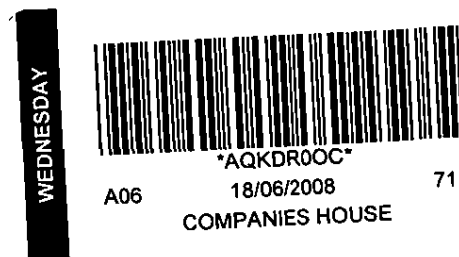




NEXEN EXPLORATION U.K. LIMITED
DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007



A company Registered in England and Wales, No 04323945
Registered Office Charter Place, Vine Street, Uxbridge, Middlesex UB8 1JG

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DIRECTORS' REPORT

The directors of Nexen Exploration U K Limited ("Nexen" or the "company") present their report on the affairs of the company together with the financial statements for the year ended 31 December 2007. The company's immediate parent is Nexen Petroleum U K Limited, and its ultimate parent undertaking and controlling party at 31 December, 2007 is Nexen Inc, a company incorporated in Canada. This directors' report has been prepared in accordance with the special provisions relating to small companies under section 246(4) of the Companies Act 1985.

Principal activities

The company is in the business of exploration and production of crude oil, natural gas and natural gas liquids. The company has no production at present.

The company holds interests in one exploration licence (P244) encompassing four blocks (21/2NJR, 21/2NCR, 21/2S and 29/6a).

The company acquired a package of prospective Coal Bed Methane assets in the U K in December 2005 and embarked on an exploration and appraisal programme to evaluate their potential. During 2006, two exploratory wells were drilled, one with a short lateral. In 2007 these wells were evaluated by conducting a production test for over a four month period. The test has been encouraging so far, demonstrating that CBM is technically viable in the U K. The company then acquired some additional acreage in January 2007 and an additional two wells were drilled during the year. Cores were taken from these wells for ongoing analysis and the wells plugged and abandoned.

In 2008 it is proposed that a further four wells and four laterals are drilled at a cost of £12m. This will serve to secure Nexen's current acreage position by fulfilling drill or drop well obligations and will evaluate all of its core areas. It is expected that by the end of this programme Nexen will be in a position to decide whether to sanction CBM development in the U K or to monetise the assets.

A deferred consideration is to be paid to Arco British Limited now BP Petroleum, in the event and at the time of development sanction by the Secretary of State of the Department of Trade and Industry for the 21/2 Jurassic formation in which the company (or its Affiliate(s)) is involved.

Future developments

The company will continue to investigate the opportunities for development of the exploration blocks held and are carrying out continuing reviews of other prospects in the area.

Results and dividends

The loss for the year amounts to £66,005 (2006 profit £55,905). The directors do not recommend the payment of a dividend for the current year (2006 £nil).

Directors

The directors of the company during the year and since the year end are as listed below.

Name	Date of Appointment	Date of Resignation
P Oldham		
P A C Doble		30 September 2007
P D Addy	30 September 2007	
E W Bogle		
I R Habke		
A O'Brien		
D O'Driscoll		
D O Tudor		

DIRECTORS' REPORT

The Office of Company Secretary during the year ended 31 December 2007 was held by L L White A O'Brien resigned as Company Secretary on 15 May 2007

Auditors

Each of the persons who is a director at the date of the approval of this report confirms that

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware, and
- the director has taken all the steps that he/she ought to have taken as director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of the information

This information is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985

The company has passed an elective resolution in accordance with the Companies Act 1985 to dispense with the annual re-appointment of auditors Deloitte & Touche LLP will, accordingly, continue in office as auditors of the company pursuant to section 386 of the Companies Act 1985



By order of the Board
A O'Brien, Director

Date 30 May 2008

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company as at the end of the financial year and of its profit or loss for the period then ended. In preparing these 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,
- state whether applicable UK Accounting Standards have been followed, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NEXEN EXPLORATION U.K. LIMITED

We have audited the financial statements of Nexen Exploration U K Limited for the year ended 31 December 2007 which comprise the profit and loss account, the balance sheet and the related notes 1 to 17. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and 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 Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NEXEN EXPLORATION U.K. LIMITED

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2007 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP
Registered Auditors and Chartered Accountants
London

3 June, 2008

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	2007 £	2006 £
Exploration expenses	5 & 8	(48,618)	(18,265)
Administrative expenses		<u>(31,902)</u>	<u>-</u>
OPERATING LOSS		(80,520)	(18,265)
Net interest income	6	<u>71,335</u>	<u>74,170</u>
(LOSS)/PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		(9,185)	55,905
Tax on (loss)/profit on ordinary activities	7	<u>(56,820)</u>	<u>-</u>
(LOSS)/PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION AND RETAINED FOR THE FINANCIAL YEAR	14	<u>(66,005)</u>	<u>55,905</u>

All items dealt with in the above profit and loss account relate to continuing operations

There were no recognised gains or losses in either the current or prior years other than the (loss)/profit for the year. Accordingly no statement of total recognised gains and losses is required.

BALANCE SHEET AT 31 DECEMBER 2007

	Notes	2007 £	2006 £
FIXED ASSETS			
Intangible assets	8	<u>15,348,491</u>	<u>9,289,422</u>
CURRENT ASSETS			
Inventory	9	274,658	21,601
Debtors	10	2,060,769	395,100
Cash at bank		<u>896</u>	<u>925</u>
		<u>2,336,323</u>	<u>417,626</u>
CREDITORS – amount falling due within one year	11	<u>(19,329,071)</u>	<u>(11,269,119)</u>
NET CURRENT LIABILITIES		<u>(16,992,748)</u>	<u>(10,851,493)</u>
PROVISION FOR LIABILITIES			
Abandonment and decommissioning	12	<u>(735,481)</u>	<u>(751,662)</u>
NET LIABILITIES		<u>(2,379,738)</u>	<u>(2,313,733)</u>
CAPITAL AND RESERVES			
Called up share capital	13	894,060	894,060
Profit and loss account		<u>(3,273,798)</u>	<u>(3,207,793)</u>
SHAREHOLDERS' DEFICIT	14	<u>(2,379,738)</u>	<u>(2,313,733)</u>



Approved on behalf of the Board
I R Habke, Director

Date 30 May 2008

NOTES TO THE ACCOUNTS – 31 DECEMBER 2007

1 ACCOUNTING POLICIES

A summary of the principal accounting policies, all of which have been applied consistently throughout the current and preceding year, is set out below

(a) Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

The company's financial statements fall within the scope of the UK Oil Industry Accounting Committee's Statement of Recommended Practice (SORP), "Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities" and have been prepared in accordance with provisions thereof

(b) Taxation

Current Corporation Tax is provided on the basis of amounts to be paid or recovered using tax rates and laws that have been enacted or substantially enacted at the balance sheet date

Full provision is made for deferred taxation on all timing differences that have arisen but not reversed at the balance sheet date. Deferred tax assets are only recognised to the extent that it is more likely than not that they will be recovered. Amounts related to deferred taxation are undiscounted

(c) Joint ventures

Exploration activities are conducted as co-licensee in joint ventures with other companies. The financial statements reflect the relevant proportions of capital and operating expenditures applicable to the company's interests

(d) Intangible fixed assets and oil and gas property related tangible fixed assets

Expenditures on pre-licence, licence acquisition, exploration and appraisal activities are initially capitalised as intangible fixed assets until the discovery or otherwise of commercial reserves has been established and development consent is received. The recoverability of such intangible assets is dependent on future successful drilling results and successful development of commercial reserves. Intangible assets are held undepreciated, but are reviewed annually for impairment

Where it is determined that no commercial reserves exist, in the absence of a producing pool, the related intangible assets are written off to the profit and loss account as exploration expenses

(e) Inventory

Inventory is recorded at the lower of cost and net realisable value

(f) Foreign currencies

Transactions denominated in currencies other than pounds sterling are translated into sterling at the rates of exchange prevailing at the dates of the transactions. Monetary assets and liabilities denominated in such currencies are translated into sterling at the rates of exchange prevailing at the balance sheet date. All exchange differences arising are taken to the profit and loss account for the year

NOTES TO THE ACCOUNTS – 31 DECEMBER 2007

(g) Abandonment and decommissioning

Provision is made for the present value of the future cost of abandonment of exploration wells where additional work is required for their abandonment. The estimated costs, based upon engineering cost levels estimated as at the balance sheet date, are computed on the basis of the latest assumptions as to the scope and method of abandonment. The corresponding amount is capitalised as part of intangible assets. The unwinding of the discount applied to the abandonment provision (if material) is treated as a component of the interest charge.

(h) Capitalised costs

Costs relating directly to exploration and development activities are capitalised.

(i) Cash flow statement

The company has taken advantage of the exemptions in Financial Reporting Standard (FRS) 1 from the requirement to prepare a cash flow statement for the company on the grounds that its results are consolidated in the financial statements of its ultimate holding company, Nexen Inc, a company incorporated in Canada, which are publicly available (see note 17).

(j) Related parties

In accordance with the exemption allowed by paragraph 3(c) of FRS 8, no disclosure is made of transactions with other member companies of Nexen Inc or any of its subsidiaries.

2 DIRECTORS' EMOLUMENTS

Directors' emoluments were £Nil for the year (2006 £Nil)

3 STAFF COSTS

The company did not employ any staff for the year (2006 None)

4 AUDITORS' REMUNERATION

Audit fees were borne by the immediate parent undertaking. The audit fee in respect of the audit of the company's annual accounts is £4,400 (2006 £4,160).

NOTES TO THE ACCOUNTS – 31 DECEMBER 2007

5 EXPLORATION EXPENSES

	<u>2007</u>	<u>2006</u>
	£	£
Exploration costs written off (see note 8)	<u>48,618</u>	<u>18,265</u>

The charge for exploration costs in the profit and loss account represents capitalised costs that have been impaired prior to the commencement of commercial production, on determination that no commercial reserves have been discovered

6 NET INTEREST INCOME

	<u>2007</u>	<u>2006</u>
	£	£
Interest receivable and similar income		
Net gain on foreign exchange	113,006	76,869
Interest payable and similar charges		
Interest payable - joint venture partners	(260)	(217)
Interest on unwinding of discount on future site restoration liability	(41,411)	(2,482)
	<u>71,335</u>	<u>74,170</u>

7 TAXATION

(a) Analysis of corporation tax charge for the year

	<u>2007</u>	<u>2006</u>
	£	£
Current taxation - prior year adjustment	22,996	-
Current taxation - current year	<u>33,824</u>	<u>-</u>
	<u>56,820</u>	<u>-</u>

NOTES TO THE ACCOUNTS – 31 DECEMBER 2007

Taxation (continued)

(b) Factors affecting the corporation tax charge for the year

The difference between the total current corporation tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows

	£	£
(Loss)/profit on ordinary activities before tax	<u>(38,534)</u>	<u>55,905</u>
(Loss)/profit on ordinary activities multiplied by average 2007 UK corporation tax rate of 30% (2006 30%)	(11,560)	16,772
Effects of:		
Pre-trading income not subject to tax	-	(22,252)
Pre-trading expenditure not deductible for tax purposes	45,384	5,480
Prior year adjustment	22,996	-
	<u>56,820</u>	<u>-</u>
Current tax charge for the year		

8 FIXED ASSETS

	<u>2007</u> £	<u>2006</u> £
Intangible assets		
Cost		
At 1 January	12,190,210	4,299,688
Additions	<u>6,107,687</u>	<u>7,890,522</u>
At 31 December	<u>18,297,897</u>	<u>12,190,210</u>
Impairment		
At 1 January	2,900,788	2,882,523
Impairment charge	<u>48,618</u>	<u>18,265</u>
At 31 December	<u>2,949,406</u>	<u>2,900,788</u>
Net book value		
At 31 December	<u>15,348,491</u>	<u>9,289,422</u>

Intangible assets are comprised of licence acquisition costs and exploration expenditure

The net book value of the abandonment and decommissioning asset included in the above intangible assets is £691,588 (2006 £749,180)

9 INVENTORY

	<u>2007</u> £	<u>2006</u> £
Materials and consumables	<u>274,658</u>	<u>21,601</u>

NOTES TO THE ACCOUNTS – 31 DECEMBER 2007

10 DEBTORS: Amounts due within one year

	<u>2007</u> £	<u>2006</u> £
Amounts owed by parent undertaking	1,740,659	230,423
VAT recoverable	26,966	150,635
Other debtors	292,444	-
Accrued receivables from co-venturers	700	14,042
	<u>2,060,769</u>	<u>395,100</u>

11 CREDITORS Amounts falling due within one year

	<u>2007</u> £	<u>2006</u> £
Trade creditors	4,569	816,727
Amounts owed to immediate parent undertaking	17,986,539	7,455,166
Accruals	1,281,142	2,997,226
Corporation tax	56,820	-
	<u>19,329,070</u>	<u>11,269,119</u>

Amounts due to the parent undertaking are interest free, with no fixed repayment date

12 ABANDONMENT AND DECOMMISSIONING

	<u>2007</u> £	<u>2006</u> £
At 1 January	751,662	57,180
Additions and changes in assumptions	(57,592)	692,000
Interest on unwinding of discount	41,411	2,482
At 31 December	<u>735,481</u>	<u>751,662</u>

The provision is based on the net present value of Nexen's estimated future cost of £80,767 for restoring Block 29/6a in 2010 and £735,438 for restoring CBM field locations potentially in 2009

13 CALLED UP SHARE CAPITAL

	<u>2007</u> £	<u>2006</u> £
Attributable to equity interests:		
Ordinary shares		
Authorised 10,000,000 shares of £1 each	<u>10,000,000</u>	<u>10,000,000</u>
Allotted, called up and fully paid		
894,060 of £1 each	<u>894,060</u>	<u>894,060</u>

NOTES TO THE ACCOUNTS – 31 DECEMBER 2007

14 RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	<u>2007</u> £	<u>2006</u> £
(Loss)/profit for the year	(66,005)	55,905
Net (decrease)/increase in equity shareholders' (deficit)/funds	(66,005)	55,905
Shareholder's deficit at beginning of the year	(2,313,733)	(2,369,638)
Closing shareholder's deficit	<u>(2,379,738)</u>	<u>(2,313,733)</u>

15 CONTINGENT LIABILITIES

A deferred acquisition consideration cost of £355,518 becomes payable by the immediate parent undertaking should the Secretary of State of the Department of Trade and Industry give consent to a development programme for the 21/2 Jurassic formation in which the Company (or its Affiliate(s)) is involved

16 CAPITAL COMMITMENTS

At 31 December 2007, capital expenditures contracted but not provided for were £4,586,000 (2006 £1,500,000)

17 ULTIMATE PARENT COMPANY AND CONTROLLING PARTY

The immediate parent undertaking at 31 December 2007 is Nexen Petroleum U K Limited

The ultimate parent undertaking and controlling party at 31 December 2007 is Nexen Inc , a company incorporated in Canada, which is the largest corporate entity to prepare consolidated group financial statements incorporating these accounts. Copies may be obtained from the Corporate Secretary, Nexen Inc , 801-7th Avenue S W, Calgary, Alberta, Canada T2P 3P7. The smallest group to consolidate these financial statements is Nexen Petroleum U K Holdings Limited. Copies of the financial statements may be obtained from the company secretary, Nexen U K Holdings Limited, Charter Place, Vine Street, Uxbridge, Middlesex, UB8 1JG, UK