Xcite Energy Limited

Interim consolidated financial statements

For the 3 and 6 month periods ended June 30, 2010

(Unaudited)

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Management's Discussion and Analysis

The Management's Discussion and Analysis ("MD&A") of the operating and financial results of Xcite Energy Limited ("XEL" or the "Company") should be read in conjunction with the Company's interim unaudited consolidated financial statements and related notes thereto for the three and six month periods ended June 30, 2010, the audited consolidated financial statements and related notes thereto for the year ended December 31, 2009 and the annual MD&A of the Company. This MD&A is dated August 26, 2010. These documents and additional information about XEL, including its annual information form dated December 8, 2009, are available on SEDAR at www.sedar.com.

XEL is an oil issuer and disclosures pertaining to oil activities are presented in accordance with National Instrument 51-101 ("NI-51-101") of the Canadian Securities Administrators.

This MD&A includes an analysis of the XEL results from January 1, 2010 to June 30, 2010 and from January 1, 2009 to June 30, 2009, which include the results of the operating subsidiary Xcite Energy Resources Limited ("XER"). In this MD&A, XEL and XER are together defined as the "Group". All figures and the comparative figures contained herein are expressed in Pounds Sterling unless otherwise noted.

Certain statements in this MD&A may be regarded as "forward-looking statements" including outlook on oil prices, estimates of future production, estimated completion dates of constructions and development projects, business plans for drilling and exploration, estimated amount and timing of capital expenditures and anticipated future debt levels. Forward-looking statements often, but not always, are identified by the use of words such as "seek", "anticipate", "believe", "plan", "estimate", "expect", "targeting" and "intend" and statements that an event or result "may", "will", "should", "could" or "might" occur or be achieved and other similar expressions.

Information concerning resources may also be deemed to be forward looking statements as such estimates involve the implied assessment that the resources described can be profitably produced in the future. These statements are based on current expectations, estimates and projections that involve a number of risks and uncertainties, including crude oil resource estimations, crude oil prices, exchange rates, interest rates, and prevailing rates of taxation (see "Risk Management" section below), which could cause actual results to differ from those anticipated by the Group. The reader should not place undue importance on forward looking statements and should not rely upon this information as of any other date. While the Company may elect to, it is under no obligation and does not undertake to update this information at any particular time, unless required by applicable securities law.

Overview

The Company, through its wholly owned subsidiary XER, is an oil appraisal and development company focused on the appraisal and development of heavy oil resources in the North Sea on the UK Continental Shelf. In 2003, XER was awarded its 100% working interest in the Bentley field in Block 9/3b in the UK North Sea.

The Company's strategy initially is to evaluate and develop the identified heavy oil discoveries in the Bentley field and in Block 9/3b and also to pursue potential acquisitions and participate in future UK offshore licensing rounds to become a significant independent heavy oil producer in the North Sea by 2014. In the pre-development phase, the Company's aim is to maximise shareholder return on the funds invested until such time as production commences and operations become self-funding.

Xcite Energy Limited
For the 3 and 6 month periods ended June 30, 2010

Summary of Results

The following table summarises the Group's performance for the eight most recent quarters. All of these results are unaudited. The Group has no trading revenue in these periods. The interim unaudited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations issued by the International Accounting Standards Board ("IASB"). The interim unaudited consolidated financial statements of the Company have also been prepared in accordance with IFRS's adopted by the European Union ("EU") and therefore they comply with Article 4 of the EU International Accounting Standards Regulation.

	Q2 10	Q1 10	Q4 09	Q3 09	Q2 09	Q1 09	Q4 08	Q3 08
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
Net loss	**(246)**	(265)	(359)	(249)	(145)	(127)	(205)	(90)
EPS *	**(0.2p)**	(0.3p)	(0.5p)	(0.4p)	(0.2p)	(0.2p)	(0.3p)	(0.1p)
Total assets	**48,281**	48,282	24,790	23,240	23,507	23,779	23,860	24,005
Long term liabilities	**505**	505	505	-	-	-	-	-

***** Loss per share (basic and diluted) in pence

The three months ended June 30, 2010 was characterised by continued progression on the Bentley field development programme. Of particular significance was the work undertaken in securing a drilling rig to undertake the 9/3b-R well, details of which were formally announced in early July 2010. The higher loss in the current period compared with the three months ended June 30, 2009 was principally as a result of performance related payments made to Directors and staff during the three months to June 30, 2010. The Company is not influenced by seasonality to any significant extent.

The primary reason for quarter on quarter fluctuations in the net loss reported in the table above is due to charges under the Company's Stock Option Plan. In all other material respects, the three months to June 30, 2010 has been consistent with previous quarters. Operational expenditure in the quarter has remained materially consistent, with interest income increasing due to the interest earned on funds on deposit, further details of which are discussed within the "Income" section below.

Liquidity and Capital Resources

The cash balance as at June 30, 2010 was £23.32 million, compared with £1.74 million as at December 31, 2009. The increase in cash balance during the six months ended June 30, 2010 has arisen from a placing of new shares in the Company with investors in the UK and Canada.

The financing was completed in March 2010 to enable the work programme for the 9/3b-R well to proceed during 2010. This financing comprised an equity share issue to raise approximately £24.7 million gross and £23.1 million net of costs, which provides adequate funds for the 9/3b-R well. The 9/3b-R well programme is the Group's only current material capital expenditure requirement and therefore the Group has forecasted that it maintains sufficient liquidity to meet its ongoing obligations.

In May 2010 a further cash injection of £0.3 million was received from the exercise of broker warrants issued at the time of the March 2010 financing.

Lease and Contractual Commitments

On July 19, 2010 XER signed a contract with Diamond Offshore Drilling (UK) Limited for the hire of the Ocean Nomad semi-submersible drilling rig to conduct a one firm well programme on the Bentley field, the 9/3b-R well. The signing of this contract commits XER to fund an escrow account prior to spud with sufficient funds to cover the rig day-rate commitment for the minimum expected duration of the programme, equating to approximately £7.2 million.

In preparation for the drilling of the 9/3b-R well, XER has committed purchases at June 30, 2010 of approximately £1.7 million in respect of tooling, pipelines and oilfield equipment

Income

Interest income earned on funds invested during the three months ended June 30, 2010 amounted to £44,652 (three months to June 30, 2009: £623). The interest income generated has increased quarter on quarter due to the inward investment received in March 2010 from the public offering.

Interest income earned on funds invested during the six months ended June 30, 2010 amounted to £45,508 (six months to June 30, 2009: £5,033). The increase noted when comparing equivalent periods in 2010 to 2009 has arisen due to the significant differences in the average cash balances held during these periods, principally as a result of the March 2010 public offering and subsequent exercise of broker warrants, which increased the Company's cash balance by £23.1 million.

In order to maximise the possible levels of return whilst maintaining a suitably low level of credit risk, the Company has placed funds on deposit across a number of financial institutions, utilising a number of differing financial products, such as fixed term deposits, Treasury Deposits and Special Interest Bearing Deposit Accounts. Interest income levels are expected to remain high until such time as the Company is required to fund an escrow account to facilitate the 9/3b-R well drilling rig commitment, at which point the interest-earning potential of a significant portion of the Company's liquid cash will be reduced, as funds are placed into an instant access deposit account rather than higher interest rate products.

Management has maintained its policy of keeping cash deposits with banks with "AA" rating or better. The policy of the Group is to ensure that all cash balances earn a market rate of interest and that interest rate exposures are regularly reviewed and managed. However, as interest base rates remain at a historical low, the expectation for achieving an acceptable rate of return is heightened but the Company's focus remains balanced on minimising credit risk whilst pursuing negotiated enhanced rates of interest with specific financial institutions.

Operations and Administrative Expenses

The Group only operates in a single business and geographical segment. The Group's single line of business is the appraisal and evaluation of oil and gas reserves and the geographical segment in which it currently operates is the North Sea. The Group's sole operational focus is the development of the Bentley field, but it will continue to pursue other commercial opportunities as and when they arise.

During the three months ended June 30, 2010 the Group incurred total administrative expenses of £290,342 (three months to June 30, 2009: £146,142). The underlying increase in administrative charges during the current quarter compared with the comparative period in 2009 has arisen primarily due to bonus payments made to Executive Directors and the Management Team, reflecting the strong progress made on the Bentley field development programme. In all other material respects the Company has continued to incur operational overheads on a consistent basis.

Additions to Exploration and Evaluation ("E&E") assets during the three months ended June 30, 2010 were £928,510 (three months ended June 30, 2009: £357,557), comprising work carried out on a geotechnical borehole and site survey in preparation for the drilling of the 9/3b-R well, now expected in Q3 2010, and operational working capital, including staff performance based remuneration and share based payment charges under the Stock Option Plan. These costs have been capitalised in accordance with the Group's accounting policies and will be amortised against the revenue from production, if any, from the Bentley field. The Group has not incurred any additional material research and development costs or deferred development costs over and above those costs capitalised as E&E assets.

During the six months ended June 30, 2010 the Group incurred total administrative expenses of £556,286 (six months to June 30, 2009: £277,511). The increase of £278,775 between the two periods is explained by additional non-capitalised payroll costs arising from bonus payments and share based payment charges for certain members of the Executive and Management Team, which have been expensed in accordance with the Company's accounting policy. In all other material respects, the administrative expenses for the six months ended June 30, 2010 was similar to those for the six months ended June 30, 2009.

Related Party Transactions

Using a loan facility, XEL has continued to provide its wholly owned subsidiary, XER, with net cash funding of £1.28 million during the three month period to June 30, 2010 (three months to June 30, 2009: £0.54 million) to finance XER's operational requirements. The cumulative six month period funding to June 30, 2010 by XEL to XER was £1.79 million (six months to June 30, 2009: £1.06 million). No interest is payable on the outstanding loan balance from XEL, which is unsecured and repayable on demand. The total balance owing by XER to XEL at June 30, 2010 was £24.5 million (as at June 30, 2009: £21.8 million).

The Executive Directors have received performance based remuneration, details of which are given in Note 4 to the financial statements. The Executive and Non-Executive Directors have also been granted share options over the ordinary share capital of the Company during the period, details of which are given below.

Share Options, Warrants and Rights

In the six month period to June 30, 2010, the Company issued an aggregate of 4,093,000 share options under the Stock Option Plan as follows: 100,000 to each of the four Non-Executive Directors, 831,000 to each of the three Executive Directors, and an aggregate of 1,200,000 amongst four members of the XER management team. All these share options vest in three equal tranches over a two year period with an exercise price of CAD$0.68 and a term of five years. In the six months to June 30, 2009 a total of 950,000 share options were issued.

The total expense to the Group in respect of share based payment transactions under the Stock Option Plan was £358,663 for the six months to June 30, 2010 (six months to June 30, 2009: £11,385). Of this total, £141,983 (six months to June 30, 2009: £6,781) has been charged to the Income Statement and £216,680 (six months to June 30, 2009: £4,604) has been capitalised under intangible assets in accordance with the Company's accounting policy.

In the six months ended June 30, 2010, the Company issued total warrants over the share capital of the Company of 3,270,168 (six months ended June 30, 2009: nil warrants issued) to its brokers in respect of the

March 2010 fund raising programme. The aggregate share based payment charge in respect of these warrants of £431,419 has been offset against share capital in the Balance Sheet to be consistent with the accounting treatment adopted for previous warrants issued.

On May 12, 2010 a total of 740,878 of these UK broker warrants were exercised for a total consideration of £296,351.

On July 12, 2010 a total of 21,450 Canadian broker warrants were exercised by Canaccord Financial Limited for a total consideration of CAD$13,299 (£8,692).

As at the date of signing this MD&A there were 10,608,000 options outstanding and 2,507,840 broker warrants outstanding, which would be equal to 13,115,840 further ordinary shares in the Company upon full conversion.

Disclosure Controls and Procedures

In conformance with the Canadian Securities Administrators National Instrument 52-109, the Company has filed certificates signed by the Chief Executive Officer and the Chief Financial Officer that, amongst other things, deal with the matter of disclosure controls and procedures.

Outstanding Share Capital

The following table sets out the ordinary shares issued during the six month period.

	Ordinary Shares
As at January 1, 2010	**71,555,798**
Issue of ordinary shares from fund raising	61,972,394
Issue of ordinary shares through broker warrant exercise	740,878
As at June 30, 2010	**134,269,070**

As at the date of signing this MD&A, the number of shares in issue was 144,268,276.

Risk Management

The principal risk factors facing the Group are as follows:

Exploration and development

The nature of oil exploration is such that there is no assurance that exploration activities will be successful. Industry statistics show that few properties that are explored go on to being fully developed. Operations can also be adversely affected by weather conditions and drilling rig and other operating equipment availability outwith the control of the Group.

Commodity pricing

The Group has no control over the market price of crude oil. Suitable hedging arrangements will be considered to mitigate the volatility of oil prices when the Group enters into the production phase.

Financing

Future field development will depend upon the ability of the Group to secure financing, whether this is by joint venture projects, farm down arrangements, public financing or other means.

Currency

The Group's reporting and functional currency is Pounds Sterling. However, the market for heavy crude is in US Dollars. The Group does not currently engage in active hedging to minimise exchange rate risk although this will remain under review as the Group approaches the production phase.

Resource estimation

Oil resource estimation techniques are inherently judgemental and involve a high degree of technical interpretation and modelling techniques. Incorrect resource estimation may result in inappropriate capital investment decisions being made.

Significant Accounting Judgements and Estimates

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Directors make estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual costs. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying value of assets and liabilities within the next financial period are discussed below.

(a) Income taxes

There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(b) Fair value of share options and warrants

The Company has valued the fair value of outstanding share options and warrants over the Company's shares using the Black-Scholes valuation methodology. The Company uses judgement to derive such valuation model assumptions that are mainly based on market conditions existing at the Balance Sheet date.

(c) Impairment of E&E assets

A review is performed at the end of each financial period for any indication that the value of the Group's E&E assets may be subject to impairment. In the event of any such indication, an impairment test is carried out and, if necessary, an impairment charge is made representing the surplus of capitalised cost over estimated recoverable value of the related commercial oil reserves. Estimated recoverable value is based upon anticipated discounted net cash flows attributable to such oil reserves.

Changes in Accounting Policies

During the six month period the Group has adopted ‘Improvements to IFRSs (issued April 2009)’, Revised IAS 24 ‘Related Party Disclosures’ and the amendments to IFRS 2 in respect of ‘Group Cash-settled Share-based Payment Transactions’, although the adoption of these amendments had no impact on the results of the Group. ‘Amendments to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First Time Adopters’, Amendment to IFRIC 14 ‘Prepayments of a Minimum Funding Requirement’ and “ Amendments to IFRS 1 Additional Exemptions for First Time Adopters’, all of which were endorsed during the three months to June 30, 2010, were not relevant to the Group.

Financial Instruments and Other Derivatives

Details regarding the Group’s policies in respect of financial instruments are disclosed in Notes 1 and 12 to the interim unaudited consolidated financial statements.

Outlook for the Remainder of 2010

As noted above, the Company successfully completed a financing in March 2010 to enable the work programme for the 9/3b-R well to proceed during 2010 and to provide adequate funds for working capital for the foreseeable future.

On July 19, 2010 XER signed a contract with Diamond Offshore Drilling (UK) Limited for the provision of the Ocean Nomad semi-submersible drilling rig for the 9/3b-R work programme. This rig provides significant metocean operating advantages over a jack-up unit for the 9/3b-R well and test programme, which continues to be managed by Applied Drilling Technology International.

On August 26, 2010 the Company completed a private placement to raise gross proceeds of approximately £5.8 million (C$9.3 million) from investors in the UK through the issue of 9,727,756 ordinary shares of no par value. The net proceeds will be used on an enhanced 9/3b-R well work programme, which the Company believes will provide greater certainty of outcome from the planned horizontal flow test, significant additional data and an acceleration of the planned first stage production (“FSP”) programme. Greater detail on the scope of the enhanced 9/3b-R well work programme can be found in the Company’s press release dated August 19, 2010, which has been filed on www.sedar.com.

The planning for the 9/3b-R well and test is now approaching completion and the Company anticipates the rig being available in the coming weeks to spud the well. The Company’s intention is to demonstrate the commercial potential of the Bentley field through a representative flow test rate and thereby confirm its value as a significant North Sea oil field.

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Consolidated Income Statement (in Pounds Sterling)

	Note	**6 month period ended June 30 2010 (unaudited)**	**3 month period ended June 30 2010 (unaudited)**	6 month period ended June 30 2009 (unaudited)	3 month period ended June 30 2009 (unaudited)
	Note	**£**	**£**	£	£
Administrative expenses		**(556,286)**	**(290,342)**	(277,511)	(146,142)
Operating loss	3	**(556,286)**	**(290,342)**	(277,511)	(146,142)
Finance income		**45,508**	**44,652**	5,033	623
Loss before tax		**(510,778)**	**(245,690)**	(272,478)	(145,519)
Tax expense	5	**-**	**-**	-	-
Loss for the period		**(510,778)**	**(245,690)**	(272,478)	(145,519)
Loss per share:					
Basic and diluted	6	**(0.47p)**	**(0.18p)**	(0.44p)	(0.24p)

All results relate to continuing operations. The notes on pages 15 to 28 form part of these financial statements.

Xcite Energy Limited
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Consolidated Statement of Comprehensive Income (in Pounds Sterling)

	6 months ended June 30 2010 (unaudited)	**3 months ended June 30 2010 (unaudited)**	6 months ended June 30 2009 (unaudited)	3 months ended June 30 2009 (unaudited)
	£	**£**	£	£
Loss for the period	**(510,778)**	**(245,690)**	(272,478)	(145,519)
Total comprehensive income for the period	**(510,778)**	**(245,690)**	(272,478)	(145,519)
Attributable to:				
Equity shareholders	**(510,778)**	**(245,690)**	(272,478)	(145,519)

The notes on pages 15 to 28 form part of these financial statements.

Xcite Energy Limited
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Consolidated Statement of Changes in Equity (in Pounds Sterling)

	Share Capital	Retained Earnings	Merger Reserve	Other Reserves	Total
	£	£	£	£	£
At January 1, 2009	**22,252,625**	**(1,182,669)**	**218**	**1,679,684**	**22,749,858**
Loss for the year to December 31, 2009	-	(880,218)	-	-	(880,218)
Total comprehensive loss for the year ended December 31, 2009	**-**	**(880,218)**	**-**	**-**	**(880,218)**
Transactions with owners:					
Issue of shares	1,947,646	-	-	-	1,947,646
Fair value of share warrants and options	-	-	-	255,982	255,982
At January 1, 2010	**24,200,271**	**(2,062,887)**	**218**	**1,935,666**	**24,073,268**
Loss for the period to June 30, 2010	-	(510,778)	-	-	(510,778)
Total comprehensive loss for the period ended June 30, 2010	**-**	**(510,778)**	**-**	**-**	**(510,778)**
Transactions with owners:					
Issue of shares	23,453,438	-	-	-	23,453,438
Broker warrant issue	(431,419)	-	-	431,419	-
Transfer upon exercise of share warrants		97,741		(97,741)	-
Fair value of share warrants and options	-	-	-	358,663	358,663
At June 30, 2010	**47,222,290**	**(2,475,924)**	**218**	**2,628,007**	**47,374,591**

The notes on pages 15 to 28 form part of these financial statements.

Xcite Energy Limited
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Consolidated Statement of Financial Position (in Pounds Sterling)

	Note	**June 30, 2010 (unaudited) £**	December 31 2009 (audited) £
Assets			
Non-current assets			
Intangible assets	7	**24,902,780**	23,022,835
Property, plant and equipment	8	**40,900**	12,775
Total non-current assets		**24,943,680**	23,035,610
Current assets			
Trade and other receivables	9	**18,381**	17,767
Cash and cash equivalents		**23,319,287**	1,736,367
Total current assets		**23,337,668**	1,754,134
Total assets		**48,281,348**	24,789,744
Liabilities			
Non-current liabilities			
Deferred tax	10	**505,167**	505,167
Total non-current liabilities		**505,167**	505,167
Current liabilities			
Trade and other payables	11	**401,590**	211,309
Total current liabilities		**401,590**	211,309
Net assets		**47,374,591**	24,073,268
Equity			
Share capital	13	**47,222,290**	24,200,271
Retained earnings	14	**(2,475,924)**	(2,062,887)
Merger reserve	14	**218**	218
Other reserves	14	**2,628,007**	1,935,666
Total equity		**47,374,591**	24,073,268

The notes on pages 15 to 28 form part of these financial statements. These interim unaudited consolidated financial statements were approved by the Board of Directors and authorised for issue on August 26, 2010 and were signed on its behalf by:

Richard Smith
Chief Executive Officer

Rupert Cole
Chief Financial Officer

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Consolidated Statement of Cash Flows (in Pounds Sterling)

	6 months ended June 30 2010 (unaudited) £	**3 months ended June 30 2010 (unaudited) £**	6 months ended June 30 2009 (unaudited) £	3 months ended June 30 2009 (unaudited) £
Loss for the period after tax	**(510,778)**	**(245,690)**	(272,478)	(145,519)
Adjustment for share based payments	**141,983**	**21,077**	6,781	6,641
Adjustment for interest income	**(45,508)**	**(44,652)**	(5,033)	(623)
Adjustment for depreciation	**8,655**	**4,917**	4,582	2,291
Movement in working capital				
- Trade and other receivables	**(614)**	**10,416**	10,173	16,026
- Trade and other payables	**190,281**	**(90,626)**	(92,307)	(132,645)
Net cash flow from operations	**(215,981)**	**(344,558)**	(348,282)	(253,829)
Additions to exploration and evaluation	**(1,663,266)**	**(928,510)**	(816,285)	(357,557)
Purchase of fixed assets	**(36,780)**	**(11,132)**	-	-
Interest income	**45,508**	**44,652**	5,033	623
Net cash flow from investing	**(1,654,538)**	**(894,990)**	(811,252)	(356,934)
Net proceeds from issue of new shares	**23,453,439**	**314,931**	-	-
Cash flow from financing	**23,453,439**	**314,931**	-	-
Net increase/(decrease) in cash and cash equivalents	**21,582,920**	**(924,617)**	(1,159,534)	(610,763)
Cash and cash equivalents as at beginning of period	**1,736,367**	**24,243,904**	1,828,183	1,279,412
Cash and cash equivalents as at end of period	**23,319,287**	**23,319,287**	668,649	668,649
Cash and cash equivalents comprise:				
Short term deposits (< 1 year)	**16,135,355**	**16,135,355**	-	-
Cash available on demand	**7,183,932**	**7,183,932**	668,649	668,649

The notes on pages 15 to 28 form part of these financial statements.

Notes to the Interim Consolidated Financial Statements

1 Accounting Policies

Basis of preparation

The interim unaudited consolidated financial statements for the three and six months ended June 30, 2010 have been prepared in accordance with IAS 34 Interim Financial Reporting. However, the interim unaudited consolidated financial statements for the three and six months ended June 30, 2010 have not been reviewed or audited by the Company's auditors.

These interim unaudited consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards following the same accounting policies and methods of computation as the audited consolidated financial statements for the year ended December 31, 2009. These interim unaudited consolidated financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and the notes thereto in the Xcite Energy Limited ("XEL" or "the Company") annual report for the year ended December 31, 2009.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Xcite Energy Resources Limited ("XER"). XEL and XER together comprise the "Group". All inter-company balances and transactions have been eliminated upon consolidation.

New accounting standards adopted during the period

During the six month period the Group has adopted 'Improvements to IFRSs (issued April 2009)', Revised IAS 24 'Related Party Disclosures' and the amendments to IFRS 2 in respect of 'Group Cash-settled Share-based Payment Transactions', although the adoption of these amendments had no impact on the results of the Group. 'Amendments to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First Time Adopters', Amendment to IFRIC 14 'Prepayments of a Minimum Funding Requirement' and " Amendments to IFRS 1 Additional Exemptions for First Time Adopters', all of which were endorsed during the three months to June 30, 2010, were not relevant to the Group.

New standards and interpretations not yet applied

The new standards and interpretations listed under the "Status of EU Endorsement" section below, which have been issued by the International Accounting Standard Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC"), have yet to be endorsed by the European Union ("EU") and/or are effective for future periods and thus have not been adopted in these interim unaudited consolidated financial statements. A description of these standards and interpretations, together with (where applicable) an indication of the effect of adopting them, is set out in the section below. None are expected to have a material effect on the reported results or financial position of the Group.

Status of EU endorsement

Entities in EU Member States which report in accordance with EU-endorsed IFRS can only apply IFRS and IFRIC where the endorsement process has been completed at the date of approval of their financial statements. Of the standards and interpretations listed above, the following had not yet been endorsed by the EU at the date these interim unaudited consolidated financial statements were authorised for issue:

- IFRS 9 'Financial Instruments';
- IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments'; and
- Improvements to IFRSs (issued May 2010).

2 Segment Information

The Group only operates in a single business and geographical segment. The Group's single line of business is the appraisal and evaluation of oil and gas reserves and the geographical segment in which it currently operates is the North Sea.

3 Operating Loss

The operating loss on ordinary activities is stated after charging the following:

	6 months ended June 30, 2010 (unaudited)	**3 months ended June 30, 2010 (unaudited)**	6 months ended June 30, 2009 (unaudited)	3 months ended June 30, 2009 (unaudited)
	£	**£**	£	£
Share based payment charges	**141,983**	**21,077**	6,781	6,641

The Company incurred total charges in respect of share based payments in the three month period to June 30, 2010 of £21,077 (three months to June 30, 2009: £6,641). Of this, £nil was in respect of employees (see Note 4) (three months to June 30, 2009: £nil). In accordance with the Company accounting policy, the whole of this amount has been expensed within operating loss (three months to June 30, 2009: £6,641 expensed within operating loss).

In the six month period to June 30, 2010 the Company incurred total charges in respect of share based payments of £358,663 (six months to June 30, 2009: £11,385). Of this, £287,119 was in respect of employees (six months to June 30, 2009: £3,628). In accordance with the Company accounting policy, £216,680 has been capitalized within E&E assets and the balance of £141,983 expensed within operating loss (six months to June 30, 2009: £4,604 capitalized within E&E assets and the balance of £6,781 expensed within operating loss).

4 Staff Costs and Directors' Emoluments

a) The average number of persons employed by the Group (including Executive Directors) during the period was as follows:

	6 months ended June 30, 2010 (unaudited)	**3 months ended June 30, 2010 (unaudited)**	6 months ended June 30, 2009 (unaudited)	3 months ended June 30, 2009 (unaudited)
Technical and administration	**7**	**7**	8	8

The aggregate payroll and performance based remuneration costs of staff and Executive Directors were as follows:

	6 months ended June 30, 2010 (unaudited)	**3 months ended June 30, 2010 (unaudited)**	6 months ended June 30, 2009 (unaudited)	3 months ended June 30, 2009 (unaudited)
	£	**£**	£	£
Wages and salaries	**959,850**	**677,675**	572,930	285,295
Social security costs	**120,607**	**85,768**	70,543	35,115
Share based payments	**287,119**	**-**	3,628	-
	1,367,576	**763,443**	647,101	320,410

b) Executive Directors' emoluments and performance based remuneration:

	6 months ended June 30, 2010 (unaudited)	**3 months ended June 30, 2010 (unaudited)**	6 months ended June 30, 2009 (unaudited)	3 months ended June 30, 2009 (unaudited)
	£	**£**	£	£
Wages and salaries	**529,350**	**369,675**	319,350	159,675
Social security costs	**66,844**	**46,953**	39,809	19,889
Share based payments	**193,823**	**-**	-	-
	790,017	**416,628**	359,159	179,564

The Executive Directors comprise the key management personnel of the Group.

In addition to the above, during the three month period ended June 30, 2010, the Group paid to Roger Ramshaw, Gregory Moroney, Scott Cochlan and Tim Jones in their capacity as Non-Executive Directors of the Company fees of £6,000, £1,500, £2,250 and £7,500 respectively. The comparatives for the three month period ended June 30, 2009 were £6,000, £1,500, £1,500 and £6,000 respectively.

In the six months ended June 30, 2010 the total fees for Roger Ramshaw, Gregory Moroney, Scott Cochlan and Tim Jones were £14,250, £4,500, £3,750 and £11,250 respectively. The comparatives for the six months ended June 30, 2009 were £13,500, £4,500, £3,000 and £10,500.

5 Taxation

	6 months ended June 30, 2010 (unaudited)	**3 months ended June 30, 2010 (unaudited)**	6 months ended June 30, 2009 (unaudited)	3 months ended June 30, 2009 (unaudited)
	£	**£**	£	£
Current tax				
Overseas tax charges	-	-	-	-
Tax on loss on ordinary activities	-	-	-	-

Current tax is calculated at the rates prevailing in the respective jurisdictions. XEL is incorporated in the British Virgin Islands, a jurisdiction subject to a tax exemption. XER is incorporated in the UK, is considered a company which profits from oil extraction and oil rights, and is therefore subject to current tax on taxable profits at a rate of 30% (June 30, 2009: 30%).

6 Loss per Share

The basic loss per share is calculated by dividing the loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. The calculation of basic loss per ordinary share for the three month period ended June 30, 2010 is based on a three month period loss of £245,690 (three months to June 30, 2009: loss of £145,519) and on 133,910,843 (three months to June 30, 2009: 61,413,800), being the weighted average number of ordinary shares in issue during the period.

The calculation of basic loss per ordinary share for the six month period ended June 30, 2010 is based on a six month period loss of £510,778 (six months to June 30, 2009: loss of £272,478) and on 107,356,628 (six months to June 30, 2009: 61,413,800), being the weighted average number of ordinary shares in issue during the period.

Details of potentially dilutive financial instruments are given in Note 13 to these financial statements.

7 Intangible Assets

Exploration and Evaluation Assets	Licence Fees	
	June 30 2010 (unaudited) £	December 31 2009 (audited) £
Cost and carrying value:		
At January 1, 2010 / January 1, 2009	**475,047**	253,287
Additions during period	**-**	221,760
At June 30, 2010 / December 31, 2009	**475,047**	475,047

	Appraisal and Exploration Costs	
	June 30 2010 (unaudited) £	December 31 2009 (audited) £
Cost and carrying value:		
At January 1, 2010 / January 1, 2009	**22,547,788**	21,743,584
Additions during period	**1,879,945**	804,204
At June 30, 2010 / December 31, 2009	**24,427,733**	22,547,788

	Total	
	June 30 2010 (unaudited) £	December 31 2009 (audited) £
Cost and carrying value:		
At January 1, 2010 / January 1, 2009	**23,022,835**	21,996,871
Additions during period	**1,879,945**	1,025,964
At June 30, 2010 / December 31, 2009	**24,902,780**	23,022,835

The costs associated with the appraisal of the Bentley field have been capitalised in accordance with the Group’s accounting policy in Note 1.

Based on the Group’s success in drilling its appraisal well on Bentley, and in view of the forecast revenue streams and cash flows of this project, management is satisfied that the carrying amount of the related intangible assets as disclosed above will be recovered in full and that there is no need for any impairment provision. The situation will be monitored by management and adjustments made in future periods if future events indicate that such adjustments are appropriate.

8 Property, Plant and Equipment

	Furniture, fittings and computing equipment
Year ended December 31, 2009	£
Opening net book amount at January 1, 2009	21,317
Additions	745
Depreciation charge	(9,287)
Closing net book amount at December 31, 2009	12,775
At December 31, 2009	
Cost or valuation	28,235
Accumulated depreciation	(15,460)
Net book amount	12,775
Period ended June 30, 2010	
Opening net book amount at January 1, 2010	12,775
Additions	36,780
Depreciation charge	(8,655)
Closing net book amount at June 30, 2010	**40,900**
At June 30, 2010	
Cost or valuation	65,015
Accumulated depreciation	(24,115)
Net book amount	**40,900**

9 Trade and Other Receivables

	June 30 2010 (unaudited)	December 31 2009 (audited)
	£	£
Indirect taxes receivable	**14,706**	13,842
Other receivables	**3,675**	3,925
	18,381	17,767

10 Deferred tax

	June 30 2010 (unaudited)	December 31 2009 (audited)
	£	£
At January 1, 2010 / January 1, 2009	**505,167**	-
Profit and loss charge	**-**	505,167
At June 30, 2010 / December 31, 2009	**505,167**	505,167

The total deferred tax liability at June 30, 2010 comprised temporary differences arising from a Research and Development tax claim in the UK. As at June 30, 2010 the Group had pre-trading losses of £819,137 (December 31, 2009: £714,499). No deferred tax asset has been recognised on these losses until such time as the Group is expected to have sufficient taxable profits in future periods against which the asset can be relieved.

11 Trade and Other Payables

	June 30 2010 (unaudited)	December 31 2009 (audited)
	£	£
Trade payables	**310,525**	118,739
Social security and other taxes payable	**51,273**	46,527
Accruals and other creditors	**39,792**	46,043
	401,590	211,309

12 Financial Instruments

The Group's principal financial instruments are other receivables, trade and other payables and cash, which are denominated in various currencies. The main purpose of these financial instruments is to finance the Group's ongoing operational requirements.

The Group does not currently trade in derivative financial instruments. The principal financial risks faced by the Group are credit risk, liquidity and foreign currency risk. Policies for the management of these risks, which have been consistently applied throughout the period, are shown below.

Non-market risk

a) Credit risk

Group management has a responsibility to minimise the risk of default on credit advanced to customers and on deposits held by suppliers. At present the Group has no customers and therefore advances no credit. Deposits held by suppliers comprise an office rent deposit recorded as receivables and, as such, it is regarded as low risk. On this basis, Group management is satisfied that any credit risk has been minimised.

Credit risk also arises from cash and cash equivalents and deposits held by banks and financial institutions. To minimise the credit risk on banks and financial institution deposits, only independently rated parties with a minimum rating of "AA" equivalent or better are used by the Group to hold such deposits.

b) Liquidity risk

Group management has responsibility for reducing exposure to liquidity risk and for ensuring that adequate funds are available to meet anticipated requirements. The Group's objective is to ensure that sufficient liquid resources are available to meet its obligations on time. Liquidity risk is managed on a consolidated basis by forecasting operational requirements and financial commitments. It operates according to the policies and guidelines established by the Board. Cash management is carried out centrally.

	Carrying Amount	
	June 30 2010 (unaudited)	December 31 2009 (audited)
	£	£
Financial assets – loans and receivables		
- Cash	**23,319,287**	1,736,367
- Receivables (current)	**3,675**	3,925
	23,322,962	1,740,292
Financial liabilities – measured at amortised cost		
- Payables (current)	**350,317**	164,782

The management believes that as all financial instruments are short term, the fair values for all such items equate to their carrying amount.

The accounting policies for financial assets and financial liabilities are disclosed in Note 1.

Market risk

c) Interest rate and foreign currency risks

The currency and interest profile of the Group's financial assets and liabilities are as follows:

	Interest Free Liabilities	
	June 30 2010 (unaudited)	December 31 2009 (audited)
	£	£
Sterling	**191,954**	158,756
Euro	**114,251**	-
USD$	**21,993**	-
CAD$	**22,119**	6,026
	350,317	164,782

	Fixed rate assets	**Floating rate assets**	**Interest free assets**	**Total**
	June 30 2010 (unaudited)	**June 30 2010 (unaudited)**	**June 30 2010 (unaudited)**	**June 30 2010 (unaudited)**
	£	**£**	**£**	**£**
Sterling	**10,038,741**	**6,801,911**	**3,675**	**16,844,327**
CAD$	**-**	**6,337**	**-**	**6,337**
USD$	**5,133,486**	**1,338,812**	**-**	**6,472,298**
	15,172,227	**8,147,060**	**3,675**	**23,322,962**

	Floating rate assets	Interest free assets	Total
	December 31 2009 (audited)	December 31 2009 (audited)	December 31 2009 (audited)
	£	£	£
Sterling	1,681,622	3,675	1,685,297
CAD$	53,437	250	53,687
USD$	1,308	-	1,308
	1,736,367	3,925	1,740,292

Sterling floating rate assets earn interest at rates linked to the Bank of England Base Rate, with higher rates of return being achieved on deposits placed on longer maturities. The Company currently earns interest on Sterling deposits in the range of 0.25% to 2.5%. At June 30, 2010 the weighted average rate of interest being earned on Sterling deposits was 1.16%.

US Dollar floating rate assets earn interest within the range of rates of 0.18% to 0.28%, depending upon the liquidity of the deposit placed. At June 30, 2010 the weighted average rate of interest being earned on US deposits was 0.24%.

Due to the currently low level of Canadian overnight rates, Canadian Dollar floating rate assets earn a nominal rate of interest. Cash deposits are only kept with banks with “AA” rating or better. The policy of the Group is to ensure that all cash balances earn a market rate of interest and that interest rate exposures are regularly reviewed and managed.

Foreign currency risk arises where purchase transactions are undertaken in a currency other than Sterling (transactional risk) and where non-Sterling financial derivatives are held at the Balance Sheet date (translational risk). The Group is exposed to exchange rate movements in the US Dollar and, to a lesser extent, the Canadian Dollar and the Euro. In light of the forthcoming 9/3b-R well programme, for which the rig day rate will be paid for in US Dollars, the Company feels that it has a sufficient natural hedge in place against the US Dollar. Aside from the 9/3b-R well programme, considering the infrequency and relative small value of non-Sterling denominated transactions, the Group considers that at present its foreign currency risk is not material. The Group will continue to monitor its exposure to such foreign currency risks and will manage future risks using derivative financial instruments as considered appropriate.

As the Group is at the development stage, it is not yet subject to significant non-hedged exposure to the Sterling/US Dollar exchange rate fluctuations.

(d) Interest rate sensitivity analysis

Interest rate sensitivity analysis has been determined based on the exposure to interest rates for financial instruments during the financial period.

Based on the Group’s cash balances during the period, if interest rates had been 50 basis points higher and all other variables were held constant, the Group’s loss for the three month period ended June 30, 2010 would decrease by £20,717 (three month period to June 30, 2009; the Group's loss would decrease by £1,024). If interest rates had been 50 basis points lower and all other variables were held constant, the Group's loss for the three month period ended June 30, 2010 would increase by £17,375 (three month period to June 30, 2009; the Group's loss would increase by £635).

On a similar basis, for the six months ended June 30, 2010 if interest rates had been 50 basis points higher and all other variables were held constant, the Group's loss for the six month period ended June 30, 2010 would decrease by £22,292 (six month period to June 30, 2009; the Group's loss would decrease by £3,382). If interest rates had been 50 basis points lower and all other variables were held constant, the Group's loss for the six month period ended June 30, 2010 would increase by £18,231 (six month period to June 30, 2009; the Group's loss would increase by £2,992).

13 Share Capital

	June 30 2010 (unaudited)	December 31 2009 (audited)
	Number of shares	Number of shares
Authorised		
- Ordinary shares of no par value each	**Unlimited**	Unlimited
Issued and fully paid up		
- Ordinary shares of no par value each	**134,269,070**	71,555,798

	June 30 2010 (unaudited)	December 31 2009 (audited)
	£	£
Authorised		
- Ordinary shares of no par value	**Unlimited**	Unlimited
Issued and fully paid up		
- Ordinary shares of no par value	**47,222,290**	24,200,271

Shares issued

In March 2010 the Company issued a total of 61,972,394 ordinary shares for a total consideration of £23.1 million after the deduction of transaction costs as a result of a fund raising in the UK and Canada. In addition, in May 2010 a total of 740,878 new ordinary shares were issued following the exercise of broker warrants for a consideration of £0.3 million.

The Company issued no new ordinary shares during the six months ended June 30, 2009.

Following the private placement funding and the issue of ordinary shares noted in Note 17, Post balance sheet event, the Company has 144,268,276 ordinary shares in issue at the date of signing of these financial statements.

Stock Option Plan

An element of the Group's reward strategy is the implementation of the Stock Option Plan, the purpose of which is to provide an incentive to the Directors, officers and key employees of the Group to achieve the objectives of the Group; to give suitable recognition to the ability and industry or such persons who contribute materially to the success of the Group; and to attract and retain persons of experience and ability, by providing them with the opportunity to acquire an increased proprietary interest in the Company. The Stock Option Plan is administered by the Remuneration and Nominating Committee.

In the six month period to June 30, 2010, the Company issued an aggregate of 4,093,000 share options under the Stock Option Plan as follows: 100,000 to each of the four Non-Executive Directors, 831,000 to each of the three Executive Directors, and an aggregate of 1,200,000 amongst four members of the XER management team. All these share options vest in three equal tranches over a two year period with an exercise price of CAD$0.68 and a term of five years.

In the six month period to June 30, 2009 a total aggregate of 950,000 share options were issued. 850,000 of these share options vested immediately with an exercise price of CAD$0.10 and a term of five years and the remaining 100,000 vested immediately with an exercise price of CAD$0.29 and a term of five years.

The following assumptions were used in the share option pricing model for the vesting of options and warrants during the six month period at the following dates:

Vesting Date	January 7, 2010 Options	March 18, 2010 Warrants	March 26, 2010 Options	April 12, 2010 Options
Share bid price	CAD$0.89	CAD$0.62	CAD$0.68	CAD$0.91
Exercise price	CAD$0.37	CAD$0.62	CAD$0.68	CAD$0.37
Expected volatility	59%	58%	58%	58%
Expected life	4.75 years	2 years	5 years	4.5 years
Expected dividends	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	2.54%	1.69%	2.98%	2.53%

At June 30, 2010 there were 10,608,000 options outstanding (December 31, 2009: 6,530,000).

Share warrants

In the period to March 31, 2010, the Company issued warrants of 3,270,168 (three months to March 31, 2009: nil warrants issued) to its brokers in respect of the March 2010 fund raising programme. There were no warrants issued in the three month period to June 30, 2010 (three months to June 30, 2009: nil warrants issued).

On May 12, 2010 Arbuthnot Securities Limited exercised 740,878 of its broker warrants at an exercise price of £0.40 (CAD$0.62) for a total consideration of £296,351.

The Company had the following outstanding warrants over the ordinary share capital of the Company at June 30, 2010:

Security	Holder	Number of ordinary shares	Exercise price	Market price at grant date	Expiry date
Broker warrants	Arbuthnot Securities Limited	1,500,000	GBP£0.40	GBP£0.40	March 18, 2012
Broker warrants	Canaccord Financial Limited	76,500	CAD$0.62	CAD$0.62	March 18, 2012
Broker warrants	Global Maxfin Capital	31,521	CAD$0.62	CAD$0.62	March 18, 2012
Broker warrants	GUNDYCO	177,411	CAD$0.62	CAD$0.62	March 18, 2012
Broker warrants	Octagon Capital Corporation	743,858	CAD$0.62	CAD$0.62	March 18, 2012

On July 12, 2010 Canaccord Financial Limited exercised 21,450 of its broker warrants at an exercise price of CAD$0.62 for a total consideration of CAD$13,299.

14 Retained earnings and other reserves

The following explains the nature and purpose of each reserve within owners' equity:

- Retained Earnings: Cumulative profits recognised in the Group Income Statement less cumulative losses and distributions made.

- Merger Reserve: The difference between the nominal value of the shares issued to acquire a subsidiary and the nominal value of the shares acquired.

- Other Reserves: The fair value of share based payments and warrants granted over ordinary shares in the Company at the date of grant.

15 Commitments and contingencies

On July 19, 2010 XER signed a contract with Diamond Offshore Drilling (UK) Limited for the hire of the Ocean Nomad semi-submersible drilling rig to conduct a one firm well programme on the Bentley field, the 9/3b-R well. The signing of this contract commits XER to fund an escrow account prior to spud with sufficient funds to cover the rig day-rate commitment for the minimum expected duration of the programme, equating to approximately £7.2 million.

In preparation for the drilling of the 9/3b-R well, XER has committed purchases at June 30, 2010 of approximately £1.7 million in respect of tooling, pipelines and oilfield equipment.

16 Related parties

XEL is a company incorporated in the British Virgin Islands and whose registered office is at Geneva Place, Waterfront Drive, PO Box 3469 Road Town, Tortola, VG1110, British Virgin Islands. The Group defines related parties as:

- The Group's Executive and Non-Executive Directors;
- The Company's subsidiary XER;
- The Company's key management; and
- Companies in which the Executive Directors exercise significant influence.

Using a loan facility, XEL provided its wholly owned subsidiary, XER, with net cash funding of £1.28 million during the three month period to June 30, 2010 (three month period to June 30, 2009: £0.54 million) to finance XER's operational requirements. No interest is payable on the outstanding loan balance from XEL, which is unsecured and repayable on demand. The cumulative six month period funding to June 30, 2010 provided by XEL to XER was £1.79 million (six months to June 30, 2009: £1.06 million). The total balance owing by XER to XEL at June 30, 2010 was £24.5 million (as at June 30, 2009: £21.8 million).

The Executive Directors have received performance based remuneration, details of which are given in Note 4 to these financial statements. The Executive and Non-Executive Directors have also been granted certain share options over the ordinary share capital of the Company, details of which are given in these interim unaudited financial statements.

17 Post balance sheet event

On August 26, 2010 the Company completed a private placement to raise gross proceeds of approximately £5.8 million (C$9.3 million) from investors in the UK through the issue of 9,727,756 ordinary shares of no par value. The net proceeds will be used on an enhanced 9/3b-R well work programme, which the Company believes will provide greater certainty of outcome from the planned horizontal flow test, significant additional data and an acceleration of the planned first stage production ("FSP") programme. Greater detail on the scope of the enhanced 9/3b-R well work programme can be found in the Company's press release dated August 19, 2010, which has been filed on www.sedar.com.