Xcite Energy Limited

Annual Report and Financial Statements

for the year ended 31 December 2011

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Contents

Board of Directors

Roger S. Ramshaw is the Chairman and a Non-Executive Director of the Company and is a member of the Remuneration and Nominating Committee. From 2002 until his retirement in 2003, Mr. Ramshaw was Chairman and Managing Director of ConocoPhillips (UK) Ltd, where he led the company's exploration, development and production business on the UK Continental Shelf. From 1999 to 2002, he was President of Conoco Venezuela Ltd. Mr. Ramshaw has over 30 years of domestic and international experience in operations, project and commercial activity in the petroleum industry.

Richard E. Smith is Chief Executive Officer and Director of Xcite Energy Resources Limited ("XER") and the Company. From 2000 until joining XER in 2003, Mr. Smith was Programme Director at Granherne, formerly of the Halliburton group of companies, where he was responsible for the creation and formation of a business providing programme management services to clients in the international onshore and offshore oil and gas business. Mr. Smith is a Chartered Engineer and has over 25 years of experience in engineering and business management in onshore and offshore oil and gas projects. He is a Fellow of the Institute of Civil Engineers and a Corporate Member of the Institute of Marine Engineers and the Royal Institute of Naval Architects.

Rupert E. Cole is Chief Financial Officer and Director of XER and the Company. From 2002 until joining XER in 2003, Mr. Cole was Programme Management Business Adviser at Granherne, a company within the Halliburton group of companies, providing strategic, commercial and financial advice to upstream oil and gas services providers. From 1990 to 1996, Mr. Cole was Finance Director at Harpur, an international downstream service provider to major oil companies. Mr. Cole is a Chartered Accountant and has over 20 years of experience in corporate finance.

Stephen A. Kew is Exploration and Development Director of XER and the Company. After leaving Conoco in 1999 after 25 years, he provided petroleum engineering consulting in the upstream oil and gas industry for a wide range of clients before joining XER in 2003. Mr. Kew is a Petroleum Engineer and has over 35 years of development engineering and project management experience in the oil and gas industry, including previous experience in respect of the Bentley field while at Conoco. He is an associate of the Institution of Chemical Engineers and a member of the Society of Petroleum Engineers.

Gregory J. Moroney is a Non-Executive Director of the Company and Chairman of the Remuneration and Nominating Committee. Mr. Moroney is the Founding and Managing Member of Energy Capital Advisors LLC of Greenwich, Connecticut, which he founded in 2003 to assist independent energy companies and energy fund managers in North America in their fund-raising activities. Mr. Moroney is also a director of BreitBurn Energy Partners, L.P., an oil and gas limited partnership listed on NASDAQ. From 1993 to 2002, he was head of the Structured Finance Group for the Energy and Natural Resource Sector - Western Hemisphere at Deutsche Bank Securities in New York. Mr. Moroney has over 25 years of experience as an energy finance specialist.

Scott R. Cochlan is a Non-Executive Director of the Company and is a member of the Remuneration and Nominating Committee. Mr. Cochlan is a partner at the law firm of Torys LLP in the Corporate and Capital Markets group. Mr. Cochlan has represented senior and junior public issuers in numerous aspects of general corporate law and securities regulatory matters including corporate governance, continuous disclosure, regulatory compliance and transaction negotiation and completion. Mr. Cochlan also has extensive experience in representing both issuers and underwriters in a wide variety of complex private and public financing matters (equity and debt), including cross-border financings, mergers, acquisitions and other business reorganizations and restructurings. Mr. Cochlan holds a law degree from the University of Calgary and a B.A. from the University of Western Ontario. Mr. Cochlan has received a number of recognitions as a leading lawyer in his field.

Timothy S. Jones is a Non-Executive Director of the Company and also Chairman of the Audit Committee. Mr. Jones is a Chartered Accountant with over 20 years of experience in professional practice covering a number of industries including oil and gas. Following major public company roles, he formed his own accountancy and consulting practice to focus on the oil and gas sector, where he specialises in providing advice to AIM listed companies and he is currently on the board of a number of AIM listed natural resources companies.

Chairman's Review

The year 2011 began on a very positive note following the successful testing of the 9/3b-6 and 6z wells on the Bentley field, with the demonstration that the Bentley heavy-oil reservoir could now be developed economically with the application of current technology.

The Reserves Assessment Report published in May 2011 supported this view with reserves status being assigned to the field for 28 million stock tank barrels ("MMstb") in the First Phase Development programme. It was said at the time that assignment of further reserves only depended upon comfort being obtained from the Department of Energy and Climate Change ("DECC") of the project to develop the core area and this opinion has subsequently been borne out in the latest Reserves Assessment Report with an effective date of 31 December 2011, prepared by the Company's independent auditor of reserves and resources, TRACS International Consultancy Limited ("TRACS"), in February 2012. Following the results of a review by and technical comments from DECC in response to the submitted Bentley Field Development Plan ("FDP"), TRACS has increased our proven and probable reserves to 116 MMstb, in line with our original expectations at the start of the year.

Extensive project planning work has been performed during the year to determine the optimum development of the Core Area of the field. At first this was envisaged as a two phased approach and the FDP for the First Phase Production ("FPD") and Second Phase Production ("SPD") was submitted to the DECC in the latter half of 2011 for their consideration. In the interests of all stakeholders, the FPD was itself split into two consecutive phases; in FPD 1A we intend to drill a motherbore well with two laterals and produce for about 90 days, after which formal approval of the FPD 1B from the DECC will be sought to commence the permanent production from the field.

In December 2011 a £25.8 million private placing with Socius CG II, Ltd was announced and also a £60 million Equity Line Facility with Esousa Holdings LLC. This Equity Line Facility replaced the previous arrangement the Company had through Yorkville Advisers, which raised £52.3 million during the year.

Funding has been used predominantly to secure the necessary equipment and make the required commitments to execute the Bentley Phase 1A development and, of particular importance, to increase the capacity of the project team and the Xcite Energy Resources Limited ("XER") organisation to be a competent production operator. Of significance, the Rowan Norway jack-up drilling unit, designed for simultaneous drilling and production operations in harsh deep water environments, was secured and became available to the Company at the end of November 2011, with the departure from Dundee for the field on 12 March 2012 and the 9/3b-7 well having been spudded on 18 March 2012. Also a shuttle tanker was secured through a letter of intent between Teekay Shipping Norway AS and the Company in December 2011 with the contract expected to be finalised shortly.

Finally, we would like to express our appreciation of all the support and dedication we have received during this year from the XER team. The uncertainty in the capital markets has added to the normal challenges of a North Sea project, but the XER team has maintained its focus on the prize and shown remarkable flexibility to overcome problems. Of course, we also wish to express our appreciation to our investors who continue to share our belief in the Company's potential value. It has been, without doubt, a demanding year, but the expected value of the Company remains unchanged and we look forward to the results of the Phase 1A work programme and the future development of the Bentley field.

Roger Ramshaw
Chairman
22 March 2012

Management Discussion and Analysis

The Management 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 audited consolidated financial statements and related notes for the year ended 31 December 2011. This MD&A is dated 22 March 2012. These documents and additional information about XEL, including its annual information form dated 26 October 2010 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").

This MD&A includes an analysis of the XEL results for the year to 31 December 2011, which include the results of the operating subsidiary Xcite Energy Resources Limited ("XER") for the year to 31 December 2011. The comparative results for both companies comprise the year to 31 December 2010 and in this MD&A, XEL and XER are together defined as the "Group". All figures and the comparatives 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 reserves 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, 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.

Summary of Results

The following table summarises the Group's performance in the year to 31 December 2011 and the comparatives for the year to 31 December 2010 and the year to 31 December 2009. The Group had no trading revenue in any of these periods. The 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 consolidated financial statements of the Company have also been prepared in accordance with IFRSs adopted by the European Union ("EU").

	Year ended 31 December	Year ended 31 December	Year ended 31 December
	2011	2010	2009
	£	£	£
Net profit/(loss)	**129,563**	(2,446,998)	(880,218)
Earnings/(loss) per share (basic) in pence	**0.1p**	(1.9p)	(1.4p)
Earnings/(loss) per share (diluted) in pence	**0.1p**	(1.9p)	(1.4p)
Total assets	**152,771,290**	102,801,482	24,789,744
Long term liabilities (deferred tax)	**505,167**	505,167	505,167

When comparing the current year against past performance, the net profit in 2011 arises primarily as a result of unrealised foreign exchange gains on US dollar cash balances, together with reduced share-based payment charges compared with previous years. Reduced share-based payment charges have arisen due to a significantly lower number of share options being issued during 2011 compared with 2010. The increase in foreign exchange gains has arisen due to the strengthening of the US dollar in the fourth quarter of 2011.

Underlying operating costs of running the Company have generally remained consistent, except for increased headcount and office space resulting in small increases to general overheads. Fundraising activities during 2011 has increased the overall total assets of the Company as it enters into First Phase Development ("FPD") of the Bentley field.

The deferred tax balance exists as a result of a Research and Development ("R&D") tax rebate during 2009. There was no such equivalent tax rebate during either 2010 or 2011. The Company has no other long term liabilities and has elected not to recognise its deferred tax assets.

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.

	Q4 11	Q3 11	Q2 11	Q1 11	Q4 10	Q3 10	Q2 10	Q1 10
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
Net profit/(loss)	1,099	(662)	(294)	(13)	(1,724)	(212)	(246)	(265)
EPS *	0.6p	(0.4p)	(0.2p)	(0.0p)	(1.1p)	(0.2p)	(0.2p)	(0.3p)
Total assets	152,771	130,219	118,064	99,158	102,801	54,688	48,281	48,282
Long term liabilities	505	505	505	505	505	505	505	505

***** Earnings/(loss) per share (basic) in pence

Fourth Quarter Highlights

A number of key operational events for the Company took place in the fourth quarter of 2011:

- In October the Company announced the arrival of the Rowan Norway drilling rig into Dundee prior to handover to XER;
- In November the Rowan Norway came on charter hire to XER;

- In December the Company announced new fundraising of US$40 million (£25.8 million), to be provided in two tranches of $20 million each, together with a new Equity Credit Line Agreement of £60 million to replace the Standby Equity Distribution Agreement ("SEDA") facility.

With respect to the financial performance during the fourth quarter, the impact of the Eurozone problems saw a strengthening of the US dollar, regarded as a safe haven for the currency markets, the consequence of which was the recognition of a material unrealised foreign exchange gain on the Company's holding of US dollars. Except for this foreign exchange gain and an increasing spend profile associated with the work programme for the FPD of the Bentley field, the financial performance of the Company in the fourth quarter was similar to the immediately preceding quarters.

The Company is not influenced by seasonality to any significant extent. The variations noted above in the quarterly net profits/losses have arisen in line with the execution of the work programme for the Bentley field, together with share-based payment charges in relation to the Company's Share Option Plan and performance-related pay charges directly related to the success of the work carried out on the Bentley field.

New investment in the Company from use of the SEDA facility, provided by YA Global Master SPV Ltd ("Yorkville") has resulted in an increasing net assets position over the course of the year in addition to new investment by Socius CG II, Ltd ("Socius") in December. The principal increases have been firstly to the cash balance as a result of the financing activities, and secondly to the Exploration & Evaluation ("E&E") assets carrying value as a result of the 9/3b-6 well programme spend during the first quarter of 2011, together with the planning, preparatory and long-lead equipment item spend for the FPD programme on Bentley during the year.

Liquidity and Capital Resources

The cash balance as at 31 December 2011 was £64.1 million, compared with £36.0 million as at 31 December 2010. The increase in cash balance during the year ended 31 December 2011 has arisen due to draw downs on the SEDA facility, details of which are given in the table below, providing gross funds of £52.3 million in addition to a Private Placement in December 2011 that raised an additional £12.9 million. This was partially offset by fundraising costs, the settlement of the outstanding financial obligations and working capital commitments in respect of the 9/3b-6 and 9/3b-6Z wells completed at the end of December 2010, and expenditure towards study work and long-lead equipment items for the FPD work programme on the Bentley field.

Announcement Date	Gross Funds (in GBP £)	New Ordinary Shares	Pricing (in GBP £)
1 February 2011	5,000,000	1,440,922	3.47
23 February 2011	5,000,000	1,480,754	3.38
28 March 2011	5,000,000	1,558,314	3.21
18 April 2011	6,000,000	1,796,514	3.34
29 June 2011	12,500,000	10,593,220	1.18
19 July 2011	4,200,000	2,680,451	1.57
13 September 2011	6,900,000	5,383,894	1.28
25 October 2011	3,200,000	2,707,504	1.18
11 November 2011	2,500,000	2,168,257	1.15

1 December 2011	2,000,000	1,814,059	1.10

On 16 December 2011, the Company announced that it had terminated the SEDA facility with Yorkville, of which £74.95 million remained to be drawn at that time, whilst at the same time securing a new Equity Line Facility ("ELF") with Esousa Holdings LLC ("Esousa") of £60 million. Upon termination of the SEDA facility, the Company unwound the remaining unamortised facility costs in their entirety.

Also on 16 December 2011, the Company announced that it had agreed to a Private Placement in the amount of US$40 million with Socius to be conducted in two tranches. The first of the two tranches, in the amount of US$20 million (£12.9 million) with Socius, closed on 16 December 2011.

The second tranche was announced on 10 February 2012 with new funds of US$20 million (£12.6 million) being received at that time.

On 30 January 2012 the Company announced that it had drawn down £3.54 million under the ELF with the issue of 3,765,060 new ordinary shares.

On 2 March 2012 the Company announced that it had drawn down £10.89 million under the ELF with the issue of 7,912,891 new ordinary shares.

On 21 March 2012 the Company announced that it had drawn down £10.30 million under the ELF with the expected issue of 8,310,540 new ordinary shares in due course.

There remains an undrawn ELF of £35.27 million at the Company's disposal at the date of this MD&A.

In addition to the SEDA draw downs, a number of share warrant and share options were exercised during 2011, with total proceeds of £0.2 million (CAD$0.3 million) being received by the Company.

Of the cash balance held at 31 December 2011, the Company holds £38.8 million (US$60 million) in an escrow account in respect of contractual commitments under the Rowan Norway rig agreement. These funds will remain in escrow to fund the rig day rate owed during the initial rig term of the FPD. The Company held a further £8.3 million in a separate escrow account in respect of commitments placed under the well management contract for the drilling programme under Phase 1A of the Bentley development project.

Taking into account the Group's financial obligations, management has forecast that it has sufficient financial resources for working capital for the foreseeable future and to continue the execution of Phase 1A of the Bentley field development programme.

Lease and Contractual Commitments

As noted above, at 31 December 2011 the Group held a total of £47.1 million in two escrow accounts to meet certain contractor commitments under the drilling and management contracts for the FPD work programme (at 31 December 2010 a total of £19.8 million was held in two escrow accounts in respect of the 9/3b-6 well programme). These escrow accounts will remain in place until the settlement of all associated contractor obligations under the FPD work programme.

Included in the total escrow balance above, the rig lease commitment as at 31 December 2011 of US$60 million (£38.8 million) reflects the minimum lease period of 240 days from rig arrival at the first drilling location. Following an announcement by the Company on 3 February 2012, this commitment may be reduced should the Company decide to shorten the Phase 1A work programme.

In preparation for the Second Phase Development ("SPD") on the Bentley field, XER has placed commitments for various long-lead items of oilfield equipment, including power generators and topside equipment. The total commitment at the balance sheet date for such items was £4.7 million.

The Group continues to have commitments to its office premises in Guildford and Aberdeen, which in aggregate are £423,750 (2010: £88,331).

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, although it intends to pursue other commercial opportunities as and when they arise, subject to available management and financial resources.

2010 was characterised by the drilling of the 9/3b-6 and 6Z wells on the Bentley field. By contrast, 2011 was a year of reserves studies and preparatory work for the FPD of the Bentley field, which is currently underway.

During 2011 a total of £22.39 million was charged to E&E assets (year ending 31 December 2010: £41.92 million), the majority of which was in respect of the planning, management, borehole and site surveys and equipment procurement for Phase 1A of the FPD and the commencement of charter for the Rowan Norway drilling rig following its handover to XER in late November 2011. Also included in the E&E asset additions are progress payments of £2.0 million made towards certain long-lead items for Step 1B. Comparing year on year, net additions to E&E assets are lower in 2011 due to less drilling activity during the year.

A total of £0.42 million (year ended 31 December 2010: £0.32 million) was paid in respect of XER's obligations under the UK North Sea licencing agreements, which now includes Blocks 9/3c and 9/3d in addition to the existing Block 9/3b following the award of two new licences in the UK 26th Licencing Round.

The Group charged to the Income Statement total administrative expenses of £1.6 million compared to £2.6 million in the year to 31 December 2010. Such expenses represent the costs of operating as a public company, including a proportion of the remuneration costs of certain Executive Directors, Non-Executive Director fees, Nominated Advisor, stockbrokers, registrars and stock exchange fees. The decrease in total administrative expenses in 2011 compared to 2010 has arisen principally due to reduced share-based payment charges of £0.41 million (year ended 31 December 2010: £1.46 million), offset by increased wages and salary costs as a result of increased average staff numbers from 8 to 12 during the year.

The overall net administrative gain in the current year has arisen due to material unrealised foreign exchange gains, resulting primarily by the strengthening US dollar against the reporting currency of pounds sterling during the fourth quarter of 2011. This US dollar strengthening has had the effect of increasing the underlying value of the Company's US dollar escrow account held at the balance sheet date. The comparable foreign exchange gains and losses in 2010 were insignificant due to the majority of financial assets and liabilities being held in pounds sterling and more stable exchange rates. Whilst the Company continues to hold large balances of cash in currencies other than pounds sterling, there will be an increased level of exposure to both positive and negative foreign currency movements. As the current financial year has demonstrated, this can have a significant influence on the overall reported financial performance.

Related Party Transactions

XEL has continued to provide a loan facility to its wholly owned subsidiary, XER, to finance XER's operational requirements, with net cash funding of £39.0 million during the year to 31 December 2011 (year to 31 December 2010: £3.2 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 under this facility at 31 December 2011 was £64.8 million (as at 31 December 2010: £25.8 million).

The Executive Directors have received remuneration, details of which are given in the table below. The Executive and Non-Executive Directors have also been granted share options over the ordinary share capital of the Company during year, details of which are also given below.

	Year ended 31 December 2011	Year ended 31 December 2010
	£	£
Wages and salaries	**691,200**	1,006,200
Social security costs	**90,862**	126,784
Share-based payments charge	**392,653**	1,122,927
	1,174,715	2,255,911

In the normal course of business XER incurred charges totalling £4,605 during the year to 31 December 2011 (year to 31 December 2010: £4,769) for consultancy services from Esher Management Services Limited, a company of which Timothy Jones is a Director. There was a balance payable by XER at the year end of £5,526 (as at 31 December 2010: £nil).

In the normal course of business XER incurred charges totalling £16,097 during the year to 31 December 2011 (year to 31 December 2010: £nil) for property rentals from Seaburome Limited, a company of which Rupert E. Cole is a Director. There was no outstanding balance payable by XER at the year end.

Share Options and Warrants

In the year to 31 December 2011, the Company issued aggregate share options to Non-Executive Directors, contractors and management of 1,850,000 under the Stock Option Plan (2010: 9,323,000 aggregate share options issued). The total expense to the Group in respect of share-based payment transactions under the Stock Option Plan was £1.30 million (2010: £4.21 million). Of this total, £0.41 million (2010: £1.33 million) has been charged to the Income Statement and £0.89 million (2010: £2.88 million) has been capitalised under intangible assets in accordance with the Company's accounting policy.

In the year to 31 December 2011, the Company issued aggregate share warrants of 7,597,647 as part of the December 2011 fundraising (2010: 3,770,168 share warrants issued). The total expense to the Group for share-based payment transactions in respect of share warrants was £2.18 million (2010: £0.46 million). Of this total, £nil million (2010: £0.13 million) has been charged to the Income Statement and £2.18 million (2010: £0.33 million) has been charged against share capital in accordance with the Company's accounting policy.

As at the date of signing this MD&A there were 17,223,000 options outstanding and 14,624,166 warrants outstanding.

Income

Interest income received on funds invested up to 31 December 2011 amounted to £101,557 (2010: £135,148). The decrease in interest generated on funds invested during the year in comparison to 2010 was as a result of a change in the currency composition of the average balance of funds held on deposit. During 2011 there was a relative increase to funds deposited in US dollars, for which the Company receives a much lower interest rate than its pounds sterling deposits.

In light of current challenging financial markets, management has felt it necessary to review its policy of keeping cash deposits only with banks with “AA” rating or better. Such a restriction in a period where many high street financial institutions have seen their credit ratings amended was placing an over-reliance upon an increasingly limited number of deposit takers. In order to balance risk and return, a revised policy of using “A” rated or better has been adopted. The Group policy is to ensure that all cash balances earn a market rate of interest and that interest rate exposures are regularly reviewed and managed. The Group’s treasury policy will be kept under review in light of market conditions.

The Company received other financial income of £21,119 during the year in respect of a VAT repayment supplement. There was no such equivalent during 2010.

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.

The Board meets at least quarterly during the year and on an ad hoc basis as required. The attendance record of each Director during the year to 31 December 2011 is given below. The Full Board held a total of 6 meetings, and both the Audit Committee and the Remuneration and Nominating Committee (“R&N”) a total of 4 meetings during the year.

	Board	**Audit Committee**	**R&N Committee**
Richard E. Smith	6	n/a	n/a
Rupert E. Cole	6	n/a	n/a
Stephen A. Kew	6	n/a	n/a
Roger S. Ramshaw	6	4	4
Gregory J. Moroney	5	4	4
Scott R. Cochlan	6	n/a	4
Timothy S. Jones	6	4	n/a

Outstanding Share Capital

The following table sets out the ordinary shares issued during the year.

	Ordinary Shares
As at 1 January 2011	**158,703,998**
Issue of ordinary shares through broker warrant exercises	482,183
Issue of ordinary shares through SEDA Equity Line	31,623,889
Issue of ordinary shares through Private Placement	15,195,294
As at 31 December 2011	**206,005,364**

As at the date of signing this MD&A, the number of shares in issue was 231,066,678, which will increase to 239,377,218 on the assumption that the shares relating to the latest ELF drawdown are admitted for trading in due course. This increased number since 31 December 2011 is as the result of the issue of 3,765,060 new ordinary shares on 6 February 2012 following a draw down under the ELF, the issue of 30,325 new ordinary shares on the exercise of broker warrants on 7 February 2012, the issue of 13,353,038 new ordinary shares on 10 February 2012 for tranche two of the Socius transaction, the issue of 7,912,891 new ordinary shares announced on 8 March 2012 following a draw down under the ELF and the proposed issue of 8,310,540 new ordinary shares following the latest draw down under the ELF as announced on 21 March 2012.

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.

Offshore exploration

The Company faces additional risks due to its concentration on offshore activities. In particular, drilling conditions, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells.

Commodity pricing

The Group has no control over the market price of crude oil. Suitable hedging arrangements are currently being considered to mitigate the volatility of oil prices as the Group approaches 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 crude oil 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. To minimise this risk, Group resources are independently assessed to provide additional assurance over the accuracy of internal estimates.

Dependence on key executives and personnel

The Company's development and future potential are dependent upon the continued services and performance of its senior management and other key personnel. The loss of the services of any of the senior management or key personnel may have an adverse impact on the Company.

Early stage of development

The Company is subject to certain risks related to the nature of its business in the acquisition, exploitation, development and production of oil resources and its early stage of development. The Company has no history of earnings and there can be no assurance that the Company's business will be successful or profitable. The Company may be subject to growth-related risks, capacity constraints and pressure on its internal systems and controls, particularly given the early stage of the Company's development. The ability of the Company to manage growth effectively will require it to continue to implement and improve its operational and financial systems and to expand, train and manage its employee base. The inability of the Company to deal with this growth could have a material adverse impact on its business, operations and prospects.

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 outcome. 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 option issue date.

(c) Impairment of Exploration and Evaluation ("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

Whilst the Group has adopted 'Improvements to IFRSs (2010)' and Amendments to IFRS 7 'Disclosures – Transfers of financial assets' during the year, these have had no material impact in the consolidated financial statements or business of 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 financial statements.

2012 Outlook

Based on the successful spud of the 9/3b-7 well on 18 March 2012, the Group is underway with the Phase 1A work programme on the First Phase Development of the Bentley field, which has an estimated duration until approximately the end of the third quarter of 2012.

Following the significant work in the latter half of 2011 to submit the Bentley Field Development Plan to the DECC, XER was able to upgrade its 2P reserves to 115.8 MMstb. This was accompanied by an updated reserves report from TRACS International Consultancy Ltd, which was completed in February 2012, and confirms the previous volumes and underpinning economic value contained within the core area of the Bentley reservoir.

With the success of the 9/3b-6 and 6z wells as reported in last year's financial statements, we anticipate the current Phase 1A work programme to be equally important in 2012. We look forward to the progress that we anticipate being able to report on the Bentley field in the coming months.

Report of the Remuneration and Nominating Committee

The Remuneration and Nominating Committee, in accordance with its written charter, reviews and makes recommendations to the Board concerning the appointment, remuneration and benefits and performance of executive management and Directors.

The Remuneration and Nominating Committee consists of three Non-Executive Directors, all of whom are independent within the meaning of National Instrument 52-110. The chairman of the Remuneration and Nominating Committee is Gregory J. Moroney.

Executive and Non-Executive Director Remuneration

The remuneration of the Executive Directors, who are the key personnel, and of the Non-Executive Directors for the year ended 31 December 2011 was as follows:

	Basic salary	Fees	Other compensation (i)	Share-based payments	**2011 Total**	2010 Total
	£	£	£	£	**£**	£
Rupert E. Cole	175,000	-	55,400	130,884	**361,284**	709,709
Stephen A. Kew	175,000	-	55,400	130,884	**361,284**	709,709
Richard E. Smith	175,000	-	55,400	130,884	**361,284**	709,709
Roger S. Ramshaw	-	56,000	-	61,672	**117,672**	191,799
Gregory J. Moroney	-	26,418	-	61,672	**88,090**	180,549
Scott R. Cochlan	-	27,958	-	61,672	**89,630**	173,799
Timothy S. Jones	-	33,167	-	61,672	**94,839**	191,049

(i) Other compensation comprises performance-related bonus, together with cash allowances in lieu of pension contributions, company car and fuel, private healthcare and life insurance and permanent health insurance cover.

The XER service contracts for Mr Cole, Mr Kew and Mr Smith were signed on 1 September 2003 and last amended on 24 October 2007.

The Group's policy is to review salary and benefits annually against market data and analysis and to adjust accordingly where the Remuneration and Nominating Committee believes it is appropriate; no changes to Executive remuneration have been made during the year. The service and employment contracts for the Executive Directors are not of fixed duration but continuation in office as a director is subject to annual re-election by shareholders. The Group's policy is for Executive Directors to have service and employment contracts with provision for termination of no longer than twelve months' notice.

The fees for the Non-Executive Directors in respect of their duties are determined by the Board and are reviewed on an annual basis. During 2011, the Board reviewed industry comparables for Non-Executive Directors fees. Based on an independent report in 2011 for the AIM100 and Equivalent FTSE Small Cap market, the Board revised the basis of Non-Executive Director fees from a day rate of £1,500 to an annualised sum. Letters of Appointment for the Non-Executive Directors provide for termination of the appointment with one month notice by either party. In accordance with the Company's Articles of

Association, Non-Executive Directors will retire after a term of two years at which point they may, subject to being eligible, offer themselves for re-election.

Beneficial Interests

The beneficial interests, shown in thousands, of the Directors in the ordinary share capital of the Company are as follows:

	Shares (‘000s)	**Option Tranche (‘000s)**							**Options Total (‘000s)**
		1	**2**	**3**	**4**	**5**	**6**	**7**	
Rupert E. Cole	7,000	1,000	-	100	831	400	90	100	2,521
Stephen A. Kew	6,213	1,000	-	100	831	400	90	100	2,521
Richard E. Smith	5,198	1,000	-	100	831	400	90	100	2,521
Roger S. Ramshaw	-	200	-	100	100	100	90	100	690
Gregory J. Moroney	100	100	-	-	100	100	90	100	490
Scott R. Cochlan (i)	25	100	-	100	100	100	90	100	590
Timothy S. Jones	50	-	100	100	100	100	90	100	590

Tranche 1- These share options, which vested immediately, were granted to the Directors on 16 November 2007 at the date of the Initial Public Offering (except for Scott R. Cochlan as noted below) with an exercise price of CAD$1.60 and a term of five years.

Tranche 2 - Timothy S. Jones was appointed to the Board on 19 March 2009 and on 23 April 2009 100,000 share options were awarded and vested immediately with an exercise price of CAD$0.29 and a term of five years.

Tranche 3 - These share options, which vested immediately, were granted to the Directors on 30 November 2009 with an exercise price of CAD$0.74 and a term of five years.

Tranche 4 – These share options, which vested in three equal tranches over a two year period, were granted to the Directors on 26 March 2010 with an exercise price of CAD$0.68 and a term of five years.

Tranche 5 - These share options, which vested immediately, were granted to the Directors on 3 November 2010 with an exercise price of CAD$2.92 and a term of five years.

Tranche 6 - These share options, which vested immediately, were granted to the Directors on 31 December 2010 with an exercise price of CAD$5.95 and a term of five years.

Tranche 7 - These share options, which vested immediately, were granted to the Directors on 6 August 2011 with an exercise price of CAD$2.30 and a term of five years.

(i) Scott R. Cochlan was appointed to the Board on 18 January 2008 at which time 100,000 share options were awarded and vested immediately with an exercise price of CAD$2.09 and a term of five years.

As announced by the Company on 29 June 2011, Stephen A. Kew and Rupert E. Cole increased their holdings in the Company by 1,000,000 shares each at a purchase price of £1.18. As announced by the Company on 13 September 2011, Rupert E. Cole further increased his holding through the purchase of an additional 801,666 shares at a purchase price of £1.28.

Further details of the stock options in issue are given in Note 13 to the financial statements. There has been no trading of shares by the Directors since the year end.

Share options

An element of the Group's reward strategy is through the implementation of the Stock Option Plan, the purpose of which is to provide an incentive to the Directors, officers, employees, consultants and other personnel of the Group ("Optionees") to achieve the objectives of the Group; to give suitable recognition to the ability and industry of 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 an unapproved stock option plan which is not intended to qualify for HM Revenue & Customs in the UK but complies with the rules and policies of the TSX-Venture stock exchange.

The Stock Option Plan is administered by the Remuneration and Nominating Committee. The number of options granted to an Optionee and the exercise price thereof are set at the time of grant, subject to any limitations imposed by the Stock Option Plan or any relevant regulatory authority, provided that if the ordinary shares are listed on a stock exchange, the exercise price shall not be lower than the market price of the ordinary shares on the date of the grant, where "market price" is defined as the highest closing trading price of the ordinary shares on any stock exchange on which the ordinary shares are listed on the day of grant.

The exercise of an option may be conditional on the performance of the Company and, if the Remuneration and Nominating Committee so determines, on the performance of a subsidiary and/or the performance of the Optionee over such period and measured against such objective criteria as shall be determined by the Remuneration and Nominating Committee and notified in writing to the Optionee when the option is granted.

Signed on behalf of the Remuneration and Nominating Committee by:

Gregory J. Moroney
Non-Executive Director
22 March 2012

Report of the Independent Auditors

To the Directors of Xcite Energy Limited

We have audited the consolidated financial statements of Xcite Energy Limited ("the financial statements"), which comprise the consolidation of the parent company Xcite Energy Limited and its subsidiary Xcite Energy Resources Limited (collectively referred to as the "Group"), for the year ended 31 December 2011, which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Statement of Financial Position, the Consolidated Statement of Cash Flows, and related notes. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards (IFRS) as adopted by the European Union.

Our report has been prepared pursuant to the requirements of our engagement letter dated 7 December 2011 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of our engagement letter or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Respective responsibilities of directors and auditors

The Group's directors are responsible for the preparation of the financial statements in accordance with IFRS as adopted by the European Union.The directors are responsible for preparing financial statements for each financial period which give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period.

The directors are also required to prepare financial statements in accordance with the rules of the London Stock Exchange for companies trading securities on the Alternative Investment Market and with those relating to companies trading securities on the Venture Exchange of the Toronto Stock Exchange. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the European Union and comply with IFRS as issued by the IASB, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the financial position of the Group. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Our responsibility is to audit and express an opinion on the financial statements in accordance with International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board’s (APB’s) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

This includes an assessment of: whether the accounting policies are appropriate to the group’s circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group’s affairs as at 31 December 2011 and of the Group’s profit for the year then ended and;
- have been properly prepared in accordance with IFRS as adopted by the European Union.

Separate opinion in relation to IFRS as issued by the International Accounting Standards Board (IASB)

As explained in note 1 to the consolidated financial statements, the group in addition to complying with its obligation to apply IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the consolidated financial statements have been properly prepared in accordance with IFRSs as issued by the IASB.

BDO LLP
Epsom
United Kingdom
22 March 2012

Xcite Energy Limited
For the year ended 31 December 2011

Consolidated Income Statement (in Pounds Sterling)

	Note	**Year ended 31 December 2011 £**	Year ended 31 December 2010 £
Share-based payment charge		**(410,777)**	(1,462,223)
Foreign exchange gains		**1,619,756**	567
Other expenses		**(1,202,093)**	(1,120,490)
Net administrative gains/(expenses)		**6,886**	(2,582,146)
Operating profit/(loss)	3	**6,886**	(2,582,146)
Finance income – bank interest		**101,557**	135,148
Finance income – other		**21,119**	-
Profit/(loss) before taxation		**129,563**	(2,446,998)
Tax expense	5	-	-
Profit/(loss) for the year attributable to Equity holders of the Company		**129,563**	(2,446,998)
Profit/(loss) per share attributable to Equity holders of the Parent Company	6		
- basic		0.1p	(1.9p)
- diluted		0.1p	(1.9p)

All results relate to continuing operations.

Consolidated Statement of Comprehensive Income (in Pounds Sterling)

	Year ended 31 December 2011 £	Year ended 31 December 2010 £
Profit/(loss) for the year	**129,563**	(2,446,998)
Total comprehensive income for the year	**129,563**	(2,446,998)
Attributable to:		
Equity holders of the Company	**129,563**	(2,446,998)

The notes on pages 25 to 45 form part of these financial statements.

Consolidated Statement of Changes in Equity (in Pounds Sterling)

	Share Capital	Retained Earnings	Merger Reserve	Other Reserves	Total
	£	£	£	£	£
At 1 January 2010	24,200,271	(2,062,887)	218	1,935,666	24,073,268
Loss for the year to 31 December 2010	-	(2,446,998)	-	-	(2,446,998)
Total comprehensive loss for the year ended 31 December 2010	-	(2,446,998)	-	-	(2,446,998)
Transactions with owners:					
Issue of shares	53,153,038	-	-	-	53,153,038
Associated share issue costs	(536,664)	-	-	-	(536,664)
Broker warrant issue	(329,283)	-	-	329,283	-
Transfer upon exercise of share options & warrants	-	289,637	-	(289,637)	-
Fair value of share warrants and options	-	-	-	4,341,901	4,341,901
At 1 January 2011	**76,487,362**	**(4,220,248)**	**218**	**6,317,213**	**78,584,545**
Profit for the year to 31 December 2011	-	129,563	-	-	129,563
Total comprehensive gain for the year ended 31 December 2011	**-**	**129,563**	**-**	**-**	**129,563**
Transactions with owners:					
Issue of shares	65,401,434	-	-	-	65,401,434
Associated share issue costs	(2,651,340)	-	-	-	(2,651,340)
Share warrant issue	(2,177,459)	-	-	2,177,459	-
Transfer upon exercise of share options & warrants	-	45,270	-	(45,270)	-
Fair value of share warrants and options	-	-	-	1,301,106	1,301,106
At 31 December 2011	**137,059,997**	**(4,045,415)**	**218**	**9,750,508**	**142,765,308**

The notes on pages 25 to 45 form part of these financial statements.

Consolidated Statement of Financial Position (in Pounds Sterling)

	Note	**31 December 2011 £**	31 December 2010 £
Assets			
Non-current assets			
Intangible assets	7	**88,080,610**	65,263,377
Property, plant and equipment	8	**186,545**	30,225
Total non-current assets		**88,267,155**	65,293,602
Current assets			
Trade and other receivables	9	**380,729**	1,555,433
Cash and cash equivalents	12b	**64,123,406**	35,952,447
Total current assets		**64,504,135**	37,507,880
Total assets		**152,771,290**	102,801,482
Liabilities			
Current liabilities			
Trade and other payables	10	**9,500,815**	23,711,770
Total current liabilities		**9,500,815**	23,711,770
Non-current liabilities			
Deferred tax	11	**505,167**	505,167
Total non-current liabilities		**505,167**	505,167
Net assets		**142,765,308**	78,584,545
Equity			
Share capital	13	**137,059,997**	76,487,362
Retained earnings	14	**(4,045,415)**	(4,220,248)
Merger reserve	14	**218**	218
Other reserves	14	**9,750,508**	6,317,213
Total equity		**142,765,308**	78,584,545

The notes on pages 25 to 45 form part of these financial statements. These financial statements were approved by the Board of Directors and authorised for issue on 22 March 2012 and were signed on its behalf by:

Xcite Energy Limited
For the year ended 31 December 2011

Richard Smith
Chief Executive Officer

Rupert Cole
Chief Financial Officer

Consolidated Statement of Cash Flows (in Pounds Sterling)

	Year ended 31 December 2011	Year ended 31 December 2010
	£	£
Net cash flow from operating activities		
Profit/(loss) for the period before tax	**129,563**	(2,446,998)
Adjustment for interest income	**(101,557)**	(135,148)
Adjustment for share-based payments	**410,777**	1,462,223
Adjustment for depreciation	**41,020**	19,330
Movement in working capital		
- Trade and other receivables	**1,174,704**	(1,537,666)
- Trade and other payables	**(14,210,954)**	23,500,461
Net cash flow from operations	**(12,556,447)**	20,862,202
Cash flow from investing activities		
Additions to exploration and evaluation assets	**(21,926,904)**	(39,360,864)
Purchase of property, plant and equipment	**(197,340)**	(36,780)
Interest income	**101,557**	135,148
Net cash flow from investing activities	**(22,022,687)**	(39,262,496)
Cash flow from financing activities		
Net proceeds from issue of new shares	**62,750,094**	52,616,374
Cash flow from financing activities	**62,750,094**	52,616,374
Net increase in cash and cash equivalents	**28,170,959**	34,216,080
Cash and cash equivalents at the beginning of the year	**35,952,447**	1,736,367
Cash and cash equivalents at the end of the year	**64,123,406**	35,952,447
Cash and cash equivalents comprise:		
Short term deposits	**47,119,005**	22,393,499
Cash available on demand	**17,004,401**	13,558,948

The notes on pages 25 to 45 form part of these financial statements.

Notes to the Consolidated Financial Statements

1 Accounting Policies

Basis of preparation

The principal accounting policies adopted in the preparation of the consolidated financial statements are set out below.

The consolidated financial statements 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 consolidated financial statements have also been prepared in accordance with IFRSs adopted by The European Union and they comply, therefore, with Article 4 of the EU International Accounting Standards ("IAS") Regulation.

The consolidated financial statements have been prepared on a going concern basis, taking into account the 2012 Outlook in the Management Discussion and Analysis on page 15 of these financial statements.

Basis of consolidation

The Company was incorporated with the sole purpose of acquiring its controlling interest in its directly held, wholly owned, subsidiary Xcite Energy Resources Limited ("XER"). XER was acquired on 26 June 2007 through a transaction under common control, as defined in IFRS 3 *Business Combinations*. As a result of the transaction, the equity shareholders of Xcite Energy Limited ("XEL" or the "Company") and XER became the equity shareholders of the combined entities. The Directors note that transactions under common control and those that involve a new shell company (XEL) with no business of its own acquiring a controlling interest in an existing entity (XER), are outside the scope of IFRS 3 and that there is no guidance elsewhere in IFRS covering such transactions.

IFRS contains specific guidance to be followed where a transaction falls outside the scope of IFRS. This guidance is included at paragraphs 10 to 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* This requires, *inter alia*, that where IFRS does not include guidance for a particular issue, the Directors may also consider the most recent pronouncements of other standard setting bodies that use a similar conceptual framework to develop accounting standards. In this regard it is noted that the UK Accounting Standards Board ("ASB") has issued an accounting standard covering acquisitions and mergers ("FRS 6"). FRS 6 allows for merger accounting to be applied where two or more companies are combined to form one group on terms such that the equity shareholders in each company become the equity shareholders in the combined entity.

Having considered the requirements of IAS 8, and the guidance included within FRS 6, it is considered appropriate to apply an accounting treatment similar to "merger accounting" as described by FRS 6 when dealing with the transaction in which the Company acquired its controlling interest in XER (together the "Group") in order to provide a true and fair view. The effect of the above is:

- New shares issued by XEL as consideration for the merger are recorded at their nominal amount in books of XEL;
- The net assets of XER and XEL are combined using existing book values;

- No amount is recognised as consideration for goodwill or negative goodwill; and
- The consolidated profit and loss includes profits of each company for the entire period, regardless of the date of the merger, and the comparative amounts in the consolidated accounts are restated to the aggregate of the amounts recorded by the two companies.

Revenue

Revenue arises from the sale of oil produced and reflects the actual sales value, net of value-added-tax ("VAT") and overriding royalties. Revenues are recognised when the risks and rewards of ownership together with effective control are transferred to the customer and the amount of revenue and associated costs incurred in respect of the relevant transaction can be reliably measured. Revenue is not recognised unless it is probable that the economic benefits associated with the sales transaction will flow to the Group.

Finance income

Finance income is recognised on an accruals basis and is disclosed separately on the face of the Income Statement.

Foreign currency

The functional currency of the Group is pounds sterling. Transactions entered into by the Group in a currency other than the functional currency are recorded at the rates ruling when the transactions occur. Foreign currency monetary assets and liabilities are translated at the rates ruling at the Balance Sheet date. Exchange differences arising on the retranslation of unsettled monetary assets and liabilities are recognised immediately in the Income Statement.

Financial assets

The Group's financial assets are classified as loans and receivables and comprise the following:

Other receivables – these are measured on initial recognition at fair value and are subsequently measured at amortised cost. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset value is impaired.

Cash and cash equivalents – comprise cash on hand and cash on deposit accessible without penalty and are subject to an insignificant risk of changes in value.

Financial liabilities

The Group's financial liabilities comprise trade and other payables and are recognised on initial recognition at fair value and are subsequently measured at amortised cost.

Current taxation

The total tax expense represents the sum of current and deferred tax. Current tax is based on the taxable result for the period. The taxable result may differ from the net result as reported in the Income Statement as it may exclude certain items of income or expense that are taxable or deductible in other periods and it further excludes items that are never taxable or deductible.

The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the Balance Sheet date.

Deferred taxation

Deferred tax assets and liabilities are recognised where the carrying amount of an asset or liability in the Balance Sheet differs to its tax base.

Recognition of deferred tax assets is restricted to those instances where it is probable that taxable profit will be available against which the difference can be utilised. The amount of the asset or liability is determined using tax rates that have been enacted or substantively enacted by the Balance Sheet date and are expected to apply when the deferred tax liabilities/assets are settled/recovered. Deferred tax assets and liabilities are offset when the Company has a legally enforceable right to offset current tax assets and liabilities and the deferred tax assets and liabilities relate to taxes levied by the same tax authority on either:

- The same taxable group company; or
- Different group entities which intend either to settle current tax assets and liabilities on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax assets or liabilities are expected to be settled or recovered.

Share-based payments

The Company has a Stock Option Plan as described in Note 13. The share-based payment expense arising under this Stock Option Plan is recorded in the Income Statement, or as a direct reduction in share capital where the charge relates to the issue of such share capital, or as an increase in exploration and evaluation assets ("E&E" assets) where the charge relates to employees or contractors employed wholly for the benefit of such E&E assets for all options granted in the period, with a corresponding increase recorded in other reserves. The share-based expense is calculated on the estimated fair values at the time of the grant and the expense is recognised over the vesting period of the options. Upon the exercise of the stock options, consideration paid is recorded as an increase in share capital and amounts previously recorded in other reserves are transferred to retained earnings. In the event that vested options expire unexercised, previously recognised share-based payment expense associated with such stock options is not reversed.

The Black-Scholes model is used to fair value share options and warrants granted, unless the underlying market value of the goods or services for which the share options, rights or warrants are being granted can be reliably determined, in which case market value is considered to be equal to fair value.

Where equity instruments are granted to persons other than employees, the Income Statement, Exploration & Evaluation Assets or Share Capital account is charged with the fair value of the goods and services received as appropriate.

Critical accounting estimates and judgements

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 Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual outcome. 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 Company 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 Group has valued the fair value of the outstanding share options and warrants over the Company's shares using the Black-Scholes valuation methodology. The Group uses judgement to derive such valuation model assumptions that are mainly based on market conditions existing at the Balance Sheet date.

(c) Impairment of Exploration and Evaluation ("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.

Intangible fixed assets – Exploration and Evaluation Assets

Capitalisation

Certain costs (other than payments to acquire the legal right to explore) incurred prior to acquiring the rights to explore are charged directly to the Income Statement. All costs incurred after the rights to explore an area have been obtained, such as geological and geophysical costs and other direct costs of exploration (drilling, trenching, sampling and technical feasibility and commercial viability activities) and appraisal, which includes certain payroll costs and associated employee share-based payment charges, are accumulated and capitalised as E&E assets.

E&E costs are not amortised prior to the conclusion of appraisal activities. At completion of appraisal activities if technical feasibility is demonstrated and commercial reserves are discovered, then, following development sanction, the carrying value of the relevant E&E asset will be reclassified as a development and production asset, but only after the carrying value of the relevant E&E asset has been assessed for impairment, and where appropriate, its carrying value adjusted. If after completion of appraisal in an area it is not possible to determine technical feasibility and commercial viability, or if the legal right to explore expires or if the Company decides not to continue exploration and evaluation, the carrying value of the E&E asset is written off to the Income Statement in the period the relevant events occur.

Impairment

If and when facts and circumstances indicate that the carrying value of an E&E asset may exceed its recoverable amount an impairment review is performed. This is carried out by identifying groups of assets, within the E&E asset, which together form the Cash Generating Unit ("CGU") and comparing the carrying value of the CGU with its recoverable amount. Any shortfall in carrying value, the impairment loss, is written off directly to the Income Statement. The recoverable amount of the CGU is determined as the higher of its fair value less costs to sell and its value in use.

Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. All repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation on assets is calculated using the straight-line method to allocate their cost over their estimated useful life, as follows:

- Furniture, fittings and computing equipment 3-5 years

New accounting standards adopted during the year

The following new standards and amendments to standards are mandatory for the first time for the financial year beginning 1 January 2011:

- Revised IAS 24 'Related Party Disclosures';
- Amendments to IFRIC 14 IAS 19 'Limit on a defined benefit asset, minimum funding requirements and their interaction'; and
- Improvements to IFRSs (2010).

Whilst mandatory for accounting periods beginning on or after 1 January 2011, the Group previously chose to early adopt Revised IAS 24 and Amendments to IFRIC 14 IAS 19 during the financial year ending 31 December 2010.

The adoption of these standards, interpretations and amendments did not affect the Group's results of operations or financial position.

The Group has chosen to early adopt the following amendment during the financial year. However, it is not considered relevant for the Group and has therefore had no impact in these financial statements:

- Amendments to IFRS 7 'Disclosures – Transfers of financial assets'.

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 IASB and the IFRIC, have yet to be endorsed by the European Union and/or are effective for future periods and thus have not been adopted in these consolidated financial statements. None are expected to have a material effect on the reported results or financial position of the Group.

- IFRS 9 'Financial instruments';
- IFRS 10 'Consolidated Financial Statements';
- IFRS 11 'Joint Arrangements';
- IFRS 12 'Disclosure of Interests in Other Entities';
- IFRS 13 'Fair Value Measurement';
- IAS 19 'Employee Benefits';

- IAS 27 ‘Separate Financial Statements’;
- IAS 28 ‘Investments in Associates and Joint Ventures’;
- IFRIC 20 ‘Stripping costs in the production phase of a surface mine’;
- Amendments to IAS 1 ‘Presentation of Items of Other Comprehensive Income’;
- Amendments to IAS 12 ‘Deferred tax: recovery of underlying assets’;
- Amendments to IAS 19 ‘Employee Benefits’;
- Amendments to IAS 32 ‘Offsetting financial assets and financial liabilities’; and
- Amendments to IFRS 1 ‘Severe hyperinflation and removal of fixed dates for first-time adopters’.

Status of EU endorsement

Entities in EU Member States which report in accordance with EU-endorsed IFRS can only apply IFRSs and IFRICs 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 European Union at the date these consolidated financial statements were authorised for issue:

- IFRS 9 ‘Financial Instruments’;
- IFRS 10 ‘Consolidated Financial Statements’;
- IFRS 11 ‘Joint Arrangements’;
- IFRS 12 ‘Disclosures of Interests in Other Entities’;
- IFRS 13 ‘Fair Value Measurement’;
- IAS 27 ‘Separate Financial Statements’;
- IAS 28 ‘Investments in Associates and Joint Ventures’;
- Amendments to IAS 1 ‘Presentation of Items of Other Comprehensive Income’;
- Amendments to IAS 12 ‘Deferred tax: Recovery of underlying assets’;
- Amendments to IAS 19 ‘Employee Benefits’;
- Amendments to IAS 32 ‘Offsetting Financial Assets and Financial Liabilities’; and
- Amendments to IFRS 1 ‘Severe hyperinflation and removal of fixed dates for first-time adopters’.

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 development of oil and gas reserves and the geographical segment in which it currently operates is the North Sea.

Financial information is presented to management in accordance with the measurement principles of IFRS. There are no adjustments or eliminations made in preparing the Group's financial statements from the reportable segment revenues, profit or loss, asset and liabilities.

3 Operating Profit/(Loss)

The operating profit/(loss) is stated after crediting/(charging) the following:

	Year ended 31 December 2011	Year ended 31 December 2010
	£	£
Foreign exchange gains	**1,619,756**	567
Auditors' remuneration:		
- Group audit fee	**(25,000)**	(20,000)
- Audit of subsidiary pursuant to legislation	**(15,000)**	(20,000)
- Tax advisory fees	**(13,638)**	(17,250)

The Group incurred total charges in respect of equity-settled share-based payments in the current year of £3,478,565 (2010: £4,671,184). Of this, £897,803 (2010: £3,488,246) was in respect of employees (see Note 4). In accordance with the Group's accounting policy, £890,329 (2010: £2,879,678) has been capitalised within E&E assets and £410,777 (2010: £1,462,223) has been expensed within operating loss. The balance of £2,177,459 (2010: £329,283) has been charged to the share capital account in accordance with the Group's accounting policy.

The Group incurred total charges in respect of property leases in the current year of £133,879 (year to 31 December 2010: £44,100). These have all been capitalized to E&E assets in accordance with the Group's accounting policy.

The Group incurred total charges in respect of drilling rig leases in the current year of £4,173,947 (year to 31 December 2010: £13,560,226). These have all been capitalized to E&E assets in accordance with the Group's accounting policy.

4 Staff Costs and Directors' Emoluments

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

	Year ended 31 December 2011	Year ended 31 December 2010
Technical and administration	**12**	8

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

	Year ended 31 December 2011	Year ended 31 December 2010
	£	£
Wages and salaries	**1,790,551**	1,940,410
Social security costs	**232,725**	243,133
Share-based payments charge	**897,803**	3,488,246
	2,921,079	5,671,789

b) Executive Directors' emoluments

	Year ended 31 December 2011	Year ended 31 December 2010
	£	£
Wages and salaries	**691,200**	1,006,200
Social security costs	**90,862**	126,784
Share-based payments charge	**392,653**	1,122,927
	1,174,715	2,255,911

In addition to the above, during the year the Group paid to Roger Ramshaw, Gregory Moroney, Scott Cochlan and Timothy Jones in their capacity as Non-Executive Directors of the Group fees of £56,000 (2010: £24,750), £26,418 (2010: £13,500), £27,958 (2010: £6,750) and £33,167 (2010: £24,000) respectively. Charges in respect of share-based payments for the Non-Executive Directors in the year to 31 December 2011 were £246,690 (2010: £668,196).

The Executive Directors and Non-Executive Directors comprise the key personnel of the Group. The total compensation for key personnel for the year ended 31 December 2011 was as follows:

	Year ended 31 December 2011	Year ended 31 December 2010
	£	£
Director wages and salaries	**691,200**	1,006,200
Non-Executive Director fees	**143,543**	69,000
Share-based payments	**639,343**	1,791,123
	1,474,086	2,866,323

5 Tax Expense

	Year ended December 31 2011	Year ended December 31 2010
	£	£
Current tax	**-**	-
Deferred tax	**-**	-
Total tax charge	**-**	-

The tax assessed for the year is different to the standard rate of corporation tax in the British Virgin Islands (0%). The differences are explained below.

	Year ended December 31 2011	Year ended December 31 2010
	£	£
Profit/(loss) before tax	**129,563**	(2,446,998)
Profit/(loss) before tax multiplied by the standard rate of corporation tax in the British Virgin Islands of 0% (2010: 0%)	-	-
Tax charge for the year	**-**	-

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.

XER is considered to be a company which profits from oil extraction and oil rights in the UK and the UK Continental Shelf and is, therefore, subject to corporation tax on taxable profits at a rate of 30% or 19% where the profits fall within the limit of the small companies rate.

On 23 March 2011 the UK Government announced changes to the UK Oil and Gas Tax Regime. The most significant change was an increase in the supplementary corporation tax charge for UK North Sea producing oil companies from 20% to 32%, with a mechanism to reduce this increase should oil prices fall below a certain level. This increase became effective 24 March 2011.

On 5 July 2011 the UK Government announced an increase in the Ring Fence Expenditure Supplement from 6% to 10% with effect from 1 January 2012.

6 Earnings Per Share

The basic earnings per share is calculated by dividing the profit/(loss) attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. The calculation of basic earnings per ordinary share for the year to 31 December 2011 is based on a profit of £129,563 (year to 31

December 2010: loss of £2,446,998) and on shares of 174,233,405 (year to 31 December 2010: 126,542,827), being the weighted average number of ordinary shares in issue during the year.

The calculation of diluted earnings per ordinary share is based on a profit of £129,563 (year to 31 December 2010: loss of £2,446,998) and on shares of 191,612,789 (year to 31 December 2010: 138,459,294), being the weighted average number of ordinary shares, warrants and options issued during the year.

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

7 Intangible Assets

	Licence Fees	
	2011	2010
Exploration and Evaluation Assets	**£**	£
Opening cost and carrying value at 1 January	**791,847**	475,047
Additions	**423,540**	316,800
Closing cost and carrying value at 31 December	**1,215,387**	791,847

	Appraisal and Exploration Costs	
	2011	2010
	£	£
Opening cost and carrying value at 1 January	**64,471,530**	22,547,788
Additions	**22,393,693**	41,923,742
Closing cost and carrying value at 31 December	**86,865,223**	64,471,530

	Total	
	2011	2010
	£	£
Opening cost and carrying value at 1 January	**65,263,377**	23,022,835
Additions	**22,817,233**	42,240,542
Closing cost and carrying value at 31 December	**88,080,610**	65,263,377

The costs associated with the continuing appraisal of Block 9/3b have been capitalised in accordance with the Group's accounting policy in Note 1.

Based on the Group's success in drilling the 9/3b-6 and 9/3b-6Z wells at the end of 2010 on Block 9/3b, and in view of the forecast revenue streams and cash flows of this project, the Directors are 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 31 December 2010	
Opening net book amount at 1 January 2010	12,775
Additions	36,780
Depreciation charge	(19,330)
Closing net book amount at 31 December 2010	30,225
At 31 December 2010	
Cost or valuation	65,015
Accumulated depreciation	(34,790)
Net book amount	30,225
Year ended 31 December 2011	
Opening net book amount at 1 January 2011	**30,225**
Additions	**197,340**
Depreciation charge	**(41,020)**
Closing net book amount at 31 December 2011	**186,545**
At 31 December 2011	
Cost or valuation	**262,355**
Accumulated depreciation	**(75,810)**
Net book amount	**186,545**

9 Trade and Other Receivables

	31 December 2011	31 December 2010
	£	£
Indirect taxes receivable	**309,729**	139,485
Other receivables	**71,000**	1,415,948
	380,729	1,555,433

10 Trade and Other Payables

	31 December 2011	31 December 2010
	£	£
Trade payables	**3,962,950**	23,098,455
Social security and other taxes payable	**79,385**	254,773
Accruals and other payables	**5,458,480**	358,542
	9,500,815	23,711,770

11 Deferred Tax

	2011	2010
	£	£
At 1 January	**505,167**	505,167
Profit and loss charge	**-**	-
At 31 December	**505,167**	505,167

There is a deferred tax liability at 31 December 2011 comprising of temporary differences arising from a R&D tax claim in the UK. As at 31 December 2011 the Group no longer has a pre-trading loss, within XER, (31 December 2010; pre-trading losses of £1,009,931) as it is now trading following the decision to proceed with development. There is a trading loss of approximately £59 million at 31 December 2011, but in addition there is a deferred tax liability arising on accelerated capital allowances of £59 million. Accordingly no further deferred tax balance has been recognised.

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 on-going 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 revenue and therefore generally 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 "A" or better are currently 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	
	31 December 2011	31 December 2010
	£	£
Financial assets – loans and receivables measured at amortised cost		
- Cash	**64,123,406**	35,952,447
- Receivables (current)	**71,000**	1,415,948
	64,194,406	37,368,395
Financial liabilities – measured at amortised cost		
- Payables (current)	**9,421,431**	23,456,997

Included in cash balances are amounts held in escrow of £47,119,005 (2010: £19,846,410). The balances held in escrow are not currently available for use by the Group but only available for the purposes of meeting the rig hire and drilling and well management commitments under Phase 1A of the FPD of the Bentley field.

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.

c) Capital disclosures

The Company considers its capital to comprise its ordinary share capital and accumulated retained earnings.

In managing its capital, the Company's primary objective is to ensure preservation of capital and ultimately capital growth for its equity shareholders. In order to achieve this objective, the Company seeks to balance risks and returns at an acceptable level and also to maintain a sufficient funding base to enable the Company to meet its working capital and strategic investment needs. In making decisions to adjust its capital structure to achieve these aims, the Company considers not only its short-term position but also its long-term operational and strategic objectives.

There have been no other significant changes to the Company's capital management objectives, policies and processes in the year nor has there been any change in what the Company considers to be its capital.

Market risk

d) 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	
	31 December 2011	31 December 2010
	£	£
Sterling	**3,941,333**	13,549,166
USD$	**5,474,040**	9,767,007
Norwegian Kroner	**-**	132,211
CAD$	**6,058**	8,613
	9,421,431	23,456,997

	Floating rate assets	**Interest free assets**	**Total**
	31 December 2011	**31 December 2011**	**31 December 2011**
	£	**£**	**£**
Sterling	**23,498,964**	**71,298**	**23,570,262**
Euro	**4,740**	**191**	**4,931**
Norwegian Kroner	**-**	**38**	**38**
CAD$	**74,343**	**151**	**74,494**
USD$	**40,544,645**	**36**	**40,544,681**
	64,122,692	**71,714**	**64,194,406**

	Floating rate assets	Interest free assets	Total
	31 December 2010	31 December 2010	31 December 2010
	£	£	£
Sterling	25,255,783	557,142	25,812,925
CAD$	256,592	-	256,592
USD$	10,440,072	858,806	11,298,878
	35,952,447	1,415,948	37,368,395

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% to 0.65%. At 31 December 2011 the weighted average rate of interest being earned on Sterling deposits was approximately 0.63% (31 December 2010: 0.8%).

US Dollar floating rate assets earn interest within the range of rates of 0.0% to 0.18%, depending upon the liquidity of the deposit placed. At 31 December 2011 the weighted average rate of interest being earned on US deposits was 0.06% (31 December 2010: 0.11%).

The Company also maintains working capital balances of Euros and Canadian Dollars. These all earn nominal rates of interest. Cash deposits are kept with banks with "A" 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, the Euro and the Norwegian Kroner. During well drilling programmes the Group aligns its expected future foreign expenditure with the necessary foreign currency cash balances, in effect creating a natural hedge. 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.

(e) Foreign exchange rate sensitivity analysis

Foreign exchange rate sensitivity analysis has been determined based on the exposure to financial instruments denominated in currencies ("transactional currencies") other than the reporting currency of Pounds Sterling (the "base currency") as at the Balance Sheet date.

Based on the Group's financial instruments at the Balance Sheet date, had the base currency been stronger than the transactional currencies by 2% then the Group would have reported an additional unrealised exchange loss in the Income Statement of £702,069 (year to 31 December 2010; the Group would have reported an additional unrealised exchange loss of £19,650). Had the base currency been weaker than the transactional currencies by 2% then the Group would have reported an additional unrealised exchange gain in the Income Statement of £704,006 (year to 31 December 2010; the Group would have reported an additional unrealised exchange gain of £46,836).

(f) 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 gain for the year to 31 December 2011 would increase by £279,057 (year to 31 December 2010; the Group's loss would decrease by £98,868). If interest rates had been 50 basis points lower and all other variables were held constant, the Group's gain for the year to 31 December 2011 would decrease by £77,127 (year to 31 December 2010; the Group's loss would increase by £72,655).

13 Share Capital

	Number of shares 31 December 2011	Number of shares 31 December 2010
Authorised		
- Ordinary shares of no par value each	**Unlimited**	Unlimited
Issued and fully paid up		
- Ordinary shares of no par value each	**206,005,364**	158,703,998

	£ Value of shares 31 December 2011	£ Value of shares 31 December 2010
Authorised		
- Ordinary shares of no par value each	**Unlimited**	Unlimited
Issued and fully paid up		
- Ordinary shares of no par value each	**137,059,997**	76,487,362

Xcite Energy Limited is registered in the British Virgin Islands under the BVI Business Companies Act 2004. Under BVI laws and regulations there is no concept of "share premium", and all proceeds from the sale of no par value equity shares is deemed to be share capital of the Company.

Shares issued

During the year the Company has issued a total of 47,301,366 new ordinary shares, all of which rank pari pasu with the existing ordinary shares.

31,623,889 of these new ordinary shares were issued through use of the SEDA facility, which raised additional funding of £50.7 million after associated costs.

An additional 15,195,294 new ordinary shares were issued as part of a Private Placement in December 2011, which raised £12.2 million after associated costs.

A total of 482,183 new ordinary shares were issued following the exercise of broker warrants, providing additional funds of £0.2 million. Further details of these are provided in the sections below.

Stock Option Plan

An element of the Group's remuneration and reward strategy is through the implementation and use 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 of 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 an equity-settled plan with a current maximum five year vesting period for options granted.

The Stock Option Plan is administered by the Remuneration and Nominating Committee. At 31 December 2011 there were 17,223,000 options outstanding with a weighted average exercise price of CAD$2.02, exercise prices ranging from CAD$0.10 to CAD$5.95 and with a weighted average remaining life of 1,073 days. At 31 December 2010 there were 15,473,000 options outstanding, with the weighted average exercise price per option being CAD$1.99, exercise prices ranging from CAD$0.10 to CAD$5.95 and a weighted average remaining life of 1,370 days. At 1 January 2010 there were 6,530,000 options outstanding, with the weighted average exercise price per option being CAD$1.21, with exercise prices ranging from CAD$0.10 to CAD$2.09 and a weighted average remaining life of 911 days.

During the year to 31 December 2011 a total of 1,850,000 share options were issued under the Stock Option Plan at a weighted average exercise price of CAD$2.30 and a life of five years. During the year ended 31 December 2010 a total of 9,323,000 share options were issued under the Stock Option Plan at a weighted average exercise price of CAD$2.47.

No share options were exercised during the year to 31 December 2011. In the year to 31 December 2010 350,000 options were exercised at a weighted average exercise price of CAD$0.32 and at a weighted average prevailing share price of CAD$2.32. Total proceeds from exercise during 2010 were £0.1 million in consideration for a total of 350,000 new ordinary shares in the Company.

In accordance with the Stock Option Plan rules a total of 100,000 share options expired during the year to 31 December 2011, with a weighted average exercise price of CAD$2.30.

At the date of these financial statements there were 17,223,000 exercisable options outstanding, with exercise prices ranging from CAD$0.10 to CAD$5.95.

Details of the Directors' interests in ordinary shares held under the Stock Option Plan are given in the Report of the Remuneration and Nominating Committee.

The following assumptions were used in the share option pricing model for the grant of options and warrants during the year:

Instrument	Option	Option	Warrant
Grant Date	26 March 2010	4 August 2011	16 December 2011
Vesting Date	26 March 2011	4 August 2011	16 December 2011
Share bid price	C$0.68	£1.46	£1.06
Exercise price	C$0.68	£1.46	£1.02
Expected volatility	58%	63%	64%
Expected life	2 years	2 years	1 year
Expected dividends	0%	0%	0%
Risk-free interest rate	2.98%	1.88%	1.25%

The expected share price volatility was determined by a review of the share trading performance of comparable oil and gas companies in the same industry sector.

The Group incurred total charges in respect of equity-settled share-based payments in the current year of £3,478,565 (2010: £4,671,184), further details of which are provided in Note 3.

Share warrants

As a result of a private placement in December 2011, a total of 7,597,647 new broker warrants were issued by the Company with an exercise price of £1.02 (CAD$1.63).

The total expense to the Group in respect of share-based payment transactions in respect of warrants issued was £2.18 million (2010: £0.46 million). Of this total, £nil million has been charged to the Income Statement and £2.18 million has been charged to the share capital account in accordance with the Company's accounting policy. The total Group expense has been measured at fair value of the warrants granted due to the lack of open market value data to attribute to the underlying services provided by the warrant holders. This treatment is consistent with prior years.

The Group had 7,977,972 outstanding warrants over the ordinary share capital of the Company at 31 December 2011 with a weighted average exercise price of CAD$1.74 (as at 31 December 2010: 862,508 warrants with a weighted average exercise price of CAD$2.06), with exercise prices ranging from CAD$1.63 to CAD$5.83.

Since the year end, the exercise of 30,325 warrants in February 2012 and the issue of 6,676,519 new share warrants to Socius in February 2012 in respect of tranche two on the fundraising announced 12 December 2011 means that at the date of these financial statements there are now a total of 14,624,166 exercisable share warrants outstanding, with exercise prices ranging from CAD$1.63 to CAD$5.83.

14 Owners' Equity

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

- Retained Earnings: Cumulative gains recognised in the Group Consolidated Statement of Comprehensive Income 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 unexercised share-based payments and warrants granted over ordinary shares in the Company at the date of grant.

15 Commitments and Contingencies

At 31 December 2011 the Company had minimum lease commitments under non-cancellable operating property leases as follows:

	2011	2010
	£	£
Amounts payable on leases which expire:		
Within one year	**7,800**	88,331
In two to five years	**415,950**	-

In addition to property lease commitments above, at the Balance Sheet date the Company had commitments under contract of £4.7 million for topside and power generation equipment (2010: £nil).

With reference to the Group's obligations under the British American Offshore Limited rig contract, the Group had as at 31 December 2011 rig lease commitments of US$60 million (£38.8 million) in respect of an initial minimum term of 240 days starting from rig arrival on first drilling location, the full financial provision for which had been made into an escrow account during 2011, further details of which are given in note 12. There was no such equivalent rig lease commitment as at 31 December 2010.

16 Subsequent Events

On 3 February 2012 the Company announced that it had negotiated amendments to the Rowan Norway rig contract with British American Offshore Limited, providing XER with the ability to shorten its rig commitment should the current Phase 1A work programme finish ahead of schedule, whilst retaining optionality over the procurement of an appropriate rig from the Rowan rig fleet for Phase 1B of the Bentley field development.

On 10 February 2012 the Company announced the closing of the second tranche of new private placement equity funding from Socius. For gross proceeds of £12.6 million the Company issued 13,353,038 new ordinary shares.

On 20 February 2012 the Company announced the results of an independent reserves audit conducted by TRACS International Consultancy Limited. Oil reserves of the type 1P, 2P and 3P of 96 million stock tank barrels ("MMstb"), 116 MMstb and 140 MMstb respectively were assigned to the core area of the Bentley field, the core area being defined as the production to be covered by the First and Second Phase Developments planned for the Bentley field.

NPV(10) after tax values for the core area of US$1.076 billion, $1.464 billion and $1.921 billion were assigned on a 1P, 2P and 3P basis respectively.

Since the year end, the Group has drawn down a total of £24.7 million under the Equity Line Facility for the issue of a total of 19,988,491 new ordinary shares, of which 8,310,540 new ordinary shares will be admitted for trading on AIM and TSX-V in due course.

17 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.

XEL has continued to provide a loan facility to its wholly owned subsidiary, XER, to finance XER's operational requirements, with net cash funding of £39.0 million during the year to 31 December 2011 (year to 31 December 2010: £3.2 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 under this facility at 31 December 2011 was £64.8 million (as at 31 December 2010: £25.8 million).

The Executive Directors have received 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 year, details of which are given in these financial statements.

In the normal course of business XER incurred charges totalling £4,605 during the year to 31 December 2011 (year to 31 December 2010: £4,769) for consultancy services from Esher Management Services Limited, a company for which Timothy Jones is a Director. There was a balance payable by XER at the year end of £5,526 (as at 31 December 2010: £nil).

In the normal course of business XER incurred charges totalling £16,097 during the year to 31 December 2011 (year to 31 December 2010: £nil) for property rentals from Seaburome Limited, a company for which Rupert E. Cole is a Director. There was no outstanding balance payable by XER at the year end.

Officers and Principal Advisers

Directors
Richard E. Smith
Rupert E. Cole (Company Secretary)
Stephen A. Kew

Non-Executive Directors
Roger S. Ramshaw
Gregory J. Moroney
Scott R. Cochlan
Timothy S. Jones

Registered office
Geneva Place
Waterfront Drive
PO Box 3469 Road Town
Tortola, VG1110
British Virgin Islands

XER operations office
2 Queen's Gardens
Aberdeen
AB15 4YD

XER corporate office
1 Farnham Road
Guildford
Surrey GU2 4RG

Auditors
BDO LLP
Emerald House
East Street
Epsom
Surrey KT17 1HS

Principal bankers
Royal Bank of Scotland plc
40 Albyn Place
Aberdeen
AB10 1YL

Solicitors
United Kingdom
Stikeman Elliott
Dauntsey House
4B Fredericks Place
London EC2R 8AB

Marriott Harrison
Staple Court
11 Staple Inn Buildings
London WC1V 7QH

Canada
Stikeman Elliott S.E.N.C.R.L., s.r.l. / LLP
1155, boul. René-Lévesque Ouest
40e étage
Montréal, Quebec H3B 3V2

British Virgin Islands
Conyers Dill & Pearman Limited
Commerce House
Wickhams Cay 1
PO Box 3140 Road Town
Tortola, VG1110

Joint broker and nominated adviser
Oriel Securities Limited
150 Cheapside
London
EC2V 6ET

Joint broker
Morgan Stanley Limited
20 Bank Street
Canary Wharf
London
E14 4AD

Registrars
Computershare Investor Services Inc.
100 University Avenue
9th Floor, North Tower
Toronto, Ontario M5J 2Y1
Canada

Stock exchanges
AIM, London Stock Exchange
Code: XEL.L

Xcite Energy Limited
For the year ended 31 December 2011

TSX, TSX-Venture Exchange
Code: XEL.