Island Oil & Gas Plc
Annual report 2008

Creating international opportunities

Founded in 2003, Island Oil & Gas Plc is an independent exploration and production company with interests in nine Irish offshore licences, including a producing gas field. Island has also secured projects offshore The Netherlands and onshore Morocco and continues to investigate selected opportunities internationally where it can build value through the application of its technical expertise.

01 Financial highlights
02 At a glance
04 Chairman's statement
10 Operational review
34 Board of Directors
36 Corporate governance report
38 Directors' report
42 Statement of Directors' responsibilities
43 Independent auditor's report
44 Statement of accounting policies
49 Consolidated income statement
50 Consolidated statement of total recognised income and expense
50 Company statement of total recognised income and expense
51 Consolidated balance sheet
52 Consolidated cash flow statement
53 Company balance sheet
54 Company cash flow statement
55 Notes forming part of the financial statements
Ibc Corporate information

Financial highlights

"This has been a transformational year, driven by the significant profit generated by the disposal of the Company's Dutch assets and the resultant positive rebalancing of our financial position."

"We see this as a validation of the Island business model: low cost entry; adding value through technical expertise and operating capability; and bringing forward the value of our projects whether that is by production, or through a value enhancing transaction.

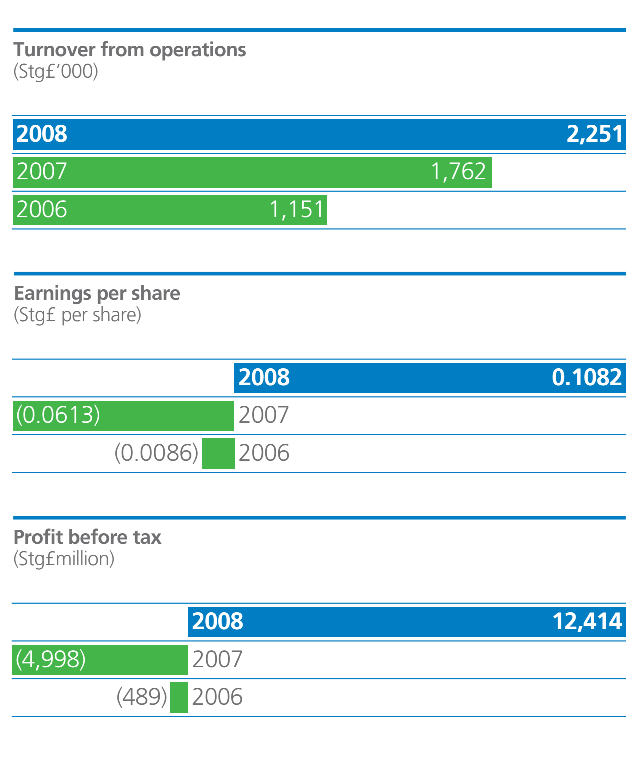
The announcement by Marathon during 2008 to initiate a process to dispose of its assets offshore Ireland creates an opportunity for Island to monetise its discovered, but as yet undeveloped, Celtic Sea gas fields, and Atlantic Margin gas prospects adjacent to the Kinsale and Corrib infrastructure. We see these as vital assets in the regional play, both for extending production like in the Celtic Sea, but also as a potential basis for an independent Irish gas storage facility.

Island has a successful development model which it has profitably applied across its portfolio, delivering considerable results. With this model and the team we have in place, the Board can look to the future with confidence as it continues to successfully develop a global portfolio."

Paul Griffiths, Chief Executive Officer

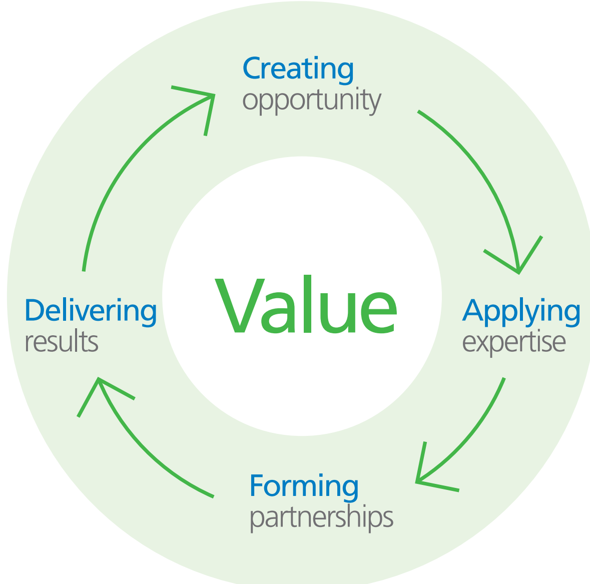
A year of strong development

- Profit before tax of Stg£12.414 million (year ended 31 July 2007: loss before tax Stg£4.998 million).
- Increase in turnover from operations of 28% to Stg£2.25 million (2007: Stg£1.76 million).
- Basic earnings per share Stg£0.1082 (2007: loss per share Stg£0.0613).
- Financial year end cash balance of Stg£3.407 million.
- RMB bank debt fully discharged.



At a glance

Our business model



Creating opportunity

- Ability to operate upstream projects with a focused technical, operations, commercial and legal team with experience in many different countries with proven hydrocarbon resources.
- Our experienced management team seeks to identify opportunities with potential for value enhancement before our industry competitors.

Applying expertise

- Integrated multi-disciplinary approach using our in-house geologists, geophysicists, reservoir engineers and drilling operations team with experience in Europe, Africa, Asia, South America and the United States.
- Organically grown track record as a 'hands on' operator.
- Country managers with unique knowledge and insight into the hydrocarbon potential of their country based on their previous and present relationships with State agencies.
- Selective, cost-effective use of new technology but primarily reliant on traditional oil-finding skills based on a wealth of international experience in many different hydrocarbon provinces.

Forming partnerships

- Substantial and credible partners and major industry players are attracted to make inward investment in Island by:
  - Our operating credentials.
  - Our business model and business ethics which facilitates a flow of opportunities sourced and screened by our experienced technical and management team.
  - Our streamlined deal-making capabilities and track record to execute and deliver complex, yet innovative and creative business deals.

Delivering results

- Short term cash flow from production and asset sale to sustain business growth.
- Medium term near development potential to create future cash flow.
- Long term exploration, appraisal and development potential by diversifying the portfolio and our risk profile with large acreage positions in strategically important geographic regions in energy deficient countries with potential for new gas infrastructure links to Europe.

A proven business model...

Island is an approved operator in Ireland, The Netherlands, Morocco and Albania – this gives us an access route into new projects denied to many of our peers.

We are the only Company in the last decade to have announced three successfully tested gas exploration and appraisal wells in offshore Ireland.

Our proven capability as a successful and profitable asset trader is demonstrated throughout this report.

Acreage under licence – Ireland

4,502.72km²

(2312.57km² pro-rata to Island). Representing 23.15% of total equivalent acreage offshore Ireland.

Acreage under licence – The Netherlands
Q/13b Royalty Area:

369km²

Acreage under licence – Albania
Durresi Block:

4,208km²

Acreage under licence – Morocco
Morocco Total:

35,241km²

Zag Reconnaissance:	21,807 km²
Tarfaya Exploration:	13,434 km²

...creating opportunities

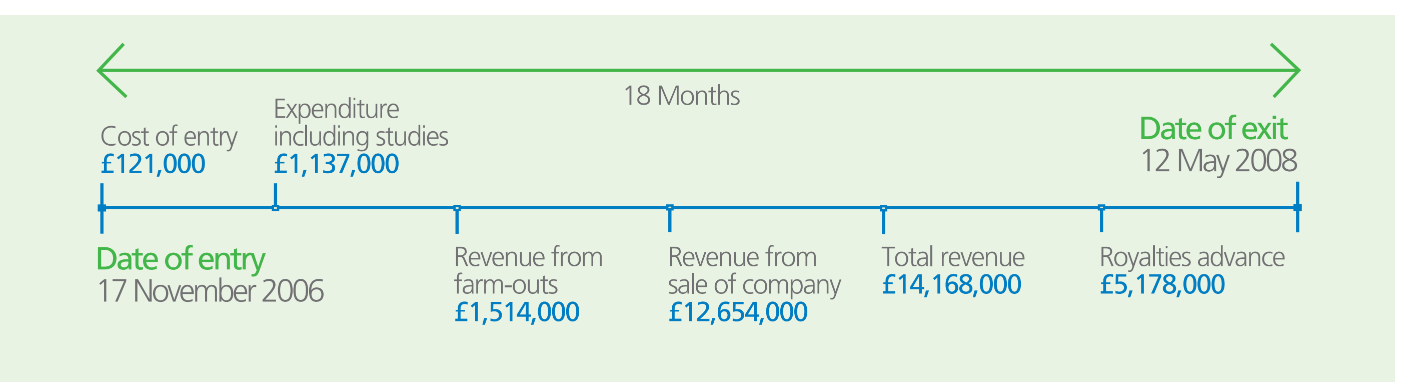
Amstel

The approved operator status was required to expedite a licence award. We applied technical expertise to improve the understanding of the reservoir architecture and likely recoverable oil. We acquired the interest before a significant rise in oil prices.

Through our top quality technical, operational and corporate expertise, Island was able to enter, add value to the project and exit at a considerable profit in a classic example of a strategy that the Board hopes to be able to repeat.

This transaction delivered Island's stated business model. We acquired the asset for minimal cost, enhanced the asset by applying our specific technical expertise and our ability to operate. We realised the value of the asset within 18 months of acquisition, through an early sale at a time of favourable market conditions.

Amstel timeline
(Stg£)



Chairman's statement

Profit before tax
(Stg£million)

£12.414m

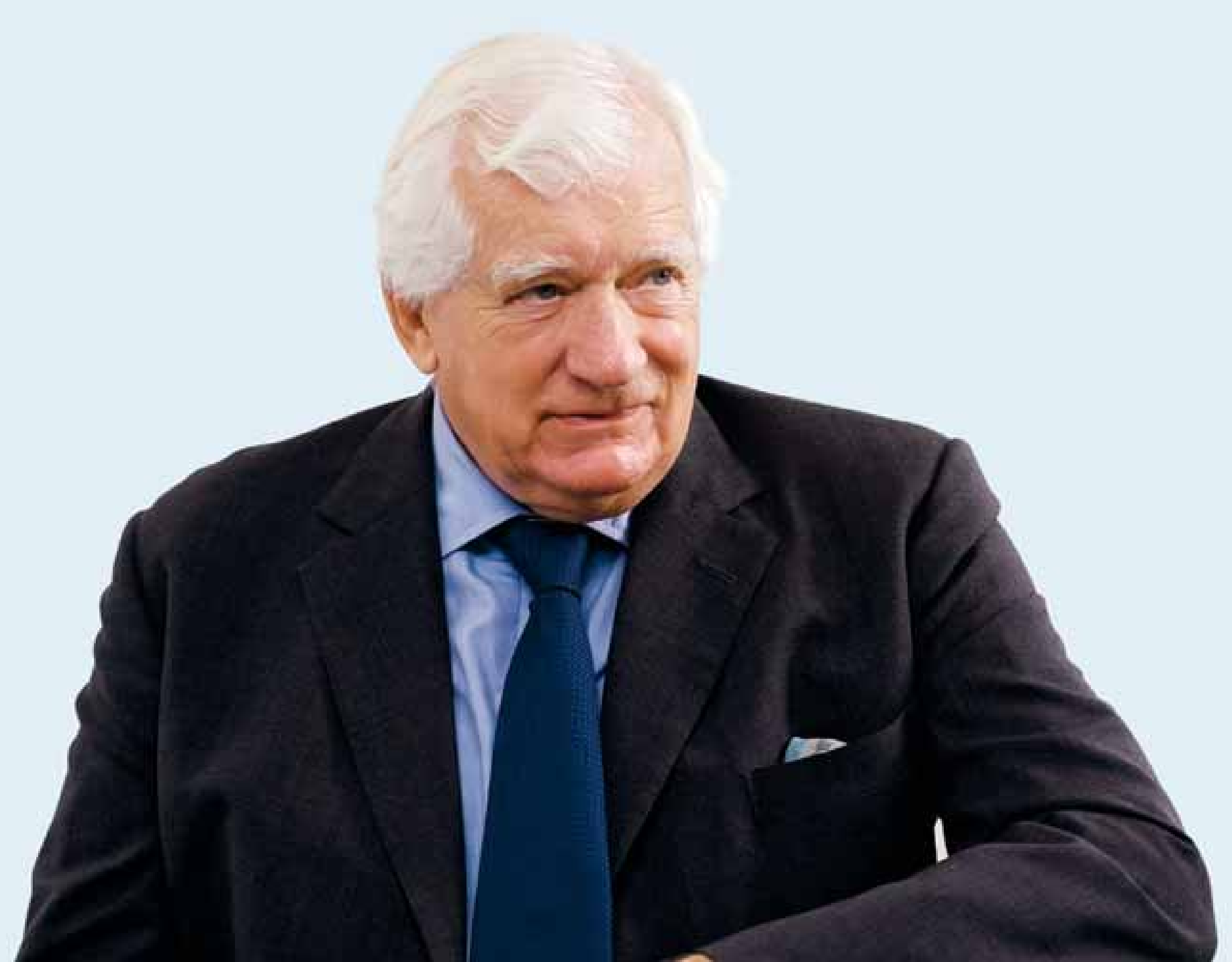
I am pleased to report the year under review has seen Island Oil & Gas Plc ('Island' or 'the Company') transformed through the creation of a profit before tax of Stg£12.414 million. This largely results from the sale in May 2008 of one of our Dutch subsidiary companies, Island Netherlands BV, which owned the Q13a Production Lease, containing the undeveloped Amstel oil field, and the Q13b Exploration Licence which was awarded to Island in April 2008 and contains the Zaan oil discovery. Through this transaction Island has established a track record for delivering its stated business model: low cost entry; value enhancement through the application of our technical expertise and operating capability; and bringing forward the realisation of potential asset values through sale or farm-out when prudent to do so.

The Board considered carefully the offer from Delta Hydrocarbons of a US$35 million cash payment together with royalty payments from future Amstel production, augmented by several satellite tie-backs to the Amstel facilities, should these come on stream. The Board acted in a decisive manner taking into consideration the deteriorating financial markets and the confidence senior management had in the ability of Delta Hydrocarbons to finance and deliver its development strategy for the Amstel oil field.

As a result of this transaction, Island was able to completely discharge the outstanding RMB corporate debt facility and to create the potential for future royalty revenues from production without the need for further expensive capital investment. This was a considerable achievement for the Island executive management team and I congratulate them on delivering this important transaction for the Company and its shareholders at a time of volatile activity in the financial markets.

Island continues to seek new ground floor opportunities offshore The Netherlands where it can add value to any new licences using the tried and tested Island business model.

Transformation through profit



Island awarded the Barryroe Licensing Option
(30% stake in the undeveloped Seven Heads oil accumulations)

30%

Celtic Sea forward strategy

At the beginning of the period, Island tested 21 million standard cubic feet per day ('mm scfpd') of dry gas in the 57/2-3 gas appraisal well at Schull, which was the culmination of a four well Celtic Sea drilling programme spread over 2006 and 2007. This programme delivered four successful gas wells and cemented Island's position as the most successful operator offshore Ireland in recent years.

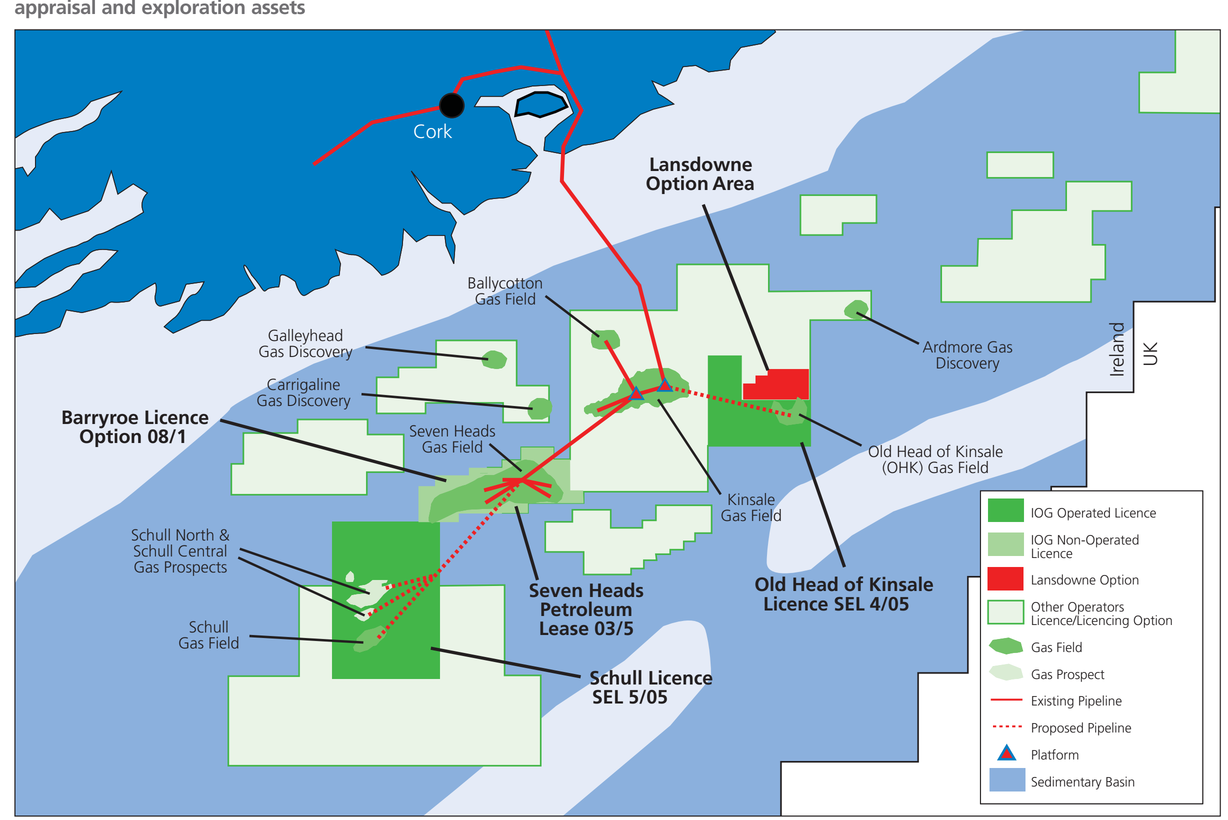
During the year under review, Island has been involved in a detailed reservoir engineering study for the Old Head and Schull gas fields. We have also acquired new high resolution 2D seismic data over both gas fields. Preliminary indications are that the proven limit of the Old Head gas field may extend further to the south-east than has previously been interpreted. Information from our West Seven Heads 48/23-3 gas well has proved invaluable to the understanding of potential production behaviour for the extended area of the Old Head gas field.

Scoping production profiles for Old Head and Schull indicate conducive conditions for conversion to gas storage projects relatively early in field life, a situation which would materially contribute to the debate on Ireland's security of supply issue and to the provision of additional strategic gas storage capacity for Ireland. Several low risk exploration leads have also been matured in the Old Head and Schull licences.

During the year, Island was also awarded the Barryroe Licensing Option, which includes a 30% stake in the undeveloped Seven Heads oil accumulations. Island has consistently maintained that the potential oil and wet gas reservoirs in the Lower Cretaceous, which have flowed light, waxy oil at rates between 1,300 and 1,600 barrels per day ('bpd'), may ultimately be developed and may contribute to prolonging the life of the Seven Heads and Kinsale infrastructure.

As part of our core area Celtic Sea strategy to 'hoover up' proven, probable and possible oil and gas accumulations around a wasting infrastructure, Island has embarked upon a reservoir modelling study in the West Seven Heads area to determine the level of gas-in-place with greater certainty in the area tested by our 48/23-3 appraisal well. Potential unperforated gas sand intervals below the main producing horizons are also being targeted by this study.

Ireland Celtic Sea – Gas production, near-development, appraisal and exploration assets



Chairman's statement
continued

Sale of 20% interest in the North Porcupine Basin Frontier Exploration Licence 1/04

20%

The results from this work will be used by Island to pursue discussions with Marathon on a way forward to unitise interests in the West Seven Heads area tested by the 48/23-3 and 48/24-6 gas wells.

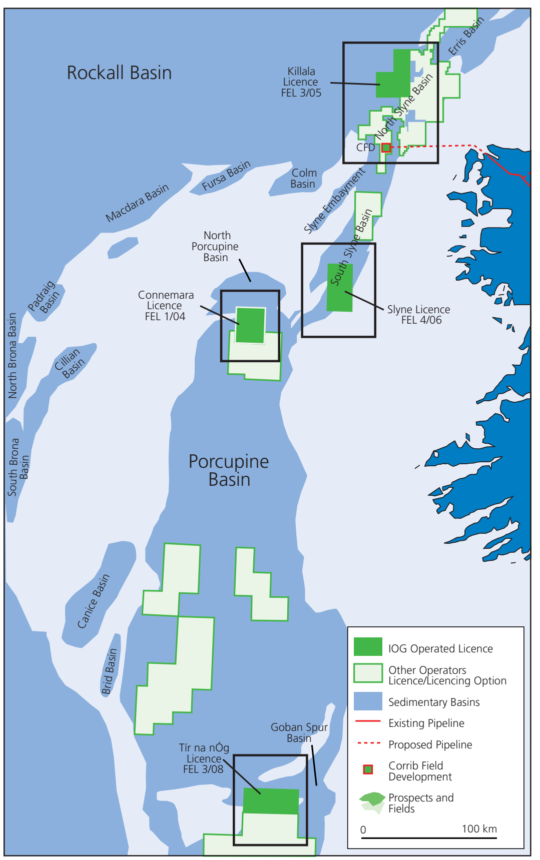
The announcement by Marathon during 2008 of the initiation of a sales process to dispose of its assets in Ireland means that Island is well-placed to avail of any near-term opportunity to realise value and consolidate its Celtic Sea assets as these have the potential to extend the projected current economic life of the Kinsale field by several years, thereby adding additional value to the infrastructure for the owners of the facilities. This objective is compatible with a desire to maintain security of supply by fully developing Ireland's indigenous gas resources in a timely manner in addition to the opportunity of increasing gas storage capacity. Island has available the 'cushion gas' required to establish a new commercially viable gas storage project in the Celtic Sea. Given the recent rise in wholesale gas prices this represents a potentially valuable asset for the Company which justifies our timely investment in our Celtic Sea drilling programme during 2006 and 2007 and puts Island in a unique position to monetise its gas assets at the earliest opportunity.

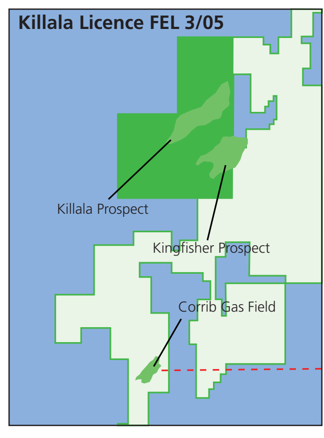
Atlantic Margin strategy

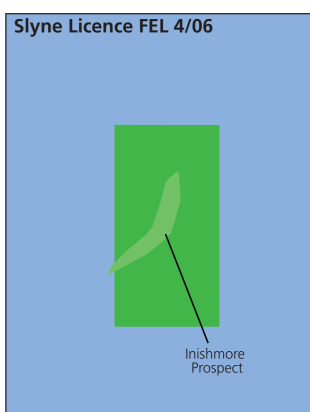
In the Irish Atlantic Margin, the Company began the longer term process of gradually monetising its exploration portfolio with the sale of a 20% stake in the North Porcupine Basin Frontier Exploration Licence 1/04, containing the undeveloped Connemara oil field, to Supernova Energy, a wholly owned subsidiary of the Bluewater Group and one of the world's leading providers of floating production storage and offloading facilities for a cash consideration and an investment in Island shares at a significant premium to market price. During the year, Island has identified and developed a new Lower Cretaceous stratigraphic trap, with multi-billion barrel oil potential, in a previously over-looked area of the Licence. This is an important addition to Island's growing portfolio of prospective structures in its Atlantic Margin acreage.

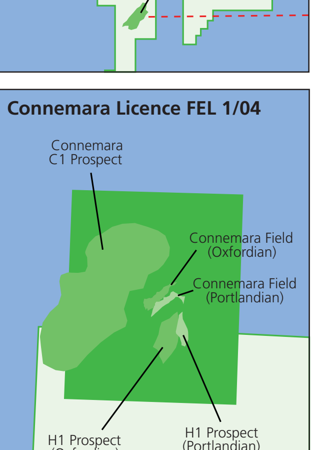
Island has expanded its area under licence on the Atlantic Margin, which we consider to be a vital area for future long-term exploration activity as this region is a very much under-explored part of the 'Atlantic Basin' hydrocarbon province relative to offshore West Africa, Norway, Eastern Canada, UK-Faeroes, Gulf of Mexico and Brazil, with the award of the Tír na nÓg Frontier

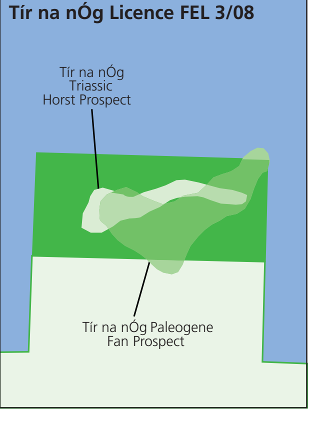
Ireland Atlantic Margin – Potential for world class discoveries











Bluewater FPSO vessel (Bluewater is a wholly-owned subsidiary of Supernova Energy who is a significant shareholder in Island)

Exploration Licence in the South Porcupine Basin. Island operates the Licence, with a 50% stake, in a joint venture partnership with Supernova Energy. The Licence contains a large Triassic prospect overlain by an early Tertiary deep-sea fan which is considered even at this early, immature stage in evaluation to have multi-billion barrel oil potential.

In our Rockall Basin Licence, geological and geophysical studies have identified the Kingfisher Triassic gas prospect which, together with the neighbouring multi-TCF Killala Triassic gas prospect, makes this acreage potentially even more attractive to companies wishing to exploit the proximity of these sizeable prospects to Shell's Corrib gas field development.

Our Slyne Licence also contains a sizeable Triassic oil prospect which provides Island with a balanced portfolio of Triassic oil and gas prospects in an area with a proven active hydrocarbon system.

The Atlantic Margin is a hostile deep-water environment where access to deep-water rigs is costly and difficult, mainly due to Ireland's poor record of drilling activity relative to other Atlantic Basin oil and gas provinces. Island's portfolio-building concept is designed to create a materially significant package of diverse exploration prospects that may prove attractive to a large multi-national oil company or utility company seeking access to new North-West European sources of potential energy supplies. Island will seek to monetise these assets at an early stage through a sale of equity in the licence portfolio whilst retaining exposure to drilling success through a royalty arrangement on any future production revenues.

International expansion strategy

Our successful track record as an operator offshore Ireland enables us to create exciting new opportunities in North-West Africa and Central and South-East Europe. Both are strategic regions for exploiting expanding indigenous energy markets and for the creation of new alternative gas export supplies into the lucrative west European gas market to address issues of long term security of European supply. The Island business model is to identify strategically important, energy-deficient countries and to use our proven operating capability and deal-making expertise to create: basin-dominant licence positions in under-explored regions with proven hydrocarbon systems (onshore Southern Morocco); re-appraisal opportunities of oil and gas discoveries made at a time of low oil price (offshore Albania); and oil and gas field rehabilitation opportunities (Moldova).

Doul wellhead

Island has implemented this strategy during the year under review with the addition of new exploration licence interests (7 exploration permits) in Southern Morocco in the Tarfaya Basin. This basin is prospective for Triassic and Jurassic oil and there are a number of existing discoveries in the region. In Albania, we acquired OMV's and Lundin's entire interest in the offshore Durresi Block, where plans to eventually appraise the A4-1x gas/condensate discovery and deeper Jurassic and Lower Cretaceous targets, not reached in the original discovery well drilled in 1993 but oil-bearing to the west in Italian waters, are being assessed. Island has subsequently agreed farm-out terms with the Australian company Beach Petroleum whereby Beach can increase its stake from 25% up to 45% in the Durresi Block by promoting Island in a well.

We continue to make progress in Moldova towards acquiring upstream and downstream assets. Post year end, Island has executed a mandate letter with the European Bank for Reconstruction and Development ('EBRD') regarding the financing of plans to increase the level of production from the Valeni oil field in Moldova. Island will be commissioning an Environmental Impact Study and a new independent Petroleum Engineer's Resources Report for the Valeni field as part of the due diligence effort required to assist with EBRD's internal process for approving the financing of the rehabilitation of the field to optimise production output.

The Board was further strengthened with the appointment of Karl Prenderville as Commercial Director in August 2007*. Post year end Adrian Doull has been appointed as a Non-executive Director and Carl Kindinger as Chief Financial Officer.

* Karl Prenderville resigned as Commercial Director in November 2008.

Chairman's statement
continued

Revenue
(Stg£million)

£2.251m

Cost of sales
(Stg£million)

£1.143m

Financial review

The Group recorded a profit before taxation and finance income and finance expense of Stg£13.115 million for the current year compared to a loss of Stg£4.450 million in the year ended 31 July 2007. The profit relates mainly to the sale of Island Netherlands BV, a wholly owned subsidiary, and to the sale of a 10% interest in the Amstel oil field development in The Netherlands to Encore Oil. In addition to the cash sales price of US$25 million for the sale of Island Netherlands BV to Delta Hydrocarbons, Island also received a US$10 million advance on future royalty payments. Island also received a cash payment from Encore of Stg£1.5 million for the sale of a 10% interest in the Amstel oil field development.

Supernova Energy Ireland BV ('Supernova') bought 3,750,000 ordinary shares in Island at an issue price of Stg£0.60 in December 2007. At the same time Supernova acquired a 10% interest in Frontier Exploration Licence 1/04 in the North Porcupine Basin, in the prospective Atlantic Margin off the west coast of Ireland, and an option to acquire an additional 10% interest for a cash price of Stg£2.25 million. Supernova exercised their option in March 2008 by paying Island Stg£2.25 million in cash.

Gross revenue from our interest in the Seven Heads gas field was Stg£2.251 million compared to Stg£1.762 million in the previous year. Gas revenue improved for the third year in succession and represented a 28% increase year-on-year.

Cost of sales at Stg£1.143 million compared to Stg£0.902 million, represents a 27% increase over the previous accounting year and was mainly related to pipeline maintenance work during this year. Gross profit of Stg£1.108 million compared to Stg£0.860 million in the previous year. The field has produced at rates in excess of 10 mm scfpd. Although it is anticipated that production next year will reduce, recent high prices will continue and revenue may be maintained close to the current level. Estimated gross remaining gas resources for the Seven Heads gas field, based on the operator, Marathon's, estimates from 1 January 2008, have been revised upwards to 9.3 billion cubic feet ('bcf') or 1.163 bcf net to Island, up from 8.6 bcf or 1.075 bcf net to Island based on the previous estimates of Marathon.

Administration expenses were Stg£2.306 million compared to Stg£1.174 million in the previous year, representing a 96% increase year-on-year. This reflects increased staffing and larger premises to progress our current portfolio of near-development assets generated by the highly successful 2006 and 2007 drilling programmes. A significant contribution to Island's overheads is made by the Company's joint venture partners in our various licences of which Island is the operator.

In October 2007, Island secured an additional Stg£4.5 million short term loan facility ('facility') from RMB Resources ('RMB') increasing the overall debt facility to Stg£12 million. In December 2007, RMB extended the loan repayment date and at the same time surrendered their right to 5,759,631 warrants at an exercise price of Stg£0.7813 per ordinary share in exchange for 1,000,000 fully paid up shares. The retained earnings reserve was increased by Stg£0.261 million to reflect the net effect of surrendering the warrants and issuing the fully paid up shares. In May 2008, Island repaid in full the Stg£12 million short term debt facility with RMB Resources.

RMB have provided a Stg£5 million project debt facility none of which has been utilised to date.

Cash balances at the year end amounted to Stg£3.407 million.

It is anticipated that farm-out and asset sale transactions will continue to be generated and these may result in further cash payments to the Company over the next 12 months.

There were no major write-offs during the year.

The financial results for the current accounting year have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU ('EU IFRS'). In accordance with IFRS 6, 'Exploration for and Evaluation of Mineral Resources', costs incurred prior to the award of exploration licences have not been capitalised. Stg£0.129 million in the current year and Stg£0.152 million in the previous year has been written off in accordance with IFRS 6.

Also in accordance with International Accounting Standards ('IAS') 23 'Borrowing Costs', borrowing costs directly attributable to the acquisition and construction of qualifying assets have been added to the cost of these assets. This amounted to Stg£0.713 million in the current year. Stg£0.037 million of borrowing costs in the prior year have been capitalised in accordance with IAS 23.

In accordance with IFRS 2 'Share based payment' share options awarded during the year to key personnel have been independently valued. The fair value of share options granted during the year is Stg£0.530 million compared to Stg£0.315 million in the previous year.

Post year end, the appointment of Carl Kindinger as Chief Financial Officer will set in motion a fundamental review of administration, staff and consultant costs to ensure that in the prevailing market conditions that Island's shareholders are receiving full value for money spent on administrative overhead in relation to the efficient management of its licences and the execution of its work programmes.

Operating profit
(Stg£million)

£13.115m

Outlook and prospects

The sale of Island's Dutch assets to Delta Hydrocarbons for cash and royalties has brought forward the potential for generating cash flow from production revenues. Post year end, the execution of a mandate letter with the EBRD enhances our ability to close and finance the transaction with Valiexchimp S.R.L. ('Valiexchimp') to acquire downstream and upstream assets in Moldova which could generate additional cash flow for Island from producing properties in 2009.

Having engineered a massive upside from the sale of its Dutch assets during 2008, Island is now focused on monetising its Celtic Sea assets, either through an asset sale for cash and future royalties, or through a part equity sale to finance the development of the Old Head and/or Schull satellite gas fields. The Marathon sales process creates the opportunity for Island to demonstrate to a wider audience the value of our Celtic Sea assets, in potentially maintaining and extending the life of the Kinsale facilities and to contributing, therefore, to the security of supply and increased strategic gas storage capacity issues.

In the Atlantic Margin, our portfolio of large oil and gas prospects is attracting widespread industry attention as we seek to crystallise the value of these assets in a timely manner through farm-out and asset sales. The exploration, appraisal and development cycle in the deep-water Atlantic Margin hydrocarbon province is spread out over an extended period. Therefore Island must consider its options to monetise early whilst retaining its exposure to exploration success and future cash flow through a royalty arrangement. Cash from any successful farm-out and equity sale transaction will be prudently managed to take into account the new financial climate that will result from a resolution of the 'Banking Crisis'. Investment in producing assets and oil and gas field rehabilitation projects will be a key focus of the Company to increase cash flow from oil and gas operations.

Gaining revenue from some of our international exploration and appraisal assets in Morocco and Albania will also be a key consideration for the Company as we attempt to recreate our highly successful Amstel transaction.

Particular attention will be given by the Board to cost savings and effective use of personnel resources as we enter a period of volatility in the world's financial markets. Oil prices are likely to remain high relative to historical prices, whilst forward gas prices have strengthened considerably over the past 12 months and we believe will remain strong in the near future given the security of supply issues that Europe is now facing. These factors will drive oil and gas transactions between Exploration and Production companies as they seek access to a dwindling number of mature oil and gas projects. Island is well-placed with its large portfolio of oil and gas assets to take advantage of this trend.

On behalf of the Board of Directors, I would like to thank our shareholders for their continued support, loyalty and understanding in what are very difficult times for the world's financial system. I look forward to reporting on the Company's achievements during the year under review at the next Annual General Meeting.

Bryan Benitz
Chairman

Operational review

The past year has seen Island through its Amstel transaction in The Netherlands establish a track record for delivering its stated business model: low cost entry; value enhancement through the application of our technical expertise and operating capability; and bringing forward the realisation of potential asset values through sale or farm-out when prudent to do so.

The 2007 appraisal drilling programme in the Celtic Sea was successfully brought to a close with the testing of gas at a rate of 21 mm scfpd from the 57/2-3 Schull gas field appraisal well. During the past year, emphasis has been placed on reservoir engineering studies, utilising production data available to Island from our interest in the Seven Heads gas field and reservoir geometry and connectivity studies. This programme was designed to assess the most likely amount of gas-in-place in the fields and to determine a range of likely future production profiles. The results to date of these reservoir engineering and geological studies have indicated that the Schull and Old Head gas fields might become suitable candidates for future gas storage and winter profiling of gas, particularly as no investment in expensive cushion gas would be required. The proposed development options for Old Head and Schull will emphasise these new commercial opportunities.

The string of drilling successes that Island has achieved in the Celtic Sea, once developed, could potentially extend the life of the Seven Heads and Kinsale facilities, thereby making a significant contribution to the security of supply issue by helping to accelerate the development of indigenous gas and providing additional options for gas storage based on the availability of accessible indigenous cushion gas in its Old Head and Schull fields.

Island is encouraged by the level of interest it is receiving from the industry in its farm-out portfolio of Atlantic Margin gas prospects: Killala, Kingfisher and Inishmore. Island is seeking a strategic multi-national, gas-focused, partner, through a partial asset sale, to assist with developing a material gas business in Ireland based on indigenous Celtic Sea production, future storage potential and the eventual ability of the Atlantic Margin to potentially provide a source of gas for the Western European market.

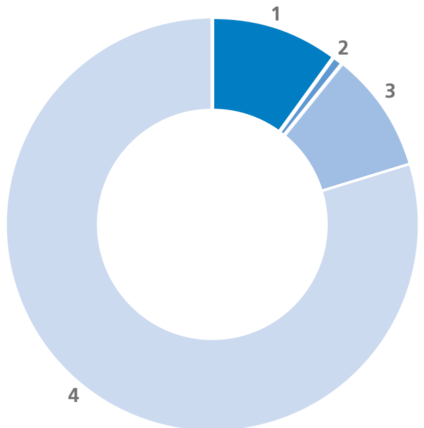
Elsewhere on the Atlantic Margin, Island is focused on oil (in the South Porcupine and Connemara licences), where we have a strategic partnership with Supernova Ireland Resources BV, a subsidiary of the Bluewater Group, one of the world's largest providers of floating production vessels. This will provide Island with a window to new technologies necessary to assist with the offshore development of any significant oil discovery made in our Atlantic Margin portfolio. It will also provide us with access to new potential partners through the established Bluewater business relationships as we seek to apply the same successful Amstel business model to our Atlantic Margin portfolio, albeit over a longer timescale due to the higher cost of drilling in the deeper water environment of the Atlantic Margin.

Island has successfully used its local country knowledge, proven operating capability and technical expertise to organically grow, for a low entry cost, an attractive package of onshore licences in two highly prospective sedimentary basins covering much of Southern Morocco.

During the past year, Island has identified substantial new, low risk, oil and gas exploration prospects in its offshore Durresi licence which have greatly increased the material significance to Island of this strategically important area of South-East Europe. Island has strengthened its business relationships in Albania and is seeking to prudently expand its acreage position there in the near future.

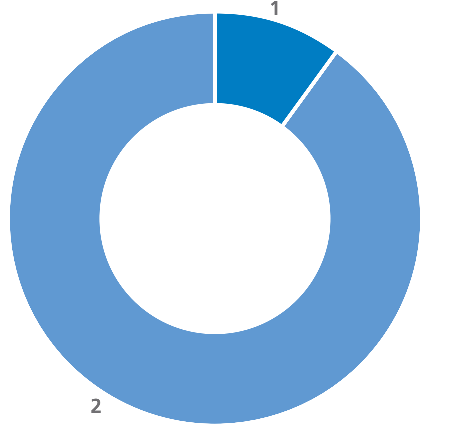
Island has continued to review during the year, based on our extensive network of business relationships and our successes as an approved operator, potential oil and gas field rehabilitation projects in Moldova, the Former Soviet Union countries, South-East Europe and North-West Africa that are capable of providing early future cash flow and operating income. The key drivers for Island in ranking and potentially de-risking these projects is to minimise entry costs; complete satisfactory technical, commercial and legal due diligence; and to present favourable project economics that are necessary to attract the seed capital required to 'kick-start' the rehabilitation of existing oil and gas fields.

Acreage held under licence
Area under licence per country (km²)



1 Ireland	4,502.72
2 The Netherlands	369
3 Albania	4,208
4 Morocco	35,241

Irish vs International acreage (km²)



1 Ireland	4,502.72
2 International	39,818

Ireland

Celtic Sea – Building a Gas Business

Seven Heads Gas Petroleum Lease

Part blocks

48/22	23	24	27	28	29	30

Interest: Non-operator with 12.5%

Target reservoirs: Lower Cretaceous Upper Wealden gas sands equivalent to one of the producing horizons in the nearby Kinsale gas field and the storage reservoir in the South-West Kinsale storage facility.

The Seven Heads gas field

Seven Heads has produced approximately 19.55 bcf of gas to 1 April 2008 and has estimated remaining resources of 6.3 to 7.9 bcf based on a gas-in-place estimate of 35 bcf. This represents a 66% increase in gas-in-place compared to the original estimates made in 2004 following the early decline in production rates from the field's reservoirs. The discrepancy between estimated connected volumes has been revealed by subsequent production history and material balance calculations. This additional gas-in-place is interpreted to be derived predominantly from thin-bedded sands which provided secondary support to recharge the productive higher permeability sands at a low rate.

The important conclusion from the Seven Heads production history is that there is good communication between the reservoirs over time but that the rate of recharge of the higher quality reservoirs from poorer quality reservoir units is slow and needs to be carefully managed early in field life so as not to cause rapid depletion by over-producing wells too early. The reservoirs are potentially suitable therefore for gas storage and winter and day ahead profiling. The Seven Heads gas field is structurally complex with a number of isolated structures each drained relatively efficiently by a single production well. The drainage areas are limited by the size of the structures.

The field has now been tied to compression facilities on Marathon's Kinsale Alpha platform. This has greatly improved field performance.

Up until 30 June 2008, Seven Heads continues to produce gas at an average rate of approximately 10 mm scfpd.

Seven Heads gas continues to provide an important source of revenue for Island, particularly as gas prices have increased significantly since the field first started producing gas in 2004.

West Seven Heads Sub-Area

Part blocks

48/23	28

Interest: Non-operator with 55.75%

Target reservoirs: Lower Cretaceous Upper Wealden gas sands equivalent to one of the producing horizons in the nearby Kinsale gas field and the storage reservoir in the South-West Kinsale storage facility.

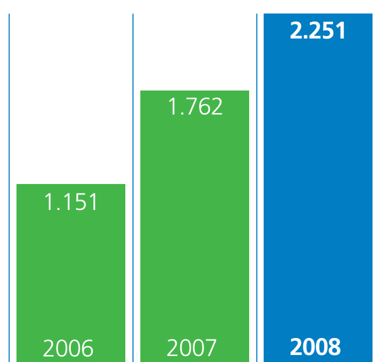
West Seven Heads Sub-Area

Island concluded a Sub-Area Equity Interest Assignment Agreement for the unappraised part of the Seven Heads Petroleum Lease (West Seven Heads), west of a defined partition line close to the 48/24-6 production well, with Marathon International Petroleum Hibernia Limited (through its wholly-owned subsidiary Marathon Seven Heads Limited) in February 2006.

In June 2006, Island announced that its farm-in well 48/23-3 had successfully tested dry gas at a combined maximum rate of 13.2 mm scfpd through a 48/64" choke from two separate Upper Wealden reservoir horizons in the Lower Cretaceous, extending the limits of the Seven Heads gas field further westwards.

Following the completion of the drilling of 48/23-3, Island increased its interest in West Seven Heads from 12.5% to 55.75% as a result of earning half of Marathon's interest in the Sub-Area.

Gas revenue for Seven Heads
(Stg£million)



Operational review
continued

Increase in West Seven Heads
(2007: 12.5%)

55.75%

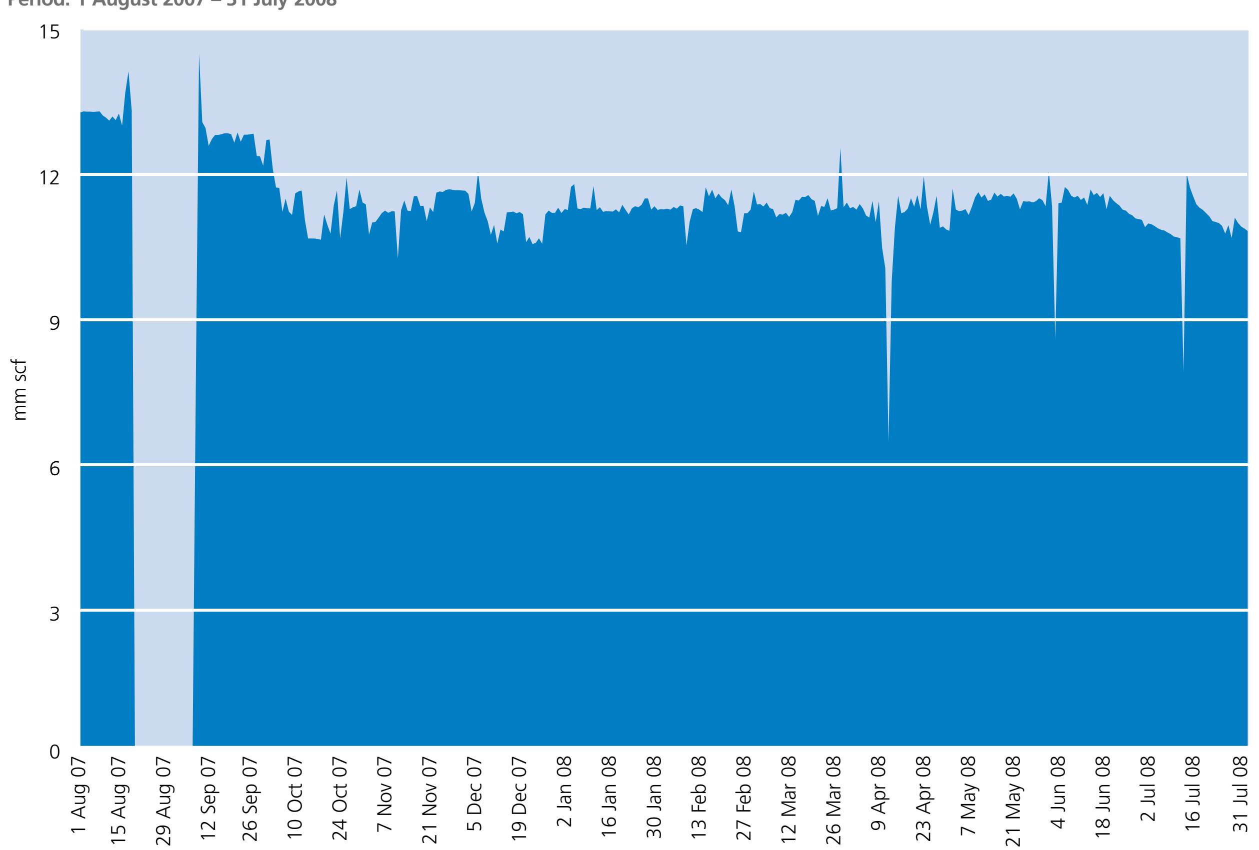
West Seven Heads Sub-Area continued

The results from Island's reservoir engineering and reservoir modelling studies, when combined with our analysis of the production performance of the 48/24-6 well, indicates that some of the gas reservoirs encountered in the 48/23-3 West Seven Heads well are being produced from the 48/24-6 Seven Heads Production Well to the east, albeit probably at a slow rate but with the potential for enhanced production following access to compression at Kinsale in late 2006. The evidence is conclusive therefore that the area drained by 48/24-6 includes a large area to the west of the current 48/24-6 production well which was not proven until Island drilled the 48/24-6 appraisal well.

Appraisal well 48/23-3 also tested dry gas from a deeper Upper Wealden horizon that has to date not been produced in the Seven Heads gas field. Island's proprietary technical studies indicate that there is potential to perforate and develop these additional gas sands simultaneously with the development of the Old Head and Schull satellite gas fields using cost-saving synergies.

Island's commercial and legal position is that following the drilling of its farm-in well it increased its equity interest in the West Seven Heads Sub-Area to 55.75% and therefore should be entitled to 55.75% of all gas produced from the Sub-Area from the effective date that the interest was earned. These matters are the subject of ongoing discussions with Marathon.

Seven Heads gas production
Period: 1 August 2007 – 31 July 2008



Old Head of Kinsale Exploration Licence 4/05

Part blocks

49/17	49/22	49/23

Interest: Operator with 65%

Target reservoirs: Lower Cretaceous Upper Wealden gas sands equivalent to one of the producing horizons in the nearby Kinsale gas field and the storage reservoir in the South-West Kinsale storage facility.

The Petrolia Rig testing gas in the Celtic Sea

Lansdowne Option Agreement East Kinsale Exploration Licence 4/07

Part blocks

49/11(p)	49/12(p)	49/13(p)
49/17(p)	49/18(p)	

Interest: Operator with 58.34% on exercise of Option Agreement

Target reservoirs: Greensand and Lower Cretaceous Upper Wealden gas sands equivalent to the producing horizons in the nearby Kinsale gas field and the storage reservoir in the South-West Kinsale storage facility.

Old Head of Kinsale

During 2008, Island acquired 377 kilometres of new high resolution seismic data on Old Head which is currently being processed and interpreted. Initial indications are that the new seismic has substantially de-risked the extension of the Old Head of Kinsale gas field to the south-east of the 49/23-1 discovery well and the 49/23-2 and 49/23-2z appraisal wells.

Island continued with ongoing development planning and engineering studies during the year together with detailed geological studies and simulated reservoir engineering models designed to determine the likely range of production profiles for the gas field based on the original 49/23-1 well being used for a single well development tied back to host facilities on the Kinsale platform. A major area of focus continues to be to determine the additional gas-in-place in the gas field in the 'heterolithic' reservoirs by using the well-documented recent production history and geological data for the Seven Heads gas field as an analogue. These thin-bedded reservoirs potentially make a significant contribution to the cushion gas required to provide reservoir support for commercial gas storage operations and the ability to winter profile gas.

The results of these studies have so far indicated that there may be significant potential to convert the Old Head gas field to a future gas storage facility. Island and its joint venture partners are working towards the completion of a draft Plan of Development for the Old Head of Kinsale gas field. This should be finalised in Q1 2009. The commercial opportunities presented by the potential contribution of the Old Head gas field to Ireland's security of supply through the provision of additional gas storage capacity and the ability to winter profile gas under the terms of a flexible gas sales contract will be important components of the draft Plan of Development. A satisfactory and timely conclusion to the Marathon sales process will also be required before the Plan of Development for Old Head can be submitted to the Irish regulatory authorities in its final form.

Lansdowne Option Agreement East Kinsale

Island executed in June 2008 an Option Agreement (the 'Option') with Lansdowne Celtic Sea Limited ('LCS') to farm into an area (the 'Area') of Standard Exploration Licence 4/07 covering part-blocks 49/11(p), 49/12(p), 49/13(p), 49/17(p) and 49/18(p) in the Celtic Sea offshore Ireland. The Option, if exercised, would be subject to the approval from the Irish Minister for Communications, Energy and Natural Resources.

Under the Option Agreement, Island acquired a seismic survey over the Area and has the right to carry out the drilling and testing of a farm-in well (the 'Well') in the Area. The Option extends to the 31 December 2008 and, if exercised, the Well would commence before 31 July 2010, depending on rig availability. The Well, subject to the exercise of the Option, will be drilled and will test potentially the same reservoirs that are gas-bearing in the 49/23-1, 49/23-2 and 49/23-2z wells drilled by Island in the Old Head gas field immediately to the south of the Area.

Upon exercise of the Option, Island will acquire a 58.34% equity interest in the Option Area and assume operatorship.

Following comprehensive seismic, geological and reservoir engineering studies in the area of the Old Head gas field, Island now believes that there is additional potential for low risk gas prospects along the 'Old Head Trend' in an area of the Celtic Sea that was formerly under-explored until the Old Head gas discovery was made by Island in 2006. The seismic acquired during 2008 is currently being processed and interpreted and will determine whether or not Island will exercise its option to participate in the Area.

Any potential farm-in well would benefit from synergies created by the development of existing infrastructure at Old Head.

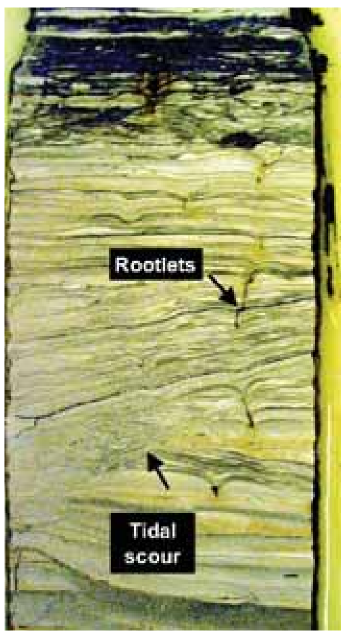
Operational review
continued

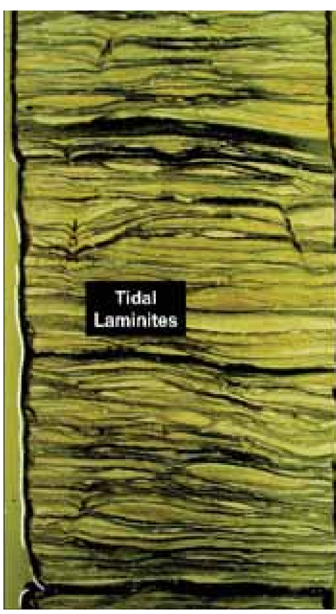
Schull Exploration Licence 5/05

Blocks		
57/2		
Part blocks		
57/1	48/26	48/27

Interest: Operator with 62.5%

Target reservoirs: Lower Cretaceous Upper Wealden gas sands.





Understanding the geology of the reservoirs is the key to determining the commercial options for these gas sands

Schull

In August 2007, Island announced that gas appraisal well 57/2-3 had successfully tested dry gas at a rate of 21 mm scfpd through a 72/64" restricted choke size, with absolute open flow potential of 40 mm scfpd. The gas was produced from the Upper Wealden reservoirs between 2,332 feet Measured Depth ('MD') and 2,559 feet MD below the rotary table ('BRT').

The well encountered a gross gas column of 292 feet, significantly greater than that prognosed pre-drilling, and the reservoir was encountered 84 feet high to prognosis. The well encountered additional, previously untested, gas reservoirs that will potentially provide follow-up targets in the additional offset structures mapped in the Schull licence area.

Well 57/2-3 was suspended as a potential gas producer.

During 2008, Island has completed the acquisition of 448 kilometres of new high resolution 2D seismic data over the Schull licence area to firm up two low risk exploration targets that have been upgraded and de-risked following the successful testing of the 57/2-3 well. Seismic processing and interpretation will be completed during early 2009.

Island is continuing with ongoing development planning and engineering studies together with simulated reservoir engineering models to determine the likely range of production profiles for the gas field based on the 57/2-3 well being used for a single well development tied back subsea to the Seven Heads pipeline. Quantifying the additional gas-in-place in the gas field in the 'heterolithic' reservoirs is very important as, in the case of the Old Head gas field, this potentially makes a significant contribution to gas-in-place estimates which impacts the potential amount of cushion gas available to provide reservoir support for commercial gas storage operations and the ability to winter profile gas.

The simultaneous development of the Schull and Old Head satellite gas fields is being evaluated on the basis of the synergies that will be created to help reduce capital investment per bcf of discovered resources and also in relation to the fields providing the potential for future gas storage and winter profiling operations.

Island and its joint venture partners are working towards the completion of a draft Plan of Development for the Schull gas field in Q1 2009.

During the year, Island opened scoping discussions with a potential gas buyer regarding the purchase of any future gas produced from the Old Head and Schull gas fields. The multi-field development programme is ideally suited to drive commercial discussions based on maximising winter production of gas from the fields, when gas prices are seasonally higher and demand is traditionally strongest. Optimising any gas sales agreement to take advantage of fluctuations in day ahead prices is a commercial priority supported by the projected technical performance of the Upper Wealden gas reservoirs based on offset production data and the extensive flow testing of the Old Head and Schull gas wells.

The development options for Old Head and Schull are subject to the consents and approvals of the Department of Communications, Energy and Natural Resources in accordance with the normal procedures required.

Following the completion of the processing of the seismic acquired in 2008, Island will begin to evaluate the deep Triassic gas potential of the Schull licence area as part of an overall strategy to determine the remaining under-explored contingent prospective gas resources in all of its Celtic Sea licences. Triassic reservoir rocks and salt caprocks have been penetrated in this area of the Celtic Sea. Lower Jurassic source rocks mature for gas generation are also present and therefore the potential for significant Triassic gas finds may exist if robust structures can be seismically defined.

Celtic Sea – Other Interests Barryroe Licensing Option (Formerly Seven Heads Oil Licensing Option)

Licensing Option 08/1

Part blocks

48/22	23	24	27	28	29	30

Interest: Non-operator with 30%

Target reservoirs: Lower Cretaceous Middle and Lower Wealden oil- and gas-bearing sands between 4,600 feet and 7,550 feet subsea.

Schull continued

During the past year, Island has continued to seek a strategic multi-national, gas-focused partner through a partial asset sale, to assist with developing a material gas business in Ireland based on indigenous Celtic Sea production; future storage potential; and the eventual ability of the Atlantic Margin to potentially provide a source of gas for the Western European market. Island has established a licence position in the Celtic Sea, adjacent to the Kinsale infrastructure, and on the Atlantic Margin of sufficient materiality to potentially attract a multi-national company seeking to find new areas of North-West Europe with the geological conditions that are necessary to provide future gas resources to supply to the European market.

Celtic Sea – Other interests

Island announced in July 2008 that, through its subsidiary Island Expro Limited, it had been awarded a new Licensing Option in the North Celtic Sea basin, off the south coast of Ireland. The Barryroe Licensing Option ('Barryroe Licence') replaces the Seven Heads Oil Licensing Option and the Lansdowne Option Agreement. Following the award of this new licensing option Island has increased its equity interest in the oil- and gas-bearing reservoirs below 4,000 feet subsea underneath the Seven Heads Gas Petroleum Lease from 12.5% to 30% without exercising its pre-existing farm-in option to drill a well.

Three previous wells in the licensing option area tested oil at rates of between 1,300 and 1,619 barrels of oil per day ('bopd'). The oil tested was light (30 to 42 degree API), good quality crude with associated wet gas. The oil, however, has high wax content. The Barryroe oil accumulations lie partly beneath the Seven Heads gas field. Previous technical work focused on the Lower Wealden oil- and gas-bearing sands. It was demonstrated that these had greater potential continuity and a greater possibility for containing lighter oil and wetter gas. Island has concentrated on delineating the limits of two oil accumulations – East Barryroe (which successfully flowed oil and gas in the 48/24-3 well) and West Barryroe (which encountered excellent live oil shows in the Lower Wealden sands in 48/23-1 but failed to flow test the oil sand found productive in 48/24-3). Island's third party reservoir engineering and simulation studies indicated that a production profile of 9,000 bopd was achievable from the East Barryroe structure alone.

The initial work programme involves carrying out reservoir engineering studies on the West Barryroe structure and to re-visit the economics for the potential development of these oil accumulations. A major challenge will be to address the issue of better seismic definition of the hydrocarbon-bearing structures prior to appraisal drilling. The potential to acquire 3D seismic in 2009 is currently being investigated.

Island is currently investigating any possible synergies between a pilot development study which it has undertaken for the undeveloped Connemara oil field in the Porcupine Basin and a similar development concept for the Barryroe oil accumulations. The potential to process wet gas from the Barryroe oil accumulations to add to the throughput for the Seven Heads and Kinsale facilities potentially could extend the life of the infrastructure. The ability to offer materiality and a diversified portfolio of potential development options is seen by Island as critical to attracting a suitable partner to assist with the development of these fields. This would be primarily through an asset disposal and retaining exposure to upside and cash flow through a royalty arrangement, similar to the successful transaction achieved for Amstel.

Operational review
continued

Atlantic Margin – Sustaining a Future Gas Business: Slyne Basin – Inishmore Licence

Frontier Exploration Licence 4/06

Blocks

27/18 | **27/23**

Part-Blocks

27/17(E) | **27/22(E)**

Interest: Operator with 50%

Target reservoirs: Triassic sands prospective for oil or gas.

Atlantic Margin – Sustaining a Future Gas Business

Slyne Basin, Inishmore Licence

Island was awarded Frontier Exploration Licence ('FEL') 4/06 in the Southern Slyne Basin in August 2006 following the Slyne-Erris-Donegal Offshore Licensing Round. The Licence lies approximately 110 kilometres south of the Corrib gas field, which is under development, and 85 kilometres off the west coast of Ireland. Water depths over the Licence area are less than 200 metres.

The Slyne Basin contains the Corrib gas field (Triassic reservoir). Two wells, 27/5-1 and 27/13-1, have also encountered oil in shallow breached Jurassic reservoirs. There is therefore the potential in this basin for both Jurassic-sourced oil and Carboniferous-sourced dry gas.

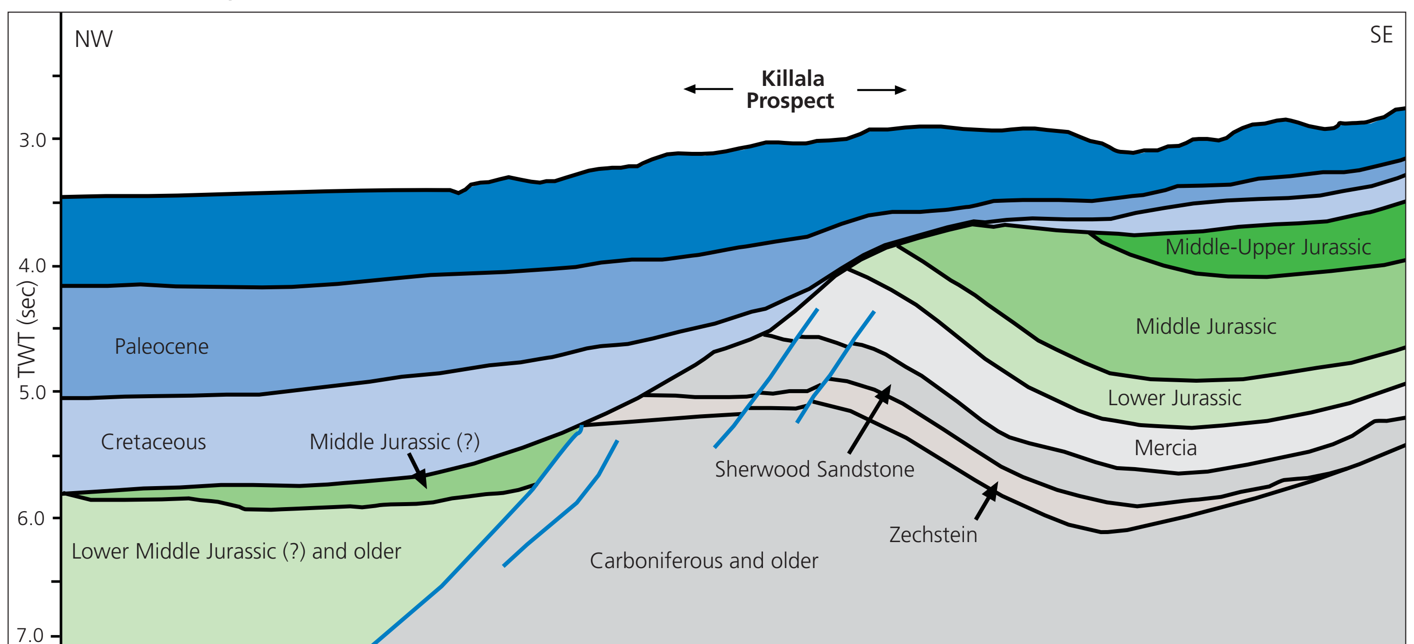
Island has completed the reprocessing and re-interpretation of parts of the existing 3,000 kilometres of 2D seismic data over and adjacent to the licence area. The principle drilling target is the Inishmore Prospect which, based on the seismic re-interpretation, is believed to potentially contain a gross Triassic reservoir thickness of up to 400 metres analogous to the good quality reservoir section encountered in 27/5-1.

Project economics for the Inishmore Prospect are attractive based on either of two assumptions, a Jurassic-sourced oil discovery or a Carboniferous-sourced dry gas discovery, as the potentially thick Triassic reservoirs of excellent reservoir quality could deliver gas or oil at high flow rates.

Island is currently evaluating the opportunity to acquire a 3D seismic survey in either 2009 or 2010, subject to vessel availability and market conditions. Island is seeking to farm-out some equity interest in the licence for a carry through the 3D seismic acquisition. Island is encouraged by the level of interest it is receiving from the industry in its farm-out portfolio of Atlantic Margin gas prospects and is seeking a strategic multi-national, gas-focused, partner, through a partial asset sale, to assist with developing a material gas business in Ireland based on indigenous Celtic Sea production; future storage potential; and the eventual ability of the Atlantic Margin to potentially provide a source of gas for the Western European market.

Post year end, Serica Energy announced that RWE Dea AG had farmed into its Slyne Basin licence immediately north of Island's Inishmore Licence thereby confirming the industry's interest in this area as a potential source of indigenous Irish gas.

Ireland – Killala Gas Prospect, Rockall Licence



North-East Rockall Basin, Killala Licence

Frontier Exploration Licence 3/05

Blocks

18/10	19/1	19/6

Interest: Operator with 50%

Target reservoirs: Triassic sands equivalent to the dry gas reservoirs in the nearby Corrib gas field, which is under development.

North-East Rockall Basin, Killala Licence

The Killala Licence covers an area of approximately 715 square kilometres and is located in deep-water on the Atlantic Margin approximately 70 kilometres off the west coast of Ireland and approximately 35 kilometres north of the Corrib gas field, which is at the development stage.

The Irish sector of the Rockall Basin has been tested by only three wells to date, the second of which, 12/2-1 (Dooish), confirmed the presence of hydrocarbons in this vast and as yet under-explored series of sedimentary basins.

Island has completed the reprocessing and re-interpretation of all the existing 2D seismic data over the licence area as a result of which two large Triassic dry gas prospects (Killala and Kingfisher), geologically analogous to the nearby Corrib gas field, have been identified. Both prospects have multi-tcf gas potential and occur within a proven hydrocarbon province as confirmed by the development of the Corrib gas field by Shell and its partners. Several other potentially prospective leads are developed in the North-West part of the licence area that are geologically analogous to the Dooish discovery and to the Lower Cretaceous C1 Prospect in Island's Frontier Exploration Licence 1/04 (Connemara) in the North Porcupine Basin.

Project economics for the Killala Prospect are potentially very robust based on the assumption that there would be significant spare available capacity in the Corrib subsea pipeline at a time when any potential development of a Killala gas discovery would be contemplated.

Island is currently evaluating the opportunity to acquire a 3D seismic survey in either 2009 or 2010, subject to vessel availability and market conditions. Island is seeking to farm-out some equity interest in the licence for a carry through the 3D seismic acquisition. Island's strategy remains flexible, however, with regard to any opportunity through consolidation of its Celtic Sea and Atlantic Margin exploration and production and near-production portfolio of gas assets to create value from a partial sale of interest in its integrated upstream gas business to a suitable industry partner.

Donegal Basin – Inishowen Licence

Frontier Exploration Licence 3/06

Blocks

13/4 (S)	13/5(S)	13/9(S)	13/13(N)
13/14(N)	14/1(N)		

Interest: Operator with 40%

Target reservoirs: Triassic sands prospective for oil and gas.

Donegal Basin, Inishowen Licence

Island was awarded FEL 3/06 in the Donegal Basin in August 2006 following the Slyne-Erris-Donegal Offshore Licensing Round. The Licence lies approximately 60 kilometres east of the Dooish hydrocarbon discovery in the Rockall Basin and between 50 and 70 kilometres off the north coast of Ireland. Average water depth over the Licence area is 100 metres.

The Donegal Basin has been tested by only two wells: 12/12-1, in which Island participated, encountered good reservoirs but lacked significant hydrocarbon shows due to the absence of an effective seal; 13/3-1, drilled by Texaco, had oil and gas shows but conversely lacked good quality reservoirs. There remains the potential in this basin for both oil and gas in shallow Triassic and older reservoirs within the Inishowen Licence, which lies at the present day in the deepest part of the Donegal Basin.

Island has completed a re-interpretation of the existing seismic data within the licence area incorporating the results of its 12/12-1 exploration well. Future activity will focus on attempting to delineate the extent of the shallow Triassic reservoir section and investigating the potential for direct hydrocarbon indicators using existing airborne and satellite Seep Finder data. Once these data have been acquired and reviewed, an analysis of the remaining Triassic and Carboniferous prospectivity within the licence area will be made and a decision taken as to what any future work programme might be.

Operational review
continued

Atlantic Margin – Oil Play
North Porcupine Basin, Connemara Field

Frontier Exploration Licence 01/4

Blocks

26/28

Part-Blocks

26/27 | **35/2** | **35/3**

Interest: Operator with 41.5%

Target reservoirs: Middle and Upper Jurassic sands, which have tested oil at rates in excess of 5,000 bopd in the undeveloped Connemara field, and early Cretaceous fan-delta, slope-fan and turbidite sands, the distal equivalents of which were gas-bearing in Britoil's 35/19-1 and Marathon's 35/30-1 wells.

Atlantic Margin – Oil Play

North Porcupine Basin, Connemara Field

Island was awarded FEL 01/4 in the Northern Porcupine Basin in April 2004 following the Porcupine Offshore Licensing Round. The Licence lies approximately 150 kilometres off the west coast of Ireland. Average water depth over the Licence area is 350 metres.

The Connemara oil accumulation was originally discovered and appraised by BP in 1979 and later operated by Statoil in the 1990s. Statoil made a significant investment in re-appraising the field by drilling two horizontal wells before exiting in 1999 at a time of low oil prices. Following the appraisal drilling, Statoil estimated oil in place in the field to be 180 million barrels ('mmb') in Middle Jurassic and 40 mmb for the Upper Jurassic reservoirs. However, a lower recovery factor was predicted for the Middle Jurassic reservoir sands than was initially estimated pre-drill based on the fact that the field was compartmentalised and that water injection would probably be required to improve oil recoveries.

During the year, Island completed a new independent reservoir engineering study for the Connemara oil field which has incorporated the results of our previous seismic reprocessing and reservoir modelling studies. Using geological scenarios built with Petrel software up to 166 mmb of oil are in place in the Connemara field in the Middle Jurassic reservoirs alone (compared to the figure of 180 mmb generated by Statoil).

Island has completed a desktop study to evaluate the potential commerciality of a pilot Floating Production, Storage and Offloading ('FPSO') development option for the Connemara oil field based on different oil price scenarios and targeting three separate fault-bounded compartments. The outline pilot development scenario envisages one production well in each compartment drilled from a single surface location with multi-lateral components to reduce drilling costs. Water injection wells are also being considered. For the latter option recovery ranges up to 16.2 mmb with approximately 8 mmb recovered in the first 24 months of production. This desk top study indicates that initial production rates of up to 16,500 barrels of oil per day are achievable in the first year of production. Project economics are however highly sensitive to oil price, FPSO lease and operating costs and development costs.

Re-processing and re-interpretation of existing 2D and 3D seismic data has also revealed significant low risk exploration and appraisal upside within the licence area.

Within and immediately adjacent to the Connemara oil field Upper Jurassic, marine sands deposited in fan-delta and slope environments have been found to be oil-bearing in the BP well 26/28-1 and the Statoil horizontal well 26/28-A2 (which was not tested at the time due to a decision to abandon the development of the Connemara field following the disappointing results from the first horizontal appraisal well in the primary reservoir objective). Seismic re-interpretation of the reprocessed 3D seismic data confirms the potential for a stratigraphic trap for the Upper Jurassic sands analogous to similar traps for some producing oil fields in the UK Sector of the North Sea (Northern Viking Graben). The Upper Jurassic reservoir development is similar to that described for the Spanish Point discovery immediately to the south of the Connemara field except that reservoirs in the Connemara wells are of superior quality, less deeply buried and contain light oil with very low amounts of associated gas (making them compatible with the envisaged FPSO development option for the Connemara field).

The new seismic interpretation has also defined a second low risk Middle Jurassic structural trap, the H1 Prospect, analogous to the Connemara field trap. The H1 Prospect is significantly larger than the Connemara structure and is located in an area of potentially even better Middle Jurassic reservoir quality. Seismic interpretation indicates that the structure is far less compartmentalised by faulting compared to the Connemara structure and the reservoirs therefore are favourably disposed to greater aquifer support.

North Porcupine Basin, Connemara Field continued

The largest exploration prospect delineated by the new seismic reprocessing is the C1 Prospect located to the North-West of the Connemara oil field. Seismic facies analysis supports the development of a fan-delta, slope-fan and turbidite complex at the base of the Cretaceous analogous to the reservoirs developed in a number of producing oil and gas fields in the UK Sector of the North Sea (Central Graben). Gas-bearing slope- and turbidite-fan sands have been encountered in Britoil's 35/19-1 and Marathon's 35/30-1 wells to the south of the Connemara field. In these areas reservoir quality is poor and the hydrocarbon type is gas due to deep burial. Reservoir quality is expected to be potentially far better in the Connemara area, based on analogies with the Jurassic reservoirs encountered in the Connemara field, and hydrocarbon-type is anticipated to be oil (as the C1 Prospect is immediately adjacent to the Connemara oil field). The C1 Prospect has the potential to contain several billion barrels of oil in place.

Island is currently evaluating the opportunity to acquire a 3D seismic survey in either 2009 or 2010, subject to vessel availability and market conditions, in order to mature the C1 Prospect ready for drilling.

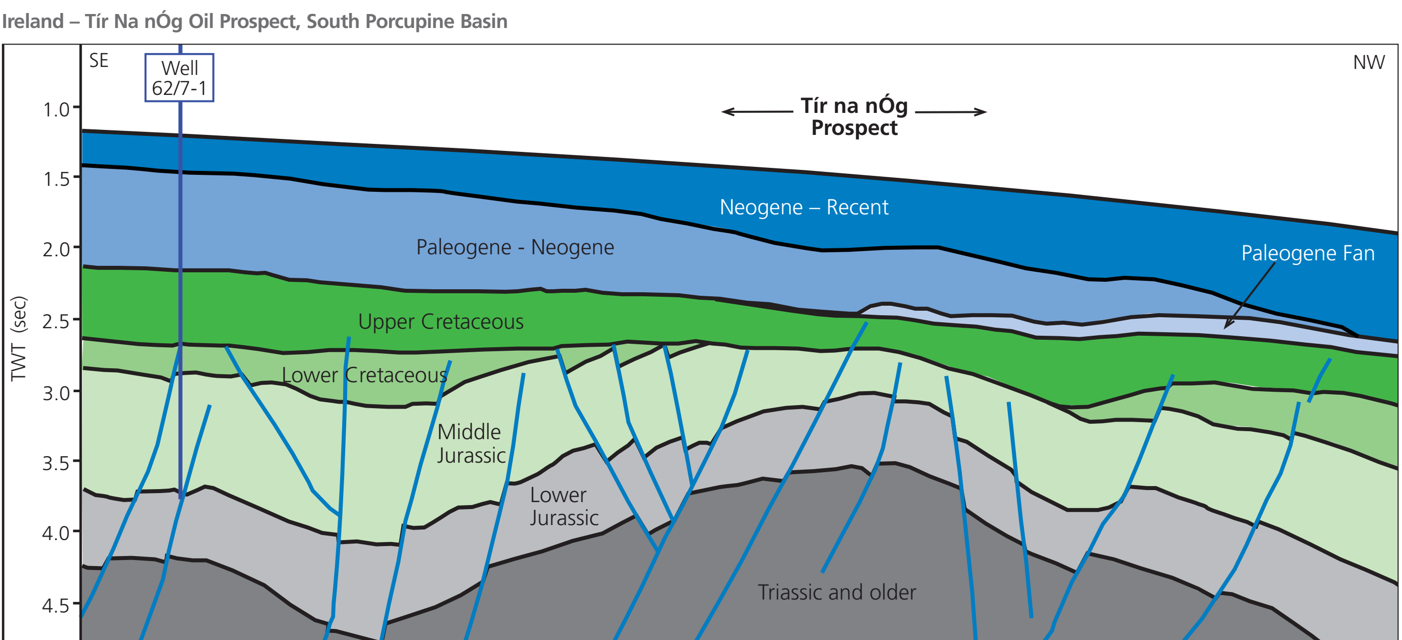
A commitment well is presently scheduled for drilling in 2010, subject to rig availability and market conditions. There are three potential options for the commitment well: a pre-development well in the Connemara field; an exploration well in the H1 Prospect; or an exploration well, subject to the acquisition and interpretation of new 3D seismic data, on the potentially very large C1 Prospect.

The Connemara Licence contains a multitude of pre-development, appraisal and low risk exploration opportunities. In order to accelerate drilling activity and unlock value, Island is seeking to reduce its equity in the licence area, through farm-out, sale of equity interests, and/or asset swap, to a level that can allow the Company to have a much smaller, but materially significant, exposure in each of the opportunities for drilling. This would allow a prudent spread of geological risk across each stage of the exploration, appraisal and development cycle.

As part of this process Island completed the sale during the year of a 20% equity interest in Frontier Exploration Licence 1/04 to Supernova Energy BV, a wholly owned subsidiary of the Bluewater Group. Bluewater also brings FPSO expertise and technology to the Joint Venture Partnership and new international opportunities for the companies to evaluate jointly based on Island's status as an approved operator and the balance sheet of the Bluewater Group.

There is on-going farm-in interest in Island's Connemara oil field and adjacent exploration prospects which may or may not lead to a further reduction in Island's equity interest in this licence in the near future.

Ireland – Tír Na nÓg Oil Prospect, South Porcupine Basin



Operational review
continued

South Porcupine, 'Tír na nÓg Licence'

Frontier Exploration Licence 3/08

Blocks

61/9	61/10	62/6

Interest: Operator with 50%

Target reservoirs: Early Tertiary and Triassic sands.

South Porcupine, 'Tír na nÓg Licence'

Island was awarded FEL 3/08 in the Southern Porcupine Basin, adjacent to the Goban Spur on the Atlantic Margin, in March 2008 following the South Porcupine Offshore Licensing Round. The Licence lies approximately 250 kilometres off the south-west coast of Ireland. The Tír na nÓg Licence, which covers an area of approximately 800 square kilometres, is located in deep-water (averaging 1,500 metres). The Licence lies north of and is contiguous with ExxonMobil's Goban Spur Licence.

This area of the Porcupine and Goban Spur Basins is largely under-explored and has been tested by only one well to date, 62/7-1. This well is immediately adjacent to Island's new Licence and encountered live oil shows in the Lower Jurassic and good quality Middle Jurassic reservoir sands. The well did not reach the Triassic sands, terminating in section of early Jurassic age.

The Licence contains one very significant high risk/high reward exploration prospect, covering an area of up to 360 square kilometres, which Island and its partner Supernova Energy Ireland BV believe has the potential to be a multi-billion barrel target. Two potential reservoir targets have been recognised based on the existing 2D seismic coverage: an early Tertiary deep-sea turbidite fan (analogous to the reservoirs developed in a number of producing oil and gas fields in the UK Sector of the North Sea Central Graben area) and Triassic sands (in a structure potentially with a similar geological history to that of the Corrib gas field). Both targets can be juxtaposed in the same well. Both have the potential to be charged with oil from Jurassic source rocks which are believed to be present in the under-explored South Porcupine Basin.

Any success gained through the planned and future work being carried out in the Basin by other operators will significantly de-risk this prospect as well as potentially increase the level of interest from possible potential farminees. Frontier Exploration Licence 3/08 is effective from 12 March 2008 and is valid until 11 March 2021 unless surrendered or revoked. Unless a well is committed to on or before 12 December 2011, the Licence will expire on 11 March 2012. The work programme committed to during the first phase of the licence includes regional desktop studies, basin modelling work and new 3D seismic acquisition. Current activity will focus on investigating the potential for direct hydrocarbon indicators in the shallow early Tertiary potential reservoirs using existing airborne and satellite Seep Finder data.

Island and Supernova will be seeking additional partners, through a farm-out process, prior to the acquisition of the 3D seismic to further strengthen the joint venture partnership going forward.

International projects

Introduction

Our operating track record in Ireland has opened up many international opportunities for Island. We have approved operator status in Albania, The Netherlands, Moldova, and Morocco. Our integrated technical, commercial and legal team is currently active in a number of these countries in seeking out oil and gas field rehabilitation projects. Our status as an independent, politically unaligned, Irish operator will allow us to exploit further opportunities.

Island is focusing on building its portfolio in a small number of strategically important, energy deficient countries with potential for an expanding domestic energy market – these countries are promoting deregulation and the development of new indigenous resources to reduce dependence on imported energy. Geographically these are strategically important areas for developing more diversity in the sources of energy for Western Europe and for potential investment in alternative regional infrastructure routes.

Introduction continued

We have chosen countries that have proven hydrocarbon systems but lack new investment in exploration, appraisal and development. They were first looked at by the oil majors in the 1950s through to the early 1990s but then neglected due to the lack of material discoveries for the oil majors and a decline in oil price. Island is of a size and operating capability and technical expertise that it can quickly assess the wealth of historical exploration data to identify and exploit these new opportunities for appraisal and field rehabilitation projects through its stream-lined decision-making process and its ability to attract partners confident in Island's ability to deliver viable commercial opportunities.

The Netherlands

Assets of Island Oil & Gas BV

In May 2008, Island Oil & Gas Plc announced that it had sold its wholly owned subsidiary, Island Netherlands BV ('INBV') to Delta Hydrocarbons BV ('Delta').

The assets being disposed of included INBV's 83.33% interest in the Q13a Production Licence, which contains the undeveloped Amstel Oil Field, and its 100% interest in the Q13b Exploration Licence, covering the shallow part of the Licence and including the undeveloped Zaan oil field and several appraisal and exploration prospects.

The Consideration for the Transaction was US$25 million. In addition, Delta advanced to Island US$10 million (the 'Advance'). It is intended that the Advance will be repaid from an Overriding Royalty Interest ('ORI') granted to Island Oil & Gas BV ('IOGBV') of 2.5% of the gross (100%) export production from the Amstel Oil Field; and 2% and 1.5% respectively of the gross (100%) export production from the Zaan oil field and any other tie-backs via the future Amstel facilities resulting from any of the licence areas that are the subject of the Transaction. In the event that the ORI does not cover the full amount of the Advance any remaining balance would be repayable in cash or at Delta's discretion can be converted into Island shares at the average weighted 20 day trading price prior to conversion.

The Netherlands: Assets of Island Oil & Gas BV

Q13a Production Licence

Part-block

Q13a

Interest: 2.5% Overriding Royalty Interest

Target reservoirs: Lower Cretaceous Vlieland sands

Q13b Production Licence

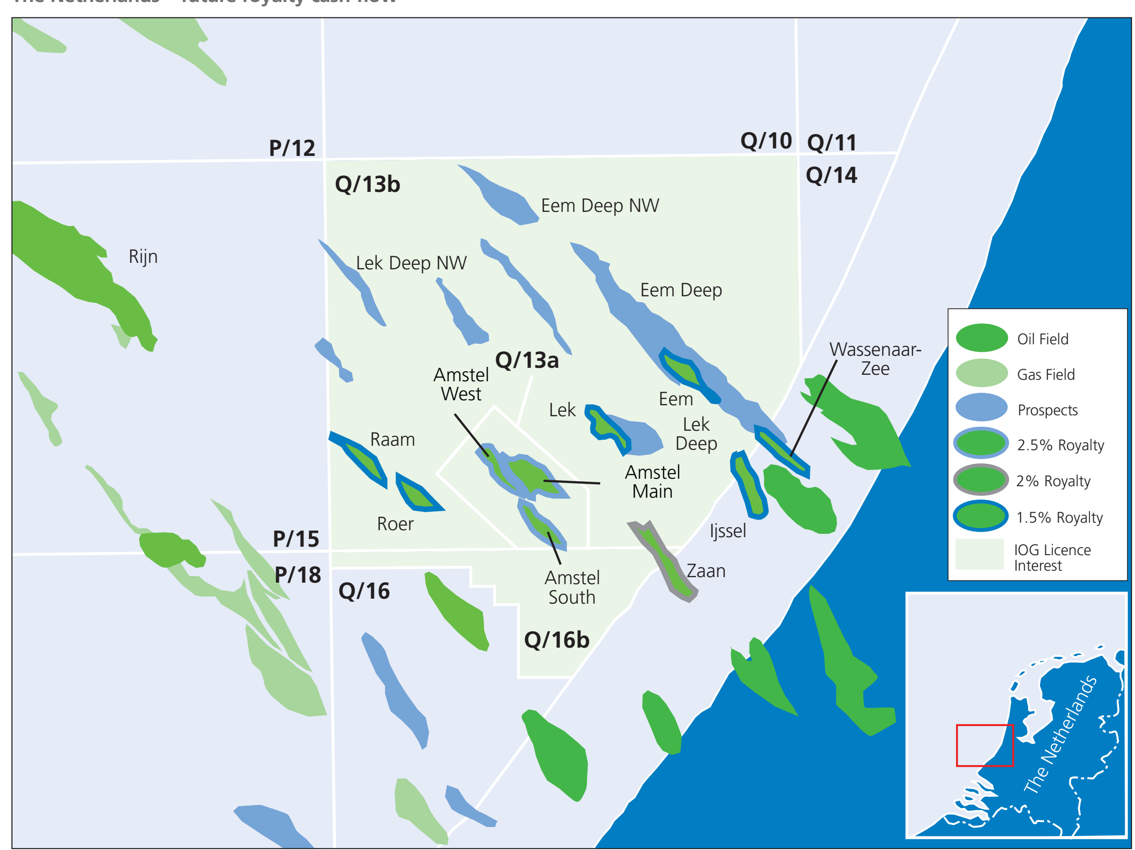
Part-block

Q13b

Interest: 2% and 1.5% Overriding Royalty Interests

Target reservoirs: Lower Cretaceous Vlieland sands.

The Netherlands – future royalty cash flow



Operational review
continued

Revenue from farm-outs
(Stg£million)

£1.137m

Revenue from sale of Company
(Stg£million)

£12.654m

Q13a Amstel Production Licence

The Amstel oil field is an appraised but undeveloped discovery that was awarded by the Dutch Ministry of Economic Affairs of The Netherlands as a Production Licence to IOGBV effective 17 November 2006 following Island acquiring the interest in the application for the Production Licence from Nido Petroleum for a cash consideration of Australian $300,000. Island's successfully operated drilling programme in the Celtic Sea offshore Ireland in 2006 was the principal reason for Island being approved as an operator in The Netherlands and therefore securing the ability to be awarded the Q13a Production Licence. A 16.67% interest in Q13a was subsequently sold to EnCore Oil for a cash consideration of Stg£1.5 million and a 10% overriding royalty interest in favour of Island on Encore's share of any future Amstel Q13a oil production.

Two overriding royalties of 1% each on Amstel Q13a production were also granted by Island in December 2007 in favour of, respectively, San Leon (The Netherlands) Limited and Aceiro Energy BV ('Aceiro'). The EnCore royalty is payable after cost recovery and is net of Encore's share of the San Leon and Aceiro royalties.

The Q13a production lease covers an area of 30 square kilometres in offshore The Netherlands and contains the undeveloped Amstel oil field. It lies in water depths of 21 to 23 metres approximately 10 kilometres from the Dutch coastline.

It was discovered in 1962 by NAM ('Shell/Esso'). The field is located in the West Netherlands Basin, a prolific oil and gas province in which, to date, over 1.3 billion barrels of oil, and 3 trillion cubic feet ('tcf') of gas-in-place have been encountered through drilling activity. The Amstel field is on trend with the producing Dutch offshore Rijn field and the onshore Wassenaar field.

Three wells have been drilled in Q13a: Q13-1, the discovery well, drilled by NAM in 1962, and Q13-6 and Q13-9, appraisal wells drilled in the 1990s by Pancanadian Petroleum Limited. Q13-8 flowed at 3,500 bopd from a reservoir at an average depth of 1820 meters subsea with 1.12 million cubic feet ('mcf') per day of associated gas. The other wells were not flow-tested but oil was proven from pressure testing and sampling. Despite the good flow rates the field was considered non-commercial in the 1990s primarily due to low oil price and supply economics.

Island added value to the project with a small investment in desk top studies to build a new reservoir model for the field to provide greater insight into the distribution of better quality reservoir sands which led to greater confidence in the proven and probable oil-in-place and assisted with the construction of a new reservoir simulation model to optimise the location of future development wells and hence potentially improve recovery factors. These studies also coincided at the time with a sharp rise in oil prices.

The hydrocarbon resources of the Amstel field are planned to be developed from 2 high angle or horizontal wells and one vertical well. Production start-up is anticipated during 2010 with oil produced through an unmanned wellhead protector jacket. The oil is anticipated to be exported through a 24 kilometre pipeline to the Rijn field platform facilities for processing and onward transmission.

The Dutch fiscal regime applicable to the Amstel field comprises Corporate Income Tax ('CIT') and State Profit Share ('SPS'). CIT is a general income tax applicable to all companies in The Netherlands and is therefore not petroleum-industry specific. SPS and CIT are interdependent, in that SPS is an allowable deduction for CIT and CIT is a creditable tax in determining the SPS payable. The 2007 overall CIT rate is 25.5% but reduced rates apply for taxable profits up to €25,000 (20% rate) and the taxable profit between €25,000 and €60,000 (23.5%). The SPS rate is 50% of the profit remaining after CIT has been deducted.

Total consideration
(Stg£million)

£14.168m

Q13b Zaan Exploration Licence

Island announced in April 2008 that the Minister of Economic Affairs of The Netherlands had awarded the Q13b Exploration Licence (the 'Licence') to Island Netherlands BV ('INBV'), a wholly owned subsidiary of Island, and Aceiro. Island, the designated operator, holds a 100% working interest in the Licence. The Licence is effective from 19 March 2008 and is valid for five years. Island filed a request with the Minister of Economic Affairs in The Netherlands for splitting the Licence into a shallow (oil) and deep (gas) part defined by the top of the Triassic stratigraphic marker. Island would operate the shallow part with a 100% equity interest and Cirrus Energy Nederland BV would operate, on behalf of its partner Petro-Canada Netherlands BV, the deep part in which Island will have no equity interest.

The Q13b Exploration Licence covers an area of 369 square kilometres and contains the northern part of the Zaan Oil Field, a Lower Cretaceous field with up to 12.4 mmb of gross oil-in-place based on material balance calculations generated by the Operator NAM following testing of the Q13-4 discovery well. Q13-4 flowed at an initial rate of 2,641 bopd from three separate oil-bearing intervals.

The Q13-5 well on the Licence also encountered oil shows in the Lower Cretaceous. An area covering 3.7 square kilometres, approximately the area of the Zaan Field, lies untested up-dip from the Q13-5 well and will be the subject of further evaluation.

The Q13b Exploration Licence further contains the North-West-extension of the Wassenaar-Zee field, where in 1980 the Wassenaar-Zee 01 well tested some 400 bopd, and several untested structures.

The Licence work programme includes the drilling, subject to technical and commercial justification, and testing of an appraisal well in the Zaan Oil Field in the second year of the Licence and a further well in the third year of the Licence.

The Zaan Oil Field and the Q13-5 Appraisal Prospect, if successfully appraised, are anticipated to be developed as satellite tie-backs to the Amstel field development project for relatively low incremental development costs.

IOGBV, through the Delta Transaction, has an Overriding Royalty Interest ('ORI') of 2% and 1.5% respectively of the gross (100%) export production from the Zaan oil field and any tie-backs via the future Amstel facilities resulting from any of the licence areas that are the subject of the Delta Transaction.

In May 2008, a 1% ORI previously granted on the Q13b licence by Island in favour of Aceiro was bought out and cancelled as part of the Delta Transaction.

Since acquiring the Q13a Amstel Production Licence in 2006 and the additional exploration and appraisal upside in the Q13b Zaan Exploration Licence in April 2008 for a low entry cost and prudently investing a small amount of capital in maturing the assets, Island has moved quickly to complete the cycle of acquisition, development and subsequent sale to monetise the value of its Dutch interests whilst retaining the potential for significant future cash flow arising from production from a Delta Hydrocarbons core-area development strategy. Delta Hydrocarbons bring the necessary technical expertise and financial strength to accelerate the development of this important asset.

Amstel is an example of a successful application of the Island business model. Island retains the belief that there is considerable potential for adding value through acquiring new licences in The Netherlands and is therefore considering new ground floor opportunities as and when they arise.

Operational review
continued

Albania

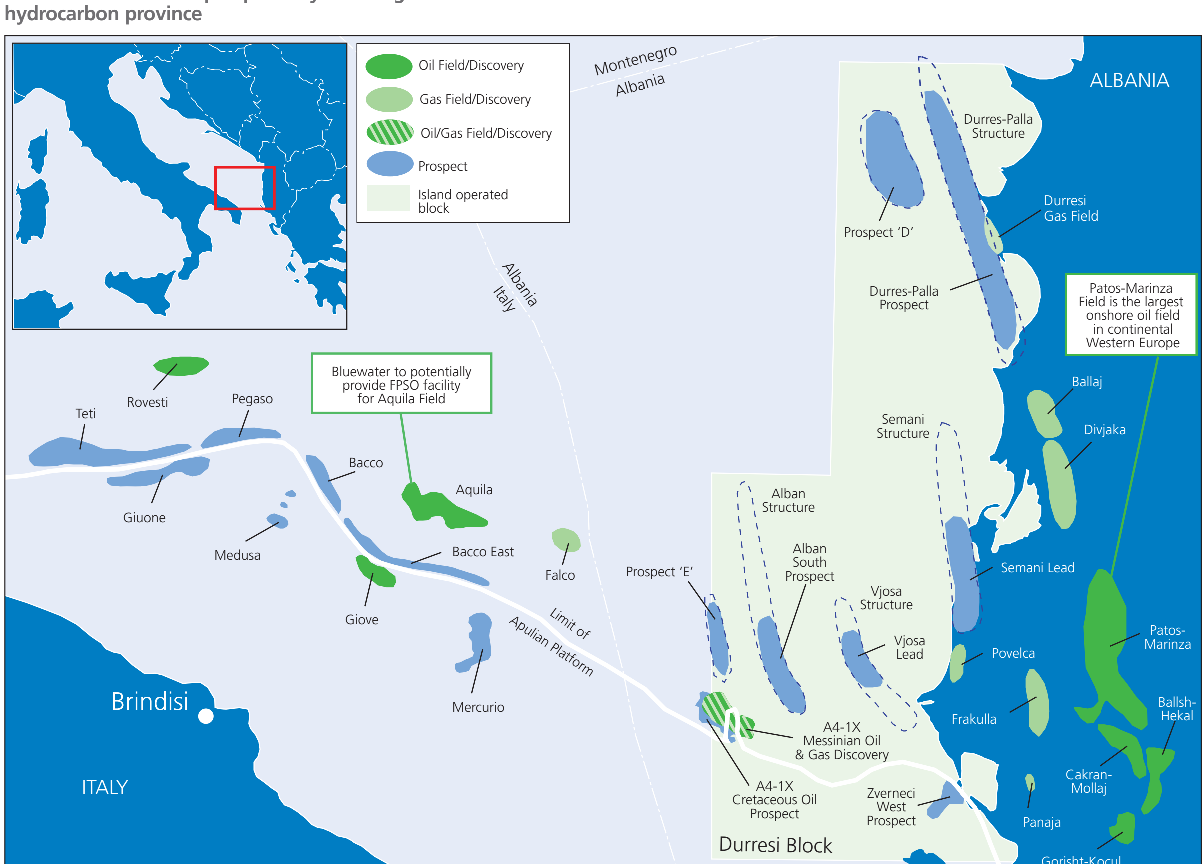
Albania occupies a pivotal strategic geographic position in South-East Europe, being the closest point in the Adriatic Sea to the Italian mainland and the vast natural gas and LNG market of Southern Europe. South-East Europe lacks significant indigenous gas resources: for example Greece has no domestic gas production but is supplied with gas from Gazprom (through Bulgaria), LNG (via Sonatrach in Algeria) and via the Turkish gas infrastructure network. There are plans for a West Balkan gas pipeline to transit gas from Turkey through Greece to the West Balkan Region and from there to Austria. There are also plans for an interconnector between Greece and Italy and potentially for oil and gas interconnectors ('AMBO' and 'TAP') between Albania and Italy to carry Caspian and Black Sea oil and gas to Italy and, if appropriate, from there to Europe. Security of Western European gas supply is currently a significant political issue, with the long term objective being to diversify the sources of gas supply by by-passing the Russian gas export infrastructure. Conversely the Balkan region is also seen as an alternative export route for Russian oil and gas (with a Russian-built oil pipeline to the port of Vlora in Albania and an LNG plant in Bosnia being considered).

Albania has been a republic since 1991 and has made significant political and economic progress since that time, culminating in the signing of a European Stabilisation and Association Agreement. GDP and Per Capita Income has increased steadily since 1999.

A favourable investment environment is being promoted. The EBRD is actively investing in Albanian infrastructure projects. Albania's medium term objective is to apply for membership of the European Union which, if achieved, will act as an additional catalyst for economic growth and the development of indigenous energy resources.

More than 3,000 wells have been drilled in onshore Albania in what is a proven hydrocarbon province. Oil production peaked at 50,000 bopd in the mid-1970s but then declined rapidly due to lack of investment in new secondary recovery technologies to rehabilitate depleting fields. The largest onshore field, Patos-Marinza, is currently being rehabilitated by Bankers Petroleum and is producing over 6,600 bopd. Target production levels are 20,000 bopd by 2010.

Albania – Oil and Gas prospectivity in a long established hydrocarbon province



Albania continued

Gas production in Albania reached 0.2 billion cubic metres per annum ('bcma') from the 1970s to the end of the 1980s but currently there is minimal domestic gas production.

Since 1991, only six wells have been drilled onshore Albania and six wells offshore. The only significant discovery made in that time was made by Chevron/Agip in 1993 in Island's Durresi Block. OMV, the previous licence holder, has estimated potential resources of 38 mmb of condensate (54 degrees API) and 151 bcf of gas.

Two oil refineries are operational but have limited capacity. Some oil is now exported directly to refineries in Italy. The onshore oil and gas pipeline infrastructure requires investment in upgrading and maintenance.

Albania represents a developing market with high potential in a proven hydrocarbon province where full exploitation of its indigenous oil and gas resources potential is lacking due to under-investment in recent times. It is therefore an ideal candidate for the Island business model.

Offshore Albania, Durresi Licence

Durresi Production Sharing Contract ('PSC')

Durresi Block

Interest: Operator with 100%*

Target reservoirs: Miocene and Pliocene sands and Cretaceous and Jurassic limestones.

* Island's interest reduces to 75% on completion of a farm-in agreement with Beach Petroleum and to 55% should Beach exercise an option to drill.

Offshore Albania, Durresi Licence

The Durresi Block covers an area of 4,200 square kilometres along the Adriatic coast of Albania and at its nearest point is only 35 kilometres from the Italian coastline. Most of the Block extends over the shelf and lies in less than 200 metres of water. The south-west part of the Block extends to water depths of up to 700 metres.

This area of the Adriatic is sparsely explored. However, the drilling of only four wells to date in the entire licence area has confirmed the existence of an active petroleum system with the discovery of gas and condensate (ultra light oil) in the A4-1x well. There are three well-developed petroleum systems which are the targets for future drilling activity on the Block.

The first is a biogenic dry gas play in post-Messinian Evaporite turbidite and deltaic sands of Pliocene and later Messinian age. Analogous producing gas fields occur in the Po Valley in Italy and in Croatia. Historical gas production onshore Albania was mainly from these sands. Depleted onshore gas fields such as Divjaka, Povelca and Frakulla are located on the flanks of large north-northwest trending anticlines extending for tens of kilometres. The structures extend offshore into the Durresi Block where they have been tested only in one case, and only at a crestal location. Data from the onshore fields indicate that gas sands are encountered primarily on the flanks of the structures and not in crestal positions. The biogenic gas play is well developed in the northern part of the Block on the western flank of the Durresi Anticline, where an onshore discovery was made at Durresi in Miocene turbidites. The offshore area within the Block is covered by a 400 square kilometres 3D seismic survey which has identified several potential gas sand packages on the western flank of the Durresi Anticline.

The second is a thermogenic wet gas and oil play in pre-Messinian Evaporite turbidite and deltaic sands of later Miocene age and Messinian deltaic sands. Analogous producing oil and gas fields occur onshore Albania. The Patos-Marinza oil field onshore Albania, operated by Bankers Petroleum, is one of the largest oil fields in continental Europe. In April 2005, a Canadian National Instrument independent reserves evaluation indicated P50 original in place oil of 1.95 billion barrels with proven and probable resources, based on the shallow depth of the reservoir and the low gravity of the oil, of 98 mmb. The reservoirs are Messinian deltaic sands. The distal equivalents of these oil sands were encountered offshore at much greater depth in the A4-1x discovery well in the Durresi Block, where they were found to contain wet gas and condensate/ultra-light oil. This discovery was never appraised at the time by Chevron and Agip, partly due to low oil prices and the lack of a short term potential gas market in Albania. The Durresi Block is covered by approximately 8,800 kilometres of existing 2D seismic data. Island is currently focused on reprocessing some of these data to determine the potential for identifying hydrocarbon-bearing sands from their seismic rock property signature. If this technique proves successful the next step would be to acquire 3D seismic data over the A4-1x discovery to determine the possible extent of these hydrocarbon-bearing intervals. In addition to this potential Messinian drilling target, the Alban Anticline forms a second possible drilling objective

Operational review
continued

Well head oil seep on shore Albania (not Island acreage)

Oil staining in fractured Upper Cretaceous limestones, Albania

Offshore Albania, Durresi Licence continued

to test this play. The structure extends over a distance of 30 kilometres and has been tested by one well in the northern part of the structure which was drilled in a crestal position. The well encountered thermogenic gas shows but was drilled north of the limit of the Messinian hydrocarbon bearing sands encountered in A4-1x and the Patos-Marinza oil field onshore Albania. The primary objective, the Tortonian-age deltaic sands similar to those producing onshore at the Divjaka field, were not reached due to difficulties in controlling over-pressuring whilst drilling the original well. These two targets remain highly prospective over the southern part of this very large structural feature and are the focus for seismic reprocessing and modelling to determine the potential for identifying hydrocarbon-bearing sands from their seismic rock property signature.

The third petroleum system active in the Durresi Block is an oil play in the late Jurassic to early Cretaceous shallow water shelf and deeper marine turbidite limestone reservoirs associated with the edge of the Apulia Platform and charged from the underlying Triassic-oil prone source rocks. Several oil fields, Rovesti and Aquila for example, are developed along this trend immediately adjacent to the Durresi Block in Italian waters. The A4-1x well penetrated reefal limestones at the base of the Miocene and in the uppermost Cretaceous but encountered only heavy residual oil. The effectiveness of the seal at the time of migration is an issue due to prolonged uplift and flushing at the base Miocene unconformity. The well was terminated in the Upper Cretaceous. The Zverneci-3 well, drilled onshore by Albpetrol in 1988 at the edge of the Apulia Platform, encountered light oil shows in Lower Cretaceous leached shallow water limestone reservoirs. These reservoirs are believed to extend beneath the A4-1x well and to be contained in an untested structure covering an area of up to 38 square kilometres. The presence of oil, condensate and gas at shallower levels in the A4-1x well provides proof of hydrocarbon charge and therefore the potential for untested deep oil plays is high. Island and Beach are currently focused on evaluating the deep Cretaceous structure with a view to deepening the A4-1x well to evaluate the oil potential of the deeper Cretaceous and Upper Jurassic reservoirs whilst flow testing the already penetrated shallow Miocene gas/condensate (ultra-light oil) reservoirs.

Any success gained through the planned and future work being carried out in the Italian sector of this part of the Adriatic Basin by other operators, will significantly de-risk Island's prospect as well as potentially increase its value.

In 2007, Island agreed farm-out terms with Australian company Beach Petroleum Limited ('Beach'). The farm-out will result in Beach acquiring an initial 25% equity interest in the Durresi Block for back costs. Island has granted Beach an option to increase its equity to 45% by contributing 55% of the dry hole cost of one well at a location to be mutually agreed between both parties. Currently both parties anticipate deepening and testing the A4-1x gas/condensate discovery.

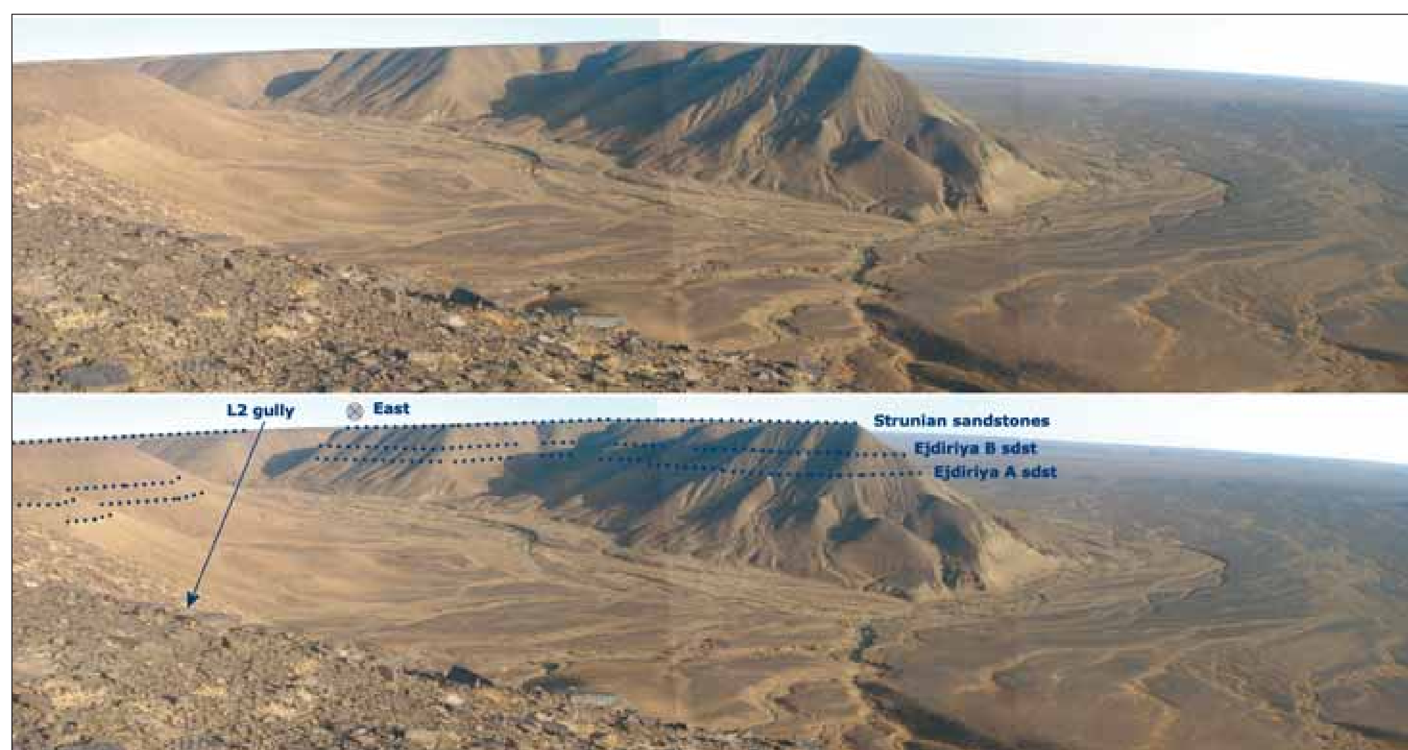
The assignment of interests from OMV and Lundin to Island has been approved by AKBN, the Albanian agency responsible for the oil and gas sector. However, a condition of all the above transactions requires Island to be granted a one year extension to the First Exploration Period of the Production Sharing Contract ('PSC') to allow Island sufficient time to plan for and execute in a timely manner the drilling of one commitment well. This requires the approval of the Council of Ministers in Albania following a positive recommendation from AKBN. In August 2008, the Albania Government also introduced a new 10% royalty tax for all existing and future PSC's. In order that the economic criteria for existing PSC's be maintained it has been agreed that it will be necessary to renegotiate the terms of the existing PSC's to ensure that the new royalty tax does not adversely impact the original profit margins as defined by the current PSC's. The new PSC terms will also require the approval of the Council of Ministers.

Offshore Albania, Durresi Licence continued

Island has sought and been granted a 'Suspension Period' until the new PSC terms and extension to the First Exploration Period have been approved by the Council of Ministers. The one year extension to the First Exploration Period will then run from the date of approvals given by the Council of Ministers. This gives Island, as operator, sufficient time to plan its drilling activities and to complete farm-out transactions to seek a carry through the drilling of the proposed well.

The Durresi PSC is effective until August 2011, unless surrendered or revoked. The work programme committed to during the First Exploration Period includes 1,000 kilometres of seismic reprocessing (completed); a 400 square kilometre 3D survey (completed); and the drilling of one exploration well with 35% of the licence area being relinquished (outstanding). Current activity will focus on planning to deepen the A4-1x structure and Island is advancing its plans to farm-out the well.

The Durresi Block contains a number of low risk exploration and appraisal targets for oil and gas in an area of high potential in the Southern Adriatic. It forms a core area in Island's future corporate strategy. There is the potential for the Durresi Block to contain several tcf of undiscovered dry gas which if realised would further greatly increase the strategic importance of this region as a potential source of new gas for the European market. The Southern Adriatic Region has geo-political significance and is consequently attracting renewed industry interest. The Durresi Block fits Island's strategy of acquiring proven hydrocarbon discoveries with the potential for near and medium term development, at a reasonable entry cost and in a favourable investment environment.



Paleozoic outcrops in The Zag Basin, Morocco

Operational review
continued

Morocco

Morocco represents a favourable investment opportunity for Island. The country is politically and economically stable and is growing in importance as a potential new energy market in Northwest Africa as deregulation of the oil and gas industry is being implemented to create the freedom to sell oil and gas to the domestic market.

Morocco's gas consumption over the next five years is estimated to be 115 bcf, rising to 175 bcf by 2015. Morocco currently imports 78% of its requirement for gas. The gas is used mainly for power generation and refinery operations. The demand for electricity is currently growing at 8% per annum in Morocco which shows that the country is hungry for new sources of energy supply.

To address this, Morocco is also planning to build a 176 bcf LNG Terminal in either Jorf Lasfar or in Tangier and a 400 to 500 kilometre pipeline which will connect the terminal to the main industrial centres and to future power plants.

Morocco is promoting the development of gas consumption. A 'Gas Code' has been implemented and it will be approved by the Government and the two Chambers of Parliament by the end of 2009.

Morocco's current refining capacity is 7.7 million metric tonnes but is expected to be increased in the near future. The average annual growth rate of demand for petroleum products is 6.5%. There is a growing hydrocarbon transport infrastructure system, including pipelines, ports, tankages and marketing outlets.

Indigenous oil and gas production is limited. The current oil production is restricted to 11,100 metric tonnes per annum. Gas production increased from 26 thousand cubic metres in 2005 to 61 thousand cubic metres in 2007 from which currently only 7.5% of the produced gas is used for power generation.

In 2006, ONHYM, the Moroccan State oil company, also made gas discoveries in the Gharb region, which are reported to have combined resources of at least 10m cubic metres.

There is significant renewed industry interest in Morocco with 30 foreign companies holding interests in 100 permits.

The presence of active petroleum systems has been confirmed by drilling to date which has proved up commercial resources in the more adequately explored basins. However, many sedimentary basins remain sparsely explored, particularly the Palaeozoic basins, which bear great geological similarities with the prolific oil- and gas-producing basins of Algeria and Libya, and the offshore basins, where the geology also bears some similarities with the neighbouring deep-water basins in Mauritania, where recent world-class discoveries have been made.

The under-explored nature of Morocco is reflected in the current well density of 0.04 wells drilled per 100 square kilometres, much lower than the global average of eight wells per 100 square kilometres. The statistical chance of new significant oil and gas finds being made is therefore high, particularly in those areas that were lightly explored in the 1960s and early 1970s before the advent of modern seismic acquisition and processing techniques.

Carboniferous Conglomerates, Zag Basin, Morocco

Morocco continued

ONHYM has a highly skilled technical and administrative team that allows for rapid award of licences relative to many other countries. In addition there is an exhaustive and freely accessible exploration database available.

Morocco has an attractive fiscal regime which includes the following key features:

- Maximum State participation 25%; first 300,000 tonnes of oil and 300 cubic metres of gas are exempt from royalties;
- The Moroccan Code offers a 10 year corporate tax holiday from the start of regular production and consolidation that allows exploration costs, including dry hole costs, to be deducted against revenues of any exploitation concession held by the tax payer;
- Royalties and surface rentals are fixed and are tax deductible.

Morocco is therefore a country that is ideally suited to the Island business model: low entry costs; under-explored but with several proven and active petroleum systems; benign fiscal regime; strategic geographic significance with respect to the European gas market and a potential North American LNG market; and energy hungry with the exploitation of indigenous oil and gas resources being positively encouraged.

Onshore Morocco, Tarfaya Permit

Tarfaya Exploration Licence

Interest: Operator with 40%*

Target reservoirs: Triassic sands and Jurassic limestones.

* Island's interest reduces to 30% if ONHYM, the State oil company, exercises its right to back-in in the event of a commercial discovery.

Onshore Morocco, Tarfaya Permit

The Tarfaya Exploration Licence is located in Southern Morocco and covers an area of 13,434 square kilometres. It is located onshore and borders the coastline of the Atlantic Ocean. The Exploration Licence was awarded by ONHYM in November 2007 and is effective from 14 January 2008 for an eight year term divided into three work phases. ONHYM has the right to exercise a back-in option of up to 25%, reducing Island's net interest to 30% if ONHYM were to exercise its back-in option to the maximum extent. State participation is carried only through the exploration phase with no reimbursement for exploration costs.

The Phase 1 work programme for the licence is of 30 months duration and requires the acquisition, processing and interpretation of 500 kilometres of 2D seismic data and to conduct geochemical modelling. A drill or drop decision will be made at the end of the initial period.

Based on the existing seismic and well database in the Licence area, 15 exploration leads have been identified and mapped. There are two primary play types related to Mesozoic age reservoirs: Jurassic marine carbonate platform sediments and Triassic continental fluvio-deltaic red bed clastics. These occur at between 2,500 and 4,000 metres and 4,000 to 5,200 metres respectively. Fault- and dip-closed structures and anticlinal folds with four-way dip closure have been identified to date.

On-trend discoveries include the offshore Cap Juby Field and fields in the Essaouira Basin. Cap Juby is the nearest oil field on trend with Tarfaya and lies only 40 kilometres offshore from the Tarfaya Licence. The field was discovered in 1969 by Esso with the drilling of the MO-2 well. The well flowed 10 to 12 degrees API oil at a rate of 2,377 bpd from an Upper Jurassic fractured limestone at a depth of 2,076 metres subsea. A subsequent appraisal well on the flank of the structure encountered a small amount of light 38 degrees API oil from an older Jurassic limestone reservoir, thus proving the light oil potential of the area. Oil migrated and was trapped in the Cap Juby structure during the Middle to Late Cretaceous, however the structure was deeply eroded at the beginning of the Tertiary at which time the oil was biodegraded.

Operational review
continued

Onshore Morocco, Tarfaya Permit continued

The Cap Juby field has not been monetised to date due to the heavy nature of the oil and the complex reservoir distribution. However, this proven oil play extends onshore into the Tarfaya Licence where the influence of Tertiary erosion is much less and the potential for the preservation of light oil in the Jurassic is very high.

A total of seven discoveries in the Triassic and Jurassic intervals were made in the onshore Essaouira Basin, north of the licence area, including one oil field and two gas and gas-condensate fields.

The principle structural leads in the Tarfaya Licence are the Daora Structure, covering a probable area of 23 square kilometres and prospective for multiple targets in the Jurassic and Triassic; and the J North Structure, covering a probable area of 105 square kilometres with a primary reservoir target in the Trias.

Netherland, Sewell and Associates have produced a Competent Persons' Report for San Leon Energy Ltd, one of Island's partners in the Tarfaya Licence, as part of that Company's AIM Listing requirements, which gives, as of 1 May 2008, gross unrisked 'Probable Prospective' oil in place for the Tarfaya exploration leads of 2,511.5 mmb and gross 'Probable Prospective Oil Resources' of 711.3 mmb. It quotes gross unrisked 'Possible Prospective Oil Resources' of 3,878.6 mmb. For the J North Triassic Structure Netherland, Sewell and Associates prepared unrisked economics for the unrisked 'Probable' ('Best Estimate') development case of 156 mmb of gross oil resources. Using an oil price of US$80/barrel, this gave a gross unrisked value of approximately US$708 million discounted at 10% NPV. Netherland, Sewell and Associates have risked the chances of success for the J North Structure as 0.09%.

Island, the operator of the Tarfaya Licence, has currently completed a review of prospectivity and will now embark upon a seismic reprocessing programme to high-grade prospects for new infill seismic acquisition in order to define potential drilling locations.

Island will continue to prudently manage its exposure to the potential cost of the Phase 1 work commitment through farm-outs or the sale of equity interest in the Licence in order to accelerate drilling activity in this very prospective Mesozoic basin. As part of this process, and in order to secure an interest in this potentially valuable licence, in January 2008, during which time Island's business growth strategy was constrained by the terms and conditions of Island's outstanding debt facility with RMB, Island agreed with its partner in the Tarfaya Licence, Longreach Oil & Gas Ventures Limited ('Longreach'), that Longreach would carry Island's share of the Bank Guarantee (US$400,000), required to be put in place at the time of execution of the Tarfaya Licence, based on certain agreed terms and conditions as follows:

- Carry Longreach's share of all costs incurred in relation to the Tarfaya Licence up to an amount equivalent to US$420,000 plus interest at 2% above Federal Reserve Rate;
- Grant Longreach an overriding royalty of 0.2% of gross monthly production, attributable to the Island interest, in any FSU licence it acquires jointly with its Moldovan partner Valiexchimp. In the event that none of these projects in the FSU were executed within one year of putting in place the Tarfaya Bank Guarantee, then Island would grant Longreach an overriding royalty, attributable to the net Island interest, of 0.4% of gross monthly production in the Tarfaya Licence and of 0.2% of gross monthly production in the Zag Reconnaissance Permit.

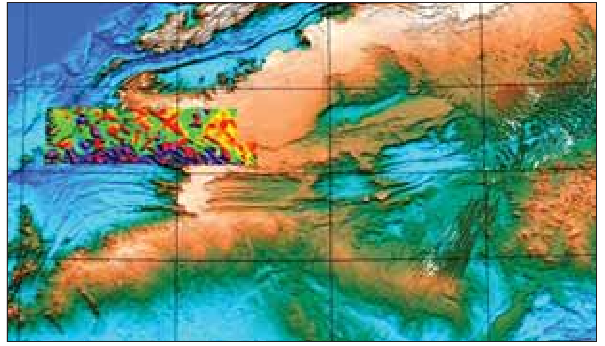
Onshore Morocco, Zag Basin

Zag Exploration Reconnaissance Licence

Interest: Non-operator with 20%*

Target reservoirs: Palaeozoic sands.

* Island's interest reduces to 15% if ONHYM, the State oil company, exercises its right to back-in in the event of a commercial discovery.



2008 Aeromagnetic survey confirms potential for large structures

Onshore Morocco, Zag Basin

The Zag Exploration Reconnaissance Licence is located in Southern Morocco and covers approximately 21,807 square kilometres. The Licence was awarded on 12 December 2006 for an initial 12 month period. ONHYM subsequently granted a 12 month extension valid until December 2008 at which time a decision will be made to convert the Reconnaissance Licence to an Exploration Licence.

The current work programme includes reviewing existing studies; conducting geological field studies and a geochemical study; acquisition, processing and interpretation of aeromagnetic data; and the interpretation of satellite image data. The integration of these data will aid in high-grading areas for acquisition of a future 2D seismic survey to delineate leads and prospects.

The Zag Exploration Reconnaissance Licence lies within the Zag-Tindouf Basin of Southern Morocco and Western Algeria and is the westernmost of the prolific hydrocarbon-producing Palaeozoic Basins of North Africa. The Palaeozoic and Triassic reservoirs contain some 43% of known oil and 84% of the known gas resources of the entire North African region, with more than 460 billion barrels of oil equivalent of recoverable hydrocarbons discovered in 350 separate accumulations. The Zag-Tindouf Basin is predominantly a gas-prone hydrocarbon system. As a result of this the basin is poorly explored because historically it was considered remote and lacking production and transportation facilities. Large gas discoveries in Algeria and Libya, planned export gas pipelines to the European market together with the potential to transport gas to Morocco's Atlantic Margin for conversion to LNG and export to the United States market, the lack of a strategic gas reserve and gas storage facilities in Morocco, the renewed political focus on security of supply issues, have revitalised industry interest in the Zag-Tindouf Basin, as demonstrated by the fact that Petro-Canada holds acreage immediately to the north of and adjoining Island's licence interest.

The Zag-Tindouf Basin contains in excess of 8,000 metres of sediments and therefore the central parts of the basin have the potential to contain mature hydrocarbon source rocks. Despite this only eight exploration wells have been drilled in the Zag Basin, between 1961 and 1965. There is no indication that seismic data were ever acquired in this basin. Two wells encountered gas shows in the Palaeozoic. The Morcba-1 well, drilled in 1965, was classified as a gas discovery after testing 0.3 million cubic feet of gas per day ('mm cfgpd') from Silurian reservoirs at 650 metres.

The Zag-Tindouf Basin extends into Western Algeria and shares a common tectonic and sedimentary history with the Reggane Basin of South-Central Algeria. The Reggane Basin has been more extensively explored between 1957 and 2005. Gas has been tested from Ordovician, Lower Devonian and Carboniferous reservoirs, at depths between 1,500 and 4,500 metres subsea, at rates varying from 1.17 to 33 mm cfgpd. B.P. made two gas discoveries in 1980 and Sonatrach drilled ten exploration wells from 1995 to 2005 in the Reggane Basin. Estimates of discovered gas-in-place up until 2003 are 1.4 tcf (Petroconsultants). Repsol is reported to have drilled 13 exploration wells since 2003 in the Reggane Basin and to have made 5 gas discoveries with proved and probable resources in the order of several tcf.

From the available well data and surface rock outcrops, the Zag-Tindouf Basin is interpreted to contain the same prolific Silurian source rocks that are present in the Algerian and Libyan hydrocarbon-producing basins and to have sourced the gas discovered to date in the Morcba-1 well drilled in 1965.

The Zag Basin is in the earliest stages of exploration with drilling prospects yet to be identified. Initial geological studies by the Operator, San Leon Energy Ltd, have been completed and have demonstrated the presence of an active petroleum system. A 19,750 line-kilometre aeromagnetic survey will be acquired, processed and interpreted during the latter part of 2008. The objective will be to delineate deep basin structures over which 2D seismic will be acquired, subject to converting the Reconnaissance Licence into an Exploration Licence, to further assess the potential for the presence of fault block and folded anticlinal traps similar to those containing the hydrocarbons in the Palaeozoic oil and gas fields of Algeria and Libya. The Zag Basin in Southern Morocco has the potential to be a significant source of gas in North-West Africa, close to the European Market, in future years. Post year end, (October 2008) Fugro Robertson has completed for the Zag licensees a scoping economic analysis and feasibility study for a potential gas development in the Zag Basin. The results are positive and support the potential for the Zag Basin to make a significant contribution to the development of indigenous gas resources in Morocco in the event that future exploration drilling proves successful.

Oil and Gas Field Rehabilitation and Development Projects

Moldova, Former Soviet Union, South-East Europe and North-West and West Africa

During the past year, Island has been evaluating a number of potential oil and gas field rehabilitation and development projects in Moldova, the Former Soviet Union ('FSU'), South-East Europe and North-West and West Africa. We have high-graded a small number of these projects based on the quality of the available technical, commercial and legal information and the likely entry costs. The ability of these projects to support the raising of the seed investment capital required to 'kick-start' operations and the timing of positive cash flow from operating revenues are key considerations for ranking the opportunities that are currently available to Island.

During the year, we have pursued evaluating the Moldovan opportunity. Post year end, the changing economic climate and weakening commodity prices requires that, in common with many of our industry peers, Island re-evaluates and ranks each and every opportunity that is available on the basis of the cost of acquiring and progressing the development of new assets. Island will complete this process by the end of 2008 to ensure that the commercial terms Island may offer to acquire new assets are consistent with the prevailing economic climate and recognise the fact that Island will wish to operate any assets that are subsequently acquired.

Valiexchimp S.R.L., comrat oil refinery

Moldova

Moldova is very much a net energy importer. All its requirements come primarily from Russia via part of a strategic gas pipeline infrastructure that passes through the Ukraine, which in Moldova is jointly owned by Gazprom and the Moldovan State. In 2001, oil consumption amounted to approximately 24,000 bpd. Energy shortages are a common occurrence in Moldova. Moldova wishes to reduce its reliance on imported energy and is therefore seeking to stimulate and encourage domestic oil and gas production from the country's only two producing fields – the Valeni oil field and the Victorovca gas field. Both assets have the potential to generate immediate cash flow for Island should Island progress to acquire an interest in the fields for an acceptable entry price.

Efforts to diversify Moldova's sources of energy supply include arrangements to access secure international supplies through 'Protocol Agreements' of economic cooperation with FSU countries (such as Tatarstan for example). This would potentially involve investment and the provision of new drilling and completion oil technology by an indigenous Moldovan exploration and production company in field rehabilitation projects in such countries. Island envisages that, through its wholly owned Dutch subsidiary Island Moldova BV, it would become a 50:50 stakeholder with Valiexchimp in a Moldovan registered joint venture company thereby allowing Island access to potential oil field rehabilitation projects in the FSU for a relatively low entry cost, in order to meet Island's medium term business strategy to increase its potential cash flow from producing assets and add value through Island's status as an approved and successful operator. However, there are now alternative options for Island to become involved in similar projects in the FSU without necessarily pursuing this option.

Moldova has only one fully operational refinery (the Comrat refinery). This was built in 2005 and refurbished in 2006 and 2007. The refinery has a current capacity of 684,000 bbls per year based on 365 operating days per year. The refinery has been processing both indigenous oil from the Valeni oil field and imported oil from the Ukraine. It is not currently operating anywhere near full capacity. The refinery produces high quality gasoline from the Valeni field feedstock for the local market and for export at near market prices to Romania and Bulgaria. If working at full capacity the refinery could satisfy up to 10% of the demand for oil-based energy products in Moldova.

The refinery is owned by AS Petrol, a subsidiary of Valiexchimp. Although Island is an upstream company and does not naturally become involved in downstream refining activities, there would be potential added value to the existing upstream activities in Island acquiring an interest in the refinery.

Moldova represents a developing indigenous energy market with high potential in a proven hydrocarbon province where full exploitation of its indigenous oil and gas resources potential is lacking due to under-investment in recent times. It is therefore a potential candidate for the Island business model under the right investment conditions.

Moldova continued

In November 2007, Island announced that it had concluded a Memorandum of Understanding with Valiexchimp, a privately owned Moldovan oil and gas company, covering a number of upstream and downstream assets in the Republic of Moldova. The principal upstream asset owned by Valiexchimp is the Moldovan Concession Agreement that was executed in 1995 between an American company, 'Redeco', and the Moldovan Government. This gave Redeco the exploration and exploitation rights for the whole of Moldova until 2015, subject to the exercise of certain options on extensions. During 2007, the Moldovan Government approved the transfer of the existing rights and obligations under the Concession Agreement to an indigenous Moldovan private oil and gas company, Valiexchimp, as a consequence of the reorganisation of Redeco Limited after it was bought by Valiexchimp. A condition of the transfer of the Concession Agreement to Valiexchimp was that as Redeco's exclusive Concession rights had expired in 2005, Valiexchimp's rights and obligations would be restricted solely to the areas covered by the Valeni and Victorovca oil and gas fields.

Valiexchimp S.R.L., Valeni oil field

Valeni oil field

Production from the Valeni oil field, discovered by the Russians in 1957, comes from Lower Pliocene Reservoirs at an average depth of 450 metres subsea. The Valeni structure is subtle, based on historical drilling results, and requires modern 2D seismic imaging to determine the maximum extent of the structure and the location of possible satellite structures.

The Russians produced the field at relatively low rates from 1958 to 1982 before abandoning operations. Redeco took over the field in 1995 but after 2005 the field again fell into decline due to lack of investment and operational management. Due to the low gravity of the oil (approximately 18 degrees API), the low reservoir pressures, the current lack of modern logs to assist with selection of intervals for perforating the thin-bedded reservoirs to avoid zones with high water saturations, and the lack of modern completion techniques, there is scope to potentially improve average well productivities.

Victorovca gas field

The Victorovca gas field is located on a north-west-south-east trending subtle anticline covering up to 30 square kilometres. The gas occurs in Lower Pliocene sandy limestone reservoirs similar to those present in the Valeni oil field to the south. Gas was discovered by the Russians in 1963. The field was appraised during 1963 to 1967 and indications of moderately pressured gas (40 to 48 atmospheres) were confirmed at an average depth of 600 metres. During one extended well test over 82 days gas flowed at a sustainable rate of 9,100 cubic metres per day whilst downhole pressures remained fairly constant at 40 atmospheres.

Based on a Reserves Report for the Valeni and Victorovca fields generated in March 1996 by W. Scott Epley, a Consulting Petroleum Geologist based in Midland, Texas (the 'Epley Report'), the initial total recoverable resources for the Valeni oil field were estimated to be 580,000 tonnes of which 43,000 tonnes have been produced to date. This leaves approximately 537,000 tonnes of proved and probable resources to be produced (equivalent to 3.92 mmb). These resources only include three of the five potential oil-bearing reservoir intervals. This figure has now been approved by the Moldovan Commission for Reserves.

The Epley Report also estimates remaining recoverable resources in the Victorovca gas field to be in the range from 8 to 10 bcf.

Currently Island has completed its initial technical, commercial and legal due diligence on the assets that are the subject of the Memorandum of Understanding with Valiexchimp to a sufficient level in order to be able to sign a mandate letter with the EBRD in order to progress to the next stage of seeking to finance the investment required to increase production levels from the Valeni and Victorovca oil and gas fields respectively. This is involving the commissioning of a comprehensive Environmental Impact Study and the generation of a new independent Petroleum Engineering and Resources Report to bring up to date the resource potential of the fields and to re-categorise the resources based on current reporting standards.

Post year end, in the light of the fall in oil and gas prices, Island is reviewing the Memorandum of Understanding with Valiexchimp with respect to the commercial terms outlined therein with particular focus on minimising the entry costs.

Paul Griffiths
Chief Executive

Board of Directors

Bryan Benitz
75, Non-executive Chairman

Bryan spent his career as an investment broker. During this 45 year period he funded junior resource companies, particularly in the energy field. He was formerly a member of the New York and Toronto Stock Exchanges. Bryan sits on Island's Audit Committee, Remuneration Committee and Nominating & Corporate Governance Committee.

Paul Griffiths
54, Chief Executive

Paul is a career geologist and geophysicist with over 29 years' experience in international oil and gas exploration. Paul co-founded IPDL, an Irish exploration company, in 1998, where he built a portfolio of oil and gas assets offshore Ireland prior to its sale in September 2002 to DNO ASA.

Responsible and expert direction

Carl Kindinger

57, Chief Financial Officer and Executive Director

Carl is a UK qualified accountant (ACMA) as well as holding a Bachelor's degree in Economics and a Masters in Business Administration. He has held both financial and general managerial posts of increasing seniority in medium-sized multinational companies covering a variety of industries including mining, ethanol production and fuel distribution in Africa and the Middle East for the past two decades. He has considerable experience in financial planning, project cost control, feasibility studies, cross border mergers and acquisitions and international tax planning. Carl has successfully raised finance for both project and working capital from international banks, and has managed a number of IPOs.

Adrian Doull

64, Non-executive Director

Adrian has a long association with the oil and gas industry, particularly in North America where he was Chief Operating Officer of the Anglo American Group's operating businesses. He has been on the board of a number of oil and gas companies, including Adobe Oil & Gas, Francana Oil & Gas, Canadian Merrill and Trend Exploration. He has considerable international experience in natural resources in Africa and North America, as well as in Europe, where he has lived for the past 20 years. Until 2003, he was Senior Director – Europe, Africa & the Middle East – of the international energy research and consulting firm, Cambridge Energy Research Associates (CERA). Adrian sits on Island's Audit Committee, Remuneration Committee and Nominating & Corporate Governance Committee.

Appointed 16 September 2008

From left to right
Bryan Benitz
Paul Griffiths
Carl Kindinger
Adrian Doull

Corporate governance report

The Board of Directors is accountable to the Company's shareholders for good corporate governance. Even though compliance with the Combined Code is not mandatory for AIM listed companies, the Directors support principles of good governance.

Board of Directors

At the financial year end, there were two Executive Directors and two Non-executive Directors on the Board of the Company. Subsequently, a Non-executive Director has been appointed, one Executive Director has retired and a Non-executive Director has become an Executive Director.

The Company considers the Non-executive Directors to be independent of management because they have never held an executive position at the Company and were selected with the approval of the other Directors.

The Company does not combine the role of Chairman and Chief Executive.

Regular Board meetings are scheduled to take place throughout the year. All major policies are approved by the Board, including acquisitions, disposals and major capital expenditure. In addition, approval of the annual budget is performed by the main Board. The Board is provided with all appropriate papers in advance of each meeting.

If required or requested, the Directors are entitled to obtain independent advice and, if the Board is informed in advance, the cost of the advice will be reimbursed by the Company.

Any Director who has been co-opted on to the Board during a particular year is obliged to retire at the Annual General Meeting immediately following his appointment. In addition, in each year, one third of the remaining Directors are required to resign from office. All such Directors are generally eligible to put themselves forward for re-election.

Board committees

The current standing committees are:
- Audit;
- Remuneration; and
- Nominating and Corporate Governance.

The members of these committees consist only of independent Non-executive Directors. The Board may form and disband new temporary or permanent committees, depending upon circumstances from time to time. The chair of each committee, in consultation with the committee members, will determine the frequency and length of the committee meetings consistent with the requirements set forth in the committee's charter. The chair of each committee, in consultation with the appropriate member of the committee and management, will develop the committee's agenda.

Audit Committee

The Audit Committee comprises of the two independent Non-executive Directors; Bryan Benitz and Adrian Doull and assists the Board in fulfilling their oversight responsibilities in respect of the integrity of Island's financial statements; risk management and internal control arrangements; compliance with legal and regulatory requirements; the performance, qualifications and independence of the external auditors; and the performance of the internal audit function.

Remuneration Committee

The Remuneration Committee comprises itself of the two independent Non-executive Directors; Bryan Benitz and Adrian Doull and concerns itself with:
- The remuneration and benefits of the Directors;
- The design and terms of share based incentive plans; and
- The remuneration policy for the Executive Team and Senior Corporate Officers.

The Remuneration Committee makes proposals to the Board in the above areas, including specific remuneration packages for each of the Executive Directors as well as for the Non-executive Directors.

The Committee is entitled to use the services of remuneration consultants at the expense of the Company.

Corporate governance report
continued

Nominating and Corporate Governance Committee

The Nomination Committee comprises of the two independent Non-executive Directors; Bryan Benitz and Adrian Doull and concerns itself with candidates for nomination of Executive Directors and Non-executive Directors.

The Nomination Committee is concerned with succession planning within the Board. It is also responsible for the oversight of all matters relating to corporate governance, bringing any issues to the attention of the Board. The Committee is entitled to use the services of recruitment consultants and other external experts at the expense of the Company.

Investor relations

The Company continues to use its website (http://www.islandoilandgas.com) as an effective medium for shareholder communication and invites all shareholders to visit the site for information and news updates. Island encourages shareholders to avail of its e-communications option, which they can subscribe to by request via the Information Request Form in the Investor Relations section of the website. The Company's website and email communication facilities are continually reviewed.

Internal control

The Board of Directors acknowledges its responsibility for the Group's system of internal control, including suitable monitoring procedures. This system only provides reasonable, not absolute, assurance with respect to the preparation of financial information and the safeguarding of assets.

The Group's organisational structure has clear lines of responsibility. Operating and financial responsibility for subsidiary companies is delegated to the operational management, including key risk assessment. Investment policy, acquisition and disposal proposals and major capital expenditure are authorised and monitored by the Group Board.

The Group operates a budget and financial reporting system. Management accounts are prepared on a monthly basis. Material variances are thoroughly investigated.

The Directors confirm that an on-going process for identifying, evaluating and managing risks is in place to comply with the Turnbull guidance ('Internal Control: Guidance for Directors on the Combined Code', published in September 1999). The Directors confirm that they have conducted an annual review of the effectiveness of the system of internal control.

Directors' report

The Directors present their report together with the audited financial statements of the Group and Company for the year ended 31 July 2008.

These are the Group's first consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU ('EU IFRS'). The key impacts on the financial statements arising from the transition to EU IFRS's are set out in detail in note 28 of the financial statements.

Principal activities and business review

The Group is engaged in oil and gas exploration. The Company is an investment company with a number of oil and gas interests. A detailed business review is included in the operational review.

The Group earned a profit before tax of Stg£12,414,000 for the year ended 31 July 2008 (2007: Loss of Stg£4,998,000). The Group's net assets at 31 July 2008 are Stg£60,140,000 (2007: Stg£44,511,000).

Principal risks and uncertainties

There are a number of risks and uncertainties which could have an impact on the Group's long-term performance. Risks and uncertainties facing the Group include but are not limited to:

- The Group's main income source is from production at the Seven Heads gas field. Island's exploration successes may lead to development projects that are capital intensive. There can be no guarantee that the Group will be able to raise the additional funding required to develop these projects or commence others.
- The demand for, and price of, oil and gas is dependant on global and local supply and demand, weather conditions, availability of alternative fuels, actions of governments or cartels and general global economical and political developments.
- The Group operates in different parts of the world which may be subject to political, economic and other uncertainties, including but not limited to terrorism, military repression, war or other unrest, nationalism or expropriation of property, changes in national laws and energy policies and exposure to less developed legal systems.

The Group has a risk management structure in place which is designed to identify, manage and mitigate business risk. Risk assessment and evaluation is an essential part of the Group's internal control system.

The Group's policy in relation to managing financial and related risks is detailed below:

Liquidity/Interest rate risk

Surplus funds on short term deposit are currently at floating rates of interest except for US$1m which is on a fixed rate (2.4%) three month deposit to February 2009.

The Group ensures that it has sufficient financing facilities available through cash flow generated from operating activities, banking facilities and access to equity markets to meet its projected short and medium term funding requirements.

Foreign currency risk

Although the Group reports in Sterling, a portion of its business is conducted in US Dollar and Euros. The Group manages this, and other exposures, by matching receipts and payments in the same currency and actively managing the residual net position. This is achieved by comparing currencies of projected short term outgoings with currencies of cash holdings.

No forward foreign exchange contracts were entered into during the year and there were no outstanding foreign exchange contracts at the start of the year or at the end of the year.

Maturity of financial liabilities

The maturity of the Group's financial liabilities is provided in note 27.

Results and dividends

The results for the year are set out in the profit and loss account on page 49. The Directors do not propose declaring a dividend for the year.

Directors' report
continued

Directors, secretary and their interests

Adrian Doull was appointed as a Director of the Company on the 12 September 2008. Karl Prenderville resigned as a Director of the Company on 18 November 2008. In accordance with the Articles of Association, Adrian Doull retires and offers himself for re-election at the AGM.

The Directors who held office at 9 January 2009 held the following share interests in the Company at 9 January 2009, 31 July 2008 and 31 July 2007.

Director	9 January 2009 Number of shares	31 July 2008 Number of shares	31 July 2007 Number of shares
Paul Griffiths			
Ordinary shares at €0.01 each	3,022,468	3,022,468	3,022,468
Martin Carl Kindinger			
Ordinary shares at €0.01 each	14,440	14,440	14,440
Bryan Macintosh Benitz			
Ordinary shares at €0.01 each	401,350	401,350	401,350
Adrian Doull			
Ordinary shares at €0.01 each	–	–	–

Share options (all held at start, end of year and as at 9 January 2009)

The Directors have the following share options:

	Share options	Exercise price	Market price at grant date	Expiry date
Grant Date: 15 October 2004				
Paul Griffiths	750,000	£0.400	£0.400	14 October 2011
Bryan Macintosh Benitz	250,000	£0.400	£0.400	14 October 2011
Grant Date: 18 May 2007				
Paul Griffiths	250,000	£0.415	£0.415	17 May 2014
Martin Carl Kindinger	250,000	£0.415	£0.415	17 May 2014
Bryan Macintosh Benitz	300,000	£0.415	£0.415	17 May 2014
Karl Prenderville	250,000	£0.415	£0.415	17 May 2014
Grant Date: 15 May 2008				
Paul Griffiths	475,000	£0.300	£0.300	14 May 2015
Martin Carl Kindinger	225,000	£0.300	£0.300	14 May 2015
Bryan Macintosh Benitz	225,000	£0.300	£0.300	14 May 2015
Karl Prenderville	425,000	£0.300	£0.300	14 May 2015
Grant Date: 3 December 2008				
Paul Griffiths	275,000	£0.105	£0.105	2 December 2015
Martin Carl Kindinger	225,000	£0.105	£0.105	2 December 2015
Bryan Macintosh Benitz	225,000	£0.105	£0.105	2 December 2015
Adrian Doull	250,000	£0.105	£0.105	2 December 2015

The closing share price at 31 July 2008 was Stg£0.225 (2007: Stg£0.42) and the price range during the period was between Stg£0.4425 and Stg£0.21.

There was no change in the Directors share interests from 31 July 2008 to the date of approval of the financial statements except for the cancellation of all of the share options held by Karl Prenderville on 18 November 2008 following his resignation as a Director. The number of options cancelled was 675,000. This is equivalent to 0.6% of the Company's issued Ordinary shares. The nominal value of the related shares would be €6,750. Karl Prenderville agreed as part of his termination deal to the cancellation of his share options.

All Directors' share options are exercisable upon being granted.

The rules of the share options scheme are available for inspection at the Company's registered address on request. Further details on share options are provided in note 20.

Directors' report
continued

Remuneration Committee report

The Group's policy on senior executive remuneration is designed to attract and retain individuals of the highest calibre who can bring their experience and independent views to the policy, strategic decisions and governance of the Group.

In setting remuneration levels, the Remuneration Committee takes into consideration the remuneration practices of other companies of similar size and scope. A key philosophy is that staff must be properly rewarded and motivated to perform in the best interests of the shareholders.

Remuneration during the years ended 31 July 2008 and 31 July 2007 was as follows:

31 July 2008	Basic salary Stg£	Expenses Stg£	Fees Stg£	Share based payment Stg£	Pension Stg£	2008 Total Stg£
Paul Griffiths	193,750	49,330	–	52,427	29,063	324,570
Martin Carl Kindinger	–	–	10,000	24,833	–	34,833
Bryan Macintosh Benitz	–	–	50,000	24,833	–	74,833
Karl Prenderville*	–	–	315,359	46,907	–	362,266
Philip Beck**	–	–	–	–	–	–
	193,750	49,330	375,359	149,000	29,063	796,502

31 July 2007	Basic salary Stg£	Expenses Stg£	Fees Stg£	Share based payment Stg£	Pension Stg£	2007 Total Stg£
Paul Griffiths	228,131	43,059	–	39,184	22,500	332,874
Martin Carl Kindinger	–	–	8,333	39,184	–	47,517
Bryan Macintosh Benitz	–	–	50,000	47,021	–	97,021
Philip Beck**	–	–	56,667	15,674	–	72,341
	228,131	43,059	115,000	141,063	22,500	549,753

* Appointed to the Board on 23 August 2007 and resigned on 18 November 2008.
** Resigned from the Board on 23 August 2007.

Details of related party transactions, including those with companies related to the Directors have been outlined in note 26 to the Financial Statements.

Substantial shareholdings

As far as the Company is aware, the following held shares representing 3% or more of the Company's issued share capital at 8 January 2009:

Shareholder	Number of shares	% Holding
Platinum Petroleum Limited	25,000,000	21.45
Davy Crest Nominees	16,206,072	13.90
Gartmore Investment Management plc	16,119,567	13.83
Lundin Petroleum	4,000,000	3.43
NCB Nominees	3,990,525	3.42
Supernova Ireland Resources Limited	3,750,000	3.22
Bloxham Nominees	3,634,799	3.12

Accounting records

The Directors believe that they have complied with the requirements of Section 202 of the Companies Act, 1990 with regard to books of account by employing accounting personnel with appropriate expertise and by providing adequate resources to the financial function. The books of account of the Company are maintained at 27 Lower Mount Street, Dublin 2.

Directors' report
continued

Health, safety and environmental policy

Island takes very seriously its commitments to health, safety and the environment, and to its wider social responsibilities. The Group is continuously reviewing and updating its formal Health, Safety and Environmental ('HSE') Policy alongside the development of its ongoing drilling programme. This ensures that Island's policy to conduct all of its activities in an environmentally responsible manner is strictly adhered to and that its HSE policies continue to meet its rapidly changing business needs. Island is committed to undertaking corporate activities safely and responsibly whilst aiming to limit the impact of operations on the physical environment of the areas in which the Group operates.

The Group is committed to meeting or exceeding all regulatory and legislative requirements and to ensuring that strict adherence to appropriate planning and environmental laws is maintained by its management and staff. It also dictates that partners, contractors and suppliers meet the same standards. The Group's projects are assessed for environmental impact.

Going concern

The Directors have reviewed budgets, projected cash flows and other relevant information, and on the basis of this review, are confident that the Company and Group will have adequate financial resources to continue in operational existence for the foreseeable future. Consequently the Directors consider it appropriate to prepare the financial statements on a going concern basis.

Political donations

The Company has made no political donations either during the financial year or since.

Post balance sheet events

There have been no significant post balance sheet events.

Auditor

In accordance with Section 160(2) of the Companies Act, 1963, the auditor, KPMG will continue in office.

On behalf of the Board

Bryan Benitz	**Paul Griffiths**
Director	Director

9 January 2009

Statement of Directors' responsibilities

The Directors are responsible for preparing the Directors' report and Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Company financial statements for each financial year. As required by AIM rules and as permitted by Company law the Directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRS's) as adopted by the EU ('EU IFRS') and have elected to prepare the Company financial statements in accordance with EU IFRS, as applied in accordance with the provisions of the Companies Acts 1963 to 2006.

The financial statements are required by law and IFRS's as adopted by the EU to fairly present the financial position and performance of the Group and the Company; the Companies Acts,1963 to 2006 provide in relation to such financial statements that references in the relevant part of these Acts to financial statements giving a true and view are references to their achieving a fair presentation.

In preparing each of the Group and Company 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; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Acts 1963 to 2006. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are also responsible for preparing a Directors' report that complies with the requirements of the Companies Acts 1963 to 2006.

On behalf of the Board

Bryan Benitz
Director

Paul Griffiths
Director

9 January 2009

Independent auditor's report to the members of Island Oil & Gas Plc

We have audited the Group and Company financial statements of Island Oil & Gas Plc for the year ended 31 July 2008 which comprise the Group and Company income statements, the Group and Company statement of total recognised income and expense, the Group and Company balance sheets, the Group and Company cash flow statements, the statement of accounting policies and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 193 of the Companies Act 1990. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, are set out in the Directors' responsibility statement on page 42.

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

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRSs as adopted by the EU and, in the case of the Company, as applied in accordance with the provisions of the Companies Acts 1963 to 2006, and have been properly prepared in accordance with the Companies Acts 1963 to 2006. We also report to you our opinion as to: whether proper books of account have been kept by the Company; whether at the Balance Sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the Company under Section 40(1) of the Companies (Amendment) Act 1983; and whether the information given in the Directors' report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the Company balance sheet is in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law regarding Directors' remuneration and Directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's statement, operational review, corporate governance report and the Directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- The Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 July 2008 and of its profit for the year then ended;
- The Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Acts, 1963 to 2006, of the state of the Company's affairs as at 31 July 2008; and
- The financial statements have been properly prepared in accordance with the Companies Acts, 1963 to 2006.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion, proper books of account have been kept by the Company. The Company financial statements are in agreement with the books of account.

In our opinion, the information given in the Directors' report on pages 38 to 41 is consistent with the financial statements.

The net assets of the Company, as stated in the Company balance sheet are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 July 2008 a financial situation, which under Section 40(1) of the Companies (Amendment) Act, 1983, would require the convening of an extraordinary general meeting of the Company.

KPMG
Chartered Accountants
Registered Auditor
Dublin
9 January 2009

Statement of accounting policies

As permitted by Company Law and in accordance with AIM rules, the Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and their interpretations issued by the International Accounting Standards Board (IASB) as adopted by the EU ('EU IFRS'). The individual financial statements of the Company ('Company financial statements') have been prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the Companies Acts, 1963 to 2006 which permits a company, that publishes its company and group financial statements together, to take advantage of the exemption in Section 148(8) of the Companies Act 1963, from presenting to its members its company income statement and related notes that form part of the approved company financial statements.

These are the Company's and Group's first financial statements prepared in accordance with IFRS as adopted by the EU and IFRS 1, First-time Adoption of International Financial Reporting Standards, has been applied.

The IFRSs adopted by the EU as applied by the Company and Group in the preparation of these financial statements are those that were effective for accounting periods beginning on or after 31 July 2007.

The IASB and the International Financial Reporting Interpretations Committee (IFRIC) have issued the following standards and interpretations that are not yet effective for the Group:

- IFRS 8 Operating Segments (effective date: financial periods beginning on or after 1 January 2009);
- IFRS 2 Share based Payments – Vesting Conditions and Cancellations (effective date: financial periods beginning on or after 1 January 2009);
- IFRS 3 Business Combinations (effective date: financial periods beginning on or after 1 July 2009);
- IAS 1 Presentation of Financial Statements (effective date: financial periods beginning on or after 1 January 2009);
- IAS 23 Borrowing Costs (effective date: financial periods beginning on or after 1 January 2009);
- IAS 32 Financial Instruments: Presentation (effective date: financial periods beginning on or after 1 January 2009);
- IAS 27 Consolidated and Separate Financial Statements (effective date: financial periods beginning on or after 1 July 2009);
- IAS 39 Financial Instruments: Recognition and Measurement (effective date: financial periods beginning on or after 1 July 2009);
- IFRIC Interpretation 12 Service Concession Arrangements (effective date: financial periods beginning on or after 1 January 2008);
- IFRIC Interpretation 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective date: financial periods beginning on or after 1 January 2008);
- IFRIC Interpretation 16 Hedges of a Net Investment in a Foreign Operation (effective date: financial periods beginning on or after 1 October 2008).

These standards and interpretations will be applied for the purposes of the Group and Company financial statements with effect from their respective effective dates.

Whilst the application of IFRS 8 will result in amendments to the segment information note accompanying the Group financial statements, these amendments will not be of a recognition and measurement nature, given the disclosure focus of the standard.

The application of the revised IAS 1 will result in some presentational changes to the Group financial statements.

Application of the other standards and interpretations is not expected to have a material impact on the Group or Company financial statements.

First time adoption of IFRS

The Group and Company are required to determine their EU IFRS accounting policies and apply them retrospectively to establish their opening Balance Sheets under EU IFRS at their date of transition. The date of transition to EU IFRSs for the Group and Company is 1 August 2007. The impact of the transition to EU IFRS is outlined in note 28. Where estimates had been made under Irish GAAP, consistent estimates (after adjustments to reflect any difference in accounting policies) have been made on transition to EU IFRS. Judgements affecting the Balance Sheets of the Company and Group have not been revisited with the benefit of hindsight.

Functional and presentation currency

The financial statements are presented in Sterling, rounded to the nearest thousand (Stg£'000) except when otherwise indicated. Sterling is the functional currency of the Company and all of the Group's subsidiaries.

Statement of accounting policies
continued

Basis of measurement
The financial statements are prepared on a historical cost basis except for the measurement of share options and warrants which are stated at fair value at grant date.

Use of estimates and judgements
The preparation of financial information requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are in the following areas:
- Measurement of the recoverable amounts of intangible assets;
- Utilisation of tax losses;
- Measurement of share based payments; and
- Measurement of provisions in relation to decommissioning.

Basis of consolidation
The consolidated financial information includes the financial information of Island Oil & Gas Plc and its subsidiaries.

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and any income and expenses and unrealised gains arising from intra-group transactions are eliminated in preparing the consolidated financial information. Unrealised losses are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Revenue recognition
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group, that it can be reliably measured, that the product passes out of the ownership of the Group to external customers pursuant to enforceable sales contracts and that the significant risks and rewards of ownership of gas have passed to the buyer. Revenue comprises the invoiced value of gas supplied by the Operator of a gas rig which is a jointly controlled asset and excludes trade discounts and value added tax.

Pensions
The Group contributes to a defined contribution pension scheme for employees. Pension scheme costs are accounted for on an accruals basis.

Share based payments
The Group has applied the requirements of IFRS 2 'Share based Payment'. The Group issues equity settled share options as an incentive to certain key management and staff (including Directors). The fair value of share options granted to Directors and employees under the Company's option schemes is recognised as an expense with a corresponding credit to the share based payments reserve. The fair value is measured at grant date and spread over the period during which the awards vest. The fair value is measured using a binomial lattice model, taking into account the terms and conditions upon which the options were granted.

The options issued by the Group are subject only to service related vesting conditions. Service related vesting conditions are not taken into account when estimating the fair value of awards as at grant date; such conditions are taken into account through adjusting the number of equity instruments that are expected to vest.

In certain instances, the Group issues share warrants to third parties in relation to the settlement of underwriting service fees. The value of these share based payments is determined by reference to the fair value of the services received and is recorded as a cost in the income statement with a corresponding credit to share warrants reserve.

The proceeds received net of any directly attributable transactions costs will be credited to share capital (nominal value) and share premium when options or share warrants are converted into ordinary shares.

Statement of accounting policies
continued

Foreign currency
Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period translated at the rates on the dates they occur, and the amortised cost in functional currency translated at the exchange rate at the end of the period. Foreign currency differences arising on retranslation are recognised in profit or loss.

Taxation
Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Convertible loan notes
Where the Group issued convertible loan notes, the terms of the loan notes are assessed to determine whether they should be presented as debt or equity. Where the manner of settlement of the convertible loan notes is only by issue of a fixed number of shares, the shares to be issued are shown in equity as soon as the proceeds are receivable. Where warrants are issued concurrently with the debt, the proceeds received are apportioned between the shares to be issued and the warrants to the extent that there is value inherent in the warrants.

Earnings per share
The Group presents basic and diluted earnings per share ('EPS') data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise convertible notes and share options granted to employees.

Lease payment
Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Exploration, evaluation and production assets
The Group adopts the successful efforts method of accounting for exploration and evaluation costs. All licence acquisition, exploration and evaluation costs are initially capitalised in cost centres by well, field or exploration area, as appropriate. Directly attributable administration costs and interest payable are capitalised insofar as they relate to specific development activities. Pre-licence costs are expensed in the period in which they are incurred. Exploration and evaluation assets are not amortised but are assessed for impairment in accordance with the Group's Depletion, Amortisation and Impairment Policy.

Exploration and evaluation assets are transferred to production assets within intangible assets when the technical feasibility and commercial viability of extracting oil or gas are demonstrable. Subsequent expenditure is capitalised only where it either enhances the economic benefits of the production assets or replaces part of the existing production asset. Any costs associated with the replacement of assets are expensed to the income statement. Production assets are amortised in accordance with the Group's Depletion, Amortisation and Impairment Accounting Policy.

Statement of accounting policies
continued

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

Depletion, amortisation and impairment
Impairment reviews on exploration and evaluation assets and production assets are carried out on each cash-generating unit identified in accordance with IAS36 'Impairment of Assets'. The Group's cash-generating units are those assets which generate largely independent cash flows and are normally, but not always, single development areas or fields.
Exploration and evaluation assets are assessed for impairment in certain circumstances including:

- the period for which the Group has the right to explore in the specific area has expired or will expire in the near future and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of resources in a specific area is neither budgeted nor planned;
- the Group has decided to discontinue exploration and evaluation activities in a specific area as commercially viable quantities of oil or gas have not been discovered; and
- the carrying amount of an exploration and evaluation asset is unlikely to be recovered in full from successful development or sale.

Any such impairment is recognised in the income statement.

Where there has been a charge for impairment in an earlier period that charge will be reversed in a later period where there has been a change in circumstances to the extent that the discounted future net cash flows are higher than the net book value at the time. In reversing impairment losses, the carrying amount of the asset will be increased to the lower of its original carrying value or the carrying value that would have been determined (net of depletion) had no impairment loss been recognised in prior periods.

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

Decommissioning
Provision is made for the decommissioning of oil and gas wells and other oilfield facilities. The cost of decommissioning is determined through discounting the amounts expected to be payable to their present value at the date the provision is recorded and is reassessed at each balance sheet date. This amount is regarded as part of the total investment to gain access to future economic benefit and consequently is capitalised as part of the cost of the asset and the liability is included in provisions. Such cost is depleted over the life of the asset and charged to the income statement. The unwinding of the discount is reflected as a finance cost in the income statement over the remaining life of the well or field.

Property, plant and equipment
Property, plant and equipment are stated in the Balance Sheet at cost less accumulated depreciation and any recognised impairment loss. Depreciation on property, plant and equipment other than exploration and production assets, is provided at rates calculated to write off the cost less estimated residual value of each asset on a straight-line basis over its expected useful economic life as follows:

- Equipment 33% per annum;
- Oil and Gas infrastructure 14.3% per annum.

Non-derivative financial instruments
Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Statement of accounting policies
continued

Trade and other receivables
Trade and other receivables are carried at amortised cost less provisions for impairment.

Cash and cash equivalents
Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Loans and borrowings
Interest bearing loans and borrowings after initial recognition are carried at amortised cost using the effective interest rate method. Arrangement fees and issue costs of debt are deducted from the debt proceeds on initial recognition of the liability and are amortised to the income statement as a finance expense over the term of the debt.

Trade and other payables
Trade and other payables are carried at amortised cost.

Jointly controlled assets or operations
Jointly controlled assets and operations arise from an arrangement that is a joint venture carried on with assets that are controlled jointly (whether or not owned jointly), but not through a separate entity. The consolidated financial information include the Group's share of a jointly controlled asset being an interest in a gas rig, the Group's share of expenses incurred by the operator of the rig and the Group's share of income from the sale of gas from the rig.

Issue expenses and share premium account
Issue expenses of new shares are written off against the premium arising on the issue of share capital.

Borrowing costs
Borrowing costs based on the effective interest rate directly attributable to intangible exploration and evaluation assets are added to the cost of those assets, until such time as the assets become production assets or are available for sale.

Consolidated income statement
for the year ended 31 July 2008

	Note	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000 (as restated)
Revenue	1	2,251	1,762
Cost of sales		(1,143)	(902)
Gross profit		1,108	860
Profit on sale of subsidiary undertaking	2	11,001	–
Gain on sale of licence	3	3,465	–
Administration expenses		(2,306)	(1,174)
Costs associated with uncommercial projects	4	(153)	(4,537)
Other operating income		–	401
Operating profit/(loss) – continuing operations		13,115	(4,450)
Finance income	5	115	181
Finance expense	6	(816)	(729)
Profit/(loss) before taxation	8	12,414	(4,998)
Taxation on profit/(loss) for year	9	–	–
Profit/(loss) for the financial year attributable to equity holders of the parent		12,414	(4,998)
Earnings/(loss) per share (Stg£)	11		
Basic		0.1082	(0.0613)
Diluted		0.1082	(0.0613)

On behalf of the Board

Bryan Benitz
Director

Paul Griffiths
Director

Consolidated statement of total recognised income and expense
for the year ended 31 July 2008

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000 (as restated)
Profit/(loss) for the financial year	12,414	(4,998)
Surrender of warrants in return for shares	262	–
Total recognised income and expense for the year attributable to equity holders of the parent	12,676	(4,998)

Company statement of total recognised income and expense
for the year ended 31 July 2008

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000 (as restated)
Loss for the financial year	(3,254)	(1,249)
Surrender of warrants in return for shares	262	–
Total recognised income and expense for the year attributable to equity holders of the parent	(2,992)	(1,249)

Consolidated balance sheet
at 31 July 2008

	Note	2008 Stg£'000	2007 Stg£'000 (as restated)
Assets			
Non current assets			
Intangible exploration and evaluation assets	13	61,212	55,096
Property, plant and equipment	12	1,403	1,761
		62,615	56,857
Current assets			
Other receivables	15	1,159	2,612
Cash and cash equivalents		3,407	11,602
		4,566	14,214
Total assets		67,181	71,071
Equity and liabilities			
Equity attributable to equity holders of the parent			
Called up share capital	20	798	762
Share premium	21	51,167	48,571
Shares to be issued	19	238	–
Share warrants reserve	23	–	447
Share based payment reserve	23	1,185	655
Unrealised revenue reserve	22	47	47
Retained earnings	23	6,705	(5,971)
Total equity		60,140	44,511
Non current liabilities			
Provisions	17	704	675
Loans	18	5,178	–
		5,882	675
Current liabilities			
Trade and other payables	16	1,159	18,385
Interest bearing loans and borrowings	16	–	7,500
		1,159	25,885
Total liabilities		7,041	26,560
Total equity and liabilities		67,181	71,071

On behalf of the Board

Bryan Benitz
Director

Paul Griffiths
Director

Consolidated cash flow statement
for the year ended 31 July 2008

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000 (as restated)
Cash flow from operating activities		
Profit/(loss) before taxation	12,414	(4,998)
Finance income	(115)	(181)
Finance expense	816	729
Operating profit/(loss)	13,115	(4,450)
Adjusted for:		
Depreciation	402	396
Gain on disposal of licence	(3,465)	–
Gain on disposal of subsidiary	(11,001)	–
Exploration costs written off	153	4,537
Cost of share awards	530	315
Foreign exchange gain/(loss)	156	(44)
	(110)	754
Decrease/(increase) in other receivables	1,458	(156)
Increase in trade and other payables	881	307
Net cash from operating activities	2,229	905
Cash flows from investing activities		
Disposal of oil and gas assets	3,764	3,617
Disposal of subsidiary	12,654	–
Expenditure on intangible exploration and evaluation assets	(26,818)	(41,366)
Contribution from partners for exploration and evaluation assets	1,042	16,742
Purchase of property, plant and equipment	(44)	(10)
Finance income	56	181
Net cash used in investing activities	(9,346)	(20,836)
Cash flows from financing activities		
Net proceeds from issue of share capital	2,243	19,142
Debt arrangement fees	(344)	(590)
Drawdown of bank loans	4,500	7,500
Drawdown of other loans	5,178	–
Repayment of bank loan	(12,000)	–
Finance expenses	(655)	(590)
Net cash (used)/generated by financing activities	(1,078)	25,462
Net (decrease)/increase in cash and cash equivalents	(8,195)	5,531
Cash and cash equivalents at beginning of period	11,602	6,071
Cash and cash equivalents at end of period	3,407	11,602

Company balance sheet
at 31 July 2008

	Notes	2008 Stg£'000	2007 Stg£'000 (as restated)
Assets			
Non current assets			
Intangible exploration and evaluation assets	13	666	667
Property, plant and equipment	12	51	29
Investment in subsidiaries	14	2,986	2,986
		3,703	3,682
Current assets			
Other receivables	15	41,766	58,199
Cash and cash equivalents		3,119	11,438
		44,885	69,637
Total assets		48,588	73,319
Equity and liabilities			
Equity attributable to equity holders of the parent			
Called up share capital	20	798	762
Share premium	21	51,167	48,571
Shares to be issued	19	238	–
Share warrants reserve	23	–	447
Share based payment reserve	23	1,185	655
Unrealised revenue reserve	22	47	47
Retained earnings	23	(5,821)	(2,829)
Total equity		47,614	47,653
Current liabilities			
Trade and other payables	16	974	18,166
Interest bearing loans and borrowings	16	–	7,500
		974	25,666
Total liabilities		974	25,666
Total equity and liabilities		48,588	73,319

On behalf of the Board

Bryan Benitz
Director

Paul Griffiths
Director

Company cash flow statement
for the year ended 31 July 2008

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000
Cash flow from operating activities		
(Loss) before taxation	(3,254)	(1,249)
Finance income	(106)	(173)
Finance expense	1,084	729
Operating profit/(loss)	(2,276)	(693)
Adjusted for:		
Depreciation	21	15
Cost of share awards	530	315
Foreign exchange gain/(loss)	156	(44)
	(1,569)	(407)
Decrease/(increase) in other receivables	16,146	(23,970)
(Decrease)/Increase in trade and other payables	(16,528)	4,909
Net cash from operating activities	(1,951)	(19,468)
Cash flows from investing activities		
Expenditure on intangible exploration and evaluation assets	(124)	(566)
Disposal of intangible assets	–	104
Purchase of property, plant and equipment	(43)	(25)
Finance income	56	173
Net cash used in investing activities	(111)	(314)
Cash flows from financing activities		
Net proceeds from issue of share capital	2,243	19,143
Debt arrangement fees	(344)	(590)
Drawdown of bank loans	4,500	7,500
Repayment of bank loan	(12,000)	–
Finance expenses	(655)	(590)
Net cash generated by financing activities	(6,256)	25,463
Net (decrease)/increase in cash and cash equivalents	(8,319)	5,681
Cash and cash equivalents at beginning of period	11,438	5,757
Cash and cash equivalents at end of period	3,119	11,438

Notes
forming part of the financial statements

1 Revenue and segmental information
Revenue represents the Group's share of the sale of gas in the Republic of Ireland made by a third party operator of the field. All of the Group's activities relate to a single segment, oil and gas exploration. A geographical analysis of the Group's exploration and evaluation assets is set out in note 13.

2 Profit on sale of subsidiary undertaking
In May 2008, Island Oil & Gas Plc completed the sale of its wholly owned subsidiary, Island Netherlands BV ('INBV'), to Delta Hydrocarbons BV ('Delta') for a total consideration of Stg£12.654m. Costs previously capitalised amounted to Stg£1.258m and transaction costs amounted to Stg£0.395m. The profit on disposal amounted to Stg£11.001m.

3 Gain on sale of licence
The gain on sale of licence relates to two transactions, details of which are set out below:
- In March 2008, Island Oil & Gas Plc disposed of a 10% interest in a frontier exploration licence to Supernova Ireland Resources BV for a consideration of Stg£2.25m. Associated costs amounted to Stg£0.285m which had all been previously capitalised;
- In December 2007, EnCore Oil Plc acquired 10% of the Q13a licence held by INBV for a consideration of Stg£1.5m.

4 Costs associated with uncommercial projects
During the year, Stg£0.153m (2007: Stg£4.437m) was written off in relation to projects that the Company considered to be uncommercial.

5 Finance income

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000
Bank deposit interest receivable	115	181

6 Finance expense

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000
On bank loans, overdrafts and other loans wholly repayable within one year	655	282
Charge for share warrants	161	447
	816	729

In addition to the interest on bank loans, overdrafts and other loans wholly repayable within one year charged to the income statement, interest of Stg£712,590 was capitalised during the year ended 31 July 2008 (2007: Stg£337,000).

7 Staff numbers and costs
The average number of full-time employees in the Group during the year (including Executive Directors), analysed by category, was as follows:

	Year ended 31 July 2008 Number	Year ended 31 July 2007 Number
Technical	2	2
Administration	10	8
	12	10

The aggregate payroll costs of these persons were as follows:

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000
Wages and salaries	546	477
Social welfare costs	55	41
Other pension costs	54	40
Share based payments	530	315
	1,185	873

Notes
continued

8 Statutory and other information

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000
Depreciation	402	396
Auditor's remuneration		
– Audit fees	50	45
– Other services	35	17
Operating lease payments	142	68
Foreign exchange (loss)/gain	(156)	44
Directors' emoluments		
– Salary and expenses	243	271
– Fees	375	115
– Pension contribution	29	23
– Cost of share awards relating to Directors	149	141

In addition to the above fees, there were payments made by the Group for services rendered by companies connected with certain Directors, details of which are set out in note 26.

The statutory and other information in relation to the Company is the same as that for the Group with the exception that depreciation of property, plant and equipment for the Company during the year ended 31 July 2008 was Stg£21,000 (2007: Stg£15,000).

9 Income tax expense

Recognised in the income statement

	Year ended 31 July 2008 Stg£'000	Year ended 31 July 2007 Stg£'000
Current tax expense:		
Current year	–	–
Total income tax expense in income statement	–	–

Reconciliation of effective tax rate

	Year ended 31 July 2008	Stg£'000	Year ended 31 July 2007	Stg£'000
Profit/(Loss) before tax		12,414		(4,998)
Income tax using the domestic corporation tax rate	(25%)	3,101	(25%)	(1,250)
Effects of:				
Income not taxable	(24.88%)	(3,088)		–
Depreciation	0.77%	95		–
Non-deductible expenses	3.45%	428	3.25%	163
Capital items deductible	(18.27%)	(2,268)		–
Losses carried forward	15.57%	1,933	21.75%	1,087
Losses utilised from previous period	(1.64%)	(204)		–
Total tax expenses reported in the income statement		–		–

Notes
continued

10 Loss for the financial year

The loss for the financial year in the parent undertaking amounted to Stg£3,254,000 (year ended 31 July 2007: loss of Stg£1,249,000).

As permitted by Section 148(8) of the Companies Act 1963, a separate income statement for the parent undertaking has not been presented.

11 Earnings per share

The calculation of basic and diluted earnings/(loss) per share for the year was on the profit/(loss) attributable to equity holders of Stg£12,414,000 (2007: loss of Stg£(4,998,000)). The weighted average number of ordinary shares outstanding were 114,714,422 (basic) (2007: 81,552,827) and 114,746,005 (diluted) (2007: 81,552,827).

	Year ended 31 July 2008	Year ended 31 July 2007
Basic and diluted profit/(loss) per ordinary share:		
Profit/(loss) on ordinary activities after taxation (Stg£'000)	12,414	(4,998)
Weighted average number of ordinary shares in issue		
– basic	114,714,422	81,552,827
– diluted	114,746,005	81,552,827
Basic earnings/(loss) per ordinary share (Stg£)	0.1082	(0.0613)
Diluted earnings/(loss) per ordinary share (Stg£)	0.1082	(0.0613)

The average market value of the Company's shares for the purposes of calculating the dilutive effect of share options and warrants was based on quoted market prices for the period in which the options and warrants were outstanding.

Share options and warrants which could potentially dilute basic earnings per share in the future have not been included in the calculation of diluted earnings per share as they are antidilutive for the periods.

12 Property, plant and equipment

Group	Oil and Gas infrastructure Stg£'000	Office equipment Stg£'000	Computer equipment Stg£'000	Total Stg£'000
Cost				
At 31 July 2006	2,729	–	42	2,771
Additions	–	19	6	25
Transfer to intangible exploration and evaluation assets	(15)	–	–	(15)
At 31 July 2007	2,714	19	48	2,781
Additions	–	20	24	44
At 31 July 2008	2,714	39	72	2,825
Depreciation				
At 31 July 2006	601	–	23	624
Charge for year	381	1	14	396
At 31 July 2007	982	1	37	1,020
Charge for year	381	9	12	402
At 31 July 2008	1,363	10	49	1,422
Net book value				
At 31 July 2008	1,351	29	23	1,403
At 31 July 2007	1,732	18	11	1,761
At 31 July 2006	2,128	–	19	2,147

Under the terms of an asset purchase agreement dated 22 December 2004, the Group acquired a portfolio of assets from Lundin Petroleum AB in return for the issue of 4,000,000 €0.01 ordinary shares in the Company at Stg£0.55p per share. The value of the purchase consideration of Stg£2,200,000 was allocated to the interest acquired in the Seven Heads Gas infrastructure and related decommissioning liability as the other assets were not considered to have any value.

Notes
continued

12 Property, plant and equipment continued

Company	Office equipment Stg£'000	Computer equipment Stg£'000	Total Stg£'000
Cost			
At 31 July 2006	–	42	42
Additions	19	6	25
At 31 July 2007	19	48	67
Additions	20	23	43
At 31 July 2008	39	71	110
Depreciation			
At 31 July 2006	–	23	23
Charges for year	1	14	15
At 31 July 2007	1	37	38
Charge for year	9	12	21
At 31 July 2008	10	49	59
Net book value			
At 31 July 2008	29	23	51
At 31 July 2007	18	11	29
At 31 July 2006	–	19	19

13 Intangible exploration and evaluation assets

	Group 31 July 2008 Stg£'000	Company 31 July 2008 Stg£'000
At 31 July 2006	30,950	656
Additions during the year	32,286	566
Disposals during the year	(3,618)	(104)
Transfer to subsidiaries	–	(451)
Write down during the year	(4,537)	–
Transfer from property, plant and equipment	15	–
At 31 July 2007	55,096	667
Additions during the year	7,811	124
Disposals during the year	(1,542)	–
Write down during the year	(153)	–
Transfer to subsidiaries	–	(125)
At 31 July 2008	61,212	666

The carrying value of oil and gas interests by geographical area is as follows:

	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Ireland	60,010	54,440
Morocco	294	72
Albania	617	65
Moldova	291	–
The Netherlands	–	519
	61,212	55,096

During the year Stg£592,871 (year ended 31 July 2007: Stg£336,963) was capitalised in relation to wages and salaries.

During the year Stg£712,590 (year ended 31 July 2007: Stg£337,000) was capitalised in relation to interest payments on the Group's bank loan. This represented 75% of the relevant interest payments (year ended 31 July 2007: 75%).

The Group has the following oil and gas interests, details of which are provided in the operational review:

Island Oil & Gas Plc

(i) Frontier Exploration Licence 4/06 Slyne
(ii) Frontier Exploration Licence 3/06 Donegal
(iii) Reconnaissance Licence – Zag Basin, Morocco
(iv) Standard Exploration Licence option 4/07 – Farm-in option with Lansdowne Oil & Gas Plc
(v) Tir na nOg Frontier Exploration Licence 3/08

Notes
continued

13 Intangible exploration and evaluation assets continued

Island Expro Limited
(i) Barryroe Licensing Option 08/1
(ii) Exploration Licence 4/05 Old Head of Kinsale
(iii) Exploration Licence 5/05 Schull

Island Assets Porcupine Limited
(i) Frontier Exploration Licence 1/04

Island (Seven Heads) Limited
(i) 12.5% participating interest in Seven Heads Petroleum Lease and related infrastructure
(ii) Petroleum Lease West Seven Heads Sub-Equity Area

Island Rockall JV Limited
(i) Frontier Exploration Licence 3/05 Rockall

Island International Exploration BV
(i) Tarfaya Basin on shore Licences (Morocco)
(ii) Durresi Block Licence (Albania)

Island Oil & Gas BV
Island Oil & Gas BV ('IOGBV') has an overriding royalty interest of 2.5% of the gross export production from the Amstel Oil Field; and 2% and 1.5% respectively of the gross export production from the Zaan oil field and any tie-backs via the future Amstel facilities from licence areas Q13a,Q13b & Q16b.

The Directors have considered the carrying value of the Group's intangible assets and are satisfied that they are worth at least the amount stated in the financial statements. In making this assessment the Directors have made certain assumptions in relation to the future price of oil and gas, potential development opportunities and the ability of the Group to dispose or divest interests in certain assets at more than the carrying value.

14 Investment in subsidiaries

Company	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Investment in Group undertakings, at cost		
At beginning of year	2,986	2,986
Additions during year	–	–
Disposals	–	–
At end of year	2,986	2,986

The following companies are subsidiary undertakings of Island Oil & Gas Plc incorporated and operating in the Republic of Ireland. All shareholdings consist of ordinary shares.

Name and registered office	Principal activity	Proportion held by Company
Island Expro Limited	Oil and gas exploration	100%
Island Assets Porcupine Limited	Oil and gas exploration	100%
Island (Seven Heads) Limited	Oil and gas exploration	100%
Island Donegal Limited	Oil and gas exploration	100%
Island Rockall JV Limited	Oil and gas exploration	100%

All the above are directly held subsidiaries of Island Oil & Gas Plc
The Registered office of the above companies is 27 Lower Mount Street, Dublin 2, Ireland

Name and registered office	Principal activity	Proportion held by Company
Island International Exploration BV	Oil and gas exploration	100%
Island Oil & Gas BV	Oil and gas exploration	100%
Island Moldova BV	Oil and gas exploration	100%

Island Oil & Gas BV is a directly held subsidiary of Island Oil & Gas Plc
Island International Exploration BV and Island Moldova BV are directly held subsidiaries of Island Oil & Gas BV

The Registered office of the above companies is Satijnvlinder 20 – 2317 JK Leiden, The Netherlands

Notes
continued

15 Other receivables

	Group		Company	
	31 July 2008 Stg£'000	31 July 2007 Stg£'000	31 July 2008 Stg£'000	31 July 2007 Stg£'000
VAT recoverable	–	27	–	27
Accrued income	250	102	162	–
Other receivables	833	362	248	277
Prepayments	76	2,121	76	2,121
Amounts due from subsidiary undertakings	–	–	41,280	55,774
	1,159	2,612	41,766	58,199

All receivables are current and there have been no impairment losses during the year (2007: Stg£nil). The Group's exposure to credit and currency risks related to other receivables is set out in note 27.

16 Trade and other payables

	Group		Company	
	31 July 2008 Stg£'000	31 July 2007 Stg£'000	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Trade creditors	419	12,466	419	12,466
Accruals	699	5,903	514	5,684
PAYE/PRSI	41	16	41	16
Bank loan	–	7,500	–	7,500
	1,159	25,885	974	25,666

During the year the Group and Company fully discharged the bank loan from the proceeds generated by the sale of Island Netherlands BV (see note 2).

Rand Merchant Bank have provided a Stg£5m project debt facility, none of which has been utilised to date.

17 Provision for liabilities

Group	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Decommissioning costs:		
At beginning of year	675	646
Unwinding of discount on decommissioning provision	29	29
At end of year	704	675

The decommissioning costs relates to Island's 12.5% share of future decommissioning costs associated with Seven Heads Gas infrustructure (note 12) and represents the Directors' best estimate of the Group's decommissioning liability.

18 Loans

During the year, the entire share capital of Island Netherlands BV ('INBV'), a wholly owned subsidiary of Island Oil & Gas BV ('IOGBV') was sold to Delta Hydrocarbons BV ('Delta').

As part of the transaction, Delta advanced to Island US$10m. It is intended that the Loan will be repaid from 95% of the gross proceeds of an Overriding Royalty Interest ('ORI') granted to IOGBV of 2.5% of the gross export production from the Amstel Oil Field; and 2% and 1.5% respectively of the gross export production from the Zaan oil field and any tie-backs via the future Amstel facilities or any other operated tie-backs resulting from any of the licence areas that are the subject of the transaction. There is no fixed repayment period for the loan, but it will approximate the life of the Amstel field. If at any time it is determined that the ORI proceeds will not repay the loan in full including interest, then Delta can call for repayment in cash or, at Delta's discretion, on seven days notice, require conversion of such amount into ordinary shares in the company at the average weighted 20 day trading price prior to conversion.

In the event that Delta elects not to proceed with the development of the Amstel field, the Loan will be repayable in equal monthly installments over 30 months commencing six months after the date of notice provided by Delta.

Notes
continued

19 Shares to be issued

In accordance with the terms of an agreement with Aceiro Energy BV ('Aceiro'), the Company is liable to reward Aceiro by way of an issue of Island Oil & Gas Plc shares. This is for services provided to the Company in connection with the Amstel transaction. Ordinary shares in the value of Stg£238,000 will be issued on obtaining The Netherlands Government's ratification of the transaction.

20 Called up share capital

Group and Company	31 July 2008 €'000	31 July 2007 €'000
Authorised		
400,000,000 (2007: 400,000,000) ordinary shares of €0.01 each	4,000,000	4,000,000

	Stg£'000	Stg£'000
Allotted, called up and fully paid equity shares		
116,556,990 (2007: 111,706,990) ordinary shares of €0.01 each	798	762

	Year ended 31 July 2008 Number of shares	Year ended 31 July 2007 Number of shares
Shares in Issues		
Shares in issue at 1 August	111,706,990	69,641,000
Shares issued during the year (see below)	4,850,000	35,253,365
Shares converted from warrants	–	6,812,625
Shares in issue at 31 July	116,556,990	111,706,990

In November 2007, the Company issued 100,000 ordinary €0.01 shares to Valiexchimp S.L.R. on the signing of a Memorandum of Understanding.

In December 2007, the Company issued 3,750,000 ordinary €0.01 shares to Supernova Ireland Resources BV for a 10% farm-in to the Connemara licence for Stg£2,250,000.

In December 2007, the Company issued 1,000,000 ordinary €0.01 shares to First Rand (Ireland) Plc in return for the cancellation of 5,759,631 three year warrants held by them.

The movement on outstanding options during the year was as follows:

	2008 Number of options	Weighted average exercise price	2007 Number of options	Weighted average exercise price
Outstanding at start of year	4,125,000	Stg£0.410	2,000,000	Stg£0.400
Granted during the year	4,079,000	Stg£0.320	2,125,000	Stg£0.415
Lapsed during the year	–	–	–	–
Exercised during the year	–	–	–	–
Outstanding at end of year	8,204,000	Stg£0.360	4,125,000	Stg£0.410
Of which exerciseable at year end:	8,204,000	Stg£0.360	4,125,000	Stg£0.410

(a) On 17 September 2007, 350,000 options with an exercise price of Stg£0.4125 and an exercise period to 17 September 2014 were issued to the Group's advisors.
(b) On 22 January 2008, 600,000 options with an exercise price of Stg£0.35 and an exercise period to 22 January 2015 were issued to certain employees.
(c) On 25 February 2008, 1,779,000 options with an exercise price of Stg£0.30 and an exercise period to 25 February 2015 were issued to certain employees.
(d) On 12 May 2008, 1,350,000 options with an exercise price of Stg£0.30 and an exercise period to 13 May 2015 were issued to Directors.

The average share price at the date of grant of these options was Stg£0.36.

There were no warrants outstanding at 31 July 2008.

In accordance with IFRS 2 'Share based payment': a charge of Stg£530,000 (2007: Stg£315,000) arises in respect of share options. A corresponding entry has been made to share based payment reserve.

The share option scheme is primarily designed to reward and incentivise the Company's employees and Directors. The options are awarded at the Directors' discretion and are usually awarded on an annual basis. There are different vesting rules depending on whether the grantee is an existing employee, new employee or director. The longest possible vesting period is seven years from the date of grant. The Board also has certain discretionary powers to withdraw or divest share options.

Notes
continued

20 Called up share capital continued

A binomial lattice model was used to determine the fair value of share options at grant date.

The assumptions used to determine the fair value of options at grant dates during the year were as follows:

	2008	2007
Weighted average share price at date of grant (Stg£)	0.314	0.415
Average exercise price (Stg£)	0.312	0.415
Expected volatility (%)	60%	50%
Average expected terms to exercise (years)	3.25	2.83
Risk free rate (%)	4.5%	5.5%
Expected dividend yield	0%	0%

Expected share price volatility was determined by taking account of the historic daily share price movements.

The average expected term to exercise used in the models has been adjusted based on the Directors' best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk free rate has been determined from market yields for government bonds with outstanding terms equal to the average expected term to exercise for each relevant grant.

21 Share premium

	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Group and Company		
At beginning of year	48,571	29,712
On shares issued during the year	2,596	19,554
Issue expenses	–	(695)
At end of year	51,167	48,571

22 Unrealised revenue reserve

	31 July 2008 Stg£'000	31 July 2007 Stg£'000
At beginning and end of year	47	47

23 Capital and reserves

	Share capital Stg£'000	Share premium Stg£'000	Shares to be issued Stg£'000	Share warrants reserve Stg£'000	Share based payment reserve Stg£'000	Unrealised reserve Stg£'000	Group retained earnings Stg£'000	Group total equity Stg£'000
Balance at 1 August 2006	478	29,712	5,500	–	340	47	(973)	35,104
Shares issued	284	18,859	(5,500)	–	–	–	–	13,643
Share warrants issued	–	–	–	447	–	–	–	447
Share based payments charge	–	–	–	–	315	–	–	315
Loss for the financial year	–	–	–	–	–	–	(4,998)	(4,998)
Balance at 31 July 2007 and 1 August 2007	762	48,571	–	447	655	47	(5,971)	44,511
Shares issued for cash	27	2,216	–	–	–	–	–	2,243
Shares issued – intangible assets	1	33	–	–	–	–	–	34
Share based payments charge	–	–	–	–	530	–	–	530
Share warrants charge	–	–	–	170	–	–	–	170
Reversal of share warrants	8	347	–	(617)	–	–	262	–
Shares to be issued	–	–	238	–	–	–	–	238
Profit for financial year	–	–	–	–	–	–	12,414	12,414
Balance at 31 July 2008	798	51,167	238	–	1,185	47	6,705	60,140

The share capital, share premium, shares to be issued, share warrants reserve, share based payment reserve and unrealised reserve for the Company do not differ to that of the Group.

Notes
continued

23 Capital and reserves continued

Company retained earning can be reconciled as follows:

	Stg£'000
Balance at 1 August 2006	(1,580)
Loss for the financial year	(1,249)
Balance at 31 July 2007 and 1 August 2008	(2,829)
Reversal of share warrants	262
Profit for financial year	(3,254)
Balance at 31 July 2008	(5,821)

Shares to be issued

This reserve represents shares that the Company is legally bound to issue but were not issued at 31 July 2008.

Share warrants reserve

This reserve comprises amounts expensed in the income statement in connection with share warrants issued.

Share based payment reserve

This reserve comprises amounts expensed in the income statement in connection with share based payments.

24 Commitments and contingencies

Operating leases

Non-cancellable operating lease rentals are payable as set out below. These amounts represent the minimum future lease payments, in aggregate, that the Group is required to make under existing lease obligations.

	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Within one year	184	151
Between two and five years	445	515
After more than five years	–	–
	629	666

25 Deferred tax asset

Unrecognised deferred tax asset

Deferred tax assets have not been recognised in respect of the following item:

	31 July 2008 Stg£'000	31 July 2007 Stg£'000
Trading losses	241	–

The losses do not expire under current tax legislation.

Deferred tax assets have not been recognised in respect of this item because it is not probable that future taxable profits will be available against which the Group can utilise the benefit therefrom.

26 Related party transactions

Paul Griffiths, a Director of the Company, is also a Director and owner of Petro-Celtex Consultancy Limited ('Petro Celtex'). At 31 July 2008, Petro-Celtex own 1,219,755 ordinary shares in the Company (2007: 1,219,755).

Paul Griffiths also owns more than 20% of the issued share capital of Celtex Exploration Services Limited ('Celtex'). At 31 July 2008, Celtex own 2,225,456 ordinary shares in the Company (2007: 1,725,456).

Karl Prenderville, a former Director of the Company (resigned 18 November 2008), is also a Director and owner of K&B Productions Limited. During the year, K&B Productions Limited were paid Stg£315,359 for services rendered on an arms length basis to the Group. Amounts owing to K&B Productions Limited at year end amounted to Stg£nil (2007: Stg£28,171).

Notes
continued

26 Related party transactions continued

John Hamilton is Company Secretary and is also a Partner with LHM Casey McGrath. The Group uses the accounting, administrative and consultancy services of LHM Casey McGrath on an arms length basis. During the year, LHM Casey McGrath were paid Stg£19,136 (2007: Stg£81,944) for services rendered to the Group. Amounts owing to LHM Casey McGrath at year end amounted to Stg£nil (2007: Stg£nil).

John Hamilton is also a Director of CMG Interactive Limited, a company incorporated in Ireland. The Group used CMG Interactive Limited for IT outsourcing, consultancy and the purchasing of hardware and software on an arms length basis. During the year, CMG Interactive Limited were paid Stg£9,955 (2007: Stg£80,006) for services rendered to the Group. Amounts owing to CMG Interactive Limited at year end amounted to Stg£nil (2007: Stg£10,053).

All the above transactions were undertaken with the Company, Island Oil & Gas Plc.

IAS 19 also requires the disclosure of compensation paid to the Group's key management personnel. This comprises its Executive and Non-executive Directors, together with other persons discharging managerial responsibility. In the opinion of the Directors, persons discharging managerial responsibility are limited to Executive and Non-executive Directors. Details of the remuneration of the Group's individual Directors is set out in the remuneration committee section of the Directors' report on page 40.

27 Financial assets and liabilities

Group

(a) Overview of risk exposures and risk management strategy

The Group's operations expose it to various financial risks in the ordinary course of business that include credit risk, liquidity risk, currency risk and interest rate risk. The Group's financial exposures are predominantly related to changes in foreign exchange rates and interest rates as well as the creditworthiness of counterparties. The Group has a risk management programme in place which seeks to limit the impact of these risks on the financial performance of the Group and it is Group policy to manage these risks in a non-speculative manner.

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing the risk, and the Group's management of liquid resources. Further quantitative disclosures are included throughout this note.

The Board of Directors has the overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has reviewed the process for identifying and evaluating the significant risks affecting the business and the policies and procedures by which these risks will be managed effectively. The Board has embedded these structures and procedures throughout the Group and considers there to be a robust and efficient mechanism for creating a culture of risk awareness at every level of management.

The Group's overall risk management programme seeks to minimise potential adverse effects on the Group's financial performance from fluctuations in financial markets.

(b) Financial assets and liabilities – fair values

The Group's financial assets and liabilities are as follows:

	2008 Loans, other liabilities and receivables Stg£'000	2007 Loans, other liabilities and receivables Stg£'000
Cash and cash equivalents	3,407	11,602
Other receivables	634	389
Other payables	(459)	(12,482)
Other loan	(5,178)	–
Bank loan	–	(7,500)
Total	(1,596)	(7,991)

In each case, management have determined that there is no difference between the carrying value of these assets and liabilities and their fair values.

Set out below are the methods and assumptions used in estimating the fair values of financial assets and liabilities:

Cash and cash equivalents

For cash and cash equivalents, all of which have a remaining maturity of less than three months, the nominal amount is deemed to reflect fair value.

Notes
continued

27 Financial assets and liabilities continued

Trade and other receivables/payables

All receivables and payables (except the other (Delta) loan) have a remaining life of less than six months or are demand balances, and therefore the carrying value is deemed to reflect fair value.

(c) Credit risk

Credit risk arises from the Group's holding of cash and cash equivalents. Given the nature of the Group's receivables, it has no significant exposure to credit risk arising from other receivables. The Group's maximum exposure to credit risk is the carrying value of cash and cash equivalents and other receivables.

Cash and cash equivalents

The Group enters into transactions with financial institutions for the purposes of placing deposits. From a credit risk management perspective, it is the Group's policy to enter into such transactions only with highly rated financial institutions and, accordingly, the Group does not expect any counterparty to fail to meet its obligations. All significant deposits are with Allied Irish Bank plc and are therefore covered by the Irish Government's guarantee scheme.

Details of these deposits, which are all for terms of three months or less are as follows:

At 31 July 2008	Balance invested Stg£'000	Weighted average interest rate
Currency		
US Dollar	2,160	1.93%
Euro	589	2.63%
Sterling	643	2.86%
Canadian Dollar	15	–
	3,407	2.22%

At 31 July 2007	Balance invested Stg£'000	Weighted average interest rate
Currency		
US Dollar	4,494	5.18%
Euro	158	–
Sterling	6,950	5.75%
	11,602	5.45%

At 31 July 2008, the Group did not have any interest bearing liabilities except for the loan outlined in note 18. At 31 July 2007 the Group had a bank loan at a rate of LIBOR plus 4%.

(d) Liquidity risk

The Group has significant cash balances on hand, and accordingly, no liquidity risk exists at present.

All cash and cash equivalent amounts are on demand except for US$1m which is on a three month facility, and all trade and other receivables and trade and other payables are due within three months of the Balance Sheet date except for the Delta loan.

The Board monitors the availability of and requirements for funds in the Group. Surplus cash within the Group is put on deposit in accordance with limits and counterparties agreed by the Board, the objective being to maximise return on funds whilst ensuring that the short-term cash flow requirements of the Group are met.

The Group estimates its future contractual cash flows on its loan and other payables to be as follows:

	Carrying value at 31 July 2008 Stg'000s	Less than one year Stg'000s	One to two years Stg'000s	Two to five years Stg'000s	Greater than five years Stg'000s	Total Stg'000s
Loan	5,178	–	–	6,300	2,100	8,400
Payables	460	460	–	–	–	460
Total	5,638	460	–	6,300	2,100	8,860

(e) Interest rate risk

Cash and cash equivalents are invested primarily in US Dollars, Euro and Sterling. Exposure to interest rate risk on cash and cash equivalents is actively monitored and managed. The Company currently has no loans with variable interest rates.

Notes
continued

27 Financial assets continued

(f) Currency risk

The US Dollar, Euro and Sterling are the primary currencies in which the Group conducts business. Sterling is used for planning and budgetary purposes and as the presentation currency for financial reporting. The Group also has significant costs, assets and liabilities, denominated in Euros.

The Group manages the exposure by matching receipts and payments in the same currency and monitoring the residual net position.

This is achieved by comparing the currencies of projected short term outgoings with the currencies of cash holdings.

The Group may in future, with the approval of the Board, use derivative financial instruments to manage its exposure to fluctuations in foreign currency exchange rates. However no such instruments have been used to date. The Group does not undertake any trading activity in financial instruments.

The effect of a 1% general increase in interest rates paid on deposits would lead to a Stg£31,000 increase in the Group's profit after tax for the financial year based on the cash holdings at 31 July 2008.

At the year end, the Group's foreign currency balances were as follows:

	Denominated in Euro Stg£	Denominated US Dollar Stg£
Other receivables	13	178
Trade and other payables	188	180
Cash and cash equivalents	589	2,159

The exchange rates used in the preparation of the financial statements were as follows:

	2008 Stg£ per foreign currency Year end	2007 Stg£ per foreign currency Year end
Euro	1.27	1.48
US Dollar	1.98	2.00

The main effect of a change in the US$/Stg£ exchange rate would be on the Group's foreign currency assets and liabilities. Based on the Group's Dollar deposits and the US$10m loan at 31 July 2008, a 1% appreciation in the Dollar against the Pound Sterling would lead to approximately a Stg£40,000 decrease in the Group's profit after tax for the financial year.

The main effect of a change in the Euro/Stg£ exchange rate would be on the Group's expenditure. A 1% appreciation in the Euro against the Pound Sterling would lead to approximately a Stg£25,000 decrease in the Group's profit after tax for the financial year.

(g) Market risk

In the opinion of the Directors, there is no market risk.

All of the above items were transacted through the books of Island Oil & Gas Plc. Accordingly, in the opinion of the Directors the Company's disclosure is not materially different from the Group's disclosure.

Notes
continued

28 Transition to international financial reporting standards

As stated in the accounting policies, these are the Group's and Company's first financial statements prepared in accordance with IFRS, as adopted by the EU. The accounting policies set out on pages 44 to 48 have been applied in preparing the financial statements for the year ended 31 July 2008, the comparative information presented in these financial statements for the year ended 31 July 2007 and in the preparation of an opening IFRS Balance Sheet at 1 August 2006 (the Group and Company's date of transition).

In preparing its opening IFRS Balance Sheet, the Company has adjusted amounts reported previously in its financial statements prepared in accordance with Irish GAAP. An explanation of how the transition from Irish GAAP to IFRS has affected the Group's and Company's financial positions, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

In restating the Group and Company financial statements, the Group has availed of an exemption in accordance with IFRS 1, 'First-time adoption of International Financial Reporting Standards', and deemed the foreign currency translation reserve at 1 August 2006 to be nil.

Reconciliation of loss for the year ended 31 July 2007

	Irish GAAP Stg£'000	Effect of transition to adopted IFRS's Stg£'000	EU Adopted IFRS's Stg£'000
Revenue	1,762		1,762
Cost of sales	(902)		(902)
Gross profit	860		860
Administration expenses	(1,022)	(152)	(1,174)
Costs associated with uncommercial projects	(4,537)		(4,537)
Other operating income	401		401
Operating profit/(loss) – continuing operations	(4,298)	(152)	(4,450)
Finance income	181		181
Finance expense	(1,066)	337	(729)
Loss on ordinary activities before taxation	(5,183)	185	(4,998)
Taxation on loss on ordinary activities	–		–
Loss for the financial year attributable to equity holders of the parent	(5,183)	185	(4,998)
Loss per share (Stg£)			
Basic	(0.0636)		(0.0613)
Diluted	(0.0636)		(0.0613)

Notes
continued

28 Transition to international financial reporting standards continued

Reconciliation of total recognised income and expense for the year ended 31 July 2007

	Irish GAAP Stg£'000	Effect of transition to adopted IFRS's Stg£'000	EU Adopted IFRS's Stg£'000
Loss for the year	(5,183)	185	(4,998)
Total recognised income and expense	(5,183)	185	(4,998)

Reconciliation of balance sheets as at 1 August 2006 and 31 July 2007

Assets	1 August 2006 Irish GAAP	1 August 2006 Transition adjustments	1 August 2006 IFRS	31 July 2007 Irish GAAP	31 July 2007 Transition adjustments	31 July 2007 IFRS
Non current assets						
Intangible exploration and evaluation assets	30,950		30,950	54,911	185	55,096
Property, plant and equipment	2,147		2,147	1,761		1,761
	33,097		33.097	56,672		56,857
Current assets						
Other receivables	9,893		9,893	2,612		2,612
Cash and cash equivalents	6,071		6,071	11,602		11,602
	15,964		15,964	14,214		14,214
Total Assets	49,061		49,061	70,886	185	71,071
Equity and liabilities						
Called up share capital	478		478	762		762
Share premium	29,712		29,712	48,571		48,571
Shares to be issued	5,500		5,500	–		–
Share warrants reserve	–		–	447		447
Share based payment reserve	340		340	655		655
Unrealised revenue reserve	47		47	47		47
Retained earnings	(973)		(973)	(6,156)	185	(5,971)
Total Equity	35,104		35,104	44,326	185	44,511
Non current liabilities						
Provisions	646		646	675		675
Loans	–		–	–		–
	646		646	675		675
Current liabilities						
Trade and other payables	13,292		13,292	18,369		18,369
Interest bearing loans and borrowings	–		–	7,500		7,500
Current tax liabilities	19		19	16		16
	13,311		13,311	25,885		25,885
Total liabilities	13,957		13,957	26,560		26,560
Total equity and liabilities	49,061		49,061	70,886		71,071

The only impacts on transition arose from the adoption of IFRS 6 'Exploration for and Evaluation of Mineral Resources' and the adoption of an accounting policy for the capitalisation of interest in accordance with International Accounting Standards ('IAS') 23 'Borrowing Costs'. Explanations of how the transition to IFRS has affected the previously reported financial position and results in the year ended 31 July 2007 under Irish GAAP are shown below:

(a) Under IFRS 6 'Exploration for and Evaluation of Mineral Resources' expenditures on non-licensed oil and gas interests are expensed as incurred. The adjustment to the income statement for the year ended 31 July 2007 is a loss of Stg£0.152m. The corresponding adjustment on the balance sheet was to reduce intangible exploration and evaluation assets.

(b) Under IAS 23 'Borrowing Costs' interest that relates to expenditure on intangible assets has been capitalised. Stg£0.337m has been capitalised as intangible exploration and evaluation assets in respect of borrowing costs and equivalent reductions were made to the finance expenses in the income statement for the year ended 31 July 2007.

29 Approval of financial statements

The financial statements were approved by the Directors on 9 January 2009.

Corporate information

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Martin Carl Kindinger (South Africa)
Karl Prenderville
(resigned 18 November 2008)
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