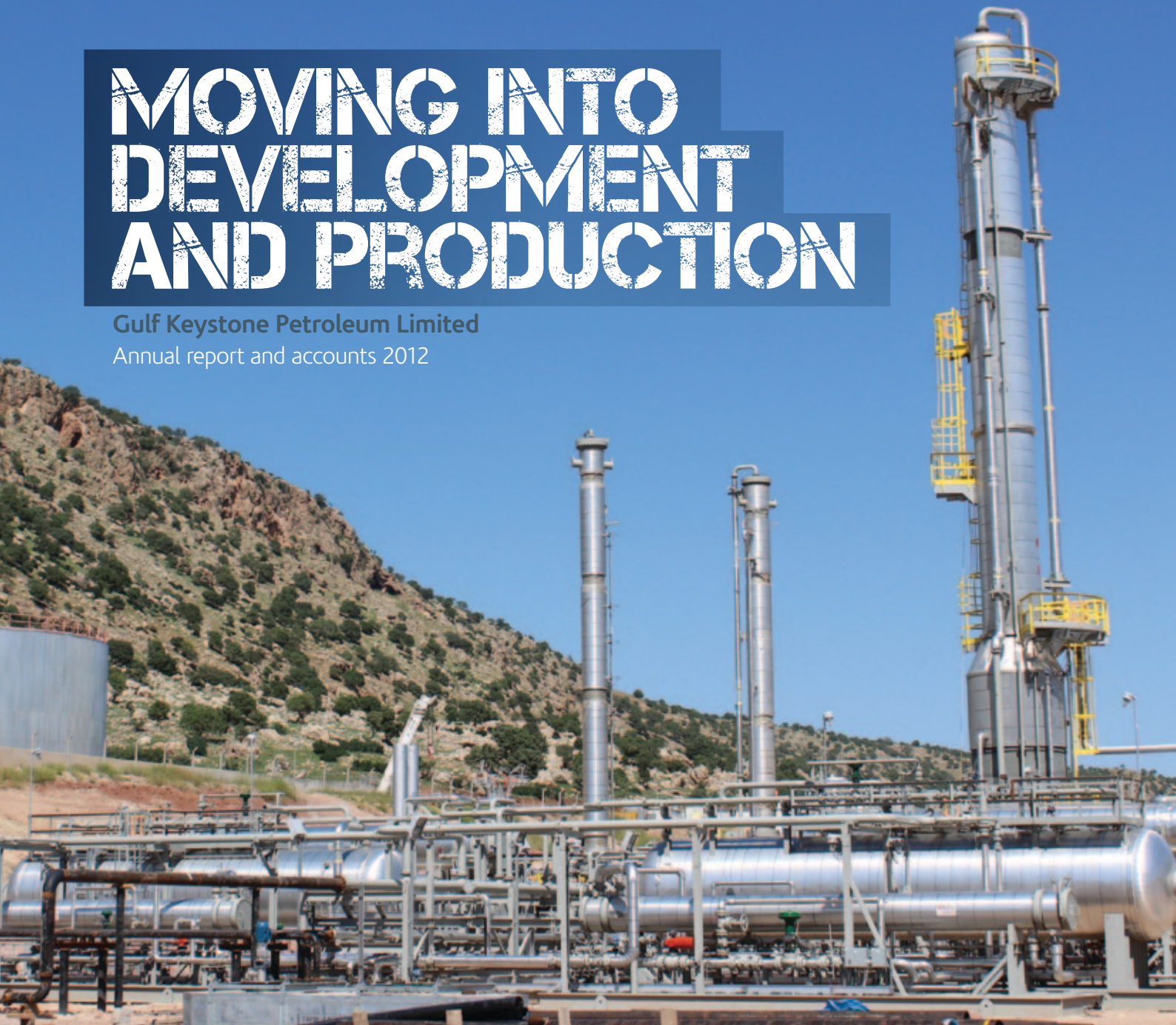




# MOVING INTO DEVELOPMENT AND PRODUCTION

Gulf Keystone Petroleum Limited  
Annual report and accounts 2012



Highlights

A GREAT TRACK RECORD

As one of the first companies to see the potential of the region, over the last five years Gulf Keystone has drilled or participated in nearly 20 wells and remains one of the most active operators in the Kurdistan Region of Iraq. We strongly believe that there is considerable momentum in the development of Kurdistan's vast natural resources and Gulf Keystone is in a prime position to benefit as the region moves to this next stage. Our remarkable journey continues and we have never been more excited about the future.

Over the past 12 months Gulf Keystone has continued with a high impact drilling campaign across our four licence areas resulting in outstanding success in the field. This success is a function of our assets, extensive commercial and marketing relationships on the ground and of the team we have in place. Our consistent operational results have allowed us to make significant progress in further proving up the value of our business.

Shaikan-5  
Appraisal well



# PROVING OUR DISCOVERIES

## 20 wells

currently 20 wells drilled or being drilled across the Shaikan, Sheikh Adi, Akri-Bijeel and Ber Bahr blocks with six spudded and two completed in 2012



## 13.7 billion

barrels of oil-in-place at Shaikan



## 45 billion barrels

Estimated oil reserves in the Kurdistan Region of Iraq



Shaikan-2  
appraisal well



### Shaikan: Multi-billion barrel asset

- ⌚ **July 2012:** Significant upgrade of Shaikan's gross oil-in-place volumes to 13.7 billion barrels (Pmean)
- ⌚ **Q2 2012:** Shaikan five-well appraisal programme completed with Shaikan-5 and -6
- ⌚ **August 2012:** Shaikan declared a Commercial Discovery
- ⌚ **January 2013:** Shaikan Field Development Plan submitted



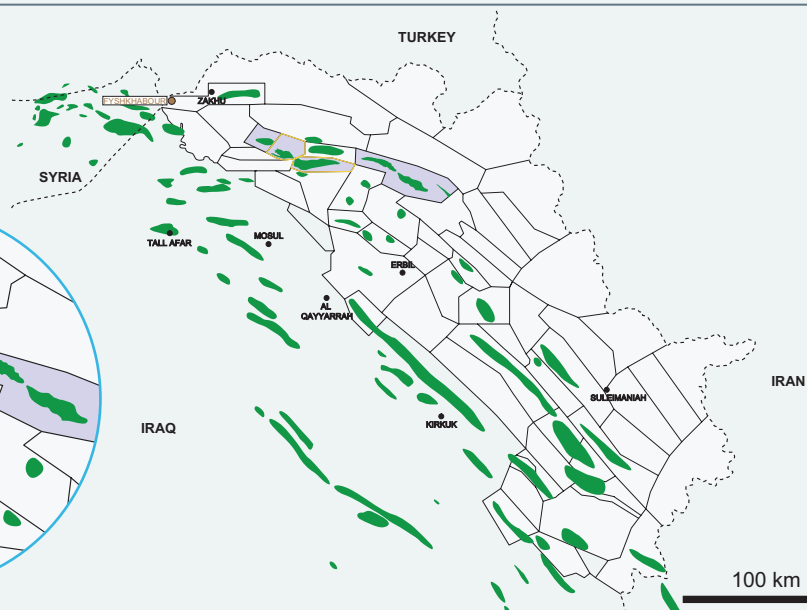
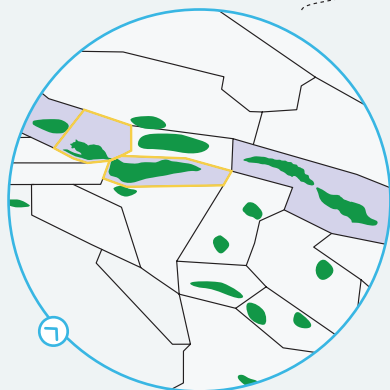
Seismic acquisition  
on Shaikan



## Locations overview

### Key

- Gulf Keystone block
- Gulf Keystone operated block



### New discoveries

- ⌚ **November 2012:** Jurassic discovery with the Sheikh Adi-2 exploration well
- ⌚ **January 2013:** Triassic discovery made on the Akri-Bijeel block with the Bakrman-1 exploration well
- ⌚ **May 2013:** Discovery made with the Ber Bahr-1 exploration well



**Shaikan-6**  
Operator

**2,276** bopd

average gross production in 2012

Over

**1** million

barrels of oil produced to date

**Production Facility-2**  
(PF-2)



**5** Discoveries across  
**4** licence areas



### Production

- ⌚ **Shaikan early gross production for 2012** totalled 832,859 barrels of oil generating \$32.2 million in revenues

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- Ⓢ Significant increase in training initiatives for the Company's staff in the Kurdistan Region of Iraq
- Ⓢ Local community relations initiatives in the areas of the Company's operations

- Ⓢ Fully funded for the 2013 work programme
- Ⓢ Aiming to achieve additional revenues through significant production growth

- Ⓢ The Shaikan Extended Well Test facility ("EWT") has been replaced with the first production facility (PF-1) capable of producing at least 20,000 barrels of oil per day ("bopd")

- Ⓢ Construction of the second Shaikan production facility (PF-2) is ongoing with the aim of commissioning the unit, also capable of producing at least 20,000 bopd, in H2 2013



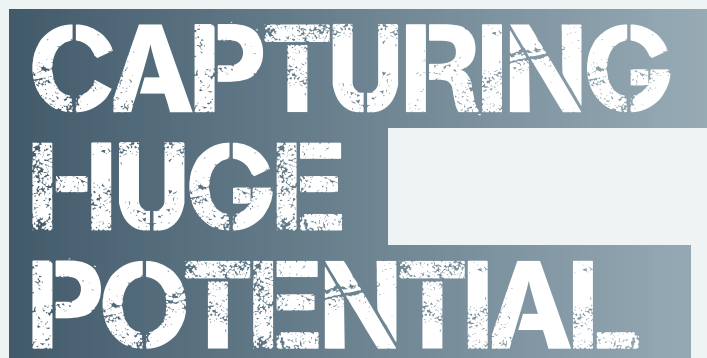
**40,000 bopd**  
Initial production capacity

**\$275 million**  
Placement of unsecured convertible bonds



- Ⓢ Approval of the Shaikan Field Development Plan is expected in 2013

## Company overview



### Overview

Gulf Keystone Petroleum Limited is an independent exploration and production company with a world class exploration, appraisal and production portfolio in the Kurdistan Region of Iraq. The Company holds working interests in four adjacent blocks in the Region, including the world class commercial discovery at Shaikan.

The Company is registered in Bermuda with further offices in Erbil, Kurdistan Region of Iraq, and London, UK. Gulf Keystone has been quoted on the AIM market of the London Stock Exchange since 2004 (stock quote GKP). Today, the Company is a leading operator in the Kurdistan Region of Iraq with plans to become one of the major independent exploration and production players listed on the official list of the London Stock Exchange.

With the Shaikan commercial discovery alone, Gulf Keystone has one of the world's largest onshore conventional oil and gas developments and, combining estimates from all four exploration blocks, Gulf Keystone has a share of at least 19 billion barrels of oil-in-place. Our story of success thus far is one we strive to maintain going forward and, as we verge upon a move to the large-scale staged development of the Shaikan field with a ramp up in production. We look forward to a future which is sure to prove as challenging as it is exciting.

### Region



#### Kurdistan

The Kurdistan Region of Iraq is an autonomous region in Iraq bordering Syria to the west, Iran to the east and Turkey to the north

**Area:** 40,643km<sup>2</sup>

**Population:** 5.2 million

**Capital city:** Erbil (also known as Hawler)

**Source:** [www.krg.org](http://www.krg.org)

As a company with over 600 personnel in the Kurdistan Region of Iraq including national staff, expats and contractors, Gulf Keystone understands the value of preserving a high-calibre team on the ground. In 2012 we decided to move our Erbil office to much larger premises in order to facilitate the expansion of our operations and, in the past year, a number of our technical personnel relocated from London to Erbil, reflecting the Company's current transition to large-scale phased development at Shaikan.

# 1,749,438

hours worked by the Company's personnel in the Kurdistan Region of Iraq

## People



Head office in Erbil, Kurdistan Region of Iraq



Commissioning of Shaikan PF-1



During a training session

## Assets

### Shaikan

**Discovery well:**  
Shaikan-1

**Date of discovery:**  
August 2009

**Wells drilled:** 9

### Sheikh Adi

**Discovery well:**  
Sheikh Adi-2

**Date of discovery:**  
November 2012

**Wells drilled:** 2

### Akri-Bijeel

**Discovery well:**  
Bijell-1

**Date of discovery:**  
March 2010

**Discovery well:**  
Bakrman-1

**Date of discovery:**  
February 2013

**Wells drilled:** 7

### Ber Bahr

**Discovery well:**  
Ber-Bahr-1

**Date of discovery:**  
May 2013

**Wells drilled:** 1

## Executive Chairman and Chief Executive Officer's statement

# SET FOR SIGNIFICANT PRODUCTION GROWTH

**Todd F Kozel**  
Executive Chairman and  
Chief Executive Officer



**I am very pleased to report another year of significant progress for Gulf Keystone, as the Company transitions from an independent oil and gas explorer to join the ranks of key producers in the Kurdistan Region of Iraq during 2013.**

## 1 million bopd

Kurdistan Regional Government's  
production target in 2015

## 150,000 bopd

Shaikan Field Development Plan's initial target

As one of the most active companies in the region, since January 2012 we have achieved a number of important development milestones in relation to our flagship asset, the Shaikan field, which is widely considered to be amongst the biggest onshore development opportunities in the world today not in the hands of an international major operator.

Since we drilled the Shaikan-1 discovery well in 2009, Shaikan has been our key operational focus, as well as the engine behind the Company's development and investment story. As the operator of the Shaikan block, our objective is to maintain the momentum by completing the ongoing transition from the appraisal and well test production phase to the large-scale and long-term phased development of the field. We are targeting the capacity to produce up to 40,000 barrels of oil per day ("bopd")

from Shaikan in the coming months and up to 400,000 bopd in the coming years.

The Shaikan field was declared a commercial discovery in August 2012. We subsequently completed and submitted a Field Development Plan ("FDP") for the field in January 2013. Once approved by the Ministry of Natural Resources of the Kurdistan Regional Government, the FDP will become a roadmap for unlocking significant oil and gas volumes, already de-risked by extensive appraisal drilling and seismic analysis, establishing the necessary infrastructure required to develop this giant field and bringing to market the world class resources, which are of increasing strategic importance.

Our asset portfolio in the region retains significant remaining exploration potential, as demonstrated by three additional discoveries made between October 2012

and May 2013. Our second exploration well drilled on the Company-operated Sheikh Adi block, which is on trend with Shaikan, made a Jurassic discovery in October 2012. We plan to appraise the Sheikh Adi discovery and continue to target additional exploration prospects on the block, taking into account clear future synergies with the Shaikan block in terms of production facilities, infrastructure and logistics. On the Ber Bahr block, the first exploration well was successfully re-tested and made a Jurassic discovery in May 2013.

Meanwhile, our partner MOL Hungarian Oil and Gas plc achieved a success in the course of the extensive exploration and appraisal programme on the Akri-Bijeel block, making a new Triassic discovery with the first exploration well drilled on the Bakrman structure. We are keen to explore deep untapped resources of the Shaikan block itself. To this end, the Triassic and, potentially, Permian horizons will be targeted in 2013 by Shaikan-7, our first deep exploration well.

2013 will continue to be a period of major operational milestones on Shaikan. As well as further development drilling, forthcoming activity includes the commissioning of two new production facilities, Shaikan PF-1 and PF-2. Once the Shaikan FDP has been approved, we will step up our production operations achieving 40,000 bopd of combined PF-1 and PF-2 output and generating stable revenues for the Company, before moving to the next production target of 150,000 bopd in 2015. A pipeline to connect Shaikan to the fast-expanding regional pipeline infrastructure and, ultimately, to international markets,

## Performance summary

1

### Producing results

Significant operational progress has been made since the Shaikan discovery in 2009, including submission of the Field Development Plan and construction of two new production facilities in under four years. Production capacity is expected to reach 40,000 bopd in 2013 and will increase to 150,000 bopd in 2015.

2

### Structured plans

Ramp up in production is fully aligned with the ongoing infrastructure development in the region. Alternative transport options exist for our crude whilst the Shaikan pipeline is constructed, including trucking and the ability to access growing pipeline infrastructure.

3

### Creating value

We continue to be highly active with the drill bit in order to further prove the value of our blocks, with our 20th well to spud in 2013, further drilling planned for the 1.9 billion barrel Sheikh Adi field, as well as an extensive exploration and appraisal programme on Akri-Bijeel block, today containing two discoveries. Phased development of the Ber Bahr discovery will follow.

is expected to be constructed in the near future. These key developments will create value not only for our shareholders, but also for the Kurdistan Region and all of Iraq.

Gulf Keystone will play a key role in assisting the Kurdistan Regional Government in meeting their ambitious oil production targets of 1 million bopd in 2015 and 2 million bopd by 2019. The Company is extremely well positioned to take advantage of the developments on regional oil and gas infrastructure planning. We firmly believe it is important to be prepared for the step change in the scale of the Company's operations on Shaikan both operationally and financially. Being a responsible operator is a natural priority for the Company. We have significantly increased our training initiatives for the Company's national staff, who now account for approximately 75% of the workforce.

We have also taken a number of funding steps to facilitate the Company's transition from an independent explorer to a fully-established exploration and production company. Our ultimate goal is to finance our future operational activities in full from revenues generated as a result of increasing production. Additionally, we believe that the phased approach to the implementation of the Shaikan FDP will ensure the Company's flexibility in financing the development of this giant field. Once we complete and commission the two Shaikan production facilities our output levels are due to increase to 40,000 bopd which will allow us to make considerable steps towards our goal of fully financing our activities from production cash flows over the medium term.

Meanwhile, we are extremely pleased to have raised \$275 million through a fully subscribed offering of senior unsecured convertible bonds in October 2012. It was our first attempt to access the debt capital markets and we succeeded in attracting a significant number of new investors. The funding has enabled Gulf Keystone to move ahead with its plans for the development of the Shaikan field and to proceed with the ongoing exploration and appraisal programmes on the Sheikh Adi, Akri-Bijeel and Ber Bahr blocks.

In 2012 and early 2013, Gulf Keystone vigorously disputed and contested all the allegations and claims asserted by Excalibur Ventures LLC ("Excalibur") against Gulf Keystone and two of its subsidiaries in December 2010, in the course of the pre-trial proceedings and the trial in the English Commercial Court, which commenced on 15 October 2012 and was completed on 1 March 2013. At the time of writing, the Company is currently awaiting the Judge's decision, which is expected later this year.

As one of the largest companies currently on the AIM market, the Board remains committed to establishing Gulf Keystone as one of the major independent exploration and production players listed on the London Stock Exchange. The Company will initially make an application for the common shares of the Company to be admitted to the standard segment of the Official List of the UK Listing Authority ("Official List").

In order to prepare for the move to the Official List and in keeping with its corporate governance best practice, the Board has decided to split the roles of Chairman and Chief Executive Officer. I have indicated to the Board my intention to resign as Executive Chairman as soon as a suitable Independent Non-Executive Chairman has been appointed, whereupon I shall continue solely as Chief Executive Officer. A search process has commenced for an Independent Non-Executive Chairman of the Board and at least one other Independent Non-Executive Director, and this process is being led by the Chair of the Nominations Committee, Field Marshal the Lord Guthrie of Craigiebank. Therefore, this is my last letter to you as Executive Chairman.

I would like to take this opportunity to thank my fellow Board members, my management team and all the Company's employees for their commitment, dedication and hard work over the past twelve months. We have successfully delivered another year of strong growth and this is testament to the quality of our employees.

Looking ahead, Gulf Keystone is on the cusp of becoming a fully-established exploration and production company following the submission of the Shaikan FDP, which will result in a significant ramp up of production at the field. We believe that recent momentum on a number of fronts clearly signals that the Kurdistan Region of Iraq itself is entering the next stage of developing its oil and gas resources. We look forward to continuing this remarkable journey for the benefit of our hosts and all our stakeholders. We have never been more excited about the future.

## Business model

# FROM VISION TO DELIVERY



## What makes Gulf Keystone unique?

1

### Key position

- > Working interests in four adjacent on-trend blocks in the Kurdistan Region of Iraq, one of the most desirable upstream destinations in the world today

2

### Diversified portfolio

- > Balanced portfolio of exploration, development and production assets: Shaikan, Sheikh Adi, Akri-Bijeel and Ber Bahr
- > 5 discoveries across 4 licence areas



## Unique factors that lead to value creation

- > Highly prospective oil province, underexplored with many undrilled surface structures
- > One of the most stable parts of Iraq and the wider Middle East region
- > Gulf Keystone was among the first entrants to the Kurdistan Region and has one of the largest acreage positions and some of the lowest oil recovery costs
- > Shaikan is one of the largest onshore conventional oil and gas developments in the world today
- > Alternative transport options exist for Gulf Keystone's crude whilst the Shaikan pipeline is constructed
- > Asset portfolio with significant remaining exploration potential
- > High calibre team in place

3

### Strong track record

- > Demonstrated drilling success
- > Move from a discovery well to development in record time

4

### Network of local partnerships and talent

- > Transparency with surrounding communities and businesses in the areas in which we operate
- > Long-standing relationships on the ground with local government and the Ministry of Natural Resources

5

### Sustainability

- > Operations creating decades of work, training opportunities and experience for Kurdistan national employees

## Asset overview

Gulf Keystone Petroleum International Limited ("GKPI") holds Production Sharing Contracts ("PSCs") for four blocks with a total area under licence of 1,624 km<sup>2</sup>, about 85 km from Erbil, the biggest regional centre of the Kurdistan Region of Iraq, 50 km from the border with Turkey and over 400 km to the north-east from Baghdad. Five discoveries across these four blocks have been made to date, including the commercial discovery at the Shaikan field.

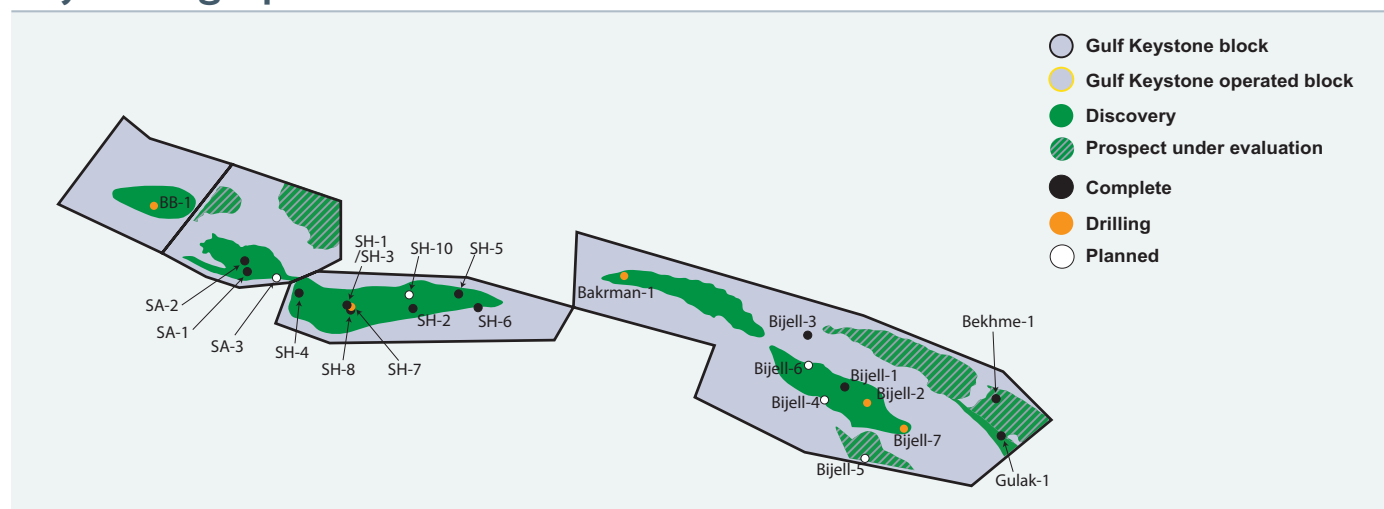
### Largest discoveries in the Kurdistan Region of Iraq



Million barrels (estimated recoverable resources)

Source: IHS EDIN, June 2012

## Key strategic position



### Ber Bahr

> Area under licence: 206 km<sup>2</sup>

### Sheikh Adi

> Area under licence: 249 km<sup>2</sup>

### Shaikan

> Area under licence: 280 km<sup>2</sup>

### Akri-Bijeel

> Area under licence: 889 km<sup>2</sup>

## Operator and partner

Block	Working interest	Fully diluted interest	Operator	Other partners
Shaikan <sup>(1)</sup>	75%	51% <sup>(3)</sup>	GKP	MOL (20%), TKI (5%) <sup>(2)</sup>
Sheikh Adi	80%	80%	GKP	KRG (20)%
Ber Bahr	40%	40%	Genel	Genel (40%), KRG (20)%
Akri-Bijeel <sup>(1)</sup>	20%	12.8%	MOL	MOL (80)%

### Notes

(1) GKPI holding subject to third party and Kurdistan Regional Government's ("KRG") back-in rights.

(2) Texas Keystone Inc. ("TKI") holds its interest in trust for GKPI, pending transfer of its interest to GKPI.

(3) Inclusive of TKI's holding increases to 54.3%.

## Strategic overview

# DEFINED PATH TO GROW VALUE

### Exploration

01 

- > Explore undrilled horizons in the Shaikan block with the Shaikan-7 well to realise significant remaining exploration potential
- > Target two additional exploration leads on the Sheikh Adi block following acquisition of 70 km of additional 2D seismic data
- > Continue extensive exploration programme on the Akri-Bijeel block
- > Bakrman-1 exploration well testing programme is nearing completion
- > Ber Bahr-1 exploration block made a discovery in 2013

### Appraisal

02 

- > Appraise the Sheikh Adi-2 well discovery, appraisal drilling is planned for the 1.9 billion barrel Sheikh Adi field (independently audited P50 gross oil-in-place estimate), as well as further exploration work on the block
- > Continue aggressive appraisal of the Akri-Bijeel block with the drilling of two additional appraisal wells Bijell-7 and Bijell-2



### Development

03 

- > Obtain approval for the Shaikan Field Development Plan and the development concept, and move to the large-scale staged development in 2013 beginning with Shaikan-10, the first development well
- > Phased development of the Ber Bahr-1 discovery will begin in the second half of 2013



## Production

04 

- > Increase production from the Shaikan PF-1 and PF-2 to at least 40,000 bopd by the end of 2013
- > Depending on the confirmation of the wider regional oil and gas pipeline outlook, make a decision on the construction of an export pipeline from the Shaikan field and additional production facilities to get to the initial Shaikan FDP's target of 150,000 bopd
- > Construction and commissioning of an EWT facility for the Bijell discovery on the Akri-Bijell block is nearing completion with first test production expected in 2013

**Read more**   
Page 10 Operational overview



## Corporate

05 

Gulf Keystone is set to progress in its planned move from AIM to the standard/premium segment of the Official List of the London Stock Exchange. The Board has decided to split the roles of Chairman and Chief Executive Officer and a search process has commenced for an Independent Non-Executive Chairman of the Board, as well as for at least one other Independent Non-Executive Director.

**Read more**   
Page 33 Corporate governance



## Local targets

06 

Corporate and Social Responsibility ("CSR") is a high priority for Gulf Keystone. In the last year we have significantly increased training for our national staff as well as community relations initiatives in the Kurdistan Region and we aim to further enhance CSR activity going forward.

## Financial

07 

Our financial strategy is to maintain the appropriate financial flexibility and to broaden the sources of funding available to Gulf Keystone, whilst ensuring an appropriate capital structure. Allied to this, we will work to ensure that our cost base remains appropriate as we continue to build our organisational capacity.


**Read more**   
Page 18 Financial review



## Safety and environment

08 

The safety of the Company's employees, contractors and those in the local communities in which we operate is critical to the effective running of our operations. We have developed processes and procedures as well as a health, safety and environment ("HSE") training programme to ensure health and safety practices are of the highest standard.

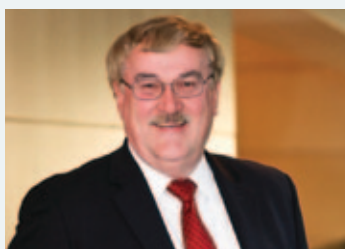
**Read more**   
Page 24 Corporate social responsibility

## Operational review

# GROSS OIL IN PLACE

# 83%

Increase in PMean  
oil-in-place of  
Shaikan



**John Gerstenlauer**  
Chief Operating Officer

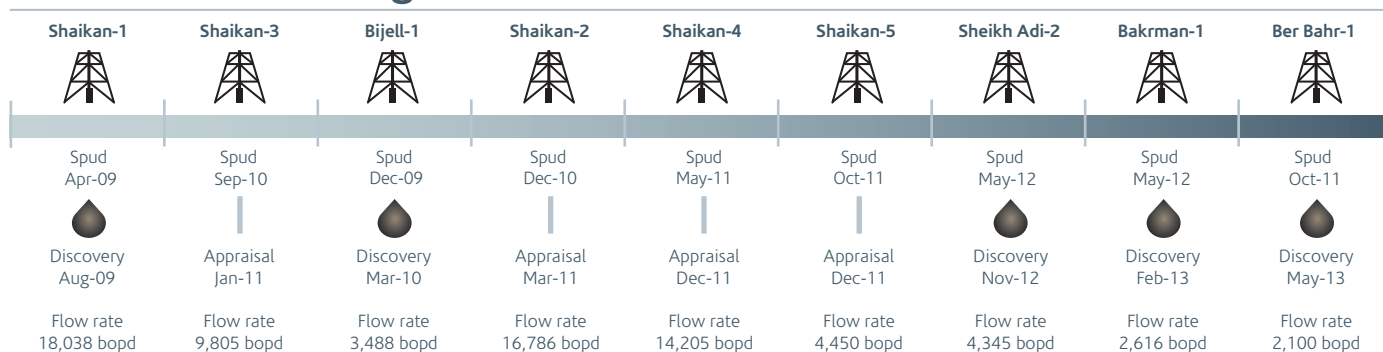
In 2012, Gulf Keystone made significant progress in its operations spanning four blocks in the Kurdistan Region of Iraq, including the giant Shaikan field, which was declared a commercial discovery in August. This flagship asset is currently in transition from the appraisal phase to the staged large-scale development of the field. While awaiting approval of the Shaikan FDP, submitted for review and approval in January 2013, the Company is planning to complete two production facilities capable of producing, in aggregate, 40,000 bopd by the end of 2013, drill its first development well and continue exploration of the deep, yet untapped resources of the massive Shaikan structure. In 2012 and early 2013, the Company succeeded in making three additional discoveries, a Jurassic discovery on the Company-operated Sheikh Adi block, a new Triassic discovery on

the Akri-Bijeel block, operated by MOL Hungarian Oil and Gas plc, and a Jurassic discovery on the Ber Bahr block operated by Genel Energy plc. Operations are currently progressing across the four blocks, which are at different stages of exploration, appraisal, early production and development, which makes our task as the Operator of the Shaikan and Sheikh Adi projects and partner in the Akri-Bijeel and Ber Bahr blocks both challenging and exciting.

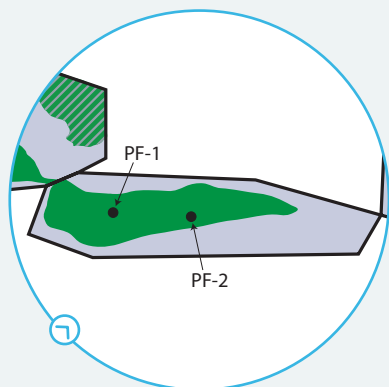
The Company's workforce in the Kurdistan Region of Iraq continues to grow and approximately 75% of our employees today are national staff. To reflect the increasing scale of the Company's operations, in 2012 we continued to develop our organisational capacity, recruiting new staff in order to be

able to manage our operations safely and effectively and moving to a new large office space in Erbil. Following the completion of the Shaikan FDP, our core technical personnel relocated to Erbil to expand and develop the Company's subsurface engineering team, whose task is to implement the Shaikan FDP. The Company's surface operations and engineering team is now fully recruited and the drilling organisation has been streamlined to reflect our near to medium-term drilling work programme.

## Demonstrated drilling success



## Shaikan (75% working interest; Operator)

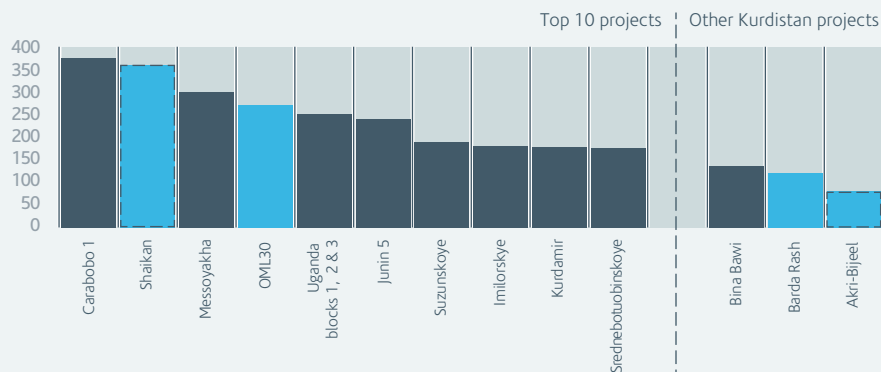


**Shaikan**  
 Location of Shaikan production facilities

### Shaikan is the largest global independent onshore development

Expected peak production (kboe/d)

■ Major O&G player present ■ Major O&G player not present



Source: Goldman Sachs: 360 projects to change the world (2013)  
 'Major O&G player' assumes an industry partner with market value above \$10bn

### Appraisal Programme Completed

The five-well appraisal programme for the Shaikan field, agreed with the Ministry of Natural Resources, was completed in August 2012, after the Shaikan-4, -5 and -6 appraisal wells had been drilled. Shaikan-4 became the Company's best well drilled to date in terms of the total net pay, after achieving total maximum aggregate flow rates of 24,000 bopd in the course of the well testing programme in April 2012. Shaikan-5 and -6 were drilled to appraise the giant structure down the flanks and their results indicate a potential divide in terms of future productivity between the west and the east parts of the field. While solid results obtained with Shaikan-5 confirmed the extremely prolific nature of the Jurassic interval of the structure, we decided to suspend Shaikan-6, which may require a re-test, while we evaluate results obtained with this well in more detail. The Shaikan-2, -4 and -5 wells were completed as Jurassic producers and will be tied to the Shaikan production facilities, currently under construction.

### Transition to the Field Development Plan

A major milestone was achieved in August 2012, when, after completing the appraisal programme, Gulf Keystone and its partners under the Production Sharing Contract ("PSC") relating to the Shaikan block, submitted a Declaration of Commercial

Discovery with effect from 1 August 2012 to the Shaikan Block Management Committee under Clause 12.6 (a) of the PSC. This event signalled the beginning of the Company's transition from the exploration and appraisal phase to the staged large-scale development of the Shaikan field. In October 2012, the Company submitted a detailed Appraisal Report for the Shaikan field to the Ministry of Natural Resources, while continuing to work on the Shaikan FDP. The work on the Shaikan FDP commenced in the summer of 2011 and was completed in January 2013 with the document submitted for review and approval by the regulatory authorities on 27 January 2013.

The Shaikan FDP envisages the first phase of the field development targeting the initial major production goal of 150,000 bopd, followed by a ramp-up to achieve full plateau production. The Shaikan field development is a very significant project, which will require a large number of development and producing wells; additional production, oil and gas processing and blending facilities; and considerable infrastructure, including a pipeline to bring to market Shaikan's increasing production. While awaiting regulatory approvals of the FDP, the Company has been implementing a number of specific pre-development initiatives:

- Shaikan-8, the first post-appraisal well, was drilled in the proximity of the Shaikan-1 and -3 producing wells. The well spudded in September and was completed in December successfully meeting its pre-drill objectives. Shaikan-8 is a sour gas re-injection well that will assist in minimising gas flaring and associated emissions from the Shaikan production operations.
- Re-processing of the significant amount of 3D seismic data, acquired over the Shaikan block in 2010 and processed in 2011 in order to determine best locations for future development wells; the process is ongoing.
- Shaikan-10, the Company's first development well, will spud in July 2013 close to the Shaikan-2 well location. Shaikan-10 will become a producer and will be tied, along with Shaikan-2 and -5, to the Shaikan PF-2 facility.

Gulf Keystone will benefit from a number of ongoing developments on regional oil and gas infrastructure planning. A pipeline connection from Shaikan to the fast developing regional oil and gas infrastructure system, which is expected to be constructed in the near future, is an integral part of our plan to transition from 40,000 bopd to the initial target of the Shaikan FDP of 150,000 bopd.

## Operational review continued

### Production

Shaikan Extended Well Test ("EWT"), which commenced in late 2010, continued in 2012, providing the Company with an opportunity to continue to gain new data and a better understanding of the Shaikan discovery. The EWT also facilitated the Company's commercial and marketing relationships in the domestic market of the Kurdistan Region of Iraq, where all the test production output was sold in 2012. The Shaikan-1 and -3 producing wells, which were tied to the EWT facility, have achieved total output of over one million barrels gross since the commencement of stable production testing operations in November 2011, until the EWT facility was replaced by PF-1 in Q1 2013.

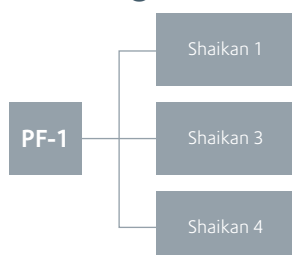
In early 2012, Gulf Keystone commenced working on the construction of two production facilities in parallel to the work on the Shaikan FDP in order to be able to achieve the initial production target of

150,000 bopd of export quality crude in line with expectations of the Ministry of Natural Resources. The first Shaikan production facility is an upgrade development of the EWT facility with the aim of increasing its output to 20,000 bopd and storage capacity to 50,000 barrels. All equipment modules were delivered from Calgary, Canada via Houston, USA and through the port of Mersin in Turkey and assembly work on the first Shaikan production facility (PF-1) commenced in early 2013. Prolonged cold, snowy and rainy weather conditions from January to April and delays in the shipping schedule impacted our original schedule. Shaikan PF-1 has now replaced the original EWT facility and its commissioning is ongoing. PF-1, which is tied to the Shaikan-1 and -3 producing wells, will be linked to the Shaikan-4 well later in 2013. The facility is designed to produce 20,000 bopd, processing the crude to export specification.



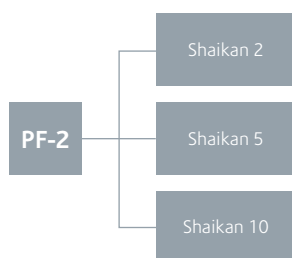
Shaikan  
PF-1

### Unlocking Shaikan value through phased development



#### Upgrade Development:

- > Original EWT facility produced over 1 million barrels
- > In May 2013 it was replaced by PF-1 with 20,000 bopd production capacity
- > Storage capacity of up to 50,000 bbl



#### New Development:

- > PF-2 is under construction
- > Production capacity of 20,000 bopd
- > Storage capacity of 100,000 bbl

Source: GKP

## Work programme

Field/Prospect	Activity	Well	2013				2014				Comments
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Shaikan	Exploration	Shaikan-7		🏠	→	🛢					First deep exploration well, targeting undrilled deeper Triassic and Permian targets
	Development	Shaikan-10		🏠	→	🛢					First development well: will become a Jurassic producer
	FDP drilling	Various				🏠	🏠	🏠	🏠	🏠	Further post-FDP development wells planned to ramp-up field production

Shaikan PF-1 will be followed by PF-2, also designed to produce 20,000 barrels of oil per day, later in 2013. The construction of PF-2 is ongoing and it is expected to be commissioned in H2 2013. Shaikan PF-2 will be tied to the Shaikan-2 and -5 producing wells, as well as Shaikan-10. Once the Shaikan FDP has received all necessary approvals, we look forward to joining the ranks of key producers in the Kurdistan Region of Iraq, contributing to the steadily rising production capacity of the region. We also look forward to finding the most effective solution to deal with the associated gas. The configuration of PF-1 and PF-2 includes an amine plant, which is designed to sweeten a part of the associated gas stream and use it for fuel gas to power the Company's operations. It is the Company's current plan to re-inject the remaining concentrated gas stream.

Configuration of future production and processing facilities will depend on the guidance from the regulatory authorities regarding regional plans to put in place the necessary facilities and infrastructure to collect and transport associated gas.

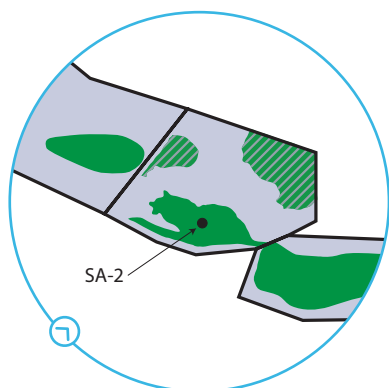
#### Resource Base and Additional Exploration Upside

As a result of the successful five-well appraisal programme of the Shaikan field, a new range of the gross oil-in-place volumes for the Shaikan field was calculated by Dynamic Global Advisors ("DGA") in July 2012. These independent estimates of between 12.4 billion (P90) and 15.0 billion (P10) barrels of gross oil-in-place, with a mean value of 13.7 billion barrels of gross oil-in-place, are very significant and will be further refined when results of Shaikan-7,

the Company's first deep exploration well, become available. Shaikan-7, which spudded in June 2013 in proximity of the producing wells Shaikan-1 and -3, will explore the mid to lower Triassic and, potentially, Permian horizons of the Shaikan structure. Potential additional oil volumes exist in the Cretaceous formation to the north of the field, which have not been accounted for as yet by the Company. As we move from the early stages of test output from the Shaikan field to consistent levels of production at stable rates of between 20,000 bopd and 40,000 bopd, we expect to gain significant additional data about the potential of Shaikan's multiple reservoirs.

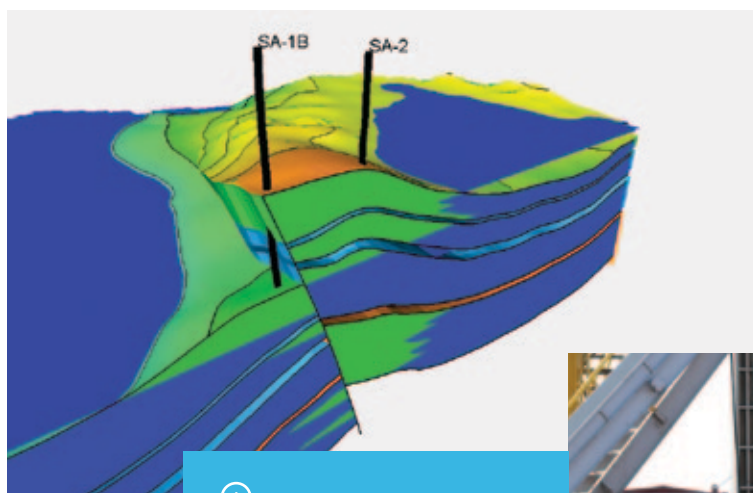
## Sheikh Adi

(80% working interest; Operator)



**Sheikh Adi**  
Location of Sheikh Adi-2 discovery well

In May 2012, we spudded Sheikh Adi-2, the second exploration well on the block, located immediately to the west of the Shaikan block. The location for this well, 1.45 km to the north of Sheikh Adi-1, was selected as a result of the analysis of extensive 3D seismic data acquired over the



Sheikh Adi cross section



## Work programme

Field/Prospect	Activity	Well	2013				2014				Comments
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Sheikh Adi	Appraisal	Sheikh Adi-3				.....▶					First well to appraise the Sheikh Adi discovery
	Exploration	n/a		.....▶							2D 70 km seismic programme being acquired

## Operational review continued

block in 2010–2011. By drilling Sheikh Adi-2, we were looking for a well-developed system of natural fractures similar to Shaikan in order to support the preliminary gross oil-in-place estimates with a range of between 1.0 billion (P90) and 3.0 billion (P10) barrels, as independently estimated by DGA in August 2011, following the drilling of Sheikh Adi-1. Sheikh Adi-2 was drilled to a measured depth 2,754 metres, following which we successfully tested four out of seven target reservoir zones at measured depths of between 1,420 metres and 1,700 metres, achieving total stabilised aggregate flow rates of 4,235 bopd of approximately

15 to 18 degrees API gravity across the Upper Butmah, Adaiyah, Mus and Sargelu formations in the Jurassic. The oil gravity is similar to that found in the same formations in the Shaikan block.

The Company notified the Ministry of Natural Resources of the Jurassic discovery in November 2012. Earlier this year, the Company and the Kurdistan Regional Government, its partner in the block, unanimously agreed to move to an appraisal programme. Furthermore, we plan to target two additional exploration leads, comprising potential extensions of the

Atrush and Swara Tika discoveries, following the planned acquisition of 70 km of additional 2D seismic data to be undertaken in 2013. The Company is enthusiastic about the forthcoming appraisal programme and additional exploration work, as it is the Company's belief that the Shaikan field shows signs of a significant extension into the Sheikh Adi block.

## Akri-Bijeel

(20% working interest)

Significant progress was achieved in 2012 in the extensive exploration and appraisal programme of the massive Akri-Bijeel block by the operator, Kalegran Ltd., a 100% subsidiary of MOL Hungarian Oil and Gas plc. Most notably, a new Triassic discovery was made with the Bakrman-1 exploration well in October 2012. This is the second discovery on the block following the Bijell discovery made in 2010.

### Bakrman-1 Exploration Well Discovery

Bakrman-1, the first exploration well to target the Bakrman structure on the block, spudded in May 2012, 32 km to the north-west of the Bijell-1 discovery well. The Bakrman structure is a large anticline in the western portion of the Akri-Bijeel block and appears to be on trend with the nearby Atrush discovery, immediately to the north of the Shaikan block. The well was drilled to a total depth ("TD") of 4,100 metres in the Kurra Chine B formation in the Triassic, following which a well testing programme commenced, targeting reservoir zones in the Jurassic and Triassic. According to the operator, the second open hole well test performed at 3,930–4,100 metres MD (measured depth) in the Kurra Chine B formation in the Triassic resulted in

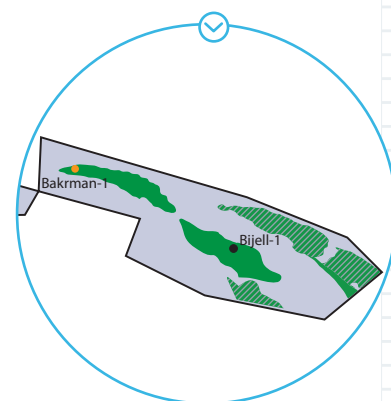
calculated daily flow rates of approximately 2,616 bopd of light (32 to 35 degrees API gravity) and a gas rate of approximately 5.86 million standard cubic feet per day. The well testing programme is expected to be completed in the near future.

### Bijell Appraisal Programme

Bijell-3, the first well to appraise the Bijell discovery, spudded in January 2012. It has been drilled 8 km to the north-west of the Bijell-1 discovery well and 26 km to a TD of 4,980 metres in the Sarki formation in the Lower Jurassic. Bijell-3 did not encounter commercial inflow of hydrocarbons, thus marking the northern boundary of the field

### Akri-Bijeel

Location of Bijell-1 and Bakrman-1 discovery wells



Storage tanks at Bijell EWT facility



discovered by the Bijell-1 well. The extensive appraisal programme of the Bijell discovery continues with two additional appraisal wells: Bijell-7 spudded in December 2012 and Bijell-2 spudded in February 2013. Three further appraisal wells are scheduled to spud in 2013: Bijell-4, -5 and -6.

#### Bijell Extended Well Test

Construction and commissioning of an Extended Well Test ("EWT") facility for the Bijell discovery commenced in 2012 and is expected to be completed in Q2 2013. The Bijell EWT facility, of a total gross capacity of 10,000 bopd and a storage capacity of 30,000 barrels, will be tied to the Bijell-1 discovery well. Bijell-1 is in the process of being completed as a producer and first test production is expected later in 2013.

#### Gulak-1 Exploration Well

Gulak-1, the first exploration well to target the Gulak anticline, spudded in July 2012 and was drilled 21 km to the east from the Bijell-1 discovery well to a TD of 3,641 metres in the Kurra Chine B formation in the Triassic. In the course of the well test programme only minor inflows of hydrocarbons were encountered, which, given the size of oil column, indicates a lack of natural fracture, and the well was suspended.

Finally, the acquisition of 490 km<sup>2</sup> of 3D seismic data, which commenced in 2012, is continuing.



Bijell-7 appraisal well



## Work programme

Field/Prospect	Activity	Well	2013				2014				Comments
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Akri-Bijell	Exploration	Bakrman-1	.....→	●							Triassic discovery achieving flow rates of 2,616 bopd; testing complete in the Jurassic
	Appraisal	Bijell-2, 4, 6, 7	⚙	⚙	⚙	⚙	.....→				Test southern extension of accumulation proved by Bijell-1
	Appraisal	Bijell-5		⚙	.....→	●					Part of the Bijell discovery appraisal programme/explore southern structure
	Seismic	n/a	.....→								Continuation of 2012 3D programme, with minor changes to reflect drilling results

## Operational review continued

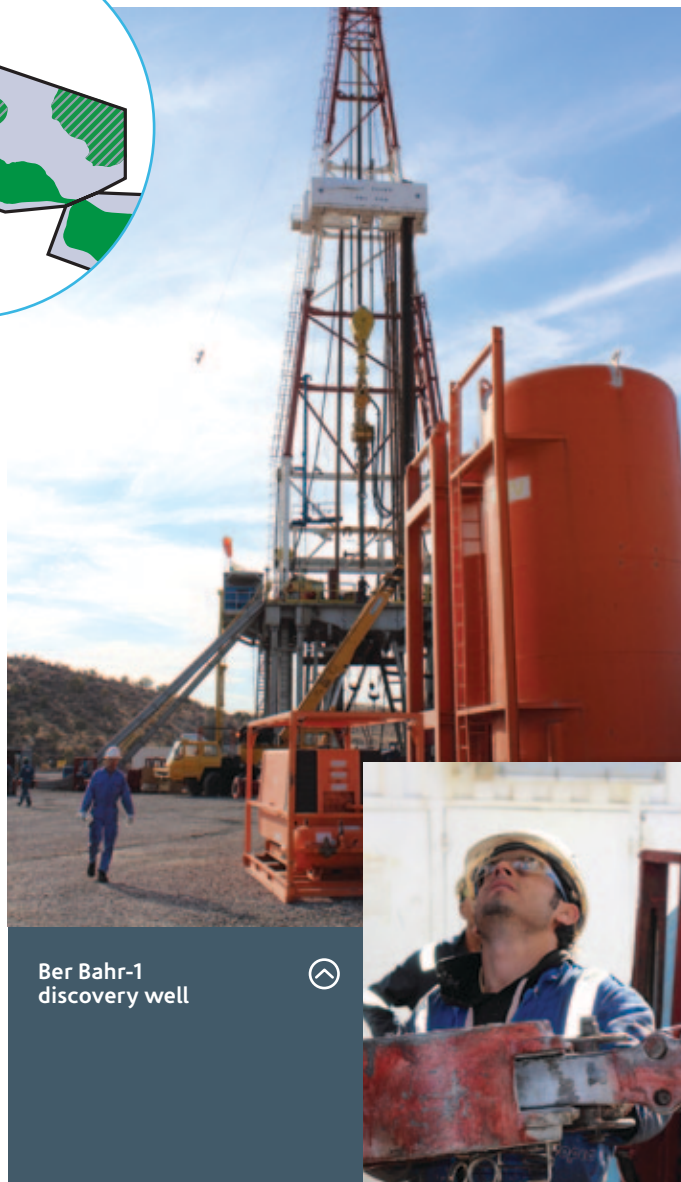
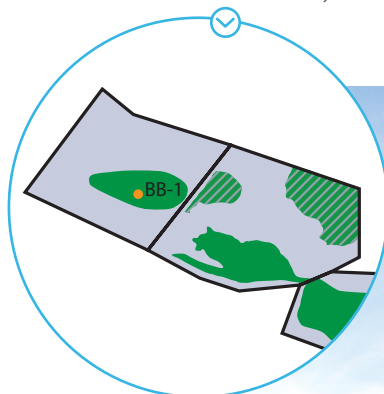
### Ber Bahr

(40% working interest)

- Ber Bahr-1, the first exploration well to be drilled on the block, completed drilling and initial testing in May – June 2012. The well was drilled to a TD of 3,933 metres in the Chia Zairi formation. According to Genel Energy plc, the operator, the well encountered a 300 metre oil column in the Jurassic with matrix porosity of 17% but two drill stem tests over the interval failed to flow and yielded inconclusive results. In order to determine the commercial viability of the well, the operator drilled a side-track in early 2013. In May 2013, the Ber Bahr-1 well made a Jurassic discovery achieving a sustainable flow rate of 2,100 stock tank barrels ("STB") per day of 15 API oil from the Middle Jurassic age Sargelu formation. The operator has also stated their intention to begin a phased development of the field in the second half of this year.

#### Ber Bahr

Location of Ber Bahr-1 discovery well



Ber Bahr-1 discovery well

#### Algeria

In line with the Company's decision to undertake a gradual strategic exit from Algeria, our remaining limited activities in Algeria will continue to focus on an orderly exit from the small GKN/GKS oil fields in the Ferkane area.

#### JB Gerstenlauer

Chief Operating Officer

## Work programme

Field/Prospect	Activity	Well	2013				2014				Comments
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Ber Bahr	Exploration	Ber Bahr-1		●							First exploration well; 300m oil column encountered in May 2012; side-track drilled to re-test; testing in the Jurassic is ongoing
	Seismic	3D			.....→						Gathering 3D seismic data to gain better understanding of the structure
	Development	Ber Bahr-2				⚙️.....→					Second well on Ber Bahr structure

Our role as Operator of the Shaikan and Sheikh Adi projects and partner in the Akri-Bijeel and Ber Bahr blocks is an increasingly pertinent one, as we move towards becoming a significant producer in the Kurdistan Region of Iraq

Ber Bahr-1  
discovery well



## Financial review

# STRONG FINANCIAL POSITION



**Ewen Ainsworth**  
Finance Director

**\$262.3 million**

Cash, cash equivalents and liquid investments as at 31 December 2012

**\$275 million**

Gross proceeds raised through the placing of unsecured convertible bonds

### Results for the year

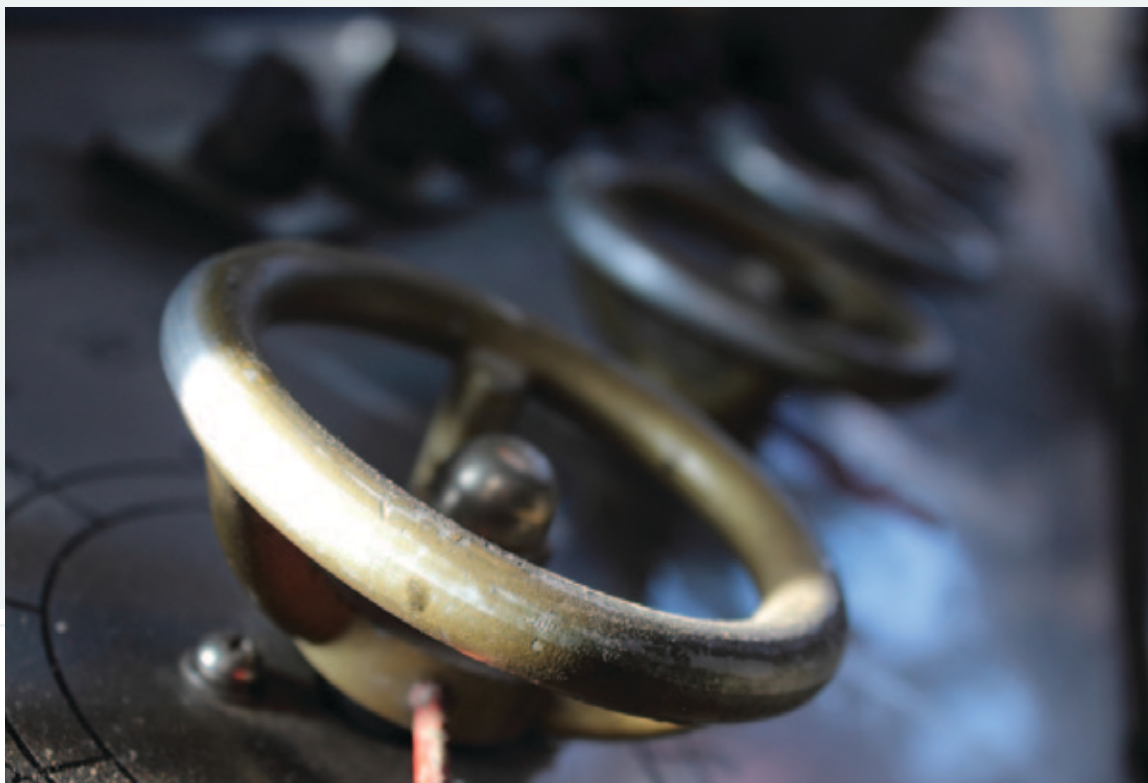
#### Operating results

The Company has continued to produce from the Shaikan -1 and -3 wells during the year. Gross production for 2012 totalled 832,859 barrels of oil (2011: 200,137 barrels of oil) and gross sales were 825,485 barrels of oil (2011: 207,848 barrels of oil). These sales have generated net revenues of \$32.2 million (2011: \$6.9 million) for the Company with an average realised price achieved of \$48.70 per barrel (2011: \$41.61 per barrel). Operating costs on a per barrel basis, excluding inventory movements, depreciation, depletion and amortisation costs and share-based payment charges were \$28.31 per barrel during the period (2011: \$33.97 per barrel).

As the Company is still in the early stages of producing oil from the Shaikan field and production rates are variable, revenue continues to be shown in the income statement with an equal and offsetting amount against cost of sales and a \$nil gross profit. An amount equal to the revenue is credited to intangible assets against exploration and evaluation costs, reducing the net book value in the balance sheet. The Company will consider recognising earnings and accounting for this activity as a gross profit or loss in the income statement as the full development of the field commences and when there is evidence of oil production being achieved on a regular and consistent basis.

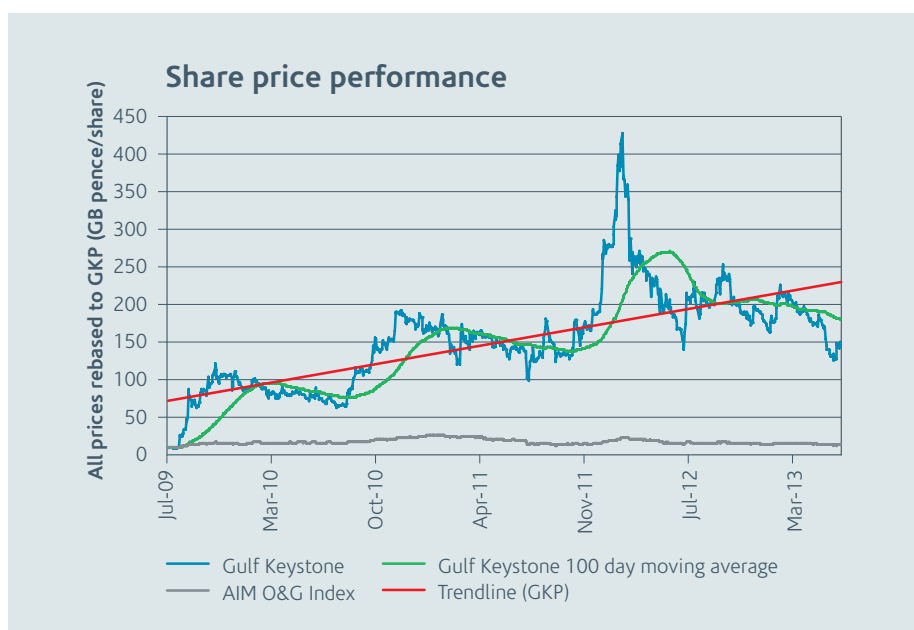
### Non-operating results

General and administrative expenses for 2012 were \$82.1 million, compared to \$60.4 million in 2011. Administrative costs have increased by \$21.7 million primarily due to a significant increase in advisers' fees incurred in relation to the Company's defence of the claim made by Excalibur Ventures LLC ("Excalibur"). For further details of the Company's response to the claim please refer to note 22 to the consolidated financial statements. Furthermore, the Company saw an increase in the operational activities in the Kurdistan Region of Iraq as the Company's projects expand and mature, requiring an increase in expenditure on supporting functions. The costs associated with the share bonus awards and the options awarded under the Company Share Options Plan and Long Term Incentive Plan went down to \$25.9 million in 2012 from \$42.5 million in 2011. Of these costs, \$6.0 million has been included within intangible assets (2011: \$7.9 million), as these employment costs are directly attributable to technical staff.



Other gains of \$5.2 million (2011: other gains of \$5.8 million) comprise foreign exchange gains of \$6.4 million (2011: \$4.7 million gain) and mark-to-market valuation loss of \$1.2 million (2011: \$1.1 million gain) which includes the revaluation of the Standby Equity Distribution Agreement derivative from an asset of \$0.4 million to \$nil following the expiry of the agreement. The mark-to-market loss is a result of the Company entering into currency and interest rate hedges which are held to maturity. Currency hedges were used to partly mitigate the risk associated with converting sterling to US dollars following funds received in sterling from the share placing in 2011 and converting US dollars to sterling following funds received in US dollars from the issue of the senior unsecured convertible bonds ("Convertible Bonds") by Gulf Keystone during 2012.

Interest revenue remained at a similar level to 2011 amounting to \$1.2 million in 2012 (2011: \$1.2 million). Finance costs of \$4.5 million (2011: \$0.5 million) are made up of the accretion charge on the decommissioning provision of \$0.3 million (2011: \$0.5 million); and interest payable in respect of the Convertible Bonds of \$4.6 million (2011: \$nil) out of which \$0.5 million was capitalised within intangible assets.



## Financial review continued



Over  
1 million

barrels of oil

Total gross test production  
to 31 December 2012



outflow (2011: \$0.9 million inflow) adding to the operational cash outflow. The working capital movements, such as increase in inventories and payables, are in line with the increase in drilling and construction activities as well as higher general and administrative expenses. The increase in receivables is attributable to the higher oil sales made in November and December 2012 as compared to the same period in 2011 as well as the loans made to certain Directors of the Company that were outstanding as at 31 December 2012. These loans have been partially repaid as at the date of this report; the remainder of the loans shall be repaid by the end of August 2013 (see note 24 to the consolidated financial statements). Tax paid in 2012 was \$1.7 million (2011: \$0.7 million) and interest received was \$1.2 million (2011: \$1.2 million). Net cash outflow from operating activities after tax and interest was \$59.4 million (2011: \$23.7 million).

Cash used in investing activities totalled \$172.3 million (2011: \$172.5 million), which comprises \$191.9 million spent on intangible assets (2011: \$152.5 million) and \$1.3 million (2011: \$0.6 million) spent on property, plant and equipment offset by a reduction in liquid investments of \$20.9 million (2011: \$19.4 million increase). The majority of the \$191.9 million cash spent on intangible assets relates to the Company's exploration activities in the Kurdistan Region of Iraq, including the drilling, testing and workovers of wells on the Shaikan, Sheikh Adi, Ber Bahr and Akri-Bijeel blocks, construction of the Shaikan production facilities, preparation of the Shaikan FDP, Akri-Bijeel surface facility construction and the acquisition and

**"Our financial strategy remains to maintain the appropriate financial flexibility to fund high-impact exploration, appraisal and development programmes in order to realise the full potential of our multi-billion barrel resources."**

The tax cost for 2012 is \$1.6 million (2011: credit of \$1.4 million) and arises on UK activities.

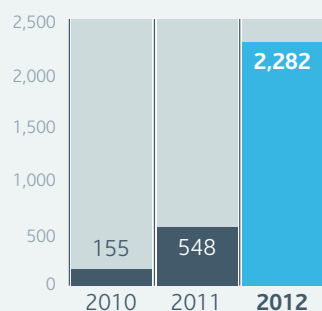
The results for 2012 show an increased loss after tax of \$81.8 million (2011: \$62.4 million) reflecting the increase in administrative expenses, interest expense now arising on the Convertible Bonds and the increase in tax charge.

### Cash flow

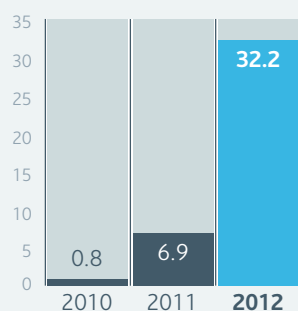
Net cash outflow from oil and gas operations after general and administrative expenses was \$59.0 million (2011: \$24.2 million). The loss from operations of \$82.1 million (2011: \$70.4 million) was adjusted for non-cash expenditure of \$25.3 million (2011: \$45.2 million) which included share-based payments, provisions for overdue receivables and Algeria decommissioning obligation, depreciation and amortisation. The working capital adjustments result in a \$2.2 million cash

## Selected operational and financial data

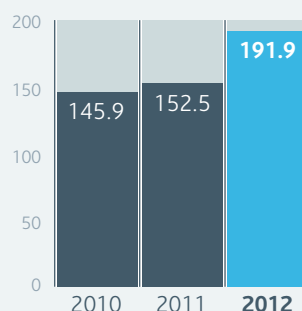
Average gross production  
bopd



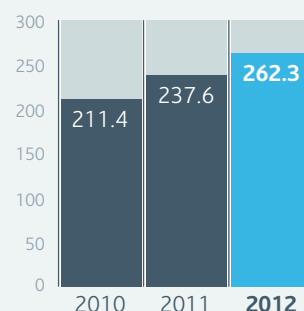
Test production sales  
\$ million



Total cash capital investment  
\$ million



Year end cash, cash equivalents  
and liquid investments balance  
\$ million



processing of seismic data. The expenditure on property, plant and equipment reflects the expansion of the Kurdistan office.

Cash generated by financing activities amounted to \$270.2 million (2011: \$197.9 million). A total of \$268.9 million was raised in proceeds on issue of the Convertible Bonds. A further \$1.3 million was raised through the funds received following the exercises of the warrants previously granted and options under the Company's share option plan.

The net overall increase in cash and cash equivalents during the period was \$38.5 million (2011: \$1.8 million increase). Foreign exchange gains on cash balances were \$7.1 million (2011: \$5.1 million).

Cash and cash equivalents totalled \$253.7 million at 31 December 2012 (31 December 2011: \$208.1 million). Cash, cash equivalents and liquid investments totalled \$262.3 million at 31 December 2012 and \$154.0 million at 1 June 2013 (31 December 2011: \$237.6 million).

### Convertible Bonds

In order to fund the Company's ongoing work programme the Company completed an oversubscribed offering of the Convertible Bonds, raising \$275.0 million gross proceeds. Subsequent to the year end, the Convertible Bonds were admitted to the Official List of the Luxembourg Stock Exchange in January 2013.

Funds raised via the offering of the Convertible Bonds enhanced the Company's liquidity position and will contribute to the Company's ongoing move to the staged

large-scale development of its Shaikan field in the Kurdistan Region of Iraq which was declared a commercial discovery in August 2012, and the exploration and appraisal of its other three blocks in the region.

This is the first time Gulf Keystone has accessed the debt capital markets, and the success of the offering demonstrates investors' confidence in the Company's ongoing move from appraisal, to development, of its world class Shaikan field and the maturing hydrocarbon profile of the Kurdistan Region of Iraq.

The Convertible Bonds will be convertible into common shares of the Company at the initial conversion price of \$4.39 (£2.72 at the prevailing USD:GBP spot rate at the time of pricing). The conversion right in respect of a Convertible Bond may be exercised, at the option of the holder, at any time from 18 October 2012 to the close of business on 8 October 2017. The Convertible Bonds carry a coupon rate of 6.25% per annum payable bi-annually in arrears. The Convertible Bonds are redeemable at 100% of their principal amount and, unless previously redeemed, converted or cancelled, will mature on the fifth anniversary of the issue of the Convertible Bonds in October 2017.

### Excalibur claims

The Company vigorously disputed and contested the allegations and claims asserted by Excalibur in December 2010 in the course of the pre-trial proceedings and the trial in the English Commercial Court, which commenced in London on 15 October 2012 and was completed

on 1 March 2013. The Judge will give his decision in a written Judgement, which is expected later this year.

As at the date of this report, Excalibur has made two payments into Court totalling £10.7 million as security for the costs of Gulf Keystone and two of its subsidiaries (together "the Companies") of defending the legal action, further to the decision of the English Commercial Court in London. In addition, total payments of £6.7 million were made into Court as security for the costs of Texas Keystone Inc.. Further details are given in note 22 to the consolidated financial statements.

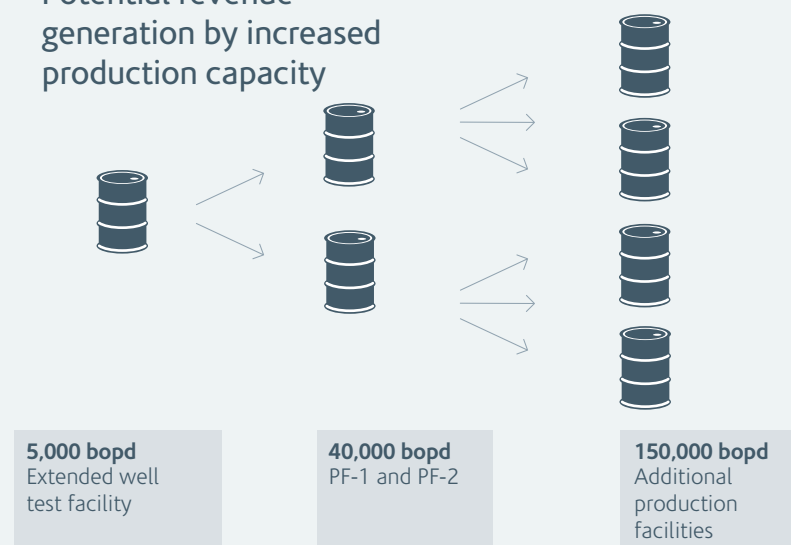
### Corporate activities

At the Annual General Meeting on 19 July 2012, approval was obtained to increase the authorised share capital of the Company by \$1,000,000 through the creation of an additional 100,000,000 new common shares of \$0.01. At the date of this report, 887,686,957 common shares are in issue.

During March 2012, 11.0 million common shares were also issued in relation to outstanding awards made under the 2009, 2010 and 2011 Executive Bonus Scheme and 0.3 million common shares in response to option exercises by the Company's employees. A further 10.0 million common shares were issued to satisfy the cash settled awards to certain Executive Directors and employees, conditional on the occurrence of an Exit Event. These issues were previously detailed in the 2011 Annual Report and Accounts.

## Financial review continued

### > Potential revenue generation by increased production capacity



"Once we complete and commission the two Shaikan production facilities our output levels are due to increase to 40,000 bopd which will allow us to make considerable steps towards our goal of fully financing our activities from production cash flows over the medium term."

Subsequent to 31 December 2012, 7.1 million common shares have been issued, including 6.5 million to the Employee Benefit Trust ("EBT"), to satisfy awards made under the 2010 and 2011 Executive Bonus Scheme that were deemed to have vested. Further details of the awards granted and vested are given in the Directors' Report and notes 19 and 23 to the consolidated financial statements. A further 4.4 million common shares were issued in response to option exercises by the Company's employees in February 2013. The common shares issued during 2012 and subsequent to year end to satisfy awards under the Company's bonus and option incentive schemes represent 3.70% of the Company's share capital as at 19 June 2013.

There were no additional share bonuses or LTIP options granted in 2012.

#### Other and further events

The Company continues to explore options for the disposal of its 20% working interest in the Akri-Bijeel block and appointed corporate advisers in 2012 who are responsible for coordination of and advice on the process. The disposal process remains ongoing at the date of this report. The Akri-Bijeel intangible asset (2012: \$64.6 million; 2011: \$35.8 million), including the associated working capital balances, continues to be classified as an asset held for sale.

The Company continues to effect an orderly exit from its Algerian operations and continues the discussions with Sonatrach regarding the exit from Block 126a (GKN and GKS oilfields under the Ferkane Permit).

#### Financial strategy and outlook for 2013

The Company has gone through another year of significant growth in which we achieved important operational and financial milestones including the highly successful fundraising through the issue of the Convertible Bonds, Declaration of Commercial Discovery at Shaikan, three additional discoveries, including the Sheikh Adi and Akri-Bijeel discoveries in 2012, and the Ber Bahr discovery in 2013.

Gulf Keystone, together with its partners, carries on its exploration and appraisal programmes on the prospects identified in the Sheikh Adi, Akri-Bijeel and Ber Bahr blocks aimed at unlocking significant value across all of the Company's licence interests. Furthermore, once the Shaikan FDP is approved by the relevant authorities, we will start a new exciting phase of the Company's development.

Our financial strategy remains to maintain the appropriate financial flexibility to fund high-impact exploration, appraisal and development programmes in order to realise the full potential of our multi-billion barrel resources. We will also look to broaden the sources of funding for Gulf Keystone, whilst ensuring an appropriate capital structure. Allied to this, we will work to ensure that our cost base remains appropriate as we continue to build our organisational capacity. These goals will enable us to support the Company's growth strategy with a robust, well-funded business.

Once we complete and commission the two Shaikan production facilities our output levels are due to increase to 40,000 bopd which will allow us to make considerable steps towards our goal of fully financing our activities from production cash flows over the medium term. Further funds will become available to the Company in the event that the Kurdistan Regional Government formally exercises its Third Party Assignment and Government options under the terms of the Production Sharing Contract regarding the Shaikan block, and the Production Sharing Contract regarding the Akri-Bijeel block. In addition, the Company continues to evaluate the ongoing disposal process of the Company's 20% interest in the Akri-Bijeel block as the forthcoming results of the wells currently being drilled and tested, and planned early production from the Bijell discovery, are taken into consideration.

Gulf Keystone is now entering a new phase of its development as it matures from a proven oil explorer to a production company. As the commercial viability of the Shaikan field is demonstrated, and the Company's exploration and appraisal programmes on Sheikh Adi, Akri-Bijeel and Ber Bahr progress, there continue to be excellent opportunities for increasing shareholder value.

**KE Ainsworth**  
Finance Director

“Gulf Keystone is now entering a new phase of its development as it matures from a proven oil explorer to a production company.”

Shaikan  
PF-2



## Corporate social responsibility

# MAKING A POSITIVE CONTRIBUTION



- > 75% Kurdistan employees
- > Regular training for Kurdistan national staff in country and abroad
- > Working with over 50 local providers
- > 30% of expenditure represents business done with local vendors
- > Working with nearby universities to provide invaluable field experience

# 75%

Kurdistani employees

Incinerator



## Gulf Keystone bases its actions on the principles of openness, integrity and accountability, believing in fair practice and cross-cultural sensitivity in the interests of the people of Iraq.

### Responsible operations

Gulf Keystone bases its actions on the principles of openness, integrity and accountability, believing in fair practice and cross-cultural sensitivity in the interests of the people of Iraq. Our goal is to be a partner of choice, a competent and responsible operator known for making a positive contribution to those with whom we interact.

By implementing a number of local employment and training initiatives we are ensuring sustainability of our operations in the Kurdistan Region of Iraq and development of the country as a whole, through the skills of its workforce.

We have adopted a number of environmental improvement programmes including our waste management, bio-remediation, evaporation and de-watering systems that meet international standards and benefit surrounding communities.

### Country leader for waste disposal

Gulf Keystone is proud to be a leader among oil and gas operators in the Kurdistan Region of Iraq in the area of waste disposal. We plan to hold forums for other operators with the aim to encourage wider employment of waste management initiatives.

In 2011, Gulf Keystone developed and began implementing a waste management initiative across our Shaikan and Sheikh Adi blocks. We purchased and installed an industrial incinerator which meets all EU guidelines for air emissions, giving the Company the ability to monitor and control the disposal of all solid waste. The ash generated by this

process is used in the bio-remediation process to close its pits in accordance with Louisiana Law 29-B for pit closure.

Our incinerator is operated by our Green Team, made up of Kurdistan employees. As part of the Company's continuing Community Relations Programme, the Green Team also collect waste from neighbouring villages to be disposed of in the incinerator, meaning that local people are also benefiting from the Company's initiative aimed at protecting the environment in the area of our operations.

### In the community

Over the past year we have spent time working with local communities to pin-point some of their more essential needs in order to implement projects that are sure to make a valued difference. We aim to build on what we have already accomplished in the area, which includes supplying Qasrok District School with over 1,000 uniforms and providing equipment such as computers, tools and sports apparatus for the Youth Centre in the Atrosh District.

As our Company grows, so does our responsibility and we are currently looking at plans to undertake a number of new projects, including school renovations, the building of event halls and roads as well as further increasing our training and recruitment programmes for national staff in the Kurdistan Region of Iraq.



Gulf Keystone's Green Team



## Management of principal risks and uncertainties

Getting risk management right is an essential component of business success. It supports the achievement of our strategic objectives and protects our business, our people and our reputation. Identifying, understanding and mitigating the risks we face, whilst being able to maximise the value from business opportunities, supports effective decision making. Responding quickly when risks crystallise to mitigate their impact is a key element of our risk management process which underpins the safe delivery of our business plans and strategic objectives, protects our licence to operate, and helps to create a long-term competitive advantage.

### STRATEGIC RISKS

Key risk factor	Potential impact	Mitigation
<b>Meeting shareholder expectations, particularly with regard to the Group's long-term strategy, production profile and funding</b>	Ineffective or poorly executed strategy fails to create shareholder value and to meet shareholder expectations. It may lead to loss of investor confidence and reduction in the Company's share price, which reduces the Company's ability to access finance and increases vulnerability to a hostile takeover.	The Company maintains a regular dialogue with the Company's shareholder base and the general public.  A website is maintained to disseminate information widely and in a timely manner.  Gulf Keystone employs an investor relations team. All key developments are released to the market through the Regulatory Information Service, also available on the Company's website.
<b>Organisational capability</b>	With the Group's transition from exploration to development, it is of utmost importance to ensure that the capability of the organisation is adequate to deliver plans for growth.  Organisational capability is a function of both the strength of the Group's human resources and internal controls.  Inability of the Group to recruit and retain staff with the right skills and to implement succession plans may lead to a loss of knowledge and skills to the Group and other short and long-term disruption to the business.  Weak controls or lack of compliance may lead to loss of value and failure to achieve growth targets.	Gulf Keystone has created competitive remuneration packages including bonus, share options and long-term incentive plans that are reviewed regularly to ensure key executives and senior management are appropriately compensated.  Executive and senior management turnover rate in the Group continues to remain at low levels.  In 2012, the Audit Committee engaged PricewaterhouseCoopers ("PwC") to perform a series of internal control procedures audits with a risk based focus. This process is ongoing with areas of focus determined by the Audit Committee, who also monitor timely and adequate implementation of the recommendations made.
<b>Political and regional risk, including risks relating to disputes regarding title and exploration and production rights</b>	Unfavourable developments in politics, laws and regulations can affect our operations, earnings and our ability to deliver the strategy.  The Group has the right to explore its assets in the Kurdistan Region of Iraq and, to the best of its knowledge, those rights are in good standing. However, The Iraq Oil Ministry has publicly stated that the PSCs entered into by the Kurdistan Regional Government ("KRG") are not valid. If the validity of the PSCs was successfully challenged, the Group could be required by the KRG to accept contractor entitlements that are materially less favourable than the current PSCs.  Consequences may include limits on production or cost recovery, import and export restrictions, price controls, uncertainty over payment mechanisms for the export sales, tax increases and other retroactive tax claims, expropriation of property, cancellation of contract rights and increase in regulatory burden.	The history of political and social instability of Iraq, including the Kurdistan Region of Iraq where the majority of the Group's operations are concentrated, is noted by the Board who mitigate the political risk as far as possible. While the Group cannot control or completely mitigate the risks of disputes between the Kurdistan Region of Iraq and the Republic of Iraq in relation to the Kurdistan PSCs, it maintains continuous dialogue with appropriate government departments and closely monitors the local situation for emerging risks to the business and has business continuity plans in place.  Gulf Keystone strives to be a good corporate citizen globally, and fosters reputation by strong and positive relationships with the governments and communities where we do business. The Group has a number of ongoing corporate social responsibility initiatives.
<b>Risks associated with infrastructure and export market</b>	The Group's ability to export oil may be curtailed by current uncertainty relating to the export market and the payment mechanism for export oil in the Kurdistan Region of Iraq.  The construction of a pipeline connecting the Company's blocks to the export market is critical to the future operations of the Group as transportation by truck has limited capacity.	The Group continues to have a regular dialogue with the KRG as part of its engagement with stakeholders.  Gulf Keystone has an option to sell into the local market in the Kurdistan Region of Iraq, which has provided a reliable revenue stream for the Group's test production sales to date.  The Group monitors the developments in the Kurdistan Region of Iraq infrastructure and availability of transport options. As a short-term solution, Gulf Keystone can rely on transportation by truck. However, this is potentially less safe, secure and environmentally sound than transport by pipeline.
<b>Outstanding litigation risk</b>	The Group's current outstanding litigation brought by Excalibur Ventures LLC could adversely affect the Group's business, prospects, financial condition or results of operations.	The Group vigorously disputed and contested the allegations and claims made by Excalibur in the course of the pre-trial proceedings and the trial in the English Commercial Court. The Group has been working closely with its legal counsel since December 2010. The Group is currently awaiting judgement following the trial, which completed on 1 March 2013.

The Board, its Committees and the senior management team are actively engaged in monitoring and limiting, where possible, the risks to which the Company and its subsidiaries (together “the Group”) are exposed. During 2012, we have regularly considered our risk profile and updated the Group risk register. The following table indicates the key risks the Group faces, their potential impact and the mitigation measures that we have in place. The list is not exhaustive or in priority order, and may change at any time.

#### Business conduct and bribery act

Due to the nature of the industry sector and the regions in which Gulf Keystone operates, the Group is potentially exposed to accusations of poor practice when it comes to the requirements introduced by the UK Bribery Act in 2010. Violations of this Act may result in a criminal case against Gulf Keystone and/or our employees, leading to reputational damage, possible imprisonment and fines.

The Group ensures that it has appropriate procedures in place to mitigate the risk of bribery and that all employees, agents and other associated persons are made fully aware of the Group's policies and procedures with regard to ethical behaviour, business conduct and transparency.

A detailed bribery risk assessment has been performed and reviewed by the Board with measures to mitigate the risks identified and implemented.

The Board has requested an independent Bribery Act compliance review to be performed by PwC in 2013.

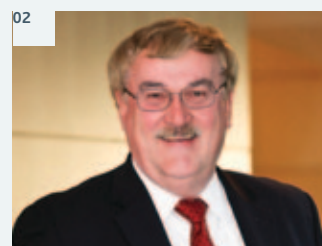
### OPERATIONAL RISKS

Key risk factor	Potential impact	Mitigation
<b>Field delivery risk</b>	Field delivery risk applies to all phases of the exploration and production (“E&P”) cycle from seismic acquisition through to production operations. At each phase the mitigating measures will be different; however, failure to control risks will manifest itself as project delays, cost overruns, high production costs, early field decommissioning and, ultimately, lower than expected reserves.	<p>Technical, financial and Board approvals are required for all projects, and for all dedicated project teams.</p> <p>The technical team analyse results from appraisal wells and determine the appropriate course of action in terms of drilling programme and facility design.</p> <p>All projects are closely monitored to ensure the project delivers against plan and to enable actions to be taken to maintain progress.</p> <p>Project finances are monitored against budget to minimise overruns.</p>
<b>Health, safety, environment and security (“HSES”)</b>	<p>The Group may be exposed to specific risks in relation to social and environmental factors as well as health and safety matters, including security.</p> <p>Consequences may include accidents resulting in loss of life, injury and/or significant pollution of the local environment, destruction of facilities and disruption to business activities.</p>	<p>Gulf Keystone has put in place comprehensive HSES and operations management procedures including emergency and incident response plans. The Group actively engages with local communities and governments using specialist consultants.</p> <p>Clear policies and procedures are supported by strong leadership, accountability and commitment throughout the organisation.</p> <p>The Board has requested an independent HSES procedures review to be performed by PwC in 2013.</p>

### FINANCIAL RISKS

Key risk factor	Potential impact	Mitigation
<b>Capital availability</b>	<p>Access to financing to maintain the ongoing operations of the business is critical.</p> <p>If the Group's financial performance and access to funding do not match the capital requirements, it will be impossible for Gulf Keystone to fulfil commitments and deliver the exploration and development programme.</p> <p>In the extreme case, this could impact the Group's ability to continue as a going concern.</p>	<p>Finances are controlled through a comprehensive annual budgeting process and periodic forecast updates, including sensitivity reviews. The projected cash balance is reviewed on an ongoing basis.</p> <p>All significant expenditure is approved by the Board.</p> <p>Short-term and long-term cash forecasts are monitored and reported regularly to senior management and the Board.</p> <p>Active dialogue is maintained with financial institutions and investors and potential sources of funding the Group's ongoing work programme are considered.</p> <p>Gulf Keystone's management have a strong track record of successful fundraisings.</p>
<b>Liquidity and credit risk</b>	The Group carries significant cash balances and has convertible bonds in issue, thereby increasing its exposure to liquidity and credit risk.	Cash balances are invested in short term, non-equity instruments with multiple institutions that have good credit ratings. Rates offered are reviewed on an ongoing basis to ensure returns are maximised.

## Board of Directors



### 01 Todd F Kozel Executive Chairman and Chief Executive Officer

#### BIOGRAPHY

Todd is a co-founder of Gulf Keystone Petroleum. He also founded Texas Keystone Inc., an independent oil and gas exploration, development and production company, headquartered in Pittsburgh, USA, where he has served as a Director since its founding in 1988. He served as Texas Keystone's President from 1995 to 2004. Todd also co-founded Falcon Drilling Company LLC, an American independent drilling and oilfield services company, in 2001 and serves on its Board of Directors.

#### TERM OF OFFICE

Todd is a co-founder of the Company where he has served as Director and Chief Executive Officer since incorporation.

#### COMMITTEE MEMBERSHIP

Chair of Nominations and Appointments prior to formation of the Nominations Committee in February 2012.

#### EXTERNAL APPOINTMENTS

Director, Texas Keystone Inc.  
Director, Falcon Drilling Co. LLC

### 02 John B Gerstenlauer Chief Operating Officer

Prior to joining Gulf Keystone, John was Managing Director for BASF's Wintershall Nederland Group, The Hague. He has over 35 years' experience within the oil and gas sector and he began his career with Shell as a Petrophysical Engineer in 1978. He assumed increasingly senior production and drilling engineering roles within Shell until he was seconded to Canadian Occidental Yemen as Operations Manager in 1993. Here, John managed the project from start-up to full production of 210,000 bopd before leaving to join UMC.

John was appointed to the Board as Chief Operating Officer in October 2008.

Attendee of Committees by invitation.

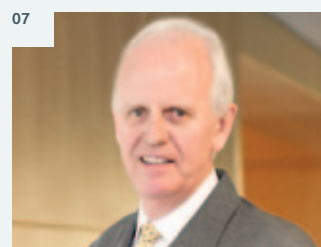
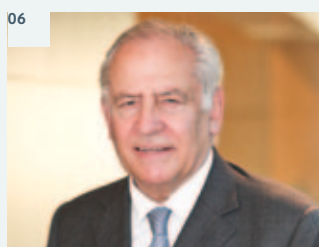
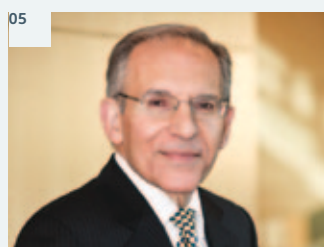
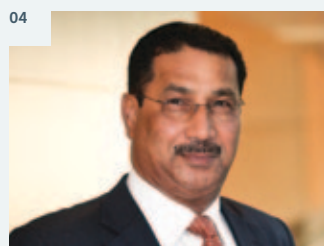
### 03 Ewen Ainsworth Finance Director

Ewen is a qualified accountant with over 20 years' experience in finance roles within the oil and gas industry. Prior to joining Gulf Keystone, he was Finance Director of London AIM-listed Europa Oil & Gas (Holdings) plc. Ewen has held increasingly senior finance positions within companies such as Conoco (U.K.) Ltd, Murco Petroleum Ltd, Texaco Ltd and CIECO Exploration & Production (UK) Ltd. He brings significant transaction and funding experience to the Board as well as experience of managing public company finances.

Ewen was appointed as Finance Director in January 2008.

Attendee of Audit Committee and other Committees by invitation.

Director, Discovery Energy Ltd



04 **Ali Al Qabandi**  
**Business Development**  
**Director**

**BIOGRAPHY**

Alongside Todd, Ali is a co-founder of Gulf Keystone Petroleum. He has held numerous executive positions and committee chairmanships at Kuwait Oil Company ("KOC"), which he joined in 1979. Most recently, Mr Al Qabandi served as the Executive Assistant Managing Director of Planning and Finance for the KOC and a Director of the Kuwait National Petroleum Company. He has been a board member of Kuwait Gulf Oil Company and of United Oil Projects, as well as serving on several Steering Committees.

**TERM OF OFFICE**

Ali is a co-founder of the Company and was appointed to the Board in July 2007.

**COMMITTEE MEMBERSHIP**

Attendee of Committees by invitation.

**EXTERNAL APPOINTMENTS**

Director, United Oil Projects

05 **Mehdi Varzi**  
**Non-Executive Director**

Mehdi is President of Varzi Energy, an independent global energy consultancy which he set up in June 2001 following his retirement from Dresdner Kleinwort Wasserstein as Managing Director of Global Energy Research. Varzi Energy has advised a large number of leading international financial institutions on global oil and gas developments.

A graduate of the London School of Economics and Political Science, Mehdi began his career with the National Iranian Oil Company before joining the Iranian Ministry of Foreign Affairs.

Mehdi was appointed as an independent Non-Executive Director in January 2008.

Chair of the Remuneration Committee and a member of the Audit and the newly formed Nominations Committees.

Director, Varzi Energy  
Board Adviser, Una Oil

06 **Field Marshal the Lord Guthrie of Craigiebank**  
**Non-Executive Director**

Lord Guthrie served in the British Army from 1957 to 2001 and was Chief of the Defence Staff from 1997 to 2001 and the Principal Military Adviser to two Prime Ministers and three Secretaries of State for Defence. He was Colonel Commandant of the SAS from 2001 to 2010 and was Colonel Commandant of the Intelligence Corps for 10 years. He is currently Colonel of The Life Guards, Gold Stick to The Queen.

Lord Guthrie was Director of NM Rothschild & Sons Limited from 2001 to 2011.

Field Marshal the Lord Guthrie was appointed as an independent Non-Executive Director in October 2011.

Chair of the recently formed Nominations Committee and a member of the Audit and Remuneration Committees.

Director, Sciens Capital (US)  
Director, Colt Defense (US)  
Director, Petropavlovsk plc.  
Director, Rivada Networks  
Director, Region Holdings

07 **Mark Hanson**  
**Non-Executive Director**

Mark is a qualified barrister and solicitor and was CEO of Global Banking Corporation in Bahrain from 2006 to 2008. He has served as Chief Executive of Bain Securities Limited, MD of Peregrine Capital Limited, Deputy CEO at the Hong Kong Stock Exchange and COO of Crosby Financial Holdings.

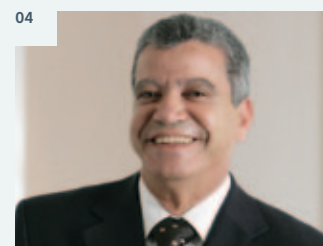
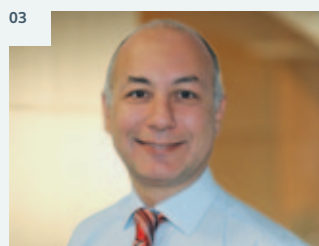
His previous experience includes the listing in Hong Kong and New York of Shanghai Petrochemical Company, the first mainland upstream Chinese oil company to list outside of the People's Republic of China.

Mark was appointed as an independent Non-Executive Director in November 2011.

Chair of the Audit Committee since February 2012 and a member of the Nominations and Remuneration Committees.

Director, Cynosure Associates Ltd

## Senior management



01 **Chris Garrett**  
Vice President Operations  
and Managing Director, UK

BIOGRAPHY

Chris is a certified Geologist with the American Association of Petroleum Geologists and a Fellow of the Geological Society. In his 35 years in the petroleum industry, he has spent 12 years overseas working in the USA and the Middle East. He brings oil field experience to Gulf Keystone, gained initially with Core Laboratories and Western Geophysical and latterly with Baker Hughes and Randall & Dewey where he assumed a number of roles ranging from international exploration and operations management through to property and prospect evaluation.

02 **Tony Peart**  
Legal and Commercial  
Director

Tony has over 32 years' legal, commercial and management experience in the oil and gas industry. From 2006 to 2008 he was Legal and Commercial Director of African Arabian Petroleum Limited and from 2000 to 2005 he was Senior Vice President, General Counsel and Corporate Secretary of Petrokazakhstan Inc. which was acquired by the Chinese National Petroleum Corporation.

He was previously Managing Director of Bula Resources plc and MMS Petroleum plc. He is an Attorney and holds a Master's degree in General Management from the Vlerick Leuven Gent Management School.

03 **Umur Eminkahyagil**  
Country Manager  
Kurdistan Region of Iraq

Umur received his BSc in Petroleum and Natural Gas Engineering from Middle East Technical University, Ankara, Turkey, with High Honors, in 1991. He spent the first 11 years of his career holding various Reservoir Engineering positions with Shell, mainly in Turkey and Thailand. He joined the Expro Group in 2002 and held progressively more challenging roles within the Group, spanning Malaysia, South East Asia and finally Angola in West Africa, where he worked as General Manager. In 2007, he became Vice President for MB Petroleum Services, responsible for international business, a position he held for a number of years before joining Gulf Keystone.

04 **Mohamed Messaoudi**  
Country Manager  
Algeria

Mohamed is a petroleum geologist with over 30 years' experience in the oil and gas industry in Algeria. He joined Sonatrach, the Algerian National Oil Enterprise, in 1979, becoming Chief Geologist for the Hassi Messaoud Basin in 1996 and then the Regional Exploration Manager of the North Algeria Area/ Onshore and Offshore Basins. Prior to his retirement from Sonatrach, he held the position of Regional Exploration Manager for the South East Algeria Region, Algeria's most important hydrocarbon area containing the Hassi Messaoud, Berkine, Illizi and Oued Mya basins.

ROLES AND RESPONSIBILITIES

Chris joined the Company in 2004 as Managing Director of the UK entity and Operations Manager for Algeria. He currently leads all exploration and drilling operations in Kurdistan, Iraq.

Tony joined the Company in 2008 and became the Company's Legal and Commercial Director in 2009.

Umur joined the Company in March 2012 as Development and Production Manager and was subsequently appointed the Company's Country Manager for Kurdistan, Iraq as of 1 September 2012.

Mohamed joined the Company in 2007 as the Country Manager of Algeria.

## Directors' report

The Directors are pleased to present their report on the affairs of the Group, together with the consolidated financial statements of the Company and auditor's report, for the year ended 31 December 2012. A review of the business is set out in the preceding sections of this Annual Report, including the Executive Chairman and Chief Executive Officer's Statement, Operational Review and Financial Review, which are incorporated into this report by reference. The Corporate Governance statement also forms part of this report.

### Company history and principal activities

Gulf Keystone is an independent oil and gas exploration and production company with operations in the Kurdistan Region of Iraq. The Company was incorporated in Bermuda in 2001 and listed on AIM, a market operated by the London Stock Exchange in 2004 (stock quote GKP).

In addition to Gulf Keystone's registered office in Bermuda, the Gulf Keystone Group has further offices in Erbil, Kurdistan Region of Iraq, Algiers, Algeria and London, UK. The Group operates through a number of subsidiaries which are detailed in note 12 to the consolidated financial statements and include Gulf Keystone Petroleum International ("GKPI"), a wholly-owned subsidiary of the Company, which holds the Production Sharing Contracts ("PSCs") for four exploration blocks in the Kurdistan Region of Iraq.

### Results and dividends

The Group's financial results for the year ended 31 December 2012 are set out in the consolidated financial statements. The Group made a net loss after taxation for the year of \$81.8 million (2011: \$62.4 million loss) and the Directors do not recommend a dividend for the year (2011: \$nil). Future payments of dividends are expected to depend on the earnings and financial condition of the Company and such factors as the Board of Directors consider are appropriate.

### Capital structure

Details of the authorised and issued share capital, together with movements in the Company's issued share capital during the year, are shown in note 19 to the consolidated financial statements. The business is financed by means of debt (see note 16 to the consolidated financial statements), internally generated funds and external share capital.

### Directors' interests in shares

The Directors who held office at 31 December 2012 had the following interests in the common shares of the Company, including family interests:

There are no specific restrictions on the size of a holding nor on the transfer of common shares, both of which are governed by the general provisions of the Company's Bye-laws and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's common shares that may result in restrictions on the transfer of securities or on voting rights. No person has any special rights of control over the Company's share capital and all issued common shares are fully paid.

Details of the employee share schemes are set out in note 23 to the consolidated financial statements and details of the Directors' awards are included in the Report of the Remuneration Committee.

### Voting rights and Bye-law amendments

The Company's Bye-laws may only be revoked or amended by the shareholders of the Company by resolution passed by a majority of not less than three-fourths of such shareholders as vote in person, or where proxies are allowed, by proxy at a general meeting. Resolutions put to the vote of any general meeting are decided on a show of hands unless a poll is demanded in accordance with the Company's Bye-laws.

### Directors

With regard to the appointment and replacement of Directors, the Company is governed by its Bye-laws, the Companies Act (Bermuda) and related legislation. Every year, one-third of all the Directors retire by rotation and stand for re-election.

The following Directors have held office during the year:  
TF Kozel – Executive Chairman and Chief Executive Officer  
AA Al Qabandi – Business Development Director  
JB Gerstenlauer – Chief Operating Officer  
KE Ainsworth – Finance Director  
M Varzi – Non-Executive Director<sup>(1)</sup>  
P Truscott – Non-Executive Director<sup>(1)</sup>  
(retired by rotation 19 July 2012)  
MAC Hanson – Non-Executive Director<sup>(1)</sup>  
CRL Guthrie – Non-Executive Director<sup>(1)</sup>

(1) Member of the Audit, Remuneration and Nominations Committees.

Name of Director	Number of common shares <sup>(1)</sup>						
	At 1 January 2012	Shares issued in 2012	Shares sold/transferred in 2012	At 31 December 2012	Shares issued post year end	Shares sold/transferred post year end	At date of report
TF Kozel	18,126,670	4,614,166	(17,433,333)	<b>5,307,503</b>	5,947,501 <sup>(2)(3)</sup>	(11,000,000)	255,004
AA Al Qabandi	10,116,666	333,334	–	<b>10,450,000</b>	–	–	10,450,000
JB Gerstenlauer	231,777	922,834	–	<b>1,154,611</b>	589,500 <sup>(3)</sup>	–	1,744,111
KE Ainsworth	1,237,297	922,834	–	<b>2,160,131</b>	589,500 <sup>(3)</sup>	(11,000)	2,738,631
M Varzi	468,888	366,667	(257,347)	<b>578,208</b>	333,334 <sup>(3)</sup>	(268,219)	643,323
MAC Hanson	–	–	–	–	–	–	–
CRL Guthrie	–	–	–	–	–	–	–

(1) Includes common shares held directly, by family members and through the Gulf Keystone EBT which are held subject to the discretion of the EBT Trustee.

(2) Includes 3 million common shares issued as a result of share options exercise post year end.

(3) Includes common shares issued pursuant to the vesting of the remaining awards granted under the 2010 Company's Executive Bonus Scheme and the vesting of the second third of the awards granted under the 2011 Company's Executive Bonus Scheme.

## Directors' report continued

Subsequent to year end, the Gulf Keystone EBT subscribed for 6,459,169 new common shares so as to be able to fulfil the vested shares awarded under the Executive Bonus Scheme (see the Report of the Remuneration Committee and note 23 to the consolidated financial statements) and released 8,277,505 common shares. At the date of this report, the EBT held 11,078,220 common shares of the Company. A further 10,000,000 common shares are held by the Exit Event Trustee in relation to the Exit Event Award (see note 23 to the consolidated financial statements).

Directors' interests in share options of the Company and the Company's bonus scheme grants, including family interests, as at 31 December 2012 are disclosed under the Report of the Remuneration Committee.

### Significant shareholdings

The Company has been notified of the following significant shareholdings as at 31 May 2013:

	Number of common shares	Percentage of issued share capital
TD Direct Investing	59,123,475	6.66%
Barclays Wealth	54,036,195	6.09%
Capital Research Global Investors	49,596,975	5.59%
M&G Investment Mgt	45,350,000	5.11%
Hargreaves Lansdown Asset Management	37,838,687	4.26%
Halifax Share Dealing	31,964,809	3.60%
Selftrade Investments	30,631,160	3.45%

### Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Executive Chairman and Chief Executive Officer's Statement and Operational Review. The financial position of the Group at the year end and its cash flows and liquidity position are included in the Financial Review. In addition, note 25 to the consolidated financial statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives and details of its financial instruments and hedging activities. Note 25 also describes exposures to credit risk and liquidity risk.

The Group closely monitors and manages its capital position and liquidity risk regularly throughout the year to ensure that it has sufficient funds to meet forecast cash requirements and satisfy the planned capital programme. Following the Convertible Bonds issue during 2012, the Group is in a strong financial position and at 1 June 2013 had approximately \$154 million of cash, cash equivalents and liquid investments. Further, the Group expects to receive production revenue streams from its operations in the Kurdistan Region of Iraq once the Shaikan Production Facilities are commissioned and production resumed. Management has also considered the possible impact that an unfavourable outcome of the Excalibur litigation would have on the going concern assessment. Management considered various outcomes and, in all cases, concluded that an unfavourable outcome of the litigation would not create a material uncertainty around the Group's going concern status. Consequently, the Directors believe that the Group

is well placed to satisfy its obligations and finance its exploration and evaluation programme for the foreseeable future, being at least the next 12 months.

Based on the forecasts and projections prepared at the time of preparation of this Annual Report and after making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing this Annual Report and Accounts.

### Significant agreements – change of control

There are a number of agreements that take effect, alter or terminate upon a change of control of the Company including employee share plans and the Convertible Bonds. None of these are considered to be significant in terms of their likely impact on the business of the Group as a whole. Furthermore, the Directors are not aware of any agreements between the Company and its Directors or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid.

### Auditor

Each of the persons who is a Director at the date of approval of this Annual Report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

### Annual General Meeting 2013

The resolutions to be proposed at the Annual General Meeting ("AGM") to be held on 25 July 2013 in Bermuda will be set out in the Notice of the AGM. The Company will also hold an Investor Day on 4 July 2013 in London.

By order of the Board

**TF Kozel**

**Executive Chairman and Chief Executive Officer**

19 June 2013

## Corporate governance statement

### Gulf Keystone's commitment to corporate governance

The Board is committed to high standards of governance and aims to create a culture which demands the same commitment and performance from all of our employees and contractors and in all our business activities. As the Company makes the transition from an exploration company to that of a development company, we continue to build organisational capacity and improve our management processes and procedures. We seek to strike a balance between entrepreneurial risk-taking and prudent risk management focussing on effective risk management and maintaining high standards of corporate governance without compromising Gulf Keystone's unique culture. Although Gulf Keystone is not required to comply with the UK Corporate Governance Code (the "Code"), it is the policy of the Board to manage the Company's affairs in accordance with the underlying principles in so far as is appropriate given the circumstances of the Group. While the Board supports the values of the Code, it does not believe that good governance can be defined merely in terms of compliance with a set of rules. Set out below is a statement of how the Company has applied the principles of the Code for the year ended 31 December 2012.

### The Gulf Keystone Board

Gulf Keystone's business is international in scope and carries political, commercial and technical risks. Accordingly, particular attention is paid to the composition and balance of the Board to ensure that it has wide experience of the sector and regulatory environments in which the Group operates and appropriate financial and risk management skills. In each Board appointment, the Board considers that objectivity and integrity are pre-requisites for appointment, as well as the skills, experience, ability and diversity that will assist the Board in its key functions and decision-making.

The Board of Directors currently comprises the Executive Chairman and Chief Executive Officer, three further Executive Directors and three Non-Executive Directors. The Company's Executive and Non-Executive Directors come from a variety of backgrounds and bring different ideas and perspectives to the table, as well as ensure that the Company's Directors have the right experience to meet business needs. The Company places high importance on having an appropriate Board composition with the three Independent Non-Executive Directors ensuring that the strategies proposed by the Executive Directors are fully considered and appropriately challenged.

The Company acknowledges that the offices of Chairman and Chief Executive Officer are currently held by one individual. As Chairman of the Company, Todd Kozel has been leading the Board and ensuring it is effective in all aspects of its role; while as Chief Executive Officer, he is best placed to develop and implement the business strategy and enable the Company to access the opportunities that the Kurdistan Region of Iraq offers. This has been mitigated by the fact that oversight over executive decisions is exercised by the Independent Non-Executive Directors and, in particular, the Company's Vice Chairman, Mehdi Varzi, who is the Company's most senior Independent Director. In May 2013, however, the Board resolved that, as part of the previously announced proposed move from AIM to the Official List, and in keeping with the best practice of the Official List, the roles of Chairman and Chief Executive Officer will be split. Gulf Keystone has engaged Odgers Berndtson, one of the UK's pre-eminent

executive search firms, to assist in the search process for a Non-Executive Chairman and at least one other Independent Non-Executive Director, both to be appointed as soon as practicable. The search process is being led by the Non-Executive Director Field Marshal the Lord Guthrie of Craigiebank, Chair of the Nominations Committee.

### Independence of Directors

The independence of each of the Non-Executive Directors is considered upon appointment, annually and at any other time a Director's circumstances change in a way that warrants reconsideration. The Board considers whether the Director is independent of management and any business or other relationship that could materially interfere with the exercise of objective and independent judgement by the Director or the Director's ability to act in the best interests of the shareholders. In particular, the Board has considered each Non-Executive Director's interest in share compensation schemes, including the Company Share Options Plan and Executive Bonus Schemes, and any positions which the Director holds, or held, in companies with which Gulf Keystone has commercial relationships. The Board has concluded that, in all cases, compensation arrangements are not material to any Non-Executive Director and that any relationship between the Company and companies in which the Director holds, or held, positions does not interfere with that Director's ability to exercise independent and objective judgement.

### The role of the Board

The Board has a formal schedule of matters specifically reserved to it for decision. The Board is responsible for the overall Group strategy, the appointment and removal of any Director, the approval of the Group's annual budget, acquisition and divestment policy, approval of major capital expenditures, the overall capital structure of the Group and consideration of significant financing and operational matters, and the approval of management incentive schemes. In addition, the Board is responsible for ensuring that the major business risks are actively monitored and managed and is responsible to shareholders for the proper management of the Group. In 2012, the Board has continued to focus its efforts on strategic objectives that will create shareholder value and ensuring that these are properly pursued.

### Re-election of Directors

The Company's Bye-laws provide for each Director to be re-elected by shareholders at least once every three years. The Board believes that continuity is essential for a business like Gulf Keystone and that allowing each Director to serve a three-year term prior to standing for re-election facilitates the retention of experienced and appropriately skilled individuals.

### Performance of the Board and its Committees

The Board and its Committees are satisfied that they are operating effectively and that each Director has performed well in respect of his individual role on the Board. The Board believes that the performance of all the Directors continues to be effective and that they each demonstrate commitment to the role. The Board is satisfied that the individuals currently fulfilling key senior management positions in the organisation have the requisite depth and breadth of skills, knowledge and experience.

## Corporate governance statement continued

### How the Board operates

Board meetings are held on a regular basis, outside of the UK, and effectively no decision of any consequence is made other than by the Directors. All Directors participate in all key areas of decision-making. During 2012, a total of 11 Board meetings were held and three meetings have been held to date in 2013. All of the meetings were held outside of the UK. The agenda for each Board meeting is set by the Chairman in consultation with other members of the Executive Management. To enable the Board to discharge its duties, all the Directors have full and timely access to all relevant information.

There is no agreed formal procedure for the Directors to take independent professional advice at the Group's expense. However, independent professional advice is made available where considered appropriate. The Company has directors' and officers' liability insurance in place.

### Delegated authorities

During 2012, the Board had three established Committees, the Remuneration Committee, the Audit Committee and the Nominations Committee each of which deals with specific aspects of the Group's affairs and has written terms of reference. The key governance mandates of each of the Board's three main Committees are shown below.

#### Board of Directors

- > Determine the overall strategy of the Group and oversee its implementation
- > Agree risk appetite and oversee management of risk
- > Monitor business and management performance
- > Manage the relationship with shareholders
- > Oversee capital structure and funding requirements



#### Audit and Risk Committee

- > Review the integrity of the Group's financial reporting and significant financial accounting estimates and judgements
- > Monitor the effectiveness of the Groups risk management framework and internal controls
- > Advise the Board on the appointment of the external auditor and on the remuneration for both audit and non-audit work
- > Discuss the nature and scope of the audit with the external auditor
- > Assess the performance, independence and objectivity of the external auditor and any supply of non-audit services
- > Consider any requirements for internal audit. Determine internal audit scope and effectiveness and review management's response to the findings

#### Remuneration Committee

- > Make recommendations to the Board on the Company's framework of executive remuneration and its cost
- > Review the ongoing appropriateness and relevance of remuneration policy
- > Recommend to the Board for approval the quantum of the Group's annual variable compensation and the annual compensation packages for individual Executive Directors and senior management
- > Engage and liaise with external advisers, as necessary, on the appropriateness of the recommended variable and fixed compensation packages
- > Maintain a dialogue with shareholders on remuneration

#### Nominations Committee

- > Review the structure, size and composition required of the Board and the balance of skills, experience, independence and knowledge
- > Oversee executive succession planning taking into account challenges and opportunities facing the Group
- > Identify and nominate for the approval of the Board candidates to fill Board vacancies as and when they arise
- > Make recommendations to the Board concerning the continuation in office of any Director, including suspension and termination of service
- > Appoint external search consultants to assist with appointments as required
- > Determine skills and capabilities required for new appointments

Set out below are reports from the Audit Committee, the Remuneration Committee and the Nominations Committee.

### Audit Committee Report

The Audit Committee currently comprises the three Non-Executive Directors, all of whom are considered to be independent. The members of the Audit Committee during the year were as follows:

- MAC Hanson (Chairman)
- M Varzi
- CRL Guthrie
- P Truscott (retired by rotation 19 July 2012)

The Audit Committee met three times during 2012 and has conducted one meeting to date in 2013. At the request of the Committee, the Company's Finance Director and Legal and Commercial Director as well as senior members of the finance team attended these meetings. Three of the meetings were also attended by the external auditor and one meeting was attended by the internal auditor.

### Matters considered during the period

#### Internal audit

The Audit Committee recognise that a robust and scalable control framework is key to supporting the Company's business needs. With the Company delivering significant organisational growth, the Committee re-evaluated Gulf Keystone's requirements for an internal audit function and commissioned PricewaterhouseCoopers, an independent audit firm, to conduct regular reviews of the Group's controls and processes on a continuing basis.

The Committee approved the programme for 2012 internal audit work aimed at addressing both financial and overall risk management objectives identified within the Group. Three internal audit reviews were undertaken during the year, covering a range of financial and business processes in the Group's Corporate, UK and Kurdistan business segments.

Detailed results from these reviews were reported to management and to the Audit Committee during the year. Recommendations made as a result of the work of Internal Audit are tracked for timely implementation and reported to the Audit Committee periodically. No significant weaknesses were identified as a result of the risk management and internal control reviews undertaken by Internal Audit during 2012. The Committee is satisfied with the speed and diligence with which these findings are resolved.

Internal audits will continue into 2013 with the areas to be audited agreed between the Audit Committee, management and internal auditors using a risk-based approach.

### Financial statements and formal announcements

The Audit Committee meetings held during 2012 were primarily focussed on key judgement items for financial reporting at both 30 June and 31 December 2012, planning of the next year's audit and the adequacy of the Company's internal control environment. The Committee continued to monitor the integrity of the financial statements of the Company and review any significant financial reporting judgements contained in them.

The Committee met with the external auditor who reported its findings in respect of the 2011 year end accounts at the first meeting of 2012, presented its audit plan for the 2012 financial statements at the final meeting and summarised the results of its 2012 audit at the first meeting in 2013. During these meetings the Committee considered the key audit risks identified as being significant to the 2012 accounts and the most appropriate treatment and disclosure of any new or judgemental matters identified during the audit as well as any recommendations or observations made by the external auditor.

### External auditor

The Audit Committee is responsible for the development, implementation and monitoring of the Group's policy on external audit including ensuring that the auditor remains objective and independent. To fulfil its responsibility regarding independence, the Audit Committee considered:

- the external auditor's plan for the current year, noting the role of the audit partner, who signs the audit report and who, in accordance with professional rules, has not held office for more than five years, and any changes in the key audit staff;
- the overall extent of non-audit services provided by the external auditor, in addition to its case-by-case approval of the provision of non-audit services by the external auditor;
- the external auditor's written confirmation of independence to the Audit Committee; and
- the past service of the auditor who was first appointed in 2006.

The Committee has considered the likelihood of a withdrawal of the auditor from the market and noted that there are no contractual obligations to restrict the choice of external auditor.

To assess the effectiveness of the external auditor, the Audit Committee reviewed:

- the arrangements for ensuring the external auditor's independence and objectivity;
- the external auditor's fulfilment of the agreed audit plan and any variations from the plan; and
- the robustness and perceptiveness of the auditor in its handling of the key accounting and audit judgements.

As a safeguard to help to avoid the objectivity and independence of the external auditor becoming compromised, the Committee has a formal policy governing the supply of non-audit services by the external auditor. The Company engages external advisers to provide non-audit services based on the skills and experience required for the work, and cost. The Company may engage the external auditor to provide a limited range of non-audit services where this is the most effective and efficient way of procuring such services as long as the Company is satisfied that the auditor's objectivity and independence will not be compromised as a result. A breakdown of the fees paid to the external auditor in respect of audit and non-audit work is included in note 2 to the consolidated financial statements. There were no matters of concern by the Committee regarding the independence and objectivity of the Company's external auditor during 2012.

Following the above, the Audit Committee has recommended to the Board that Deloitte LLP be reappointed.

## Corporate governance statement continued

### Committee evaluation

During the year, a review of the Audit Committee's effectiveness was completed. This was conducted by reference to the Committee's responsibilities as stated in the Audit Committee's Terms of Reference. The assessment concluded that the Audit Committee was effective in carrying out its duties.

### Nominations Committee Report

The Nominations Committee currently comprises the three Non-Executive Directors, all of whom are considered to be independent. The members of the Nominations Committee during the year were as follows:

- CRL Guthrie (Chairman)
- MAC Hanson
- M Varzi
- P Truscott (retired by rotation 19 July 2012)

The Nominations Committee reviews the structure, size and composition required of the Board and makes recommendations with regard to any changes to the Board, if necessary, and succession planning. The Committee identifies and nominates candidates to fill Board vacancies as and when they arise based on the balance of skills, knowledge and experience on the Board. The Committee also reviews the results of the Board performance evaluation process.

The Committee is also responsible for making recommendations to the Board concerning the continuation in office of any Director, including suspension and termination of service, as well as the appointment of any Director, but not the appointment of the Chairman and Chief Executive, which would be considered at a meeting of the full Board.

In 2013, following the Company's announcement on the split of the Chairman and Chief Executive Officer roles, the Nominations Committee will significantly increase its activity as it is in charge of the search process for an Independent Non-Executive Chairman and at least one other Non-Executive Director, which is being led by Field Marshal the Lord Guthrie of Craigiebank, the Chair of the Nominations Committee. Gulf Keystone intends to make the appointments as soon as practicable and has engaged Odgers Berndtson, one of the UK's pre-eminent executive search firms, to assist in the search process.

### Remuneration Committee Summary Report

The Remuneration Committee currently comprises the three Non-Executive Directors, all of whom are considered by the Board to be independent. The members of the Remuneration Committee during the year were as follows:

- M Varzi (Chairman)
- CRL Guthrie
- MAC Hanson
- P Truscott (retired by rotation 19 July 2012)

The Committee held one meeting during 2012 and one meeting to date in 2013. Certain of the Executive Directors and the Legal and Commercial Director attended meetings of the Committee on invitation of the Committee. None of the Directors participated in any meetings or discussions relating to their own remuneration.

Details of the Company's policies and objectives on remuneration, service contracts and compensation payments, as well as the details of Directors' remuneration, are given in the full Report of the Remuneration Committee.

### Internal control

The Board acknowledges its responsibility for establishing and monitoring the Group's systems of internal control. Although no system of internal control can provide absolute assurance against material misstatement or loss, the Group's systems are designed to provide the Directors with reasonable assurance that problems are identified on a timely basis and dealt with appropriately. The Board regularly reviews the effectiveness of the systems of internal control and considers the major business risks and the control environment. The Board is accordingly satisfied that effective controls are in place and that risks have been mitigated to an acceptable level.

The Company is subject to a variety of risks which derive from the nature of the oil and gas exploration and production business and relate to the countries in which it conducts its activities. The key procedures that have been established and which are designed to provide effective control are as follows:

- regular meetings between the executive management and the Board to discuss all issues affecting the Group;
- a clearly defined framework for investment appraisal, with Board approval required as appropriate; and
- an internal audit function.

The Board also believes that the ability to recognise the value of working as a partnership with host governments is a critical ingredient in managing risk successfully.

The Directors have derived assurance over the control environment from the following internal and external controls during 2012:

- implementation of policies and procedures for key business activities;
- an appropriate organisational structure;
- control over non-operated activities through delegated representatives;
- specific delegations of authority for all financial and other transactions;
- segregation of duties where appropriate and cost effective;
- business and financial reporting, including KPIs;
- reports from the Group Audit Committee;
- reports and findings from the Group's internal auditors on the areas identified and recommended for review by the Audit Committee; and
- reports from the Group's external auditor on matters identified during its audit.

The above procedures and controls have been in place in respect of the Group for the 2012 accounting period and up to the date of approval of the Annual Report and Accounts. There were no significant weaknesses or material failings in the risk management and internal control system identified in any of the above reviews and reports.

**Relations with shareholders**

Regular communications with shareholders are given high priority by the Board. The Chairman and Chief Executive Officer, Chief Operating Officer, Finance Director and Head of Investor Relations are the Company's principal spokespeople with investors, fund managers, the press and other interested parties.

The Company is committed to providing a regular quarterly update to major shareholders. Each of the Non-Executive Directors are available to attend meetings with major shareholders (without the Executive Directors present), if requested by such major shareholders.

Gulf Keystone seeks to respond to all correspondence from shareholders as far as is applicable. The Company's website contains a wide range of information on the Company's operations and corporate developments, including a dedicated investor section. The Executive Directors of the Board regularly present at public conferences and meetings. Throughout 2012, the Company has given a number of investor presentations, all of which are available to the public on the Company's website. Since the Annual General Meeting in 2013 is to be held in Bermuda, the Board has decided to hold a dedicated shareholder event in London on 4 July 2013. The Investor Day will be hosted by the Board and management of Gulf Keystone who will present to shareholders on all aspects of the Company's business and corporate strategy, and then take questions.

In accordance with its Bye-laws, this year the Company has also implemented the provisions of the Bermuda Companies Act 1981, in accordance with the AIM rules, regarding electronic communications with its shareholders in order to give shareholders more choice and flexibility in how they receive information from the Company. The number of communications sent by post has been reduced, resulting not only in cost savings for the Company but also speeding up the provision of information to shareholders.

A list of the Company's major shareholders can be found in the Directors' Report.

**Annual General Meeting**

The Board uses the AGM to communicate with private and institutional investors and welcomes their participation. It is policy for all Directors to attend the AGM if at all possible.

Details of resolutions to be proposed at the AGM on 25 July 2013 in Bermuda can be found in the Notice of Annual General Meeting together with further explanation of the resolutions. The Company will also hold a presentation for shareholders as part of the Investor Day on 4 July 2013 in London, further details of which are set out at <http://www.investor-day-gulfkeystone.com/>.

## Report of the Remuneration Committee

### Statement from the Chairman of the Remuneration Committee

Dear Shareholder,

On behalf on the Board, I am pleased to present the Directors' report on remuneration for 2012.

2012 has been a year in which Gulf Keystone achieved a number of important milestones. We submitted a declaration of commercial discovery to the Shaikan Block Management Committee, saw another remarkable upgrade in independently audited gross oil-in-place numbers for the Shaikan block, made two new discoveries on Sheikh Adi and Akri-Bijeeel blocks and started the construction of two Shaikan production facilities, which will allow the Company to ramp up its production to 40,000 bopd and produce export quality oil. Shortly after the year end, the Company submitted the Shaikan Field Development Plan and Sheikh Adi Appraisal Programme for review and approval by the relevant authorities.

In addition to having made significant progress in our ambitious exploration and appraisal programme, we have set a challenging forward-looking strategy aiming to prove the full potential of our assets and delivering maximum value to our shareholders. The successful Convertible Bonds issue in October 2012 raised \$275 million gross proceeds, transforming the Company's financial position and demonstrating investors' confidence in our ability to deliver results. Gulf Keystone has delivered a healthy return to its shareholders with the share price showing a general upwards trend since the Company made a discovery in the Kurdistan Region of Iraq in 2009. Further 2012 performance highlights are set out within the other sections of this report.

Even though some of the events listed above did not take place until 2013, the majority of planning, preparation and work had been done in 2012. Therefore, the Remuneration Committee took all of the above into consideration when determining the 2012 bonus awards.

The Company's achievements would not be possible without the expertise, executive leadership and commitment of our Board and employees, who always perform to the best of their abilities despite the many challenges they face. We have designed our remuneration policy in a way that will allow us to retain and motivate our high performing team and attract new talent as required. With that in mind, the Remuneration Committee continues to focus on aligning our remuneration policy with the shareholders' interests so that it closely reflects the Company's business strategy, whilst remaining mindful of the external focus on executive remuneration.

The following sections explain our remuneration policy for the Board and senior management and sets out individual payments made to Executive Directors in relation to the year under review as well as the reasons for this Committee's decisions.

**M Varzi**

Remuneration Committee Chairman

### Current Remuneration Committee Members

#### Chairman

M Varzi

#### Members

CRL Guthrie

MAC Hanson

This report has been prepared by the Remuneration Committee and has been approved by the Board for presentation to shareholders.

### 2012 Remuneration: Key Issues and Considerations

#### Remuneration mix

Given the nature of the Company's achievements in 2012 and its ongoing transition from an exploration company to development company, the Committee concluded that for the year ended 31 December 2012 the most appropriate form of variable remuneration was a deferred cash bonus. No new bonus shares were granted in relation to 2012 performance. The Remuneration Committee expects to return to this aspect of remuneration in 2013 and reassess the appropriateness of the remuneration mix on an annual basis.

#### Introduction of Executive Deferred Cash Bonus Scheme

In 2012, the Remuneration Committee introduced a deferred cash bonus into the remuneration mix. One-third of this bonus award was paid out to the participants of the scheme immediately, with the second and third tranches payable on the second and third anniversaries of the award respectively.

#### Share-based awards

In 2012, the Board received 62% of its total remuneration in the form of shares through the Executive Bonus Shares Schemes. The share bonus awards received in 2012 were granted in 2011 and 2010.

#### Value of the Executive Directors' remuneration

The fixed element of the Executive Directors' remuneration remained unchanged from 2011. The Remuneration Committee recommended notably more moderate variable awards in 2012 which were 44% lower than in 2011.

### Remuneration Committee

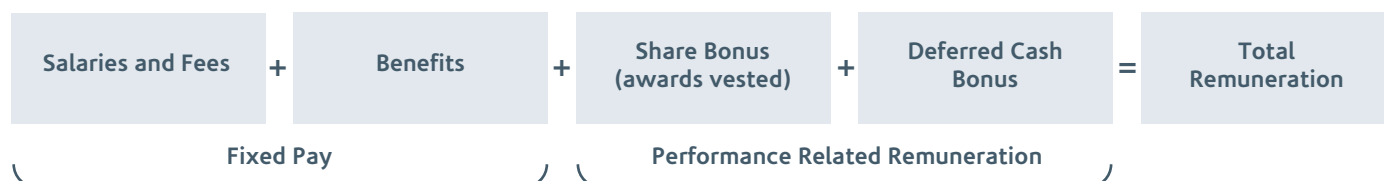
In 2012, the Remuneration Committee comprised Mehdi Varzi (Chairman), Lord Guthrie, Mark Hanson and Lord Truscott (retired by rotation on 19 July 2012), who are independent Non-Executive Directors of the Company. The Committee provides recommendations to the Board regarding the individual remuneration packages of each Executive Director. No Director plays a part in any discussion about his own remuneration. Non-Executive Directors' remuneration is recommended by the Chairman and Chief Executive Officer and determined by the Board as a whole.

### Remuneration policy

The Company's underlying objective is to ensure that individuals are appropriately rewarded relative to their responsibility, experience and value to the Company. This objective has been and continues to be applied as consistently and fairly as possible to all the Company's employees and executives. This approach is essential for the Company to be able to attract, retain and motivate individuals of the highest calibre who are key to delivering sustainable long-term value growth and substantial returns to shareholders.

The policy of the Committee is to reward Executive Directors in line with the current remuneration of Directors in comparable businesses within a competitive market place. The Committee regularly seeks the advice of independent remuneration consultants when making a recommendation on any awards to be granted to the Company's senior executives and employees.

In 2012, the main elements of the remuneration packages for Executive Directors and senior management were as follows:



### Cash-based awards in place

Base salaries are reviewed annually with effect from 1 January, taking into account the scale, scope, responsibility of the role, skills and experience of the individual, retention risk and base salary increases of other employees. Base salary levels for the Executive Directors in 2012 remained the same as in 2011. Non-Executive Directors' fees were increased in 2012 commensurate with the growing time commitment and responsibilities of the Non-Executive Directors' roles.

In previous years, cash bonus was determined annually and paid out as immediate cash. In 2012, for the reasons discussed below, the Remuneration Committee proposed to introduce the Executive Deferred Cash Bonus Scheme. Under this scheme one-third of the award is payable immediately with the remaining two-thirds payable on the first and second anniversaries of the award.

The Committee based their recommendation for the 2012 deferred cash bonus proposal on the following factors and events that took place in 2012 and early 2013:

- operational successes, in particular the submission of the Shaikan Field Development Plan, increased test production from the Extended Well Test facilities and the discoveries at the Sheikh Adi and Akri-Bijeel blocks;
- transition of the Company from exploration to development;
- avoidance of further dilution to the shareholders' interests through no additional Bonus Shares and LTIP awards;
- robust and professional defence against the Excalibur claims in the course of a complex trial in the English Commercial Court; and
- successful issue of the Convertible Bonds in October 2012 raising \$275 million. The dilution effect of the Convertible Bonds is much reduced in comparison to the previous share placings as the initial conversion price of \$4.39 (£2.72 at the prevailing USD:GBP spot rate at the time of pricing) is 93% higher than the placing price of £1.40 achieved for the share placing completed in September 2011.

## Report of the Remuneration Committee continued

### Share-based awards in place

- Share options granted under the Company share option plan are granted to the senior executives upon their first appointment and only vest after three years of employment with certain market-based performance criteria attached to them. The Directors have share options granted to them under the terms of the Share Option Scheme which is open to other qualifying employees. The exercise and vesting of options under the Scheme is contingent upon the satisfaction of conditions relating to the share price and length of employment. The conditions may vary from grant to grant.
- Bonus share awards are discretionary awards made in the form of the Company's common shares that vest over three years. The size of the award in any given year depends on the share price and the Company's performance in the year. In early 2013, the second tranche of 2011 awards and third tranche of 2010 awards vested. No new bonus share awards were made in respect of 2012 performance.
- Long Term Incentive Plan ("LTIP") options were first introduced in 2010 in respect of 2009 financial year and have a set of stretching market-based and operational conditions attached to them. These options vest in three equal tranches over three years assuming that the performance conditions are satisfied. A second LTIP award was made in 2011 in respect of 2010 financial year. No additional LTIP options were granted in 2012.

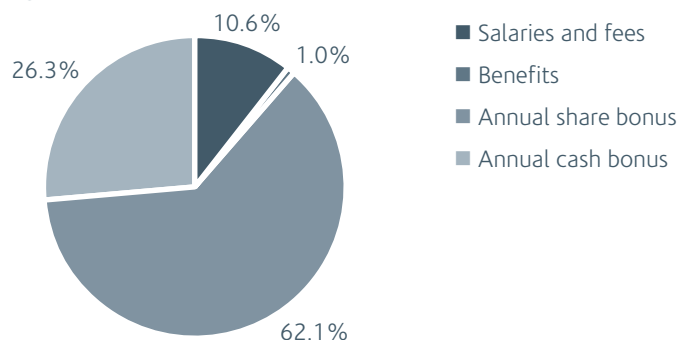
### Other remuneration

- Benefits include private medical insurance and travel. There are no Company-funded pension arrangements in Gulf Keystone.

### Remuneration mix

The Remuneration Committee reviews its policy annually and endeavours to adjust the ways it rewards the Company's executives and employees as appropriate. In 2012, the Committee recognised that the Company is making the transition from an exploration company to a development company and as a result introduced changes to the remuneration mix and value. In 2012, the Company made notably more moderate bonus awards than in 2011. We maintained the principle of fixed salaries for senior executives and continued to place emphasis on incentive-based remuneration via a combination of a deferred cash bonus payable over three years and share-based rewards that were granted in previous years and vested in early 2013. This remuneration mix aims at encouraging senior executives to focus on longer-term goals and remain with the business. The contribution of each of the remuneration components to the total remuneration value in 2012 and 2011 was as follows:

2012



We have materially reduced the quantum of the variable component of the remuneration in 2012 as compared to 2011. The total remuneration received by the Board in 2012 decreased by 40% (from \$36.7 million in 2011 to \$22.1 million in 2012) mostly due to the absence of any new bonus shares or LTIP option grants. Instead, the variable remuneration portion was delivered through a deferred cash bonus spread over three years as the Company expects to generate operational cash inflows in the near term. The Board is also mindful of the additional dilution of shareholders' interests that any further share bonus grants will cause. The Company continues to ensure that a significant part of the performance awards is deferred over several years which encourage long-term focus and retention. Consequently 88% of 2012 total remuneration came from deferred awards compared to 83% in 2011.

Over half of remuneration is still delivered in the form of share bonus awards that were granted in previous years and vested in early 2013. Deferred share bonuses align Directors' interests with those of shareholders and we continue to believe that it is critical for permanent employees to have a stakeholding in the business.

The Remuneration Committee considers that the Executive Directors' remuneration for 2012 is a fair balance that reflects strong executive performance while also serving the best interests of our shareholders.

### Directors' contracts

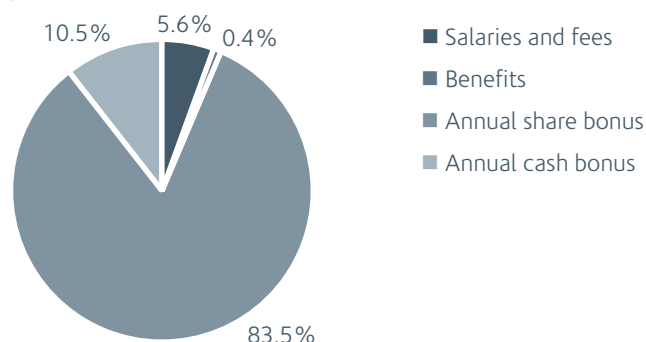
It is the Company's policy that Executive Directors should have contracts with an indefinite term providing for a maximum of one year's notice. In the event of early termination, the Directors' contracts provide for compensation up to a maximum of basic salary for the notice period.

Todd Kozel, Ali Al Qabandi, John Gerstenlauer and Ewen Ainsworth have service contracts with the Company. These can be terminated by either side on 12 months' notice for Todd Kozel, six months for John Gerstenlauer and Ewen Ainsworth and one week for Ali Al Qabandi.

### Non-Executive Directors

The fees of Non-Executive Directors are recommended by the Chairman and Chief Executive Officer and determined by the Board as a whole. Remuneration levels are set based on the review of practices in similar companies, giving consideration to the time commitment and responsibilities of the role. Non-Executive Directors are not involved in determining their own remuneration.

2011



In 2012, in consideration of increasing demands and fee levels in recent years generally, the Board resolved to increase the annual fees payable to each of the Non-Executive Directors by £20,000 (\$31,880 at the average 2012 GBP/USD FX rate) with effect from 1 January 2012. An additional increase of \$24,550 was given to Mehdi Varzi with effect from 1 July 2013 in order to bring his remuneration in line with that of the other Non-Executive Directors. The decision to increase the Non-Executive Directors' remuneration also reflects the considerable increase in Non-Executive Directors' time commitment and responsibilities that evolve with the growth of the Company.

### Directors' emoluments for 2012

Name of Director	Fees/ basic salary \$	Benefits in kind <sup>(1)</sup> \$	Share bonus <sup>(2)</sup> \$	Cash bonus <sup>(2)</sup> \$	2012 Total \$	2011 Total \$
Todd Kozel	675,000	—	8,420,775	4,527,168	<b>13,622,943</b>	22,230,811
Ali Al Qabandi	270,000	—	—	—	<b>270,000</b>	1,628,446
John Gerstenlauer	594,000	223,989	1,684,156	825,264	<b>3,327,409</b>	5,044,133
Ewen Ainsworth	285,282	4,327	1,684,156	446,760	<b>2,420,525</b>	4,603,622
Mehdi Varzi	136,430	—	952,309	—	<b>1,088,739</b>	1,574,289
Peter Truscott <sup>(4)</sup>	58,495	—	952,309	—	<b>1,010,804</b>	1,606,371
Mark Hanson	158,635	—	—	—	<b>158,635</b>	15,265
Charles Guthrie	158,671	—	—	—	<b>158,671</b>	32,082
	<b>2,336,513</b>	<b>228,316</b>	<b>13,693,705</b>	<b>5,799,192</b>	<b>22,057,726</b>	<b>36,735,019</b>

(1) Benefits in kind comprise personal travel and accommodation associated with work in a number of locations and medical insurance.

(2) The share bonus quantum is based on the market value of the common shares awarded pursuant to the 2010 and 2011 Executive Bonus Schemes on the vesting date, being 26 February 2013.

(3) The cash bonus quantum represents the value of the immediate cash bonus awards made in early 2013 and exclude the deferred portion of the bonus.

(4) Peter Truscott retired by rotation on 19 July 2012.

### Directors' share options

Details of previous share option awards for Directors who served during the year are as follows:

Name of Director	Scheme	1 January 2012	Granted	31 December 2012
Todd Kozel	Share Option Plan	3,000,000	—	<b>3,000,000</b>
Ali Al Qabandi	Share Option Plan	1,000,000	—	<b>1,000,000</b>
John Gerstenlauer	Share Option Plan	2,000,000	—	<b>2,000,000</b>
Ewen Ainsworth	Share Option Plan	1,000,000	—	<b>1,000,000</b>
Mehdi Varzi	Share Option Plan	100,000	—	<b>100,000</b>
Charles Guthrie	Share Option Plan	250,000	—	<b>250,000</b>
Mark Hanson	Share Option Plan	—	250,000	<b>250,000</b>
Todd Kozel	2009 LTIP Options	9,766,473	—	<b>9,766,473</b>
John Gerstenlauer	2009 LTIP Options	1,953,295	—	<b>1,953,295</b>
Ewen Ainsworth	2009 LTIP Options	1,953,295	—	<b>1,953,295</b>
Todd Kozel	2010 LTIP Options	4,195,000	—	<b>4,195,000</b>
John Gerstenlauer	2010 LTIP Options	839,000	—	<b>839,000</b>
Ewen Ainsworth	2010 LTIP Options	839,000	—	<b>839,000</b>

At 31 December 2012, two-thirds of the 2009 LTIP Options have vested and are exercisable (Todd Kozel: 6,510,982; John Gerstenlauer: 1,302,197; Ewen Ainsworth: 1,302,197). There have been no variations to the terms and conditions or performance criteria for the schemes during the financial year. During the year, the Company Share Option Plan options for Todd Kozel (3,000,000 options) and Ali Al Qabandi (1,000,000 options) vested. The Company Share Option Plan options for John Gerstenlauer, Ewen Ainsworth and Mehdi Varzi (2,000,000; 1,000,000 and 100,000 options respectively) vested in 2011.

On 21 March 2012, an option to acquire 250,000 common shares in the capital of the Company at a price of 250 pence per common share was granted under Gulf Keystone's Share Option Plan to Mark Hanson, who joined the Company as a Non-Executive Director in November 2011. Subject to certain performance criteria having been met prior to exercise, these options will vest on 25 November 2015 and can be exercised at any time until expiry on 25 November 2021.

## Report of the Remuneration Committee continued

Subsequent to the year end, the Company was notified of the following exercise of options to acquire common shares in the Company granted to or held by the Directors pursuant to the Share Option Plan. Details of the options exercised post year end are as follows:

Name of Director	Scheme	Number of options	Exercise price	Market price at exercise date	Gains on exercise 2012	Gains on exercise 2011
Todd Kozel	Share Option Plan	3,000,000	30p	187.75p	<b>\$7,180,149</b>	—

### LTIP options

LTIP options are structured option grants under the existing Share Option Plan with stretching performance criteria known as the Long Term Incentive Performance conditions.

There were no LTIP awards granted in 2012.

One-third of the 2009 LTIP awards vested in 2010 when the share price reached 150 pence.

During 2012, the share price reached 200 pence and as a result the second third of the 2009 LTIP options vested.

Details of the LTIP awards which vested in the year are as follows:

	Scheme	No. of awards vested	Exercise price	Market price at award date	Market price at vesting date
Todd Kozel	2009 LTIP Options	3,255,491	75.00p	71.25p	201p
John Gerstenlauer	2009 LTIP Options	651,098	75.00p	71.25p	201p
Ewen Ainsworth	2009 LTIP Options	651,098	75.00p	71.25p	201p

Subsequent to the year end and at the date of this report, 50% of the remaining third of the 2009 LTIP options have vested as the following operational conditions have been met:

- 30% of one-third tranche of LTIP Share Options vested on successful resource addition through a combination of appraisal and production testing resulting in a significant movement of P10 hydrocarbons in place resources to P90 hydrocarbon in place resources; and
- 20% of one-third tranche of LTIP Share Options vested as a significant new discovery was made.

These performance conditions were satisfied in 2011 and 2012 respectively. However, the vesting was deferred, as only one-third of the total award can vest in any one financial year.

Details of the vested LTIP awards to date in 2013 are as follows:

	Scheme	No. of awards vested	Exercise price	Market price at award date	Market price at vesting date
Todd Kozel	2009 LTIP Options	976,647	75.00p	71.25p	142.8 <sup>(1)</sup>
		651,098	75.00p	71.25p	190.2 <sup>(2)</sup>
John Gerstenlauer	2009 LTIP Options	195,329	75.00p	71.25p	142.8 <sup>(1)</sup>
		130,220	75.00p	71.25p	190.2 <sup>(2)</sup>
Ewen Ainsworth	2009 LTIP Options	195,329	75.00p	71.25p	142.8 <sup>(1)</sup>
		130,220	75.00p	71.25p	190.2 <sup>(2)</sup>

(1) For the vesting of 30% of the third tranche of LTIP Share Options, the closing share price on 8 November 2011 was used as this was the date on which the significant upwards revision of gross oil-in-place volumes for the Shaikan discovery was announced.

(2) For the vesting of 20% of the third tranche of LTIP Share Options, the closing share price on 8 November 2012 was used as this was the date on which the Sheikh Adi block discovery was announced.

All of the 2010 LTIP options remain unvested. The vesting criteria for 2010 LTIP options were met in early 2012 when the share price reached 275, 325 and 375 pence, however, the Board resolved to postpone the vesting until these price levels are sustained for a longer period of time.

No LTIP options were exercised by the Directors during the year or subsequent to the year end.

### Bonus shares granted and vested

There were no bonus shares granted in respect of 2012.

On 26 February 2013, on the recommendation of the Remuneration Committee, the Board resolved that the remaining awards granted under the 2010 Company's Executive Bonus Scheme awards had vested. The EBT Trustee agreed to satisfy these awards and subscribed for sufficient common shares as follows:

	Scheme	Market price at vesting date	No. of common shares vested
Todd Kozel	2010 Executive Bonus Scheme	188.80p	1,488,334
John Gerstenlauer	2010 Executive Bonus Scheme	188.80p	297,667
Ewen Ainsworth	2010 Executive Bonus Scheme	188.80p	297,667

The awards of the remaining 2010 Company's Executive Bonus Scheme to the Non-Executive Directors were made and have been satisfied by the Company directly as follows:

	Scheme	Market price at vesting date	No. of common shares vested
Mehdi Varzi	2010 Executive Bonus Scheme	188.80p	333,334
Peter Truscott <sup>(1)</sup>	2010 Executive Bonus Scheme	188.80p	333,334

(1) Peter Truscott retired by rotation on 19 July 2012.

All of the remaining 2010 Executive Bonus Scheme awards disclosed above have been included in the 2012 Directors' remuneration.

Also on 26 February 2013, on the recommendation of the Remuneration Committee, the Board resolved that the second third of the remaining awards granted under the 2011 Company's Executive Bonus Scheme had vested.

Details of Directors receiving bonus share awards under the 2011 Executive Bonus Scheme are as follows:

	Scheme	Market price at vesting date	No. of common shares vested
Todd Kozel	2011 Executive Bonus Scheme	188.80p	1,459,167
John Gerstenlauer	2011 Executive Bonus Scheme	188.80p	291,833
Ewen Ainsworth	2011 Executive Bonus Scheme	188.80p	291,833

The EBT Trustees have agreed to satisfy these awards and common shares were issued to the EBT in February 2013 to satisfy these awards.

The second instalment of the 2011 Executive Bonus Scheme awards has been included in the 2012 Directors' remuneration.

### Bonus shares

Details of outstanding bonus share awards for Directors who served during the year are as follows:

	Scheme	1 January 2012 <sup>(1)</sup>	Awards granted	Vested <sup>(2)</sup>	31 December 2012 <sup>(3)</sup>
Todd Kozel	Executive Bonus Scheme	4,406,667	—	(2,947,501)	1,459,166
John Gerstenlauer	Executive Bonus Scheme	881,334	—	(589,500)	291,834
Ewen Ainsworth	Executive Bonus Scheme	881,334	—	(589,500)	291,834
Mehdi Varzi	Executive Bonus Scheme	333,334	—	(333,334)	—
Peter Truscott	Executive Bonus Scheme	333,334	—	(333,334)	—

(1) The bonus shares awarded as at 1 January 2012 include the bonus shares awarded pursuant to the 2011 and 2010 Executive Bonus Schemes that had as yet not vested following the awards of 21 March 2012 and 4 February 2011.

(2) "Vested" awards are the 2010 and 2011 Executive Bonus Scheme awards that were deemed to have vested on 26 February 2013. Shares for these vested awards have been issued either directly to the beneficiary or to the EBT, which are held at the discretion of the EBT Trustee, and are included in Directors' Interests in Shares and Options as shares issued post year end.

(3) Bonus share awards as at 31 December 2012 include the final instalment of the bonus shares awarded pursuant to the 2011 Executive Bonus Scheme awards made on 21 March 2012 but have not yet vested.

## Report of the Remuneration Committee continued

### Bonus shares lapsed

No Directors' bonus shares lapsed during the year or subsequent to the year end.

### Cash bonus

In March 2013, on the recommendation of the Remuneration Committee, the Board approved the 2012 cash bonus awards made under the Company's 2012 Discretionary Executive Bonus Scheme.

The 2012 cash bonus awards for Directors who served during the year were as follows:

	Gross value of award \$	Immediate cash award <sup>(1)</sup> \$	Deferred cash award <sup>(2)</sup> \$
Todd Kozel	13,581,504	4,527,168	9,054,336
John Gerstenlauer	2,475,792	825,264	1,650,528
Ewen Ainsworth	1,340,010	446,760	893,250

(1) The value of the first cash bonus instalment paid in 2013.

(2) The value of the second and third cash bonus instalments to be paid out in 2014 and 2015 respectively.

For performance year 2012, one-third of the discretionary cash bonus award was paid immediately. The remaining two-thirds of the award will be paid in equal instalments, 12 and 24 months, from the date of the first cash bonus instalment.

### Exit Event Awards

The Remuneration Committee recommended during 2012 that the Company makes cash settled awards to certain Executive Directors and employees conditional on the occurrence of an Exit Event (as defined below) ("Exit Event Awards"), up to a maximum amount equivalent to the value of 10,000,000 common shares at the time of an Exit Event, and that a trustee (the "Exit Event Trustee") be appointed to hold and, subject to the occurrence of an Exit Event, to sell sufficient common shares to satisfy the Exit Event Awards.

On 21 March 2012, the Board approved Exit Event Awards to certain Executive Directors, subject to the occurrence of an Exit Event, as follows:

	Number of common shares to be cash settled, subject to the occurrence of an Exit Event
Todd Kozel	300,000
John Gerstenlauer	140,000
Ewen Ainsworth	140,000

The value of the common shares to be settled pursuant to the Exit Event Awards is dependent on the Company's share price, if and when an Exit Event occurs.

The objective of the Exit Event Awards is to retain and incentivise the Company Executives and staff in the event of any corporate transaction. The Exit Event Awards align the interests of the Company's employees and key management personnel with shareholders and reward the loyalty of all members of staff.

An Exit Event is defined in detail in the share award agreement in relation to an Exit Event Award and envisages a sale of either the Company or a substantial proportion (i.e. more than 50%) of its assets. No such event has occurred as of the date of this report.

The market price of the shares at 31 December 2012 and 31 December 2011 was £1.77 and £1.90 respectively and the range during 2012 was £1.42 to £4.25.

This report was approved by the Board on 19 June 2013 and signed on its behalf by:

**M Varzi**

**Remuneration Committee Chairman**

## Directors' responsibilities in the preparation of the financial statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

The Directors have elected to prepare the Group financial statements under International Financial Reporting Standards ("IFRSs") as adopted by the European Union and Article 3 of the IAS regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements". In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. The Directors are also responsible for:

- properly selecting and applying accounting policies;
- presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- providing additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- making an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company. They are also responsible for safeguarding assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website.

Legislation in Bermuda governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### Directors' Responsibility Statement

We confirm that to the best of our knowledge:

1. the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
2. the sections of the Annual Report include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

**TF Kozel**

**Executive Chairman and Chief Executive Officer**

19 June 2013

## Independent auditor's report to the members of Gulf Keystone Petroleum Limited

We have audited the consolidated financial statements of Gulf Keystone Petroleum Limited for the year ended 31 December 2012 which comprise the Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Balance Sheet, Consolidated Statement of Changes in Equity, Consolidated Cash Flow Statement, Summary of Significant Accounting Policies and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards ("IFRSs") as adopted by the European Union.

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

### Respective responsibilities of directors and auditor

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

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2012 and of the Group's loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union.

### Emphasis of matter – uncertain outcome of legal proceedings

In forming our opinion on the consolidated financial statements, which is not modified, we have considered the adequacy of the disclosures made in note 22 to the consolidated financial statements concerning the uncertain outcome of legal proceedings which include a claim against up to 30% of the Group's blocks in the Kurdistan Region of Iraq, which comprise the substantial majority of the Group's petroleum operations. The Company and two of its subsidiaries received notice on 23 December 2010 of the claims, since which time they have been vigorously contesting the claims.

The related trial in the English Commercial Court in London was completed on 1 March 2013 but no verdict has yet been announced. The ultimate outcome of the matter cannot presently be reliably estimated, and consequently no provision for any liability that may result has been made in the consolidated financial statements.

### Opinion on other matters

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

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where we are required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- we have not received all the information and explanations we require for our audit.

### Deloitte LLP

Chartered Accountants  
London, United Kingdom

19 June 2013

## Consolidated income statement

For the year ended 31 December 2012

	Notes	2012 \$'000	2011 \$'000
<b>Continuing operations</b>			
Revenue	4	32,190	6,919
Cost of sales		(32,190)	(6,919)
<b>Gross profit</b>		–	–
<b>Other operating expenses</b>			
Impairment of assets held for sale		–	(10,000)
General and administrative expenses		(82,137)	(60,350)
<b>Loss from operations</b>	2	(82,137)	(70,350)
Other gains and (losses)	5	5,210	5,791
Interest revenue	4	1,199	1,239
Finance costs	6	(4,456)	(473)
<b>Loss before tax</b>		(80,184)	(63,793)
Tax (charge)/benefit	7	(1,638)	1,437
<b>Loss after tax for the year</b>		(81,822)	(62,356)
<b>Loss per share (cents)</b>			
Basic	8	(9.61)	(8.01)
Diluted	8	(9.61)	(8.01)

## Consolidated statement of comprehensive income

For the year ended 31 December 2012

	2012 \$'000	2011 \$'000
Loss for the year	(81,822)	(62,356)
Exchange differences on translation of foreign operations	1,010	(250)
<b>Total comprehensive loss for the period</b>	<b>(80,812)</b>	<b>(62,606)</b>

## Consolidated balance sheet

As at 31 December 2012

	Notes	2012 \$'000	2011 \$'000
<b>Non-current assets</b>			
Intangible assets	9	546,229	360,005
Property, plant and equipment	10	2,285	4,295
Deferred tax asset	18	6,796	7,977
		<b>555,310</b>	<b>372,277</b>
<b>Current assets</b>			
Assets classified as held for sale	11	64,612	35,840
Inventories	13	19,783	17,233
Trade and other receivables	14	23,674	8,594
Liquid investments		8,600	29,528
Cash and cash equivalents		253,713	208,103
Derivative financial instruments	25	207	1,838
		<b>370,589</b>	<b>301,136</b>
<b>Total assets</b>		<b>925,899</b>	<b>673,413</b>
<b>Current liabilities</b>			
Trade and other payables	15	(90,872)	(58,199)
Current tax liabilities		(444)	(712)
Provisions	17	(4,185)	–
Derivative financial instruments	25	(168)	(358)
		<b>(95,669)</b>	<b>(59,269)</b>
<b>Non-current liabilities</b>			
Convertible bonds	16	(243,495)	–
Provisions	17	(9,044)	(8,070)
		<b>(252,539)</b>	<b>(8,070)</b>
<b>Total liabilities</b>		<b>(348,208)</b>	<b>(67,339)</b>
<b>Net assets</b>		<b>577,691</b>	<b>606,074</b>
<b>Equity</b>			
Share capital	19	7,847	7,627
Share premium account	19	791,479	790,435
Share option reserve		29,280	34,065
Convertible bonds reserve		25,485	–
Exchange translation reserve		449	(561)
Accumulated losses		(276,849)	(225,492)
<b>Total equity</b>		<b>577,691</b>	<b>606,074</b>

The financial statements were approved by the Board of Directors and authorised for issue on 19 June 2013 and signed on its behalf by:

**TF Kozel**  
Executive Chairman and Chief Executive Officer

**KE Ainsworth**  
Finance Director

## Consolidated statement of changes in equity

For the year ended 31 December 2012

	Notes	Attributable to equity holders of the Company						Total equity \$'000
		Share capital \$'000	Share premium account \$'000	Share option reserve \$'000	Exchange translation reserve \$'000	Accumulated losses \$'000	Convertible bonds reserve \$'000	
Balance at 1 January 2011		6,628	593,470	20,468	(311)	(193,414)	—	426,841
Transfer relating to share-based payments		—	—	(30,332)	—	30,332	—	—
Share-based payment expense	23	—	—	42,540	—	—	—	42,540
Deferred tax on share-based payment transactions	18	—	—	1,389	—	—	—	1,389
Share conversion and issue	19	999	196,965	—	—	—	—	197,964
Foreign currency translation differences		—	—	—	(250)	—	—	(250)
Own shares held	19	—	—	—	—	(54)	—	(54)
Net loss for the year		—	—	—	—	(62,356)	—	(62,356)
Balance at 1 January 2012		7,627	790,435	34,065	(561)	(225,492)	—	606,074
Transfer relating to share-based payments		—	—	(29,591)	—	29,591	—	—
Share-based payment expense	23	—	—	25,899	—	—	—	25,899
Deferred tax on share-based payment transactions	18	—	—	(1,093)	—	—	—	(1,093)
Share conversion and issue	19	220	1,044	—	—	—	—	1,264
Foreign currency translation differences		—	—	—	1,010	—	—	1,010
Own shares held by EBT	19	—	—	—	—	(202)	—	(202)
Issue of convertible bonds	16	—	—	—	—	—	26,561	26,561
Convertible bonds equity amortisation	16	—	—	—	—	1,076	(1,076)	—
Net loss for the year		—	—	—	—	(81,822)	—	(81,822)
<b>Balance at 31 December 2012</b>		<b>7,847</b>	<b>791,479</b>	<b>29,280</b>	<b>449</b>	<b>(276,849)</b>	<b>25,485</b>	<b>577,691</b>

## Consolidated cash flow statement

For the year ended 31 December 2012

	Notes	2012 \$'000	2011 \$'000
<b>Operating activities</b>			
Cash used in operations	20	(58,974)	(24,236)
Tax paid		(1,667)	(665)
Interest received		1,199	1,239
<b>Net cash used in operating activities</b>		<b>(59,442)</b>	<b>(23,662)</b>
<b>Investing activities</b>			
Purchase of intangible assets		(191,887)	(152,508)
Purchase of property, plant and equipment		(1,345)	(612)
Decrease/(increase) in liquid investments <sup>(1)</sup>		20,928	(19,351)
<b>Net cash used in investing activities</b>		<b>(172,304)</b>	<b>(172,471)</b>
<b>Financing activities</b>			
Proceeds on issue of share capital		1,264	197,905
Proceeds on issue of convertible bonds		268,972	–
<b>Net cash generated by financing activities</b>		<b>270,236</b>	<b>197,905</b>
<b>Net increase in cash and cash equivalents</b>		<b>38,490</b>	<b>1,772</b>
Cash and cash equivalents at beginning of year		208,103	201,268
Effect of foreign exchange rate changes		7,120	5,063
<b>Cash and cash equivalents at end of the year being bank balances and cash on hand</b>		<b>253,713</b>	<b>208,103</b>

(1) Liquid investments comprise short-term liquid investments of between three to 12 months maturity while cash and cash equivalents comprise cash at bank and other short-term highly liquid investments of fewer than three months maturity. The combined cash, cash equivalents and liquid investments balance at 31 December 2012 was \$262.3 million (2011: \$237.6 million).

## Summary of significant accounting policies

### General information

The Company is incorporated in Bermuda and is quoted on AIM, a market operated by the London Stock Exchange (registered address: Cumberland House, 9th Floor, 1 Victoria Street, Hamilton, Bermuda). In 2008, the Company established a Level 1 American Depositary Receipt programme in conjunction with the Bank of New York Mellon which has been appointed as the depositary bank. The Company serves as the holding company for the Group, which is engaged in oil and gas exploration and production, operating in the Kurdistan Region of Iraq and the Republic of Algeria.

### Adoption of new and revised accounting standards

#### Standards not affecting the reported results or the financial position

In the current year, the following new and revised Standards and Interpretations have been adopted. Their adoption has not had any impact on the amounts reported in these financial statements but may impact the accounting for future transactions.

IFRS 7 (amended)	Financial Instruments: Disclosures
IAS 12 (amended)	Deferred Tax: Recovery of Underlying Assets
IFRS 1 (amended)	Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

IFRS 1 (amended)	Government Loans
IFRS 7 (amended)	Disclosures – Offsetting Financial Assets and Financial Liabilities
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 10, IFRS 12 and IAS 27	Investment Entities (amended)
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurements
IAS 1 (amended)	Presentation of Items of Other Comprehensive Income
IAS 19 (revised)	Employee Benefits
IAS 27 (revised)	Separate Financial Statements
IAS 28 (revised)	Investments in Associates and Joint Ventures
IAS 32 (amended)	Offsetting Financial Assets and Financial Liabilities
IFRIC 20	Stripping Costs in the Production Phase of Surface Mine
IFRIC 21	Levies
Annual Improvements 2009–2011 Cycle	

Other than to expand the disclosure on fair value measurements within the financial statements, the Directors do not anticipate that the adoption of the Standards and Interpretations listed above will have a material impact on the financial statements of the Group in future periods.

### Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) as adopted by the European Union.

### Basis of accounting

The financial statements have been prepared under the historical cost basis, except for the valuation of hydrocarbon inventory and the valuation of certain financial instruments, and on the going concern basis. The principal accounting policies adopted are set out below.

### Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Going Concern section of the Directors’ Report.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and enterprises controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

## Summary of significant accounting policies continued

### Sales and interest revenue

Revenue is measured at the fair value of the consideration received or receivable. Sales revenue represents the Group's share of sales from petroleum production, net of sales related taxes, VAT and royalties.

Revenue is recognised when all of the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Sales revenue is recognised when the goods are delivered and the title has passed. To the extent that revenue arises from test production during an evaluation programme, an amount is charged from evaluation costs to cost of sales so as to reflect a zero net margin.

Interest revenue is accrued on a time basis, by reference to the principal outstanding and at the effective rate of interest applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

### Property, plant and equipment other than oil and gas interests

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is provided at rates calculated to write each asset down to its estimated residual value evenly over its expected useful life as follows:

Fixtures and equipment – 20% straight-line

### Intangible assets other than oil and gas interests

Intangible assets, other than oil and gas assets, have finite useful lives and are measured at cost and amortised over their expected useful economic lives as follows:

Computer software – 33% straight-line

### Oil and gas assets

The Group adopts the full cost method of accounting for its oil and gas interests having regard to the requirements of IFRS 6 – "Exploration for and Evaluation of Mineral Resources".

### Pre-licence costs

Costs incurred prior to having obtained the legal rights to explore an area are expensed directly to the income statement as they are incurred.

### Exploration and evaluation costs

Under the full cost method of accounting all costs relating to the exploration for and appraisal of oil and gas exploration and evaluation ("E&E") interests, whether commercial or not, are accumulated and capitalised as non-current assets within geographic cost pools.

Expenditure directly associated with evaluation or appraisal activities is initially capitalised as intangible non-current assets. Such costs include licence acquisition, technical services and studies, seismic acquisition, exploration and appraisal well drilling, payments to contractors, interest payable and directly attributable administration and overhead costs.

E&E costs incurred during the exploration and evaluation phase are carried forward, subject to there being no indication of impairment, where activities in an area have not reached a stage which permits reasonable assessment of the existence of economically recoverable reserves. E&E costs are transferred to development and production assets within property, plant and equipment upon the approval of a development programme by the relevant authorities and the determination of commercial reserves existence. Unsuccessful E&E costs are retained within intangible non-current assets and amortised as described below. E&E costs are not amortised prior to the conclusion of appraisal activities.

### Development and production assets

Development and production assets are accumulated within geographic cost pools and represent the cost of developing the commercial reserves discovered and bringing them into production, together with the E&E expenditures incurred in finding commercial reserves transferred from intangible E&E assets as outlined above.

The cost of development and production assets also includes the cost of acquisition and purchases of such assets, directly attributable overheads, and costs for future restoration and decommissioning.

### Depreciation of oil and gas assets

The net book values of producing assets are depreciated generally on a field-by-field basis using the unit of production ("UOP") basis which uses the ratio of oil and gas production in the period to the remaining commercial reserves plus the production in the period. Costs used in the calculation comprise the net book value of the field, and any further anticipated costs to develop such reserves.

Any unsuccessful E&E costs retained within intangible non-current assets are depreciated on a UOP basis by reference to the commercial reserves of the wider geographic cost pool.

Commercial reserves are proven and probable ("2P") reserves estimated using standard recognised evaluation techniques. The estimate is regularly reviewed by independent consultants.

### Impairment of tangible and intangible non-current assets

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset, or group of assets, is estimated in order to determine the extent of the impairment loss (if any). For exploration and evaluation assets, the group of assets is the relevant full cost pool. Where the assets fall into an area that does not have an established pool or if there are no producing assets to cover the unsuccessful exploration and evaluation costs, those assets would fail the impairment test and be written off to the income statement in full.

For other assets where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Any impairment identified is immediately recognised as an expense.

### Disposals of oil and gas interests

The difference between the fair value of the consideration receivable and the carrying value of the relevant proportion of the oil and gas asset disposed of is first used to reduce any unsuccessful exploration and evaluation cost carried in the pool, with any excess gain recognised in the income statement.

### Carry of expenditures and farm-in arrangements

Where the Group enters into a commercial agreement which includes carry of expenditures or a farm-in, the arrangement is accounted for according to its commercial substance. Generally, in the case of a farm-in, the substance is that the counterparty has acquired a share, or a greater share, of the underlying oil and gas reserves and the arrangement is treated as a partial disposal. Where the substance is that the counterparty has acquired a right, or a conditional right to be reimbursed by the Group out of future production, a liability is recognised at the time the obligation arises. In the case of a carry, a liability is recognised when the obligation is probable and is no longer conditional upon factors under the Group's control.

### Borrowing costs

Borrowing costs directly relating to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised and added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the income statement in the period in which they are incurred.

### Non-current assets held for sale

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying value and fair value less costs to sell.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. The condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from date of classification.

## Summary of significant accounting policies continued

### Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part assets to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

### Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and the financial position of the Group are expressed in US dollars, which is the functional currency of the Company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on retranslation are included in the income statement for the year.

On consolidation, the assets and liabilities of the Group's foreign operations which use functional currencies other than US dollars are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity in the Group's translation reserve. On the disposal of a foreign operation, such translation differences are reclassified to profit or loss.

### Inventories

Inventories, except for hydrocarbon inventories, are valued at the lower of cost and net realisable value. Hydrocarbon inventories are recorded at net realisable value with changes in hydrocarbon inventories being adjusted through cost of sales.

### Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group has become a party to the contractual provisions of the instrument.

### Trade receivables

Trade receivables are measured at amortised cost using the effective interest method less any impairment.

### Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

### Liquid investments

Liquid investments comprise short-term liquid investments of between three to 12 months maturity.

### Financial assets at fair value through profit and loss

Financial assets are held at fair value through profit and loss ("FVTPL") when the financial asset is either held for trading or it is designated at FVTPL. Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the other gains and losses line in the income statement.

### Derivative financial instruments

The Group may enter into derivative financial instruments including foreign exchange forward contracts to manage its exposure to foreign exchange rate risk.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in the profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a liability. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

### Impairment of financial assets

Financial assets, other than those valued at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in local or national economic conditions that correlate with default on receivables.

### Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

### Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs, which are charged to share premium.

### Convertible bonds

The net proceeds received from the issue of convertible bonds are split between a liability element and an equity component at the date of issue. The fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, is included in equity and is not remeasured. The liability component is carried at amortised cost using the effective interest method until extinguished upon conversion or at the instrument's maturity date.

Issue costs are apportioned between the liability and equity components of the convertible bonds based on their relative carrying amounts at the date of issue. The portion relating to the equity component is charged directly against equity.

The interest expense on the liability component is calculated by applying the prevailing market interest rate for similar non-convertible debt to the liability component of the instrument. The difference between this amount and the interest paid is added to the carrying amount of the convertible bonds.

### Borrowings

Interest-bearing loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption, are accounted for on an accrual basis and are added to the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

## Summary of significant accounting policies continued

### Trade payables

Trade payables are stated at amortised cost. The average maturity for trade and other payables is one to three months.

### Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event which it is probable will result in an outflow of economic benefits that can be reliably estimated.

### Decommissioning provision

Provision for decommissioning is recognised in full when damage is done to the site and an obligation to restore the site to its original condition exists. The amount recognised is the present value of the estimated future expenditure for restoring the sites of drilled wells and related facilities to their original status. A corresponding amount equivalent to the provision is also recognised as part of the cost of the related oil and gas property. The amount recognised is reassessed each year in accordance with local conditions and requirements. Any change in the present value of the estimated expenditure is dealt with prospectively. The unwinding of the discount is included as a finance cost.

### Share-based payments

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the entity instruments at the grant date. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in note 23.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest. At each balance sheet date, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to equity reserve.

For cash-settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability. At each balance sheet date until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognised in profit or loss for the period. Details regarding the determination of the fair value of cash-settled share-based transactions are set out in note 23.

### Leasing

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

### Critical accounting estimates and judgements

In the application of the Group's accounting policies, which are described above, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

### Carrying value of intangible exploration and evaluation assets

The outcome of ongoing exploration, and therefore the recoverability of the carrying value of intangible exploration and evaluation assets, is inherently uncertain. Management makes the judgements necessary to implement the Group's policy with respect to exploration and evaluation assets and considers these assets for impairment at least annually with reference to indicators in IFRS 6. Further details are provided in note 9.

When an asset is expected to be disposed of or abandoned, the recoverable amount reflects the expected net disposal consideration, together with the value of any liabilities avoided or transferred.

### Decommissioning costs

The cost of decommissioning is estimated by reference to the Group's experience, with key judgements including the application of local laws and regulations, estimates of the related costs, inflation and discount rates. Further details are provided in note 17.

**Reserves estimates**

Commercial reserves are determined using estimates of oil-in-place, recovery factors and future oil prices. Future development costs are estimated using assumptions as to numbers of wells required to produce the commercial reserves, the cost of such wells and associated production facilities, and other capital and operating costs. Reserves estimates principally affect the depreciation, depletion and amortisation charges.

**Recoverability of deferred tax assets**

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that future taxable profits will be available against which the losses can be utilised. Judgement is required to determine the value of the deferred tax asset, based upon the timing and level of future taxable profits. Further details are provided in note 18.

**Share-based payments**

The share-based payments charge is determined based on a number of assumptions which include but are not limited to the fair value of awards, vesting period and number of shares to vest. Further details are provided in note 23.

**Contingent liabilities**

The outcome of the legal proceedings related to Excalibur's claim for up to 30% in the Group's blocks in the Kurdistan Region of Iraq is one of the critical judgements that the Directors of the Company have made in applying the Group's accounting policies. For further information and disclosures see note 22.

**Convertible bonds and capitalisation of borrowing costs**

The net proceeds received from the issue of the convertible bonds were split between a liability element and equity component at the date of issue. The fair value of the liability component was estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, was included in equity reserves. The accounting policy for oil and gas assets describes the nature of the costs that the Group capitalises, which include applicable borrowing costs that are directly attributable to qualifying assets as defined in IAS 23 Borrowing Costs ("IAS 23"). Management has considered the definition of qualifying assets in IAS 23 and has determined that the Group's capitalised cash expenditures on its four Kurdistan blocks meets the definition of qualifying assets. Consequently, the interest associated with cash expenditures on the four Kurdistan blocks has been capitalised.

**Classification of assets as held for sale**

The classification of Akri-Bijeel asset as an asset held for sale is one of the critical accounting judgements made by the Group's Directors. The Directors believe that the Akri-Bijeel block continues to meet the criteria of an asset held for sale as set out in IFRS 5 notwithstanding the temporary suspension of the sale process in 2012.

## Notes to the consolidated financial statements

### 1. Segment information

For the purposes of resource allocation and assessment of segment performance, the Group is organised into three regional business units – Algeria, Kurdistan and the United Kingdom. These geographical segments are the basis on which the Group reports its segmental information. The chief operating decision maker is the Executive Chairman and Chief Executive Officer. He is assisted by the Chief Operating Officer, the Finance Director, the Legal and Commercial Director and the Vice President of Operations as well as the Country Managers in the Kurdistan Region of Iraq and Algeria.

The accounting policies of the reportable segments are consistent with the Group's accounting policies.

Each segment is described in more detail below:

- Kurdistan Region of Iraq: the Kurdistan segment consists of the Shaikan, Akri-Bijeel, Sheikh Adi and Ber Bahr blocks and the Erbil office which provides support to the operations in Kurdistan;
- United Kingdom: the UK segment provides geological, geophysical and engineering services to the Gulf Keystone Group; and
- Algeria: the Algerian segment consists of the Algiers office and the Group's operations in Algeria.

Corporate manages activities that serve more than one segment. It represents all overhead and administration costs incurred that cannot be directly linked to one of the above segments.

31 December 2012	Algeria \$'000	Kurdistan \$'000	United Kingdom \$'000	Corporate \$'000	Elimination \$'000	Total \$'000
<b>Revenue</b>						
Oil sales	–	32,190	–	–	–	<b>32,190</b>
Inter-segment sales	–	–	16,132	–	(16,132)	–
<b>Total revenue</b>	<b>–</b>	<b>32,190</b>	<b>16,132</b>	<b>–</b>	<b>(16,132)</b>	<b>32,190</b>
<b>Cost of sales</b>						
Production costs	–	(32,190)	–	–	–	<b>(32,190)</b>
<b>Gross profit</b>	<b>–</b>	<b>–</b>	<b>16,132</b>	<b>–</b>	<b>(16,132)</b>	<b>–</b>
<b>General and administrative expenses</b>						
Allocated general and administrative expenses	(4,946)	(1,577)	(16,862)	(75,697)	17,678	<b>(81,404)</b>
Depreciation and amortisation expense	–	(535)	(197)	(1)	–	<b>(733)</b>
<b>(Loss)/profit from operations</b>	<b>(4,946)</b>	<b>(2,112)</b>	<b>(927)</b>	<b>(75,698)</b>	<b>1,546</b>	<b>(82,137)</b>
Other gains and (losses)	(7)	(117)	–	5,334	–	<b>5,210</b>
Interest revenue	–	68	289	1,132	(290)	<b>1,199</b>
Finance costs	(159)	(189)	(290)	(4,616)	798	<b>(4,456)</b>
<b>(Loss)/profit before tax</b>	<b>(5,112)</b>	<b>(2,350)</b>	<b>(928)</b>	<b>(73,849)</b>	<b>2,054</b>	<b>(80,184)</b>
Tax expense	–	–	(1,638)	–	–	<b>(1,638)</b>
<b>(Loss)/profit after tax</b>	<b>(5,112)</b>	<b>(2,350)</b>	<b>(2,566)</b>	<b>(73,849)</b>	<b>2,054</b>	<b>(81,822)</b>
Capital expenditure	–	215,993	206	1	–	<b>216,200</b>
Total assets	102	671,680	40,465	1,061,637	(847,985)	<b>925,899</b>

### 1. Segment information continued

31 December 2011	Algeria \$'000	Kurdistan \$'000	United Kingdom \$'000	Corporate \$'000	Elimination \$'000	Total \$'000
<b>Revenue</b>						
Oil sales	–	6,919	–	–	–	<b>6,919</b>
Inter-segment sales	–	–	15,166	–	(15,166)	–
<b>Total revenue</b>	<b>–</b>	<b>6,919</b>	<b>15,166</b>	<b>–</b>	<b>(15,166)</b>	<b>6,919</b>
<b>Cost of sales</b>						
Production costs	–	(6,919)	–	–	–	<b>(6,919)</b>
<b>Gross profit</b>	<b>–</b>	<b>–</b>	<b>15,166</b>	<b>–</b>	<b>(15,166)</b>	<b>–</b>
Impairment of assets held for sale	(10,000)	–	–	–	–	<b>(10,000)</b>
Allocated general and administrative expenses	(3,099)	(1,634)	(18,779)	(57,463)	21,154	<b>(59,821)</b>
Depreciation and amortisation expense	(1)	(402)	(124)	(2)	–	<b>(529)</b>
<b>(Loss)/profit from operations</b>	<b>(13,100)</b>	<b>(2,036)</b>	<b>(18,903)</b>	<b>(57,465)</b>	<b>21,154</b>	<b>(70,350)</b>
Other gains and (losses)	(36)	(7)	–	5,834	–	<b>5,791</b>
Interest revenue	–	–	179	1,237	(177)	<b>1,239</b>
Finance costs	(344)	(129)	(177)	–	177	<b>(473)</b>
<b>(Loss)/profit before tax</b>	<b>(13,480)</b>	<b>(2,172)</b>	<b>(3,735)</b>	<b>(50,394)</b>	<b>5,988</b>	<b>(63,793)</b>
Tax expense	–	–	1,437	–	–	<b>1,437</b>
<b>(Loss)/profit after tax</b>	<b>(13,480)</b>	<b>(2,172)</b>	<b>(2,298)</b>	<b>(50,394)</b>	<b>5,988</b>	<b>(62,356)</b>
Capital expenditure	–	166,643	645	2	–	<b>167,290</b>
Total assets	2,863	426,002	92,217	823,943	(671,612)	<b>673,413</b>

### Geographical information

The Group's information about its segment assets (non-current assets excluding deferred tax assets and other financial assets) by geographical location is detailed below:

	2012 \$'000	2011 \$'000
Algeria	–	2,690
Kurdistan	<b>548,021</b>	361,014
Bermuda	<b>3</b>	3
United Kingdom	<b>490</b>	593
	<b>548,514</b>	364,300

### Information about major customers

Included in revenues arising from the Kurdistan Segment are revenues of approximately \$17.5 million (2011: \$4.9 million) and \$9.2 million (2011: \$nil) which arose from sales to the Group's two largest customers.

## Notes to the consolidated financial statements continued

### 2. Loss from operations

	2012 \$'000	2011 \$'000
Loss from operations has been arrived at after charging:		
Depreciation of property, plant and equipment	559	412
Amortisation of intangible assets	175	117
Impairment of assets held for sale	–	10,000
Staff costs (see note 3)	38,642	45,007
Auditor's remuneration for audit services (see below)	106	91
Operating lease rentals (see note 21)	2,235	766

	2012 \$'000	2011 \$'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	85	73
<i>Fees payable to the Company's auditor for other services to the Group</i>		
– The audit of the Company's subsidiaries pursuant to legislation	21	18
<i>Total audit fees</i>	106	91
Corporate finance services	62	290
Other services	8	–
<i>Total fees</i>	176	381

### 3. Staff costs

The average monthly number of employees (including Executive Directors) for the year was as follows:

	2012 Number	2011 Number
Office and management	63	41
Technical and operational	88	98
	151	139

Employee benefits recognised as an expense during the year comprised:

	2012 \$'000	2011 \$'000
Wages and salaries	15,005	6,831
Social security costs	3,663	3,539
Share-based payment (see note 23)	19,974	34,637
	38,642	45,007

### 4. Revenue

	2012 \$'000	2011 \$'000
Oil sales	32,190	6,919
Interest revenue	1,199	1,239
	33,389	8,158

Oil sales relate entirely to test production.

### 5. Other gains and (losses)

	2012 \$'000	2011 \$'000
Exchange gains	6,355	4,673
Mark-to-market valuation of foreign exchange contracts	(794)	1,118
Change in the fair value of the SEDA derivative financial instrument	(351)	–
	5,210	5,791

## 6. Finance costs

	2012 \$'000	2011 \$'000
Interest payable in respect of convertible bonds (see note 16)	<b>4,617</b>	–
Unwinding of discount on provisions (see note 17)	<b>348</b>	473
Capitalised finance costs	<b>(509)</b>	–
	<b>4,456</b>	473

The amount of finance costs capitalised was determined in accordance with IAS 23 by applying the effective interest rate of 9.26% on an annual basis applicable to the borrowings under the convertible bonds to the expenditures on the qualifying asset (see note 16).

## 7. Tax

	2012 \$'000	2011 \$'000
Corporation tax		
Current year	<b>(1,092)</b>	(1,043)
Adjustment in respect of prior years	<b>(203)</b>	–
Deferred UK corporation tax (expense)/benefit	<b>(343)</b>	2,480
Tax (expense)/benefit attributable to the Company and its subsidiaries	<b>(1,638)</b>	1,437

Under current Bermudian laws, the Group is not required to pay taxes in Bermuda on either income or capital gains. The Group has received an undertaking from the Minister of Finance in Bermuda exempting it from any such taxes at least until the year 2035.

Any corporate tax liability in Algeria is settled out of Sonatrach's share of oil under the terms of the PSCs and is therefore not reflected in the tax charge for the year.

In the Kurdistan Region of Iraq, the Group is subject to corporate income tax on its income from petroleum operations under the PSCs. The rate of corporate income tax is currently 15% on total income. However, any corporate income tax arising from petroleum operations will be paid from the Kurdistan Regional Government of Iraq's share of petroleum profits.

The tax currently payable is based on taxable profit for the year earned in the United Kingdom by the Group's UK subsidiary. UK corporation tax is calculated at 24.5% (2011: 26.5%) of the estimated assessable profit for the year of the UK subsidiary.

On 20 March 2013, the UK Government announced a reduction in the main rate of UK corporation tax from 24% to 23% effective from 1 April 2013. The Government has also indicated that it intends to enact a further 2% reduction to 21% at 1 April 2014 to be legislated in the Finance Bill 2013 as well as an additional reduction to 20% on 1 April 2015. The 23% rate was substantively enacted as at 31 December 2012 and was reflected in the deferred tax calculation. The additional reductions were not substantively enacted at the balance sheet date and are not yet reflected in these financial statements in accordance with IAS 10.

Deferred tax is provided for due to the temporary differences which give rise to such a balance in jurisdictions subject to income tax. During the current period no taxable profits were made in respect of the Group's Kurdistan PSCs, nor were there any temporary differences on which deferred tax is required to be provided. As a result, no corporate income tax or deferred tax has been provided for Kurdistan in the period.

In addition to the deferred tax charge to the income statement, a \$1.1 million deferred tax charge (2011: \$1.4 million credit) relating to estimated excess tax deductions related to share-based payments has been recognised directly in equity (see note 18). All deferred tax arises in the UK.

The expense for the year can be reconciled to the loss per the income statement as follows:

	2012 \$'000	2011 \$'000
Loss before tax	<b>(80,184)</b>	(63,793)
Tax at the Bermudian tax rate of 0% (2011: 0%)	–	–
Effect of different tax rates of subsidiaries operating in other jurisdictions	<b>(1,638)</b>	1,437
Tax (charge)/benefit for the year	<b>(1,638)</b>	1,437

## Notes to the consolidated financial statements continued

### 8. Loss per share

The calculation of the basic and diluted loss per share is based on the following data:

	2012 \$'000	2011 \$'000
<b>Loss</b>		
Loss after tax for the purposes of basic and diluted loss per share	<b>(81,822)</b>	(62,356)
	2012 Number (000s)	2011 Number (000s)
Number of shares		
Weighted average number of common shares for the purposes of basic loss per share	<b>851,486</b>	778,858
Adjustments for:		
– bonus shares	n/a	n/a
– share options	n/a	n/a
– warrants	n/a	n/a
– ordinary shares held by the Employee Benefit Trustee	n/a	n/a
– ordinary shares held by the Exit Event Trustee	n/a	n/a
– shares issuable under convertible bonds	n/a	n/a
Weighted average number of common shares for the purposes of diluted loss per share	<b>851,486</b>	778,858

The Group followed the steps specified by IAS 33 in determining whether potential common shares are dilutive or anti-dilutive. It was determined that all of the potential common shares including bonus shares, share options, warrants, convertible bonds and common shares held by the Employee Benefit Trustee have an anti-dilutive effect on loss per share. As a result, there is no difference between basic and diluted earnings per share.

As at 31 December 2012, 41.9 million share options (2011: 41.8 million), 6.6 million unissued bonus shares (2011: 21.5 million), 1.0 million warrants (2011: 1.7 million), 12.9 million common shares held by the EBT (2011: 8.8 million), 10.0 million common shares held by the Exit Event Trustee (2011: nil), and 62.6 million common shares to be issued if the bonds are converted at the initial conversion price of \$4.39 were excluded from the loss per share calculation as they were anti-dilutive.

## 9. Intangible assets

	Exploration & evaluation costs \$'000	Computer software \$'000	Total \$'000
<b>Year ended 31 December 2011</b>			
Opening net book value	223,749	75	223,824
Additions	166,163	507	166,670
Reclassification as held for sale (note 11)	(30,355)	–	(30,355)
Amortisation charge	–	(117)	(117)
Foreign currency translation differences	–	(17)	(17)
Closing net book value	359,557	448	360,005
<b>At 31 December 2011</b>			
Cost	359,557	849	360,406
Accumulated amortisation	–	(401)	(401)
Net book value	359,557	448	360,005
<b>Year ended 31 December 2012</b>			
Opening net book value	359,557	448	360,005
Additions <sup>(1)</sup>	186,383	109	186,492
Reclassified to profit and loss account	–	(125)	(125)
Amortisation charge	–	(175)	(175)
Accumulated amortisation eliminated on reclassification	–	14	14
Foreign currency translation differences	–	18	18
Closing net book value	545,940	289	546,229
<b>At 31 December 2012</b>			
Cost	545,940	858	546,798
Accumulated amortisation	–	(569)	(569)
Net book value	545,940	289	546,229

(1) Net of a recharge to cost of sales of \$32.2 million made in accordance with the Company's accounting policy for test production.

The net book value at 31 December 2012 includes intangible assets relating to: Shaikan \$357.7 million (2011: \$220.0 million); Ber Bahr \$51.0 million (2011: \$37.4 million), and Sheikh Adi \$137.2 million (2011: \$102.1 million).

The additions to oil and gas exploration and evaluation costs in the year include the Shaikan -4, -2, -5 and -6 wells drilling, testing and workover, the drilling of the Shaikan-8 well, the construction of the Shaikan production facilities, the preparation of the Shaikan development plan, the drilling of the Sheikh Adi-2 well, the drilling and testing of the Ber Bahr exploration well, and the acquisition and processing of seismic data.

The Akri-Bijeel asset was reclassified as an asset held for sale as at 31 December 2011 (see note 11) following the Board's resolution to dispose of the Group's 20% working interest in the block. Management intends to sell the Akri-Bijeel block within 12 months of the balance sheet date.

The amortisation charge of \$175,000 (2011: \$117,000) for computer software has been included in general and administrative expenses.

## Notes to the consolidated financial statements continued

### 10. Property, plant and equipment

	Oil & Gas Properties \$'000	Fixtures & Equipment \$'000	Total \$'000
<b>Year ended 31 December 2011</b>			
Opening net book value	2,690	1,412	4,102
Additions	–	620	620
Disposals	–	(8)	(8)
Depreciation charge	–	(412)	(412)
Foreign currency translation differences	–	(7)	(7)
Closing net book value	2,690	1,605	4,295
<b>At 31 December 2011</b>			
Cost	2,690	3,718	6,408
Accumulated depreciation	–	(2,113)	(2,113)
Net book value	2,690	1,605	4,295
<b>Year ended 31 December 2012</b>			
Opening net book value	2,690	1,605	4,295
Additions	–	1,345	1,345
Disposals	–	(169)	(169)
Depreciation charge	–	(559)	(559)
Accumulated depreciation eliminated on disposals	–	53	53
Revaluation of Algerian oil and gas decommissioning assets	(2,690)	–	(2,690)
Foreign currency translation differences	–	10	10
<b>Closing net book value</b>	<b>–</b>	<b>2,285</b>	<b>2,285</b>
<b>At 31 December 2012</b>			
Cost	–	4,939	4,939
Accumulated depreciation	–	(2,654)	(2,654)
<b>Net book value</b>	<b>–</b>	<b>2,285</b>	<b>2,285</b>

The depreciation charge of \$0.6 million on fixtures and equipment (2011: \$0.4 million) has been included in general and administrative expenses.

### 11. Asset classified as held for sale

In 2011, as part of the forward strategy to rationalise its asset portfolio, the Group announced the intention to sell the Group's 20% working interest in the Akri-Bijeel block. The Group subsequently appointed Joint Corporate Advisers responsible for co-ordination of and advice on the sale and this process is ongoing. The Company is awaiting the forthcoming results of the wells currently being drilled and tested and the commencement of the planned early production from the Bijell discovery. These results should be taken into consideration when valuing the asset.

The Akri-Bijeel asset of \$64.6 million (2011: \$35.8 million), which is included within the Kurdistan operating segment, is expected to be sold within 12 months and has been classified as an asset held for sale as at 31 December 2012 and presented separately in the balance sheet. The value of the asset held for sale as at 31 December 2012 includes \$5.9 million (2011: \$5.5 million) that relates to a prepayment balance to the operator. The additions in the year include the drilling and testing of exploration and appraisal wells, construction of Akri-Bijeel Extended Well Test Facility and the acquisition and processing of seismic data.

The proceeds of disposal are expected to substantially exceed the book value of the related net assets and, accordingly, no impairment losses have been recognised on the classification of this asset as held for sale. A further amount of \$0.9 million (2011: \$0.2 million), representing the net present value of the decommissioning costs associated with this asset is included within the provisions balance at 31 December 2012 (see note 17).

## 12. Subsidiaries

Details of the Company's subsidiaries at 31 December 2012 are as follows:

Name of subsidiary	Place of incorporation	Proportion of ownership interest	Proportion of voting power held	Principal activity
Gulf Keystone Petroleum (UK) Limited	United Kingdom	100%	100%	Geological, geophysical and engineering services
Gulf Keystone Petroleum International Limited	Bermuda	100%	100%	Exploration and evaluation activities in Kurdistan
Gulf Keystone Petroleum Numidia Limited	Bermuda	100%	100%	Exploration and evaluation activities
Gulf Keystone Petroleum HBH Limited	Bermuda	100%	100%	Exploration and evaluation activities
Shaikan Petroleum Limited	Bermuda	100%	100%	Exploration and evaluation activities

## 13. Inventories

	2012 \$'000	2011 \$'000
Exploration materials	19,063	16,822
Crude oil	720	411
	<b>19,783</b>	<b>17,233</b>

## 14. Trade and other receivables

	2012 \$'000	2011 \$'000
Trade receivables	6,983	4,122
Other receivables	12,759	2,185
Prepayments and accrued income	3,932	2,287
	<b>23,674</b>	<b>8,594</b>

Included within other receivables for 2012 is an amount of \$0.7 million (2011: \$0.3 million) being the deposits for leased assets which are receivable after more than one year, as well as \$10.7 million (2011: \$1.7 million) of amounts owed by related parties (see note 24). An impairment of overdue trade receivables of \$1.2 million has been recognised during the year.

Otherwise, the Directors consider that the carrying amount of trade and other receivables approximates to their fair value and no amounts are provided against them.

## 15. Trade and other payables

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs.

The Directors consider that the carrying amount of trade payables approximates to their fair value.

	2012 \$'000	2011 \$'000
Trade payables	21,908	23,450
Accrued expenses	68,964	34,749
	<b>90,872</b>	<b>58,199</b>

Accrued expenses include interest payable of \$3.5 million (2011: \$nil) in respect of convertible bonds (see note 16).

## Notes to the consolidated financial statements continued

### 16. Convertible bonds

On 18 October 2012, the Group issued senior unsecured convertible bonds at a par value of \$275 million which will be convertible into common shares of the Company at the option of the bondholder, at any time from 18 October 2012 until 10 days prior to the final maturity date, 18 October 2017. As described in the convertible bond listing particulars, available on the Bourse de Luxembourg website, the Company can redeem all or some of the bonds under certain conditions. At the initial conversion price of \$4.39 per common share (£2.72 at the prevailing USD:GBP spot rate at the time of pricing), there were 62,642,369 common shares of the Company underlying the bonds.

If the bonds have not been previously purchased and cancelled, redeemed or converted, they will be redeemed at par value on 18 October 2017. Interest of 6.25% per annum will be paid bi-annually in arrears up to that date.

The net proceeds received from the issue of the convertible bonds were split between a liability element and equity component at the date of issue. The fair value of the liability component was estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, was included in equity reserves.

Issue costs were apportioned between the liability and equity components of the convertible bonds based on their relative carrying amounts at the date of issue. The portion related to the equity component was charged directly to equity.

	2012 \$'000
Net proceeds of issue of convertible bonds	268,972
Equity component	(26,561)
Liability component at the date of issue	242,411
Interest charged	4,617
	<b>247,028</b>
Reported in:	
Interest payable in current liabilities (see note 15)	3,533
Non-current liabilities	243,495
<b>Total liability component as at 31 December</b>	<b>247,028</b>

The equity component of \$26.6 million has been credited to equity reserve.

The interest charged for the year is calculated by applying an effective interest rate of 9.26% on an annual basis to the liability component for the period since the bonds were issued. Each year, an amount equal to the difference between the total interest charge (at 9.26% per annum) and the coupon rate charge (at 6.25% per annum) is transferred within equity from the convertible bonds reserve to accumulated losses.

There is no material difference between the carrying amount of the liability component of the convertible bonds, which is carried at amortised cost, and their fair value. This fair value is calculated by discounting the future cash flows at the market rate.

The Group's remaining contractual liability comprising principal and interest, based on undiscounted cash flows at the earliest date on which the Group is required to pay and assuming the bonds are not purchased and cancelled, redeemed or converted prior to 18 October 2017, is as follows:

	2012 \$'000
Within one year	17,188
Within two to five years	343,750
	<b>360,938</b>

## 17. Provisions

	2012 \$'000	2011 \$'000
Current	4,185	–
Non-current	9,044	8,070
	<b>13,229</b>	<b>8,070</b>
Decommissioning provision		\$'000
At 1 January 2012		8,070
New provisions and changes in estimates		4,811
Unwinding of discount		348
<b>At 31 December 2012</b>		<b>13,229</b>

The provision for decommissioning is based on the net present value of the Group's share of expenditure which may be incurred in the removal and decommissioning of the wells and facilities currently in place and restoration of the sites to their original state. This expenditure is estimated to be incurred over the next 12 months on Algerian oil and gas assets and over the next 30 years on Kurdistan blocks. Included within the provision are decommissioning costs of \$0.9 million (2011: \$0.2 million) associated with the Akri-Bijeel asset (see note 11).

## 18. Deferred tax asset

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

	Accelerated tax depreciation \$'000	Share-based payments \$'000	Total \$'000
At 1 January 2011	9	4,097	4,106
(Charge)/credit to income statement	(43)	2,523	2,480
Credit direct to equity	–	1,389	1,389
Exchange differences	2	–	2
At 1 January 2012	(32)	8,009	7,977
(Charge)/credit to income statement	33	(376)	(343)
Charge direct to equity	–	(1,093)	(1,093)
Exchange differences	–	255	255
<b>At 31 December 2012</b>	<b>1</b>	<b>6,795</b>	<b>6,796</b>

## 19. Share capital

	2012 \$'000	2011 \$'000
<b>Authorised</b>		
Common shares of \$0.01 each	10,500	9,500
Non-voting shares of \$0.01 each	500	500
Preferred shares of \$1,000 each	20,000	20,000
Series A Preferred shares of \$1,000 each	40,000	40,000
	<b>71,000</b>	<b>70,000</b>

The authorised common share capital was increased from \$9.5 million to \$10.5 million at the 2012 Annual General Meeting.

## Notes to the consolidated financial statements continued

### 19. Share capital continued

	Common shares		Share capital \$'000	Share premium \$'000
	No. of shares '000	Amount \$'000		
<b>Issued and fully paid</b>				
Balance at 1 January 2011	754,243	600,098	6,628	593,470
Bonus scheme shares issued	6,966	70	70	–
Share placement	91,120	200,001	911	199,090
Shares issued under Option Scheme	1,028	1,038	10	1,028
Issue costs on share placement	n/a	(4,050)	–	(4,050)
Warrant exercise	762	905	8	897
<b>Balance 31 December 2011</b>	<b>854,119</b>	<b>798,062</b>	<b>7,627</b>	<b>790,435</b>
Bonus scheme shares issued	10,980	110	110	–
Shares issued under Option Scheme	322	170	3	167
Exit Event shares issued	10,000	100	100	–
Warrant exercise	761	884	7	877
<b>Balance 31 December 2012</b>	<b>876,182</b>	<b>799,326</b>	<b>7,847</b>	<b>791,479</b>

During the year, a total of 10,979,672 shares were issued as part of the Company's bonus share scheme (2011: 6,965,689), of which 10,246,338 new common shares were issued to the Gulf Keystone EBT at par value of \$0.01 (see note 23). A further 10,000,000 common shares were issued under the Company's Exit Event Awards Plan, all of which are held by the Exit Event Trustee. Following an exercise of warrants, 761,500 common shares were issued at a price of £0.75 per share.

A further 322,000 common shares were issued following exercise of options by the employees of the Company. The details of the issues were as follows:

Date of issue	Number of shares issued	Weighted average option exercise price	Weighted average share price realised on issue
23 February 2012	322,000	33.01 pence	254.17 pence

At 31 December 2012, a total of 12,896,556 common shares were held by the EBT and 10,000,000 shares were held by Exit Event Trustee. All 22,896,556 common shares were included within reserves.

Subsequent to year end, a further 7,125,837 new common shares were issued as part of the Company's bonus share scheme to satisfy the awards granted for 2010 and 2011 performance, including 6,459,169 to the EBT. In addition, the Company has been notified by the Trustee of the EBT and by certain employees of an exercise of options under the Share Option Plan. Consequently, the Board has approved the issue of 4,129,500 common shares under the Company's Share Option Plan at a price of 30 pence per share and 250,000 common shares at a price of 80.75 pence per share, totalling 4,379,500 common shares, raising gross proceeds of £1,440,725 in March 2013.

The total number of common shares in issue on 19 June 2013, including those held by the EBT Trustee and the Exit Event Trustee, is 887,686,957.

#### Rights attached to share capital

The holders of the common shares have the following rights (subject to the other provisions of the Bye-laws):

- (i) entitled to one vote per common share;
- (ii) entitled to receive notice of, and attend and vote at, general meetings of the Company;
- (iii) entitled to dividends or other distributions; and
- (iv) in the event of a winding-up or dissolution of the Company, whether voluntary or involuntary or for a reorganisation or otherwise or upon a distribution of capital, entitled to receive the amount of capital paid up on their common shares and to participate further in the surplus assets of the Company only after payment of the Series A Liquidation Value (as defined in the Bye-laws) on the Series A Preferred Shares.

## 20. Reconciliation of loss from operations to net cash used in operating activities

	2012 \$'000	2011 \$'000
Loss from operations	(82,137)	(70,350)
<i>Adjustments for:</i>		
Depreciation of property, plant and equipment	559	412
Amortisation of intangible assets	175	117
Impairment loss on assets held for sale	–	10,000
Increase in Algerian decommissioning provision	3,462	–
Share-based payment expense	19,974	34,637
Impairment of overdue receivables	1,212	–
Increase in inventories	(2,550)	(2,810)
Increase in receivables	(14,845)	(4,897)
Increase in payables	15,176	8,655
<b>Net cash used in operating activities</b>	<b>(58,974)</b>	<b>(24,236)</b>

## 21. Commitments

### Operating lease commitments – the Group as a lessee

	2012 \$'000	2011 \$'000
Minimum lease payments under operating leases recognised as expense for the year	2,235	766

At the balance sheet date, the Group had outstanding total commitments under non-cancellable operating leases, which fall due as follows:

	2012 \$'000	2011 \$'000
Within one year	1,345	660
In the second to fifth years inclusive	566	308
After five years	–	–
	<b>1,911</b>	<b>968</b>

Operating lease payments represent rentals payable by the Group for certain of its office and residence properties and facilities in the United Kingdom and the Kurdistan Region of Iraq. The UK office leases are for five and four years from February 2010 and April 2011 respectively. The office equipment lease is for five years and commenced in 2009. The non-cancellable operating leases within Kurdistan are for up to one year in duration.

### Exploration commitments

Due to the nature of the Group's operations in exploring and evaluating areas of interest, it is difficult to accurately forecast the nature or amount of future expenditure, although it will be necessary to incur expenditure in order to retain present exploration and appraisal rights.

Expenditure commitments on current permits for the Group could be reduced by selective relinquishment of exploration tenure or by the renegotiation of expenditure commitments. The level of exploration expenditure expected in the year ending 31 December 2013 for the Group is approximately \$197 million (2012: \$209 million) of which the majority is contracted. This includes the minimum amounts required to retain the relevant licences.

## Notes to the consolidated financial statements continued

### 22. Contingent liabilities

In December 2010, Excalibur commenced legal action against Gulf Keystone and two of its subsidiaries (together "the Companies") and Texas Keystone Inc. ("Texas Keystone") asserting certain contractual and non-contractual claims against the Companies and Texas Keystone and claiming that Excalibur is entitled to an interest of up to 30% in the Companies' blocks in the Kurdistan Region of Iraq. The operations in the Kurdistan Region of Iraq comprise the substantial majority of the Group's overall petroleum operations.

The allegations and claims made by Excalibur have been vigorously disputed and contested by the Company and are being contested through the due process of law. Excalibur claims will be determined by the English Commercial Court following the conclusion of the trial on 1 March 2013. The Judge will give his decision in a written Judgement, which is expected later this year.

In April 2012 and further to the decision of the English Commercial Court in London, a payment of £6,000,000 was made into Court by Excalibur as security for the costs of the Companies of defending the legal action commenced by Excalibur in December 2010. Subsequent to year end, on 8 March 2013, a further payment of £4,700,000 was made. In total, Excalibur has paid £10,700,000 into Court as security for the costs of the Companies. No contingent asset has been recognised by the Company in respect of these payments.

Excalibur also made payments of £3,500,000 in April 2012 and £3,300,000 in March 2013 into Court as security for the costs of Texas Keystone.

In addition, further to the decision of the English Commercial Court to award costs of the hearing on 15 February 2013 to the Companies and Texas Keystone, interim payments of £50,000 and £40,000 were made by Excalibur to the Companies and Texas Keystone respectively.

Due to the uncertain outcome of the legal proceedings and the wide range of potential financial outcomes, the ultimate outcome of the legal case cannot presently be reliably estimated, and consequently no provision for any liability that may result has been made in the financial statements.

### 23. Share-based payments

	2012 \$'000	2011 \$'000
Bonus shares charge	15,881	33,560
Share options charge	10,018	8,980
	<b>25,899</b>	<b>42,540</b>

During the year \$6.0 million (2011: \$7.9 million) of the above charge has been capitalised into the cost of the Group's intangible assets in accordance with the Group's accounting policy for E&E assets.

#### Equity-settled share option plan

The Group's share option plan provides for an exercise price at least equal to the closing market price of the Group shares on the date prior to grant. Awards made under the Group's share option plan have a vesting period of at least three years except for awards made under the Long Term Incentive Plan, which vest in equal tranches over a minimum of three years subsequent to the achievement of a number of operational and market-based performance conditions. If options remain unexercised after a period of 10 years from the date of grant, the options expire. Furthermore, options are forfeited if the employee leaves the Group before the options vest.

	2012		2011	
	Number of share options '000	Weighted average exercise price (in pence)	Number of share options '000	Weighted average exercise price (in pence)
Outstanding at 1 January	41,795	91.9	31,183	61.4
Granted during the year	650	250.0	11,790	170.1
Exercised during the year	(322)	33.0	(1,028)	61.9
Forfeited during the year	(250)	175.0	(150)	112.2
Outstanding at 31 December	41,873	94.3	41,795	91.9
Exercisable at 31 December	22,472	55.8	20,644	57.0

The weighted average share price at the date of exercise for share options exercised during the period was £2.54. The options outstanding at 31 December 2012 had a weighted average exercise price of £0.94, and a weighted average remaining contractual life of seven years.

### 23. Share-based payments continued

During 2012, 650,000 options with market-based performance conditions attached were granted to new employees and Directors under the Group's share option plan.

The inputs into the stochastic (binomial) valuation model were as follows:

	2012	2011
Weighted average closing share price on date of grant (in pence)	<b>272.6</b>	180.0
Weighted average exercise price of options granted in the year (in pence)	<b>250.0</b>	170.1

The expected volatility was calculated as 85.5% (2011: 81% for the February, June and July 2011 awards, 82% for the September and October 2011 awards) and has been based on the Company's share price averaged for the five years prior to grant date.

The expected term of the 2012 awards is three years (2011: 2.5 to 4.5 years). The risk free rate was 0.61% (2011: 2.86% for the February, June and 8 July 2011 awards, 1.3% for the 21 July 2011 award, 0.9% for the September 2011 award and 0.6% for the October 2011 award).

The weighted average fair value of the options granted in 2012 was £1.54 (2011: £0.96).

The Company has made no dividend payments to date and as there is no expectation of making payments in the immediate future the dividend yield variable has been set at zero for all grants.

Share options outstanding at the end of the year have the following expiry date and exercise prices:

Expiry date	Exercise price (pence)	Options ('000)	
		2012	2011
10 October 2017	39.50	–	23
4 December 2017	33.00	–	250
13 February 2018	30.00	<b>1,450</b>	1,450
24 September 2018	30.00	<b>2,110</b>	2,150
31 December 2018	30.00	<b>4,391</b>	4,400
15 March 2019	30.00	<b>250</b>	250
30 July 2019	30.00	<b>1,650</b>	1,650
7 December 2019	80.75	<b>250</b>	250
3 June 2020	80.75	<b>250</b>	250
23 June 2020	75.00	<b>18,882</b>	18,882
22 September 2020	147.50	<b>250</b>	250
11 October 2020	175.00	<b>250</b>	250
6 February 2021	175.00	<b>9,440</b>	9,690
19 June 2021	146.25	<b>550</b>	550
7 July 2021	146.25	<b>250</b>	250
14 July 2021	146.25	<b>250</b>	250
21 July 2021	146.25	<b>500</b>	500
19 September 2021	152.50	<b>250</b>	250
26 October 2021	146.25	<b>250</b>	250
25 November 2021	250.00	<b>250</b>	–
20 March 2022	250.00	<b>400</b>	–
		<b>41,873</b>	41,795

### Bonus shares

Through the Company's Executive Bonus Scheme, the Group issues bonus shares to certain employees for \$nil consideration. Bonuses are generally awarded over three years and vest in three equal tranches during those years subject to continued employment. These share-based payments are measured at fair value at the date of grant. The fair value of the shares granted is recognised as an employee expense with a corresponding increase in equity. The fair value of the shares granted is the market price on the date of the award and is charged to the income statement over the vesting period taking into account the terms and conditions upon which the shares were granted.

## Notes to the consolidated financial statements continued

### 23. Share-based payments continued

Awards of 7,125,837 relating to the 2010 and 2011 Executive Bonus Schemes, as reported in 2010 and 2011 Annual Reports and Accounts, have vested in February 2013. Details of all awards to Directors have been included in the Directors' Emoluments for the year ended 31 December 2012.

	Bonus shares ('000)	
	2012	2011
Balance at 1 January	10,474	11,514
Granted during the year	–	10,000
Forfeited during the year	(42)	(60)
Issued during the year	(7,126)	(10,980)
<b>Balance at 31 December</b>	<b>3,306</b>	<b>10,474</b>

### Exit Event Awards

In March 2012, the Remuneration Committee recommended that the Company make cash settled awards to certain Executive Directors and employees conditional on the occurrence of an Exit Event (as defined below) up to a maximum amount equivalent to the value of 10,000,000 common shares each at the time of an Exit Event, and that a trustee (the "Exit Event Trustee") be appointed to hold and, subject to the occurrence of an Exit Event, to sell sufficient common shares to satisfy the Exit Event Awards.

On 21 March 2012, the Board approved the Exit Event Awards to certain Executive Directors and employees, subject to the occurrence of an Exit Event, equivalent to the value of 2,000,000 common shares. The Exit Event Trustee will hold the remaining 8,000,000 common shares to satisfy any future Exit Event Awards to full-time employees of the Company and subsidiary companies, subject to the occurrence of an Exit Event, with such beneficiaries to be determined in due course.

An Exit Event envisages a sale of either the Company or a substantial proportion (i.e. more than 50%) of its assets.

These share-based payments are measured at the fair value of the associated liability at the year end. As at 31 December 2012, the fair value of Exit Event Awards was \$nil based on the market value of the shares and the probability of the Exit Event occurring assessed as of that date.

### 24. Related party transactions

#### Transactions with related parties

During the year, Group companies entered into the following transactions with related parties which are not members of the Group.

#### Texas Keystone Inc.

Texas Keystone Inc. is a related party of the Group because Mr Todd Kozel, a Director of the Company, is also a Director of Texas Keystone, Inc. ("TKI").

On 21 December 2007, Gulf Keystone Petroleum International Limited ("GKPI") entered into a Joint Operating Agreement ("the Agreement") for the Shaikan block in the Kurdistan Region of Iraq in which TKI holds a 5% participating interest. TKI initially led the pursuit of opportunities in the Kurdistan Region of Iraq and participated in the successful signature of the Production Sharing Contract for the Shaikan block. In return for this and TKI's continuing participation, GKPI was liable to pay for TKI's share of the costs of the Exploration Work Programme and all costs ancillary to the joint operations up until the drilling of the first exploration well. TKI elected not to participate in the drilling of the Shaikan-1 well and as a consequence agreed to assign its interest under the contract to GKPI. Currently TKI holds its interest in trust for GKPI pending the transfer of its interest to GKPI.

#### Directors' transactions

During 2012, the Company paid for certain personal expenses of \$2.8 million (2011: \$1.7 million) on behalf of Todd Kozel that will be refunded to the Company at its demand during 2013. No interest is charged on these advances. The Group also issued interest-bearing loans of \$7 million to Todd Kozel and \$0.7 million to another Director. The loans were taken out in order to meet the Directors' tax and other liabilities and bear an annual interest charge of 7.5%. By virtue of their directorship, these individuals are related parties of the Group. The following amounts were outstanding at the balance sheet date and are included within other receivables:

	2012 \$'000	2011 \$'000
Personal expenses of key management personnel to be refunded to the Group	2,846	1,742
Loans to key management personnel	7,710	–
Interest on loans to key management personnel	68	–
	<b>10,624</b>	<b>1,742</b>

Subsequent to the year end, the \$0.7 million loan was repaid in full. Todd Kozel has settled \$4.5 million of the outstanding \$9.9 million, the remaining balance shall be repaid in full by the end of August 2013.

## 24. Related party transactions continued

### Remuneration of key management personnel

The remuneration of the Directors and Officers, the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 Related Party Disclosures. The names and positions held by those Directors and employees identified as key management personnel are as follows:

TF Kozel – Executive Chairman and Chief Executive Officer  
 AA Al Qabandi – Business Development Director  
 JB Gerstenlauer – Chief Operating Officer  
 KE Ainsworth – Finance Director  
 M Varzi – Non-Executive Director  
 PDT Truscott – Non-Executive Director (until 19 July 2012)  
 MAC Hanson – Non-Executive Director

CRL Guthrie – Non-Executive Director  
 CH Garrett – Vice President Operations  
 AR Peart – Legal and Commercial Director  
 AA Samarraï – Kurdistan Country Manager (until 1 September 2012)  
 U Eminkahyagil – Kurdistan Country Manager (from 2 September 2012)  
 M Messaoudi – Algeria Country Manager

The values below are calculated in accordance with IAS 19 and IFRS 2.

	2012 \$'000	2011 \$'000
Short-term employee benefits	17,310	8,347
Other allowances	169	150
Share-based payment – options	8,085	7,657
Share-based payment – bonus shares	14,305	30,322
	<b>39,869</b>	<b>46,476</b>

Further information about the remuneration of individual Directors is provided in the Directors' Emoluments section of the Report of the Remuneration Committee.

## 25. Financial instruments

	2012 \$'000	2011 \$'000
<b>Financial assets</b>		
Cash and cash equivalents	253,713	208,103
Liquid investments	8,600	29,528
Loans and receivables	19,742	6,307
Derivative asset – SEDA (Level 3)	–	351
Other derivative assets (Level 2)	207	1,487
	<b>282,262</b>	<b>245,776</b>
<b>Financial liabilities</b>		
Loans and payables	90,872	58,199
Other derivative liabilities (Level 2)	168	358
Convertible bonds	243,495	–
	<b>334,535</b>	<b>58,557</b>

All loans and payables, except for the convertible bonds, are due to be settled within one year and are classified as current liabilities.

The maturity profile of the convertible bond is disclosed in note 16. The maturity profile of all other financial liabilities is indicated by their classification in the balance sheet as "current" or "non-current". Further information relevant to the Group's liquidity position is disclosed in the Directors' Report under "Going Concern".

### Fair value hierarchy

In line with IAS 39 – Financial Instruments: Recognition and Measurement, the Group uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded value that are not based on observable market data.

## Notes to the consolidated financial statements continued

### 25. Financial instruments continued

#### Capital risk management

The Group manages its capital to ensure that the entities within the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group is not subject to externally imposed capital requirements. The capital structure of the Group consists of cash, cash equivalents and liquid investments, convertible bonds and equity attributable to equity holders of the parent, comprising issued capital, reserves and accumulated losses as disclosed in note 19, the Consolidated Statement of Comprehensive Income and the Consolidated Statement of Changes in Equity.

#### Capital structure

The Group's Board of Directors reviews the capital structure on a regular basis and makes adjustments to it in light of changes in economic conditions. As part of this review, the Board considers the cost of capital and the risks associated with each class of capital.

Until 2012, the Group had financed its business by means of internally generated funds and external share capital. On 18 October 2012, the Group raised \$275.0 million through an issue of convertible bonds. The net proceeds of the issue of the bonds will contribute to the Group's move to the large-scale stage development of its Shaikan block and its aggressive exploration and appraisal of the Akri-Bijeel, Ber Bahr and Sheikh Adi blocks. As a result, the Group carried a non-current liability of \$243.5 million as at 31 December 2012 (see note 16).

#### Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in the Summary of Significant Accounting Policies.

#### Financial risk management objectives

The Group's management monitors and manages the financial risks relating to the operations of the Group. These financial risks include market risk (including commodity price, currency and fair value interest rate risk), credit risk, liquidity risk and cash flow interest rate risk.

The Group has entered into currency risk hedges and interest rate hedges during 2012. The Group does not presently hedge against other financial risks as the benefit of entering into such agreements is not considered to be significant enough as to outweigh the significant cost and administrative burden associated with such hedging contracts. The Group does not use derivative financial instruments for speculative purposes.

The risks are closely reviewed by the Board on a regular basis and steps are taken where necessary to ensure these risks are minimised.

#### Market risk

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates, oil prices and changes in interest rates in relation to the Group's cash balances. The operating currencies of the Group are Great British pounds (GBP), US dollars (USD), Algerian dinars (DZD) and Iraqi dinars (IQD).

The Group's exposure to currency risk has decreased following the issue of the convertible bonds where the proceeds were received in USD, which is the main currency for the Group's transactions, and following the utilisation of sterling funds from previous equity raises. Currency hedges were entered into to address foreign currency risk arising when entering into funding transactions in GBP.

There have been no changes to the Group's exposure to other market risks or any changes to the manner in which the Group manages and measures the risk. The Group does not hedge against the effects of movement in oil prices. The risks are monitored by the Board on a regular basis.

**25. Financial instruments** continued**Foreign currency risk management**

The Group undertakes certain transactions denominated in foreign currencies, being any currency other than the functional currency of the Group subsidiary concerned. Hence, exposures to exchange rate fluctuations arise.

At 31 December 2012, a 10% weakening or strengthening of the US dollar against the other currencies in which the Group's monetary assets and monetary liabilities are denominated would not have a material effect on the Group's net current assets or loss before tax.

**Interest rate risk management**

The Group's policy on interest rate management is agreed at the Board level and is reviewed on an ongoing basis. The current policy is to maintain a certain amount of funds in the form of cash for short-term liabilities and have the rest on relatively short-term deposits, usually one month notice to maximise returns and accessibility. The Group has entered into liquid investments of up to 12 months maturity during 2012 to maximise interest returns. The Group pays fixed coupon interest rate on the convertible bonds and has no floating rate financial liabilities.

**Interest rate sensitivity analysis**

Based on the exposure to the interest rates for cash and cash equivalents at the balance sheet date, a 0.5% increase or decrease in interest rates would have resulted in \$1.2 million decrease or increase in the Group's loss for the year. A rate of 0.5% is used as it represents management's assessment of the reasonably possible changes in interest rates.

**Credit risk management**

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group does not have any significant trade and other receivables outstanding from any one customer at balance sheet date (2011: \$nil).

The credit risk on liquid funds is limited because the counterparties for a significant portion of the cash and cash equivalents at the balance sheet date are banks with good credit ratings assigned by international credit-rating agencies.

**Liquidity risk management**

Ultimate responsibility for liquidity risk management rests with the Board of Directors. It is the Group's policy to finance its business by means of internally generated funds, external share capital and debt. In common with many exploration companies, the Group raises finance for its exploration and appraisal activities in discrete tranches to finance its activities for limited periods. The Group seeks to raise further funding as and when required.

## Directors, advisers and officers

### Directors

Todd Kozel	Executive Chairman and Chief Executive Officer
John Gerstenlauer	Chief Operating Officer
Ewen Ainsworth	Finance Director
Ali Al Qabandi	Business Development Director
Mehdi Varzi	Non-Executive Director
Charles Guthrie	Non-Executive Director
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#### **Disclaimer**

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