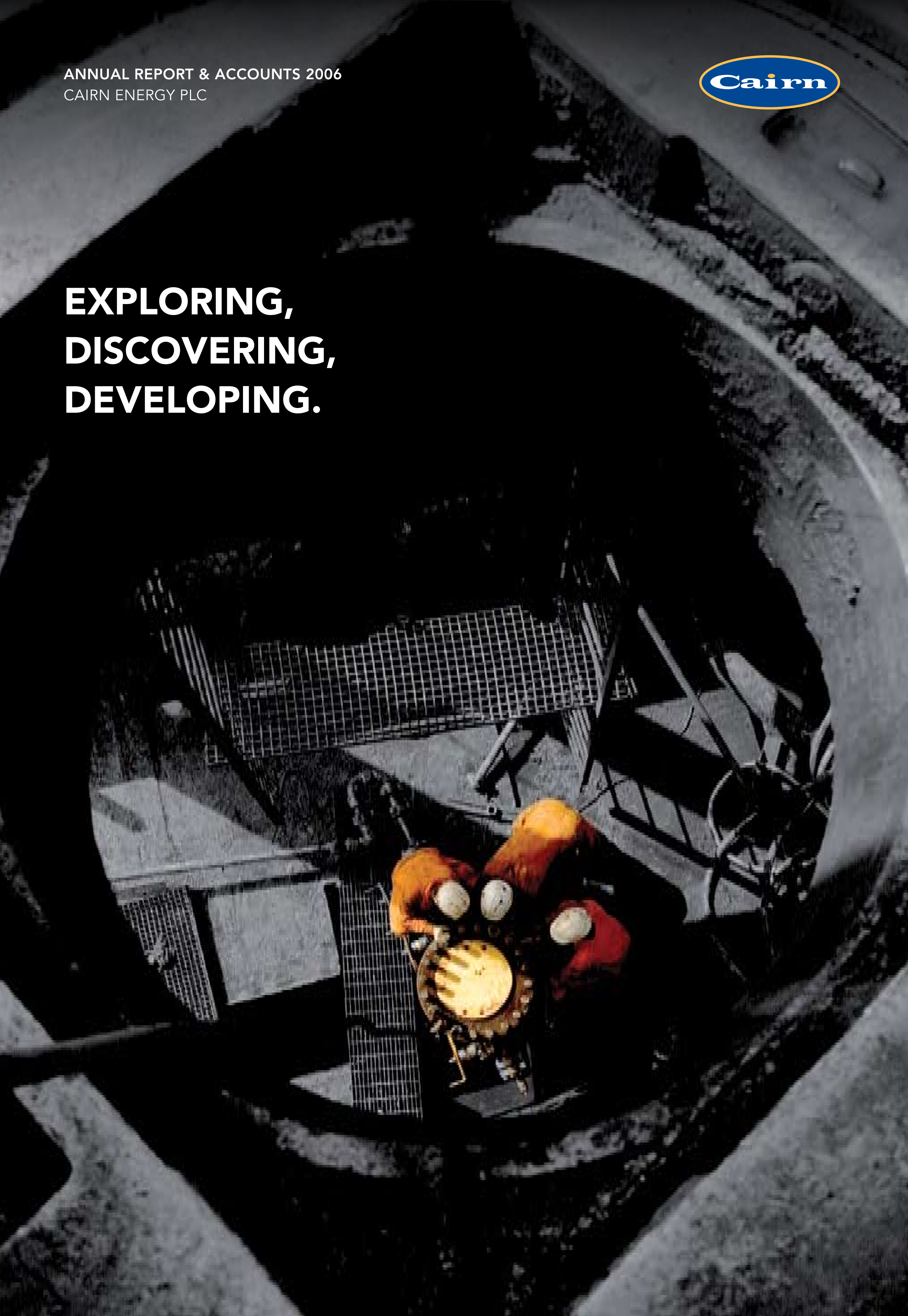
ANNUAL REPORT & ACCOUNTS 2006
CAIRN ENERGY PLC

EXPLORING, DISCOVERING, DEVELOPING.



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CAIRN ENERGY PLC IS AN EDINBURGH BASED OIL AND GAS EXPLORATION AND PRODUCTION COMPANY LISTED ON THE LONDON STOCK EXCHANGE.

OUR OIL AND GAS INTERESTS AND ACTIVITIES ARE FOCUSED IN SOUTH ASIA (IN INDIA, BANGLADESH AND NEPAL), WHERE WE HAVE BUILT UP A WORLD CLASS PORTFOLIO OF ASSETS OVER THE LAST DECADE.

OUR INDIAN ASSETS ARE NOW MANAGED BY CAIRN INDIA LIMITED, WHICH LISTED ON THE BOMBAY STOCK EXCHANGE AND NATIONAL STOCK EXCHANGE IN INDIA IN JANUARY 2007. CAIRN ENERGY PLC CURRENTLY HOLDS A 69% INTEREST IN CAIRN INDIA.

OUR ASSETS IN BANGLADESH AND NEPAL ARE NOW HELD BY CAPRICORN ENERGY LIMITED, WHICH IS A WHOLLY OWNED SUBSIDIARY OF CAIRN ENERGY PLC.

2006 HIGHLIGHTS

CORPORATE

- IPO of Cairn India completed in January 2007 raising $1.98bn
- Return of £3 per share to Cairn Energy PLC shareholders to be completed in April 2007
- IPO proceeds of $600m retained by Cairn India – $300m available to Capricorn

OPERATIONAL

- Gross operated production 105,028 boepd (entitlement 24,523 boepd)

India

- Rajasthan midstream solution progressing well – alignment with ONGC on pipeline evacuation, subject to Government of India (GoI) approval
- Rajasthan oil in place in excess of 3.6 billion barrels
- Rajasthan planned production of 150,000 bopd, including increased Bhagyam production plateau target of 40,000 bopd
- Enhanced Oil Recovery (EOR) potential for recovery increase and plateau extension
- First oil production from Mangala on schedule for 2009

Bangladesh

- Drilling operations ongoing in Bangladesh – separate potentially high impact exploration campaign planned for late 2007/early 2008
- Final Sangu gross booked reserves reduction of 213 bscf (increased from the 187 bscf reduction announced in January 2007)

Nepal

- Agreement to acquire 100% interest in blocks 3 and 5, subject to required consents
- Seismic field operations planned to commence early 2008

FINANCIAL

- Average entitlement production 24,523 boepd (2005: 28,240 boepd)
- Cash generated from operations $207.2m (2005: $139.6m)
- Exceptional oil and gas write off $71.5m, relating to impairment on Sangu
- Loss for the year of $82.0m (2005 profit: $79.1m)
- Net cash at year end of $701.3m (2005: $95.5m), including $751.8m raised in pre IPO placing
- Expected gain of $1.1bn on IPO to be reported in 2007

>3.6bn barrels

(GROSS) OF OIL IN PLACE IN RAJASTHAN

$1.98bn

IPO PROCEEDS

Corporate Overview

The last year has been momentous for Cairn as it set about creating an autonomous business in India (Cairn India) and a separate company (Capricorn) based in Edinburgh and more focused on exploration. Cairn Energy PLC continues to be the parent company of each of these businesses.

The flotation and listing of Cairn India on the Bombay Stock Exchange and the National Stock Exchange of India was successfully completed on 9 January 2007 raising a total of $1.98bn and leaving Cairn with a holding of 69% in Cairn India. From the funds raised, approximately $940m is being returned to existing Cairn shareholders, representing £3 per share. A further $600m has been retained to fund ongoing working capital requirements in Cairn India. The balance of around $300m, after transaction fees and debt repayment, is being retained by Cairn and is therefore available for potential investment in new business opportunities.

The IPO of Cairn India was the largest IPO to date in the Indian primary equity markets, and Cairn India currently has a market capitalisation in excess of $5 billion, ranking it the fourth largest oil and gas company in India. The IPO attracted a number of high quality investors (including PETRONAS, which holds 10%) thereby signifying investor confidence in the Indian equity story, the regulatory environment and the capital markets. Cairn India is committed to continuing investment in India and is very much focused on creating shareholder value by developing its world class resource base in Rajasthan and seeking to continue Cairn's track record of exploration success.

As previously announced, all of the assets not transferred to Cairn India in the IPO – those in Bangladesh, Nepal and certain exploration interests in northern India – have been brought under Capricorn, which is currently a wholly owned subsidiary of Cairn. The balance of proceeds raised in the IPO, which are not being returned to shareholders, have been retained to support the growth of Capricorn, with the aim of creating further value for shareholders in the future.

The Group continues to be well placed financially with a strong balance sheet, positive operating cash flows, an $850m syndicated revolving credit facility, and cash generated from the flotation of the Indian business to drive forward the Rajasthan development and pursue opportunities in other business areas.

INITIAL PUBLIC OFFERING (IPO) OF CAIRN INDIA LIMITED SUCCESSFULLY COMPLETED.

TRADING COMMENCED IN JANUARY 2007; RETURN OF CASH TO CAIRN ENERGY PLC SHAREHOLDERS TO BE COMPLETED IN APRIL 2007.

Staff

The IPO was completed in less than 10 months from inception to execution, and the manner in which Cairn's staff dealt with not only the restructuring of the business, but also the additional workload of this complex transaction is a testament to their dedication and efficiency.

In recognition of the fact that a significant part of Cairn India's future operations will be focused on Rajasthan, a new Indian headquarters has been established at Gurgaon, on the outskirts of Delhi. Cairn's original Indian headquarters in Chennai, Tamil Nadu, has now closed. This has necessitated the relocation of a number of Cairn staff and their families, and I would like to thank them for their ongoing support.

Cairn Energy PLC (and Capricorn) will continue to be run from Edinburgh with operational offices in Dhaka and Chittagong. In addition, Cairn has recently opened an office in Kathmandu to support its proposed operational activities in Nepal.

The Cairn Board held two meetings in India during 2006, and heard at first hand about the support work carried out in Rajasthan during the floods that affected the region in 2006.

We also continued our numerous community programmes in all of our operational areas across South Asia.

Outlook

The restructuring of Cairn's activities into two separate businesses means that each is now positioned more effectively to pursue their respective strategies.

Cairn India will focus on delivering the very significant future cash flows associated with production from the Rajasthan discoveries, while also maximising new investment opportunities in the rapidly growing Indian market.

In parallel with this, and by using its established exploration and transaction expertise, Capricorn will continue to follow a strategy of seeking to add shareholder value through material growth.

Norman Murray
Chairman
27 March 2007

REVENUE

$600m

IPO PROCEEDS RETAINED BY CAIRN INDIA

$850m

LOAN FACILITY FOR RAJASTHAN DEVELOPMENTS

CHIEF EXECUTIVE'S REVIEW

Overview

Just over three years ago, Cairn made the transformational discovery of Mangala in Rajasthan. Following successful completion of the IPO in January 2007, and its establishment as an autonomous business, Cairn India is well placed to move that discovery and others in Rajasthan forward in preparation for first oil production in 2009.

In parallel with this, Capricorn is examining a number of opportunities for growth.

India

The IPO of Cairn India is a natural evolution of our business, building on the decade of remarkable achievement that Cairn has enjoyed in South Asia. The successful completion of the IPO has created an autonomous business with an experienced management team capable of developing and building on our world class assets in India.

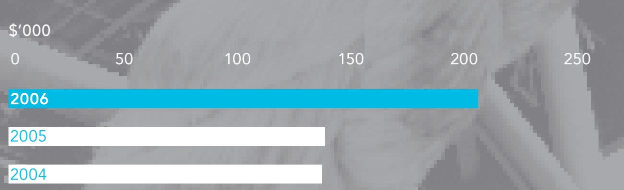
Cairn India's oil and gas fields at Ravva and CB/OS-2 continue to be the cornerstone of its existing production. During 2006 both of these assets benefited from revised gas prices and improved oil production. An ongoing drilling programme at Ravva and new developments planned on CB/OS-2 will ensure that these assets continue to underpin Cairn India's activities elsewhere in India.

A step change in production is expected from 2009, when the first of the Rajasthan developments is scheduled to come onstream. The Mangala field will be brought on production first, followed by the Bhagyam and Aishwariya fields; targeted gross production from all three is 150,000 bopd. Once onstream, these fields will create enormous value for the GoI, the Rajasthan State Government and for investors and other stakeholders in both Cairn and Cairn India.

Laboratory studies have indicated that the early application of enhanced oil recovery (EOR) techniques on the Mangala and Bhagyam fields is expected to significantly extend the production plateau and ultimate reserves for these fields. Further work is also planned to determine the best method of extracting the oil from the potentially productive Barmer Hill formation.

India's exploration potential is huge, with the majority of the 26 hydrocarbon basins in the country being under-explored. Cairn India has recently secured two new exploration blocks in the NELP VI licensing round and now has an interest in a total of 15 blocks in India. Cairn India is well placed to build on this asset base and to bid for further exploration acreage that may be offered in future licensing rounds.

OPERATING CASH FLOW



150,000

BOPD GROSS PRODUCTION TARGET FOR RAJASTHAN

15 blocks

HELD BY CAIRN INDIA

Rajasthan Upstream

The upstream picture in Rajasthan is progressing well. Current estimates for the proven and probable (2P) hydrocarbons in place for the six fields; Mangala, Bhagyam, Aishwariya, Saraswati, Raageshwari Oil and Raageshwari Deep Gas; total 2.2 billion boe and the associated 2P reserves plus contingent resources are 864 million boe.

The additional smaller and/or low permeability fields and reservoirs have an estimated 2P hydrocarbons in place volume of more than 1.4 billion boe. Over the coming years, Cairn India's focus will be on converting as much of this contingent resource base into 2P reserves as is economically possible.

In this regard, work is also ongoing to establish optimal EOR techniques in the Rajasthan block to extend plateau production and maximise recovery factors. Laboratory work is currently underway to establish the potential of these technologies, particularly in relation to how they can be used in Mangala and Bhagyam, the largest of the Rajasthan fields.

The first phase of development drilling on Saraswati has been completed and development drilling is now underway on Raageshwari. Development drilling on Mangala is scheduled to commence in 2008.

The GoI has approved the Declaration of Commerciality for Bhagyam, the second largest field in Block RJ-ON-90/1, along with the Shakti field. Field development plans (FDPs) for Bhagyam and Shakti have been completed and are expected to be submitted to the GoI in Q2 2007.

Rajasthan Midstream

Cairn India is aligned with its joint venture (JV) partner, ONGC, on a midstream solution and intends to become an active participant in midstream activities with a view to optimising value from its exposure to the entire production and oil sales chain.

Through third party discussions and studies relating to the evacuation of the crude, Cairn India now has a comprehensive understanding of the construction schedule for a pipeline from the fields in Rajasthan. Specialist consulting engineers have been retained to help develop this knowledge base further and to assist Cairn India in addressing the associated technical and commercial issues involved.

A proposal is currently being prepared for submission to the GoI seeking approval to include within the FDP a pipeline to transport Rajasthan crude from Mangala to a coastal terminal facility. The proposed routing of the pipeline will allow access to the existing pipeline infrastructure and refinery network, with a final coastal delivery point that also affords access to the majority of India's refining capacity. It is proposed that the pipeline will fall within the definition of the field development activities and will, accordingly, be funded 70% by Cairn India and 30% by ONGC. If the pipeline is included in the FDP and approved by the GoI, the costs would be recoverable under the Production sharing contracts (PSCs). The conceptual engineering and route identification for the pipeline are at an advanced stage.

Cairn India and ONGC are continuing discussions on the approach to pricing the Rajasthan crude.

CAIRN HAS UNDERGONE AN EXTENSIVE RESTRUCTURING OF ITS BUSINESS WITH THE IPO OF CAIRN INDIA AND THE FORMATION OF CAPRICORN.

WE CONTINUE TO BE FOCUSED ON DELIVERING THE RAJASTHAN DEVELOPMENT AND ENSURING THE UPSTREAM PROJECT REMAINS ON TRACK TO PRODUCE FIRST OIL IN 2009. CAIRN INDIA IS ALIGNED WITH ITS JOINT VENTURE PARTNER ONGC AND INTENDS TO BECOME AN ACTIVE PARTICIPANT IN MIDSTREAM ACTIVITIES WITH A VIEW TO OPTIMISING VALUE FROM ITS EXPOSURE TO THE ENTIRE PRODUCTION AND OIL SALES CHAIN.

WE ARE ACTIVELY EVALUATING GROWTH OPPORTUNITIES FOR CAPRICORN.

RAHUL DHIR, CEO OF CAIRN INDIA

On the appointment of Rahul Dhir as CEO of Cairn India in April 2006, Sir Bill Gammell commented "Rahul's intimate knowledge of India, and his international banking and specialist experience of world energy markets, will be invaluable to Cairn."

On completion of his studies in Delhi and the US, Rahul started his career as an oil and gas engineer before moving into investment banking. Prior to his move to Cairn India to lead the IPO, Rahul worked for Merrill Lynch, where he advised some of the world's leading oil and gas companies.

"Both of my parents worked for ONGC and so the oil and gas industry was part of my upbringing. As a student, I even worked in the Cambay Basin which is located to the south of the Rajasthan Basin, in which Cairn India is now very active. Coming back to India as CEO of Cairn India has been very exciting – India today is very different from the country I left 20 years ago. India's growth potential is increasingly recognised and understood, with virtually every major business now paying attention to it. Around the globe, the oil and gas sector is also realising that India is relatively under explored as a hydrocarbon province. Cairn India is well placed to play its part in fulfilling this tremendous potential and I believe that the next decade is going to be remarkable for us and for India."

Rahul Dhir
Chief Executive Officer
Cairn India Limited

Rajasthan Project Funding
Cairn India's funding for the initial upstream development will be provided from ongoing cash generation, its retained proceeds of the IPO ($600m) and specific banking facility ($850m). Funding for the midstream pipeline can also largely be met from these sources. Once the Mangala oil field is onstream, subsequent development phases will be funded out of the resultant cash flows and borrowings under the facility.

Bangladesh
A planned three well offshore drilling campaign in Bangladesh commenced in January 2007 and is ongoing. However, due to operational delays the third well in the sequence – an exploration well on the Hatia prospect – will now not be drilled in the current weather window. A separate high impact exploration campaign targeting both the Hatia and Magnama prospects is being planned for late 2007/early 2008.

The first well drilled in the current programme was a down-dip appraisal well on the South Sangu field, which unfortunately encountered a gas/water contact in the main reservoir. The gas volumes associated with South Sangu are now considered to be non-commercial and a decision has been made not to proceed with its development.

Present drilling operations are focused on a Sangu infill development well (Sangu-10). The principal objective of the Sangu-10 well is to test a potentially undrained compartment in the main Sangu field. At the time of the January 2007 operational update, it was expected that the results of Sangu-10 would be known by the time of the preliminary results announcement. However, operational delays have meant that the results of this well are not yet available. It has therefore been decided to reclassify 88 bscf of the 100 bscf attributable to the success case from the 2P to the 3P category to reflect fully the risk that this compartment may be partially drained. This has had the effect of increasing the gross Sangu reserves reduction to 213 bscf compared to the 187 bscf announced in the January 2007 operational update.

The Sangu gas field, although now in decline, has produced in excess of 400 bscf since commencement of production in 1998. To date, the Sangu JV has generated gross revenue in excess of $830m.

Results and Financial Performance
Production for the year, on an entitlement interest basis, has decreased by 13% to 24,523 boepd (2005: 28,240 boepd). This is primarily due to reduced gross field production at Sangu with entitlement further impacted by reduced development expenditure incurred in 2006. A breakdown of production is shown in the table in the Operating and Exploration Review on page 21.

The Group's production mix continues to be gas biased (approximately 73% on an entitlement basis). This, combined with contractual gas price caps, resulted in an average price realised by the Group for the year of $31.84 per boe (2005: $25.44 per boe). The increase was mainly due to higher oil prices achieved. Cairn's exposure to world oil prices will increase significantly when production commences from Rajasthan.

Revenue for the year was $286.3m (2005: $262.6m).

Operating profit (pre-exceptional items) and operating cash flows were $6.9m and $207.2m respectively (2005: $55.6m and $139.6m). The Group made a loss after tax of $82.0m (2005 profit: $79.1m), mainly due to the exceptional oil and gas write down of $71.5m as a result of the downward reserves revision on Sangu.

On 9 January 2007, Cairn's Indian business was floated on the Bombay Stock Exchange and the National Stock Exchange of India, pursuant to Cairn's strategy of increasing the autonomy of that business and of realising value for shareholders.

The total proceeds raised in the flotation were $1.98bn and, on 27 February 2007, the Company announced the proposed return of £481m (approximately $940m) of this cash to shareholders of Cairn Energy PLC (equivalent to £3 per share). Cairn India has retained $600m, with the remainder of the proceeds currently being held to fund Cairn's ongoing business held by its wholly owned subsidiary Capricorn. This provides financial flexibility to support the growth of Capricorn, with the aim of creating and realising further value for shareholders in the future.

The expected $1.1bn gain on disposal of the 31% interest in Cairn India in the IPO will be included in the results for 2007.

The Group signed a $1bn syndicated revolving credit facility on 27 June 2006 ($845m unutilised at 31 December 2006). Following the IPO, the $150m corporate facility was cancelled and the remaining $850m transferred to Cairn India to finance the Rajasthan development.

At the year end the Group had net cash of $701.3m, including funds raised in the pre IPO placing of $751.8m (2005: net cash $95.5m).

Sir Bill Gammell
Chief Executive
27 March 2007

69%

CAIRN ENERGY PLC HOLDING IN CAIRN INDIA POST IPO

$940m

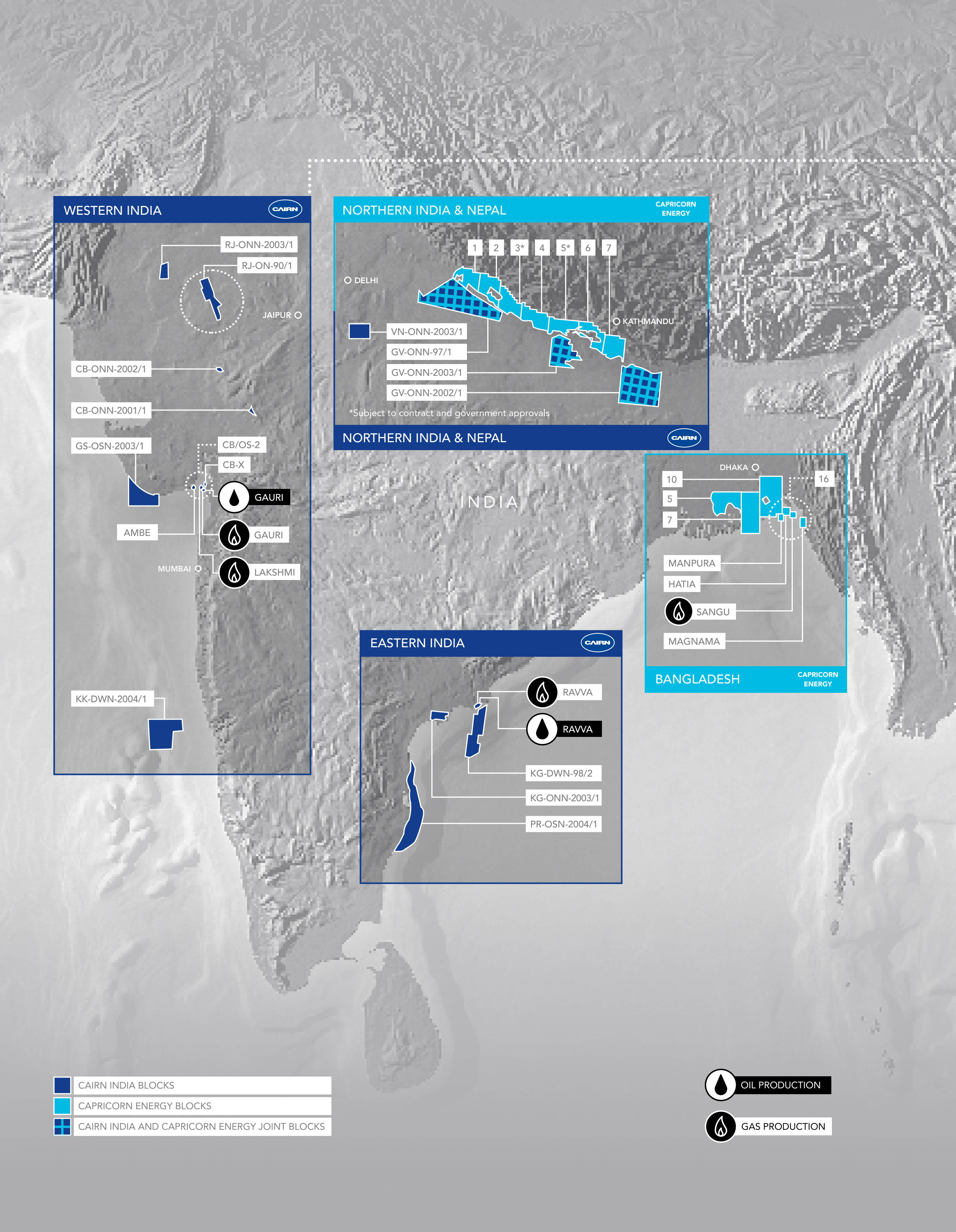
RETURN TO CAIRN ENERGY PLC SHAREHOLDERS

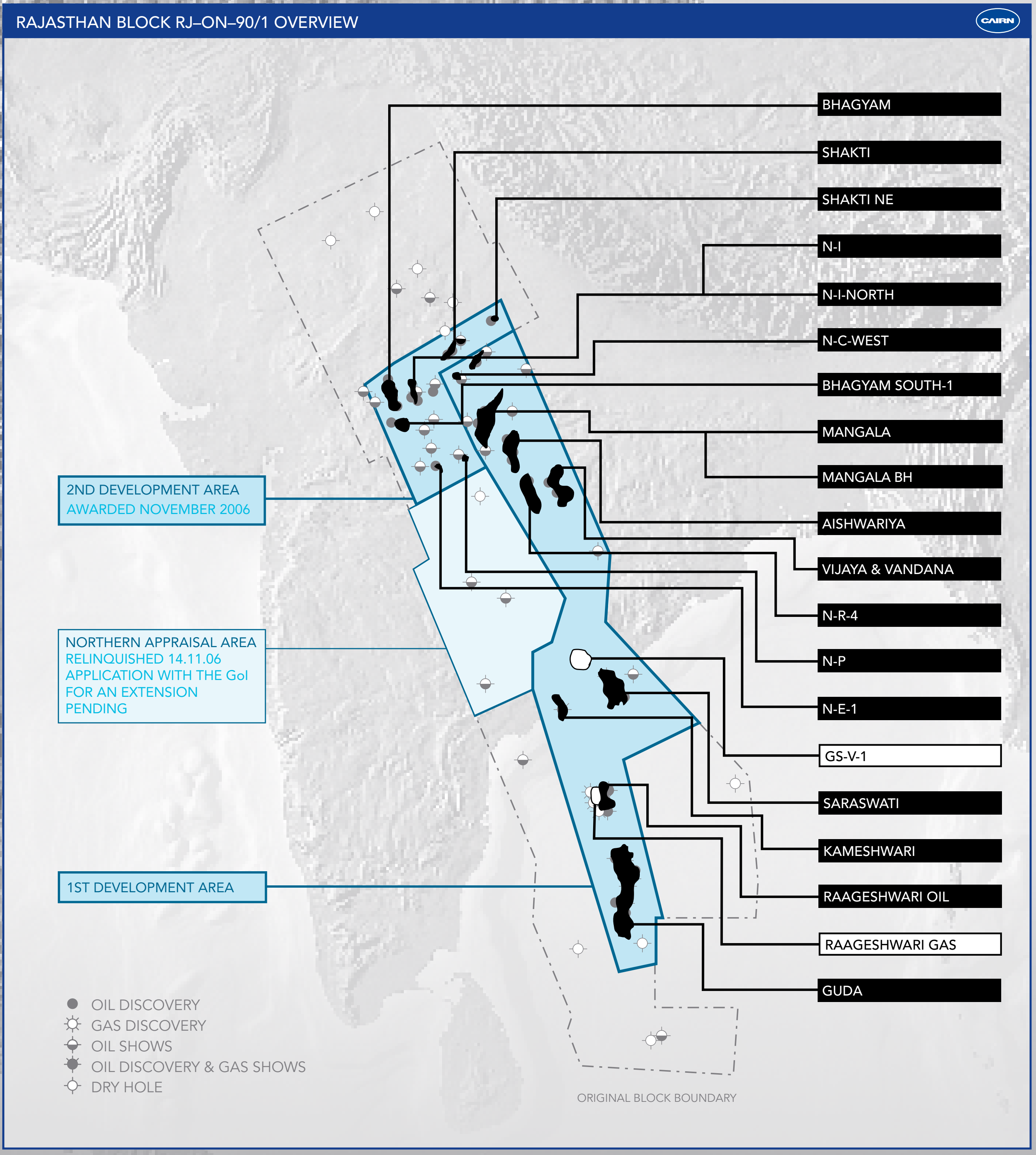
$300m

IPO PROCEEDS AVAILABLE TO CAPRICORN

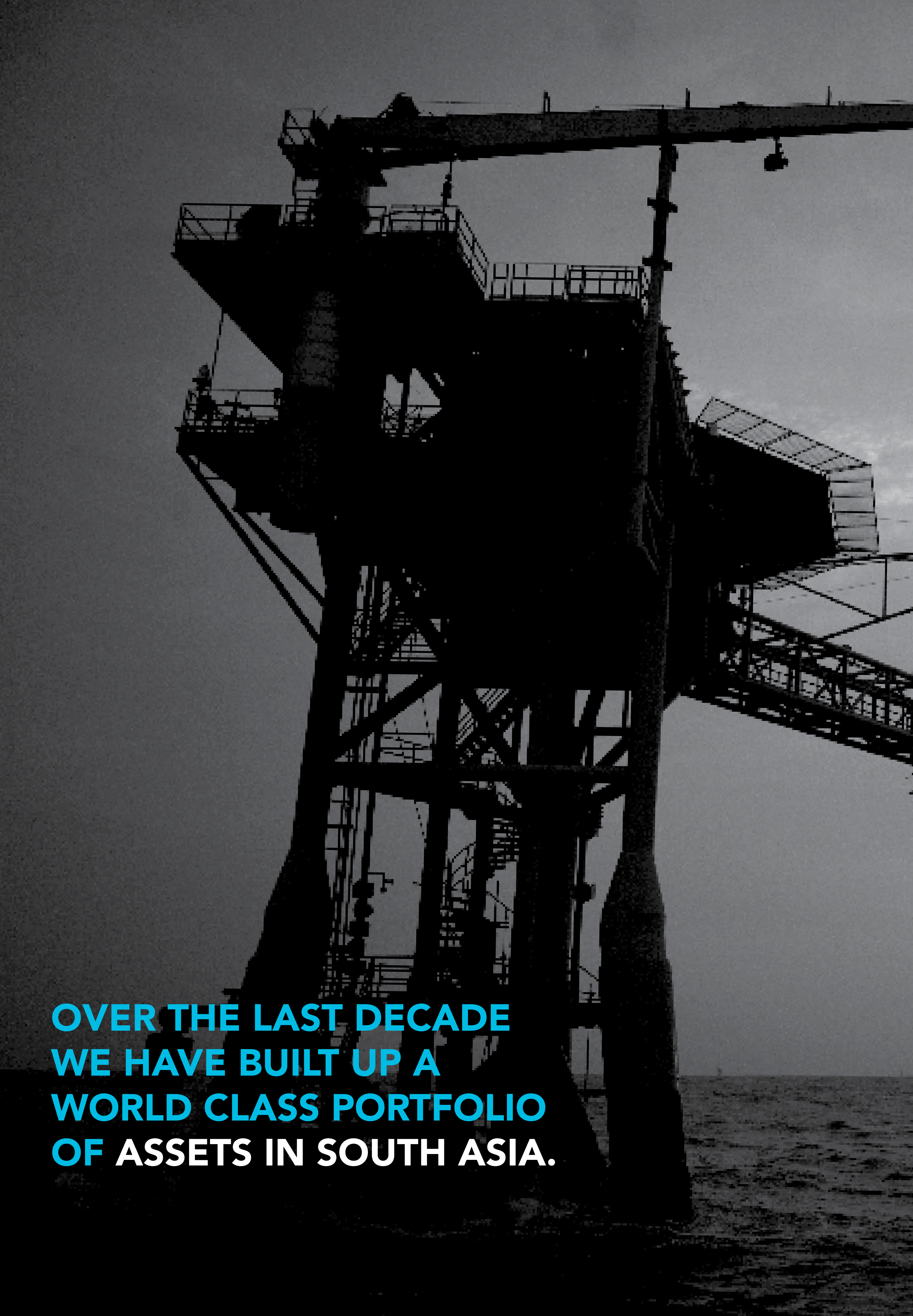
ASSETS

Below is a map of South Asia with close up maps of western India, eastern India, northern India & Nepal and Bangladesh. Each map shows the blocks in which Cairn India & Capricorn Energy have interests.





RAJASTHAN BLOCK RJ–ON–90/1 OVERVIEW
CAIRN
BHAGYAM
SHAKTI
SHAKTI NE
N-I
N-I-NORTH
N-C-WEST
BHAGYAM SOUTH-1
MANGALA
MANGALA BH
AISHWARIYA
VIJAYA & VANDANA
N-R-4
N-P
N-E-1
GS-V-1
SARASWATI
KAMESHWARI
RAAGESHWARI OIL
RAAGESHWARI GAS
GUDA
2ND DEVELOPMENT AREA
AWARDED NOVEMBER 2006
NORTHERN APPRAISAL AREA
RELINQUISHED 14.11.06
APPLICATION WITH THE GoI
FOR AN EXTENSION
PENDING
1ST DEVELOPMENT AREA
OIL DISCOVERY
GAS DISCOVERY
OIL SHOWS
OIL DISCOVERY & GAS SHOWS
DRY HOLE
ORIGINAL BLOCK BOUNDARY



OVER THE LAST DECADE
WE HAVE BUILT UP A
WORLD CLASS PORTFOLIO
OF ASSETS IN SOUTH ASIA.

OPERATING AND EXPLORATION REVIEW

Cairn's gross operated production across South Asia during 2006 was 105,028 boepd (net entitlement 24,523 boepd).

Operational activity has been largely focused on the continued appraisal of Block RJ-ON-90/1 in Rajasthan. There are now a total of 20 discoveries in this block including the world class Mangala and Bhagyam oil fields in the northern part of the acreage. FDPs have been approved or are pending on 6 of these 20 discoveries.

An independent report, prepared by DeGolyer and McNaughton (D&M) in August 2006, estimates 3.4 billion boe in place in the combined discoveries in the Rajasthan block. Cairn currently estimates there to be at least 3.6 billion boe hydrocarbons in place, of which 2.2 billion are under active development planning, with the remaining 1.4 billion identified in other fields under review.

The Mangala, Aishwariya, Saraswati, Raageshwari Oil and Raageshwari Deep Gas fields all have GoI development approval, while work on approvals for the development of other discoveries, in particular Bhagyam and Shakti, is ongoing. It is planned to submit FDPs for Bhagyam and Shakti in Q2 2007. The remaining discoveries require further appraisal or evaluation.

Ongoing drilling campaigns are taking place in eastern India and Bangladesh, while the other operated and non-operated exploration blocks in India, and elsewhere in South Asia, are at various stages of evaluation.

RAJASTHAN BASIN – North West India, RJ-ON-90/1 Development Area (Cairn India 70% (Operator); ONGC 30%)

Civil construction work is now underway to meet the planned first oil production from Mangala in 2009. FDPs for the Mangala, Aishwariya, Saraswati and Raageshwari fields have been agreed by the GoI and, in addition to the retained IPO proceeds, bank funding has been secured for the development. The first phase of development drilling on Saraswati has been completed and development drilling is now underway on the Raageshwari Oil field.

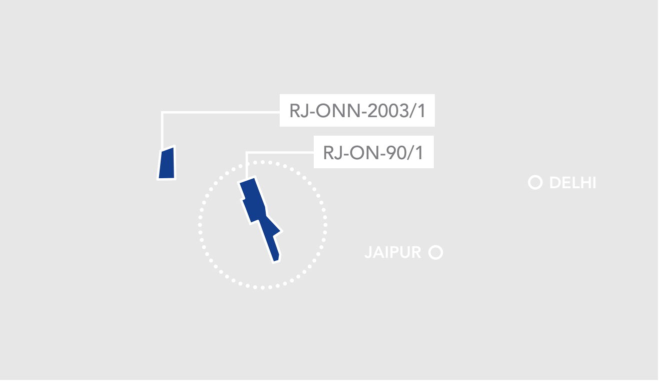
All the permits and permissions required to begin major construction work have been granted and Cairn India is in the process of procuring the major items of long lead equipment required to establish the production facilities. It is planned to contract three purpose built rigs which will be used to drill the development wells. These state-of-the-art rigs will allow the drilling of the Mangala wells (some horizontal) and running completions, which Cairn India intends to use to deliver the first phase of the target production rate of 150,000 bopd for the Rajasthan fields.

The detailed engineering design for the Mangala development is progressing in Houston; the design team comprises Cairn India personnel working alongside consultants from Mustang Engineering. The assessment of the impact of the severe flooding in Rajasthan last year on field development design and activities is ongoing. Work carried out to date confirms the future viability of the current design and facilities locations, provided that reasonable flood protection measures are implemented as a contingency (these are currently being designed).

Dr Mike Watts,
Exploration &
New Business Director

Phil Tracy,
Engineering &
Operations Director

RAJASTHAN BASIN – NORTH WEST INDIA



>3.6bn boe

(GROSS) HYDROCARBONS IN PLACE

2.2bn boe

(GROSS) UNDER ACTIVE OIL DEVELOPMENT PLANNING

1.4bn boe

(GROSS) IDENTIFIED IN OTHER FIELDS

The GoI has approved the Declaration of Commerciality for Bhagyam, the second largest field in Block RJ-ON-90/1, along with the Shakti field. These fields are contained within a second development area of 430 km^2. It is currently anticipated that the final FDPs for Bhagyam and Shakti will be submitted to the GoI in Q2 2007. The current 2P base case for Bhagyam envisages a plateau production rate of 40,000 bopd.

Two more recent small scale discoveries (Shakti North East and N-I-North) have been retained within the Bhagyam/Shakti development area, together with the N-I, N-E, N-P and Bhagyam South discoveries.

Enhanced Oil Recovery

Work is also ongoing to establish optimal EOR techniques in the Rajasthan block with a view to extending plateau production and increasing ultimate recovery of oil. Laboratory work is currently underway to establish the potential of these technologies to facilitate early implementation of a field scale pilot project at Mangala; the largest of the Rajasthan fields.

Northern Appraisal Area (Cairn India 100%)

In June 2005, Cairn was granted an 18 month extension (until 14 November 2006) to complete its activities in the northern appraisal area to the north and west of the Development Area. However, the work programme in this area was interrupted by the severe flooding in Rajasthan in 2006. Cairn India has ceased operations in this area, and is in discussions with the GoI for a further extension of part of this acreage to complete its planned work programme. As at 31 December 2006, expenditure incurred in this area was approximately $24m.

Reservoir Stimulation Programme

A programme of hydraulic fracture stimulation on various lower permeability reservoirs was completed in 2006. The hydraulic fracture programme highlighted the potential for new reserves in the lower permeability reservoirs. The currently estimated hydrocarbons in place associated with these reservoirs is in excess of 1 billion boe.

Test results from two Barmer Hill wells highlighted the potential to unlock material oil resources in this reservoir at two of the three main fields. Additional work is required to quantify the potential of the Barmer Hill formation and will be addressed during the development drilling programme at Mangala and Aishwariya.

Results on the Raageshwari deep gas field from a single tested zone in Raageshwari-5 indicated a two-fold increase in productivity. Gas from the Raageshwari wells will be utilised as fuel for the Mangala development and subsequent northern area developments.

The Vijaya, Vandana, N-R and southern fields are also potential candidates for future fracture stimulation to access new reserves and/or accelerate production.

Southern Fields

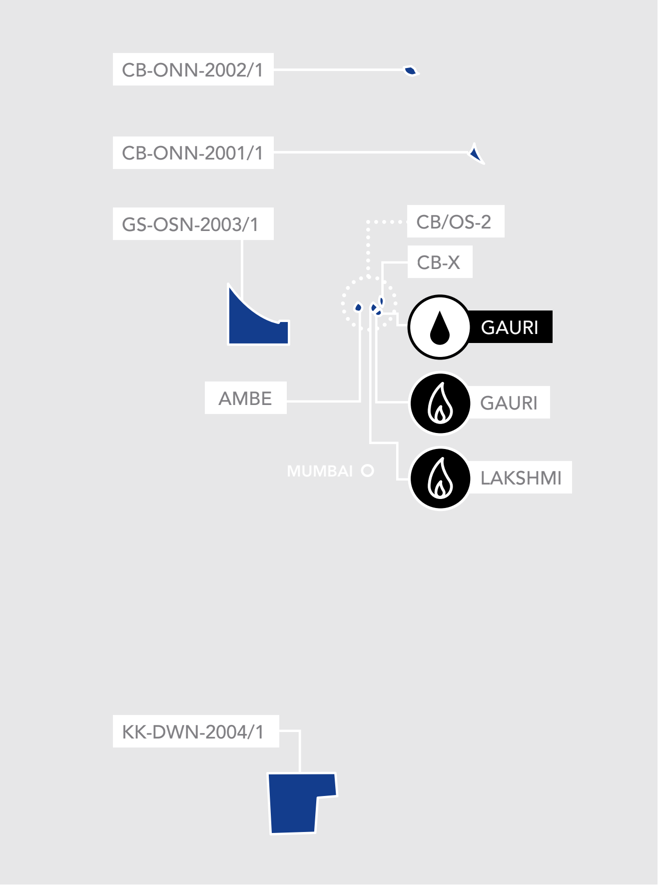
In the south of the Rajasthan block, first commercial production by trucking from the Saraswati field is ready to start and will begin as soon as an arrangement for oil sales has been finalised with the GoI. First commercial production from the Raageshwari oil field is expected to commence within 12 months of Saraswati. The first phase of development drilling has recently been successfully completed at Saraswati, and development drilling is currently underway in Raageshwari.

Block RJ-0NN-2003/1 (Cairn India 30%, ENI (Operator))

In early January 2007, the operator commenced acquisition of a 3D seismic survey on this Rajasthan block, which was awarded in NELP V.

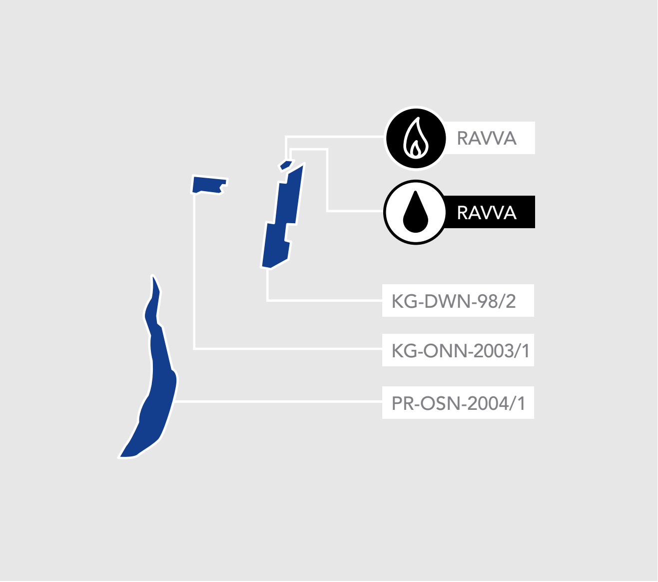
CAMBAY BASIN – WESTERN INDIA

2006 GROSS PRODUCTION: **21,176 BOEPD**



KRISHNA-GODAVARI BASIN – EASTERN INDIA

2006 GROSS PRODUCTION: **61,595 BOEPD**



CAMBAY BASIN – Western India
Block CB/OS-2: Lakshmi and Gauri Gas Fields (Cairn India 40% (Operator))

Average gross production from the Lakshmi and Gauri fields for the year 2006 was 21,176 boepd, including 3,452 bopd.

The gas sales contracts (GSCs) with the buyers (GTCL and GPEC) have been successfully re-negotiated whereby the contractual terms for volume commitment and price have been reset and the Gauri gas field volume committed to the current buyers under the new pricing scheme.

The CB/OS-2 JV is focused on further development of the field with a planned offshore four well infill development drilling programme and also the conversion of three wells into oil producing wells following the continuing success of the Gauri-3 oil producer. The infill development drilling programme is scheduled to commence in H2 2007.

Engineering studies to upgrade the oil handling facilities at Gauri to 9,000 bopd have been completed and this upgrade is scheduled for completion in Q3 2007. During 2006 oil sales to private buyers from Gauri averaged 3,452 bopd.

The onshore CB-X well has been completed and the pipeline installation is in progress to deliver planned first gas in Q2 2007.

CB-ONN-2001/1 (Cairn India 30%, ONGC (Operator))
Following the acquisition of an 89 km^2 3D seismic programme two wells were drilled on this block in 2006 – one encountered sub-commercial quantities of oil and the other was dry. One further well is currently operating prior to making a decision on whether to proceed to the next phase.

CB-ONN-2002/1 (Cairn India 30%, ONGC (Operator))
Following the acquisition of a 100 km^2 3D seismic programme on this block, three wells are scheduled to be drilled during 2007.

GS-OSN-2003/1 (Cairn India 49%, ONGC (Operator))
The operator is currently acquiring a 3D marine seismic programme on this block.

KRISHNA-GODAVARI BASIN – Eastern India
Ravva (Cairn India 22.5% (Operator))

Average gross production from the Ravva field for the year 2006 was 61,595 boepd (comprising average oil production of 49,695 bopd and average gas production of 71.4 mmscfd).

The ceiling prices under each of the Ravva GSCs have been increased following re-negotiation with the buyer (GAIL). The ceiling price for associated gas has increased by 18% and the ceiling price for non-associated gas has increased by 30%.

An onshore exploration well (RX-9), spudded in June 2006, was plugged and abandoned after encountering non-commercial quantities of hydrocarbons.

An extensive offshore infill, appraisal and exploration drilling programme on Ravva commenced in October 2006. The first appraisal well (RD-7) encountered oil and gas in the main, producing intervals at Ravva with 38 metres of net oil pay. The second well (RD-8), an appraisal well on one of the main Ravva fault blocks, encountered 16 metres of net oil pay. In addition a 3.5 metre thick unprognosed sand was encountered in an oil leg in RD-8. Production from RD-7 commenced in December 2006 and from RD-8 in January 2007.

The RC-5 well has been completed and commenced production in March 2007. A subsequent workover well on RC-3 was also successfully carried out in March 2007. The rig is currently operating on a further infill well (RE-4).

Two exploration prospects (MM 301 & LM 403) are scheduled to be drilled in Q2 2007.

KG-DWN-98/2 (Cairn India 10%, ONGC (Operator))
Three exploration wells were drilled in water depths of 600 metres to 1,200 metres during 2006. Two discovered gas, one of which flowed at a rate of approximately 9 mmscfd and the third was dry. In addition, 1,208 km^2 of 3D Q-marine seismic data was acquired on this block.

The UD-1 ultra-deep water exploration well, located 140 km south of Ravva, was spudded in late September 2006 in 2,841 metres water depth after the acquisition and interpretation of an additional 255 km of 2D seismic data. The well encountered gas in a secondary objective and options for further appraisal are currently under consideration.

KG-ONN-2003/1 (Cairn India 49%, ONGC (Operator))
Plans are underway to commence a seismic acquisition programme of 2D and 3D data on this block in late 2007.

ONSHORE EXPLORATION WELL, RAVVA

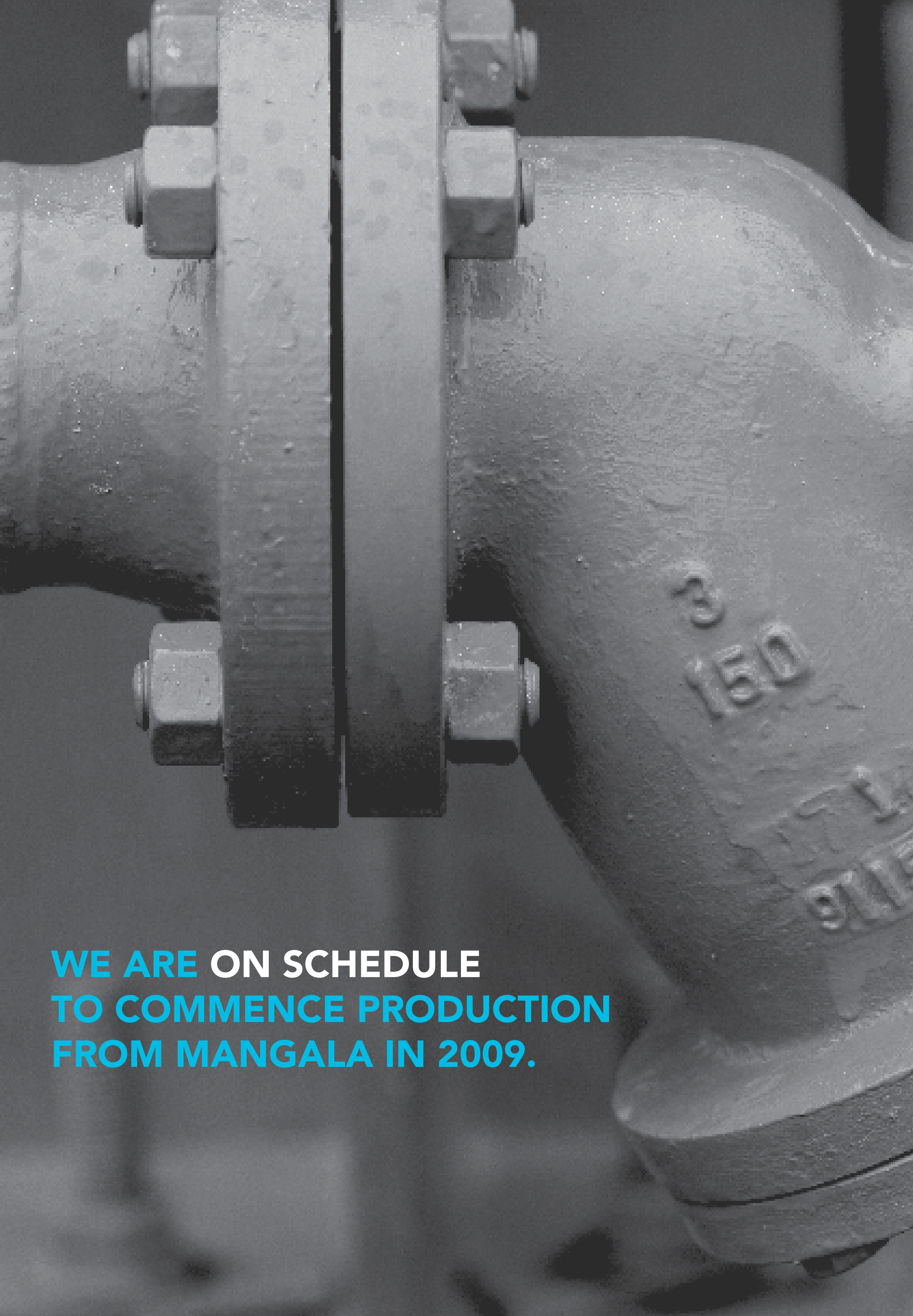
2 blocks

AWARDED TO CAIRN INDIA IN NELP VI

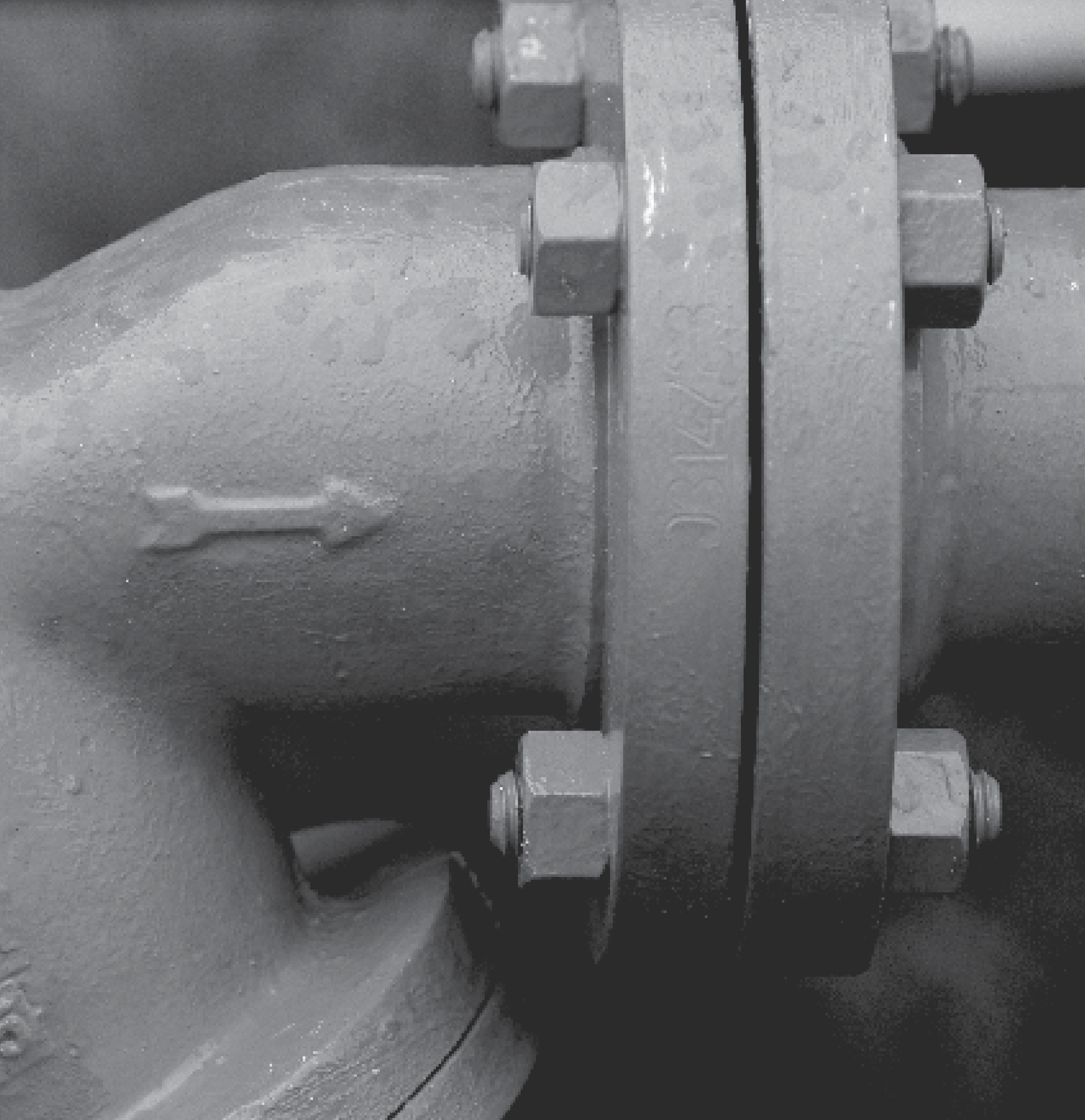
Cairn India has secured an interest in two new exploration blocks in India – PR-OSN-2004/1 and KK-DWN-2004/1 – in NELP VI.

There was an unprecedented level of interest in this latest licensing round, with 165 bids submitted for 52 blocks and a total of 68 companies bidding, 20 of which were foreign firms participating in NELP for the first time.

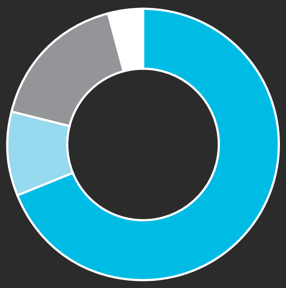
To date, 80% of the 26 basins identified in India are under-explored and Cairn India intends to apply for further acreage that may be offered in forthcoming licensing rounds.



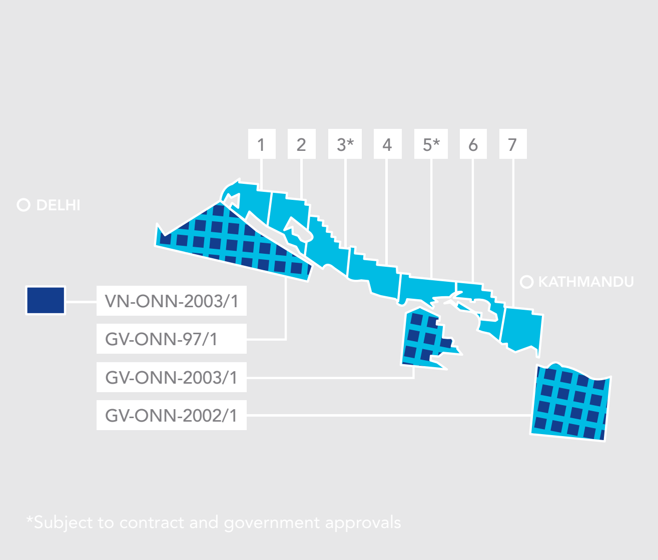
WE ARE ON SCHEDULE
TO COMMENCE PRODUCTION
FROM MANGALA IN 2009.



CAIRN INDIA SHAREHOLDERS AS AT 9 JANUARY 2007

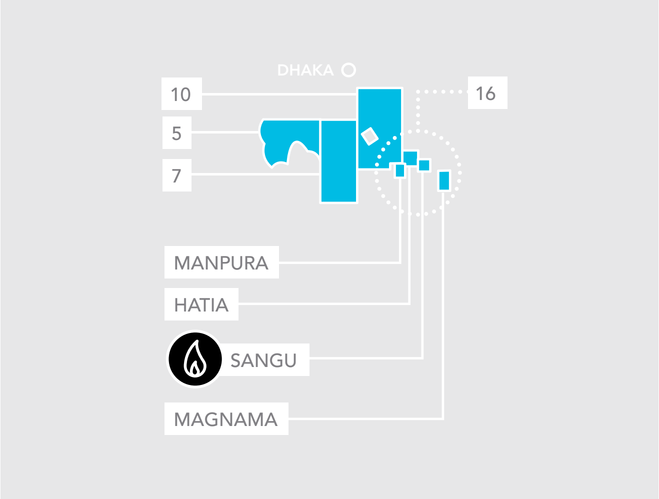


HIMALAYAN FORELAND BASIN – NEPAL & NORTHERN INDIA



BENGAL BASIN – BANGLADESH

2006 GROSS PRODUCTION 22,257 BOEPD



HIMALAYAN FORELAND BASIN – Northern India
Ganga Valley

GV-ONN-2002/1 (Cairn India 50% (Operator), Capricorn 50%)
An aeromagnetic survey commenced in January 2007 and is expected to be completed in April 2007. This will be followed by a 2D seismic acquisition programme.

GV-ONN-97/1 (Cairn India 15%, Capricorn 15%; ONGC (Operator))
The first exploration well in the Himalayan Foreland Basin in which Cairn India and Capricorn participated (Tisua-1) was plugged and abandoned after encountering residual oil shows.

GV-ONN-2003/1 (Cairn India 24% (Operator), Capricorn 25%)
Subject to receipt of the requisite approvals, a 2D seismic acquisition programme is scheduled to commence in Q4 2007 or early 2008.

VN-ONN-2003/1 (Cairn India 24% (Operator), Capricorn 25%)
Seismic reprocessing is underway and a 2D seismic acquisition programme is expected to commence in 2008.

HIMALAYAN FORELAND BASIN – Nepal
Blocks 1, 2, 4, 6 & 7 (Capricorn 100% (Operator))

Assuming continued improvement in the political climate in Nepal, it is anticipated that Capricorn will be in a position to commence seismic field operations in early 2008, subject to agreement with the Government to cease the contractual force majeure currently in place in respect of these blocks.

In addition, Capricorn has reached agreement with Texana for the acquisition of a 100% interest in Blocks 3 and 5 in Nepal, subject to contract and required Government approvals.

During 2006, a new office was established in Kathmandu in readiness for proposed operational activity in country.

BENGAL BASIN – Bangladesh
Sangu (Capricorn 75% (Operator))

The Sangu gas field, although now in decline, has produced in excess of 400 bscf since commencement of production in 1998. To date, the Sangu JV has generated gross revenue in excess of $830m.

A planned three well offshore drilling programme in Bangladesh commenced in January 2007, comprising one appraisal well (South Sangu-3), one development well (Sangu-10, which is targeted at a potentially undrained compartment in the main Sangu field) and one exploration well (Hatia-1).

South Sangu-3 encountered non-commercial quantities of gas and was plugged and abandoned. The South Sangu discovery will not be developed now.

The Sangu-10 well is currently operating behind schedule and as a result, the Hatia-1 exploration well cannot be drilled in the current weather window. A separate, potentially high impact exploration drilling campaign targeting both the Hatia and Magnama prospects is therefore being planned for late 2007/early 2008.

In addition to the above, well intervention work has been undertaken on some of the existing producing wells at Sangu, increasing production by approximately 10%.

Blocks 5 & 10 (Capricorn 90% (Operator))
A 392 km 2D seismic survey has recently been completed on Block 10 and a further 296 km 2D survey has been completed on Block 5. Processing of this data is close to completion.

Block 7 (Capricorn 45%)
A 2D seismic survey of 1,054 km was acquired during 2006 and evaluation of the potential of this block is ongoing.

GROUP PRODUCTION

The Group's average entitlement production for 2006 was 24,523 boepd net to Cairn compared to 28,240 boepd in 2005.

Production (boepd)	Ravva	Lakshmi & Gauri	Sangu	Total
Gross field	61,595	21,176	22,257	**105,028**
Working interest	13,859	8,470	16,693	**39,022**
Entitlement interest	6,504	8,088	9,931	**24,523**

Cairn's current production is 73% gas: 27% oil. This high gas weighting, combined with contractual caps on the gas price received, means that the average price per boe in 2006 was $31.84. On commencement of oil production from Rajasthan, the majority of Group production will be oil (currently estimated to be approximately 90%). As a direct consequence of this, the Group will become much more highly geared to prevailing world oil prices.

GROUP RESERVES

The table below shows reserves information at the end of 2006 on an entitlement basis for the Group. For accounting and reserves purposes, the Group has used an oil price assumption of $30 per bbl (real) (2005: $20 per bbl).

	Reserves 31.12.05 mmboe	Produced in 2006 mmboe	Additions in 2006 mmboe	Revisions in 2006 mmboe	Reserves 31.12.06 mmboe
India	208.4	(5.3)	0.1	(17.5)	185.7
Bangladesh	29.5	(3.6)	0.0	(15.6)	10.3
Total	237.9	(8.9)	0.1	(33.1)	196.0

On a direct working interest basis, reserves as at 31 December 2006 totalled 230.5 mmboe (2005: 275.7 mmboe), comprising 216.0 mmboe in India and 14.5 mmboe in Bangladesh.

India Reserves

FDPs for the Mangala, Aishwariya, Saraswati and Raageshwari fields have been approved by the GoI and the associated net entitlement 2P reserves until 2020 for Mangala, Saraswati and Raageshwari were booked in 2005. The current proposed development sequence for the Rajasthan northern fields is Mangala, Bhagyam and Aishwariya. The timing of the Aishwariya investment is dependent on the timing of the Bhagyam development, so a decision on the booking of the Aishwariya reserves will be deferred until the Bhagyam FDP and associated expenditure have been approved. It is planned to submit FDPs for Bhagyam and Shakti to the GoI in Q2 2007.

The downward revision to India reserves of 17.5 mmboe in 2006 is mainly as a result of the change in the Group's oil price assumption, which affects the Group's entitlement interest.

LOCAL WOMAN, RAJASTHAN

Bangladesh Reserves

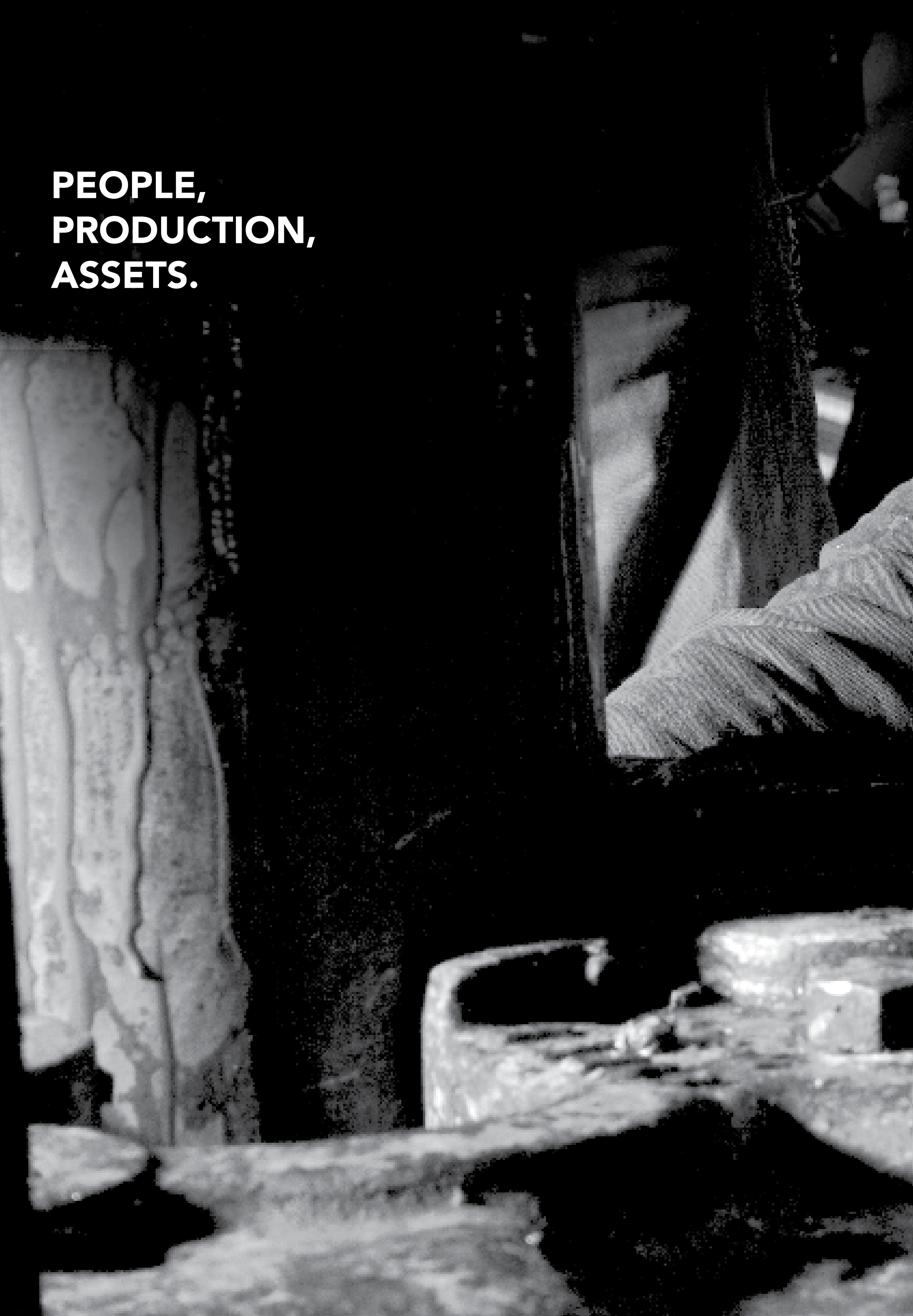
Sangu gross proven and probable (2P) reserves have been reduced by a total of 213 bscf. Of this, 69 bscf is attributable to poorer than predicted production performance from the field after the infill drilling programme in 2005, with another 56 bscf being attributable to a decision to reclassify the reserves associated with Sangu gas compression to the contingent resources category. The remaining reduction of 88 bscf is associated with the reclassification from the probable (2P) to the possible (3P) reserves category for the reasons set out in the Chief Executive's Review on page 8.

The impact of these adjustments is to reduce current estimated Sangu gross 2P booked reserves to 116 bscf (10.3 mmboe on a net entitlement basis), which represents approximately 5% of the total estimated currently booked Group reserves for 2006.

Dr Mike Watts
Exploration & New Business Director
27 March 2007

Phil Tracy
Engineering & Operations Director
27 March 2007

PEOPLE, PRODUCTION, ASSETS.




TAMULY

CORPORATE RESPONSIBILITY

OUR 2006 HIGHLIGHTS

- UPDATED GROUP CR POLICIES AND GUIDING PRINCIPLES ISSUED
- RAJASTHAN COMMUNITY DEVELOPMENT INITIATIVES PROGRESSING WITH IFC SUPPORT
- ISO 14001 CERTIFICATION MAINTAINED AT ALL PRODUCING SITES

2 years

WORKING WITH TRANSPORTATION CONTRACTORS IN RAJASTHAN TO IMPROVE DRIVING STANDARDS

8 years

WITHOUT AN LTI ACHIEVED BY OUR SANGU OPERATIONS TEAM

£970,000

OF SOCIAL INVESTMENT IN 2006 (UP 60%)

Corporate Responsibility – What Does it Mean to Cairn?

For Cairn, 2006 was a year of transformation. While this transformation presented many business challenges we have remained committed to our vision of corporate responsibility (CR), encapsulated in the 3Rs – Respect, Relationships and Responsibility.

Respect – People are Cairn's key asset and the attitude of the Cairn team is critical to our business culture. Cairn's entrepreneurial spirit is underpinned by a depth of knowledge and a strong set of cultural core values including integrity, social and environmental responsibility, team work and nurturing of individuals, creativity, risk management and developing alliances with key partners. The restructuring of the Group in 2006 presented many challenges for the Cairn team and the successful outcome is testament to this spirit.

Relationships – These are key to developing any business and Cairn's success in South Asia over more than a decade would not have been possible without the consistent support of all stakeholders, from governments, regulators and JV partners, to the people living near to our sites in Rajasthan and our other operational bases in the region. The establishment of the Cairn India Board, with highly experienced non-executive and executive directors, should enable further strengthening of local relationships that support business development in India.

Responsibility – Cairn is operating in many areas that face economic, social and environmental challenges. We have a

A CAIRN WELL SITE IN RAJASTHAN

responsibility to understand these CR challenges, identify the potential impact of our activities and through engaging with stakeholders, look for opportunities for mutual benefit.

Key CR Challenges

As an oil and gas exploration and production company with current operations concentrated in South Asia, Cairn is, by virtue of the nature of its business and the countries in which it operates, subject to a variety of CR challenges and risks in our business activities. We recognise that applying our CR Guiding Principles in all activities is essential in maintaining our 'licence to operate' and business reputation. CR risks occur when any part of the business fails to implement these CR Guiding Principles and can affect the Group's ability to deliver business performance, for example developing oil and gas fields on time and within budget.

Our key CR challenges and approach to dealing with them are more fully discussed in the Corporate Responsibility Report 2006 and are summarised here.

Cairn India's key CR risks are in Rajasthan where the Mangala development faces challenges on water resource use, the land acquisition process and managing community expectations for employment and local development. These risks are being mitigated by regular engagement and dialogue with key local stakeholders, strict adherence to well established processes and targeting of community development funding towards project affected peoples. The flooding in August 2006 also highlighted the potential impact of natural disasters on the Mangala development and this risk is being mitigated through detailed engineering design and through the targeting of community development funding to damaged infrastructure. Demands for local employment opportunities and community development are being addressed through implementation of an employment strategy targeted at local peoples and the establishment of an Enterprise Centre, with the support of the International Finance Corporation (IFC), the purpose of which is to facilitate capacity building of local enterprises.

Within Cairn India's producing fields the key CR challenges are protecting people's health and safety, minimising environmental impacts and maintaining positive relations with local communities. Each of our production sites have well developed safety and ISO 14001 certified environmental management systems, and community engagement and development programmes.

In Bangladesh, key CR risks include maintaining the security of our personnel and minimising the potential safety and environmental risks associated with our Sangu facilities, the offshore drilling campaign and during seismic operations in Blocks 5 and 10.

In Nepal, the political and security situation has been extremely sensitive in 2006 and as a consequence there have been no activities on the ground. If operations do recommence, we will complete an environmental and social impact assessment (ESIA) prior to the commencement of seismic operations.

Our Approach to Managing CR

CR has long been an essential part of the way we do business. Cairn has an integrated internal control and assurance framework in place that is overseen by the Board. This is described in more detail in the Corporate Governance Statement on pages 41 to 51.

While ultimate responsibility for CR performance lies with the Board, management responsibility and accountability has been delegated to specific executive directors. Dr Mike Watts is the director responsible for health, safety, environment, community and human rights; Jann Brown is the director responsible for employee matters and Malcolm Thoms is the director responsible for security issues. These directors are supported by Group functional managers with expertise in each of the areas covered by CR.

The Board are provided with regular updates on CR matters and performance. A Group CR Committee, comprising both executive directors and Group functional managers has also been in place since 2003 and meets regularly to inform the Board and management on strategic direction, oversight and setting of policies on CR matters within the Group. The potential impact of CR risks and the progress of our CR programmes are also reviewed on a regular basis by the Group CR Committee.

CR Policies and Guiding Principles

We have had Group Health, Safety and Environment (HSE), Security and CSR Policies in place since 2002. Following a review of biodiversity management practices, we issued an updated HSE policy in 2006 that confirms a commitment to 'no net loss' and management processes have been developed to support this new policy.

Our Group CR Guiding Principles describe our fundamental values, identify the international standards which underpin our performance aspirations in our operations, and explain our approach to managing all aspects of CR in our business activities. The Group CR Policies and Guiding Principles are available on our website.

In 2006, Cairn Energy agreed a new $1bn loan facility with 14 international banks, including the IFC, to help finance ongoing exploration, appraisal and development plans across the Group. $850m of this facility have now been transferred to Cairn India to fund the Rajasthan development. As part of the loan facility with the IFC, Cairn agreed that, in addition to complying with our policies, local laws and regulations, we would also strive to conduct activities in accordance with the IFC's policies and in cognisance of the IFC's best practice guidance and performance standards. These commitments were reflected in the amendment to the Group CR Guiding Principles issued in June 2006.

During 2006 we also developed a new Group CR Management System framework that describes and provides guidance to the business on management of the wide arena of issues covered under the CR 'umbrella' at the different stages in the life cycle. This new system will be rolled out across the business during 2007.

Risk Management

Business risks, including CR risks, are managed through implementation of our risk management strategy. The risk management organisation and processes have been in place throughout 2006 and have regularly and systematically identified, analysed, assessed and treated the business risks faced at the asset, country and Group levels. See also the Risk Factors section on pages 37 to 40.

Managing Stakeholder Expectations

Our success has only been possible through building effective external relationships and partnerships that can drive the business forward. Through working with National and State Governments and our JV partners over the years, we have developed an in-depth understanding of the regulatory environment in our areas of operation and, more importantly, have laid the foundation for strong relationships.

It is vital to building these relationships that we also understand the needs and aspirations of the people living in the vicinity of our operations, appreciate issues raised by authorities and are able to talk and listen to other concerned parties and create value for our shareholders.

A Group 'Public Consultation and Disclosure Plan' (PCDP) has been developed which provides a framework for developing stakeholder engagement plans for informing and consulting with those peoples affected by our investment projects.

Working with our Suppliers and Contractors

In conducting our business activities we are committed to behaving with honesty and integrity, and seek to treat our suppliers and contractors with fairness and encourage them to work to our standards.

Our suppliers and contractors come from both local and international companies and we aim to build relationships with them to influence them towards achieving CR performance consistent with our Group CR policies and Guiding Principles.

RESPECT,
RELATIONSHIPS,
RESPONSIBILITY.

SEISMIC OPERATIONS IN BANGLADESH

Working with our Investors
We look to engage proactively with our investors and financial agencies on our approach to CR and respond to specific investor queries when they arise. Examples during 2006 include participating in the Carbon Disclosure Project Report and the FTSE4GOOD climate change survey. Cairn is a member of FTSE4GOOD and, during 2007, we will explore ways of addressing the recently revised climate change criteria that have recently been included.

Cairn also hosted trips during 2006 for analysts, investors and the international media to see some of Cairn's assets in India.

Business Ethics
Cairn employs staff who come from a number of countries and cultures bringing with them different personal values. However, our stakeholders expect consistency in the way we work. Our Group CR Guiding Principles and Group Code of Business Ethics provide guidance to employees on relations and dealings with third parties and public interest disclosures. An updated Group Code was developed in 2006 and will be rolled out across the Group during 2007.

Climate Change
We recognise that climate change is an important international issue. As part of our climate change strategy, we have been monitoring and setting targets for both methane and greenhouse gas (GHG) emissions since 2000 and have implemented several initiatives to reduce these emissions, including the installation of high efficiency flares, additional compression and improving plant operations to minimise volumes of gas flared during plant upsets.

Our operations are located in developing countries and the Kyoto Protocol provides these countries with the opportunity and incentive to control the growth of emissions through the Clean Development Mechanism (CDM). We have therefore been exploring the application of the CDM to our Mangala Development in Rajasthan.

Revenue Transparency
An important benefit of our activities is the revenue that flows to governments in the form of taxes and royalties. The Extractive Industries Transparency Initiative (EITI) is a UK Government sponsored initiative aimed at promoting transparent reporting of these revenues by governments in the mineral resource extraction sector. A partnership between industry, governments and other stakeholders is critical to the success of this initiative. The governments of the countries in which Cairn operate have not signed up to the EITI, however, as Cairn supports the principles of the EITI, we have included for the second year, the figures for tax and royalty payments in our Corporate Responsibility Report 2006.

Performance Monitoring and Reporting
We measure our CR performance using a number of Key Performance Indicators (KPIs) some of which are presented in the graphs on these pages, and are presented more fully in the Corporate Responsibility Report 2006.

External Assurance
External assurance over our CR approach and performance is achieved both through reviews by independent external parties and through benchmarking with other UK and international companies. Implementation of our CR policies in our operations has been assessed by IFC, as part of the due diligence process associated with the financing negotiations. Environmental Resource Management (ERM) has also verified the contents of the Corporate Responsibility Report 2006.

2006 CR Performance

There were a number of notable CR achievements during 2006, in particular the efforts of staff in both our CB/OS-2 and Rajasthan operations during flooding in Gujarat and Rajasthan in August. In CB/OS-2 we continued to supply gas to our customers from our processing facility despite being surrounded by high floodwaters, while in Rajasthan our efforts in the relief operations, and subsequent support, showed our continuing commitment to the communities in which we operate.

In Rajasthan we made significant progress during 2006 in acquiring the land, establishing community development projects and gaining the regulatory approvals required for construction to commence on the Mangala development project. Plans for the establishment (with IFC support) of an Enterprise Centre in Barmer are progressing well. Other community initiatives in Rajasthan include a rural dairy project, construction of further water harvesting structures and support for schools in the region. Our commitment to CR and good environmental and social performance has led to the IFC playing a key role in the implementation of community initiatives in Rajasthan.

Particular emphasis was placed in 2006 on the ongoing programme of human rights awareness training and the utilisation of the 'rights aware' approach in determining strategies for dealing with such issues as water usage in Rajasthan and meeting our human rights obligations when using security forces in Bihar.

Total social investment increased by 60% to £970,000 in 2006. This includes donations of £207,000 to disaster relief following the flooding in Rajasthan and Gujarat.

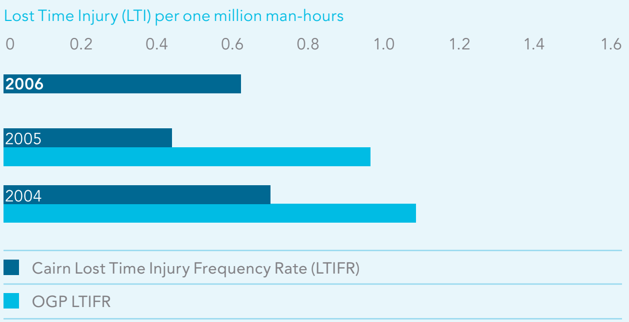
At an operating level there were a number of notable achievements during 2006. Sangu operations in Bangladesh recorded eight years without a lost time injury (LTI) and the overall LTI frequency rate of 0.6 per million man-hours, while slightly higher than in 2005, is still well ahead of the industry average. The Ravva and Suvali sites are also making good progress in implementing the DuPont Safety Training Observation Programme (STOP).

There was a mixed performance against our environmental objectives and targets. All of our producing sites have maintained their ISO 14001 certification during 2006. We also met our target for oil in water; however, our methane and GHG targets were missed due to unscheduled activities at our producing sites. Nevertheless, our environmental performance remains well above the industry averages, as reported by the OGP.

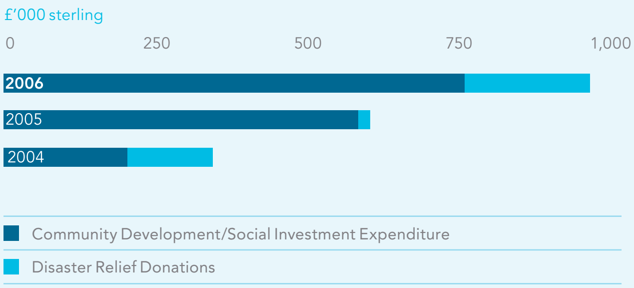
When operating in remote locations such as the Thar Desert in Rajasthan there are health and safety challenges. Although not a direct result of our activities, there were two fatalities, both contractors, which fell within our sphere of influence during 2006. Cairn has subsequently conducted investigations to determine the 'lessons learnt' and has implemented recommendations with the aim of preventing any further fatalities.

SCHOOL CHILDREN NEAR RAVVA

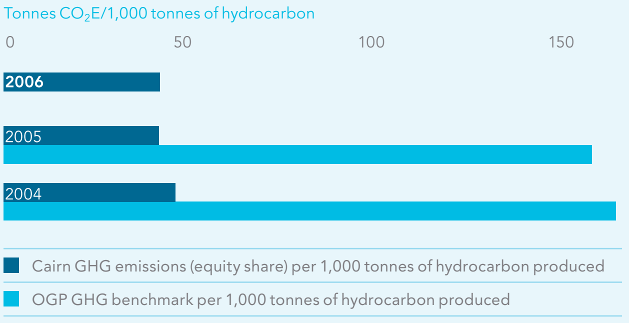
Lost Time Injury Frequency Rate



Social Investment



GHG Emissions



KEY FINANCIAL PERFORMANCE INDICATORS

	2006	2005	% Increase (Decrease)
Production (boepd)*	24,523	28,240	(13.2)
Average price per boe ($)	31.84	25.44	25.2
Revenue ($m)	286.3	262.6	9.0
Average production costs per boe ($)	6.36	4.87	30.6
Operating profit pre-exceptional items	6.9	55.6	(87.6)
Exceptional items	** (71.5)	15.3	(567.3)
(Loss)/profit before tax ($m)	(90.6)	101.2	(189.5)
(Loss)/profit after tax ($m)	(82.0)	79.1	(203.7)
Cash generated from operations ($m)	207.2	139.6	48.4
Net assets ($m)	681.2	757.6	(10.1)
Net cash ($m)	*** 701.3	95.5	634.3

* on an entitlement interest basis
** relates to impairment on Sangu
*** includes $751.8m raised in pre IPO placing

Profit And Loss

Turnover

Production for the year on an entitlement interest basis has decreased by 13% to 24,523 boepd (2005: 28,240 boepd). This is primarily due to reduced gross field production at Sangu, with entitlement also impacted by reduced development expenditure incurred in 2006.

The Group's production mix continues to be gas biased (approximately 73% on an entitlement basis) with contractual caps on the prices realised. This results in an average price realised by the Group for the year of $31.84 per boe (2005: $25.44 per boe). The increase is due to a higher oil price environment and a revision of the pricing for gas sold from Ravva and CB/OS-2.

Revenue for the year was $286.3m (2005: $262.6m).

CAIRN CONTINUES TO BE WELL PLACED FINANCIALLY WITH A STRONG BALANCE SHEET, POSITIVE OPERATING CASH FLOWS, AN $850M SYNDICATED REVOLVING CREDIT FACILITY AND CASH GENERATED FROM THE FLOTATION OF THE INDIAN BUSINESS TO DRIVE FORWARD THE RAJASTHAN DEVELOPMENT AND PURSUE OPPORTUNITIES IN OTHER BUSINESS AREAS.

Gross Profit

Cost of sales for the year was $222.4m (2005: $168.8m). This includes a write off of unsuccessful exploration costs and general exploration expenditures of $62.0m (2005: $26.9m) in accordance with the Group's successful efforts based accounting policies. The increase is partly due to the write off of expenditure on relinquished areas in Rajasthan.

Production costs for the year were $56.9m (2005: $50.2m) with the increase due mainly to stock movements. Production costs for 2006 were $6.36 per boe compared to $4.87 per boe in 2005. Production costs also include pre-exploration costs that are expensed.

The average Group rate for depletion and decommissioning has increased by 29.9% to $11.56 per boe (2005: $8.90 per boe), mainly as a result of the downward reserves revision at the year end for Sangu as outlined in the Chief Executive's Review on page 8.

The Group generated a gross profit of $63.9m (2005: $93.7m).

Profit for the Year

Administrative expenses for the year were $60.3m (2005: $41.2m). This includes a charge of $18.5m (2005: $10.0m) for share based payments in accordance with IFRS 2 (including IPO related awards to certain senior executives of Cairn India) and associated national insurance contributions. Administrative expenses were also increased by one-off reorganisation costs in connection with the IPO.

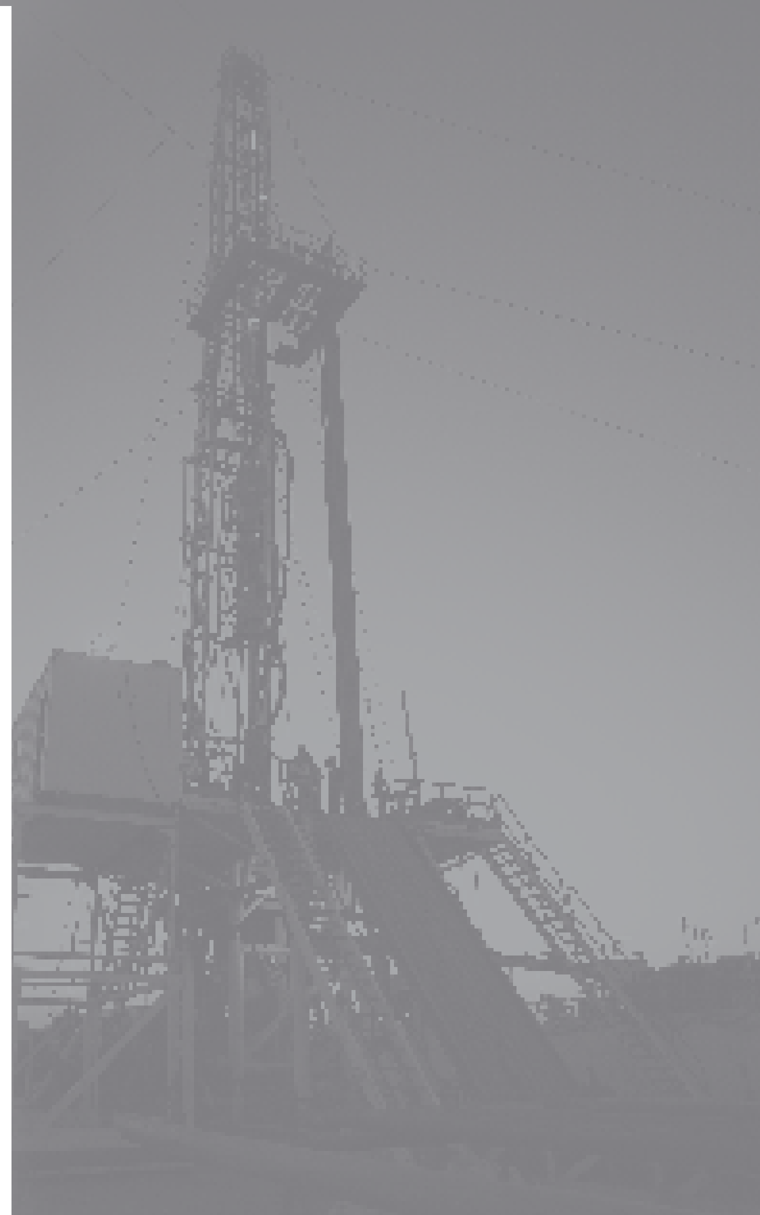
Net finance costs for the year were $26.0m (2005: net finance income $30.3m), including a foreign currency exchange loss of $13.0m (2005: gain $27.1m) and a $9.7m (2005: nil) fair value charge in respect of foreign exchange options entered into to manage the currency exposure on funds raised in the IPO, which have since been unwound. Realised exchange rate losses arose primarily due to the treatment under IFRS of exchange movements on intra-group funding arising from the weakening of the US dollar against sterling in the year.

The $8.6m tax credit (2005: $22.1m charge) arises principally due to the exceptional oil and gas write down, increased depletion and decommissioning charges and the write off of unsuccessful exploration costs, all of which reduce the deferred tax provision.

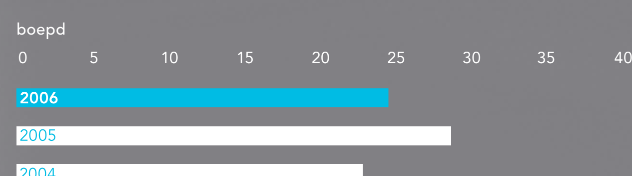
Exceptional Items

The exceptional oil and gas write down of $71.5m relates to impairment on Sangu arising under IAS 36 due to the downward reserves revision at the year end (as outlined in the Chief Executive's Review on page 8). The prior year exceptional gain of $15.3m relates to the gain arising on the sale of assets to ONGC.

After the exceptional charge, the Group made a loss for the year of $82.0m (2005: profit $79.1m).



AVERAGE NET ENTITLEMENT PRODUCTION



$207.2m

CASH GENERATED FROM OPERATIONS (NET TO CAIRN)

$701.3m

NET CASH (INCLUDES $751.8m RAISED IN PRE IPO PLACING)

Balance Sheet

Capital expenditure

Capital expenditure during the year was $284.0m, comprising $161.0m on exploration/appraisal activities, $110.5m on development activities and $12.5m on other fixed assets (2005: $241.8m – $193.1m exploration/appraisal, $41.0m development and $7.7m other). The exploration/appraisal expenditure during the year relates principally to the continued drilling programme in Rajasthan. The majority of the development expenditure was pre-development expenditure on Rajasthan. Further development expenditure was incurred on Ravva and Sangu pursuant to the drilling activities detailed in the Operating and Exploration Review on pages 17 and 20.

Cash Flow

Cash flows from operating activities

Cash generated from Group operations increased to $207.2m (2005: $139.6m). Interest paid was $5.6m (2005: $1.2m). Tax payments during 2006 were $12.2m (2005: $6.6m).

Cash flows from investing activities

Cash outflow from capital expenditure during the year was $281.6m, made up of $157.5m exploration/appraisal expenditure, $115.0m development expenditure and $9.1m other expenditure. (2005: $290.9m – $218.3m exploration/appraisal, $64.9m development and $7.7m other). Pre IPO placing proceeds of $751.8m were received prior to the year end and are also included in deferred income. The balance of the proceeds were received in 2007.

Cash flows from financing activities

Purchases of own shares by the ESOP Trust during the year were $21.7m (2005: $17.2m). Arrangement and facility fees were $17.1m (2005: nil).

Net assets/net funds

Net assets at 31 December 2006 were $681.2m (2005: $757.6m). At the year end, the Group had net cash of $701.3m, including $751.8m raised in the pre IPO placing (2005: net cash $95.5m).

The Group signed a $1bn syndicated revolving credit facility on 27 June 2006 ($845m unutilised at 31 December 2006). On 22 November 2006, an amendment agreement was signed, which became effective on 31 January 2007, to cancel the $150m corporate facility and transfer the remaining $850m to Cairn India to finance the Rajasthan development. Drawings under the facility are based on LIBOR.

IPO Transaction

On 9 January 2007, the Group's Indian business was floated on the Bombay Stock Exchange and the National Stock Exchange of India, pursuant to Cairn's strategy of increasing the autonomy of that business and of realising value for shareholders.

The total proceeds raised in the flotation were $1.98bn with $751.8m pre IPO placing funds included in net cash at the year end. On 27 February 2007, the Company announced the proposed return of £481m (approximately $940m) of this cash to shareholders of Cairn Energy PLC (equivalent to £3 per share). Cairn India has retained $600m, with the remainder of the proceeds currently being held to fund Cairn's ongoing business held by its wholly owned subsidiary Capricorn. This provides financial flexibility to support the growth of Capricorn, with the aim of creating and realising further value for shareholders in the future.

The expected $1.1bn gain on disposal of the 31% interest in Cairn India in the IPO will be included in the results for 2007.

I would like to take this opportunity to thank all of the staff and advisers involved in this unique and complex transaction for their hard work and commitment, without which the IPO could not have been achieved in such a short timescale; a remarkable achievement.

Jann Brown
Finance Director
27 March 2007

COMPLETING THE IPO IN LESS THAN 10 MONTHS WAS A REMARKABLE ACHIEVEMENT BY ALL INVOLVED.

BOARD OF DIRECTORS

1 Sir Bill Gammell, Chief Executive (54)

Sir Bill Gammell holds a BA in Economics and Accountancy from Stirling University. He founded Cairn and was appointed Chief Executive on its initial listing in 1988. Sir Bill has over 25 years' experience in the international oil and gas industry. He is Chairman of the Scottish Institute of Sport Foundation, a director of the Scottish Institute of Sport and a director of Artemis AiM VCT plc. In the 2006 New Year Honours List he was awarded a knighthood for services to industry in Scotland. He is also the non-executive Chairman of Cairn India Limited.

2 Dr Mike Watts, Exploration Director (51)

Dr Mike Watts holds a First Class Hons degree and a PhD in Geology. He joined Shell in 1980, Burmah in 1985 and Premier in 1986. In 1991 he was appointed Managing Director of the Amsterdam listed Holland Sea Search, becoming CEO in 1993. At this time he also carried out new ventures in India, Yemen and Vietnam for Command Petroleum and SOCO International, who were major investors in HSS. In 1996, HSS was acquired by Cairn and Mike was appointed Exploration & New Business Director of Cairn in 1997. He has been closely associated with numerous oil and gas discoveries (in the North Sea, Pakistan, Myanmar, Thailand, Bangladesh and India), the south Asian strategy at Holland Sea Search/Command/Cairn, the acquisition of Command by Cairn, the Bangladesh and Rajasthan transactions with Shell and the emergence of Cairn as the pre-eminent foreign-owned oil and gas company in India.

3 Jann Brown, Finance Director (51)

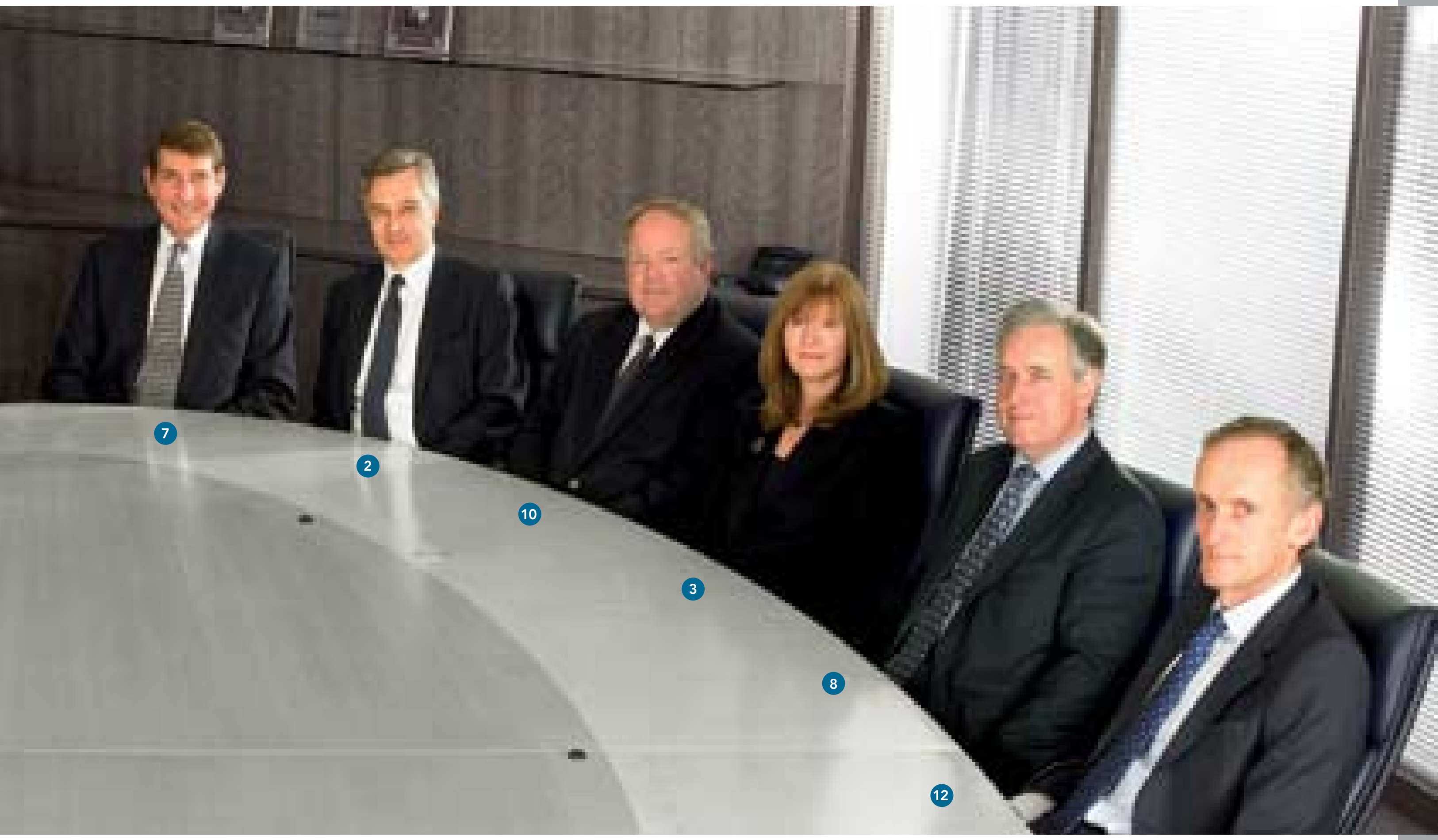
Jann Brown was appointed Finance Director of Cairn with effect from 17 November 2006. She holds an MA from Edinburgh University and joined Cairn in 1998 after a career in the accountancy profession, mainly with KPMG. Prior to her appointment as Finance Director, she served on the Group Management Board for seven years. She is a member of the Institute of Chartered Accountants of Scotland and the Chartered Institute of Taxation.

4 Malcolm Thoms, Chief Operating Officer (51)

Malcolm Thoms holds a BSc Hons in Physics from Edinburgh University and an MBA from Heriot-Watt University. He started his career as a field engineer with Schlumberger and subsequently became manager of their businesses in Qatar and Brunei. He joined Cairn in 1989 where he held a number of senior management positions prior to his appointment as an executive director in 2000. Malcolm is also a non-executive director of Revus Energy AS.

5 Phil Tracy, Engineering & Operations Director (56)

Phil Tracy holds an MSc in Petroleum Engineering from Imperial College and a BSc in Chemical Engineering from Leeds University. He is a Chartered Engineer with over 30 years' experience in the international oil and gas industry. He originally joined Cairn in 1988 and served as an executive director from 1989 until 1999. He subsequently became managing director of Providence Resources P.l.c. before re-joining Cairn in 2002. He was appointed Engineering & Operations Director in 2004 and served as Rajasthan Project Director until December 2006. Phil is also a non-executive director of Vienco Oil & Gas Limited.



6 Simon Thomson, Legal & Commercial Director (42)
Simon Thomson was appointed Legal & Commercial Director of Cairn with effect from 17 November 2006. He holds an LLB Hons from Aberdeen University and a Diploma in Legal Practice from Glasgow University. He joined Cairn in 1995 as a lawyer before becoming Group Commercial Manager. Prior to his appointment as Legal & Commercial Director, he served on the Group Management Board for six years.

7 Norman Murray, Non-Executive Chairman (59)
Norman Murray was appointed an independent non-executive director of Cairn in 1999 and Chairman in 2002. He was a co-founder and former chairman of Morgan Grenfell Private Equity Limited and was also a director of Morgan Grenfell Asset Management Limited and a non-executive director of Bristow Helicopter Group Limited. He is a past chairman of the British Venture Capital Association and is currently President of the Institute of Chartered Accountants of Scotland and a non-executive director of Greene King PLC and Robert Wiseman Dairies plc. He is also the non-executive Deputy Chairman of Cairn India Limited.

8 Hamish Grossart, Non-Executive Deputy Chairman (50)
Hamish Grossart was appointed an independent non-executive director of Cairn in 1994 and became Deputy Chairman in 1996. He has over 20 years' experience on public company boards in a wide range of industries, both in an executive and non-executive capacity. He is currently also Deputy Chairman of British Polythene Industries PLC, Chairman of Indigo Vision Group plc and a non-executive director of Artemis Investment Management Limited and Cairn India Limited.

9 Ed Story, Non-Executive Director (63)
Ed Story was appointed an independent non-executive director of Cairn in 1997. He is President, Chief Executive and founder of SOCO International plc and has over 40 years' experience in the international oil and gas industry. He also serves as the Honorary Consul of Mongolia in Houston.

10 Todd Hunt, Non-Executive Director (54)
Todd Hunt was appointed an independent non-executive director of Cairn in 2003. He is President and joint owner of Atropos Exploration Company and Atropos Production Company based in Dallas, Texas. He has over 30 years' experience in the oil and gas industry.

11 Mark Tyndall, Non-Executive Director (49)
Mark Tyndall was appointed an independent non-executive director of Cairn in 2003. He is Chief Executive of Artemis Investment Management Limited and a director of Standard Life European Private Equity Trust PLC.

12 Andrew Shilston, Non-Executive Director (51)
Andrew Shilston was appointed an independent non-executive director of Cairn in 2004. He is a Chartered Accountant and has been Finance Director of Rolls-Royce plc since 2003. Prior to that he was the Finance Director of Enterprise Oil plc from 1993 to 2002. He has over 20 years' experience in the oil and gas industry.

ACCOUNTS

RISK FACTORS

As an oil and gas exploration and production company with current operations concentrated in South Asia, Cairn is, by virtue of the nature of its business and the countries in which it operates, subject to a variety of business risks. Outlined below is a description of the principal risk factors that may affect the Group's business. Such risk factors are not intended to be presented in any assumed order of priority. Any of the risks, as well as the other risks and uncertainties discussed in this document, could have a material adverse effect on our business. In addition, the risks set out below may not be exhaustive and additional risks and uncertainties, not presently known to the Company, or which the Company currently deems immaterial, may arise or become material in the future. The risk factors should be considered in conjunction with the cautionary note to shareholders in relation to forward-looking statements set out on page 124.

The Company's performance is dependent upon the performance of Cairn India and the Capricorn Group

Following the IPO, the Company's principal assets are its holding of shares in Cairn India and its shareholding in Capricorn. Accordingly the Company's performance and market price are dependent upon the performance of Cairn India and Capricorn. Any failure by Cairn India or by Capricorn to successfully develop their respective businesses could have a material adverse effect on the Company's business.

The Company's material shareholding in Cairn India represents a significant proportion of the Company's value. Any fluctuations in the market price of Cairn India's share price may have a direct effect on the Company's share price.

Project Assessment and Delivery

There are a number of steps prior to a decision by management to invest in or 'sanction' a project or new venture. Risks during this pre-sanction period include technical, engineering, commercial and regulatory risks. Typical risks include over or under-estimation of crude oil and natural gas initially in place and recoverable, inadequate front end engineering design, not securing appropriate long-term commercial agreements or, where required, applicable governmental or regulatory consents, permits, licences or approvals. This can cause delays to commercialisation of reserves and this may have a material effect on the Group's medium-to long-term cash flow and income.

Project delivery is subject to CR technical, commercial, contractor, and economic risks. Projects can be delayed or unsuccessful for many reasons, including cost and time overruns of projects under construction, availability, competence and capability of human resources and contractors, mechanical and technical difficulties and infrastructure constraints. In addition, some development projects may require the use of new and advanced technologies or produce hydrocarbons from challenging reservoirs, which can exacerbate such problems. Production from the Mangala field is currently scheduled to start during 2009. Delays in completing the engineering design, construction, fabrication, installation or commissioning activities may lead to the start of production being delayed.

Transportation infrastructure at the Cairn India Group's operations in Rajasthan may not be constructed on time by the GoI's nominee or, once constructed, may not be operated successfully and, if necessary, the Cairn India Group's involvement in midstream development options will increase the scale and complexity of its development project in Rajasthan. Furthermore, the crude oil at the northern fields in Block RJ-ON-90/1 is characterised by its viscous nature in the reservoir and its propensity, inside or outside the reservoir, to solidify at higher temperatures than is commonly the case for most producing oil fields. This presents both extraction and transportation risks. The development and production plans for the northern fields are also dependent upon the Cairn India Group obtaining a reliable fuel supply for power generation and heating of the facilities.

The development plans for the northern fields assume, or are expected to assume, the use of EOR techniques to extract an additional incremental percentage of the estimated oil in place in the reservoirs. There is a risk that Cairn India Group may not be able to use enhanced oil recovery techniques successfully. These risks include sourcing and purchasing large quantities of the types of polymer that would be required for the EOR techniques, and ensuring their efficient transportation to the fields, maintaining the polymer at the correct temperature in the reservoir, polymer fouling of the surface facilities might occur, leading to a deterioration of the operating efficiency of the processing plant and the use of such a recovery technique will significantly increase the operational expenditure.

Operations

The Group's revenues are dependent on the continued performance of its operating facilities. Operational risks include maintaining asset integrity, which can be affected by a number of factors including improper operating and maintenance regimes and plant availability, which can be significantly impacted by unplanned shutdowns and/or equipment failure, the performance by and sharing of risk between JV partners and the location of some of the Group's operations (which may expose them to natural hazards such as cyclones, flooding and earthquakes). If these risks materialise, the Group may not be able to meet its planned HSE standards, output levels or unit operating costs. These factors may have an effect on cost control, or a potentially material impact on the Group's reputation and the results of the Group's operations.

Future production of crude oil and natural gas is dependent on the Group finding or acquiring, and developing further reserves. The Group has exploration licences for various interests in India, Bangladesh and Nepal. Environmental, geological and infrastructural conditions in many of these areas are challenging and costs can be high.

The cost of drilling, completing and operating wells is often uncertain. As a result, the Group may incur cost overruns or may be required to curtail, delay or cancel drilling operations because of many factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions, the need for compliance with environmental regulations, governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

If the Group fails to conduct successful exploration activities or to acquire assets holding proved reserves, the Group's proved reserves will decline as it extracts and depletes existing reserves. The Group's future production depends significantly upon its success in finding or acquiring and developing additional reserves. If the Group is unsuccessful, it may not meet its production targets, and its total proved reserves and production will decline, which could adversely affect the results of its operations and financial condition.

Commercial

The Cairn India Group may not be able to obtain competitive market prices for its crude oil sales from its fields in Rajasthan. The Cairn India Group is obliged to sell 100% of its crude oil from the Block RJ-ON-90/1 to the GoI or its nominee, and the GoI is obliged to buy the Cairn India Group's crude oil pursuant to the PSC. The purchase price will be based upon a basket of crude oils to be decided between the Cairn India Group and the nominee based upon a mixture and weighting of crude oils that would produce a quality similar to the quality of crude oil expected to be produced by the Cairn India Group. There can be no assurance that the basket of crude oils used to determine the price of the Cairn India Group's crude oil sales to the nominee will result in a value approximating the price used by the Cairn India Group in its development and financial planning.

Under the gas sales agreement for the Sangu gas field in Bangladesh, the price payable to the Capricorn Group for the supplied gas is capped at a price which equates to approximately $21 per barrel (Brent). As the price is presently at that cap, the price payable to the Capricorn Group will not increase in line with increases in oil price. The operating costs of the Sangu gas field have however increased as a result of recent high oil prices. There is a risk therefore that further increases in the price of oil may further increase operating costs at the Sangu gas field and that, accordingly, whilst operating costs will ultimately be recoverable under the PSC cost recovery mechanism, the Capricorn Group's margin under the sales agreement may be further reduced.

Exchange Rates, Interest Rates and Currency Controls

The Group's cash flow, income statement and balance sheet are reported in US dollars and may be significantly affected by fluctuations in exchange rates. Shares in Cairn India are, and any dividends which may become payable in respect of them will be, denominated in Rupees. The material holding in Cairn India by the Group, whose principal currency is not Rupees, exposes the Group to foreign currency exchange rate risk.

The Group's financing costs may be significantly affected by interest rate volatility. The Group is also exposed to liquidity risks, including risks associated with refinancing borrowings as they mature, the risk that borrowing facilities are not available to draw down and the risk that financial assets cannot readily be converted to cash without loss of value.

Furthermore, the Government of India currently operates certain controls on currency exports which restrict the transfer from India of Rupees. There is a risk therefore that any dividend payments paid by Cairn India to the Group could be subject to such restrictions.

Regulation

The Group may incur material costs in complying with, or as a result of, safety, health and environmental laws and regulations. The Group is subject to a broad range of safety, health and environmental laws and regulations that impose controls on, among other things, the storage, handling and transportation of petroleum products, employee exposure to hazardous substances and other aspects of its operations.

The Group may also incur environmental liabilities for environmental damage caused by acts or omissions of any third party contractors. Further, the adoption of new safety, health and environmental laws and regulations, new interpretations of existing laws, increased governmental enforcement of environmental laws or other developments in the future may require additional capital expenditures or result in the Group incurring additional operating expenses in order to maintain current or future operations. These laws and regulations are increasingly stringent and may in the future create substantial environmental compliance or remediation liabilities and costs.

If the Group fails to meet environmental requirements or has a major accident or disaster, it may also be subject to administrative, civil and criminal proceedings by governmental authorities, as well as civil proceedings by environmental groups and other individuals, which could result in fines, penalties and damages against it as well as orders that could limit, halt or even cause closure of its operations, any of which could have material adverse effect on its business, results of operations and financial condition.

The Cairn India Group is also subject to limits as to how much it may borrow under both the Indian Companies Act 1956 and its articles of association. Indian law further restricts the ability of the Group to dispose of shares in Cairn India for certain periods of time.

The Cairn India Group has not yet received certain consents and approvals required for its business, including its development plans and operating activities in Rajasthan. Substantial costs or disruptions to the business could be incurred if these cannot be obtained, renewed or maintained. Furthermore, the Capricorn Group is still waiting for amendments to its PSCs in Blocks 5 and 10 in Bangladesh to be formalised in writing, further details of which are set out on page 70.

Market Place

The Group's results of operations and financial condition are subject to fluctuations in oil and gas prices. The oil and natural gas industry is highly competitive. Due to, amongst other things, the significant increases in the international oil price, the Group is competing in a highly competitive market for the resources required to conduct its ongoing business, in particular with regard to the engagement of leading third party service providers and the purchase of capital equipment. Coupled with relatively limited resources and expertise in India, in particular in the area surrounding Rajasthan, this has resulted in a strain on the specialist engineering and other services that the Group needs to develop its fields in Rajasthan. The remaining development costs, as well as the Group's current target of 2009 for first commercial production from the Mangala field, are subject to these risks of raw material and equipment shortages, or price increases above those anticipated and an inability to procure or design the engineering services required.

Insurance

Consistent with good industry practice, a comprehensive insurance programme is maintained to mitigate significant losses. There is a risk, however, that the Group's insurance policies may not be sufficient in covering all losses which it or any third parties may suffer. If the Group suffers an event for which it is not adequately insured, there is a risk that it could have a material adverse effect on its business, results of operations and financial condition. The programme is also subject to certain limits, deductibles and other terms and conditions.

Human Resources

The Group's performance and its ability to mitigate those risk factors within its control depend on the skills and efforts of its employees and management teams across the Group. Future success will depend to a large extent on the Group's continued ability to attract, retain and motivate highly skilled and qualified personnel. If the Group is unable to attract or retain its managerial and technical personnel, its business and operations may be adversely affected. Attracting and retaining top quality managerial talent has become a serious challenge facing companies in the oil and gas exploration and production sector. Failure to have or retain key positions and functions in place could have a material adverse effect on the Group's business, results of operations and financial condition.

Corporate Responsibility

The Group recognises that applying its CR 'Guiding Principles' in all activities is essential in maintaining its 'licence to operate' and business reputation. CR risks occur when any part of the business fails to implement these 'Guiding Principles'. CR risks that could affect the Group's ability to deliver projects on time and within budget include inadequate stakeholder engagement, failure to put in place appropriate controls to mitigate environmental and social impacts, not having adequate processes in place to protect human rights in activities in our 'sphere of influence' and the ineffective implementation of health and safety policies.

War, Terrorist Attack and Natural Disasters

The Group's business may be adversely affected by a war, terrorist attack, natural disaster or other catastrophe, particularly given the location of the Group's assets. In recent times, terrorist attacks in India, Bangladesh and Nepal have become more prevalent.

In addition, unusually heavy rains during the 2006 monsoon season in the states of Rajasthan and Gujarat triggered floods which caused widespread destruction in these states. The area in which the Mangala field is located experienced severe flooding in August 2006, which directly affected existing well-sites and roads and the site of the proposed crude oil terminal and associated facilities is located in the flood-affected area. While all reasonable precautions are being taken to mitigate the impact of such flooding, there is a risk that this may occur again with a potentially detrimental effect on construction, fabrication and installation activities and for the future operation of the oil processing terminal, any pipeline and associated facilities in the Rajasthan Block or other fields in which Cairn India has an interest, which may have a material adverse effect on its business, results of operations and financial condition.

Furthermore, the Capricorn Group's interests in Bangladesh are exposed to risks from extreme weather conditions, which are often experienced in South Asia. In addition, the low-lying nature of much of Bangladesh puts it at risk from any rise in sea levels as a result of global warming. Any damage to the Capricorn Group's infrastructure in Bangladesh or disruption or suspension of production (in particular from the Sangu gas field) could have a material adverse affect on the financial condition and/or operating results of the Capricorn Group.

Political Climate

The Group is active in a number of overseas markets, and may be affected by a change in fiscal policy in respect of, or which impacts upon, these markets. The Group cannot predict the impact of future changes in fiscal policy in the countries and markets in which it operates. Amendments to existing legislation (particularly increases in tax rates or withdrawals of tax relief), the introduction of new tax laws (such as the imposition of import and/or export quotas or import and/or export tariffs) and changes from time to time in the interpretation of existing tax laws could materially adversely affect the Group's reputation, financial condition and/or operating results.

In particular, the Cairn India Group may be liable to pay cess under the Indian Oil Industry (Development) Act 1974 ('OIDA cess') in relation to the production of crude oil from Rajasthan. After receiving an order confirming its liability to pay OIDA cess on pit oil in March 2006, the Cairn India Group appealed this decision with the Customs, Excise and Service Tax Appellate Tribunal in New Delhi, which is currently pending. Any requirement to pay OIDA cess on commercial production of crude oil from Block RJ-ON-90/1 whether or not recoverable pursuant to the terms of the PSC may have a material adverse effect on the Cairn India Group's financial condition and results of operations.

In respect of the political climate in Nepal, despite the recent ceasefire and ongoing negotiations between the Government of Nepal and Maoist rebels in Nepal, the political situation in that country is extremely sensitive. The Group has sought to preserve its contractual position with respect to its Nepalese interests by serving force majeure notices on the Government of Nepal. There is a risk that the situation in Nepal may never improve sufficiently to enable the Group to recommence its activities in that country. In addition, there is a risk that if the Government of Nepal changes as a result of the recent political instability in that country, the new government may seek to disclaim the Group's interests in Nepal.

Cash Flow

Due to its concentration on exploration, appraisal and development activities, the Cairn India and Capricorn Group's business is expected to be cash flow negative. As a result, the Group expects to finance its operations from cash generated from its producing fields, from the cash proceeds received in respect of the IPO and from debt made available to it. If production from any of the Group's currently producing fields is interrupted or suspended, this would have a further impact on the Group's cash flow.

The Group is also exposed to credit risks if counterparties fail to meet their payment obligations.

CORPORATE GOVERNANCE STATEMENT

Cairn is committed to achieving compliance with the principles and provisions set out in the Combined Code appended to the Listing Rules and to ensuring that high standards of corporate governance are maintained. The Board considers that the Company is compliant with the Combined Code, other than in the areas detailed on page 51. The Chairman met with PIRC at the end of 2006 to discuss current corporate governance issues, their report on the Company's annual report and accounts for the previous financial year and, in particular, the steps that had been taken by the Company during 2006 in respect of the procedures that are in place to ensure the continuing independence of the non-executive directors. The Chairman and Deputy Chairman also met with Research Recommendations and Electronic Voting (RREV) to discuss these issues during 2006. Set out below is a statement of how the Company applied the principles of the Combined Code for the year ended 31 December 2006.

The Board

Cairn's business is international in scope and carries political, commercial and technical risks. Accordingly, particular attention is paid to the composition and balance of the Board to ensure that it has wide experience of the sector and regulatory environment in which Cairn operates and appropriate financial and risk management skills. In each Board appointment, whether executive or non-executive, the Board considers that objectivity and integrity, as well as skills, experience and ability which will assist the Board in its key functions, are prerequisites for appointment.

The Board currently comprises the Chairman, the Chief Executive, five other executive directors and five independent non-executive directors. The directors' biographies are on pages 34 and 35. Kevin Hart also served as Finance Director during the year under review but, following his resignation with effect from 17 November 2006, his biographical details are no longer included.

Hamish Grossart, Deputy Chairman, is Cairn's senior independent non-executive director. A key responsibility for the senior independent non-executive director is to be available to shareholders in the event that they may feel it inappropriate to relay views through the Chairman or the Chief Executive. In addition, the senior independent non-executive director takes the lead when the non-executive directors assess the performance of the Chairman, further details of which are set out on page 43.

All of the directors are subject to election by shareholders at the first annual general meeting after their appointment to the Board and to re-election by shareholders at least once every three years. In addition, any non-executive director who has served on the Board for more than nine years is subject to annual re-election.

The division of responsibilities between the Chairman and the Chief Executive has been clearly established, set out in writing and agreed by the Board.

The Board has a formal schedule of matters specifically reserved to it for decision. These reserved matters include determination of the overall strategy of the Group and approval of the annual report and accounts and any other financial statements, the Group's annual budget and amendments to that budget over a particular amount, borrowing and security, acquisitions and disposals, capital expenditure over a specified amount, amendments to the organisational structure of the Group and Board, approval of significant changes to accounting policies and approval of management incentive schemes and Group policy on pensions. The Board delegates operational management of the Group on a day-to-day basis to the Group Management Board (the 'GMB'), which comprises the executive directors and senior management.

The Board has full and timely access to all relevant information to enable it to perform its duties. The Company Secretary is responsible for advising the Board, through the Chairman, on all corporate governance matters. In addition, each director has access to the advice and services of the Company Secretary and Deputy Company Secretary. There is also a procedure agreed by the Board for directors, in furtherance of their duties, to take independent professional advice if necessary, at the Company's expense, up to a predetermined limit.

During 2006 eight scheduled meetings of the Board were held. Six of those meetings were held in Edinburgh; the other two Board meetings were held at our office in Gurgaon, India. Details of attendance at each of those meetings, and at meetings of Board committees, are set out on page 47.

After the Board meeting held in India in October, the Board visited the Company's operations in Rajasthan and observed a number of the Group's corporate and social responsibility initiatives in India, details of which are set out in the accompanying Corporate Responsibility Report.

Due to the considerable amount of work involved in the IPO in addition to the day to day running of the business, a number of additional meetings of the Board were held and a committee constituted for the purposes of the IPO, comprising Norman Murray, Hamish Grossart, Mark Tyndall, Sir Bill Gammell and Kevin Hart. The Board believes that the flexibility and commitment shown by all members of the Board during this particularly busy period was of great benefit in ensuring that the IPO proceeded in accordance with the timetable.

The Board (continued)

In addition to the scheduled meetings of the Board and meetings required for the purposes of the IPO, during the year certain further meetings took place to deal with specific matters which required to be considered at short notice. When a specific matter requires consideration at short notice, there is a procedure setting out when those matters must be considered at a short notice Board meeting and when they may be dealt with by a committee of the Board (comprising at least two non-executive directors (one of whom must be the Chairman or Deputy Chairman) and two executive directors).

All directors unable physically to attend Board and committee meetings are given the opportunity to be consulted and comment in advance of the meeting by telephone or in writing. Video and telephone conferencing facilities are also used when directors are not able to attend meetings in person.

The formal agenda, which regularly includes presentations from senior operational management, for each scheduled Board meeting is set by the Chairman in consultation with the Chief Executive and the Company Secretary. Formal minutes of all Board and committee meetings are circulated to all directors prior to the following Board meeting and are considered for approval at that Board meeting. In addition, the Board is in frequent contact between meetings to progress the Group's business. The non-executive directors also meet informally, without any executives present, on a regular basis to discuss matters in respect of the business.

New directors receive a full and appropriate induction on joining the Board. This involves meetings with other Board members, members of the GMB and certain of the Company's principal advisers. In addition, a new director is provided with an induction pack which contains background materials and general information on the Company, the Company's policies and procedures, financial information, an operational review and a briefing on directors' legal and regulatory responsibilities. Details of the procedures followed for the appointment of Jann Brown and Simon Thomson, who were appointed as directors of the Company during the year, are set out on page 46.

The Company provides the necessary resources for developing and updating its directors' knowledge and capabilities. In particular, the Company is committed to the provision of continuing professional development training to its directors and in 2006 held a number of seminars for Board members on subjects appropriate to the Company's business, such as changes to legislation, regulation and market practice. These seminars, which are regularly presented by the Company's external advisers, were held at the end of Board meetings and were attended by all directors present at such meetings. This process is continuing in 2007. Any director may request that a particular subject is covered in a seminar. In addition, all press cuttings relating to the Company and all brokers' and analysts' reports on the Company are distributed to all directors. At least once a year, the Board visits an operational site and in October 2006 all of the directors visited the Company's operations in Rajasthan.

The Company has directors' and officers' liability insurance in place.

Performance Evaluations

The Board has a formal annual process of rigorous performance evaluation for the Board, audit, nomination and remuneration committees and individual directors. The Board reviews on an annual basis whether such performance evaluation should be conducted using an external resource. The Board has decided, however, that there is value in conducting the process internally in order to develop an appropriately tailored approach and benefit first hand from direct input from individual directors.

The performance evaluation of the Board and the Board committees was primarily based upon answers to a detailed questionnaire which had been updated since the previous year's evaluation and which was prepared internally. The questionnaire was distributed to all Board members and the Company Secretary. The areas covered in the questionnaire included the effectiveness of the Board and Board committees, performance against objectives, preparation for and performance at meetings and corporate governance matters. The questionnaire addressed all of the issues raised by the Higgs Review of the role and effectiveness of non-executive directors, published in January 2003.

The review process carried out pursuant to the questionnaires can be summarised as follows:

Evaluators	Chairman	Executive directors	Non-executive directors
Evaluating			
Board	✓	✓	✓
Chairman		✓	✓
Board committees	✓	✓	✓
Executive directors	✓		✓
Non-executive directors	✓	✓	
Self assessment	✓	✓	✓

Once a questionnaire had been completed by each member of the Board and the Company Secretary, the Chairman held a meeting with each director and the Company Secretary individually to discuss their responses. The Chairman then reported the results of the process to the Board at a Board meeting, which discussed the comments and implemented the conclusions. The Board and Board committees are satisfied that they are operating effectively.

The Deputy Chairman, who is also the Company's senior independent non-executive director, sought the views of the executive directors and met with each of the other non-executive directors, in the absence of the Chairman, to discuss and assess the Chairman's performance. The results of this review were then discussed with the Chairman. The Board (not including the Chairman) is satisfied that the Chairman's performance is effective and that he demonstrates continued commitment to the role.

The evaluation indicated areas for improvement, but no significant problems were identified. A performance evaluation of the Board, the Board committees and individual directors will continue to be conducted annually and the process for such review will continue to be reviewed by the Board in order to optimise the process.

The executive directors have their performance individually reviewed by the remuneration committee against objectives which are set annually. The bonus payable to the executive directors under the Company's cash bonus scheme (described further on page 62) is linked directly to the results of these reviews.

Independence of Non-Executive Directors

The Board evaluation and review process also covered the independence of each of the non-executive directors, taking into account their integrity, objectivity and contribution to the Board and its committees. In particular, the process considered the independence of Hamish Grossart, Ed Story and Mark Tyndall.

Hamish Grossart

Since Mr Grossart has served on the Board for more than nine years, in terms of the Combined Code he can be counted as independent only if the Board deems him to be so.

Mr Grossart commits a substantial amount of time to the affairs of the Company. During 2006 he was heavily involved in a supervisory role in respect of the IPO. Mr Grossart has also been the Deputy Chairman and a member of the Company's nomination, remuneration and audit committees for a number of years and has been the Company's senior independent non-executive director since the role was created in 2003. Mr Grossart is a well respected and highly experienced businessman with a thorough knowledge of the Group's business.

The Board is aware that PIRC have queried whether Mr Grossart can be classed as an independent director of the Company. We understand that, in terms of its internal policies, PIRC does not consider a non-executive director who has been on a board for more than nine years to be independent, notwithstanding that the Combined Code permits the Board to consider a director with this length of tenure to be independent. Accordingly, the Board has rigorously reviewed the matter, without Mr Grossart being present. Having undergone such a process, the Board is firmly of the view that Mr Grossart remains independent in character and judgement and that his performance continues to be effective and he demonstrates continued commitment to the role. In particular, the Board noted that Mr Grossart does not participate in the Company's cash bonus scheme, share option plans, long term incentive plans or pension scheme and is not dependent upon the fees received from the Company as his primary source of income.

Mr Grossart is also a non-executive director of Artemis, which manages a fund that has had a notifiable shareholding in the Company within the last three years (although this shareholding is currently not large enough, and indeed has not been large enough since 2004, to be classed as a notifiable interest under UK law). The Head of Compliance at Artemis has confirmed in writing to the Company that Mr Grossart does not participate in any investment management decisions at Artemis. The Company seeks such confirmation on an annual basis. The Board therefore does not consider that Mr Grossart's relationship with Artemis results in him not being independent.

Mr Grossart has indicated that he is willing to stand for re-election as a director of the Company on an annual basis and a resolution will be proposed at the AGM to be held on 17 May 2007 to this effect. The Board believes that it is in shareholders' interests for Mr Grossart to be re-elected as an independent non-executive director of the Company. The Board believes Mr Grossart continues to challenge rigorously the executive directors, the Board and the committees on which he sits in both a constructive and appropriate manner and brings a longer term perspective of the Company and the oil industry to the Board in his position as Deputy Chairman and senior independent non-executive director.

Ed Story

Mr Story has also now served on the Board for more than nine years and, accordingly, can only be considered as independent if the Board deems him to be so.

Mr Story was appointed an independent non-executive director of Cairn in 1997. He is a highly respected individual in the international oil and gas industry, in which he has more than 40 years' experience. Mr Story is a member of the Company's nomination, remuneration and audit committees.

After rigorous review, and without Mr Story being present, the Board has concluded that Mr Story remains independent in character and judgement and that his performance continues to be effective as well as demonstrating a continued commitment to his role as a non-executive director. The Board also noted that Mr Story does not participate in the Company's cash bonus scheme, share option plans, long term incentive plans or pension scheme and is not dependent upon the fees received from the Company as his primary source of income.

Mr Story has indicated that he is willing to stand for re-election as a director of the Company on an annual basis and a resolution will be proposed at the AGM to be held on 17 May 2007 to this effect. The Board believes that it is in shareholders' interests for Mr Story to be re-elected as an independent non-executive director of the Company. The Board believes Mr Story continues to challenge rigorously the executive directors, the Board and the committees on which he sits in both a constructive and appropriate manner and his considerable expertise and industry experience is of great benefit to the Board, the Company and shareholders.

Mark Tyndall

Mark Tyndall is the chief executive of Artemis, which manages a fund that has had a notifiable shareholding in the Company. As stated above, however, this shareholding is currently not large enough to be classed as a notifiable interest under UK law. Furthermore, the Company seeks confirmations from Artemis on an annual basis in respect of the 'chinese wall' arrangements that are in place and that Mr Tyndall does not participate in any investment management decisions at Artemis in respect of Cairn. The Board concluded, after rigorous review and without Mr Tyndall being present, that he is independent in character and judgement and that his performance is effective and that he demonstrates continued commitment to the role.

Following the evaluation and review process, the Board believes that, in addition to Mr Grossart, Mr Story and Mr Tyndall, all of the other non-executive directors are independent in character and judgement.

Board Committees

The Board has established an audit committee, a remuneration committee and a nomination committee, each of which has formal terms of reference approved by the Board. The terms of reference for each of these committees satisfy the requirements of the Combined Code and are reviewed internally on an ongoing basis by the Board. Copies of the terms of reference are available for inspection on request and will be available for inspection before the AGM to be held on 17 May 2007.

The committees are provided with all necessary resources to enable them to undertake their duties in an effective manner. The Company Secretary acts as secretary to the remuneration and nomination committees and the Deputy Company Secretary acts as secretary to the audit committee. The minutes of all committee meetings are circulated to all directors.

Set out below are reports from each of the audit committee, remuneration committee and nomination committee.

1. Audit Committee Report

The audit committee comprises three non-executive directors, all of whom are considered by the Board to be independent. Currently, its members are Andrew Shilston (chairman), Hamish Grossart and Ed Story. The Board is satisfied that two members of the committee have recent and relevant financial experience. Mr Shilston was the Finance Director of Enterprise Oil plc from 1993 to 2002 and is currently the Finance Director of Rolls-Royce plc. Mr Grossart serves on audit committees of other listed companies and trained as an investment banker.

The audit committee met five times in 2006. At the request of the audit committee, the Finance Director and senior members of the Finance Department attended each of these meetings. The Chairman also attended two meetings as an observer, on being invited to do so by the committee. In addition, all five meetings were attended by the external auditors and four meetings were attended by the internal auditors.

The external auditors receive copies of all audit committee papers (including papers to be considered at meetings when they are not in attendance) and minutes of all committee meetings. In addition, the chairman of the committee regularly meets with the external audit partner to discuss matters relevant to the Company.

The role of the committee includes:

- monitoring the integrity of the financial statements of the Company and formal announcements relating to the Company's financial performance and reviewing any significant financial reporting judgements contained in them;
- reviewing accounting policies, accounting treatments and disclosures in financial reports;
- reviewing the Company's internal financial controls and internal control and risk management systems;
- monitoring and reviewing the effectiveness of the Company's internal audit function;
- overseeing the Company's relationship with the external auditors, including making recommendations to the Board as to the appointment or reappointment of the external auditors, reviewing their terms of engagement, and monitoring the external auditors' independence, objectivity and effectiveness; and
- reviewing the Company's whistleblowing procedures and ensuring that arrangements are in place for the proportionate and independent investigation of possible improprieties in respect of financial reporting and other matters and for appropriate follow-up action.

The audit committee meets on at least two occasions during the year end process. Issues likely to impact the financial statements are raised at the initial meeting by both the senior management and the external auditors. The auditors will also present their audit plan. Audit committee guidance is sought on accounting policies and assumptions to be adopted in preparing the financial statements. After discussing and challenging the issues raised, the audit committee will recommend the policies to be adopted or direct senior management to produce further information if deemed necessary.

At the final meeting, the external auditors report their audit results to the audit committee, including a summary of the significant accounting and auditing issues, internal control findings and a summary of audit differences identified. The audit committee will consider any disagreements in accounting treatment between management and the auditors, should any arise.

The audit committee has established a policy in relation to the supply of non-audit services by the external auditors and other third parties. The Company will engage an external adviser to provide non-audit services on the basis of the skills and experience required for the work, where benefit will be derived as a result of the third party's knowledge of the Company and on the cost of doing so. These advisers may include the Company's external auditors for a restricted list of non-audit services, although, before the engagement commences, the Company must be satisfied that the auditors' objectivity and independence would not be compromised in any way as a result of being instructed to carry out those services. If the cumulative fees to be paid to an external adviser for the provision of non-audit services are below a certain level, the adviser may be engaged in accordance with the Company's financial delegations of authority after a quotation has been received. If the fees payable are expected to exceed that level on a cumulative basis, the engagement must be approved by the audit committee in advance after following a tender process.

KPMG LLP has been appointed by the audit committee to supervise and co-ordinate the Company's internal audit function. At the beginning of each year, an internal audit plan is developed by the internal auditor, in consultation with senior management, based on a review of the outcome of the previous year's internal audit, the significant risks in the Group Risk Matrix and identified mitigation measures. The internal auditor also attends the Risk Management Committee meetings to maintain an understanding of the business activities and associated risks. The audit committee receives updates on the internal audit workplan on an ongoing basis. The external auditors do not place any reliance on the work undertaken by the Company's internal audit function due to the nature of the scope and the timing of their work. The external auditors do, however, meet with the internal auditors and attend audit committee meetings where internal audit updates are given.

The Company undertook an audit tender process in 2003, as a result of which Ernst & Young LLP were re-engaged as the Company's auditors. The Company monitors its auditors' performance on an ongoing basis, including an annual assessment carried out by the audit committee with input from the Finance Director and other key members of the finance team. Following such assessment, the audit committee meets to discuss what actions, if any, require to be taken.

2. Remuneration Committee Report

The remuneration committee comprises four non-executive directors, all of whom are considered by the Board to be independent. Currently, its members are Hamish Grossart (Chairman), Ed Story, Mark Tyndall and Todd Hunt. The remuneration committee met eight times in 2006.

The Chief Executive, at the request of the committee, attends its meetings. In addition, he is consulted by the committee on its proposals. The Chairman also attended seven meetings of the committee during 2006 as an observer, on being invited to do so by the committee. None of the members of the committee, nor the Chief Executive, nor the Chairman participated in any meetings or discussions relating to their own remuneration.

2. Remuneration Committee Report (continued)

The role of the committee includes:

- determining and agreeing with the Board the remuneration policy for all the executive directors, the Chairman and the members of the GMB;
- within the terms of the agreed policy, determining the total individual remuneration package for each executive director;
- determining the level of awards made under the Company's share option plans and long term incentive plans and the performance conditions which are to apply;
- determining bonuses payable under the Company's cash bonus scheme;
- determining the vesting of awards under the Company's long term incentive plans and exercise of share options; and
- determining the policy for pension arrangements, service agreements and termination payments for executive directors.

Details of the Company's policies on remuneration, service contracts and compensation payments are given in the Directors' Remuneration Report on pages 56 to 67.

3. Nomination Committee Report

The nomination committee comprises Norman Murray (Chairman), two independent non-executive directors (Hamish Grossart and Ed Story) and, to ensure input from the executive, one executive director, Sir Bill Gammell (Chief Executive).

The Combined Code requires there to be a formal, rigorous and transparent procedure for the appointment of new directors, which should be meritocratic and made against objective criteria. For this purpose, the Board has established the nomination committee, whose role includes considering the composition, balance and skills of the Board and making recommendations to the Board on these matters, on the appointment of new directors and on the re-appointment and orderly succession of existing directors.

Details of the procedures followed for the appointments of Jann Brown and Simon Thomson, who were appointed as Finance Director and Legal & Commercial Director respectively during the year, are set out below.

The nomination committee met five times in 2006.

Organisational Planning

In 2006, Cairn continued to build on the success of its 'making a difference' initiative. In May, focus groups and feedback questionnaires were rolled out to employees and managers for them to assess the return on investment and the impact and success of our performance management system. 100% of managers felt the initiative helped them understand how to develop their team's competence and performance. 86% of employees were putting into practice what they had learned about themselves during the development and performance review process.

To develop employees' behavioural and technical competencies, individual and departmental training plans were put together in December. These training plans will be implemented throughout 2007 and will be supported by an extensive in-house training calendar consisting of training modules to meet the needs identified.

Work on establishing a set of Group Technical Competencies has now been completed. These were put together through interviews with employees and workshops to identify the technical skills and knowledge needed to perform effectively in all areas of the business.

Appointment of new directors in 2006

During 2006, Jann Brown and Simon Thomson were appointed as directors of the Company. The following procedures were followed:

- **Appointment of Jann Brown**
  Following the resignation of Kevin Hart as Finance Director, the nomination committee considered the technical abilities, experience, "City" exposure and leadership skills required of his successor. After detailed consideration, the nomination committee identified Jann Brown, an internal candidate and the then Group Financial Controller at the Company, as a suitable successor. Jann has been a member of the GMB for seven years and, in addition to her duties as Group Financial Controller, she had the key responsibility of project managing the IPO. After seeking the views of the audit committee and other non-executive directors, a proposal that Jann Brown be appointed as Finance Director was put to the Board, who unanimously approved the appointment. Jann Brown was appointed as Finance Director with effect from 17 November 2006.

- **Appointment of Simon Thomson**
  The nomination committee evaluated the balance of skills, knowledge and experience on the Board and recommended that the Company appoint a new executive director to the position of Legal & Commercial Director. After discussions with all the other members of the Board, the committee recommended to the Board that it meet formally to consider its recommendation that Simon Thomson, an internal candidate, who is a qualified solicitor and a member of the GMB, be appointed to the position. Mr Thomson was appointed as Legal & Commercial Director with effect from 17 November 2006.

Directors' Attendance at Board and Board Committee Meetings

The table below sets out the attendance record of each director at scheduled Board and Board committee meetings during 2006:

	Board	Audit Committee	Remuneration Committee	Nomination Committee
Meetings held during 2006	8	5	8	5
	Meetings attended	Meetings attended	Meetings attended	Meetings attended
Executive Directors[5]				
Sir Bill Gammell	7[4]	n/a[1]	n/a[2]	5
Mike Watts	8	n/a	n/a	n/a
Jann Brown[3]	1	n/a[2]	n/a	n/a
Malcolm Thoms	8	n/a	n/a	n/a
Phil Tracy	8	n/a	n/a	n/a
Simon Thomson[3]	1	n/a	n/a	n/a
Non-executive Directors				
Norman Murray	8	n/a[2]	n/a[2]	4[4]
Hamish Grossart	8	5	8	5
Ed Story	7[4]	5	6[4]	2[4]
Todd Hunt	7[4]	n/a	6[4]	n/a
Mark Tyndall	8	n/a	8	n/a
Andrew Shilston	8	4[4]	n/a	n/a

Notes:

(1) n/a = not applicable (where a director is not a member of the committee).
(2) During 2006, certain directors who were not committee members attended meetings of the audit committee and remuneration committee by invitation. These details have not been included in the table.
(3) Jann Brown and Simon Thomson were appointed as directors on 17 November 2006. The number of Board meetings attended is stated with effect from that date.
(4) Where a director was unable to attend meetings of the Board or of Board committees, he reviewed the relevant papers for the meetings and provided his comments to the Board or the Board committees in advance of such meetings.
(5) Kevin Hart was a director from 1 January 2006 to 17 November 2006. During this time he attended seven Board meetings. He also attended meetings of the audit committee by invitation.

Relations with Shareholders

Communications with shareholders are given high priority by the Board. Cairn sends both its annual report and accounts and interim report and accounts to all shareholders. In order to ensure that the members of the Board develop an understanding of the views of major shareholders there is regular dialogue with institutional shareholders, including meetings after the announcement of the year end and interim results. The Chairman attends a number of these meetings. At the Board meeting immediately following these meetings, a detailed report is given to all directors who were not in attendance at those meetings. In addition, the Company maintains an external relations database that details all meetings attended by the directors with third party stakeholders. All analysts' and brokers' reports on the Company are also distributed to all directors. Cairn responds to all correspondence from shareholders and also has a website that contains a range of information, including a dedicated investor relations section.

Mr Grossart, the senior independent non-executive director, is available to shareholders if they have concerns that contact through the normal channels of the Chairman, Chief Executive or Finance Director has failed to resolve or for which such contact is inappropriate.

Each of the non-executive directors is available to attend meetings with major shareholders (without the executive directors present), if requested by such major shareholders.

Annual General Meeting

The Board uses the AGM to communicate with private and institutional investors and welcomes their participation. It is our policy for all directors to attend the AGM if at all possible. Whilst this may not always be possible for business or personal reasons, in normal circumstances this means that the chairmen of the audit, remuneration and nomination committees will attend the AGM and be available to answer questions.

Annual General Meeting (continued)

It is part of our policy to involve shareholders fully in the affairs of the Company and to give them the opportunity at the AGM to ask questions about the Company's activities and prospects.

Details of resolutions to be proposed at the AGM on 17 May 2007 can be found in the Notice of Annual General Meeting on pages 118 to 121 and on the Company's website.

The proxy votes for and against each resolution, as well as abstentions, will be counted before the AGM and the results will be made available at the meeting after the shareholders have voted on each resolution on a show of hands. The Form of Proxy for the AGM includes a 'vote withheld' option in respect of each resolution, to enable shareholders to abstain on any particular resolution. It is explained on the Form of Proxy that a 'vote withheld' is not a vote in law and will not be counted in the calculation of the proportion of the votes 'for' or 'against' a resolution.

Directors' Responsibility Statement

The directors are responsible for preparing the annual report and the Group and Company financial statements in accordance with applicable law and regulations.

UK company law requires the directors to prepare Group and Company financial statements for each financial year. Under such law the directors are required to prepare the Group financial statements in accordance with IFRS (as adopted by the EU) and have also elected to prepare the Company financial statements in accordance with IFRS (as adopted by the EU).

The Group and Company financial statements are required by law and IFRS (as adopted by the EU) to present fairly the financial position and performance of the Group and the Company; the Companies Act provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Company financial statements, the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS (as adopted by the EU); and
- prepare the financial statements on the going concern basis unless it is inappropriate to assume that the Group and the Company will continue in business.

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

Going Concern

The directors have considered the factors relevant to support a statement on going concern. They have a reasonable expectation that the Group will continue in operational existence for the foreseeable future and have therefore used the going concern basis in preparing the financial statements.

Internal Control

The Board acknowledges its responsibility for the Group's system of internal control and for reviewing its effectiveness. The Group's system of internal control plays a critical role in managing the risks towards the achievement of Cairn's corporate vision and objectives, and is also central to safeguarding Cairn's shareholders' interests and the Group's assets. This system of internal control is in accordance with the guidance of the Turnbull Committee and is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The process has been in place in respect of the Group for the 2006 accounting period and up to the date of approval of the annual report and accounts. The Board has carried out a review of the effectiveness of the Group's system of internal control during 2006, and will ensure that further reviews are performed in 2007. The Board is satisfied that effective internal control is in place and that risks have been mitigated to an acceptable level.

As an oil and gas exploration and production company with current operations concentrated in South Asia, Cairn is, by virtue of the nature of its business and the countries in which it operates, subject to a variety of business risks. However, the directors believe that Cairn derives its competitive edge by focusing activities in this core area and the experience that Cairn has gained over many years in the area enables the Company to manage these risks effectively.

Operations in any country are only possible when values are shared, and the directors believe that Cairn's values of integrity, social and environmental responsibility, teamwork and nurturing of individuals, creativity, risk management and alliances with key partners are ingredients that are central to Cairn's success. The ability to recognise the value of working as a partnership with host governments, both nationally and regionally, has also been a critical ingredient in Cairn's approach and success.

2006 was a year of transformation for Cairn, with re-organisations at both the Group and India levels, and the subsequent IPO in January 2007. Following the IPO, Cairn Energy PLC has retained a 69% holding in CIL. This transformation was successfully achieved while maintaining effective control in relation to the risks in Cairn's business activities.

CIL is subject to the rules, regulations and guidelines of SEBI and to its listing agreements with each of the BSE and the NSE. Under the terms of a relationship agreement between Cairn Energy PLC and CIL, both companies have also agreed to use reasonable endeavours to ensure that they can comply with their obligations to SEBI, the FSA, the BSE, the NSE and under the SEBI Insider Trading Regulations and the UK Disclosure and Insider Trading Rules. This includes adopting and following the principles and policies of corporate governance, including risk management, which will enable each to comply with these obligations.

The following describes the key elements of the internal control system and the processes used by the Board during 2006 to review the effectiveness of the system. It also describes the approach to be taken in 2007.

1. Strategic Direction

The Cairn business model is conventional in that Group strategy is set by the directors and approved by the Board, and its implementation is delegated to the GMB. Following its listing on the BSE and NSE in January 2007, CIL is now an autonomous company and its directors decide the company's strategy. Cairn Energy PLC has three non-executive directors on the CIL board (including Sir Bill Gammell as its Chairman) and therefore has an input to this strategy.

2. Operating Management

Cairn operates several business units in different countries and with various partners. Work programmes and budgets are prepared annually to meet the Group strategy, starting at the asset level before being consolidated at both country and Group levels. After an iterative process, the country budgets are presented as part of the Group budget to the GMB and the Board for approval.

Each country then prepares a detailed business plan to meet the agreed annual work programme and budget. This sets out detailed objectives and KPIs for each asset and supporting functional department, and is consolidated into the country business plan. The country business plans are firstly approved by the in-country management teams and are then submitted to the GMB and the Board for approval.

The in-country management teams then have the required authority to implement the business plans and to deliver the agreed work programme within the approved budget and delegation of authorities, and in accordance with the internal control framework.

The remit of the GMB is to oversee the delivery of the Group strategy through the annual work programmes, budgets and the country business plans. The directors have also appointed Group Functional Heads whose roles include providing input and 'challenge' to the work programmes, budgets and business plans, and supplying the relevant director with full and accurate information and to make statements on the adequacy of internal control.

In view of the significance of the Rajasthan northern fields development, the GMB established a Project Board and project governance process in 2005, to ensure these fields are developed efficiently and in accordance with the project boundary conditions agreed by the GMB and the Board. The Project Board continued to perform this role during 2006 and will be replaced in 2007 by a Project Review Board reporting to the CIL Executive Committee. A Project, Engineering and Technology Advisory Board, chaired by Phil Tracy, has also been established to provide independent, expert advice to the CIL Board on the various projects being undertaken by CIL.

3. Risk Management

The Risk Management Committee ('RMC'), established by the Board in 1999, continues to be responsible for the development of risk management strategy and processes within the Group and for overseeing the implementation of the requirements of this strategy. It does this by ensuring the Group's framework for the identification, assessment, mitigation and reporting on all areas of risk is 'fit for purpose' and that appropriate assurance arrangements are in place in relation to these risks.

The RMC is chaired by the Finance Director and comprises executive directors, senior country and Group functional management. In order to improve transparency of key business risks, non-executive directors also attended committee meetings during 2006, including Norman Murray and Andrew Shilston. The new Finance Director, Jann Brown, took over as chair of the Group RMC on the departure of her predecessor, Kevin Hart, in November 2006. Further changes to the RMC membership, in order to maintain a robust and challenging approach to risk management, are planned in 2007.

3. Risk Management (continued)

The Business Risk Management Guidelines ('BRMG'), that define the processes through which Cairn seeks to systematically identify, analyse, assess, treat and monitor the business risks faced by the Group, were issued in April 2005. The BRMG also identifies the risk management organisational structure through which business risks are managed and regularly reviewed at operating, asset and country levels.

Country level RMCs have continued to operate in India and Bangladesh during 2006. Business risks, together with the identified mitigating measures and responsibilities, have been recorded in Asset and Country Risk Registers, which following endorsement by the in-country RMCs are reported through to the Group Risk Register. These Country and Group Risk Registers are regularly reviewed by the Group RMC to ensure that the business understands the key risks it faces and that there is an embedded risk management approach in place. At each Group RMC meeting a specific risk item has also been reviewed in more detail, through presentations by and questioning of the responsible manager. During 2006 these more detailed reviews have included business systems strategy, the Rajasthan export pipeline, the business processes employed in treasury and financing, and the risks associated with the IPO process.

Since KPMG's appointment to manage the internal audit process in August 2004, steps have been taken to ensure internal audit's integration with the risk management process, including attendance at RMC meetings.

Following the IPO, the following steps have been taken in order to meet the risk management requirements under SEBI and the Combined Code:

- a separate autonomous CIL RMC has been established under the chairmanship of the Chief Operating Officer. The CIL RMC reports to the CIL audit committee, whose purpose it is to co-ordinate the business risk management process throughout the Cairn India Group on behalf of the CIL Board;
- CIL business risk management guidelines have been developed based on the Group BRMG; and
- Group monitoring of the CIL risk management process is being achieved through the Group Risk Manager attending CIL RMC meetings, the CIL Risk Register being made available and integrated into the Group Risk Register and CIL participation in the Group RMC meetings.

4. Assurance

The integrated assurance framework adopted by the Board provides for three levels of assurance against the risks facing the Group: firstly at the operational level; secondly through overview by Group functional management and the RMC; and thirdly through internal, external or joint venture audits.

During 2006 the directors regularly reviewed the effectiveness of the Group's system of financial and non-financial controls, including operational and compliance controls, risk management and the Group's high level internal control arrangements. The directors derive assurance from the following internal and external controls:

- a regularly updated schedule of matters specifically reserved for a decision by the Board;
- policies and procedures for key business activities;
- an appropriate organisational structure;
- control over non-operated joint venture activities through delegated Cairn representatives;
- specific delegations of authority for all financial and other transactions;
- segregation of duties where appropriate and cost effective;
- business and financial reporting, including KPIs;
- functional management reviews;
- the presence of various directors of the Company on CIL's board (in a non-executive capacity) and certain of its committees. The Board will also receive copies of minutes of meetings of the CIL board of directors;
- a relationship agreement with CIL, which contains provisions for the supply by CIL to the Company of such information and confirmations as the Company may require to comply with legal, regulatory and reporting obligations;
- a transition support agreement with CIL, to help ensure a smooth process in respect of the relocation of certain managerial functions from the Company's headquarters in Edinburgh to CIL in India;
- annual 'letters of assurance' process, through which country managers confirm the adequacy of internal financial and non-financial controls, their compliance with Group policies and report any control weaknesses identified in the past year;
- internal audits to assess compliance – the internal auditor implements a number of audits during the year in line with the annual internal audit plan approved by the audit committee and the Board;
- reports from the audit committee and RMC (including reports from the CIL RMC and CIL audit committee, which have been established following the IPO);
- reports from the external auditor on matters identified during its statutory audit;
- reports from audits by governments and co-venturers; and
- independent third party reviews commissioned by Cairn.

Compliance With Combined Code

Throughout 2006 the Company complied with the provisions of the Combined Code, except in the following areas:

Provision of the Combined Code	Company Position	Explanation
A.3.2 – at least half the Board, excluding the chairman, should comprise non-executive directors determined by the Board to be independent.	The Company complied with this provision from the start of 2006 until 16 November 2006. During the period from 17 November 2006 to 31 December 2006 the Company did not comply with this principle.	At the start of 2006, the Board comprised five executive directors and six non-executive directors (including the Chairman). The Board determined that the six non-executive directors were independent and the Company therefore complied with this provision at this time. On 17 November 2006, Kevin Hart resigned as Finance Director and was replaced by Jann Brown. On this date, Simon Thomson was appointed as Legal & Commercial Director, resulting in the Board comprising six executive directors and six non-executive directors (including the Chairman). Nevertheless, the Board believes that these appointments were in the best interests of the Company and its shareholders and is satisfied that it maintained a sufficient degree of independence throughout this period effectively and properly to discharge its obligations under the Combined Code. The composition of the Board is being reviewed in conjunction with the Company's strategy following the IPO.
A.4.1 – a majority of the members of the nomination committee should be independent non-executive directors.	Throughout 2006 the nomination committee comprised two independent non-executive directors, the Chairman and one executive director.	The Board believes that the membership of the committee is appropriate and effective.

DIRECTORS' REPORT

The directors of Cairn Energy PLC present their annual report for the year ended 31 December 2006 together with the financial statements of the Group for the year. These will be laid before the shareholders at the AGM to be held on Thursday 17 May 2007.

Results and Dividend

The Group made a loss after tax and exceptional items of $82.0m (2005: $79.1m).

The directors do not recommend the payment of a dividend for the year ended 31 December 2006.

Subsequent events that have occurred after the Balance Sheet dated at 31 December 2006 are included in note 34 of the Notes to the Accounts.

Principal Activities and Business Review

The principal activity of the Company and its subsidiary undertakings is the exploration for and development and production of oil and gas in India, Bangladesh and Nepal. Details of the development of the Group's business during the year and the information that fulfils the requirements of the Business Review can be found in the Highlights of 2006, Chairman's Statement, Chief Executive's Review, Assets, Operating & Exploration Review, Corporate Responsibility and Financial Review on pages 2 to 33 of this document and the Risk Factors section on pages 37 to 40, which are deemed to form part of this report by reference.

Details of Cairn's offices are given on the back cover of this report and details of Cairn's advisers are given on page 124.

Charitable and Political Donations

The Company has a Charities Committee which is responsible for distributing the Company's charitable donations to selected charities within an overall annual budget. During the year the Group made various charitable contributions in the UK totalling $270,943 (2005: $332,960). Contributions in the UK are made to a variety of charitable organisations whose areas of operation and activities are aligned with Cairn's. In addition, the Group provides funding to various charitable initiatives outwith the UK. Further details of these can be found in our Corporate Responsibility Report.

No political donations were made and no political expenditure was incurred during the year.

Directors

The names and biographical details of the current directors of the Company are given on pages 34 and 35. The beneficial interests of the directors in the ordinary shares of the Company are shown below:

	As at 31 December 2005 (or date of appointment if later)	As at 31 December 2006	As at 27 March 2007
Sir Bill Gammell	800,000	805,000	672,225*
Mike Watts	275,000	300,000	258,915
Malcolm Thoms	126,736	74,437	94,052
Phil Tracy	25,000	61,519	61,519
Jann Brown	41,519	41,519	40,581
Simon Thomson	39,519	39,519	38,956
Norman Murray	100,000	100,000	81,250
Hamish Grossart	50,000	40,000	32,500
Ed Story	50,000	5,000	4,062
Todd Hunt	35,000	35,000	28,436
Mark Tyndall	5,000	5,000	4,062
Andrew Shilston	5,000	5,000	4,062
Former director			
Kevin Hart	100,593	100,000	22,434

* Sir Bill Gammell's interest includes 92,257 shares which are held in discretionary trusts, where his children are potential beneficiaries.

At 31 December 2006, none of the directors (or any members of their families) holds an interest in options over ordinary shares in the Company.

None of the directors has a material interest in any contract, other than a service contract, with the Company or any of its subsidiary undertakings. Details of the directors' service contracts are set out on pages 63 and 64.

Major Interests in Share Capital
The Company has been notified, in accordance with sections 198 to 202 of the Act, of the following interests in its ordinary shares as at 27 March 2007.

	Number of Shares	% of Share Capital
BlackRock Investment Management	23,182,432	14.46
Baillie Gifford	12,937,097	8.07
F&C Asset Management	11,806,642	7.37
Legal & General Asset Management	10,876,073	6.78
Lazard Asset Management	7,758,811	4.84
HSBC Investments	5,834,273	3.64

Creditor Payment Policy and Practice
It is Cairn's payment policy to ensure settlement of suppliers' services in accordance with the terms of the applicable contracts. In most circumstances, settlement terms are agreed prior to business taking place. Trade creditors of the Company at 31 December 2006 were equivalent to 31 days' purchases, based on the average daily amount invoiced by suppliers to the Company during the year.

Financial Instruments
The financial risk management objectives and policies of the Company are detailed in note 27 of the Notes to the Accounts.

Election/Re-election of Directors
Kevin Hart resigned as a director on 17 November 2006.

Jann Brown and Simon Thomson were appointed as directors on 17 November 2006 (as Finance Director and Legal & Commercial Director respectively). Both are therefore due to retire at the AGM to be held on 17 May 2007 (being the first AGM following their appointment) and, being eligible, will offer themselves for election as directors.

Mark Tyndall and Malcolm Thoms retire by rotation at the AGM to be held on 17 May 2007 in accordance with the Company's articles of association and, being eligible, offer themselves for re-election as directors. Hamish Grossart and Ed Story have each served on the Board for more than nine years and in accordance with the Combined Code will therefore seek re-election as directors on an annual basis.

The Board has carried out a formal performance evaluation and confirms that, after rigorous review, it has determined that the performance of each of the directors who are subject to re-election continues to be effective and that each demonstrates commitment to the role. An explanation of the performance evaluation procedure carried out by the Company is contained in the Corporate Governance Statement.

The directors' biographies are on pages 34 and 35.

Share Capital Authorities
Resolution 10 in the Notice of AGM seeks to give the directors authority to allot up to 43,455,715 unissued ordinary shares, being up to an aggregate nominal amount of £2,674,197.85. This maximum amount represents 33.33% of the Company's total issued ordinary share capital as at 27 March 2007. As at 27 March 2007 the Company holds no shares in treasury, representing 0% of the total ordinary share capital (calculated exclusive of treasury shares). The authority conferred by this resolution will expire on 16 May 2012, although the directors intend to seek the renewal of this authority on an annual basis. The directors consider that the authority proposed to be given pursuant to resolution 10 is desirable to allow the Company to retain flexibility, although they have no present intention of exercising this authority.

Resolution 11 in the Notice of AGM seeks to give the directors power to allot unissued ordinary share capital and to sell ordinary shares held in treasury for cash up to an aggregate nominal amount of £2,674,197.85 in aggregate without first being required to offer such shares to existing shareholders but this authority is limited to:
(i) the allotment of ordinary shares and sale of treasury shares avoiding legal or practical problems should there be an offer of shares or other securities to shareholders pro rata in the future; and
(ii) the allotment and sale of up to 6,519,009 ordinary shares and treasury shares for cash (for any purpose) representing 5% of the issued ordinary share capital of the Company as at 27 March 2007.

The authority conferred by this resolution will expire on 16 May 2012, although the directors intend to seek the renewal of this authority on an annual basis.

Purchase of Own Shares

Resolution 12 in the Notice of AGM will be proposed to authorise the Company to make market purchases of its own ordinary shares. Shares repurchased by the Company pursuant to such authority may be cancelled or held in treasury and then either sold (in whole or in part) for cash or cancelled (in whole or in part).

The directors intend to take advantage of the flexibility afforded by this resolution as they deem appropriate. No dividends will be paid on treasury shares and no voting rights attach to them.

The maximum aggregate number of ordinary shares that may be purchased pursuant to the authority shall be 14.99% of the issued ordinary share capital of the Company as at 27 March 2007, being 19,543,989 ordinary shares. The maximum price which may be paid for an ordinary share pursuant to this resolution (exclusive of expenses) shall be the higher of an (i) amount equal to 105% of the average of the middle market quotations for the Company's ordinary shares for the five business days immediately preceding the date of purchase and (ii) the higher of the price of the last independent trade of an ordinary share and the highest current independent bid for an ordinary share as derived from the London Stock Exchange Trading System (SETS). The minimum price that may be paid for an ordinary share pursuant to this resolution (exclusive of expenses) shall be $6^{2}/_{13}$ pence, being the nominal value of an ordinary share.

In accordance with the Listing Rules, the Company will not repurchase shares in the period of sixty days immediately preceding the preliminary announcement of its annual or interim results or, if shorter, the period from the end of the financial period concerned up to and including the time of a relevant announcement or, except in accordance with the Listing Rules, at any other time when, in terms of the Company's Dealing Rules, the directors would be prohibited from dealing in shares.

This authority, if conferred, will only be exercised if to do so would be in the best interests of shareholders generally.

This authority will expire on the earlier of 16 November 2008 or the conclusion of the AGM of the Company to be held in 2008 (unless previously revoked, varied or renewed by the Company in general meeting). The directors intend to seek renewal of this authority at subsequent Annual General Meetings.

As at 27 March 2007, options to subscribe for shares were outstanding over an aggregate of 1,616,517 ordinary shares (representing 1.01% of the issued share capital of the Company as at 27 March 2007). If the outstanding amount of the existing buy-back authority granted at the 2006 AGM is utilised in full prior to the 2007 AGM and the new authority is granted at the AGM to be held on 17 May 2007 and is then utilised in full, the options outstanding at 27 March 2007 would represent 1.35% of the issued share capital of the Company.

Repurchase of Deferred Shares

As a consequence of the return of cash to shareholders in April, approval will also be sought at the forthcoming AGM to repurchase the deferred shares resulting from the B Shares upon which shareholders elect to receive the single B Share dividend payable on 4 April 2007. This proposal is detailed in resolution 13 of the Notice of AGM.

Amended Borrowing Powers

Resolution 14 in the Notice of AGM proposes amendments to the Company's borrowing powers set out in the Company's Articles of Association. In common with most listed companies, the Company's borrowing powers are restricted under its Articles of Association. The borrowing limit is a multiple of 'Adjusted Capital and Reserves', which is calculated by reference to certain numbers extracted from the most recent consolidated balance sheet of the Group.

As from 1 January 2005, the Group's consolidated balance sheet has been required to be prepared in accordance with IFRS, consistently applied from year to year. As a consequence of this, the Board believes that certain provisions in those parts of the Company's Articles of Association which establish the Company's borrowing powers require minor modification in order to now be clear and consistent with the bases under which the Group's consolidated balance sheet is now being produced.

Furthermore, the Board believes that certain provisions in those parts of the Company's Articles of Association which establish the Company's borrowing powers require minor modification to exclude from the calculation of monies borrowed any borrowings or indebtedness of Cairn India and its subsidiaries. The Board believes this to be in the best interest of the Company because under the Indian Companies Act and in line with normal Indian regulatory practice Cairn India is permitted to borrow an amount up to the limit of its capital reserves. As a matter of normal accounting practice, those reserves are significantly higher than the total equity of the Company and the directors of the Company believe it is appropriate for Cairn India's borrowing limits to be excluded from the calculation of the borrowing limits of the Company.

Accordingly, it is proposed that the borrowing power in the Company's existing Articles of Association be altered, the principal changes being:

(a) to increase the ability of the Company to borrow money up to the greater of $2 billion and an amount equal to 2.5 times of the adjusted total equity (total equity being the new terminology used by IFRS and appearing in the consolidated balance sheets of the Group prepared under IFRS). The increase in the multiple to 2.5 times, from the previous multiple of 2 times, will provide headroom to compensate for any reductions that may arise as a direct result of the introduction of IFRS and the consequent change in definition of total equity. The introduction of a fixed amount approximately equal to what the limit would currently be based on the total equity formula protects the Company against adverse fluctuations in the amount of total equity under IFRS and is in line with other market precedents; and

(b) to exclude from the calculation of monies borrowed any borrowings or indebtedness of CIL and its subsidiaries.

The effect of resolution 14 will be to modify the wording of the Company's Articles of Association in so far as they relate to the Company's borrowing powers, such that the wording is clear and consistent with the Group's consolidated balance sheet now being prepared in accordance with IFRS. These are technical amendments to the Company's borrowing powers as a result of accounting standards changes and the recent restructuring of the Group for the IPO and do not reflect any current intention to increase the level of borrowing.

Copies of the existing Articles of Association and of the revised Article 128 will be available for inspection by shareholders at the Company's registered office between 9.00 a.m. and 5.00 p.m. Monday to Friday (other than public holidays) from the date of the Notice of AGM to the conclusion of the AGM to be held on 17 May 2007.

Disclosure of Information to Auditors

The directors of the Company who held office at 31 December 2006 confirm, as far as they are aware, there is no relevant audit information of which the Company's auditors are unaware. In making this confirmation, the directors have taken appropriate steps to make themselves aware of the relevant audit information and that the Company's auditors are aware of this information.

Re-appointment of Auditors

Ernst & Young LLP have expressed their willingness to continue as auditors and their re-appointment at the AGM to be held on 17 May 2007 will be proposed in accordance with section 385 of the Act.

AGM 2007

The resolutions to be proposed at the AGM to be held on 17 May 2007 are set out in the Notice of AGM.

Please note that this Annual Report and Accounts (which includes the Notice of AGM) is an important document and requires your immediate attention. If you are in any doubt as to what action you should take, you should consult your stockbroker, bank manager, solicitor, accountant or other professional adviser immediately.

If you have sold or transferred all your shares in Cairn Energy PLC please send this document and the accompanying Form of Proxy to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected, for transmission to the purchaser or transferee.

The directors consider that all of the resolutions set out in the Notice of AGM are in the best interests of the Company and its shareholders as a whole and recommend that shareholders vote in favour of each of them.

By order of the Board
Duncan Wood
Company Secretary
27 March 2007

DIRECTORS' REMUNERATION REPORT

Remuneration Committee and Advisers

Reference is made to pages 45 and 46 of the Corporate Governance Statement, where there is a summary of the role of the remuneration committee.

Cairn's remuneration committee operates within terms of reference set by the Board. These are reviewed periodically to ensure that the remuneration committee remains up to date with best practices appropriate to Cairn, its strategy and the business environment in which it operates.

The deliberations and decisions of the remuneration committee are governed by the provisions in the Listing Rules and the Combined Code (appended to the Listing Rules) and the remuneration committee has followed these provisions and those of the Companies Act, as amended by the Directors' Remuneration Report Regulations 2002, in preparing this report.

As and when the remuneration committee deems appropriate, it takes external advice on remuneration from the Company's legal advisers, Shepherd and Wedderburn LLP, and auditors, Ernst & Young LLP in respect of the Company's share option schemes and long term incentive plans. Advice obtained from Ernst & Young LLP is purely in relation to their independent verification of the Company's performance against performance criteria applicable to the Company's share option schemes and long term incentive plans.

In respect of comparative remuneration, advice had also previously been obtained from New Bridge Street Consultants, who last conducted a comprehensive review of the directors' remuneration packages in 2004. The remuneration committee had intended to instruct a further review at the end of 2006 but given the transition phase the Company had entered into following the flotation of Cairn India, decided that this was not currently appropriate.

The current members of the remuneration committee are Hamish Grossart (Chairman), Ed Story, Mark Tyndall and Todd Hunt. The Chairman and Chief Executive are not members of the remuneration committee but may attend its meetings by invitation and are consulted in respect of certain of its proposals (although they are not consulted or involved in any discussions in respect of their own remuneration).

The remuneration committee determines and agrees with the Board the overall remuneration policy for the executive directors, the Chairman and the members of the GMB. The remuneration committee also determines, within the terms of the agreed policy and having consulted with the Chairman and the Chief Executive about their proposals, specific remuneration packages for each of the executive directors, including pension rights and any compensation payments to be paid on termination.

Remuneration Policy

Cairn's policy on executive directors' remuneration for the current year and subsequent financial years is that the overall remuneration package should be sufficiently competitive to attract, retain and motivate high quality individuals capable of achieving the Group's objectives and thereby enhance shareholder value. The package is generally weighted more towards variable pay and, in relation to the variable pay element, the package is weighted more towards long term performance.

Each executive director's remuneration package currently consists of basic salary, benefits, annual performance related bonuses, long term incentive plans, defined contribution pension (if appropriate) and life assurance of four times basic annual salary.

The package is designed to support the Group's business strategy and to provide an appropriate incentive to maximise individual and corporate performance, whilst ensuring that overall rewards are market competitive. Details of the individual components of the package and of contracts are given below.

The remuneration of the non-executive directors takes the form solely of fees, which are agreed by the executive members of the Board and the Chairman, having taken independent advice on appropriate levels, within an overall limit determined by shareholders. The fees are designed to attract experienced individuals and reflect the responsibilities of the role. The fees stated are in respect of all responsibilities undertaken by the non-executive directors, including membership of Board committees.

Basic Salary and Benefits

Basic salary is reviewed annually by the remuneration committee and any changes take effect from 1 January each year. For the year 2007, the basic salaries of the executive directors were retained at 2006 levels, being £480,000 for Sir Bill Gammell, £350,000 for Dr Mike Watts, £300,000 for each of Malcolm Thoms and Phil Tracy, and £250,000 for each of Jann Brown and Simon Thomson. The salaries of Jann Brown and Simon Thomson were agreed as at their date of appointment as directors and will next be reviewed in January 2008.

The non-executive directors' fees were retained at 2006 levels being £140,000 for Norman Murray, £90,000 for Hamish Grossart and £50,000 for each of Ed Story, Todd Hunt, Mark Tyndall and Andrew Shilston.

Benefits available to the executive directors comprise a company car, permanent health insurance, private health insurance and death in service benefit.

Share Options

Details of the Group's current share option plans are as follows:-

1. 1996 Second Share Option Scheme ('1996 Scheme')
2. 2002 Unapproved Share Option Plan ('2002 Plan')
3. 2003 Approved Share Option Plan ('2003 Plan')
4. 2006 Share Option Plan ('2006 Plan')
5. Cairn India Share Option Schemes ('Cairn India Schemes')

1996 Scheme

The 1996 Scheme was adopted in 1996 and expired in May 2006. The date of grant of the last award of options under the 1996 Scheme was 1 October 2002.

2002 Plan and 2003 Plan

The 1996 Scheme was superseded by two subsequent share option plans – the 2002 Plan and the 2003 Plan. The principal difference between the 2002 Plan and the 2003 Plan is that the approval of the Inland Revenue was not sought for the 2002 Plan. The 2003 Plan was approved by shareholders at the 2003 AGM and subsequently by the Inland Revenue. The date of grant of the first award of options under the 2002 Plan was 18 March 2003. The date of grant of the first award of options under the 2003 Plan was 30 June 2003.

Following the adoption of the 2006 Plan, no further awards will be granted under the 2002 Plan or the 2003 Plan. The date of grant of the last award of options under these arrangements was 4 July 2006.

Options granted under the 1996 Scheme, 2002 Plan and 2003 Plan are exercisable three to ten years following the date of grant and are subject to performance conditions on exercise. In the case of all outstanding options under these arrangements, the option holder may only exercise their awards if Cairn's share price has increased by 5% on a compound basis over the period from the date of grant of options up to the date they are exercised. In addition, the percentage increase in Cairn's share price over the period must be at least equal to or greater than the percentage movement in the FTSE Oil & Gas Index.

2006 Plan

The 2006 Plan was approved by shareholders at the EGM held on 17 November 2006, conditional on the flotation of Cairn India becoming effective, which occurred on 9 January 2007. No awards have yet been made under the 2006 Plan. It is, however, expected that the 2006 Plan will be used to make regular annual grants to those of the Group's employees who do not participate in the new LTIP. No options will be granted to the Company's executive directors or to any employee or director of the Cairn India Group.

This new plan, together with the new LTIP described below, reflects the fact that, following the flotation of Cairn India, there are two distinct arms to the Group's business (namely, a majority shareholding in Cairn India and an exploration and production business owned and operated by the Capricorn Group) and therefore seeks to incentivise employees of the Group in relation to the arm(s) which they can affect.

The 2006 Plan will enable selected employees (excluding those that are employed by the Cairn India Group) to be granted 'phantom options' over 'units' in the Capricorn Group (see below under New LTIP for how these units are created and valued). On the exercise of an option, participants will generally become entitled to such number of Cairn shares as have a market value equal to the notional gain that they realise (i.e. the difference between the 'notional exercise price' attributable to their option and the price of the units in respect of which their option has been exercised). However, the extent to which options become exercisable will be dependent on continued employment with the Group and the extent to which predetermined performance conditions are met over a specified period.

The remuneration committee has decided that, initially, all options granted under the 2006 Plan will be subject to a Capricorn unit price target measured over a three year performance period. Under this target, vesting will occur as follows:

Percentage of Capricorn units comprised in option that vest	Average annual compound growth in Capricorn unit price over the performance period
0%	Less than 5%
50%	5%
100%	10% or more
50% – 100% on a straight-line basis	More than 5% but less than 10%

Notwithstanding the above condition, no part of an option will vest unless the notional total shareholder return ('TSR') of a Capricorn unit over the performance period is sufficient to place it at or above the median level in the same comparator group of companies that is used for the purposes of the Capricorn awards granted pursuant to the New LTIP (see below).

None of the directors hold any options under any of the Company's share option plans. Since 1999, the long term incentives for executive directors and certain other senior executives have been made pursuant to long term incentive plans and therefore no options have been granted to these individuals under any of the Company's share option plans since that time.

Cairn India Schemes

As part of the arrangements surrounding its flotation, Cairn India established the following share option schemes pursuant to which options to acquire its shares can be granted:
- the Cairn India Senior Management Plan;
- the Cairn India Employee Stock Option Plan (2006); and
- the Cairn India Performance Option Plan (2006).

These arrangements (brief details of which are set out on pages 90 and 91 in note 5 of the Notes to the Accounts) have been or will be used to grant options to selected employees and executive directors of Cairn India and its various subsidiary undertakings. None of the executive directors of the Company participate, or will participate, in any of the Cairn India Schemes.

Existing LTIP

Details of directors' awards granted pursuant to the existing LTIP, which was implemented in 2002 (the 'Existing LTIP') are given on pages 66 and 67. The Existing LTIP has now been replaced by the New LTIP, further details of which are set out below on pages 60 to 62. As such, no further awards will be made under the Existing LTIP.

Participants have been granted Tier One and Tier Two awards under the Existing LTIP. Performance conditions for each are determined by the remuneration committee and the calculation of shares vesting based on these conditions is subject to independent verification by Ernst & Young LLP.

Performance Conditions – Tier One

A Tier One award is an award of Cairn shares with the vesting and release of all/part of those shares being dependent upon the executive remaining an employee and achievement of performance conditions over a performance period of three years.

The vesting of all outstanding Tier One awards is subject to a TSR target which is calculated in two steps, each of which must be satisfied.

Step One

First, the TSR of a Cairn share during the performance period is compared to the average TSR performance of the companies comprising the relevant FTSE Index ('the Index') at the beginning and at the end of the performance period (details of the FTSE Indices used are set out on the page opposite). If Cairn's TSR performance exceeds the average TSR performance of the Index, then the step one test has been passed. The step two test is then used to calculate how many (if any) Cairn shares the subject of the award will vest.

Step Two
Under step two, the TSR of Cairn shares is compared to the TSR of a share in each company in a comparator group comprising exploration, production and integrated oil companies over the performance period (details of the relevant comparator groups are set out on page 60). Each company is then ranked in order of TSR performance. Cairn's position in the comparator group list then determines how many (if any) Cairn shares the subject of the award will vest, as follows:

Percentage of Cairn shares comprised in Tier One Award that vest	Ranking of Cairn in relevant comparator group
0%	Below median
20%	Median
100%	Upper quartile or above
20% – 100% on a straight-line basis	Between median and upper quartile

In addition, no Tier One award will vest unless the remuneration committee is satisfied that there has been a satisfactory and sustained improvement in Cairn's underlying financial position and performance over the performance period.

Performance Conditions – Tier Two
A Tier Two award is a share appreciation right over a number of notional Cairn shares. The maximum potential benefit a participant may receive under a Tier Two award is calculated by comparing the increase in Cairn's share price over the performance period with the change in the average share price of the comparator group over the same period. The increase in Cairn's share price (if any) over the rise (or fall) in the average share price of the comparator group over the performance period is then multiplied by the number of notional shares the subject of the award. This gives rise to a monetary figure which is then converted into an actual number of Cairn shares using the market value as at the date of vesting. Where there has been a fall in Cairn's TSR, no Tier Two award will vest. Vesting of the Tier Two award is then subject to a further TSR target which is calculated in two steps, each of which must be satisfied.

Step One
This step is the same as step one of the performance conditions in respect of Tier One.

Step Two
Under step two, the TSR of Cairn shares is compared to the TSR of a share in each company comprised in the comparator group over the performance period. As with Tier One awards, each company is then ranked in order of TSR performance. Cairn's position in the comparator group list then determines how many (if any) shares the subject of the award will vest, as follows:

Percentage of Cairn shares comprised in Tier Two Award that vest	Ranking of Cairn in relevant comparator group
0%	Below upper quartile
40%	Upper quartile
100%	Number one position
40% – 100% on a straight-line basis	Between upper quartile and number one position

In addition, no Tier Two award will vest unless the remuneration committee is satisfied that there has been a satisfactory and sustained improvement in Cairn's underlying financial position and performance over the performance period.

Release of shares following vesting
At the end of the performance period, 50% of vested shares under both Tier One and Tier Two awards are transferred to participants immediately, and the remaining shares are transferred at the end of one year.

FTSE Indices used for Existing LTIP
For the first step of the TSR target described on the previous page, for 2004 and 2005 awards, the Company's performance is measured against the FTSE 250 Index. The remuneration committee reviewed this performance condition in March 2006 and decided to measure awards made in 2006 against the FTSE 350 Index. For awards prior to 2004, the Company's performance was measured against the FTSE Small Cap Index (excluding investment trusts).

Comparator Groups used for Existing LTIP

The table below shows the comparator groups applicable to:
- awards made in 2003 and 2004;
- awards made in 2005; and
- awards made in 2006.

As such, the comparator group applicable to awards made on 18 March 2003 and which vested on 20 April 2006 (details of which are on page 67) is shown in the first column of the table below:

2003 and 2004 Awards	2005 Awards	2006 Awards
BG Group PLC	BG Group PLC	BG Group PLC
Chevron Texaco Corporation	Burren Energy PLC	Burren Energy PLC
Dana Petroleum PLC	Chevron Texaco Corporation	Dana Petroleum PLC
First Calgary Petroleums Limited	Dana Petroleum PLC	Melrose Resources PLC
Fortune Oil PLC	First Calgary Petroleums Limited	Occidental Petroleum Corporation
John Wood Group PLC	Melrose Resources PLC	Premier Oil PLC
Melrose Resources PLC	Occidental Petroleum Corporation	SOCO International PLC
Occidental Petroleum Corporation	Paladin Resources PLC	Talisman Energy, Inc
Paladin Resources PLC	Premier Oil PLC	Tullow Oil PLC
Premier Oil PLC	SOCO International PLC	Venture Production PLC
Ramco Energy PLC	Tullow Oil PLC	Woodside Petroleum Ltd
SOCO International PLC	Venture Production PLC	
Tullow Oil PLC		
Venture Production PLC		

New LTIP

A new LTIP (the 'New LTIP') was approved by shareholders at the EGM held on 17 November 2006, conditional on the flotation Cairn India becoming effective, which occurred on 9 January 2007.

The New LTIP will enable selected executive directors and employees (excluding those that are employed by the Cairn India Group) to be granted conditional awards over two separate pools of notional 'units', the first relating to Cairn India ('Cairn India Units') and the second relating to the Capricorn Group ('Capricorn Units') (together, 'Units').

For the purposes of the New LTIP, each of these Cairn India Units and Capricorn Units will be ascribed a notional price. On any day, the price of a Cairn India Unit will be equal to the price of a Cairn India share, as quoted on the Bombay Stock Exchange and the National Stock Exchange of India (the 'Exchanges'). The price of a Capricorn Unit will be calculated by taking the total value of the Capricorn Group and dividing it by the number of Capricorn Units created for the purposes of the New LTIP. (For these purposes, the value of the Capricorn Group will generally be determined by deducting (i) the value of the Company's holding in Cairn India; and (ii) the amount of any cash held by the Company that is to be returned to shareholders, from the total market capitalisation of the Company).

The extent to which an award over Cairn India Units (a 'Cairn India Award') or an award over Capricorn Units (a 'Capricorn Award') (together 'Awards') vests will be dependent on continued employment within the Group and the extent to which predetermined performance conditions relating to Cairn India or the Capricorn Group are met over a specified period (see below).

Following the vesting of an Award, the participant will then generally become entitled to such number of Cairn shares as have a market value equal to the aggregate price of the vested Units. Only 50% of these shares will be transferred to the participant immediately. The remaining 50% will be held for a further year.

No Awards have as of the date of this report been made under the New LTIP. It is however expected that the New LTIP will be used to make regular annual grants to the Company's senior management team, including its executive directors. On each occasion that Awards are granted, the remuneration committee will determine whether a participant is granted a Cairn India Award or a Capricorn Award or both. This decision will be based on the extent to which the ongoing role of the individual in question relates to the Company's holding in Cairn India or the business of the Capricorn Group (or a mixture of both). Notwithstanding this discretion, it is the remuneration committee's intention that:
- on any occasion that the Company's Chief Executive is granted Awards, half those Awards will be Cairn India Awards and half will be Capricorn Awards; and
- on any occasion that Awards are granted to any other executive directors of the Company, not more than 75% of such Awards will be either Cairn India Awards or Capricorn Awards.

Performance Conditions

The remuneration committee has decided that, initially, all Awards granted under the New LTIP will be subject to a relative TSR target measured over a three year performance period. For the purposes of applying this measure to any Cairn India Award, the TSR of a Cairn India share will be used. For a Capricorn Award, the condition will be based on the notional TSR of a Capricorn Unit.

Under the TSR condition, the extent to which a Cairn India Award or Capricorn Award vests will be determined by comparing the TSR of a Cairn India share or Capricorn Unit (as appropriate) over the performance period with the TSR of a share in each company in a comparator group. For the purposes of the first Awards to be granted under the New LTIP the comparator groups will initially be as follows:

Comparator Group for Cairn India Awards	Comparator Group for Capricorn Awards
BG Group PLC	Tullow Oil PLC
Bharat Petroleum Corporation Limited	Sibir Energy PLC
Burren Energy PLC	Burren Energy PLC
Chesapeake Energy Corporation	Dana Petroleum PLC
CNOOC Limited	SOCO International PLC
EOG Resources, Inc	Premier Oil PLC
Hindustan Petroleum Corporation Limited	JKX Oil & Gas PLC
Indian Oil Corporation Limited	Imperial Energy Corporation PLC
Newfield Exploration Company	Melrose Resources PLC
Noble Energy, Inc	Sterling Energy PLC
Oil and Natural Gas Corporation Limited	Star Energy Group PLC
PTT Exploration & Production PLC	Hardy Oil & Gas PLC
Santos Limited	Regal Petroleum PLC
Talisman Energy, Inc	Indago Petroleum Limited
Tullow Oil PLC	Egdon Resources PLC
Western Oil Sands, Inc	
Woodside Petroleum Limited	

Vesting will then take place as follows:

Percentage of Cairn India Units/Capricorn Units comprised in Award that vest	Ranking of Cairn India Share/Capricorn Unit against relevant comparator group
0%	Below median
20%	Median
100%	Upper decile
20% – 100% on a straight-line basis	Between median and upper decile

In order to ensure that the New LTIP adequately encourages and rewards exceptional performance, the terms of the above performance condition will also provide that, where the TSR of a Cairn India share/Capricorn Unit produces a ranking at or above the upper decile level in the appropriate comparator group, a participant will then be given the opportunity to increase the percentage of the relevant award that vests through the application of a 'multiplier' that is linked to the TSR actually achieved over the performance period. The way in which this multiplier will operate is as follows:

Multiplier applied to determine the number of Cairn India Units/Capricorn Units that actually vest	TSR of a Cairn India share over the performance period	TSR of a Capricorn Unit over the performance period
1	40% or less	75% or less
1.33	80% or more	150% or more
1 – 1.33 on a straight-line basis	Between 40% and 80%	Between 75% and 150%

Notwithstanding the performance of a Cairn India Share or Capricorn Unit against the above targets, no part of any Award will vest unless the remuneration committee is satisfied that there has been an overall satisfactory and sustained improvement in the performance of the Company as a whole over the performance period.

The New LTIP is designed to provide the executive directors and other senior executives with a long term incentive based on the performance of the particular arm of the business that they can affect. As such, the performance conditions described above are deemed appropriate by the remuneration committee.

Individual Limits
The total value of Units over which an individual may be granted Awards under the New LTIP during the period commencing on 9 January 2007 (i.e. the date of its adoption) and ending on the final day of the Company's financial year ending 31 December 2007 will not exceed 400% of his/her rate of annual base salary. In any subsequent financial year of the Company, the total value of Units over which an individual may be granted Awards during that year will not exceed 300% of his/her annual base salary (save in exceptional circumstances where a 400% limit may be applied). These limits are broadly consistent with those that applied under the Existing LTIP and reflect the remuneration committee's policy of placing a significantly higher weighting on variable pay rather than fixed pay.

Share Scheme Dilution
In any 10 year rolling period, the number of shares which may be issued in connection with the New LTIP and 2006 Plan, when added to the number of unissued shares which have been allocated in that same period under any other discretionary share scheme adopted by the Company, cannot exceed 5% of Cairn's issued ordinary share capital.

In addition, in any 10 year rolling period, the number of shares which may be issued in connection with the New LTIP and 2006 Plan, when added to the number of unissued shares which have been allocated in that same period under any other discretionary share scheme adopted by the Company, cannot exceed 10% of Cairn's issued ordinary share capital.

Annual Cash Bonus Scheme
Cairn's annual cash bonus scheme has been in place since 1999 and applies to all employees and executive directors. Bonuses under the scheme are based on individual and Company performance measures. Individual performance is measured through the Company's performance management system. Company performance measures are based on annually defined key performance indicators ('KPIs'). The KPIs for 2006 encompassed various budgetary, portfolio growth and procedural compliance targets, the substantial majority of which were met. For employees other than executive directors, only the individual and Company performance measures determine the overall bonus award.

As was the case in 2004 and 2005, the bonus award to the executive directors was subject to two additional performance measures, being performance against annually defined corporate objectives and reserve replacement performance. This resulted in one quarter of the award being determined by individual performance, one quarter by company performance, one quarter by performance against corporate objectives and one quarter by reserve replacement performance. The corporate objectives for 2006 are commercially sensitive and are therefore excluded from this report, as are the 2007 corporate objectives.

The maximum level of bonus award for the executive directors for 2006 was up to 100% of salary. The bonuses awarded to the executive directors for performance in 2006 are shown in the table on page 66. The maximum level of bonus award for other senior executives for 2006 was 40% of salary.

The remuneration committee has the discretion to award bonuses in addition to those payable under the annual cash bonus scheme in recognition of particular efforts or achievements by employees, including executive directors.

In this regard, the remuneration committee approved a limited number of discretionary bonus awards to employees in the project team responsible for implementation of the IPO. These included bonus awards to Kevin Hart, Jann Brown and Simon Thomson, which are shown in the table on page 66.

Pension Arrangements

The Company is the principal employer for a defined contribution pension scheme in the UK: the Cairn Energy PLC Retirement Benefits Scheme. This scheme is non-contributory and all UK employees aged 18 and over are eligible to participate in the scheme. The Company contributes 10% of basic annual salary (15% in respect of senior executives) to the pension scheme on behalf of all qualifying employees.

Sir Bill Gammell was a member of the Cairn Energy PLC Retirement Benefits Scheme for the period to 31 March 2006. With effect from 1 April 2006, he instead elected to receive an amount equivalent to the contributions to him as additional salary. The total amount paid by the Company in 2006 in respect of Sir Bill Gammell's pension arrangements was equivalent to 15% of his annual basic salary.

Dr Mike Watts, Jann Brown and Simon Thomson were members of the Cairn Energy PLC Retirement Benefits Scheme throughout 2006 and received a contribution to the scheme equal to 15% of their respective annual basic salaries. With effect from 1 February 2007, Simon Thomson is no longer a member of the scheme and has instead elected to receive contributions into a self-invested personal pension plan.

Malcolm Thoms has a personal pension plan and receives a contribution from the Company equal to 15% of his annual basic salary.

For the period to 31 March 2006, Phil Tracy also received contributions into a personal pension plan. With effect from 1 April 2006, Mr Tracy has instead elected to receive an amount equivalent to the contributions to him as additional salary. The total amount paid by the Company in 2006 in respect of Mr Tracy's pension arrangements was equivalent to 15% of his annual basic salary.

Kevin Hart was a member of the Cairn Energy PLC Retirement Benefits Scheme for the period to 17 November 2006 and received a contribution to the scheme equal to 15% of his annual basic salary for that period.

Further details of the contribution made by the Company in respect of each executive director are set out in the table on page 66.

The Company is also the principal employer for a Small Self-Administered Scheme. Sir Bill Gammell is the sole member of this scheme. The Company is not contractually obliged to make any contributions into this scheme on behalf of Sir Bill Gammell.

Service Contracts

The Company's policy is for all executive directors to have contracts of service which can be terminated by either the director concerned or the Company on giving 12 months' notice of termination. On a change of control of the Company resulting in the termination of a director's employment, each of the directors is entitled to compensation of a sum equal to their annual basic salary as at the date of termination of employment.

Each of the non-executive directors has a letter of appointment in terms of which he is appointed for a fixed three year period, subject to the Company's articles of association, which provide for retirement by rotation at least once every three years. The letters of appointment set out the time commitment expected by the Company and can be terminated with immediate effect by either the director concerned or the Company. The Board is satisfied that each of the non-executive directors commits sufficient time to fulfil his duties as a director of the Company. None of the non-executive directors has any conflict of interest which has not been disclosed to the Board in accordance with the Company's articles of association.

The terms and conditions for the appointment of the non-executive directors of the Company are available for inspection on request and will be available for inspection before and during the AGM to be held on 17 May 2007.

Service Contracts (continued)

Details of the service contracts and letters of appointment of the current directors of the Company are given in the table below.

	Effective Date	Unexpired Term	Notice Period
Executive service contracts			
Sir Bill Gammell	19.02.03	n/a	12 months
Dr Mike Watts	19.02.03	n/a	12 months
Malcolm Thoms	19.02.03	n/a	12 months
Phil Tracy	06.02.04	n/a	12 months
Jann Brown	17.11.06	n/a	12 months
Simon Thomson	17.11.06	n/a	12 months
Former director			
Kevin Hart	19.02.03	n/a	n/a*

*Mr Hart's service contract was terminated with effect from 17 November 2006, being the date of his resignation as a director. The notice period in Mr Hart's contract was waived by mutual consent.

	Effective Date	Unexpired Term	Notice Period
Non-executive letters of appointment			
Norman Murray	19.02.06	23 months	None
Hamish Grossart	19.02.06	23 months	None
Ed Story	19.02.06	23 months	None
Todd Hunt	14.05.06	25 months	None
Mark Tyndall	10.10.06	30 months	None
Andrew Shilston	08.11.04	7 months	None

Certain of the Company's executive directors serve as non-executive directors on the boards of other companies and are permitted to retain the fees relating to those positions. Details of the positions held and the fees receivable are set out in the table below:

	Position Held	Fees (2006)
Executive Director		
Sir Bill Gammell	Non-executive director, Artemis AiM VCT plc	£12,500
Malcolm Thoms	Non-executive director, Revus Energy AS	£25,854.06(1)
Phil Tracy	Non-executive director, Vienco Oil & Gas Limited	£18,000
Former director		
Kevin Hart	Non-executive director, Glasgow Income Trust PLC	£9,000(2)
	Non-executive director, Argent Energy PLC	£10,634(3)

(1) Payable partly in cash and partly in shares.
(2) Kevin Hart resigned as a director of the Company on 17 November 2006 and consequently these fees are for the period from 1 January 2006 to that date.
(3) Kevin Hart was appointed a director of Argent on 1 August 2006 and consequently these fees are for the period from that date to 17 November 2006.

The Board believes, in principle, in the benefits of executive directors accepting positions as non-executive directors of other companies in order to widen their skills and knowledge for the benefit of the Company, provided that the time commitments are not unduly onerous.

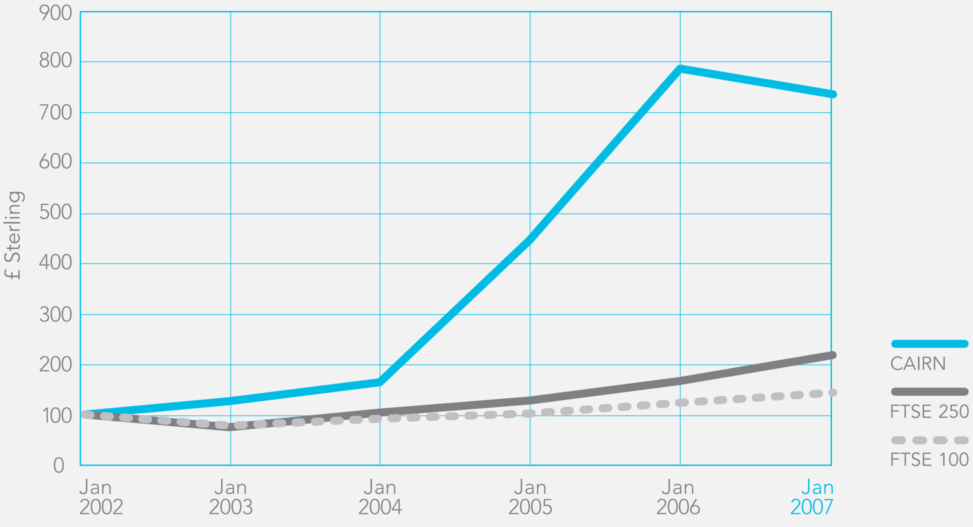
The appointment of any executive director to a non-executive position with another company must be approved by the Board. In the case of a proposed appointment to a company within the oil and gas industry, permission will only be given if the two companies do not compete in the same geographical area.

Performance Graphs

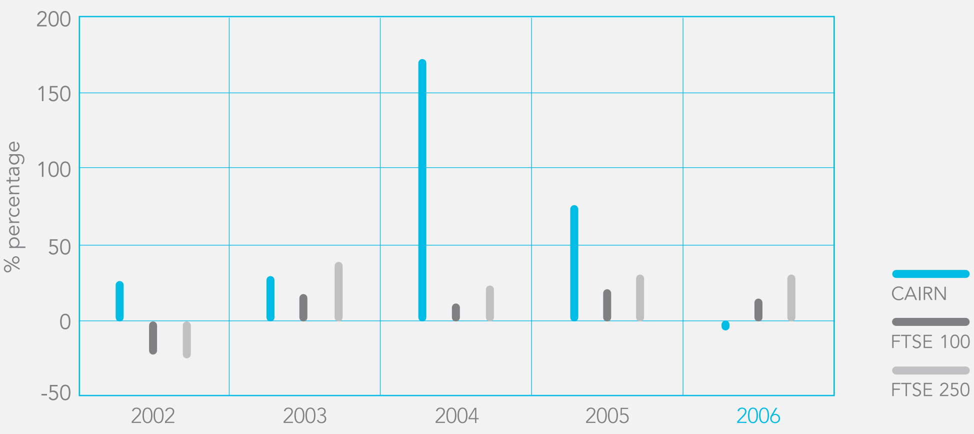
Both the FTSE 100 Index and FTSE 250 Index were selected as appropriate comparator indices for the two performance graphs shown below as although Cairn was a constituent member of the FTSE 100 Index throughout 2006, it has subsequently dropped out of this index and became a member of the FTSE 250 Index with effect from 19 March 2007.

The graphs compare Cairn's TSR with that of the chosen indices. The bar chart is presented as additional information to that required by the Companies Act, as amended by the Directors' Remuneration Report Regulations 2002.

Performance Graph – Comparison of Five Year Cumulative Total Shareholder Return on an investment of £100



Performance graph – Comparison of year on year change in the value of an investment over the past five years



The market value of one Cairn share on 29 December 2006 was £17.99. During 2006, the range of high and low market value of shares was £25.08 to £17.55.

INFORMATION SUBJECT TO AUDIT

Directors' Remuneration

The remuneration of the directors for the year ended 31 December 2006 was as follows:

	Salary £	Benefits[1] £	Annual Bonus[2] £	Other Payments £	Fees £	Total 2006 £	Total 2005 £	Pension 2006 £	Pension 2005 £
Executive									
Sir Bill Gammell	480,000	26,716	480,000	–	–	986,716	720,237	72,000	63,750
Dr Mike Watts	350,000	21,844	210,000	–	–	581,844	442,761	52,500	43,500
Malcolm Thoms	300,000	24,435	180,000	–	–	504,435	416,606	45,000	39,750
Phil Tracy	300,000	11,296	180,000	–	–	491,296	382,991	45,000	37,500
Jann Brown[3]	30,822	1,340	20,832	200,000[4]	–	252,994	–	4,623	–
Simon Thomson[3]	30,822	2,561	15,208	200,000[5]	–	248,591	–	4,623	–
Non-executive									
Norman Murray	–	–	–	50,000[6]	140,000	190,000	120,000	–	–
Hamish Grossart	–	–	–	50,000[7]	90,000	140,000	80,000	–	–
Ed Story	–	–	–	–	50,000	50,000	45,000	–	–
Todd Hunt	–	–	–	–	50,000	50,000	45,000	–	–
Mark Tyndall	–	–	–	25,000[8]	50,000	75,000	45,000	–	–
Andrew Shilston	–	–	–	–	50,000	50,000	45,000	–	–
Former director									
Kevin Hart[9]	263,836	46,594	200,000	150,000[10]	–	660,430	403,346	39,575	39,750

Notes:

(1) Benefits comprise a company car, permanent health insurance, private health insurance and death in service benefit.

(2) The annual bonus for 2006 is payable in the subsequent financial year, with the exception of Kevin Hart's which was paid in 2006.

(3) Jann Brown and Simon Thomson were appointed as directors on 17 November 2006. With the exception of the IPO bonuses detailed at (4) and (5) below, the figures stated are in respect of the period from that date to 31 December 2006.

(4) This bonus payment was made to Jann Brown in respect of the IPO – 50% of the bonus was paid in December 2006 and the remaining 50% in January 2007.

(5) This bonus payment was made to Simon Thomson in respect of the IPO and was paid in January 2007.

(6) This payment was made to Norman Murray in respect of additional work on the IPO and his services as a non-executive director of Cairn India. The payment was made in 2007.

(7) This payment was made to Hamish Grossart in respect of additional work on the IPO and his services as a non-executive director of Cairn India. The payment was made in 2007.

(8) This payment was made to Mark Tyndall in respect of additional work on the IPO. The payment was made in 2007.

(9) Kevin Hart resigned as a director on 17 November 2006. The figures stated are in respect of the period from 1 January 2006 to that date.

(10) This bonus payment was made to Kevin Hart in respect of the IPO and Kevin subsequently donated the full amount to charities of his choice.

LTIP Awards

The total number of combined Tier One and Tier Two awards held by the executive directors pursuant to the Existing LTIP is as follows:

	At 01.01.06	Awarded in year	Vested in year	Lapsed in year	At 31.12.06
Sir Bill Gammell	497,900	56,400	193,775	66,225	294,300
Dr Mike Watts	363,400	49,900	161,775	66,225	185,300
Malcolm Thoms	338,000	41,100	144,775	66,225	168,100
Phil Tracy	235,500	36,200	73,038	24,962	173,700
Jann Brown	194,800	21,400	73,038	24,962	118,200
Simon Thomson	194,800	23,700	73,038	24,962	120,500
Former director					
Kevin Hart	338,000	–	144,775	193,225	–

An analysis of the Tier One and Tier Two awards held by directors pursuant to the Existing LTIP during 2006 is as follows:

Tier One Awards

Performance Period	Market Value*	Sir Bill Gammell	Dr Mike Watts	Malcolm Thoms	Phil Tracy	Jann Brown	Simon Thomson	Former director Kevin Hart
18.03.03 – 17.03.06	£3.055	130,000	98,000	81,000	49,000	49,000	49,000	81,000
10.03.04 – 09.03.07	£8.735	63,000	38,000	38,000	32,000	21,000	21,000	38,000
20.04.05 – 19.04.08	£11.52	–	–	–	–	22,100	22,100	–
28.04.05 – 27.04.08	£11.90	53,500	36,500	33,400	31,500	–	–	33,400
24.04.06 – 23.04.09	£23.99	30,000	21,800	18,700	18,700	11,800	12,500	–

Tier Two Awards

Performance Period	Market Value*	Sir Bill Gammell	Dr Mike Watts	Malcolm Thoms	Phil Tracy	Jann Brown	Simon Thomson	Former director Kevin Hart
18.03.03 – 17.03.06	£3.055	130,000	130,000	130,000	49,000	49,000	49,000	130,000
10.03.04 – 09.03.07	£8.735	50,000	–	–	32,000	32,000	32,000	–
20.04.05 – 19.04.08	£11.52	–	–	–	–	21,700	21,700	–
28.04.05 – 27.04.08	£11.90	71,400	60,900	55,600	42,000	–	–	55,600
24.04.06 – 23.04.09	£23.99	26,400	28,100	22,400	17,500	9,600	11,200	–

*The prices shown in the tables above represent the market value of a Cairn share on the date of commencement of the performance period.

Vested Awards

Details of awards which vested during 2006 are given in the table below. Calculations to determine the number of shares vesting, based on the performance conditions described on pages 58 to 60 of this report were carried out by Cairn and independently verified by Ernst & Young LLP.

	Performance Period	Market value of a Cairn share on date of award	Vesting Date	Market value of a Cairn share on date of vesting	Tier One Shares	Tier Two Shares
Director						
Sir Bill Gammell	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	130,000	63,775
Dr Mike Watts	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	98,000	63,775
Malcolm Thoms	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	81,000	63,775
Phil Tracy	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	49,000	24,038
Jann Brown	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	49,000	24,038
Simon Thomson	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	49,000	24,038
Former director						
Kevin Hart	18.03.03 – 17.03.06	£3.055	20.04.06	£23.205	81,000	63,775

The total aggregate gain made by the executive directors (including Kevin Hart) on vesting, based on the market value at the date of vesting multiplied by the total number of shares vesting, was £20,054,000 (2005 total aggregate gain: £8,409,000).

By Order of the Board
Duncan Wood
Company Secretary
27 March 2007

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CAIRN ENERGY PLC

We have audited the Group and parent company financial statements (the 'financial statements') of Cairn Energy PLC for the year ended 31 December 2006 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statement of Changes in Equity and the related notes 1 to 34. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act. 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 Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited 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 whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act and, as regards the Group financial information, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Highlights, Chairman's Statement, Chief Executive's Review, Operating and Exploration Review, Financial Review and Corporate Responsibility and Risk Factors sections that are cross referred from the Principal Activities and Business Review section of the Directors' Report.

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 are not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the Combined Code specified for our review by the Listing Rules and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Highlights, Chairman's Statement, Chief Executive's Review, Operating and Exploration Review, Financial Review and Corporate Responsibility, Risk Factors, Corporate Governance Statement, Directors' Report and the unaudited part of the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and 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 and the part of the Directors' Remuneration Report to be audited 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 and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its loss for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act, of the state of the parent company's affairs as at 31 December 2006;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

Ernst & Young LLP
Registered auditor
London
March 2007

PRINCIPAL LICENCE INTERESTS

	Working interest %
India	
Block PKGM-1 (Ravva)	22.50
Block KG-DWN-98/2	10.00
Block KG-ONN-2003/1	49.00
Block CB/OS-2 Development Areas	40.00
Block RJ-ON-90/1 Development Areas	70.00
Block RJ-ONN-2003/1	30.00
Block CB-ONN-2001/1	30.00
Block CB-ONN-2002/1	30.00
Block GV-ONN-97/1	30.00
Block GV-ONN-2002/1	100.00
Block GV-ONN-2003/1	49.00
Block VN-ONN-2003/1	49.00
Block GS-OSN-2003/1	49.00
Block KK-DWN-2004/1	40.00
Block PR-OSN-2004/1	35.00
Bangladesh	
Block 5*	90.00
Block 7	45.00
Block 10*	90.00
Block 16 – Development Area	75.00
Block 16 – Exploration	75.00
Nepal	
Blocks 1 & 2	100.00
Blocks 4, 6 & 7	100.00

* These PSCs were due to terminate on 4 July 2006 if the parties did not agree that a viable market existed in Bangladesh for any gas discovered in those blocks. Although this long stop date has passed, the parties have agreed in principle to amend the work commitments in the PSCs and also that a viable market exists in Bangladesh, however these amendments still require to be formalised in writing by the parties.

GROUP INCOME STATEMENT

For the year ended 31 December 2006

	Notes	Group 2006 $'000	Group 2005 $'000
Revenue	2	286,304	262,562
Cost of sales			
Production costs		(56,931)	(50,235)
Unsuccessful exploration costs		(62,018)	(26,867)
Depletion and decommissioning charge		(103,487)	(91,740)
Gross profit		63,868	93,720
Other operating income	2	3,340	3,116
Administrative expenses		(60,323)	(41,204)
Exceptional impairment of oil and gas assets	4	(71,455)	–
Exceptional gain on sale of oil and gas assets	4	–	15,272
Operating (loss)/profit	4	(64,570)	70,904
Finance income	7	4,603	32,543
Finance costs	8	(30,609)	(2,236)
(Loss)/profit before taxation		(90,576)	101,211
Taxation credit/(expense) on (loss)/profit	9	8,559	(22,139)
(Loss)/profit for the year attributable to the equity holders of the parent	26	(82,017)	79,072
Earnings per ordinary share – basic (cents)	10	(52.02)	50.37
Earnings per ordinary share – diluted (cents)	10	(52.02)	50.10

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2006

	Notes	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Opening equity		757,598	711,197	252,147	296,330
Currency translation differences	26	10,725	(23,893)	45,400	(24,191)
Total income/(expense) recognised directly in equity		10,725	(23,893)	45,400	(24,191)
(Loss)/profit for the year		(82,017)	79,072	164,870	(11,214)
Total recognised income and expense for the year		(71,292)	55,179	210,270	(35,405)
New shares issued in respect of employee share options	24/25	3,219	3,782	3,219	3,782
Share based payments	26	13,304	4,592	6,739	4,592
Cost of shares purchased	26	(21,659)	(17,152)	(21,659)	(17,152)
Closing equity attributable to the equity holders		681,170	757,598	450,716	252,147

BALANCE SHEETS
As at 31 December 2006

	Notes	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Non-current assets					
Intangible exploration/appraisal assets	11	419,239	321,855	–	–
Property, plant & equipment – development/producing assets	12	394,010	456,929	–	–
Property, plant & equipment – other	13	5,891	4,158	1,291	1,127
Intangible assets – other	14	6,724	2,601	1,730	1,253
Investments	15	96	96	508,056	24,829
Deferred tax assets	20	18,911	2,606	–	–
		844,871	788,245	511,077	27,209
Current assets					
Inventory	16	4,615	5,533	–	–
Trade and other receivables	17	218,159	124,725	80,936	229,195
Bank deposits	18	–	20,000	–	–
Cash and cash equivalents	18	856,266	75,509	19,513	33,764
		1,079,040	225,767	100,449	262,959
Total assets		1,923,911	1,014,012	611,526	290,168
Current liabilities					
Trade and other payables	19	897,232	94,736	113,810	38,021
Obligations under finance leases	21	1,380	–	–	–
Provisions	23	6,845	–	–	–
Derivative financial instruments	28	9,694	–	–	–
Income tax liabilities		6,064	7,550	–	–
		921,215	102,286	113,810	38,021
Non-current liabilities					
Loans and borrowings	22	155,000	–	47,000	–
Obligations under finance leases	21	3,092	–	–	–
Provisions	23	24,740	17,456	–	–
Deferred tax liabilities	20	138,694	136,672	–	–
		321,526	154,128	47,000	–
Total liabilities		1,242,741	256,414	160,810	38,021
Net assets		681,170	757,598	450,716	252,147
Equity					
Called-up share capital	24	25,870	25,775	25,870	25,775
Share premium	25	201,019	197,895	201,019	197,895
Shares held by ESOP Trust	26	(55,756)	(37,311)	(55,756)	(37,311)
Foreign currency translation	26	2,798	(7,927)	37,181	(8,219)
Other reserves	26	37,284	37,284	–	–
Capital reserves – non distributable	26	45,331	45,331	79	79
Capital reserves – distributable	26	178,429	178,429	–	–
Retained earnings	26	246,195	318,122	242,323	73,928
Total equity attributable to the equity holders		681,170	757,598	450,716	252,147

STATEMENT OF CASH FLOWS
For the year ended 31 December 2006

	Notes	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Cash flows from operating activities					
Cash generated from/(used in) operations	4b	207,199	139,621	26,967	(15,218)
Interest paid		(5,599)	(1,201)	(1,877)	(1,637)
Income tax paid		(12,184)	(6,563)	–	–
Net cash generated from/(used in) operating activities		189,416	131,857	25,090	(16,855)
Cash flows from investing activities					
Expenditure on exploration/appraisal assets		(157,535)	(218,324)	–	–
Expenditure on development/producing assets		(114,995)	(64,921)	–	–
Purchase of property, plant & equipment – other		(1,346)	(4,079)	(775)	(766)
Purchase of intangible assets – other		(7,779)	(3,623)	(1,940)	(2,295)
Purchase of investments		–	–	(63,636)	–
Proceeds on disposal of exploration/appraisal assets		–	91,930	–	–
Proceeds on disposal of development/producing assets		–	35,574	–	–
Proceeds on disposal of property, plant & equipment		20	95	1	79
Movement in funds on bank deposit		20,000	(5,656)	–	14,344
Interest received		5,568	4,378	973	3,013
Net cash (used in)/from investing activities		(256,067)	(164,626)	(65,377)	14,375
Cash flows from financing activities					
Payments for IPO costs		(23,276)	–	–	–
Proceeds from IPO pre-placement		751,849	–	–	–
Arrangement and facility fees		(17,074)	–	(866)	–
Proceeds from issue of shares		3,219	3,782	3,219	3,782
Purchase of own shares		(21,659)	(17,152)	(21,659)	(17,152)
Payment of finance lease liabilities		(285)	–	–	–
Proceeds from borrowings		155,000	–	47,000	–
Net cash flows from/(used in) financing activities		847,774	(13,370)	27,694	(13,370)
Net increase/(decrease) in cash and cash equivalents		781,123	(46,139)	(12,593)	(15,850)
Opening cash and cash equivalents at beginning of year		75,509	122,961	33,764	50,707
Exchange losses on cash and cash equivalents		(366)	(1,313)	(1,658)	(1,093)
Closing cash and cash equivalents	18	856,266	75,509	19,513	33,764

1 ACCOUNTING POLICIES

a) Basis of preparation
Cairn prepares its accounts on a historical cost basis. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the relevant accounting policy.

b) Accounting standards
Cairn prepares its accounts in accordance with applicable International Financial Reporting Standards (IFRS) as adopted by the EU. The Group's financial statements are also consistent with International Financial Reporting Standards as issued by the IASB.

Relevant new standards and interpretations issued by the IASB, but not yet effective and not applied in these financial statements, are as follows:

Title	Change to accounting policy	Date of adoption by Cairn	Impact on initial application
Effective date from 1 May 2006			
IFRIC 8 'Scope of IFRS 2'	Share based payments under the phantom options scheme will be accounted for in the same way as other share-based payment schemes	1 Jan 2007	Increase in the Group's retained earnings brought forward as at 1 Jan 2007
Effective date from 1 January 2007			
IFRS 7 'Financial Instruments: Disclosures' and amendment to IAS 32 'Financial Instruments: Disclosure and Presentation'	No changes to current accounting policy	1 Jan 2007	Additional disclosures regarding financial instruments
Amendment to IAS 1 Presentation of 'Financial Statements – Capital Disclosures'	No changes to current accounting policy	1 Jan 2007	Additional disclosures required concerning an entity's capital
Effective date from 1 March 2007			
IFRIC 11 'Group and Treasury Share Transactions'	Share based payment awards relating to employees of subsidiary will be recognised in the equity of that company	1 Jan 2008	Decrease in retained earnings of Cairn Energy PLC, with corresponding adjustment in other debtors
Effective date from 1 January 2009			
IFRS 8 'Operating Segments'	No changes to current accounting policy	1 Jan 2009	Alternative disclosures regarding segmental performance

No other IFRS as issued by the IASB which are not yet effective, are expected to have an impact on the Group's financial statements.

During the year, Cairn adopted IFRIC 4 'Determining whether an arrangement contains a lease' and IFRIC 5 'Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds'.

c) Presentational currency
The functional currency of Cairn Energy PLC, the ultimate parent company of the Group, is sterling. These accounts have been presented in US dollars ($), the functional currency of most companies within the Group. It is deemed to be more appropriate to present the financial statements in line with the functional currency of the majority of the Group. The Group's policy on foreign currencies is detailed in note 1(p).

1 ACCOUNTING POLICIES (CONTINUED)

d) Basis of consolidation

The consolidated accounts include the results of Cairn Energy PLC and its subsidiary undertakings to the Balance Sheet date. The results of subsidiaries acquired or disposed during the year are included in the Income Statement and Cash Flow Statement from the effective date of acquisition or up to the effective date of disposal as appropriate.

Cairn allocates the purchase consideration of any acquisition to assets and liabilities on the basis of fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the assets and liabilities is recognised as goodwill. Any goodwill arising is recognised as an asset and subject to annual review for impairment.

Business combinations arising prior to the Group's transition date to IFRS (1 January 2004) have not been revisited under the exemption provided by IFRS 1. Deferred tax liabilities have, however, now been recognised on fair value adjustments that arose from past business combinations in accordance with IAS 12 'Income Taxes'.

Cairn has used the exemption granted under s230(1)(b) of the Companies Act 1985 that allows for the non disclosure of the Income Statement of the parent company. The profit attributable to the Company for the year ended 31 December 2006 was $164,870,000 (2005: loss $11,214,000).

e) Joint Ventures

Cairn participates in several unincorporated Joint Ventures which involve the joint control of assets used in the Group's oil and gas exploration and producing activities. Cairn accounts for its share of assets, liabilities, income and expenditure of Joint Ventures in which the Group holds an interest, classified in the appropriate Balance Sheet and Income Statement headings. Cairn's principal licence interests are jointly controlled assets.

A list of Cairn's interests in unincorporated joint ventures is given on page 70.

f) Revenue and other income

Revenue from operating activities

Revenue represents Cairn's share of oil, gas and condensate production, recognised on a direct entitlement basis and tariff income received for third party use of operating facilities and pipelines in accordance with agreements.

Other income

Income received as operator from Joint Ventures is recognised on an accruals basis in accordance with Joint Venture agreements and is included within 'Other operating income' in the Income Statement. Interest income is recognised using the effective interest method on an accruals basis and is recognised within 'Finance income' in the Income Statement.

g) Oil and gas intangible exploration/appraisal assets and property, plant & equipment – development/producing assets

Cairn follows a successful efforts based accounting policy for oil and gas assets.

Costs incurred prior to obtaining the legal rights to explore an area are expensed immediately to the Income Statement.

Expenditure incurred on the acquisition of a licence interest is initially capitalised on a licence by licence basis. Costs are held, un-depleted, within exploration until such a time as the exploration phase on the licence area is complete or commercial reserves have been discovered.

Exploration expenditure incurred in the process of determining exploration targets is capitalised initially within exploration/appraisal assets and subsequently allocated to drilling activities. Exploration/appraisal drilling costs are initially capitalised on a well by well basis until the success or otherwise of the well has been established. The success or failure of each exploration/appraisal effort is judged on a well by well basis. Drilling costs are written off on completion of a well unless the results indicate that hydrocarbon reserves exist and there is a reasonable prospect that these reserves are commercial.

Following appraisal of successful exploration wells, if commercial reserves are established and the technical feasibility of extraction demonstrated, then the related capitalised exploration/appraisal costs are transferred into a single field cost centre within development/producing assets after testing for impairment (see opposite). Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are written off to the Income Statement.

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

Net proceeds from any disposal of an exploration asset are initially credited against the previously capitalised costs. Any surplus proceeds are credited to the Income Statement. Net proceeds from any disposal of development/producing assets are credited against the previously capitalised cost. A gain or loss on disposal of a development/producing asset is recognised in the Income Statement to the extent that the net proceeds exceed or are less than the appropriate portion of the net capitalised costs of the asset.

Depletion
Cairn depletes separately, where applicable, any significant components within development/producing assets, such as fields, processing facilities and pipelines which are significant in relation to the total cost of a development/producing asset.

Cairn depletes expenditure on property, plant & equipment – development/producing assets on a unit of production basis, based on proved and probable reserves on a field by field basis. In certain circumstances, fields within a single development area may be combined for depletion purposes.

Impairment
Exploration/appraisal assets are reviewed regularly for indicators of impairment and costs are written off where circumstances indicate that the carrying value might not be recoverable. In such circumstances the exploration asset is allocated to development/producing assets within the same geographic segment, as disclosed in the segmental analysis notes to the financial statements, and tested for impairment. Any such impairment arising is recognised in the Income Statement for the period. Where there are no development/producing assets within a geographic segment, the exploration/appraisal costs are charged immediately to the Income Statement.

Impairment reviews on development/producing assets are carried out on each cash-generating unit identified in accordance with IAS 36 'Impairment of Assets'. Cairn's cash generating units are those assets which generate largely independent cash flows and are normally, but not always, single development areas.

At each reporting date, where there are indicators of impairment, the net book value of the cash generating unit is compared with the associated expected discounted future net cash flows. If the net book value is higher, then the difference is written off to the Income Statement as impairment. Discounted future net cash flows for IAS 36 purposes are calculated using an estimated oil price of $30/bbl (2005: $20/bbl) or the appropriate gas price as dictated by the relevant gas sales contract, escalation for prices and costs of 3% and a discount rate of 10% (2005: 3% and 10% respectively). Forecasted production profiles are determined on an asset by asset basis, using appropriate petroleum engineering techniques.

Where there has been a charge for impairment in an earlier period, that charge will be reversed in a later period where there has been a change in circumstances to the extent that the discounted future net cash flows are higher than the net book value at the time. In reversing impairment losses, the carrying amount of the asset will be increased to the lower of its original carrying value or the carrying value that would have been determined (net of depletion) had no impairment loss been recognised in prior periods.

h) Property, plant and equipment – other
Property, plant and equipment are measured at cost less accumulated depreciation and impairment and depreciated over their expected useful economic lives as follows:

	Annual Rate (%)	Depreciation Method
Tenants' improvements	10 – 33*	straight line
Vehicles and equipment	25 – 50*	straight line

* Depreciation is charged over the shorter of 2 – 10 years or the remaining term of the lease.

i) Intangible assets – other
Intangible assets have finite useful lives and are measured at cost less accumulated amortisation and impairment and amortised over their expected useful economic lives as follows:

	Annual Rate (%)	Amortisation Method
Software costs	25 – 50	straight line

1 ACCOUNTING POLICIES (CONTINUED)

j) Investments

The Company's investments in subsidiaries are carried at cost less provisions resulting from impairment. The recoverable value of investments is the higher of its fair value less costs to sell and value in use. Value in use is based on the discounted future net cash flows of the oil and gas assets held by the subsidiary.

The Group's unlisted investments are carried at cost where there is no quoted market price available.

k) Inventory

Inventories of oil and condensate held at the balance sheet date are valued at net realisable value based on the estimated selling price in accordance with established industry practice.

l) Financial instruments

Derivative financial instruments

The Group uses derivative financial instruments such as foreign currency options to hedge its risks associated with foreign currency fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives during the year that do not qualify for hedge accounting are taken directly to the Income Statement.

Trade and other receivables

Trade receivables are recognised and carried at the original invoiced amount less any allowances for doubtful debts. Other debtors are recognised and measured at nominal value. Trade and other receivables are recognised when invoiced.

Bank deposits

Bank deposits with an original maturity of over three months are held as a separate category of current asset and presented on the face of the Balance Sheet.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and short term deposits with an original maturity of three months or less.

For the purposes of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Trade payables and other creditors

Trade payables and other creditors are non-interest bearing and are measured at cost.

Interest bearing bank loans and borrowings

All interest bearing bank loans and borrowings represent amounts drawn under the Group's revolving credit facilities, classified according to the length of time remaining under the respective facility. Loans are initially measured at fair value less directly attributable transaction costs. After initial recognition, interest bearing loans are subsequently measured at amortised cost using the effective interest method. Interest payable is accrued in the Income Statement using the effective interest rate method.

Finance leases

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the Income Statement, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see over).

Borrowing costs
Borrowing costs are recognised in the Income Statement in the period in which they are incurred except for borrowing costs incurred on borrowings directly attributable to development projects which are capitalised within the development/producing asset.

m) Equity
Equity instruments issued by Cairn are recorded at the proceeds received, net of direct issue costs, allocated between share capital and share premium.

n) Taxation
The tax expense represents the sum of current tax and deferred tax.

The current tax is based on taxable (loss)/profit for the year. Taxable (loss)/profit differs from net (loss)/profit as reported in the Income Statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the Balance Sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable (loss)/profit.

Deferred income tax liabilities are recognised for all taxable temporary differences except in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in Joint Ventures where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future. A deferred income tax liability is not recognised if a temporary difference arises on initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred income tax assets are recognised for all deductible temporary differences and carry forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, carry forward of unused tax assets and unused tax losses can be utilised except where the deferred income tax asset relating to the deductible temporary timing difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss. In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in Joint Ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profits will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each Balance Sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the periods in which the asset is realised or the liability is settled, based on tax rates and laws enacted or substantively enacted at the Balance Sheet date.

Deferred tax assets and liabilities are only offset where they arise within the same entity and tax jurisdiction and the group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

o) Decommissioning
At the end of the producing life of a field, costs are incurred in removing and decommissioning production facilities. Cairn recognises the full discounted cost of dismantling and decommissioning as an asset and liability when the obligation arises. The decommissioning asset is included within property, plant & equipment – development/producing assets with the cost of the related installation. The liability is included within provisions. Revisions to the estimated costs of decommissioning which alter the level of the provisions required are also reflected in adjustments to the decommissioning asset. The amortisation of the asset, calculated on a unit of production basis based on proved and probable reserves, is included in the 'Depletion and decommissioning charge' in the Income Statement, and the unwinding of discount of the provision is included within 'Finance costs'.

1 ACCOUNTING POLICIES (CONTINUED)

p) Foreign currencies

In the accounts of individual Group companies, Cairn translates foreign currency transactions into the functional currency at the rate of exchange prevailing at the transaction date. Monetary assets and liabilities denominated in foreign currency are translated into the functional currency at the rate of exchange prevailing at the Balance Sheet date. Exchange differences arising are taken to the Income Statement except for those incurred on borrowings specifically allocable to development projects, which are capitalised as part of the cost of the asset.

Cairn maintains the accounts of the parent and subsidiary undertakings in their functional currency. Where applicable, Cairn translates parent and subsidiary accounts into the presentational currency, $, using the closing rate method for assets and liabilities which are translated into $ at the rate of exchange prevailing at the Balance Sheet date and rates at the date of transactions for Income Statement accounts. Cairn takes exchange differences arising on the translation of net assets of Group companies whose functional currency is non $ directly to reserves.

Rates of exchange to $1 were as follows:

	31 December 2006	Average 2006	31 December 2005	Average 2005
Sterling	0.511	0.543	0.578	0.549

q) Employee benefits

Pension schemes

Cairn operates defined contribution pension schemes in the UK and India. The assets of the schemes are held separately from those of Cairn and its subsidiaries. Cairn also operates an insured benefit scheme for certain Indian and Bangladeshi employees as required under local legislation. In accordance with IAS 19 'Employee Benefits' this is treated as a defined contribution scheme. The pension cost charged represents contributions payable in the year in accordance with the rules of the schemes.

Share schemes

The cost of awards to employees under Cairn's LTIP and share option plans, granted after 7 November 2002, are recognised over the three year period to which the performance relates. The amount recognised is based on the fair value of the shares as measured at the date of the award. The shares are valued using either the black scholes or binomial model, further details of which are given in note 5.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('the vesting date'). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The Income Statement charge or credit for a period represents the movement in cumulative expense as recognised at the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, the minimum expense recognised is the expense if the terms had not been modified. An additional expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

Shares acquired to meet awards under these shares schemes are held by the ESOP Trust. The accounts of the ESOP Trust are aggregated into these financial statements.

The costs of awards to employees, in the form of cash but based on share performance (phantom options) are recognised over the period to which the performance relates. The amount recognised is based on the fair value of the liability arising from the transaction.

Termination benefits
Cairn recognises a liability for termination benefits at the point where the Group is committed to making the payments in return for employee redundancy.

r) Operating lease commitments
Cairn charges rental payable under operating leases to the Income Statement on a straight line basis over the lease term.

s) Exceptional items
Exceptional items are those not considered to be part of the normal operation of the business. Such items are identified as exceptional and a full explanation is given in the notes to the accounts.

t) Key estimations and assumptions
The Group has used estimates and assumptions in arriving at certain figures within the financial statements. The resulting accounting estimates may not equate with the actual results which will only be known in time. Those areas believed to be key areas of estimation are noted below, with further details of the assumptions used listed at the relevant note.

Item	Refer to:
Impairment testing	1(g)
Depletion	1(g)
Share based payments	5
Decommissioning estimates	23
Deferred tax	20
Oil and gas reserves	Reserves table

2 REVENUE AND OTHER INCOME

	2006 $'000	2005 $'000
Revenue from sale of oil, gas and condensate	285,709	262,180
Tariff income	595	382
Revenue from operating activities	286,304	262,562
Interest receivable	4,603	5,431
Other operating income – Joint Venture operator fee income	3,340	3,116
Total income	294,247	271,109

During the year Joint Venture operator fee income of $3.1m for 2005, previously included within administrative expenses, has been reclassified to other operating income in the Income Statement to improve the presentation of revenue and other income in accordance with the International Accounting Standard 1 'Presentation of Financial Statements'.

3 SEGMENTAL ANALYSIS

Operating segments
The Group's operating segments were revised following the restructuring carried out in anticipation of the IPO in India to reflect the revised organisational structure.

During the year ended 31 December 2006, the Group's operating activities were internally reported to the chief operating decision maker based on two separable areas grouped into different subsidiary entities: Capricorn Energy Limited Group and Cairn India Limited Group. A third segment 'Other' exists to accumulate Cairn UK Holdings Limited and Cairn Energy PLC company which will include the administrative expenses of Cairn's head office in Edinburgh. This also includes taxation and interest expenses of the Group which cannot be allocated to an operating segment.

In 2005 the operating segments were North Sea, South Asia and Head Office Costs. Comparative information has been restated to reflect the new operating segments. There is no overall financial impact of this change.

3 SEGMENTAL ANALYSIS (CONTINUED)

The segment results for the year ended 31 December 2006 are as follows:

	Cairn India Limited Group $'000	Capricorn Energy Limited Group $'000	Other $'000	Group 2006 $'000
Revenue from sale of oil, gas and condensate	221,956	63,753	–	285,709
Tariff income	595	–	–	595
Total revenue	222,551	63,753	–	286,304
Cost of sales	(143,751)	(78,685)	–	(222,436)
Gross profit	78,800	(14,932)	–	63,868
Segmental operating profit/(loss)	119,725	(143,675)	(40,620)	(64,570)
Cost of sales in the segment results above includes:				
Production costs	38,585	18,346	–	56,931
Unsuccessful exploration costs	56,650	5,368	–	62,018
Depletion and decommissioning charge	48,516	54,971	–	103,487
Other segment items included in the Income Statement are:				
Gain on sale of oil and gas assets	–	–	–	–
Impairment of oil and gas assets	–	71,455	–	71,455
Depreciation	2,393	3	749	3,145
Amortisation	2,242	–	1,620	3,862

The segment results for the year ended 31 December 2005 were as follows:

	Cairn India Limited Group $'000	Capricorn Energy Limited Group $'000	Other $'000	Group 2005 $'000
Revenue from sale of oil, gas and condensate	173,676	88,504	–	262,180
Tariff income	382	–	–	382
Total revenue	174,058	88,504	–	262,562
Cost of sales	(108,307)	(60,535)	–	(168,842)
Gross profit	65,751	27,969	–	93,720
Segmental operating profit/(loss)	71,792	26,778	(27,666)	70,904
Cost of sales in the segment results above includes:				
Production costs	32,030	18,205	–	50,235
Unsuccessful exploration costs	26,867	–	–	26,867
Depletion and decommissioning charge	49,410	42,330	–	91,740
Other segment items included in the Income Statement are:				
Gain on sale of oil and gas assets	15,272	–	–	15,272
Impairment of oil and gas assets	–	–	–	–
Depreciation	1,759	23	768	2,550
Amortisation	1,142	–	1,248	2,390

The segment assets and liabilities as at 31 December 2006 and capital expenditure for the year then ended are as follows:

	Cairn India Limited Group $'000	Capricorn Energy Limited Group $'000	Other $'000	Group 2006 $'000
Assets	1,092,022	151,250	680,639	1,923,911
Liabilities	1,132,689	35,620	74,432	1,242,741
Capital expenditure	249,622	31,624	2,715	283,961

The segment assets and liabilities as at 31 December 2005 and capital expenditure for the year then ended are as follows:

	Cairn India Limited Group $'000	Capricorn Energy Limited Group $'000	Other $'000	Group 2005 $'000
Assets	725,109	241,910	46,993	1,014,012
Liabilities	189,980	56,993	9,441	256,414
Capital expenditure	189,200	49,573	3,061	241,834

Segment assets include intangible exploration/appraisal assets; property, plant & equipment – development/producing assets; property, plant & equipment – other; intangible assets – other; trade receivables and operating cash. They exclude deferred tax assets and inter-company balances.

Segment liabilities comprise operating liabilities and exclude items such as taxation, corporate borrowings and inter-company balances.

Other assets include assets of Cairn's head office in Edinburgh, as well as deferred tax assets, interest receivable, deposits, cash and cash equivalents of the Group which cannot be allocated to an operating segment.

Other liabilities include liabilities of Cairn's head office in Edinburgh, as well as income tax liabilities and deferred tax liabilities of the Group which cannot be allocated to an operating segment.

Capital expenditure comprises intangible exploration/appraisal asset additions and acquisitions (note 11); property, plant & equipment – development/producing asset additions and acquisitions (note 12); property, plant & equipment – other additions (note 13); and intangible assets – other additions (note 14).

Business Segments

Cairn operates in only one business segment, being the oil and gas extractive industry, and therefore no business segmental analysis is provided.

4 OPERATING (LOSS)/PROFIT

a) Operating (loss)/profit is stated after charging/(crediting):

	2006 $'000	2005 $'000
Depletion & decommissioning charge of property, plant & equipment – development/producing assets	103,487	91,740
Impairment of oil and gas assets	71,455	–
Unsuccessful exploration costs	62,018	26,867
Gain on sale of oil and gas assets	–	(15,272)
Depreciation of property, plant & equipment – other	3,145	2,550
Amortisation of intangible assets – other	3,862	2,390
Movement in inventory of oil and condensate	918	(3,373)
Operating lease costs – land and buildings	2,650	2,229
– other	283	208
Auditors' remuneration		
Fees payable to the Group's auditor for the audit of the Group's annual accounts	460	228
Fees payable to the Company's auditor for the audit of the Company's annual accounts	22	18
Fees payable to the Group's auditor and its associates for other services:		
– for the audit of subsidiaries pursuant to legislation	642	167
– other services pursuant to legislation	41	25
– other services relating to taxation	48	21
– services relating to corporate finance transactions	132	–
– all other services	232	62
Fees in respect of Cairn Energy PLC pension scheme:		
– audit	2	2
Other advisors' fees in respect of taxation work	60	63
Other advisors' fees in respect of other work	303	549

In addition, the Group incurred further fees during the year payable to the Group's auditor in connection with corporate finance services relating to the IPO of Cairn India. The fees amounted to $3.7m and will be set off against the gain in the year in which the transaction completes.

The Group has a policy in place for the award of non-audit work to the auditors which, in certain circumstances, requires Audit Committee approval.

Other advisers comprise accountancy firms other than the Group's auditors.

4 OPERATING (LOSS)/PROFIT (CONTINUED)

b) Reconciliation of operating (loss)/profit to net cash inflow/(outflow) from operating activities

	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Operating (loss)/profit	(64,570)	70,904	(64,299)	(25,748)
Depletion, depreciation, decommissioning and amortisation	110,494	96,680	2,368	2,017
Share based payments charge	13,304	4,592	3,474	2,677
Inventory movement	918	(3,373)	–	–
Trade receivables movement	(7,037)	(16,590)	7,785	(15,021)
Trade payables movement	15,139	14,551	67,957	30,273
Exceptional gain on sale of oil and gas assets	–	(15,272)	–	–
Movement in other provisions	5,762	(39,048)	–	–
Gain on sale of other non current assets	(2)	(41)	–	(25)
Impairment write off	71,455	–	–	–
Unsuccessful exploration costs	62,018	26,867	–	–
Foreign exchange differences	(282)	351	9,682	(9,391)
Net cash inflow/(outflow) from operating activities	207,199	139,621	26,967	(15,218)

Included within unsuccessful exploration costs for 2005 is a credit of $538,000 for insurance proceeds received.

c) Exceptional items

	2006 $'000	2005 $'000
Write down of oil and gas assets	(71,455)	–
Sale of intangible exploration/appraisal assets	–	2,188
Sale of property, plant & equipment – development/producing assets	–	13,084
	(71,455)	15,272

The write-down of oil and gas assets followed an impairment review in the year, details of which are in note 4(e).

The gain on sale in 2005 arose on the sale of assets, which completed in March 2005, as part of the ONGC transaction. See note 4(d) for details.

d) Transaction with ONGC

In March 2005 Cairn completed the transaction with ONGC whereby Cairn farmed-out interests in Blocks KG-DWN-98/2 (90%) and CB/OS-2 (15% exploration interest and 10% interest in the Lakshmi and Gauri Development Areas) and farmed-in to interests in Blocks GV-ONN-97/1 (30%) and CB-ONN-2001/1 (30%). On completion, Cairn received gross proceeds of $135m. A working capital adjustment of $5.2m was paid to ONGC in July 2005 and professional costs of $2.3m were incurred in the completion of the deal.

The operating profits from the farmed-out interests in the CB/OS-2 producing interest have been recognised in the Income Statement up to the date of completion.

The farmed-out assets were included within the India geographical segment.

A total gain on sale of $15.3m was recognised in the Income Statement in 2005 in respect of the farm-out. $2.2m of this gain is in respect of intangible exploration/appraisal assets. The proceeds relating to the sale of the development/producing assets were compared to the appropriate share of costs and the resultant gain of $13.1m was recognised in the Income Statement in 2005.

4 OPERATING (LOSS)/PROFIT (CONTINUED)

e) Impairment of oil and gas assets

During the year the Group carried out an impairment review of certain specific cash generating units within property, plant & equipment – development/producing assets. The review determined that the commercial viability of some of the units in the Capricorn Group segment has been exhausted. As a result an exceptional write down was charged to the Income Statement. Refer to details on the reason for impairment in the Operational Review on page 14 and note 1(g) for details of the assumption used in the impairment calculation.

f) Continuing operations

All profits and losses in the current and preceding year were derived from continuing operations.

5 STAFF COSTS

	2006 $'000	2005 $'000
Wages and salaries	57,733	45,203
Redundancy costs	1,667	–
Social security costs	2,792	3,308
Pension costs	2,612	2,255
Share based payments charge	18,527	10,011
	83,331	60,777

Staff costs are shown gross before amounts recharged to Joint Ventures and include the costs of share-based payments. The share-based payments charge includes amounts in respect of the cash settled phantom options and associated National Insurance contributions.

The average number of full time equivalent employees, including executive directors and individuals employed by the Group working on Joint Venture operations, was:

	Number of employees 2006	2005
UK	110	107
India	431	460
Bangladesh	83	72
Group	624	639

The Cairn Energy Group operates a number of share-based schemes for the benefit of its employees:

Cairn Energy PLC Group and Company

No difference in the schemes below apply for Group and Company other than charges for these schemes that are made to Cairn India and the Cairn Bangladesh companies where their staff are members of these schemes.

Share options

Under the 1996 Scheme, at 1 January 2006, certain executive directors and employees had been granted options to subscribe for ordinary shares which are exercisable between 2003 and 2012, at prices between £1.950 and £2.965. At 31 December 2006, there were 60,500 options outstanding (2005: 161,600 options outstanding) with a weighted average remaining contractual life of 4.97 years (2005: 5.96 years) (options exercised in 2006: 96,100; 2005: 757,534). All awards under the 1996 scheme were granted prior to 7 November 2002.

Under the 2002 Plan, at 1 January 2006, certain executive directors and employees had been granted options to subscribe for ordinary shares which are exercisable between 2006 and 2016, at prices between £3.055 and £21.530. At 31 December 2006, there were 1,548,584 options outstanding (2005: 1,144,872 options outstanding) with a weighted average remaining contractual life of 8.51 years (2005: 8.43 years) (options exercised in 2006: 225,382; 2005: 1,034).

The options outstanding at the end of the year under the 2002 Plan can be broken down into the following weighted average exercise price (WAEP) variants:

	2006		2005	
Exercisable between	Number	WAEP (£)	Number	WAEP (£)
2006 – 2013	64,550	3.08	265,426	3.08
2007 – 2014	359,659	8.74	410,427	8.74
2008 – 2015	416,226	11.56	469,019	11.55
2009 – 2016	708,149	21.53	–	–
	1,548,584		1,144,872	

Under the 2003 Plan, at 1 January 2006, certain executive directors and employees had been granted options to subscribe for ordinary shares which are exercisable between 2006 and 2016, at prices between £3.095 and £21.530. At 31 December 2006, there were 196,400 options outstanding (2005: 380,766 options outstanding) with a weighted average remaining contractual life of 7.76 years (7.98 years) (options exercised in 2006: 198,889; 2005: nil).

The options outstanding at the end of the year under the 2003 Plan can be broken down into the following WAEP variants:

	2006		2005	
Exercisable between	Number	WAEP (£)	Number	WAEP (£)
2006 – 2013	46,500	3.10	240,900	3.10
2007 – 2014	52,385	8.74	61,918	8.74
2008 – 2015	67,479	11.66	77,948	11.65
2009 – 2016	30,036	21.53	–	–
	196,400		380,766	

The exercise price of the options awarded in 2006 is higher than the current share price.

The above share option schemes are subject to performance conditions on exercise. The option holder may only exercise options if Cairn's share price has increased by 5% on a compound basis over the period from the date of grant of options up to the date they are exercised. In addition, the percentage increase in Cairn's share price over the period must be at least equal to or greater than the percentage movement in the FTSE Oil and Gas Index.

The following table details the number and WAEP of share options for the various Cairn Energy PLC share option schemes at the Balance Sheet date:

	1996 Scheme		2002 Plan		2003 Plan	
	Number	WAEP (£)	Number	WAEP (£)	Number	WAEP (£)
Outstanding at the beginning of the year	161,600	2.54	1,144,872	8.58	380,766	5.76
Granted during the year	–	–	723,287	21.53	31,429	21.53
Lapsed during the year	(5,000)	2.68	(94,193)	11.92	(16,906)	11.28
Exercised during the year	(96,100)	2.52	(225,382)	3.88	(198,889)	3.24
Outstanding at the end of the year	60,500	2.55	1,548,584	15.11	196,400	10.36
Exercisable at the end of the year	60,500		125,725		50,211	
Fair value of shares granted in year	–		£8.70		£8.70	

5 STAFF COSTS (CONTINUED)

The following table details the number and WAEP of share options for the various share option schemes as at 31 December 2005:

	1996 Scheme		2002 Plan		2003 Plan	
	Number	WAEP (£)	Number	WAEP (£)	Number	WAEP (£)
Outstanding at the beginning of the year	925,000	2.45	719,518	6.57	304,886	4.32
Granted during the year	–	–	477,521	11.53	75,880	11.57
Lapsed during the year	(5,866)	2.77	(51,133)	7.88	–	–
Exercised during the year	(757,534)	2.52	(1,034)	8.74	–	–
Outstanding at the end of the year	161,600	2.54	1,144,872	8.58	380,766	5.76
Exercisable at the end of the year	161,600		–		–	
Fair value of shares granted in year	–		£4.46		£4.46	

Cairn Energy PLC share options were exercised on a regular basis throughout the year. The weighted average share price during the year was £20.19 (2005: £14.70).

The Cairn Energy PLC share options have been valued using a binomial model. The main inputs to the model include the number of options, share price, leaver rate, trigger points, discount rate and volatility.

- Leaver rate assumptions are based on past history of employees leaving the Company prior to options vesting and are revised to equal the number of options that ultimately vest.
- Trigger points are the profit points at which the relevant percentage of employees are assumed to exercise their options.
- The risk free rate is based on the yield on a zero coupon Government bond with a term equal to the expected term on the option being valued.
- Volatility was determined as the annualised standard deviation of the continuously compounded rates of return on the shares of a peer group of similar companies selected from the FTSE over a 10 year period to the date of award as disclosed in the Directors' Remuneration Report over a ten year period to the date of award.

	2002 Scheme	2003 Scheme	2006 Scheme
Vesting %	85.74% – 89.48%	85.74% – 88.34%	85.74%
Trigger points	25% profit – 15% 50% profit – 25% 75% profit – 25% 100% profit – 15% 125% profit – 10% No trigger – 10%	25% profit – 15% 50% profit – 25% 75% profit – 25% 100% profit – 15% 125% profit – 10% No trigger – 10%	25% profit – 15% 50% profit – 25% 75% profit – 25% 100% profit – 15% 125% profit – 10% No trigger – 10%
Risk free rate	4.0% – 4.8%	4.0% – 4.8%	4.7%
Volatility	40.24%	40.24%	41.02%

LTIP

The fair value of the LTIP awards has been calculated using a binomial model. The main inputs to the model are as per the share options scheme above. For details on the vesting conditions attached to the LTIP refer to the Directors' Remuneration Report on page 56.

At 31 December 2006, there were 1,484,200 options outstanding with a weighted average remaining contractual life of 1.17 years.

The following awards granted after 7 November 2002 existed under the existing LTIP are detailed in the table below together with the weighted average grant price (WAGP) at the Balance Sheet date:

	Number	WAGP (£)
Outstanding at the beginning of the year	2,697,500	6.61
Vested during the year	(1,379,518)	3.08
Granted during the year	397,300	23.99
Lapsed during the year	(231,082)	13.67
Outstanding at the end of the year	1,484,200	13.45

The awards outstanding at the end of the year can be broken down into the following WAGP variants:

	2006		2005	
Vesting	Number	WAGP (£)	Number	WAGP (£)
2003	–	–	1,389,000	3.05
2004	500,000	8.74	553,000	8.74
2005	645,700	11.57	755,500	11.76
2006	338,500	23.99	–	–
	1,484,200		2,697,500	

The fair value of shares granted in the year was £5.97.

At 31 December 2005, there were 2,697,500 options outstanding with a weighted average remaining contractual life of 1 year.

The following awards granted after 7 November 2002 existed under the LTIP and are detailed in the table below together with the WAGP at 31 December 2005:

	Number	WAGP (£)
Outstanding at the beginning of the year	1,942,000	4.61
Granted during the year	755,500	11.76
Outstanding at the end of the year	2,697,500	6.61

The fair value of shares granted in the year was £2.63.

The following awards granted before 7 November 2002 existed under the LTIP at 31 December 2005:

	Number	WAGP (£)
Outstanding at the beginning of the year	1,270,000	2.71
Vested during the year	(1,270,000)	2.71
Outstanding at the end of the year	–	–

The fair value of shares granted in the year was £nil.

The fair value of the LTIP awards is based on an independent valuation using the following assumptions:

	Tier 1	Tier 2
Vesting %	25.03%	19.03%
Volatility	41.37%	41.37%
Risk free rate	4.6%	4.6%

No dividends have been distributed in the current or past few years. The discount rates used has been set as the yield on a zero coupon Government bond with a term equal to the expected term on the option being valued (allowing for expected early redemption of the option).

Employee Share Related Bonuses
Cairn granted benefits to certain employees whereby they receive a cash sum that is calculated by reference to the improvement in share price from the date of grant of the award. At 31 December 2006 $92,000 was outstanding in respect of such awards (2005: $63,000) and is disclosed within 'Other creditors and accruals' within trade and other payables.

5 STAFF COSTS (CONTINUED)

Cairn India Limited

Cairn India Senior Management Plan

The Cairn India Senior Management Plan was adopted by the company in November 2006. This is a discretionary arrangement that allowed the company to grant pre IPO options over its shares to a limited number of its key senior management team. Following the completion of the company's flotation, no further options will be granted pursuant to this arrangement.

The vesting conditions for options granted under the Senior Management Plan are the successful completion of Cairn India's flotation, the continued employment of the relevant participant within the Cairn India Group over a specified period of time and the achievement of certain specified performance targets relating to the Rajasthan development. Option exercises will be settled by an allotment of shares in Cairn India Limited to the relevant individual.

The options granted during the year are exercisable between 9 January 2007 and 1 April 2010, at Rs33.70. At 31 December 2006, there were 8,298,713 options outstanding with a weighted average remaining contractual life of 3.25 years (options exercised in 2006: nil).

The fair value of the options is based on an independent valuation using the following assumptions:

Vesting date	9 January 2007	9 July 2008	31 December 2009	1 April 2010
Vesting %	33.33% – 50%	25% – 33.33%	25%	33.33%
Volatility	45.99%	41.49%	39.67%	39.67%
Risk free rate	6.82%	7.22%	7.44%	7.46%

The following table details the number and WAEP of share options for the Cairn India share option scheme:

	CISMP Number	CISMP WAEP (Rs)
Outstanding at the beginning of the year	–	–
Granted during the year	8,298,713	33.70
Lapsed during the year	–	–
Exercised during the year	–	–
Outstanding at the end of the year	8,298,713	33.70
Exercisable at the end of the year	–	
Fair value of shares granted in year	Rs131.19	

No Cairn India share options were exercised during the year; consequently there is no weighted average share price. The Cairn India share options have been valued using the black scholes model. The main inputs to the model include the number of options, share price, trigger points, discount rate, expected life of the options and volatility. Volatility was determined as the annualised standard deviation of the continuously compounded rates of return on the shares over a period of time.

Cairn India Employee Stock Option Plan (2006)

The Cairn India Employee Stock Option Plan (2006) – (CIESOP), which was adopted by Cairn India Limited in November 2006, is a discretionary arrangement that allows the company to grant options over its shares to selected employees and executive directors.

Under the plan, Cairn India will grant options equivalent to 88,265,718 equity shares (when aggregated with the number of options to be granted pursuant to the Cairn India Performance Option Plan (2006) (CIPOP)) of the face value of Rs10 each at an exercise price that will be determined by the Remuneration Committee, but not less than the fair market value of the equity shares on the date of grant to each of the eligible employees of Cairn India.

Options will generally vest on the third anniversary of grant, subject to the individuals remaining in employment. In accordance with generally prevailing practice in India, the ability to exercise these options will not be subject to the satisfaction of any additional performance conditions. Option exercises will be settled by an allotment of shares to the relevant individual.

No options were granted and therefore none were exercised during the year.

Cairn India Performance Option Plan (2006)
The CIPOP was adopted by Cairn India in November 2006, and is a discretionary arrangement that allows the company to grant options over its shares to selected employees and executive directors.

Under the plan, Cairn India will grant options equivalent to 88,265,718 equity shares (when aggregated with the number of options to be granted pursuant to the CIESOP) of the face value of Rs10 each at an exercise price of Rs10 each to each of the eligible employees of the Cairn India.

The vesting of these options will generally be dependent on both continued employment and the extent to which predetermined performance conditions are met over a specified period of at least three years. Initially, the performance condition attached to options granted pursuant to the CIPOP will be based on the total shareholder return (TSR) of Cairn India compared to the TSR of a group of exploration, production and integrated oil companies.

No options were granted and therefore none were exercised during the year.

6 DIRECTORS' EMOLUMENTS

Details of each director's remuneration, pension entitlements, share options and awards pursuant to the LTIP are set out in the Directors' Remuneration Report on pages 56 to 67. Directors' emoluments are included within remuneration of key management personnel disclosures in note 33.

7 FINANCE INCOME

	2006 $'000	2005 $'000
Bank interest	3,838	5,217
Other interest	765	214
Exchange gain	–	27,112
	4,603	32,543

8 FINANCE COSTS

	Note	2006 $'000	2005 $'000
Bank loan and overdraft interest		6,649	29
Other finance charges		4,727	1,172
		11,376	1,201
Less: borrowing costs capitalised		(4,625)	–
		6,751	1,201
Other finance costs – unwinding of discount		1,183	1,035
– fair value movement on currency exchange option	27/28	9,694	–
Exchange loss		12,981	–
		30,609	2,236

Under UK tax law, borrowing costs that are capitalised in the accounts will generally be deductible expenses for tax in the period in which they are capitalised. Under Indian tax law, capitalised costs must be apportioned between property, plant & equipment and intangible assets based on the nature of the assets which were funded by the borrowing. To the extent that the borrowing costs relate to property, plant & equipment, they will be deductible for tax according to the normal tax depreciation rules. Borrowing costs relating to intangibles will be a deductible expense, for Indian tax purposes, in the period in which they are capitalised.

9 TAXATION ON (LOSS)/PROFIT

a) Analysis of tax (credit)/charge in year

	Note	2006 $'000	2005 $'000
Current tax:			
UK corporation tax			
Adjustments in respect of prior periods		(1)	349
		(1)	349
Foreign Tax			
India			
Tax on profits for the year at 41.82% (2005: 41.82%)		–	7,063
Minimum Alternate Tax on profits for the year at 7.84% (2005: 7.84%)		8,273	2,137
Withholding tax at 15% (2005: 15%)		1,388	323
		9,661	9,523
Total current tax		9,660	9,872
Deferred Tax:			
United Kingdom			
Accelerated allowances		(11,308)	(4,708)
Other temporary differences		(349)	(124)
Losses		(27,262)	8,548
		(38,919)	3,716
India			
Accelerated allowances		21,482	(19,707)
Other temporary differences		(604)	20,834
Losses		(178)	7,424
		20,700	8,551
Total deferred tax	20	(18,219)	12,267
Tax (credit)/charge on (loss)/profit		(8,559)	22,139

b) Factors affecting tax (credit)/charge for year

A reconciliation of income tax expense applicable to profit before income tax at the applicable tax rate to income tax expense at the Group's effective income tax rate is as follows:

	2006 $'000	2005 $'000
(Loss)/profit before taxation	(90,576)	101,211
Tax at the weighted average rate of corporation tax of 36.68% (2005: 28.58%)	(33,223)	28,926
Effects of:		
Minimum Alternate Tax payable	4,506	1,176
Adjustments in respect of prior periods – current tax	(1)	349
– deferred tax	(4,083)	(1,600)
Temporary differences not recognised	14,017	5,146
Non-deductible expenses and non-taxable income	7,421	(6,219)
Withholding tax	1,388	323
Foreign exchange movements	1,040	(4,344)
Other	376	(1,618)
Total tax (credit)/charge	(8,559)	22,139

The applicable tax rate was the weighted average rate for the year of the UK, Netherlands, Australian, Indian, Jersey and Bangladeshi tax rates. There have been no major changes in the statutory tax rates applying in each of these jurisdictions, however, the weighted average rate is subject to fluctuations from year to year based on the level of profits and losses which arise to the Group in each jurisdiction.

c) Factors that may affect future corporation tax charges

At 31 December 2006 Cairn had losses of approximately $167.4m (2005: $98.0m) available for offset against future trading profits chargeable to UK Corporation Tax. These losses have been recognised for deferred tax purposes as it is expected that they will be utilised against future trading profits. In addition there are surplus management expenses of $54.0m (2005: $17.7m) and non-trade deficits of $26.7m (2005: $7.0m) available for offset against future investment income. There were also capital losses of $24.3m at 31 December 2006 (2005: $24.3m) available to offset future capital gains arising in the UK in Cairn Energy Bangladesh. None of the surplus management expenses, non-trade deficits or capital losses were recognised for deferred tax as there is no reasonable certainty that they will be used. Under UK tax law, tax losses may generally be carried forward indefinitely.

At 31 December 2006 Cairn had losses of approximately $14.7m (2005: $5.4m) available for offset against future trading profits chargeable to Netherlands Corporate Income Tax but there are restrictions on the use of these losses. Under Netherlands tax law, losses may be carried forward for a period of up to nine years. No deferred tax asset has been recognised in respect of these losses.

At 31 December 2006 Cairn had losses of approximately $5.3m (2005: $4.8m) available for offset against future trading profits chargeable to Indian Corporate Income Tax. Under Indian tax laws, losses may be carried forward for a period of up to eight years. These losses have been recognised for deferred tax purposes as it is expected that they will be utilised against future trading profits chargeable to Indian tax.

Tax losses incurred in one jurisdiction cannot usually be offset against profits or gains arising in another jurisdiction.

10 EARNINGS PER ORDINARY SHARE

The earnings per ordinary share is calculated on a loss of $82,017,000 (2005: profit $79,072,000) and on a weighted average of 157,654,751 ordinary shares (2005: 156,995,878). The weighted average of ordinary shares excludes shares held by the Cairn Energy PLC Employees' Share Trust. In respect of 2006, 587,128 potential ordinary shares were anti-dilutive.

The 2005 diluted earnings per ordinary share were calculated on a profit of $79,072,000 and on 157,841,207 ordinary shares being the basic weighted average of 156,995,878 ordinary shares and the dilutive potential ordinary shares of 845,329 ordinary shares relating to share options.

11 INTANGIBLE EXPLORATION/APPRAISAL ASSETS

Group	Cairn India Limited Group $'000	Capricorn Energy Limited Group $'000	Total $'000
Cost and net book value			
At 1 January 2005	353,604	10,585	364,189
Additions	172,262	20,833	193,095
Transfers between categories	(118,285)	–	(118,285)
Disposals	(89,739)	–	(89,739)
Unsuccessful exploration costs	(27,405)	–	(27,405)
At 1 January 2006	290,437	31,418	321,855
Additions	141,826	19,142	160,968
Transfers between categories	(1,566)	–	(1,566)
Unsuccessful exploration costs	(56,650)	(5,368)	(62,018)
At 31 December 2006	374,047	45,192	419,239

During the year Cairn booked reserves in respect of the CB-X field (2005: certain Rajasthan fields and Gauri oil). As a consequence $1.6m (2005: $118.3m) of costs were transferred to property, plant & equipment – development/producing assets.

The disposal of assets in 2005 relates to the farm-out of a 90% interest in KG-DWN-98/2 and a 15% interest in CB/OS-2 exploration interest. See note 4(d) for details.

12 PROPERTY, PLANT & EQUIPMENT – DEVELOPMENT/PRODUCING ASSETS

Group	Cairn India Limited Group $'000	Capricorn Energy Limited Group $'000	Total $'000
Cost			
At 1 January 2005	323,422	200,447	523,869
Additions	12,297	28,740	41,037
Transfers between categories	118,285	–	118,285
Disposals	(36,625)	–	(36,625)
At 1 January 2006	417,379	229,187	646,566
Additions	97,975	12,482	110,457
Transfers between categories	1,566	–	1,566
At 31 December 2006	516,920	241,669	758,589
Depletion and decommissioning			
At 1 January 2005	95,546	16,586	112,132
Exchange differences arising	(99)	–	(99)
Charge for the year	49,411	42,329	91,740
Disposals	(14,136)	–	(14,136)
At 1 January 2006	130,722	58,915	189,637
Charge for the year	48,516	54,971	103,487
Impairment of oil and gas assets	–	71,455	71,455
At 31 December 2006	179,238	185,341	364,579
Net book value at 31 December 2006	337,682	56,328	394,010
Net book value at 31 December 2005	286,657	170,272	456,929
Net book value at 1 January 2005	226,241	185,496	411,737

The disposal in 2005 relates to the farm-out of a 10% development/producing interest in CB/OS-2. See note 4(d) for details.

During the year Cairn booked reserves in respect of the CB-X field (2005: certain Rajasthan fields and Gauri oil). As a consequence $1.6m (2005: $118.3m) of costs were transferred from intangible exploration/appraisal assets.

Included within additions during the year is an amount of $4.6m of borrowing costs capitalised at a rate of 6.3%.

The net book value at 31 December 2006 includes $198.0m (2005: $112.3m) in respect of assets under construction which are not being depleted.

13 PROPERTY, PLANT & EQUIPMENT – OTHER

Group	Tenants' Improvements $'000	Vehicles and Equipment $'000	Total $'000
Cost			
At 1 January 2005	4,088	11,250	15,338
Exchange differences arising	(216)	(542)	(758)
Additions	2,772	1,307	4,079
Disposals	(8)	(167)	(175)
At 1 January 2006	6,636	11,848	18,484
Exchange differences arising	284	727	1,011
Additions	3,307	1,450	4,757
Disposals	(358)	(189)	(547)
At 31 December 2006	9,869	13,836	23,705
Depreciation			
At 1 January 2005	2,751	9,830	12,581
Exchange differences arising	(148)	(536)	(684)
Charge for the year	1,101	1,449	2,550
Disposals	(8)	(113)	(121)
At 1 January 2006	3,696	10,630	14,326
Exchange differences arising	205	667	872
Charge for the year	1,687	1,458	3,145
Disposals	(358)	(171)	(529)
At 31 December 2006	5,230	12,584	17,814
Net book value at 31 December 2006	4,639	1,252	5,891
Net book value at 31 December 2005	2,940	1,218	4,158
Net book value at 1 January 2005	1,337	1,420	2,757

The net book value of assets held under finance leases or hire purchase contract at 31 December 2006 was $4.1m (2005: $nil). Additions during the year include $4.8m (2005: $nil) of property, plant & equipment – others are held under finance leases or hire purchase contracts. Leased assets are pledged as security for the related finance lease or hire purchase liability.

13 PROPERTY, PLANT & EQUIPMENT – OTHER (CONTINUED)

Company	Tenants' Improvements $'000	Vehicles and Equipment $'000	Total $'000
Cost			
At 1 January 2005	2,160	5,142	7,302
Exchange differences arising	(216)	(536)	(752)
Additions	195	571	766
Disposals	–	(152)	(152)
At 1 January 2006	2,139	5,025	7,164
Exchange differences arising	284	721	1,005
Additions	28	747	775
Disposals	–	(38)	(38)
At 31 December 2006	2,451	6,455	8,906
Depreciation			
At 1 January 2005	1,366	4,669	6,035
Exchange differences arising	(148)	(521)	(669)
Charge for the year	243	526	769
Disposals	–	(98)	(98)
At 1 January 2006	1,461	4,576	6,037
Exchange differences arising	205	626	831
Charge for the year	214	570	784
Disposals	–	(37)	(37)
At 31 December 2006	1,880	5,735	7,615
Net book value at 31 December 2006	571	720	1,291
Net book value at 31 December 2005	678	449	1,127
Net book value at 1 January 2005	794	473	1,267

The Company does not hold assets under finance leases or hire purchase contracts.

14 INTANGIBLE ASSETS – OTHER

Group	Software Costs $'000	Total $'000
Cost		
At 1 January 2005	7,749	7,749
Exchange differences arising	(278)	(278)
Additions	3,623	3,623
At 1 January 2006	11,094	11,094
Exchange differences arising	617	617
Additions	7,779	7,779
At 31 December 2006	19,490	19,490
Amortisation		
At 1 January 2005	6,402	6,402
Exchange differences arising	(299)	(299)
Charge for the year	2,390	2,390
At 1 January 2006	8,493	8,493
Exchange differences arising	411	411
Charge for the year	3,862	3,862
At 31 December 2006	12,766	12,766
Net book value at 31 December 2006	6,724	6,724
Net book value at 31 December 2005	2,601	2,601
Net book value at 1 January 2005	1,347	1,347

Company	Software Costs $'000	Total $'000
Cost		
At 1 January 2005	2,524	2,524
Exchange differences arising	(276)	(276)
Additions	2,295	2,295
At 1 January 2006	4,543	4,543
Exchange differences arising	613	613
Additions	1,940	1,940
At 31 December 2006	7,096	7,096
Amortisation		
At 1 January 2005	2,265	2,265
Exchange differences arising	(223)	(223)
Charge for the year	1,248	1,248
At 1 January 2006	3,290	3,290
Exchange differences arising	492	492
Charge for the year	1,584	1,584
At 31 December 2006	5,366	5,366
Net book value at 31 December 2006	1,730	1,730
Net book value at 31 December 2005	1,253	1,253
Net book value at 1 January 2005	259	259

15 INVESTMENTS

Group	Unlisted investment $'000	Associated undertaking $'000	Total $'000
Cost			
At 1 January 2005	96	342	438
Investments written off	–	(342)	(342)
At 1 January 2006 and 31 December 2006	96	–	96
Accumulated impairment losses			
At 1 January 2005	–	342	342
Investments written off	–	(342)	(342)
At 1 January 2006 and 31 December 2006	–	–	–
Net book value at 31 December 2006	96	–	96
Net book value at 31 December 2005	96	–	96

During 2005, the associated undertaking, representing Cairn's share in Energy Services Hub Limited, was liquidated. Cairn previously held 38% of the ordinary share capital of the associate and 40% of the voting rights.

Company	Subsidiary undertaking $'000	Total $'000
Cost		
At 1 January 2005 and 31 December 2005	24,829	24,829
At 1 January 2006	24,829	24,829
Exchange differences arising	33,564	33,564
Additions	615,629	615,629
Disposals	(165,966)	(165,966)
At 31 December 2006	508,056	508,056
Accumulated impairment losses		
At 1 January 2005 and 31 December 2006	–	–
Net book value at 31 December 2006	508,056	508,056
Net book value at 31 December 2005	24,829	24,829

During the year the company acquired various investments in subsidiaries from Cairn Energy Bangladesh Limited as settlement of a capital reduction by that company. Two further subsidiaries were incorporated during the year, Cairn UK Holdings Limited and Capricorn Energy Limited (originally incorporated as Cairn Resources Limited) and the investments transferred to these companies through share for share exchanges. In addition, inter-company loan balances due to Cairn Energy PLC from both Cairn UK Holdings Limited and Capricorn Energy Limited were settled through equity issued from the subsidiaries. Further details on these transactions are contained in note 33. Disposals during the year represent the elimination of the Company's investment in Cairn Energy Bangladesh Limited on receipt of a dividend in specie following a capital reduction in the subsidiary.

Included in the total consideration for company investment additions in the year of $615.6m is $63.6m directly settled by means of cash and cash equivalents.

The Company's principal subsidiaries as at the Balance Sheet date are set out below:

Company	Principal activity	Country of incorporation	Country of operation	Proportion of voting rights and ordinary shares
Direct holdings				
Capricorn Energy Limited	Holding company	Scotland	Scotland	100%
Cairn UK Holdings Limited	Holding company	Scotland	Scotland	100%
Indirect holdings – Capricorn Energy Limited Group				
Cairn Energy Bangladesh Limited*	Exploration & production	Scotland	Bangladesh	100%
Cairn Energy Sangu Field Limited*	Exploration & production	Scotland	Bangladesh	100%
Cairn Energy Exploration (Bangladesh) Limited*	Exploration	Scotland	Bangladesh	100%
Holland Sea Search Holdings N.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Exploration (No. 1) Limited	Exploration	Scotland	India	100%
Cairn Energy Search Limited	Exploration	Scotland	India	100%
Cairn Energy Exploration and Production Limited	Exploration	Scotland	India	100%
Cairn Energy Nepal Holdings Limited*	Holding company	Scotland	Scotland	100%
Cairn Energy Dhangari Limited	Exploration	Scotland	Nepal	100%
Cairn Energy Karnali Limited	Exploration	Scotland	Nepal	100%
Cairn Energy Lumbini Limited	Exploration	Scotland	Nepal	100%
Cairn Energy Malangawa Limited	Exploration	Scotland	Nepal	100%
Cairn Energy Birganj Limited	Exploration	Scotland	Nepal	100%
Indirect holdings – Cairn UK Holdings Limited Group (including Cairn India Limited Group)				
Cairn India Limited	Holding company	India	India	100%
Cairn India Holdings Limited	Holding company	Jersey	Jersey	100%
Cairn Energy Holdings Limited	Holding company	Scotland	Scotland	100%
Cairn Energy Hydrocarbons Limited	Exploration & production	Scotland	India	100%
Cairn Energy Australia Pty Limited	Holding company	Australia	Australia	100%
Cairn Energy India Pty Limited	Exploration & production	Australia	India	100%
Cairn Energy Netherlands Holdings B.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Energy Group Holdings B.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Energy India Holdings B.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Energy India West Holdings B.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Energy Cambay Holdings B.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Energy Gujarat Holdings B.V.	Holding company	The Netherlands	The Netherlands	100%
Cairn Energy India West B.V.	Exploration & production	The Netherlands	India	100%
Cairn Energy Cambay B.V.	Exploration & production	The Netherlands	India	100%
Cairn Energy Gujarat B.V.	Exploration & production	The Netherlands	India	100%
Cairn Energy Discovery Limited	Exploration	Scotland	India	100%
Cairn Energy Gujarat Block 1 Limited	Exploration	Scotland	India	100%
Cairn Energy Exploration (No. 2) Limited	Exploration	Scotland	India	100%
Cairn Energy Exploration (No. 4) Limited	Exploration	Scotland	India	100%
Cairn Energy Exploration (No. 6) Limited	Exploration	Scotland	India	100%
Cairn Energy Exploration (No. 7) Limited	Exploration	Scotland	India	100%

* These Companies were, as at 31 December 2005, owned directly by the Company.

There is a restriction in the ability of some Group companies to distribute profits to Cairn Energy PLC, the ultimate parent company, as a result of negative distributable reserves in Cairn Energy Holdings Limited, an intermediate holding company.

On 9 January 2007, Cairn India Limited listed on the Bombay Stock Exchange and the National Stock Exchange of India. As a result Cairn Energy PLC's proportion of voting rights and Ordinary Shareholding reduced to 69.0%. A full explanation of this is provided in note 34.

16 INVENTORY

	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Oil and condensate inventories	4,615	5,533	–	–
	4,615	5,533	–	–

17 TRADE AND OTHER RECEIVABLES

	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Trade receivables	62,487	67,043	–	–
Amounts owed by subsidiary undertakings	–	–	71,782	218,186
Other debtors and prepayments	57,969	21,124	9,154	11,009
Joint Venture debtors and prepayments	97,703	36,558	–	–
	218,159	124,725	80,936	229,195

Included within other debtors and prepayments is an amount of $36.8m (2005: nil) relating to costs of the IPO of Cairn India Limited.

Joint Venture debtors and prepayments for the Group include an amount in respect of outstanding and overdue cash calls of $49.4m (2005: $24m) receivable from the Rajasthan joint venture partner ONGC. Management is currently pursuing payment of this amount.

18 NET FUNDS

Group	At 1 January 2006 $'000	Cash flow $'000	New finance leases $'000	Exchange movements $'000	At 31 December 2006 $'000
Bank deposits	20,000	(20,000)	–	–	–
Bank deposits	20,000	(20,000)	–	–	–
Cash at bank	15,831	12,779	–	(1,037)	27,573
Short term deposits	59,678	768,344	–	671	828,693
Cash and cash equivalents	75,509	781,123	–	(366)	856,266
Bank loans	–	(155,000)	–	–	(155,000)
Net cash	95,509	606,123	–	(366)	701,266
Finance leases	–	953	(5,432)	7	(4,472)
Net funds	95,509	607,076	(5,432)	(359)	696,794

Group	At 1 January 2005 $'000	Cash flow $'000	New finance leases $'000	Exchange movements $'000	At 31 December 2005 $'000
Bank deposits	15,361	5,656	–	(1,017)	20,000
Bank deposits	15,361	5,656	–	(1,017)	20,000
Cash at bank	17,820	(1,603)	–	(386)	15,831
Short term deposits	105,141	(44,536)	–	(927)	59,678
Cash and cash equivalents	122,961	(46,139)	–	(1,313)	75,509
Net funds	138,322	(40,483)	–	(2,330)	95,509

In addition to the cash and cash equivalents shown above in 2005 the Group had a deposit of $20m as at 31 December 2005 which matured on 31 March 2006. This deposit was classified under bank deposits as it was placed on deposit for a period of greater than three months. There is no equivalent deposit as at 31 December 2006.

As at the year end, the group had cash balances equivalent to $245,000 in Bangladeshi Taka in Bangladesh which are not readily convertible into other currencies.

Cash and bank earns interest at floating rates based on daily bank deposit rates. Short term deposits are made for varying periods from overnight deposits to three months depending on the cash requirements of the Company.

The bank overdraft is repayable on demand.

Company	At 1 January 2006 $'000	Cash flow $'000	Exchange movements $'000	At 31 December 2006 $'000
Cash at bank	1,892	2,258	(1,937)	2,213
Short term deposits	31,872	(14,851)	279	17,300
Cash and cash equivalents	33,764	(12,593)	(1,658)	19,513
Bank loans	–	(47,000)	–	(47,000)
Net funds	33,764	(59,593)	(1,658)	(27,487)

Company	At 1 January 2005 $'000	Cash flow $'000	Exchange movements $'000	At 31 December 2005 $'000
Bank deposits	15,361	(14,344)	(1,017)	–
Bank deposits	15,361	(14,344)	(1,017)	–
Cash at bank	2,966	(907)	(167)	1,892
Short term deposits	47,741	(14,943)	(926)	31,872
Cash and cash equivalents	50,707	(15,850)	(1,093)	33,764
Net funds	66,068	(30,194)	(2,110)	33,764

19 TRADE AND OTHER PAYABLES

	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Trade payables	2,816	1,065	2,760	446
Amounts owed to subsidiary undertakings	–	–	90,403	26,705
Other taxation and social security	2,205	511	873	456
Other creditors and accruals	42,645	40,173	19,774	10,414
Deferred income	751,849	–	–	–
Joint Venture creditors and accruals	97,717	52,987	–	–
	897,232	94,736	113,810	38,021

Deferred income as at 31 December 2006 represents pre-placement proceeds received in respect of the IPO which completed after the year end and will be recognised in the 2007 financial statements. See note 34 for details.

20 DEFERRED TAXATION

	Assets $'000	Exceptional provision $'000	Liabilities $'000	Group $'000
At 1 January 2005	8,744	14,800	(148,263)	(124,719)
Charge to income statement	(5,273)	–	(6,994)	(12,267)
Exchange differences	(865)	–	3,785	2,920
Exceptional deferred tax movement	–	(14,800)	14,800	–
At 1 January 2006	2,606	–	(136,672)	(134,066)
Credit to income statement	15,039	–	3,180	18,219
Exchange differences	1,266	–	(5,202)	(3,936)
At 31 December 2006	18,911	–	(138,694)	(119,783)

	Assets $'000	Liabilities $'000	Group $'000
Deferred taxation – UK			
Accelerated allowances	(31,307)	(7,440)	(38,747)
Other temporary differences	–	478	478
Losses	50,218	–	50,218
	18,911	(6,962)	11,949
Deferred taxation – India			
Accelerated allowances	–	(135,770)	(135,770)
Other temporary differences	–	1,820	1,820
Losses	–	2,218	2,218
	–	(131,732)	(131,732)
Total deferred taxation as at 31 December 2006	18,911	(138,694)	(119,783)

	Assets $'000	Liabilities $'000	Group $'000
Deferred taxation – UK			
Accelerated allowances	(19,487)	(28,685)	(48,172)
Other temporary differences	–	124	124
Losses	22,093	–	22,093
	2,606	(28,561)	(25,955)
Deferred taxation – India			
Accelerated allowances	–	(111,278)	(111,278)
Other temporary differences	–	1,176	1,176
Losses	–	1,991	1,991
	–	(108,111)	(108,111)
Total deferred taxation as at 31 December 2005	2,606	(136,672)	(134,066)

At the Balance Sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was $110.6m (2005: $69.9m). No liability has been recognised in respect of these differences because Cairn is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

As at the Balance Sheet date, a deferred tax asset was not recognised in respect of Group losses of $95.4m (2005: $30.1m) (Company: $64.8m; 2005: $17.7m) where it is not probable that they can be utilised in future periods.

A deferred tax asset has been recognised in respect of trading losses of $172.7m (2005: $102.8m) as it is considered that these losses will be utilised against future trading profits arising to the Group.

21 OBLIGATIONS UNDER FINANCE LEASES

The Group has finance leases for various items of tenants' improvements and office equipment all of which provide the specific entity which holds the lease with the option to purchase. Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
Group	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Amounts payable:				
Within one year	1,613	–	1,380	–
Between two and five years	3,614	–	3,092	–
	5,227	–	4,472	–
Less: future finance charges	(755)	–	–	–
Present value of lease obligations	4,472	–	4,472	–

The average lease term is 3 to 5 years. For the year ended 31 December 2006, the average effective borrowing rate was 16.92% (2005: not applicable). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. The fair value of the Group's lease obligations approximates their carrying amount. The Group's obligations under finance leases are secured by the lessors' rights over the leased assets.

The Company does not have any obligations under finance leases.

22 LOANS AND BORROWINGS

	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Bank loans	155,000	–	47,000	–

The loans were advanced under the Group's $1bn hybrid, syndicated, revolving floating rate credit facilities; see note 27 for details. Interest during the year was charged at an average rate of 6.6%.

23 PROVISIONS

Group	Decommissioning $'000	Other provisions $'000	Total $'000
At 1 January 2005	18,031	40,774	58,805
Change in decommissioning estimate	(3,336)	–	(3,336)
Increase of provision	–	1,821	1,821
Provision utilised	–	(40,869)	(40,869)
Discount unwound in the year	1,035	–	1,035
At 1 January 2006	15,730	1,726	17,456
Change in decommissioning estimate	7,184	–	7,184
Increase of provision	–	9,171	9,171
Provision utilised	–	(3,409)	(3,409)
Discount unwound in the year	1,183	–	1,183
At 31 December 2006	24,097	7,488	31,585
At 31 December 2006			
Current	–	6,845	6,845
Non-current	24,097	643	24,740
	24,097	7,488	31,585
At 31 December 2005			
Current	–	–	–
Non-current	15,730	1,726	17,456
	15,730	1,726	17,456

Provisions at 31 December 2005 and 31 December 2006 are categorised as non-current liabilities.

Decommissioning costs are expected to be incurred between 2008 and 2020 (2005: 2013 and 2020). The provision has been estimated using existing technology at current prices and discounted using a real discount rate of 7% p.a. (2005: 7%). The change in decommissioning estimate in 2006 arose primarily as a result of the recognition of a decommissioning provision for the Rajasthan field. The change in decommissioning estimate in 2005 arose primarily as a result of the disposal of a 10% development interest in the Lakshmi and Gauri development areas.

Other provisions are production related payments payable to the GoI specified within the respective PSCs.

A contingent liability has been disclosed within these financial statements in respect of additional payments that may fall due with regard to the Ravva arbitration proceedings; see note 32 for details.

24 SHARE CAPITAL

Group and Company	2006 Number 10p Ordinary '000	2005 Number 10p Ordinary '000
Authorised ordinary shares		
At 1 January and 31 December	225,000	225,000

Group and Company	2006 Number £1 Ordinary Redeemable '000	2005 Number £1 Ordinary Redeemable '000
Authorised redeemable shares		
At 1 January	–	50
Cancelled in year	–	(50)
At 31 December	–	–

	2006 Number 10p Ordinary '000	2005 Number 10p Ordinary '000	2006 10p Ordinary $'000	2005 10p Ordinary $'000
Allotted, issued and fully paid ordinary shares				
At 1 January	159,767	159,008	25,775	25,635
Issued and allotted during the year for employee share options	520	759	95	140
At 31 December	160,287	159,767	25,870	25,775

25 SHARE PREMIUM

Group and Company	2006 $'000	2005 $'000
At 1 January	197,895	194,253
Arising on shares issued for employee share options	3,124	3,642
At 31 December	201,019	197,895

26 RESERVES

Group	Shares held by ESOP Trust $'000	Foreign currency translation $'000	Other reserves $'000	Capital reserves – non distributable $'000	Capital reserves – distributable $'000	Retained earnings $'000	Total $'000
At 1 January 2005	(23,624)	15,966	37,284	45,331	178,429	237,923	491,309
Share based payments	–	–	–	–	–	4,592	4,592
Cost of shares vesting	3,465	–	–	–	–	(3,465)	–
Cost of shares purchased	(17,152)	–	–	–	–	–	(17,152)
Currency translation differences	–	(23,893)	–	–	–	–	(23,893)
Profit for year	–	–	–	–	–	79,072	79,072
At 1 January 2006	(37,311)	(7,927)	37,284	45,331	178,429	318,122	533,928
Share based payments	–	–	–	–	–	13,304	13,304
Cost of shares vesting	3,214	–	–	–	–	(3,214)	–
Cost of shares purchased	(21,659)	–	–	–	–	–	(21,659)
Currency translation differences	–	10,725	–	–	–	–	10,725
Loss for year	–	–	–	–	–	(82,017)	(82,017)
At 31 December 2006	(55,756)	2,798	37,284	45,331	178,429	246,195	454,281

Shares held by ESOP Trust
Shares held by the ESOP Trust represent the cost of shares held by the Cairn Energy PLC Employees' Share Trust at 31 December 2006. The number of shares held by the Cairn Energy PLC Employees' Share Trust at 31 December 2006 was 2,293,478 (2005: 2,782,843) and the market value of these shares was £41,259,669 (2005: £53,430,586).

Foreign currency translation
Group
Unrealised foreign exchange gains and losses arising on consolidation of subsidiary undertakings are taken directly to reserves in accordance with IAS 21.

In accordance with IAS 21 'The effects of changes in foreign exchange rates', foreign exchange differences arising on intra-group loans are not eliminated on consolidation reflecting the exposure to currency fluctuations where the subsidiaries involved have differing functional currencies. These intra-group loans are not considered to be an investment in a foreign operation.

Company
Unrealised foreign exchange gains and losses arise on translation of the Company's £ functional results into $ presentational currency in accordance with IAS 21.

Other reserves
Other reserves include capital redemption reserves of subsidiary undertakings.

Capital reserves – non distributable
Capital reserves – non distributable include non distributable amounts arising on various Group acquisitions.

Capital reserves – distributable
Capital reserves – distributable include distributable amounts relating to issue of shares for prior year acquisitions and amounts arising on the cancellation of share premium held by a subsidiary which have been reduced following the buy back of shares in prior years.

Company	Shares held by ESOP Trust $'000	Foreign currency translation $'000	Capital reserves – non distributable $'000	Retained earnings $'000	Total $'000
At 1 January 2005	(23,624)	15,972	79	84,015	76,442
Share based payments	–	–	–	4,592	4,592
Cost of shares vesting	3,465	–	–	(3,465)	–
Own shares acquired in year	(17,152)	–	–	–	(17,152)
Currency translation differences	–	(24,191)	–	–	(24,191)
Loss for year	–	–	–	(11,214)	(11,214)
At 1 January 2006	(37,311)	(8,219)	79	73,928	28,477
Share based payments	–	–	–	6,739	6,739
Cost of shares vesting	3,214	–	–	(3,214)	–
Own shares acquired in year	(21,659)	–	–	–	(21,659)
Currency translation differences	–	45,400	–	–	45,400
Profit for year	–	–	–	164,870	164,870
At 31 December 2006	(55,756)	37,181	79	242,323	223,827

27 FINANCIAL RISK MANAGEMENT: OBJECTIVES AND POLICIES

Cairn Energy PLC Group and Company

The primary financial instruments comprise bank loans, cash and short and medium term deposits. The Group's strategy has been to finance its operations through a mixture of retained profits and bank borrowings. Other alternatives like equity finance and project finance are reviewed by the Board, when appropriate, to fund substantial acquisitions or oil and gas development projects.

The Group and local treasury functions are responsible for managing investment and funding requirements including banking and cash flow monitoring. They must also recognise and manage interest and foreign exchange exposure whilst ensuring that Cairn Energy PLC and Cairn Energy PLC Group has adequate liquidity at all times in order to meet its immediate cash requirements.

Cairn Energy PLC and Cairn Energy PLC Group may from time to time, opt to use derivative financial instruments to minimise its exposure to fluctuations in foreign exchange and interest rates. During the year, Cairn Energy PLC Group entered into a currency exchange option contract in order to hedge the impact of currency fluctuations resulting from transactions carried out in Indian Rupees as part of the IPO. The movement in fair value of the currency exchange contract is disclosed in note 8 to the financial statements.

The main risks arising from Cairn Energy PLC and Cairn Energy PLC Group's financial instruments are liquidity risk, interest rate risk, foreign currency risk, commodity price risk and credit risk. The Board reviews and agrees policies for managing each of these risks and these are summarised below:

Liquidity risk

Cairn Energy PLC and certain of its subsidiaries signed a $1billion hybrid unsecured syndicated revolving credit facility on 27 June 2006 principally to finance development activities in Rajasthan.

On 22 November 2006 the Group signed an Amendment Agreement to the above facility to transfer, following the IPO, $850m of the facility to Cairn India Holdings Limited Group (a 100% subsidiary of Cairn India) to fund Rajasthan developments and to cancel the remaining $150m of the facility. Immediately upon signing the Amendment the amount available to drawdown was capped at $300m ($150m corporate facility and $150m Rajasthan development).

27 FINANCIAL RISK MANAGEMENT: OBJECTIVES AND POLICIES (CONTINUED)

Liquidity risk (continued)

Following the listing of Cairn India on the Bombay Stock Exchange and National Stock Exchange of India the above Amendment Agreement become fully effective on 31 January 2007. On this date, the amount available to drawdown was capped at $75m as Cairn India Limited retained $600m from the proceeds of the IPO. The balance of the $850m facility becomes available once certain condition precedents are met regarding the development.

The facility is provided by a consortium of 10 International banks (expiry date 31 December 2011) and the International Finance Corporation (expiry date 31 December 2015). Interest is charged at floating rates determined by LIBOR plus an applicable margin. The maximum that can be drawn at any point in time is determined by reference to the net present value of the Rajasthan developments. The Group may cancel and repay the facility at any time.

In addition, as at 31 December 2006 $65m (2005: $35m) of facilities are in place to cover the issue of bank guarantees. Fixed rates of interest apply to these. $28.9m (2005: $28.7m) was unutilised at 31 December 2006.

Following the IPO the facilities for the issue of bank guarantees have been replaced with revised facilities of $55m for Cairn India and of $45m for Capricorn Energy Limited.

The Group currently has surplus cash that it has placed on short and medium term deposit, ensuring sufficient liquidity to enable the Group to meet its short/medium term expenditure requirements.

Interest rate risk

Surplus funds are placed on short/medium term deposit at floating rates. It is Cairn's policy to deposit funds with banks or other financial institutions that offer the most competitive interest rate at time of issue.

Short/medium term borrowing arrangements are available at floating rates. The treasury function may from time to time opt to manage a proportion of the interest costs on this debt by using derivative financial instruments like interest rate swaps. At this time, however, there are no such instruments (2005: none).

Foreign currency risk

Cairn manages exposures that arise from receipt of revenues in foreign currencies, by matching receipts and payments in the same currency, and actively managing the residual net position.

In order to minimise Cairn's exposure to foreign currency fluctuations, currency assets are matched with currency liabilities by borrowing or entering into foreign exchange contracts in the applicable currency if deemed appropriate. The loan facilities allow loans denominated in US dollars, sterling, Euro or such other currency as may be agreed between the lenders and Cairn from time to time.

Cairn reports in US dollars which, with most assets US dollar denominated, minimises the impact of foreign exchange movements on the Group's Balance Sheet.

During the year the Group completed an IPO of Cairn India Limited on the Bombay Stock Exchange and the National Stock Exchange of India. These transactions took place in Indian Rupees and gave rise to a foreign currency risk. This risk was mitigated by the Group entering into foreign currency options to convert Rs45bn to sterling.

Commodity price risk

There are implicit product price hedges in place through the pricing mechanisms applicable to Sangu, Lakshmi and Ravva Gas Sales Contracts (GSCs). The requirement for hedging instruments to unwind these pricing mechanisms is reviewed on an ongoing basis. These implicit product price hedges do not give rise to any embedded derivatives under IAS 39.

Ravva and CB-OS/2 oil sales are required to be made to approved government nominated buyers at floating prices.

No commodity price hedging contracts have been entered into during either the current or the previous year. There were no outstanding commodity price contracts at the start of the year or at the end of the year.

Credit risk

Cairn has obtained payment guarantees or letters of credit from buyers as payment security on both the Lakshmi and Sangu GSCs. With respect to Ravva there is no payment security, however the buyers have been nominated by the GoI.

With respect to deposit, money market and other treasury arrangements, as a general rule the Cairn Board will only approve a bank or financial institution that has a Moody's or Standard & Poor's rating for long term deposits of A and above. Banks rated A offer good credit quality.

The Board will continue to assess the Group's strategies for managing credit risks but at this time they view existing policies as satisfactory for oil and gas sales in South Asia. At the year end the Group does not have any significant concentrations of bad debt risk other than that disclosed in note 17.

The maximum credit risk exposure relating to financial assets is represented by the carrying value as at the Balance Sheet date.

28 FINANCIAL INSTRUMENTS

The Group and Company calculates the fair value of assets and liabilities by reference to amounts considered to be receivable or payable on the Balance Sheet date. The Group's financial assets and liabilities, together with their fair values are as follows:

Financial assets	Carrying amount		Fair value	
	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Cash and cash equivalents	856,266	75,509	856,266	75,509
Bank deposits	–	20,000	–	20,000
	856,266	95,509	856,266	95,509

Financial liabilities	Carrying amount		Fair value	
	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Bank loans	155,000	–	155,000	–
Finance leases	4,472	–	4,472	–
Other provisions	643	1,726	643	1,726
Decommissioning provision	24,097	15,730	24,097	15,730
Derivative financial liability	9,694	–	9,694	–
	193,906	17,456	193,906	17,456

The derivative financial liability represents the foreign exchange currency option entered into to manage the currency risk from the IPO of Cairn India Limited (see note 27) and is not hedge accounted for.

The fair value of financial assets and liabilities has been calculated by discounting the expected future cash flows at prevailing interest rates.

28 FINANCIAL INSTRUMENTS (CONTINUED)

The following table sets out the carrying amount, by maturity, of the Group's financial instruments that are exposed to interest rate risk:

At 31 December 2006	Less than one year $'000	One to two years $'000	Two to three years $'000	Three to four years $'000	Four to five years $'000	More than five years $'000	Total $'000
Floating rate							
Cash and cash equivalents	856,266	–	–	–	–	–	856,266
Bank loans	–	–	–	–	(131,750)	(23,250)	(155,000)
Finance leases	(1,775)	–	–	–	(2,697)	–	(4,472)
	854,491	–	–	–	(134,447)	(23,250)	696,794

At 31 December 2005	Less than one year $'000	One to two years $'000	Two to three years $'000	Three to four years $'000	Four to five years $'000	More than five years $'000	Total $'000
Floating rate							
Bank deposits	20,000	–	–	–	–	–	20,000
Cash and cash equivalents	75,509	–	–	–	–	–	75,509
	95,509	–	–	–	–	–	95,509

The Company's financial assets and liabilities, together with their fair values are as follows:

Financial assets	Carrying amount 2006 $'000	Carrying amount 2005 $'000	Fair value 2006 $'000	Fair value 2005 $'000
Cash and cash equivalents	19,513	33,764	19,513	33,764
	19,513	33,764	19,513	33,764

Financial liabilities	Carrying amount 2006 $'000	Carrying amount 2005 $'000	Fair value 2006 $'000	Fair value 2005 $'000
Bank loans	47,000	–	47,000	–
	47,000	–	47,000	–

The following table sets out the carrying amount, by maturity, of the Company's financial instruments that are exposed to interest rate risk:

At 31 December 2006	Less than one year $'000	One to two years $'000	Two to three years $'000	Three to four years $'000	Four to five years $'000	More than five years $'000	Total $'000
Floating rate							
Short term bank deposits	17,300	–	–	–	–	–	17,300
Cash and cash equivalents	2,213	–	–	–	–	–	2,213
Bank loans	–	–	–	–	(39,950)	(7,050)	(47,000)
	19,513	–	–	–	(39,950)	(7,050)	(27,487)

At 31 December 2005	Less than one year $'000	One to two years $'000	Two to three years $'000	Three to four years $'000	Four to five years $'000	More than five years $'000	Total $'000
Floating rate							
Short term bank deposits	31,872	–	–	–	–	–	31,872
Cash and cash equivalents	1,892	–	–	–	–	–	1,892
	33,764	–	–	–	–	–	33,764

The short term bank deposits are included within cash and cash equivalents in the Balance Sheet.

29 CAPITAL COMMITMENTS

	Group 2006 $'000	Group 2005 $'000	Company 2006 $'000	Company 2005 $'000
Oil and gas expenditure:				
Intangible exploration/appraisal assets	208,724	125,857	–	–
Property, plant & equipment – development/producing assets	44,811	61,114	–	–
Contracted for	253,535	186,971	–	–

The above capital commitments represent Cairn's share of obligations in relation to its interests in Joint Ventures. As all Cairn Joint Ventures are jointly controlled assets, these commitments also represent Cairn's share of the capital commitment of the Joint Ventures themselves.

30 PENSION COMMITMENTS

The Group and Company have no pension commitments as at the Balance Sheet date.

31 OTHER FINANCIAL COMMITMENTS

Group

Operating leases – as lessee

Group entities have entered into commercial leases for certain land and buildings and for plant, machinery and office equipment. The leases have an average life of between 1 and 6 years. There are no restrictions placed on the lessee by entering into these leases.

Total future minimum lease payments under non-cancellable operating leases are as follows:

	Minimum lease payments 2006 $'000	Minimum lease payments 2005 $'000
Land and buildings, within:		
One year	3,427	2,928
Two to five years	12,958	10,647
After five years	2,538	4,541
	18,923	18,116
Other, within:		
One year	5,970	1,938
Two to five years	21	202
	5,991	2,140

31 OTHER FINANCIAL COMMITMENTS (CONTINUED)

Included within other operating lease commitments is Cairn's share of operating leases entered into by Joint Ventures of $5,923,000 due within one year and $1,000 due between two to five years. These are also included in 'Capital Commitments' disclosed in note 29 where appropriate.

Company

Operating leases – as lessee

The Company has entered into commercial leases for certain land and buildings and for office equipment. The leases have an average life of between 1 and 6 years. There are no restrictions placed on the lessee by entering into these leases.

Total future minimum lease payments under non-cancellable operating leases are as follows:

	Minimum lease payments 2006 $'000	Minimum lease payments 2005 $'000
Land and buildings, within:		
One year	2,337	2,039
Two to five years	9,346	8,156
After five years	2,531	4,248
	14,214	14,443
Other, within:		
One year	47	–
Two to five years	20	–
	67	–

32 CONTINGENT LIABILITIES

Ravva Arbitration

The calculation of the Government of India's share of petroleum produced from the Ravva oil field has been a matter of disagreement for some years. Ravva is an unincorporated Joint Venture in which Cairn has an interest.

An arbitration panel opined in October 2004 and Cairn has been willing to be bound by the award, although it was not as favourable as had been hoped. The GoI, however, has lodged an appeal in the Malaysian courts and Cairn continues to maintain their challenge to the GoI's appeal.

Cairn has challenged both the GoI's right to appeal, and the grounds of that appeal. If the GoI were successful on both these points, it is unclear what process would then follow to resolve the original issue under dispute. Cairn will defend its right to continue to refer to the existing arbitration panel, whose composition and terms of reference were agreed by all parties at the outset. It is expected that this appeal will be heard sometime during 2007.

In the event that the GoI's appeal succeeded and a process then ensued which concluded with the arbitration award being reversed in a manner and a forum which Cairn accepted as binding, then Cairn would be due to pay an additional $63.9m.

In a separate and unrelated dispute related to the profit petroleum calculations under the Ravva PSC, the Ravva JV received a claim from the DGH for approximately $166.4m (representing $37.4m net to Cairn) for an alleged underpayment of profit petroleum to the Indian Government, together with interest on that amount through to 30 June 2006 of $30.6m (representing $6.9m net to Cairn).

This claim relates to the Indian Government's allegation that the Ravva JV has recovered costs in excess of the Base Development Costs ('BDC') cap imposed in the PSC and that the Ravva JV has also allowed these excess costs in the calculation of the PTRR. Cairn believes that such a claim is unsustainable under the terms of the PSC because, amongst other reasons, the BDC cap only applies to the initial development of the Ravva field and not to subsequent development activities under the PSC. Additionally the Ravva JV has also contested the basis of the calculation in the above claim from the DGH. Even if upheld, Cairn believes that the DGH has miscalculated the sums that would be due to the Indian Government in such circumstances.

Guarantees

It is normal practice for the Group to issue guarantees in respect of obligations during the normal course of business.

The Group had provided the following guarantees at 31 December 2006:

- Issued under the Group's bank facilities, see note 27:
  - various guarantees for the Group's share of minimum work programme commitments for the current year of $16.1m,
  - a $20m guarantee to the National Stock Exchange of India in respect of the IPO of Cairn India Limited.
- Parent company guarantees for the Group's obligations under PSC, sales and other contracts.

33 RELATED PARTY TRANSACTIONS

a) Group reorganisations

Capitalisation of loan with Cairn Energy Bangladesh Limited and capital reduction

On 24 March 2006, the Company received equity from Cairn Energy Bangladesh Limited ('CEBL') in settlement of an inter-company loan of $70m. On 28 April 2006, a further $63.6m of share capital was injected into CEBL by Cairn Energy PLC. On 21 June 2006, CEBL received court approval for a capital reduction where $408m was returned to Cairn Energy PLC, reducing investments by $166m and creating a dividend in specie of $242m. The $408m was settled by way of transfer of the share capital of the following subsidiaries:

- Cairn Petroleum India Limited
- Cairn Energy Discovery Limited
- Cairn Energy Search Limited
- Cairn Energy Hydrocarbons Limited
- Cairn Energy Holdings Limited
- Cairn Exploration and Production Company Limited

Loan capitalisation and share exchange agreement with Capricorn Energy Limited for investments in subsidiaries

On 24 April 2006, Cairn Energy PLC incorporated a new subsidiary, Capricorn Energy Limited ('Capricorn'), which was initially incorporated as Cairn Resources Limited and changed its name on 4 September 2006.

On 30 June 2006, Cairn Energy Nepal Holdings Limited, a subsidiary of the company, issued 2,039,011 ordinary £1 shares at par in settlement of a loan balance.

On 30 June 2006, the company received 8,610,481 ordinary £1 shares from Capricorn in a share for share exchange for the entire issued share capital of the following companies:

- Cairn Energy Bangladesh Limited
- Cairn Energy Exploration Bangladesh Limited
- Cairn Energy Sangu Field Limited
- Cairn Energy Nepal Holdings Limited
- Cairn Energy Management Limited
- Cairn Oil Limited
- Cairn Energy North Sea Limited
- Cairn Resources Management Limited
- Energy Explorer Limited
- Cairn Energy Assets Limited

Share exchange agreement with Cairn UK Holdings Limited for investments in subsidiaries

On 26 June 2006, the company incorporated a new subsidiary, Cairn UK Holdings Limited. On 30 June 2006 the Company received 221,444,034 ordinary £1 shares at par from Cairn UK Holdings Limited in a share for share exchange for the entire issued share capital of the following companies:

- Cairn Petroleum India Limited
- Cairn Energy Discovery Limited
- Cairn Energy Gujarat Block 1 Limited
- Cairn Energy Hydrocarbons Limited
- Cairn Energy Holdings Limited
- Cairn Exploration (No. 7) Limited
- Cairn Exploration (No. 6) Limited
- Cairn Exploration (No. 4) Limited
- Cairn Exploration (No. 2) Limited

33 RELATED PARTY TRANSACTIONS (CONTINUED)

a) Group reorganisations (continued)

Increase in investments in subsidiaries and debt conversion

On 1 September 2006 Cairn UK Holdings Limited issued 29,780,710 £1 ordinary shares at par to Cairn Energy PLC pursuant to a debt conversion agreement between Cairn Energy PLC, Cairn UK Holdings Limited, Cairn India Holdings Limited and Cairn Energy Hydrocarbons Limited (a subsidiary of Cairn India Holdings at this time).

In summary, this agreement provided that $56.8m due to Cairn Energy PLC from Cairn Energy Hydrocarbons Limited was assigned to Cairn UK Holdings in exchange for an issue of shares. Cairn UK Holdings then assigned the debt to Cairn India Holdings in exchange for 29,780,710 £1 ordinary shares in Cairn India Holdings.

Further loan capitalisations and capital contributions

Following the restructuring of the group, Cairn Energy PLC made the following additional investments in subsidiaries:

- $10.0m in Capricorn Energy Limited following the capitalisation of a loan balance;
- $0.5m in Cairn UK Holdings Limited following the capitalisation of a loan balance; and
- $0.6m in Cairn Energy Holdings Limited following a capital contribution.

The Company's principal subsidiaries are listed in note 15. The following table provides the balances which are outstanding with subsidiary companies at the Balance Sheet date:

	2006 $'000	2005 $'000
Amounts owed from subsidiary undertakings	71,782	218,186
Amounts owed to subsidiary undertakings	(90,403)	(26,705)
	(18,621)	191,481

The amounts outstanding are unsecured, repayable on demand and will be settled in cash. Interest, where charged, is at market rates. No guarantees have been given.

The following table provides the transactions with subsidiary companies recorded in the loss for the year, all of which were carried out on an arms length basis:

	2006 $'000	2005 $'000
Amounts invoiced	43,546	23,645
Management fees	4,574	6,717
Waiver of intercompany loan balances	(11,258)	–
Intercompany interest receivable	923	1,436
Intercompany interest payable	925	485

b) Remuneration of key management personnel

The remuneration of directors, who are the key management personnel of the Group, is set out below in aggregate. Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on pages 56 to 67.

Group and Company	2006 $'000	2005 $'000
Short-term employee benefits	7,664	5,035
Pension contributions	413	371
Share based payments	1,555	1,018
	9,632	6,424

c) Other transactions

During the year the Group made purchases of $356,000 (2005: $249,000) in the ordinary course of business from an entity under common control. The amount owed by the party at the year end was $nil (2005: $nil).

34 EVENTS AFTER THE BALANCE SHEET DATE

Cairn India listed on the Bombay Stock Exchange and National Stock Exchange of India on 9 January 2007 with a partial Initial Public Offering of 538.5m shares of 10 Rupees each, including 209.7m by way of pre IPO placing. A further 13.1m shares were issued during the subsequent stabilisation period. Cairn Energy PLC's indirect percentage holding in Cairn India Limited reduced as a result from 100% to 69.0%. A gain to the Group of approximately $1.1bn arose as a result of the partial disposal of Cairn India and will be included in the results for 2007.

A proposed dividend of £481,000,000 (300p per share) (2005: nil) was announced on 27 February 2007 and was approved at an Extraordinary General Meeting of Cairn Energy PLC held on 22 March 2007. This dividend will be paid by means of a B Share structure with the new B shares being created on 26 March 2007. The B Shares will not be listed on the Official List or admitted to trading on the London Stock Exchange. The proposed dividend is not included as a liability in these Accounts. There are no income tax consequences arising from this proposal for the Cairn Group of companies.

RESERVES

Group proved plus probable oil reserves	Direct working interest basis mbbls	Direct entitlement basis mbbls
At 1 January 2006	216,654	199,219
Revisions of previous estimates	(4,881)	(17,204)
Production	(4,595)	(2,397)
At 31 December 2006	207,178	179,618

Group proved plus probable gas reserves	mmscf	mmscf
At 1 January 2006	354,321	232,095
Addition of reserves in place	693	649
Revisions of previous estimates	(157,003)	(95,172)
Production	(57,887)	(39,321)
At 31 December 2006	140,124	98,251

Group proved plus probable oil and gas reserves	mboe	mboe
At 31 December 2006	230,532	195,993
At 31 December 2005	275,708	237,902

Reserves by geographical segment at 31 December 2006 are as follows:	mboe	mboe
India	216,017	185,704
Bangladesh & Nepal	14,515	10,289
At 31 December 2006	230,532	195,993

Reserves by geographical segment at 31 December 2005 are as follows:	mboe	mboe
India	228,354	208,358
Bangladesh & Nepal	47,354	29,544
At 31 December 2005	275,708	237,902

Production by geographical segment in the year was as follows:	mboe	mboe
India	8,150	5,326
Bangladesh & Nepal	6,093	3,625
	14,243	8,951

For the purposes of this table, 6 mscf of gas has been converted to 1 boe.

In India and Bangladesh absolute title to any hydrocarbon reserves is vested in the host government. However, under the terms of the PSCs, Cairn is entitled to receive a share of the hydrocarbon production and associated revenues.

Group reserves have therefore been presented both on a direct entitlement basis and a direct working interest basis. The direct entitlement basis takes into account projections of government share of production calculated in accordance with certain price and expenditure assumptions. Entitlement interest reserves are utilised for unit of production basis calculations in the financial statements.

Direct working interest basis is Cairn's share of production calculated by reference to our JV participating interest as shown in the Principal Licence Interests on page 70.

For details of the booking of new reserves and the revision to existing reserves during the year, see the Operating and Financial Review on page 21.

Group reserves on an entitlement interest basis are calculated on the Group's long term oil price assumption of $30/bbl (2005: $20/bbl). If the Group's long term oil price assumption was $40/bbl, the addition of reserves in place in the year would be 107 mbbls and the Group's total entitlement reserves at 31 December 2006 would be 180,686 mboe.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Cairn Energy PLC will be held in the Wallace Suite at the Sheraton Grand Hotel, 1 Festival Square, Edinburgh EH3 9SR on Thursday 17 May 2007 at 12 noon for the following purposes:

As Routine Business

To consider and, if thought fit, pass the following resolutions, of which resolutions 1 to 9 will be proposed as ordinary resolutions:

1 That the report and accounts for the year ended 31 December 2006 be received.

2 That the Directors' Remuneration Report contained in the report and accounts be approved.

3 That Ernst & Young LLP be re-appointed as auditors and that the directors be authorised to fix their remuneration.

4 That Jann Brown, who retires at the first Annual General Meeting following her appointment, be elected as a director.

5 That Simon Thomson, who retires at the first Annual General Meeting following his appointment, be elected as a director.

6 That Malcolm Thoms, who retires by rotation, be re-elected as a director.

7 That Mark Tyndall, who retires by rotation, be re-elected as a director. Mr Tyndall is a member of the remuneration committee.

8 That Hamish Grossart, who retires pursuant to the provisions of the Combined Code, be re-elected as a director. Mr Grossart is a member of the audit, remuneration and nomination committees.

9 That Ed Story, who retires pursuant to the provisions of the Combined Code, be re-elected as a director. Mr Story is a member of the audit, remuneration and nomination committees.

As Special Business

To consider and, if thought fit, pass the following resolutions, of which resolution 10 will be proposed as an ordinary resolution and resolutions 11, 12, 13 and 14 will be proposed as special resolutions:

10 That, in substitution for any existing authority pursuant to section 80 of the Companies Act 1985 (as amended) (the 'Act') and in accordance with section 80 of the Act (and so that expressions used in this resolution shall bear the same meanings as in that section), but without prejudice to the exercise of any such authority prior to the date hereof, the directors of the Company be and are hereby generally and unconditionally authorised to allot relevant securities of the Company up to an aggregate nominal amount of £2,674,197.85, provided that this authority shall expire on 16 May 2012 (unless previously revoked, varied or extended by the Company in general meeting), but shall allow and enable the directors of the Company to make offers or agreements in relation to relevant securities before the expiry of this authority which would or might require relevant securities to be allotted in pursuance of such offers or agreements after the expiry of such period and to make allotments pursuant to such offers or agreements notwithstanding that such period has expired.

11 That, in substitution for any existing power under section 95 of the Companies Act 1985 (as amended) (the 'Act'), but without prejudice to the exercise of any such power prior to the date hereof, the directors of the Company be and they are hereby empowered, pursuant to section 95(1) of the Act, to:

(a) allot equity securities (as defined in section 94(2) of the Act) for cash pursuant to the authority referred to in resolution 10 set out in the Notice convening the Annual General Meeting of the Company on 17 May 2007 as if section 89(1) of the Act did not apply to any such allotment; and

(b) sell relevant shares (as defined in section 94(5) of the Act) in the Company if, immediately before the sale, such shares are held by the Company as treasury shares (as defined in section 162A(3) of the Act) ('treasury shares') for cash (as defined in section 162D(2) of the Act), as if section 89(1) of the Act did not apply to any such sale,

up to an aggregate nominal amount of £2,674,197.85, such power to expire on 16 May 2012, unless previously revoked, varied or extended by the Company in general meeting, provided that such power shall be limited to the allotment of equity securities and the sale of treasury shares:

(i) in connection with an offer of equity securities open for acceptance for a period fixed by the directors of the Company to the holders of ordinary shares in the share capital of the Company on a fixed record date in proportion (as nearly as practicable) to their respective holdings of such ordinary shares (but subject to such exclusions or other arrangements as the directors of the Company may consider necessary or expedient to deal with legal problems under or resulting from the application or apparent application of the laws of any territory or the requirements of any regulatory body or any stock exchange in any territory or in connection with fractional entitlements or otherwise howsoever); and

(ii) other than pursuant to sub-paragraph (i) of this resolution, up to an aggregate nominal amount of £401,169.80; save that the Company may, at any time prior to the expiry of such power, make an offer or enter into an agreement that would or might require equity securities to be allotted or treasury shares to be sold after the expiry of such power and the directors of the Company may allot equity securities or sell treasury shares in pursuance of such an offer or agreement as if such power had not expired.

12 That, in substitution for any existing authority pursuant to section 166 of the Companies Act 1985 (as amended) (the 'Act'), the Company be and is hereby generally authorised to make market purchases (within the meaning of section 163(3) of the Act) pursuant to and in accordance with section 166 of the Act of fully paid ordinary shares of 6 2/13 pence each in the capital of the Company (the 'ordinary shares' and each an 'ordinary share') upon and subject to the following conditions but otherwise unconditionally:

(a) the maximum number of ordinary shares hereby authorised to be purchased is 19,543,989 ordinary shares in the capital of the Company (representing 14.99% of the Company's issued ordinary share capital as at 27 March 2007);

(b) the minimum price (exclusive of expenses) that may be paid for an ordinary share shall not be less than the nominal value of the ordinary shares at the time of purchase;

(c) the maximum price (exclusive of expenses) that may be paid for each such ordinary share is, in respect of an ordinary share contracted to be purchased on any day, the higher of (a) an amount (exclusive of expenses) equal to 105% of the average of the mid-market quotations for an ordinary share of the Company and derived from the Daily Official List of the London Stock Exchange for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased; and (b) an amount equal to the higher of the price of the last independent trade of an ordinary share and the highest current independent bid for an ordinary share as derived from the London Stock Exchange Trading System (SETS); and

(d) unless previously varied, revoked or renewed, the authority conferred by this resolution shall expire on the earlier of 16 November 2008 or at the conclusion of the next Annual General Meeting of the Company after the date on which this resolution is passed, provided that the Company may before such expiry enter into a contract to purchase ordinary shares under this authority which will or may be completed or executed wholly or partly after the expiration of such authority and may make a purchase of ordinary shares in pursuance of such contract.

13 THAT the terms of the proposed contract between: (1) all holders of deferred shares of 5 pence each in the capital of the Company (the 'Deferred Shares'), which will be executed by Duncan Alexander Wood on behalf of such holders pursuant to Article 7B of the Articles of Association of the Company; and (2) the Company, under which the Company will purchase all of its Deferred Shares (a draft of which is produced to the meeting and signed for the purposes of identification by the Chairman) be and are hereby approved and authorised for the purposes of section 164 of the Companies Act 1985 (as amended) and otherwise but so that such approval and authority shall expire on 16 November 2008.

14 THAT Article 128 of the Articles of Association of the Company, being the Article relating to the borrowing powers of the Company, be altered by deleting the existing Article 128 and adopting in substitution therefor the new Article 128 set out in the printed copy marked 'A' produced to the Annual General Meeting and initialled by the Chairman for the purposes of identification.

By order of the Board
Duncan Wood
Company Secretary
50 Lothian Road
Edinburgh EH3 9BY

17 April 2007

Notes:

1 A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote instead of him or her. A proxy need not be a member of the Company. A Form of Proxy accompanies this Annual Report and must be lodged with the Company at the office of its registrars, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6ZR (the 'Registrars') or received via the Sharevote service (see note 2 below) (a) not less than 48 hours before the time appointed for the meeting or any adjournment(s) thereof, or (b) lodged using the CREST proxy voting service (see note 5 below). Only holders of ordinary shares are entitled to attend (in person or by proxy) and vote at the meeting. The appointment of a proxy will not preclude a member entitled to attend and vote at the meeting from doing so if he or she wishes.

2 Members may register their proxy appointments or voting directions electronically via the www.sharevote.co.uk website, where full details of the procedure are given. Members will need the Reference Number, Card ID and Account Number set out on the Form of Proxy which accompanies this Annual Report. If more than one proxy appointment per member is returned, either by paper or by electronic communication, those received last by the Registrars before the latest time for the receipt of proxies will take precedence. Members are advised to read the terms and conditions of use carefully. Electronic communication facilities are available to all shareholders and those who use them will not be disadvantaged. The Company will not accept any communication that is found to contain a computer virus.

3 There will be available for inspection at the registered office of the Company during normal business hours on any weekday (excluding public holidays) from the date of this notice until the date of the meeting and at the place of the meeting for at least 15 minutes prior to the meeting and during the meeting, copies of the following documents:
(a) the register of directors' interests in ordinary shares of the Company;
(b) the executive directors' service contracts and non-executive directors' letters of appointment;
(c) the Company's memorandum of association, articles of association and proposed new article 128 referred to in resolution 14 of this notice; and
(d) the draft contract between the Company and all holders of deferred shares of 5 pence each in the capital of the Company, as referred to in resolution 13 of this notice.

4 The Company, pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, hereby specifies that only those shareholders registered on the register of members of the Company as at 6.00 pm on 15 May 2007 shall be entitled to attend or vote at the meeting in respect of shares registered in their name at that time. Changes to entries on the register of members after 6.00 pm on 15 May 2007 shall be disregarded in determining the rights of any person to attend or vote at the meeting, notwithstanding any provisions in any enactment, the articles of association of the Company or other instrument to the contrary.

5 CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so for the Annual General Meeting meeting to be held on 17 May 2007 and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with CRESTCo's specifications and must contain the information required for such instructions, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID 7RA01) by the latest time(s) for receipt of proxy appointments specified in the notice of meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

CREST members and, where applicable, their CREST sponsors or voting service providers should note that CRESTCo does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting service providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

6. This Notice of Annual General Meeting should be read in conjunction with the sections of the Annual Report entitled 'Board of Directors' on pages 34 and 35 and 'Directors' Report' on pages 52 to 55.

GLOSSARY

The following are the main terms and abbreviations used in this announcement:

CORPORATE

AGM	Annual General Meeting
Artemis	Artemis Investment Management Limited
Board	the Board of Directors of Cairn Energy PLC
BSE	Bombay Stock Exchange
Cairn / Cairn Energy	Cairn Energy PLC and/or its subsidiaries as appropriate
Cairn India / CIL / Cairn India Group	Cairn India Limited and/or its subsidiaries as appropriate
Capricorn Energy / Capricorn Group	Capricorn Energy Limited and/or its subsidiaries as appropriate
CEBL	Cairn Energy Bangladesh Limited
Combined Code	The Combined Code appended to the Listing Rules
Companies Act/ the act	The Companies Act 1985 (as amended) and/or the Companies Bill 2006 (as amended), as appropriate
Company	Cairn Energy PLC
D&M	DeGolyer and McNaughton
DGH	Director General of Hydrocarbons
EU	European Union
FDP	field development plan
FSA	Financial Services Authority
GAIL	Gas Authority of India Limited
GMB	Group Management Board
GoI	Government of India
GPEC	Gujarat Powergen Energy Company Limited
Group	the Company and its subsidiaries
GSC	gas sales contract
GTCL	Gujarat Gas Trading Company Limited
IFC	International Finance Corporation
IPO	initial public offering of shares in Cairn India Limited
JV	joint venture
KPI	key performance indicator
Listing Rules	The Listing Rules of the United Kingdom Listing Authority
LTIP	Long Term Incentive Plan
NELP	New Exploration Licensing Policy
NELP V	fifth New Exploration Licensing Policy round
NELP VI	sixth New Exploration Licensing Policy round
NSE	National Stock Exchange of India Limited
OIDA	Indian Oil Industry (Development) Act 1974
ONGC	Oil and Natural Gas Corporation Ltd
PETRONAS	Petroliam Nasional Berhad
PIRC	Pensions Investment Research Consultants Limited
PSC	Production Sharing Contract
RMC	Risk Management Committee
RREV	Research Recommendations and Electronic Voting
SEBI	Securities and Exchange Board of India
TSR	total shareholder return

TECHNICAL

2P	proven plus probable
3P	proven plus probable and possible
2D/3D	two dimensional/three dimensional
boe	barrel(s) of oil equivalent
boepd	barrel(s) of oil equivalent per day
bopd	barrel(s) of oil per day
bscf	billion standard cubic feet of gas
EOR	enhanced oil recovery
mmboe	million barrel(s) of oil equivalent
mmscfd	million standard cubic feet of gas per day
PSC	production sharing contract

ACCOUNTING

bn	billion
BDC	Base Development Costs
CIESOP	Cairn India Employee Stock Option Plan (2006)
CIPOP	Cairn India Performance Option Plan (2006)
ESOP	Employee Share Ownership Plan
IAS 36	International Accounting Standard 36 'Impairment of Assets'
IFRS	International Financial Reporting Standards
IFRS 2	International Financial Reporting Standard 2 'Share-based Payment'
LIBOR	London Inter-Bank Offered Rate
m	million
$	United States dollars
WAEP	weighted average exercise price
WAGP	weighted average grant price

CORPORATE RESPONSIBILITY

BRMG	Business Risk Management Guidelines
CR	Corporate Responsibility
CRE	Corporate Responsibility Exchange
CSR	Corporate Social Responsibility
EC	Enterprise Centre
EITI	Extractive Industries Transparency Initiative
ERM	Environmental Resource Management
ESG	Energy Environmental, Social and Governance
ESIA	Environmental and social impact assessment
GHG	Greenhouse gas
Guiding Principle	Group CR Guiding Principles
HSE	Health, safety and environment
ISO 14001	International Standard for Environmental Management Systems
LTI	lost time injury
NGO	non governmental organisation
PCDP	Public Consultation and Disclosure Plan
STOP	DuPont Safety Training Observation Programme

COMPANY INFORMATION

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London EC2M 4AA

N M Rothschild & Sons Limited
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20 Castle Terrace
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London SE1 2AF

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250 Bishopsgate
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Merrill Lynch International
2 King Edward Street
London EC1A 1HQ

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Lloyds TSB Registrars
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www.shareview.co.uk

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Edinburgh EH2 1AF

International Finance Corporation (IFC)
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Washington DC 20433
United States of America

Citigroup
33 Canada Square
Canary Wharf
London E14 5LB

Note:
Cairn India has an $850m syndicated revolving credit facility with 11 international banks, including IFC.

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