Magnolia Petroleum plc
Annual Report 2012

CONTENTS

OFFICERS AND PROFESSIONAL ADVISORS

Directors	Dr John Malcolm Cubitt (Non-Executive Chairman) Steven Otis Snead (Chief Executive Officer) Rita Fern Whittington (Chief Operations Officer) Gavin John Burnell (Non-Executive Director) Ronald Sanford Harwood (Non-Executive Director)
Secretary	Stanley Anthony Salter
Registered Office	The Fitzpatrick Building 188-194 York Way London N7 9AS
Nominated Advisor & Broker	Cairn Financial Advisers LLP 61 Cheapside London EC2V 6AX
Broker	Northland Capital Partners Limited 60 Gresham Street London EC2V 7BB
Legal Advisors	Pray Walker, P.C. 100 W.5th Street Suite 900 Tulsa OK 74103, USA
Independent Auditors	Littlejohn LLP Statutory Auditors 1 Westferry Circus Canary Wharf London E14 4HD
Registrars	Share Registrars Limited Suite E, First Floor 9 Lion and Lamb Yard Farnham Surrey GU9 7LL
Registered Number	05566066

CHIEF EXECUTIVE OFFICER'S STATEMENT

We aim to create substantial value for shareholders through the acquisition and subsequent development of leases in producing US onshore formations, such as the Bakken in North Dakota and the Mississippi Lime, Hunton and Woodford in Oklahoma. By systematically drilling acquired leases both as a partner and operator, we are focused on proving up and growing the Company's net reserves. Set against this context, I am pleased to report that the year under review has been a transformative period for Magnolia Petroleum, one that has seen a step up in the scale of our operations culminating in a four fold increase in the discounted value of our proved, probable and possible reserves ('3P') to US$94 million, a considerable increase in the Company's asset backing.

In 2011, with limited capital we successfully proved the potential of our low risk/high return business model to generate multiples of the capital employed. In the two years prior to our Admission to AIM, we participated in the drilling of 23 wells, 22 of which generated commercial returns, illustrating the relatively low exploration risk associated with drilling historic US onshore plays. In aggregate we turned an initial £300,000 capital into a NPV of US$1.5 million as valued by Moyes & Co in the Company's AIM Admission document.

Having successfully moved to AIM at the end of 2011, we immediately set about putting in place the key building blocks, specifically leases and capital that would enable us to replicate our previous success on a larger scale. The numbers speak for themselves. At the beginning of the year, Magnolia held 1,259 net mineral acres in proven US onshore hydrocarbon formations such as the Bakken/Three Forks Sanish in North Dakota and the Hunton/Woodford in Oklahoma. By 31 December 2012 this figure had risen to 13,513 net mineral acres. Similarly, over the course of 2012, we raised $11.1 million in five tranches, each at a higher price than previously. Importantly we secured a £10 million Equity Financing Facility ('EFF') and a £500,000 investment from Henderson Global Investors. £4.665 million of the EFF remains available for utilisation.

Armed with leases and access to capital, we stepped up our involvement in drilling activity during the period under review with the aim of growing reserves. In January 2012 we had interests in 66 producing properties with a further three at various stages of drilling/completion. By the end of the year, the number of producing/drilling wells Magnolia had an interest in had risen to 101. Drilling serves four main purposes: to grow net production and revenues; to prove up reserves; to increase the number of proven undeveloped reserves; and to hold leases by production.

In line with our strategy, revenues generated from production are reinvested into new wells. With this in mind, payback (recovery of costs) is a key metric that we focus on when evaluating initial production rates, as this tells us how quickly we can recycle funds invested into more drilling to prove up our reserves further.

The results of the activity we undertook in 2012 were highlighted in the updated Reserves Report by our Competent Person, Moyes & Co. ('Moyes'). This shows that in the period between our Admission to AIM in November 2011 and 31 December 2012, Magnolia's 2P reserves grew from 68,700 barrels of oil and condensate and 249.8 million cubic feet ('MMcf') of natural gas to 1.367 million barrels and 4,513 MMcf.

Meanwhile our 3P reserves grew to 2.818 million barrels of oil and 9,231 MMcf of gas from 975.6 thousand barrels of oil and 1,175 MMcf of gas previously. Moyes has assigned a Net Present Value after applying a 10% discount rate of approximately US$94 million to our 3P reserves, a figure that stands at a significant premium to our current market capitalisation and highlights the considerable value we have created in our first full year on AIM.

As expected, the early stage nature of our recently acquired Montana acreage and limited drilling activity in the area to date meant that it did not contribute to the reserves upgrade this time round; however, Moyes has classified our leases in Montana as prospective resources with a value of over US$12 million. Our acreage is surrounded by the 320,000 net acres acquired by Apache last year. In addition to producing formations such as the Ratcliffe, Apache, like us, view their acreage in Daniels County as having the potential to be an extension of the Bakken/Three Forks Sanish formations that are so prolific in North Dakota. As Apache press on with their drilling programme in Montana, the prospectivity of our acreage in the area will become more apparent. We remain highly confident that our entry into Montana will lead to another substantial increase in Magnolia's net 3P reserves in the future.

Financial Review

During the twelve month period, our net production generated revenues of US$709,395 compared to US$241,038 the previous year. Importantly, the monthly run rate consistently improved over the course of the year so that December's revenues were almost three times as much as those of January. We expect this trend to continue. The growth in revenues has been mirrored by a near quadrupling in tangible assets to US$3,437,869 at end December 2012 compared to US$861,975 the previous year. Growth in intangible assets (new leases and wells that are drilling but not yet completed) was even stronger having increased to US$6,200,828 from US$1,111,634 in 2011. At the end of the year we retained $2,293,151 in cash for continued development of our acreage. Administrative costs continue to be tightly managed, allowing the vast majority of additional revenues generated to be recycled into further wells or acquiring additional leases. In 2012, $8,098,566 was invested in increasing the asset base with only $623,249 used in operating activities.

Outlook

Reflecting the results of activity covering just a little over twelve months, the recently reported 422% growth in 3P reserves is just the beginning. Having amassed a portfolio of 13,513 net mineral acres with over 600 potential drilling locations, considerable scope remains for further substantial reserves growth for many years to come just by drilling our existing portfolio alone. We continue to receive multiple proposals to drill new wells, and at the same time we are constantly working towards increasing our acreage, providing further opportunities to create value above and beyond our existing leases. With this in mind and a considerable pipeline of drilling locations in place, we are highly excited by the scale of the opportunity in front of us, as we look to build a significant US onshore focused oil and gas company.

Finally, I would like to thank the Board, management team and all our advisers for their hard work during the year and also to our shareholders for their support over the last twelve months.

Steven Snead
Chief Executive Officer

10 May 2013

CHIEF OPERATIONS OFFICER'S REPORT

The Bakken/Three Forks Sanish Formations, North Dakota

At the time of our Admission to AIM in November 2011, the Company anticipated participating in four new wells on its Bakken/Three Forks Sanish ('TFS') acreage in North Dakota in 2012. In the event, Magnolia elected to participate in ten new wells targeting the Bakken and TFS formations, bringing the total number of wells in which the Company has an interest in these two formations to 24, of which 22 are currently producing.

Four of the wells brought on stream during the year are producing from the Bakken, a reservoir which currently produces over 700,000 bopd and is estimated to hold mean undiscovered recoverable volumes of 3.65 Bbbls and 1.85 Tcf (2008 US Geological Survey). Initial production rates for these four wells were:

- Eckelberg 14-23 H well: 1,263 bopd and 625 MCF;
- Quill 2-12-3H well: 877 bopd;
- Skunk Creek 14H well: 212 bopd;
- Stocke 1-4-9H 295 bopd.

Post period end, the Company reported initial production rates for two wells operated by Marathon Oil: Nicky Kerr 14-8 well (1,501 boepd); and Curtis Kerr 24-8H (1,496 boepd).

Two further wells, Skunk Creek 15H and Eckelberg 14-23 TF, are producing from the Three Forks Sanish formation, a separate reservoir lying directly below the Bakken. At 2,303bopd and 1,234bopd and 602MCF respectively, the initial production rates for both wells exceeded the directors' expectations and in the case of Skunk Creek 15H are Magnolia's best rates recorded to date. A state study evaluating oil reserves in the Three Forks Sanish formation in western North Dakota concluded that there could be as much as 2 billion barrels of recoverable oil in this formation.

The remaining two wells in which Magnolia has an interest and where drilling/stimulating operations are on-going are the Jake 2-11 1H and Jake 2-11 TFH, both operated by Statoil.

Magnolia holds leases in respect of 11,520 gross acres across 28 sections, equating to 421 net mineral acres within the boundaries of the Bakken / TFS formations. As the Three Forks Sanish lies beneath the Bakken, the number of wells which can be drilled per section doubles to eight (four per formation), providing Magnolia with a total of 120 proven development locations on its acreage, 60 on the Bakken and 60 on the Three Forks Sanish, as set out in the Updated Reserves Report by Moyes & Co. dated 8 April 2013. In their report, Moyes & Co. estimated Magnolia's Bakken 2P reserves at 153,000 barrels of oil and condensate and 83 MMcf of natural gas to which Moyes has assigned a value of US$1.35 million.

As expected, the initial production rates from the Skunk Creek 15H and Eckelberg 14-23 TF wells have led to an upgrade in Magnolia's Three Forks Sanish reserves. In the updated Competent Person's Report, Magnolia's 2P reserves in this formation are estimated at 27,000 barrels of oil and condensate and 15 MMcf of natural gas to which Moyes has assigned a value of US$0.673 million.

Mississippi Lime Formation, Oklahoma

At the time of Magnolia's Admission to AIM, the directors identified the Mississippi Lime as the next big play in onshore US. In 2012, Magnolia entered this historic formation and over the course of the year, acquired 4,319.55 net mineral acres. The acquired acreage includes leases with working interests of up to 100%, 74 proven undeveloped locations and an additional 222 increased density locations in which Magnolia could propose and/or operate. In total, there are 296 potential drilling locations on the Company's acreage.

Over the course of the year, Magnolia participated in 13 wells targeting the Mississippi Lime. Initial production rates for seven of these wells were reported during 2012, all of which were ahead of expectations:

- Brady 17-27-12 1H (702.5 boepd);
- Lois Rust 7-27-12 1H (353.75 boepd);
- LaDonna 19-28-16 1H (297 boepd);
- Thomason 10-27-12 1H (441 boepd);
- Westline 30-28-16 1H (403 boepd);
- Brandt 31-28-12 1H (499.33 boepd);
- Otis 2-27-12 1H (341 boepd).

Due to higher than expected recovery rates, production was temporarily shut down at the Thomason and Lois Rust wells to enable the installation of additional sales capacity.

The remaining six wells were at various stages of drilling/completion or fracture stimulation as at end of December 2012. Post period end, the Company has since reported Initial Production Rates for the Montecristo 6-1H well (50 boepd).

In the updated Reserves Report, Moyes & Co. estimated the Company's Mississippi Lime 2P reserves at 1.164 million barrels of oil and condensate and 3,857 MMcf with a value of US$40.592 million.

The Mississippi Lime is an historic oil and gas system that has been producing at depths ranging from 4,500 to 7,000 feet from several thousand vertical wells for over 50 years. As with the Bakken, new technology and horizontal drilling has reopened the oil play. Due to the relatively shallow depths and less tight rock formation, drilling costs at between US$2.4 million and US$3.5 million per well in the Mississippi Lime are considerably lower than those in the Bakken, which should lead to shorter pay-out periods than with the Bakken wells.

Woodford/Hunton Formations, Oklahoma

At the time of the AIM Admission, the Company anticipated participating in five new wells on its Woodford/Hunton acreage in 2012. In the event, Magnolia participated in the drilling of ten new wells in the formation, bringing the overall total to 18. Initial production rates for three wells were made available during the period under review:

- Bollinger 1-27XL targeting the Woodford (686.388 boepd);
- SPS 6-26 vertical well targeting the Hunton (108 boepd);
- Zenyatta 2-6 vertical well targeting the Hunton (17 bopd).

Post period end, initial production for the Beebe 24-W1H in the Woodford formation was reported at 73 boepd.

In the updated Reserves Report, Moyes & Co. estimated the Company's Woodford / Hunton 2P reserves at 6 million barrels of oil and condensate and 397 MMcf natural gas with a value of US$387,000.

Like the Bakken, the Woodford / Hunton formations in Oklahoma are established reservoirs that have been reopened following the introduction of horizontal drilling and stimulation technology. As a result the Woodford oil play in particular is increasingly being drilled by leading operators. Magnolia holds leases in respect of approximately 67,200 gross mineral acres (800 net mineral acres), giving rights to participate in the drilling of wells in 87 sections located in 26 counties in central Oklahoma.

Montana

In November 2012, Magnolia acquired 6,700 acres in the Montana section of the Bakken/Three Forks Sanish formation located in Daniels County and three surrounding counties in Montana. The acreage lies amongst, and is surrounded by, leases owned by Apache Corporation ('Apache'), a leading international oil and gas exploration and production company. Post period end, Magnolia acquired a further 985 net mineral acres in the Montana section of the Bakken/Three Forks Sanish formation, bringing the total acreage acquired in the district to 7,866.

In recent years, activity in the Montana section of the Bakken has been increasing. According to oil services company Baker Hughes, as of April 2012, there were 18 rigs active in eastern Montana, compared to 10 the previous year and zero in July 2009. In addition, the Montana Board of Oil and Gas issued 228 oil permits in June 2012, more than the total number issued in 2011.

In 2012, Apache acquired 320,000 net acres, an indication of the growing interest in the Bakken in Montana. Apache believe there are over 1,900 potential drilling locations on its 320,000 net mineral acres and that sixteen horizontal wells, eight for the Bakken and a further eight for the Three Forks Sanish, will be required to optimise the recovery of reserves. According to Apache, the Estimated Ultimate Recovery ('EUR') of reserves stands at 670MBo for the Bakken and 377MBo for the Three Forks Sanish on each drilling location.

Oil production in Montana peaked in 2006 at approximately 100,000 bopd, a similar level to North Dakota during that year. The figure in Montana has since dropped and there is currently no horizontal Bakken production in Daniels County, Montana, though conventional oil has historically been recovered by vertical wells from the Ratcliff, Madison, Mission Canyon and McGowan formations. In addition to the Bakken/Three Forks Sanish, there is the potential for unconventional oil to be recovered from the Mississippian aged Lodge Pole and Madison formations as well as the deeper Devonian aged Nisku members.

At 7,000-7,400ft, the Bakken in Daniels County lies at a shallower depth than in North Dakota. As a result, costs to drill horizontal wells to the Bakken in Montana are estimated at US$7.5 million compared with US$10 million in North Dakota.

In the updated Reserves Report, Moyes & Co. classified the Company's Montana leases as prospective resources and estimated these at 5.77 million barrels of oil and condensate and 2,885 MMcf of natural gas with a value of US$12.267million, reflecting the early stage nature of the play.

Summary

In 2012, Magnolia achieved a number of key milestones: the acquisition of over 12,000 net mineral acres in Oklahoma and Montana; the participation in wells with significantly higher working interests; the drilling of a first well as operator with a 100% working interest; and the securing of a £10 million EFF together with the financial backing of Henderson Global Investors. Post period end, the updated reserves report provides a summary of the progress made during the period between the Company's Admission to AIM in November 2011 and 31 December 2012: a 422% increase in 3P reserves to 2.8 million barrels of oil and 9,231 MMcf of gas with an estimated value of US$94 million. As a result of these achievements, Magnolia is well placed for further significant growth in both net production and reserves in the year ahead.

Rita Whittington
Chief Operations Officer

10 May 2013

REPORT OF THE DIRECTORS

The Directors present their Annual Report and the audited Financial Statements for the year ended 31 December 2012.

Principal Activities and Review of the Business

The principal activity of the Group is onshore oil and gas exploration and production in the United States of America. The Company acts as a holding company and provides technical and other services to its subsidiary.

The Company subsidiary is Magnolia Petroleum Inc. ("Magnolia"), an independent oil and gas exploration and production company based near Tulsa, Oklahoma, USA. Magnolia's core area of business is in the Bakken/Three Forks Sanish area in North Dakota and Montana, the emerging Mississippi Formation in Oklahoma and the Woodford/Hunton oil and gas formations in Oklahoma, United States.

A business and financial review of operations for the financial year 2012 as well as the future developments of the Group are included in the Chief Executive Officer's and Chief Operations Officer's Statement.

Results and Dividends

The loss for the year after taxation was $1,075,178 (2011 – loss $342,447).

The Directors do not recommend the payment of a dividend.

Political and Charitable Contributions

During the period the Company did not make any payments for charitable or political purposes.

Going Concern

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future and, therefore, continue to adopt the going concern basis in preparing the Annual Report and Financial Statements. Further details on their assumptions and their conclusion thereon are included in the statement on going concern included in Note 2 to the Financial Statements.

Risks and Uncertainties

The Group's activities expose it to a variety of risks and uncertainties.

Market risk

The Group operates in an international market for hydrocarbons and is exposed to risk arising from variations in the demand for and price of the hydrocarbons. Oil and gas prices historically have fluctuated widely and are affected by numerous factors over which the Group does not have any control, including world production levels, international economic trends, currency exchange fluctuations, inflation, speculative activity, consumption patterns and global or regional political events.

Non-operator risk

On non-operated interests, the Group has no influence on the timing of drilling of the oil and gas wells in which it participates and will depend on operators to initiate and supervise the drilling and operation of such wells. As such the Group cannot accurately predict the timing of the cash flows associated with the drilling of these wells. If the Group is unable or unwilling to comply with its payment obligations, it would seek to negotiate a wellbore assignment of the lease, thus retaining the right to participate in future wells that may be drilled on that acreage. If an assignment could not be negotiated, the Group would lose the right to participate in the acreage if it does not participate in the original well. This could have an adverse affect on the Group's future revenues and earnings.

Risks and Uncertainties (continued)

Oil and gas exploration and production risks

The Group is primarily a non-operator working interest owner and is reliant on the operator for managing all aspects of its exploration and production activities in its non-operated interests. There are significant risks and hazards inherent in the exploration and production of oil and gas, including environmental hazards, industrial incidents, labour disputes, fire, drought, flooding and other acts of God. The occurrence of any of these hazards can delay or interrupt production and increase production costs. There is no guarantee that oil and/or gas will be discovered in any of the Group's existing or future licences/permitted acreage or that commercial quantities of oil and/or gas can be recovered.

The Group currently holds less than a 100 per cent working interest in the majority of its completed wells and in wells which are being drilled. It is also likely to hold less than 100 per cent in wells which may be drilled in the future. The Group could be held liable for the joint activity obligations of the other working interest owners, such as non-payment of costs and liabilities arising from the actions of those other working interest owners. In the event that other working interest owners do not pay their share of such costs, the Group would be likely to have to pay those costs.

Environmental risk

The Group's operations are subject to environmental regulation in all the jurisdictions in which it operates. The Group is unable to predict the effect of additional environmental laws and regulations which may be adopted in the future, including whether any such laws or regulations would adversely affect the Group's operations. There can be no assurance that such new environmental legislation once implemented will not oblige the Group to incur significant expenses and undertake significant investments.

Licences and title

The leases in which the Group has or is seeking to have an interest will be subject to termination after the primary term of such leases unless there is current production of oil and/or gas in commercial quantities. If a lease is not extended after the primary term, the Group may lose the opportunity to develop and discover any hydrocarbon resources on that lease area. In taking an assignment of an oil and/or gas lease, the Group would, in accordance with industry practice, rely on the warranty provisions and would not perform a title check in respect of previous assignments or the title of the original mineral rights lessor. Other parties may therefore dispute the Group's title to its properties.

Decommissioning

The full extent to which the decommissioning provision is required depends on the legal requirements at the time of decommissioning, the costs and timing of any decommissioning works and the discount rate applied to such costs.

Financial risk management disclosures are included in Note 3 of the Financial Statements.

Directors and Directors' interests

The Directors who held office during the year to the date of approval of these Financial Statements, together with their beneficial interests in the ordinary shares of the Company, are shown below.

	31 December 2012		*1 January 2012*	
	Ordinary Shares	*Options and warrants*	*Ordinary Shares*	*Options and warrants*
Gavin J Burnell (1)	14,185,797	11,220,768	13,950,503	11,220,768
Dr John M Cubitt	619,908	4,400,000	384,614	4,400,000
Steven Otis Snead (2)	199,915,998	14,110,000	197,436,360	14,110,000
Rita Fern Whittington	11,635,294	10,126,000	11,400,000	10,126,000
Ronald Sanford Harwood (3)	29,732,426	1,660,000	24,618,180	1,660,000

(1) Figures at 1 January and 31 December 2012 included 830,000 ordinary shares owned by Elizabeth Burnell, the wife of Gavin Burnell.

(2) Includes 93,209,040 ordinary shares owned by the Snead Family LLC, 50,000,000 held by Snead Family 2012 LLC and 11,400,000 ordinary shares owned by R. Sterling Snead.

(3) Ronald Sanford Harwood's shares are held by the Ronald S. Harwood Trust.

Directors and Directors' interests (continued)

Dr John Malcolm Cubitt, Non-Executive Chairman

Dr John Cubitt has more than 30 years' commercial experience in the oil exploration and production industry, following a period in academic research and graduate/post-graduate education in the UK and USA. He is a registered Chartered Geologist (CGeol) and has a BSc and PhD in geology. His experience has included asset evaluation and project management, as well as board-level strategic and operational direction. Until December 2011 he was Managing Director of Woburn Energy Plc (formerly Black Rock Oil and Gas Plc), an AIM-listed oil and gas exploration company whose primary asset at that time was in Colombia. He is also a director of Terrasciences Inc, an oil industry software house, Triox Limited, an oil and gas E&P shell company listed on the TSXV, and Bridgecreek Resources Ltd, a private US oil and gas E&P company.

Steven Otis Snead, Chief Executive Officer

Mr Snead is a Certified Professional Landman with 34 years' experience in the oil and gas industry. In 1980 he founded Energy Land Services Inc., an oil and gas service company that was contracted by small and medium-sized oil companies to perform title research, determine owners of mineral interests in a prospective drilling area, and then purchase leases from those mineral owners or negotiate agreements with other exploration companies. Energy Land Services also obtained permits or regulatory agency approvals, and secured necessary title curative to ensure clear title to ownership of wells. Energy Land Services, which employed up to 32 landmen and support staff, was sold to its employees in 1989, and still operates today.

In 1984, he founded (and still owns and operates) Enerlex Inc. ("Enerlex") for the purpose of purchasing and managing royalty interests. In 1987, he acquired Magnolia Petroleum Limited, an exploration and production company which at that time had over 30 operated wells in Oklahoma. By 1999, when the properties were profitably sold, Magnolia Petroleum Limited had acquired, drilled and managed working interests (operated and non-operated) in over 200 wells. The company was then liquidated solvently, but Mr Snead retained the rights to the name "Magnolia Petroleum".

In 1988 he co-founded International Searchers Inc. ("ISI"), a research company that located and recovered unpaid royalties or uncollected assets. ISI recovered significant royalties and assets for its clients and had a research process that allowed it to identify royalty owners in wells throughout the United States. In 2000, Enerlex acquired ISI's research process and its proprietary database of 2.25 million names and addresses of royalty owners which is used by Enerlex to identify royalty interests available for acquisition.

Rita Fern Whittington, Chief Operations Officer

Mrs Whittington is a petroleum landman with more than 30 years' experience in acquisition, operations and management of oil and gas properties.

She began her career in 1977 working for an Oklahoma based oil exploration company where she became a prospect manager. In 1985, she joined Kaiser-Francis Oil Company in Oklahoma as a land supervisor. Between 1987 and 1989, she acted as a title analyst for Terra Resources Inc. specialising in Gulf Coast, Texas and Louisiana properties. In 1989, she joined Enerlex Inc. as vice president where she spent nine years negotiating and purchasing thousands of mineral acres. From 1998 to 2001, she was land administrator for Brighton Energy LLC, focusing on building the company's portfolio through acquisitions and disposals. In 2001, she joined Primary Natural Resources, Inc as a primary member of the asset management team, developing and expanding the company until it sold its assets in 2003. It commenced business again in 2004 and sold its assets in 2008.

Directors and Directors' interests (continued)

Gavin John Burnell, Non-Executive Director

Mr Burnell has specialised in advising smaller capitalised companies for the last twelve years. He joined Ruegg & Co in 2001 where he became an equity partner, and which was later purchased by Astaire Group plc. He is a Director of Corporate Finance at Northland Capital Partners Limited which specialises in assisting companies in AIM flotations and fundraisings. He is a non-executive Director of a number of companies in various sectors including Globo plc, Sula Iron & Gold plc, Hot Rocks Investments plc, Elephant Oil Limited and Rare Earths and Metals plc.

Ronald Sanford Harwood, Non-Executive Director

Mr Harwood graduated in 1957 from Wharton School of Finance and Commerce, University of Pennsylvania, with a Bachelor of Science degree in Economics. During the course of his extensive business career, he has had active involvement in originating and developing projects in a wide range of sectors, mainly in oil and gas exploration and production (since 1981) but also in financial and business development services, telecommunications, computer software, power generation and specialty chemicals.

Mr Harwood has had active involvement in originating and developing projects in oil and gas exploration and production since 1981. He founded Bellwood Petroleum Corporation in 1985, Bellwood Petroleum LLC in 2007 and Colony Petroleum, LLC in 1990. Colony, an oil and gas investment fund, secured US and international investors to participate in oil and gas exploration and production ventures originated and operated by American and Canadian independent oil and gas companies.

Directors' Remuneration

The Remuneration Committee of the Board of Directors is responsible for determining and reviewing compensation arrangements for all Directors and Senior Executives. The Remuneration Committee assesses the appropriateness of the nature and amount of emoluments of such officers on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality Board and senior executive team.

The following remuneration table comprises Directors' fees and benefits in kind that were payable to Directors who held office during the year ended 31 December 2012:

	Basic Salary/ Fees for the year ended 31 December 2012 US$	*Bonus for the year ended 31 December 2012 US$*	*Pension contributions for the year ended 31 December 2012 US$*	*Benefits in Kind for the year ended 31 December 2012 US$*	*Total for the year ended 31 December 2012 US$*	*Total for the year ended 31 December 2011 US$*
Gavin J Burnell	14,995	40,963	–	–	62,538	1,604
Dr John M Cubitt	14,995	–	–	–	14,995	1,604
Steven Otis Snead	16,900	–	–	–	16,900	1,604
Rita Fern Whittington	192,400	–	7,020	20,740	220,159	13,500
Ronald Sanford Harwood	16,900	–	–	–	16,900	1,604

Substantial interests

As of 19 April 2013, the following interests of three per cent or more of the issued ordinary share capital had been notified to the Company:

	%	*Number of ordinary shares*
Steven Otis Snead	22.16	188,515,998
TD Hargreaves Lansdown (Nominees) Limited	10.57	89,891,826
Direct Investing Nominees (Europe) Limited	10.96	93,209,049
HSDL Nominees Limited	5.57	47,420,862
Barclayshare Nominees Limited	5.46	46,508,586
HSBC Client Holdings Nominee (UK) Limited	4.61	39,255,327
L R Nominees Limited	3.76	32,012,594
Ronald Sanford Harwood	3.50	29,732,426
Share Nominees Ltd	3.40	28,910,758

Key Performance indicators

The Board monitors the overall performance of the Group by reference to Key Performance Indicators ("KPIs"). KPIs for the year, together with comparative data, are presented below:

	2012	*2011*
Revenue	$709,395	$241,038
Gross profit margin	66.1%	39.7%

Participations in well drilling programmes are monitored on an individual project basis in terms of revenue and cost per barrel of oil or mcf (one thousand cubic feet) of gas, together with the anticipated payback period on each project.

Supplier Payment Policy

Whilst there is no formal code or standard, it is Company policy to settle terms of payment with creditors when agreeing the terms of each transaction and to abide by the creditors' terms of payment. There are no creditors subject to special arrangements outside of suppliers' terms and conditions except those creditors which are party to the Deferral Amendment Agreement dated 15 November 2011. Under this agreement, payment of certain fees and expenses are deferred until 23 April 2013.

At 31 December 2012 the number of creditor days in respect of trade creditors was 20 (2011: 101).

Directors' and Officers' Indemnity Insurance

The Company has made qualifying third-party indemnity provisions for the benefit of its Directors and Officers. These were made during the previous period and remain in force at the date of this report.

Events After the Reporting Period

The events after the reporting period are set out in note 23 to the Financial Statements.

Provision of information to auditors

So far as each of the Directors is aware at the time this report is approved:

- there is no relevant audit information of which the Company's auditors are unaware; and
- the Directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

Auditors

Littlejohn LLP has signified its willingness to continue in office as auditors.

Annual General Meeting – Explanation of Business

The 2012 annual general meeting will be held at 10.00am on 5 June 2013 at 18452 E 111th, Broken Arrow, Oklahoma, OK74011, USA. The notice of meeting is set out on pages 51 to 53 of this document and a form of proxy is enclosed.

Details of the business to be considered at the meeting are given below.

Resolution 1 is to receive the annual report and financial statements. Resolutions 2, 3 and 4 concern John Cubitt, Ronald Harwood and Rita Whittington who retire by rotation and offer themselves for re-election as directors. Resolution 5 is to reappoint Littlejohn LLP as auditors and to authorise the directors to set their fees.

Authority of directors to allot shares (Resolutions 6 and 7)

Under UK law, directors are not permitted to allot new shares (or to grant rights over shares) unless they are authorised to do so by shareholders. In addition, directors require specific authority from shareholders before allotting new shares (or granting rights over shares) for cash without first offering them to existing shareholders in proportion to their holdings. Resolution 6 gives the directors the necessary authority to allot up to a maximum of 425,000,000 relevant securities. This represents approximately 50% of the current issued ordinary share capital.

Resolution 7 empowers the directors to allot such securities for cash otherwise than on a pro-rata basis to existing shareholders, up to a maximum of 425,000,000 ordinary shares of 0.1p each, equivalent to approximately 50% of the current issued ordinary share capital. These authorities will continue in force until the AGM to be held in 2014 or 30 June 2014, whichever is the earlier.

Authority for the Company to purchase its own shares (Resolution 7)

Resolution 8 authorises the Company, until next year's AGM or 30 June 2014 (whichever is earlier) to purchase in the market up to a maximum of 127,600,000 ordinary shares (equivalent to approximately 15% of the current issued share capital of the Company). The Companies Act 2006 allows the Company to hold any repurchased shares in treasury, instead of cancelling them immediately. If the Company buys back its own shares and holds them in treasury it may then deal with some or all of them in several ways. It may sell them for cash; transfer them under the provisions of an employee share scheme; cancel them; or continue to hold them in treasury. Holding shares in treasury in this way would allow the Company to reissue them quickly and cost effectively, giving increased flexibility to the management of its capital base. Dividends are not paid on shares held in treasury, nor do they carry voting rights while they remain there. The directors intend to decide at the time of any share buyback, whether to cancel the shares immediately or to hold them in treasury, depending on the interests of the Company and its shareholders as a whole, at the time. The Company does not currently hold any shares in treasury.

The proposal should not be taken as an indication that the Company will purchase shares at any particular price or indeed at all, and the directors will only consider making purchases if they believe that such purchases would result in an increase in earnings per share and are in the best interests of shareholders.

It is intended to renew each of the above authorities at each annual general meeting.

This report was approved by the board on 10 May 2013 and signed on its behalf:

Gavin Burnell
Director

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Financial Statements for each financial year. Under that law the Directors have elected to prepare the Group and Parent Company Financial Statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company as at the end of the financial year, and of the profit or loss of the Group for that period. In preparing these Financial Statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent; and
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the Financial Statements.

The Directors confirm that they have complied with the above requirements in preparing the Financial Statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of the Financial Statements and other information included in annual reports may differ from legislation in other jurisdictions.

CORPORATE GOVERNANCE REPORT

The Board of Directors

As at 31 December 2012, the Board of Directors comprised five members: two Executive Directors and three Non-Executive Directors including the Chairman, Dr John Cubitt. The Executive Directors have a wealth of experience in the oil and gas industry. Similarly the Non-Executive Directors together have extensive mineral, oil and gas exploration experience and financial experience.

Board meetings

The Board ordinarily meets on a monthly basis and as and when further required, providing effective leadership and overall management of the Company's affairs by reference to those matters reserved for its decision. This includes the approval of the budget and business plan, major capital expenditure, acquisitions and disposals, risk management policies and the approval of the financial statements. Formal agendas, papers and reports are sent to the Directors in a timely manner, prior to the Board meetings.

	Number held and entitled to attend	*Number attended*
Dr John Cubitt	24	20
Gavin Burnell	24	24
Ronald Harwood	24	19
Steven Snead	24	19
Rita Whittington	24	23

Corporate governance practices

The Board recognises the importance of sound corporate governance commensurate with the size of the Company and the interests of Shareholders. As the Company grows, the Directors will develop policies and procedures which reflect the requirements of the UK Corporate Governance Code, as published by the Financial Reporting Council so far as is practicable, taking into account the size and nature of the Company.

Remuneration and audit committees

The remuneration committee comprise of Ronald Harwood (Chairman), John Cubitt and Gavin Burnell, and is responsible for reviewing the performance of the Executive Directors and for setting the framework and broad policy for the scale and structure of their remuneration taking into account all factors which it shall deem necessary. The remuneration committee also determines the allocation of share options and is responsible for setting up any performance criteria in relation to the exercise of options granted under any share options schemes adopted by the Company.

The audit committee comprise John Cubitt (Chairman), Gavin Burnell and Ronald Harwood, and has primary responsibility for monitoring the quality of internal controls, ensuring that the financial performance of the Company is properly measured and reported on and for reviewing reports from the Company's auditors relating to the Group's accounting and internal controls.

Internal controls

The Board recognises the importance of both financial and non-financial controls and has reviewed the Company's control environment and any related shortfalls during the year. Since the Company was established, the Directors are satisfied that, given the current size and activities of the Company, adequate internal controls have been implemented. Whilst they are aware that no system can provide absolute assurance against material misstatement or loss, in light of the current activity and proposed future developments of the Company, continuing reviews of internal controls will be undertaken to ensure that they are adequate and effective.

Relations with Shareholders

The Board is committed to providing effective communication with the shareholders of the Company. Significant developments are disseminated through stock exchange announcements and regular updates on the Company website. The Board views the Annual General Meeting as a forum for communication between the Company and its shareholders and encourages their participation in its agenda.

INDEPENDENT AUDITORS' REPORT

Independent Auditors' Report to the members of Magnolia Petroleum Plc

We have audited the Group and Parent Financial Statements of Magnolia Petroleum plc for the year ended 31 December 2012 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Statement of Financial Position, the Consolidated and Parent Company Statements of Cash Flow, the Consolidated and Parent Company Statements of Changes in Equity, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior written consent in writing.

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances, and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2012 and of the Group's loss for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Parent Company Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company Financial Statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Mark Ling (Senior statutory auditor)
For and on behalf of
Littlejohn LLP
Statutory Auditor

1 Westferry Circus
Canary Wharf
London E14 4HD

10 May 2013

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2012

	Note	*Year ended 31 December 2012 $*	*Year ended 31 December 2011 $*
Continuing Operations			
Revenue		709,395	241,038
Operating expenses		(240,173)	(145,365)
Gross Profit		469,222	95,673
Impairment of property, plant and equipment	11	(9,333)	–
Impairment of mineral leases	12	(218,525)	(224,892)
Administrative expenses	7	(1,314,973)	(213,228)
Operating Loss	6	(1,073,609)	(342,447)
Finance costs		(1,569)	–
Loss before Tax		(1,075,178)	(342,447)
Taxation	10	–	–
Loss for the year attributable to the equity holders of the Company		(1,075,178)	(342,447)
Other Comprehensive Income:			
Currency translation differences		173,924	(10,931)
Other Comprehensive Income for the Year, Net of Tax		173,924	(10,931)
Total Comprehensive Income for the Year attributable to the equity holders of the Company		(901,254)	(353,378)
Loss per share for loss attributable to the equity holders of the Company during the year			
Basic and diluted (cents per share)	8	(0.16)	(0.09)

The Company has elected to take the exemption under Section 408 of the Companies Act 2006 from presenting the Parent Company Statement of Comprehensive Income.

The loss for the Parent Company for the year was $334,035 (2011: $80,574).

The Notes on pages 27 to 50 form part of these Financial Statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

	Note	*As at 31 December 2012 $*	*As at 31 December 2011 $*
Non–Current Assets			
Property, plant and equipment	11	3,437,869	861,975
Intangible assets	12	6,200,828	1,111,634
Total Non-Current Assets		9,638,697	1,973,609
Current Assets			
Trade and other receivables	14	208,936	70,308
Cash and cash equivalents	15	2,293,151	874,037
Total Current Assets		2,502,087	944,345
TOTAL ASSETS		12,140,784	2,917,954
EQUITY AND LIABILITIES			
Equity attributable to Owners of Parent			
Share capital	16	1,390,244	926,128
Share premium	16	11,888,717	2,218,877
Merger reserve		1,975,950	1,975,950
Share option and warrants reserve		66,603	66,603
Reverse acquisition reserve		(2,250,672)	(2,250,672)
Translation reserve		47,300	(126,624)
Retained losses		(1,577,896)	(502,718)
Total Equity		11,540,246	2,307,544
Non-Current Liabilities			
Trade and other payables	17	–	278,431
Total Non-Current Liabilities		–	278,431
Current Liabilities			
Trade and other payables	17	600,538	331,979
Total Current Liabilities		600,538	331,979
TOTAL EQUITY AND LIABILITIES		12,140,784	2,917,954

These Financial Statements were approved by the Board of Directors on 10 May 2013 and were signed on its behalf by:

Gavin Burnell
Director

Rita Whittington
Chief Operations Officer

The Notes on pages 27 to 50 form part of these Financial Statements.

COMPANY STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

	Note	*As at 31 December 2012 $*	*As at 31 December 2011 $*
Non–Current Assets			
Investments in subsidiaries	13	3,782,525	3,615,907
Total Non–Current Assets		3,782,525	3,615,907
Current Assets			
Trade and other receivables	14	10,809,790	1,057,957
Cash and cash equivalents	15	103,919	193,788
Total Current Assets		10,913,709	1,251,745
TOTAL ASSETS		14,696,234	4,867,652
EQUITY AND LIABILITIES			
Equity attributable to owners of Parent			
Share capital	16	1,390,244	926,128
Share premium	16	11,888,717	2,218,877
Merger reserve		1,975,950	1,975,950
Share option and warrants reserve		66,603	66,603
Translation reserve		(101,368)	(425,334)
Retained losses		(568,887)	(234,852)
Total Equity		14,651,259	4,527,372
Non–Current Liabilities			
Trade and other payables	17	–	243,431
Total Non–Current Liabilities		–	243,431
Current Liabilities			
Trade and other payables	17	44,975	96,849
Total Current Liabilities		44,975	96,849
TOTAL EQUITY AND LIABILITIES		14,696,234	4,867,652

These Financial Statements were approved by the Board of Directors on 10 May 2013 and were signed on its behalf by:

Gavin Burnell
Director

Rita Whittington
Chief Operations Officer

The Notes on pages 27 to 50 form part of these Financial Statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2012

	Attributable to the owners of the parent							
Group ($)	*Share capital*	*Share Premium*	*Merger reserve*	*Share option reserve*	*Reverse acquisition reserve*	*Translation reserve*	*Retained losses*	*Total equity*
Balance at 1 January 2011	587,336	1,347,983	1,867,790	66,603	(2,250,672)	(115,693)	(160,271)	1,343,076
Loss for the year	–	–	–	–	–	–	(342,447)	(342,447)
Other Comprehensive Income								
Currency translation differences	–	–	–	–	–	(10,931)	–	(10,931)
Total Comprehensive Income for the Year	–	–	–	–	–	(10,931)	(342,447)	(353,378)
Proceeds from share issues	338,792	1,524,567	–	–	–	–	–	1,863,359
Share issue costs	–	(653,673)	–	–	–	–	–	(653,673)
Movements in the year	–	–	108,160	–	–	–	–	108,160
Total contributions by and distributions to owners of the parent, recognised directly in equity	338,792	870,894	108,160	–	–	–	–	1,317,846
Balance at 31 December 2011	926,128	2,218,877	1,975,950	66,603	(2,250,672)	(126,624)	(502,718)	2,307,544
Balance at 1 January 2012	926,128	2,218,877	1,975,950	66,603	(2,250,672)	(126,624)	(502,718)	2,307,544
Loss for the year	–	–	–	–	–	–	(1,075,178)	(1,075,178)
Other Comprehensive Income								
Currency translation differences	–	–	–	–	–	173,924	–	173,924
Total Comprehensive Income for the Year	–	–	–	–	–	173,924	(1,075,178)	(901,254)
Proceeds from share issue	464,116	10,664,377	–	–	–	–	–	11,128,493
Share issue costs	–	(994,537)	–	–	–	–	–	(994,537)

The Notes on pages 27 to 50 form part of these Financial Statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

Year ended 31 December 2012

	Attributable to the owners of the parent							
Group ($)	*Share capital*	*Share Premium*	*Merger reserve*	*Share option reserve*	*Reverse acquisition reserve*	*Translation reserve*	*Retained losses*	*Total equity*
Total contributions by and distributions to owners of the parent, recognised directly in equity	464,116	9,669,840	–	–	–	–	–	10,133,956
Balance at 31 December 2012	1,390,244	11,888,717	1,975,950	66,603	(2,250,672)	47,300	(1,577,896)	11,540,246

The movement in the merger reserve during the year ended 31 December 2011 consisted of the partial write back of a liability and the recovery of input VAT in respect of certain share issue costs incurred in the year ended 31 December 2009.

The Notes on pages 27 to 50 form part of these Financial Statements.

COMPANY STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2012

	Attributable to the owners of the parent						
Company ($)	*Share capital*	*Share Premium*	*Merger reserve*	*Share option reserve*	*Translation reserve*	*Retained earnings*	*Total equity*
Balance at 1 January 2011	587,336	1,347,983	1,867,790	66,603	(372,117)	(154,278)	3,343,317
Loss for the year	–	–	–	–	–	(80,574)	(80,574)
Other Comprehensive Income							
Currency translation differences	–	–	–	–	(53,217)	–	(53,217)
Total Comprehensive Income for the Year	–	–	–	–	(53,217)	(80,574)	(133,791)
Transactions with Owners							
Proceeds from share issues	338,792	1,524,567	–	–	–	–	1,863,359
Share issue costs	–	(653,673)	–	–	–	–	(653,673)
Movements in the year	–	–	108,160	–	–	–	108,160
Total contributions by and distributions to owners of the parent, recognised directly in equity	338,792	870,894	108,160	–	–	–	1,317,846
Balance at 31 December 2011	926,128	2,218,877	1,975,950	66,603	(425,334)	(234,852)	4,527,372
Balance at 1 January 2012	926,128	2,218,877	1,975,950	66,603	(425,334)	(234,852)	4,527,372
Loss for the year	–	–	–	–	–	(334,035)	(334,035)
Other Comprehensive Income							
Currency translation differences	–	–	–	–	323,966	–	323,966
Total Comprehensive Income for the Year	–	–	–	–	323,966	(334,035)	(10,069)
Transactions with Owners							
Proceeds from share issue	464,116	10,664,377	–	–	–	–	11,128,493
Share issue costs	–	(994,537)	–	–	–	–	(994,537)

The Notes on pages 27 to 50 form part of these Financial Statements.

COMPANY STATEMENT OF CHANGES IN EQUITY (continued)

Year ended 31 December 2012

	Attributable to the owners of the parent						
Company ($)	*Share capital*	*Share Premium*	*Merger reserve*	*Share option reserve*	*Translation reserve*	*Retained earnings*	*Total equity*
Total contributions by and distributions to owners of the parent, recognised directly in equity	464,116	9,669,840	–	–	–	–	10,133,956
Balance at 31 December 2012	1,390,244	11,888,717	1,975,950	66,603	(101,368)	(568,887)	14,651,259

The movement in the merger reserve during the year ended 31 December 2011 consisted of the partial write back of a liability and the recovery of input VAT in respect of certain share issue costs incurred in the year ended 31 December 2009.

The Notes on pages 27 to 50 form part of these Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2012

	Note	*Year ended 31 December 2012* $	*Year ended 31 December 2011* $
Cash Flows from Operating Activities			
Loss before tax		(1,075,178)	(342,447)
Impairment	11,12	227,858	224,892
Depreciation	11	222,033	101,284
Foreign exchange		158,351	(781)
(Increase)/Decrease in trade and other receivables		(136,925)	19,619
(Decrease)/Increase in trade and other payables		(19,388)	147,892
Net Cash (used in)/generated from Operating Activities		(623,249)	150,459
Cash Flows from Investing Activities			
Purchases of intangible assets	12	(5,691,408)	(364,998)
Purchases of property, plant and equipment	11	(2,407,158)	(213,593)
Net Cash used in Investing Activities		(8,098,566)	(578,591)
Cash Flows from Financing Activities			
Proceeds from issue of ordinary shares	16	11,128,493	1,863,359
Issue costs	16	(994,537)	(653,673)
Net Cash generated from Financing Activities		10,133,956	1,209,686
Net Increase in Cash and Cash Equivalents		1,412,141	781,554
Movement in Cash and Cash Equivalents			
Cash and cash equivalents at the beginning of the year	15	874,037	97,523
Exchange gain/(loss) on cash and cash equivalents		6,973	(5,040)
Net increase in cash and cash equivalents		1,412,141	781,554
Cash and Cash Equivalents at the End of the Year	15	2,293,151	874,037

The Notes on pages 27 to 50 form part of these Financial Statements.

COMPANY STATEMENT OF CASH FLOWS

Year ended 31 December 2012

	Note	Year ended 31 December 2012 $	Year ended 31 December 2011 $
Cash Flows from Operating Activities			
Loss before tax		(334,035)	(80,574)
Foreign exchange		158,191	–
Increase in trade and other receivables		36,659	5,384
Decrease in trade and other payables		(304,824)	(43,942)
Net Cash used in Operating Activities		(444,009)	(119,132)
Cash Flows from Financing Activities			
Proceeds from issue of ordinary shares	16	11,128,493	1,863,359
Issue costs	16	(994,537)	(597,139)
Increase in funding subsidiary undertaking		(9,786,789)	(1,042,486)
Net Cash from Financing Activities		347,167	223,734
Net (Decrease)/Increase in Cash and Cash Equivalents		(96,842)	104,602
Movement in Cash and Cash Equivalents			
Cash and cash equivalents at the beginning of the year	15	193,788	94,226
Exchange gain/(loss) on cash and cash equivalents		6,973	(5,040)
Net (decrease)/increase in cash and cash equivalents		(96,842)	104,602
Cash and Cash Equivalents at the End of the Year	15	103,919	193,788

The Notes on pages 27 to 50 form part of these Financial Statements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

1. General information

The Consolidated Financial Statements of Magnolia Petroleum plc ("the Company") consists of the following companies; Magnolia Petroleum plc and Magnolia Petroleum Inc. (together "the Group").

The Company is a public limited company which is listed on the AIM market of the London Stock Exchange and incorporated and domiciled in England and Wales. Its registered office address is The Fitzpatrick Building, 188-194 York Way, London, N7 9AS.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation of Financial Statements

The consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) to companies reporting under IFRS, and IFRIC interpretations and the parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Financial Statements have been prepared under the historical cost convention.

The preparation of Financial Statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated Financial Statements, are disclosed in Note 4.

2.2 Basis of consolidation

The consolidated Financial Statements consolidate the Financial Statements of Magnolia Petroleum plc and the audited Financial Statements of its subsidiary undertaking made up to 31 December 2012.

Subsidiaries are entities over which the Group has control. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Group obtains and exercises control through voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The Company acquired Magnolia Petroleum Inc. on 23 October 2009 through a share exchange. As the shareholders of Magnolia Petroleum Inc. have control of the legal parent, Magnolia Petroleum plc, the transaction was accounted for as a reverse acquisition in accordance with IFRS 3 "Business Combinations". The following accounting treatment has been applied in respect of the reverse acquisition:

- the assets and liabilities of the legal subsidiary Magnolia Petroleum Inc. are recognised and measured in the Consolidated Financial Statements at their pre-combination carrying amounts, without restatement to fair value; and

- the equity structure appearing in the Consolidated Financial Statements reflects the equity structure of the legal parent, Magnolia Petroleum plc, including the equity instruments issued to effect the business combination.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.2 Basis of consolidation (continued)

The cost of acquisition was measured as the fair value of the assets acquired, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus certain costs directly attributable to the acquisition.

In accounting for the acquisition of Magnolia Petroleum Inc., the Company has taken advantage of Section 612 of the Companies Act 2006 and accounted for the transaction using merger relief.

Investments in subsidiaries are accounted for at cost less impairment. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by other members of the Group. All significant inter-company transactions and balances between Group entities are eliminated on consolidation.

2.3 Going concern

The Group's business activities, together with the factors likely to affect its future development and performance are set out in the Chief Executive Officer's Statement. In addition, notes 3 and 19 to the Financial Statements disclose the Group's and Company's objectives, policies and processes for managing financial risks and capital.

The Company raised $11.1 million before expenses via a number of placings during the year. In addition, the Company has approximately $7.54 million (equivalent to £4.665 million) available for utilisation in the future under the terms of the Equity Finance Facility (see note 16). The Group's cash flow forecasts and projections prepared up to June 2014 show that the Group has sufficient funds to fund its ongoing operating costs. The Directors have a reasonable expectation that the Company and Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis of accounting in preparing the Financial Statements.

2.4 Changes in accounting policy and disclosure

a) New and amended standards adopted by the Group

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 1 January 2012 that would be expected to have a material impact on the Company or Group.

b) New and amended standards, and interpretations mandatory for the first time for the financial year beginning 1 January 2012, but not currently relevant to the Group

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Company or Group.

Amendments to IFRS 1, 'First time adoption' on fixed dates and hyperinflation. The first amendment replaces references to a fixed date of 1 January 2004 with "the date of transition to IFRSs", thus eliminating the need for companies adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation.

IFRS 7, 'Financial instruments: Disclosures' was amended in October 2012 for the transfer of financial assets. These amendments are as part of the IASB's comprehensive review of off Statement of Financial Position activities. The amendments promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial asset.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.4 Changes in accounting policy and disclosure (continued)

b) New and amended standards, and interpretations mandatory for the first time for the financial year beginning 1 January 2012, but not currently relevant to the Group (continued)

Amendments to IAS 12, 'Income Taxes' on deferred tax. Currently IAS 12 requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 Investment Property. Hence this amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC 21, 'income taxes – recovery of revalued non-depreciable assets', would no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is accordingly withdrawn.

c) New and amended standards and interpretations issued but not yet effective for the financial year beginning 1 January 2012 and not early adopted

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the financial statements are disclosed below. The Company and Group intend to adopt these standards, if applicable, when they become effective.

Amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

IAS 19, 'Employee benefits', was amended in June 2011. The amendments eliminate the option to defer the recognition of gains and losses, known as the "corridor method"; streamline the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring re-measurements to be presented in other comprehensive income; and enhance the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The amendment has no impact on the Group.

Amendment to IFRS 1, 'First-time Adoption of International Financial Reporting Standards' on government loans. This amendment addresses how first-time adopters would account for a government loan with a below-market rate of interest when transitioning to IFRS. It also adds an exception to the retrospective application of IFRS, which provides the same relief to first time adopters granted to existing preparers of IFRS Financial Statements when the requirement was incorporated into IAS 20 'Accounting for Government Grants and Disclosure of Government Assistance' in 2008. The amendment is effective for the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU. The amendment has no impact on the Group.

IFRS 7, 'Financial Instruments: Disclosures' was amended for asset and liability offsetting. This amendment requires disclosure of information that will enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. The amendment is effective for the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.4 Changes in accounting policy and disclosure (continued)

c) *New and amended standards and interpretations issued but not yet effective for the financial year beginning 1 January 2012 and not early adopted (continued)*

IFRS 10, 'Consolidated financial statements', builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The Group is yet to assess IFRS 10's full impact and intends to adopt IFRS 10 no later than the accounting period beginning on or after 1 January 2013.

IFRS 11, 'Joint Arrangements' provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. There are two types of joint arrangement; joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and therefore accounts for its share of assets, liabilities, revenue and expenses. Joint ventures arise where the joint venture has rights to the net assets of the arrangement and therefore equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Group is yet to assess IFRS 11's full impact and intends to adopt IFRS 11 no later than the accounting period beginning on or after 1 January 2013.

IFRS 12, 'Disclosures of interests in other entities', includes the disclosure requirements for all forms of interests in entities, including joint arrangements, associates, special purpose vehicles and other off Statement of Financial Position vehicles. The Group is yet to assess IFRS 12's full impact and intends to adopt IFRS 12 no later than the accounting period beginning on or after 1 January 2013.

Amendments to IFRS 10, 'Consolidated Financial Statements', IFRS 11, 'Joint Arrangements and IFRS 12, 'Disclosure of Interests in Other Entities', provide additional transition relief to IFRSs 10,11 and 12 by limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The Group is yet to assess the full impact of these amendments and intends to adopt the amended standards no later than the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU.

IFRS 13, 'Fair value measurement', aims to provide consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRS and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards with IFRSs or US GAAP. The standard becomes effective for annual periods beginning on or after 1 January 2013.

IAS 27, 'Separate Financial Statements', replaces the current version of IAS 27, 'Consolidated and Separate Financial Statements' as a result of the issue of IFRS 10. The revised standard includes the requirements relating to separate financial statements. The revised standard becomes effective for annual periods beginning on or after 1 January 2013.

IAS 28, 'Investments in Associates and Joint Ventures', replaces the current version of IAS 28,'Investments in Associates', as a result of the issue of IFRS 11. The revised standard includes the requirements for associates and joint ventures that have to be equity accounted following the issue of IFRS 1. The Group is yet to assess full impact of the revised standard and intends to adopt IAS 28 (revised) no later than the accounting period beginning on or after 1 January 2013.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.4 Changes in accounting policy and disclosure

c) New and amended standards and interpretations issued but not yet effective for the financial year beginning 1 January 2012 and not early adopted (continued)

IFRIC 20, 'Stripping Costs in the Production Phase of a Surface Mine', clarifies when production stripping should lead to the recognition of an asset and how that asset should be measured, both initially and in subsequent periods. The interpretation may require the Group to write off existing stripping assets to opening retained earnings if the assets cannot be attributed to an identifiable component of an ore body. The Group is yet to assess IFRIC 20's full impact and intends to adopt IFRIC 20 no later than the accounting period beginning on or after 1 January 2013.

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics for the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Group is yet to assess IFRS 9's full impact and intends to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015, subject to endorsement by the EU. The Group will also consider the impact of the remaining phases of IFRS 9 when completed by the Board.

Amendments to IAS 32, 'Financial Instruments: Presentation', add application guidance to address inconsistencies identified in applying some of the criteria when offsetting financial assets and financial liabilities. This includes clarifying the meaning of "currently has a legally enforceable right of set-off" and that some gross settlement systems may be considered equivalent to net settlement. The Group is yet to assess the full impact of the amendments to IAS 32 and intends to adopt the amended standard no later than the accounting period beginning on or after 1 January 2014.

Annual Improvements 2009 – 2011 Cycle' sets out amendments to various IFRSs as follows:

- An amendment to IFRS 1, 'First-time Adoption' clarifies whether an entity may apply IFRS 1:
  - (a) if the entity meets the criteria for applying IFRS 1 and has applied IFRS 1 in a previous reporting period; or
  - (b) if the entity meets the criteria for applying IFRS 1 and has applied IFRSs in a previous reporting period when IFRS 1 did not exist.
- The amendment to IFRS 1 also addresses the transitional provisions for borrowing costs relating to qualifying assets for which the commencement date for capitalization was before the date of transition to IFRSs.
- An amendment to IAS 1, 'Presentation of Financial Statements' clarifies the requirements for providing comparative information:
  - (a) for the opening Statement of Financial Position when an entity changes accounting policies, or makes retrospective restatements or reclassifications; and
  - (b) when an entity provides Financial Statements beyond the minimum comparative information requirements.
- An amendment to IAS 16, 'Property, Plant and Equipment' addresses a perceived inconsistency in the classification requirements for servicing equipment.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.4 Changes in accounting policy and disclosure

c) *New and amended standards and interpretations issued but not yet effective for the financial year beginning 1 January 2012 and not early adopted (continued)*

- An amendment to IAS 32, 'Financial Instruments: Presentation' addresses perceived inconsistencies between IAS 12, 'Income Taxes' and IAS 32 with regard to recognizing the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction.

- An amendment to IAS 34, 'Interim Financial Reporting' clarifies the requirements on segment information for total assets and liabilities for each reportable segment.

The Group intends to adopt the amended standards no later than the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU. These improvements are not expected to have an impact on the Group.

2.5 Revenue recognition

Revenue represents the amounts receivable from operators for the Group's share of oil and / or gas revenues less any royalties payable to the lessor or assignor of the mineral rights. Revenue is recognised in the period to which the declarations from the operators relate.

2.6 Foreign Currency Translation

(a) Functional and presentation currency

Items included in the Financial Statements of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The functional currency of the UK parent entity is sterling and the functional currency of the subsidiary is US Dollars. The Financial Statements are presented in US Dollars, rounded to the nearest Dollar, which is the Group's functional and Company's presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where such items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income.

(c) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each Statement of Financial Position presented are translated at the closing rate at the date of that Statement of Financial Position;
- income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.6 Foreign Currency Translation (continued)

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of monetary items receivable from foreign subsidiaries for which settlement is neither planned nor likely to occur in the foreseeable future are taken to other comprehensive income. When a foreign operation is sold, such exchange differences are recognised in the statement of comprehensive income as part of the gain or loss on sale.

2.7 Commercial reserves

Proven and probable oil and gas reserves are estimated quantities of commercially producible hydrocarbons which the existing geological, geophysical and engineering data show to be recoverable in future years from known reservoirs. The proven and probable reserves included therein conform to the definition approved by the Society of Petroleum Engineers (SPE) and the World Petroleum Council (WPC).

2.8 Intangible assets

a. Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any impairment. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised immediately and is not subsequently reversed.

Under the reverse acquisition, goodwill represents the excess of the cost of the combination over the acquirer's interest in the net fair values of the legal parent. The fair value of the equity instruments of the legal subsidiary issued to effect the combination was not available and therefore the fair value of all the issued equity instruments of the legal parent prior to the business combination was used as the basis for determining the cost of the combination.

b. Drilling costs and mineral leases

The Group applies the successful efforts method of accounting for oil and gas assets, having regard to the requirements of IFRS 6 'Exploration for and Evaluation of Mineral Resources'. Costs incurred prior to obtaining the legal rights to explore an area are expensed immediately to the statement of comprehensive income.

Expenditure incurred on the acquisition of a licence interest is initially capitalised within intangible assets on a licence by licence basis. Costs are held, unamortised, within exploration costs until such time as the exploration phase of the licence area is complete or commercial reserves have been discovered. The cost of the licence is subsequently transferred into "Producing Properties" within property, plant and equipment and depreciated over its estimated useful economic life.

Exploration expenditure incurred in the process of determining exploration targets is capitalised initially within intangible assets as exploration costs. Exploration costs are initially capitalised on a well by well basis until the success or otherwise has been established. The success or failure of each exploration effort is judged on a well by well basis. Drilling costs are written off on completion of a well unless the results indicate that hydrocarbon reserves exist and there is a reasonable prospect that these reserves are commercially viable. All such costs are subject to regular technical, commercial and management review on at least an annual basis to confirm the continued intent to develop or otherwise extract value from the discovery. Where this is no longer the case, the costs are immediately expensed to the statement of comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.8 Intangible assets (continued)

Impairment of Non-Financial Assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. An impairment loss is recognised for the amount by which the assets are carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.9 Property, plant and equipment

Following evaluation of successful exploration wells, if commercial reserves are established and the technical feasibility of extraction demonstrated, and once a project is sanctioned for commercial development, then the related capitalised exploration costs are transferred into a single field cost centre within 'producing properties' within property, plant and equipment after testing for impairment. Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are written off to profit or loss.

The net book values of 'producing properties' are depreciated on a unit of production basis at a rate calculated by reference to proven and probable reserves and incorporating the estimated future cost of developing and extracting those reserves.

All costs incurred after the technical feasibility and commercial viability of producing hydrocarbons has been demonstrated are capitalised within 'drilling costs and equipment' on a well by well basis. Subsequent expenditure is capitalised only where it either enhances the economic benefits of the development/producing asset or replaces part of the existing development/producing asset. Any costs remaining associated with the part replaced are expensed.

Net proceeds from any disposal of an exploration asset are initially credited against the previously capitalised costs. Any surplus proceeds are credited to profit or loss.

All property, plant and equipment other than oil and gas assets are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is charged so as to allocate the cost of assets, over their estimated useful lives, on a straight line basis as follows:

Drilling Costs and Equipment – 10 years
Motor vehicles and office equipment – 4 years

Oil and gas producing properties held in property, plant and equipment are mainly depreciated on a unit of production basis at a rate calculated by reference to proven and probable reserves and incorporating the estimated future cost of developing and extracting those reserves.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial year-end.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.9 Property, plant and equipment (continued)

Gains and losses on disposal are determined by comparing proceeds with carrying amount. These are included in profit or loss.

Decommissioning

Where a material liability for the removal of production facilities and site restoration at the end of the production life of a field exists, a provision for decommissioning is recognised. The amount recognised is the present value of estimated future expenditure determined in accordance with local conditions and requirements. The cost of the relevant property, plant and equipment asset is increased with an amount equivalent to the provision and depreciated on a unit of production basis. Changes in estimates are recognised prospectively, with corresponding adjustments to the provision and the associated non-current asset.

2.10 Financial Instruments

Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables.

Trade and other payables

Trade and other payables are initially measured at fair value and are subsequently measured at amortised cost using the effective interest method.

2.11 Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and demand deposits with banks.

2.12 Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments as consideration for the acquisition of a business are included in the cost of acquisition.

2.13 Taxation

The tax expense or credit comprises current and deferred tax. It is calculated using tax rates that have been enacted or substantively enacted by the Statement of Financial Position date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit. In principle, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction, which affects neither the tax profit nor the accounting profit.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.13 Taxation (continued)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled. Deferred tax is charged or credited in the Statement of Comprehensive Income, except when it relates to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

2.14 Leasing

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

2.15 Financial assets and liabilities

Financial assets comprise trade and other receivables and cash and cash equivalents in the Statement of Financial Position. They are classified as loans and receivables. Financial liabilities comprise trade and other payables in the Statement of Financial Position.

Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of the ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

Derecognition also takes place for certain assets when the Group writes-off balances pertaining to the assets deemed to be uncollectible.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Identification and measurement of impairment

At each Statement of Financial Position date, the Group assesses whether there is objective evidence that financial assets are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

The Group considers the evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortized cost) with similar risk characteristics.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

2. Summary of significant accounting policies (continued)

2.16 Share based payment

The Group operates a number of equity-settled, share-based compensation plans under which the entity receives services from employees and suppliers as consideration for equity instruments (options and warrants) of the Company. The fair value of the services received in exchange for the grant of options and warrants is recognised as an expense and as a component of equity, if material. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options and warrants granted using the Black-Scholes pricing model.

2.17 Segment Information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-makers, who are responsible for allocating resources and assessing performance of the operating segments and making strategic decisions.

2.18 Pension Obligations

The Group makes contributions to defined contribution pension plans. The Group has no legal or constructive obligations to pay further contributions if the plans do not hold sufficient assets to pay all employees the benefits relating to employee service in the current or prior periods. The contributions are recognised as employee benefit expense when they are paid.

3. Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including currency risk), credit risk and liquidity risk.

Market risk

The Group operates in an international market for hydrocarbons and is exposed to risk arising from variations in the demand for and price of the hydrocarbons. Oil and gas prices historically have fluctuated widely and are affected by numerous factors over which the Group has no control, including world production levels, international economic trends, exchange rate fluctuations, speculative activity and global or regional political events.

a) Foreign exchange risk

The majority of the Group's sales and purchase transactions are denominated in US dollars. The Company's expenditure is predominantly denominated in sterling. The currencies are stable and any exchange risk is managed by maintaining bank accounts denominated in those currencies.

Credit risk

Credit risk represents the risk of loss the Group would incur if operators and counterparties fail to fulfil their credit obligations. The maximum exposure to credit risk is represented by the carrying amount of each financial asset.

Where the Group is not an operator of wells, the Group's trade receivables and accrued income result from contractual amounts due from third party operators. The risk is concentrated between a relatively small group of operators given the small number of parties involved in oil and gas exploration and production activities. The Group seeks to mitigate this risk where possible by assessing the credit quality of the operators and by establishing ongoing and long term relationships.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

3. Financial risk management (continued)

Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities to finance the Group's operations. The Group monitors its cash flow position and overall liquidity risk. The Group maintains a level of cash deemed sufficient to finance operations to mitigate the effects of fluctuations in cash flows. The Group negotiates its payment terms in its sales agreements so as to minimize any periods of negative cash flows in any agreement.

4. Critical accounting estimates and judgements

Use of estimates and judgements

The preparation of Financial Statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described below:

Recoverability of mineral leases

Mineral leases and drilling costs on non producing properties have a carrying value at 31 December 2012 of $5,828,199 (2011: $755,418). Management tests annually whether non producing mineral leases have future economic value in accordance with the accounting policy stated in note 2.8. This assessment takes into consideration the likely commerciality of the asset, the future revenues and costs pertaining and the discount rates to be applied for the purposes of deriving a recoverable value. In the event that a lease does not represent an economic drilling target and results indicate that there is no additional upside, the mineral lease and drilling costs will be impaired. The Directors have reviewed the estimated value of the licences and have concluded that no additional impairment charge is necessary above that recognised in the year.

Decommissioning

Where the Group has decommissioning obligations in respect of its assets, the full extent to which the provision is required depends on the legal requirements at the time of decommissioning, the costs and timing of any decommissioning works and the discount rate applied to such costs.

Estimated impairment of goodwill

Goodwill has a carrying value at 31 December 2012 of $372,629 (2011: $356,216). The Group tests annually whether goodwill has suffered any impairment in accordance with the accounting policy stated in Note 2.8. Management have concluded that there is no impairment charge necessary to the carrying value of goodwill.

Estimated useful lives of property, plant and equipment

Useful lives are based on industry standards and historical experience which are subjected to yearly evaluation. For producing properties, the Group's considerations include the lease period of the agreement. Management review property, plant and equipment at each Statement of Financial Position date to determine whether there are any indications of impairment. If any such indication exists, an estimate of the recoverable amount is performed, and an impairment loss is recognised to the extent that the carrying amount exceeds the recoverable amount.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

4. Critical accounting estimates and judgements (continued)

Share based payments

The Group has made awards of options and warrants over its unissued capital. The valuation of these options and warrants involves making a number of estimates relating to price volatility, future dividend yields, expected life and forfeiture rates (see note 16).

5. Segmental information

The Group operates in two geographical areas, the United Kingdom and the United States of America. Activities in the UK are mainly administrative in nature whilst the activities in the USA relate to exploration and production from oil and gas wells. The reports reviewed by the Board of Directors that are used to make strategic decisions are based on these geographical segments.

	Year ended 31 December 2012			
	USA	*UK*	*Intra-segment balances*	*Total*
	$	*$*	*$*	*$*
Revenue from external customers	709,375	–	–	709,395
Gross profit	469,222	–	–	(469,222)
Operating loss	(739,574)	(334,035)	–	(1,073,609)
Impairment – property, plant and equipment	9,333	–	–	9,333
Impairment - expired leases	218,525	–	–	218,525
Depreciation	222,033	–	–	222,033
Capital expenditure	8,098,566	–	–	8,098,566
Total assets	11,646,146	14,696,234	(14,574,225)	11,768,155
Total liabilities	11,347,265	44,975	(10,791,700)	600,538

	Year ended 31 December 2011			
	USA	*UK*	*Intra-segment balances*	*Total*
	$	*$*	*$*	*$*
Revenue from external customers	241,038	–	–	241,038
Gross profit	95,673	–	–	95,673
Operating loss	(261,873)	(80,574)	–	(342,447)
Impairment – expired leases	224,892	–	–	224,892
Depreciation	101,284	–	–	101,284
Capital expenditure	578,593	–	–	578,593
Total assets	2,314,906	4,867,652	(4,620,820)	2,561,738
Total liabilities	1,275,042	340,280	(1,004,912)	610,410

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

5. Segmental information (continued)

A reconciliation of the operating loss to loss before taxation is provided as follows:

	Year ended 31 December 2012 $	*Year ended 31 December 2011 $*
Operating loss for reportable segments	(1,073,609)	(342,447)
Finance costs	(1,569)	–
Loss before tax	(1,075,178)	(342,447)

The amounts provided to the Board of Directors with respect to total assets are measured in a manner consistent with that of the Financial Statements. These assets are allocated based on the operations of the segment and physical location of the asset. Goodwill recognised by the Group is managed centrally and is not considered to be a segmental asset.

Reportable segments' assets are reconciled to total assets as follows:

	Year ended 31 December 2012 $	*Year ended 31 December 2011 $*
Segmental assets for reportable segments	11,768,155	2,561,738
Unallocated: goodwill	372,629	356,216
Total assets per balance sheet	12,140,784	2,917,954

Information about major customers

In the year ended 31 December 2012 revenues of $148,869, $107,570, $85,724 and $84,637 are derived from four external operators. These revenues were all generated in the USA.

In the year ended 31 December 2011 revenues of $94,649 and $30,768 are derived from two external operators. These revenues were all generated in the USA.

6. Group operating loss

	2012 $	*2011 $*
Loss from operating activities is stated after charging/(crediting):		
Auditors' remuneration		
– audit of parent company and consolidated financial statements	16,000	16,044
– other services in relation to accountancy and tax	9,225	8,423
Depreciation	222,033	101,284
Impairment of property, plant and equipment	9,333	–
Impairment of mineral leases	218,525	224,892
Differences due to foreign exchange	263,774	(10,988)

Fees payable to the auditors of $72,196 for work undertaken on the placing at the date of admission to AIM in 2011 have been charged to share premium.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

7. Expenses by nature

Group

	2012 $	2011 $
Directors' fees	331,492	8,186
Consulting fees	292,418	24,350
Legal, professional and compliance costs	127,431	90,762
Differences due to foreign exchange	263,774	(10,988)
Depreciation	182,116	51,113
Other costs	117,742	49,805
Total administrative expenses	1,314,973	213,228

8. Loss per share

The calculation of the basic loss per share of 0.16 cents per share (31 December 2011 loss per share: 0.09 cents) is based on the loss attributable to ordinary shareholders of $1,075,178 (31 December 2011 loss: $342,447) and on the weighted average number of ordinary shares of 691,240,908 (31 December 2011: 363,155,502) in issue during the period.

In accordance with IAS 33, no diluted earnings per share are presented as the effect on the exercise of share options and warrants would be to decrease the loss per share.

Details of share options and warrants that could potentially dilute earnings per share in future periods are set out in Note16.

9. Staff costs

The Group and Company incurred the following staff costs (including Directors):

	Group		Company	
	2012 $	2011 $	2012 $	2011 $
Wages & salaries	340,399	8,186	77,533	(5,314)
Social security costs	22,319	–	10,143	–
Pension costs	7,020	–	–	–
Other benefits	28,496	–	–	–
	398,234	8,186	87,675	(5,314)

Directors' Emoluments

The Directors' emoluments in respect of qualifying services were:

	Group		Company	
	2012 $	2011 $	2012 $	2011 $
Directors' salary and fees	303,733	8,186	77,533	(5,314)
Pension costs	7,020	–	–	–
Other benefits	20,740	–	–	–
	331,492	8,186	77,533	(5,314)

Directors' fees for 2010 and for the period up to AIM admission have been waived. The accrual originally recognised in 2009 was released in 2011.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

9. Staff costs (continued)

Directors' Emoluments (continued)

	2012	*2011*
	$	*$*
J M Cubitt	14,995	1,604
S O Snead	16,900	1,604
R S Harwood	16,900	1,604
G J Burnell	62,538	1,604
R F Whittington	220,159	13,500
Total	331,492	19,916

The average monthly number of staff, including the Directors, during the financial year was as follows:

	Group	
	2012	*2011*
	$	*$*
Administrative and managerial	6	5

10. Taxation

Tax charge for the period

The tax charge for the period is $Nil (2011: $Nil).

Factors affecting the tax charge for the period

The tax charge for each period is explained below:

	2012	*2011*
	$	*$*
Loss for the period before taxation	(1,075,178)	(342,447)
Loss for the period before tax multiplied by the standard rate of UK corporation tax of 24.5% (2011: 26.5%)	(263,419)	(90,748)
Tax losses carried forward - US	181,580	132,198
Tax losses carried forward - UK	81,839	21,352
IFRS adjustments	–	13,778
US tax permanent and timing differences	–	(76,580)
	–	–

The Group has UK tax losses of approximately $574,000 (2011: losses of approximately $225,000) and US tax losses of approximately $1,558,000 (2011: losses of approximately $817,000) available to carry forward against future taxable profits. A potential deferred tax asset of approximately $132,000 (2011: $56,250) on the UK losses and $93,000 (2011: $49,000) on the US losses has not been recognised because of uncertainty over the timing of future taxable profits against which the losses may be offset.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

11. Property, plant and equipment

Group

	Producing properties $	*Drilling costs and equipment* $	*Motor vehicles and office equipment* $	*Total* $
Cost				
At 1 January 2011	323,890	398,606	–	722,496
Additions	–	213,593	–	213,593
Transferred from intangible assets	133,758	–	–	133,758
At 31 December 2011	457,648	612,199	–	1,069,847
Additions	405,015	1,986,889	15,254	2,407,158
Transferred from intangible assets	35,104	364,998	–	400,102
Impairment	(14,000)	–	–	(14,000)
At 31 December 2012	883,767	2,964,086	15,254	3,863,107
Accumulated Depreciation				
At 1 January 2011	47,787	58,801	–	106,588
Charge for the period	50,171	51,113	–	101,284
At 31 December 2011	97,958	109,914	–	207,872
Charge for the period	39,918	179,266	2,850	222,033
Impairment	(4,667)	–	–	(4,667)
At 31 December 2012	133,208	289,180	2,850	425,238
Net Book Amount				
At 1 January 2011	276,103	339,805	–	615,908
At 31 December 2011	359,690	502,285	–	861,975
At 31 December 2012	750,559	2,674,906	12,404	3,437,869

Transfers from intangible assets represent licence areas where production has commenced together with drilling costs associated with these licences.

Depreciation expense of $39,918 (2011: $50,171) has been charged in operating expenses and $182,116 (2011: $51,113) in administrative expenses.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

12. Intangible assets

	Goodwill $	*Drilling costs* $	*Mineral leases* $	*Total* $
Cost				
At 1 January 2011	360,918	–	749,070	1,109,988
Additions	–	364,998	–	364,998
Transferred to property, plant and equipment	–	–	(133,758)	(133,758)
Exchange movements	(4,702)	–	–	(4,702)
Impairment	–	–	(224,892)	(224,892)
At 31 December 2011	356,216	364,998	390,420	1,111,634
Additions	–	710,727	4,980,681	5,691,408
Transferred to property, plant and equipment	–	(364,998)	(35,104)	(400,102)
Exchange movements	16,413	–	–	16,413
Impairment	–	–	(218,525)	(218,525)
As at 31 December 2012	372,629	710,727	5,117,472	6,200,828
Amortisation				
At 1 January 2011, 31 December 2011 and 31 December 2012	–	–	–	–
Net Book Amount				
At 1 January 2011	360,918	–	749,070	1,109,988
At 31 December 2011	356,216	364,998	390,420	1,111,634
At 31 December 2012	372,629	710,727	5,117,472	6,200,828

Impairment review

Drilling costs and mineral leases represent acquired intangible assets with an indefinite useful life and are tested annually for impairment. As disclosed within Accounting Policies, expenditure incurred on the acquisition of mineral leases is capitalised within intangible assets until such time as the exploration phase is complete or commercial reserves have been discovered. Exploration expenditure including drilling costs are capitalised on a well by well basis if the results indicate the existence of a commercially viable level of reserves.

The Directors have undertaken a review to assess whether circumstances exist which could indicate the existence of impairment as follows:

- The Group no longer has title to the mineral lease.
- A decision has been taken by the Board to discontinue exploration due to the absence of a commercial level of reserves.
- Sufficient data exists to indicate that the costs incurred will not be fully recovered from future development and participation.
- The lease has expired.

Following their assessment the Directors recognised an impairment charge to the cost of mineral leases and producing properties of $218,525 (2011 – $224,892) in respect of expired mineral leases.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

12. Intangible assets (continued)

Impairment review (continued)

The Directors believe that no impairment is necessary on the carrying value of goodwill. Goodwill arose on the reverse acquisition of Magnolia Petroleum Plc. The goodwill represents the value of the parent company being an AIM listed entity to Magnolia Petroleum Inc.

13. Investments

Investments in subsidiaries

Company

	2012	*2011*
	$	*$*
Shares in group undertakings		
At 1 January	3,615,907	3,662,897
Exchange movements	166,618	(46,990)
At 31 December	3,782,525	3,615,907

Investments in group undertakings are recorded at cost, which is the fair value of the consideration paid.

Principal subsidiaries

Name	*Country of incorporation and residence*	*Nature of business*	*Registered capital*	*Proportion of equity shares held by Company*
Magnolia Petroleum Inc.	United States of America	Oil and gas exploration	Ordinary shares US$1	100%

This subsidiary undertaking is included in the consolidation. The proportion of the voting rights in the subsidiary undertaking held directly by the Parent Company does not differ from the proportion of ordinary shares held.

14. Trade and other receivables

	Group		*Company*	
	2012	*2011*	*2012*	*2011*
	$	*$*	*$*	*$*
Trade receivables	85,715	16,820	–	–
Other receivables	68,145	47,670	4,538	47,227
Amounts due from Group undertakings	–	–	10,791,701	1,004,912
Prepayments	55,076	5,818	13,551	5,818
	208,936	70,308	10,809,790	1,057,957

Trade receivables comprise customer receivables in credit. The Group retains all risks associated with these receivables until fully recovered.

As at 31 December 2012, trade receivables of $85,715 (2011: $16,820) were fully performing.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

14. Trade and other receivables (continued)

Group

The carrying amounts of the Group's trade and other receivables are denominated in the following currencies:

	2012	*2011*
	$	*$*
UK Pounds	190,847	53,044
US Dollar	18,089	17,264
	208,936	70,308

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Group does not hold any collateral as security.

Company

The carrying amounts of the Company's trade and other receivables are denominated in UK pound sterling.

15. Cash and cash equivalents

	Group		*Company*	
	2012	*2011*	*2012*	*2011*
	$	*$*	*$*	*$*
Cash at bank	2,293,151	874,037	103,919	193,788
Cash and cash equivalents	2,293,151	874,037	103,919	193,788

At 31 December 2012, the Group held cash of $103,919 in a bank with a Fitch credit rating of A (Stable) and $2,189,232 in a bank where no Fitch credit rating is available.

At 31 December 2011, the Group held cash of $193,788 in a bank with a Fitch credit rating of A (Stable) and $680,249 in a bank with a credit rating of AA-minus.

16. Share capital and premium

	Ordinary shares			*Share Premium*	
	Number	*Nominal value*	*Nominal value*	*Nominal value*	*Nominal value*
		£	*$*	*£*	*$*
At 1 January 2012 – shares of 0.1p each	559,220,261	559,220	926,128	1,292,073	2,218,877
Issued in the year	291,452,590	291,453	464,116	6,051,917	9,669,840
At 31 December 2012 – shares of 0.1p each	850,672,851	850,673	1,390,244	7,343,990	11,888,717

On 20 January 2012, 4,545,455 share warrants over ordinary shares of 0.1p each were exercised for a total consideration of $38,930 (£25,000).

On 27 January 2012, 4,999,999 share warrants over ordinary shares of 0.1p each were exercised for a total consideration of $43,414 (£27,500).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

16. Share capital and premium (continued)

On 9 March 2012, the Group raised approximately \$2.05 million (£1.30 million) before expenses via a placing of 100,115,270 new ordinary shares at a price of 1.3p per share.

On 18 June 2012, the Group raised approximately \$887,898 (£565,000) before expenses via a placing of 26,588,235 new ordinary shares at a price of 2.125p per share.

On 9 August 2012 the Company signed an Equity Finance Facility ("EFF") with Darwin Strategic Limited ("Darwin") whereby Darwin has agreed to invest up to £10,000,000 in the Company through the subscription of ordinary shares. The Company can draw on the facility at any time during a three year period, subject to certain limited restrictions. The subscription price for any ordinary shares to be subscribed by Darwin will be at a 5% discount to the average of the three lowest closing bid prices over the 15 days following the subscription notice. Broker's fees of 2% of the gross amount are payable on each completed draw down.

On 11 September 2012, the Group raised approximately \$1.22 million (£761,000) before expenses via a placing of 33,823,529 new ordinary shares at a price of 2.25p per share.

On 5 October 2012, the Group raised approximately \$2.02 million (£1.25 million) before expenses via a placing of 52,222,208 new ordinary shares at a price of 2.40p per share.

On 4 December 2012, the Group raised approximately \$3.03 million (£1.9 million) before expenses via a placing of 39,850,000 new ordinary shares at a price of 4.733p per share.

On 4 December 2012, the Group raised approximately \$1.57 million (£980,000) before expenses via a placing of 23,307,894 new ordinary shares at a price of 4.2p per share.

On 27 December 2012, 6,000,000 share warrants over ordinary shares of 0.1p each were exercised for a total consideration of \$266,211 (£165,000).

Of the 291,452,590 shares issued during the year 291,452,590 held voting rights.

Issue costs of \$994,537 (£620,023) have been netted off against share premium in the year.

	Number of shares	*Ordinary shares $*	*Share premium $*	*Total $*
At 1 January 2011	341,038,441	587,336	1,347,983	1,935,319
Placing shares	218,181,820	338,792	1,524,567	1,863,359
Issue costs	–	–	(653,673)	(653,673)
At 31 December 2011	559,220,261	926,128	2,218,877	3,145,005

	Number of shares	*Ordinary shares $*	*Share premium $*	*Total $*
At 1 January 2012	559,220,261	926,128	2,218,877	3,145,005
Placing shares	275,907,136	439,464	10,340,474	10,779,938
Exercise of warrants	15,545,454	24,652	323,903	348,555
Issue costs	–	–	(994,537)	(994,537)
At 31 December 2012	850,672,851	1,390,244	11,888,717	13,278,961

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

16. Share capital and premium (continued)

Under reverse acquisition accounting, the equity structure appearing in the consolidated Financial Statements reflects the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the combination.

Share options and warrants

Share options and warrants outstanding and exercisable at the end of the year have the following expiry dates and exercise prices:

Expiry date	*Exercise price in pence per share*	*No. Options/warrants 2012*	*2011*
25 November 2016	0.55	–	9,545,454
25 November 2018	1.30	52,820,768	52,820,768
		52,820,768	62,366,222

The options and warrants are exercisable starting immediately from the date of grant. The Company and Group have no legal or constructive obligation to settle or repurchase the warrants or options in cash.

	Year ended 31 December 2012		*Year ended 31 December 2011*	
	No. of options and warrants	*Weighted average exercise price (in pence)*	*No. of options and warrants*	*Weighted average exercise price (in pence)*
Outstanding at beginning of year	62,366,222	1.19	63,801,527	1.42
Granted during the year	12,000,000	2.75	9,545,454	0.55
Exercised during year	(15,545,454)	1.40	–	–
Cancelled in the year	(6,000,000)	2.75	–	–
Expired during the year	–	–	(10,980,759)	2.00
Outstanding at end of year	52,820,768	1.3	62,366,222	1.19
Exercisable at end of year	52,820,768	1.3	62,366,222	1.19

The warrants and options outstanding at 31 December 2012 had a weighted average remaining contractual life of 5.87 years (2011: 6.57 years).

On 20 January 2012, 4,545,455 share warrants over ordinary shares of 0.1p each were exercised for a total consideration of $38,930 (£25,000).

On 27 January 2012, 4,999,999 share warrants over ordinary shares of 0.1p each were exercised for a total consideration of $43,414 (£27,500).

On 12 July 2012, 12,000,000 share warrants over ordinary shares of 0.01p each were granted with an exercise price of 2.75p each. Subsequently, on 27 December 2012, 6,000,000 of these share warrants were exercised for a total consideration of $266,211 (£165,000). The remaining 6,000,000 warrants were cancelled as part of a cashless exchange provision.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

17. Trade and other payables

	Group		Company	
	2012	*2011*	*2012*	*2011*
	$	*$*	*$*	*$*
Non-current				
Trade and other payables	–	278,431	–	243,431
	–	278,431	–	243,431

	Group		Company	
	2012	*2011*	*2012*	*2011*
	$	*$*	*$*	*$*
Current				
Trade and other payables	555,563	227,907	–	41,604
Social security and other taxes	–	122	–	122
Accrued expenses	44,975	103,950	44,975	55,123
	600,538	331,979	44,975	96,849

18. Treasury policy and financial instruments

The Company and Group operate informal treasury policies which include ongoing assessments of interest rate management and borrowing policy. The Board approves all decisions on treasury policy.

The Company has financed its activities by the raising of funds through the placing of shares. There are no material differences between the book value and fair value of the financial assets.

19. Capital management policies

The Group and Company's capital management objectives are:

- to ensure the Group's and Company's ability to continue as a going concern; and
- to provide an adequate return to shareholders.

The Group and Company monitor capital on the basis of the carrying amount of equity less cash and cash equivalents as presented on the face of the Statement of Financial Position.

Although the Group and Company are not constrained by any externally imposed capital requirements, its goal is to maximise their capital-to-overall financing structure ratio.

The Group and Company set the amount of capital in proportion to its overall financing structure and manage their capital structure and make adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets.

20. Capital commitments

The Group has capital commitments for drilling and equipment costs contracted but not provided for of approximately $691,275 (2011:$433,000) at the Statement of Financial Position date.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2012

21. Related party transactions

Transactions with Group undertakings

During the year ended 31 December 2012 the Company charged management fees of $68,960 (2011: $17,632) to Magnolia Petroleum Inc, the Company's wholly owned subsidiary for the provision of administrative and management services. $68,690 (2011: $17,632) in relation to these fees was outstanding at the balance sheet date and is included within Trade and other receivables. As at 31 December 2012, the amount due to the Company from Magnolia Petroleum Inc was $10,791,701 (2011: $1,004,912).

All Group transactions were eliminated on consolidation.

Transactions with Enerlex Inc

Steven Snead and his wife have a 100% interest in the issued share capital of Enerlex Inc. ("Enerlex"). Under the Enerlex Services Agreement dated 23 October 2009, Enerlex agreed to provide executives, staff, premises and business services to Magnolia Petroleum Inc. to enable it to acquire, manage and develop its drilling and working interests business. In addition, Enerlex provided 50 per cent of the working time of Steven Snead as Chief Executive Officer, of Rita Whittington as Operations Manager and of Ronald Harwood as Chairman and Chief Financial Officer, as well as the use of other unnamed personnel required for the performance of the above services. The Enerlex Services Agreement ran for a fixed period of one year and was renewable in the twelfth month of each year for a further year by agreement.

A Services Termination Agreement dated 15 November 2011 between Enerlex, Magnolia Petroleum Inc and the Company terminated the Enerlex Services Agreement with effect from 31 October 2011. A rental agreement between Enerlex and Magnolia Petroleum Inc was signed on 15 November 2011 whereby Enerlex agreed to provide Magnolia Petroleum Inc on a month to month basis with office premises and services for $2,500 per month. A charge of $30,000 (2011: $2,500) was recognised during the year under this agreement.

At 31 December 2011 accrued interest of $26,143 was due to Enerlex in relation to a loan granted to the Company which was paid in full during the year.

Enerlex gave an undertaking to Magnolia Petroleum Inc dated 15 November 2011 whereby Enerlex undertakes that if any of the leases granted to Magnolia Petroleum Inc on any of the mineral interests in the Woodford/Hunton play in Oklahoma expires at the end of the primary period because of non-drilling, Enerlex will at Magnolia Petroleum Inc's request grant a further three year lease on the same terms as the expired lease.

During 2012 a motor vehicle was purchased from Enerlex for a cost of $15,000 and loan of $35,000 was repaid to Enerlex.

Other Transactions

At 31 December 2012 the total accrued remuneration to Directors was $nil (2011: $18,137).

Under the Deferral Amendment Agreement dated 15 November 2011, all Directors agreed to waive their services fees up to the date of AIM admission.

22. Ultimate Controlling party

As at the Statement of Financial Position date, the Directors do not consider there is an ultimate controlling party.

23. Events after the reporting period

On 24 January 2013 1,754,386 options were granted to an employee with an exercise price of 2.85p. The options vest after 12 months and are exercisable for a period of 5 years from grant.

On 29 January 2013 20,338,982 options were granted to Directors with an exercise price of 2.925p exercisable for a period of 7 years.

NOTICE OF ANNUAL GENERAL MEETING

Notice is given that the Annual General Meeting of Magnolia Petroleum plc ("the Company") will be held at 10.00 a.m. on 5 June 2013 at 18452 E 111th, Broken Arrow, Oklahoma, OK74011, USA to consider and, if thought fit, pass the following resolutions, of which resolutions 1 to 6 will be proposed as ordinary resolutions and resolutions 6 and 7 as special resolutions:

1. To receive the directors' report and audited financial statements of the Company for the year ended 31 December 2012.

2. To re-elect John Cubitt as a director of the Company.

3. To re-elect Ronald Harwood as a director of the Company.

4. To re-elect Rita Whittington as a director of the Company.

5. To re-appoint Littlejohn LLP as auditors of the Company and to authorise the directors to set their fees.

6. THAT, in substitution for any existing authority the directors be and they are hereby generally and unconditionally authorised under section 551 of the Companies Act 2006 to exercise all the powers of the Company to allot shares in the Company or grant rights to subscribe for or to convert any security into shares in the Company ("Rights") within the meaning of that section on and subject to such terms as the directors may determine up to an aggregate nominal amount of £425,000 such authority unless previously renewed, revoked or varied to expire at the end of next year's AGM on 30 June 2014 save that the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities under such an offer or agreement as if the authority conferred hereby had not expired.

7. THAT, subject to the passing of Resolution 6 above, the directors be and are hereby empowered under section 570 of the Companies Act 2006 ("the Act") to allot equity securities (within the meaning of section 560 of the Act) for cash under the general authority already given as if sub-section 561(1) of the Act did not apply to any such allotment, provided that this power shall be limited to:

   (a) the allotment of equity securities in connection with an offer of such securities to holders of ordinary shares where the equity securities for which ordinary shares are respectively entitled to subscribe are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them, but subject to such exclusions or other arrangements as the directors may deem necessary or expedient in relation to fractional entitlements or any legal or practical problems under the laws of any overseas territory or the requirements of any regulatory body or stock exchange; and

   (b) the allotment (otherwise than under sub-paragraph (a) above) of equity securities up to an aggregate nominal value of £425,000;

   and so that such power (unless previously revoked or varied) shall expire at the end of next year's annual general meeting, (or if earlier at the close of business on 30 June 2014) provided that the directors may, before the power expires, make an offer or enter into an agreement which would or might require equity securities to be allotted after such power expires.

8. THAT, the Company be generally and unconditionally authorised to make market purchases (as defined in the Companies Act 2006) of ordinary shares of 0.1p each in the capital of the Company ("ordinary shares") on such terms and in such manner as the directors may from time to time determine, provided that:

   (a) the maximum number of ordinary shares authorised to be purchased shall be 127,600,000;

   (b) the minimum price which may be paid for an ordinary share is 0.1p;

   (c) the maximum price which may be paid for an ordinary share is an amount equal to 105 per cent of the average of the middle market quotations for an ordinary share (as derived from the Daily

NOTICE OF ANNUAL GENERAL MEETING (continued)

Official List) for the five business days immediately preceding the date on which the ordinary share is contracted to be purchased;

(d) the minimum and maximum prices per ordinary share referred to in sub-paragraphs (b) and (c) of this resolution are in each case exclusive of any expenses payable by the Company;

(e) the authority conferred by this resolution shall expire at the end of next year's annual general meeting (or if earlier at the close of business on 30 June 2014) unless such authority is varied, revoked or renewed prior to such time by the Company in general meeting; and

(f) the Company may make a contract to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be completed wholly or partly after the expiration of such authority.

By Order of the Board

S Salter
Secretary

Registered Office:

The Fitzpatrick Building
188-194 York Way
London N7 9AS
United Kingdom

Dated 2013

Notes:

1. Right to attend, speak and vote

If you want to attend, speak and vote at the AGM you must be on the Company's register of members at 6pm on 3 June 2013. This will allow us to confirm how many votes you have on a poll. Changes to the entries in the register of members after that time, or, if the AGM is adjourned, 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend, speak or vote at the AGM.

2. Appointment of proxies

If you are a member of the Company you may appoint one or more proxies to exercise all or any of your rights to attend, speak and vote at the meeting. You may only appoint a proxy using the procedures set out in these notes and in the notes on the proxy form, which you should have received with this notice of meeting.

A proxy does not need to be a member of the Company but must attend the meeting to represent you. Details of how to appoint the Chairman of the meeting or another person as your proxy using the proxy form are set out in the notes on the form. If you wish your proxy to speak on your behalf at the meeting you will need to appoint your own choice of proxy (not the Chairman) and give your instructions directly to them.

You may appoint more than one proxy in relation to the AGM provided that each proxy is appointed to exercise the rights attached to a different share or shares which you hold. If you wish to appoint more than one proxy you may photocopy the proxy form or alternatively you may contact the Company's registrars, Share Registrars Limited on 01252 821 390.

3. Appointment of proxy using hard copy proxy form

The notes to the proxy form explain how to direct your proxy how to vote on each resolution or withhold their vote. A vote withheld is not a vote in law, which means that the vote will not be counted in the calculation of votes for or against the resolution. If you do not indicate on the proxy form how your proxy should vote, they will vote or abstain from voting at their discretion. They will also vote (or abstain from voting) at they think fit in relation to any other matter which is put before the meeting.

To appoint a proxy using the proxy form, the form must be completed and signed and received by Share Registrars Limited no later than 48 hours before the meeting. Any proxy forms (including any amended proxy appointments) received after the deadline will be disregarded.

The completed form may be returned by any of the following methods:

- Sending or delivering it to Share Registrars Limited at Suite E, First Floor, 9 Lion and Lamb Yard, Farnham, Surrey GU9 7LL
- Sending it by fax to 01252 719 232
- Scanning it and sending it by email to proxies@shareregistrars.uk.com;

If the shareholder is a company, the proxy form must be executed under its common seal or signed on its behalf by an officer or attorney. Any power of attorney or any other authority under which the proxy form is signed (or a duly certified copy of such power or authority) must be included with the proxy form.

4. Appointment of proxy by joint members

In the case of joint holders, where more than one joint holder purports to appoint a proxy, only the appointment submitted by the most senior holder will be accepted. Seniority is determined by the order in which the names of the joint holders appear in the Company's register of members in respect of the joint holding (the first-named being the most senior).

NOTICE OF ANNUAL GENERAL MEETING (continued)

5. Changing your instructions

To change your proxy instructions simply submit a new proxy appointment using the methods set out above. The amended instructions must be received by the registrars by the same cut-off time noted above. Where you have appointed a proxy using a hard copy proxy form and would like to change the instructions using another hard copy proxy form, please contact Share Registrars Limited on 01252 821 390. If you submit more than one valid proxy form, the one received last before the latest time for the receipt of proxies will take precedence.

6. Termination of proxy appointments

In order to revoke a proxy instruction you will need to inform the Company by sending a signed hard copy notice clearly stating your intention to revoke your proxy appointment to Share Registrars Limited at Suite E, First Floor, 9 Lion and Lamb Yard, Farnham, Surrey GU9 7LL. Alternatively you may send the notice by fax to 01252 719 232. In the case of a member which is a company, the revocation notice must be executed under its common seal or signed on its behalf by an officer or attorney. Any power of attorney or any other authority under which the revocation notice is signed (or a duly certified copy of such power or authority) must be included with the revocation notice.

In either case, your revocation notice must be received by Share Registrars Limited no later than 48 hours before the meeting. If your revocation is received after the deadline, your proxy appointment will remain valid. However, the appointment of a proxy does not prevent you from attending the meeting and voting in person. If you have appointed a proxy and attend the meeting in person, your proxy appointment will automatically be terminated.

7. Communications with the Company

Except as provided above, members who have general queries about the meeting should telephone Share Registrars on 01252 821 390 (no other methods of communication will be accepted). You may not use any electronic address provided either in this notice of general meeting; or any related documents (including the Chairman's letter and proxy form), to communicate with the Company for any purposes other than those expressly stated.

8. Issued shares and total voting rights

As at 5.00 p.m. on the day immediately prior to the date of posting of this notice of AGM, the Company's issued share capital comprised 850,672,851 ordinary shares of 0.1p each. Each ordinary share carries the right to one vote at a general meeting of the Company and, therefore, the total number of voting rights in the Company at that time was 850,672,851.

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