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# PAN ANDEAN RESOURCES PLC

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ANNUAL REPORT 2002

## CHAIRMAN'S STATEMENT

If you were to pick an industry in which to invest in 2002 it has to be oil and gas in the Americas. As the war drums beat louder in the Middle East, hydrocarbon prices rise. Producers such as Pan Andean, with oil and gas production in the Gulf of Mexico and in South America, reap significant cash benefits. That is the future. Meanwhile, the period under review to end March 2002 was one of frustration rather than achievement. We failed, despite frequent and vigorous attempts to conclude a deal on our El Dorado gas asset in Bolivia. This project had the potential to be a company maker but political posturing between Bolivia and Brazil, weakening economies and strategic considerations between two of the world's oil majors stymied our every effort. On the other hand, the decision to purchase producing assets in the Gulf of Mexico and in Bolivia in 2000 now looks inspired. Though low gas prices in the US in the last half of 2001 resulted in a drop in our revenue we remained cash positive. I am happy and relieved to report that both income and cash flow are strongly positive in the current year. Pan Andean is financially strong, generating cash and has no debt. Financial strength combined with good share liquidity on the London Stock Exchange and a base of 7000 shareholders makes Pan Andean an attractive partner. Your board has received a number of proposals. All but one was rejected. The one project not rejected has been the subject of long drawn out negotiations which show no sign of reaching a conclusion.

The stock market environment facing small oil and gas producers like Pan Andean is harsh. Share buyers are on strike and it may be some time before they return. The ongoing bear market results in continuous downward pressure on our share price. This is exacerbated by our good liquidity. Unlike many of our peers, shareholders can always trade in our shares. If an investor needs cash, Pan Andean may be the easiest share to sell. The bad market makes it virtually impossible to raise new equity capital. A low share price means that significant fund raising seriously dilutes existing shareholders.

Weak stock markets are symptoms of a wider economic malaise. The world economy is not in good shape. There are ominous signs of a double dip recession and, even more worrying, the spectre of deflation looms. A stagnant world economy is good for no industry, even oil and gas. The 2001 fall in US gas prices was directly attributable to a substantial reduction in Californian power demand. The predicted energy shortage in Brazil has failed to materialize so the demand for Bolivian gas to supply the energy has fallen. Our partner in El Dorado, Pan American, is an Argentinian company suffering from the virtual implosion of the local economy. Hard times lead to political instability and civil strife. Though Bolivia remains one of the most stable countries in a volatile continent there has been some civil unrest. This is a worrying sign and one that we will closely monitor.

As I write this in Autumn 2002, war in the Middle East looks imminent. A war is probably good for Pan Andean – at least in the short run. Already oil prices are pushing \$30 a barrel and rising. US gas prices have risen by 50% during the summer! They are expected to go much higher this winter. A war in the Middle East will provide a quick fix for Western economies. This too is good for oil and gas demand. But the longer-term effects are less certain. It is to be hoped that diplomacy will prevail. Peace may be bad for oil prices but war is bad for everyone.

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The Review of Operations below provides details on our various activities but let me give you a quick summary.

*Gulf of Mexico:* We have significant interests in three blocks in the shallow waters of the Gulf of Mexico offshore Texas. We hold 62.9% of High Island 30L, a 500 barrel a day oil producer, 39.6% of High Island A68, producing over 1 million cubic feet of gas a day and 39.7% of High Island A52 producing over 1.5 million cubic feet of gas a day. Each block has its own platform, two of which are shown on the covers of this report. There is significant exploration potential on High Island A52. A small part of the block was farmed out to a US company who drilled a discovery well at 17000 feet. They have brought the find on stream and are now drilling additional wells. Pan Andean has a 2.1% royalty on production. The royalty has been as much as \$25000 a month. It is believed that the block contains an additional 7 billion cubic feet of gas in undeveloped reservoirs. Proposals to drill identified structures are being developed. Pan Andean will participate in drilling.

*Offshore Louisiana:* Pan Andean has a small interest in Eugene Island block 255. We receive a small monthly income. Recently there have been significant new discoveries on surrounding blocks.

*Onshore US:* We hold a 1% royalty on the North Bob West field on the Texas/Mexico border. This high potential gas field is being drilled by El Paso. As a royalty holder we obtain little information but anecdotal evidence suggests that the drilling has been successful. We have a good monthly income. Danbury Dome in Texas is a joint venture with El Paso. The joint venture is currently mired in confusion over costs and drilling. Discussions are ongoing to resolve outstanding issues. There is a deep play, which needs to be drilled.

*Monteagudo Block in Bolivia:* Our 30 per cent interest in Monteagudo was acquired so that we might participate in drilling high potential exploratory wells for gas. We placed little value on the shallow oil wells, which had been producing for 30 years. We had initial success drilling for gas but the wells quickly depleted. The deeper gas plays were not drilled, as there was no ready market. Meanwhile the oil continued to flow. Currently Monteagudo produces over 600 barrels a day. We are in constant discussions with our two partners Repsol, the operator, and Petrobras as to how best to maximize the value of the field. Certain improvements have been made and I am hopeful that this asset will soon generate good monthly cash flows to Pan Andean.

*El Dorado Gas field Bolivia:* The failure to secure a supply contract for this large gas deposit is disappointing. We were close. Throughout 2001 our local Bolivian management worked with the Bolivian authorities and with Brazilian companies to fashion a deal, which would allow the development of El Dorado as a 100-mmcf a day gas supplier to Brazil. We had a buyer for the gas, a contractor to drill and build the required facilities and agreement with the local authorities in Santa Cruz. Our 90% partner, Pan American, and the Brazilian buyer could not agree on a price. As the discussions dragged on the Brazilian economy went into recession and gas prices fell. It proved impossible to finalise a deal. Now we are further than ever from commercializing El Dorado.

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## Corporate Activity

As hopes for a deal in Bolivia faded your board began to consider alternatives in South America and elsewhere. We examined projects in Bolivia, Colombia and Argentina. None of these were deemed worthy of investment. We had discussions with groups wishing to merge with Pan Andean. Most of these brought no obvious benefit. One we liked but we have not been able to finalise an agreement due to changing circumstances on the other side. While maintaining a dialogue on this proposal we have commenced discussions with a private group in the Americas, which may lead to a joint venture to explore three areas with substantial exploration upside for gas. This project has the added benefit of a ready market for gas.

## The Future

We are in good shape and ready to move on. We are generating cash, have no debt and have a range of options. Our roots are in exploration so we are attracted to projects, which offer high potential but in return are high risk. An alternative way forward is to pursue a corporate strategy of acquiring companies with production. This has the advantage that as we grow in production we attract a wider range of investors. Over the coming months we will review all options.



John J. Teeling,  
Chairman

20 September 2002

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## REVIEW OF OPERATIONS

### United States Operations

Pan Andean produces oil and natural gas in the United States Gulf of Mexico and onshore Texas. We entered the USA with the purchase of Endeavour Oil and Gas Limited, now a wholly owned subsidiary, in June 2000.

In September 2001 Pan Andean acquired further working interests in two fields from a larger group, which was streamlining its assets. During the year we reviewed further investment opportunities but were deterred by high asking prices. We feel that there will be better opportunities to acquire good assets from distressed sellers.

The US assets accounted for the bulk of revenues and cash flow in the reporting period.

#### Endeavour Gulf of Mexico assets

We added to the original Endeavour assets in late 2000 with two new gas producing properties located in the High Island Area: blocks 52 and A68 are close to our existing High Island 30L oil field. This acquisition was largely funded with debt, which has been paid off from the cash flow from these assets. Subsequent to the Endeavour and ERT acquisitions, asset prices rose even as gas prices moderated. Accordingly we deferred additional acquisitions until there is a better balance of supply and demand.

Our American acquisitions have proved fruitful for Pan Andean, and we will consider similar transactions when they can be conducted on comparable terms.

#### High Island 30L

We have a 67.9% working interest in High Island 30L, in Texan State waters.

This single platform field continues to perform: production is 590 barrels of oil daily (bopd), 1750 thousand cubic feet daily (mcf/d) and 230 barrels of water (bwd) from the number 2U well.

Last year we scaled back gas production because of the fall-off in gas prices and a desire to shut in well 4U to maintain a secure gas source for future gas lift operations.

The no.2 well is now beginning to produce natural gas from the gas cap. Gas production has been rising since October 2001 while oil output is falling off. We expect this trend to continue, though the decline in oil production seems to have slowed.

#### High Island 52

High Island 52 is a six well field of which two wells are currently producing and two are currently shut in (i.e. proven discoveries that are not currently producing).

The licence is located in Federal waters some miles east of our High Island 30L-producing asset. Our original working interest purchased in mid 2000 was 28.5% and this has been increased by further incremental acquisition to 44.7%, falling to 40% after payout.

We are producing from multiple reservoirs. Remaining reserves are at shallow depths and are assessed to be 185,000 net risked barrels of oil equivalent to Pan Andean.

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Current production is around 1,400 thousand cubic feet daily (mcf/d) gross, with no oil or water production. The no. 2 well is producing steadily on a normal decline curve.

The no. 3 well is currently shut in, but will be jetted in with coiled tubing when work on adjacent HI 30 makes a jack-up rig available in the area. The well should produce 350 thousand feet of gas.

We believe that 3D seismic acquired by neighbours and partners indicates considerable drilling potential, and plan to participate in drilling over the coming year. There are some low risk, relatively shallow wells that can be drilled for approximately \$0.5 million each. There is also a deep gas target (at about 17,000 feet) similar to the Gryphon Exploration discovery on their farm-in to the northeast quadrant of our licence last year. Given the \$6 to \$8 million cost of such wells, our preference is to have this well drilled by a farm-in partner.

### High Island A68

High Island A68 is located 40 miles south of High Island 52 and 30L. This is a three well field producing around 1,700 thousand cubic feet of gas daily (mcf/d) gross. Our working interest in this field is 44.55%, falling to 40% after payout.

Production is from very shallow reservoirs, between 2,000 and 3,000 ft. Operations are contracted to EnField Operating LLC, our co-investor, and operator of the High Island 30L field.

Improved operating practices following our purchase has significantly reduced down time and boosted production.

Well no. 3 is currently producing 1,000 thousand cubic feet of gas and 300 barrels of water. Production is steadily declining. Well A5 produces 40 thousand cubic feet of gas and 400 barrels of water.

### North Bob West

We have a 1% royalty interest in the southern part of North Bob West and a 0.6% royalty interest in the north. The advantage of being a royalty holder is that we are not hit for cash calls. However, we have limited rights to information and effectively no ability to influence the operator.

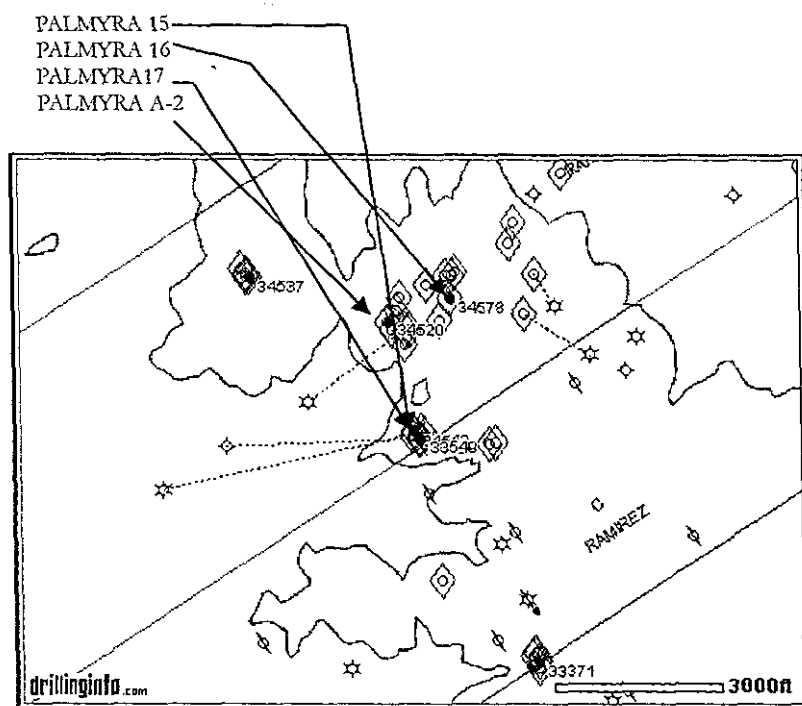
In October 2001, a new Operator (El Paso) purchased from TransTexas 100% working interest in the North Bob West Field. This does not affect our royalty interest. El Paso has been more aggressive than TransTexas with tentative plans to develop existing 'behind pipe' gas reserves and as-yet undeveloped gas reserves in the North Bob West Field.

The new Operator has already drilled two additional deep wells (Palmyra 15 and 16 wells), currently under evaluation. El Paso has permitted and staked one additional deep well for late 2002.

The North Bob West Field is located on the Texas-Mexico border beneath the Falcon Lake water reservoir. The wells are directionally drilled from the shore location beneath the lake. The shorter directional wells have already been drilled/developed under the lake while the longer directional drilled wells await future development. The new Operator is in the process of unitising (finalising the division of future production) both the shallow and deep rights with the current royalty partners. Once this process is complete, the Operator can exploit the longer directionally drilled wells in the field from the existing shore facilities.

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Pan Andean, through its wholly owned subsidiary Endeavour, has an override royalty interest (up to 1%) in the field area with certain depth limitations applied in specific areas. While we pay no costs associated with the development of the North Bob West Field, we cannot provide a definitive timetable whereby additional behind pipe completions or additional drilling activities will occur.

There remain significant behind-pipe undeveloped reserves that will be perforated depending on the gas price and decline of producing horizons. We believe the Operator will be prudent in plans to complete behind pipe reserves in the existing wells only after the current completion intervals become non-commercial. Drilling activity will be influenced by budgetary constraints.

Net gas production to Pan Andean was less than last year because no behind pipe reserves were recompleted (due to the sale of the property to El Paso) and no additional drilling activity was undertaken during 2001.

The substantial upside at North Bob West is on the northern part of the property, under a lake, which will require more costly drilling, and consequently has been delayed until later in the development programme. The operator has suffered budgetary constraints following new accounting treatment of energy trading activities. We are heartened by the fact that while they have put approximately \$1.5 billion of assets up for sale, they appear to be holding this property as a core asset.

## Danbury Dome

El Paso is also the operator at Danbury Dome, where Pan Andean owns a 40% working interest in the shallow and deep leases. Pan Andean owns a 100% of the deeper 'Vieman' lease.

This property produces gas from the Korenek no. 4 well, a 1998 discovery, which is on a steady decline curve and now produces under 70mcf daily. We believe that production from this well could be doubled or tripled if it were put on compression.

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We have agreed an Area of Mutual Interest with the operator, entitling Pan Andean to participate in the exciting plays that have been identified in the locality.

We had concluded an agreement in principle with our partner to swap our share of the shallow leases (8,000 to 9,000 ft) for the highly prospective deeper plays (at 13,000 ft). Following a review our partner decided to retain their interest in the deep play. Our priority is to resolve legal uncertainties, particularly over neighbouring leases, so as to drill the deep target, probably by a farm-in partner in 2003.

### **Anomalina Drill target**

Seismic re-interpretation of the Danbury area, in 2001, indicates an attractive prospect that warrants drilling. We are working with El Paso management in the Danbury area to obtain an additional 100 to 300 acres (covering approximately 1/3rd of the target structure) in order to further exploit the deeper rights at approximately 13,000 feet. El Paso has expressed its desire to explore this deeper prospect during 2003. Exploratory potential for this target structure is approximately 16 to 20 Bcf gas recoverable.

The 224 acre area on which the gas-producing Korenek #4 well is located covers one third of the deeper target structure.

Pan Andean recently leased a further 805 acres that cover the remaining third of the target structure. We therefore control and own 40% to 60% of the entire target structure.

There may be deeper exploratory potential in addition to the target structure described above.

### **Impact of Oil and Gas price**

Oil and gas prices have been volatile. Since costs are largely fixed, price drives the bottom line.

We write (September 2002) at a time of high-energy prices, with oil (WTI) approaching \$30 per barrel. Analyst consensus is that about \$5 of this is a 'war premium' due to Middle East tensions. The underlying price, after subtracting the war premium, is at the upper end of expectations. The reason is that free oil capacity is only about 5 million barrels daily, much lower than for several years. About half of this is in Saudi Arabia, and thus exposed to Middle East upheaval. Extra capacity came on stream following the supply crunch of winter 2000/01, which depressed the gas price temporarily. Yet most American production is on a steep decline curve, typically halving within 18 months unless there is renewed drilling.

Gas is essentially a local market and only secondarily driven by the price of substitutes, such as fuel oil. Hence the gas price in developed markets, especially the USA and Europe, is generally higher than for emerging markets close to gas supplies, such as Brazil.

Over time we expect emerging markets to follow similar pricing behaviour to that experienced in early markets: at first gas is considered a waste product and often flared. Later, applications are developed and infrastructure built. In Bolivia, exploration success generated large reserves compared to the immediately available market. To build markets takes time, especially for capital-intensive applications such as Liquefied Natural Gas (LNG) or Gas to Liquids (GTL). Periodic economic shocks can depress demand, further exacerbating price pressure. This explains why the US price is typically twice to three times that available in Bolivia.



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The US gas supply/demand situation has generally been favourable, though volatile, since the Endeavour acquisition. Gas prices rose dramatically to over \$9 per thousand cubic feet (mcf) during a 2000/2001-winter supply crunch. Gas prices fell back during the 2001/2002 winter, to a depressed level of \$2.3, as new production met reduced demand. This depressed our US income in the year under review.

But this gas supply bubble has now worked its way through the system and most analysts forecast an excellent winter as well as longer-term prospects ahead, even if economic growth is subdued. For example, Raymond James Equity Research forecast 'a significant gas supply shock, which could be felt as early as this winter'. They remain 'very bullish on the longer-term outlook for gas.'

The immediate gas supply/demand is influenced by weather and electricity demand. Many power generators can switch to fuel oil if the gas price per unit of calorific value is excessive. During the summer, gas is injected into storage reservoirs, whence it is extracted during the peak winter demand season. Recently the price has recovered to \$3.14 per thousand cubic feet (mcf) for our properties, while the 12 month forward rate implies \$3.8.

Medium term prospects for gas in the USA, as for oil worldwide, are favourable. North America increasingly relies on foreign oil, and expensive to import gas. By contrast the available price for new gas export contracts to Brazil has been falling, at least in the short term, due to a combination of large new discoveries, delayed market liberalisation, stalled investment and subdued demand due to the Argentine crisis and effective state subsidies for dirty fuel oil.

Bolivian exporters are now considering a Liquefied Natural Gas project to export gas over the Andes to a compressing station, whence it would be shipped to Mexico and California, on the assumption that the long-term gas price in the USA will be at least \$4 per million BTU.

The best way to transport gas is by pipeline over flat terrain. The economics of sub-sea pipelines are more difficult, requiring expensive processing prior to shipment. The high costs of the main compression technologies will provide a price umbrella for U.S. gas for years to come.

North American import dependence is rising. Increasingly exploration targets small or difficult targets. There seems little prospect of an early opening of Mexico's gas export potential. What market liberalisation possibilities exist are for smaller gas developments such as that bordering our interest in onshore Texas, which we have under review.

### **Bolivian Operations**

We produce high quality light oil and natural gas from our 30% stake in the Montegudo Field, in southern Bolivia. The field is operated by Maxus, which has a 30% stake and is now owned by Repsol-YPF. Repsol owns an additional 20% stake via its ownership of the privatised Bolivian oil company Andina. The remaining 20% is held by Petrobras, the Brazilian semi-state oil company. Oil output from relatively shallow reservoirs has remained strong. There is scope to enhance production through work-overs.

Pan Andean has approached the operator with a view to buying out their stake and investing in enhanced recovery on these excellent reservoirs. Given the sweet quality of the oil and condensate, we believe that it should be possible to capture a larger premium by selling to micro-refineries to

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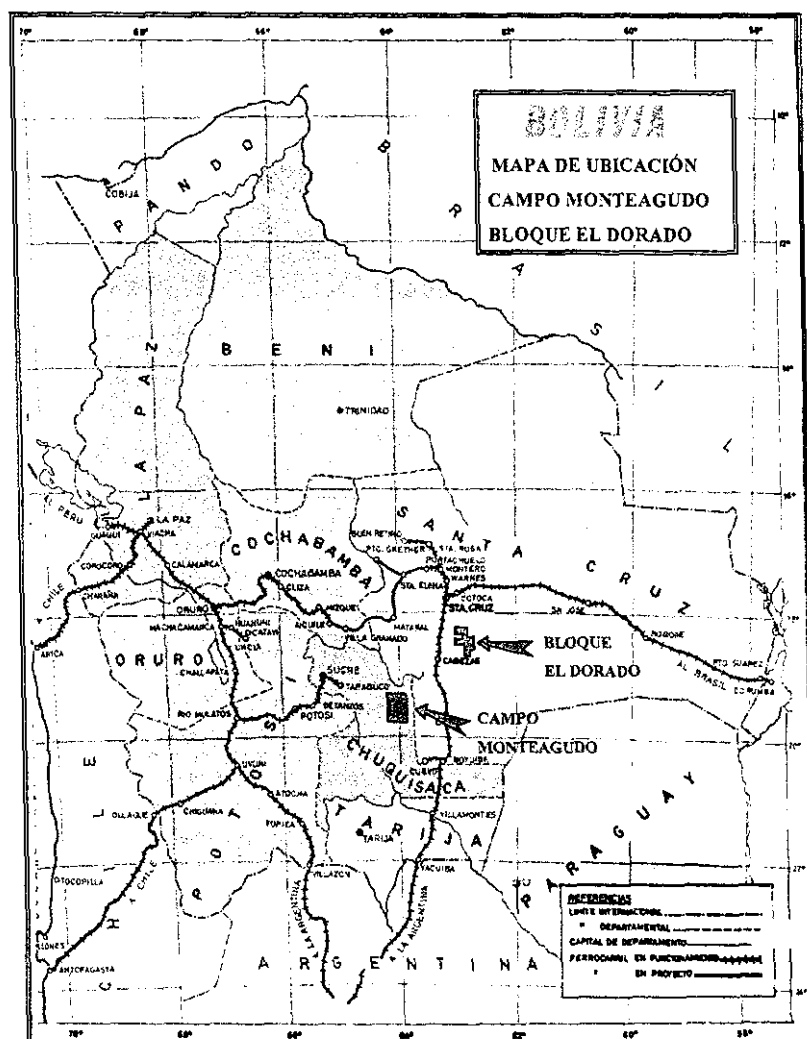
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whom its special properties are particularly valuable. The currently producing reservoirs are smaller than Repsol considers ideal, given its structure, but so far there has been no agreement on a deal.

Monteagudo gas production fell sharply during 2001, as the key reservoir hit the water gradient earlier than had been predicted by the operator and technicians. There remains very large gas potential at Monteagudo, but at much deeper levels. These gas and condensate targets will be drilled when market circumstances warrant.

Pan Andean owns a 10% stake in the large and strategically situated gas discovery at El Dorado, some 40km south of the city of Santa Cruz. We had an offer to increase our stake to 30% by drilling an additional well. We did not exercise this option because we were unable to nail down a marketing contract.

The balance of the block is owned by Pan American Energy, part of the BP group. BP has considerable interests elsewhere in Bolivia, primarily via the privatised state company Chaco. Pan American's main current focus is on their Liquefied Natural Gas project aiming to sell gas from their stake in the mega-gas fields of southern Bolivia, via a pipeline to the Pacific Ocean and on by tanker to Mexico and the Californian market.



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We are working on a number of options to generate early value added for shareholders from the El Dorado discovery. The best option is to tap into the nearby gas export pipeline to Brazil. We are situated within 30km of the gas gathering station and appear to have a considerable transport cost advantage. Our gas is very rich in liquids: some 30 to 40% of revenues are modelled to come from liquids. This condensate can only be produced when a gas market is available, as flaring is forbidden.

Accordingly our priority is to secure an early gas market. This necessitates a recovery from the sharp economic correction Brazil has experienced since 2001. Brazil has a history of high, but volatile energy demand growth. We are confident that the current difficulties will pass and that Brazil represents an excellent long-term market.

### Monteagudo Field, southern Bolivia

#### Operations update

When we acquired our interest in October 2000, Monteagudo produced approximately 650 BPD of oil and 11 MMPCD of Gas. Oil production has fluctuated somewhat, between 580 and 710 barrels daily. As I write in mid September 2002, oil production is higher than in 2000.

Gas production has fallen sharply to 2.3 million cubic feet daily. This results from the premature invasion of water into the key Yahua Reservoir. We believe that the gas-bearing reservoir thickness and area are less than originally estimated by third party consultants.

From April 2001 until end July 2002, we produced 328,321 barrels of oil and 1.4 Billion cubic feet of gas.

Yahua sandstone proven reserves are estimated to be 26 Billion cubic feet of gas and 26,030 barrels of oil, after taking into account water intrusion into the reservoir.

These calculations ignore the sizeable Probable Reserves in the deeper Huamampampa and Santa Rosa Formations.

Working with the operator, we have dramatically cut field costs. The collapse in gas production left the partners with lease liabilities on a surplus gas compression plant, as well as a gas transport contract. The final payment on the surplus gas compression plant was made in June 2002. The gas transport contract expires in December 2002. Together, with other cost reductions, this has improved the profitability and cash flow of Monteagudo.

Pan Andean believes that there is considerable further scope for cost cutting. We have now discharged the debt acquired when purchasing the field in 2000.

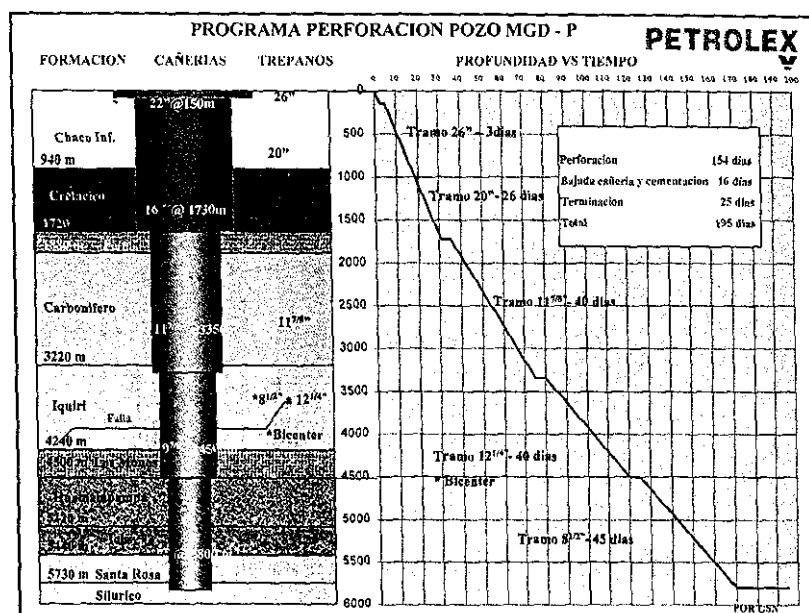
The gas price for Monteagudo production is \$1.57 per million BTU. This is excellent by current South American standards, though modest compared to developed markets. The field's inability to meet its market requirements opens up the possibility of Pan Andean capturing value by swapping this market with other producers able to supply immediately.

Accordingly we negotiated a Gas Swap with a leading US independent company in April 2002. This arrangement lasts until early 2003, when we hope to renew the swap for a further period, depending on production and market availability.

We receive effectively \$0.25 per thousand cubic feet, which moves with the general gas price.

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## Monteagudo exploration upside

Major exploration potential exists in the Huamampampa and Santa Rosa Formation sandstones beneath the existing producing horizons on the Monteagudo block. The Huamampampa sands, located at 5,200 metres, are prolific producers in neighbouring blocks operated by Total and Petrobras. Much of the giant Bolivian discoveries, totaling about 40 trillion cubic feet since 1997, have been in this area in the Huamampampa Formation.

Potential structure size is up to 4 trillion cubic feet (tcf) of gas, as well as oil and condensate. To capture the entire upside would necessitate drilling to 5,800 metres, for which we estimate drilling cost at \$15 million. Testing the Huamampampa Formation only would involve drilling to 5,200 metres at a \$12 million well cost. The Huamampampa Formation is much better understood in this area because of the large discoveries nearby. The high exploration hit rate in the area also reduces the drilling risk. The deeper Santa Rosa Formation is more speculative.

The deep Monteagudo play is one of the largest and lowest risk projects we have seen.

Because of prolific recent discoveries and a Latin American energy demand downturn, we are unlikely to be drilling this prospect in the near future. Market demand will decide when it makes economic sense to prove up and develop reserves.

## Total Recoverable Reserves (5,800 metre well at \$15 million well cost)

	Trillion Cubic Feet of Gas	Million barrels of Oil Condensate	Probability
Upside	3.7	74	5%
Most Likely	2.1	43	25%
Lower Case	1.0	20	40%

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Huamampampa Formation only (5,200 metre well at \$12 million well cost)

	<i>Trillion Cubic Feet of Gas</i>	<i>Million barrels of Oil Condensate</i>	<i>Probability</i>
Upside	2.6	52	10%
Most Likely	1.6	31	50%
Lower Case	0.8	16	80%

Recoverable reserves are modeled at 2.1 tcf and 43mm barrels of condensate most likely, with upside of 3.7 tcf and 74 mmbo. The Huamampampa Formation constitutes most of this, with 1.6 tcf and 31mmbo. The formation is proven in neighbouring blocks and constitutes most of Bolivia's mega gas discoveries since 1997. The balance is composed of the deeper and riskier Santa Rosa Formation, which is also an established regional play, though not as prolific.

The variables are Formation thickness and area. They are large structures, identified by 3d seismic, so should be relatively easy to hit. Maxus and Western Geophysical mainly conducted the 3d seismic analysis, though some of the resolution in this zone was poor.

Explorers manage risk and must assess probabilities. What is the probability of the 3 scenarios given? Even low-end estimates (assuming 10 and 18 km<sup>2</sup> structures and 50 to 90 metre thickness) are still an attractive 1 tcf and 20 mmbo. The real downside is the possibility of problematic drilling, reservoir problems, no gas/condensate or no gas market.

The geology is well understood. The negative is that the potential for major oil discoveries is low, but there seems reasonable certainty (80%+) of at least substantial gas in the structures.

Cost estimates are \$12 million (only to Huamampampa Formation at 4,500 to 5,200m) or \$15 million if we also drill the Santa Rosa Formation (final depth 5800m). This is broadly consistent with feedback from majors who have drilled similar wells in the locality; the wells will be deep, but are drillable without great difficulty, excessive risk or cost. We can use the same pad and access road as for MGD X-51. Drilling is easy to 3,300m, after which the normally 200 metre thick Los Monos Formation is complicated.

### El Dorado Block, Central Bolivia

El Dorado is a large gas discovery with a high content of sweet liquids situated close to the gas-gathering station at Rio Grande.

It has proven reserves of 88 billion cubic feet and 1.5 million barrels of oil. Including probable reserves this rises to 236 bcf and 4 mmbo, and including possible reserves to 416 bcf and 7.3 mmbo. There is additional upside potential in the Los Monos Formation and particularly the deeper Huamampampa Formation, which was the original target of the discovery well, DRD x-1001. This 6,750 metre well logged gas but did not test because of mechanical difficulties and the fact that major gas had already been discovered at shallower depths by the well.

Drilling is straightforward, with simple and well understood stratigraphy.

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El Dorado is ideally situated on flat terrain, near major roads and Santa Cruz city. It is unaffected by the rainy season and represents an easier and more secure source of gas for the Brazilian market than any other Bolivian discovery.

The impact of an early development on Pan Andean would be dramatic. During 2001/02 we worked with Brazilian buyers, the Bolivian authorities and our partners to maximise early production. The negotiations failed on price: our partners are part of the BP group, which also includes Chaco, a major current exporter to Brazil under the existing gas export contract. Our partner, Pan American Energy, was reluctant to concede on price so as to secure an early development of El Dorado. Pan Andean believed strongly that the present value of an early deal was much greater than delaying in the hope of a better price later. We would like to have been proven wrong, but sadly the available gas price has fallen further.

More seriously Brazil has cut back, rather than dramatically increased its gas offtake as expected by the industry, and is now paying cash on the take-or-pay contracts. These difficulties will pass but have delayed all Bolivian gas developments.

### **Brazilian market developments**

Just as a number of factors combined to produce a Brazilian energy crunch in 2000, now many factors reduce Brazilian gas demand. By August 2002 the spot price for electrical power has fallen from \$300 per MW hour to a (fairly stable) \$4, which only makes sense for hydro-electricity. Ninety five percent of Brazilian power is from hydro sources. Planning and environmental problems, combined with a lengthy drought, had led to a Brazilian 'dash-for-gas' by late 1999. Many gas-fired power station projects have since been put on hold. Petrobras is gloomy on the gas export market to Brazil in the short term (to end 2003): current off-take is below all projections for a variety of interacting reasons:

Brazil, like its neighbours, has suffered a sharp fall in industrial demand and levelling-off in private consumer demand because of the economic downturn. There is practically no new capital investment (other than cost efficiency measures); investors fear left wing electoral success in 2003. The Argentine crisis has hammered international investment and sentiment. Slowing international demand for Brazilian exports, especially energy-intensive goods such as steel and alumina, depresses heavy industry.

Energy users are still able to burn sulphurous residual fuel oil in the Brazilian industrial market without effective emission controls. Petrobras produces a lot of residual fuel oil, which they are under political pressure to sell domestically at subsidised rates; they hope to build refining capacity to crack much of this into lighter, more valuable fractions. Whereas the industry had planned on the basis of an average 7% yearly energy demand growth, actual demand is lower than in 2000.

The result is that planned additional gas developments have been delayed by about 18 months. Now Brazil is taking taking 13 million cubic metres of gas daily (mmcmd). This will rise to 18 mmcmd, but it will take time before they will use the current gas pipeline capacity of 30 mmcmd. Plans to double the pipeline capacity have been shelved indefinitely.

The 'open season' and general market liberalisation in Brazil has slowed down: Only the thermo-electric market (where prices are now low) and interruptible supply is currently free. Industrial markets are restricted and domestic access currently closed.

# PAN ANDEAN RESOURCES PLC

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## ANNUAL REPORT 2002

### Revised economics

Delays in developing the Brazilian market have forced us to consider alternatives. One possibility is to develop El Dorado at a smaller scale, and more gradually, possibly combining some local with export sales. This would cut investment costs so the project still generates an attractive present value: if we scale back investment to \$54 million and delay production until 2005, incorporate basement gas prices and a pessimistic transport cost, the project still generates a present value of \$30 million (at a 10% discount rate), even though it leaves much of the gas and condensate in the ground.

If we begin production in 2004, achieve the targeted transport tariff and gas price and take into account the terminal value of yet to be sold hydrocarbons, the present value grows to \$67 million.

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

### REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements of the group for the year ended 31 March 2002.

#### PRINCIPAL ACTIVITIES

The group's main activity is in hydrocarbon exploration and production.

The group has several projects in Bolivia and the USA.

Further information concerning the activities of the group and its future prospects is contained in the Chairman's Statement on page 1 and Review of Operations on page 4.

#### RESULTS AND DIVIDENDS

Loss for the year after taxation transferred to reserves was £364,563 (2001 : £3,912,385).

The directors do not propose that a dividend be paid (2001 : Nil).

#### CREDITORS

It is the group's normal practice to agree terms of transactions, including payment terms, with suppliers and provided the suppliers perform in accordance with the agreed terms, payment is made accordingly. The group's average creditors payment period at March 31, 2002 was 35 days (2001 : 35 days).

#### DIRECTORS AND THEIR INTERESTS IN THE SHARES OF THE COMPANY

The following directors held office throughout the year:

J.J. Teeling

D. Horgan

J. Finn

M. Gonzalez (Resigned 19 February 2002).

The directors had the following interests in the ordinary shares of the company at 31 March 2002 and 31 March 2001 or date of appointment, if later:

	<i>Ordinary Shares</i>		<i>Options</i>	
	2002	2001	2002	2001
J.J. Teeling	518,000	518,000	3,115,000	2,715,000
D. Horgan	800,000	800,000	2,690,000	2,290,000
J. Finn	65,000	65,000	1,365,000	965,000



# PAN ANDEAN RESOURCES PLC

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## ANNUAL REPORT 2002

### SUBSTANTIAL SHAREHOLDINGS

The share register records that the following shareholders held 3% or more of the issued share capital of the company as at 31 August 2002.

	<i>Number of Ordinary Shares</i>	<i>%</i>
Vidacos Nominees Limited	3,892,949	4.0
TD Waterhouse Nominees (Europe) Limited	3,579,316	3.7
BNY Gil Client Account Nominees Limited - NWSC	3,518,795	3.6
Sharelink Nominees Limited	2,958,713	3.0

### CHARITABLE AND POLITICAL DONATIONS

The company made no political or charitable contributions during the year.

### AUDITORS

A resolution to re-appoint the auditors, Deloitte & Touche, will be proposed at the annual general meeting.

By Order of the Board:



James Finn  
Secretary

20 September 2002

# PAN ANDEAN RESOURCES PLC

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ANNUAL REPORT 2002

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the group and of the profit or loss of the group for that period.

In preparing those financial statements, the directors are required to :

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business;
- state that all accounting standards which they consider to be applicable have been followed.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and of the group and to enable them to ensure that the financial statements are prepared in accordance with accounting standards generally accepted in the United Kingdom and comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# PAN ANDEAN RESOURCES PLC

ANNUAL REPORT 2002

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PAN ANDEAN RESOURCES PLC

We have audited the financial statements of Pan Andean Resources Plc for the year ended 31 March 2002 which comprise the consolidated profit and loss account, the group and company balance sheets, the consolidated cash flow statement, the statement of total recognised gains and losses, reconciliation of movement in shareholders' funds and the related notes 1 to 22. These financial statements have been prepared under the accounting policies set out therein.

### Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read the chairman's statement, review of operations and report of the directors for the above year and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

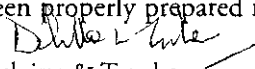
### Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards 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 give a true and fair view of the state of affairs of the company and the group as at 31 March 2002 and of the loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act, 1985.

  
Deloitte & Touche  
Chartered Accountants and Registered Auditors  
Deloitte & Touche House  
Earlsfort Terrace  
Dublin 2  
20 September 2002

# PAN ANDEAN RESOURCES PLC

ANNUAL REPORT 2002

## CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 MARCH 2002

	<i>Notes</i>	<i>2002</i> £	<i>2001</i> £
<b>TURNOVER - continuing operations</b>	2	3,846,754	4,893,481
Cost of sales		(3,470,309)	(2,834,312)
<b>GROSS PROFIT - continuing operations</b>		376,445	2,059,169
Administrative expenses		(646,565)	(724,415)
Exceptional item - discontinued operations	3	—	(5,045,440)
<b>OPERATING (LOSS)/PROFIT</b>			
- Continuing Operations		(270,120)	1,334,754
- Discontinued Operations		—	(5,045,440)
		(270,120)	(3,710,686)
Interest receivable and similar income	4	9,270	101,808
Interest payable	5	(103,713)	(78,917)
<b>LOSS BEFORE TAXATION</b>	6	(364,563)	(3,687,795)
Tax on ordinary activities	7	—	(224,590)
<b>LOSS ON ORDINARY ACTIVITIES AFTER TAXATION</b>		(364,563)	(3,912,385)
Loss per share	10	(.37p)	(4.53p)
Loss per share - diluted	10	(.37p)	(4.53p)

# PAN ANDEAN RESOURCES PLC

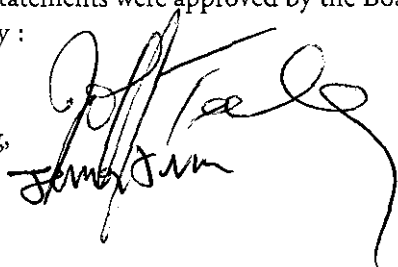
## ANNUAL REPORT 2002

### BALANCE SHEETS AT 31 MARCH 2002

	Notes	Group 2002 £	Company 2002 £	Group 2001 £	Company 2001 £
<b>FIXED ASSETS</b>					
Tangible assets	11	12,970,195	121,046	13,138,280	10,320
Investments	12	3,219	6,837,344	2,203	6,837,367
		<u>12,973,414</u>	<u>6,958,390</u>	<u>13,140,483</u>	<u>6,847,687</u>
<b>CURRENT ASSETS</b>					
Debtors	13	988,095	5,122,542	1,788,364	5,083,528
Cash at bank	14	975,831	9,431	1,513,328	223,039
		<u>1,963,926</u>	<u>5,131,973</u>	<u>3,301,692</u>	<u>5,306,567</u>
<b>CREDITORS : (Amounts falling due within one year)</b>	15	(1,662,961)	(169,399)	(2,541,013)	(356,379)
<b>NET CURRENT ASSETS</b>		<u>300,965</u>	<u>4,962,574</u>	<u>760,679</u>	<u>4,950,188</u>
<b>PROVISION FOR LIABILITIES AND CHARGES</b>	16	(854,747)	—	(1,059,364)	—
<b>TOTAL ASSETS LESS LIABILITIES</b>		<u>12,419,632</u>	<u>11,920,964</u>	<u>12,841,798</u>	<u>11,797,875</u>
<b>CAPITAL AND RESERVES</b>					
Called-up share capital	17	973,220	973,220	973,220	973,220
Share premium	18	17,715,926	17,715,926	17,715,926	17,715,926
Profit and loss account - deficit	19	(6,269,514)	(6,768,182)	(5,847,348)	(6,891,271)
<b>EQUITY SHAREHOLDERS' FUNDS- ALL EQUITY</b>		<u>12,419,632</u>	<u>11,920,964</u>	<u>12,841,798</u>	<u>11,797,875</u>

The financial statements were approved by the Board of Directors on 20 September 2002 and signed on its behalf by :

John J. Teeling,  
Director



# PAN ANDEAN RESOURCES PLC

ANNUAL REPORT 2002

## CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2002

	<i>Notes</i>	<b>2002</b> £	<b>2001</b> £
NET CASH INFLOW FROM OPERATING ACTIVITIES	20(a)	696,391	3,183,504
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		9,270	101,808
Interest paid		(103,713)	(78,917)
NET CASH (OUTFLOW)/INFLOW FROM RETURNS ON INVESTMENTS AND SERVICING OF FINANCE		(94,443)	22,891
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Disposals of tangible fixed assets		14,427	5,944
Payments to acquire intangible fixed assets		—	( 2,516,403)
Payments to acquire tangible fixed assets		(1,302,661)	( 3,081,440)
NET CASH OUTFLOW FROM CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT		(1,288,234)	(5,591,899)
ACQUISITIONS AND DISPOSALS			
Purchase of subsidiary undertakings		—	(5,179,677)
NET CASH OUTFLOW BEFORE FINANCING		(686,286)	(7,565,181)
FINANCING			
Issue of ordinary share capital		—	5,886,500
Costs associated with shares issued during the year		—	( 280,875)
NET CASH INFLOW FROM FINANCING		—	5,605,625
DECREASE IN CASH	20(b)	(686,286)	(1,959,556)

# PAN ANDEAN RESOURCES PLC

ANNUAL REPORT 2002

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2002

	2002 £	2001 £
Loss attributable to group shareholders	(364,563)	(3,912,385)
Currency translation adjustments	(57,603)	85,677
Total recognised losses for the year	<u>(422,166)</u>	<u>(3,826,708)</u>

## RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	2002 £	2001 £
Total recognised losses	(422,166)	(3,826,708)
New share capital subscribed	—	10,919,000
Costs associated with shares issued during the year	—	(280,875)
Net change in shareholders' funds	<u>(422,166)</u>	<u>6,811,417</u>
Opening shareholders' funds	12,841,798	6,030,381
Closing shareholders' funds	<u>12,419,632</u>	<u>12,841,798</u>

# PAN ANDEAN RESOURCES PLC

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ANNUAL REPORT 2002

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2002

### 1. PRINCIPAL ACCOUNTING POLICIES

(i) **Basis of preparation**

The financial statements have been prepared in accordance with applicable accounting standards generally accepted in the United Kingdom and United Kingdom statute comprising the Companies Act 1985. Accounting standards generally accepted in the United Kingdom in preparing financial statements giving a true and fair view are those published by the Institute of Chartered Accountants in England and Wales and issued by the Accounting Standards Board.

(ii) **Basis of consolidation**

The consolidated financial statements include the accounts of Pan Andean Resources plc, its subsidiaries and its branch in Bolivia made up to 31 March 2002.

Where necessary the accounting policies of the entities were adjusted to make them comparable with the accounting policies adopted by the group.

(iii) **Tangible fixed assets**

Plant and equipment assets are depreciated over their estimated useful lives on a straight line basis at the rate of 10% per annum.

(iv) **Investments**

Investments are stated at the lower of cost and directors' valuation.

(v) **Foreign currencies**

Assets and liabilities in foreign currencies are translated at the rate ruling at the balance sheet date. Transactions are converted at the rate ruling at the date of the transaction. Exchange differences are dealt with in the profit and loss account.

For the purposes of consolidation the foreign entities are translated using the closing rate method and any translation gain or loss is transferred directly to reserves.

(vi) **Deferred development expenditure**

Exploration costs, which are based on geographic areas, are capitalised until the results of the projects are known in accordance with the Statement of Recommended Practice on 'Accounting for oil and gas exploration and development activities'. Exploration costs include an allocation of administrative and salary costs as determined by management. When a project proves successful the costs are then transferred to depreciable cost pools within tangible fixed assets. An annual assessment is made of whether the economic value of interests is in excess of costs capitalised as intangible assets. Any impairment is transferred to depreciable regional cost pools within tangible fixed assets and depreciated. Where a project is terminated, which is ascertained on a country basis, the related exploration costs are written off immediately.



# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

### (vii) **Tangible fixed assets – oil and gas interests**

The group uses the full cost method of accounting for oil and gas operations, under which all costs of exploring for and developing oil and gas properties, whether productive or not, are capitalised as fixed assets. Costs dealt with in this way include licence acquisition costs, technical work, exploration and appraisal drilling, general technical support and a proportion of administrative and overhead costs. The group recognises its share of income, costs, assets and liabilities where it enters into participation agreements with third parties.

Costs are initially capitalised as intangible fixed assets and treated as non-depletable interests. Costs are transferred to depreciable pools within tangible fixed assets in each regional cost pool upon declaration of commerciality or upon cessation of exploration on each licence. Any proceeds arising from the sale or farm-out of assets are deducted from the relevant cost pool.

Depreciation and depletion of costs in depreciable pools is provided under the unit of production method based on estimated commercial reserves in each regional cost pool. Commercial reserves are net proven and probable developed and undeveloped oil and gas reserves, as defined in the UK Statement of Recommended Practice on Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities.

Changes in estimates affecting unit-of-production calculations for depreciation, decommissioning and production tax provisions are accounted for prospectively.

Costs capitalised as tangible fixed assets in excess of the estimated value of the group's discounted future net revenues of its commercial reserves are written-off immediately as additional depreciation.

### (viii) **Decommissioning**

Provisions for decommissioning costs are recognised in accordance with Financial Reporting Standard No. 12 "Provisions, Contingent Liabilities and Contingent Assets". Provisions are recorded at the present value of the expenditures expected to be required to settle the company's future obligation, to the extent any damage has been caused to date and taking risks and uncertainties into account in reaching the best estimate of the provision. Provisions are reviewed at each balance sheet date to reflect the current best estimate of the cost at present value. A decommissioning asset is also established, since the future cost of decommissioning is regarded as part of the total investment to gain access to future economic benefit.

### (ix) **Deferred tax**

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date.

Deferred tax assets are only recognised to the extent that they are regarded as recoverable. They are regarded as recoverable to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

### 2. SEGMENTAL ANALYSIS

The analysis of turnover, the loss before taxation and the net assets employed by geographical segment is shown below :

	<i>Turnover</i>		<i>Profit / (Loss) before taxation</i>		<i>Net assets employed</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
	£	£	£	£	£	£
United Kingdom	—	—	138,309	112,141	183,257	244,000
Bolivia	1,433,922	1,461,574	21,179	(4,883,685)	3,308,883	2,906,642
USA	2,412,832	3,431,907	(524,051)	1,083,749	8,927,492	9,691,156
	<u>3,846,754</u>	<u>4,893,481</u>	<u>(364,563)</u>	<u>(3,687,795)</u>	<u>12,419,632</u>	<u>12,841,798</u>

### 3. EXCEPTIONAL ITEM

During 2001, the accumulated development expenditure of £5,045,440 in relation to the Chaparé Block in Bolivia, was written-off after final drilling efforts in Chipirir X-1 Well failed to discover oil or gas reserves.

### 4. INTEREST RECEIVABLE AND SIMILAR INCOME

	<i>2002</i>	<i>2001</i>
	£	£
Interest earned	<u>9,270</u>	<u>101,808</u>

### 5. INTEREST PAYABLE

	<i>2002</i>	<i>2001</i>
	£	£
Interest	33,508	41,308
Unwinding of discount on provisions	70,205	37,609
	<u>103,713</u>	<u>78,917</u>

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

### 6. LOSS ON ORDINARY ACTIVITIES

	2002 £	2001 £
The loss on ordinary activities is stated after charging:		
Auditors' remuneration - audit	25,500	24,000
Depreciation	1,379,639	1,186,888
	<u>          </u>	<u>          </u>

Nil (2001 : £1,600) was paid to the auditors in respect of non audit services.

### 7. TAX ON LOSS ON ORDINARY ACTIVITIES

	2002 £	2001 £
Foreign tax	—	224,590
	<u>          </u>	<u>          </u>
	—	224,590
	<u>          </u>	<u>          </u>

Foreign tax is a result of corporation tax incurred on 2001 operations from the group's US subsidiary, Endeavour Oil & Gas Inc.

No charge to taxation arises in the current year due to the utilisation of available loss reliefs.

### 8. EMPLOYEE INFORMATION

The average monthly number of persons employed by the group during the year was :

	2002	2001
Management and administration	5	4
	<u>          </u>	<u>          </u>
Staff costs for the above persons (excluding directors) were :	£	£
Wages and salaries	131,985	116,701
	<u>          </u>	<u>          </u>

### 9. DIRECTORS' EMOLUMENTS

		2002 £	2001 £
Directors' remuneration	:Fees	50,000	40,000
	:Salary	148,896	116,746
		<u>          </u>	<u>          </u>

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

### 10. LOSS PER SHARE

Basic earnings per share is computed by dividing the profit or loss after taxation for the year available to ordinary shareholders by the sum of the weighted average number of ordinary shares in issue and ranking for dividend during the period. Diluted earnings per share is computed by dividing the profit or loss after taxation for the year by the weighted average number of ordinary shares in issue, adjusted for the effect of all dilutive potential ordinary shares that were outstanding during the year.

The following table sets forth the computation for basic and diluted earnings per share (EPS):

	2002 £	2001 £
<b>Numerator</b>		
Numerator for basic EPS retained loss	(364,563)	(3,912,385)
<b>Denominator</b>		
Denominator for basic EPS	97,321,979	86,314,562
Basic EPS	(.37p)	(4.53p)
Diluted EPS	(.37p)	(4.53p)

The basic and diluted loss per share are the same, as the effect of the outstanding share options is anti-dilutive, and is therefore excluded.

### 11. TANGIBLE ASSETS

Group	Plant & Equipment £	Oil & Gas Interests £	Total £
<b>Cost</b>			
At 1 April 2001	37,754	14,658,347	14,696,101
Exchange adjustments	(392)	(95,467)	(95,859)
Additions	—	1,302,661	1,302,661
Disposals	(17,341)	—	(17,341)
At 31 March 2002	20,021	15,865,541	15,885,562
<b>Depreciation</b>			
At 1 April 2001	10,274	1,547,547	1,557,821
Exchange adjustments	(82)	(19,097)	(19,179)
Charge for year	2,371	1,377,268	1,379,639
Disposals	(2,914)	—	(2,914)
At 31 March 2002	9,649	2,905,718	2,915,367
<b>Net book value</b>			
At 31 March 2002	10,372	12,959,823	12,970,195
At 31 March 2001	27,480	13,110,800	13,138,280

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

<i>Company</i>	<i>Plant &amp; Equipment £</i>	<i>Oil &amp; Gas Interests £</i>	<i>Total £</i>
<b>Cost</b>			
At 1 April 2001	15,257	—	15,257
Exchange adjustments	(135)	—	(135)
Additions	—	112,829	112,829
Disposals	(2,462)	—	(2,462)
	<hr/>	<hr/>	<hr/>
At 31 March 2002	12,660	112,829	125,489
	<hr/>	<hr/>	<hr/>
<b>Depreciation</b>			
At 1 April 2001	4,937	—	4,937
Exchange adjustments	(28)	—	(28)
Charge for year	1,704	—	1,704
Disposals	(2,170)	—	(2,170)
	<hr/>	<hr/>	<hr/>
At 31 March 2002	4,443	—	4,443
	<hr/>	<hr/>	<hr/>
<b>Net book value</b>			
At 31 March 2002	8,217	112,829	121,046
	<hr/>	<hr/>	<hr/>
At 31 March 2001	10,320	—	10,320
	<hr/>	<hr/>	<hr/>

### 12. INVESTMENTS

	<b>Group 2002 £</b>	<b>Company 2002 £</b>
<b>At Cost:</b>		
At 1 April 2001	2,203	6,837,367
Additions	1,039	—
Exchange adjustments	(23)	(23)
	<hr/>	<hr/>
At 31 March 2002	3,219	6,837,344
	<hr/>	<hr/>
<b>Net Book Value:</b>		
At 31 March 2002	3,219	6,837,344
	<hr/>	<hr/>
At 31 March 2001	2,203	6,837,367
	<hr/>	<hr/>

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

The subsidiaries of the company at 31 March 2002 were :

<i>Direct</i>	<i>Total allotted capital</i>	<i>Country of incorporation and operation</i>	<i>Nature of business</i>
Pan Andean Oil & Gas Limited	200 ordinary Shares of 1p each	England	Dormant
Pan Andean Resources (Jersey) Limited	2 ordinary shares of £1 each	Jersey	Management company
*Petrolex S.A.	1,000 ordinary Shares of 1,000 BS each	Bolivia	Exploration and Production
Endeavour Oil & Gas Limited	100 ordinary Shares of £1 each	England	Exploration and Production
*Endeavour Oil & Gas Incorporated	100 ordinary Shares of \$1 each	USA	Exploration and Production

\*indirectly held

The investment in the group at 31 March 2002 and 31 March 2001 represents a certificate of participation in the Telephone Co-Operative of La Paz, Bolivia.

### 13. DEBTORS : (Amounts falling due within one year)

	<i>Group 2002 £</i>	<i>Company 2002 £</i>	<i>Group 2001 £</i>	<i>Company 2001 £</i>
Trade	696,047	—	1,425,660	—
Amounts due by subsidiaries	—	5,098,562	—	5,079,174
Other debtors	292,048	23,980	362,704	4,354
	<u>988,095</u>	<u>5,122,542</u>	<u>1,788,364</u>	<u>5,083,528</u>

### 14. CASH AT BANK

£752,316 of the bank balance is held in separate escrow bank accounts to meet anticipated future decommissioning costs, and is therefore not available to the group for alternative uses.

# PAN ANDEAN RESOURCES PLC

## ANNUAL REPORT 2002

### 15. CREDITORS : (Amounts falling due within one year)

	<i>Group</i> <i>2002</i>	<i>Company</i> <i>2002</i>	<i>Group</i> <i>2001</i> £	<i>Company</i> <i>2001</i> £
Trade	585,749	—	858,744	—
Accruals	928,423	169,399	1,682,269	356,379
Bank overdraft	148,789	—	—	—
	<u>1,662,961</u>	<u>169,399</u>	<u>2,541,013</u>	<u>356,379</u>

### 16. PROVISIONS FOR LIABILITIES AND CHARGES

	<i>Group</i> £
<b>Decommissioning costs:</b>	
At 1 April 2001	1,059,364
Abandoned well cost	(353,749)
Additions to decommissioning provisions	86,331
Unwinding of discount charged to profit and loss account	70,943
Exchange adjustment	(8,142)
	<u>854,747</u>
At 31 March 2002	

The provision has been recognised at the present value of the company's year end obligation for expected decommissioning costs. The provision has been estimated in accordance with the operators' expectations of the decommissioning costs and of the period when those costs are to be incurred.

The costs are expected to be incurred over the next eight years.

### 17. CALLED-UP SHARE CAPITAL

	<i>2002</i> £	<i>2001</i> £
Authorised 200,000,000 ordinary shares of 1p each	<u>2,000,000</u>	<u>2,000,000</u>
Allotted Called-Up and Fully Paid Ordinary shares of 1p each:		
At 1 April 2001 : 97,321,979 shares (2001 : 69,527,979)	973,220	695,280
Shares issued during year – Nil (2001 : 27,794,000)	<u>—</u>	<u>277,940</u>
At 31 March 2002 : 97,321,979 shares (2001 : 97,321,979)	<u>973,220</u>	<u>973,220</u>

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### Options

A total number of 10,467,000 share options (including those to the directors as outlined in the report of the directors) were in issue at 31 March 2002. These options are exercisable, at prices ranging between 1p - 50p, for a period up to seven years from the date of granting the options unless otherwise determined by the board.

### 18 SHARE PREMIUM

	2002	2001
	£	£
At 1 April 2001	17,715,926	7,355,741
Arising on shares issued during the year (see Note 17)	—	10,641,060
Costs associated with shares issued during the year	—	(280,875)
At 31 March 2002	17,715,926	17,715,926

### 19. PROFIT AND LOSS ACCOUNT

	Group	Company
	£	£
Accumulated deficit at 1 April 2001	(5,847,348)	(6,891,271)
Translation adjustment	(57,603)	-
(Loss)/Profit for the year transferred to reserves	(364,563)	123,089
Accumulated deficit at 31 March 2001	(6,269,514)	(6,768,182)

As permitted by Section 230 of the Companies Act 1985 the profit and loss account of the parent company has not been presented separately in these financial statements.

### 20 CASH FLOW STATEMENT

#### (a) Reconciliation of operating loss to net cash inflow from operating activities

	Group	2001
	2002	£
	£	£
Operating (loss)/gain	(270,120)	1,334,754
Depreciation and fixed asset write down	1,379,639	1,186,888
Increase in investments	(1,016)	(224)
Decrease in debtors	800,269	801,902
Decrease in creditors	(1,231,458)	(140,631)
Exchange movements	19,077	815
	696,391	3,183,504



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### (b) Analysis of net funds

	<i>At 1 April 2001</i>	<i>Cash flow</i>	<i>At 31 March 2002</i>
	£	£	£
Cash in hand and at bank	1,513,328	(537,497)	975,831
Bank overdraft	—	(148,789)	(148,789)
	<u>1,513,328</u>	<u>(686,286)</u>	<u>827,042</u>

### (c) Reconciliation of net cash flow to movement in net funds

	<i>2002 £</i>	<i>2001 £</i>
Decrease in cash in the period	(686,286)	(1,625,850)
Change in net funds resulting from cash flows	<u>(686,286)</u>	<u>(1,625,850)</u>
Net funds at start of year	1,513,328	3,139,178
Net funds at end of year	<u>827,042</u>	<u>1,513,328</u>

## 21. RISK MANAGEMENT

The group's financial instruments comprise cash balances, short term bank borrowings and various items such as trade debtors and trade creditors which arise directly from trading operations. The main purpose of these financial instruments is to raise finance to fund group operations.

The group does not enter into any derivative transactions, and it is the group's policy that no trading in financial instruments shall be undertaken.

The main financial risk arising from the group's financial instruments is currency risk. The Board reviews and agrees policies for managing this risk and such policies are discussed in further detail below. These policies have remained unchanged since last year.

### Interest Rate Risk

The group has short term bank borrowings which are used to finance operations. New projects and acquisitions are financed by a combination of existing cash surpluses and through funds raised from equity share issues. The group may use project finance in the future to finance exploration and development costs on existing licences. The weighted average cost of capital associated with bank borrowings is 16%. The group's exposure to interest rate risk is not considered significant.

### Liquidity Risk

As regards liquidity, the group's exposure is confined to meeting obligations under short term trade creditor agreements. This exposure is not considered significant. The group's commitments have been fully met from equity finance raised to date. Long term liabilities, such as decommissioning costs will be met from funds deposited in designated bank accounts, which then become unavailable to the company for other purposes.

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### Foreign Currency Risk

Although the group is based in the UK, it has significant investments in overseas subsidiaries which operate in Bolivia and in the United States of America. Both of these overseas operations generate cash surpluses, primarily denominated in US dollars. The group holds surplus cash in US dollars and buys sterling as required at the most advantageous rates available to meet short term creditor obligations and fund other expenditure. The group is exposed at any point in time to exchange rate fluctuations, but this exposure is not considered to be very significant.

The group seeks to minimise its exposure to currency risk by closely monitoring exchange rates, and restricting the buying and selling of currencies to predetermined exchange rates within specified bands.

### Foreign Currency Risk

The functional currency of the majority of the group's operations is in US Dollars and Bolivianos, and the reporting currency is Sterling Pounds. The net currency exposure of the net assets of the group at the balance sheet dates was as follows:

Year ended	Total £'000	Stg Pounds £'000	Bolivianos £'000	US Dollars £'000	Euros £'000
31 March 2002	12,420	(181)	3,654	8,947	—
31 March 2001	12,842	(113)	3,278	9,651	26

The group does not presently utilise swaps or forward contracts to manage its currency exposures, although such facilities are considered and will be used where appropriate in the future.

## 22. CONTINGENCIES – Legal Claims

### Intergas Limited

Intergas Limited, a Bolivian drilling company, has filed legal proceedings against Pan Andean Resources Plc. The company is claiming US\$1,358,706 in respect of costs incurred as part of a risk-sharing joint venture contract in relation to drilling at the Chípíri X-1 well. Pan Andean Resources Plc have applied to the court to issue a declaration that there is no liability. The case awaits trial in court, and the group legal advisors and directors affirm that the case will not succeed. No provision has been made in respect of legal liability that could result from these proceedings.

### Coastal Oil & Gas, L.P. ("Coastal")

Coastal issued legal proceedings against Endeavour Oil & Gas Inc, a subsidiary company of the group, in relation to drilling in Texas USA during the year 1999. Coastal are claiming US\$608,000 in respect of drilling costs as part of a joint operating agreement. The company has refuted Coastal's claim, and has filed a counter claim alleging misconduct by Coastal, resulting in financial loss to Endeavour Oil & Gas Inc. The directors of Pan Andean Resources Plc affirm that Endeavour Oil & Gas Inc. have no liability in respect of the claim. Estimated legal costs relating to both the claim and the counter claim have been provided for.

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## NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Pan Andean Resources PLC will be held at the offices of Deloitte & Touche, Stonecutter Court, 1 Stonecutter Street, London EC4A 4TR at 12 noon on 16 October 2002 for the following purposes :

1. To receive and consider the Directors' Report and Audited Accounts for the year ended 31 March 2002.
2. To elect Director.  
The following will be proposed for-re-appointment:  
J. Finn retires in accordance with article 98 and seeks re-appointment.
3. To re-elect Deloitte & Touche as auditors and to authorise the Directors to fix their remuneration.
4. To transact any other ordinary business of an Annual General Meeting.

5. Special Business.

To consider and, if thought fit, pass the following special resolution:

That:

- (a) the authorised share capital of the Company be increased from £2,000,000 to £10,000,000 by the creation of 800,000,000 new Ordinary Shares of 1p each;
- (b) the Directors be and they are hereby generally and unconditionally authorised in accordance with Section 80 of the Companies Act 1985, to exercise all the powers of the Company to allot, grant options over, offer, deal with or otherwise dispose of any relevant securities (as defined in sub-section (2) of the said Section 80) of the Company up to a maximum aggregate nominal amount equal to the authorised but unissued share capital of the Company at the date of passing of this Resolution (and after the passing of this Resolution) such authority (unless previously revoked varied or extended by the Company in general meeting) to expire on the day five years after the passing of this Resolution 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 pursuant to such offer or agreement as if the power conferred hereby had not expired and;
- (c) pursuant to Section 95 of the Companies Act 1985, the Directors be and they are hereby empowered to allot equity securities (as defined in Section 94 of the Companies Act 1985) of the Company pursuant to the authority conferred by paragraph (b) above as if sub-section (1) of Section 89 of the Companies Act 1985 did not apply to such allotment and this power shall expire on the day five years after the passing of this Resolution save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if the power conferred hereby had not expired

By order of the Board :

James Finn

Secretary

20 September 2002

*Note :* A member who is unable to attend and vote at the above Annual General Meeting is entitled to appoint a proxy to attend, speak and vote in his stead. A proxy need not be a member of the company.

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## FORM OF PROXY

For use at the Annual General Meeting to be held on 16 October 2002 and at any adjournment thereof:

I/We .....  
(block letters)

of .....  
(being a member/members of the above named hereby appoint the \*Chairman of the Meeting)

.....  
as my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held at the offices of Deloitte & Touche, Stonecutter Court, 1 Stonecutter Street, London EC4A 4TR on 16 October 2002 at 12 noon and at any adjournment thereof. I/We direct that my/our vote(s) be cast on the specified Resolution as indicated by an X in the appropriate box.

### ORDINARY RESOLUTION

	For	Against
1. To receive and consider the Directors' Report and audited financial statements for the year ended 31 March 2002.	<input type="checkbox"/>	<input type="checkbox"/>
2. To elect Director. The following will be proposed for re-appointment. J. Finn	<input type="checkbox"/>	<input type="checkbox"/>
3. To re-elect Deloitte & Touche as auditors and to authorise the Directors to fix their remuneration.	<input type="checkbox"/>	<input type="checkbox"/>
4. To transact any other ordinary business of an Annual General Meeting.	<input type="checkbox"/>	<input type="checkbox"/>
5. Special Business.	<input type="checkbox"/>	<input type="checkbox"/>

\* Unless otherwise directed, and in respect of any other business resolution properly moved at the Meeting, the proxy will vote, or may abstain from voting, as he/she thinks fit.  
If it is desired to appoint another person as a proxy these words should be deleted and the name and address of the proxy, who need not be a member of the Company, inserted.

Dated this ..... day of ..... 2002

Signature .....

### NOTES:

1. To be effective the Form of Proxy duly signed, together with the power of attorney (if any) under which it is signed, must be deposited at the Company's Registrars, Computershare Services (Ireland) Ltd, Heron House, Corrig Road, Sandford Industrial Estate, Dublin 18 not less than forty-eight hours before the time appointed for the Meeting or any adjournment thereof, at which the person named in the Form is to vote.
2. If the Form of Proxy is given to a body corporate it must be given under its Common Seal or under the hand of the attorney or officer duly authorised.
3. A proxy need not be a member of the Company.
4. In the case of joint holders the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the other registered holders and for this purpose seniority shall be determined by the order in which the names stand in the Register of Members in respect of such holding.

FOLD 2

**The Company Registrar,  
Computershare Services (Ireland) Ltd,  
Heron House,  
Corrig Road,  
Sandyford Industrial Estate,  
Dublin 18.**

FOLD 1

FOLD 3

## DIRECTORS AND OTHER INFORMATION

### CURRENT DIRECTORS

John J. Teeling (Chairman)  
David Horgan (Managing)  
James Finn

### SECRETARY

James Finn

### REGISTERED OFFICE

20-22 Bedford Row  
London WC1R 4JS.  
Telephone: 0117 - 923 0600

### LONDON OFFICE

1 Russell Chambers  
The Piazza  
Covent Gardens  
London WC2E 8AA.  
Telephone: 0207 - 836 6913

### DUBLIN OFFICE

162 Clontarf Road  
Dublin 3  
Ireland.  
Telephone: 353 1 833 2833  
Facsimile: 353 1 833 3505  
Email: panand@iol.ie  
www.panandeanresources.com

### AUDITORS

Deloitte & Touche  
Deloitte & Touche House  
Earlsfort Terrace  
Dublin 2  
Ireland

### SOLICITORS

Ivor Fitzpatrick & Co.  
44-45 St. Stephen's Green  
Dublin 2  
Ireland

### BANKERS

Bank of Ireland  
Allied Irish Bank  
Anglo Irish Bank  
Banco de Santa Cruz de la Sierra  
Barclays Bank  
First State Bank of Texas

### NOMINATED ADVISOR/ CORPORATE BROKER/ STOCKBROKERS

Rowan Dartington & Co. Limited  
6th Floor, Colston Tower,  
Colston Street,  
Bristol BS1 4RD  
England.

### REGISTRARS

Computershare Services (Ireland) Ltd.  
Heron House  
Corrig Road  
Sandyford Industrial Estate  
Dublin 18.

### COMPANY REGISTRATION NUMBER

02231725

**[www.panandeanresources.com](http://www.panandeanresources.com)**