



# SOUND OIL

Annual Report 2006

Sound is an independent oil and gas exploration company listed on the AIM market of the London Stock Exchange.

Our strategy is to add significant value from a portfolio of exploration and production assets.

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# Highlights

- **Successful Acquisition** of first business:
  - Gasfield onshore Indonesia
  - 83.5 bcfg of gas resources
  - Two exploration Licences
  
- **Exploration well** spudded May 2007
- **Three exploration wells** planned for 2007
  
- **Plan of development** approved for gasfield
  
- **Raised £11 Million** working capital from institutional investors
- **Significant talent** joins Board and senior management
  
- **New Offices** in UK and Indonesia



# Board of Directors

## Gerald Orbell

### Chairman and Chief Executive

Gerald Orbell is a petroleum geologist with over 30 years of technical, managerial and director level experience in the hydrocarbon and utilities sectors. Gerald has previously held the position of executive director of Fina Exploration, Fina Development, Premier Oil plc and United Utilities plc. Gerald is currently the chairman of Antrim Energy Inc. where he oversees the company's business in the UK. He is also a member of the board, and chairman of the audit committee, at the compliance company Valpak Limited.

## Tony Heath

### Finance Director

Tony Heath has over thirty years financial and general management experience in a variety of roles including finance manager of Burmah Oil's North Sea exploration activity, Finance Director of Halfords retailing Group and Controller of the Burmah-Castrol Group. Tony was Finance Director of Premier Oil plc the international oil and gas exploration and production group from 1990 to 1997.

## Jossy Rachmantio

### Executive Director

Jossy Rachmantio obtained a BSc in Material Engineering in the USA and a Masters in International Management. He has held a number of management positions in Indonesia including with Repindo Nusa Jaya (power project development), managing director of Flotec (bandwidth optimization software) and managing director of Profescripta Wahana (company restructuring). Jossy was a founding director of Mitra Energia Ltd which merged with Sound Oil in 2006.

## Simon Davies

### Non-executive Director

#### Chairman of Remuneration Committee

#### Member of Audit Committee

Simon Davies is chief executive of Threadneedle Asset Management, which manages over £62 billion in

equities, bonds, property and hedge funds for individual and corporate investors. Simon is also a director of the Investment Management Association and JP Morgan Fleming Overseas Investment Trust and is also on the investment committee of Westminster Abbey.

## Michael Nobbs

### Non-executive Director

#### Chairman of Audit Committee

#### Member of Remuneration Committee

Michael Nobbs has a thirty year track record in investment banking, with a focus on corporate and project finance. He was a managing director and senior credit officer for Citigroup/Citibank and at present is the group finance director for Tishman International Companies, a major global real estate development and investment business.

## Ilham Habibie

### Non-executive Director

#### Member of Remuneration Committee

Ilham Habibie holds a PhD in aeronautical engineering from the Technical University of Munich and an MBA from the University of Chicago. Ilham worked as an engineer with Boeing and was then involved in the development of an advanced regional jet airplane in Indonesia with the state company IPTN becoming Executive Vice President Operation and Commercial. Ilham was a founding director of Mitra Energia Ltd which merged with Sound Oil in 2006.

## Patrick Alexander

### Non-executive Director

#### Member of Audit Committee

Patrick Alexander has held a number of senior positions with Chase Manhattan in banking and other businesses in New York, Indonesia and Hong Kong. Patrick is currently an Independent Commissioner of PT Astra International and is managing director of Batavia Investment Management Ltd where he has worked since 1993. Patrick was a founding director of Mitra Energia Ltd which merged with Sound Oil in 2006.

# Chairman's Statement

Sound Oil plc has made solid progress in the last year. In mid 2006 we acquired Mitra Energia of Indonesia in an all-share deal and raised funds of £10.7 million net of costs. We returned to the market in mid July following the suspension brought about by this acquisition, with total cash reserves of £21 million.

The company now has two large and prospective assets in Indonesia – the Citarum Contract area in Java where we hold a 20% position and the Bangkanai Contract in Central Kalimantan with equity of 34.99%. We anticipated that these licenses would fit with our strategy of adding significant value in the event of an early discovery or an early revenue return, and preferably both.

In Citarum, the Great Wall drilling rig has now commenced drilling the Pasundan No 1 well. There had been a delay in drilling of several months brought about by unusually severe flooding and consequent damage to the wellsite; and a more extensive refit of the rig than had been expected. The Kujang well nearby is expected to follow Pasundan directly. Further detailed geophysical work has confirmed that these two prospects are at least as big as we first thought – this is not always the case! We shall also be acquiring a series of 2D seismic programs across the more prospective parts of the Citarum license during the course of 2007 to firm up more drilling opportunities.

At Bangkanai, we are progressing with exploration drilling and the development of the proven Kerendan gas field in the centre of this large license. We are currently concentrating our exploration efforts in and around the Kerendan gas field which is an area of lower exploration risk. Here we have identified a significant new exploration target below the existing gas reservoir. We will be drilling the Sungei Lahei No 1 well towards the end of the year, through both the proven Kerendan gas level and the new exploration

horizon below. Whatever the exploration outcome at the deep level, we expect to complete this well as a gas producer in the shallow reservoir, thus saving the cost of one development well. Should the deep level prove the volumes of gas that we anticipate, this will have a significant impact on our reserves.

We have experienced significant escalation in drilling costs during the year. We are confident, however, in fulfilling the programme we set out at re-admission time by financial prudence and adopting cost saving strategies as at Sungei Lahei. Sound finished the year as we started – with cash reserves which we believe to be sufficient for our commitments. We had £17.4 million in the bank. Our major expenditures in 2006 were related to long lead items for the wells in the Citarum Contract area.

We have increased the technical capability of the Company over the year by the addition of expert staff and we are now making a significant contribution to the technical understanding of the Contracts. I would like to thank all the staff for their hard work during the year.

During the coming year we shall consolidate our position in Indonesia and complete the integration of the UK and Indonesia offices. We expect to focus on adding production to our portfolio, both through development of Kerendan but also through acquisition.

This is the first opportunity I have had to welcome to the Board our new colleagues, Jossy Rachmantio, Ilham Habibie and Patrick Alexander. I would like to thank them and the original Sound Directors, Simon Davies, Michael Nobbs and Tony Heath, for their contribution and support during the year.

**Gerry Orbell**

Chairman

June 2007

# Financial Review

## Economic environment

The high oil prices seen in 2005 and 2006 have encouraged a major expansion in oil and gas exploration and development activity and this has led to a severe shortage of drilling equipment and a considerable increase in the cost of these facilities. On the other hand, the high oil price has also brought an increase in the number of opportunities becoming economic to explore and develop, although this in turn has caused a rise in the price being sought for such opportunities.

## Income statement

Loss after tax for 2006 was £2,170,000 compared with £193,000 in 2005. Pre licence exploration expenditure was £653,000 (2005 £151,000). Administration costs rose from £210,000 to £999,000 due to higher staff levels and office costs following the acquisition of the Mitra group in mid 2006. Operating loss was £1,735,000 compared with £361,000. Net interest received was £641,000 (2005 £234,000), due to an increase in cash balances following from a share issue at mid year. There was an unrealised foreign exchange loss of £1,142,000 on the group's holdings of US\$ following the weakness of that currency. The US\$ were bought after the Mitra acquisition in order to protect the purchasing power of the group's funds since most of the group's expenditure is now in US\$. Although accounting requirements are for this to be shown as a loss, albeit unrealised, the sterling cost of the Indonesian assets being acquired with the US dollars has fallen pro rata, so the purchasing power remains the same. Basic loss per share was 0.45 pence compared with 0.12 pence in 2005.

## Cash flow/balance sheet

Net cash outflow before movements relating to financing was £5,004,000 (2005 £102,000). Following the £11,554,000 raised from share issues, the group's cash balance at year end was £17,389,000 (2005 £10,839,000). Cash balances were invested in short term deposits.

# Technical Review



Great Wall rig 93 drilling the Pasundan 1 exploration well - Citarum licence

# Technical Review

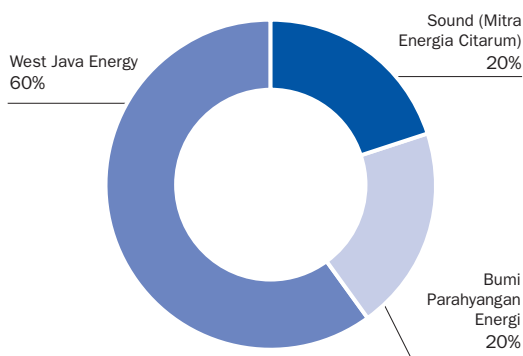
continued

## Licence Interests

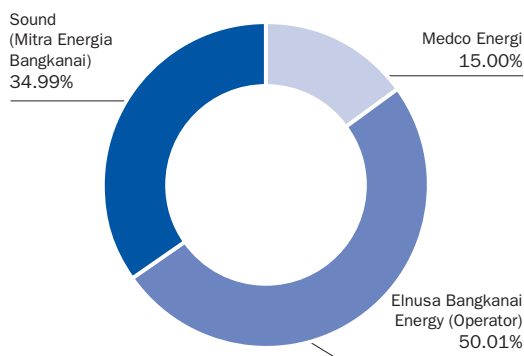
The group participates in two Production Sharing Contract (PSC) areas in Java and Kalimantan, Indonesia through its subsidiary company Mitra Energia Limited.

Our working interests and partners are:

### Citarum PSC (participation through shareholding in BPREC operating company)



### Bangkanai PSC



## Citarum PSC

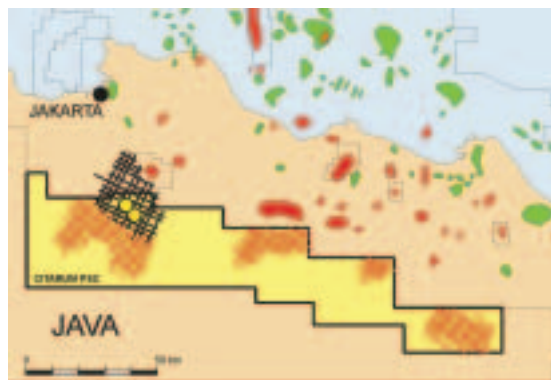
Activity during the last year has been focused on the preparations for drilling the first two exploration wells on the Pasundan and Kujang prospects in the northern part of the licence close to the Jatirarong gas field and the JGN-1 oil discovery. Both wells are being drilled to test multiple reservoir levels in Miocene (carbonates; Baturaja Fm) and Oligocene (clastics; Talang Akar and Jatibarang Fms); the Jatibarang Fm is the producing formation in nearby Jatirarong field. The wells will target separate wrench-controlled fault compartments along a NW-SE trend. The compartments are probably sealed from one another,

but could be part of a connected megastructure at certain levels. Estimated P50 prospective resources<sup>4</sup> for both structures combined are 570 bcfg (gas case P10, 910 bcfg).

These two wells will form part of the work commitment on the licence. The remaining obligations of 750 km of new 2D seismic data and two further exploration wells will be undertaken in 2007-2008. The Pasundan-1 well was spudded with the Great Wall rig 93 on 9 May 2007 and the Kujang-1 wellsite is currently being prepared.

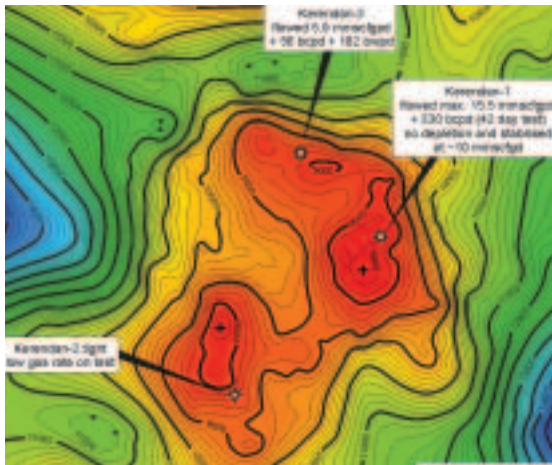


Boring to install the 30" conductors

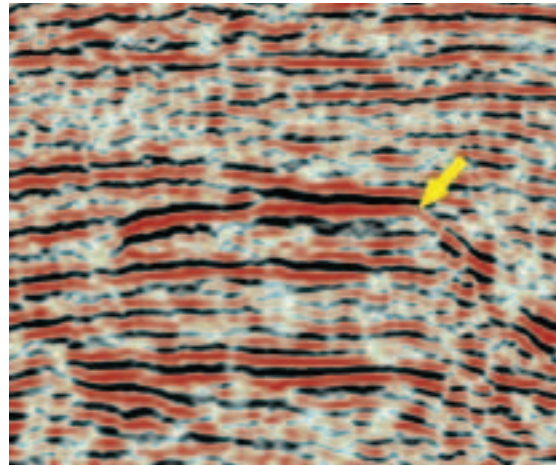


Map of Citarum PSC showing position of existing (black) and proposed (red) seismic lines, location of Pasundan-1 and Kujang-1 wells (yellow) and discovered oil (green) and gas (red) fields.

## Bangkanai PSC



Depth structure map of Kerendan gas field



Seismic line across Kerendan gas field (arrow indicates level of reef limestone reservoir)

Independent assessment of Kerendan Field contingent recoverable resources by RML-Senergy<sup>3</sup> are:

	Gross	Net to Sound (34.99%)
Proved (P1, bcfg)	187.0	65.4
Proved + Probable (P1+P2, bcfg)	238.5	83.5

A Plan of Development (POD) for the Kerendan gas field was granted in August 2006 by BPMigas (the Indonesian government agency responsible for the supervision and control of upstream oil and natural gas business activities). The field, first discovered in the 1980s, will be developed to supply gas to a local, new-build integrated power plant operated by Medco Power. The POD calls for the supply of 134 bcfg<sup>1</sup> over 20 years at a maximum rate of 20 mmcf/day<sup>2</sup>. The development plan will include re-entry of existing wells and up to five new development wells. Initial field development activities are anticipated to commence in 2007.

Exploration activity on the licence included the acquisition of a 205 km 2D seismic survey as part of the PSC work commitment. Study of the new seismic data identified new prospect areas and deeper prospective horizons below the existing Kerendan field Berai Fm reservoir. A location has been identified (Sungai Lahei-1) to test this deeper play at several levels in the clastic Tanjung Formation. The well will target estimated P50 prospective resources<sup>4</sup> of 220 bcfg (P10 540 bcfg). Planning for the well is currently being undertaken for drilling in 2007. This well is one of two obligation exploration wells on the licence, for which BPMigas has granted an extension of the first exploration period to 31 December 2007.

<sup>1</sup> bcfg = billion cubic feet of gas

<sup>2</sup> mmcf/day = million cubic feet of gas per day

<sup>3</sup> RML-Senergy compiled the Competent Person's Report included in the Admission Documents of July 2006, from which these figures are taken.

<sup>4</sup> Prospective resources, consistent with SPE (the Society of Petroleum Engineers) guidelines, are quantified in terms of the statistical probability to find a given recoverable hydrocarbon (oil or gas) volume in a prospective structure considering all the geological variables involved. The P50 figure indicates a 50% chance of finding a given volume and is generally considered the best or most-likely estimate. The P10 figure indicates a 10% chance of finding a given volume and is generally used to express the high estimate. The figures quoted in this report have been verified by Sound Oil's Head of Exploration Dr. M. J. Cope BSc PhD FGS, a qualified petroleum geologist.

# Report of the Directors

The directors submit their report and the audited accounts for the year ended 31 December 2006.

## Results and dividends

The group's loss after tax for the year amounted to £2,170,000. A dividend is not proposed.

## Activities

The principal activities of the group are oil and gas exploration, development and production. A review of activities, prospects for the future and key performance indicators is included in the Chairman's Statement and Technical Review.

## Acquisition

On 12 July 2006 the group acquired all of the share capital of Mitra Energia Limited, a company with oil and gas interests in Indonesia. Details of the acquisition are shown on page 24.

## Likely future developments

The group believes that there exists the potential for the group to generate a high value portfolio of energy resource assets. The acquisition of Mitra in mid 2006 is an excellent start and the group is focusing on enhancing its value while also actively seeking further investments that will maximise shareholder returns.

## Share capital

The company's authorised share capital consists of £3,000,000 divided into 3,000,000,000 Ordinary Shares of 0.1 pence each.

On 12 July 2006 223,376,623 ordinary shares were issued for the acquisition of Mitra Energia Limited and 161,500,000 ordinary shares were issued for a placing.

At the end of the year 76.92 per cent of the authorised Ordinary Share capital of the company remained unissued.

The authority given to the directors to allot shares at the 2006 Annual General Meeting was granted for a period of one year. A resolution will be put to the Annual General Meeting to renew this authority.

At the 2006 Annual General Meeting authority was also given to the directors for one year to allot shares for cash as if statutory pre-emption did not apply. A similar resolution will be put to the Annual General Meeting to renew this authority, although at the present time the directors do not have plans for any issue of shares.

At the Annual General Meeting, authority will be sought for the directors to grant options up to 5% of the issued share capital.

## Directors

Directors of Sound holding office during the year were:

Patrick Alexander	Appointed 12.7.06
Simon Davies	
Ilham Habibie	Appointed 12.7.06
Tony Heath	
Michael Nobbs	
Gerry Orbell	
Jossy Rachmantio	Appointed 12.7.06

## Substantial Shareholders

At 21 May 2007 the Company had received notification of the following interests in excess of 3% of the Company's issued ordinary shares:

	Notified number of voting rights	Notified % of voting rights
Pershing Keen Nominees Ltd	222,529,803	32.14
Credit Suisse Securities (Europe) Ltd	76,077,636	10.99
Vidacos Nominees Ltd	52,010,000	7.51
Credit Suisse Client Nominees (UK) Ltd	36,592,182	5.28
State Street Nominees Ltd	30,000,000	4.33
HSBC Global Custody Nominee (UK) Ltd	28,807,781	4.16

### Directors' interests

The interests, all of which are beneficial, of directors holding office at the year-end, and of their families, in Ordinary Shares of the company are set out below.

#### Ordinary Shares

Name	31 Dec 2005*	31 Dec 2006	21 May 2007
Simon Davies	1,500,000	2,500,000	2,500,000
Tony Heath	500,000	1,327,586	1,327,586
Michael Nobbs	1,945,545	1,945,545	1,945,545
Gerry Orbell	3,454,545	5,109,717	5,109,717
Ilham Habibie	147,288,696	147,288,696	147,288,696
Patrick Alexander	18,411,155	18,411,155	18,411,155
Jusuf Rachmantio	36,822,852	36,822,852	36,822,852

\*or date of appointment if later. The shares of Messrs. Habibie, Alexander and Rachmantio were all acquired on 12 July 2006 in connection with the acquisition of Mitra Energia Limited.

Details of the remuneration of all directors who served during the period are shown in the Report on Directors' Remuneration on page 11.

Directors' interests in share options are shown in the Report on Directors Remuneration on page 11.

### Financial risk management objectives and policies

The group's principal financial instruments comprise cash and short term deposits. The main purpose of these financial instruments is to finance the group's operations. In addition the group has various financial liabilities in the form of short term, non interest bearing sundry payables. The main risks arising from the group's financial instruments include interest rate risk, currency risk and liquidity risk. The board reviews and agrees policies for managing these risks. The group's exposure to the risk from changes in market interest rates relates primarily to the group's cash and term deposits subject to floating interest rates. Current policy is to retain these assets primarily in higher interest earning cash management facilities with the Bank of Scotland. The group's objective regarding liquidity risk is to maintain a balance between continuity of funding through the use of sustainable debt and equity financing. A high proportion of the group's expenditure is in US\$ so the group's policy is to minimize the risk of a fall in the value of sterling by maintaining a high percentage of its cash in US\$. The group's exposure to commodity price risk and credit risk is considered minimal at this stage of the group's development.

### Director election

Messrs. Ilham Habibie, Jusuf Rachmantio and Patrick Alexander are the directors who were appointed during the year and will retire and, being eligible, will offer themselves for re-election at the Annual General Meeting.

Mr. Gerry Orbell is the Director retiring by rotation and, being eligible, will offer himself for re-election at the Annual General Meeting.

Mr. Tony Heath is the Director who will retire pursuant to the provision of Article 136 of the Articles of Association at the conclusion of the meeting and, being eligible, will offer himself for re-election at the Annual General Meeting.

Following changes to the Companies Act, it will be proposed at the Annual General Meeting that the Articles of Association be amended by removing Article 136, which requires a director who attains the age of 70 to retire and be re-appointed annually.

### Payment policy

The group's policy in respect of its suppliers is to establish terms of payment when agreeing the terms of business transactions and to abide by the terms of payment.

### Charitable contributions

During the period the group made no charitable contributions.

### Auditors

Ernst & Young LLP have confirmed their willingness to continue in office and a resolution to re-appoint them as auditors will be put to shareholders at the forthcoming Annual General Meeting.

### Going Concern

In the light of the company's cash balances, the directors have reasonable expectation that the company has adequate resources to continue operations in the foreseeable future. The going concern basis has therefore been adopted for the accounts.

By order of the Board  
 Stephen Ronaldson  
 Company Secretary  
 1 June 2007

# Report on Directors' Remuneration

## Compliance

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002.

The remuneration of all executive directors is determined by the Remuneration Committee (the 'Committee') and ratified by the Board. The Committee is composed entirely of non-executive directors, and comprises Mr Simon Davies, who chairs the Committee, Mr Michael Nobbs and Mr Ilham Habibie. None of the executive directors of the company is involved in determining his own remuneration.

The Committee consults with the Chief Executive and takes independent advice from MM&K Limited, a leading firm of remuneration consultants, which is appointed as an advisor to the Remuneration Committee in respect of executive remuneration and share schemes. MM&K Limited does not provide any other services to the company. No other person or company materially assisted the Committee during the year.

## Remuneration approach

The company's remuneration policy is to provide remuneration packages which ensure that directors and senior management are fairly and responsibly rewarded for their contributions.

The Committee endorses the principle of mitigation of damages on early termination of a service contract.

It is the Committee's current intention to continue with the above remuneration approach for 2007 and subsequent years although the Committee will keep the matter under review. The Committee's current intention with regard to share options is that they may be awarded but only in special circumstances.

## Remuneration structure

The executive directors' remuneration is basic salary. There are no formal annual performance related bonus schemes with a deferred element, benefits, longer-term incentives or pension provision.

## Base salary

Base salary is reviewed each year against other comparable companies in the oil sector and general market data on the basis of companies in similar industries and those of a similar size. The objective is to ensure that the base salary provides a competitive remuneration package. The base salaries of the executive directors are currently positioned between the median and the upper quartile. While salary is reviewed by reference to market conditions, the performance of the company and the performance of the individual, the Committee would not regard this element of remuneration as directly performance related.

### Contracts of employment

The details of executive directors' contracts of employment and non-executive directors' letters of appointment are set out below:

- Gerald Orbell has a contract of employment with a notice period for termination of 12 months.
- Tony Heath has a contract of employment with a notice period for termination of 3 months.
- Jossy Rachmantio has a contract of employment with a notice period of 6 months.
- Non-executive directors have letters of appointment with a notice period for termination of 2 months.
- The company has granted an indemnity to all its directors under which the company will, to the fullest extent permitted by applicable law and to the extent provided by the Articles of Association, indemnify them against all costs, charges, losses and liabilities incurred by them in the execution of their duties.
- In the event of a change of control of the company Tony Heath has the option to give notice and receive a lump sum equivalent to 6 months' salary. Gerald Orbell, and the non-executive directors have a similar option but with an entitlement of 12 months' salary or fees.

### Summary of actual remuneration

	Salary and fees £'000's
<b>Executive directors</b>	
Gerry Orbell (i)	335
Tony Heath (ii)	200
Jossy Rachmantio (iii)	72
<b>Non-executive directors</b>	
Simon Davies	20
Michael Nobbs	20
Ilham Habibie (iii)	12
Patrick Alexander (iii)	12
<b>Total for all directors</b>	<b>671</b>

(i) Includes a bonus of £200,000 following the acquisition of Mitra.

(ii) Includes a bonus of £100,000 following the acquisition of Mitra.

(iii) Messrs. Rachmantio, Habibie and Alexander joined the Board on 12 July 2006.

Options to acquire 1,400,000 and 700,000 ordinary shares at 7.25p each were awarded to Gerry Orbell and Tony Heath respectively on 13 July 2006 exercisable from six months after award until six years after award.

# Corporate Governance Report

The Board recognises the importance of sound corporate governance and the guidelines set out in the Combined Code on Corporate Governance (the "Combined Code"). Companies on the AIM market of the London Stock Exchange ("AIM") are not required to comply with the Combined Code, and due to its size, the company is not in full compliance. However, the company intends to comply so far as is practicable and appropriate.

In accordance with the Combined Code for corporate governance no director has an employment contract of more than one year.

The Board is responsible for overall strategy, acquisition policy, major capital expenditure projects, corporate overhead costs and significant financing matters. No one individual has unfettered powers of decision. There are three experienced executive directors and four non-executive directors two of which are independent. In 2006 the Board has held ten full Board meetings attended by all directors.

The Board has an Audit Committee comprising three of the non-executive directors. The Audit Committee receives and reviews reports from management and external auditors relating to the published accounts and the system of internal financial control.

The Board has established levels of authorisation of financial commitments and cheque signing procedures appropriate to the size of the business. The Board receives monthly reports on income and expenditure and on the company's financial position.

On the wider aspects of internal control, relating to operational and compliance controls and risk management as included in provision D.2.1 of the Combined Code, the Board, in setting the control environment, now identifies, reviews, and reports on the key areas of business risk facing the Group.

There is close, day-to-day involvement by the executive directors in all of the Group's activities. This includes the comprehensive review of both management and technical reports, the monitoring of foreign exchange and interest-rate fluctuations, government and fiscal-policy issues and cash-control procedures. Regular attendance at joint-venture meetings and frequent site visits are made. In this way, the key-risk areas can be monitored effectively and specialist expertise applied in a timely and productive manner.

Any system of internal control can provide only reasonable, and not absolute, assurance that the risk of failure to achieve business objectives is eliminated. The directors acknowledge that they are responsible for the company's system of internal control and for reviewing its effectiveness. The directors, having reviewed the effectiveness of the system of internal controls and risk management, consider that the system of internal control operated effectively throughout the financial year and up to the date that the financial statements were signed.

The company has less than twenty employees and the directors do not believe the company is sufficiently complex to warrant the use of an internal audit function. The directors will review this policy as and when the company's circumstances warrant.

The Board has a Remuneration Committee as described in the Report on Directors' Remuneration. In addition to directors' remuneration, the Committee is responsible for assessing directors' performance, planning succession for the Chairman and Chief Executive and for new nominees to the Board.

# Statement of Directors' Responsibilities

United Kingdom company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the accounts 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 accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

As far as each of the directors are aware there is no information of which the auditors have not been made aware and all steps have been taken by all directors to make themselves aware of any matters that should be disclosed.

# Independent Auditor's Report

to the members of Sound Oil Plc

We have audited the group and parent company financial statements (the "financial statements") of Sound Oil plc for the year ended 31 December 2006 which comprise the group consolidated profit and loss account, the consolidated statement of group total recognised gains and losses, the group reconciliation of movements in shareholders' funds, the group and parent company balance sheets, the consolidated cash flow statement, the statement of accounting policies and the related notes 1 to 21. These financial statements have been prepared under the accounting policies set out therein.

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

## Respective responsibilities of directors and auditors

The directors are responsible for the preparation of the Annual Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities in relation to the financial statements.

Our responsibility is to audit the 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 financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the

audited financial statements. This other information comprises only the Chairman's Statement, the Financial Review, the Directors' Report and the Report on Directors' Remuneration, and the Corporate Governance Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## 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 financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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 financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion:

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

**Ernst & Young LLP**

Registered Auditors, London

## Consolidated Profit and Loss Account

for the year ended 31 December 2006

	Note	2005 £'000's	2006 £'000's
Exploration costs		(151)	(653)
Share of loss of associate		-	(14)
Gross loss		(151)	(667)
Administrative costs		(210)	(999)
Share-based payments	16	-	(69)
Operating loss	2	(361)	(1,735)
Interest receivable	5	234	641
Foreign exchange gains/(losses)		-	(1,142)
Loss on ordinary activities before tax		(127)	(2,236)
Tax	6	(66)	66
Loss after tax from continuing operations		(193)	(2,170)
Loss per share (pence): basic	7	(0.12)	(0.45)

## Consolidated Statement of Group Total Recognised Gains and Losses

for the year ended 31 December 2006

	2005 £'000's	2006 £'000's
Net loss for the year attributable to members of the company	(193)	(2,170)
Foreign currency loss	-	(157)
<b>Total recognised losses</b>	<b>(193)</b>	<b>(2,327)</b>

## Group Reconciliation of Movements in Shareholders' Funds

for the year ended 31 December 2006

	2005 £'000's	2006 £'000's
Total recognised losses relating to the year	(193)	(2,327)
New shares issued	11,115	26,123
Costs associated with raising capital	(174)	(608)
Provisions for share-based payments	-	69
Total movements during the year	10,748	23,257
Shareholders' funds at 1 January	-	10,748
Shareholders' funds at 31 December	10,748	34,005

# Balance Sheets

as at 31 December 2006

	Note	Group 2005 £'000's	Group 2006 £'000's	Company 2005 £'000's	Company 2006 £'000's
<b>Fixed assets</b>					
Intangible assets	8	-	16,105	-	-
Tangible assets	10	-	54	-	8
Investments in subsidiaries and associated undertakings	11	-	13	-	-
<b>Total fixed assets</b>			<b>16,172</b>		<b>8</b>
<b>Current assets</b>					
Debtors falling due after one year	12	-	583	-	17,885
Debtors due within one year	13	24	601	24	47
Cash and short-term deposits		10,839	17,389	10,839	16,762
<b>Total current assets</b>		<b>10,863</b>	<b>18,573</b>	<b>10,863</b>	<b>34,694</b>
Creditors: amounts falling due within one year	14	(115)	(684)	(115)	(153)
<b>Net current assets</b>		<b>10,748</b>	<b>17,889</b>	<b>10,748</b>	<b>34,541</b>
<b>Total assets less current liabilities</b>		<b>10,748</b>	<b>34,061</b>	<b>10,748</b>	<b>34,549</b>
Creditors: amounts falling due after one year		-	-	-	-
Provisions for liabilities and charges		-	(56)	-	-
<b>Net assets</b>		<b>10,748</b>	<b>34,005</b>	<b>10,748</b>	<b>34,549</b>
<b>Capital and reserves</b>					
Share capital	16	300	692	300	692
Share premium account	16	10,641	35,764	10,641	35,764
Profit and loss account	16	(193)	(2,363)	(193)	(1,976)
Foreign currency translation	16	-	(157)	-	-
Share-based payments	16	-	69	-	69
<b>Total equity shareholders' funds</b>		<b>10,748</b>	<b>34,005</b>	<b>10,748</b>	<b>34,549</b>

Approved by the Board on 1 June 2007

**G Orbell**  
Director

**J A Heath**  
Director

The accounting policies on pages 18 to 20 and notes on pages 21 to 31 form part of these accounts.

# Consolidated Cash Flow Statement

for the year ended 31 December 2006

	Note	2005 £'000's	2006 £'000's
Net cash outflow from operating activities	17	(336)	(3,063)
<b>Returns on investment and servicing of finance</b>			
Interest received		234	641
		234	641
<b>Capital expenditure and financial investment</b>			
Capital expenditure		-	(1,483)
Cash acquired through acquisition		-	27
Acquisition costs		-	(692)
Loan to associate		-	(434)
		-	(2,582)
Cash outflow before management of liquid resources and financing		(102)	(5,004)
<b>Financing</b>			
Issue of Ordinary Shares		11,115	12,162
Costs associated with raising capital		(174)	(608)
Net cash from financing		10,941	11,554
Increase in cash		10,839	6,550

# Notes to the Accounts

## 1 Accounting policies

These financial statements are presented in UK£.

### Accounting convention

The accounts are prepared under the historical cost convention and UK GAAP and in accordance with the Oil Industry Accounting Committee Statement of Recommended Practice – 'Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities' and applicable accounting standards.

### Consolidation

The group accounts consolidate the accounts of Sound Oil plc (the company) and all its subsidiary undertakings drawn up to 31 December. No profit and loss account is presented for the company as provided by Section 230 of the Companies Act 1985. Mitra Energia Limited has been included in the group financial statements using the acquisition method of accounting. Accordingly, the group profit and loss account and statement of cash flows include the results and cash flows of Mitra Energia Limited for the five and a half month period from its acquisition on 12 July 2006. The purchase consideration has been allocated to the assets and liabilities on the basis of fair value at the date of acquisition.

Entities in which the group holds an interest on a long-term basis and are jointly controlled by the group and one or more other ventures under a contractual arrangement are treated as joint arrangements. In the group accounts Sound Oil's proportion of operating profit or loss, exceptional items, interest, taxation, gross assets and gross liabilities of the joint arrangements are included.

Entities, other than subsidiary undertakings or joint arrangements, in which the group has a participating interest and over whose operating and financial policies the group exercises a significant influence are treated as associates. In the group financial statements, associates are accounted for using the equity method.

### Adoption of new accounting standard FRS20, share-based payments

With effect from 1 January 2006, the group has adopted FRS20 share-based payments. The adoption of this standard has not resulted in the re-statement of retained earnings and has had immaterial impact on the results or net assets for the prior year.

### Fixed assets

#### Oil and Gas assets

The group applies the successful efforts method of accounting for exploration and evaluation (E&E) costs.

#### (a) Intangible assets

Under the successful efforts method of accounting, all licence acquisition, exploration and appraisal costs are initially capitalised in well, field or specific exploration cost centres as appropriate, pending determination. Expenditure incurred during the various exploration and appraisal phases is then written off unless commercial reserves have been established or the determination process has not been completed.

**Exploration and evaluation costs:** Costs are initially capitalised as intangible assets. Payments to acquire the legal right to explore, costs of technical services and studies, seismic acquisition, exploratory drilling and testing are capitalised as intangible assets.

**Treatment of E&E assets at conclusion of appraisal activities:** Intangible E&E assets relating to each exploration licence/prospect are carried forward, until the existence (or otherwise) of commercial reserves have been determined subject to certain limitations including review for indications of impairment. If commercial reserves have been discovered and development has been approved, the carrying value, after any impairment loss, of the relevant E&E assets is then reclassified as development and production assets. If, however, commercial reserves have not been found, the capitalised costs are charged to expense after conclusion of appraisal activities.

**(b) Development and production assets**

Development and production assets are accumulated generally on a field-by-field basis and represent the cost of developing the commercial reserves discovered and bringing them into production, together with the E&E expenditures incurred in finding commercial reserves transferred from intangible E&E assets as outlined in accounting policy (a) above.

The cost of development and production assets also includes the cost of acquisitions and purchases of such assets, directly attributable overheads, finance costs capitalised, and the cost of recognising provisions for future restoration and decommissioning.

**(c) Impairment of development and production assets**

An impairment test is performed whenever events and circumstances arising during the development or production phase indicate that the carrying value of a development or production asset may exceed its recoverable amount.

The carrying value is compared against the expected recoverable amount of the asset, generally by reference to the present value of the future net cash flows expected to be derived from production of commercial reserves. The cash generating unit applied for impairment test purposes is generally the field, except that a number of field interests may be grouped as a single income generating unit where the cash flows of each field are inter-dependent.

**Acquisitions, asset purchases and disposals**

Acquisitions of oil and gas properties are accounted for under the purchase method where the transaction meets the definition of a business combination.

Transactions involving the purchases of an individual field interest, or a group of field interests, that do not qualify as a business combination are treated as asset purchases, irrespective of whether the specific transactions involve the transfer of the field interests directly, or the transfer of an incorporated entity. Accordingly, no goodwill arises, and the consideration is allocated to the assets and liabilities purchased on an appropriate basis.

**Tangible fixed assets and depreciation**

Tangible fixed assets are stated at cost or valuation less depreciation. Depreciation is provided at rates calculated to write off the cost or valuation, less the estimated residual value of each asset, over its expected useful life, as follows:

Equipment and fixtures	25% straight-line basis
------------------------	-------------------------

**Translation of foreign currencies**

In the accounts of individual companies, transactions denominated in foreign currencies are recorded in the local currency at actual exchange rates as of the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the period end are reported at the rates of exchange prevailing at the period end. Any gain or loss arising from a change in exchange rate subsequent to the date of the transaction is included as an exchange gain or loss in the profit and loss account.

For the purposes of consolidation, the closing rate method is used under which translation gains and losses on the opening net assets of overseas undertakings are shown as a movement in reserves. All other translation differences are taken to the profit and loss account. Profit and loss accounts of overseas undertakings are translated at the average exchange rate for the period.

**Cash and liquid resources**

Cash, for the purposes of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Liquid resources comprise funds held in term deposit accounts.

**Share-based payments**

The group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest.

# Notes to the Accounts

continued

Fair value is measured by use of a binomial model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

## Provisions

Provisions are recognised when the group has a present obligation as a result of a past event and it is probable that the group would be required to settle that obligation. Provisions are measured at the management's best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

## Interest income

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

## Post-Retirement Benefits

Provision is made for post-retirement benefits under Indonesian law.

## Production Sharing Contracts

The group has interests in various Production Sharing Contracts (PSC) the terms of which provide for the Company and its joint-venture participants to recover all costs out of the proceeds of production. Where these are insufficient in any one year to recover costs fully, they are carried forward. Production remaining after cost recovery is divided between joint-venture participants and the Indonesian governing authority according to pre-agreed formulae. Whilst under the form of a PSC, the title of all property, equipment and inventories passes to the Indonesian governing authority, so the substance of each contract is that the participants have use of all assets and market all oil produced.

## 2 Operating loss and segmental analysis

The loss is stated after charging:

	Note	2005 £'000's	2006 £'000's
Depreciation		-	3
Auditors remuneration	3	29	100
Staff costs	4	142	931

The loss comprises:

	2005 £'000	2006 £'000
Operations (UK)	361	1,277
Acquisition (South Asia)	-	444
Investment in associate (South Asia)	-	14
<b>Total – continuing operations</b>	<b>361</b>	<b>1,735</b>

Net assets comprise:

	2005 £'000	2006 £'000
UK	10,748	16,664
South Asia	-	17,341
<b>Total</b>	<b>10,748</b>	<b>34,005</b>

## 3 Auditors' remuneration

	2005 £'000's	2006 £'000's
Audit of the financial statements	11	90
Other fees to auditors	-	10
Fees in relation to corporate finance services	18	-
Charged to profit and loss	29	100
Non-audit services - taken to equity	-	174
<b>Total</b>	<b>29</b>	<b>274</b>

The non-audit services in 2005 were for reporting on the Admission Document on 29 June 2005 and in 2006 for reporting on the Admission Document on 24 June 2006.

Audit services relate entirely to the current auditors, Ernst & Young LLP. Non audit services relate to the company's previous auditors Chapman Davis LLP in 2005 and to the Company's current auditors Ernst & Young LLP in 2006.

# Notes to the Accounts

continued

## 4 Employee costs

	2005 £'000's	2006 £'000's
<b>Staff costs, including executive directors</b>		
Share-based payments	-	69
Wages and salaries	126	786
Social security costs	16	76
<b>Total</b>	<b>142</b>	<b>931</b>

The expense of share-based payments all arose from transactions accounted for as equity-settled share-based payment transactions.

### Average number of employees (including executive directors) during the year

	2005	2006
Technical and operations	1	9
Management and administration	1	8
<b>Total</b>	<b>2</b>	<b>17</b>

Details of directors' emoluments, in aggregate and by director, are shown in the Report on Directors' Remuneration on page 11.

## 5 Interest Receivable

	2005 £'000's	2006 £'000's
Short-term deposits	234	641
<b>Total</b>	<b>234</b>	<b>641</b>

## 6 Tax on profit on ordinary activities

Analysis of tax charge

	2005 £'000's	2006 £'000's
Loss on ordinary activities before tax	(127)	(2,236)
Loss on ordinary activities at Standard Rate of UK Corporation Tax (30%)	38	671
Non-deductible expenditure at Standard Rate	(108)	(7)
Small companies relief	4	-
Tax loss not recognised for deferred tax purposes	-	664
Adjustment for prior year	-	66
<b>Total tax – Current</b>	<b>(66)</b>	<b>-</b>
<b>Total tax</b>	<b>(66)</b>	<b>66</b>

Tax on management expenses carried forward of £700,000 (2006: £664,000, 2005: £36,000) may be available for offset against tax on future taxable income in the UK.

The most significant event to affect the tax charge in the future will be the commencement of production activity.

## 7 Loss per share

The calculation of basic loss per Ordinary Share is based on the loss after tax and on the weighted average number of Ordinary Shares in issue during the period. Basic loss per share is calculated as follows:

	Loss after tax		Weighted average number of shares		Earnings per share	
	2005 £'000's	2006 £'000's	2005 million	2006 million	2005 Pence	2006 Pence
Basic	(193)	(2,170)	165	486	(0.12)	(0.45)

Diluted loss per share has not been disclosed as inclusion of unexercised options would be anti-dilutive in 2006.

## 8 Intangible fixed assets

	Oil and gas properties	
	South Asia £'000 2006	Total £'000 2006
<b>Group Cost</b>		
At 1 January 2006	-	-
Acquisition of subsidiary undertaking, Mitra Energia Limited	14,791	14,791
Additions during the year	1,314	1,314
<b>At 31 December 2006</b>	<b>16,105</b>	<b>16,105</b>

The company has no intangible fixed assets.

# Notes to the Accounts

continued

## 9 Acquisition

On 12 July 2006, the group acquired the entire issued share capital of Mitra Energia Limited, an unquoted gas exploration and development company with interests in Indonesia for a consideration of £13,961,039 satisfied by the issue of 223,376,633 ordinary shares of 0.1p at 6.25p each. The investment in Mitra Energia Limited has been included in the group's balance sheet at its fair value at the date of acquisition at the market price of the shares at the date of the transaction.

Analysis of the acquisition of Mitra Energia Limited:

Net assets at date of acquisition:	Book value	Book Value	Adjustments	Fair Value
	Indonesian GAAP £000	UK GAAP £000	Revaluation £000	to company £000
Intangible Assets	-	957	13,834	14,791
Tangible fixed assets	11	43		43
Investments	1,167	-		-
Investment in associate undertaking	-	27		27
Debtors due within one year	176	194		194
Debtors due after more than year	1	33		33
Loan to employee	66	66		66
Cash	22	27		27
Creditors due within one year	(305)	(447)		(447)
Provision for liabilities and charges	(39)	(81)		(81)
<b>Net Assets</b>	<b>1,099</b>	<b>819</b>	<b>13,834</b>	<b>14,653</b>
Discharged by:				
Fair value of shares issued				13,961
Costs associated with the acquisition				692
				<b>14,653</b>

Prior to acquisition, the loss after tax of Mitra Energia Limited for 2005 was US\$785,000. For 2006 until date of acquisition there was a profit of US\$492,000.

## 10 Tangible fixed assets

	Furniture, fittings and office equipment	
	Company £'000	Group £'000
<b>Group</b>		
<b>Cost</b>		
At 1 January 2006	-	-
Additions during the year	9	14
Acquisition of subsidiary undertaking	-	43
<b>At 31 December 2006</b>	<b>9</b>	<b>57</b>
<b>Amortisation and depreciation</b>		
At 1 January 2006	-	-
Charge for the year	(1)	(3)
<b>At 31 December 2006</b>	<b>(1)</b>	<b>(3)</b>
<b>Net book value at 31 December 2006</b>	<b>8</b>	<b>54</b>
Net book value at 31 December 2005	-	-

## 11 Investments

	Associated undertakings £ million	Subsidiary undertakings £ million	Total £ million
<b>Group</b>			
Cost and net book value			
At 1 January 2006	-	-	-
Acquisitions	27	-	27
Share of loss	(14)	-	(14)
<b>At 31 December 2006</b>	<b>13</b>	<b>-</b>	<b>13</b>

The company had no investments in 2005 or 2006 other than in Sound Oil International Limited, an intermediate holding company.

The subsidiary undertakings of the company, all of which are 100 per cent owned, are as follows:

Name of Company	Business and area of operation	Country of incorporation or registration
Sound Oil International Limited	Intermediate holding company, UK	British Virgin Islands
Mitra Energia Limited	Intermediate holding company, Indonesia	Mauritius
Mitra Energia Bangkanai Limited	Exploration and development, Indonesia	Mauritius
Mitra Energia Citarum Limited	Exploration, Indonesia	Mauritius

Investment in associated company comprises:

Name of Company	Business and area of operation	Classification	Ordinary Shares held %	Country of incorporation or registration
PT. Bumi Parahyangan Ranhill Energia Citarum	Exploration, Indonesia	Associate	20	Indonesia

The group accounts for its 20 per cent share in PT. Bumi Parahyangan Ranhill Energia Citarum (BPREC) as interest in associate under FRS 9 – 'Associates and Joint Ventures'. The remaining interest in BPREC is owned by Ranhill Energy SDN BHD (60 per cent) and Bumi Parahyangan Energi (20 per cent).

# Notes to the Accounts

continued

## 12 Debtors: amounts due in more than one year

	Group 2005 £'000's	Group 2006 £'000's	Company 2005 £'000's	Company 2006 £'000's
Amounts owed by subsidiary undertakings	-	-	-	17,885
Loan due from BPREC*	-	515	-	-
Other debtors	-	68	-	-
<b>Total</b>	<b>-</b>	<b>583</b>	<b>-</b>	<b>17,885</b>

\*For advances made to associated undertaking.

## 13 Debtors: amounts due within one year

	Group 2005 £'000's	Group 2006 £'000's	Company 2005 £'000's	Company 2006 £'000's
Amounts owed by fellow licence participants	-	344	-	-
Prepayments	24	55	24	43
VAT receivables	-	151	-	4
Sundry debtors	-	51	-	-
<b>Total</b>	<b>24</b>	<b>601</b>	<b>24</b>	<b>47</b>

## 14 Creditors: amounts falling due within one year

	Group 2005 £'000's	Group 2006 £'000's	Company 2005 £'000's	Company 2006 £'000's
Trade creditors	11	8	11	8
Taxes payable	66	35	66	-
Employee benefits*	-	104	-	-
Accruals	38	270	38	124
Other creditors	-	267	-	21
<b>Total</b>	<b>115</b>	<b>684</b>	<b>115</b>	<b>153</b>

\*Based on internal estimates to cover the requirements of Indonesian Labour Law 13, 2003.

## 15 Share capital

Ordinary shares	0.1p shares	2005	0.1p shares	2006
		£		£
Authorised	3,000,000,000	3,000,000	3,000,000,000	3,000,000
Called up, issued and fully paid	300,272,309	300,272	692,427,348	692,427

On 12 July 2006, following approval at an Extraordinary General Meeting of shareholders on that date, the company acquired the entire issued share capital of Mitra Energia Limited, an unquoted gas exploration and development company with interests in Indonesia comprising a 34% interest in the Bangkanai Block onshore central Kalimantan and a 20% interest in the Citarum Block onshore central Java.

On the same date the company raised approximately £10.7 million net of expenses through the placing of 161,500,000 new ordinary shares at 7.25p per share.

The consideration for the acquisition of Mitra was the issue of 223,376,623 ordinary shares credited as fully paid.

In connection with the acquisition and share placing, the executive directors of the company were awarded bonuses of 1,635,172 ordinary shares to Gerry Orbell and 827,586 ordinary shares to Tony Heath. Furthermore certain advisers to the company were issued a total of 4,795,658 ordinary shares as part of their fees.

As a result of these transactions, the issued share capital of the company was increased to 692,427,348 ordinary shares. The former shareholders of Mitra hold approximately 32% of the enlarged share capital of the company.

In connection with the acquisition and share placing, Gerry Orbell and Tony Heath were awarded options on 13 July 2006 over 1,400,000 and 700,000 ordinary shares respectively at an exercise price of 7.25p exercisable from six months after award until six years after award.

# Notes to the Accounts

continued

## 16 Share capital and reserves

	Foreign currency £'000's	Share capital £'000's	Share premium account £'000's	Profit and loss account £'000's	Share-based payments £'000's	Total £'000's
<b>Group</b>						
At 1 January 2006	-	300	10,641	(193)	-	10,748
Shares issued	-	392	25,123	-	-	25,515
Share-based payments	-	-	-	-	69	69
Loss for the year	(157)	-	-	(2,170)	-	(2,327)
<b>At 31 December 2006</b>	<b>(157)</b>	<b>692</b>	<b>35,764</b>	<b>(2,363)</b>	<b>69</b>	<b>34,005</b>
<b>Company</b>						
At 1 January 2006	-	300	10,641	(193)	-	10,748
Shares issued	-	392	25,123	-	-	25,515
Share-based payments	-	-	-	-	69	69
Loss for the year	-	-	-	(1,783)	-	(1,783)
<b>At 31 December 2006</b>	<b>-</b>	<b>692</b>	<b>35,764</b>	<b>(1,976)</b>	<b>69</b>	<b>34,549</b>

## 17 Cash flow reconciliations

### a) Reconciliation of operating loss to net cash flow from operating activities

	2005 £'000's	2006 £'000's
Operating loss	(361)	(1,735)
(Increase)/decrease in ST debtors	(24)	(400)
(Increase)/decrease in LT debtors	-	(35)
(Increase)/decrease in ST creditors	49	188
(Increase)/decrease in LT creditors	-	(25)
(Increase)/decrease in LT provisions	-	69
Depreciation	-	3
Foreign exchange gains/(losses)	-	(1,142)
Share of loss of associate	-	14
<b>Net cash outflow from operating activities</b>	<b>(336)</b>	<b>(3,063)</b>

### b) Reconciliation of net cash flow to movement in net debt

	2005 £'000's	2006 £'000's
Increase in cash in the period	10,839	6,523
Cash acquired	-	27
Cash flow from movement in liquid resources	-	-
Change in net cash resulting from cash flows	-	-
Opening net cash	-	10,839
<b>Net cash at 31 December</b>	<b>10,839</b>	<b>17,389</b>

## 17 Cash flow reconciliations - continued

### c) Analysis of Net Cash

	At 1 January 2006 £'000's	Cash Flow £'000's	At 31 December 2006 £'000's
Cash in hand and at bank	144	611	755
Short term deposits	10,695	5,939	16,634
<b>Total net cash</b>	<b>10,839</b>	<b>6,550</b>	<b>17,389</b>

## 18 Financial Instruments

The company has taken advantage of the exemption in FRS13 "Derivatives and Other Financial Instruments" in respect of short-term debtors and creditors and consequently those items are not included in the relevant analysis within the following note.

### Interest rate and currency risk profiles of financial assets

The interest rate risk profile and the currency risk profile of the financial assets of the group as at 31 December was:

Currency	Floating rate £ million	Interest-free £ million	Total £ million	Weighted average interest rate
<b>2006</b>				
Cash and short-term deposits				
Sterling	1,562	-	1,562	4.47%
US\$	15,200	627	15,827	5.09%
<b>Total</b>	<b>16,762</b>	<b>627</b>	<b>17,389</b>	
<b>2005</b>				
Cash and short-term deposits				
Sterling	10,839	-	10,839	4.47%
US\$	-	-	-	-
<b>Total</b>	<b>10,839</b>	<b>-</b>	<b>10,839</b>	

US\$ cash balances have been converted at the exchange rate on 31 December 2006 of US\$1.9591/£1.

The floating rate cash and short-term deposits comprise of cash held in interest bearing current accounts and deposits placed on the money markets for periods ranging from overnight to three months.

Financial instruments exposed to interest rate risk (eg US Federal Funds Rate and UK Base Rate) were floating rate cash assets maturing within one year: £16,762,000 (2005: £10,839,000).

Cash on which no interest is received relates to balances available to meet immediate operating payments and are therefore only held for short periods interest-free.

# Notes to the Accounts

continued

## 18 Financial Instruments - continued

### Fair Values

	2005		2006	
	Carrying amount £'000's	Fair value £'000's	Carrying amount £'000's	Fair value £'000's
Financial assets				
Cash – Sterling	10,839	10,839	1,562	1,562
– US \$	-	-	15,832	15,832

The fair values are based on market values at the end of the year.

## 19 Share-based payments

Share options have been granted to senior executives and the company's stockbrokers.

An option to acquire 500,000 ordinary shares at 7.5p each was awarded to Hichens Harrison on 22 June 2005, exercisable on any date up to 29 June 2010. Options to acquire 1,400,000 and 700,000 ordinary shares at 7.25p each were awarded to Gerry Orbell and Tony Heath respectively on 13 July 2006 exercisable from six months after award until six years after award.

The exercise price of the options is equal to the estimated market price of the shares on the date of grant. The contractual life of each option granted is six years. There are no cash settlement alternatives.

The expense recognised for share-based payments in respect of employee services received during the year to 31 December 2006 is £69,353. No part of that expense arose from cash-settled share-based payment transactions.

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

	2006 No	2006 WAEP
Outstanding as at 1 January	500,000	7.50p
Granted during the year	2,600,000	6.77p
Outstanding at 31 December	3,100,000	6.87p
Exercisable at 31 December	2,600,000	6.77p

For share options outstanding as at 31 December 2006, the weighted average remaining contractual life is 4.78 years (2005 5.49 years).

## 19 Share-based payments – continued

The weighted average fair value of options granted during the year was 2.12p (2005 1.86p). The range of exercise prices for options outstanding at the end of the year was 4.75p – 7.25p (2005 7.5p).

The fair value of equity-settled share options granted is estimated as at the date of grant using a binomial model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used for the years ended 31 December 2006 and 31 December 2005.

	2006
Dividend yield (%)	0
Expected share price volatility (%)	58
Historical volatility (%)	58
Risk-free interest rate (%)	4.78
Expected life of options (years)	6

The expected life of the options is based on the maximum option period and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

No other features of options grant were incorporated into the measurement of fair value.

Fair value of goods or services received during the period.

2005 – On 29 June 2005 454,545 new ordinary shares of 0.1p per share with a fair value of £25,000 were issued to the company's stockbrokers Hichens Harrison & Co plc in settlement of their placing fee.

2006 – No shares were issued in settlement for goods or services provided.

## 20 Capital Commitments and Guarantees

At 31 December 2006 the Group had capital commitments of £12,000,000 (2005: Nil) on exploration and development licences. The Company had no capital commitments in 2006 (2005: Nil).

Under the terms of a farm-out agreement dated 1 October 2004 with Elnusa Bangkanai Energy Limited (Elnusa), the company has agreed to carry Elnusa's share of the initial three year minimum work obligation costs. Under the terms of the Bangkanai PSC the company is required to spend US\$15,100,000 to fulfil its initial three year minimum work obligations. Under the terms of the Citarum PSC the company is required to spend US\$5,650,000 to fulfil its three year minimum work obligations.

## 21 Contingent liabilities

The company has granted RAB Octane (Master) Fund Limited ("RAB") the option to put to the company the entire issued and allotted share capital, namely two ordinary shares, of Sound Oil Bangladesh Limited at any time up to 17 May 2086. If the put option is exercised, the maximum price payable by the company will be 2,195,222 Ordinary Shares of the company or, with the consent of both the company and RAB, US\$300,000 in cash.

# Dealing Information

FT Share Price Index – Telephone 0906 8433711

SEAQ short code – SOU

# Financial Calendar

## Announcements

Interim – September 2007

Preliminary – May 2008

# Addresses

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## Solicitors

Ronaldsons, 55 Gower St, London, WC1E 6HQ

## Stockbrokers

Hichens Harrison & Co. plc, Bell Court House, 11, Blomfield St, London, EC2M 1LB

## Nominated Advisers

Smith & Williamson Corporate Finance Limited, 25 Moorgate, London EC2R 6AY

## Registrars

Share Registrars Limited, Craven House, West St, Farnham, Surrey, GU9 7EN



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