



**Financial Statements of
Heritage Oil Limited**

Period ended 31 December 2008
(All dollars are US\$ unless otherwise stated)

Heritage Oil Limited (the "Company") was incorporated under the Companies (Jersey) Law 1991 on February 6, 2008.

Directors

Michael J. Hibberd	appointed 18 March 2008
Anthony Buckingham	appointed 25 February 2008
Paul Atherton	appointed 6 February 2008
Salim Hassan Macki	appointed 12 August 2008
General Sir Michael Wilkes KCB, CBE	appointed 18 March 2008
Gregory Turnbull	appointed 18 March 2008
John McLeod	appointed 18 March 2008

Company Secretary and Registered Office

Woodbourne Secretaries (Jersey) Limited
Ordnance House
31 Pier Road
St Helier
Jersey JE4 8PW
Channel Islands

Status of Financial Statements and Directors' Responsibilities Statement

The attached financial statements are the unconsolidated financial statements of Heritage Oil Limited (the "Company") for the period from 6 February 2008 (the date of incorporation) to 31 December 2008.

The Company has separately published its Annual Report & Accounts 2008 which includes an Operations Review, Financial Review, Directors' Report, Remuneration Report and the Company's consolidated financial statements for the year ended 31 December 2008.

These financial statements should be read in conjunction with Heritage Oil Limited's Annual Report & Accounts 2008.

The Directors are responsible for preparing 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 they have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and applicable law.

The financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position of the Company and the performance for that period.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance;
- make judgements and estimates which are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, it is inappropriate to presume the Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies (Jersey) Law 1991. They have general responsibility for taking such steps as are reasonably open to them for safeguarding the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the statutory and audited information on the Company's website. Jersey legislation, governing the preparation and dissemination of financial statements, may differ from requirements in other jurisdictions.

Independent Auditors' Report to the Members of Heritage Oil Limited

We have audited the unconsolidated financial statements of Heritage Oil Limited for the period ended 31 December 2008 which comprise the income statement, statement of recognised income and expense, balance sheet, cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

We have separately reported on the consolidated financial statements of Heritage Oil Limited for the year ended 31 December 2008.

This report is made solely to the Company's members, as a body, in accordance with Article 110 of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Status of Financial Statements and Directors' Responsibilities Statement on page 1, the Company's Directors are responsible for preparation of the financial statements in accordance with applicable law and International Financial Reporting Standards as adopted by the European Union.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies (Jersey) Law 1991. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the financial statements of Heritage Oil Limited give a true and fair view, in accordance with International Financial Reporting Standards as adopted by the European Union, of the state of the Company's affairs as at 31 December 2008 and of its loss for the period then ended; and
- the financial statements have been properly prepared in accordance with the Companies (Jersey) Law 1991.

KPMG Audit Plc Chartered Accountants

8 Salisbury Square
London EC4Y 8BB
United Kingdom
18 May 2009

Heritage Oil Limited

Income Statement

Period from incorporation (6 February 2008) to 31 December 2008

	2008 \$
Expenses	
General and administrative	(10,063,486)
Depreciation (note 7)	(2,451)
Operating loss	(10,065,937)
Finance income	
Foreign exchange loss	(409,640)
Interest income	49,952
	(359,688)
Net loss for the period	(10,425,625)

Statement of Recognised Income and Expense

Period from incorporation (6 February 2008) to 31 December 2008

	2008 \$
Net loss for the period	(10,425,625)
Total recognised loss for the period	(10,425,625)

The notes are an integral part of these financial statements.

Heritage Oil Limited

Balance Sheet

As at 31 December 2008

31 December 2008
\$

ASSETS

Non-current assets

Investments in subsidiaries (note 6)	218,775,078
Property, plant and equipment (note 7)	10,620
	<hr/>
	218,785,698

Current assets

Prepaid expenses	61,922
Cash and cash equivalents (note 8)	2,051,161
	<hr/>
	2,113,083
	<hr/>
	220,898,781

LIABILITIES

Current liabilities

Payables to subsidiaries	5,202,996
Trade and other payables (note 9)	1,192,969
	<hr/>
	6,395,965

Net Assets

214,502,816

SHAREHOLDERS' EQUITY

Share capital (note 10)	215,509,055
Reserves (note 11)	9,419,386
Retained deficit (note 11)	(10,425,625)
	<hr/>
	214,502,816

The notes are an integral part of these financial statements.

Heritage Oil Limited

Cash Flow Statement

Period from incorporation (6 February 2008) to 31 December 2008

	2008 \$
Cash provided by (used in) Operating Activities	
Net loss from operations for the period	(10,425,625)
Items not affecting cash	
Depreciation	2,451
Share-based compensation	5,944,629
Increase in prepaid expenses	(61,922)
Increase in trade and other payables and payables to subsidiaries	6,395,965
	<u>1,855,498</u>
Investing Activities	
Property, plant and equipment expenditures	(13,071)
	<u>(13,071)</u>
Financing Activities	
Shares issued for cash	208,734
	<u>208,734</u>
Increase in cash and cash equivalents	2,051,161
Cash and cash equivalents – beginning of period	–
Cash and cash equivalents – end of period	<u>2,051,161</u>
Supplementary information	
The following have been included within cash flows for the period under operating activities	
Interest received	49,952
Interest paid	–

The notes are an integral part of these financial statements.

Notes to Financial Statements

1 Reporting Entity

Heritage Oil Limited (the "Company") was incorporated under the Companies (Jersey) Law 1991 (as amended) on 6 February 2008. Its primary business is to hold the investments in the subsidiaries of the Company. The Company was established in order to implement a corporate reorganisation of Heritage Oil Corporation ("HOC", the "Corporation").

On 24 March 2008, HOC entered into a corporate reorganisation (the "Reorganisation") which resulted in the Company becoming the parent company of HOC and its subsidiaries. The Company's corporate head office is now located in the Channel Islands. In connection with the Reorganisation, the Company listed its Ordinary Shares ("Ordinary Shares") on the Official List of the United Kingdom Listing Authority (the "UKLA") and trades on the Main Market of the London Stock Exchange plc (the "LSE") (collectively, "Admission"). HOC delisted its existing Common Shares ("Heritage Shares") from the Toronto Stock Exchange (the "TSX") and obtained a listing for a new class of Exchangeable Shares (the "Exchangeable Shares") on the TSX. As part of the Reorganisation, implemented by way of a court-approved plan of arrangement (the "Arrangement") under the Business Corporations Act (Alberta), HOC split its stock such that each existing HOC Share was exchanged for either ten Ordinary Shares or ten Exchangeable Shares in accordance with the terms of the Arrangement.

On 2 April 2008, HOC and the Company collectively, together with their subsidiaries and affiliates, announced that Articles of Arrangement implementing the previously announced Arrangement involving HOC and the Company had been filed with the Registrar of Corporations for the Province of Alberta with an effective date of 31 March 2008. As a result, former holders of Common Shares of HOC were entitled to either ten Ordinary Shares of the Company or ten Exchangeable Shares of HOC for each Common Share held depending on the elections previously made by such shareholders. Effective at the opening of business on 3 April 2008, the Exchangeable Shares were listed and posted for trading in substitution for the previously listed Common Shares of HOC which were delisted at that time. The Exchangeable Shares were also admitted to trading on the Main Market of the LSE on 2 April 2008. Trading of Ordinary Shares commenced on the LSE on 31 March 2008.

The Exchangeable Shares are designed to have rights as near as possible equivalent to the Ordinary Shares of the Company. Each Exchangeable Share is exchangeable on a one-for-one basis for an Ordinary Share. The holders of Exchangeable Shares are entitled to Voting Rights equivalent to Ordinary Shares through the Special Voting Share (see below). Dividends to Ordinary Shareholders can only be declared or paid simultaneously with the declaration or payment of an identical dividend to Exchangeable Shareholders. On liquidation, dissolution or winding-up of HOC, the Exchangeable Shareholders will be given one Ordinary Share per Exchangeable Share held.

The Company has issued one Special Voting Share. The Special Voting Share has the number of votes, which may be cast at any meeting at which holders of Ordinary Shares are entitled to vote, equal to the number of Exchangeable Shares of HOC outstanding at the relevant time. The holders of Exchangeable shares are entitled to Voting Rights through the Special Voting Share held by the trustee of the Voting and Exchange Trust by the Company, and have the right to receive notice of, speak and vote at the general meetings of the Company (on the basis of one vote for every Exchangeable Share) on the same basis as if they had exchanged their Exchangeable Shares for Ordinary Shares.

In connection with this Reorganisation the Company has agreed that the 2007 convertible bonds outstanding were convertible into Ordinary Shares of the Company rather than Common Shares of HOC.

The Company's financial statements are presented in US dollars, which is the Company's functional and presentation currency.

The Company and its subsidiaries are collectively referred to as the Group.

The financial statements were approved by the Board and authorised for issuance on 18 May 2009.

2 Significant Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below.

a) Basis of Preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value.

Based on the Group's current plans and knowledge, its projected capital expenditure and operating cash requirements, the Group has sufficient cash to finance its operations for more than 12 months from the date of this report. The Company raises financing for its activities from time to time using a variety of sources. Sources of funding for future exploration and development programmes will be derived from, *inter alia*, new credit facilities, reinvesting funds from operations, using existing treasury resources, disposal proceeds from the sale of non-core assets, farm-outs and,

Notes to Financial Statements continued

2 Significant Accounting Policies continued

when considered appropriate, issuing debt and additional equity. Accordingly, the Company has a number of different sources of finance available and the Directors are confident that additional finance will be raised as and when needed.

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

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 Company's accounting policies.

b) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value. The assets' useful lives and residual values are assessed on an annual basis. Corporate capital assets are depreciated on a straight-line basis over their estimated useful life.

c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are stated at amortised cost using the effective interest rate method.

d) Investments in subsidiaries

Investments in subsidiaries are initially recorded at the fair value of consideration given unless the investment results from a transfer from an entity under common control in which case it is recorded at the book value of the investment in that company's accounts immediately prior to transfer. The cost of the investments is reduced due to any impairment.

e) Trade and Other Payables

These amounts represent liabilities for goods and services provided to the Company prior to the end of the financial year which are unpaid.

f) Foreign Currency Translation

The Company's financial statements are presented in US dollars, which is the Company's functional and presentation currency.

Foreign currency transactions are translated into US dollars using the exchange rates prevailing at the dates of the transactions. 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 income statement.

g) Share-based Compensation Plans

The Company applies the fair value method of accounting to all equity classified share-based compensation arrangements for both employees and non-employees. Compensation cost of equity classified awards to employees are measured at fair value of the awards at the time when the services are rendered at the grant date and recognised over the periods during which the employees become unconditionally entitled to the options. The compensation cost is charged to the income statement with a corresponding increase in equity. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

The compensation cost of equity classified awards to non-employees is initially measured at fair value, and periodically remeasured to fair value until the non-employees' performance is complete, and recognised over their vesting period with a corresponding increase to share-based payment reserve. Fair value of share-based payments granted to the employees of the subsidiaries is charged to investments in subsidiaries with a corresponding increase to share-based payment reserve. Upon the exercise of the award, consideration received is recognised in equity.

h) Share Capital

Ordinary Shares are classified as share capital and are initially recorded at the fair value of consideration received unless the shares are issued in exchange for shares of an entity under common control in which case the shares are recorded at the book value of the shares transferred in that company's accounts immediately prior to transfer. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

If the Company re-acquires its own equity instruments the cost is deducted from equity and the associated shares are cancelled.

i) Earnings per Share

Earnings per share is disclosed in separately published Annual Report & Accounts 2008 of the Company, which includes the consolidated financial statements for the year ended 31 December 2008.

Notes to Financial Statements continued

2 Significant Accounting Policies continued

j) *New Accounting Standards and Interpretations*

Certain new accounting standards and interpretations have been published that are not mandatory for the year ended 31 December 2008. The Company's assessment of the impact of these new standards and interpretations which have not been adopted is set out below.

- i) IFRS 8, "Operating segments" (effective from 1 January 2009), replaces International Accounting Standard ("IAS") 14 and aligns segment reporting with the requirements of the US standard Statement of Financial Accounting Standards ("SFAS") 131, "Disclosures about segments of an enterprise and related information". The new standard requires a "management approach", under which segment information is presented on the same basis as that used for internal reporting purposes. The expected impact is still being assessed by management, but is expected to only impact the disclosures of the Company.

The following standard is assessed not to have any impact on the Company's financial statements:

- i) IAS 23 (Amendment), "Borrowing costs" (effective from 1 January 2009), requires the Company to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The Company does not have borrowing costs, and therefore this standard is not applicable to the Company.

The following amendments have been published, but have not been applied in these financial statements:

- i) IFRS 2 (Amendment), Share-based payment-Vesting Conditions and Cancellations: effective for accounting periods commencing on or after 1 January 2009;
- ii) IFRS 3 (Amendment) Business Combinations: effective for accounting periods commencing on or after 1 July 2009;
- iii) IAS 1 (Amendment), Presentation of Financial Statements: effective for accounting periods commencing on or after 1 January 2009; and
- iv) IAS 27 (Amendment), Consolidated and Separate Financial Statements: effective for accounting periods commencing on or after 1 July 2009.

The Directors do not anticipate that the adoption of these amendments will have a material impact on the Company's financial statements in the period of initial application.

3 Risk Management

The Company's activities expose it to a variety of financial risks. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

a) *Financial Risk Management*

i) *Foreign Exchange Risk*

Foreign exchange risk arises when transactions and recognised assets and liabilities of the Company are denominated in a currency that is not the Company's functional currency. The Company is exposed to foreign exchange risk arising from currency exposures to the US dollar.

There are no forward exchange rate contracts in place at, or subsequent to, 31 December 2008.

At 31 December 2008, if the Pounds Sterling had strengthened/weakened by 10% against the US dollar with all other variables held constant, the loss for the period would have been \$40,964 lower/(higher), mainly as a result of foreign exchange gains/losses on translation of Pounds Sterling denominated cash at bank.

ii) *Liquidity Risk*

Liquidity risk is the risk that the Company will not have sufficient funds to meet liabilities. Cash forecasts identifying liquidity requirements of the Company are produced quarterly. These are reviewed regularly to ensure sufficient funds exist to finance the Company's current operational and investment cash flow requirements.

Management monitors rolling forecasts of the Company's cash position on the basis of expected cash flow.

The Company had available cash of \$2 million at 31 December 2008. The Company and its subsidiaries had cash of approximately \$91 million at 31 December 2008, as disclosed in the consolidated financial statements for the year ended 31 December 2008. Based on its current plans and knowledge, its projected capital expenditure and operating cash requirements, the Company has sufficient cash to finance its operations for more than 12 months from the date of this report.

The Company's financial liabilities consist of trade and other payables and payables to subsidiaries. Trade and other payables and payables to subsidiaries are due within 12 months.

Notes to Financial Statements continued

3 Risk Management continued

b) Capital Risk Management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In accordance with the terms of the convertible bonds, the Company shall not, over the life of the convertible bonds (note 10), make any dividend payment or share repurchase.

The Company monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including "trade and other payables" and "payables to subsidiaries" as shown in the balance sheet) less cash and cash equivalents. Total capital is calculated as "equity" as shown in the balance sheet plus net debt.

	As at 31 December 2008
	\$
Total borrowings	6,395,965
Less cash and cash equivalents (note 8)	(2,051,161)
Net debt	4,344,804
Total equity	214,502,816
Total capital	218,847,620
Gearing ratio	2%

4 Income Tax Expense

In Jersey the tax rate applicable to Company's operations is nil.

5 Staff Costs

The Company employed two employees (including the Executive Directors: CEO and CFO) during the period ended 31 December 2008.

The aggregate compensation expenses of CEO and CFO were as follows:

	Period ended
	31 December 2008
	\$
Base packages and other short-term benefits	2,949,514
Share-based compensation	5,324,062
	8,273,576

Non-Executive Directors' emoluments were \$623,788.

6 Investments in Subsidiaries

	Investments in subsidiaries
	\$
Cost	
On Reorganisation (note 1)	214,147,903
Exchange of Exchangeable Shares of a subsidiary for Ordinary Shares	1,009,470
Other additions	3,617,705
At 31 December 2008	218,775,078

7 Property, Plant and Equipment

	As at 31 December 2008
	\$
Office assets – additions during the period	13,071
Property, plant and equipment, at cost	13,071
Accumulated depreciation – charge for the period	(2,451)
Net book amount	10,620

Notes to Financial Statements continued

8 Cash and Cash Equivalents

	2008 \$
Cash at bank and in hand	2,051,161

Cash at bank and in hand includes cash held in interest-bearing accounts.

9 Trade and Other Payables Due Within One Year

	2008 \$
Trade and other payables	1,192,969
	1,192,969

Trade and other payables comprise current amounts outstanding for trade purchases and ongoing costs. The carrying amount of trade and other payables approximates to their fair value.

10 Share Capital

The Company was incorporated under the Companies (Jersey) Law 1991 (as amended) on 6 February 2008. The Company's authorised share capital is an unlimited number of Ordinary Shares without par value. At incorporation, one Ordinary Share was issued in exchange for cash of \$42. On 22 February 2008, a second Ordinary Share was issued for cash of \$41.

As part of the Reorganisation (note 1), the Corporation split its stock such that each existing Common Share of the Corporation was exchanged for either ten Ordinary Shares or ten Exchangeable Shares. The estimated fair value of the share capital of the Corporation at the date of the Reorganisation was approximately \$1.3 billion, based on the market value of Common Shares of the Corporation at that date. The Corporation was a US dollar functional currency entity as is the Company and therefore the balance of Share Capital was carried forward at its historical amount into the financial statements of the Company. The rights of different classes of shares are the same and therefore economically equivalent.

Information about movements in share capital issued before the Reorganisation is presented in the table below on the after split basis, i.e. taking into account, the one for ten split.

Ordinary Shares

	Period ended 31 December 2008	
	Number	Amount \$
On incorporation	1	42
Issue of shares	1	41
Exchange of HOC Common Shares for Ordinary Shares	250,513,030	214,147,903
Exchange of Exchangeable Shares for Ordinary Shares	1,182,012	1,009,470
Issued on exercise of stock options (note 12)	163,330	351,599
Balance – end of period	251,858,374	215,509,055

Special Voting Share

	Period ended 31 December 2008	
	Number	Amount \$
Issued during the period	1	–
Balance – end of period	1	–

Notes to Financial Statements continued

10 Share Capital continued

Exchangeable Shares of HOC Each Carrying One Voting Right in the Company

	Period ended 31 December 2008	
	Number \$	Amount \$
Exchange of HOC Common Shares for Exchangeable Shares	4,431,120	3,784,296
Exchange of Exchangeable Shares for Ordinary Shares	(1,182,012)	(1,009,470)
Balance – end of period	3,249,108	2,774,826

2007 Convertible Bonds of HOC

On 16 February 2007, HOC raised \$165,000,000 by completing the private placement of convertible bonds. The Corporation issued 1,650 unsecured convertible bonds at par, which have a maturity of five years and one day and an annual coupon of 8% payable semi-annually on 17 August and 17 February of each year. Following the reorganisation, the bondholders have the right to convert the bonds into Ordinary Shares at a price of \$4.70 per share (after one for ten split (note 1)) at any time. The number of Ordinary Shares receivable on conversion of the bonds is fixed.

Bondholders have a put option requiring the Corporation to redeem the bonds at par, plus accrued interest, in the event of a change of control of the Company or revocation or surrender of the Zapadno Chumpasskoye Licence in Russia. In the event of a change of control and redemption of the bonds or exercise of the conversion rights, a cash payment of up to \$19,700 on each \$100,000 bond will be made to the bondholder, the amount of which depends upon the date of redemption and market value of shares at the date of any change of control event.

In April and May 2009, bondholders with \$16.5 million of bonds gave notice of the exercise of 165 bonds. These bondholders received 3,510,630 Ordinary Shares (note 15).

11 Reserves and Retained Deficit

(a) Reserves

	31 December 2008 \$
Share-based payments reserve	9,419,386
	9,419,386
Movements	
Share-based payments reserve	
Compensation costs – stock based awards issued	9,562,334
Transfer to share capital on exercise of options	(142,948)
Balance – End of period	9,419,386

(b) Retained Deficit

	31 December 2008 \$
Net loss for the period	(10,425,625)
Balance – End of period	(10,425,625)

(c) Nature and Purpose of Share-Based Payments Reserve

The share-based payments reserve, as described in note 2g, is used to recognise the fair value of options and long term incentive plan awards issued, but not exercised, to employees.

12 Share-Based Payments

Stock Options

The Company had a stock option plan whereby certain Directors, officers, employees and consultants of the Group have been granted options to purchase Ordinary Shares. Under the terms of the plan, options granted normally vest one third immediately and one third in each of the years following the date granted and have a life of five years.

As part of the Reorganisation (note 1) the 2008 Replacement Share Option Scheme (the “2008 Scheme”) was adopted. The 2008 Scheme served as a replacement of the Stock Option Plan of HOC which was cancelled just after the Reorganisation of HOC and its subsidiaries companies which occurred on 31 March 2008. Pursuant to the Reorganisation, the HOC optionholders exchanged each outstanding option to acquire a

Notes to Financial Statements continued

12 Share-Based Payments continued

Common Share in the capital of HOC for ten options to acquire ten Ordinary Shares in the capital of the Company. The HOC optionholders were put in substantially the same economic position in the Company that they were in prior to the Reorganisation. The exercise prices of the options to acquire Ordinary Shares in the capital of the Company are expressed in Pounds Sterling and represent the exercise prices of the HOC's options, expressed in Canadian dollars, translated at the exchange rate at 31 March 2008.

Information about stock options granted before the Reorganisation is presented in the tables below on the same basis as it is stipulated by the 2008 Scheme, i.e. after taking into account the one for ten exchange and translation of exercise prices to Pounds Sterling.

Ordinary Share options outstanding and exercisable:

	Period ended 31 December 2008	
	Number of options	Average exercise price (GBP) £
On Reorganisation	24,545,340	1.51
Exercised (note 10)	(163,330)	0.89
Balance – end of period	24,382,010	1.51
Exercisable – end of period	23,040,343	1.45

Exercise price (GBP)	Number of options		Remaining life (years)
	Outstanding	Exercisable	
£0.48	2,000,000	2,000,000	1.39
£0.81	150,000	150,000	2.48
£1.08–£1.43	18,207,010	18,207,010	2.95
£2.45–£2.51	4,025,000	2,683,333	3.93
	24,382,010	23,040,343	2.98

Long Term Incentive Plan (“LTIP”)

On 19 June 2008, the AGM of the Company approved the 2008 LTIP. Under the terms of the plan, the LTIP awards will be in the form of full-value shares (Performance Shares), subject to performance and time-vesting conditions. Eligible employees will normally be considered by the Remuneration Committee for an award once each year. Awards made to the Executive Directors of the Company under the LTIP are called First Awards. Participants in the First Award, however, will not be entitled to any further awards until the 2011 financial year. Awards will normally be made during the period of 42 days following the announcement of year end or half-year financial results. Exceptionally, the First Awards under the plan on 19 June 2008, were permitted to be made within 42 days following approval of the LTIP at the June 2008 AGM.

The plan is intended to apply to Executive Directors and other employees in senior management or leadership roles. By exception, other higher performing and high potential employees may be considered for awards. Participants in the LTIP will not be entitled to any further awards under the 2008 Scheme.

The vesting of shares under award are subject to performance conditions agreed by the Remuneration Committee when the award is made. For the First Awards made in 2008 the performance conditions are relative TSR (capital gain plus dividends) performance of the Company versus that of a comparator group of international oil companies and a requirement for the share price of the Company to have increased by 20% over the vesting period of three years. Furthermore there is an additional holding period of one year following the awards vesting.

The Remuneration Committee in consultation with executive reward consultants, approved grants of shares to Executive Directors, senior management and other employees in leadership roles under the LTIP. The maximum annual, individual award for participants who are not Executive Directors is 250% of base package (expressed as the “face value” of the shares). The First Award to Executive Directors is 1,200% of base package for the CEO and 800% of base package for the CFO.

The First Awards vest after three years provided that the performance conditions are met. The awards granted to senior management and other employees in leadership roles are in three tranches that vest after three, four and five years respectively, provided that the performance condition is met at that time.

Notes to Financial Statements continued

12 Share-Based Payments continued

The award would vest in line with the following schedule:

TSR Performance vs Comparator Group of 18 Companies	First Awards proportion vesting	Senior management and other employees in leadership role awards proportion vesting
3rd place and above	100% of the award	100% of the award
4th place	80%	100%
5th place	50%	100%
6th place	30%	100%
7th place and below	0%	100%
9th place (median)	0%	100%
10th place and below	0%	0%

TSR is measured in comparison to a peer group of 18 oil companies selected based on one of, or a combination of, size (market capitalisation, revenue, turnover, cash expenditure or a combination thereof), area of operations and country of domicile. The TSR measurement is conducted by independent consultants in discussion with the Remuneration Committee.

Since there are market-related conditions the awards of the shares under LTIP were fair valued using the Monte Carlo model which takes into account the market-based performance conditions which effectively estimate the number of shares expected to vest. No subsequent adjustment is made to the fair value charge for shares that do not vest in the event that these performance conditions are not met. Adjustments are, however, made for leavers. The fair value of the awards is recognised as an employee expense with the corresponding increase in equity. The total amount to be expensed is spread over the vesting period during which the employees become unconditionally entitled to the shares and options.

The table below summarises the main assumptions used to fair value the awards made under the above LTIP and the fair values of the shares granted.

Award date	First Awards 19 June 2008	19 June 2008	19 June 2008	19 June 2008
Vesting period	3	3	4	5
Exercise price	nil	nil	nil	nil
Share price at date of grant	£3.45	£3.45	£3.45	£3.45
Expected volatility	40%	40%	40%	40%
Expected dividend yield	0%	0%	0%	0%
Fair value as at grant date	£1.55	£2.49	£2.61	£2.70
Number of shares granted	3,507,246	473,061	473,061	473,061

The share-based payment recognised with respect to the stock options and LTIP in the period ended 31 December 2008 was \$9,562,334 out of which \$3,617,705 was charged to investments in subsidiaries.

13 Related Party Transactions

During the period ended 31 December 2008, the Company incurred transportation costs of \$134,978 with respect to the services provided by a company indirectly owned by Mr. Anthony Buckingham, CEO and a Director of the Company.

Notes to Financial Statements continued

14 Commitments and Contingencies

Heritage's outstanding contractual commitments at 31 December 2008 was estimated at:

	Total \$000	Less than 1 year \$000	1-3 years \$000	4-5 years \$000	After 5 years \$000
Operating leases	2,462	274	547	547	1,094

15 Subsequent Events

In April and May 2009, bondholders with \$16.5 million of bonds gave notice of the exercise of 165 bonds. These bondholders received 3,510,630 Ordinary Shares.

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