CANARGO ENERGY CORP
Form 10-K
March 16, 2005

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

þ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004**

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 0-9147

CANARGO ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**91-0881481**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

P.O. Box 291, St Peter Port, Guernsey, British Isles GY1 3RR
(Address of Principal Executive Offices)

Registrant s telephone number, including area code: **(44) 1481 729 980**

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $0.10 per share	American Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated herein by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: Common Stock, $0.10 par value, 197,766,338 shares outstanding as of 14 March, 2005.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
YES þ NO o

The aggregate market value of the Registrant s common stock held by non-affiliates was approximately $334.6 million as of 11 March 2005, based upon the last reported sales price of such stock on the American Stock Exchange on that date. For this purpose, the Registrant considers Dr. David Robson, Vincent McDonnell, Michael Ayre, Russ Hammond and Nils Trulsvik to be its only affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive Proxy Statement to be issued in connection with its 2005 Annual Meeting of Shareholders are incorporated by reference in Part III of this Report. Other documents incorporated by reference in this Report are listed in the Exhibit Index.

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PART I

Qualifying Statement With Respect To Forward-Looking Information

The United States Private Securities Litigation Reform Act of 1995 provides a safe harbour for certain forward-looking statements. Such forward-looking statements are based upon the current expectations of CanArgo Energy Corporation (CanArgo or the Company) and speak only as of the date made. These forward-looking statements involve risks, uncertainties and other factors. The factors discussed in Item 1. Business Risks Associated with CanArgo s Oil and Gas Activities , Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Annual Report on Form 10-K are among those factors that in some cases have affected CanArgo s historic results and could cause actual results in the future to differ significantly from the results anticipated in forward-looking statements made in this Annual Report on Form 10-K, future filings by CanArgo with the Securities and Exchange Commission, in CanArgo s press releases and in oral statements made by authorized officers of CanArgo. When used in this Annual Report on Form 10-K, the words estimate, project, anticipate, expect, intend, believe, hope, may and similar expressions, as well as will, shall and other in future tense, are intended to identify forward-looking statements.

In this Annual Report, CanArgo or the company , we , us and our refer to CanArgo Energy Corporation and, unle otherwise indicated by the context**,** our consolidated subsidiaries.

GLOSSARY OF CERTAIN TERMS

The definitions set forth below shall apply to the indicated terms as used in this Form 10-K. All volumes of natural gas referred to herein are stated at the legal pressure base of the state or area where the reserves exist and at 60 degrees Fahrenheit and in most instances are rounded to the nearest major multiple.

AMEX The American Stock Exchange, Inc.

bbl One stock tank barrel, or 42 U.S. gallons liquid volume, used herein in reference to crude oil or other liquid hydrocarbons.

boe Barrel of oil equivalent, determined by using the ratio of one Bbl of oil or natural gas liquids to six Mcf of gas.

bopd Barrels of oil produced per day.

Brent means pricing point for selling North Sea crude oil.

Development drilling The drilling of a well within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

Exploration prospects or locations A location where a well is drilled to find and produce natural gas or oil reserves not classified as proved, to find a new reservoir in a field previously found to be productive of oil or gas in another reservoir or to extend a known reservoir.

Finding and development costs Costs associated with acquiring and developing proved natural gas and oil reserves which are capitalized pursuant to generally accepted accounting principles, including any capitalized general and administrative expenses.

Farm-in or farm-out An agreement under which the owner of a working interest in an oil and gas lease assigns the working interest or a portion thereof to another party who desires to drill on the leased acreage. Generally, the assignee is required to drill one or more wells in order to earn its interest in the acreage. The assignor usually retains a royalty or reversionary interest in the lease. The interest received by an assignee is a farm-in while the interest transferred by the assignor is a farm-out.

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Gross acreage or gross wells The total acres or wells, as the case may be, in which a working interest is owned.

Km means kilometer.

Mcf One thousand cubic feet of natural gas.

mD A milli Darcies.

MMbbl One million barrels.

MMboe Million barrels of oil equivalent.

Net acres or net wells The sum of the fractional working interests owned in gross acres or gross wells.

Producing property A natural gas and oil property with existing production.

Proved developed reserves Proved reserves that can be expected to be recovered from existing wells with existing equipment and operating methods.

Proved reserves The estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions.

Proved undeveloped reserves Proved reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage shall be limited to those drilling units that offset productive units and that are reasonably certain of production when drilled.

Recomplete This term refers to the technique of drilling a separate well bore from all existing casing in order to reach the same reservoir, or redrilling the same well-bore to reach a new reservoir after production from the original reservoir has been abandoned.

SEC means United States Securities and Exchange Commission.

Undeveloped acreage Lease acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of natural gas and oil regardless of whether such acreage contains proved reserves.

Working interest An operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and to receive a share of production.

Workovers Operations on a producing well to restore or increase production.

ITEM 1. BUSINESS

General Development of Business

We operate as an oil and gas exploration and production company and as a holding company carry out our activities through a number of subsidiaries and associated companies. These companies are generally focused on one of our projects, and this structure assists in maintaining separate cost centers for these different projects.

The address and telephone number of the principal and administrative offices of CanArgo is P.O. Box 291, St Peter Port, Guernsey, British Isles GY1 3RR (Tel. No. (44) 1481 729 980).

We file reports with the Securities and Exchange Commission (the Commission). The public may read and copy any materials that we file with the Commission at the Commission s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. We make available free of charge our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act on our internet website at www.canargo.com as soon as reasonably practicable after we electronically file or furnish such material with or to the Commission.

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Our principal activities are oil and gas exploration, development and production, principally in the Republic of Georgia, and to a lesser extent through our minority ownership interest in non-consolidated investees in Kazakhstan. During 2004, we disposed of our oil and gas interests in Ukraine. Also, in 2004, we disposed of our petroleum product marketing and refining activities in Georgia. To date, we continue to direct most of our efforts and resources to the development of our Georgian exploration program, the development of the Ninotsminda Field in Georgia and in the development of the Samgori Field in Georgia (in which we acquired an interest in April 2004).

Exploration, Development and Production Activities

In Georgia our exploration, development and production activities are carried out under five production sharing contracts and agreements (collectively, PSC), these being:

1. The Ninotsminda, Manavi and West Rustavi Production Sharing Contract, covering Block XI^{E}, (Ninotsminda PSC), in which Ninotsminda Oil Company Limited owns a 100% interest. Ninotsminda Oil Company Limited is a wholly owned subsidiary of CanArgo. This PSC covers an area of approximately 27,739 acres (113 km^2);

2. The Nazvrevi and Block XIII Production Sharing Contract (Nazvrevi PSC), covering Blocks XI^{D} and XIII, in which CanArgo (Nazvrevi) Limited owns a 100% interest. CanArgo (Nazvrevi) Limited is a wholly owned subsidiary of CanArgo. This PSC covers an area of approximately acres 388,450 acres (1,572 km^2);

3. The Norio (Block XI^{C}) and North Kumisi Production Sharing Agreement (Norio PSA) in which CanArgo Norio Limited currently owns a 100% interest, although this interest will be reduced to 85% following completion of a farm-in by the state oil company, Georgian Oil, to the MK72 well, and potentially to 50% if Georgian Oil exercises its option under that farm-in agreement. CanArgo Norio Limited is now 100% owned by CanArgo following the buy out of minority interests in 2004. This PSA covers an area of approximately 378,523 acres (1,542 km^2); and

4. The Block XI^{G} and XI^{H} Production Sharing Contract (Tbilisi PSC), in which CanArgo Norio Limited owns a 100% interest. CanArgo Norio Limited is now 100% owned by CanArgo following the buy out of minority interests in 2004. This PSC covers an area of approximately 119,843 acres (485 km^2).

5. The Samgori, Block XI^{B} Production Sharing Contract (Samgori PSC), in which CanArgo Samgori Limited owns a 50% interest. CanArgo Samgori Limited is a wholly owned subsidiary of CanArgo. This PSC covers an area of approximately 169,514 acres (634 km^2).

Under production sharing contracts and agreements, the contractor party (generally a foreign investor) assumes the risk and provides investment into the project (in the above mentioned contracts, CanArgo through its appropriate subsidiary is a contractor party) and in return is entitled to a share of any petroleum produced which is split into a cost recovery and profit share element. The remaining profit petroleum produced from the project is delivered to the State from which the State will assume, pay and discharge, in the name and on behalf of each contractor party, the contractor party s profit tax liability and all other host States taxes, levies and duties. PSCs are a common form of oil and gas exploration and production contract in many parts of the world.

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Ninotsminda and Samgori Fields

Since completion of the business combination with CanArgo Oil & Gas Inc., our resources have, through our wholly owned subsidiary Ninotsminda Oil Company Limited, been focused on the development of the Ninotsminda Field and related exploration activities. The Ninotsminda Field covers approximately 3,276 acres (13.26 km^2) and is located approximately 25 miles (40 kms) north east of the Georgian capital, Tbilisi. It is adjacent to and east of the Samgori Oil Field, which was Georgia s most productive oil field and in which we acquired an interest in early 2004. The Ninotsminda Field was discovered later than the Samgori Field and has experienced substantially less development activity. Georgian Oil and others, including Ninotsminda Oil Company Limited, have drilled 36 wells in the Ninotsminda Field, of which nine are currently producing. A total of 144 wells have been drilled in the Samgori Field area which includes a complex of three separate oil accumulations namely Samgori, South Dome and Patardzeuli. We have been advised that Samgori prior to our ownership interest has produced over 180 MMbbl of oil since 1974 at rates of up to 70,000 bopd. Nineteen wells are currently producing from the Samgori complex.

We believe both the Ninotsminda and Samgori PSC areas both outside of and beneath the currently producing reservoirs of these Fields have significant additional exploration potential. To date, we have invested substantial funds in exploring the Ninotsminda PSC area.

Other Projects

We also have additional exploratory and developmental oil and gas properties and prospects in Georgia and we own interests in other oil and gas projects in the former Soviet Union through our minority ownerships investment in non-consolidated investees. During 2004, we disposed of our single remaining Ukrainian asset, the Bugruvativske Field, in order to focus on our business in Georgia. Our principal product is crude oil, and the sale of crude oil and crude oil products is our principal source of revenue.

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Business Structure

CanArgo is a holding company organized under the laws of the State of Delaware and its principal active subsidiaries are as follows:

Background

Ninotsminda PSC

Our activities at the Ninotsminda Field are conducted through Ninotsminda Oil Company Limited, a Cypriot corporation (NOC). Initially we had a partner in NOC named JKX Oil & Gas plc (JKX) however in May 2000, we reached an agreement with JKX to acquire its final interest in NOC. In July 2000, this transaction was completed and NOC became our wholly owned subsidiary.

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NOC (then named JKX Ninotsminda Limited) obtained its rights to the Ninotsminda Field, including all existing wells, one other field and exploration acreage in Block XI[E] under a 1996 production sharing contract with Georgian Oil and the State of Georgia (Ninotsminda PSC) which came into effect in February 1996. NOC s rights under the contract expire in December 2019, subject to the possible loss of undeveloped areas prior to that date and a possible extension with regard to developed areas. As such the initial term of the Ninotsminda PSC is until 2019, however, in respect of any development area, if commercial production remains possible beyond 2019 upon giving notice to the State we have an automatic right to extend the contract in respect of such development area for an additional term of 5 years (until 2024) or, if earlier, for the producing life of the development area. Under the Ninotsminda PSC, NOC is required to relinquish at least half of the area then covered by the production sharing contract, but not in portions being actively developed, at five year intervals commencing December 1999. In 1998, these terms were amended with the initial relinquishment being due in 2006 and a reduction in the area to be relinquished at each interval from 50% to 25%.

Under the Ninotsminda PSC, up to 50% of petroleum produced under the contract (Production) is allocated to NOC for the recovery of the cumulative allowable capital, operating and other project costs associated with the Ninotsminda Field and exploration in Block XI[E]. NOC pays 100% of the costs incurred in the project as the sole contractor party under the Ninotsminda PSC. The balance of Production is allocated on a 70/30 basis between Georgian Oil and NOC respectively. While NOC continues to have unrecovered costs, it will receive 65% of Production (profit petroleum). After recovery of its cumulative capital, operating and other allowable project costs, NOC will receive 30% of Production. Thus, while NOC is responsible for all of the costs associated with the Ninotsminda PSC, it is only entitled to receive 30% of Production after cost recovery. The allocation of a share of Production to Georgian Oil, however, relieves NOC of all obligations it would otherwise have to pay the Republic of Georgia for taxes, duties and levies related to activities covered by the production sharing contract. Georgian Oil and NOC take their respective shares of oil production in kind, and they market their oil independently, however the intention is to market gas jointly.

Until the end of 2001, Georgian Oil had a priority right to receive oil representing a projection of what the Ninotsminda Field would have yielded based upon the wells and equipment in use at the time the contract was entered into. This priority right has now ceased.

Samgori PSC

In April 2004, we acquired a 50% interest in the Samgori PSC in Georgia. This interest was acquired from Georgian Oil Samgori Limited (GOSL), a company wholly owned by Georgian Oil, by one of our subsidiaries, CanArgo Samgori Limited (CSL). Under the terms of the agreement dated January 8, 2004, up to 10 horizontal wells will be drilled on the Samgori Field. Completion of well S302 in the autumn of 2004, which was funded 100% by us, satisfied our commitment to GOSL under the acquisition agreement. The intention is that the remainder of the drilling program will be funded jointly by CSL and GOSL, the Contractor parties, pro rata their interest in the Samgori PSC. The total cost to us of participating in the whole program, which is due to be completed within 36 months of the commencement of the joint work program, is anticipated to be up to $13,500,000.

The Samgori PSC came into effect on September 1, 2001 and extends for an initial period of twenty years with the final year of the contract being September 1, 2021 this period may be extended subject to commercial production being available for up to a further fifteen years until 2036.

The original Contractor party to the Samgori PSC, National Petroleum Limited (NPL), has an option to reacquire its Contractor s interest in the Samgori PSC and its 50% interest in the operating company in the event that the agreed work program is not completed in part within 18 months of the work commencement date (which is expected to be set within the next two months) and completed in full within 36 months of the work commencement date. Furthermore,

NPL has outstanding costs and expenses of $37,528,964 in relation to the Samgori PSC which are recoverable by NPL receiving 30% of annual net profit from the Field until such costs have been fully repaid. Under the Samgori PSC, up to 50% of petroleum produced under the contract is allocated to the Contractor parties for the recovery of the cumulative allowable capital, operating and other project costs associated with the Samgori Field and exploration in Block XI[B] (Cost Recovery Oil). The cost recovery pool includes the $37,528,964 costs previously incurred by NPL. The balance of production (Profit Oil) is allocated on a 50/50 basis between the State and the

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Contractor parties respectively. While GOSL and CSL continue to have unrecovered costs, they will receive 75% of total production (net 37.5% to us). After recovery of their cumulative capital, operating and other allowable project costs including the NPL costs, the Contractor parties will receive 30% of Profit Oil (net 15% to us). As with our other PSCs, the allocation of a share of production to the State relieves the Contractor parties of all obligations they would otherwise have to pay the Republic of Georgia for taxes, duties and levies related to activities covered by the Samgori PSC. After NPL s costs are repaid from either Field production or other production in the PSC (in the event that new fields are developed in areas identified using seismic surveys originally performed by NPL), NPL shall continue to receive 5% of annual net profit.

Under the Samgori PSC, Georgian Oil as the State representative in the contract is entitled to receive up to 250,000 tons (approximately 1.6 million barrels) of oil (Base Level Oil) from a maximum of 50% per calendar quarter of production when the value of the cumulative Cost Recovery Petroleum, cumulative Profit Oil and cumulative Profit Natural Gas delivered to the Contractor parties exceeds the cumulative allowable capital, operating and other project costs including finance costs associated with the Samgori Field and exploration in Block XI^{B} and the NPL costs. While Base Level Oil is being delivered to Georgian Oil, the Contractor parties will continue to be entitled to a maximum of 50% of the remaining Profit Oil. The Base Level Oil is an estimate of the amount of oil that Georgian Oil would have expected to produce from the contract area had the State not come to a contractual arrangement with the previous Contractor party in 1996.

Pursuant to the terms of CanArgo s PSCs in Georgia, including the Ninotsminda and Samgori PSCs, a Georgian not-for-profit company must be appointed as field operator. Until recently, there were four such field operating companies, relating to CanArgo s five PSCs: Georgian British Oil Company Ninotsminda, Georgian British Oil Company Nazvrevi and Georgian British Oil Company Norio (in respect of both the Norio PSA and the Tbilisi PSC), each of which is 50% owned by a company within the CanArgo group with the remainder owned by Georgian Oil, but with CanArgo having chairmanship of the board and a casting vote; The field operator for the Samgori PSC, Ioris Valley Oil and Gas, is currently owned by Georgian Oil and a subsidiary of Georgian Oil, Georgian Oil Samgori Limited, but CanArgo, under its farm-in agreement to the Samgori PSC, has a right to acquire a 50% controlling interest in this company for one US dollar. However, on February 1, 2005 Georgian Oil, the State Agency for Regulation of Oil and Gas Resources in Georgia and CanArgo reached agreement on restructuring the field operator companies in our PSCs. A single operator company, CanArgo Georgia Limited, a wholly owned subsidiary company of CanArgo, was appointed the field operator for the Ninotsminda, Nazvrevi, Norio and Tbilisi PSCs. We are currently in the process of moving the operatorship of the Samgori PSC to a CanArgo controlled company. The field operator provides the operating personnel and is responsible for day-to-day operations. CanArgo or a company within the CanArgo group together with any other contractor party in the contracts such as in the Samgori PSC pays the operating company s expenses associated with the development of the fields, and the operating company performs its services on a non-profit basis.

Operations under each of the PSCs are determined by a co-ordinating body (Co-ordinating Committee) composed of members designated by the respective CanArgo company and Georgian Oil, representing the State, with the deciding vote allocated to us. If Georgian Oil believes that any action proposed by us with which Georgian Oil disagrees would result in permanent damage to a field or reservoir or in a material reduction in production over the life of a field or reservoir, it may refer the disagreement to a western independent expert for binding resolution. Since we acquired our interest in the PSCs, there has been no such disagreement. Georgian regulatory authorities must approve any drilling sites tentatively selected by us before drilling may commence.

Ninotsminda, Manavi and West Rustavi Production Sharing Contract

Ninotsminda

The Ninotsminda Field was discovered in 1979, with commercial production from the Middle Eocene reservoir established in the same year. When NOC assumed developmental responsibility for the Field in 1996, production was minimal hampered by, we believe, among other factors, a lack of funding, civil strife and utilization of old technology and methods.

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The Ninotsminda Field is the easternmost element of an elongate anticline which includes the Samgori and Patardzeuli Fields. The Ninotsminda Field is separated from Patardzeuli by a saddle and a NW-SE trending cross fault. The field structure comprises an elongate anticline which measures 10 km (E-W) by 3 km and has a maximum structural relief of around 2,493 feet (760 meters). The main reservoir horizon is the Middle Eocene which consists of well-bedded deep marine sedimentary rocks eroded from volcanoes. Such rocks typically have low matrix porosity with the gross fieldwide effective porosity of around 0.1% and permeability in the range of 0.5-10 mD, however, in the Ninotsminda Field there are well developed sub-vertical fractures which provide secondary porosity and permeability of up to 100-500mD. The reservoir which in the field area is up to 1,640 feet (500 meters) thick is at a depth of 8,530 feet (2,600 meters) below surface to 9,843 feet (3,000 meters) below surface. Production from the Field is facilitated by a strong water drive. The oil accumulation has a gas cap which together form a maximum hydrocarbon column of 1,060 feet (323 meters) thickness, with the gas-oil contact at 4,839 feet (1,475 meters) True Vertical Depth Sub Sea (TVDSS) and the oil-water contact at 5,413 feet (1,650 meters) TVDSS. The oil itself is a high quality sweet crude: 41°API, with just 0.24% sulphur, 4.9% paraffin and 8.7% tar and asphaltene.

NOC began an immediate rehabilitation of the Ninotsminda Field in 1996 which included repairing and adding perforations to existing wells, obtaining additional seismic data and a limited drilling program. The first new well (named N96) was completed in October 1997 and a second well (N98) was completed in October 1998, and sidetracked as a horizontal producer in 2000. This well had produced 304,587 barrels of oil to the end of January 2005.

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As a result of this development work, subsequent drilling and the completion of a dynamic reservoir model, it was suggested that a higher level of production could be achieved from the Middle Eocene reservoir from horizontal wells drilled in a preferred orientation so as to intersect the main fracture sets. In January 2003, a new horizontal sidetrack well (N4H) was successfully completed and originally put on production at over 1,000 barrels of oil per day (bopd). At the end of January 2005, this well had produced 366,431 barrels of oil. Two further horizontal sidetrack wells (N100H and N96H) were successfully completed in September 2003 and in December 2003 respectively. The N100H well tested at rates of over 2,000 bopd and N96H at rates in excess of 1,200 bopd. Although all three wells were put on production at lower rates in accordance with the recommendations of independent petroleum engineering specialists, it has not been possible to maintain long term production due to water incursion resulting from, what we believe to be, reservoir damage caused by conventional drilling techniques.

On June 2, 2004, we announced that we had signed a contract with WEUS Holding Inc., a subsidiary of Weatherford International Ltd (Weatherford), for the supply of Under Balanced Coiled Tubing Drilling (UBCTD) services to our projects in Georgia. Under the terms of the contract, Weatherford will supply and operate a UBCTD unit to be used on a program of up to 14 horizontal wellbores on our Ninotsminda and Samgori Fields. Elsewhere in the oil industry, the use of under balanced drilling techniques has been shown to result in significantly less formation damage, resulting in higher sustained production rates and ultimate recovery. At the same time, utilisation of coiled tubing drilling gives greater flexibility in the drilling process and in the control of the horizontal section. Although UBCTD is now used commonly in North America, with significant success, these techniques have not yet been applied in the former Soviet Union. However, we believe that these combined drilling technologies will provide the best way to develop and produce both the Ninotsminda and Samgori Fields.

We plan to drill at least five under balanced horizontal sidetracks on the Ninotsminda Field. These include N22H and N30H, which were previously planned to be drilled using conventional drilling techniques. A second horizontal well (N100H2 east horizontal) will be drilled from the N100 well bore which achieved good rates of production when drilled horizontally with conventional techniques and which was later the subject of a blow out in September 2004. A sidetrack is also being planned from the N49 well. A new well (N99) is included in the program; this well will be designed so as to have more than one horizontal wells drilled from it. These will be drilled into the eastern part of the Field, an area that is currently largely undeveloped. The UBCTD equipment will be utilized to drill only the horizontal section through the reservoir. Preparatory work on the existing vertical wells, including sidetracking and cutting of casing windows for the horizontal wellbores, and the drilling of any new wells will be undertaken by our own operating company using our own drilling rigs and equipment.

UBCTD operations started on the first well in the program, the N22H well, in December 2004. The well is located in the east part of the Ninotsminda Field where the reservoir is tighter but it is believed to be relatively un-drained. We prepared the well with our own crew which involved sidetracking from the existing well-bore at 8,661 feet (2,640 meters) down to 9,193 feet (2,802 meters) and setting a 4½ inch liner. However, technical problems with the equipment caused a number of delays which resulted in the under balance drilling not being completed until late February, 2005. These initial teething problems have now been resolved and it is anticipated that the under balanced drilling in future wells in the program will be completed within a much shorter period. The production interval in the N22H well is approximately 1,148 feet (350 meters). During drilling, sustained gas flow rates of between 20 to 25 MMcf of gas per day were measured using Weatherford s equipment. We believe that this is the biggest gas flow rate ever measured from a well in Georgia to date. At March 14, the well was still undergoing production testing.

The UBCTD unit has now been mobilised to the N100H2 well, in an area of the reservoir which has shown prolific production in the past. Following the experience while drilling N22H certain modifications to the equipment are being made and as such, commencement of drilling on the N100H2 well is not expected before late March 2005. Significant additional work has also been undertaken at other well locations to prepare them for recompletion as horizontal producers. These include the N49 well, which has a surface location very close to N100 and as such requires minimal

mobilisation, and the N30 well on the Ninotsminda Field, which are currently shut-in,

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Manavi

The first exploration well drilled on the Manavi structure, a large prospect at Cretaceous level, within the Ninotsminda PSC area reached total depth in September 2003. This well was the second well drilled under a Participation Agreement with AES Gardabani (a subsidiary of AES Corporation) (AES) relating to the exploration and potential future development of sub Middle Eocene gas prospects in parts of the Ninotsminda PSC. In January 2002, the first well drilled under the Participation Agreement, N100, reached a depth of 16,165 feet (4,927 meters) without having reached the targeted Cretaceous zone. The well was terminated primarily for mechanical reasons, having penetrated a significant thickness of hydrocarbon bearing sandstones in the Lower Eocene and Palaeocene sequences. Three formation tests were carried out on these sandstones which recovered 35º API (SG 0.85) oil, but without commercial flow, despite the installation of a down hole progressive cavity pump. We have concluded that the reason for the lack of commercial flow was either that the zone was of low permeability, or that it suffered substantial formation damage due to the mud used to drill the well. Potential still remains in this sequence but the N100 well was recompleted in 2003 as a Middle Eocene horizontal oil producer on the Ninotsminda Field. Under the Participation Agreement, AES was to earn a 50% interest in identified prospects at the sub Middle Eocene stratigraphic level (rocks older than the Middle Eocene sequence i.e., below the producing horizons of the Ninotsminda Field) by funding two-thirds of the cost of a three-well exploration program. However, prior to the completion of the program as defined in the Participation Agreement, AES withdrew from the Participation Agreement in February 2002 in order to focus on its core business. The Participation Agreement was terminated without AES earning any rights to any of the Ninotsminda / Manavi area reservoirs. Under a separate Letter Agreement, if gas from the sub Middle Eocene is discovered and produced from the Ninotsminda / Manavi area, AES will be entitled to recover at the rate of 15% of future gas sales from the sub Middle Eocene, net of operating costs, their funding under the Participation Agreement. AES also has an option to enter into a five year take or pay gas sales agreement for a quantity up to 200 million cubic meters per year at an initial contract price of $1.30 per thousand cubic feet ($46.00 per thousand cubic meters).

The Manavi well, M11, was targeting a large Cretaceous prospect in the Manavi area, east of the Ninotsminda Field, with further potential in the Middle Eocene. This well was suspended for financial reasons in 2002, following the withdrawal of AES from the Participation Agreement, at a depth of 13,720 feet (4,182meters), but re-started following a farm-in by a local oil service company in September 2003. This well was drilled to a total depth of 14,765 feet (4,500 meters), and encountered the Cretaceous limestone target at 14,265 feet (4,348 meters). Drilling data and wire line logs indicated the presence of hydrocarbons in the Cretaceous and a production liner was set for testing. After initially very encouraging clean-up flows of drilling fluid accompanied by good quality 34.4º API oil, and gas, flow stopped due to a mechanical collapse of the production tubing. We believe that this is the first discovery of oil in the Cretaceous sequence in Georgia; however, this sequence is a prolific producer in nearby Chechnya and Dagestan. Regional outcrop studies in east-central Georgia indicate that the Cretaceous reservoir unit to be over 1,000 feet (~300 meters) thick. Although over 490 feet (150 meters) of hydrocarbons were encountered in the Manavi well, no oil-water contact was identified on the logs. An earlier well, the Manavi M7 well, drilled to the south of the M11 location, encountered hydrocarbons in the Cretaceous limestone sequence over 4,265 feet (1,300 meters) deeper, before this well was abandoned without testing being completed.

Mapping of the Manavi Cretaceous oil discovery indicates a substantial potential oilfield might be present. In addition, the shallower Middle Eocene sequence encountered in the well also had hydrocarbon indications, and awaits testing. This is approximately 3,280 feet (1,000 meters) deeper than the currently assumed oil-water contact for eastern Ninotsminda, and may indicate deeper oil in this area. Following the initial testing of the M11 well, CanArgo and NOC agreed with its farm-in partner GBOSC, to buy out its 50% interest in the well by issuing to GBOSC two million shares of CanArgo common stock. As such NOC has now regained its 100% interest in the well, subject only to the possible gas sales related arrangements with AES mentioned above.

Attempts to recover the damaged tubing from the M11 well were unsuccessful. The well was prepared subsequently for sidetracking and additional drilling equipment including more powerful mud pumps and bicentrical drilling bits were added to our rig for this work. Operations recommenced in December 2004 and the M11Z sidetrack is currently at a depth of 12,461 feet (3,798 meters). Drilling in this section is complicated by the presence of extremely over-pressured swelling clays, and these continue to cause drilling problems for our equipment. After extensive technical analysis and discussions with the international drilling contractor Saipem S.p.A. (Saipem), and

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with a major drilling mud company it has been decided that the optimum way to sidetrack this well to the top of the reservoir as planned will be to use an oil-based mud system (to control the swelling clays) on the Sapiem Ideco E-2100Az drilling rig (which is equipped with a top-drive drilling system and can use an oil-based mud system unlike our current Ural-Mash rig). As described below, we have already concluded an agreement with Saipem to provide a rig and drilling services to the company. It is expected that the sidetrack will be completed in a more effective manner utilising this new equipment. It is now planned to sidetrack the well with the Saipem rig to the top of the reservoir sequence at 13,633 feet (4,155 meters) where a 5-inch casing will be set. The Saipem rig is currently being mobilised to Georgia and should be ready to re-commence drilling of the sidetrack by the middle of April. The conventional drilling operations are expected to be completed by the middle of May, after which Weatherford will take over using the UBCTD unit to drill down into the Cretaceous and fully evaluate the oil discovery.
Although management is excited about the potential of the Manavi prospect, a fair amount of additional drilling and analysis is still required before we will be able to fully evaluate the reserves and productive possibilities of this prospect. On June 22, 2004, we announced that our operating subsidiary in Georgia had signed a contract with Great Wall Drilling Company (GWDC) of China to supply drilling services for the drilling of a first appraisal well (M12) on the Manavi oil discovery with an option to drill further wells. However, due to an unacceptable delay in mobilising the rig to Georgia, on January 28, 2005, we signed an alternative contract with Saipem.

Under the terms of the contract, Saipem will supply an Ideco E-2100 Az drilling rig complete with crew to drill the Manavi 12 appraisal well to an approximate depth of 16,400 feet (5,000 meters) in the Cretaceous. The contract includes an option to drill further wells. The rig and associated equipment is currently being mobilised from Astrakhan in southern Russia to Georgia where it will now first complete the M11Z sidetrack. In order to expedite the Manavi appraisal program, we plan to drill and set surface casing on the M12 well while Saipem first complete the M11Z sidetrack, thereby minimising any delay in the appraisal of this potentially important discovery.

The M12 location is approximately 4 km to the west of the Manavi M11 Cretaceous oil discovery well, and located on seismic data acquired by CanArgo in 1998.

Apart from the Middle Eocene sequence on the Ninotsminda Field there are a number of other reservoirs which contain oil. We have not yet fully evaluated the reserves and economics of production from these zones which include shallower oil reservoirs, the gas cap on the Ninotsminda Field itself or from the hydrocarbon bearing zones below the Middle Eocene. To fully evaluate these zones, further seismic, technical interpretation and drilling will be required.

With respect to gas production, only limited short duration gas supply contracts currently exist for production directly from the gas cap. Gas currently produced from the Middle Eocene and upper zones is subject to market conditions and environmental constraints within Georgia and the ability of NOC to arrange short-term gas supply agreements as required.

West Rustavi and Kumisi

In addition to the Ninotsminda Field and Manavi prospect, under the Ninotsminda PSC, NOC has rights to one other field, West Rustavi and an underlying gas prospect named Kumisi.

The West Rustavi Field is located approximately 25 miles (40 km) southeast of the Ninotsminda Field. Prior to NOC gaining the Ninotsminda PSC, Georgian Oil drilled ten wells in the West Rustavi Field area, two of which produced oil. The Middle Eocene zone is thinner and less productive in this area than what is found in the Ninotsminda Field and only limited production has taken place from the West Rustavi Field. However NOC has carried out only very limited workover activity on West Rustavi, and potential may yet exist for further oil production from the Middle Eocene dependant on technical and economic factors. Horizontal drilling may also be appropriate for this deposit. One of the ten wells drilled in the West Rustavi Field was tested in the deeper Cretaceous/Paleocene horizon. This well

was tested and produced 1 million cubic feet of gas and 3,500 barrels of water per day, and is interpreted to have tested the down dip extent of a Cretaceous gas deposit named Kumisi. Additional seismic data has been acquired by NOC over this structure, but further geo-technical work is required on this horizon to determine its potential size, which could be significant. Given a positive outcome from this work,

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NOC has potential plans to appraise this discovery dependent on this technical work and on commercial sales contracts for gas off take.

In addition to the horizons discussed above, seismic and well data are currently being interpreted to identify further prospects in the Ninotsminda area at several different stratigraphic levels.

Samgori

The Samgori Field complex is the largest field discovered to date in Georgia. It was discovered in 1974, when oil was produced from the Middle Eocene fractured volcanoclastic sequence in the Samgori area. Further exploration resulted in the discovery in 1975 of the Patardzeuli extension to the east, and subsequently in 1979 of the South Dome accumulation. Production of the high quality low sulphur crude increased, focused initially on Samgori, then on Patardzeuli, with peak production reaching over 70,000 bopd in 1981. The primary reservoir in the Samgori complex is the Middle Eocene as in the Ninotsminda Field, with additional potential in the Upper Eocene and Lower Eocene. However, the reservoir is somewhat thicker than in Ninotsminda on average approximately 2,200 feet thick (670 meters) and having better porosity and permeability. Samgori oil is sweet and light (38.9º API) having very similar characteristics to Ninotsminda crude but unlike Ninotsminda there is no gas cap. The state company Georgian Oil originally operated the field and in the latter years of the Soviet regime production dropped off rapidly falling to almost nothing over the period to 1998.

In October 1995, National Petroleum Limited (NPL) signed an agreement with Georgian Oil to further develop the Samgori Field complex, and to explore the surrounding licence Block XI^{B}. Under the original joint venture the commercial terms were extremely tough for NPL, and this was subsequently re-negotiated in the form of a production sharing contract. This followed the Georgian Petroleum Law which came into force in 1999 and in 2001 NPL signed a new Production Sharing Contract with a much more appropriate commercial structure. Despite this, no further significant work was carried out and field production stood at approximately 700 bopd at the end of 2003. Georgian Oil Samgori Limited (GOSL), a wholly owned subsidiary of Georgian Oil, acquired NPL s interest in the PSC in December 2003, but with NPL having an option to reclaim their interest in the event that an Agreed Work Programme was not carried out. In addition NPL have the right to recover their previous costs from a portion of GOSL s net profits, and retain a small net profit interest. It is this agreement that we farmed into in January 2004.

Within the Samgori PSC area there are several identified prospects and discoveries in other horizons, notably the Upper Eocene, Lower Eocene and Cretaceous. Independent evaluations carried out previously indicate significant potential, not only in the Samgori Field itself, but also in other discoveries and prospects in the large block. These include the Krtsanisi Middle Eocene oil discovery, the Rustavi gas/condensate discovery and the West Teleti and Varketili Lower Eocene/Palaeocene gas discoveries. As this acreage lies adjacent to other CanArgo licence areas, the potential of this Block will be integrated into an overall exploration / appraisal programme with our existing discoveries and prospects, involving further seismic acquisition and appraisal/exploration drilling.

On August 2, 2004 we announced that we had commenced drilling operations on a new Samgori Field development well (S302), the first new well to be drilled on the field for several years. The well which was targeting a previously undrilled area of the field was drilled to a total depth of 7,776 feet (2,370 meters) in mid-October 2004 having encountered moveable oil in the Middle Eocene reservoir. The well will be completed with one or more horizontal sidetracks utilising the UBCTD unit. Completion of this well at our cost fulfilled our farm-in obligations under our agreement with GOSL.

As with our existing producing Ninotsminda Field, it has been recommended that future horizontal wells should be drilled under balanced on the Samgori Field complex, utilising coiled tubing. It is expected that such techniques will result in more efficient production, longer horizontal sections, and less chance of causing damage to the reservoir. It is

planned to drill up to 10 horizontal sections from existing vertical wells or new well bores. This will be undertaken as part of an integrated development program planned for both the Ninotsminda and Samgori Fields under the Weatherford UBCTD contract described above. In the meantime, work is going on to extend the Ninotsminda dynamic reservoir model to include the Samgori complex which will be used to identify the under balanced drilling locations.

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ITEM 2. PROPERTIES

Production History

The Ninotsminda Field was discovered and initial development began in 1979. Current gross field production as of March 11, 2005 was approximately 640 bopd. Gross and net production from the Ninotsminda Field for the past three years was as follows:

Year Ended December 31,	Oil (Barrels) Gross	Oil (Barrels) Net (PSC Entitlement)[1]	Gas (mcf) Gross	Gas (mcf) Net (PSC Entitlement)[1]
2004	370,176	241,131	65,066	42,293
2003	695,174	451,863	108,630	70,610
2002	292,289	189,988	212,499	138,124

(1) PSC Entitlement Volumes attributed to CanArgo are calculated using the economic interest method applied to the terms of the production sharing contract. PSC Entitlement Volumes are those produced volumes which, through the production sharing contract, accrue to the benefit of the contractor party after deduction of Georgian Oil s share which includes all Georgian taxes, levies and duties. NOC owns 100% of the contractor s interest in the PSC. As a result of CanArgo s interest in NOC, these volumes accrue to the benefit of CanArgo for the recovery of capital, repayment of operating costs and share of profit.

In April 2004, we announced that we had completed our acquisition of a 50% interest in the Samgori (Block XI[B]) Production Sharing Contract (Samgori PSC) in Georgia. The gross field production as of March 11, 2005 was approximately 530 bopd. The gross and net production for the nine month period ending December 31, 2004 was as follows:

Year Ended December 31,	Oil (Barrels) Gross	Oil (Barrels) Net (PSC Entitlement)[2]	CSL Net Share
2004 (nine months)	152,169	114,127	57,063

(2) PSC Entitlement Volumes attributed to CanArgo are calculated using the economic interest method applied to the terms of the production sharing contract. PSC Entitlement Volumes are those produced volumes which, through the production sharing contract, accrue to the benefit of the contractor parties after deduction of Georgian Oil s share which includes all Georgian taxes, levies and duties. CSL owns 50% of the contractor s interest in the PSC. As a result of CanArgo s interest in CSL, these volumes accrue to the benefit of CanArgo for the recovery of capital, repayment of operating costs and share of profit.

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Productive Wells and Acreage

The following table summarizes as of December 31, 2004 with respect to NOC the number of productive oil and gas wells and the total developed acreage for the Ninotsminda Field. Such information has been presented on a gross basis, representing our 100% interest in NOC.

	Gross Number of Wells	Acres
Ninotsminda Field	11	492

On December 31, 2004, there were no productive wells or developed acreage within the Ninotsminda PSC area except for one gross well on the West Rustavi Field which was shut-in at that date.

The only other productive wells or developed acreage on any of our other Georgian properties were within the Samgori PSC area. This information is presented on a net basis representing our 100% interest in CSL which in turn has a 50% interest in the Samgori PSC.

	Net Number of Wells	Acres
Samgori Field Complex	11.5	950

Reserves

The following table summarizes net hydrocarbon reserves for the Ninotsminda Field. This information is derived from a report dated as of January 1, 2005 prepared by Oilfield Production Consultants (OPC), independent petroleum consultants headquartered in London, England. This report is available for inspection at our principal executive offices during regular business hours. The reserve information in the table below has also been filed with the Oslo Stock Exchange.

Oil Reserves	**Oil Reserves - Gross (Million Barrels)**	**PSC Entitlement Volumes(1) (Million Barrels)**
Proved Developed	3.264	2.122
Proved Undeveloped	3.007	1.954
Total Proven	6.271	4.076

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Gas Reserves	Gas Reserves - Gross (Billion Cubic Feet)	PSC Entitlement Volumes (1) (Billion Cubic Feet)
Proved Developed	1.462	0.950
Proved Undeveloped	1.158	0.753
Total Proven	2.620	1.703

(1) PSC Entitlement Volumes attributed to CanArgo are calculated using the economic interest method applied to the terms of the production sharing contract. PSC Entitlement Volumes are those produced volumes which, through the production sharing contract, accrue to the benefit of the respective contractor parties after deduction of Georgian Oil s share which includes all Georgian taxes, levies and duties. As a result of CanArgo s interest in NOC, these volumes accrue to the benefit of CanArgo for the recovery of capital, repayment of operating costs and share of profit.

Proved reserves are those reserves estimated as recoverable under current technology and existing economic conditions from that portion of a reservoir which can be reasonably evaluated as economically productive on the basis of analysis of drilling, geological, geophysical and engineering data, including the reserves to be obtained by enhanced recovery processes demonstrated to be economically and technically successful in the subject reservoir. Proved reserves include proved developed reserves (producing and non-producing reserves) and proved undeveloped reserves.

Proved developed reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive wells that are reasonably certain of production when drilled.

Uncertainties exist in the interpretation and extrapolation of existing data for the purposes of projecting the ultimate production of oil from underground reservoirs and the corresponding future net cash flows associated with that production. The estimating process requires educated decisions relating to the evaluation of all available geological, engineering and economic data for each reservoir. The amount and timing of cost recovery is a function of oil and gas prices which can fluctuate significantly over time. The oil price used in the report by OPC as of January 1, 2005 was $27.16 per barrel based on the net price per barrel received by NOC in December 2004. The net gas price is $1.27 per mcf. Having considered the geological and engineering data in the interpretation process, the company believes with reasonable certainty that the stated proven reserves represent the estimated quantities of oil and gas to be recoverable in future years under existing operating and economic conditions.

No independent reserves have been assessed for the West Rustavi Field. Neither have independent reserves been assessed for the Samgori Field complex as the original Contractor party to the Samgori PSC, NPL, has an option to reacquire its contractor s interest in the Samgori PSC and its 50% interest in the operating company in the event that the agreed work program which includes the drilling of 10 horizontal well sections is not completed in accordance with the agreement NPL concluded with GOSL in December 2003. We are committed to this work program through our farm-in agreement with GOSL dated January 8, 2004. On completion of the agreed work program, we would aim to book reserves for the Field which are properly attributable to us. In the meantime, we will continue to benefit from our share of production.

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Undeveloped Acreage

The following table summarizes the gross and net undeveloped acreage held under the Ninotsminda, Nazvrevi/Block XIII, Norio/North Kumisi, Tbilisi and Samgori production sharing contracts as of December 31, 2004. The information regarding net acreage represents our interest based on our 100% interest in NOC and the subsidiaries holding the Nazvrevi/Block XIII contract, the Norio/North Kumisi and the Tbilisi Block XI^{G} and XI^{H} contracts, and our current 50% interest in the Samgori Block XI^{B} contract through our wholly owned subsidiary CSL.

	Gross		Net	
PSC	**Acres**	**Square Kilometers**	**Acres**	**Square Kilometers**
Ninotsminda, Manavi and West Rustavi covering Block XI^{E}	27,739	113	27,739	113
Nazvrevi and Block XIII	388,450	1,572	388,450	1,572
Norio (Block XI^{C}) and North Kumisi.	378,523	1,542	378,523	1,542
Block XI^{G} and XI^{H}	119,843	485	119,843	485
Samgori	169,514	634	84,757	317
Total	1,084,069	4,346	999,312	4,029

We lease office space in London, England; Guernsey, Channel Islands; and Tbilisi, Republic of Georgia. The leases have remaining terms varying from nine months to five years and six months and annual rental charges ranging from $24,000 to $300,000.

Processing, Sales and Customers

Georgian Oil built a considerable amount of infrastructure in and adjacent to the Samgori and Ninotsminda Fields prior to entering into the production sharing contracts for these Fields. NOC and CSL now use that infrastructure, including initial processing equipment.

The mixed oil, gas and water fluid produced from the Ninotsminda Field wells flows into a two-phase separator located at the Ninotsminda Field, where gas associated with the oil is separated. The oil and water mixture is then transported eleven kilometers either in a pipeline or by truck to Georgian Oil s central processing facility at Sartichala for further treatment. The gas is transported to Sartichala in a separate pipeline where some is used for fuel and the rest is either piped 34 kilometers to Rustavi where it is delivered to the Rustavi industrial complex for sale to a number of customers or delivered to the neighbouring communities. Oil produced from the Samgori Field complex is also transported to Sartichala for treatment prior to sale.

At Sartichala, the water is separated from the oil. NOC and CSL then sell their share of oil in this state to buyers at Sartichala for local consumption or transfers it by pipeline 20 kilometers to a railhead at Gatchiani or by road tanker to Vaziani rail loading terminal primarily for export sales. At the railheads, the oil is loaded into railcars for transport to the Black Sea port of Batumi, Georgia, where oil can be loaded onto tankers for international shipment. Buyers transport the oil at their own risk and cost from the delivery point at Sartichala.

NOC sells its oil directly to local and international buyers. In 2004, NOC sold its oil production in accordance with the terms of sales agreements concluded with Sveti Limited and Primrose Financial Group which included the sale of oil to customers nominated under these agreements. During the year, oil was purchased and paid for by a total of 14

customers. Of these customers, the following four customers represented sales greater than 10% of oil revenue:

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Customer	Percent of Oil Revenue
Crownhill	27.5%
Gero	21.9%
Interchem Energy	20.7%
Viva	11.6%

Management believes that the loss of any of the foregoing customers should not materially adversely affect our production revenues because of the existence of a ready market for our production and an established export route for crude oil from the Caspian area via Georgia and its Black Sea ports. However, there can be no assurance that such substitute purchasers of our production will offer to purchase our production on the same terms and conditions.

In 2003, NOC sold its oil production to 11 customers of which the following three customers represented sales greater than 10% of oil revenue:

Customer	Percent of Oil Revenue
Crownhill	42.4%
Baslam	32.3%
Sveti	16.9%

In 2002, NOC sold its oil production to eight customers of which the following four customers represented sales greater than 10% of oil revenue:

Customer	Percent of Oil Revenue
Caspian Trading	28.4%
Sveti	26.4%
Crownhill	20.1%
Trafigura	19.9%

For NOC, sales to both the domestic and international markets during 2004 were based on the average of a number of quotations for Dated Brent Mediterranean or Urals Mediterranean with the latter being used when the monthly quantity of oil available under the Primrose Financial Group Agreement was less than 7,000 metric tonnes (approximately 53,060 barrels) per month with an appropriate discount for transportation and other charges. Of the sales in 2004, 43.2 % was sold against a Brent quotation at an average discount of $7.50 per barrel and 56.8 % against an Urals quotation at an average discount of $7.00 per barrel while the average discounts to the price of Brent crude oil as quoted in *Platts Crude Oil Marketwire*© for Brent Dated Mediterranean for all sales in 2003 and 2002 were $7.70 and $5.09 respectively. The higher discount in 2003 and 2004 is due to significant upfront non-interest bearing security payments being made by the buyer to NOC in return for the option to lift oil over a twelve-month period which was later extended for a further period (described more fully under Item 7. Management s Discussion and Analysis of Financial Condition and Operations Liquidity and Capital Resources). For the period of the option, NOC will retain the security for its own use and account.

The average sales price and the average production cost per unit (excluding depreciation, depletion and amortization) of oil and gas produced by NOC for each of the last three years was as follows:

Year Ended December 31,	Average Sales Price Oil $/boe	Average Sales Price Gas $/mcf	Unit Production Cost $/boe
2004	24.94	1.41	5.81
2003	20.07	1.25	2.59
2002	17.09	1.25	4.69

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Since April 2004, when CSL acquired an interest in the Samgori PSC, the company sold its share of production to seven customers of which the following four customers represented sales greater than 10% of oil revenue for the period to December 31, 2004:

Customer	Percent of Oil Revenue
Mercury	34.6%
Interchem Energy	24.0%
GanOil	15.5%
Valimpex	10.9%

For CSL, sales to both the domestic and international markets during the period April to end-December 2004 were based on the average of a number of quotations for Dated Brent Mediterranean with an appropriate discount for transportation and other charges. The average discount to the price of Brent crude oil as quoted in *Platts Crude Oil Marketwire*© for Brent Dated Mediterranean for all sales in 2004 was $5.12 per barrel. There were no prior year sales made by CSL.

The average sales price and the average production cost per unit of oil and gas produced by CSL in 2004 was as follows:

	Average Sales Price		
Year Ended December 31,	Oil $/boe	Gas $/mcf	Unit Production Cost $/boe