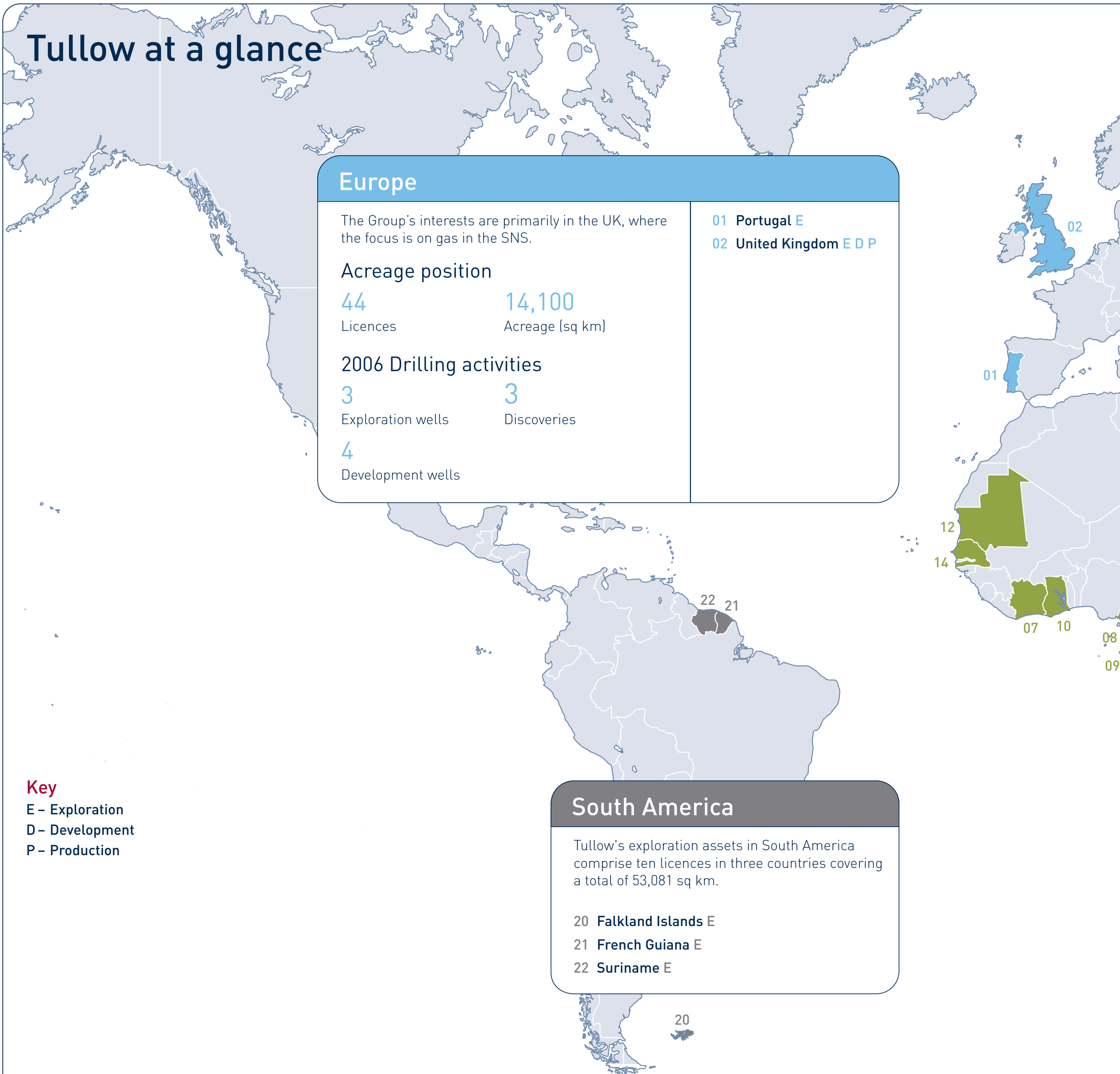
**Tullow Oil plc**

Annual Report and Accounts 2006

# Tullow at a glance




## Europe

The Group's interests are primarily in the UK, where the focus is on gas in the SNS.

### Acreage position

44
Licences

14,100
Acreage (sq km)

### 2006 Drilling activities

3
Exploration wells

3
Discoveries

4
Development wells

01 **Portugal** E
02 **United Kingdom** E D P

## South America

Tullow's exploration assets in South America comprise ten licences in three countries covering a total of 53,081 sq km.

20 **Falkland Islands** E
21 **French Guiana** E
22 **Suriname** E

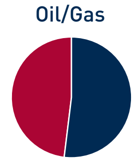
**Key**
**E – Exploration**
**D – Development**
**P – Production**

## 2006 business summary

Sales revenue increased by 30% compared with 2005. This growth was driven by strong increases in European gas production against a background of stable African oil production, and sales prices which were on average some 29% ahead of 2005. The Group achieved 89% organic reserves replacement and total reserves and resources increased by 149 mmboe.

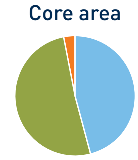
### Average production

**Oil/Gas**



Oil **52%**
Gas **48%**

**Core area**



Europe **46%**
Africa **51%**
South Asia **3%**

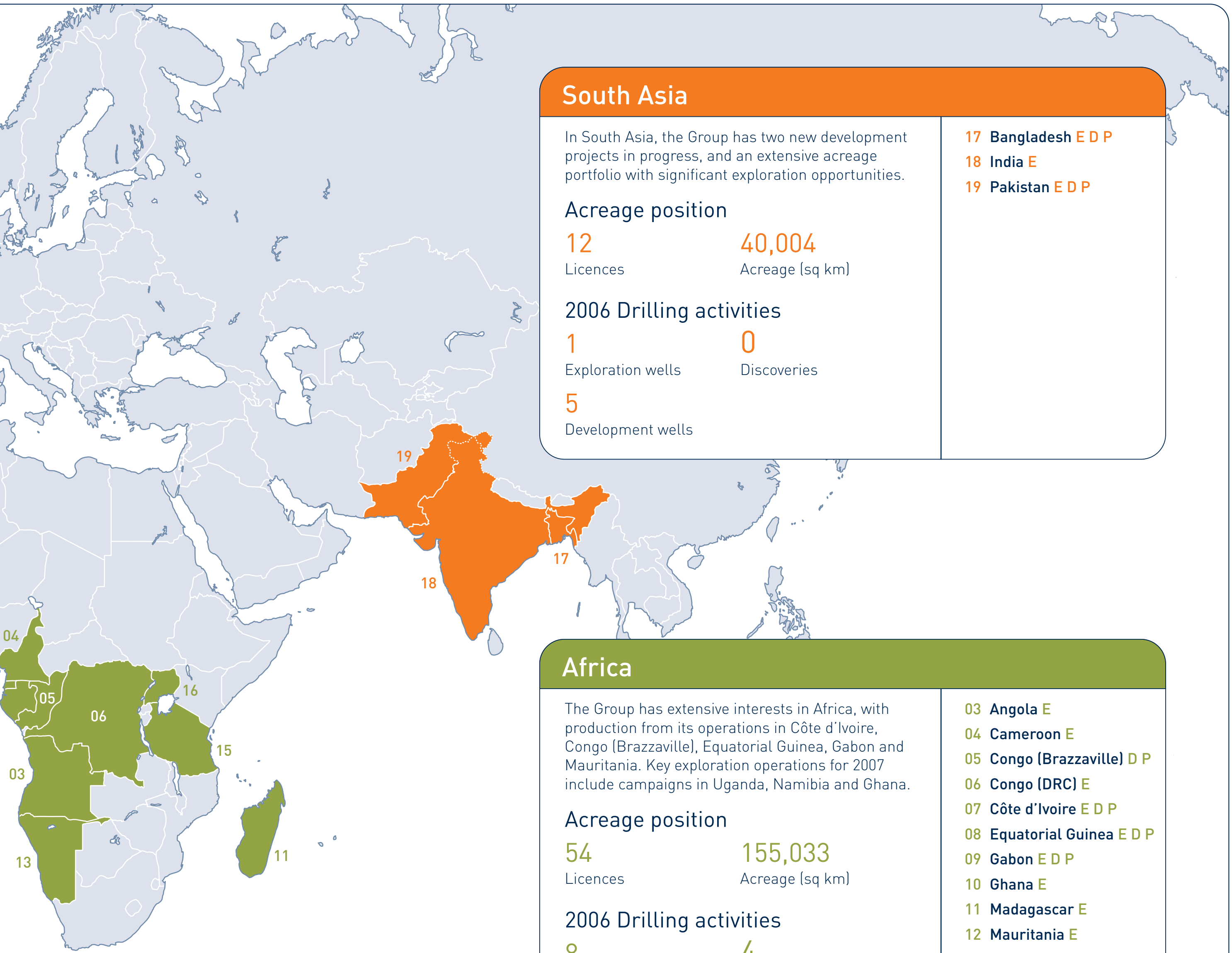
**Total 64,720 boepd**

### Operational achievements

**January**
Mputa well drilled, the first of five oil discoveries in Uganda for Tullow during 2006; which proved the existence of a working hydrocarbon system.

**March**
Humphrey field discovered, the first of three gas discoveries for Tullow in the CMS region of the Southern North Sea in 2006.

**May**
First ever oil production in Uganda – Waraga-1 tested high quality oil at a cumulative rate of over 12,000 bopd.




## South Asia

In South Asia, the Group has two new development projects in progress, and an extensive acreage portfolio with significant exploration opportunities.

### Acreage position

12
Licences

40,004
Acreage (sq km)

### 2006 Drilling activities

1
Exploration wells

0
Discoveries

5
Development wells

17 **Bangladesh** E D P
18 **India** E
19 **Pakistan** E D P

## Africa

The Group has extensive interests in Africa, with production from its operations in Côte d'Ivoire, Congo (Brazzaville), Equatorial Guinea, Gabon and Mauritania. Key exploration operations for 2007 include campaigns in Uganda, Namibia and Ghana.

### Acreage position

54
Licences

155,033
Acreage (sq km)

### 2006 Drilling activities

8
Exploration wells

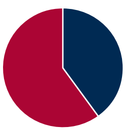
4
Discoveries

52
Development wells

03 **Angola** E
04 **Cameroon** E
05 **Congo (Brazzaville)** D P
06 **Congo (DRC)** E
07 **Côte d'Ivoire** E D P
08 **Equatorial Guinea** E D P
09 **Gabon** E D P
10 **Ghana** E
11 **Madagascar** E
12 **Mauritania** E
13 **Namibia** D
14 **Senegal** E
15 **Tanzania** E
16 **Uganda** E

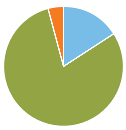
## Year end reserves and resources

### Oil/Gas



- Oil **40%**
- Gas **60%**

### Core area

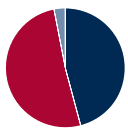


- Europe **16%**
- Africa **80%**
- South Asia **4%**

**Total 506 mmboe**

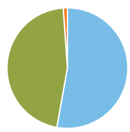
## Revenue

### Oil/Gas/Tariff



- Oil **46%**
- Gas **51%**
- Tariff income **3%**

### Core area



- Europe **53%**
- Africa **46%**
- South Asia **1%**

**Total £579 million**

### August

Tullow awarded 50% operated interest in Angolan Block 1/06; the West Espoir development, in Côte d'Ivoire, came on stream.

### September

US$1.1 billion bid for Hardman Resources Limited announced. The transaction became effective in December 2006.

### December

First oil production from the Okume Complex in Equatorial Guinea; Tullow achieved year-end production target of 75,000 boepd.

# Operational highlights

- 11% increase in average annual production to 64,720 boepd
- Total reserves and resources increased by 149 mmboe to 506 mmboe
- Okume, West Espoir and Bangora developments successfully on stream
- Seven out of 12 exploration wells were discoveries, representing a 58% success rate
- Significant hydrocarbon province discovered in the Lake Albert Rift Basin, Uganda
- Three gas discoveries in the UK, including the potentially significant K4 discovery

# Contents



06 Our strategy is clear, our business is growing and we are continuing to deliver record performance throughout the business, with another remarkable year in 2006.

08 The acquisition of Hardman Resources represents an outstanding strategic opportunity for Tullow.

10 Based on our annual production rate, Tullow needs to find over 30 million barrels of oil per year to maintain reserves and keep growing. We believe, our portfolio is more than capable of achieving this objective.

24 In 2006, Tullow had no significant environment, health, safety or security issues and spent US$1.5 million in funding social and community projects within its core areas.

30 Tullow's strong cash flow and rigorous management of financial risk allowed us to comfortably fund our 2006 capital expenditure programme and increased dividend.

37 The Board and management work within a clear and effective governance framework and the Directors have ultimate responsibility for the effectiveness of the Group's risk management activities and internal control processes.

54 Accounts for the Group are prepared in accordance with International Financial Reporting Standards (IFRS) and for the Company in accordance with United Kingdom Generally Accepted Accounting Principles (UK GAAP).

98 Since 2000, Tullow's business has grown beyond all recognition. We have built not just a great business, but also a great team.

For more information, see our website:
**www.tullowoil.com**

**Tullow Oil plc** is one of the largest independent oil and gas exploration and production companies in Europe with operations in the UK Southern North Sea (SNS), Africa and South Asia. In January 2007, the Group completed the acquisition of Hardman Resources Limited which materially enhances its operations in Mauritania and Uganda and adds high-impact exploration licences in South America.

## Financial highlights

**Sales revenue**

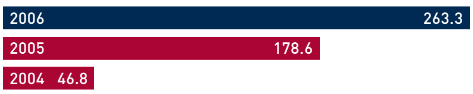
£578.8m +30%


**Operating profit**

£262.6m +32%


**Profit before tax**

£263.3m +47%




**Operating cash flow before working capital**

£446.7m +44%


**Basic earnings per share**

24p +38%


**Dividend per share**

5.5p +38%

# Chairman's statement

Tullow is a versatile and balanced oil and gas exploration and production group with a portfolio of quality assets managed by a team with excellent technical, commercial and financial skills. Our strategy is clear and our objective is to consistently deliver value to shareholders.

- A key part of our performance and growth has been our consistent ability to attract and retain great people
- Our portfolio of over 200 leads and prospects and our balanced approach to developing our assets allows us to allocate resources where they will be most effective
- In an industry that is constantly evolving, Tullow has developed a strong track record of identifying opportunities and executing transactions

## Strong performance trends

During 2006, we invested close to £1 billion in growing the business, including £332 million on capital expenditure, 70% of which was invested in our production and development assets. The 30% increase in revenue and the Group's operating cash flow of £447 million comfortably funded all our capital investment and a dividend 38% higher than that for 2005.

The spread and balance of our business and assets limits our exposure, volatility and risk in any single asset or territory, and also allows us to put in place financing facilities that would not be available for a single-asset or single-region company. Thus, we have the flexibility to allocate capital to wherever it will attract the best return at any time.

## Excellent operational delivery

Each of our three core areas demonstrated major progress during 2006.

In the UK, gas production increased from 130 to 172 mmscfd, enabling Tullow to take advantage of record gas prices in the first half of the year. Effective operational management of the Schooner and Ketch fields brought average uptime to 98% and maximum production to over 100 mmscfd. However, the overall outcome of the 2006 redevelopment programme resulted in a 45 bcf reduction in reserves for these fields. The performance of the other SNS producing assets was positive and, in parallel with growing production, Tullow also participated in four successful exploration wells, including the potentially significant K4 discovery in the Caister Murdoch System (CMS) Area. These discoveries, along with the Thurne, Kelvin and Wissey projects already in progress, form the basis of our future development programme.

+38%

**increase in dividend per share.**

In Africa, Tullow invested over £150 million during 2006, representing 45% of overall capital expenditure, and carried out a wide range of near-infrastructure and high-impact exploration, infill drilling and development activity. Our production objectives were substantially achieved. Infill drilling results were positive across all fields, and our Gabon output was in line with expectations. On the development front, both the West Espoir and Okume fields were brought on stream as anticipated. In exploration, while the outcome of the programme in Gabon was disappointing, results to date from Uganda have exceeded our most optimistic expectations and point to the potential for a world-class new hydrocarbon province to be delivered by the 2007 and 2008 exploration and appraisal programmes. Encouraging progress was also achieved on the Kudu project in 2006, leading to a two-well appraisal drilling programme in 2007 which will test the major upside potential of this strategic Namibian asset.

In Asia, the regeneration of our portfolio continued apace in 2006 and the foundations were laid for an equally exciting 2007 programme. In Bangladesh, first gas was produced from the Tullow-operated Bangora project in May and this, together with the success of the appraisal drilling programme, led to a declaration of commerciality and a material upgrade to year end reserves. In Pakistan, ongoing development work will result in first gas being produced from Chachar in the second quarter, while a two-well exploration programme on the potentially significant Kohat Block will start late this year. Perhaps most encouraging, however, has been India, where seismic acquisition undertaken during 2005 and 2006 has led to the delineation of a number of distinct targets in the CB-ON/1 licence in the Cambay Basin, which will be the subject of a multi-well drilling campaign in 2007.

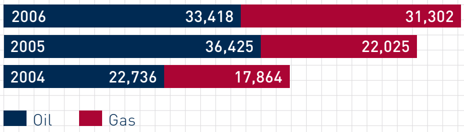
## Carefully managed responsibilities

Tullow recognises that its opportunities come with associated responsibilities. Our commitment to those responsibilities is fully endorsed by the Board and clearly set out in our Corporate and Social Responsibility (CSR) Report and on our website. Our operations must be safe, our activities transparent and our environmental impact carefully managed and monitored. In 2006, Tullow had no significant environmental, health, safety or security issues. The Lost Time Incident Frequency Ratio (LTIFR) was 0.81, well within our target of 1.0, despite a 65% increase to 6.1 million hours worked across the Group, both onshore and offshore, during the year. Furthermore, our responsibilities also include working with communities in a sustainable manner. In 2006, Tullow spent US$1.5 million in funding social and community projects


Service vessel leaves the Horne & Wren platform in the UK SNS.

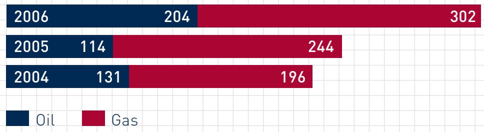
**Working interest production**

# 64,720 boepd +11%




**Total reserves and resources**

# 506 mmboe +42%




within our core areas. We are particularly proud of our activities to date in Uganda where, in addition to establishing local agricultural, fishing and manufacturing enterprises, our Lake Rescue support programme has already saved lives.

## Focused growth strategy

The combination of our excellent operating performance and a positive macro environment has enabled Tullow to focus on the long-term growth and health of our business and portfolio, and invest accordingly. The most obvious example of this during 2006 was the £595 million acquisition of Hardman Resources Limited (Hardman) announced in September and completed in January 2007. The Hardman acquisition represented an outstanding strategic opportunity for Tullow and is a clear demonstration of the substantial financial and operational capability of our business and the skills of our team. Interestingly, the acquisition of Hardman cost less than Tullow's combined capital expenditure for 2006 and projected 2007 expenditure, an effective illustration of the scale the Group has achieved and the major opportunities present within our existing portfolio. Our strong cash flow and rigorous approach to the management of financial risk allows us to implement our growth plans with confidence while comfortably servicing net debt of over £450 million following this acquisition.

## A dynamic external environment

The continued strength of oil and gas pricing has prompted a significant acceleration of exploration, development and corporate activity in the sector. This rapid build up of activity has created pressure on the supply of people, rigs, oil field services and seismic vessels, leading to sharply increased costs. Similarly, the strong cash flows being generated by oil and gas companies have increased competition for quality acreage and assets including corporate deals.

In the UK gas market, following unprecedented pricing in early 2006, the recent addition of much-needed pipeline capacity and impact of a comparatively mild winter have combined to drive gas prices for the first quarter of this year down to 2003 levels. Looking forward, the overall underlying supply and demand fundamentals, allied to the gradual convergence of UK and European gas markets, means the outlook continues to be positive. The oil market has also retreated from a mid-2006 high. However, current and forward pricing remains extremely attractive in historic terms, supporting Tullow's overall strategy of investing in the development of long-life oil assets such as Okume in Equatorial Guinea, Espoir in Côte d'Ivoire, Chinguetti in Mauritania and M'Boundi in Congo (Brazzaville) and exploring in exciting territories such as Uganda and India.

**The £595 million acquisition of Hardman cost less than Tullow's combined 2006 and projected 2007 capital expenditure.**

## Investing in people

In 2006, we strengthened the Board with the appointment of three new Directors. Paul McDade, the Group's Chief Operating Officer, was appointed to the Board in March, while Angus McCoss, who joined Tullow as General Manager Exploration in April 2006, was appointed to the Board and as Exploration Director in December. In June, David Williams joined as a non-executive Director.

Our strong reputation enables us to recruit top people and, combined with the development of internal talent, puts us in an excellent position to capitalise on the exciting opportunities available to Tullow. At a time when our sector is increasingly resource constrained, the Group is well placed for the future with over 45% of our staff being under 45 years of age and with 100 people in an operational or technical capacity.

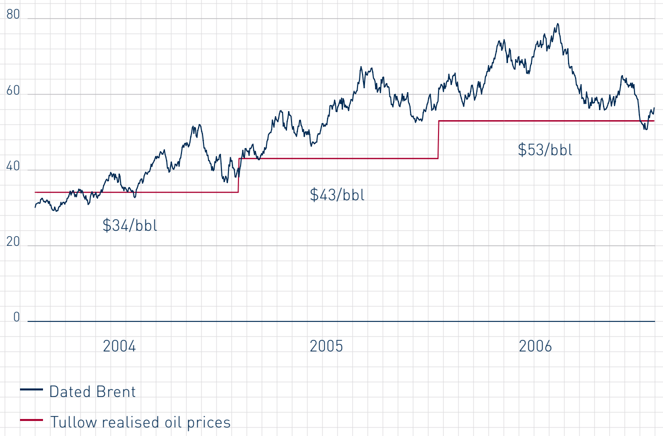
## Positive positioning and outlook

The balance and diversity of Tullow's business allows us to adapt swiftly to opportunities as they arise and to tailor our investment plans to the changing circumstances of the industry.

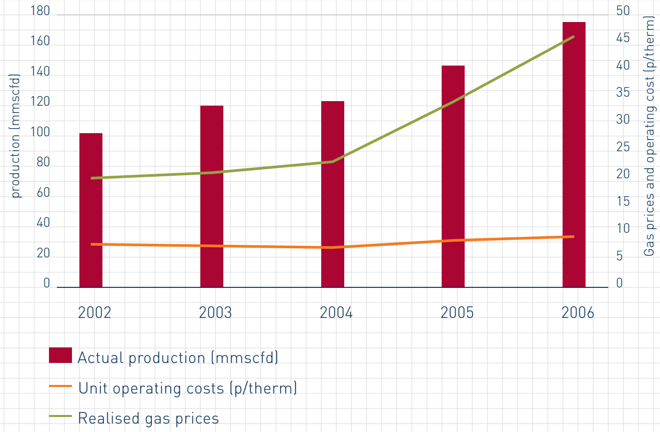
Our production assets, along with our development and exploration activities and the Hardman business, leave Tullow with a high-quality, opportunity-rich portfolio in each of its core areas. Our business is healthy and growing and should remain so for the foreseeable future.

**Pat Plunkett**, Chairman

## Oil prices ($)




## Gas prices





Production facilities at the Bangora field in Bangladesh.

# Chief Executive's review

Tullow had another remarkable year. Our assets delivered strong production growth and good organic reserves replacement. Over 50% of our exploration activity was successful and we completed our largest acquisition ever.

- The quality and spread of our assets and strong oil and gas pricing means the Group is in excellent shape
- Our disciplined approach to reinvestment gives us exciting development opportunities and the financial flexibility to build a balanced long-term business

### Our business is performing

Tullow's growth in recent years has been driven by a clear strategy, assisted by a positive market environment. Since 2000, Group production has risen from 2,500 boepd to over 76,000 boepd currently and we now have over 120 licences in 22 countries.

In 2006, in the UK, the investment and consistent exploration success of recent years enabled Tullow to maintain a steady stream of new projects to replace production and extend the lives of fields. In Africa, our production and development assets are performing well and output should exceed 45,000 bopd by the end of 2007. In Asia, production is growing steadily in Pakistan and Bangladesh, and exciting exploration prospects have been identified in India. Finally the addition of the Hardman business has materially enhanced Tullow's world-wide portfolio and in particular delivered operational control of the logistically critical Block 2 in the Lake Albert Rift Basin in Uganda.

### Comprehensive asset knowledge

Our technical and commercial teams in each area have between them hundreds of years' experience and Tullow has a reputation as a capable, committed and responsible operator with partners and governments. This assists us in gaining consistent access to opportunities and allows us to assess projects swiftly and efficiently against our strategic objectives. For example, we acquired new licence interests in Madagascar in 2005 and Ghana in 2006, in each case benefiting from Tullow's regional experience and core skills in particular geological play types. We were also in a position to respond quickly to the Hardman acquisition opportunity and had the capabilities to complete the deal in over a short time frame.

### The growth challenge

The recent announcement of first production from the Okume field was a major milestone for Tullow. For our African business, Okume is a critical asset which, allied to existing Ceiba production, should make Equatorial Guinea our third largest producing area by 2008. For the Group, bringing Okume onstream means that over 80% of our commercial reserves at the end of 2006 are now successfully producing. While this is a positive achievement it also creates a challenge to initiate the next generation of development projects. Based on our current annual production rate, Tullow needs to discover over 30 million barrels of oil per year to maintain reserves and still keep growing. We believe our portfolio is more than capable of achieving this objective and our exploration, development and new ventures activities are geared towards exceeding it.

### Managing risk

As Tullow has evolved, so also have the risks we face in maintaining control of our business and pursuing growth. The understanding and management of a wide variety of risks is a central part of Tullow's business and a critical element of its strategy.

The principal risks for Tullow include the management of volatility in oil and gas pricing, maintaining safe and cost effective operations and successful relationships with stakeholders including governments, communities, licence partners, finance providers and shareholders. Tullow has established a comprehensive process to ensure that each of these risks is managed in a structured way appropriate to the Group's size and stage of development. Day-to-day risks associated with our exploration, development and production activities are covered by an Integrated Management System which has been adopted across the entire Group. In addition, during 2006, the Group established an Internal Audit Function to facilitate and support the overall risk management and reporting process within Business Units and to the Board.

As an independent oil and gas group, in many ways, Tullow views risk as a positive. Much of our growth has been based on the technical, financial, strategic and operational skill and judgement we apply in accepting the risks inherent in our exploration and development activities, our corporate acquisitions and our allocation of resources. Just as our asset portfolio is balanced, we also seek to ensure that our risk exposure is appropriate to a group of our size with our resources. This involves minimising, at all times, the operational risks faced by our staff and other stakeholders, while simultaneously applying a commercial and investment strategy with a suitable risk/reward balance to ensure the Group can continue its growth in a consistent manner.

### Consistent value creation

By understanding our strengths and applying them with focus and consistency, we have been able to demonstrate a clear record of value creation. Over the last three years, Tullow has delivered total shareholder return (TSR) of

The Central Processing Facility in transit to the Okume Complex in Equatorial Guinea. First production from the field commenced in December 2006.

## Our vision is clear

To be a leading independent oil and gas group, with a balanced portfolio of exploration and production assets.

## Our strategy is consistent and repeatable

- Sustainable long-term profitable growth
- Balance between core areas
- 100% organic reserve replacement annually
- Organic growth through infill programmes and operational excellence
- Development growth through new ventures, licensing rounds and acquisitions
- Safe people, procedures and operations
- Minimise environmental impacts and work with local communities
- A strong team with excellent commercial, technical and financial skills

## Our three year performance is strong

| | | | |
|---|---|---|---|
| Reserves[1] | +623% | Cash flow[2] | +433% |
| Production | +161% | Staff | +81 |
| Sales revenue | +347% | Licences | +44 |
| Operating profit | +666% | Total shareholder return | +371% |

1 2P reserves and resources
2 Operating cash flow before working capital

## Our objective is straightforward

>20% Total shareholder return annually

371%, production growth of 161% and an increase in reserves of 623%. We have a strong concentration on value and consistently seek to replenish our portfolio through new ventures, acquisitions and ongoing portfolio management. Each year we aim to produce efficiently, replace our reserves and drill the best prospects that emerge from our exploration ranking process. During 2007 our attention will be on continuing to increase production to a targeted level of 85,000 boepd by the end of the year, and drilling over 40 wells, including major multi-well campaigns in Uganda, Namibia and India.

### A long-term perspective

Our industry is both competitive and cyclical and so we plan for the future while recalling the past. For Tullow, this entails ensuring our business is not over-geared, planning well in advance for our programmes and not being afraid to walk away, either temporarily or permanently, where we do not see value.

The oil and gas industry is constantly evolving and the opportunities for a group of Tullow's size frequently arises from the changing focus of larger companies, the strengths and weaknesses of our peers and the creativity and skills of our employees. We have a balanced portfolio, a quality team and the ambition and opportunity to keep growing our business. The future looks very exciting.

Aidan J Heavey

**Aidan Heavey**, Chief Executive Officer

# Hardman Resources Limited

## This acquisition is an excellent strategic fit with Tullow's production, development and exploration activities and significantly enhances the Group's world-wide portfolio.

On 25 September 2006 Tullow announced a proposal to acquire Hardman by way of a Scheme of Arrangement, for US$1.1 billion. Following regulatory and shareholder approval, the transaction became effective on 20 December 2006 and formal completion, which involved the payment of A$819.5 million and the issue of 65 million Tullow shares, occurred on 10 January 2007. The integration of the Hardman assets is now substantially complete. Operationally, the African assets are being managed out of Tullow's office in Cape Town and the South American assets will be managed out of our Dublin office.

The acquisition provides material additions to the Group's production, development and exploration activities in Africa and adds exciting exploration opportunities in South America. In particular, the addition of the Hardman assets to Tullow's portfolio:

- increases production by approximately 4,000 boepd;
- increases year end 2P reserves and resources by 35%;
- delivers a full cycle business in Mauritania;
- establishes operational control of Block 2 in the Lake Albert Rift Basin, Uganda;
- significantly enhances Tullow's prospective acreage position; and
- adds 16 exploration wells to the 2007 campaign.

### Mauritania

Tullow now has a unique position in Mauritania with interests in eight contiguous offshore blocks. These include a 19% interest in the producing Chinguetti field and interests in material but undeveloped fields including the Tiof and Tevet oil discoveries and the Banda, Faucon and Pelican gas discoveries. The region is a proven oil and gas province with a diversity of geological plays. While exploration success has been high since 2000 this is still an under-explored basin. Tullow believes that by working closely with our Joint Venture partners on the 2007/2008 exploration campaigns and applying our knowledge and skills to the multiple play types, we can realise some of the significant upside potential of these assets.

### Uganda

The Group now has a 100% operated interest in Block 2 in the Lake Albert Rift Basin. Tullow and Hardman jointly made four oil discoveries in the Kaiso-Tonya region of the block in 2006. These discoveries proved up a working hydrocarbon system in the basin and tested good quality oil from highly productive reservoirs. Building on this success, substantial upside potential has been identified in the block in the Kaiso-Tonya area, the Butiaba Area to the north and beneath Lake Albert, where the larger prospects are located. Block 2 in Uganda is also likely to be the hub of any future development due to the relatively easy access to the lake shore, the level terrain for operations and the logical oil export route to the coast. Gaining operational control was therefore key for Tullow to drive the pace of further exploration, appraisal and future development across the basin, where Tullow is the largest acreage holder. In 2007, Tullow will undertake a programme of 2D and 3D seismic acquisition and further drilling across the basin to prove up the reserves. In addition, Tullow plans to sanction the development of an Early Production System in 2007, with a view to producing first oil in 2009.

### Additional prospective acreage

The acquisition expands Tullow's prospective acreage position through the addition of licences in Tanzania, Mauritania, Suriname, French Guiana and the Falkland Islands and adds 16 exploration wells to the 2007 programme. Extending Tullow's acreage into new frontier basins in South America allows the Group to apply its expertise from comparable geology in West Africa.

For more information, see our website:
**www.tullowoil.com**

# Business review: Production and Development

2006 was a year of delivery: successful key development projects achieved our year end target of 75,000 boepd; UK operating capability delivered record gas production and facilities uptime; and business development significantly enhanced the Group's portfolio.

- Development projects on schedule and providing continued production growth
- Enhanced operating capability with a strong focus on safety, the environment and our neighbours
- 89% reserves replacement, with total commercial reserves and contingent resources now exceeding 500 mmboe

**Delivery of key objectives in 2006**
2006 was dominated by the production of first oil and gas from several of Tullow's key developments. The most significant project was Okume, which produced first oil in December. This US$1.2 billion development is performing ahead of expectations and is now well on its way to delivering around 10% of Tullow's production by early 2008. The Tullow operated Bangora development in Bangladesh delivered first gas in May 2006, only 18 months after the field was discovered. In Africa, the West Espoir development delivered first oil in July and is now enhancing the value of the overall Espoir area. The strong operational performance of our UK portfolio resulted in record levels of gas production at an all time peak of pricing in the UK gas market. Overall we continued to deliver on our objectives of strong reserves replacement and ongoing production growth.

The management of key developments, producing assets and exploration drilling activities was performed with a strong focus on costs, operational safety and minimisation of our impact on the environment. This resulted in lower operating costs, against a backdrop of an inflationary contractor market, combined with an excellent safety and environmental performance despite significantly expanded operations.

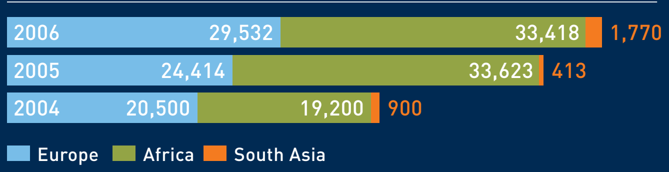
**Challenging external environment**
Whilst the commodity pricing environment has been strong, leading to increased ability to commercialise our oil and gas assets, it has been countered by a tight and inflationary contractor environment. In 2006, despite significant inflationary pressures on our field operating costs we managed to maintain our cost of production below 2005 levels. This has been achieved by strong cost management, but more importantly on more optimal use of our infrastructure by increasing throughput and synergies. This will continue in 2007 where operational synergies, especially in the Espoir and Ceiba/Okume projects, will have a greater impact.

+11%

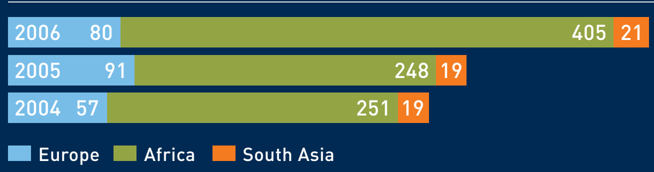
**increase in average annual production to 64,720 boepd.**

Competition increased for new assets and licences during the year and Tullow's entrepreneurial approach, combined with our diverse portfolio of assets, enables us to meet this challenge. Recently we have seen lead times for future developments significantly increase. To address this industry-wide problem we have enhanced our skills

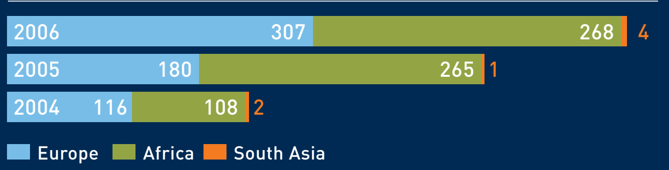
Production by core area (boepd)




Total reserves and resources by core area (mmboe)




Sales revenue by core area (£m)




in medium to long-term operational planning and improved our capacity to share resources across our global asset base.

### Strong operating capability and team

Tullow has built a highly skilled team of operational management and technical specialists, and despite the competitive employment environment, we continue to attract and retain excellent people. The ongoing strengthening of the team and improvements to our organisational structure help to guarantee that we have the capacity to continue to expand our business, whilst ensuring that existing operations and developments are executed on schedule, to budget and in a manner that is safe and environmentally aware.

85,000 boepd

**targeted level of production by year end.**

### Operational control of strategic assets

A key element of our strategy is to enhance our operational control or influence over key assets. Our SNS and South Asia portfolios are well balanced in this regard and our focus is now on achieving a similar balance in the Africa core area. This includes acquiring African licences as operator where possible, direct operational control of Kudu and gaining control and operatorship of the strategically important Block 2 in Uganda, a key element of the rationale for the Hardman acquisition. This block will be central to all oil developments in the Lake Albert Rift Basin, and we have already integrated it into our operational structure to ensure early production from recent discoveries.

### Continued growth and delivery in 2007

Our extensive and balanced portfolio of opportunities has assisted Tullow in managing the recent changes in both the global contractor market and the UK gas pricing environment. Tullow prioritises financial and operating flexibility and undertakes a structured and rigorous process of project and prospect evaluation to ensure effective allocation of funds at any point in the cycle. Thus for 2007, we will have a greater focus on funding and resources, mainly in Africa and South Asia, until the anticipated improvement in pricing and the contractor environment occurs in the UK gas market.

Our ability to continue to access and drive development activity across our portfolio is central to our continued growth. In 2006 this was achieved through exploration success, the addition of new licences and the Hardman acquisition, which gives the Group significant opportunities in Uganda and Mauritania. The portfolio of resources and assets that Tullow has built over recent years is expected to continue to deliver strong production and development growth in 2007.

**Paul McDade**, Chief Operating Officer

## Production and development

**22 producing fields**
**120 licences, 22 countries**

### Challenges

- Improve asset performance and extend field lives
- Maintain quality and diversity of portfolio
- Deliver production and reserves growth
- Retain the ability to adapt to the external environment

### Skills and opportunities

- Clear Management of EHS performance across the business
- Strong operational team and operating capability to drive performance
- Maintaining production growth and asset enhancement
- Continuing to build the portfolio and deliver development opportunities

# Business review: Exploration

Tullow continuously develops its high quality exploration portfolio, strengthening the potential for sustained long-term growth. This is achieved through a consistent programme of new ventures, effective deployment of core skills, strong Joint Venture partnering and quality execution of exploration campaigns.

2006 was a successful year for Tullow's exploration. Seven out of 12 wells were discoveries and the Group opened a new and significant hydrocarbon basin in Uganda. We also acquired material acreage in Ghana, Angola, Congo (DRC) and Madagascar, adding to the Group's leads and prospects, which will help deliver future reserves replacement.

## Four core plays

Tullow excels in four core play types and we leverage our capabilities in those plays across the world, in effect ensuring geology surpasses geography when it comes to finding oil and gas. The Group has over 200 leads and prospects in these core plays, covering all stages of evaluation from initial screening through to delivering developable commercial discoveries. Each of the core plays is proven to have first class potential and each comes with its particular value and challenges.

- **Salt basins** – Salt is a first class seal and salt tectonics form a rich diversity of trap types. Tullow's seismic acquisition, processing and interpretation expertise in Salt Basins provides a tangible competitive advantage.

- **Stratigraphic traps** – These targets can have exceptional upside and often lie subtly within held acreage. We are working consistently to develop Tullow's portfolio and proven expertise in this play and in particular to tap the vast potential of significant stratigraphic traps lying offshore West Africa.

- **Rift basins** – These are a fundamentally rich setting for petroleum exploration and customarily benefit from world-class source rocks and generally straightforward structural geology. Tullow has gained extensive expertise in this core play through our work on discoveries and prospects in the UK North Sea, Uganda, Madagascar and India.

- **Fold belts** – These provide substantial upside potential within Tullow's prospect inventory, particularly in Pakistan. Reservoirs folded into very large anticlines can trap material volumes of hydrocarbons with good follow up potential.

Focusing on our core geological plays allows us to grow through a controlled extension of our geographic footprint. This is through strategic 'step-out' of drilling to pursue familiar plays across national boundaries and by cross-connecting between 'Atlantic twins', which are familiar but new basins on the opposite side of the Atlantic Ocean. Tullow's knowledge of West African basins and plays directly complements acreage on the eastern continental margin of South America, acquired with the Hardman portfolio.

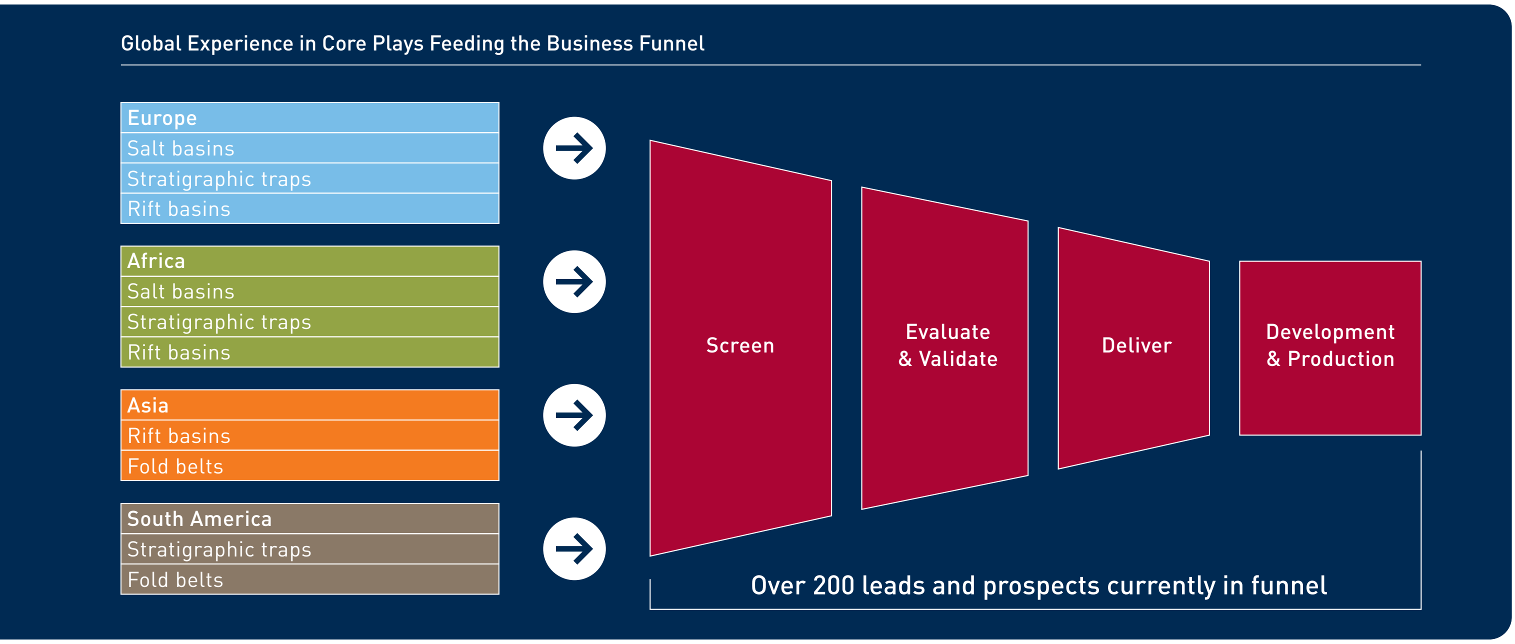
## Three leading campaigns

High-impact exploration campaigns targeting multiple leads and prospects are central to Tullow's growth. Each is led by an exploration manager who is a member of Tullow's global exploration leadership team. This team has over 200 years of exploration experience and works alongside over 50 high-calibre geological and geophysical professionals across the Group.

43%

**is Tullow's average licence interest.**

During 2006 the Group drilled 12 exploration wells, seven of which were hydrocarbon discoveries. Three successful near-infrastructure exploration wells were drilled in the UK Southern North Sea including the potentially significant K4 discovery in the CMS Area.




Tullow's Ugandan exploration campaign in the Lake Albert Rift Basin this year had a 100% success rate, yielding five oil discoveries. These discoveries established a totally new proven hydrocarbon basin. The oil is light and sweet, albeit waxy, with a low gas content and, on testing, flowed at remarkably high rates from very permeable reservoirs. Following the acquisition of Hardman, Tullow now has operational control of Block 2, the central acreage containing four of the five discoveries and the key location for basin-wide operations.

Our exploration campaign in India in the Cambay Rift Basin is geologically analogous to the Lake Albert Rift Basin in Uganda and targets proven plays within which, immediately to the north, there have been material oil discoveries and from which, immediately to the south, substantial oil production is being delivered to a strong local market. Significant progress was made in India with the completion in 2006 of an extensive, block-wide, 1500km 2D seismic programme. Interpretation and integration of data is generating independent prospects in multiple plays which will lead to the drilling of several wells, commencing in the second half of 2007.

Detailed geological studies of well and seismic data from the Kudu offshore gas field in Namibia have enabled us to develop a predictive model of the reservoir types and distributions in and around the Kudu field. A highly productive gas reservoir forms the Kudu main field and a laterally extensive gas reservoir, albeit less productive, establishes a play with very substantial multi-tcf upside volumes. This will be appraised through drilling and flow testing two wells in Kudu East in 2007.

### Emerging upside

In offshore Ghana, seismic interpretation and prospect evaluation through 2006 identified the Mahogany prospect in the West Cape Three Points block in 2007. Mahogany is a large high-impact oil prospect. Detailed analysis of the 3D seismic response indicates the potential to encounter hydrocarbons.

In blocks CI-107 and 108 in Côte d'Ivoire, two significant structural highs have been identified that are analogous to the Espoir and Baobab fields to the east. Acquisition of 3D seismic data was completed in November 2006 and the data is currently being processed with a view to drilling one of these features in 2008.

Mauritania also has significant upside potential and an exploration campaign is being developed. Considerable 3D seismic coverage over our extensive acreage allows us to work up the plays in detail, fine tune our geological understanding and target prospects in sweet spots.

### An exciting exploration outlook

While we are extending and expanding upon the newly discovered plays, we are also fast-tracking the appraisal of discoveries, as we prepare for development, production and early commercialisation. In addition, we aim to maintain a balance between 'near-infrastructure' and 'high-impact' exploration opportunities and between core plays and regions through ongoing portfolio and risk management.

**Angus McCoss**, Exploration Director

## Exploration

**200 leads and prospects, 120 licences, 22 countries**

### Challenges

- Expand the funnel of opportunities based on core plays
- Acquire fairly priced and attractive prospective acreage
- Improve portfolio quality
- Balance near-infrastructure and high impact exploration
- Find 30 mmboe per year to maintain reserves

### Skills and opportunities

- Team with global and core plays experience
- Clear strategy to bring focus to a wide range of prospects and leads
- Opportunity rich portfolio with mix of onshore and offshore activities in different territories
- Access key resources in a competitive market

# Business review: Europe

During 2006 Tullow's UK business reported record production and gas price realisations and, despite recent volatility, longer-term gas price fundamentals support a strong outlook for indigenous producers.

## 2006 highlights

- Production averaged 172 mmscfd, 32% above 2005 levels
- Schooner and Ketch redevelopment brought two wells on stream, uptime to 98% and peak production of over 100 mmscfd
- Two new development projects, Thurne and Kelvin, sanctioned
- Three exploration well successes with Humphrey, Cygnus and the potentially significant K4 gas discoveries
- Awarded six blocks in February 2007 in the 24th licensing round

Tullow's interests in Europe are primarily focused on gas and infrastructure in the UK SNS. Since 2000, Tullow has established a dominant position in the Thames-Hewett and CMS infrastructure hubs through a combination of acquisitions, an active development and exploration programme and participation in licensing rounds. As a consequence, Tullow is well placed to increase its production and benefit from a favourable UK gas market.

### UK gas pricing

Gas prices within the UK have increased significantly over the last few years as the region has become a net importer of gas. Following record highs in 2006, gas prices have fallen during the 2006/2007 winter period driven by unusually warm weather and the commissioning of new import infrastructure. This is set against a background of high rig rates and service costs and an increased taxation burden for companies and has temporarily reduced returns from UK gas developments. Longer-term gas price fundamentals are, however, expected to remain strong for indigenous producers and gas price seasonality continues to provide opportunities for Tullow.

### Thames-Hewett Area

In the Thames-Hewett Area Tullow has established itself as an efficient, low cost operator, successfully developing marginal fields, extending the life of mature fields and attracting third party business to generate tariff income. In 2006 Tullow's net production from these assets averaged 77.8 mmscfd.

Tullow holds a 67% interest in the Thames hub and takes an active role in the management of this asset. During 2006, the negotiation of a new gas sales contract for the Thames field, enabled the partners to accelerate production from the field. It also resulted in the approval of the Tullow-operated Thurne field development and the review of a number of possible infill well opportunities to enhance field recovery.

The Thurne development, in which Tullow has an 87% interest, will re-use the existing Deben pipeline and Thames platform reception facilities, with a horizontal development well due to spud in March 2007. First gas is targeted for September 2007 at an anticipated plateau rate of 50 mmscfd.

The Horne & Wren fields sustained production at 110 mmscfd until the end of 2006, having been shut-in over the summer months in order to conserve gas deliveries for the higher-demand winter months. Development plans for the adjacent Tullow-operated Wissey discovery were advanced during the year, and it is proposed to sanction the project in 2007 as a tie-back to the Horne & Wren platform. Tullow is also considering a number of other satellite fields for potential development.

### Hewett Complex

Within the Hewett Complex Tullow's focus has been on late-life projects to enhance production, extend field life, improve reserves recovery and reduce operating costs. The Group drilled and brought on stream the Delilah development well and completed three successful well stimulations, thereby slowing overall field decline. Further well stimulation work is planned for 2007, while the use of coiled tubing drilling is also being investigated to provide a lower cost solution for drilling infill wells on the field.

**46p/therm**

**was a record average gas price realised from Tullow's SNS assets during 2006.**

An offshore cost reduction initiative on the Hewett Complex resulted in the simplification of the satellite platforms' control systems to improve reliability and minimise the number of intervention visits. Further cost reductions are planned for 2007.

In addition, Tullow plans to drill an exploration well on the Doris prospect in the Hewett Complex in the second half of 2007.

A waterbridge linking a barge to the Horne & Wren platform during a facilities maintenance programme, which was carried out in the summer of 2006.

Heli-deck of the Ensco 101 rig which carried out development drilling on the Schooner and Ketch fields during 2006.


## CMS Area

Strong performance from the CMS Area led to average production of 94.2 mmscfd in 2006, 35% above 2005 levels. In this less mature region of the SNS, Tullow's focus has been on exploration, near-field development opportunities and redevelopment of the Schooner and Ketch fields and third party business.

Following the acquisition of the Schooner and Ketch fields in 2005, Tullow commenced a redevelopment programme, which initially focused on a successful campaign of well optimisation, and a facilities maintenance programme increased operational uptime to in excess of 98%.

Drilling operations then started in 2006 with production from the first well, Schooner-10, commencing in May at a rate of 22 mmscfd. The second well, Ketch-7, was brought on stream at 50 mmscfd in October and together the wells have enabled Schooner and Ketch production to reach over 100 mmscfd. The third well, Ketch-8, was drilled in the fourth quarter of 2006 and encountered excellent quality reservoir sands. Technical problems with this well during the completion phase led to a temporary suspension and remedial work is now planned. The Ketch-9 well was spudded in early January 2007 with first production expected in May. Following the completion of the Ketch-8 and Ketch-9 wells it is planned to release the Ensco 101 rig.

A second rig, the Borgsten Dolphin, drilled the NW Schooner Extension appraisal well during 2006. The well found depleted gas in communication with the main field and is not currently commercial. This has resulted in a 45 bcf downgrade in the Schooner and Ketch reserves.

Following development studies on the Kelvin (formerly K3) field, discovered in 2005, the Department of Trade and Industry (DTI) approved the field development plan and the project was sanctioned by partners. Key installation contracts have been awarded, platform fabrication is under way, and a rig has been secured to spud the first production well in the third quarter of 2007. Production from the Kelvin field is scheduled to commence in December 2007 at a gross rate of 80 mmscfd.

Significant opportunities remain for third party business in the CMS Area through effective utilisation of the CMS transportation system. During 2006 an extensive programme carried out by the operator identified opportunities to enhance system capacity and thereby increase its potential as a hub for new field developments.

100%

**success rate as all three of the UK exploration wells were discoveries in 2006.**

The Humphrey field was discovered in March in Block 44/16. The well encountered gas in good quality Ketch formation sands in the Upper Carboniferous, as well as in fluvial sands in the Lower Leman formation. The partners are now looking to develop the field, with production expected to commence in late-2008.

The second discovery in May was the Cygnus field in Block 44/12. This well encountered gas in the principal Lower Leman target, as well as in the underlying Ketch formation. The results of the well are now being integrated into the geological model of the area in order to optimise development plans.

The K4 well discovered gas in June in Block 44/23b. This is a complex compartmentalised field with significant upside potential, which is likely to require further appraisal drilling. Integration of the data from the well is ongoing and will help to define the appraisal and development programme and tie-in of the field to the Kelvin facilities.

Encouraged by ongoing success in these stratigraphic traps, similar prospects in the CMS Area are being worked to drill-ready status and it is planned to spud an exploration well on the Harrison prospect in Block 44/19b in mid-2007.

## Central North Sea

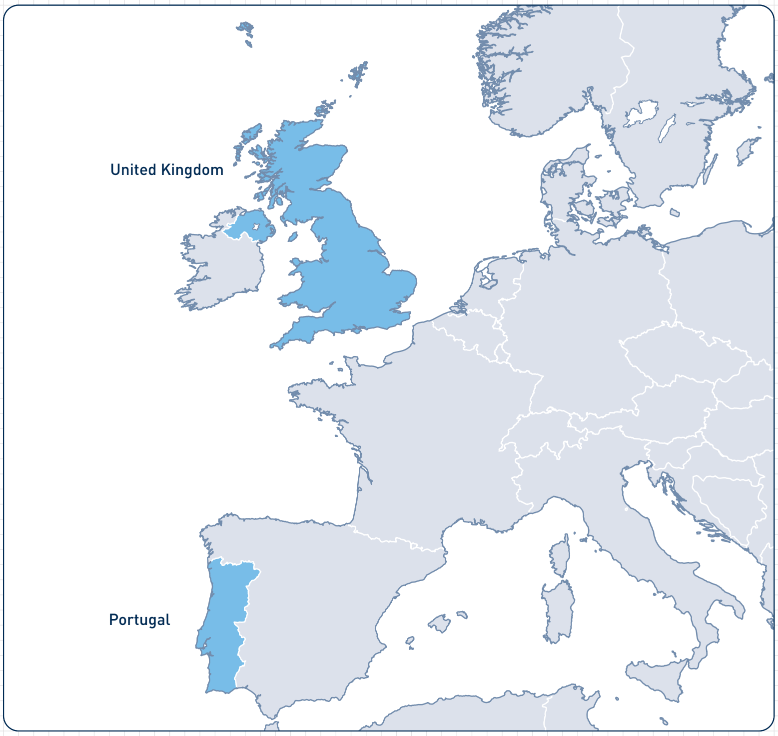
The final two explorations wells for 2006, Acer and Peveril, were delayed due to the late arrival of the drilling rigs. These wells are planned to spud in April 2007 and are targeting oil prospects in the Central North Sea.

## 24th licensing round

In February 2007 in the 24th offshore licensing round, Tullow was awarded six exploration blocks, in the Thames-Hewett and CMS Areas. Tullow plans to acquire seismic data as a part of a full evaluation of the potential of this acreage and anticipates that exploration wells on this acreage will form part of the 2008 drilling programme.

## Netherlands exploration

In 2006 Tullow made its first application for acreage in The Netherlands, for Block E/13. We anticipate receiving the result of this application in the first half of 2007. Should the application be successful, we plan to conduct detailed seismic reprocessing in 2007 and drill an exploration well in 2008.




### Portugal exploration

In February 2007, Tullow was awarded three licences in the Alentejo Basin off the southwest coast of Portugal. Following the interpretation of the 5,100km of existing seismic data, new seismic data will be acquired in 2007 in order to confirm the presence of drillable prospects in this highly under-explored basin.

## 2007 Operational outlook

The Group has an active programme for its UK Assets in 2007:

- Average production of 33,000 boepd expected in 2007;
- Thurne and Kelvin developments scheduled to come on stream in the third quarter 2007;
- Wissey development project sanction is anticipated this year;
- Schooner and Ketch redevelopment including bringing on stream Ketch-8 and 9 wells in May 2007; and
- Six exploration wells planned.

### Key producing assets/Assets under development

| Country | Activities | Producing fields/ *fields under development* | Tullow % |
|---|---|---|---|
| **United Kingdom** | | | |
| CMS Area | E D P | Boulton | 9.50 |
| | | CMS III [1] | 14.10 |
| | | *Kelvin* [2] | *22.50* |
| | | Ketch | 100.00 |
| | | Munro | 15.00 |
| | | Murdoch | 34.00 |
| | | Schooner | 90.35 |
| Thames-Hewett Area | E D P | Gawain | 50.00 |
| | | Hewett [3] | 51.69 |
| | | Horne & Wren | 50.00 |
| | | Orwell | 100.00 |
| | | Thames [4] | 66.67 |
| | | *Thurne* [5] | *86.96* |
| | | *Wissey* [6] | *62.50* |

### Key:

E – Exploration D – Development P – Production

### Exploration activities

**Portugal**

**Notes:**

1. CMS III includes Boulton H, Hawksley, McAdam, Murdoch K and Watt.
2. First gas scheduled for late 2007.
3. Hewett includes Hewett, Deborah, Delilah and Della.
4. Thames includes Thames, Bure, Wensum and Yare.
5. First gas scheduled for second half 2007.
6. First gas scheduled for second half 2008.

For more information, see our website:
www.tullowoil.com

# Business review: Africa

## 2006 was an outstanding year for Tullow's African assets. Production commenced from two major development projects, a new hydrocarbon province was discovered in Uganda and the portfolio was enhanced through the award of licences in Angola, Madagascar, Ghana, Congo (DRC) and Gabon.

### 2006 highlights

- In Gabon, new interests in three development licences and back-in rights to nine exploration assets were acquired
- First oil was achieved in July from West Espoir, Côte d'Ivoire
- First oil was achieved in December from the Okume Complex, Equatorial Guinea
- 100% success in Ugandan exploration with five oil discoveries
- Hardman acquisition resulted in operational control of Block 2 in Uganda and a new material position in Mauritania
- Seven new African licences awarded

In January 2007, Tullow completed the acquisition of Hardman which added materially to the Group's assets in Mauritania, enabled Tullow to take operational control of Block 2 in Uganda and added further high impact exploration acreage in the region. Since year end, Tullow has acquired interests in two additional licences in Côte d'Ivoire.

### Gabon

In 2006, production from Gabon averaged 15,120 bopd. Activity during the year focused on optimisation of the current producing assets, commercialisation of undeveloped assets and the acquisition of additional licence interests.

At the end of 2006 Tullow acquired a package of assets from the Gabonese Government through a 50:50 Joint Venture with AIC-Petrofi Limited. The package comprises interests in three producing fields and back-in rights to a further nine exploration licences. Further fields are expected on stream over the next 18 months. The acquisition increases Tullow's net production by approximately 350 boepd and is expected to contribute approximately 1,000 boepd by early 2008.

Tullow now has interests in a total of 12 producing fields, five exploration licences, back-in rights to three fields that are currently under development and back-in rights to a further nine exploration blocks. Through these interests, Tullow has exposure to almost 40% of the currently licensed Gabon exploration acreage and participates in fields which together account for almost one third of Gabon's daily production.

On the onshore Niungo field, a new phase of appraisal and development drilling commenced in September 2006. Five successful wells have been drilled and have assisted in increasing gross field production to over 15,000 bopd. This programme will resume during the second quarter of 2007 with the drilling of two further infill wells and an exploration well to the south of Niungo in the Nziembou Licence.

First production from the first Etame satellite, the Avouma field, commenced in January 2007 and the field is now producing at a gross rate of over 5,000 bopd. Production from the Tchatamba field declined during the year. However, following workovers on three wells in November and December, gross production had recovered to close to 27,000 bopd by year end. In 2007, methods of enhancing production by accessing bypassed oil in the field will be examined.

Exploration in Gabon in 2006 focused on targets close to existing infrastructure. Three wells were drilled on our acreage during the year, but were not successful. However, farmouts reduced overall financial exposures.

Exploration plans for 2007 comprise one onshore well on the Nziembou Licence and continuing technical work on a number of the licences to identify prospects for drilling in 2008.

### Congo (Brazzaville)

In Congo (Brazzaville), Tullow is a partner in the M'Boundi field. During 2006, 29 wells were drilled on the field and production averaged 56,000 bopd for the year, reaching a peak of 60,000 bopd in the first quarter. Following a period of rapid reserves and production growth in recent years, the field boundaries have been substantially delineated and the focus of the operations is now on water injection and optimising reserves recovery.

During the year the facilities were upgraded to provide for 60,000 bwpd water injection capacity and three injection and several water supply wells were drilled. Water injection commenced in January 2007 and it is anticipated that it will be expanded to the full field. The blending and export of M'Boundi crude with the higher quality N'Kossa blend commenced in January 2006, significantly improving the discount to Brent.

In 2007, 33 development wells are planned and field production is expected to average 50,000 bopd.


Men at work on the foundations of a water tank at the M'Boundi field in Congo (Brazzaville).

### Equatorial Guinea
The development of the Okume Complex in Equatorial Guinea continued on schedule throughout 2006. First oil was achieved ahead of schedule in mid-December. Drilling is in progress on the Oveng and Elon fields and will continue throughout 2007 and into 2008. Wells will also be drilled into the Okume and Ebano fields in the latter half of 2007. The gross production rate in March 2007 was approximately 26,000 bopd and is expected to increase to a plateau of 60,000 boepd in 2008. The oil is being blended with Ceiba production and exported via the Ceiba FPSO, for maximum operating and production efficiency.

In the Ceiba field, three infill production wells and two water injectors were drilled during the year. Gross annual production averaged 40,000 bopd and at the end of the year the rate for the field reached 50,000 bopd. This programme has continued into 2007 with the objective of maintaining an average field rate of 40,000 bopd. Up to three water injectors and three producers are planned for 2007.

Tullow also has an interest in Equatorial Guinea Block L and in May 2006 participated in the unsuccessful Banyan-1 exploration well. A farmout in exchange for a carry of costs on this well significantly reduced Tullow's financial exposure. The operator of the block is in the process of negotiating an extension and a seismic option on the permit.

### Côte d'Ivoire
In Côte d'Ivoire Tullow has production, development and exploration interests in three offshore blocks.

The CI-26 licence contains the producing East and West Espoir fields with potential satellite tie-backs. During 2006 a very successful East Espoir infill drilling programme was completed. The Al Baraka rig then moved to West Espoir in mid-2006. First oil from West Espoir was achieved in July 2006 and the field is expected to average over 10,000 boepd during 2007. Drilling is expected to continue into 2008 with six production wells planned for 2007.

During 2006 the average gross East and West Espoir production was 30,000 boepd. Production is expected to increase to 36,000 boepd by the end of 2007.

A seismic survey was conducted in CI-107 and CI-108 and is currently being interpreted. It is likely that drilling will commence on these licences in 2008.

Côte d'Ivoire has been identified as a key area for expansion of Tullow's exploration portfolio and since year end, Tullow has acquired two new licence interests.

## First oil

**from the Okume Complex was achieved in December 2006, on time and on budget.**

### Namibia
In 2006, Tullow continued to make steady progress with the development of the Kudu gas field. The Group focused on negotiating a gas sales agreement for the gas-to-power project, preparing for two appraisal wells in early 2007 and initiating negotiations to bring in a partner for up to 20% of the project.

The potential development options for the substantial proven gas volumes already discovered in the Kudu field now include both the export of electricity generated by a 800 MW power plant located in Namibia and the direct gas export by pipeline to South Africa. A review of these options by Namibian and South African stakeholders is under way.

In addition to gas reserves required for power generation, Tullow has also identified very substantial upside potential within the Kudu area. Tullow has fully integrated all the regional geoscience data to develop a geological model, which will be tested by two appraisal wells on the field starting in April 2007. The aim is to establish commercially productive flow rates in the much more laterally extensive but less permeable of two proven gas reservoirs. If this can be achieved, then a multi-tcf upside potential will be demonstrated and direct pipeline exports of Kudu gas may become feasible.

Tullow has been seeking a partner to join the Kudu partnership and this process will be completed prior to the start of the 2007 appraisal programme. Tullow expects to reduce its working interest from 90% to approximately 70% and to introduce a strategic partner who can contribute expertise, funding and other skills to achieve the optimal long-term development of this asset.

The successful development of Kudu has the potential to make a very important contribution to Namibia's long-term power needs and Tullow is committed to sanctioning this project at the earliest opportunity.

### Mauritania
Tullow has held interests in Blocks 1 and 2 offshore Mauritania since 2004. In Block 1, integration and analysis of the results from the 2005 Faucon discovery have upgraded the exploration potential on the block and a 3D seismic survey is planned for the third quarter of 2007. In addition, five prospects have been delineated in Block 2, one of which will be selected for drilling in mid 2007.

In January 2007 Tullow acquired interests in a further eight licences as part of the acquisition of Hardman. These interests include the producing Chinguetti oil field, the Tiof and Tevet potential developments and the Banda and Pelican gas discoveries.

The successful Ugandan exploration campaign in the Lake Albert Rift Basin this year included:

- four onshore wells and two flow tests to establish a working hydrocarbon system;
- acquisition of gravity, magnetic and 2D seismic data to identify new prospects in the unexplored Butiaba area;
- drilling and testing of the significant Kingfisher discovery. The Kingfisher drill site is pictured here; and
- preparation for drilling more frontier wells including Ngassa and Kingfisher–2, in 2007.

The Chinguetti field, operated by Woodside, is located in 800m of water 80km southwest of Nouakchott. Production commenced in late February 2006 and peaked at a gross rate of 75,000 boepd but has subsequently declined to 23,000 boepd, leading the Operator to downgrade the ultimate recovery from that envisaged in the original development plan.

An infill drilling programme to enhance recovery commenced in December with the C-18 well in the southwest of the field. The well has been drilled to a total depth of 2,883m and encountered a gross oil column of approximately 213m, in line with expectations. Importantly, the well also appears to be receiving pressure support from a nearby water injection well. In addition, a workover to shut off water in the C14 well was also completed. These operations are expected to provide an immediate enhancement of current production rates.

Further infill wells are scheduled to commence during the third quarter of 2007. The final locations of the wells will be determined by the results of the high density 3D and 4D seismic surveys conducted over the Chinguetti field in March 2007.

Tullow believes that Mauritania is a region with considerable long-term upside potential and, following the Hardman transaction, Tullow is developing its technical understanding of the assets acquired to support the ongoing exploration and development activities in the region.

## Ghana

Three exploration blocks were signed in Ghana during 2006 – Shallow Water Tano, Deepwater Tano and West Cape Three Points.

2007 will see the drilling of the significant Mahogany prospect in West Cape Three Points. The prospect extends into the Deepwater Tano block and if the exploration well is a success, an appraisal well from this block will follow.

There are several existing oil and gas discoveries in the Shallow Water Tano contract area, one of which will be appraised during 2007 following reprocessing of the 3D data over the block. A successful gas appraisal well could result in a rapid development of gas into the existing gas market in Ghana.

## Angola

In August 2006 Tullow was awarded a 50% operating interest in Block 1/06, offshore Angola. The block extends from a water depth of 40m to approximately 300m and contains three undeveloped oil fields, Pitangueira, Bananeira and Sapesapeiro.

Tullow's initial objective is to evaluate the commerciality of these discoveries by reprocessing the 3D data during 2007 and, following interpretation of the results, the Group expects to drill two wells in 2008. A regional interpretation is also in progress to evaluate the potential of the remainder of the block prior to planning a large 3D seismic survey.

## Uganda and Congo (DRC)

2006 has been an exceptional year for Tullow in Uganda. The Group has proved up a substantial new hydrocarbon province in the Lake Albert Rift Basin with five discoveries and well test results surpassing all expectations. The acquisition of Hardman has enabled Tullow to take operational control of the exploration and appraisal of the basin and has increased its exposure to the significant upside potential of the region. During the year, Tullow also gained interests in two prospective blocks in Congo (DRC) adjacent to its Ugandan acreage.

The initial four wells in Uganda were drilled in Block 2 from the lake shore to prove up a working hydrocarbon system in the basin. The Mputa-1 well was spudded in late December 2005 and intersected two oil-bearing sandstone reservoirs of very good quality. In March 2006 the Waraga-1 well was drilled 19km to the north of Mputa-1. This well discovered oil at three separate levels including a basal sandstone not encountered in Mputa-1. The Mputa-2 well was then drilled in May, 3km northwest of Mputa-1. This well intersected oil in a thin basal sand and also confirmed the existence of an oil column of at least 100m in the upper Mputa reservoir.

# 27,000 bopd

**cumulative test rate from three Ugandan exploration wells.**

Between June and August 2006 the Waraga-1 and Mputa-1 wells were production tested, the first time hydrocarbons have been produced to surface in Uganda. Three production tests on Waraga-1 yielded a maximum combined flow rate of 12,000 bopd. The Mputa-1 well tested at a combined maximum flow rate of 1,100 bopd from two shallower, lower pressure intervals. The test results showed that the penetrated reservoirs are of excellent quality. The crude is waxy but is generally a light oil of good quality (33-34° API), with a low gas-to-oil ratio.

The Nzizi-1 well was drilled in October and proved the presence of oil in a structure analogous to the Mputa reservoirs. This well also encountered a 30m section of oil shows in weathered basement, indicating additional upside potential.

The fifth well, Kingfisher-1, in Block 3A, targeting a much larger structure under Lake Albert, was spudded in August 2006. The well intersected two significant oil-bearing intervals, with net pay of 10m and 44m, which tested at cumulative rates of 4,120 bopd and 9,773 bopd respectively. Due to the operating capability of the rig the well could not be deepened to reach the primary target. However, the excellent results from the secondary objectives should substantially reduce the exploration risk in this deeper part of the Lake Albert Rift basin.

Following the successes of 2006 and the large upside potential identified, the plan for 2007 is to pursue an aggressive programme of 2D and 3D seismic and further exploration/appraisal drilling across the Lake Albert Rift Basin. Studies are also under way to identify solutions for drilling on the lake and, in parallel, a higher capacity rig is being sourced to drill the large Ngassa and Kingfisher deep targets from the shore.

In addition to the extensive exploration and appraisal programme, Tullow is pursuing the development of an Early Production System, in 2007, with a view to producing first oil in 2009. The initial conceptual studies are well advanced and are likely to involve the installation of a local topping plant to extract petroleum products from the crude and a power generation plant to meet local electricity demands. It is anticipated that this early development will be sanctioned in 2007.

## 2007 Operational outlook

In 2007, in Africa, the Group plans to continue with significant levels of exploration, development and production activity. The exploration activity will involve drilling 10 or more wells with a focus on the two key campaigns in Uganda and Namibia. In addition, ongoing development projects in Gabon, Congo (Brazzaville), Côte d'Ivoire, Equatorial Guinea and Mauritania, are expected to result in continued production growth.


### Key producing assets/Assets under development

| Country | Activities | Producing fields/ *fields under development* | Tullow % |
|---|---|---|---|
| Congo (Brazzaville) | D P | M'Boundi | 11.00 |
| Côte d'Ivoire | E D P | Espoir | 21.33 |
| Equatorial Guinea | E D P | Ceiba | 14.25 |
| | | Okume Complex [1] | 14.25 |
| Gabon | E D P | Avouma | 7.50 |
| | | *Ebouri [2]* | *7.50* |
| | | Echira | 40.00 |
| | | Etame | 7.50 |
| | | Limande | 40.00 |
| | | Niungo | 40.00 |
| | | Oba | 5.00 |
| | | Obangue | 3.75 |
| | | *Onal [2]* | *7.50* |
| | | Tchatamba Marin | 25.00 |
| | | Tchatamba South | 25.00 |
| | | Tchatamba West | 25.00 |
| | | Tsiengui | 3.75 |
| | | Turnix | 27.50 |
| Mauritania | E D P | Chinguetti [3] | 19.01 |
| Namibia | D | *Kudu [4]* | *90.00* |

### Key:

E – Explo ration    D – Development    P – Production

### Exploration activities

**Angola, Cameroon, Congo (DRC), Ghana, Madagascar, Senegal, Tanzania, Uganda**

Notes:

1. Okume Complex includes the Elon, Okume, Ebano and Oveng fields.
2. Tullow has back-in rights to this field which is due on stream in 2008.
3. Interest in the Chinguetti field was acquired in December 2006 as part of the Hardman acquisition.
4. Project activities focused on concluding commercial agreements for gas-to-power project.

For more information, see our website:
**www.tullowoil.com**

# Business review: South Asia

2006 was a very successful year for Tullow in South Asia, with significant progress across the exploration and development portfolio, providing a foundation for further growth in 2007.

## 2006 highlights

- Average production of 1,690 boepd, 307% above 2005 levels
- First gas achieved from the Bangora field in May 2006
- Drilling completed at the Chachar development, with first gas anticipated in April 2007
- Seismic acquisition completed at Kohat, with drilling scheduled this year
- In India, seismic acquisition increased from 600 to 1,500km with a four well campaign planned for 2007

South Asia is currently experiencing strong growth in energy demand. Tullow has had interests in the region since 1990 when it was awarded several exploration blocks in Pakistan and now has production, development and exploration activities across Pakistan and Bangladesh and highly prospective exploration interests in India.

### Pakistan

Following Government approval for the development of the Chachar field in 2005, Tullow drilled and completed two development wells. Installation of the Chachar gas plant is almost complete and first gas is anticipated in April 2007. Up to 30 mmscfd of pipeline capacity has been allocated to transport Chachar gas to the Guddu power station.

Production from the Sara and Suri fields continued to decline during 2006 but Tullow plans to install compression facilities on the field to allow increased production from the current 2.4 mmscfd to approximately 7.0 mmscfd in the second quarter of 2007.

Exploration operations in Pakistan during 2006 concentrated on the Kohat and Nawabshah blocks. In the Kohat block, 311km of 2D seismic data were acquired in this structurally complex area. Processing of the data set is scheduled for completion in the second quarter of 2007, to be followed by a drilling programme on this high potential block in late 2007.

In the Nawabshah Block, the Shahpur Chakar-1 well was spudded in February and reached total depth in April 2006. Following disappointing results, the well was plugged and abandoned and a decision made to relinquish the licence.

Exploration activities on other licences in Pakistan were curtailed during the year due to access problems. Efforts focused on getting approvals to work in these blocks. Tullow believes that good progress is being made in Balochistan and is hopeful that work in some of these very prospective blocks will commence before the end of 2007.

### Bangladesh

Following approval by the Government of Bangladesh of the Block 9 Bangora/Lalmai appraisal programme in 2005, significant progress was made on the block during 2006. A 620 sq km 3D seismic survey was completed over the entire Bangora/Lalmai structure and the data was processed and interpreted to define the appraisal well locations.

As part of the appraisal programme, three successful appraisal wells, Bangora-2, 3 and 4 were drilled during 2006. The Bangora-5 well reached total depth in early 2007 and is also planned as a gas production well. All wells to date have encountered good quality, gas-bearing reservoir sands, resulting in an upgrade in reserves. In parallel with the ongoing appraisal activity, a production facility was installed to allow the discovery well, Bangora-1, to be put on a long-term production test, which commenced in May. Since then gas from Bangora-2 was added to production in October and the combined production is currently 60 mmscfd. This is expected to increase to 75 mmscfd when the Bangora-5 well is tied in by mid-2007.

**The successful 2006 appraisal programme on the Bangora field led to a declaration of commerciality in December.**

On the basis of the encouraging appraisal seismic/drilling and production test results, the Joint Venture partners submitted a Notice of Commercial Discovery to the Bangladesh authorities in December 2006 and it is planned to submit the Field Development Plan in April 2007.

Ongoing technical work is focused on optimising additional drilling locations on the Lalmai portion of the field as well as evaluating the remaining exploration potential in the greater Block 9 area, beyond the designated appraisal boundary.

In offshore Blocks 17&18, a 294km 2D transition zone seismic programme, focusing on the St. Martins Island area of Block 18, was completed in April 2006 and an evaluation of this area is in progress. In early 2006, Tullow signed a farmout agreement whereby Total agreed to acquire a 60% interest in the licence. The assignment to Total and an extension of the Production Sharing Contracts to May 2009 was approved by the Bangladesh authorities in March 2007 and a substantial 3D seismic survey is planned for 2007/2008.

### India

Tullow's primary area in India is in the CB-ON/1 block, situated in the Cambay Basin, in a region where a number of major oil discoveries have been made. Significant progress was made during 2006 with the acquisition and processing of data in an extensive, block wide, 1,500km 2D seismic programme. Interpretation and integration of the data set has identified a number of independent play types in the block. These play types are proven in the hydrocarbon provinces on trend to the immediate north and south. An initial drilling campaign of four exploration wells is scheduled to start during the second half of 2007.

## 2007 Operational outlook

2007 will be an active year for Tullow in South Asia:

- Production is expected to average 5,800 boepd in 2007
- Bangora – full field development plan to be submitted in early 2007
- Chachar – field due on stream in the second quarter 2007
- Pakistan – exploration drilling on Kohat
- India – drilling campaign to commence in H2 2007


### Key producing assets/Assets under development

| Country | Activities | Producing fields/ *fields under development* | Tullow % |
|---|---|---|---|
| Bangladesh | E D P | Bangora/*Lalmai* [1] | 30.00 |
| Pakistan | E D P | *Chachar* [2] | *75.00* |
| | | Sara/Suri | 38.18 |

### Key:

E – Exploration D – Development P – Production

### Exploration activities

India

Notes:

1. Lalmai discovery under appraisal/development.
2. Chachar Field due on stream first half of 2007.

Seismic crews in operation on the 2D transition zone survey in Block 18.

For more information, see our website:
**www.tullowoil.com**

# Corporate and social responsibility

Tullow has a long track record of operating in developing economies, many of which have complex socioeconomic challenges or high environmental sensitivity. Our objective is to minimise our impact on the environment and to foster and support longer-term development and self-sustaining enterprise in local communities.

- In 2006, Tullow had no significant environmental, health, safety or security issues, continuing to protect Tullow staff, contractors and local communities and manage our environmental impact
- LTIFR was 0.81, well within our target of 1.0, despite a 65% increase to 6.1 million hours worked during the year in 17 countries, both onshore and offshore
- We improved our corporate and social responsibility initiatives by developing our procedures and formalising Tullow's policies for 'Working with Communities'

Overall, we performed well against our 2006 objectives set out in our first CSR Report, published during the year, achieving or exceeding all of our targets. A review of the options for full external verification has been completed and a procedure is in place for verification of the 2007 CSR Report.

**Environmental performance from our UK operated assets was strong, achieving results well within consented annual limits in each case.**

### Strong environmental performance

Environmental data is collected for our operated producing assets, the majority of which are in the UK. Full details are contained in the 2006 CSR Report, which will be published in May 2007. The key environmental performance highlights for 2006 are:

- A further 15% reduction in Carbon Dioxide emissions from the Bacton and Hewett facilities. At 216,940 tonnes, this was almost 50% below the European Union Emissions Trading Scheme consented amount.
- Water is used as part of the gas refining process and for fire water at the Bacton Terminal and this year decreased by 36% to 18,678 $m^3$, 60% below the Environment Agency's consented annual limits.
- Tullow has two discharging gas platforms in the SNS and, combined, these discharged 0.1624 tonnes versus a DTI consent of 1.11 tonnes.

### More disclosure

At Tullow we are committed to transparent disclosure and clear communication of our activities and policies, both internally and externally. We are constantly refining the Group's policies and procedures to manage the increasing range of risks we face in our business and facilitate our day-to-day work. In 2006, for example, we reviewed our driving policy in recognition of the fact that this is a frequent source of accidents occurring within the oil and gas industry. In addition, we have recently formalised and updated the Group's Human Rights and Anti-Bribery policies, which apply to all employees, contractors and agents of the Group. Tullow appointed Graham Martin, General Counsel and an executive Director of the Group, as the nominated director with responsibility for Human Rights issues.

### Investing in social entrepreneurship

One of the key tasks we set ourselves in 2006 was to develop the Groups 'Working with Communities' initiative with a particular emphasis on the development of social entrepreneurship models within the communities where we work.

Our community-based environmental and social projects got off to a great start in Uganda in 2006. Tullow undertook a US$220,000 project in the Kaiso-Tonya region on the shores of Lake Albert and in close proximity to the Group's operations there. Based on discussions with local village chiefs and communities, Tullow's initiatives and funding centred on health, safety, education and access:

- Each year more than 30 people die in the area from water borne cholera. Wells and pipelines were installed to carry fresh water
- To help prevent the spread of malaria, we gave 1,000 mosquito nets to local families
- As 25% of infants in the region die at birth, training was given to local women and traditional birthing attendants, on hygienic birthing practices and birthing rooms have been constructed in Kyehoro, Kaiso, Mbegu and Tonya
- Road access built for the drilling operation provides a route to market for local fishermen and inbound access for medical advisers and local government aid. Two new airstrips built in the region facilitate additional local access
- A beekeeping co-operative was set up incorporating seven villages and 200 hives are already in place, with 2,000 planned over two years. This is helping to build a profitable business in the substantial Ugandan honey market
- To improve safety on Lake Albert, which is used daily by thousands of people fishing, Tullow undertook two projects. For full details please see caption and picture opposite

While thousands of people fish Lake Albert for their livelihood, many do not swim and few wear life jackets, so loss of life through drowning is a constant threat. To improve safety on the lake, Tullow undertook two projects: the manufacture of life jackets by local women and the training of a locally based lake rescue team. In January this year two fishermen were rescued as a result of these initiatives.

# Corporate and social responsibility

continued

## Linking CSR and business development

During 2006 we formalised the Group's CSR activities and, through the CSR Committee, aligned funding and sponsorship with business development. Projects will be a mix of recurring long-term investment in key areas, combined with one-off investments appropriate to the context of Tullow's business. The terms of reference of the Committee are to:

- Develop and implement a framework for Group-wide CSR expenditure;
- Consider and propose an annual budget for CSR activities to the Board;
- Evolve and further develop Tullow's social and ethical policies;
- Prepare and approve the CSR Report;
- Review and coordinate internal and external CSR activities; and
- Consider other CSR matters as specified by the Board.

In 2006, the Group spent US$1.5 million on CSR projects, including funding committed under various licence agreements. This represents an increase of 12% over 2005. In 2007, total expenditure of close to US$2.5 million has been approved or is committed under licence terms, with projects spread across all the Group's core areas.

+12%

**increase to US$1.5 million in funding for social and community projects within our core areas.**

## Rigorously managing risk

There are inherent risks in the oil and gas industry. We manage these through good policies and practice which stress the need for individual and collective responsibility. With activities across 22 countries, Tullow operates in very diverse environments of regulation and compliance, but seeks to apply common Group-wide standards wherever possible.

We manage our EHS performance, and work to improve this performance, through the Group's Integrated Management System. This is a disciplined framework for the management of environment, health, safety and security matters throughout the Group. The Group's Performance Management System provides clear links between Corporate EHS targets and Business Unit targets.

Tullow Oil plc achieved International Standards Organisation (ISO) 14001 certification, an internationally recognised standard for environmental management, in May 2006. This certification and implementation of Tullow's environmental standards will be tested and verified in Bangladesh and Pakistan in 2007 and in Uganda in 2008.

During 2006, the Group prepared and adopted a Tullow standard for Environmental and Social Impact Assessment, in line with best practice and World Bank Standards. We developed the process using input from Tullow's country managers and tested our findings in the field on projects in Madagascar and Ghana with positive results. To ensure positive practice across all key areas of our Contracts and Procurement Process, we also reviewed our methods of ensuring the EHS commitment and awareness of our suppliers.

Tullow operates a 24/7 on-call crisis management system, which in 2006 was again subject to ongoing 'live' simulation exercises to test the plan, team and facilities. All exercises are independently observed and feedback is implemented to ensure continued improvement in our practices and preparedness. This system was in full operation on 11 January 2007, when a 4,500 tonne commercial cargo ship passing through the CMS Area in the SNS, lost power from its engines and began to drift in force 10 gales. Emergency Response Teams were assembled at the Bacton Terminal and in the London office. Production in the area was shut in, 30 offshore personnel were evacuated by the Coastguard and a full media briefing plan was put in place. Fortunately, the vessel passed just south of the Murdoch platform and, at a later stage, within a couple of hundred metres of the Caister platform without incident or injury. By the early hours of the morning of the 12 January, the ship was out of the CMS Area and production recommenced on a staged basis on 12 and 13 January.

## More to do

2006 was a good year for EHS and CSR in Tullow. However, the sheer pace of growth that the Group has achieved in the last number of years continues to present us with opportunities and challenges in these areas. Addressing these is given the highest priority within Tullow. We have set ourselves key plans and objectives again in 2007 including the successful transition of the Hardman assets, no significant environment incidents throughout the Group and LTIFR below 0.90. Risk management, good corporate behaviour and continuous improvement are built into the fabric of Tullow and our approach is to be responsible, aware and committed.

Street scene on the road from Bangora in Bangladesh.

# Tullow people

## Since 2000, Tullow's business has grown beyond all recognition. Tullow now operates in 22 countries and has over 250 employees. We have built not just a great business, but also a great team.

- The retention, development and ongoing expansion of our team is fundamental to Tullow's growth objectives
- All our employees have a stake in the business and in its success through the Group's reward and recognition policies
- This enables Tullow to attract and retain high-performing and high-potential people in all areas of the business

### Positive working environment

Our principal goal is to build an organisation with a spirit that reflects a 'one Tullow' ethos across all our locations and operations. Our culture is based on respect for the individual and integrity, openness and honesty in all our dealings.

As a Group we focus on ensuring safe working environments and systems for our employees and contractors, supported by appropriate policies and procedures.

**The 2007 LTIFR target is 0.90, continuing to focus on the safety and well-being of our employees and contractors.**

We encourage and support healthy living options and achieving a work-life balance, offering flexible and remote working and sponsored gym and sports activities across the Group's three main offices in London, Dublin and Cape Town.

We are also committed to transparent disclosure and clear communication of our activities and policies, both internally and externally. During 2006, as part of a Group wide initiative to improve knowledge sharing, we began rolling out a unified Tullow Intranet to give employees access to corporate and Group information and news at the same time. This is the first phase in a major Group-wide project to integrate people, systems and information onto common platforms and is already improving communication within offices and across the Group as a whole.

### Exciting career opportunities

Throughout Tullow we have numerous career development opportunities that offer exciting new personal experiences and professional challenges. We have put in place a consistent approach to remuneration and encourage secondments to different projects, transferring technical expertise and enhancing skills and knowledge on a global basis. This broadens and develops our competitive edge in the industry and helps us attract and retain talented, ambitious and versatile people.

## 100 people

**in an operational or technical capacity positions the Group well in an industry that is increasingly resource constrained.**

### Clear objectives and performance based rewards

Our recognition and reward strategy is strongly linked to performance and achievement, from both a Group and individual perspective. All employees participate in bonus and share incentive schemes and we have implemented a Group-wide Performance Management System, providing training and support for ongoing staff appraisal and development on a consistent basis. This system is based on a transparent set of complementary personal and corporate objectives with a clear link to key performance metrics in the Group's growth strategy.

In 2007, as part of a Board level initiative, Executive Directors and senior management will participate in a programme to identify and develop the leadership skills and behaviours that are fundamental to the Group's continued success. This will be integrated into our strategy and objectives to help us continue to develop our team and the business in a way that supports Tullow's long-term profitable growth.

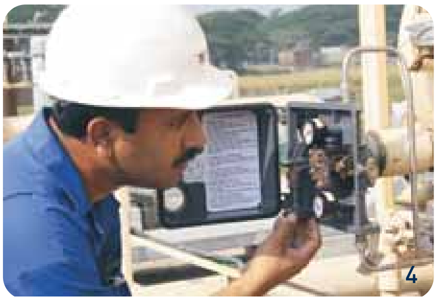
## Over 45%

**of our staff are under 45 years of age. Tullow has built a team for long-term growth.**

### Still growing

Over the coming years, we will continue to improve in all people-related areas. A range of projects – small and large – will help us remain a great place to work and move closer to our goal of being the employer of choice within the industry.

1 Bhav Amin and Tan Kent.  2 Julia Ross.
3 Gert-Jan Smulders and Monique Beattie.
4 MD Sumsojoha Talukder.  5 Ian Dunleavy.
6 Dick Lee.  7 Tim O'Hanlon.  8 Martyn Morris, Kevin Stallbom, Manu Wope.  9 Henrietta Mitford.
10 Fionnuala Davis.  11 Chris Flavell.
12 Paul Burden and Nhlanhla Kubheka.



# Finance review

## During 2006, Tullow achieved extremely strong performance across all its key indicators and this enables us to continue to invest with confidence.

- Our objective is to run a balanced international business with a long-term perspective on performance and growth
- Tullow's financial strategy supports the Group's operational and growth strategies and funded over £1 billion of investment in 2006
- The performance of our production interests and efficiency of our exploration and development programmes are critical influences on our financial capacity

### Higher production and better pricing

Working interest production averaged 64,720 boepd, 11% ahead of 2005. Sales volumes averaged 57,300 boepd, representing an increase of 7%. Production increased most notably in Europe, which rose 21% or 5,000 boepd, and Asia which rose 330% or 1,400 boepd. Oil production from Africa was in line with 2005, driven by strong performance in Equatorial Guinea and Côte d'Ivoire offset by a modest decline in Gabon.

**Record pricing achieved in 2006. Gas price realisations increased by 36%. Average oil price realisations increased by 21%.**

Prices realised for both oil and gas during 2006 showed material increases over 2005. In the UK, extreme shortness in gas supply during the first half of the year led to record prices and was the principal factor driving Tullow's realised prices to 46.2p/therm, a 36% increase over 2005. The Group also recorded tariff income of £16.6 million (2005: £14.7 million) from its UK infrastructure interests.

Increases in world oil prices during the first half were also a key influence on realisations from Tullow's African business which rose by 21% to $52.2/bbl (2005: $43.1/bbl). Tullow's oil production sold at an average discount of 5% to Brent during the year, reflecting improved competitiveness in the West African oil trading environment and revised blending and marketing arrangements in respect of the M'Boundi field.

As a result of higher production and prices, 2006 revenue amounted to £578.8 million, an increase of 30% over 2005. The mix of production also changed slightly, with UK production increasing from 41% of 2005 production to 45% of the 2006 total; with increased production from Asia, this meant that the Group's production was relatively evenly balanced between oil and gas.

### Effective operational cost control

Underlying cash operating costs, which exclude depletion and amortisation and movements on under/over lift, amounted to £112.0 million (£4.74/boe). These costs were 2% below 2005 levels, despite higher underlying oil and gas pricing, which had a direct impact on reported operating costs due to royalties in respect of Gabonese production. Reported operating costs before depletion and amortisation for the year of £114.7 million (2005: £123.5 million) were also impacted by the inclusion at market value of £2.7 million associated with overlifted volumes at 31 December 2006, principally relating to the Group's interests in Gabon and Equatorial Guinea.

### Enlarged business with more activity and investment

Depreciation, depletion and amortisation for the year amounted to £144.9 million (£6.13/boe). This represents a 21% increase over 2005, principally as a result of a higher depreciation charge on UK assets. The increased charge was driven by material investment in the Schooner and Ketch assets combined with a reduction of 45 bcf in commercial reserves attributed to the fields. The reduction in reserves followed an evaluation of the results of the 2006 redevelopment programme and the drilling of the unsuccessful Schooner NW well.

Tullow invested significantly in people during 2006. Average staff numbers increased 20% to 209 people, adding strong resources to our technical, commercial and senior managerial teams. As a result, underlying general and administrative costs have increased by 48% to £18.3 million. The total general and administrative costs charge of £22.5 million also includes a charge of £4.2 million in respect of the Group's share-based incentive schemes (2005: £1.4 million).

**Unit operating costs reduced by 2% in 2006 as a result of careful management of costs and a focus on efficiency.**

Exploration costs written off were £32.5 million (2005: £25.8 million), in accordance with the Group's 'successful efforts' accounting policy, which requires that all costs associated with unsuccessful exploration are written off to the Income Statement. The principal write downs during 2006 related to Angola, Gabon, UK exploration and new ventures/pre-licence costs. The Group drilled 12 exploration wells in 2006 and made seven discoveries, and is planning to drill over 40 wells over the next 12 months.

| Key performance indicators | 2006 | 2005 | Change |
|---|---|---|---|
| Lost Time Incident Frequency Rate per million hours worked | **0.81** | 0.82 | Down 0.01 |
| Production (boepd) | **64,720** | 58,450 | Up 11% |
| Reserve replacement (%) | **89%** | 118% | Down 29% |
| Sales volume (boepd) | **57,300** | 53,350 | Up 7% |
| Realised oil price per bbl ($) | **52.24** | 43.05 | Up 21% |
| Realised gas price (pence per therm) | **46.18** | 33.85 | Up 36% |
| Cash operating costs per boe (£)[1] | **4.74** | 4.84 | Down 2% |
| Operating cash flow before working capital per boe (£) | **18.76** | 13.50 | Up 39% |
| Net debt | **122.1** | 140.2 | Down 13% |
| Interest cover | **24.0** | 15.5 | Up 8.5 times |
| Gearing (%)[2] | **15%** | 36% | Down 21% |

1. Cash operating costs are cost of sales excluding depletion and amortisation and under/over lift movements.
2. Gearing is net debt divided by net assets.

## Strong performance indicators
Within the Group we have defined a number of business units based on geography and activity type. Each business unit is responsible for the execution of a development strategy and achievement of short-term performance targets. These targets are based on and support the Group's strategic objectives and Key Performance Indicators, which are used to assess the ongoing progress of the business.

## Operating profit increased 32%
Operating profit before exploration activities amounted to £295.1 million (2005: £224.4 million), an increase of 32%, reflecting the strong growth in Group production and realised oil and gas prices, somewhat offset by increased depreciation charges on a per barrel basis.

## Financing costs and interest cover
Tullow's growth during 2006, and in particular the Hardman acquisition, was greatly facilitated by the support of the Group's banking syndicate and the balance and diversity of our portfolio. Prudent use of debt is a core element of the Group's overall strategy and Tullow has a flexible financing facility which allows non-OECD activities to be funded at an overall financing cost of circa 8%.

The net interest charge for the year was £15.0 million (2005: £19.8 million) and reflects reduced levels of net debt during 2006. At 31 December 2006, Tullow had net debt of £122.1 million, (including £46.5 million of net cash attributable to Hardman). Since year end net debt has increased to £450 million as a result of the Hardman transaction, involving payment of A$819.5 million (£329.9 million) of cash consideration on 10 January 2007. Interest cover was very healthy at over 24.0 times (2005: 15.5 times).

## No increase in effective tax rate
The tax charge of £105.9 million (2005: £65.4 million) relates to the Group's North Sea and Gabonese activities and represents 40% of the Group's profit before tax (2005: 37%). After adjusting for non-deductible exploration costs, hedge ineffectiveness charges and non-recurring items the Group's underlying effective tax rate remained unchanged at 35%, despite the introduction of an additional 10% supplementary Corporation Tax by the UK Government on 1 January 2006.

## More effective hedging
At 31 December 2006 the Group's derivative instruments had a negative mark to market value of £21.0 million (2005: £147.8 million). Of this, £72.7 million relates to a negative mark to market on oil contracts, the majority relating to hedges acquired as part of the acquisition of Energy Africa in 2004, which is largely offset by a positive mark to market on gas contracts of £45.6 million. The Group's position also includes a positive mark to market of £5.9 million in respect of foreign exchange derivative instruments entered into in respect of the Hardman transaction and the balance relates to interest rate derivatives.

While the oil and gas arrangements all qualify for hedge accounting, the variations in crude oil discounts and gas production patterns for Tullow do cause a degree of hedge ineffectiveness. During 2006, however, the steady reduction in average discount attributable to Tullow's oil production, combined with lower year end commodity prices, has resulted in an improvement in overall cumulative hedge ineffectiveness at 31 December 2006. Consequently, a credit of £9.8 million has been recognised in the Income Statement for the year in respect of oil and gas contracts. In addition a credit of £5.9 million is reflected in the Income Statement in respect of foreign exchange derivative instruments as they do not qualify for hedge accounting under IAS 39.

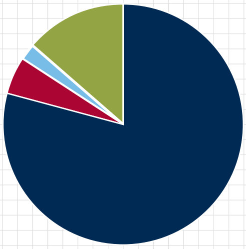
**Consistent hedging policy with over 80% of 2007 capital expenditure covered by hedged volumes.**

Tullow continues to undertake hedging activities as part of the ongoing management of its business risk and to protect the availability of cash flow for reinvestment across its asset portfolio. Hedges in respect of 2007 provide downside protection on revenue of over £280 million, representing over 75% of 2007 budgeted capital investment. The Group's hedge position as at 15 March 2007 can be summarised as follows:

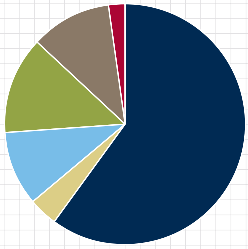
| Hedge position | H1 2007 | H2 2007 | 2008 |
|---|---|---|---|
| **Oil** | | | |
| Volume – bopd | 16,491 | 17,400 | 10,793 |
| Current price hedge – US$/bbl | 52.67 | 55.47 | 51.80 |
| **Gas** | | | |
| Volume – mmscfd | 93.6 | 69.8 | 54.4 |
| Current price hedge – p/therm | 44.35 | 44.98 | 46.11 |

## Shareholder analysis – March 2007

### By Segment




### By Geography




### Strong profit for the period and increased dividend

Profit after tax amounted to £157.4 million, representing a 39% increase over 2005. This profitability has allowed the Group to once again substantially increase its dividend. A final dividend of 3.5 pence per share has been proposed by the Board. This brings the total payout in respect of 2006 to 5.5 pence per share, representing an increase of 38% over 2005. While the Board plans to maintain a progressive dividend policy, future increases are unlikely to match those of recent years, due to the significant level of reinvestment opportunities currently available to the Group.

### Shareholder distribution and TSR

Since Tullow initiated dividend payments in 2003, cash returned to shareholders has exceeded £80 million.

+400%

**Tullow's TSR over a five year period from 2001 to 2006.**

This is an important component of TSR, which in 2006 exceeded 49%, placing Tullow in the top quartile of its peer group. Over the five year period from 2001 to 2006, Tullow's total shareholder return has been in excess of 400%, while total shares in issue have doubled from 358 million shares to the current level of approximately 717 million shares spread across over 10,000 shareholders.

### Strong balance sheet capacity and financial flexibility

The excellent pricing environment, allied to increasing production and effective control of underlying operating costs, led to record operating cash flow before working capital movements of £446.7 million, 44% ahead of 2005. This cash flow, allied to the positive asset performance and strong reserve replacement of recent years gave the Group access to substantial financial capacity throughout 2006; facilitating investment of £332 million in production, development and exploration, a 38% increase in the dividend and the acquisition of Hardman.

**Capital expenditure of £332 million in 2006 was split 70:30 between development and exploration activities.**

During 2006 approximately 70% of Group capital expenditure was associated with ongoing development and production enhancement projects in the UK, Gabon, Congo (Brazzaville), Equatorial Guinea and Côte d'Ivoire. The remainder of expenditure was reinvested in exploration and appraisal activities, where the Group drilled 12 wells, recording seven discoveries. The success of these multi-year programmes has enabled Tullow to record average organic reserve replacement of 98% for the three year period 2004 to 2006. During 2007, we plan to invest a further £350 million in our assets, with the aim of achieving average production of approximately 80,000 boepd and delivering three major exploration campaigns in Uganda, Namibia and India.

### Hardman acquisition

On 25 September 2006, Tullow announced a proposal to acquire Hardman by way of a Scheme of Arrangement. Following the approval of the acquisition by Hardman shareholders and the Australian Courts, the Scheme became effective on 20 December 2006 and formal completion occurred on 10 January 2007. The acquisition of Hardman was by a cash offer, combined with a partial equity alternative amounting to up to a maximum of 65 million Tullow shares, representing approximately 40% of the value of the transaction. The partial equity option was fully exercised by Hardman shareholders and the balance of the acquisition consideration, amounting to £359.1 million, was paid in cash funded by a mixture of existing debt and a new facility provided by Bank of Scotland Corporate. Following the transaction, Tullow has net debt totalling approximately £450 million. During 2007, the Group will seek to repay a portion of this debt and adjust the terms of the remainder to better match the Group's reserve base and long-term growth objectives.

**The £595 million Hardman acquisition was consolidated with effect from 31 December 2006.**

Hardman's business and assets have been consolidated in Tullow's financial statements with effect from 31 December 2006. A preliminary fair value exercise has been undertaken to determine the values attributable to the acquired assets and liabilities within the Group's Balance Sheet as at 31 December 2006. The total fair value attributed to the transaction amounts to £750.0 million, comprising £594.7 million of consideration and associated costs and an additional £155.3 million of deferred tax uplift provided in accordance with the provisions of IAS 12. Based upon this preliminary exercise, Tullow has allocated a total of £86.9 million to Tangible Assets, relating to the Chinguetti field in Mauritania, and a total of £623.5 million to intangible assets reflecting Hardman's interests in a variety of discoveries, potential development projects and exploration across a total of seven countries including Uganda and Mauritania. The balance of the preliminary fair value allocation, amounting to £39.6 million, is accounted for by the other net assets, including cash balances, acquired. Due to the timing of the transaction and the wide range of assets and interests

# £2.6 billion
year-end market capitalisation

# + 49%
2006 TSR

# +16%
2006 FTSE 250 outperformance

acquired, the fair value allocated at 31 December is preliminary in nature and will be reviewed during 2007 in accordance with the provisions of IFRS 3 relating to Business Combinations.

The reserves attributable to the Hardman assets have also been reflected in Tullow's commercial reserves and contingent resources analysis at 31 December 2006. In particular, Tullow has allocated a total of 9.6 mmboe of commercial reserves to its 19% interest in Chinguetti and 17.8 mmboe of commercial reserves to its additional 50% interest in the Mputa and Nzizi discoveries in Block 2 in Uganda.

**Financial strategy and outlook**
Tullow operates a business which is commercially aggressive but financially conservative. We recognise the financial risks inherent in our operations and mitigate them through portfolio diversity, prudent hedging and close attention to costs.

**Tom Hickey**, Chief Financial Officer

## Investing and reinvesting

**£600 million financial capacity**
**£450 million operating cash flow**

**Challenges**
- Maintain prudent financial strategy which retains flexibility
- Continue progressive dividend policy
- Active management of portfolio
- Access to acquisition opportunities

**Skills and Opportunities**
- Rigorous identification, execution and integration of deals
- Efficient capital allocation process
- Manage gearing and growth
- Strong cash flow and Commodities markets

# Board of Directors







### 1. Pat Plunkett
**Chairman**

Aged 56. Pat Plunkett joined the Board as a non-executive Director in 1998 and was appointed non-executive Chairman in 2000. He is also Chairman of the Nominations and Remuneration Committees. Mr Plunkett is an accountant with over 30 years' experience in the financial services sector and is a former director of the Irish Stock Exchange. He managed the stockbroking and corporate finance businesses of ABN AMRO Bank in Ireland from 1993 to 1998. Since then he has been providing strategic advice and non-executive director services to a number of private companies.

### 4. Angus McCoss
**Exploration Director**

Aged 45. Angus McCoss was appointed to the Board in December 2006. He joined Tullow in April 2006 as General Manager Exploration. A geologist with a BP sponsored PhD; Dr McCoss has 20 years of wide-ranging exploration experience, working primarily with Shell in Africa, Europe, China, South America and the Middle East. He has held a number of senior positions within Shell including Americas Regional Vice President Exploration and ultimately as the General Manager of Exploration throughout onshore and offshore Nigeria.

### 2. Aidan Heavey
**Chief Executive Officer**

Aged 54. A founding Director and shareholder of the Company, Aidan Heavey has played a key role in the development of Tullow from its formation in 1985, to its current international status as a leading independent oil and gas Exploration and Production Group. A Chartered Accountant, he previously held roles in the airline and engineering sectors in Ireland. He is a member of the Nominations Committee. Aidan is a director of Traidlinks, an Irish based charity established to develop and promote enterprise and diminish poverty in the developing world, particularly Africa.

### 5. Paul McDade
**Chief Operating Officer**

Aged 43. Paul McDade was appointed to the Board in March 2006. Mr McDade joined Tullow in 2001 and was appointed Chief Operating Officer following the Energy Africa acquisition in 2004, having previously managed Tullow's UK gas business. An engineer with over 20 years' experience he has worked in various operational, commercial and management roles with Conoco, Lasmo and ERC. He has broad international experience having worked in the UK North Sea, Latin America, Africa and South East Asia and holds degrees in Civil Engineering and Petroleum Engineering.

### 3. Tom Hickey
**Chief Financial Officer**

Aged 38. A Chartered Accountant, Tom Hickey was appointed Chief Financial Officer and to the Board in 2000. Prior to joining Tullow he was an associate director of ABN AMRO Corporate Finance (Ireland) Limited, which he joined in 1995. In this role, he advised public and private companies in a wide range of industry sectors in the areas of fund raising, stock exchange requirements, mergers and acquisitions, flotations and related transactions. He is a non-executive director of Ikon Science Limited, a specialist geological software company in which Tullow has a minority equity stake and of PetroNeft Resources plc, an Irish oil and gas company with exploration and development interests, principally in Russia.

### 6. Graham Martin
**General Counsel**

Aged 53. A solicitor, Graham Martin joined Tullow as Legal and Commercial Director in 1997 from Vinson & Elkins, a leading international law practice, where he was a partner. Prior to that, he was a partner in Dickson Minto WS, a UK corporate law firm. He has over 25 years' experience of UK and international corporate and energy transactions. He has been the principal legal adviser to Tullow since its formation in 1985 and was appointed to his current position as General Counsel in 2004.


### 7. Matthew O'Donoghue

General Manager Projects

Aged 62. Matthew O'Donoghue was appointed to the Board as Operations Director in 1998 having joined Tullow in 1987 as General Manager in Senegal. An engineer, he has over 35 years' experience in the oil and gas exploration sector and held a number of senior roles with Schlumberger Wireline, working in Europe, Africa and the Middle East. A core member of the original team that has developed the Group's business and international operating capability, he was appointed to his current position in 2004.

### 10. Steven McTiernan

Non-Executive Director

Aged 56. Steven McTiernan was appointed as a non-executive Director in 2002. He is a member of the Audit, Nominations and Remuneration Committees. Mr McTiernan began his career as a petroleum engineer, working with BP, Amoco and Mesa in the Middle East and the UK. In 1979, he joined Chase Manhattan Bank, where he became Senior Vice-President and head of the bank's energy group based in New York. From 1996 to 2001 he held senior energy related positions at NatWest Markets and then CIBC World Markets. He is currently principal of Sandown Energy Consultants Limited, a natural resources advisory firm based in London.

### 8. Rohan Courtney

Senior Independent Director

Aged 59. Rohan Courtney has been a non-executive Director since 1993 and Senior Independent Director since 2000. He is Chairman of the Audit Committee and a member of the Nominations and Remuneration Committees. Mr Courtney was a career banker for 27 years and held senior positions in London and Hong Kong, including that of Chief Executive Europe of the State Bank of New South Wales from 1982 to 1990. Between 1991 and 1996, he advised and represented major shareholders on the boards of several private and public companies. From1996 to 2001, he was Executive Chairman of West 175 Media Group Inc. He is currently a director and Partner in the UCG Partnership, a trade association established to promote underground coal gasification around the world.

### 11. David Bamford

Non-Executive Director

Aged 60. David Bamford was appointed as a non-executive Director in July 2004. He is a member of the Audit, Nominations and Remuneration Committees. With a PhD in Geological Sciences from the University of Birmingham, he has had over 23 years' exploration experience with BP where he was Chief Geophysicist from 1990 to 1995, General Manager for West Africa from 1995 to 1998, and acted as Vice President, Exploration, directing BP's global exploration programme, from 2001 to 2003. He is a non-executive director of Paras Limited, a specialist oil and gas industry consulting firm.

### 9. Clare Spottiswoode CBE

Non-Executive Director

Aged 54. Clare Spottiswoode was appointed as a non-executive Director in 2002. She is a member of the Audit, Nominations and Remunerations Committees. An economist by training, Ms Spottiswoode began her career in the Treasury before starting her own software company. Between 1993 and 1998 she was Director General of Ofgas, the UK gas regulator. She is currently Deputy Chairman of British Energy Group plc and Chairman of Economatters Limited. She is also a non-executive director of Biofuels Corporation plc, Bergesen ASA and Petroleum Geo-Services ASA. In January 2006, she became the nominated Policyholder Advocate for Aviva plc.

### 12. David Williams

Non-Executive Director

Aged 61. David Williams was appointed as a non-executive Director on 1 June 2006. He is a member of the Audit, Nomination and Remuneration committees. A Chartered Accountant, he brings a wealth of public company experience to Tullow from 15 years with Bunzl plc, where he was Finance Director, and prior to that as Finance Director of Tootal Group plc. He was a non-executive director of The Peninsular and Oriental Steam Navigation Company plc until its acquisition in 2006. He is currently a non-executive director of Meggitt PLC and of George Wimpey plc, where he is also the Senior Independent Director.

**Contents to the accounts**

# Corporate governance

year ended 31 December 2006

The Tullow Oil Board is committed to business integrity and high ethical values across the Group's activities. As an essential part of this commitment, the Board supports high standards of corporate governance.

## Compliance with the Combined Code on Corporate Governance

This report explains how the Company has applied the principles set out in Section 1 of the Combined Code on Corporate Governance (the Code) published by the Financial Reporting Council. It also discloses the extent to which the Company has complied with the detailed provisions of the Code.

The Board considers that the Company has complied with the provisions of the Code throughout the year under review (and subsequently up to the date of this report) with the following two exceptions:

- Independent non-executive Directors did not comprise at least half the Board throughout the year as recommended by the Code. The Board, whilst mindful of the Code requirement in this respect, considers the current composition to be appropriate and effective at the present time. However, the Board does regularly review the Board's composition through its Nominations Committee.
- Throughout 2006, Pat Plunkett, the Company Chairman, was a member and the Chairman of the Remuneration Committee. The Board considers that his contribution to the Committee's work in the role of its Chairman has been a significant factor in developing the environment in which management has been encouraged to perform strongly throughout the period of major growth enjoyed by the Company since 2000.

## Board of Directors

**Composition** During the year, the size of the Board was expanded from ten to twelve members so that, at the end of the year, and at the date of this report, the Board comprised a non-executive Chairman, six Executive Directors and five independent non-executive Directors. Each of the Executive Directors has extensive knowledge of the oil and gas industry. Together, the non-executive Directors bring a broad range of business and commercial experience to the Board, with four of the five non-executive Directors either currently holding or having previously held appointments in oil and gas companies or companies with energy interests. Biographical details of the Board members are set out on pages 34 and 35.

**Role of the Board** The Board is accountable to shareholders for the creation and delivery of strong, sustainable financial performance and long-term shareholder value. To achieve this, the Board directs and monitors the Group's affairs within a framework of controls which enable risk to be assessed and managed effectively. The Board sets the Group's strategic aims, ensuring that the necessary resources are in place to achieve those aims, and reviews management and financial performance. The Board also has responsibility for setting the Group's core values and standards of business conduct and for ensuring that these, together with the Group's obligations to its stakeholders, are widely understood throughout the Group.

**Chairman and Chief Executive** There is a clear separation of the roles of the Chairman and the Chief Executive. The division of responsibilities is clearly established and has been set out in writing and agreed by the Board.

The Chairman, Pat Plunkett, is responsible for the effective running of the Board, ensuring that the Board plays a full and constructive part in the development and determination of the Group's strategy, and acting as guardian and facilitator of the Board's decision-making process.

The Chief Executive, Aidan Heavey, is responsible for managing the Group's business, proposing and developing the Group's strategy and overall commercial objectives in consultation with the Board and, as leader of the executive team, implementing the decisions of the Board and its Committees. In addition, the Chief Executive is responsible for maintaining regular dialogue with shareholders as part of the Company's overall investor relations programme.

## Non-Executive Directors

**Appointment** Non-executive Directors are appointed for an initial term of three years, which may be extended by mutual agreement subject to satisfactory performance. The letters of appointment of each non-executive Director are available for inspection at the registered office.

**Meetings of Non-Executive Directors** In addition to their attendance at Board and, as appropriate, Committee meetings, the non-executive Directors also met formally on three occasions during 2006 without executive management present. At these meetings, the non-executive Directors examine and review the performance of the executive management. This review process is in part dealt with by the Board Committees referred to below. Separately, the Chairman and Chief Executive held informal meetings with the non-executive Directors to discuss issues affecting the Group such as target objectives, strategy, key performance indicators and remuneration matters etc. The Board is of the view that each non-executive Director commits sufficient time to discharge their duties effectively.

**Senior Independent Director** The Senior Independent non-executive Director is Rohan Courtney. In this role he is available to shareholders who have concerns that cannot be resolved through discussion with the Chairman, Chief Executive or Chief Financial Officer or where such contact is inappropriate.

**Independence** The Board considers each of the current non-executive Directors to be independent in character and judgement and there are no relationships or circumstances which are likely to affect (or could appear to affect) the Directors' judgement. The Board recognises that Rohan Courtney may not be considered independent on the basis that he has served on the Board since 1993. Nevertheless, the Board considers that Mr Courtney's independence is not prejudiced or compromised by his length of service. He has extensive knowledge of the Group's business and positively challenges management data and assumptions. Consequently he makes a major contribution as a non-executive Director and the Board is proposing his re-election at the Annual General Meeting (AGM).

**Election and re-election** All new Directors are required by the Company's Articles of Association to be elected by shareholders at the first AGM after their appointment. Subsequently, Directors are subject to re-election by shareholders every three years. Where a non-executive Director has served longer than nine years, it is Board policy that the Director be subject thereafter to annual re-election in accordance with the Code.

## How the Board operates

**Board meetings** The Board meets regularly during the year and on an ad hoc basis as required. The attendance record of each Director is shown in the table on this page. During 2006, the Board met formally on 11 occasions including a formal strategy review meeting held with senior management in November. In addition to the formal meetings of the Board, the Chairman and Chief Executive maintain frequent contact with the other Directors to discuss any issues of concern they may have relating to the Group or as regards their area of responsibility and to keep them fully briefed on the Group's operations.

**Information flow** Directors have access to a regular supply of financial, operational and strategic information to assist them in the discharge of their duties. Such information is provided as part of the normal management reporting process. Board papers are generally circulated seven days in advance of Board meetings. In addition, Board meetings generally include a review of the history, performance and future potential of an individual asset or business unit; this is designed to ensure that all material assets are considered on a cyclical basis and to enable Board members to familiarise themselves with the key assets and operations of the Group.

**Independent professional advice** All Directors and Committees have access to independent professional advice, at the Company's expense, as and when required.

**Insurance cover** The Company maintains Directors' and Officers' Liability insurance cover, the level of which is reviewed annually.

**Matters reserved** A formal schedule of matters reserved for Board approval is in place and is reviewed annually. The matters reserved include (amongst others): the Group's overall strategy, approval of financial statements, material acquisitions and disposals, material contracts and major capital expenditure projects, budgets and a regular review of the Group's overall corporate governance arrangements. Subject to these reserved matters, the Board delegates authority for the management of the business, primarily to the Chief Executive, the other Executive Directors and a Senior Executive Committee. Certain other matters are delegated to the Audit, Nominations and Remuneration Committees, each of which is described in more detail below.

**Attendance at meetings** The attendance of Directors at meetings of the Board and its Committees during 2006 was as follows:

| No. of Meetings | Board (11) | Audit (4) | Remuneration (4) | Nominations (3) |
|---|---|---|---|---|
| Pat Plunkett | 11/11 | – | 4/4 | 3/3 |
| Aidan Heavey | 11/11 | – | – | 3/3 |
| David Bamford | 11/11 | 3/4 | 3/4 | 3/3 |
| Rohan Courtney | 11/11 | 4/4 | 4/4 | 3/3 |
| Tom Hickey | 11/11 | – | – | – |
| Angus McCoss[1] | 0/0 | – | – | – |
| Paul McDade[2] | 9/9 | – | – | – |
| Steven McTiernan | 11/11 | 4/4 | 4/4 | 3/3 |
| Graham Martin | 11/11 | – | – | – |
| Adrian Nel[3] | 4/4 | – | – | – |
| Matthew O'Donoghue | 11/11 | – | – | – |
| Clare Spottiswoode | 10/11 | 3/4 | 4/4 | 3/3 |
| David Williams[4] | 6/7 | 2/2 | 1/1 | 1/1 |

Notes:

1 Angus McCoss was appointed to the Board on 6 December 2006. No Board meetings were held between the date of his appointment and the end of the year.

2 Paul McDade was appointed to the Board on 29 March 2006.

3 Adrian Nel retired from the Board on 31 May 2006.

4 David Williams was appointed to the Board with effect from 1 June 2006.

**Board performance evaluation** The Board carried out an evaluation of its own performance and of its Committees in 2006. This review focused on such matters as Board composition and strategic capability, ongoing development, external and internal relationships, risk management, and conduct of Board and Committee meetings. Overall, it was concluded that the Board continues to operate in an effective manner and that there were no items arising from this review that, in the Board's view, gave rise to material concern. The Board is also satisfied that no individual or group of individuals dominates the Board's decision making. Certain matters for improvement were identified from the results of the evaluation and a number of actions agreed.

The Chairman has had discussions with each of the Directors on their individual performance. Separately, the non-executive Directors have reviewed the performance of the Chairman with input from the Executive Directors.

**Induction** All new Directors receive an induction. This includes a visit to the principal offices of the Group to meet line management from each functional discipline and business unit. The Company Secretary also provides new Directors with an overview of their duties as Directors, corporate governance policies and established Board procedures as part of the induction process.

**Continuing professional development** All members of the Board have access to appropriate training in respect of their obligations and duties as Directors. During the year, briefings were given on specific relevant topics to ensure Board members remain up to date with current regulations and developments. These included corporate governance developments and the Companies Act 2006.

## Committees

The Board has established the following principal Committees, each of which has written terms of reference (approved by the Board) setting out its authority and duties. Copies of the terms of reference can be viewed on the Investor Relations section of the Company's website www.tullowoil.com or can be obtained from the Company Secretary.

## Audit Committee

This Committee currently comprises Rohan Courtney (Chairman), David Bamford, Steven McTiernan, Clare Spottiswoode and David Williams.

The main responsibilities of the Committee are:

- Monitoring the integrity of the financial statements and formal announcements relating to the Group's financial performance;
- Reviewing significant financial reporting issues and accounting policies and disclosures in financial reports;
- Reviewing the effectiveness of the Group's internal control procedures and risk management systems;
- Ensuring that an effective whistle-blowing procedure is in place;
- Considering how the Group's internal audit requirements shall be satisfied and making recommendations to the Board;
- Making recommendations to the Board on the appointment or re-appointment of the Group's external auditors; and
- Overseeing the Board's relationship with the external auditors, and where appropriate, the selection of new external auditors.

In June 2006, the membership and experience of the Committee was supplemented by the appointment of David Williams. David is a Chartered Accountant and was previously Finance Director of Bunzl plc. He is a non-executive Director of Meggitt PLC and George Wimpey plc and is a member of the audit committees of both companies. Until 2006, he was a non-executive Director and Chairman of the audit committee of The Peninsular and Oriental Steam Navigation Company plc. In addition, between them, the other members of the Committee have a range of financial and commercial experience and have all served on the Committee for a number of years. Based on the above, the Board is satisfied that the Audit Committee has the appropriate level of recent and relevant financial experience for the purposes of the Code.

The Group's external auditors are Deloitte & Touche LLP and the Committee closely monitors the level of audit and non-audit services they provide to the Group. Non-audit services are normally limited to assignments that are closely related to the annual audit or where the work is of such a nature that a detailed understanding of the Group is necessary. A breakdown of the fees paid to the external auditors in respect of audit and non-audit work is included in note 3 of the accounts on page 62. In addition to processes put in place to ensure segregation of audit and non-audit roles, as part of the assurance process in relation to the audit, Deloitte & Touche LLP are required to confirm to the Committee that they have both the appropriate independence and objectivity to allow them to continue to serve the members of the Company. No matters of concern in relation to the above were identified by the Committee.

The Chief Financial Officer, the Group Internal Audit Manager, the Group Finance Manager and a representative of the external auditors normally attend meetings of the Audit Committee, at the invitation of the Committee. The Chairman of the Board also attends meetings of the Committee by invitation. The external auditors have unrestricted access to the Committee Chairman.

During 2006, the Audit Committee met on a total of four occasions. The key work undertaken by the Committee was as follows:

- **Consideration and review of annual and interim financial statements** The Committee met with the external auditors as a part of the interim and final accounts approval process. During this exercise the Committee considered 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 auditors.
- **Audit planning and update on relevant accounting developments** Following the Group's adoption of IFRS in 2004/5, there were limited further regulatory or financial accounting changes during 2006.
- **Consideration and approval of the internal audit charter, risk management framework and periodic reports from the Group Internal Audit Manager** In March 2006, Tullow recruited a Group Internal Audit Manager with extensive oil industry experience. He has direct access and responsibility to the Audit Committee. His main responsibilities include: evaluating and developing the Group's overall control environment, operating efficiency and risk identification and management at operating, regional and corporate levels. In fulfilling his role, the Group Internal Audit Manager has regular access to the Committee without reference to executive management. During 2006, the Committee approved the Group Internal Audit Charter and a programme of internal audit work aimed at addressing both financial and overall risk management objectives identified within the Group. A number of internal audit reviews were undertaken during 2006, including an analysis of the controls and approvals surrounding the hedging activities, accounts payable and the implementation of treasury management systems within the Group. The Group also undertook regular audits of non-operated joint ventures under the supervision of business unit management and the Group Internal Audit Manager.
- **Review of the performance of the external auditors** During 2006, the Audit Committee undertook a review of the performance of Deloitte & Touche LLP as Group Auditors. Deloitte were re-appointed following a tender process in 2004, since when Tullow has continued to expand both geographically and operationally. The Committee concluded that Deloitte continues to be an effective and capable auditors for Tullow, demonstrating strong commitment and industry knowledge.
- **Acquisition of Hardman Resources** As part of the acquisition of Hardman Resources, the overall audit approach to the Hardman acquisition and potential risks identified were approved by the Committee. The Committee gave extensive consideration to the preliminary fair value allocation exercise undertaken to record the assets and liabilities acquired in Tullow's Balance Sheet at 31 December 2006. This transaction also required representatives of the external auditors to undertake significant additional work, including a visit to Hardman's head office in Perth undertaken with Tullow Group Management.

## Nominations Committee

The Committee comprises a majority of non-executive Directors. The current members of the Nominations Committee, are Pat Plunkett (Chairman), Aidan Heavey, Rohan Courtney, Steven McTiernan, Clare Spottiswoode, David Bamford and David Williams. The main responsibilities of the Committee are:

- Reviewing the structure, size and composition of the Board and making recommendations to the Board with regard to any changes required;
- Succession planning for Directors and other senior executives;
- Identifying and nominating, for Board approval, candidates to fill Board vacancies as and when they arise;
- Reviewing annually the time commitment required of non-executive Directors; and
- Making recommendations to the Board with regard to membership of the Audit and Remuneration Committees in consultation with the Chairman of each Committee.

The Committee met three times in 2006, primarily to review Board appointment and succession issues. On the recommendation of the Committee, the Board approved three appointments to the Board during the year. In March 2006, Paul McDade, Chief Operating Officer, was appointed as an Executive Director. Following a comprehensive search and interview process with the assistance of external consultants, David Williams was identified as a very suitable non-executive Director and following the Committee's recommendation, the Board approved his appointment with effect from 1 June 2006, Angus McCoss, who had been appointed as General Manager Exploration in April 2006 was appointed as Exploration Director in December 2006 following a full review by the Committee of his performance since joining the Company and a positive recommendation by the Committee to the Board. This position had previously been held by Adrian Nel who retired in May 2006.

## Remuneration Committee

This Committee comprises a majority of independent non-executive Directors, namely Pat Plunkett (Chairman), Rohan Courtney, David Bamford, Steven McTiernan, Clare Spottiswoode and David Williams. The Directors' Remuneration Report on pages 44 to 51 contains details of the role and activities of the Remuneration Committee.

## Corporate Social Responsibility Committee

In addition to the above principal committees, the Board has established a Corporate Social Responsibility Committee. This Committee (the 'CSR Committee') is responsible for managing all Tullow's Community sponsorship support programmes and considers any matters relating to social, charitable, community and educational issues, CSR publications and CSR expenditure.

Tullow's CSR strategy aligns CSR investment with key areas and countries for business development. Tullow's CSR funding is a combination of sponsorships under licence commitments and discretionary spending. Criteria for funding projects concentrate on children, education and, where appropriate, fulfilling basic needs, such as clean water. Projects considered will be mainly recurring, long-term investments where there is established production, an operated activity and/or a key country for development. One-off investment will also be considered as appropriate in the context of Tullow's business. Overall, Tullow's objective is to make a tangible, positive difference and to foster and support longer-term development and self-sustaining enterprise in local communities.

The CSR Committee comprises Graham Brunton, Head of EHS, Rohan Courtney, Non-executive Director, Tom Hickey, Chief Financial Officer, Paul McDade, Chief Operating Officer, Kevin Quinn, Business Unit Manager South Asia, Bill Torr, General Manager Cape Town Office and Caragh Whale, EHS Team Assistant

The responsibilities of the CSR Committee are to:

- Develop and implement a framework for submission, assessment and approval of discretionary and mandatory community, social and educational expenditure undertaken by Tullow Group-wide;
- Consider and propose an annual budget for CSR activities to the Board for approval as part of the overall Group budget process;
- Evolve and further develop Tullow's social and ethical policies as part of the overall risk management framework of the business;
- Prepare the CSR Report annually;
- Review the internal CSR programme, ensuring co-ordination between internal and external activities and ensuring that the internal CSR function is adequately resourced and has appropriate standing within the Group; and
- Consider other CSR matters as specified by the Board.

## Shareholder relations

Communication with shareholders is given high priority and there is regular dialogue with institutional investors, as well as general presentations to analysts at the time of the release of the annual and interim results. The Board receives regular investor relations reports covering key investor meetings and activities, as well as shareholder and investor feedback. The Group issues its results promptly to individual shareholders and also publishes them on the Investor Relations section of the Company's website. The Company's website address is www.tullowoil.com. Regular updates to record news in relation to the Company and the status of exploration and development programmes are also included on the website. Shareholders and other interested parties can subscribe to receive these news updates by email by registering online on the website. The Chairman is available to meet with institutional shareholders to discuss any issues and address any concerns in relation to the Company's governance and strategy. Non-executive Directors have the opportunity to attend meetings with major shareholders and are available to attend if requested to do so.

At the AGM, a business presentation is provided for the benefit of shareholders at which individual shareholders are given the opportunity to put questions to the Chairman, the chairmen of the Audit, Nominations and Remunerations Committees and to other members of the Board. In addition, the Board is committed to maintaining strong links with its significant Irish shareholder base and holds a business presentation in Dublin following the AGM, to allow these shareholders similar access to the Company. Notice of the AGM is sent to shareholders at least 20 working days before the meeting and details of proxy votes for and against each resolution, together with abstentions, are made available after the vote has been dealt with on a show of hands.

## Internal controls

The Directors acknowledge their responsibility for the Group's and the Company's systems of internal control, which are designed to safeguard the assets of the Group and to ensure the reliability of financial information for both internal use and external publication. The Group's internal control procedures require technical, financial and Board approval for all projects. All major expenditures require senior management approval at the appropriate stages of each transaction. Overall control is ensured by a regular detailed reporting system covering both technical progress of projects and the state of the Group's financial affairs. The Board has put in place procedures for identifying, evaluating and managing any significant risks that face the Group. During the year, the Group Internal Audit Manager reviewed a number of areas of risk with his findings reported to the Audit Committee. No significant weaknesses were identified.

The Directors, having reviewed the effectiveness of the system of internal financial, operational and compliance controls and risk management, consider that the system of internal control operated effectively throughout the financial year and up to the date on which the financial statements were signed.

## Risk

Tullow is exposed to a range of technical, geological, operational, political, environmental, health and safety and financial risks in the conduct of its day-to-day business. The Group seeks to manage and mitigate these risks by maintaining a balanced portfolio and, through compliance with the terms of its licences, the application of established policies and procedures appropriate for an international oil and gas company and the recruitment and retention of skilled personnel throughout its business.

The Directors have ultimate responsibility for the effectiveness of the Group's risk management activities and internal control processes. Any system of internal control can provide only reasonable, and not absolute, assurance that material financial irregularities will be detected or that the risk of failure to achieve business objectives is eliminated. The Board's objective is to ensure Tullow has appropriate systems in place for the identification and management of risks.

Tullow's risk management processes were upgraded during 2006. As part of its overall risk identification and management process, Tullow undertakes both 'top-down' (driven by the Board and Senior Management) and 'bottom-up' (originating from business units and operations) processes, facilitated by the Group's Internal Audit function under the ultimate supervision of the Audit Committee. The objective of this exercise is, in the first instance, to identify relevant risks and the individual, team or function within the organisation with ultimate responsibility for managing them. Following identification of a risk, a qualitative assessment is made of its potential impact on Tullow's business, the key controls operating to mitigate such a risk and the overall effectiveness of the Group's monitoring and assurance processes. This analysis determines what, if any additional work is required. The development of risk management processes will continue to ensure they remain relevant to the business.

The Group's principal risks are considered to fall into four key categories:

- **Strategic Risks**: The strategy developed by the Board may not be appropriate for industry circumstances or the Group's business environment and may fail to create shareholder value;
- **Financial Risks**: The combination of asset performance and excessive leverage may result in the Group being unable to meet its obligations to shareholders, finance providers and other stakeholders;
- **Operational Risks**: Operational failures, either by Tullow or its partners, may damage the Group's shareholder value and operational reputation, damage the environment or endanger the health and safety of personnel or communities; and
- **External Risks**: The overall external political, industry or market environment may negatively impact on the Group's ability to independently manage and grow its business.

The individual risks within each category are summarised in the table below:

**Principal risks by category**

| Strategic risks | Financial risks | Operational risks | External risks |
|---|---|---|---|
| • Mix of oil and gas interests | • Excessive debt | • EHS incident | • Oil and gas price volatility |
| • Balance of organic and acquisition-led growth | • Inadequate or excessive hedging | • Key development failure | • Political risk and asset sequestration |
| • Inefficient capital allocation mechanism | • Oil and gas price volatility | • Corruption/reputation risk | • Fiscal change |
| • Ineffective management processes | • Industry cost inflation | • Security incident | • Competitive forces |
| • Insufficient portfolio balance | • Mis-priced corporate acquisitions | • Failure to secure resources, including staff | • Shareholder sentiment |
| • Inadequate management processes | • Uninsured events | • Hostile acquisition | |
| • Corporate governance failings | | • Loss of key staff | |
| • Succession planning | | • Sustained exploration failure | |
| | | • Lack of control of key assets | |

## Going Concern

After making enquiries, the Directors have a reasonable expectation that the Company, and the Group as a whole, have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

**Pat Plunkett,** Chairman
23 March 2007

# Directors' report

year ended 31 December 2006

The Directors submit their Report together with the audited consolidated financial statements for the year ended 31 December 2006.

## Business review

The principal activities of the Company and its subsidiary undertakings (the Group) during the year continued to be oil and gas exploration and production and the provision of technical services to Joint Venture partners. Information on the Company's principal subsidiary undertakings appears in note 11 to the financial statements.

A full review of the Group's activities during the year, recent events and future developments, including the financial performance during the year, key performance indicators and a description of the principal risks and uncertainties facing the Group, is included in the Chairman's statement, Chief Executive's review, Business review, Corporate and social responsibility, Tullow people and Finance review sections on pages 2 to 33.

## Results and dividends

Tullow had an excellent year in 2006. Record operational and financial results were achieved in a favourable oil and gas pricing environment, and each core area continued to deliver strong performances.

In total during 2006, the Group invested close to £1 billion in growing the business, including £332 million on capital expenditure, 70% of which was invested in production and development assets and £595 million on the acquisition of Hardman Resources Limited. The 30% increase in revenue and the Group's operating cash flow before working capital adjustments of £446.7 million comfortably funded all Tullow's capital investment and returns to shareholders.

The profit on ordinary activities after taxation amounted to £157,438,000 (2005: £113,136,000).

An interim dividend of 2.0p (2005: 1.0p) per share was paid on 7 November 2006. The Directors recommend a final dividend of 3.5p (2005: 3.0p) per share which, if approved at the 2007 AGM, will be paid on 6 June 2007 to shareholders whose names are on the Register of Members on 4 May 2007.

## Subsequent events

Settlement of the Hardman Resources Limited acquisition occurred on 10 January 2007 with the payment of AS$819.5 million (£329.9 million) and the issue of 65 million Tullow shares. The payment of AS$819.5 million (£329.9 million) on 10 January 2007 is included within the Hardman acquisition payable as at 31 December 2006.

## Directors

The Directors of the Company at the date of this report, and their biographical details are given on pages 34 and 35. All the Directors served throughout the period except as noted below:

Paul McDade, Chief Operating Officer, was appointed a Director on 29 March 2006.

Adrian Nel retired from the Board following the Annual General Meeting held on 31 May 2006.

David Williams was appointed a non-executive Director on 1 June 2006.

Angus McCoss, was appointed a Director on 6 December 2006.

Directors appointed by the Board are required to retire at the first AGM following their appointment and accordingly resolutions to elect David Williams and Angus McCoss will be proposed at this year's AGM.

In accordance with the Company's Articles of Association, Pat Plunkett and Aidan Heavey retire at this year's AGM. Being eligible, they offer themselves for re-election. In addition, as Rohan Courtney has been a Director for more than nine years he retires annually and a resolution for his re-election will be proposed at this year's AGM. Details of Directors' service contracts and letters of appointment are set out on page 47.

Details of the Directors' interests in the ordinary shares of the Company and in share options are set out on pages 48 to 51 in the Directors' Remuneration Report.

## Directors indemnities

As at the date of this report, indemnities are in force under which the Company has agreed to indemnify the Directors, to the extent permitted by the Companies Act 1985, against claims from third parties in respect of certain liabilities arising out of, or in connection with, the execution of their powers, duties and responsibilities as Directors of the Company or any of its subsidiaries.

## Share capital

As at the date of this report 717,252,752 ordinary shares are issued and fully paid. Details of the changes in the share capital during 2006 are set out in note 21 to the financial statements. Since the end of the year, 64,998,817 shares were issued to those shareholders of Hardman Resources Limited who elected to receive Tullow shares as consideration in exchange for their shares in Hardman Resources Limited. Shares have also been issued to optionholders pursuant to the exercise of options under the terms of the Group's share option schemes.

## Substantial shareholdings

At the date of this report the Company had been notified of the following interests of 3% or more in its issued share capital:

| | Number of shares | % of issued capital |
|---|---|---|
| BlackRock Group | 107,746,819 | 15.02% |
| Prudential plc | 67,116,866 | 9.36% |
| IFG International Trust Company Limited | 38,960,366 | 5.43% |
| Standard Life Investments | 29,273,241 | 4.08% |
| Legal & General Group | 24,688,556 | 3.44% |

## Charitable and political donations

The Group made charitable, social and community related donations totalling £338,800 during the year. In line with Group policy, no donations were made for political purposes.

## Corporate social responsibility

The Group is fully committed to high standards of environmental, health and safety management. A review, together with an outline of the Group's involvement in the community is set out in the Corporate and Social Responsibility section on pages 24 to 27. In addition, Tullow publishes annually a separate Corporate Social Responsibility Report which is available on the Group website www.tullowoil.com

## Supplier payment policy

It is Company and Group policy to settle all debts with creditors on a timely basis and in accordance with the terms of credit agreed with each supplier. The Company had no trade creditors outstanding at 31 December 2006.

## Auditors

Each person 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 auditors are unaware; and
- the Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given, and should be interpreted, in accordance with the provisions of s234ZA of the Companies Act 1985.

A resolution to re-appoint Deloitte & Touche LLP as the Company's auditors will be proposed at the AGM.

## Annual General Meeting

Your attention is drawn to the Notice of Meeting enclosed with this Annual Report which sets out the resolutions to be proposed at the forthcoming AGM. The meeting will be held at Haberdashers Hall, 18 West Smithfield, London EC1 on 30 May 2007 at 12 noon.

By order of the Board

**Tom Hickey,** Company Secretary
23 March 2007

# Directors' remuneration report

year ended 31 December 2006

## Introduction

This report has been prepared in accordance with the requirements of the Directors' Remuneration Report Regulations 2002, which set out requirements for the disclosure of directors' remuneration and also in accordance with the requirements of the Listing Rules of the Financial Services Authority.

The Regulations require the auditors to report to the Company's members on the 'auditable part' of the Directors' Remuneration Report and to state whether, in their opinion, the part of the report that has been subject to audit has been properly prepared in accordance with the Companies Act 1985 (as amended by the Directors' Remuneration Report Regulations 2002). The report is therefore divided into separate sections to disclose the audited and unaudited information.

A resolution to approve the entire report will be proposed at the AGM of the Company.

# Unaudited information

## Remuneration Committee

The members of the Remuneration Committee are Pat Plunkett (Chairman), David Bamford, Rohan Courtney, Steven McTiernan, Clare Spottiswoode and David Williams. The Committee met four times during the year.

The main responsibilities of the Committee include:

- Determining and agreeing with the Board the remuneration policy for the Chief Executive, Executive Directors and senior executives;
- Approving the design of, and determining targets for, an annual performance-related pay scheme for the Executive Directors and senior executives;
- Reviewing the design of share incentive plans for approval by the Board and shareholders and determining the annual award policy to Executive Directors and senior executives under existing plans; and
- Within the terms of the agreed policy, determining the remainder of the remuneration packages (principally comprising salary and pension) for each Executive Director and senior executive.

The full terms of reference for the Committee are available on the Company's website.

The Chief Executive and other relevant executives are invited to attend meetings of the Committee but do not take part in any decision affecting their own remuneration. The Committee has appointed New Bridge Street Consultants LLP as its independent remuneration advisers who also provide technical advice to the Company in connection with the operation of its share incentive arrangements. A statement outlining the business relationship with New Bridge Street Consultants can be viewed on the Investor Relations section of the Company's website. The Committee also consults with the Company's major investors and investor representative groups as appropriate.

## Remuneration policy

The Group's policy is to maintain levels of remuneration so as to attract, motivate and retain Executive Directors and senior executives of the highest calibre who can contribute their experience to the Group's operations. The elements of the remuneration package for Executive Directors and senior management are base salary, annual bonus, taxable benefits, pension payments and participation in the Company's share incentive arrangements. A significant element of the potential remuneration package is performance-linked.

When determining the total remuneration of the Executive Directors and senior management, the Committee takes into account the remuneration practices adopted both by oil and gas companies and in the market generally (while also having regard to pay practices elsewhere in the Group).

## Executive Directors' remuneration

### Base salary

The base salaries of the Executive Directors are reviewed annually with regard given to personal performance, Company performance, changes in responsibilities and competitive market practices. Following the most recent review, the base salary of each Executive Director with effect from January 2007 is:

| | |
|---|---|
| Aidan Heavey | £610,000 |
| Tom Hickey | £390,000 |
| Graham Martin | £345,000 |
| Paul McDade | £316,250 |
| Angus McCoss | £316,250 |
| Matthew O'Donoghue | £280,000 |

When making the most recent base salary increases, the Committee took account of remuneration practices in both the oil and gas companies against which Tullow's TSR performance is measured under the Performance Share Plan (see later) and a group of companies of broadly similar market capitalisation and international scope to the Company, whilst also taking into account the excellent performance of the Company over the last few years and the contribution of the Directors towards that success. The Committee's aim when setting base salaries was to ensure that the aggregate value of the fixed remuneration of each Executive Director (i.e. the aggregate of base salary, benefits and pension payments) was broadly based around but did not exceed the relevant market median.

### Annual bonus

Each Executive Director is entitled to participate in the Executive Annual Bonus Scheme in respect of each financial year of the Company under which, for exceptional performance, a bonus of up to 100% of salary can be earned.

For 2006, the bonus arrangements for Aidan Heavey, Tom Hickey and Graham Martin were structured as follows:

- Up to 33.33% of salary could be earned subject to the achievement of relative TSR performance targets against the same comparator group used for the Performance Share Plan (see below), with upper quartile performance required for this part of the bonus to be earned in full. Over the relevant period, Tullow was placed in the top quartile of the comparator group;
- A further 33.33% of salary could be earned for the achievement of absolute TSR targets, with a 15% improvement in TSR objective required for this part of the bonus to be earned in full. Tullow's TSR over the relevant period measured 49.26%; and
- The final 33.34% of salary could be earned based on how the Committee considered that the Company had performed over the year as against certain Company-specific key performance indicators (such as production performance, reserve replacement, exploration success, health and safety and overall financial stability).

The bonus arrangements of Matthew O'Donoghue, Paul McDade and Angus McCoss were structured as follows:

- 50% of salary could be earned based on how the Committee considered that the Company had performed over the year as against the key performance indicators noted above; and
- 50% of salary could be earned based upon the achievement of individual financial and non-financial targets relating to their specific discipline or field of responsibility, with this element of the bonus only payable in full for exceptional performance against these targets.

Based upon performance in 2006 against the targets explained above, and in particular reflecting another year of excellent performance, Aidan Heavey, Tom Hickey and Graham Martin received bonus amounts for 2006 equating to 93% of base salary. In the cases of Matthew O'Donoghue, Paul McDade and Angus McCoss, where a greater proportion of bonus entitlement related to individual targets, the Committee determined their respective bonus awards for 2006 as 63%, 70% and 70% of salary respectively. The level of bonus award for Angus McCoss was then pro-rated for the period he was employed during the year.

To align the interests of Executive Directors and shareholders, the portion of any bonus amount above 60% of base salary is required to be deferred into shares under the terms of the related Deferred Share Bonus Plan adopted by the Board in 2005. Shares awarded under this plan will normally vest following the end of the period of three financial years commencing with that in which the award is granted. The first awards under the plan were made in March 2006 in respect of the bonus award for 2005. In January 2007, awards were made in respect of the bonus award for 2006 as disclosed in note 2 to the Deferred Share Bonus Plan table on page 50.

For 2007, the bonus arrangements for Aidan Heavey, Tom Hickey and Graham Martin remain structured as in 2006 although the weighting of the specific key performance indicators referred to above have been modified to give more weighting to certain key business activities. For Paul McDade and Angus McCoss, 50% of their potential bonus will be based on personal targets, 20% on the achievement of certain corporate key performance indicators and 30% on performance against the comparator group. For Matthew O'Donoghue, 50% of his potential bonus will be based on personal targets and 50% on the achievement of certain key corporate performance criteria.

**Pension and other benefits**

The Executive Directors do not participate in the Company pension plan. Each Executive Director is entitled to receive a payment of 10% of his base salary into his private pension scheme which increases to 15% at age 50, as well as 30 days annual leave, permanent health insurance, private medical insurance and life assurance benefits. Aidan Heavey is provided with a car. The Group also reimburses the Executive Directors in respect of all expenses reasonably incurred by them in the proper performance of their duties.

## Share Incentive Arrangements

**Performance Share Plan (PSP)**

Under the PSP, senior executives can be granted conditional awards of rights over whole shares worth up to 150% of salary each year (200% in exceptional circumstances). Awards will vest under the PSP subject to a TSR based performance condition under which the Company's TSR performance will be measured over a fixed three year period commencing on 1 January in the financial year in which award is granted (i.e. with no opportunity to re-test). Half of the award is subject to performance against the constituents of the FTSE 250 Index excluding Investment Trusts (as at the start of the performance period) and the other half is subject to performance against the following comparator group of international oil and gas companies. The oil and gas comparator group for awards made under the PSP in 2006 consisted of the following 15 companies:

| | |
|---|---|
| Addax Petroleum | Newfield Exploration Company |
| ATP Oil & Gas | Nexen Inc |
| Burren Energy | Noble Energy Inc |
| Cairn Energy | Pioneer Natural Resources |
| Dana Petroleum | Pogo Producing Company |
| Forest Oil | Premier Oil |
| Lundin Petroleum AB | Santos |
| | Venture Production |

For awards made or to be made in 2007 the comparator group consists of the same group of companies.

In line with best practice, a 'common currency' approach is adopted for calculating TSR in respect of the above international group of companies.

For each portion of the award, vesting will be as follows:

| Company's ranking in comparator group | Vesting Percentage |
|---|---|
| Below median | 0% |
| Median | 30% |
| Upper quartile | 100% |
| Intermediate performance | Pro rata between 30% and 100% |

However, no award will vest unless the Committee considers that both the Company's underlying financial performance and its performance against other key factors (e.g. health and safety) over the relevant period is satisfactory.

The Committee believes that this performance condition is appropriate as it encourages the Executive Directors to generate returns to shareholders in excess of both the market generally and a group of sector peers.

To further align their interests with shareholders, the Executive Directors are required to retain at least 50% of the shares that vest under the PSP (after selling sufficient shares to pay tax liabilities) until they have built up a shareholding worth at least 100% of base salary (with existing holdings taken into account).

**Share Option Scheme**

Before the introduction of the PSP in 2005, Executive Directors were eligible for grants of options under the 2000 Executive Share Option Scheme (the 2000 Scheme). The Committee does not intend to grant further options to Executive Directors under the 2000 Scheme. During the year, options were granted to substantially all employees of the Group under the 2000 Scheme, other than those senior executives who were granted awards under the PSP. The performance conditions applying to options granted under the 2000 Scheme since May 2005 no longer contain any re-testing facility.

**Share Incentive Plans**

Executive Directors may also participate, on the same terms as other employees, in the Tullow Oil UK and Irish Share Incentive Plans. These are all-employee plans that have been set up in both the UK and Ireland which enable employees to make contributions out of salary up to prescribed limits each month, which each quarter are used by the Plan trustees to acquire Tullow Oil shares (Partnership shares). The Company makes a matching contribution to the trustees to acquire a matching number of shares (Matching shares) on a one-for-one basis.

## Non-executive Directors' fees

A Committee of the Board comprising the Chairman and Executive Directors sets the remuneration of non-executive Directors. The fees paid are set at a level to attract the persons with the necessary experience and ability to make a significant contribution to the Company's activities, while also reflecting the time commitment and responsibility of the role. Each non-executive Director (other than Rohan Courtney) currently receives an annual fee of £46,000. Rohan Courtney currently receives an annual fee of £54,000 to reflect his additional responsibilities as Chairman of the Audit Committee and as Senior Independent Director. Each non-executive Director is also entitled to reimbursement of necessary travel and other expenses.

Non-executive Directors do not participate in any share scheme or annual bonus scheme and are not eligible to join the Company's Pension Scheme.

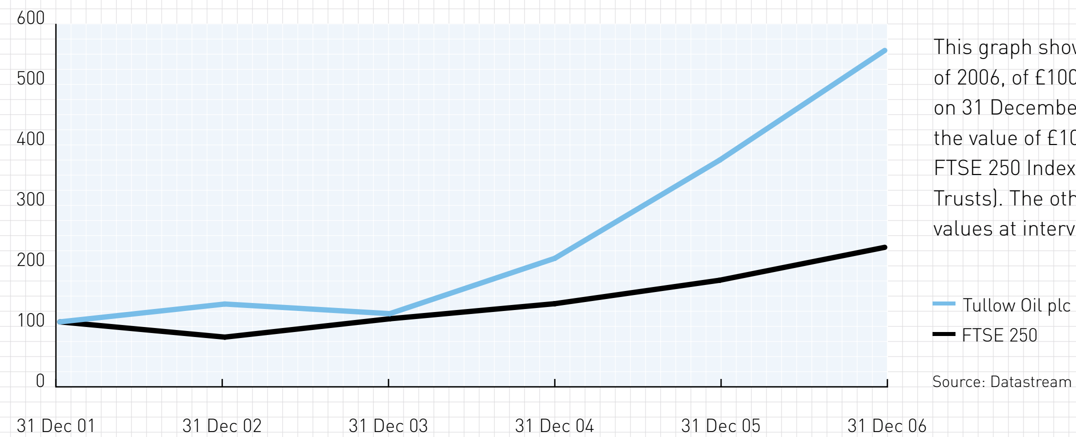
A Committee of the Board comprising all the Directors (except the Chairman), sets the remuneration of the Chairman, whose annual fee is currently £150,000.

## Performance graph

The Directors' Remuneration Report Regulations 2002 require the presentation of a graph of TSR compared to an appropriate comparator index over a five-year period. For Tullow, TSR is primarily represented by share price performance as, up to November 2003, no dividends had been declared or paid. Tullow has been a member of the FTSE 250 Index (excluding Investment Trusts) since September 2001 and, as this index is also used as a comparator for certain share plans, the Directors believe it represents the most appropriate benchmark.

The graph below shows Tullow's TSR over the five-year period from 1 January 2002 to 31 December 2006, over which period Tullow outperformed the FTSE 250 Index by 324%. The relevant indices are set to 100 at the beginning of the period.

### Total Shareholder Return




This graph shows the value, by the end of 2006, of £100 invested in Tullow Oil on 31 December 2001 compared with the value of £100 invested in the FTSE 250 Index (excluding Investment Trusts). The other points plotted are the values at intervening financial year ends.

Source: Datastream

## Service contracts and letters of appointment

Each Executive Director has entered into a service agreement with Tullow Group Services Limited (dated 2 September 2002 in the case of Aidan Heavey, Matthew O'Donoghue, Graham Martin and Tom Hickey; dated 29 March 2006 in the case of Paul McDade and dated 18 April 2006 in the case of Angus McCoss). Aidan Heavey and Matthew O'Donoghue also each entered into a service agreement with Tullow Oil International Limited on 16 September 2002 on similar terms.

The terms of each of these service contracts is not fixed, although each Executive Director is required under his service agreement to retire from service upon attaining the age of 65. Each agreement is terminable by the Director on six months' notice and by the Company on 12 months' notice. There are no specific provisions under which any Executive Director is entitled to receive compensation upon the early termination of his service agreement other than in accordance with these notice periods.

Each service agreement sets out restrictions on the ability of the Director to participate in businesses competing with those of the Group or to entice or solicit away from the Group any senior employees of the Group in the six month period after the cessation of his employment.

The above reflects the Committee's policy that service contracts should be structured to reflect the interests of the Company and the individuals concerned, while also reflecting market and best practice. Furthermore, it is the Committee's policy that, in the event of early termination of a Director's service contract, the Committee will take account of the departing Director's duty to mitigate his loss when determining the amount of any compensation that is paid.

Each of the non-executive Directors is engaged by the Company under the terms of a letter of appointment (dated 8 December 2005 in the case of Pat Plunkett and Rohan Courtney; dated 17 June 2004 in the case of David Bamford, dated 28 February 2005 in the case of Clare Spottiswoode and Steven McTiernan and dated 31 May 2006 in the case of David Williams). Subject to retirement, for example under the Articles of Association, the appointments are for the period to 31 December 2008 in respect of Pat Plunkett and Rohan Courtney, to 7 July 2007 in the case of David Bamford, to 29 February 2008 in the case of Clare Spottiswoode and Steven McTiernan and to 31 May 2009 in the case of David Williams. In each case, the appointment is renewable thereafter if agreed by the Director and the Board. The appointments for each of the non-executive Directors may be terminated by either party on three months' notice. There are no arrangements under which any non-executive Director is entitled to receive compensation upon the early termination of his or her appointment.

## Material contracts

There have been no other contracts or arrangements during the financial year in which a Director of the Company was materially interested and/or which were significant in relation to the Group's business.

## External appointments

The Board has not introduced a formal policy in relation to the number of external directorships that an Executive Director may hold. Currently, the only Executive Directors who hold external directorships are Tom Hickey and Aidan Heavey. Aidan is a director of Traidlinks, a charity promoting enterprise in the developed world, especially Africa. He receives no fee for this position. Tom has been nominated by Tullow as its representative on the board of Ikon Science Limited, a company in which Tullow has a small equity stake. Any fees payable for his services have been waived by Tullow. In addition, Tom is a non-executive director of PetroNeft Resources Plc for which he receives an annual fee of €20,000.

# Audited information

## Directors' Remuneration

The remuneration of the Directors for the year ended 31 December 2006 payable by Group companies was as follows:

| | Salary/ Fees £ | Bonuses Cash £ | Bonuses Shares[1] £ | Pension £ | Taxable Benefits[2] £ | **2006 Total £** | 2005 Total £ |
|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | |
| Aidan Heavey | 510,000 | 306,000 | 167,868 | 76,500 | 37,277 | **1,097,645** | 855,830 |
| Tom Hickey | 325,000 | 195,000 | 106,975 | 32,500 | 855 | **660,330** | 491,080 |
| Graham Martin | 300,000 | 180,000 | 98,746 | 45,000 | 2,900 | **626,646** | 506,361 |
| Angus McCoss[3] | 19,589 | 13,786 | – | 1,959 | 11,687 | **47,021** | – |
| Paul McDade[4] | 209,452 | 125,671 | 21,731 | 20,945 | 58,672 | **436,471** | – |
| Matthew O'Donoghue | 250,000 | 150,000 | 8,438 | 37,500 | – | **445,938** | 452,241 |
| Adrian Nel[5] | 114,583 | 30,821 | – | 17,188 | – | **162,592** | 392,962 |
| Subtotal | 1,728,624 | 1,001,278 | 403,758 | 231,592 | 111,391 | **3,476,643** | 2,698,474 |
| **Non-Executive Directors** | | | | | | | |
| Pat Plunkett | 125,000 | – | – | – | – | **125,000** | 110,000 |
| Rohan Courtney | 47,000 | – | – | – | – | **47,000** | 41,000 |
| Clare Spottiswoode | 40,000 | – | – | – | – | **40,000** | 35,000 |
| Steven McTiernan | 40,000 | – | – | – | – | **40,000** | 35,000 |
| David Bamford | 40,000 | – | – | – | – | **40,000** | 35,000 |
| David Williams[6] | 23,333 | – | – | – | – | **23,333** | – |
| Subtotal | 315,333 | – | – | – | – | **315,333** | 256,000 |
| Total | 2,043,957 | 1,001,278 | 403,758 | 231,592 | 111,391 | **3,791,976** | 2,954,474 |

Notes:

1 These figures represent that part of the bonus required to be deferred into shares as explained on page 45.

2 The amounts disclosed under Taxable Benefits in respect of Angus McCoss and Paul McDade include re-location expenses paid in line with contractual obligations.

3 Angus McCoss was appointed on 6 December 2006.

4 Paul McDade was appointed 29 March 2006.

5 Adrian Nel retired on 31 May 2006. Mr Nel agreed to provide part time consultancy services for a 12 month period from 1 June 2006, for which he will receive fees of ZAR 1,613,196 (£116,713).

6 David Williams was appointed on 1 June 2006.

## Directors' interests in the share capital of the Company

The interests (all of which were beneficial) of the Directors who held office at 31 December 2006 were:

| Director | Ordinary shares 31 December 2006 | Ordinary shares 1 January 2006 (or on appointment) |
|---|---|---|
| Aidan Heavey | 6,000,000 | 6,000,000 |
| Tom Hickey | 101,560 | 100,000 |
| Graham Martin | 1,102,005 | 436,005 |
| Angus McCoss | – | – |
| Paul McDade | 15,578 | 15,578 |
| Matthew O'Donoghue | 1,889,771 | 1,590,857 |
| Pat Plunkett | 1,229,326 | 1,229,326 |
| Rohan Courtney | – | – |
| David Bamford | 10,695 | 9,588 |
| Steven McTiernan | – | – |
| Clare Spottiswoode | – | – |
| David Williams | 5,000 | – |

Notes:

1 Other than as set out in the notes to the tables below, there have been no changes in the interests of any Director between 1 January 2007 and the date of this report.

2 As potential beneficiaries of the Performance Share Plan and the Deferred Share Bonus Plan, all of the Executive Directors are deemed for Companies Act purposes, to be interested in the shareholding of the Tullow Oil Employee Trust in Tullow Oil plc shares which at 31 December 2006 consisted of 1,000,000 shares.

## Tullow Oil UK Share Incentive Plan and Tullow Oil Irish Share Incentive Plan

Details of shares purchased and awarded to Executive Directors in accordance with the terms of the Irish SIP and the UK SIP. A brief description of the SIPs is set out on page 46.

| Director | Plan | Shares held 1 Jan 2006 (or on appointment) | Partnership shares acquired in year (or from appointment) | Matching shares awarded in year (or from appointment) | Shares released In year | Total Shares held 31 Dec 2006 |
|---|---|---|---|---|---|---|
| Tom Hickey | Irish SIP | 5,020 | 545 | 545 | (1,560) | 4,550 |
| Graham Martin | UK SIP | 4,182 | 492 | 492 | – | 5,166 |
| Angus McCoss | UK SIP | 196 | – | – | – | 196 |
| Paul McDade | UK SIP | 4,470 | 348 | 348 | – | 5,166 |

Note: Graham Martin, Angus McCoss and Paul McDade each acquired 99 Partnership shares and were awarded 99 Matching shares on 3 January 2007.

## Performance Share Plan 2005 (PSP)

Details of conditional awards over ordinary shares granted to Executive Directors for nil consideration under the PSP.

| Director | Award Grant Date | As at 01.01.06 | Granted in year (or from appointment) | Vested in year | As at 31.12.06 (or on cessation) | Vesting Date |
|---|---|---|---|---|---|---|
| Aidan Heavey | 29.06.05 | 347,755 | – | – | 347,755 | 29.06.08 |
| | 30.03.06 | – | 219,512 | – | 219,512 | 30.03.09 |
| Tom Hickey | 29.06.05 | 213,877 | – | – | 213,877 | 29.06.08 |
| | 30.03.06 | – | 139,885 | – | 139,885 | 30.03.09 |
| Graham Martin | 29.06.05 | 213,877 | – | – | 213,877 | 29.06.08 |
| | 30.03.06 | – | 129,125 | – | 129,125 | 30.03.09 |
| Angus McCoss | 27.04.06 | – | 100,230 | – | 100,230 | 27.04.09 |
| Paul McDade | 29.06.05 | 188,571 | – | – | 188,571 | 29.06.08 |
| | 30.03.06 | – | 118,364 | – | 118,364 | 30.03.09 |
| Adrian Nel[3] | 29.06.05 | 188,571 | – | – | 188,571 | 29.06.08 |
| Matthew O'Donoghue | 29.06.05 | 188,571 | – | – | 188,571 | 29.06.08 |
| | 30.03.06 | – | 107,604 | – | 107,604 | 30.03.09 |
| Total | | 1,341,222 | 814,720 | – | 2,155,942 | |

Notes:

1 The awards of conditional shares made in 2006 equated to shares worth 150% of salary for each Executive Director based on the share price for the dealing day preceding the date of grant in respect of the awards made on 30 March 2006 and on the average share price for the five dealing days preceding the date of grant in respect of the award made on 27 April 2006. The Tullow share price on the dates of grant of the awards made on 30 March 2006 and 27 April 2006 was 343.25p and 410p respectively.

2 Under the PSP, 50% of awards are subject to a TSR condition compared to the constituents of the FTSE 250 Index (excluding Investment Trusts) and the other 50% of the award is subject to a TSR condition compared to a specific comparator group. Full details are set out on pages 45 and 46.

3 Adrian Nel retired from the Board on 31 May 2006. The figures shown in the table are at cessation. Under the discretion given under the Rules of the PSP, the Remuneration Committee has determined that Mr Nel retain rights to a pro rata proportion of his award of 151,904 shares; the amount of such pro rata award that will vest will be subject to the performance conditions over the three year performance period that runs from 1 January 2005.

4 Awards of conditional shares were made under the PSP on 22 March 2007 to each Executive Director. The number of shares awarded were: Aiden Heavey – 230,567; Tom Hickey – 147,142; Graham Martin – 130,402; Angus McCoss – 90,539; Paul McDade – 90,539 and Matt O'Donoghue – 72,188. The vesting date for these awards is 22 March 2010.

# Directors' remuneration report

continued

## Deferred Share Bonus Plan (DSBP)

Details of awards over ordinary shares granted to Executive Directors for nil consideration under the DSBP.

| Director | Award Grant Date | As at 01.01.06 | Granted in year | Vested in year | As at 31.12.06 | Vesting Date |
|---|---|---|---|---|---|---|
| Aidan Heavey | 30.03.06 | – | 20,988 | – | 20,988 | 01.01.09 |
| Tom Hickey | 30.03.06 | – | 12,908 | – | 12,908 | 01.01.09 |
| Graham Martin | 30.03.06 | – | 12,908 | – | 12,908 | 01.01.09 |
| Paul McDade | 30.03.06 | – | 19,806 | – | 19,806 | 01.01.09 |
| Matthew O'Donoghue | 30.03.06 | – | 13,177 | – | 13,177 | 01.01.09 |
| Total | | – | 79,787 | – | 79,787 | |

Notes:

1 The awards of shares made in 2006 equated to shares worth the amount of bonus deferred into shares for 2005 based on the share price for the dealing day preceding the date of grant. The share price on the date of grant of the award was 343.25p.

2 Awards of shares under the DSBP were made on 18 January 2007 in respect of the amount of bonus award deferred into shares for 2006 as shown in the Directors' Remuneration table on page 48. The numbers of shares awarded were Aidan Heavey – 42,714; Tom Hickey – 27,220; Graham Martin – 25,126; Paul McDade – 7,260 and Matthew O'Donoghue – 2,147. These awards vest on 1 January 2010.

3 Further details of the DSBP are set out in the section of this report headed Annual bonus on page 44.

## Share Options

Details of share options granted to Directors:

| Director | Scheme | Grant Date | As at 01.01.06 (or date of appointment) | Granted during year | Exercised during year | As at 31.12.06 (or date of cessation) | Exercise Price | Date from which Exercisable | Last Date Exercisable |
|---|---|---|---|---|---|---|---|---|---|
| Aidan Heavey | 1998 | 30.04.99 | 1,230,230 | – | – | 1,230,230 | €0.84 | 30.04.02 | 29.04.09 |
| | 2000 | 10.10.01 | 550,000 | – | – | 550,000 | 80p | 10.10.04 | 09.10.11 |
| | 2000 | 06.10.03 | 600,000 | – | – | 600,000 | 85p | 06.10.06 | 05.10.13 |
| | 2000 | 20.09.04 | 450,000 | – | – | 450,000 | 131p | 20.09.07 | 19.09.14 |
| | | | 2,830,230 | – | – | 2,830,230 | | | |
| Tom Hickey | 1998 | 02.05.00 | 220,000 | – | – | 220,000 | 61p | 02.05.03 | 01.05.10 |
| | 2000 | 10.10.01 | 450,000 | – | – | 450,000 | 80p | 10.10.04 | 09.10.11 |
| | 2000 | 06.10.03 | 290,000 | – | – | 290,000 | 85p | 06.10.06 | 05.10.13 |
| | 2000 | 20.09.04 | 350,000 | – | – | 350,000 | 131p | 20.09.07 | 19.09.14 |
| | | | 1,310,000 | – | – | 1,310,000 | | | |
| Graham Martin | 1988 | 13.11.96 | 916,000 | – | (916,000) | – | €0.91 | 13.11.99 | 12.11.06 |
| | 1998 | 30.04.99 | 988,426 | – | – | 988,426 | €0.84 | 30.04.02 | 29.04.09 |
| | 2000 | 10.10.01 | 380,000 | – | – | 380,000 | 80p | 10.10.04 | 09.10.11 |
| | 2000 | 06.10.03 | 400,000 | – | – | 400,000 | 85p | 06.10.06 | 05.10.13 |
| | 2000 | 20.09.04 | 190,000 | – | – | 190,000 | 131p | 20.09.07 | 19.09.14 |
| | | | 2,874,426 | – | (916,000) | 1,958,426 | | | |
| Paul McDade | 2000 | 18.06.01 | 150,000 | – | (70,000) | 80,000 | 95p | 18.06.04 | 17.06.11 |
| | 2000 | 10.10.01 | 50,000 | – | – | 50,000 | 80p | 10.10.04 | 09.10.11 |
| | 2000 | 06.10.03 | 220,000 | – | – | 220,000 | 85p | 06.10.06 | 05.10.13 |
| | | | 420,000 | – | (70,000) | 350,000 | | | |
| Adrian Nel[5] | 2000 | 28.05.04 | 205,000 | – | | 205,000 | 103p | 01.06.06 | 27.11.07 |
| Matthew O'Donoghue | 1988 | 11.04.96 | 490,360 | – | (490,360) | – | €1.00 | 11.04.99 | 10.04.06 |
| | 1988 | 05.07.96 | 98,072 | – | (98,072) | – | €0.99 | 05.07.99 | 04.07.06 |
| | 1998 | 30.04.99 | 699,958 | – | – | 699,958 | €0.84 | 30.04.02 | 29.04.09 |
| | 2000 | 10.10.01 | 250,000 | – | – | 250,000 | 80p | 10.10.04 | 09.10.11 |
| | 2000 | 06.10.03 | 330,000 | – | – | 330,000 | 85p | 06.10.06 | 05.10.13 |
| | | | 1,868,390 | – | (588,432) | 1,279,958 | | | |
| Pat Plunkett | 1998[1] | 04.09.00 | 200,000 | – | (200,000) | – | 63p | 24.08.01 | 03.09.10 |
| Total | | | 9,708,046 | – | (1,774,432) | 7,933,614 | | | |

Notes:

1 The Schemes under which these options were granted are: 1988 – Options granted under the Tullow Oil 1988 Executive Share Option Scheme ('1988 Scheme') 1998 – Options granted under the Tullow Oil 1998 Executive Share Option Scheme ('1998 Scheme') 2000 – Options granted under the Tullow Oil 2000 Executive Share Option Scheme ('2000 Scheme') 1998[1] – Options granted pursuant to consultancy arrangements entered into with Tullow Oil Limited, the Company's wholly owned Irish subsidiary exercisable on similar terms and conditions as 1998 Scheme options.

2 No performance conditions attach to 1988 Scheme Options or 1998 Scheme Options. The performance condition that attaches to options granted under the 2000 Scheme requires Tullow's TSR to exceed that of the median company of the FTSE 250 (excluding Investment Trusts) over the three year period from the date of grant.

3 Options shown with an exercise price denominated in Euro were granted on or before 30 April 1999 with an exercise price in IR£. On conversion of IR£ to Euro effective 1 January 2002, the exercise price for each such option was converted from IR£ into Euro by dividing the original IR£ exercise price per share by the fixed Irish Pound/Euro conversion rate. All options granted after 30 April 1999 were granted with an exercise price denominated in sterling. Options are granted for nil consideration. Options must be exercised in the currency in which the grants were made.

4 The aggregate gains made by Directors on the exercise of options under the Schemes during the year as shown in the table above were £5,868,375. The market price on the dates of exercise by the Directors who exercised options during the year were: Pat Plunkett – 343.4p; Graham Martin – 435.5p; Paul McDade – 435.5p; Matt O'Donoghue – 343.4p (relating to the exercise of options granted on 11 April 1996) and 388p (relating to the exercise of options granted on 5 July 1996). In the cases of the option exercises by Graham Martin and Matthew O'Donoghue, a proportion of the gains made on exercise were notional as shares were retained by the Director concerned.

5 Adrian Nel retired from the Board on 31 May 2006. The figures shown in the table are as at cessation. In accordance with the 2000 Scheme rules, the Remuneration Committee determined that Mr Nel be entitled to exercise the options granted to him for a limited period after leaving. Mr Nel exercised options over 155,000 shares on 7 September 2006 leaving options over 50,000 shares in place at the year end.

6 During 2006, the highest mid-market price of the Company's shares was 440.25p and the lowest was 270p. The year end price was 398p.

**Pat Plunkett**, Chairman of the Remuneration Committee
23 March 2007

# Statement of Directors' responsibilities

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

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report and Directors' Remuneration Report which comply with the requirements of the Companies Act 1985.

## Group

The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRS). Company law requires the Directors to prepare such financial statements in accordance with IFRS, the Companies Act 1985 and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Group'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 International Financial Reporting Standards. Directors are also required to:

- select and apply accounting policies properly;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient; and
- enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

## Company

UK company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have elected to prepare the Company only financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of its profit or loss for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

# Independent auditors' report to the members of Tullow Oil plc

We have audited the Group financial statements of Tullow Oil plc for the year ended 31 December 2006 which comprise the Group Income Statement, the Group Statement of Recognised Income and Expense, the Group Balance Sheet, the Group Cash Flow Statement, the Accounting Policies, and the related notes 1 to 32. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Parent Company financial statements of Tullow Oil plc for the year ended 31 December 2006.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the Directors' Remuneration Report described as having been audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the Group financial statements. The information given in the Directors' Report includes the specific information presented in the Chairman's Statement, the Chief Executive's Review, the Operations Review and the Finance Review that is cross referred from the Business Review and Future Developments section of the Directors' Report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited Group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements and the part of the Directors' Remuneration Report to be audited.

## Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the part of the Directors' Remuneration Report described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the Group financial statements.

## Separate opinion in relation to IFRS

As explained in the accounting policies to the Group financial statements, the Group in addition to complying with its legal obligation to comply with IFRS as adopted by the European Union, has also complied with the IFRS as issued by the International Accounting Standards Board.

In our opinion the Group financial statements give a true and fair view, in accordance with IFRS, of the state of the Group's affairs as at 31 December and of its profit for the year then ended.

**Deloitte & Touche LLP**
Chartered Accountants and Registered Auditors
London
23 March 2007

# Group Income Statement

year ended 31 December 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **Sales revenue** | 2 | **578,847** | 445,232 |
| Cost of sales | | **(261,268)** | (243,149) |
| **Gross profit** | | **317,579** | 202,083 |
| Administrative expenses | | **(22,490)** | (13,793) |
| Disposal of subsidiaries | 25 | **–** | 30,537 |
| Profit on sale of oil and gas assets | | **–** | 5,524 |
| Exploration costs written off | 9 | **(32,494)** | (25,783) |
| **Operating profit** | 3 | **262,595** | 198,568 |
| Gain/(loss) on hedging instruments | 17 | **15,701** | (159) |
| Finance revenue | 2 | **3,030** | 4,367 |
| Finance costs | 5 | **(17,994)** | (24,197) |
| **Profit from continuing activities before tax** | | **263,332** | 178,579 |
| Income tax expense | 6 | **(105,894)** | (65,443) |
| **Profit for the year from continuing activities** | | **157,438** | 113,136 |
| **Earnings per ordinary share** | 8 | **Stg p** | Stg p |
| – Basic | | **24.23** | 17.50 |
| – Diluted | | **23.67** | 17.15 |

# Group Statement of Recognised Income and Expense

year ended 31 December 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **Profit for the financial year** | | **157,438** | 113,136 |
| Currency translation adjustments | 22 | **(55,057)** | 32,447 |
| Hedge movement | 22 | **68,236** | (120,449) |
| **Total recognised income and expense for the year** | | **170,617** | 25,134 |

# Group Balance Sheet

as at 31 December 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Intangible exploration and evaluation assets | 9 | **820,437** | 160,543 |
| Property, plant and equipment | 10 | **934,368** | 736,563 |
| Investments | 11 | **496** | 496 |
| | | **1,755,301** | 897,602 |
| **Current assets** | | | |
| Inventories | 12 | **13,735** | 5,141 |
| Trade receivables | | **74,609** | 66,441 |
| Other current assets | 13 | **28,963** | 26,851 |
| Cash and cash equivalents | 14 | **99,478** | 65,386 |
| Derivative financial instruments | 17 | **16,065** | – |
| | | **232,850** | 163,819 |
| **Total assets** | | **1,988,151** | 1,061,421 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 15 | **(161,797)** | (139,415) |
| Hardman acquisition payable | 24 | **(333,912)** | – |
| Other financial liabilities | 16 | **(7,516)** | – |
| Income tax payable | | **(20,549)** | (25,038) |
| Derivative financial instruments | 17 | **–** | (70,639) |
| | | **(523,774)** | (235,092) |
| **Non-current liabilities** | | | |
| Trade and other payables | 15 | **(17,137)** | (19,118) |
| Other financial liabilities | 16 | **(206,883)** | (198,372) |
| Deferred tax liabilities | 19 | **(311,925)** | (51,473) |
| Provisions | 19 | **(124,868)** | (91,139) |
| Derivative financial instruments | 17 | **(37,088)** | (77,208) |
| | | **(697,901)** | (437,310) |
| **Total liabilities** | | **(1,221,675)** | (672,402) |
| **Net assets** | | **766,476** | 389,019 |
| **EQUITY** | | | |
| **Equity attributable to equity holders of the parent** | | | |
| Called up share capital | 21 | **65,190** | 64,744 |
| Share premium | 21 | **126,075** | 123,019 |
| Other reserves | 22 | **69,791** | 60,589 |
| Shares to be issued | 24 | **235,621** | – |
| Retained earnings | 20 | **269,799** | 140,667 |
| **Total equity** | | **766,476** | 389,019 |

Approved by the Board on 23 March 2007

**Aidan Heavey**, Chief Executive Officer

**Tom Hickey**, Chief Financial Officer

# Group Cash Flow Statement

year ended 31 December 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 23 | 404,064 | 273,840 |
| Income taxes paid | | (61,868) | (25,360) |
| *Net cash from operating activities* | | 342,196 | 248,480 |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries | 24 | 21,336 | – |
| Disposal of subsidiaries | 25 | – | 57,227 |
| Disposal of oil and gas assets | | – | 31,769 |
| Purchase of intangible exploration and evaluation assets | | (67,976) | (69,766) |
| Purchase of property, plant and equipment | | (243,087) | (298,320) |
| Finance revenue | | 3,030 | 4,359 |
| *Net cash used in investing activities* | | (286,697) | (274,731) |
| **Cash flows from financing activities** | | | |
| Net proceeds from issue of share capital | | 3,502 | 1,570 |
| Debt arrangement fees | | (1,175) | (10,481) |
| Repayment of bank loans | | (27,914) | (351,637) |
| Drawdown of bank loan | | 59,996 | 390,515 |
| Finance costs | | (16,997) | (21,483) |
| Dividends paid | | (32,492) | (14,555) |
| Purchase of treasury shares | | (3,977) | – |
| *Net cash used in financing activities* | | (19,057) | (6,071) |
| **Net increase/(decrease) in cash and cash equivalents** | | 36,442 | (32,322) |
| **Cash and cash equivalents at beginning of period** | | 65,386 | 85,070 |
| Translation difference | | (2,350) | 12,638 |
| **Cash and cash equivalents at end of period** | 14 | 99,478 | 65,386 |

# Accounting policies

year ended 31 December 2006

## (a) Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. For these purposes, IFRS comprises the Standards issued by the International Accounting Standards Board (IASB) and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) that have been endorsed by the European Union (EU).

The financial statements have been prepared on the historical cost basis, except for derivative financial instruments that have been measured at fair value. The principal accounting policies adopted by the Group are set out below.

The Group has applied all accounting standards and interpretations issued by the IASB except for, at the date of authorisation of these financial statements, the following standards and interpretations which were in issue but not yet effective:

| | |
|---|---|
| IFRS 7 | Financial instruments: Disclosures; and the related amendment to IAS 1 on capital disclosures. |
| IFRIC 4 | Determining whether an Arrangement contains a Lease. |
| IFRIC 5 | Right to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds. |
| IFRIC 7 | Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies. |
| IFRIC 8 | Scope of IFRS 2. |
| IFRIC 9 | Reassessment of embedded derivatives. |
| IFRIC 10 | Interim reporting and impairments. |
| IFRIC 11 | IFRS 2 – Group and Treasury Share Transactions. |

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group except for additional disclosures on capital and financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007.

## (b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities 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.

The results of subsidiaries acquired or disposed of during the year are included in the Consolidated Income Statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

### Acquisitions

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognised at their fair value at the acquisition date. Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

### Joint Ventures

The Group is engaged in oil and gas exploration, development and production through unincorporated joint ventures. The Group accounts for its share of the results and net assets of these joint ventures as jointly controlled assets. In addition, where Tullow acts as operator to the joint venture, the gross liabilities and receivables (including amounts due to or from non-operating partners) of the joint venture are included in the Group Balance Sheet.

## (c) Sales revenue

Sales revenue represents the sales value, net of VAT and overriding royalties, of the Group's share of liftings in the year together with tariff income. Revenue is recognised when goods are delivered and title has passed.

Revenues received under take-or-pay sales contracts in respect of undelivered volumes are accounted for as deferred income.

## (d) Over/underlift

Lifting or offtake arrangements for oil and gas produced in certain of the Group's jointly owned operations are such that each participant may not receive and sell its precise share of the overall production in each period. The resulting imbalance between cumulative entitlement and cumulative production less stock is 'underlift' or 'overlift'. Underlift and overlift are valued at market value and included within debtors and creditors respectively. Movements during an accounting period are adjusted through Cost of Sales such that Gross Profit is recognised on an entitlements basis. The Group's share of any physical stock is accounted for at the lower of cost and net realisable value.

## (e) Foreign currencies

The Pound Sterling is the presentation currency of the Group. Financial statements of foreign currency denominated subsidiaries are translated into Sterling whereby the results of the overseas operations are generally translated at the average rate of exchange for the year and their balance sheets at rates of exchange ruling at the Balance Sheet date. Currency translation adjustments arising on the restatement of opening net assets of foreign subsidiaries, together with differences between the subsidiaries' results translated at average rates versus closing rates, are taken directly to reserves. All resulting exchange differences are classified as equity until disposal of the subsidiary. On disposal the cumulative amounts of the exchange differences are recognised as income or expense.

Transactions in foreign currencies are recorded at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities are translated into Sterling at the exchange rate ruling at the Balance Sheet date, with a corresponding charge or credit to the Income Statement. However, exchange gains and losses arising on long-term foreign currency borrowings, which are a hedge against the Group's overseas investments, are dealt with in reserves.

### (f) Exploration, evaluation and production assets

The Group adopts the successful efforts method of accounting for exploration and appraisal costs. All licence acquisition, exploration and evaluation costs are initially capitalised in cost centres by well, field or exploration area, as appropriate. Directly attributable administration costs and interest payable are capitalised insofar as they relate to specific exploration and development activities. Pre-licence costs are expensed in the period in which they are incurred.

These costs are then written off unless commercial reserves have been established or the determination process has not been completed and there are no indications of impairment.

All field development costs are capitalised as property, plant and equipment. Property, plant and equipment related to production activities are amortised in accordance with the Group's Depletion and Amortisation accounting policy.

### (g) Commercial reserves

Commercial reserves are proven and probable oil and gas reserves, which are defined as the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50% statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as a proven and probable reserves and a 50% statistical probability that it will be less.

### (h) Depletion and amortisation – discovery fields

All expenditure carried within each field is amortised from the commencement of production on a unit of production basis, which is the ratio of oil and gas production in the period to the estimated quantities of commercial reserves at the end of the period plus the production in the period, generally on a field-by-field basis. Costs used in the unit of production calculation comprise the net book value of capitalised costs plus the estimated future field development costs. Changes in the estimates of commercial reserves or future field development costs are dealt with prospectively.

Where there has been a change in economic conditions that indicates a possible impairment in a discovery field, the recoverability of the net book value relating to that field is assessed by comparison with the estimated discounted future cash flows based on management's expectations of future oil and gas prices and future costs.

Any impairment identified is charged to the Income Statement as additional depletion and amortisation. Where conditions giving rise to impairment subsequently reverse, the effect of the impairment charge is also reversed as a credit to the Income Statement, net of any depreciation that would have been charged since the impairment.

### (i) Decommissioning

Provision for decommissioning is recognised in full when the related facilities are installed. A corresponding amount equivalent to the provision is also recognised as part of the cost of the related property, plant and equipment. The amount recognised is the estimated cost of decommissioning, discounted to its net present value, and is reassessed each year in accordance with local conditions and requirements. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to property, plant and equipment. The unwinding of the discount on the decommissioning provision is included as a finance cost.

### (j) Property, plant and equipment

Property, plant and equipment is stated in the Balance Sheet at cost less accumulated depreciation. Depreciation on property, plant and equipment other than exploration and production assets, is provided at rates calculated to write off the cost less estimated residual value of each asset on a straight line basis over its expected useful economic life of between three and five years.

### (k) Finance costs and debt

Borrowing costs directly attributable 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 added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Finance costs of debt are allocated to periods over the term of the related debt at a constant rate on the carrying amount. Arrangement fees and issue costs are deducted from the debt proceeds on initial recognition of the liability and are amortised and charged to the Income Statement as finance costs over the term of the debt.

### (l) Share issue expenses and share premium account

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

### (m) Taxation

Current and deferred tax, including UK corporation tax and overseas corporation tax, are provided at amounts expected to be paid using the tax rates and laws that have been enacted or substantially enacted by the Balance Sheet date.

Deferred corporation taxation is recognised on all temporary differences that have originated but not reversed at the Balance Sheet date where transactions or events that result in an obligation to pay more, or right to pay less, tax in the future have occurred at the Balance Sheet date. Deferred tax assets are recognised only to the extent that it is considered more likely than not that there will be suitable taxable profits from which the underlying temporary differences can be deducted. Deferred tax is measured on a non-discounted basis.

Deferred tax is provided on temporary differences arising on acquisitions that are categorised as Business Combinations. Deferred tax is recognised at acquisition as part of the assessment of the fair value of assets and liabilities acquired. Any deferred tax is charged or credited in the Income Statement as the underlying temporary difference is reversed.

Petroleum Revenue Tax (PRT) is treated as an income tax and deferred PRT is accounted for under the temporary difference method. Current UK PRT is charged as a tax expense on chargeable field profits included in the Income Statement and is deductible for UK corporation tax.

### (n) Pensions

Contributions to the Group's defined contribution pension schemes are charged to operating profit on an accruals basis.

### (o) Derivative financial instruments

The Group uses derivative financial instruments to manage its exposure to fluctuations in foreign exchange rates, interest rates and movements in oil and gas prices.

Derivative financial instruments are stated at fair value.

The purpose for which a derivative is used is established at inception. To qualify for hedge accounting, the derivative must be 'highly effective' in achieving its objective and this effectiveness must be documented at inception and throughout the period of the hedge relationship. The hedge must be assessed on an ongoing basis and determined to have been 'highly effective' throughout the financial reporting periods for which the hedge was designed.

For the purpose of hedge accounting, hedges are classified as either fair value hedges, when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cash flow hedges, where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or forecasted transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from re-measuring the derivative and the hedged item at fair value is recognised immediately in the Income Statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the Income Statement.

For cash flow hedges, the portion of the gains and losses on the hedging instrument that is determined to be an effective hedge is taken to equity and the ineffective portion, as well as any change in time value, is recognised in the Income Statement. The gains and losses taken to equity are subsequently transferred to the Income Statement during the period in which the hedged transaction affects the Income Statement or if the hedge is subsequently deemed to be ineffective. A similar treatment applies to foreign currency loans which are hedges of the Group's net investment in the net assets of a foreign operation.

Gains or losses on derivatives that do not qualify for hedge accounting treatment (either from inception or during the life of the instrument) are taken directly to the Income Statement in the period.

### (p) Leases
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases and are charged to the Income Statement on a straight-line basis over the term of the lease.

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's policy on borrowing costs.

### (q) Share based payments
The Company has applied the requirements of IFRS 2 share based payments. In accordance with the transitional provisions of that standard, only those awards that were granted after 7 November 2002, and had not vested at 1 January 2005, are included.

All share-based awards of the Company are equity settled as defined by IFRS 2. The fair value of these awards has been determined at the date of grant of the award allowing for the effect of any market-based performance conditions. This fair value, adjusted by the Group's estimate of the number of awards that will eventually vest as a result of non-market conditions, is expensed uniformly over the vesting period.

The fair values were calculated using a binomial option pricing model with suitable modifications to allow for employee turnover after vesting and early exercise. Where necessary this model was supplemented with a Monte Carlo model. The inputs to the models include: the share price at date of grant; exercise price; expected volatility; expected dividends; risk free rate of interest; and patterns of exercise of the plan participants.

### (r) Critical accounting judgements and key sources of estimation uncertainty
Details of the Group's significant accounting judgements and critical accounting estimates are set out in these financial statements and include:

- Carrying value of intangible exploration and evaluation fixed assets (note 9);
- Carrying value of property, plant and equipment (note 10);
- Commercial reserves estimates (note 10);
- Derivative financial instruments (note 17);
- Decommissioning costs (note 19); and
- Acquisition of subsidiaries (note 24).

# Notes to the Group financial statements

year ended 31 December 2006

## Note 1. Segmental reporting

In the opinion of the Directors the operations of the Group comprise one class of business, oil and gas exploration, development and production and the sale of hydrocarbons and related activities. The Group also operates within four geographical markets, Europe, Africa, Asia and South America.

The following tables present revenue, profit and certain asset and liability information regarding the Group's business segments for the years ended 31 December 2006 and 2005.

| | Europe £'000 | Africa £'000 | Asia £'000 | South America £'000 | Unallocated £'000 | **Total £'000** |
|---|---|---|---|---|---|---|
| **2006** | | | | | | |
| **Sales revenue by origin** | 307,007 | 268,302 | 3,538 | – | – | 578,847 |
| **Segment result** | 129,735 | 159,304 | (3,954) | – | – | 285,085 |
| Unallocated corporate expenses | | | | | | (22,490) |
| **Operating profit** | | | | | | 262,595 |
| Gain on hedging instruments | | | | | | 15,701 |
| Finance revenue | | | | | | 3,030 |
| Finance costs | | | | | | (17,994) |
| **Profit before tax** | | | | | | 263,332 |
| Income tax expense | | | | | | (105,894) |
| **Profit after tax** | | | | | | 157,438 |
| **Total assets** | 541,684 | 1,281,760 | 62,174 | 79,815 | 22,718 | 1,988,151 |
| **Total liabilities** | (250,234) | (356,008) | (15,507) | (20,315) | (579,611) | (1,221,675) |
| **Other segment information** | | | | | | |
| Capital expenditure: | | | | | | |
| Property, plant and equipment | 161,675 | 217,693 | 10,567 | – | 3,136 | 393,071 |
| Intangible fixed assets | 37,197 | 575,808 | 15,897 | 79,815 | – | 708,717 |
| Depletion, depreciation and amortisation | (79,870) | (64,068) | (992) | – | (1,651) | (146,581) |

| | Europe £'000 | Africa £'000 | Asia £'000 | South America £'000 | Unallocated £'000 | **Total £'000** |
|---|---|---|---|---|---|---|
| **2005** | | | | | | |
| **Sales revenue by origin** | 179,501 | 264,939 | 792 | – | – | 445,232 |
| **Segment result** | 54,066 | 125,428 | (3,194) | – | – | 176,300 |
| Disposal of subsidiary | | | | | | 30,537 |
| Profit on sale of fixed assets | | | | | | 5,524 |
| Unallocated corporate expenses | | | | | | (13,793) |
| **Operating profit** | | | | | | 198,568 |
| Loss on hedging instruments | | | | | | (159) |
| Finance revenue | | | | | | 4,367 |
| Finance costs | | | | | | (24,197) |
| **Profit before tax** | | | | | | 178,579 |
| Income tax expense | | | | | | (65,443) |
| **Profit after tax** | | | | | | 113,136 |
| **Total assets** | 429,928 | 585,523 | 40,630 | – | 5,340 | 1,061,421 |
| **Total liabilities** | (146,788) | (235,629) | (10,142) | – | (279,843) | (672,402) |
| **Other segment information** | | | | | | |
| Capital expenditure: | | | | | | |
| Property, plant and equipment | 262,743 | 103,968 | 1,417 | – | 3,701 | 371,829 |
| Intangible fixed assets | 38,862 | 35,308 | 3,910 | – | – | 78,080 |
| Depletion, depreciation and amortisation | (56,716) | (59,758) | (2,238) | – | (985) | (119,697) |

Unallocated expenditure and net liabilities include amounts of a corporate nature and not specifically attributable to a geographic area, including tax balances and the Group debt.

## Note 2. Total revenue

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Sales revenue | | |
| Oil and gas revenue from the sale of goods | **562,243** | 430,542 |
| Tariff income | **16,604** | 14,690 |
| Total operating revenue | **578,847** | 445,232 |
| Finance revenue | **3,030** | 4,367 |
| Total revenue | **581,877** | 449,599 |

# Notes to the Group financial statements

continued

## Note 3. Operating profit

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Profit from operations is stated after charging/(crediting): | | |
| Staff costs (see note 4 below) | **20,637** | 16,001 |
| Depletion and amortisation | **144,930** | 118,712 |
| Depreciation of other fixed assets | **1,651** | 985 |
| Operating lease rentals for land and buildings | **1,852** | 1,465 |
| Net foreign exchange losses/(gains) | **840** | (1,220) |
| Auditors' remuneration (see below) | **550** | 585 |

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Audit services: | | |
| Fees payable to the Company's auditors for the audit of the Company's annual accounts | **130** | 125 |
| Audit of the Company's subsidiaries pursuant to legislation | **264** | 225 |
| IFRS opening balance sheet and related audit work | **–** | 160 |
| | **394** | 510 |
| Tax services: | | |
| Compliance services | **49** | 27 |
| Advisory services | **6** | 5 |
| | **55** | 32 |
| Other non-audit services: | | |
| Internal audit | **–** | 13 |
| Acquisition assistance | **62** | – |
| Other services not covered above | **39** | 30 |
| | **101** | 43 |
| **Total** | **550** | 585 |

Other services not covered above includes £5,000 payable to an associate of the Company's auditors.

## Note 4. Staff costs

The average monthly number of employees (including Executive Directors) employed by the Group worldwide was:

| | 2006 Number | 2005 Number |
|---|---|---|
| Administration | **116** | 104 |
| Technical | **93** | 70 |
| **Total** | **209** | 174 |

Staff costs in respect of those employees was as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Salaries | **18,376** | 14,448 |
| Social security costs | **1,150** | 821 |
| Pension costs | **1,111** | 732 |
| | **20,637** | 16,001 |

A proportion of the Group's staff costs shown above are recharged to the joint venture partners and a proportion is capitalised into the cost of fixed assets under the Group's accounting policy for exploration, evaluation and production assets.

Included in salaries is an expense of share based payments of £4,186,000 (2005: £1,403,000).

Details of Directors' Remuneration, Directors' Transactions and Directors' Interests are set out in the part of the Directors' Remuneration Report described as having been audited and form part of these financial statements.

## Note 5. Finance costs

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Interest on bank overdrafts and loans | 12,658 | 18,118 |
| Interest on obligations under finance leases | 374 | 444 |
| Total borrowing costs | 13,032 | 18,562 |
| Less amounts included in the cost of qualifying assets | (7,490) | (5,140) |
| | 5,542 | 13,422 |
| Finance and arrangement fees | 5,681 | 5,610 |
| Unwinding of discount on decommissioning provision (note 19) | 6,771 | 5,157 |
| Amounts payable in respect of interest rate swaps | – | 8 |
| | 17,994 | 24,197 |

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 6.78% (2005: 5.44%) to cumulative expenditure on such assets.

## Note 6. Taxation on profit on ordinary activities

**a) Analysis of charge in period**

The tax charge comprises:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| **Current tax** | | |
| UK corporation tax | 14,344 | 2,843 |
| Foreign taxation | 17,434 | 26,173 |
| **Total corporate tax** | 31,778 | 29,016 |
| UK petroleum revenue tax | 21,605 | 9,319 |
| **Total current tax** | 53,383 | 38,335 |
| **Deferred tax** | | |
| UK corporation tax | 45,585 | 16,002 |
| Foreign taxation | 6,530 | 11,496 |
| **Total corporate tax** | 52,115 | 27,498 |
| UK petroleum revenue tax | 396 | (390) |
| **Total deferred tax (note 19)** | 52,511 | 27,108 |
| **Total tax charge** | 105,894 | 65,443 |

## Note 6. Taxation on profit on ordinary activities (continued)

**b) Factors affecting tax charge for period**

As the Group earns a significant portion of its profits in the UK, the tax rates applied to profit on ordinary activities in preparing the reconciliation below is the standard rate of UK corporation tax plus the rate of the supplementary charge in respect of UK upstream profits (SCT).

The difference between the total tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax (30%) plus the rate of SCT (20%) to the profit before tax is as follows.

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| **Group profit on ordinary activities before tax** | **263,332** | 178,579 |
| Tax on Group profit on ordinary activities at a combined standard UK corporation tax and SCT rate of 50% (2005: 40%) | **131,666** | 71,432 |
| Effects of: | | |
| Expenses not deductible for tax purposes | **7,264** | 1,176 |
| Utilisation of tax losses not previously recognised | **–** | (589) |
| Net losses not recognised | **19,635** | 41,087 |
| PRT | **22,001** | 8,929 |
| UK corporation tax deductions for current PRT | **(11,001)** | (3,728) |
| Adjustments relating to prior years | **290** | 354 |
| Income taxed at a different rate | **(63,961)** | (53,218) |
| **Group total tax charge for the year** | **105,894** | 65,443 |

The Group's profit before taxation will continue to be subject to jurisdictions where the effective rate of taxation differs from that in the UK. Furthermore, unsuccessful exploration expenditure is often incurred in jurisdictions where the Group has no taxable profits, such that no related tax benefit arises. Accordingly the Group's tax charge will continue to depend on the jurisdictions in which pre-tax profits and exploration costs written off arise.

The Group has tax losses of £124 million (2005: £130 million) that are available indefinitely for offset against future taxable profits in the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as they may not be used to offset taxable profits elsewhere in the Group.

## Note 7. Dividends

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Declared and paid during year | | |
| Final dividend for 2005: Stg3p (2004: Stg1.25p) per ordinary share | **19,505** | 8,083 |
| Interim dividend for 2006: Stg2p (2005: Stg1p) per ordinary share | **12,987** | 6,472 |
| **Dividends paid** | **32,492** | 14,555 |
| Proposed for approval by shareholders at the AGM | | |
| Final dividend for 2006: Stg3.5p (2005: Stg3p) per ordinary share | **25,104** | 19,505 |

## Note 8. Earnings per ordinary share

Basic earnings per ordinary share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per ordinary share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued if employee and other share options were converted into ordinary shares.

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| **Earnings** | | |
| Net profit attributable to equity shareholders | **157,438** | 113,136 |
| Effect of dilutive potential ordinary shares | **–** | – |
| **Diluted net profit attributable to equity shareholders** | **157,438** | 113,136 |

| | **2006** | 2005 |
|---|---|---|
| **Number of shares** | | |
| Basic weighted average number of shares | **649,665,389** | 646,637,815 |
| Dilutive potential ordinary shares | **15,593,396** | 13,214,424 |
| **Diluted weighted average number of shares** | **665,258,785** | 659,852,239 |

## Note 9. Intangible exploration and evaluation fixed assets

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| At 1 January | **160,543** | 103,944 |
| Acquisition of subsidiaries (note 24) | **623,542** | – |
| Additions | **85,175** | 78,080 |
| Disposals/farm out | **–** | (6,470) |
| Amounts written off | **(32,494)** | (25,783) |
| Transfer from/(to) property, plant and equipment (note 10) | **937** | (48) |
| Currency translation adjustments | **(17,266)** | 10,820 |
| **At 31 December** | **820,437** | 160,543 |

The amounts for Intangible exploration and evaluation assets represent active exploration projects. These amounts will be written off to the Income Statement as exploration costs unless commercial reserves are established or the determination process is not completed and there are no indications of impairment. The outcome of ongoing exploration, and therefore whether the carrying value of Exploration and Evaluation assets will ultimately be recovered, is inherently uncertain.

# Notes to the Group financial statements

continued

## Note 10. Property, plant and equipment

| | Oil and Gas Assets £'000 | Other Fixed Assets £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2005 | 732,437 | 3,847 | 736,284 |
| Additions | 368,128 | 3,701 | 371,829 |
| Disposals | (112,319) | (367) | (112,686) |
| Transfer from intangible exploration and evaluation fixed assets (note 9) | 48 | – | 48 |
| Currency translation adjustments | 46,741 | 93 | 46,834 |
| At 1 January 2006 | **1,035,035** | **7,274** | **1,042,309** |
| Acquisition of subsidiaries (note 24) | **86,931** | **–** | **86,931** |
| Additions | **303,004** | **3,136** | **306,140** |
| Transfer to intangible exploration and evaluation fixed assets (note 9) | **(937)** | **–** | **(937)** |
| Currency translation adjustments | **(66,741)** | **(414)** | **(67,155)** |
| **At 31 December 2006** | **1,357,292** | **9,996** | **1,367,288** |
| **Depletion and Amortisation** | | | |
| At 1 January 2005 | 188,409 | 2,348 | 190,757 |
| Charge for the year | 118,712 | 985 | 119,697 |
| Disposals | (10,742) | (334) | (11,076) |
| Currency translation adjustments | 6,366 | 2 | 6,368 |
| At 1 January 2006 | **302,745** | **3,001** | **305,746** |
| Charge for the year | **144,930** | **1,651** | **146,581** |
| Currency translation adjustments | **(19,154)** | **(253)** | **(19,407)** |
| **At 31 December 2006** | **428,521** | **4,399** | **432,920** |
| **Net Book Value** | | | |
| **At 31 December 2006** | **928,771** | **5,597** | **934,368** |
| At 31 December 2005 | 732,290 | 4,273 | 736,563 |

Additions include capitalised interest of £7,490,000 (2005: £5,140,000).

The carrying amount of the Group's oil and gas assets includes an amount of £10,381,000 (2005: £14,184,000) in respect of assets held under finance leases.

Other fixed assets include leasehold improvements, motor vehicles and office equipment.

Depletion and amortisation for oil and gas properties is calculated on a unit-of-production basis, using the ratio of oil and gas production in the period to the estimated quantities of commercial reserves at the end of the period plus production in the period, generally on a field-by-field basis. Commercial reserves estimates are based on a number of underlying assumptions including oil and gas prices, future costs, oil and gas in place and reservoir performance, which are inherently uncertain. Commercial reserves estimates are based on a Group reserves report produced by an independent engineer. However, the amount of reserves that will ultimately be recovered from any field cannot be known with certainty until the end of the field's life.

## Note 11. Investments

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Unlisted investments | **447** | 447 |
| Government gilts | **49** | 49 |
| | **496** | 496 |

The fair value of these investments is not materially different from their carrying value.

At 31 December 2006 the Company's principal subsidiary undertakings, all of which are included in the consolidated Group financial statements, were:

| Name | % | Country of operation | Country of registration |
|---|---|---|---|
| **Directly held** | | | |
| Tullow Oil Limited | 100 | Ireland | Ireland |
| Tullow Oil UK Limited | 100 | United Kingdom | Scotland |
| Tullow Oil SK Limited | 100 | United Kingdom | England & Wales |
| Tullow Oil SPE Limited | 100 | United Kingdom | England & Wales |
| Energy Africa (Pty) Limited | 100 | South Africa | South Africa |
| Energy Africa Gabon Holdings Limited | 50 | Gabon | Isle of Man |
| Tullow Group Services Limited | 100 | United Kingdom | England & Wales |
| Tullow Overseas Holdings B.V. | 100 | Netherlands | Netherlands |
| Hardman Resources Limited | 100 | Australia | Australia |
| **Indirectly held** | | | |
| Energy Africa Holdings Limited | 100 | Isle of Man | British Virgin Islands |
| Tullow Oil International Limited | 100 | Channel Islands | Jersey |
| Tullow Pakistan (Developments) Limited | 100 | Pakistan | Jersey |
| Tullow Bangladesh Limited | 95 | Bangladesh | Jersey |
| Tullow Côte d'Ivoire Limited | 100 | Côte d'Ivoire | Jersey |
| Tullow Côte d'Ivoire Exploration Limited | 100 | Côte d'Ivoire | Jersey |
| Tullow India Operations Limited | 100 | India | Jersey |
| Tullow Cameroon Limited | 100 | Cameroon | Jersey |
| Tullow Madagascar Limited | 100 | Madagascar | Jersey |
| Tullow Angola B.V. | 100 | Angola | Netherlands |
| Energy Africa Congo Limited | 100 | Congo | Isle of Man |
| Energy Africa Equatorial Guinea Limited | 100 | Equatorial Guinea | Isle of Man |
| Energy Africa Equatorial Guinea Exploration Limited | 100 | Equatorial Guinea | Isle of Man |
| Energy Africa Kudu Limited | 100 | Namibia | Isle of Man |
| Energy Africa Senegal Limited | 100 | Senegal | Isle of Man |
| Energy Africa Uganda Limited | 100 | Uganda | Isle of Man |
| Energy Africa UK Limited | 100 | United Kingdom | Isle of Man |
| Energy Africa Gabon Holdings Limited | 50 | Gabon | Isle of Man |
| Energy Africa Gabon Limited | 100 | Isle of Man | Isle of Man |
| Tullow Oil Gabon SA | 100 | Gabon | Gabon |
| Hardman Chinguetti Production (Pty) Limited | 100 | Mauritania | Australia |
| Hardman Petroleum (Mauritania) (Pty) Limited | 100 | Mauritania | Australia |
| Planet Oil (Mauritania) Limited | 100 | Mauritania | Guernsey |
| Planet Oil Limited | 100 | French Guiana | England & Wales |
| Hardman Petroleum Africa (Pty) Limited | 100 | Uganda | Australia |
| Hardman Oil & Gas (Pty) Limited | 100 | Trinidad | Australia |

The principal activity of all companies relates to oil and gas exploration, development and production.

# Notes to the Group financial statements

continued

## Note 12. Inventories

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Warehouse stocks and materials | **8,790** | 3,473 |
| Oil stocks | **4,945** | 1,668 |
| | **13,735** | 5,141 |

## Note 13. Other current assets

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Other debtors | **25,587** | 24,334 |
| Prepayments | **1,872** | 1,991 |
| VAT recoverable | **1,504** | 526 |
| | **28,963** | 26,851 |

## Note 14. Cash and cash equivalents

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Cash at bank and in hand | **42,628** | 46,596 |
| Short-term deposits | **56,850** | 18,790 |
| | **99,478** | 65,386 |

Cash and cash equivalents includes an amount of £7,995,000 (2005: £20,000,000) which is a reserve held on fixed term deposit in support of a Letter of Credit facility which relates to the Group's share of certain decommissioning and FPSO costs.

## Note 15. Trade and other payables

**Current liabilities**

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Trade payables | **20,162** | 18,370 |
| Other payables | **37,462** | 48,747 |
| Deferred income (take or pay) | **1,372** | 653 |
| Accruals | **88,566** | 63,912 |
| PAYE and social security | **124** | 516 |
| VAT and other similar taxes | **12,067** | 4,957 |
| Current portion of finance lease (note 18) | **2,044** | 2,260 |
| | **161,797** | 139,415 |

**Non-current liabilities**

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Other payables | **8,372** | 6,812 |
| Non-current portion of finance lease (note 18) | **8,765** | 12,306 |
| | **17,137** | 19,118 |

## Note 16. Financial liabilities

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| **Current** | | |
| Short-term borrowings | **7,516** | – |
| Current portion of long-term borrowings | **–** | – |
| | **7,516** | – |
| **Non-Current** | | |
| Term loans repayable | | |
| – After one year but within two years | **1,135** | 8,719 |
| – After two years but within five years | **175,496** | 154,341 |
| – After five years | **30,252** | 35,312 |
| | **206,883** | 198,372 |

Group bank loans are stated net of unamortised arrangement fees of £7,174,000 (2005: £7,219,000).

Bank loans, overdrafts and guarantees are secured by fixed and floating charges over the producing assets of the Group.

Wherever possible the Group conducts and manages its business in Sterling (UK) and US Dollars (all other countries), the functional currencies of the industry in the areas in which it operates. Balances are held in other currencies to meet immediate operating or administrative expenses or to comply with local currency regulations. At 31 December 2006 the only material monetary assets or liabilities of the Group that were not denominated in the functional currency of the respective subsidiaries involved were $280 million (£142.9 million) cash drawings under the US$850 million Borrowing Base Facility, a $7.5 million (£3.8 million) Revolving Loan taken out in Ireland and funds in Pakistan of 389.2 million Pakistani Rupees (£3.3 million) in respect of sales income held awaiting the necessary approval for repatriation. The US$280 million drawn under the Borrowing Base Facility at 31 December 2006 continues to be held as a hedge against US$ denominated net assets in subsidiaries.

### Interest rate risk

The interest rate profile of the Group's financial assets and liabilities at 31 December 2006 was as follows:

| | Stg £'000 | Euro £'000 | US$ £'000 | Other £'000 | Total £'000 |
|---|---|---|---|---|---|
| Cash at bank at floating interest rate | **38,256** | **130** | **53,763** | **6,619** | **98,768** |
| Cash at bank on which no interest is received | **133** | **–** | **577** | **–** | **710** |
| Fixed rate debt | **(30,000)** | **–** | **(63,805)** | **–** | **(93,805)** |
| Floating rate debt | **(40,000)** | **–** | **(87,768)** | **–** | **(127,768)** |
| **Net (debt)/cash** | **(31,611)** | **130** | **(97,233)** | **6,619** | **(122,095)** |

The profile at 31 December 2005 for comparison purposes was as follows:

| | Stg £'000 | Euro £'000 | US$ £'000 | Other £'000 | Total £'000 |
|---|---|---|---|---|---|
| Cash at bank at floating interest rate | 36,102 | – | 20,228 | 359 | 56,689 |
| Cash at bank on which no interest is received | 194 | 50 | 5,330 | 3,123 | 8,697 |
| Fixed rate debt | (42,500) | – | (34,286) | – | (76,786) |
| Floating rate debt | (51,516) | – | (77,289) | – | (128,805) |
| Net (debt)/cash | (57,720) | 50 | (86,017) | 3,482 | (140,205) |

Cash at bank at floating interest rate consisted of deposits which earn interest at rates set in advance for periods ranging from overnight to one month by reference to Sterling or US Dollar LIBOR.

Floating rate debt comprises bank borrowings at interest rates fixed in advance from overnight to three months at rates determined by US Dollar LIBOR and Sterling LIBOR. Fixed rate debt comprises bank borrowings at interest rates fixed in advance for periods greater than three months or bank borrowings where the interest rate has been fixed through interest rate hedging.

### Note 16. Financial liabilities (continued)

The Borrowing Base Facility incurs interest on outstanding debt at Sterling LIBOR plus a margin ranging from 110 basis points to 240 basis points depending on utilisation and concentration of non-OECD assets and US Dollar LIBOR plus a margin ranging from 110 basis points to 240 basis points depending on utilisation and concentration of non-OECD assets. The outstanding debt is repayable in variable amounts (determined semi-annually) over the period to 31 August 2012, or such other time as is determined by reference to the remaining reserves of the assets, whichever is earlier. There is no requirement under the Borrowing Base Facility to hedge interest rate exposure to Sterling LIBOR and US Dollar LIBOR. The Borrowing Base Facility states that consideration should be given to hedging at least 30% of the interest rate exposure to fluctuations in LIBOR for Sterling and US Dollars in respect of loans under the facility from time to time, net of relevant cash balances.

In the table for 2006, £93.8 million of the gross debt has been shown as fixed rate debt as the particular bank borrowings were fixed in November 2006 for a six month duration.

In December 2005, the Group executed an interest rate hedging programme (effective February 2006), whereby 50% of the projected interest rate exposure to Sterling LIBOR and US Dollar LIBOR was hedged through the application of a series of interest rate swaps, options and zero cost collars. The effect of these derivatives limits the interest rate exposure to Sterling LIBOR at 5.7% and US Dollar LIBOR at 5.8%. The interest rate swaps, options and zero cost collars were put in place for a three year period for US Dollar (expiring November 2008) and for an 18 month period for Sterling LIBOR (expiring May 2007) at varying notional principal amounts. The interest rate swaps, options and zero cost collars do not give rise to material differences between book and fair values. Therefore the hedged amounts are included in Floating Rate Debt in the 2006 table.

### Note 17. Derivative financial instruments

The Group holds a portfolio of commodity derivative contracts, with various counterparties, covering both its underlying oil and gas businesses. In addition the Group holds a small portfolio of interest rate and foreign exchange derivatives. The Group's policy is to mitigate its exposure to oil and gas price fluctuations for a portion of its production, using a range of derivative financial instruments such as fixed price swaps, participating swaps, zero cost collars and other option structures. The Group's policy is also to mitigate its exposure to fluctuations in interest rates and foreign exchange rates through the use of similar derivative financial instruments.

**Fair values of derivative instruments**

Under IAS 39 all derivatives must be recognised at fair value on the Balance Sheet with changes in such fair value between accounting periods being recognised immediately in the Income Statement, unless the derivatives have been designated as cash flow or fair value hedges. The fair value is the amount for which the asset or liability could be exchanged in an arm's length transaction at the relevant date. Fair values are determined using quoted market prices (marked-to-market values) where available. To the extent that market prices are not available, fair values are estimated by reference to market-based transactions, or using standard valuation techniques for the applicable instruments and commodities involved. The fair value of derivative instruments are recorded on the Balance Sheet under the caption 'Derivative Financial Instruments' under Current Assets/(Liabilities) and Non-Current Liabilities.

The Group's derivative instrument book and fair values were as follows:

| Assets/(Liabilities): | 31 Dec 2006 £'000 | 31 Dec 2005 £'000 |
|---|---|---|
| **Derivative Instruments** | | |
| Gas derivatives | **45,614** | (31,520) |
| Oil derivatives | **(72,682)** | (116,344) |
| Interest rate derivatives | **156** | 17 |
| Exchange rate derivatives | **5,889** | – |
| | **(21,023)** | (147,847) |
| **Analysed as follows:** | | |
| Amounts falling due within one year | **16,065** | (70,639) |
| Amounts falling due after one year | **(37,088)** | (77,208) |
| | **(21,023)** | (147,847) |

A large portion of the oil derivative liabilities at 31 December 2005 and 31 December 2006 relate to contracts acquired as part of the acquisition of Energy Africa in May 2004; these contracts cover 4,000 bopd at a maximum Brent Dated price for the Group of $29.30/barrel, extending to 31 December 2009. These derivative liabilities are substantially offset by an increase in the economic value of the underlying hedged future oil production.

### Cash flow hedges

As at 31 December 2006 all of the Group's commodity and interest rate derivatives were designated as cash flow hedges under IAS 39. As a result, the effective portion of hedging gains or losses arising from changes in the fair values of designated hedging instruments is deferred in a separate component of reserves, subject to the establishment of a 'highly effective' correlation (defined in IAS 39 as hedge effectiveness within a range of 80 – 125%) between the commodity hedge and the underlying physical commodity's pricing and sale characteristics. Such effective gains or losses, which are deferred to reserves, are recorded on the Balance Sheet under the caption 'Hedge Reserve' (see note 22). Similar hedge effectiveness testing is carried out in relation to the Group's interest rate derivatives.

Hedge ineffectiveness is recognised immediately in the Income Statement in the period, and such hedge ineffectiveness for the oil and gas commodity hedges is described below. Hedge ineffectiveness is recorded in the Income Statement under the caption 'Gain/(Loss) on Hedging Instruments' with any associated tax effect being recorded under the caption 'Income Tax Expense'. Hedge ineffectiveness arises when the hedge correlation results are within the range of 80 – 125% but not 100% precisely. Any change in the time value component of the hedge instrument is also recognised immediately in the Income Statement under the caption 'Gain/(Loss) on Hedging Instruments'. Any associated tax effect is recorded under the caption 'Income Tax Expense'.

### Oil hedges

The Group uses a number of derivative instruments to mitigate the commodity price risk associated with its underlying oil revenues. These derivative instruments include fixed price swaps, participating swaps, zero cost collars and other option structures. Such oil derivatives will tend to be priced using pricing benchmarks, such as Brent Dated, which correlate as far as possible to the underlying oil revenues. The Group hedges its estimated oil revenues on a portfolio basis, aggregating its revenues from substantially all of its West African oil interests.

At 31 December 2006 the Group's oil hedge position was summarised as follows:

| Oil hedges | H1 2007 | H2 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Volume – bopd | 15,400 | 15,400 | 9,300 | 4,500 | – |
| Average price* – $/bbl | 53.78 | 56.04 | 50.58 | 33.37 | – |

* Average hedge prices are based on market prices as at 31 December 2006 and represent the current value of hedged volumes at that date.

As at 31 December 2006 all of the Group's oil derivatives have been designated as cash flow hedges. The Group's oil hedges have been assessed to be 'highly effective' within the range prescribed under IAS 39 using a regression analysis. There is however a degree of ineffectiveness inherent in the Group's oil hedges arising from, among other factors, the discount on the Group's underlying West African crude relative to Brent and the timing of oil liftings relative to the hedges.

As at 31 December 2006 an unrealised loss of £73.9 million has been deferred to the Hedge Reserve, net of tax effects. Changes in fair value of oil hedges which have been recognised in the Income Statement in the current period amount to a gain of £10.2 million, with an associated tax charge of £0.9 million. A proportion of the oil cash flow hedges do not generate an offsetting tax charge or credit.

### Gas Hedges

The Group uses a number of derivative instruments to mitigate the commodity price risk associated with its underlying UK gas revenues. These derivative instruments include fixed price swaps, participating swaps, zero cost collars and other option structures. Such gas derivatives will tend to be priced using pricing benchmarks which correlate as far as possible to the underlying gas revenues. The Group hedges its estimated UK gas revenues on a portfolio basis, aggregating its revenues from substantially all of its UK gas interests.

At 31 December 2006 the Group's gas hedge position was summarised as follows:

| Gas hedges | H1 2007 | H2 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Volume – mmscfd | 77.8 | 56.4 | 41.6 | 3.6 | – |
| Average price* – p/therm | 49.35 | 44.73 | 45.73 | 50.43 | – |

* Average hedge prices are based on market prices as at 31 December 2006 and represent the current value of hedged volumes at that date.

As at 31 December 2006, all of the Group's gas derivatives have been designated as cash flow hedges. The Group's gas hedges have been assessed to be 'highly effective' within the range prescribed under IAS 39 using 'ratio analysis'. There is, however, a degree of ineffectiveness inherent in the Group's gas hedges arising from, among other factors, field production performance on any day.

As at 31 December 2006, an unrealised gain of £21.6 million has been deferred to the Hedge Reserve, net of tax effects. Changes in fair value of gas hedges which have been recognised in the Income Statement in the current period amount to a loss of £0.4 million, with an associated tax credit of £0.2 million.

## Note 17. Derivative financial instruments (continued)

**Foreign Exchange Hedges**

The Group uses a number of derivative instruments to mitigate its exposures to changes in foreign exchange rates. As at 31 December 2006 none of the Group's foreign exchange derivatives were designated as cash flow hedges under IAS 39. Consequently the changes in fair value of the instruments have been recognised immediately in the Income Statement and amount to a gain of £5.9 million, with an associated tax charge of £1.8 million.

**Income statement hedge summary**

The changes in the fair value of hedges which require to be recognised immediately in the Income Statement for the year, together with associated tax effects, were as follows:

| Gain/(loss) on hedging instruments: | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Gas derivatives net | (387) | 2,407 |
| Oil derivatives net | 10,199 | (2,566) |
| Foreign exchange derivatives net | 5,889 | – |
| **Total net gain/(loss) for the year in Income Statement** | 15,701 | (159) |

| Income tax credit/(charge): | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Gas derivatives net | 194 | (963) |
| Oil derivatives net | (873) | (729) |
| Foreign exchange derivatives net | (1,767) | – |
| **Total net charge for the year in income statement** | (2,446) | (1,692) |

**Deferred amounts in hedge reserve**

The following table summarises the deferred gains/(losses) on derivative instruments, net of tax effects, recorded in Hedge Reserve (note 22) for the year:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| At 1 January | (120,449) | – |
| Amounts recognised in profit for the year | (13,255) | 1,851 |
| Deferred gains/(losses) before tax arising during the year | 122,625 | (130,494) |
| Deferred tax movement taken directly to equity | (41,134) | 8,194 |
| | 68,236 | (120,449) |
| **At 31 December** | (52,213) | (120,449) |

## Note 18. Obligations under finance leases

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Amounts payable under finance leases: | | |
| – Within one year | 2,339 | 2,662 |
| – Within two to five years | 9,354 | 10,651 |
| – After five years | – | 2,662 |
| | 11,693 | 15,975 |
| Less future finance charges | (884) | (1,409) |
| **Present value of lease obligations** | 10,809 | 14,566 |
| **Amount due for settlement within 12 months (note 15)** | 2,044 | 2,260 |
| **Amount due for settlement after 12 months (note 15)** | 8,765 | 12,306 |

## Note 19. Provisions

| (i) Decommissioning costs | 2006 £'000 | 2005 £'000 |
|---|---|---|
| At 1 January | 91,139 | 70,679 |
| Acquisition of subsidiaries (note 24) | 5,463 | – |
| New provisions and changes in estimates | 24,199 | 20,337 |
| Disposal of oil and gas assets | – | (6,854) |
| Decommissioning payments | (257) | (91) |
| Unwinding of discount (note 5) | 6,771 | 5,157 |
| Currency translation adjustment | (2,447) | 1,911 |
| **At 31 December** | 124,868 | 91,139 |

The decommissioning provision represents the present value of decommissioning costs relating to the UK, West Africa and Asian oil and gas interests, which are expected to be incurred up to 2025. These provisions have been created based on Tullow's internal estimates and, where available, operator's estimates. Assumptions, based on the current economic environment, have been made which management believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning works required which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain.

**(ii) Deferred Taxation**

| | PRT £'000 | UK and Overseas Corporate Taxation £'000 | Total £'000 |
|---|---|---|---|
| At 1 January 2005 | 13,575 | 55,228 | 68,803 |
| Adoption of IAS 39 relating to hedges | – | (19,896) | (19,896) |
| Charged to income statement | (390) | 27,498 | 27,108 |
| Disposal of subsidiary | (12,466) | (13,873) | (26,339) |
| Currency translation adjustment | 1,636 | 161 | 1,797 |
| At 1 January 2006 | 2,355 | 49,118 | 51,473 |
| Charged to income statement | 396 | 52,115 | 52,511 |
| Acquisition of subsidiaries (note 24) | – | 158,842 | 158,842 |
| Hedge movement directly to equity | – | 41,134 | 41,134 |
| Currency translation adjustment | – | 7,965 | 7,965 |
| **At 31 December 2006** | 2,751 | 309,174 | 311,925 |

Deferred UK and overseas corporation tax is provided as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Accelerated capital allowances | 155,863 | 96,188 |
| Decommissioning charges | (31,356) | (19,014) |
| Other temporary differences | 176,702 | (28,217) |
| Currency translation adjustment | 7,965 | 161 |
| **Provision** | 309,174 | 49,118 |

No deferred tax has been provided on unremitted earnings of overseas subsidiaries, as the Group has no plans to remit these to the UK in the foreseeable future.

# Notes to the Group financial statements

continued

## Note 20. Reconciliation of changes in equity

| **2006** | Share capital £'000 | Share premium £'000 | Other reserves (Note 22) £'000 | Shares to be issued (Note 24) £'000 | Retained earnings £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| Opening equity | **64,744** | **123,019** | **60,589** | **–** | **140,667** | **389,019** |
| Total recognised income and expense for the year | **–** | **–** | **13,179** | **–** | **157,438** | **170,617** |
| Purchase of treasury shares | **–** | **–** | **(3,977)** | **–** | **–** | **(3,977)** |
| Shares to be issued in respect of Hardman acquisition (note 24) | **–** | **–** | **–** | **235,621** | **–** | **235,621** |
| New shares issued in respect of employee share options | **446** | **3,056** | **–** | **–** | **–** | **3,502** |
| Share based payments charges | **–** | **–** | **–** | **–** | **4,186** | **4,186** |
| Dividends paid (note 7) | **–** | **–** | **–** | **–** | **(32,492)** | **(32,492)** |
| **Closing equity attributable to the company's equity holders** | **65,190** | **126,075** | **69,791** | **235,621** | **269,799** | **766,476** |

| 2005 | Share capital £'000 | Share premium £'000 | Other reserves (Note 22) £'000 | Shares to be issued (Note 24) £'000 | Retained earnings £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| Opening equity | 64,537 | 121,656 | 148,591 | – | 40,683 | 375,467 |
| Total recognised income and expense for the year | – | – | (88,002) | – | 113,136 | 25,134 |
| New shares issued in respect of employee share options | 207 | 1,363 | – | – | – | 1,570 |
| Share based payments charges | – | – | – | – | 1,403 | 1,403 |
| Dividends paid (note 7) | – | – | – | – | (14,555) | (14,555) |
| Closing equity attributable to the company's equity holders | 64,744 | 123,019 | 60,589 | – | 140,667 | 389,019 |

## Note 21. Called up equity share capital and share premium account

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| **(a) Authorised** | | |
| 1,000,000,000 ordinary shares of Stg10p each | **100,000** | 100,000 |

**(b) Allotted equity share capital and share premium**

| | Equity Share Capital Allotted and Fully Paid Number | Equity Share Capital Allotted and Fully Paid £'000 | Share Premium £'000 |
|---|---|---|---|
| Ordinary shares of Stg10p each | | | |
| At 1 January 2005 | 645,368,740 | 64,537 | 121,656 |
| Issues during the year | | | |
| – Exercise of share options | 2,068,983 | 207 | 1,363 |
| At 1 January 2006 | **647,437,723** | **64,744** | **123,019** |
| Issues during the year | | | |
| – Exercise of share options | **4,462,575** | **446** | **3,056** |
| **At 31 December 2006** | **651,900,298** | **65,190** | **126,075** |

## Note 22. Other reserves

| | Merger Reserve £'000 | Foreign Currency Translation Reserve £'000 | Hedge Reserve £'000 | Treasury Shares £'000 | Total £'000 |
|---|---|---|---|---|---|
| At 1 January 2005 | 178,953 | (30,362) | – | – | 148,591 |
| Hedge movement | – | – | (120,449) | – | (120,449) |
| Currency translation adjustment | – | 32,447 | – | – | 32,447 |
| At 1 January 2006 | **178,953** | **2,085** | **(120,449)** | **–** | **60,589** |
| Hedge movement (note 17) | **–** | **–** | **68,236** | **–** | **68,236** |
| Currency translation adjustment | **–** | **(55,057)** | **–** | **–** | **(55,057)** |
| Purchase of treasury shares | **–** | **–** | **–** | **(3,977)** | **(3,977)** |
| **At 31 December 2006** | **178,953** | **(52,972)** | **(52,213)** | **(3,977)** | **69,791** |

The treasury shares reserve represents the cost of shares in Tullow Oil plc purchased in the market and held by the Tullow Oil Employee Trust to satisfy awards of shares granted under the PSP and DSBP (see note 26).

## Note 23. Cash flows from operating activities

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Profit before taxation | **263,332** | 178,579 |
| Adjustments for: | | |
| Depletion, depreciation and amortisation | **146,581** | 119,697 |
| Net foreign exchange losses | **840** | 72 |
| Exploration costs written off | **32,494** | 25,783 |
| Disposal of subsidiaries | **–** | (30,537) |
| Profit on sale of oil and gas assets | **–** | (5,524) |
| Share based payment charge | **4,186** | 1,403 |
| Gain/(loss) on hedging instruments | **(15,701)** | 159 |
| Finance revenue | **(2,451)** | (4,367) |
| Finance costs | **17,415** | 24,197 |
| Operating cash flow before working capital movements | **446,696** | 309,462 |
| Decrease/(increase) in trade and other receivables | **509** | (38,538) |
| Increase in inventories | **(4,729)** | (1,749) |
| (Decrease)/increase in trade payables | **(38,412)** | 4,665 |
| **Cash generated from operations** | **404,064** | 273,840 |

## Note 24. Acquisition of subsidiaries

On 25 September 2006 the Group announced a proposal to acquire 100% of the issued share capital of Hardman Resources Limited by way of a Scheme of Arrangement. Following the approval of the acquisition by Hardman shareholders and the Australian Courts, the Scheme became effective on 20 December 2006 and formal completion, which involved the payment of A$819.5 million and the issue of 65 million Tullow shares, occurred on 10 January 2007.

The acquisition of Hardman provides additions to the Group's production, development and exploration activities in Africa and adds exploration acreage in Europe and South America. The transaction has been accounted for by the purchase method of accounting with an effective date of 20 December 2006, being the date that Tullow gained control of Hardman. For reasons of materiality and practicality, Tullow has consolidated Hardman's results from 31 December 2006.

The fair value allocation to the Hardman assets is preliminary in nature and will be reviewed in accordance with the provisions of IFRS 3 – Business Combinations. Due to the inherently uncertain nature of the oil and gas industry and intangible exploration evaluation assets in particular, the assumptions underlying the preliminary assigned values are highly judgemental in nature. The purchase consideration equals the aggregate of the fair value of the identifiable assets and liabilities of Hardman, and therefore no goodwill has been recorded on the acquisition. Deferred tax has been recognised in respect of the fair value adjustments as applicable.

| | Book Value £'000 | **Fair Value £'000** |
|---|---|---|
| Intangible exploration and evaluation assets | 58,563 | **623,542** |
| Property, plant and equipment | 79,951 | **86,931** |
| Inventories | 3,674 | **3,866** |
| Other current assets | 10,790 | **10,790** |
| Cash and cash equivalents | 46,540 | **46,540** |
| Trade and other payables | (11,480) | **(11,480)** |
| Derivative financial instruments | (1,147) | **(1,147)** |
| Deferred tax liabilities | (3,605) | **(158,842)** |
| Provisions | (5,463) | **(5,463)** |
| | 177,823 | **594,737** |
| Total consideration | | **594,737** |
| Satisfied by: | | |
| Cash | | **25,204** |
| Hardman acquisition payable | | **333,912** |
| Shares to be issued | | **235,621** |
| | | **594,737** |
| Net cash inflow arising on acquisition | | |
| Cash consideration | | **(25,204)** |
| Cash and cash equivalents acquired | | **46,540** |
| | | **21,336** |

If the acquisition of Hardman Resources Limited had been completed on the first day of the financial year, Group revenues for the year would have been £632,984,000 and Group profit attributable to equity holders of the parent would have been £131,304,000.

## Note 25. Disposal of subsidiaries

On 8 April 2005 the Group entered into a sale and purchase agreement to dispose of its interest in Unilon Oil Explorations Limited and Baytrust Oil Explorations Limited. The disposal was completed on 8 June 2005. The gain on disposal of the subsidiaries amounted to £30,537,000, total consideration received was £61,658,000 and the net cash received, after taking account of cash disposed, was £57,227,000.

## Note 26. Share based payments

### 2005 Performance Share Plan (PSP)

Under the PSP, senior executives can receive conditional awards of rights over whole shares worth up to 150% of salary p.a. (200% in exceptional circumstances). Awards vest under the PSP subject to a TSR based performance condition under which the Company's TSR performance is measured over the fixed three year period against both the constituents of the FTSE 250 index (excluding investment trusts) (the 'Index') and a comparator group of oil and gas companies. Half of an award is tested against the Index and the other half against the comparator group. The test is over a three year period starting on the 1 January prior to grant, and an individual must normally remain in employment for three years from the date of grant for the shares to vest. No dividends are paid to participants over the vesting period. Further details in relation to the PSP award measurements are provided in the Directors' Remuneration Report.

The shares outstanding under the PSP are as follows:

| | PSP Shares | Average weighted share price at grant (p) |
|---|---|---|
| Outstanding at 1 January 2006 | 1,784,417 | 187.50 |
| Granted | 1,118,665 | 354.01 |
| Outstanding at 31 December 2006 | 2,903,082 | 251.66 |

| | |
|---|---|
| The inputs of the option valuation model were: | |
| Risk free interest rate | 4.5-4.7% pa |
| Expected volatility | 32% |
| Dividend yield | 1.0-1.1% pa |

The expected life is the period from the date of grant to the vesting date. The weighted average fair value of the awards granted in 2006 was 264.96p per award.

The Company recognised a total expense of £1,392,000 (2005: £311,000) in respect of the PSP.

### 2005 Deferred Share Bonus Plan (DSBP)

Under the DSBP, the portion of any annual bonus entitlement above 60% of the base salary of a senior executive nominated by the Remuneration Committee is required to be deferred into shares. Shares awarded under the DSBP will normally vest following the end of the period of three financial years commencing with that in which the award is granted.

The shares outstanding under the DSBP are as follows:

| | DSBP Shares | Share price at grant |
|---|---|---|
| Outstanding at 1 January 2006 | – | – |
| Granted | 79,787 | 348.5p |
| Outstanding at 31 December 2006 | 79,787 | 348.5p |

| | |
|---|---|
| The inputs of the option valuation model were: | |
| Dividend yield | 1.1%pa |

The expected life is the period from the date of grant to the vesting date. The fair value of the awards granted in 2006 was 337.2p per award.

The Company recognised a total expense of £74,000 (2005: nil) in respect of the DSBP.

# Notes to the Group financial statements

continued

## Note 26. Share based payments (continued)

**2000 Executive share option scheme (ESOS)**

Options granted under the 2000 ESOS normally only become exercisable following the third anniversary of the date of the grant if the performance condition has been met. The awards are tested against the Index and 100% of awards will vest if the Company's TSR is above the median of the Index over the three year period following grant. Options awarded under the 2000 ESOS before 24 May 2005 are subject to monthly re-testing on a rolling three year basis if the TSR performance criterion is not met. Options granted on or after 24 May 2005 are not subject to monthly re-testing.

Options have previously been granted under the 1988 ESOS and the 1998 ESOS. Options granted under the 1988 ESOS and the 1998 ESOS are not subject to performance conditions. All awards under the 1988 ESOS and the 1998 ESOS were made prior to 7 November 2002 and therefore, under the IFRS transitional provisions, they have not been accounted for in accordance with IFRS 2 – share based payments.

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the year.

| | **2006 number** | **2006 WAEP (p)** | 2005 number | 2005 WAEP (p) |
|---|---|---|---|---|
| Outstanding as at 1January | **21,989,560** | **96.65** | 20,683,036 | 82.01 |
| Granted during the year | **2,311,045** | **346.02** | 3,808,600 | 169.03 |
| Exercised during the year | **(4,462,575)** | **78.54** | (1,563,626) | 79.43 |
| Expired during the year | **(200,550)** | **164.35** | (938,450) | 96.37 |
| **Outstanding at 31 December** | **19,637,480** | **129.39** | 21,989,560 | 96.65 |
| **Exercisable at 31 December** | **10,694,335** | **73.86p** | 9,299,210 | 68.59 |

The weighted average share price at exercise for options exercised in 2006 was 78.54p.

Options outstanding at 31 December 2006 had exercise prices of 56.5p to 359.5p and remaining contractual lives of one to ten years.

The principal inputs to the options valuation model were:

| | |
|---|---|
| Risk free interest rate | 4.2-4.7% p.a. |
| Expected volatility | 32-34% p.a. |
| Dividend yield | 0.8-1.4% p.a. |
| Employee turnover | From 0%-10% p.a. depending on seniority |
| Early exercise | At rates dependent upon seniority and potential gain from exercise |

The fair values and expected lives of the options valued in accordance with IFRS 2 were:

| Award date | Weighted average exercise price p | Weighted average fair value p | Weighted average expected life from grant date years |
|---|---|---|---|
| Jan – Dec 2004 | 112.6 | 52.8 | 4.6 |
| Jan – Dec 2005 | 169.3 | 53.0 | 4.8 |
| Jan – Dec 2006 | 347.7 | 109.7 | 4.4 |

The Company recognised a total expense of £2,658,000 (2005: £1,057,000) in respect of the ESOS.

**UK and Irish Share Incentive Plans (SIPs)**

The SIPs were launched at the beginning of 2004. These are all-employee plans, which have been set up in both the UK and Ireland that enable employees to make contributions out of salary up to prescribed limits each month, which are used by the Plan trustees to acquire Tullow shares (Partnership Shares). The Company makes a matching contribution to the trustees to acquire a matching number of Tullow shares (Matching Shares) on a one-for-one basis. The SIPs have a three month accumulation period.

The fair value of a Matching Share is the market value at grant adjusted for any options included. For this purpose, the grant date is the start of the accumulation period.

For the UK plan, Partnership Shares are purchased at the lower of the market values at the start of the Accumulation Period and the purchase date. For the Irish Plan, shares are bought at the market price at the purchase date.

Matching shares vest three years after grant and dividends are paid to the employee during this period.

The Company recognised a total expense of £55,000 (2005: £31,000) for the matching shares and £7,000 (2005: £4,000) for the partnership shares.

## Note 27. Operating lease arrangements

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Minimum lease payments under operating leases recognised in income for the year | **1,852** | 1,465 |

At the Balance Sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Minimum lease payments under operating leases | | |
| Due within one year | **7,087** | 1,430 |
| After one year but within two years | **7,011** | 1,430 |
| After two years but within five years | **20,503** | 4,290 |
| Due after five Years | **12,362** | 4,527 |
| | **46,963** | 11,677 |

Operating lease payments represent rentals payable by the Group for certain of its office properties and a lease for an FPSO vessel for use on the Chinguetti field in Mauritania. Leases on office properties are negotiated for an average of six years and rentals are fixed for an average of six years. The FPSO lease runs for a minimum period of seven years from February 2006 and the contract provides for an option to extend the lease for a further three years at a slightly reduced rate.

## Note 28. Capital commitments

The Directors have committed to a budget for capital expenditure for exploration and development of £362.7 million (2005: £351.7 million) and AS$819.5 million (£329.9 million) to complete the acquisition of Hardman Resources Limited announced on 25 September 2006 and settled on 10 January 2007.

## Note 29. Contingent liabilities

At 31 December 2006 there existed contingent liabilities amounting to £4.7 million (2005: £2.3 million) in respect of performance guarantees for committed work programmes.

## Note 30. Related party transactions

Transactions with the Directors of Tullow Oil plc are disclosed in the Remuneration Report on pages 44 to 50.

There are no other related party transactions.

## Note 31. Subsequent events

Since the Balance Sheet date Tullow has continued to progress its exploration, development and business growth strategies.

Settlement of the Hardman Resources Limited acquisition occurred on 10 January 2007 with the payment of AS$819.5 million (£329.9 million) and the issue of 65 million Tullow shares. The payment of AS$819.5 million (£329.9 million) on 10 January 2007 is included within the Hardman acquisition payable as at 31 December 2006.

## Note 32. Pension schemes

The Group operates defined contribution pension schemes for staff and Executive Directors. The contributions are payable to external funds which are administered by independent trustees. Contributions during the year amounted to £1,111,000 (2005: £732,000). At 31 December 2006, there was a liability of £67,000 (2005: £61,000) for contributions payable included in creditors.

# Independent auditors' report to the members of Tullow Oil plc

We have audited the Parent Company financial statements of Tullow Oil plc for the year ended 31 December 2006 which comprise the Balance Sheet and the related notes 1 to 10. These Parent Company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of Tullow Oil plc for the year ended 31 December 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the Parent Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Parent Company financial statements give a true and fair view and whether the Parent Company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the Directors' Report is consistent with the Parent Company financial statements. The information given in the Directors' Report includes that specific information presented in the Chairman's Statement, the Chief Executive's Review, the Operations Review and the Finance Review that is cross referred from the Business Review and Future Developments section of the Directors' Report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited Parent Company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Parent Company financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Parent Company financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Parent Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Parent Company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Parent Company financial statements.

## Opinion

In our opinion:

- the Parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2006;
- the Parent Company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the Parent Company financial statements.

**Deloitte & Touche LLP**
Chartered Accountants and Registered Auditors
London
23 March 2007

# Company Balance Sheet

as at 31 December 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Investments | 1 | 958,897 | 364,091 |
| **Current assets** | | | |
| Debtors | 3 | 343,052 | 272,700 |
| Cash at bank and in hand | | 9,711 | 26 |
| | | 352,763 | 272,726 |
| **Creditors – amounts falling due within one year** | | | |
| Trade and other creditors | 4 | (3,873) | (2,157) |
| Hardman acquisition payable | | (333,912) | – |
| | | (337,785) | (2,157) |
| **Net current assets** | | 14,978 | 270,569 |
| **Total assets less current liabilities** | | 973,875 | 634,660 |
| **Creditors – amounts falling due after more than one year** | | | |
| Bank loans | 5 | (206,073) | (190,038) |
| Loans from subsidiary undertakings | | (183,558) | (126,715) |
| **Net assets** | | 584,244 | 317,907 |
| **Capital and reserves** | | | |
| Called up equity share capital | 6 | 65,190 | 64,744 |
| Share premium account | 6 | 126,075 | 123,019 |
| Merger reserve | | 122,336 | 122,336 |
| Treasury shares | | (3,977) | – |
| Shares to be issued | | 235,621 | – |
| Profit and loss account | 7 | 38,999 | 7,808 |
| **Equity shareholders' funds** | | 584,244 | 317,907 |

Approved by the Board on 23 March 2007

**Aidan Heavey**, Chief Executive Officer

**Tom Hickey**, Chief Financial Officer

The notes on pages 83 to 88 form part of these financial statements.

# Accounting policies

year ended 31 December 2006

### (a) Basis of accounting

The financial statements have been prepared under the historical cost convention in accordance with the Companies Act 1985 and UK Generally Accepted Accounting Principles (UK GAAP). The following paragraphs describe the main accounting policies under UK GAAP which have been applied consistently.

In accordance with the provisions of Section 230 of the Companies Act the Profit and Loss Account of the Company is not presented separately. In accordance with the exemptions available under FRS 1 'Cash Flow Statements' the Company has not presented a cash flow statement as the cash flow of the Company has been included in the Cash Flow Statement of the Tullow Oil plc Group set out on page 56.

### (b) Investments

Fixed asset investments, including investments in subsidiaries, are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

### (c) Finance costs and debt

Finance costs of debt are allocated to periods over the term of the related debt at a constant rate on the carrying amount. Arrangement fees and issue costs are deducted from the debt proceeds and are amortised and charged to the profit and loss account as finance costs over the term of the debt.

### (d) Foreign currencies

Sterling is the reporting currency of the Company. Transactions in foreign currencies are translated at the rates of exchange ruling at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date, with a corresponding charge or credit to the profit and loss account. However, exchange gains and losses arising on long-term foreign currency borrowings, which are a hedge against the Company's overseas investments, are dealt with in reserves.

### (e) Share issue expenses and share premium account

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

### (f) Taxation

Current and deferred tax, including UK corporation tax, is provided at amounts expected to be paid using the tax rates and laws that have been enacted or substantially enacted by the Balance Sheet date.

### (g) Share based payments

The Company has applied the requirements of FRS 20 share based payments. In accordance with the transitional provisions of that standard, only those awards that were granted after 7 November 2002, and had not vested at 1st January 2005, are included.

All share based awards of the Company are equity settled as defined by FRS 20. The fair value of these awards has been determined at the date of grant of the award allowing for the effect of any market-based performance conditions. This fair value, adjusted by the Company's estimate of the number of awards that will eventually vest as a result of non-market conditions, is expensed uniformly over the vesting period.

The fair values were calculated using a binomial option pricing model with suitable modifications to allow for employee turnover after vesting and early exercise. Where necessary this model was supplemented with a Monte Carlo model. The inputs to the models include: the share price at date of grant; exercise price; expected volatility; expected dividends; risk free rate of interest; and patterns of exercise of the plan participants.

# Notes to the Company financial statements

year ended 31 December 2006

## Note 1. Investments

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Shares at cost in subsidiary undertakings | **958,401** | 363,595 |
| Unlisted investments | **447** | 447 |
| Government gilts | **49** | 49 |
| | **958,897** | 364,091 |

At 31 December 2006 the Company's principal subsidiary undertakings were:

| Name | % | Country of Operation | Country of Registration |
|---|---|---|---|
| **Directly Held** | | | |
| Tullow Oil Limited | 100 | Ireland | Ireland |
| Tullow Oil UK Limited | 100 | United Kingdom | Scotland |
| Tullow Oil SK Limited | 100 | United Kingdom | England & Wales |
| Tullow Oil SPE Limited | 100 | United Kingdom | England & Wales |
| Energy Africa (Pty) Limited | 100 | South Africa | South Africa |
| Energy Africa Gabon Holdings Limited | 50 | Gabon | Isle of Man |
| Tullow Group Services Limited | 100 | United Kingdom | England & Wales |
| Tullow Overseas Holdings B.V. | 100 | Netherlands | Netherlands |
| Hardman Resources Limited | 100 | Australia | Australia |
| **Indirectly Held** | | | |
| Energy Africa Holdings Limited | 100 | Isle of Man | British Virgin Islands |
| Tullow Oil International Limited | 100 | Channel Islands | Jersey |
| Tullow Pakistan (Developments) Limited | 100 | Pakistan | Jersey |
| Tullow Bangladesh Limited | 95 | Bangladesh | Jersey |
| Tullow Côte d'Ivoire Limited | 100 | Côte d'Ivoire | Jersey |
| Tullow Côte d'Ivoire Exploration Limited | 100 | Côte d'Ivoire | Jersey |
| Tullow India Operations Limited | 100 | India | Jersey |
| Tullow Cameroon Limited | 100 | Cameroon | Jersey |
| Tullow Madagascar Limited | 100 | Madagascar | Jersey |
| Tullow Angola B.V. | 100 | Angola | Netherlands |
| Energy Africa Congo Limited | 100 | Congo | Isle of Man |
| Energy Africa Equatorial Guinea Limited | 100 | Equatorial Guinea | Isle of Man |
| Energy Africa Equatorial Guinea Exploration Limited | 100 | Equatorial Guinea | Isle of Man |
| Energy Africa Kudu Limited | 100 | Namibia | Isle of Man |
| Energy Africa Senegal Limited | 100 | Senegal | Isle of Man |
| Energy Africa Uganda Limited | 100 | Uganda | Isle of Man |
| Energy Africa UK Limited | 100 | United Kingdom | Isle of Man |
| Energy Africa Gabon Holdings Limited | 50 | Gabon | Isle of Man |
| Energy Africa Gabon Limited | 100 | Isle of Man | Isle of Man |
| Tullow Oil Gabon SA | 100 | Gabon | Gabon |
| Hardman Chinguetti Production (Pty) Limited | 100 | Mauritania | Australia |
| Hardman Petroleum (Mauritania) (Pty) Limited | 100 | Mauritania | Australia |
| Planet Oil (Mauritania) Limited | 100 | Mauritania | Guernsey |
| Planet Oil Limited | 100 | French Guiana | England & Wales |
| Hardman Petroleum Africa (Pty) Limited | 100 | Uganda | Australia |
| Hardman Oil & Gas (Pty) Limited | 100 | Trinidad | Australia |

The principal activity of all companies relates to oil and gas exploration, development and production.

# Notes to the Company financial statements

continued

## Note 2. Dividends

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Declared and paid during year | | |
| Final dividend for 2005: Stg3p (2004: Stg1.25p) per ordinary share | 19,505 | 8,083 |
| Interim dividend for 2006: Stg2p (2005: Stg1p) per ordinary share | 12,987 | 6,472 |
| **Dividends paid** | 32,492 | 14,555 |
| Proposed for approval by shareholders at the AGM | | |
| Final Dividend for 2006: Stg3.5p (2005: Stg3p) per ordinary share | 25,104 | 19,505 |

## Note 3. Debtors

**Amounts falling due within one year**

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Other debtors | 374 | 6,926 |
| Prepayments | 22 | 548 |
| Due from subsidiary undertakings | 342,656 | 265,226 |
| | 343,052 | 272,700 |

## Note 4. Trade and other creditors

**Amounts falling due within one year**

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Other creditors | 478 | 849 |
| Accruals | 3,274 | 1,210 |
| VAT | 121 | 98 |
| | 3,873 | 2,157 |

## Note 5. Bank loans and overdrafts

**Amounts falling due after one year**

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Term loans repayable | | |
| – After one year but within two years | – | – |
| – After two years but within five years | 175,821 | 154,726 |
| – After five years | 30,252 | 35,312 |
| | 206,073 | 190,038 |

Company bank loans are stated net of unamortised arrangement fees of £6,850,000 (2005: £6,837,000).

Bank loans, overdrafts and guarantees are secured by fixed and floating charges over all the assets of the Group.

## Note 5. Bank loans and overdrafts (continued)

Wherever possible the Company conducts and manages its business in Sterling (UK) and US Dollars, the functional currencies of the industry in the areas in which it operates. At 31 December 2006 the only material monetary assets or liabilities of the Company that were not denominated in the functional currency were $280 million (£142.9 million) cash drawings under the US$850 million Borrowing Base Facility held as a hedge against US$ denominated net assets in subsidiaries in the Company's Group Accounts.

### Interest rate risk

The interest rate profile of the Company's financial assets and liabilities at 31 December 2006 was as follows:

| | Stg £'000 | US$ £'000 | Total £'000 |
|---|---|---|---|
| Cash at bank at floating interest rate | 9,001 | – | 9,001 |
| Cash at bank on which no interest is received | 133 | 577 | 710 |
| Fixed rate debt | (30,000) | (63,806) | (93,806) |
| Floating rate debt | (40,000) | (79,118) | (119,118) |
| **Net debt** | **(60,866)** | **(142,347)** | **(203,213)** |

The profile at 31 December 2005 for comparison purposes was as follows:

| | Stg £'000 | US$ £'000 | Total £'000 |
|---|---|---|---|
| Cash at bank on which no interest is received | 26 | – | 26 |
| Fixed rate debt | (42,500) | (34,286) | (76,786) |
| Floating rate debt | (51,516) | (68,573) | (120,089) |
| Net debt | (93,990) | (102,859) | (196,849) |

Cash at bank at floating interest rate consisted of deposits which earn interest at rates set in advance for periods ranging from overnight to one month by reference to Sterling or US Dollar LIBOR.

Floating rate debt comprises bank borrowings at interest rates fixed in advance from overnight to three months at rates determined by US Dollar LIBOR and Sterling LIBOR. Fixed rate debt comprises bank borrowings at interest rates fixed in advance for periods greater than three months or bank borrowings where the interest rate has been fixed through interest rate hedging.

The Borrowing Base Facility incurs interest on outstanding debt at Sterling LIBOR plus a margin ranging from 110 basis points to 240 basis points depending on utilisation and concentration of non-OECD assets and US Dollar LIBOR plus a margin ranging from 110 basis points to 240 basis points depending on utilisation and concentration of non-OECD assets. The outstanding debt is repayable in variable amounts (determined semi-annually) over the period to 31 August 2012, or such other time as is determined by reference to the remaining reserves of the assets, whichever is earlier. There is no requirement under the Borrowing Base Facility to hedge interest rate exposure to Sterling LIBOR and US Dollar LIBOR. The Borrowing Base Facility states that consideration should be given to hedging at least 30% of the interest rate exposure to fluctuations in LIBOR for Sterling and US Dollars in respect of loans under the facility from time to time, net of relevant cash balances.

In the above table for 2006, £93.8 million of the gross debt has been shown as fixed rate debt as the particular bank borrowings were fixed in November 2006 for a six month duration.

In December 2005, the Company executed an interest rate hedging programme (effective February 2006), whereby 50% of the projected interest rate exposure to Sterling LIBOR and US Dollar LIBOR was hedged through the application of a series of interest rate swaps, options and zero cost collars. The effect of these derivatives limits the interest rate exposure to Sterling LIBOR at 5.7% and US Dollar LIBOR at 5.8%. The interest rate swaps, options and zero cost collars were put in place for a three year period for US Dollar (expiring November 2008) and for an 18 month period for Sterling LIBOR (expiring May 2007) at varying notional principal amounts. The interest rate swaps, options and zero cost collars do not give rise to material differences between book and fair values. Therefore the hedged amounts are included in Floating Rate Debt in the above 2006 table.

# Notes to the Company financial statements

continued

## Note 6. Called up equity share capital and share premium account

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| **(a) Authorised** | | |
| 1,000,000,000 Ordinary shares of Stg10p each | **100,000** | 100,000 |

**(b) Allotted Equity Share Capital and Share Premium**

| | Equity Share Capital Allotted and Fully Paid Number | Equity Share Capital Allotted and Fully Paid £'000 | Share Premium £'000 |
|---|---|---|---|
| Ordinary shares of Stg10p each | | | |
| At 1 January 2005 | 645,368,740 | 64,537 | 121,656 |
| Issues during the year | | | |
| – Exercise of share options | 2,068,983 | 207 | 1,363 |
| At 1 January 2006 | **647,437,723** | **64,744** | **123,019** |
| Issues during the year | | | |
| – Exercise of share options | **4,462,575** | **446** | **3,056** |
| **At 31 December 2006** | **651,900,298** | **65,190** | **126,075** |

## Note 7. Profit and loss account

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| At 1 January | **7,808** | 14,001 |
| Retained profit for financial year | **15,294** | 7,489 |
| Share based payments | **1,474** | 1,403 |
| Currency translation adjustments | **14,423** | (15,085) |
| **At 31 December** | **38,999** | 7,808 |

The Company has tax losses of £25 million (2005: £32 million) that are available indefinitely for offset against future non-ring fence taxable profits in the Company. A deferred tax asset has not been recognised in respect of these losses as the Company does not anticipate making non-ring fence profits in the foreseeable future.

## Note 8. Share based payments

### 2005 Performance Share Plan (PSP)

Under the PSP, senior executives can receive conditional awards of rights over whole shares worth up to 150% of salary p.a. (200% in exceptional circumstances). Awards vest under the PSP subject to a TSR based performance condition under which the Company's TSR performance is measured over the fixed three year period against both the constituents of the FTSE 250 index (excluding investment trusts) (the 'Index') and a comparator group of oil and gas companies. Half of an award is tested against the Index and the other half against the comparator group. The test is over a three year period starting on 1 January prior to grant, and an individual must normally remain in employment for three years from the date of grant for the shares to vest. No dividends are paid to participants over the vesting period. Further details in relation to the PSP award measurements are provided in the Directors' Remuneration Report.

The shares outstanding under the PSP are as follows:

| | PSP Shares | Average weighted share price at grant (p) |
|---|---|---|
| Outstanding at 1 January 2006 | 1,784,417 | 187.50 |
| Granted | 1,118,665 | 354.01 |
| Outstanding at 31 December 2006 | 2,903,082 | 251.66 |

The inputs of the option valuation model were:

| | |
|---|---|
| Risk free interest rate | 4.5-4.7% p.a. |
| Expected volatility | 32% |
| Dividend yield | 1.0-1.1% p.a. |

The expected life is the period from the date of grant to the vesting date. The weighted average fair value of the awards granted in 2006 was 264.96p per award.

The Company recognised a total expense of £1,392,000 (2005: £311,000) in respect of the PSP.

### 2005 Deferred Share Bonus Plan (DSBP)

Under the DSBP, the portion of any annual bonus entitlement above 60% of the base salary of a senior executive nominated by the Remuneration Committee is required to be deferred into shares. Shares awarded under the DSBP will normally vest following the end of the period of three financial years commencing with that in which the award is granted.

The shares outstanding under the DSBP are as follows:

| | DSBP Shares | Share price at grant |
|---|---|---|
| Outstanding at 1 January 2006 | – | – |
| Granted | 79,787 | 348.5p |
| Outstanding at 31 December 2006 | 79,787 | 348.5p |

The inputs of the option valuation model were:

| | |
|---|---|
| Dividend yield | 1.1% p.a. |

The expected life is the period from the date of grant to the vesting date. The fair value of the awards granted in 2006 was 337.2p per award.

The Company recognised a total expense of £74,000 (2005: nil) in respect of the DSBP.

### 2000 Executive Share Option Scheme (ESOS)

Options granted under the 2000 ESOS normally only become exercisable following the third anniversary of the date of the grant if the performance condition has been met. The awards are tested against the Index and 100% of awards will vest if the Company's TSR is above the median of the Index over the three year period following grant. Options awarded under the 2000 ESOS before 24 May 2005 are subject to monthly re-testing on a rolling three year basis if the TSR performance criterion is not met. Options granted on or after 24 May 2005 are not subject to monthly re-testing.

Options have previously been granted under the 1988 ESOS and the 1998 ESOS. Options granted under the 1988 ESOS and the 1998 ESOS are not subject to performance conditions. All awards under the 1988 ESOS and the 1998 ESOS were made prior to 7 November 2002 and therefore, under the FRS transitional provisions, they have not been accounted for in accordance with FRS 20 share based payments.

## Note 8. Share based payments (continued)

**2000 Executive Share Option Scheme (ESOS) (continued)**

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the year.

| | 2006 number | 2006 WAEP (p) | 2005 number | 2005 WAEP (p) |
|---|---|---|---|---|
| Outstanding as at 1 January | **21,989,560** | **96.65** | 20,683,036 | 82.01 |
| Granted during the year | **2,311,045** | **346.02** | 3,808,600 | 169.03 |
| Exercised during the year | **(4,462,575)** | **78.54** | (1,563,626) | 79.43 |
| Expired during the year | **(200,550)** | **164.35** | (938,450) | 96.37 |
| Outstanding at 31 December | **19,637,480** | **129.39** | 21,989,560 | 96.65 |
| Exercisable at 31 December | **10,694,335** | **73.86p** | 9,299,210 | 68.59 |

The weighted average share price at exercise for options exercised in 2006 was 78.54p.

Options outstanding at 31st December 2006 had exercise prices of 56.5p to 359.5p and remaining contractual lives of one to ten years.

The principal inputs to the options valuation model were:

| | |
|---|---|
| Risk free interest rate | 4.2-4.7% p.a. |
| Expected volatility | 32-34% p.a. |
| Dividend yield | 0.8-1.4% p.a. |
| Employee turnover | From 0% – 10% pa depending on seniority |
| Early exercise | At rates dependent upon seniority and potential gain from exercise |

The fair values and expected lives of the options valued in accordance with FRS 20 were:

| Award date | Weighted average exercise price p | Weighted average fair value p | Weighted average expected life from grant date years |
|---|---|---|---|
| Jan – Dec 2004 | 112.6 | 52.8 | 4.6 |
| Jan – Dec 2005 | 169.3 | 53.0 | 4.8 |
| Jan – Dec 2006 | 347.7 | 109.7 | 4.4 |

The Company recognised a total expense of £2,658,000 (2005: £1,057,000) in respect of the ESOS.

## Note 8. Share based payments (continued)

### UK and Irish Share Incentive Plans (SIPs)

The SIPs were launched at the beginning of 2004. These are all-employee plans, which have been set up in both the UK and Ireland that enable employees to make contributions out of salary up to prescribed limits each month, which are used by the Plan trustees to acquire Tullow shares (Partnership Shares). The Company makes a matching contribution to the trustees to acquire a matching number of Tullow shares (Matching Shares) on a one-for-one basis. The SIPs have a three month accumulation period.

The fair value of a Matching Share is the market value at grant adjusted for any options included. For this purpose, the grant date is the start of the accumulation period.

For the UK plan, Partnership Shares are purchased at the lower of the market values at the start of the Accumulation Period and the purchase date. For the Irish Plan, shares are bought at the market price at the purchase date.

Matching shares vest three years after grant and dividends are paid to the employee during this period.

The Company recognised a total expense of £55,000 (2005: £31,000) for the matching shares and £7,000 (2005: £4,000) for the partnership shares.

## Note 9. Related party transactions

Transactions with the Directors of Tullow Oil plc are disclosed in the Remuneration Report on pages 44 to 50. The Company has taken advantage of the exemptions available under FRS 8 – Related Party Transactions with regard to the non-disclosure of transactions with Group companies.

## Note 10. Subsequent events

Settlement of the Hardman Resources Limited acquisition occurred on 10 January 2007 with the payment of AS$819.5 million (£329.9 million) and the issue of 65 million Tullow shares. The payment of AS$819.5 million (£329.9 million) on 10 January 2007 is included within the Hardman acquisition payable as at 31 December 2006.

# Licence interests

## Exploration, development and production interests

### Europe

| Licence/Unit Area | Blocks | Fields/*Discoveries* | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| **United Kingdom Offshore** | | | | | |
| **CMS Area** | | | | | |
| P449 | 43/25a | *Opal discovery* | 30.00% [1] | GDF | RWE |
| P450 | 44/21a | Boulton B & F | 9.50% | ConocoPhillips | GDF |
| P451 | 44/22a<br>44/22b | Murdoch<br>Boulton H [2], Watt [2] | 34.00% | ConocoPhillips | GDF |
| P452 | 44/23a (part) | Murdoch K [2] | 6.91% | ConocoPhillips | GDF |
| P453 | 44/28b | Ketch | 100.00% | Tullow | |
| P516 | 44/26a | Schooner [3] | 97.05% | Tullow | GDF |
| P517 | 44/27a | | 31.67% | GDF | |
| P847 | 49/02b | | 15.00% | GDF | RWE |
| P1006 | 44/17b | Munro [4] | 20.00% | GDF | ConocoPhillips |
| P1013 | 49/02a | *Topaz Discovery* | 25.00% | GDF | RWE |
| P1055 | 44/11a, 44/12a | *Cygnus Discovery* | 35.00% | GDF | E.ON, Endeavour |
| P1057 | 44/16a, 44/16b, 44/16c | *Humphrey Discovery* | 35.00% [5] | GDF | E.ON, ConocoPhillips |
| P1058 | 44/18b, 44/23b | Kelvin, *K4 Discovey* | 22.50% | ConocoPhillips | GDF |
| P1139 | 44/19b | | 22.50% | ConocoPhillips | GDF |
| P1339 | 43/23b | | 50.00% | Endeavour | |
| P1343 | 43/30b, 48/05a, 49/01b | | 33.33% | GDF | Endeavour |
| P1345 | 44/28a, 49/03a | *Arrol discovery* | 100.00% | Tullow | |
| 24th Round [6] | 44/13a | | 25.00% | GDF | E.ON, Endeavour |
| 24th Round [6] | 44/21e | | 100.00% | Tullow | |
| CMS III Unit [7] | 44/17a (part), 44/17c (part)<br>44/21a (part), 44/22a (part)<br>44/22b (part), 44/22c (part)<br>44/23a (part) | Boulton H, Hawksley,<br>McAdam, Murdoch K,<br>Watt | 14.10% | ConocoPhillips | GDF |
| Munro Unit [7] | 44/17b, 44/17a | | 15.00% | ConocoPhillips | GDF |
| Schooner Unit [7] | 44/26a, 43/30a | Schooner | 90.35% | Tullow | E.ON, GDF |
| **Thames-Hewett Area** | | | | | |
| P007 | 49/24aF1 (Excl Gawain)<br>49/24aF1 (Gawain) | <br>Gawain [8] | 100.00%<br>50.00% | Tullow<br>ExxonMobil | |
| P028 | 48/30a, 52/05a | Hewett [9] | 53.24% | Tullow | Eni |
| P037 | 49/28a, 49/28b<br><br><br>48/28a, 48/29a | Thames, Yare, Bure,<br>Deben, Wensum,<br>Thurne [10]<br>Hewett [9] | 66.67%<br><br><br>49.84% | ExxonMobil<br><br><br>ExxonMobil | Centrica<br><br><br>Eni |
| P039 | 53/04a<br>53/04d | Welland [11]<br>Wissey | 75.00%<br>62.50% | Tullow<br>Tullow | First Oil<br>First Oil |
| P060 | 50/26a | Orwell | 100.00% | Tullow | |
| P105 | 49/29a (part) | Gawain [8] | 50.00% | ExxonMobil | |
| P112 | 52/04a | Hewett [9] | 52.39% | Tullow | Eni, ExxonMobil |
| P133 | 53/03a rest<br>53/03a P4 | | 45.00%<br>35.00% | BG<br>BG | Dyon<br>Dyon |
| P467 | 48/23a | *Blythe Discovery* | 100.00% | Tullow | |
| P697 | 48/22a | *Blythe Discovery* | 100.00% | Tullow | |
| P703 | 50/26b | *Fizzy Discovery* | 100.00% | Tullow | |
| P786 | 53/03c | Horne | 50.00% | Tullow | Centrica |
| P852 | 53/04b | Horne & Wren | 50.00% | Tullow | Centrica |
| P1149 | 49/30b | *Fizzy Discovery* | 50.00% | Tullow | ATP |
| 24th Round [6] | 48/28c, 52/03a, 52/04b, 52/05b | | 100.00% | Tullow | |
| Gawain Unit [7] | 49/24F1(part), 49/29a (part) | Gawain | 50.00% | ExxonMobil | |
| Hewett Unit [7] | 48/28a (part), 48/29a (part)<br>48/30a (part), 52/04a, 52/05a | Hewett, Deborah,<br>Delilah, Della | 51.69% | Tullow | Eni, ExxonMobil |
| Welland Unit [7] | 49/29b (part), 53/04a | Welland [12] | 33.73% | ExxonMobil | First Oil |

| Licence/Unit Area | Blocks | Fields/Discoveries | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| **Central North Sea / South Central Graben** | | | | | |
| P477 | 16/13c | | 6.25% | ConocoPhillips | Maersk, BG |
| P802 | 39/01c, 39/02c | | 30.00% | Premier | Oranje Nassau, SHV, Svenska |
| P816 | 16/12b, 16/13d | | 20.00% | Maersk | |
| P1045 | 16/18b | | 6.25% | ConocoPhillips | Maersk, BG |
| P1094 | 16/13b | | 37.50% | Maersk | Venture |
| P1127 | 38/05 | | 45.00% | Tullow | Nexen, Dyon |
| P1152 | 39/02b, 39/07 | | 30.00% | Tullow | Nexen, Premier, Dyon |

**Portugal**

| Licence | Fields | Area Sq Km | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| Lavagante | | 3,089 | 80.00% | Tullow | Partex, Galp Energia |
| Santola | | 3,065 | 80.00% | Tullow | Partex, Galp Energia |
| Gamba | | 2,945 | 80.00% | Tullow | Partex, Galp Energia |

Notes

1 Tullow has 46% in the Opal discovery.

2 Refer to CMS III Unit for field interest.

3 Refer to Schooner Unit for field interest.

4 Refer to Munro Unit for field interest.

5 Tullow has 17.5% in the Humphrey discovery.

6 Licence numbers have not yet been formally allocated for the recent 24th Round awards.

7 For the UK offshore area, fields that extend across more than one licence area with differing partner interests become part of a unitised area. The interest held in the Unitised Field Area is split amongst the holders of the relevant licences according to their proportional ownership of the field. The unitised areas in which Tullow is involved are listed in addition to the nominal licence holdings.

8 Refer to Gawain Unit for field interest.

9 Refer to Hewett Unit for field interest.

10 Tullow has 86.96% interest in the Thurne field.

11 Refer to Welland Unit for field interest.

12 Production from the Welland field ceased in 2002.

# Licence interests continued

## Exploration, development and production interests

### Africa

| Licence | Fields | Area Sq Km | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| **Angola** | | | | | |
| Block 1/06 | | 3,839 | 50.00% | Tullow | Sonangol P&P, ProdOil, Force Petroleum |
| Block 10/05 | | 4,780 | 15.00% | Devon | Kerr McGee, Sonangol P & P |
| Block 24/99 | | 4,707 | 15.00% | Devon | Sonangol P & P, Petronas |
| **Cameroon** | | | | | |
| Ngosso | | 474 | 40.00% | Addax | |
| **Congo (Brazzaville)** | | | | | |
| M'Boundi | M'Boundi | 146 | 11.00% | Maurel & Prom | Burren, SNPC |
| **Congo (DRC)** | | | | | |
| Block I [13] | | 3,700 | 48.50% | Tullow | Heritage, COHYDRO |
| Block II [13] | | 2,870 | 48.50% | Tullow | Heritage, COHYDRO |
| **Côte d'Ivoire** | | | | | |
| CI-26 Special Area "E" | Espoir | 139 | 21.33% | CNR | PETROCI |
| CI-103 [14] | | 2,603 | 85.00% | Tullow | PETROCI |
| CI-105 [15] | | 2,070 | 25.00% | Al Thani | PETROCI |
| CI-107 | | 1,639 | 90.00% | Tullow | PETROCI |
| CI-108 | | 1,854 | 90.00% | Tullow | PETROCI |
| **Equatorial Guinea** | | | | | |
| Block L | | 2,551 | 15.40% | Petrobras | Sasol |
| Ceiba | Ceiba | 70 | 14.25% | Hess | GEPetrol |
| Okume Complex | Okume, Oveng, Ebano, Elon | 192 | 14.25% | Hess | GEPetrol |
| **Gabon** | | | | | |
| Ablette | | 43 | 30.77% | Perenco | |
| Akoum Marin | | 2,948 | 100.00% | Tullow | |
| Avouma | Avouma | 52 | 7.50% | Vaalco | Addax, Sasol, Sojitz, PetroEnergy |
| Azobe Marin | | 1,737 | 60.00% [16] | Tullow | MPDC Gabon |
| Echira | Echira | 76 | 40.00% | Perenco | Gabon Government |
| Etame | Etame | 49 | 7.50% | Vaalco | Addax, Sasol, Sojitz, PetroEnergy |
| Gryphon Marin | | 9,764 | 18.75% [16] | Forest | PetroSA. |
| Kiarsseny Marin | | 5,442 | 47.50% | Tullow | Addax, Sonangol P&P |
| Limande | Limande | 10 | 40.00% | Perenco | |
| Mayonami Vera | | 72 | 25.00% | Perenco | Gabon Government |
| Niungo | Niungo | 46 | 40.00% | Perenco | Gabon Government |
| Nziembou | | 1,027 | 40.00% | Perenco | |
| Oba | Oba | 44 | 5.00% | Perenco | AIC Petrofi |
| Obangue | Obangue | 40 | 3.75% | Addax | AIC Petrofi |
| Tchatamba Marin | Tchatamba Marin | 30 | 25.00% | Marathon | Devon |
| Tchatamba South | Tchatamba South | 40 | 25.00% | Marathon | Devon |
| Tchatamba West | Tchatamba West | 25 | 25.00% | Marathon | Devon |
| Tsiengui | Tsiengui | 26 | 3.75% | Addax | AIC Petrofi |
| Turnix | Turnix | 18 | 27.50% | Perenco | Gabon Government |

## Africa continued

| Licence | Fields | Area Sq Km | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| **Gabon continued** | | | | | |
| **Back-In Rights[17]** | | | | | |
| Arouwe | | 4,414 | 7.50% | Perenco | AIC Petrofi |
| Azobe Marin[16] | | 1,737 | 5.00% | Tullow | MPDC Gabon, AIC Petrofi |
| Dussafu Marin | | 2,780 | 5.00% | Sasol | AIC Petrofi, Perenco, Premier |
| Ebouri | Ebouri | 15 | 7.50% | Vaalco | Addax, Sasol, Sojitz, PetroEnergy |
| Etame Marin | | 2,972 | 7.50% | Vaalco | Addax, Sasol, Sojitz, PetroEnergy |
| Etekamba | | 773 | 5.00% | Maurel & Prom | Transworld, AIC Petrofi |
| Gryphon Marin[16] | | 9,764 | 10.00% | Forest | PetroSA |
| Maghena | | 631 | 3.75% | Addax | AIC Petrofi |
| Nyanga Mayumbe | | 2,831 | 3.75% | Maurel & Prom | AIC Petrofi |
| Ombena | | 6,025 | 5.00% | Perenco | AIC Petrofi |
| Omoueyi | | 4,179 | 7.50% | Maurel & Prom | AIC Petrofi |
| Onal | Onal | 46 | 7.50% | Maurel & Prom | AIC Petrofi |
| **Ghana** | | | | | |
| Shallow Water Tano | | 983 | 31.50%[18] | Tullow | GNPC, Sabre, InterOil[18], Al Thani[18] |
| Deepwater Tano | | 1,108 | 49.95% | Tullow | Kosmos, GNPC, Sabre, Anadarko |
| West Cape Three Points | | 1,957 | 22.90% | Kosmos | GNPC, E.O. Group, Sabre, Anadarko |
| **Madagascar** | | | | | |
| Block 3109 | | 11,050 | 50.00% | Tullow | Madagascar Oil |
| Block 3111[19] | | 9,050 | 100.00% | Tullow | |
| **Mauritania** | | | | | |
| Block 1 | | 3,936 | 38.00% | Dana | GDF, Roc Oil |
| Block 2 | | 4,898 | 48.80% | Woodside | Dana, Roc Oil |
| PSC – Area A, Block 3, Blocks 4 & 5 shallow | | 6,969 | 24.30% | Woodside | Premier, Kufpec, Roc Oil |
| PSC – Area B Blocks 4 & 5 deep | | 8,028 | 21.60% | Woodside | Premier, Kufpec, Roc Oil |
| PSC – Area B – Chinguetti | Chinguetti | 929 | 19.01% | Woodside | SMH, Premier, Kufpec, Roc Oil |
| Block 6 | | 4,023 | 22.42% | Woodside | Petronas, Roc Oil |
| Block 7 | | 10,091 | 16.20% | Dana | Woodside, GDF, Roc Oil |
| Block 8 | | 7,875 | 18.00% | Dana | GDF, Wintershall, Roc Oil |
| **Namibia** | | | | | |
| Production Licence 001 | Kudu | 4,567 | 90.00% | Tullow | NAMCOR |
| **Senegal** | | | | | |
| St Louis | | 3,910 | 60.00% | Tullow | Dana, Petrosen |
| **Tanzania** | | | | | |
| Lindi | | 7,315 | 50.00% | Aminex[20] | |
| Mtwara | | 5,045 | 50.00% | Aminex[20] | |
| **Uganda** | | | | | |
| Block 1 | | 4,285 | 50.00% | Heritage | |
| Block 2 | | 3,900 | 100.00% | Tullow | |
| Block 3A | | 1,991 | 50.00% | Heritage | |

# Licence interests continued

## Exploration, development and production interests

### South Asia

| Licence | Fields | Area Sq Km | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| **Bangladesh** | | | | | |
| Block 9 | Bangora, Lalmai | 6,880 | 30.00% | Tullow | Niko, Bapex |
| Blocks 17 &18 | | 13,724 | 32.00% | Tullow | Total, Okland, Rexwood |
| **India** | | | | | |
| AA-ONJ/2 | | 1,595 | 60.00% [21] | Tullow | ONGC |
| CB-ON/1 | | 4,600 | 50.00% | Reliance | Okland |
| **Pakistan** | | | | | |
| Bannu West | | 1,230 | 40.00% | Tullow | OGDCL, MGCL, SEL |
| Block 28 | | 6,200 | 95.00% | Tullow | OGDCL |
| Chachar D&PL | Chachar | 34 | 75.00% | Tullow | Govt. Holdings |
| Kalchas | | 2,068 | 30.00% | OGDCL | MGCL |
| Kohat | | 1,107 | 40.00% | Tullow | OGDCL, MGCL, SEL |
| Kohlu | | 2,459 | 30.00% | OGDCL | MGCL |
| Sara D&PL | Sara | 83 | 38.18% | Tullow | OGDCL, POL, Attock |
| Suri D&PL | Suri | 24 | 38.18% | Tullow | OGDCL, POL, Attock, |

### South America

| Licence | Fields | Area Sq Km | Tullow Interest | Operator | Other Partners |
|---|---|---|---|---|---|
| **French Guiana** | | | | | |
| Guyane Maritime | | 35,221 | 77.50% [22] | Tullow | GDF [22], Northern Petroleum |
| **Suriname** | | | | | |
| Coronie | | 2,592 | 40.00% [23] | Paradise Oil | |
| Uitkijk | | 757 | 40.00% [23] | Paradise Oil | |
| **Falkland Islands** | | | | | |
| PL 10 (A + B) | | 2,500 | 22.50% | Falkland O & G | |
| PL 11 | | 4,860 | 22.50% | Falkland O & G | |
| PL 12 | | 2,021 | 22.50% | Falkland O & G | |
| PL 13 (A + B) | | 198 | 22.50% | Falkland O & G | |
| PL 14 (A + B) | | 1,993 | 22.50% | Falkland O & G | |
| PL 15 (A + B) | | 1,402 | 22.50% | Falkland O & G | |
| PL 16 | | 1,537 | 22.50% | Falkland O & G | |

Notes

13 Licences still require government decree before they come into force.

14 Award pending – awaiting formal signing by government before licence becomes effective.

15 Farm-in agreement signed – pending Government approval.

16 Tullow has 'Back-In' Rights on this licence as well as a working interest.

17 Back-In Rights: Tullow has the option, in the event of a discovery, to acquire varying interests in these licences.

18 Tullow interest following farm-out deal to InterOil and Al Thani. The deal is pending government approval.

19 Licence award will come into force pending Presidential Decree.

20 Tullow to take over operatorship on completion of farm-in deal.

21 50% will be assigned to ONGC on award of PEL.

22 Tullow interest following agreed farm-out to GDF. Deal awaiting formal approval.

23 Tullow will acquire its interest on completion of work programme.

# Commercial reserves and contingent resources summary (unaudited) working interest basis

year ended 31 December 2006

| | Europe | | Africa | | Asia | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| **Commercial reserves**[1] | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Petroleum mmboe |
| At 1 Jan 2006 | – | 356.2 | 113.0 | 23.8 | – | 95.3 | 113.0 | 475.3 | 192.2 |
| Revisions | – | 4.6 | 18.1 | (1.9) | – | 12.1 | 18.1 | 14.8 | 20.6 |
| Acquisitions | – | 4.2 | 28.8 | – | – | – | 28.8 | 4.2 | 29.5 |
| Production | – | (62.6) | (12.1) | (0.7) | – | (3.7) | (12.1) | (67.0) | (23.2) |
| **At 31 Dec 2006** | **–** | **302.4** | **147.8** | **21.2** | **–** | **103.7** | **147.8** | **427.3** | **219.1** |

| **Contingent resources**[2] | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Petroleum mmboe |
|---|---|---|---|---|---|---|---|---|---|
| At 1 Jan 2006 | – | 191.4 | 0.7 | 781.2 | – | 16.2 | 0.7 | 988.8 | 165.5 |
| Revisions | – | (16.7) | 20.6 | 4.1 | – | 6.3 | 20.6 | (6.3) | 19.6 |
| Acquisitions | – | – | 34.6 | 405.9 | – | – | 34.6 | 405.9 | 102.2 |
| **At 31 Dec 2006** | **–** | **174.7** | **55.9** | **1,191.2** | **–** | **22.5** | **55.9** | **1,388.4** | **287.3** |

| **Total** | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Oil mmbbl | Gas bcf | Petroleum mmboe |
|---|---|---|---|---|---|---|---|---|---|
| **At 31 Dec 2006** | **–** | **477.1** | **203.7** | **1,212.4** | **–** | **126.2** | **203.7** | **1,815.7** | **506.4** |

1 Proven and probable Commercial reserves are based on a Group reserves report produced by an independent engineer.

2 Proven and probable Contingent resources are based on both Tullow's estimates and the Group reserves report produced by an independent engineer.

3 Tullow has classified the Ugandan discoveries Mputa and Nzizi as Commercial reserves.

4 Mauritanian reserves and resources are based on Operator or RISC (independent engineer) report values as appropriate.

The Group provides for depletion and amortisation of tangible fixed assets on a net entitlements basis using proven and probable commercial reserves, which reflects the terms of the Production Sharing Contracts related to each field. Total net entitlement reserves were 145.8 mmboe at 31 December 2006 (2005: 162.2 mmboe).

Contingent Resources relate to reserves in respect of which development plans are in the course of preparation or further evaluation is under way with a view to development within the foreseeable future.

# Five year financial summary

| | IFRS | | | UK GAAP* | | |
|---|---|---|---|---|---|---|
| | **2006 £'000** | 2005 £'000 | 2004 £'000 | 2004 £'000 | 2003 £'000 | 2002 £'000 |
| **Group Income Statement** | | | | | | |
| Sales revenue | **578,847** | 445,232 | 225,256 | 225,256 | 129,625 | 110,610 |
| Cost of sales | **(261,268)** | (243,149) | (141,228) | (131,071) | (82,249) | (75,350) |
| Gross profit | **317,579** | 202,083 | 84,028 | 94,185 | 47,376 | 35,260 |
| Administrative expenses | **(22,490)** | (13,793) | (10,926) | (10,370) | (2,727) | (3,610) |
| Profit/(loss) on disposal/farm out of oil and gas assets | **–** | 36,061 | 2,292 | 2,292 | (952) | 914 |
| Exploration costs written off | **(32,494)** | (25,783) | (17,961) | (17,961) | (12,772) | (4,169) |
| Other expenses | **–** | – | (647) | (647) | (332) | (315) |
| Operating profit | **262,595** | 198,568 | 56,786 | 67,499 | 30,593 | 28,080 |
| Gain/(loss) on hedging instruments | **15,701** | (159) | – | – | – | – |
| Finance revenue | **3,030** | 4,367 | 3,458 | 3,458 | 2,016 | 1,409 |
| Finance costs | **(17,994)** | (24,197) | (13,449) | (12,960) | (8,730) | (9,044) |
| Profit from continuing activities before taxation | **263,332** | 178,579 | 46,795 | 57,997 | 23,879 | 20,445 |
| Taxation | **(105,894)** | (65,443) | (15,460) | (25,048) | (12,958) | (7,649) |
| Profit for the year from continuing activities | **157,438** | 113,136 | 31,335 | 32,949 | 10,921 | 12,796 |
| Earnings per share | | | | | | |
| Basic – Stg p | **24.23** | 17.50 | 5.88 | 6.18 | 2.92 | 3.56 |
| Diluted – Stg p | **23.67** | 17.20 | 5.81 | 6.11 | 2.90 | 3.51 |
| Dividends paid | **32,492** | 14,555 | 6,995 | 6,995 | 3,782 | – |
| **Group Balance Sheet** | | | | | | |
| Fixed assets | **1,755,301** | 897,602 | 649,967 | 599,728 | 193,263 | 195,886 |
| Net current (liabilities)/assets | **(290,924)** | (71,273) | 21,394 | 23,353 | 32,521 | 15,771 |
| Total assets less current liabilities | **1,464,377** | 826,329 | 671,361 | 623,081 | 225,784 | 211,657 |
| Long term liabilities | **(697,901)** | (437,310) | (295,894) | (243,997) | (109,863) | (111,357) |
| Net assets | **766,476** | 389,019 | 375,467 | 379,084 | 115,921 | 100,300 |
| Called up equity share capital | **65,190** | 64,744 | 64,537 | 64,537 | 37,784 | 35,981 |
| Share premium account | **126,075** | 123,019 | 121,656 | 121,656 | 14,198 | 2,485 |
| Other reserves | **305,412** | 60,589 | 148,591 | 148,591 | 45,593 | 69,213 |
| Profit and loss account | **269,799** | 140,667 | 40,683 | 44,300 | 18,346 | (7,379) |
| Equity attributable to equity holders of the parent | **766,476** | 389,019 | 375,467 | 379,084 | 115,921 | 100,300 |

* The UK GAAP columns represents the numbers previously reported; however, the presentation has been amended to comply with IAS 1.

# Shareholder information

## Shareholder enquiries

All enquiries concerning shareholdings including notification of change of address, loss of a share certificate or dividend payments should be made to the Company's registrars, Computershare Investor Services (Ireland) Limited whose contact details are as follows:

Computershare Investor Services (Ireland) Ltd
Heron House
Corrig Road
Sandyford Industrial Estate
Dublin 18
Ireland

email: webqueries@computershare.ie

| | |
|---|---|
| Telephone number – UK shareholders: | 0870 703 6242 |
| Telephone number – Irish shareholders: | 01 2163744 |
| Telephone number – Other shareholders: | 0044 870 703 6242 |

A range of shareholder frequently asked questions and practical help on transferring shares and updating details is available online in the Shareholder Services section located in the Investors area of the Tullow website www.tullowoil.com

## Computershare online enquiry service

Computershare provides a range of services through its free online shareholder enquiry service at www.computershare.com. This service, accessible from anywhere in the world, enables shareholders to check details of their shareholdings or dividends, download forms to notify changes in personal details and, access other relevant information.

## Payment of dividends

Shareholders can have their dividends paid directly into a UK sterling or Irish euro bank account and have the tax voucher sent directly to their registered address. Please contact Computershare for a dividend mandate form or download a dividend mandate form from Computershare's online enquiry service detailed above.

Overseas shareholders should note that Computershare, in conjunction with Citibank, are launching a service, the 'Global Payments Service', which will enable overseas shareholders to receive their dividend in a range of foreign currencies. The service is expected to be launched during April 2007. At that time, details of the service will be made available in the Shareholder Service section of the Investors area of the Tullow website www.tullowoil.com.

## Share dealing service

A telephone share dealing service has been established for shareholders with Computershare for the sale and purchase of Tullow Oil shares. Shareholders who are interested in using this services can obtain further details by calling the appropriate telephone number below:

| | |
|---|---|
| UK shareholders: | 0870 703 0084 |
| Irish shareholders: | 1890 924 995 |
| Other shareholders* | 0044 141 270 3203 |

Further details on the terms applying to the service can also be obtained from the Shareholder Services section of the Investors area of the Tullow website www.tullowoil.com

*Kindly note, this service cannot be offered to residents of any territories where such offers are not permitted by local securities regulations or other regulatory requirements. It is the responsibility of shareholders outside the European Union who wish to use this service to ensure compliance with local law and regulatory requirements. If you are in any doubt you should consult an appropriate professional advisor.

## Electronic communication

Shareholders have the option to receive shareholder communications including annual reports, interim reports and notices of meetings electronically. To register for this service, shareholders should log into the Computershare website www.computershare.com and follow the instructions. Once registered, shareholders will be emailed when an Annual Report, Interim Report or Notice of Meeting is available for viewing on the Tullow Oil website.

Shareholders have been asked to approve the passing of a resolution at the 2007 AGM to allow the Company to take advantage of the new electronic communication provisions contained in the Companies Act 2006. If this resolution is passed and the Company subsequently decides to utilise the provisions, this would allow the default method of communication to switch from paper form (hard copy) to website communication with a positive opt-in required for hard copy.

As only those shareholders who want to receive hard copy will opt-in, this is expected to result in cost savings for the Company through reduced printing and mailing costs as well as the environmental benefits associated with the reduced use of paper.

In the first instance, the Company is required to write to all shareholders explaining the new arrangements and offering the opportunity to elect to continue receiving documents by post.

## Financial calendar

| | |
|---|---|
| Financial year end | 31 December 2006 |
| Results announced | 21 March 2007 |
| Annual General Meeting | 30 May 2007 |
| 2007 Interim results announced | September 2007 |

## Dividend payments

| | |
|---|---|
| 2006 Final dividend payable | 6 June 2007 |
| 2007 Interim dividend payable | November 2007 |

# Senior management

## Business support

Georgina Baines, Group HR Manager
Graham Brunton, Head of EHS
Sam Carroll, Group Contracts and Procurement Manager
Pete Dickerson, Head of Corporate Planning
Tim O'Hanlon, Vice President African Business
Peter Sloan, Senior Legal Adviser
Andrew Windham, Managing Director Africa

## Exploration

Doug Cherry, Chief Explorationist
Chris Flavell, Exploration Manager UKCS and Europe
Jerry Jarvis, Exploration Manager Global New Ventures
John McKenna, Exploration Manager Asia and South America
Jan Maier, Exploration Manager North Africa
Joe Mongan, Geophysical Operations Manager
Robin Sutherland, Exploration Manager West Africa
Bob Winter, Portfolio Manager
Manu Wope, Exploration Manager South and East Africa

## Finance and IT

Lorraine Corr, Group Data Manager
John Deehan, IT Manager
Richard Inch, Group Tax Manager
Chris Perry, Group Investor Relations Officer
Julian Tedder, Group Finance Manager
Bill Torr, Chief Financial Officer Africa
Brian Williams, Head of Risk and Marketing
Colin Wright, Head of Internal Audit

## Production and development

Doug Field, Group Engineering Manager
Jim McCann, Business Unit Manager Gabon
Martyn Morris, Business Unit Manager West Africa
Kevin Quinn, Business Unit Manager South Asia
David Roux, Business Unit Manager Angola
Mike Simpson, Business Unit Manager UKCS
Kevin Stallbom, Business Unit Manager South and East Africa
Mike Williams, Group Well Engineering Manager

# Contacts

### Secretary & registered office
Tom Hickey
Tullow Oil plc
3rd Floor
Building 11
Chiswick Park
566 Chiswick High Road
London W4 5YS

### Registrars
Computershare Investor Services (Ireland) Limited
Heron House
Corrig Road
Sandyford Industrial Estate
Dublin 18
Ireland

### Contact details
Tullow Oil plc
3rd Floor
Building 11
Chiswick Park
566 Chiswick High Road
London W4 5YS
Tel: +44 20 8996 1000
Fax: +44 20 8994 5332

Tullow Oil plc
5th Floor, Block C
Central Park
Leopardstown
Dublin 18
Ireland
Tel: +353 1 213 7300
Fax: +353 1 293 0400

Tullow Oil plc
21st Floor
Metropolitan Centre
7 Coen Steytler Avenue
Cape Town 8001
South Africa
Tel: +27 21 400 7600
Fax: +27 21 400 7660

**Email (General)** information@tullowoil.com

**Email (Investor Relations)** ir@tullowoil.com

**Website** www.tullowoil.com

### Stockbrokers
Hoare Govett Limited
250 Bishopsgate
London EC2M 4AA

Merrill Lynch International
Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

Davy Stockbrokers
Davy House
49 Dawson Street
Dublin 2
Ireland

### Auditors
Deloitte & Touche LLP
Chartered Accountants
Hill House
1 Little New Street
London EC4A 3TR

### Legal advisers
Dickson Minto W.S.
Royal London House
22/25 Finsbury Square
London EC2A 1DX

### Principal bankers
ABN AMRO Bank N.V. (London Branch)
250 Bishopsgate
London EC2M 4AA

Bank of Scotland plc
11 Earl Grey Street
Edinburgh EH3 9BN

BNP Paribas
21 place du Marché Saint-Honoré
75031 Paris Cedex 01
France

# Index

# Publications and information

Including this Annual Report, the Group publishes a range of corporate communications documents and information.

**Corporate Profile**

Tullow's Corporate Profile provides an overview of the Group and includes information on our history, our strategy, our business and our responsibilities.

**Corporate and Social Responsibility Report**

The Corporate and Social Responsibility Report covers our role as an operator, partner and neighbour and includes details of our environmental record.

**www.tullowoil.com**

Tullow's website gives up to date and archive information on the Group, including news and events, reports and presentations and shareholder information.

Front cover photo: Drilling activities at the Kingfisher site in Block 3A Uganda.

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# Glossary

| | |
|---|---|
| °API | Degrees API, a standard measure of oil density defined by the American Petroleum Institute |
| AGM | Annual General Meeting |
| bbl | Barrel |
| bcf | Billion cubic feet |
| boe | Barrels of oil equivalent |
| boepd | Barrels of oil equivalent per day |
| bopd | Barrels of oil per day |
| bwpd | Barrels of water per day |
| CMS | Caister Murdoch System |
| CMS III | A group development of five satellite fields linked to CMS |
| CSR | Corporate Social Responsibility |
| D&PL | Development and Production Lease |
| DSBP | Deferred Share Bonus Plan |
| DTI | Department of Trade and Industry (United Kingdom) |
| EHS | Environment, Health and Safety |
| ESOS | Executive Share Option Scheme |
| Farm in | To acquire an interest in a licence from another party with conditions |
| Farm-in | An agreement to acquire an interest in a licence by farming in |
| Farmout | A licence interest that has been farmed out |
| FPSO | Floating production, storage & offtake vessel |
| FRS | Financial Reporting Standard |
| IAS | International Accounting Standard |
| IFRIC | International Financial Reporting Interpretations Committee |
| IFRS | International Financial Reporting Standard |
| ISO | International Organisation for Standardisation |
| km | Kilometres |
| LIBOR | London Interbank Offered Rate |
| LTI | Lost time Incident |
| LTIFR | LTI Frequency Rate measured in LTIs per million worker hours |
| mmbbl | Million barrels |
| mmboe | Millions of barrels of oil equivalent |
| mmscfd | Millions of standard cubic feet per day |
| PEL | Petroleum Exploration Licence |
| PRT | Petroleum Revenue Tax |
| PSC | Production Sharing Contract |
| PSP | Performance Share Plan |
| SCT | Supplementary Corporation Tax |
| SIP | Share Incentive Plan |
| SNS | Southern North Sea |
| Spud | to commence drilling a well |
| sq km | Square kilometres |
| tcf | Trillion cubic feet |
| TSR | Total Shareholder Return |
| WAEP | Weighted Average Exercise Price |