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Our future vision

Annual Report and Accounts 2004

Gulf Keystone Petroleum Ltd

Contents

Who we are

Gulf Keystone is an independent company set up to explore, develop and produce oil and gas – primarily in North Africa and the Middle East.

Our focus is on under-developed oil and gas fields that can be exploited economically and profitably.

To this end we have in place Production Sharing Contracts with SONATRACH – the Algerian National Oil Enterprise – in the Republic of Algeria.

In the past year we have increased the size of our holdings in the Republic, signing three new contracts giving us exploration rights to a further eight blocks. Bringing our total holdings to nine blocks – an area of 33,216 square kilometres.

In September 2004, Gulf Keystone was admitted to trading on the AIM, raising £60 million in the process.

It gives me great pleasure to report on the significant achievements of Gulf Keystone over the past year.

Chairman's statement

Roger Parsons
Non-Executive Chairman

These include:

- Raising £60 million through an initial public offering
- Admission to trading on AIM
- Significantly expanding acreage position in Algeria from one block covering 5,891 km^2 to nine blocks covering 33,216 km^2

Of fundamental importance to achieving our business objectives was the placing of shares and admission of Gulf Keystone Petroleum to AIM, a market of the London Stock Exchange, in September 2004. The company raised £60 million in the placement, which provided the level of working capital needed to continue the work programme on our current holding, Block 126a.

We have submitted documentation to the management committee for a permanent production licence for GKN and a provisional exploitation authorisation to produce from GKS. These wells tested at an aggregate maximum production of 8,595 bopd and 11,781 mcfgd. It is hoped that authorisation will be received before the end of 2005.

This funding also enabled us to achieve our strategic initiative to expand our acreage position in Algeria. In April 2005 we acquired the exploration and appraisal rights to eight additional blocks in Algeria upon signing three new contracts with the Algerian Ministry of Energy and Mines covering the Bottena (Block 129), Benguecha (Block 108 and 128b) and Hassi Ba Hamou Perimetres (Blocks 317b1, 322b[3], 347b, 348 and 349b). Significantly, these contracts are for blocks that third party estimates indicate may have the potential of an additional 2.5 billion barrels of oil equivalent in place.

Two of these contracts, which cover the Bottena and Benguecha Perimetres, are in respect of three blocks adjacent to our current holding, Block 126a – a block that has aggregate estimated remaining proven and probable reserves of approximately 221 MMboe, of which Gulf Keystone's share is approximately 107 MMboe. In aggregate, Gulf Keystone Petroleum now has appraisal and exploration rights covering 33,216 km^2.

The two contracts covering the Bottena and Hassi Ba Hamou Perimetres were awarded in Algeria's 6th international licensing round against stiff competition. Of the 25 companies that entered, only four were successful – Gulf Keystone Petroleum, BHP Billiton, BP and Shell. The third contract, covering the Benguecha Perimeter, was the result of direct negotiation with SONATRACH and the Algerian Ministry of Energy and Mines.

I believe that we have earned these achievements thanks to the diligence and expertise of our management team who has gained a good understanding of the local operating environment as well as a high degree of technical expertise in Algeria's oil and gas sector.

Plans are well advanced for the year ahead. We will continue drilling exploratory wells on those prospects showing strong perceived geophysical and geological evidence of commercially viable oil and gas reserves. That means focusing on our existing holdings in Block 126a, where we shall be carrying out further appraisal work, in addition to other exploration activities. Also this year we will develop and implement a new work programme to appraise and explore the eight new blocks.

Concurrent with our planned exploration and appraisal activities, we will be endeavouring to pursue partnership opportunities with new and existing operators in Algeria and elsewhere in North Africa and the Middle East, where it is to our mutual advantage.

To close, I must reiterate that this past year Gulf Keystone Petroleum has taken significant steps forward. We have consolidated our position in Algeria, won new contracts against tough competition and identified significant exploration and appraisal prospects. We are ready to move forward to the next stage and view the future with confidence.

Playing to our strengths

Operating in the oil sector in the Republic of Algeria since 2001, Gulf Keystone has an in-depth knowledge of the country's local culture, and political and operating environments.

It's this understanding which has resulted in such an effective working relationship with SONATRACH, the Algerian National Oil Enterprise.

It's an on-going partnership which reflects the complementary strengths of both SONATRACH professionals and Gulf Keystone's Board and Senior Management, and one on which we intend to build in the years ahead.

Continued excellent relationships with SONATRACH, reflected in gaining exploration rights on

9 blocks

Realising the potential

The winning of the new contracts in April 2005 means Gulf Keystone currently holds exploration rights to 33,216 km^2 in the Republic of Algeria.

The holdings offer great potential in terms of pre-existing discoveries and proven and probable oil and gas reserves. We will realise this potential with a programme of drilling appraisal and development wells.

We will also carry out exploratory drilling on prospects showing strong perceived geophysical evidence of commercially viable oil and gas reserves.

Reserve estimates
3.9 billion
barrels of oil equivalent in place.

Driving ahead

Having been awarded contracts for the new blocks, Gulf Keystone plans to drive ahead with exploration and prospecting, in addition to appraising existing discoveries.

This year we will focus on our holdings in block 126a, where we shall be carrying out further prospecting and appraisal work.

We will also develop and implement a work programme on our eight new blocks – drilling on new prospects based on 3D seismic, appraising existing discoveries and developing producing fields.

33,216 km^2
new total holdings in the Republic of Algeria

A pivotal year of progress for Gulf Keystone. One which marks a significant turning point for the organisation.

Chief Executive's Review

Of all the activities that have taken place, the key achievement has been the award of two further contracts to Gulf Keystone in the Algerian Sixth Licensing Round. In addition, a further two blocks were awarded under contract by direct negotiation. This adds eight blocks to block 126a, our existing Algerian portfolio.

I am delighted to be able to report a pivotal year of progress for Gulf Keystone. One which marks a significant turning point for the organisation.

During the past year, Gulf Keystone completed the drilling of two exploration wells, GRJ-1 and RDL-1 on Block 126a. Gulf Keystone also completed 141 kilometres of 2-D seismic on the block which satisfied the work commitment for the first exploration period. Upon completion of the work programme Gulf Keystone applied and was granted an extension of the contract on Block 126a until April 2006.

Also in 2004, Gulf Keystone submitted to the management committee documentation for the GKN-1 permanent production licence and documentation for a provisional licence for GKS-2.

Of all the activities that have taken place, the key achievement has been the award of three further contracts to Gulf Keystone in Algeria. This adds an additional eight blocks to Gulf Keystone's position in Algeria.

Gulf Keystone won these contracts against fierce international competition. 25 companies placed a total of 35 bids for the nine blocks available. Only four were awarded contracts: BP (three blocks), Shell (two blocks), BHP (two blocks) and Gulf Keystone (two blocks).

It is a tremendous achievement and one which increases our holding to nine blocks overall and the size of our total holdings in the Republic of Algeria to 33,216 square kilometres.

The new blocks have great potential for the future of our enterprise. We will not only be able to exploit certain of the existing discoveries on these blocks, but also pursue actively the exploration upside. We have estimated that the drilling and seismic commitment will cost approximately $39.5 million.

Bottena perimeter (block 129)

Covering an area of 4,368 square kilometres, the Bottena perimeter is in the South Constantine Basin, situated next to the eastern border of our existing holding (block 126a) extending towards the Tunisian border. The licence area also contains the Djebel Onk field (excluded from the licence) and the Hassi El Kerma (HEK) field. This latter field was discovered in 2001 and is one that SONATRACH identifies as containing 178 million barrels of oil in place (27 million barrels defined as proven and probable). This is more than two and a half times larger than the resources they attribute to Djebel Onk, which has to date produced 9 million barrels of oil.

SONATRACH recently drilled two additional structures on the permit area, DDN (2000) and HCZ (2002) and estimate that these structures contain a combined 182 million barrels of oil in place. Using its 5,300 kilometres of 2D seismic, SONATRACH has mapped an additional two prospects and 21 leads to which they assign estimated oil in place resources of more than 750 million barrels.

Finally, SONATRACH has drilled four wells on what was the first hydrocarbon discovery in the basin (1954), the Djebel Foua Field. SONATRACH has previously tested gas at rates greater than 8 million cubic feet per day from depths above 3,000 feet. This field is only twenty kilometres from the Trans-Mediterranean Pipeline. Gulf Keystone intend to appraise the discoveries Hassi El Kerma and Djebel Foua, drill one exploration well and acquire additional 2D and 3D seismic on the Bottena Perimeter.

We are now embarking on a programme of development drilling.

Hassi Ba Hamou perimeter (blocks 317b1-322b3-347b-348-349b)

The second contract blocks awarded are in the Bechar Oued Namous basin. Called the Hassi Ba Hamou perimeter, and covering an area of 18,380 kilometres, it contains one existing gas field, HBH, which SONATRACH's engineers estimate contains over 1 trillion cubic feet of gas in place. The HBH Field was discovered in 1965 before the existence of the gas pipeline which now crosses the block, and has thus never been developed and put into production.

The HBH-1 discovery well flowed at an initial rate of approximately 3 million cubic feet per day from porous sands above 3,200 feet depth. SONATRACH's interpretation of the previously acquired 4,069 kilometres of 2D seismic has identified eight additional prospects and leads with combined exploratory potential of an additional 4.4 trillion cubic feet of gas in place.

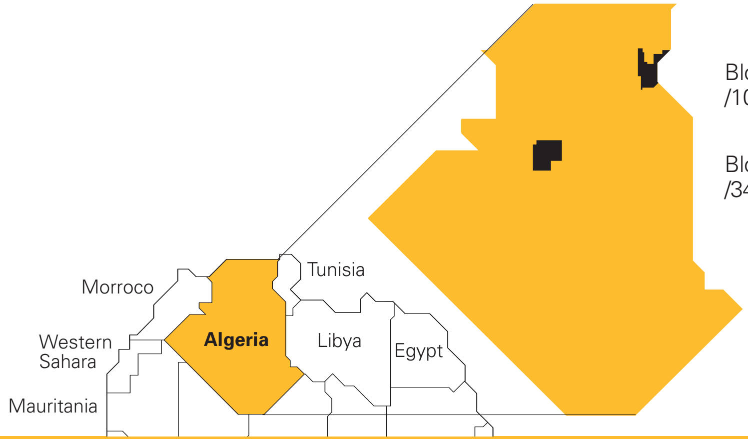
Gulf Keystone intend to appraise the existing discovery, HBH-1, drill two exploration wells, acquire 100 square kilometres of 2D seismic and acquire 400 kilometres of 3D seismic during the first three year phase of the contract.

Ben Guecha (blocks 108/128b)

The contract for these blocks, which established a joint venture between SONATRACH and Gulf Keystone, was a direct negotiation outside of the recent international bid round.

The primary focus of the JV partners on the Benguecha permit will be the further appraisal of the Ras Toumb field and the exploration for additional reserves. SONATRACH's interpretation of its previously acquired 4,457 kilometres of 2D seismic on the permit has identified 7 additional prospects and leads, one of which, OSD, SONATRACH has completed drilling and logging of the well and has temporarily abandoned the well awaiting testing equipment. The further re-working and testing of this well, OSD-1, will be conducted by the newly formed SONATRACH/Gulf Keystone joint venture. We have committed to drill 2 wells on the permit over the next three years as a minimum work program.

Importantly, this award of the Benguecha Permit outside the international bid round was further confirmation of the strong and mutually beneficial relationship that exists between Gulf Keystone, the Algerian Ministry of Energy and Mines and SONATRACH. This was the first directly negotiated exploration block award that SONATRACH has signed outside the usual bid rounds.



Todd Kozel
Chief Executive Officer

Further progress on Block 126a

In addition to the proposed exploratory work on our new blocks, we will be concentrating our main efforts on Gulf Keystone's existing Block 126a – a block which Scott Pickford has estimated has remaining proven and probable aggregate reserves of approximately 221 million barrels of oil equivalent (MMboe), of which our share is approximately 107 MMboe.

We have begun drilling operations on re-entry and sidetrack of GKS-3 in order to complete the objective section that well-logs indicate had better porosity and oil saturations than the GKS-2 field discovery well. We hope to encounter the reservoir section between the 3,500m and 4,000m depth. To better stimulate the well, we are also intending to re-drill the reservoir so as to be able to use a high volume completion technique.

On completion of GKS-3, Gulf Keystone the rig will be moved to the SONATRACH drilled GKS-2 well – the discovery well on our GKS structure – for re-completion. GKS is estimated by Scott Pickford to contain 29.6 MMboe recoverable reserves net to Gulf Keystone.

We have the Saipem rig contracted for 12 months with an option to extend for an additional year. In addition, the 3D seismic programme in the south western part of the block is under way and should be completed by the end of June 2005. Our objective is to firm up drilling locations for exploration wells such as RTB-W, on trend with the existing Ras Toumb field in block 108 and hope to commence drilling the RTB-W exploration well by the end of the 3rd Quarter of 2005. Following this we hope to drill the GRJ-2 appraisal well.

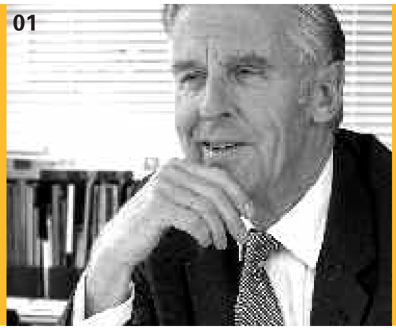
Outlook

We are now embarking on a programme of development drilling which we hope will help us start to realise the potential of our holdings in the Republic of Algeria.

We shall also continue to investigate opportunities in Algeria, in North Africa and the Middle East.

We close the year with capital in place to finance the ongoing exploration and expected production. I am confident and optimistic about the year ahead.

Board of Directors



01 Roger Wentworth Parsons
Non-Executive Chairman (62)

From 1988 to 1999, Mr. Parsons was Chief Executive of Rea Brothers Group Plc., a publicly quoted banking and financial services company. He retired from full-time employment at the end of 1999, when Rea Brothers was sold to Close Brothers Company Plc. Prior to that, he spent 25 years in international banking, firstly with Citibank and subsequently with Grindlays Bank Plc, where he was a Managing Director. He has acted as a director for both public and private companies in the UK, United States and Greece and in May retired from the Board of American Standard Companies, Inc. (an S&P 500 company) where he had been a non-executive director for ten years. He is currently a director of Höegh Capital Partners Advisors Limited, an investment advisory company.

02 Todd Francis Kozel
Chief Executive Officer (38)

Mr. Kozel co-founded Gulf UAE in 2000 where he serves as a director. In 1988, Mr. Kozel founded Texas Keystone, Inc., an independent oil and gas exploration, development and production company, headquartered in Pittsburgh, USA. Mr. Kozel served as Texas Keystone's President from 1995 to 2004 and has served as a director since 1988. Mr. Kozel also co-founded Falcon Drilling Company, LLC, an American independent drilling and oilfield services company, in 2001 and serves on its Board of Directors.

03 Caroline Anne Brown
Chief Financial Officer (42)

Dr Brown joined the board in May 2005 as Chief Financial Officer. She is an experienced finance professional with executive and advisory experience in diverse industry sectors. Previously she was the Director of Finance Change at Norwich Union Insurance and Chief Financial Officer with an AIM-quoted software and technology company. Dr. Brown has UK and international banking experience in the energy sector as Director of Corporate Finance with UBS and HSBC. She is a qualified accountant, an MBA, has a PhD in natural sciences from Cambridge University and is currently a non-executive director of WSP Group plc.

04 Sheikh Sultan Bin Saqr Al-Qassimi
Non-Executive Director (50)

Sheikh Sultan Al-Qassimi started his professional career in 1976 as co-founder of GIBCA, an industrial, construction and investment group in the United Arab Emirates. In addition to his role as Managing Director of GIBCA, Sheikh Sultan has served as a director of several public joint stock companies, amongst which are Dubai Investment (PJSC) and Union Insurance (PJSC) and is currently a director and chairman of the Executive Committee of the United Arab Bank (PJSC).

Amongst his achievements are the establishment, along with others, of the United Arab Emirates' The Banks Association and The National Contractors Association. He was awarded the title "Gulf Chief Executive Officer of 1993", (which includes The Kingdom of Saudi Arabia and Kuwait) and is an active member of, and often represents his country in, its economic delegations.

05 James William Guest
Non-Executive Director (51)

Mr. Guest is currently Vice President of Business Development for Endeavour International Corporation, a US Petroleum Exploration and Production Company. Since 1999, he has been providing independent strategic, business development and corporate advice to the upstream petroleum industry in Europe, the Middle East and USA. Mr. Guest served as a Technical Director and, latterly, Business Development Director to Monument Oil & Gas Plc from 1990 to 1999. There, he oversaw the development and implementation of the company's technical strategy and was closely involved in the company's strategic development. Mr. Guest has also worked for the Royal Dutch Shell Group in a number of international locations in a wide variety of exploration and production roles.

Directors' report

The Directors submit their report and the financial statements of Gulf Keystone Petroleum Limited for the year ended 31 December 2004. On 21 May 2004 the Company changed its name from Gulf Keystone Petroleum Algeria, Ltd to Gulf Keystone Petroleum Limited.

Principal activities
The principal activity of the Company during the year was that of an oil gas exploration company operating in the Republic of Algeria.

Review of the business and future developments
This is dealt with in the Chairman's and Chief Executive's statements.

Post balance sheet event
On 18 February 2005, 1,167,640 Common shares of $0.01 each were issued as fully paid to satisfy the exercise of warrants.

Dividends
The Directors do not recommend a dividend for the year.

Directors
The following Directors have held office during the year.

RW Parsons
TF Kozel
Sheikh Sultan Bin Saqr Al-Qassimi
JW Guest
CA Brown (appointed 9 May 2005)

Directors' interests in shares and options
Directors' interests in the shares of the Company, including family interests, were as follows:

	At 31 December 2004 Number of Common Shares	At 31 December 2004 Number of Series A Preferred Shares	At 1 January 2004 Number of Common Shares	At 1 January 2004 Number of Series A Preferred Shares
TF Kozel	20,000,000	-	-	-
RW Parsons	200,000	-	-	200
JW Guest	-	-	-	-
Sheikh Sultan Bin Saqr Al-Qassimi	-	-	-	-

In addition to the above interests:

1. TF Kozel is a shareholder in Gulf Keystone Petroleum Company LLC ("Gulf UAE") which is interested in 40,000,000 Common Shares.
2. Sheikh Sultan Bin Saqr Al-Qassimi is a shareholder in GIBCA Limited which is interested in 20,000,000 Common Shares. GIBCA Limited is also a shareholder in Gulf UAE which is interested in 40,000,000 Common Shares.

Directors' interests in share options of the Company, including family interests, as at 31 December 2004 were as follows:

	Date of grant	Number of options over Common shares	Exercise Price	Option exercise period
TF Kozel	20 Aug 04	2,650,000	48p	20 Aug 04 – 19 Aug 14
RW Parsons	20 Aug 04	50,000	48p	20 Aug 04 – 19 Aug 14
JW Guest	20 Aug 04	50,000	48p	20 Aug 04 – 19 Aug 14
Sheikh Sultan Bin Saqr Al-Qassimi	20 Aug 04	500,000	48p	20 Aug 04 – 19 Aug 14

The exercise of an option is subject to be following conditions being satisfied:

(a) on or after the share price of Common Shares reaching 96p, an option shall be exercisable in respect of one-third of total shares under option;
(b) on or after the price of the Common Shares reaching £1.44, an option shall be exercisable in respect of further third of total shares under option; and
(c) on or after the price of the Common Shares reaching £1.92, an option may be exercisable in respect of 100 per cent. of the shares under option.

There were no share options exercised or waived during the year.

There have been no changes in Directors' interests in shares or options between 1 January 2005 and 18 May 2005.

The market price of the shares at 8 September 2004 and 31 December 2004 was 48p and 54.5p respectively and the average during the period was 56.38p.

Substantial shareholdings
Other than the Directors' interests shown above, the Company has been notified of the following substantial interests as at 9 May 2005:

	Number of Common Shares	Percentage of issued share capital
Gulf UAE	40,000,000	15.76
GIBCA Limited[1]	20,000,000	7.88
BNY (OCS) Nominees Ltd	18,880,000	7.44
Goldman Sachs Securities (Nominees) Ltd	9,866,539	3.91
Market Street Bank Ltd	8,930,000	3.52

(1) GIBCA Limited is a shareholder in Gulf UAE which is interested in 40,000,000 Common Shares.

Creditor payment policy
The Company policy is to ensure that, in the absence of dispute, all suppliers are dealt with in accordance with its standard payment practice whereby all outstanding trade accounts are settled within the term agreed with the supplier at the time of the supply or otherwise 30 days from receipt of the relevant invoice. Trade creditor days based on creditors at 31 December 2004 were 35 days (2003: 88 days).

Auditors
Ernst and Young resigned as auditors during the year and Baker Tilly, Chartered Accountants, were appointed in their place. A resolution to reappoint Baker Tilly as auditors will be put to members at the Annual General Meeting.

By order of the board

Todd Kozel
Director
18 May 2005

Corporate governance statement

The policy of the Board is to manage the affairs of the Company in accordance with the principles underlying the Combined Code on Corporate Governance.

PRINCIPLES OF THE COMBINED CODE ON CORPORATE GOVERNANCE

The Board of Directors
The Company is led and controlled by a Board comprising a chief executive officer, chief financial officer, non-executive chairman and two non-executive directors.

There are no matters specifically reserved to the Board for its decision, although board meetings are held on a regular basis and effectively no decision of any consequence is made other than by the Directors. All Directors participate in the key areas of decision-making, including the appointment of new Directors, although there is no separate Nomination Committee due to the current size of the Board.

The Board receives timely information on all material aspects about the Company to enable it to discharge its duties.

There is no agreed formal procedure for the Directors to take independent professional advice at the Company's expense.

All Directors submit themselves for re-election at the Annual General Meeting at regular intervals. There are no specific terms of appointment for non-executive directors.

Directors' Remuneration
A Remuneration Committee consisting of Messrs Parsons and Guest has been established and is responsible for reviewing the individual compensation of executive directors and others, the incentive arrangements for executive directors and others and the performance of executive directors and others.

T Kozel has a service contract with the Company. This can be terminated by either side on twelve months' notice. There are no formal bonus schemes in force.

Details of the remuneration of each Director are set out in note 5 to the financial statements.

Accountability and Audit
An Audit Committee, consisting of Messrs. Parsons, Guest and Al-Qassimi has been established. The audit committee meets at least twice a year and its duties will include reviewing financial statements of the Company to ensure that they are properly reported on and for meeting the auditors and reviewing their reports relating to accounts and internal controls. The audit committee keeps under review the cost effectiveness and the independence and objectivity of the external auditor. A formal statement of independence is received from the external auditor each year.

Relations with Shareholders
The Chairman and Chief Executive are the Company's principal spokespeople with investors, fund managers, the press and other interested parties.

Internal Control
The Board acknowledges its responsibility for establishing and monitoring the Company's systems of internal control. Although no system of internal control can provide absolute assurance against material misstatement or loss, the Company's systems are designed to provide the Directors with reasonable assurance that problems are identified on a timely basis and dealt with appropriately.

The key procedures that have been established and which are designed to provide effective control are as follows:

Management Structure – The Board meets regularly to discuss all issues affecting the Company.

Investment Appraisal – The Company has a clearly defined framework for investment appraisal and approval is required by the Board where appropriate.

The Board regularly reviews the effectiveness of the systems of internal control and considers the major business risks and the control environment. No significant control deficiencies have come to light during the year and no weakness in internal financial control has resulted in any material losses, contingencies or uncertainties which would require disclosure as recommended by the guidance for directors on reporting on internal financial control.

The Board considers that in light of the control environment described above, there is no current requirement for a separate internal audit function.

Going Concern
Having made appropriate enquires and having examined the major areas which could affect the Company's financial position, the Directors are satisfied that the Company has adequate resources to continue in operation for the foreseeable future. For this reason, they consider it appropriate to adopt the going concern basis in preparing the financial statements.

Directors' responsibilities

in the preparation of financial statements

The Directors prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, the Directors have:

a. selected suitable accounting policies and then apply them consistently;
b. made judgements and estimates that are reasonable and prudent;
c. stated whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
d. prepared the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with applicable laws and are in accordance with United Kingdom Accounting Standards. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report

to the members of Gulf Keystone Petroleum Limited

We have audited the financial statements on pages 22 to 35.

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

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom Accounting Standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the accounting policies as set out on page 25. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Company is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Statement, the Chief Executive's Statement, the Directors' Report and the Corporate Governance Statement. 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 Auditing Standards issued by the United Kingdom Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company at 31 December 2004 and of the loss for the year then ended and have been properly prepared in accordance with the accounting policies set out on page 25.

Baker Tilly
Registered Auditor
Chartered Accountants
2 Bloomsbury Street
London WC1B 3ST
18 May 2005

Profit and loss account

for the year ended 31 December 2004

	Notes	2004 $'000	2003 $'000
Turnover		**–**	–
Net operating expenses	2	**(5,561)**	(3,921)
Operating loss	4	**(5,561)**	(3,921)
Other interest receivable and similar income	3	**1,928**	100
Loss on ordinary activities before taxation		**(3,633)**	(3,821)
Taxation	6	**–**	–
Loss on ordinary activities after taxation	17	**(3,633)**	(3,821)
Loss per share			
Basic and diluted	7	**2.6c**	4.2c

The operating loss for the period arises from the Company's continuing operations.

No separate Statement of Total Recognised Gains and Losses has been presented as all such gains and losses have been dealt with in the profit and loss account.

Balance sheet

31 December 2004

	Notes	2004 $'000	2003 $'000
Fixed assets			
Intangible assets	8	**38,973**	22,393
Tangible assets	9	**80**	49
Investments	10	**–**	–
		39,053	22,442
Current assets			
Stock	11	**2,485**	869
Debtors	12	**425**	64
Cash at bank and in hand		**89,882**	6,975
		92,792	7,908
Creditors: Amounts falling due within one year	13	**(4,068)**	(11,434)
Net current assets/(liabilities)		**88,724**	(3,526)
Net assets		**127,777**	18,916
Capital and reserves			
Called up share capital	14	**1,626**	24,493
Share premium account	15	**135,349**	–
Convertible warrants	16	**12**	–
Profit and loss account	17	**(9,210)**	(5,577)
Shareholders' funds	18	**127,777**	18,916
Shareholders' funds may be analysed as:			
Equity interests		**127,777**	–
Non equity interests		**–**	18,916
	18	**127,777**	18,916

Approved by the board on 18 May 2005

Roger Parsons
Non-Executive Chairman

Todd Kozel
Chief Executive Officer

Cash flow statement

for the year ended 31 December 2004

	Notes	2004 $'000	2003 $'000
Cash (outflow)/inflow from operating activities	19a	**(7,215)**	3,913
Returns on investments and servicing of finance	19b	**1,928**	100
Capital expenditure and financial investment	19b	**(24,300)**	(18,381)
Cash outflow before use of liquid resources and financing		**(29,587)**	(14,368)
Financing	19b	**112,494**	20,363
Increase in cash in the period		**82,907**	5,995
Reconciliation of net cash flow to movement in net funds			
Increase in cash in the period		**82,907**	5,995
Net funds at 1 January 2004		**6,975**	980
Net funds at 31 December 2004	19c	**89,882**	6,975

Accounting policies

Gulf Keystone Petroleum Limited (the "Company") was incorporated and registered in Bermuda on 29 October 2001 as an exempted company limited by shares. The common shares of the Company were listed on the Alternative Investment Market ("AIM") on 8 September 2004. The Company maintains its registered office in Bermuda.

Basis of accounting
The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and the Statement of Recommended Practice (SORP) 'Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities' issued by the UK Oil Industry Accounting Committee on 7 June 2001.

Foreign currencies
Assets and liabilities in foreign currencies are translated into US dollars at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are translated into US dollars at the rate of exchange ruling at the date of the transaction. Exchange differences are taken to the profit and loss account for the period.

Intangible and tangible fixed assets – oil and gas interests
The company follows the full cost method of accounting under which all costs relating to the exploration for and development of oil and gas interests, whether productive or not, are accumulated and capitalised as fixed assets. These costs, which are initially classified as intangible fixed assets, are only carried forward to the extent that they are expected to be recouped through the successful development of an area or where activities in an area have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves.

Costs dealt with in this way include seismic data, licence acquisition costs, technical work, exploration and appraisal drilling, general technical support and a proportion of directly attributable administrative and overhead costs.

Costs are transferred to depreciable pools within tangible fixed assets in each regional cost pool upon declaration of commerciality or upon cessation of exploration on each license and amortised over the life of the area according to the rate of depletion of the economically recoverable costs. Any proceeds arising from the sale or farm-out of assets are deducted from the relevant cost pool.

Depreciation and depletion of costs in depreciable pools is provided under the unit of production method which uses the estimated commercial reserves in the cost pool and the sum of the total costs in the pool and any further anticipated costs to develop such reserves.

At the end of each year, an assessment is made as to whether the economic value of interests is in excess of costs capitalised as intangible assets. Any impairment is transferred to depreciable regional cost pools within tangible fixed assets and depreciated. Where a project is terminated, which is ascertained on a country basis, the related exploration costs are written off immediately.

Other tangible fixed assets
Other tangible fixed assets are stated at historical cost.

Depreciation is provided on all other tangible fixed assets at rates calculated to write each asset down to its estimated residual value evenly over its expected useful life as follows:-

Furniture and equipment – 20% straight line

Stock
Stock relates to materials acquired for the use in exploration activities. These are valued at the lower of cost and net realisable value.

Taxation
Bermuda and Algeria currently imposes no taxes on corporate income or capital gains.

Reporting currency
The financial statements have been prepared in US dollars.

Financial instruments
The company's financial instruments comprise cash together with various items such as other debtors and trade creditors etc, that arise directly from its operations. The main purpose of these financial instruments is to provide working capital.

Notes to the Financial Statements

for the year ended 31 December 2004

1 Loss on ordinary activities before taxation

The Company's loss before taxation was all derived from its principal activity undertaken wholly in Algeria.

2 Net operating expenses

	2004 $'000	2003 $'000
Administration expenses	**5,561**	3,921

3 Other interest receivable and similar income

	2004 $'000	2003 $'000
Bank interest receivable	**706**	100
Foreign exchange gains	**1,222**	–
	1,928	100

4 Operating loss

	2004 $'000	2003 $'000
Operating loss is stated after charging/(crediting):		
Depreciation and amounts written off tangible fixed asset:		
Owned assets	**12**	12
Auditors' remuneration – audit	**50**	25
– other	**–**	–
Exceptional AIM listing costs	**635**	–

Exceptional AIM listing costs represent incidental costs associated with the admission to trading on AIM.

Included within share issue costs are fees of $183,350 paid to the Company's auditors.

5 Employees

	2004 Number	2003 Number
The average monthly number of persons (including directors) employed by the company during the year was:		
Office and management	**3**	3
Exploration staff	**25**	17
	28	20

	2004 $'000	2003 $'000
Salary costs for the above persons:		
Wages and salaries	**1,274**	654
Social security costs	**43**	12
	1,317	666

		2004 $'000	2003 $'000
Directors' remuneration			
Emoluments for directors' services		**583,500**	230,000
Highest paid director:			
T Kozel	– emoluments	**483,750**	180,000
Other directors:			
R Parsons	– emoluments	**47,250**	–
Sheikh Sultan Bin Saqr Al-Qassimi	– emoluments	**26,250**	–
W Guest	– emoluments	**26,250**	–
		99,750	–

Notes to the Financial Statements

for the year ended 31 December 2004

6 Taxation

Under current laws in Bermuda and Algeria, the Company is not required to pay taxes on either income or capital gains.

7 Loss per ordinary share

The calculation of basic and diluted loss per ordinary share is based on the following losses and number of shares.

	2004 $'000	2003 $'000
Loss for the financial period	**3,633**	3,821

	2004 No. of shares	2003 No. of shares
Weighted average number of shares	**138,101,277**	90,000,000

Due to the loss incurred in the year, there is no dilutive effect from the issue of share options and warrants.

8 Intangible fixed assets

	Oil and Gas interests $'000
Cost and net book value	
1 January 2004	22,393
Additions	16,580
31 December 2004	38,973

9 Tangible fixed assets

	Furniture and Equipment $'000
Cost	
1 January 2004	73
Additions	43
31 December 2004	116
Depreciation	
1 January 2004	24
Charged in the year	12
31 December 2004	36
Net book value	
31 December 2004	80
31 December 2003	49

10 Investments

	$
Investment in subsidiary	
1 January 2004	–
Additions	4
31 December 2004	4

On 17 November 2004 the Company acquired 100% of the ordinary share capital of a new subsidiary, Gulf Keystone Petroleum (UK) Limited, a UK company with £2 share capital. The subsidiary had not started to trade by 31 December 2004.

11 Stocks

	2004 $'000	2003 $'000
Exploration materials	**2,485**	869

12 Debtors

	2004 $'000	2003 $'000
Due within one year:		
Other debtors	**128**	64
Prepayments	**297**	-
	425	64

13 Creditors

	2004 $'000	2003 $'000
Amounts falling due within one year:		
Trade creditors	**705**	8,373
Amounts due to joint venture partner (note 23)	**2,500**	2,500
Other creditors (note 22)	**–**	561
Accruals	**863**	–
	4,068	11,434

Under various drilling contracts, the company has granted guarantees under letters of credit amounting to $3,415,000 over the Company's cash at bank.

14 Share capital

	2004 $'000	2003 $'000
Authorised:		
500,000,000 Common shares of $0.01 each		
(2003: 2,000,000 Common shares of $1 each)	**5,000**	2,000
50,000,000 Non-voting shares of $0.01 each		
(2003: 50,000 Non-voting shares of $1 each)	**500**	500
60,000 Series A Preferred shares of $1,000 each	**60,000**	60,000
	65,500	62,500
Allotted, issued and fully paid:		
252,564,500 Common shares of $0.01 each		
(2003: 900,000 Common shares of $1 each)	**1,626**	–
Nil Series A Preferred shares of $1,000 each		
(2003: 24,493 Preferred shares of $1,000 each)	**–**	24,493
	1,626	24,493

90,000,000 Common Shares of $0.01 have in prior years been issued as fully paid with no par value.

On 26 May 2004 the authorised share capital of the Company was subdivided. Each of the common shares of US$1.00 were subdivided into 100 Common Shares of US$0.01 each and each of the non-voting shares of US$1.00 were sub-divided into 100 Non-Voting Shares of US$0.01 each.

On 26 May 2004 the authorised share capital of the Company was increased from US$62,500,000 to US$65,500,000 by the creation of 300,000,000 additional Common Shares of US$0.01 each.

Between 17 May 2002 and 8 June 2004, 37,564.5 Series A Convertible Preferred Shares were issued to subscribers at a price of US$1,000 per Preferred Share. Included within the above were 9,542 and 14,951 Series A Preferred Shares that were subscribed for in the period ended 31 December 2002 and the year ended 31 December 2003, respectively.

On 8 September 2004, 37,564.5 Series A Convertible Preferred Shares of $1,000 each were converted into 37,564,500 Common Shares of $0.01 each.

On 8 September 2004, 125,000,000 Common shares of $0.01 each were placed at 48p per Common Share on admission to trading on AIM raising $107,880,000.

Rights Attached to Share Capital

The holders of the Common Shares, and the Series A Preferred Shares have the following rights:

(a) Common Shares
The holders of the Common Shares (subject to the other provisions of the Bye-laws) are:

- (i) entitled to one vote per share;
- (ii) entitled to receive notice of, and attend and vote at, general meetings of the Company;
- (iii) entitled to dividends or other distributions; and
- (iv) in the event of a winding-up or dissolution of the Company, whether voluntary or involuntary or for a reorganisation or otherwise or upon a distribution of capital, entitled to receive the amount of capital paid up on their Common Shares and to participate further in the surplus assets of the Company only after payment of the Series A Liquidation Value (as defined in the Bye-laws) on the Series A Preferred Shares.

(b) Series A Preferred Shares
The holders of Series A Preferred Shares have the following rights:

- (i) they are not entitled to receive any dividends or other distributions of the Company;
- (ii) if the Company is liquidated, dissolved or wound up (a "Liquidating Event"), after all creditors of the Company have been paid in full, the holders of the Series A Preferred Shares shall be entitled to receive, out of the assets of the Company legally available for distribution to its Shareholders before any amount is paid to the holders of any shares ranking below the Series A Preferred Shares, an aggregate amount equal to US$l,000 in cash per share;
- (iii) each outstanding Series A Preferred Share shall automatically convert into a number of fully paid and non-convertible Common Shares, with full voting rights, by reference to a formula (which will equate to 1,000 Common Shares per Series A Preferred Share converted) immediately prior to a Listing (as defined in paragraph (b) above);
- (iv) any Series A Preferred Shares converted pursuant to the Bye-laws shall be cancelled and shall not be reissuable again as such by the Company. Further, following automatic conversion of the Series A Preferred Shares the Company will not issue any further Series A Preferred Shares; and
- (v) the terms of the Series A Preferred Shares may be amended with the consent of the holders of a majority of the Series A Preferred Shares outstanding.

Share Options

At 31 December 2004, the following share options over Common Shares of $0.01 each had been granted.

Date of grant	Options over number of Common shares	Exercise price	Exercise period
20 August 2004	5,700,000	48p	20 August 2004 to 19 August 2014

The exercise of an option is subject to be following conditions being satisfied:

(a) on or after the share price of Common Shares reaching 96p, an option shall be exercisable in respect of one-third of total shares under option;
(b) on or after the price of the Common Shares reaching £1.44, an option shall be exercisable in respect of a further third of total shares under option; and
(c) on or after the price of the Common Shares reaching £1.92, an option may be exercisable in respect of 100 per cent of the shares under option.

Notes to the Financial Statements

for the year ended 31 December 2004

15 Share premium account

	2004 $'000	2003 $'000
1 January 2004	**–**	–
Common shares issued in year	**106,630**	–
Conversion of Series A Preference shares	**37,189**	–
Issue costs	**(8,470)**	–
31 December 2004	**135,349**	–

16 Convertible warrants

	2004 $'000	2003 $'000
1 January 2004	**–**	–
Issued in year	**12**	–
31 December 2004	**12**	–

Under warrant instruments dated 31 August 2004, warrants were granted in connection with the AIM flotation entitling the holders to subscribe for 1,167,640 Common Shares at a subscription price of US$ 0.01 per Common share.

The warrants were exercised and paid for on 31 August 2004 and following the expiry of the lock in period in respect of the arising common shares, the common shares were issued on 18 February 2005.

17 Profit and loss account

	2004 $'000	2003 $'000
1 January 2004	**(5,577)**	(1,756)
Loss for the financial period	**(3,633)**	(3,821)
31 December 2004	**(9,210)**	(5,577)

18 Reconciliation of movement in shareholders' funds

	2004 $'000	2003 $'000
Loss for the financial period	**(3,633)**	(3,821)
Issue of share capital	**120,952**	14,951
Issue of convertible warrants	**12**	–
Issue costs	**(8,470)**	–
Net addition to shareholders' funds	**108,861**	11,130
Opening shareholders' funds	**18,916**	7,786
Closing shareholders' funds	**127,777**	18,916

19 Cash flows

		2004 $'000	2003 $'000
a	**Reconciliation of operating loss to net cash outflow from operating activities**		
	Operating loss	**(5,561)**	(3,921)
	Depreciation	**12**	12
	Increase in stock	**(1,616)**	–
	Increase in debtors	**(361)**	(456)
	Increase in creditors	**311**	8,278
	Net cash outflow from operating activities	**(7,215)**	3,913
b	Analysis of cash flows for headings netted in the cash flow		
	Returns on investments and servicing of finance		
	Interest received	**1,928**	100
	Net cash inflow from returns on investments and servicing of finance	**1,928**	100
	Capital expenditure and financial investment		
	Purchase of tangible fixed assets	**(43)**	(12)
	Purchase of intangible fixed assets	**(24,257)**	(18,369)
	Net cash outflow from capital expenditure and financial investment	**(24,300)**	(18,381)
	Financing		
	Proceeds from issue of share capital and warrants	**120,964**	20,363
	Share issue costs	**(8,470)**	–
	Net cash inflow from financing	**112,494**	20,363

		At 1 January 2004 $'000	Cashflow $'000	At 31 December 2004 $'000
c	Analysis of net funds			
	Cash at bank and in hand	6,975	82,907	89,882

20 Commitments under operating leases

	2004 Land and buildings $'000	2004 Other $'000	2003 Land and buildings $'000	2003 Other $'000
At 31 December 2004 the company was committed to making the following payments during the next year under non-cancellable operating leases as follows:-				
Expiring within 1 year	**15**	**7,342**	–	–
Between 2 and 5 years	**124**	**–**	67	–
	139	**7,342**	67	–

21 Post balance sheet events

On 18 February 2005, 1,167,640 Common shares of $0.01 each were issued as fully paid to satisfy the exercise of warrants, which took place on 31 August 2004.

22 Related party transactions

Mr Todd Kozel, a director of the Company, is also a director of Texas Keystone, Inc. ('TKI'). The Company entered into an agreement with TKI in which the Company pays a fee to TKI for professional management and administrative services. The fee for administrative services is equal to TKI's actual cost of providing the administrative services plus 10 per cent; the fee for professional services is equal to the then hourly rates charged by TKI to third parties for such services and the Company shall reimburse TKI for reasonable out-of-pocket expenses. The TKI fees totalled US$1,874,490 during the year ended 31 December 2004 (2003: US$2,212,691). No amounts were outstanding to TKI at the year end (2003: $561,000).

23 Contingent assets and liabilities

Under the contract for the Exploration, Evaluation and Exploitation of Hydrocarbons with SONATRACH concerning the Ferkane Perimeter (Block 126), the Company agreed to acquire 600 kilometres of seismic data and drill two exploration wells. The exploration and evaluation phase of the Contract consists of a three year period, and an option to extend for two more years was granted on 29 April 2004. The Company is now required to acquire an additional 600 kilometres of seismic data and drill one exploration well. The investment commitment of performing the minimum work program is US$15 million for the first period and US$9 million for the second. During the year the Company completed the program for the first period and the option for the second period has been granted. At 31 December 2004 no significant investment has been made for the second period.

In accordance with Article 7.5 of the Contract, 500 seismic kilometres 2D were performed by SONATRACH during 2000 and were acquired by the Company. The compensation for the data acquired was US$2.5 million. The US$2.5 million will come as a deduction from the performance cost and shall be repaid in the event a discovered deposit is declared commercial exploitable. However, if no commercially exploitable deposits are discovered, the Company does not owe SONATRACH for the data acquired. As of 31 December 2004 and 2003, the Company had recorded a US$2.7 million seismic data asset and reflected a liability of US$2.5 million to SONATRACH representing the remaining amount due upon commercial declaration. The Company also paid US$230,000 to SONATRACH to acquire all of SONATRACH's pre-existing data on Block 126.

Additionally, in accordance with Article 15 of the Contract, the rate of participation of the investors in the financing of the investment costs for exploration, evaluation, development, exploitation and operating costs is set at 40 per cent. for SONATRACH and 60 per cent. for Gulf Keystone. However, in the absence of the discovery of a commercial exploitable deposit, the Company may not claim any reimbursement or compensation. As at 31 December 2004 and 2003, potentially reimbursable petroleum costs, from SONATRACH, in the event that commercial exploitable deposits are discovered, total US$14,500,000 and US$7,865,000 respectively.

24 Financial instruments

The Company's financial instruments comprise cash. The Company has various other financial instruments, such as trade debtors and trade creditors, that arise directly from its operations which have not been included in the following disclosures.

The main risks arising from the Company's financial instruments are interest rate risks and liquidity risk. The policies for managing these risks are regularly reviewed and agreed by the Board.

It is, and has been throughout the period under review, the Company's policy that no trading in financial instruments should be undertaken.

Foreign exchange risk
The functional currencies of the Company are Sterling, Algerian Dinars and US Dollars. The Company does not hedge against the effects of movement in exchange rates. The risks are monitored by the Board on a regular basis.

Interest rate risk
The Company's policy on interest rate management is agreed at Board level and is reviewed on an ongoing basis. Deposits are made at floating rates for varying periods up to 3 months. This form of deposit optimises the amount of interest earned while maintaining access to sufficient funds to meet day-to-day cash requirements.

The setting of a benchmark rate for determining interest receipts for the floating rate financial assets is under review.

Interest rate profile of financial assets
The interest rate risk profile of the Company's financial assets as at 31 December 2004 was:

	Fixed rate $'000	Floating rate $'000	Total $'000
US Dollars	–	89,408	89,408
Algerian Dinars	–	474	474
	–	89,882	89,882
Of which:			
Cash at bank and in hand	–	89,882	89,882
31 December 2003			
US Dollars	–	6,795	6,795
Algerian Dinars	–	180	180
	–	6,975	6,975
Of which:			
Cash at bank and in hand	–	6,975	6,975

Floating rate instant access deposits in Sterling earn interest at prevailing bank rates.

Liquidity risk
It is the Company's policy to finance its business by means of internally generated funds and external share capital.

Facility
The Company does not currently have an overdraft facility.

Fair value
There is no material difference between the fair value of financial assets and their book value at the balance sheet date.

Directors and advisers

Directors
Roger Parsons Non-Executive Chairman
Todd Kozel Chief Executive Officer
Caroline Brown Chief Financial Officer
Sheikh Sultan Bin Saqr Al-Qassimi Non-Executive Director
William Guest Non-Executive Director

Secretary
Louisa Barbosa

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