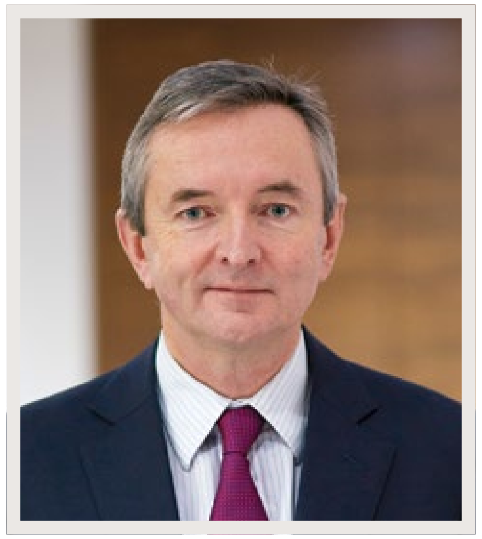

SIMON THOMPSON CHAIRMAN

BALANCING RISK & REWARD IN A CHALLENGING MARKET

2014 was a challenging year for the oil industry and for Tullow, which was reflected in our financial and share price performance.

DEAR SHAREHOLDER

For some years, cost pressures have been building across the industry, which have depressed returns on new projects, despite high oil prices. The industry as a whole, including Tullow, has also experienced low levels of commercial exploration success. Over the past three-to-four years, oil production from unconventional oil shale projects in the USA has experienced major growth. This has come at a time when demand from the developed world has been subdued and demand growth from China and the other major emerging economies has slowed. The growing imbalance between supply and demand was brought to a head at the OPEC meeting in November 2014 when low-cost producers, including Saudi Arabia, signalled that they were no longer prepared to cede market share to accommodate rising production from the USA. As a result of these pressures, the oil price collapsed from a peak of $115/bbl in mid-2014 to $53/bbl at the end of the year. The combination of high costs and falling prices means that the whole industry faces a significant margin squeeze until operating and capital costs can be reduced to more sustainable levels, a process that is already under way.

Responding to change

Throughout the year, Tullow responded to the changing landscape. At the beginning of 2014, we took the decision to reduce our future expenditure on complex deepwater exploration until the costs of exploration and development reduced sufficiently to render the risk/reward ratio attractive once again. When the oil price started to fall in mid-2014, we moved even more decisively to reduce our overall exploration budget from $0.8 billion in 2014 to approximately $0.2 billion in 2015, in order to conserve cash and refocus our exploration programme on lower-cost onshore and low complexity offshore exploration and appraisal that have the potential to yield early production and cash flows.

Prioritising shareholders' interests

A core part of our strategy over the past few years has been to monetise our exploration success by selling part of our equity interest to fund the development of new projects. As industry conditions deteriorated, and competition for assets reduced, it became clear that this part of our strategy was no longer in the best interests of our shareholders. We therefore decided to retain our full stake in the TEN Project in Ghana. We took steps to strengthen and diversify our balance sheet by issuing a second bond in early 2014. We also reallocated our capex to projects, such as TEN, that will generate new production and cash flow in the short-to-medium term, and protected part of the downside risk on our existing producing assets by hedging some 60% of our 2015 entitlement oil sales with an average floor price of around $86/bbl.

"Our focus is on maximising cash flow from our existing producing assets and advancing our world-class portfolio of development assets in Ghana, Kenya & Uganda."

Prudent financial management

Despite these steps, 2014 was still a difficult year. Production was down on the prior year at 75,200 boepd, primarily due to European gas asset sales, field performances and lower Gabon production because of licence disputes. As a result, revenues dropped from $2.6 billion in 2013 to $2.2 billion in 2014. The Board has carefully reviewed the exploration assets held on the balance sheet, writing off a total of $1.7 billion exploration costs. This write-off includes a number of past activities predominately associated with offshore drilling in French Guiana and Mauritania, and while these assets have been written-down to zero, they remain in our portfolio and in due course could have value for your Company. A further assessment of the likely date of receipt for certain Uganda project approvals was carried out at the end of the year. With FID now expected towards the end of 2016, a charge of $0.4 billion has been recognised in the income statement for the year as we no longer expect to receive the contingent consideration due from the Partners.

In common with other oil companies, we also impaired the carrying value of our producing assets as a result of lower oil price assumptions and higher decommissioning costs. The effect of the write-offs and impairment charges was to reduce net income after tax from $0.2 billion in 2013 to a loss of $1.6 billion in 2014. In view of the fall in the oil price, the Board is recommending that no final dividend be paid this year, bringing the total payment for the year to 4 pence per share. At a time when Tullow is focusing on capital allocation, financial flexibility and cost reductions, the Board believes that Tullow and its shareholders are better served by investing these funds into the business.

Creating in-country value

Despite the turbulent market conditions, we have not lost focus on our objective of creating long-term value in the countries where we operate. We continue to invest in building capacity and expertise to improve our community engagement and social performance, and our leadership position on transparency of payments to governments has been widely recognised. We have also reinforced our commitment to the safety of our workforce and the protection of the environment, and our zero tolerance approach to bribery and corruption.

An exceptional team of people

In these unsettled times we are more than ever reliant upon the talents, enthusiasm and commitment of our people. I have been impressed by the way in which the whole organisation, led by Aidan Heavey and the other members of the Executive team, has moved quickly to refocus and streamline the business to deliver our revised strategy. During the year we also welcomed Mike Daly to the Board, who brings directly relevant experience of the oil industry and has already made a valuable contribution to our debates.

Ready for a revival

The oil industry is cyclical. As majors and independents alike cut back or defer capital investment in new production in response to lower prices, the industry is already creating the conditions for a revival of the oil price. In the Chief Executive's Review, Aidan Heavey sets out the future strategy and prospects for Tullow, which the Board fully endorses. I am confident that we will emerge from the current downturn with a leaner, more cost-conscious organisation. Our operating and development capabilities will be enhanced and our entrepreneurial and exploration expertise will remain. We will be both willing and able to respond to the opportunities that the market will undoubtedly present. But in the meantime, our focus is on maximising cash flow from our existing producing assets and advancing our world-class portfolio of development assets in Ghana, Kenya and Uganda.

S.R. Thompson

Simon R Thompson
Chairman

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