Notes to the consolidated financial statements

For the year ended 31 December 2010

1 Segmental analysis

The Group's reportable and geographical segments are Thailand, Indonesia, the Philippines, Lao PDR, Vietnam and Other. Other activities include its corporate centre in the UK.

Information regarding the Group's operating segments is reported below.

Segment revenues and results

The following is an analysis of the Group's revenue and assets by reportable segment:

	2010						
	Thailand £'000s	Indonesia $'000s	Philippines $'000s	Lao PDR $'000s	Vietnam $'000s	Other $'000s	Total $'000s
Revenue (external)	203,931	122,368	–	–	–	(2,925)	323,374
Operating profit/(loss)	121,167	(167,968)	(6,909)	(7,915)	(25,058)	(19,277)	(105,960)
Interest revenue						399	399
Finance cost						(15,523)	(15,523)
Other financial gains						7,431	7,431
Loss before tax							(113,653)
Tax						(55,865)	(55,865)
Loss for the year							(169,518)
Non-current assets	443,775	316,609	–	13	798	9,018	770,213
Total assets	527,772	383,963	–	1,284	3,577	78,884	995,480
Depreciation and amortisation	35,578	102,359	–	5	–	367	138,309
Additions to non-current assets	112,383	104,185	–	(134)	(3,122)	1,667	214,979
(Reversal of impairment)/ impairment	(42,930)	91,505	–	–	–	–	48,575

	2009						
	Thailand £'000s	Indonesia $'000s	Philippines $'000s	Lao PDR $'000s	Vietnam $'000s	Other $'000s	Total $'000s
Revenue (external)	109,476	58,385	–	–	–	(10,713)	157,148
Operating profit/(loss)	44,615	(7,919)	(22)	136	(17)	(23,614)	13,179
Interest revenue						531	531
Finance cost						(4,411)	(4,411)
Other financial losses						(12,258)	(12,258)
Loss before tax							(2,959)
Tax						(10,572)	(10,572)
Loss for the year							(13,531)
Non-current assets	331,263	443,209	6,239	8,262	28,961	20,986	838,920
Total assets	375,295	466,371	6,820	8,816	29,331	75,344	961,977
Depreciation and amortisation	36,076	26,104	–	8	–	218	62,406
Additions to non-current assets	43,895	69,229	1,193	(2,095)	6,821	1,795	120,838

The accounting policies used for the reportable segments are the same as the Group's accounting policies.

1 Segmental analysis continued

For the purposes of monitoring segment performance and allocating resources between segments, the Group's Chief Operating Officer monitors the tangible, intangible and financial assets attributable to each segment. All assets are allocated to reportable segments with the exception of the segments, financial assets (except for trade and other receivables) (see note 19) and tax assets.

Information about major customers

Included in revenues arising from Thailand are revenues of approximately $203,391,000 (2009: $92,511,000), and in Indonesia revenues of $46,544,000 (2009: $37,462,000) which arose from sales to the Group's largest customers.

2 Revenue

Revenue, excluding interest revenue (see note 7), comprises:

	2010 $'000s	2009 $'000s
Sales of oil	**261,405**	134,795
Sales of gas	**64,894**	33,066
Oil and gas derivatives:		
Hedging fees	**–**	(3,401)
Realised settlement losses	**(2,925)**	(7,312)
Total revenue (excluding interest revenue)	**323,374**	157,148

Total revenue in accordance with IAS 18 includes interest revenue and amounted to $323,773,000 (2009: $157,679,000).

3 Cost of sales

Cost of sales comprises:

	2010 $'000s	2009 $'000s
Operating costs	**102,490**	69,448
Royalty payable	**16,801**	9,889
Amortisation of oil and gas properties	**137,830**	61,957
Impairment	**48,575**	–
Overlift	**2,341**	4,582
Movement in inventories of oil	**12,722**	(22,127)
Total cost of sales	**320,759**	123,749

Of total royalties payable of $16,801,000, $14,028,000 (2009: $7,768,000) was payable in respect of Thailand assets where the royalty was deductible as an advance payment of income tax to the extent income tax was payable (see note 10).

4 Employee numbers and costs

The monthly average number of employees (including Executive Directors and consultants) employed and charged to operations was as follows:

	2010 Number	2009 Number
Professional	**94**	65
Administration	**39**	27
Total employee numbers	**133**	92

4 Employee numbers and costs continued

The aggregate remuneration was as follows:

	2010 $'000s	2009 $'000s
Wages and salaries	**19,134**	15,086
Share Based Payment	**2,562**	3,434
Pension	**559**	611
Social security	**888**	869
Total employee costs	**23,143**	20,000

A proportion of total employee costs were directly attributable to capital and other projects and were capitalised or expensed consistent with the project expenditures as follows:

	2010 $'000s	2009 $'000s
Non-current assets	**9,235**	7,267
Operating costs	**9,220**	7,600
Administrative expenses	**4,688**	5,133
Total employee costs	**23,143**	20,000

5 Operating lease arrangements

	2010 $'000s	2009 $'000s
FPSO lease	**13,778**	10,950
Office leases	**2,089**	2,152
Minimum lease payments under operating leases recognised in income statement for the year	**15,867**	13,102

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

	2010		2009	
	FPSO $'000s	Offices $'000s	FPSO $'000s	Offices $'000s
Within one year	19,901	1,771	10,950	1,553
Within two to five years	34,364	2,075	10,950	852
Greater than five years	–	394	18,090	273
Total outstanding operating lease commitments	54,265	4,240	39,990	2,679

6 Operating profit/(loss)

Operating profit/(loss) is stated after charging:

	2010 $'000s	2009 $'000s
Employee costs expensed	**13,908**	12,733
Amortisation and depreciation of property, plant and equipment	**137,830**	61,957
Auditors' remuneration (see below)		
Audit services	**540**	486
Non-audit services	**1,694**	997
Net foreign exchange (losses)/gains	**(569)**	318
Movement in inventories of oil	**12,722**	(22,127)
Operating lease arrangements (see note 5)		
FPSO lease	**13,778**	10,950
Office lease	**2,089**	2,152

Auditors' remuneration

The following is an analysis of gross fees paid to the Company's Auditors, Deloitte LLP:

	2010 $'000s	2009 $'000s
Audit services		
Fees payable to the Company's Auditors for the audit of the Company's annual accounts	**360**	323
The audit of the Company's subsidiaries pursuant to legislation	**180**	163
Total audit fees	**540**	486
Non-audit services		
Other services provided pursuant to legislation	**108**	98
Corporate finance services (reporting accountant services)	**1,250**	–
Tax services	**336**	899
Total non-audit services	**1,694**	997
Total	**2,234**	1,483

Other services provided pursuant to legislation represent the fees for the Group's half year review. Corporate finance services represents the fee for reporting accountant services relating to the Group's acquisition of an additional 40% interest in the Bualuang field in Thailand.

Fees payable to Deloitte LLP and their associates for non-audit services to the Company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

7 Interest revenue

	2010 $'000s	2009 $'000s
Loan interest revenue	**17**	269
Bank interest revenue	**382**	262
Total interest revenue	**399**	531

8 Finance costs

	2010 $'000s	2009 $'000s
Long term borrowings:		
Amortisation of capitalised arrangement fees	**1,785**	724
Interest expense	**11,358**	5,851
Unwinding of discount		
Convertible bonds	**1,738**	–
Provision for decomissioning	**824**	806
Less interest capitalised	**(182)**	(2,970)
Total finance costs	**15,523**	4,411

9 Other financial gains and losses

	2010 $'000s	2009 $'000s
Profit/(loss) relating to oil price hedges	**8,251**	(11,513)
Loss relating to interest rate hedges	**(319)**	(1,108)
Profit on investments	**68**	45
Currency exchange (loss)/gain	**(569)**	318
Total other financial gains/(losses)	**7,431**	(12,258)

10 Taxation

	2010 $'000s	2009 $'000s
Current taxation		
Income tax	**50,556**	23,895
Special Remuneratory Benefit	**21,008**	–
Total current tax	**71,564**	23,895
Deferred taxation		
Income tax	**(31,029)**	(13,323)
Special Remuneratory Benefit	**15,330**	–
Total deferred tax	**(15,699)**	(13,323)
Total tax charge	**55,865**	10,572

Special Remuneratory Benefit is a tax that arises on certain fields in Thailand and which is payable at variable rate dependent on a number of financial and operational metrics.

Reconciliation of tax charge to loss before tax

The tax charge for the year can be reconciled to the loss before tax per the Income Statement as follows:

	2010 $'000s	2009 $'000s
Loss before taxation	**(113,653)**	(2,959)
Applicable rate	**44%**	44%
Tax at the applicable rate of tax	**(50,007)**	(1,302)
Tax effect of:		
Items which are not deductible for tax:		
Exploration expenses	**42,181**	5,267
Other	**12,649**	(3,406)
UK losses not recognised	**7,161**	7,368
Foreign losses not recognised	**323**	–
Thailand Special Remuneratory Benefit	**36,338**	–
Different foreign tax rates	**7,220**	2,645
Total tax charge	**55,865**	10,572

The Group's operations are conducted primarily outside the United Kingdom. Accordingly the applicable tax rate used above is the average statutory rate of tax, weighted in proportion to accounting profits, applicable across the Group. The prior year comparatives, which previously used 28%, being the UK corporation tax rate, have been restated on this basis.

11 Loss per ordinary share

The calculation of the basic and diluted loss per share is based on the following data:

	Units	2010 $'000s	2009 $'000s
Loss for the purpose of basic and diluted earnings per share being the net loss attributable to equity holders of the parent	$'000s	**(169,518)**	(13,531)
Weighted average number of ordinary shares for the purpose of basic and diluted earnings per share[1]	$'000s	**153,466**	152,781
Loss per ordinary share			
Basic and diluted	**$'s**	**(1.10)**	(0.09)

1 As there is a loss for the year ended 31 December 2010 and 2009, there is no difference between the basic and diluted earnings per share. Potentially dilutive ordinary shares for the year ended 31 December 2010 were 4,305,854 (2009: 4,490,963) in respect of share options and 18,362,337 (2009: nil) in respect of convertible bonds.

12 Intangible exploration and evaluation assets

	2010 $'000s	2009 $'000s
Exploration and evaluation		
At 1 January	**243,579**	214,814
Additions	**87,035**	34,625
Costs written off	**(91,336)**	(5,860)
At 31 December	**239,278**	243,579

The amounts shown above for intangible exploration and evaluation assets represent the Group's current exploration projects. Included within the total amount are assets held in Indonesia of $172,576,000 (2009: $130,585,000) and Thailand of $66,021,000 (2009: $68,661,000).

13 Property, plant and equipment

	Oil and gas properties			Other fixed assets			Total net book value
	Cost $'000s	**Amortisation $'000s**	**Total $'000s**	Cost $'000s	Depreciation $'000s	Total $'000s	$'000s
1 January 2009	656,969	(105,723)	551,246	1,863	(971)	892	552,138
Additions for the period	85,793	–	85,793	420	–	420	86,213
Amortisation and depreciation	–	(61,957)	(61,957)	-	(449)	(449)	(62,406)
Impairment	–	–	–	-	–	–	–
31 December 2009	742,762	(167,680)	575,082	2,283	(1,420)	863	575,945
Additions for the period	127,256	–	127,256	688	–	688	127,944
Amortisation and depreciation	–	(137,699)	(137,699)	–	(610)	(610)	(138,309)
Impairment	–	(48,575)	(48,575)	–	–	–	(48,575)
31 December 2010	870,018	(353,954)	516,064	2,971	(2,030)	941	517,005

Additions to oil and gas properties includes capitalised interest of $182,000 (2009: $2,970,000) charged at an average rate of 4.6% (2009: 5.4%) as well as $109,269,000 (2009: nil) resulting from the Group's acquisition of an additional 40% interest in the Bualuang field in Thailand. Included in the net book amount at 31 December 2010 in oil and gas properties are assets amounting to $402,315,000 (2009: $567,580,000) pledged against the Group's existing seven years reserve-based lending facility.

13 Property, plant and equipment continued

The impairment charge shown above comprises a $91,500,000 write-down in respect of the Kambuna asset in Indonesia and a $42,900,000 write-back in respect of the Bualuang asset in Thailand. These impairment adjustments were calculated based on the assets' value in use, using management's best estimate of future oil prices, the latest estimate of commercial reserves and a pre-tax discount rate of 12.5%. The impairment charge on Kambuna was due to a reserves downgrade during the year caused by faster than anticipated pressure decline being observed in production data, whilst the impairment reversal on Bualuang was primarily due to a significant reserves upgrade as a result of recent drilling activities. The Bualuang adjustment represents a full reversal of the $55,000,000 impairment charge in 2008, although the resulting credit was limited to $42,900,000 to take into consideration additional depreciation that would have been charged if the original impairment had not taken place.

14 Other receivables – restricted bank deposits

Restricted bank deposits of $4,339,000 (2009: $11,398,000) represent deposits held as security against bank guarantees issued by the bank on behalf of the Group in support of certain of its operations.

15 Commitments and guarantees

Bank guarantees

At 31 December 2010, there were outstanding bank guarantees issued by banks on behalf of the Group, amounting to $16,500,000 (2009: $21,341,000).

Capital commitments

The Group's outstanding financial capital commitments represent the minimum agreed amounts the Group will expend completing its obligated work programmes of carrying out geophysical and geological studies, and to drill exploration and appraisal wells. At 31 December 2010, the Group anticipates it will discharge its minimum financial capital commitments as follows:

	2011 $'000s	2012 $'000s	2013 $'000s
Future capital commitments	57,000	15,000	10,000

16 Group companies

The Subsidiaries and Jointly Controlled Entities of the Group, the activity of which relates to oil and gas exploration, development and production, at the Balance Sheet date were as follows:

Subsidiaries

Company	Country of operation	Country of incorporation	Percentage holding
Salamander Energy Group Limited[1]	United Kingdom, Thailand and Vietnam	United Kingdom	100.00%
Salamander Energy (E&P) Limited	United Kingdom and Thailand	United Kingdom	100.00%
PHT Partners LP	United States of America	United States of America	100.00%
Salamander Energy (Holdco) Limited	United Kingdom	United Kingdom	100.00%
Salamander Energy Singapore Pte Ltd	Singapore	Singapore	100.00%
Salamander Energy (SE Asia) Limited	United Kingdom	United Kingdom	100.00%
Salamander Energy (Bontang) Company Pte Ltd	Indonesia	Singapore	100.00%
Salamander Energy (Java & Sumatra) B.V.	The Netherlands	The Netherlands	100.00%
Salamander Energy (Java) B.V.	Indonesia	The Netherlands	100.00%
Salamander Energy (Sumatra) B.V.	Indonesia	The Netherlands	100.00%
Salamander Energy (Philippines) Limited	The Philippines	United Kingdom	100.00%
Salamander Energy (Indonesia) Limited	Indonesia	United Kingdom	100.00%
Salamander Energy (Vietnam) Limited	Vietnam	United Kingdom	100.00%
Salamander Energy (Simenggaris) Limited	Indonesia	United Kingdom	100.00%
Salamander Energy (Bengara) Limited	Indonesia	United Kingdom	100.00%
Salamander Energy (Lao) Company Limited	Lao PDR	Lao PDR	100.00%
Salamander Energy (Canada) Limited	Canada	Canada	100.00%
Salamander Energy Oil & Gas Inc	Canada	Canada	100.00%
Salamander Energy Oil & Gas USA Inc	United States of America	United States of America	100.00%
Salamander Energy Oil & Gas Crystal Inc	United States of America	United States of America	100.00%
Salamander International Holdings Limited	British Virgin Islands	British Virgin Islands	100.00%
Salamander Energy (Asahan) Limited	Indonesia	British Virgin Islands	100.00%
Salamander Energy (Seruway) Limited	Indonesia	British Virgin Islands	100.00%
Salamander Bualuang & Kambuna Holdings Limited	British Virgin Islands	British Virgin Islands	100.00%
Salamander Energy (Bualuang) Limited	British Virgin Islands	British Virgin Islands	100.00%
Salamander Energy (Glagah Kambuna) Limited	Indonesia	British Virgin Islands	100.00%
Salamander Energy (Kutai) Limited	Indonesia	United Kingdom	100.00%
Salamander Energy (S.E. Sangatta) Limited	Indonesia	United Kingdom	100.00%
Salamander Energy (North Sumatra) Limited	Indonesia	British Virgin Islands	100.00%
Salamander Energy (Bualuang Holdings) Limited	United Kingdom	United Kingdom	100.00%
Salamander Energy (Glagah Kambuna Holdings) Limited	United Kingdom	United Kingdom	100.00%
Bontang Energy Limited[1]	Indonesia	United Kingdom	100.00%
Salamander Energy Thailand LLC	Thailand	United States of America	100.00%
Salamander Energy (Thailand) Co., Ltd	Thailand	Thailand	100.00%
Salamander Energy (South Sokang) Limited	Indonesia	United Kingdom	100.00%
Salamander Energy (Bangkanai) Limited	Indonesia	British Virgin Islands	100.00%

1 Salamander Energy Group Limited and Bontang Energy Limited are the only direct subsidiaries of the Company.

16 Group companies continued

Jointly controlled entities

Company	Country of operations	Country of incorporation	Percentage holding
APICO LLC	Thailand	United States of America	27.18%
APICO (Khorat) Holdings LLC	Thailand	United States of America	27.18%
APICO (Khorat) Limited	Thailand	Thailand	27.18%

The following amounts are included in the financial statements relating to proportionately consolidated Jointly Controlled Entities of the Group:

	2010 $'000s	2009 $'000s
Total revenue	**22,208**	16,965
Total expenses	**19,836**	11,347
Non-current assets	**49,535**	57,506
Current assets	**6,440**	6,511
Non-current liabilities	**2,221**	1,861
Current liabilities	**7,914**	6,489

17 Deferred tax assets and liabilities

Net deferred tax liabilities were:

	Accelerated tax amortisation	
	2010 $'000s	2009 $'000s
At 1 January	**134,179**	147,502
Acquisition of subsidiaries	**28**	–
Credited to Income Statement	**(15,699)**	(13,323)
At 31 December	**118,508**	134,179

Deferred tax assets and liabilities included in the Balance Sheet were as follows:

	2010 $'000s	2009 $'000s
Deferred tax assets	**3,075**	2,271
Deferred tax liabilities	**(121,583)**	(136,450)
Net deferred tax liabilities	**(118,508)**	(134,179)

At 31 December 2010, the Group had not recognised a potential deferred tax asset of $10,456,000 (2009: $7,972,000) relating to tax losses as there was insufficient evidence of future taxable profits in the relevant jurisdictions. These losses can be carried forward indefinitely.

There are no significant unrecognised temporary differences associated with undistributed profits of subsidiaries and joint ventures.

18 Inventories

	2010 $'000s	2009 $'000s
Oil	**4,010**	16,732
Materials	**16,365**	7,594
Total inventories	**20,375**	24,326

19 Trade and other receivables

	2010 $'000s	2009 $'000s
Prepayments	**8,045**	3,582
Trade debtors	**61,215**	10,619
Restricted bank deposits	**5,041**	–
Underlift	**170**	–
Other debtors	**40,561**	36,777
Total trade and other receivables	**115,032**	50,978

The Group does not hold any collateral or other credit enhancements over these balances nor does it have a legal right of offset against any amounts owed by the Group to the counterparty. The average age of these receivables is 68.5 days (2009: 23.1 days).

The Group does not have any receivables that are past their due date. No provision for doubtful debts has been raised as it is believed that all trade debtor balances are recoverable. The Directors consider the carrying amount of trade and other receivables approximates to their fair value.

20 Cash and cash equivalents

	2010 $'000s	2009 $'000s
Amounts held directly by the Group	**72,405**	43,448
Amounts held in joint ventures	**17,455**	4,305
Total cash and cash equivalents	**89,860**	47,753

Of the amounts held directly by the Group, $24,491,000 (2009: $18,278,000) was held in debt service accounts and subject to restrictions in accordance with the Group's debt facility, the key terms of which are described in note 21 to the consolidated financial statements.

Financial institutions and their credit ratings which held greater than 5% of the Group's cash and cash equivalents at the Balance Sheet date were as follows:

	S&P credit rating	2010 $'000s	2009 $'000s
HSBC Bank plc	AA	**18,401**	16,228
The Hong Kong and Shanghai Banking Corporation Ltd	AA–	**7,646**	3,616
BNPP	AA	**45,330**	18,192
Sumitomo Mitsui Banking Corporation Europe Limited	A+	**5,002**	5,004

21 Borrowings

	2010 $'000s	2009 $'000s
Principal repayable on maturity	**189,468**	178,464
Less deferred fees	**(5,662)**	(3,871)
Total unamortised borrowings	**183,806**	174,593
Less amounts due within one year	**(103,796)**	(38,287)
Total long term borrowings	**80,010**	136,306

21 Borrowings continued

Net debt

	2010 $'000s	2009 $'000s
Amounts due on maturity:		
Borrowings	**189,468**	178,464
Convertible bonds (see note 22)	**100,000**	–
Total gross debt	**289,468**	178,464
Less restricted bank deposits	**(9,380)**	(11,398)
Less cash and cash equivalents	**(89,860)**	(47,753)
Total net debt	**190,228**	119,313

At the Balance Sheet date, the principal repayable on maturity (excluding the convertible bond, see note 22) is calculated to be repayable as follows:

	2010 $'000s	2009 $'000s
On demand or due within one year	**103,796**	38,287
In the second year	**30,671**	29,338
In the third to fifth year inclusive	**35,999**	110,839
After five years	**19,003**	–
Total principal payable on maturity	**189,468**	178,464

Borrowings at the Balance Sheet date include a seven year reserves based lending facility entered into in June 2009, an acquisition bridge facility entered into in September 2010 and a convertible bond issued in March 2010 (see note 22).

The reserves based lending facility is secured against certain of the Group's Thailand and Indonesia development and producing assets and includes certain covenants relating to the ratio of the loan balance outstanding to the net present value of cash flows of the secured assets. There has been no breach of terms on the borrowing facility. The key terms of the facility are:

- An initial facility amount of $200 million, increased to $230 million by the addition of a junior facility.
- The Group may draw an amount up to the lower of the facility amount or the borrowing base amount as determined by the forecast cash flows arising from the borrowing base assets.
- Interest accrues at a rate of between 2.20% and 2.95% plus LIBOR depending on the maturity of the assets. The borrowing base amount is re-determined on an annual basis, with the Group further having the option to undertake two mid-period redeterminations in each year should it elect to do so.
- Annual redeterminations of debt capacity.
- No early repayment penalties.
- Change of control provisions.

At 31 December 2010, the Group had drawn fully against the facility the amount that was available (2009: fully drawn against the facility available).

The acquisition bridge facility is secured against the additional 40% of the Bualuang asset acquired in September 2010 and includes certain covenants in respect to the Group's total debt, and Balance Sheet metrics. There has been no breach of terms on the borrowing facility. The key terms of the facility are:

- An initial facility amount of $90 million, subject to satisfaction of certain conditions.
- Interest accrues at a rate of between 1.9% and 3.5% plus LIBOR.
- A final maturity date of the earlier of 18 months from the date of the facility and 31 December 2011.
- No early repayment penalties.
- Change of control provisions.

At 31 December 2010 the Group had drawn $75 million against the facility.

22 Convertible bonds

The convertible bonds were issued on 30 March 2010 at an issue price of $100 million. The bonds are convertible into ordinary shares of the Company at any time between the date of issue of the bonds and their settlement date. On issue, each bond was convertible at a price of £3.637 per share. The conversion price is set at a 37.5% premium to the volume weighted average share price of the ordinary shares at the date the convertible bonds were issued.

If the bonds have not been converted, they will be redeemed on 30 March 2015 at par. Interest of 5% will be paid annually up until that settlement date.

The net proceeds received from the issue of the convertible bonds have been split between the financial liability element (estimated at the time of issue using the prevailing market interest rate for similar non-convertible debt) and an equity component, representing the fair value of the embedded option to convert the financial liability into equity of the Company, as follows:

	$'000s
Proceeds of issue of convertible bonds	100,000
Equity component before allocation of fees[1]	(11,586)
Liability component at date of issue	88,414
Coupon interest charged	3,795
Unwinding of discount	1,738
Interest paid	(2,500)
Less deferred fees relating to debt component	(2,068)
Total liability component at 31 December 2010	**89,379**
Reported in:	
Non-current liabilities	88,084
Interest payable in current liabilities	1,295
Total liability component at 31 December 2010	**89,379**

1 The net amount credited to equity of $11,271,000 comprises a fair value equity component of $11,586,000 after the allocation of $315,000 of fees relating to the equity component.

The total convertible bond interest expensed for the period is calculated by applying an effective interest rate of 8% to the liability component for the nine month period since the bonds were issued. The liability component is measured at amortised cost. The difference between the carrying amount of the liability component at the date of issue and the amount reported in the Balance Sheet at 31 December 2010 represents the effective interest rate less interest paid to that date.

23 Provisions

Provisions for decommissioning and restoration of oil and gas assets are:

	2010 $'000s	2009 $'000s
At 1 January	**7,400**	4,713
Additions	**1,266**	1,881
Unwinding of discount	**824**	806
At 31 December	**9,490**	7,400

Of the total above, it is expected that the first decommissioning is to take place from 2015 ($4,200,000, for the Kambuna field) with the remainder expected to fall due from 2025.

24 Trade and other payables

	2010 $'000s	2009 $'000s
Trade creditors	**768**	656
Overlift	**2,511**	4,489
Other creditors	**45,637**	22,145
Accrued expenses	**59,760**	32,659
Total trade and other payables	**108,676**	59,949

The average credit period taken for trade purchases is 80.2 days (2009: 43.8 days). The Directors consider the carrying value of trade and other payables approximates to their fair value.

25 Financial instruments

Capital risk management

The Group manages its capital to ensure that entities in the Group are able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance.
The capital structure of the Group consists of debt, which includes the borrowings disclosed in notes 21 and 22, cash and cash equivalents as disclosed in note 20, and equity attributable to equity holders of the Company, comprising issued capital, reserves and retained earnings as disclosed in note 27 and the statement of changes in equity. This is further discussed in the Directors' Report.

Gearing ratio

Management reviews the capital structure on a continuing basis. The gearing ratio is defined as borrowings divided by net book equity plus borrowings at the year end was as follows:

	2010 $'000s	2009 $'000s
Borrowings	**271,890**	174,593
Equity plus borrowings	**691,281**	746,599
Gearing ratio	**39%**	23%

Significant accounting policies

Details of significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which the income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in the Statement of Accounting Policies.

Categories of financial instruments

	2010 $'000s	2009 $'000s
Financial assets:		
Restricted bank deposits	**9,380**	11,398
Cash and bank balances	**89,860**	47,753
Loans and receivables	**68,072**	18,430
Mark to market value of oil derivatives	**494**	–
Financial liabilities:		
Mark to market value of interest swap derivatives	**1,427**	1,108
Mark to market value of oil derivatives	**–**	9,206
Amortised cost	**402,489**	221,558

Financial assets and liabilities exclude tax receivables and payables as they do not constitute a contractual right or obligation to receive or pay cash or another financial asset.

25 Financial instruments continued

Financial risk management

The Group's Board of Directors monitors and manages the financial risks relating to the operations of the Group through an internal risk register. These include commodity, foreign exchange, credit, liquidity and interest rate risks.

Commodity price risk

The Group's policy is to consider oil and gas price hedging when and where it is economically attractive to lock in prices at levels that protect the cash flow of the Salamander Group, its business plan and debt related coverage ratios. All hedging transactions to date have been related directly to expected cash flows and no speculative transactions have been undertaken.

For 2010, the Group's oil production was all sold at prices relative to the spot market. 2010 production was hedged with zero cost collars of 2,500 bopd with a put and call price of $60.00 and $78.00 and additional zero cost collars of 1,500 bopd with a put and call price of $60.00 and $90.00, purchased respectively in May and July 2009 and which all expired during 2010. During November 2010 the Group purchased puts for calendar year 2011 for 4,000 bopd with a price of $60.00.

During 2010, 76% of the Group's gas production (its Indonesian gas production) was sold at fixed prices under long term contracts with the balance (its Thai gas production) sold at prices based on a formula related to spot medium sulphur fuel oil prices. The Group held no hedges with respect to its gas production during 2010.

The key variable which affects the fair value of the Group's hedging instruments is market expectations about future commodity prices. The following illustrates the sensitivity on hedging mark to markets values to net income and equity to a twenty per cent increase and a twenty per cent decrease in this variable:

Increase/(decrease) to mark to market value

	2010 Oil $'000s	2009 Oil $'000s
Twenty per cent increase	**(256)**	(24,144)
Twenty per cent decrease	**1,165**	1,131

Foreign exchange risk

The Group undertakes certain transactions denominated in foreign currencies, hence exposures to exchange rate fluctuations arise. Exchange rate exposures are managed through maintaining the majority of the Group's cash and cash equivalent balances in US Dollars, the Group's presentational currency and the functional currency of all its subsidiaries. The Group also holds, from time to time, cash balances in UK Pounds Sterling and other currencies to meet short-term commitments in those currencies.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Assets		**Liabilities**	
	2010 $'000s	2009 $'000s	**2010 $'000s**	2009 $'000s
UK Pounds Sterling	**2,316**	935	**2,469**	1,149
Singapore Dollar	**5,888**	318	**114**	52
Indonesian Rupiah	**26,434**	15,174	**3,597**	1,131
Thailand Baht	**33,332**	13,148	**70,790**	5,783
Vietnamese Dong	**1,094**	874	**458**	611
Other	**26**	31	**13**	2

25 Financial instruments continued

The following table details the Group's sensitivity to a 20% increase or decrease in the US Dollar against the relevant foreign currency. The sensitivity analysis includes only foreign currency denominated monetary items and adjusts their translation at the year end for a 20% change in the foreign currency rate. A positive number below indicates an increase in profit after tax where the US Dollar strengthens by 20% against the relevant currency. For a 20% weakening of the US Dollar against the relevant currency, there would be an equal and opposite impact on the profit after tax and the balances below would be negative.

	2010 $'000s	2009 $'000s
Change in profit or loss		
UK Pounds Sterling	**30**	43
Singapore Dollar	**1,155**	53
Indonesian Rupiah	**4,567**	2,808
Thailand Baht	**7,492**	1,473
Vietnamese Dong	**127**	52

Credit risk

Credit risk refers to the risk that a counterparty will default on its obligations resulting in a financial loss to the Group. The Group is exposed to the following credit and counterparty risks.

In respect of cash and cash equivalents, the Group's principal financial asset, the credit risk is deemed limited because the majority of the cash and cash equivalents are deposited with banks with AA or A+ credit ratings assigned by international credit-rating agencies.

In respect of the Group's trade sales, the Group manages credit risk through dealing with, whenever possible, either international energy companies or state owned companies based in Thailand and Indonesia and obtaining sufficient collateral where appropriate. The Group consistently monitors counterparty credit risk.

The carrying value of financial assets recorded in the financial statements represents the Group's maximum exposure to credit risk at the year end without taking account of any collateral obtained. In addition, the Group's operations are typically structured via contractual joint venture arrangements. As such the Group is reliant on joint venture partners to fund their capital or other funding obligations in relation to assets and operations which are not yet cash generative. The Group closely monitors the risks and maintains a close dialogue with those counterparties considered to be highest risk in this regard.

25 **Financial instruments** continued

Liquidity risk

The Group manages its liquidity risk by maintaining adequate cash and cash equivalents, and borrowing facilities to meet its forecast short, medium and long-term commitments. The Group continually monitors its actual and forecast cash flows to ensure that there are adequate reserves and banking facilities to meet the maturing profiles of its financial assets and liabilities.

The following tables detail the Group's remaining contractual maturities for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date the Group was required to pay at the Balance Sheet date. The table includes both interest and principal cash flows.

	2010						
	Weighted average effective interest rate %	Less than 1 month $'000s	2–3 months $'000s	3 months to 1 year $'000s	1–5 years $'000s	5+ years $'000s	Total $'000s
Non-interest bearing	n/a	73,675	59,760	–	–	–	133,435
Variable interest rate instruments	4.6%	687	1,374	109,511	74,946	19,003	205,521
Fixed interest rate instruments	5%	402	803	3,750	117,500	–	122,455
Total		74,764	61,937	113,261	192,446	19,003	461,411

	2009						
	Weighted average effective interest rate %	Less than 1 month $'000s	2–3 months $'000s	3 months to 1 year $'000s	1–5 years $'000s	5+ years $'000s	Total $'000s
Non-interest bearing	n/a	22,801	32,659	–	–	–	55,460
Variable interest rate instruments	5.4%	735	1,470	44,507	157,552	–	204,264
Total		23,536	34,129	44,507	157,552	–	259,724

Additionally, note 15 to the financial statements sets out the Group's outstanding financial commitments at the Balance Sheet date.

The following table details the Group's remaining contractual maturities for its derivative financial (assets)/ liabilities:

	2010			
	Less than 1 month $'000s	1–3 months $'000s	3 months to 1 year $'000s	Total $'000s
Oil collar	(41)	(82)	(371)	(494)
Interest rate swap	119	238	1,070	1,427
Total	78	156	699	933

Interest rate risk

The Group is exposed to interest rate movements through its lendings, bank borrowings and cash and cash equivalent deposits, which are at rates fixed to LIBOR.

The sensitivity analyses below have been determined based on the Group's exposure to an interest rate movement and is prepared assuming the amount of the net debt and interest rate swaps outstanding at the Balance Sheet date were outstanding for the whole year.

25 Financial instruments continued

Interest rate risk continued

For net debt, if interest rates had been 1% higher or lower and all other variables were held constant, the Group's loss after tax for the year ended 31 December 2010 would have increased or decreased by $0.9 million (2009: $1.3 million). This is principally attributable to the Group maintaining a higher cash and cash equivalents position as described in note 20.

For interest rate swaps, if interest rates had been 1% higher or lower and all other variables were held constant, the Group's loss after tax for the year ended 31 December 2010 would have decreased or increased by $0.8 million and $0.3 million respectively (2009: decreased or increased by $1.3 million and $1.8 million respectively).

Fair value of financial instruments

Fair value of financial instruments carries at amortised cost

The Directors consider that the carrying amounts of financial assets and liabilities recorded at amortised cost in the financial statements approximate their fair values.

Valuation techniques and assumptions applied for the purposes of measuring fair value

The fair values of financial assets and liabilities are determined as follows:

- The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes).
- The fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments.
- The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives. Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts. Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

Fair value of financial assets and financial liabilities

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets and liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All of the Groups' fair value financial assets and liabilities are deemed to be Level 2. There were no transfers between Levels 1 and 2 during the year (2009: Nil).

26 Related party transactions

Transactions with key management personnel

Details of the remuneration of key management personnel are provided below:

	2010 $'000s	2009 $'000s
Short term employee benefits	**6,725**	6,710
Share Based Payment	**2,163**	1,036
Total key management employee costs	**8,888**	7,746

27 Share capital

Share capital as at 31 December 2010 amounted to $30,034,000 (2009: $29,844,000).

Allotted equity share capital

	2010 Ordinary shares 10p Number	2009 Ordinary shares 10p Number
At 1 January	152,781,255	152,781,255
8 March 2010: Allotment of Shares	792,942	–
19 October to 14 December 2010: Allotment of Shares	441,391	–
At 31 December	154,015,588	152,781,255

28 Share option schemes and Share Based Payment

The Company has implemented an equity-settled share option scheme (PSP) for employees called the Salamander Energy Performance Share Plan ('PSP'). Further details of the PSP are set out in the Remuneration Report. Awards under the PSP may be satisfied by the issue of new shares, or the transfer of shares from the Company's treasury or shares purchased in the market. In any ten year period, the Company may not issue (or have the possibility to issue) more than 10% of the issued capital of the Company pursuant to awards granted under the PSP and any other rights granted under any other employee share plan adopted by the Company. Shares held in treasury will count as new issue shares for the purposes of the above limits unless institutional bodies decide that they need not count. Shares purchased in the market will not, however, count towards the limit described above.

Movement in PSP shares during the year was as follows:

	2010		2009	
	Shares under option Number	**Weighted average price £'s**	Shares under option Number	Weighted average price £'s
Outstanding at 1 January	**3,860,196**	**0.10**	2,489,785	0.10
Granted during the year	**1,329,621**	**0.10**	1,994,754	0.10
Exercised during the year	**(441,391)**	**0.10**	–	–
Lapsed during the year	**–**	**–**	(541,946)	–
Forfeited during the year	**–**	**–**	(82,397)	–
Outstanding at 31 December	**4,748,426**	**0.10**	3,860,196	0.10
Exercisable at 31 December	**269,678**		–	

28 Share option schemes and Share Based Payment continued

The expense recognised for unvested employee share options of $2,565,447 (2009: $3,433,649) relates wholly to equity-settled Share Based Payment arising from grants made under the PSP. At 31 December 2010, the total future expense relating to unvested awards not yet recognised was $1,384,955, which is expected to be recognised over the following 3 years. The weighted average exercise price for options that were forfeited during the year was £0.10. The weighted average market price of shares at the date of exercise was £2.53. Outstanding share options at 31 December 2010 will vest between 2011 and 2013 subject to the vesting criteria.

The weighted average fair value of share options granted during the year, as estimated at the date of grant, was £1.67 per share (2009: £0.89). This was calculated using a Monte-Carlo simulation model based on the following assumptions:

	2010	2009
Weighted average share price at date of grant	**£2.36**	£1.29
Exercise price	**£0.10**	£0.10
Expected volatility	**68%**	63%
Expected life	**3 years**	3 years
Expected dividend	**0%**	0%
Risk-free interest rate	**1.83%**	1.93%

Expected volatility was determined by calculating the historical volatility of the comparator group's share price, over a period equal to the expected life of the options. The median of the constituents of the comparator group which had a three year history was used to determine the estimate for the Company volatility. The mean average of all the constituents of the comparator group (including those with only a short listing history) was 67% (2009: 54%). The average comparator group correlation was 21% (2009: 22%).

There is a 12 month window for exercise. However, as the exercise price is nominal it is assumed that recipients exercise at the end of the performance period. Therefore an expected life of three years after the date of grant has been assumed.

During 2010, following approval at the 2009 AGM, the Company implemented a new equity settled share option scheme for employees called the Salamander Energy Deferred Equity Plan ('DEP'). The DEP follows a similar principle to the PSP scheme, but removes the requirement of a comparator group with shares settled after a period of two years by the issue of new shares, or the transfer of shares from the Company's treasury or shares purchased in the market. The weighted average share price at date of grant was £2.62 with an exercise price of £0.10 and an expected life of two years. The charge for the DEP during the year was $213,775.

29 Dividends

The Company has declared no dividend for the year (2009: nil).