Further growth and financial flexibility

Tullow delivered a record set of results in 2008 and in early 2009 significantly enhanced the Group's financial flexibility with a successful equity placing and US$2 billion debt financing.

Tullow has recorded record results for 2008 driven by a strong operational performance, increased oil and gas pricing compared with 2007 and profitable portfolio management. Whilst production decreased, by 9% to 66,600 boepd, average price realisations increased by over 25%. Basic earnings per share increased to 30.9 pence per share (2007: 7.1 pence per share).

In 2008, the Group's cash flow was enhanced by portfolio management transactions with proceeds of £285.4 million. Financial flexibility was then significantly improved by an equity placing in January 2009 which raised £402 million and a US$2 billion debt financing was secured in March 2009.

Steady production and strong commodity prices
Working interest production averaged 66,600 boepd, 9% below 2007, primarily as a result of natural decline in mature fields and deferred production due to the reallocation of capital to development projects and high-impact exploration. Sales volumes averaged 55,000 boepd, representing a decrease of 12%, driven by changes in the proportion of sales arising from Production Sharing Contracts (PSC).

On average, oil prices in 2008 were significantly above 2007 levels, although they were impacted by the global economic downturn in the second half of the year. Realised oil price after hedging for 2008 was US$73.6/bbl (2007: US$62.7/bbl), an increase of 17%. Tullow's oil production sold at an average discount of 4% to Brent Crude during 2008 (2007: 3% discount).

UK gas prices in 2008 were extremely strong, returning to the exceptional levels seen in early 2006. Realised UK gas price after hedging for 2008 was 52.4p/therm (2007: 37.3p/therm), an increase of 40%. In Europe, the Group also recorded tariff income of £10.2 million (2007: £17.5 million) from its UK infrastructure interests.

Higher commodity prices, partly offset by marginally lower sales volumes, meant that revenue increased by 8% to £691.7 million (2007: £639.2 million).

Operating costs, depreciation and impairments
Underlying cash operating costs, which exclude depletion and amortisation and movements on under/overlift, amounted to £143.9 million (£5.90/boe) (2007: £5.05/boe). These costs were 17% above 2007 levels, principally due to upward pressure in oil and gas services costs and an increase in Gabonese royalty payments which are directly linked to oil prices.

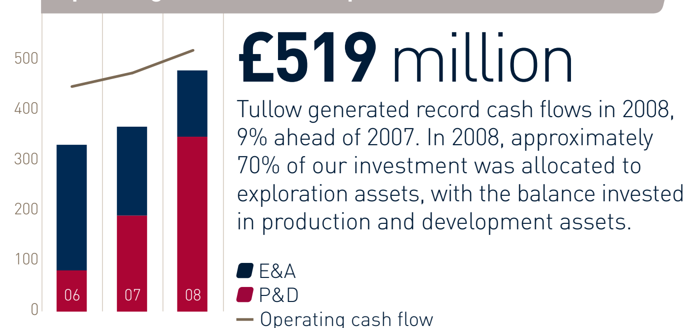
Depreciation, depletion and amortisation charges before impairment charges for the period amounted to £198.4 million (£8.14/boe) (2007: £7.61/boe).

Key financial metrics

	2008	2007	Change
Production (boepd, working interest basis)	66,600	73,100	-9%
Sales volume (boepd)	55,000	62,600	-12%
Realised oil price (US$/bbl)	73.6	62.7	+17%
Realised gas price (p/therm)	52.4	37.3	+40%
Cash operating costs per boe (£)[1]	5.90	5.05	+17%
Operating cash flow before working capital per boe (£)	21.3	17.8	+20%
Net debt (£ million)[2]	400	480	-16%
Interest cover (times)[3]	17.8	10.4	+7.4 times
Gearing (%)[4]	30	67	-37%

1. Cash operating costs are cost of sales excluding depletion, depreciation and amortisation and under/over lift movements.
2. Net debt is cash and cash equivalents less financial liabilities net of unamortised arrangement fees.
3. Interest cover is earnings before interest, tax, depreciation, amortisation charges and exploration written-off divided by net finance costs.
4. Gearing is net debt divided by net assets.

Operating cash flow and capital investment (£ million)



£519 million

Tullow generated record cash flows in 2008, 9% ahead of 2007. In 2008, approximately 70% of our investment was allocated to exploration assets, with the balance invested in production and development assets.

The Group has also recognised a further impairment charge of £26.3 million (£1.08/boe) (2007: £0.48/boe) in respect of the Chinguetti field in Mauritania and for the Chachar field in Pakistan where the asset sales price was below the carrying value in the balance sheet.

Administrative expenses of £43.1 million (2007: £31.6 million) include an amount of £7.9 million (2007: £5.4 million) associated with IFRS 2 – Share-based payments. The increase in total general and administrative costs is also due to the increase in the scale of our operations. In 2008, staff numbers increased by 46% to 540 people.

Exploration write-off and asset value reduction

Exploration write-offs associated with unsuccessful 2008 exploration activities in the UK, Bangladesh, India and Mauritania, new ventures activity and licence relinquishments totalled £62.4 million (2007: £51.1 million).

The Group has decided to primarily focus on fast-tracking its world-class discoveries in Ghana and Uganda and selective high-impact exploration. Tullow has therefore conducted a fundamental review of the exploration asset values on its balance sheet compared with expected future work programmes and the relative attractiveness of further investment in these assets. In accordance with the Group's successful efforts accounting policy, assets have been written down to reflect this more focused approach. This review has resulted in an additional write-off of £164.3 million (2007: £13.1 million) in respect of interests in Mauritania, Suriname, Tanzania and Trinidad and Tobago.

Tullow's total exploration write-off and asset value reduction for 2008 is therefore £226.7 million (2007: £64.2 million).

Operating profit

Operating profit amounted to £299.7 million (2007: £189.0 million), an increase of 59%, principally due to the higher commodity prices realised during the period, profits of £243.9 million in relation to portfolio management activities offset by exploration costs written-off of £226.7 million.

Derivative instruments

Tullow continues to undertake hedging activities as part of the ongoing management of its business risk and to protect the availability of cash flow for reinvestment in capital programmes that are driving business growth.

At 31 December 2008, the Group's derivative instruments had a net positive mark-to-market value of £49.3 million (2007: negative £158.0 million). The substantial movement in the mark-to-market position during the year has mainly been caused by the significant weakening in oil price in the second half of 2008.

While all of the Group's commodity derivative instruments currently qualify for hedge accounting, a credit of £42.9 million (2007: charge of £29.3 million) has been recognised in the income statement for 2008. This credit largely reflects the change in fair values of the Group's hedging instruments attributable to time value and implied volatility and value being conferred to Tullow by the hedge counterparties.

The Group's hedge position as at 4 March 2009 is:

Hedge position

	2009	2010	2011
Oil			
Volume (bopd)	14,958	7,500	1,500
Current price hedge (US$/bbl)	59.21	74.69	63.89
Gas			
Volume (mmscfd)	56.7	17.8	3.7
Current price hedge (p/therm)	54.32	53.01	58.86

Gearing, financing costs and interest cover

The net interest charge for the period was £43.3 million (2007: £45.6 million) and reflects the reduction in net debt levels during 2008 due to improved operating cash flow and the completion of portfolio management transactions, partially offset by increased capital expenditure.

At 31 December 2008, Tullow had net debt of £400.4 million (2007: £479.5 million), while unutilised debt capacity was in excess of £230 million. The Group's gearing was 30% (2007: 67%) and EBITDA interest cover increased to 17.8 times (2007: 10.4 times).

Portfolio management

During 2008, Tullow completed the disposal of a number of non-core assets for proceeds of £285.4 million, with an overall profit on disposal after tax of £243.9 million. In Africa, Tullow completed the sale of its 40% interest in the Ngosso licence, offshore Cameroon, to MOL in July 2008. In Europe, the sale of certain CMS assets to Venture

Summary cash flow

	2008 £'000
Revenue	691,673
Operating costs	(137,487)
Corporate expenses	(35,392)
Cash flow from operations	**518,794**
Working capital movements and tax	(7,997)
Capital expenditure	(460,352)
Other investing activities	288,736
Financing activities	(151,732)
Net increase in cash and cash equivalents	**187,449**

Production completed in June 2008 and the sale of a 51.68% interest in the Hewett-Bacton complex to Eni was completed in November 2008.

In January 2008, Tullow announced the sale of its 11% interest in the M'Boundi field to the Korea National Oil Company. Despite strenuous efforts, government approvals for the transfer of the asset were not forthcoming within a reasonable timeframe and therefore it was agreed that the transaction could not be concluded. Tullow has retained its 11% interest in the field and will benefit from future operational cash flows as well as debt capacity as the asset will be re-incorporated into the reserves-based lending facility.

Taxation

The tax charge of £73.1 million (2007: £61.6 million) relates to the Group's North Sea, Gabon, Equatorial Guinea and Mauritanian activities and represents 24% of the Group's profit before tax (2007: 54%). This low effective tax rate is principally as a result of asset disposals that were not subject to a tax charge and oil revenues under PSCs where higher prices result in lower entitlement volumes rather than higher taxes.

Dividend

Due to the requirement for major capital investment during 2009, particularly in Ghana and Uganda, and in light of the current economic uncertainty the Board feels that it is prudent to maintain the final dividend at the 2007 level. Consequently the Board has proposed a final dividend of 4.0 pence per share (2007: 4.0 pence per share). This brings the total payout in respect of 2008 to 6.0 pence per share (2007: 6.0 pence per share). The dividend will be paid on 21 May 2009 to shareholders on the register on 17 April 2009.

Record operating cash flow; focused capital investment

Increased commodity prices led to record operating cash flow before working capital movements of £518.8 million (2007: £473.8 million), 9% ahead of 2007. This cash flow facilitated 2008 capital investment of £460.4 million in exploration and development activities, payment of dividends, servicing of debt facilities and a reduction of over £60 million in net debt.

Tullow is currently budgeting for a total 2009 capital expenditure of approximately £600 million (2008: £480 million). Investment in 2009 will be split 70% on production and development and the remainder on exploration and appraisal. Tullow's activities in Africa will comprise 85% of the anticipated capital outlay, with the principal expenditures being in Ghana and Uganda. The potential impact on capital expenditure following the recent success at Tweneboa, coupled with ongoing success and further upside in Uganda, is under review.

Balance sheet

Total net assets at 31 December 2008 amounted to £1,309.2 million (31 December 2007: £712.7 million), with the increase principally due to the profit for the year, currency translation adjustments and hedge movements. Net assets increased by £161.0 million in the year due to the movement of the hedge reserve in accordance with IAS 39 – Financial Instruments: Recognition and Measurement. The significant decrease in the oil price during the second half of the year gave rise to a net positive mark-to-market of £49.3 million at the year end. An increase in net assets (foreign currency translation reserve) of £222.3 million resulted from the weakening of Sterling against the US Dollar from US$2.00 to US$1.45 in the year. As a consequence, underlying US Dollar denominated assets increased in Sterling value terms at the year end.

Accounting policies

UK listed companies are required to comply with the European regulation to report consolidated statements that conform to International Financial Reporting Standards (IFRS). The Group's significant accounting policies and details of the significant accounting judgements and critical accounting estimates are disclosed within the notes to the financial statements on pages 85 to 89. The Group has not made any material changes to its accounting policies in the year ended 31 December 2008.

Equity placing

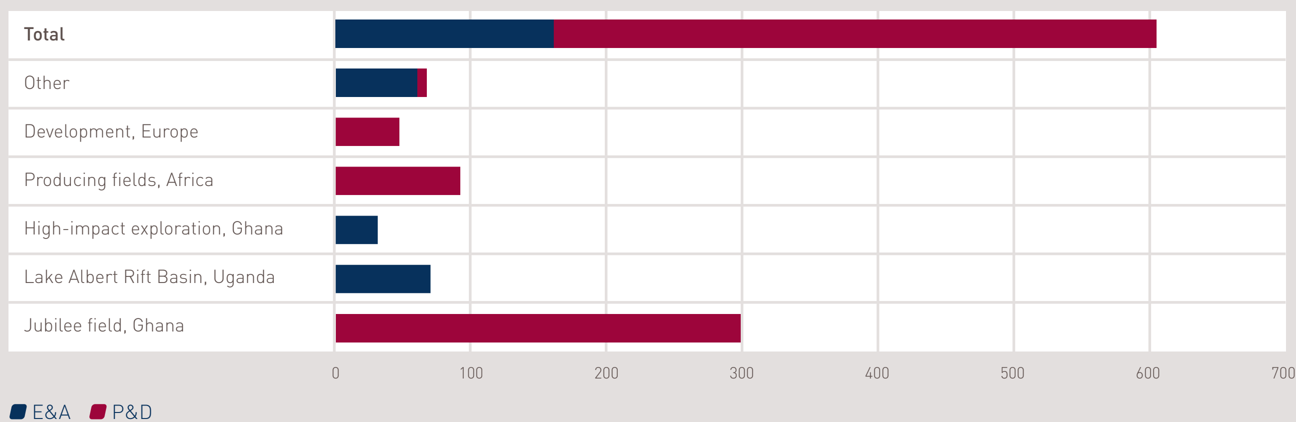
Tullow successfully placed 66,938,141 new ordinary shares with institutional investors at a price of 600 pence per share on 21 January 2009. Based on the placing price, the gross proceeds of the placing amounted to £402 million. The placing shares represent an increase of approximately 9.1% in the Group's existing share issued share capital.

Debt funding

In March 2009 Tullow finalised arrangements for US$2 billion (£1.38 billion) of new debt, structured in the form of secured reserve-based lending facilities with a seven-year term. A total of 13 commercial banks have committed to facilities of US$1.885 billion (£1.3 billion) with the remaining debt of US$115 million (£80 million) being provided by the IFC in a separate facility. The facilities have a final repayment date of December 2015 and the margin on the new facilities, depending on the amount drawn, is up to 3.75%. Tullow will use the proceeds from the facilities to repay existing debt

2009 Capital expenditure (£ million)

The current budget for 2009 capital expenditure is approximately £600 million. Activity in Africa is expected to account for 85%.



facilities and to finance the future capital expenditure requirements of the Group, particularly in Ghana and Uganda. Tullow received strong support from its banking syndicate and it is a very significant achievement to complete a US$2 billion (£1.38 billion) financing in the current economic climate.

Liquidity risk management and going concern

The Group closely monitors and manages its liquidity risk. Cash forecasts are regularly produced and sensitivities run for different scenarios including, but not limited to, changes in commodity prices and different production rates from the Group's portfolio of producing fields. The Group normally seeks to ensure that it has a minimum ongoing capacity of £200 million for a period of at least 12 months to safeguard the Group's ability to continue as a going concern.

Following the placing announced in January 2009 and securing the US$2 billion financing in March 2009, the Group's forecasts and projections show that there is significant capacity and financial flexibility for the 12 months from the date of the 2008 Annual Report and Accounts.

Although there is considerable economic uncertainty at the present time, after taking account of the above, the Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the 2008 Annual Report and Accounts.

Capital market relationships

Tullow continues to place great emphasis on achieving top quartile and best practice performance in investor relations and capital market communications. During the year, senior management regularly meet with investors, analysts and banks from the Group's lending syndicate. In 2008, senior management participated in over 200 investor meetings in 18 countries, presented at 17 conferences and hosted investors and sell-side analysts events in Uganda and the UK. There was significant positive news flow, particularly from Ghana and Uganda, and despite volatile equity markets there was positive TSR of 2% in 2008, the 9th best performance in the FTSE 100 index and in the top quintile of Tullow's comparator group.

Financial strategy and outlook

Whilst the global economic environment is extremely challenging, the Group's successful equity placing and recent debt financing means that Tullow has a strong balance sheet and significant financial flexibility.

In 2009, the Group will continue to allocate its capital to projects that provide the opportunity for the highest return for shareholders and seek to augment underlying cash flow through continued cost and capital management and ongoing portfolio activity. The outlook for the Group is very positive, supported by disciplined financial management and significant leverage to higher oil prices.