


A YEAR OF TRANSITION

Sterling Resources Ltd.

2009 ANNUAL REPORT


Profile

STERLING RESOURCES LTD. is a Calgary, Canada based energy company actively engaged in the exploration and development of crude oil and natural gas in selected areas of the world. The Company's strategy for achieving growth is to source and initiate international projects with the potential for large, low-cost reserves. High initial working interests are taken where possible, and financial exposure and technical risk are managed by obtaining industry participations. The Company currently has landholdings in three countries, the United Kingdom offshore and onshore, Romania offshore and onshore, and France. The major focus areas, the United Kingdom and Romania, both have established hydrocarbon basins, extensive infrastructure and excellent contractual and fiscal terms. The common shares of Sterling Resources Ltd. trade on the TSX Venture Exchange under the symbol SLG.

Contents

Annual General and Special Meeting

May 27, 2010, 10:00 a.m.

The Strand/Tivoli Room,
Metropolitan Conference Centre,
333 – 4th Avenue SW, Calgary, Alberta, Canada

Abbreviations and Other Oil and Gas Terms

Bcf	billion standard cubic feet
Bopd	barrels of oil per day
Boe	barrel(s) of oil equivalent
GIIP	Gas Initially in Place
Mbbls	thousands of barrels
MMbbls	millions of barrels
MMboe	millions of barrels of oil equivalent with gas being converted using a ratio of 6:1
Mscf/d	thousand of standard cubic feet of gas per day
MMscf/d	millions of standard cubic feet of gas per day
Tcf	trillions of cubic feet
Quad	A UK offshore area normally comprised of 30 Blocks.

Other terms and definitions are provided in the Company's Form 51–101F1: Statement of Reserves Data and Other Oil and Gas Information.

Message to Shareholders

Following our previous significant success with the drill bit in 2008, the year 2009 saw a transformation of our Company from one of pure exploration into one with a dual focus of developing discoveries towards production while at the same time progressing and expanding an exceptional exploration portfolio. The financial conditions prevailing following world events in late 2008 set some interesting challenges but we are pleased to report that we fulfilled our objectives thanks in the main to our strategy, the quality of our assets and the dedication of our staff.

We maintain the belief that the best way to add value to our Company is by exploration success and our strategy starts with careful technical analysis prior to selection of assets. We enter at high working interest to allow "farming down" the first well to manage the financial and technical risk but enabling us to retain a significant working interest during subsequent appraisal. Ultimately, this provides flexibility as the successful projects move towards development with further farm-down or sale possible once reserves have been proven. The Breagh partial sale in the UK North Sea and the farm-down of our discoveries in the Romanian Black Sea are examples of the strategy at work. As a result we have embarked on development planning around four significant gas discoveries which are scheduled to bring production and significant cash flow following anticipated start-up in 2012. The developments are being operated by others and this allows our team to continue to firm up and expand our exploration portfolio which includes an eight-well program for 2010 that contains several potential high impact wells.

In terms of funding our developments, the first step was to sign a fully-termed agreement with Melrose Resources PLC ("Melrose") under which they will fund up to US $90 million of our share of the development costs relating to the Ana and Doina Fields. In exchange they will assume half of our 65 percent working interest. At Breagh, we sold a 15 percent working interest in the field and varying interests in the surrounding blocks to RWE Dea UK SNS Limited ("RWE") for $103 million as part of a multiple party deal involving all previous Breagh partners. A portion of the sales proceeds are allocated to finance the development in conjunction with a project finance agreement currently being progressed with the Royal Bank of Scotland. The assets of the "Greater Breagh Area" are now held 70 percent by RWE (as operator) and 30 percent by Sterling. Melrose and RWE both are established operators within the respective geographical areas. Both developments are planned to initiate first production from only one platform with additional facilities being added on a phased basis thereby controlling capital exposure prior to first gas.

A portion of our cash on hand has been allocated to our 2010 drilling program. This program includes three wells onshore Romania in the Craiova concession which were drilled during the first quarter. Offshore Romania, we remain cautiously optimistic that the assignments to our partners will be approved during the first half of 2010 and on that basis, planning has commenced for a well on the Eugenia (formerly Gasca) prospect in the third quarter. Sterling is carried for the drilling costs on all four Romanian wells.

In the UK, RWE is continuing our exploration effort of the Greater Breagh Area with two wells at Airidh and Macanta planned to be drilled in the second quarter. As operator, we plan to drill the follow up to the Cladhan discovery (Sterling 39.9 percent) with a rig contracted to start in May depending on its existing work program with other operators. Finally, we are planning a well on the Grian prospect in the Southern North Sea for the third quarter. We currently hold a 57 percent working interest in Grian although a farm-down will be considered before drilling.

We have elected to exit our non-core UK onshore assets with the exception of our 47 percent interest in the Kirkleatham gas discovery, scheduled to commence production in the fourth quarter of 2010. Our interest onshore France in the St Laurent (33.42 percent) has also been retained given the potential associated with the pending farm-out and drilling of the Audignon prospect.

Recently, we have made progress towards adding two new areas to our portfolio. Offshore Netherlands, the F Quad blocks contain several oil discoveries which will be considered for early production testing. Onshore France we have applied for blocks in the Paris Basin. This is our first venture into an "unconventional" play, although the very thick Liassic section on the blocks has a good analogy with the proven Bakken shale oil play in the Williston Basin of the USA and in Saskatchewan in Canada. More recently, we have also been investigating the "unconventional" potential which may exist on our onshore Craiova block in Romania given the known presence of a significant Silurian shale section.

Technical activity in 2009 focused on the update and refinement of our discovered assets. As a result, the Breagh Field (100 percent) Proved plus Probable Reserves have increased by 18 percent to 609 Bcf of natural gas and the Ana and Doina Field (100 percent) Best Estimate Contingent Resources have increased by 29 percent to 345 Bcf of natural gas. Our net working interest numbers are detailed later in the report but it is pleasing that the decreases in Reserves and /or Resources resulting from the sale or farm-down of our major assets, as discussed above, have been significantly offset by these increases. For the first time, the year end process undertaken by our reserves evaluators was extended to also provide Prospective Resources for the major part of our exploration prospect portfolio. This has resulted in a Best Estimate Company interest of unrisked Prospective Resources of 916 Bcf of natural gas and 129 MMbbls of oil. (Please refer to page 12 for the appropriate Reserves and Resources definitions.)

As previously stated, the Company is now at a stage of transition preparing for a period of significant cash flow, commencing in 2012. As a result I consider it an appropriate point in the Company's development to pass over the reins associated with the position of Chief Executive Officer (CEO). At the end of March 2010, Sterling announced the appointment of Mike Azancot as the Company's President and CEO to take effect on May 27, 2010, following our annual general meeting. This will ensure that a new regime will be in place to develop and implement the optimum strategy over the next period of significant growth for our Company and shareholders. During my tenure as CEO, it has been rewarding to be associated with the successful drilling of the first part of the exploration portfolio that has been assembled. It is clear, based on the recent analysis of Prospective Resources, that the Company still has an enviable portfolio of assets waiting for the drill bit. I look forward to working with Mike as he assumes his new role as President and CEO of Sterling. I am confident that Mike and the team will develop and execute upon a strategy that builds on Sterling's successes to date and will continue to add value in the future. I would like to thank our shareholders for their support and patience during the recent challenging times, our Board for their wisdom and guidance, our staff for their continued tremendous effort and dedication and finally Bob Welty for creating the opportunity and nucleus for growth.

[Signed]

Stewart G. Gibson
Chief Executive Officer

April 20, 2010

A Message from the Chair of the Board of Directors

In recent months, Stewart Gibson, Sterling's Chief Executive Officer has indicated to the Board his desire to move towards retirement and step down from the role of CEO.

Stewart joined Sterling in 1999 in the role of Chief Operating Officer and Executive Vice President. He progressed to President in 2000 and subsequently was appointed CEO of the Company in 2006. Stewart has made an invaluable contribution to the growth of Sterling during his tenure, transforming a small micro cap company into one of the most successful and active oil and gas exploration companies in both the United Kingdom North Sea (UKNS) and the Romanian Black Sea. Among his most notable accomplishments were the pursuit of the Breagh field (now regarded as the tenth largest gas field in the UK Southern North Sea), the Cladhan field in the Northern UKNS and the drilling of the Ana and Doina prospects in the Midia Block offshore Romania.

On behalf of the Board I wish to express our thanks to Stewart for his significant contribution to Sterling, and I am pleased to announce that Stewart has agreed to let his name stand for re-election to the Board of Directors and will also continue in an advisory role to his successor in order to facilitate a smooth transition.

On March 18 we were pleased to announce the appointment of Mike Azancot as the Company's next President and Chief Executive Officer. The appointment will take effect May 27, 2010 following the Company's annual general meeting. Effective April 26, 2010, Mr. Azancot will join the Company as Executive Vice President.

Mike Azancot is a highly experienced, well-rounded and respected international oil and gas executive. During the past 30 years, he has held increasingly senior operational leadership and managerial positions in a number of companies. Since 2006, he has served as founder and Chief Executive Officer of Lateral Resources Ltd., a company focused on the acquisition of international upstream businesses, as well as founder and Director of European Energy Assets SA, a downstream business acquisition venture. Beginning in 2000, Mike served as the Senior Vice President, Exploration and Production, for Petrokazakhstan Inc. until the takeover of the company in 2005. Prior to 2000, he worked in senior operational and managerial positions at Lasmo and Occidental Petroleum in the UK, Europe, North Africa, China and Indonesia. Mike holds a Masters Degree in Engineering and is a member of the Society of Petroleum Engineers (SPE), the Petroleum Exploration Society of Great Britain (PESGB) and the Energy Institute.

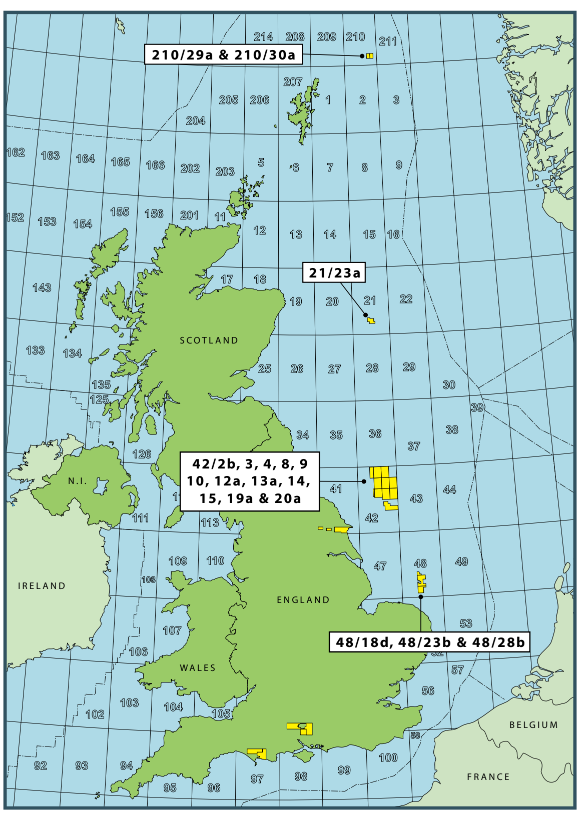
On behalf of the Board my thanks to you our shareholders and to the small and dedicated staff at Sterling for your collective patience as we smoothly transition this important leadership role from Stewart to Mike.

[Signed]

Walt DeBoni
Chair, Board of Directors

April 20, 2010

Operations Review



United Kingdom Offshore 2009 Highlights:

- Completion of appraisal drilling at Breagh
- Sale of a partial interest in Quad 42 area for gross proceeds of $103 million
- Re-appointed as operator of Block 21/23a containing the Sheryl discovery
- Extension of the license term of Block 48/28 to enable drilling in 2010

Sterling achieved a major milestone with the closing of the Breagh sales process under the terms of which we received gross proceeds of approximately $103 million less costs of disposition of $0.8 million and the repurchase of a pro-rata share of underlying encumbrances of $11.9 million in exchange for a 15 percent working interest in the Breagh field and varying interests in the surrounding exploration blocks. Following the closing of the transaction Sterling retains a 30 percent interest in the Breagh field and the surrounding blocks of Quad 42 which comprise the greater Breagh area, located in the Southern UK North Sea.

Southern North Sea (SNS)

The Breagh Field, Blocks 42/12 and 42/13

The Breagh development is progressing towards first gas during the second quarter of 2012. As initial operator of the field, the four Sterling-operated wells 42/13-3 (2007), 42/13-4 (2008), and 42/13-5 and 5z wells (2008/2009), proved up the Breagh field as one of the largest undeveloped gas reservoirs in the United Kingdom SNS. In anticipation of future evolution of the field, various development studies were moved forward by Sterling, concurrent with appraisal drilling.

Following the completion of the appraisal drilling program, the Breagh partners entered a process for the sale of a significant interest in the Breagh field and the surrounding Quad 42 exploration acreage which was successfully concluded in August 2009. RWE Dea UK SNS was the successful bidder, and through the transaction acquired a 70 percent interest in the Breagh field, with Sterling retaining the remaining 30 percent. Operatorship of the Breagh field was transferred to RWE Dea as a condition of the sale.

Development of the Breagh field is the primary focus for 2010. Conceptually, the Breagh facility will be comprised of up to three offshore platforms, depending upon the combination of field performance and third party business outside the Quad 42 area. Natural gas will be transported to landfall via a 20 inch pipeline, which will run a distance of approximately 100 kilometers to the shore, linking to an onshore pipeline of approximately 10 kilometers in length to the Teesside Gas Processing Plant (TGPP). TGPP will process the raw natural gas, prior to its entry into the National Transmission System (NTS). Current plans call for reconfiguring one of the two gas processing trains at TGPP to accommodate the Breagh gas production. The TGPP site will also contain the slug catchers and compression required for the field. The offshore platform will be controlled from the TGPP control room, with telemetered data transmitted via fibre-optic cable, with satellite backup link via very small aperture terminal (VSAT) technology.

The Breagh field will be developed in a phased approach:

- Phase one includes installation of one platform, a pipeline to shore, TGPP terminal modification and drilling of six to nine wells in the vicinity of West Breagh. Expected gross capital expenditures for this phase will be approximately £350 – £400 million.
- Phase two is expected to enable the drilling of up to 18 total wells, with further drilling centers or platforms under consideration.

The gas field contains dry natural gas with an average 2.8 percent carbon dioxide content. Phase one will have the capacity for a gross plateau production rate of 225 MMscf/d. Phase two will incorporate an additional platform and depending upon future exploration success and potential for attracting third party gas, will have the capacity for a maximum gross plateau production rate of 400 MMscf/d, with the possible addition of offshore compression. Project progress to date includes:

- Completion of the pipeline route survey;
- Export pipeline, offshore facilities and onshore facilities and pipeline front-end engineering and design (FEED) studies are all underway;
- Bids have been requested for pipe laying, pipeline materials and platform transportation and installation contract work;
- Both Onshore and Offshore Environmental Statements (ES) have been submitted; and
- The Field Development Plan (FDP) has been submitted to the government.

Joint venture approval is expected in June 2010 which will be followed by government approval shortly thereafter, with a first gas target date anticipated for the second quarter of 2012.

Sterling's independent reserves evaluators, RPS Energy, have attributed Company interest Proved Plus Probable Reserves of 183 Bcf of natural gas and 38 Bcf of natural gas (P50) Contingent Resources to the Breagh field as at December 31, 2009 as summarized in the table on page 12.

Quad 42 and the Greater Breagh Area

The exploration potential in the Greater Breagh Area was an important factor contributing to the successful completion of the Breagh deal with RWE. Development of the Breagh field provides the key to unlocking the potential in this area, providing a hub for gathering gas and onward transportation to Teesside.

Sterling holds a 30 percent interest in this area which contains a significant number of mapped prospects. Two of these prospects Airidh in Block 42/19a and Macanta in Block 42/14 are planned for drilling during the second quarter of 2010, with RWE Dea as operator. On the Crosgan discovery in Blocks 42/10 and 42/15, 3D seismic has been purchased and is being reprocessed in preparation for drilling in 2011. Further seismic is planned for the Darach prospect in Block 42/4 to bring this prospect to a drill ready state during 2011.

Our independent reserves evaluators have attributed Company interest (P50) Contingent Resources of 37 Bcf of natural gas to the acreage in the Quad 42 area as at December 31, 2009 as summarized in the table on page 12.

Quad 48 Area

Grian

Sterling has increased the working interest in Block 48/28a to 57 percent and extended this Promote License into the second two year period. The prospect target is the Permian Rotliegendes sandstone, with an expected target depth of 5,500 feet, typical of exploration drilling in the heartland of the United Kingdom SNS. Development of any gas discovered is envisaged as a single subsea well tied-back to the nearby infrastructure in the area. Drilling planning and permitting is currently ongoing with drilling expected to commence during the third quarter of 2010.

Northern North Sea (NNS)

Cladhan Discovery, UKCS Block 210/29a

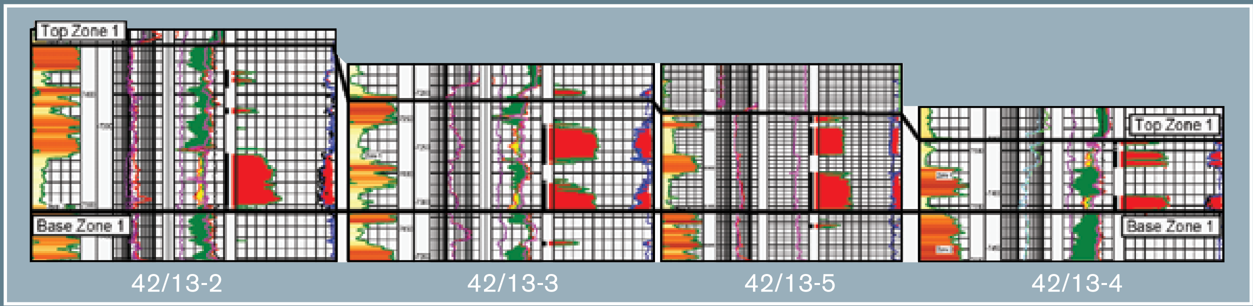
The much awaited appraisal well on the Cladhan oil discovery (Sterling 39.9%) is scheduled to commence in May of 2010 with the Transocean J W McLean rig secured for drilling. The 2008 discovery well confirmed the presence of high quality reservoir with 35.6° API oil and a moderate gas/oil ratio, typical of the Jurassic formation in the area. The trap is of a stratigraphic nature and considering the well did not find an oil/water contact, Cladhan is an exciting discovery with potential for significant resources as detailed below.

A re-entry and sidetrack is planned from the 2008 discovery 210/29a-4 well, to a target 960 meters south of the October 2008 discovery well into the main body of the channel system. With success of the first planned sidetrack, a second sidetrack may be drilled to a target 1,100 meters southeast to a downdip location, which should enhance our understanding of the oil potential in Cladhan.

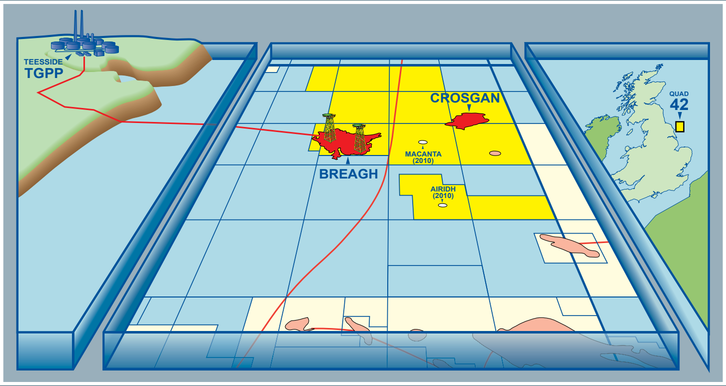
The discovery is located close to several existing and developing producing fields. Sterling has been evaluating potential host facilities for tie-in of a successful appraisal well. The successful program appraisal of the Western Isles Development and ongoing operations on the Hudson Field northeast of the Cladhan field may provide a new development hub to be considered for future delivery of Cladhan production.

Sterling's independent reserves evaluators have attributed Company interest (P50) Contingent Resources of 3.2 MMbbls to the Cladhan discovery as at December 31, 2009 as summarized in the table on page 12.

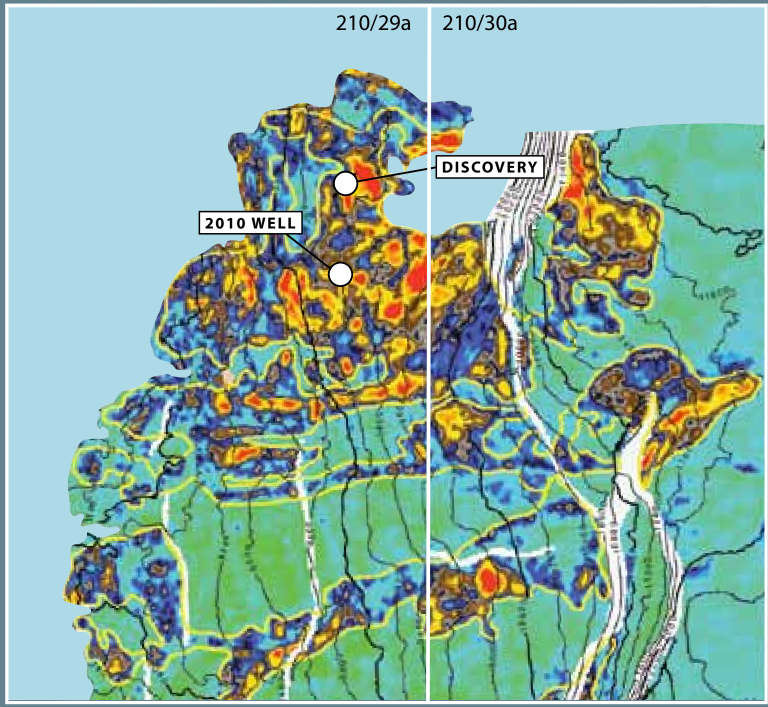
BREAGH FIELD – WELL CORRELATION

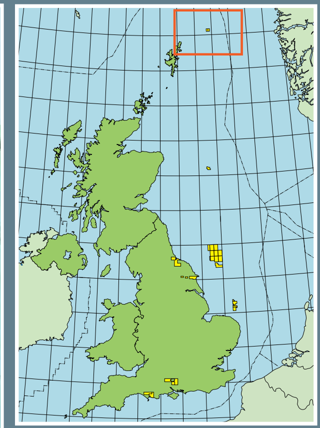


THE GREATER BREAGH AREA & RELATED GAS EXPORT SYSTEM



CLADHAN – DISTRIBUTION OF CHANNEL SYSTEMS





Central North Sea (CNS)

Sheryl

Sterling has been re-appointed operator of Block 21/23a (Sterling 35 percent) and Premier Oil is the new joint venture partner holding the remaining 65 percent. The partnership is seeking tie-in routes and have entered into discussions with the owners of the Triton pipeline through the Saxon and Pict subsea developments, and with Antrim for tie-in via potentially new infrastructure for the Fyne Development. Sterling looks forward to finalizing a tie-in route for Sheryl production during 2010 with development of the field to take place during 2011.

Our independent reserves evaluators have attributed Company interest Proved plus Probable Reserves of 1.1 MMbbls to Sheryl as at December 31, 2009 as summarized in the table on page 12.

Mid North Sea High (MNSH)

Five contiguous blocks were acquired in the 24th Licensing Round in the MNSH, located just north of Quad 42. Sterling elected to relinquish these blocks after a disappointing well was drilled by ExxonMobil in 2009 just to the south of our blocks. ExxonMobil have released their blocks after drilling the well.

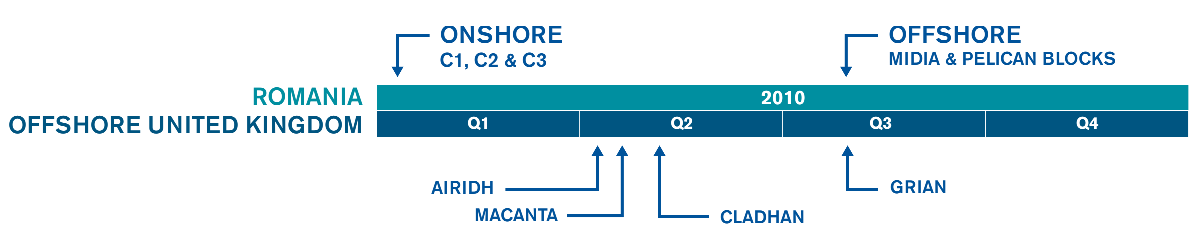
United Kingdom Onshore

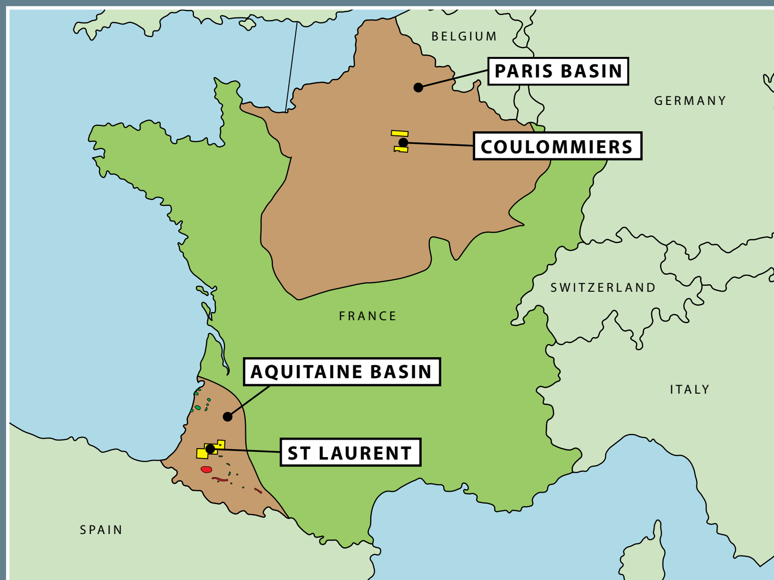
On Petroleum Exploration and Development License (PEDL) 068 (Sterling 47 percent), the operator continues to work towards natural gas production from Kirkleatham, now scheduled to commence during the fourth quarter of 2010. A gas sales agreement has been signed with Sembcorp Utilities (UK) Limited, which owns the power station and much of the land on the Wilton International site. Other agreements for the lease of a process site, the granting of right of ways for pipelines, and for the operation and maintenance of the facilities on the Wilton site have also been signed.

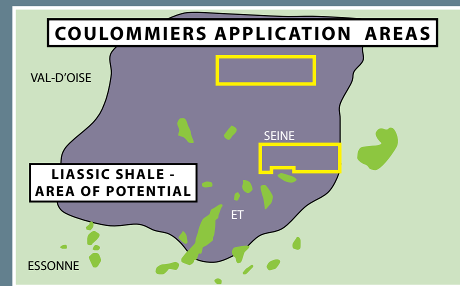
Planning consent was received for the Kirkleatham development in August 2009 which allows for production from the existing Kirkleatham-4 well site and for the drilling, testing and production from up to two additional wells at the site. Gas will be transported from the well site via a six hundred meter long underground pipeline to the Wilton site boundary, then via an above ground pipeline to a processing site within Wilton. Water and all hydrocarbon liquids will be removed at the processing site and the gas heated and metered prior to delivery to a Sembcorp-owned combined heat and power plant, which generates electricity for site and export use and generates steam for site use. It is anticipated that the first gas will be delivered in October 2010.

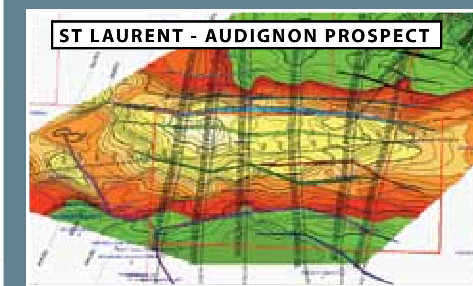
Our independent reserves evaluators have attributed Company interest Proved plus Probable gas Reserves of 1.2 Bcf of natural gas as at December 31, 2009 as summarized in the table on page 12.

2010 Drilling Schedule









France Onshore

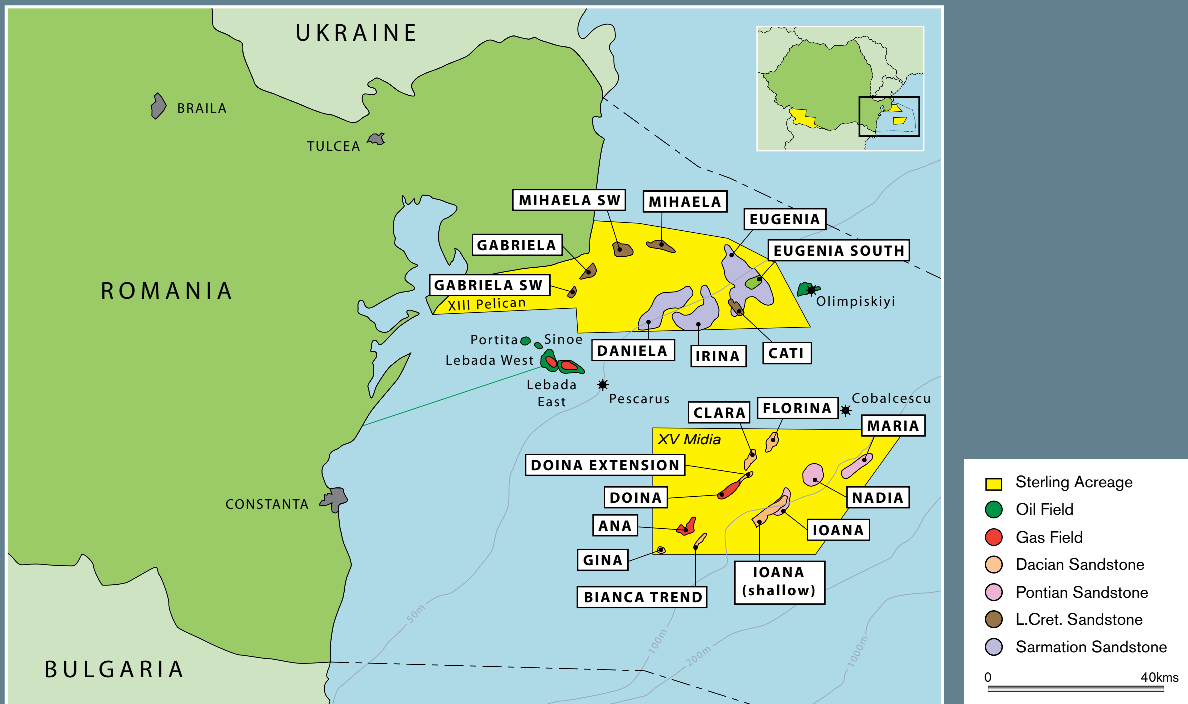
St Laurent License

The St Laurent License covers some 125,280 acres and is located 20 km northwest of the giant Lacq field in southern France. There are numerous occurrences of hydrocarbons on the St Laurent license including an undeveloped accumulation of heavy oil discovered by the Grenade Sur Adour-1 well in 1975. The Grenade Sur Adour-1 well encountered a 97 metre column of heavy oil (11° API) in a Cretaceous reef carbonate within a stratigraphic trap. The original well produced 70 Boe per day compared to the 200 to 300 Boe per day anticipated from high angle wells. During early 2008 the Grenade-3 well located on the St Laurent permit was completed and the reservoir section encountered lacked adequate porosity and permeability and thus the well was suspended. The geological model has been reevaluated to determine an alternate drilling location back towards the original Grenade-1 discovery well. In addition to the Grenade discovery, additional exploration potential exists on the block. The operator has mapped an undrilled deep gas Triassic prospect known as Audignon. The license has been renewed for a further 5 year term, and future activity will focus on both a sidetrack of the Grenade-3 well and farm-out of the Audignon prospect for drilling during 2011.

Sterling's independent reserves evaluators have attributed Company interest (P50) Contingent Resources of 2.7 MMbbls to the Grenade discovery as at December 31, 2009 as summarized in the table on page 12.

Paris Basin

In the Paris Basin, Sterling as operator, has recently applied for a total of 9.5 blocks with working interests ranging from 25 to 50 percent. The applications have passed the period of gazetting and are currently awaiting final approval by the French government's General Industry and Environment Council. With a gross area of some 150,000 acres, the blocks have the potential for conventional traps in the Jurassic and Triassic formations which are productive in nearby fields. In addition, the area has been identified for its potential as an "unconventional" oil play. Analogous to the Bakken shale oil play in the US Williston Basin, this is predicated on a very thick Liassic section (up to 600 metres) which sits in the oil window. Within the shales, there are several distinct carbonate, silt and sand units that are known to be oil bearing from old well results. The source potential oil volumes of the Liassic section are believed to be very significant and analogue well types have good potential initial production rates. Timing of first drilling will not be before 2011, although a multi-well pilot scheme targeting the same play is scheduled to start this year in the neighbouring license.



Romania Offshore

2009 has been a year of technical review and improvement as we refine our understanding of the geology and greater petroleum prospectivity of the Midia XV and Pelican XIII Blocks, while moving forward with planning for the development and production of the Ana and Doina gas discoveries.

Following a very active year of drilling and data gathering in 2008, the technical team undertook the reprocessing, interpreting and mapping of over 5,000 kilometres of seismic in the Midia XV Block and integrated conventional interpretation with improved seismic inversion providing detailed structural definition, net pay estimation and Direct Hydrocarbon Indicators (DHIs) for the prospects and fields. This work was combined with advanced petrophysical techniques to allow a better understanding of reservoir characteristics for the Doina reservoir and other hydrocarbon bearing reservoirs encountered in the wells.

The new seismic and petrophysical analysis has resulted in an overall increase in the year end Contingent Resources. Our independent reserves evaluator RPS Energy (RPS) has indicated a 29 percent increase in Full Field (P50) Contingent Resources from 267 Bcf of natural gas (Sterling's working interest value – 174 Bcf) at December 31, 2008 to 345 Bcf of natural gas (Sterling's working interest value – 112 Bcf) at December 31, 2009. This follows the 30 percent increase also recorded in 2008. These Full Field Resource numbers are stated prior to the pending transfer of one half of Sterling's 65 percent interest to Melrose Resources PLC which will reduce the numbers accordingly on a Company working interest basis.

Our independent reserves evaluators have attributed Company interest (P50) Contingent Resources of 112 Bcf of natural gas as at December 31, 2009, as summarized in the table on page 12.

It is worth noting at this point that the evaluated Full Field (P50) Contingent Resource number of 345 Bcf, combining both the Ana and Doina fields, represents an almost seven fold increase since Sterling assumed operatorship in 2007. These Resource additions of approximately 58 MMboe cost a very reasonable US $1.01 per Boe.

Field development planning for the sequential development of the Ana field, followed by the Doina field is underway and Melrose Resources was confirmed as the "Development and Production Operator" by the partnership and government agency responsible for mineral resource administration (ANMR). Melrose Resources has submitted plans to the partnership which will deliver first gas in 2012, subject to governmental approval for interest assignments.

During the year RPS also undertook an evaluation of the unrisked Prospective Resources attributable to the two blocks associated with 10 prospects. At the time of going to print, Sterling and our partners have initiated planning to drill the first of these, with one well evaluating both the Eugenia and Eugenia South prospects. The well is timed for later in 2010 assuming assignments to partners have been approved by ANMR.

On February 3, 2009, the International Court of Justice (ICJ) published their final ruling on the disputed maritime border between Romania and the Ukraine. The outcome was to confirm that the Blocks held under concession by Sterling and its partners are wholly situated within the Exclusive Economic Zone awarded to Romania, confirming the validity of the blocks under concession by Sterling and partners. However, a concerted campaign against Sterling was then mounted by certain Romanian politicians questioning the validity of the Concession Agreement between Sterling and the Romanian State. After multiple parliamentary and inter-agency investigations, no evidence supporting these allegations has been presented to Sterling. However, the procedural requirements invoked by the allegations are still being felt and until these are complied with by internal government agencies, it has not been possible to receive final governmental approvals for the assignment of interest to Sterling's partners. It is hoped, however, that this may happen during the second quarter of 2010.

Romania Onshore

Following execution of the farm-out agreement with TransAtlantic Worldwide Romania SRL, much of 2009 was spent planning the three-well drilling campaign for the Goshawk Canyon play.

Government approval for the assignment of interest to TransAtlantic was given within weeks of submission of the joint application and there were no problems with the permitting or carrying out of operations on the licence.

By December 2009 we had spudded the first well in the program. All three wells have been drilled and casing run in all three to allow testing of multiple intervals where gas shows were encountered. Final understanding and results from the well testing are not yet conclusive, with significant gas shows for both NG-04 and NG-02 while drilling. There also appears to be an absence of sufficient reservoir as indicated from logs and the lack of flowing gas on test. NG-01, the best defined structure of the three locations, encountered gas shows at two levels with these intervals to be tested during April 2010.

The technical team were also active through further assessment of the northern canyon play and identifying potential for an "Unconventional Gas Shale" play. This requires further work, but the premise lies in the confirmed existence of the Silurian shales, present in the west of the block. The Silurian is the subject of much interest in this type of play in Poland and studies are underway to allow Sterling and its partner to understand the potential of the play within the block.

Reserves, Contingent and Prospective Resources

Sterling's working interest Proved and Probable Reserves, future net revenues before income taxes, Best Estimate (P50) Contingent Resource volumes and Prospective Resource volumes were evaluated by RPS Energy at December 31, 2009 as follows:

		Working Interest	Reserves Company Share [1] (MMboe)			Net Present Value Before Tax [4] Company Share (Millions of Cdn $)		
			Proved	Proved + Probable	Proved + Probable + Possible	Proved	Proved + Probable	Proved + Probable + Possible
UK	Breagh [2]	30.0%	23.4	31.2	38.2	285.8	378.0	471.3
UK	Kirkleatham [2]	47.0%	0.1	0.2	0.5	0.1	3.8	11.4
UK	Sheryl [3]	35.0%	–	1.1	1.6	–	37.9	55.5
Company	Total [5]		23.5	32.5	40.3	285.9	419.7	538.2

		Unrisked Contingent [6] [8] Resources Company Share			Unrisked Prospective [7] [8] Resources Company Share		
		1C P(90)[9]	2C P(50)[9]	3C P(10)[9]	Low P(90)[9]	Best Estimate P(50)[9]	High P(10)[9]
Gas	Bcf	148.0	188.0	243.0	644.0	916.0	1,565.0
Oil	MMbbls	3.3	7.8	20.0	57.0	129.0	404.0

1 Gross before royalties.

2 Gas converted to Boe at 6 Mcf = 1 Boe.

3 Oil.

4 Discounted at 10% per annum.

5 Company Reserve totals are arithmetic aggregations of multiple estimates, which statistical principles indicate may be misleading as to volumes that may actually be recovered. Readers should give particular attention to the estimates of individual classes of Reserves and appreciate the differing probabilities of recovery associated with each class. For Proved (1P) Reserves these totals have a much higher than 90% probability of occurring on an unrisked basis. For Proved plus Probable plus Possible (3P) Reserves, these totals have a much lower than 10% probability of occurring on an unrisked basis.

6 Contingent Resources are those quantities of petroleum estimated as of a given date to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies. The Resource volumes shown represent probabilistic totals of several entities within each licence or block area. There is no certainty that it will be commercially viable to produce any portion of the Contingent Resources.

7 Prospective Resources are those quantities of petroleum estimated as of a given date to be potentially recoverable from undiscovered accumulations by application of future development projects. There is no certainty that any portion of the Prospective Resources will be discovered or, if discovered, that it will be commercially viable to produce any portion of the Resources. These Prospective Resources are in areas of the field or geological horizons, in which the presence of hydrocarbons require confirmation by drilling.

8 Company Resource totals shown by Resource category are statistical aggregates of unrisked Resources at a company level. For Contingent Resources the statistical aggregates assume no dependencies between discoveries and for Prospective Resources these statistical totals assume no dependencies between prospects.

9 The P(50) or 2C is considered to be the best estimate of the quantity that will actually be recovered. If probabilistic methods are used there should be at least a 50 percent probability P(50) that the quantities actually recovered will equal or exceed the estimate. Similarly, the 1C or P(90) and 3C or P(10) represent the low and high estimates respectively.

10 The estimates of Reserves and Resources for individual properties may not reflect the same confidence level as estimates of Reserves and Resources for all properties, due to the effects of aggregation.

Additional reserve information can be obtained from our Form 51-101F1 containing the Statement of Reserves and Other Oil and Gas Information which can be found on www.sedar.com or by contacting the Company.

Management's Discussion and Analysis

This management's discussion and analysis of operations and financial condition (MD&A) of Sterling Resources Ltd. ("Sterling" or the "Company") for the year ended December 31, 2009 is dated April 20, 2010 and should be read in conjunction with Sterling's audited consolidated financial statements and accompanying notes for the years ended December 31, 2009 and 2008.

The MD&A focuses on our long-term vision, strategy and growth opportunities as well as our historic performance for the two years ended December 31, 2009. All financial amounts are expressed in Canadian dollars, except as otherwise indicated.

Our Business and Strategy

We are an international energy company with our corporate head office located in Calgary, Canada, and our operations headquartered in Banchory, near Aberdeen, Scotland. We also maintain an office in Bucharest, Romania.

We are engaged in the exploration for, and development of, crude oil and natural gas in selected areas of the world outside Canada.

Our strategy for achieving growth is to source and initiate international projects with the potential for large, low-cost reserves. We concentrate on accumulating, exploring and exploiting licenses and prospects in selected core areas of the world. Our strategy also targets blocks with high initial working interests where possible and financial exposure and technical risk are managed by obtaining partner participation through farm-out and other arrangements. Under these arrangements, a portion of our interest is given up in exchange for the partner paying a share of our costs of exploration, appraisal or development of the license. Our current activities are focused primarily in the UK and Romania.

There are many operating and other factors which management expects to have a significant impact on its execution of this strategy, however, the current economic environment and the continuing focus on the possible effects of climate change, warrant particular consideration:

a) The Economic Environment

The prevailing uncertainty in international financial markets has improved during 2009, but continues to be a concern to management. We expect volatility in key areas of the economy and this will likely impact our business in a number of different ways including our strategy, the underlying value of our assets, our ability to obtain additional financing through equity or debt markets, and our share price. The key factors affecting our business are as follows:

(I) PRODUCT PRICING

Oil prices affect both the anticipated cash flows from our projects and the prices and terms of any interests which we may elect to farm-out or dispose of. Prices have improved somewhat since the lows experienced in late 2008 and earlier in 2009, but they remain volatile and substantially lower than the highs reached in 2008. General uncertainty remains in world energy markets as confidence in economic recovery remains fragile.

We do not currently have any significant oil production, but plans are in place to carry out further appraisal on our oil prone discoveries at Cladhan and Sheryl based on current and anticipated pricing levels. Because of the long lead times involved in offshore appraisal and development, we must take a longer-term view of market conditions and associated with this longer-term view is increased economic risk.

Natural gas prices tend to be driven by more regional factors, particularly in our areas of operation. Natural gas prices have eroded during 2009, although less dramatically than oil prices and internal economics continue to show robust returns on our key projects in the UK North Sea and the Romanian sector of the Black Sea. In the longer term, however, natural gas prices have tended to trend with oil prices, but we expect that for at least 2010, gas prices in our key markets will be characterized by volatility.

(II) CAPITAL EXPENDITURES

We expect that recovery from the world-wide recession of 2008/2009 will be slow, and there has already been a substantial decline in our cost structure which reflects this. In the UK, there has been a significant increase in rig availability and a corresponding decline in rig rates. We expect that current conditions will continue. With significant capital outlays required to bring our projects to first production, a lower cost structure should help to offset some of the impact of declines in energy prices on the overall economics of our projects.

(III) INTEREST RATES AND LIQUIDITY

We currently have no long-term debt and our secured notes carry a fixed interest rate. However, debt financing has traditionally been used in the international oil and gas industry to finance development projects and the current business environment may benefit us as we progress towards obtaining a senior debt facility for the development of Breagh. Offsetting this to some extent are expectations that interest rates will have to rise with the unprecedented level of government stimulus spending and the inflationary impact this will likely have in the future. Additionally, liquidity remains an issue within the international banking system, and whilst financing appears available for key projects, terms have become more restrictive than prior to the economic downturn.

(IV) EQUITY

Equity financing became more available during 2009 and depending on the levels of senior debt eventually accessed, equity may be considered to finance a limited portion of the Company's exploration program that is considered accretive to our share price.

(V) PROJECT FINANCING

Management has focused on financing the development of the Company's key projects in part for cash, in part for a carry on a portion of our share of future expenditures, and through a senior debt facility. Our high working interest positions in Breagh and Doina/Ana have been key in allowing us to do this.

Our remaining offshore license commitments for 2010 total approximately $30 million, and in addition to this we are committed to the Breagh development program which will require funding of approximately $22 million in 2010. We expect to be able to farm-out some of our drilling commitments to reduce the financial impact on the Company. With our current cash resources, and indications of availability of senior debt, we believe we are relatively well positioned to meet these obligations. However, we are also considering other options should circumstances change.

b) Climate Change

There continues to be significant emphasis placed on climate change and its possible causes by the international community, although the causes and effects have become widely debated, and, in some cases disputed. What remains clear is that the economic consequences of various measures to combat the assumed causes of climate change have not been adequately addressed by the international community or by the governments of the countries in which we operate. Management believes it has a responsibility to maintain a balanced approach between protection of the environment, and ensuring that there is a sufficient supply of energy to last into the foreseeable future while considering the interests of the Company's shareholders. This is an increasingly difficult balance to maintain.

We are concerned about pending carbon taxes, regulated emissions reduction targets and the resultant emissions trading transactions and obligations, and the ability to quantify these factors within the Company's financial statements. As the impact of these factors is realized, Sterling's management is committed to adapting as required in an effort to mitigate and reduce the associated costs. Specifically we will continue to monitor the implications of climate change in each of the following five areas:

(I) BUSINESS STRATEGY

Sterling maintains a high level of environmental, health and safety standards and sees the integration of environmental operating practices with climate change outcomes as symbiotic. Maintaining the highest of operating standards and business practices remains a priority for Sterling in order to protect the well-being of employees and contractors, equipment and the environment.

(II) RISKS

Sterling anticipates major changes in the regulatory environment in light of greater public awareness of climate change issues and the priority placed upon the issue by the new Obama administration in the U.S. Although we do not presently have any assets within the U.S., stricter governance of emissions in the U.S is likely to impact other jurisdictions in which we operate.

(III) GREENHOUSE GAS EMISSIONS

Sterling's management is aware of the fact that greenhouse gas emissions (GHGs) are produced in large measure as a result of the use of hydrocarbons to fuel transportation vehicles, to provide heating and for the generation of power through the burning of coal. As a future producer of hydrocarbons, primarily natural gas, this presents both an opportunity and a threat to Sterling. Although the consumption of natural gas does produce GHGs, in comparison to the consumption of other oil based fuels such as coal, gasoline and diesel, natural gas is a cleaner burning fuel as it produces significantly less emissions. Nevertheless the consumption of natural gas still produces some GHGs and the imposition of carbon taxes, emission limitations, or mitigation mandates such as carbon trading may add further costs.

(IV) FINANCIAL IMPACTS

In light of the uncertain regulatory environment and the fact that Sterling does not presently anticipate having significant natural gas production until 2012, it is impossible to quantify the financial impact of climate change in the short-term. Management will continue to closely monitor the regulatory landscape in an effort to both quantify and mitigate any incremental costs attributable to climate change issues.

(V) GOVERNANCE PROCESSES

Management and the Board of Directors continue to be responsible for monitoring changes in the business environment that could impact Sterling either favourably or unfavourably, including issues related to climate change. Management is already responsible to provide the Board with reports dealing with environmental issues and will provide to the Board information detailing the impact upon operations of any climate change initiatives to ensure appropriate governance of this emerging issue.

2009 Operating Highlights

The following discussion focuses on the operational highlights for the year ended December 31, 2009 only. Further discussion of operations and financial and other transactions are presented elsewhere in this MD&A together with comparisons to prior years.

Selected annual financial Information for the three years ended December 31, 2009 are presented below.

	2009	2008	2007
$ except share and per share information			
Oil and gas revenues, net of royalties	**–**	–	–
Gain on property disposition	**72,103,206**	–	–
Expenses	**(5,718,671)**	(2,278,859)	(1,815,759)
Income taxes	**–**	(34,877)	–
Net income (loss)	**66,384,535**	(2,313,736)	(1,815,759)
Per common share			
– basic	**0.51**	(0.02)	(0.02)
– diluted	**0.50**	(0.02)	(0.02)
Net working capital	**72,674,785**	13,967,470	10,858,095
Petroleum and natural gas properties and equipment additions	**(21,084,034)**	(86,966,852)	(17,417,557)
Dispositions of interests in properties	**89,612,456**	11,973,047	7,303,119
Total assets	**224,115,534**	167,249,546	81,033,587
Share capital	**157,642,776**	156,773,276	76,900,308
Common shares outstanding – basic	**132,174,806**	130,941,472	95,766,968

The Company has three key projects that are currently not generating revenues:

Breagh

Block 42/13 in the UK Southern North Sea was acquired by Sterling as operator in the UK 22nd Licensing Round. Our interest in the Block was reduced to 45 percent after a series of farm-out arrangements and in late 2007 together with our partners we drilled the 42/13-3 well which successfully tested gas at rates of up to 17.6 MMscf/d. These results confirmed that damage to the formation which had been experienced in earlier Breagh wells drilled by other operators, could be overcome by the use of oil based drilling fluids. In 2008, the Breagh 42/13-4 appraisal well was drilled on the eastern flank of the Breagh structure. This well tested gas at rates of up to 10.2 MMscf/d and confirmed the continuity of the reservoir encountered in the 42/13-3 well. In late 2008 we commenced drilling the final Breagh 42/13-5 and 5z horizontal appraisal wells which were completed and tested in early 2009. The 42/13 5z well tested gas at rates of up to 26 MMscf/d.

After the successful completion of the appraisal drilling program in early 2009, we commenced a process to dispose of a part interest in the greater Breagh area in order to provide sufficient funds to continue development. In August we completed the sale of one third of our 45 percent interest in Block 42/13 and varying interests in the surrounding blocks comprising the greater Breagh area for total gross proceeds of approximately $103 million less costs of disposition of $0.8 million and the repurchase of a pro-rata share of the underlying encumbrances of $11.9 million. Following the disposition, the Company retained a 30 percent interest in the entire greater Breagh area. The sale also resulted in the purchaser, RWE Dea, becoming operator.

The next steps in moving Breagh towards first gas in 2012 require the submission to, and approval of, a development plan by the UK Department of Energy and Climate Change (DECC) and the arrangement of a senior financing facility. We are currently working towards satisfying both these requirements and hope to have joint venture approval of the project in June of 2010 with government approvals and the senior financing facility in place shortly thereafter. In parallel with this process, the operator plans to drill two exploration wells on contiguous blocks in the greater Breagh area in 2010.

Our independent reserves evaluators have attributed Company interest Proved plus Probable Reserves of 183 Bcf of natural gas and 38 Bcf of natural gas of (P50) Contingent Resources to Breagh at December 31, 2009, as well as Company interest (P50) Contingent Resources of 37 Bcf of natural gas in the greater Breagh area.

Cladhan

We acquired our interest in Blocks 210/29a and 210/30a in the UK 21st Licensing Round and reduced our interest to 39.9 percent through a series of farm-out transactions. In late 2008 we drilled the Cladhan well to test the play containing overlying channel sands and potential fan systems. Although not tested, the log, bottom hole sample and pressure information confirmed the presence of high quality reservoir with 35.6° API oil and a moderate gas/oil ratio. The discovery is also close to several existing and developing production facilities, providing ease of tie-back.

Given that the discovery well was of a stratigraphic nature and considering the well did not find an oil/water contact, this discovery shows significant potential and in 2010 a re-entry and sidetrack is planned from the 2008 discovery well to a target to the south in the main body of the channel system. If this is successful a second sidetrack may be drilled downdip to the southeast which should further enhance our understanding of Cladhan's potential.

Our independent reserves evaluators have attributed Company interest (P50) Contingent Resources of 3.2 MMbbls to Cladhan at December 31, 2009.

Doina/Ana

In late 2006, we acquired the remaining 80 percent interest providing us with a 100 percent working interest and operatorship of the large Pelican and Midia blocks located in the Black Sea offshore Romania. We subsequently farmed out 35 percent of our interest in return for the farmees paying certain costs on our behalf. Sterling, as operator drilled the Ana-1 discovery well on the Doina trend in the Midia block in late 2007, and the well flowed gas at rates up to 19.2 MMscf/d under restricted test conditions.

In 2008, we successfully tested the north easterly extension of the Doina field with the Doina IV well, encountering the same quality gas bearing reservoir as the original Doina wells drilled by other operators. This well was followed by the Ana-2 appraisal well which encountered similar, and slightly better reservoir characteristics than the Ana-1 well.

In early 2009, Sterling entered into a fully termed farm-in agreement with Melrose Resources Plc (Melrose) under which Melrose would incur up to US $90 million of costs on behalf of Sterling in return for a 32.5 percent interest in the Blocks. Closing of this arrangement requires regulatory approval from Romanian authorities. However, this approval has been delayed due to unfounded and inaccurate allegations in the Romanian press which preceded a period of political instability in the country, and which ultimately resulted in the fall of the government. We are cautiously optimistic that the new government in Romania will recognize the importance of this project to their country's domestic gas supply and will now allow it to proceed.

Our independent reserves evaluators have attributed 112 Bcf of natural gas of Company interest (P50) Contingent Resources to Doina/Ana at December 31, 2009.

Other Projects

In addition to the major projects discussed above, we have a number of other discoveries and projects on our licenses offshore UK and Romania, as well as onshore UK, Romania and France, These include the 2006 Sheryl discovery on Block 21/23a in the UK Central North Sea and the Kirkleatham gas discovery onshore UK. We will be progressing these projects further in 2010 or may consider disposition if we consider the projects to be non-core.

Accounting Policies and Significant Estimates

It is important to understand our key accounting policies in order to understand our financial results and the extent to which estimates affect them. Our accounting policies as presented in Note 2 to the financial statements are in accordance with Canadian generally accepted accounting principles (GAAP).

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. Significant estimates in the financial statements include amounts recorded for the provision for future asset retirement obligations, stock based compensation expense and capital expenditure accruals. In addition, we use estimates for numerous variables in the assessment of our assets for impairment purposes, including oil and gas prices, exchange rates, cost estimates and production profiles. By their nature, all of these estimates are subject to measurement uncertainty and the effect on future consolidated financial statements from changes in such estimates could be significant.

Change in Functional Currency

On October 1, 2009, following the disposition of a partial interest in our key Breagh property, we determined that the UK pound better reflected the overall functional currency of our operations as future revenues and expenditures will be predominantly denominated in UK pounds. Accordingly, we prospectively changed our functional currency to the UK pound from the Canadian dollar. Prior to October 1, 2009, our operations were measured in Canadian dollars. The Canadian dollar has been retained as our reporting currency.

As a result of this change, our non-monetary assets and liabilities were re-measured at the October 1, 2009 UK pound to Canadian dollar exchange rate of 1.7283 resulting in an increase in other comprehensive income of $10,775,360 and an adjustment to retained earnings of $18,672,448.

Other comprehensive income includes the adjustment above of $10,775,360 partially offset by a charge of $1,011,881 to reflect the effect of translating our consolidated financial statements into our reporting currency of Canadian dollars using the current rate method. For reporting purposes, UK pound functional currency balances are similarly translated into Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Unrealized gains and losses resulting from the translation into Canadian dollars are included in other comprehensive income (loss).

Overview and Summary of Results for the Eight Most Recently Completed Quarters

We currently have no commercial production. Any minor pre-commercial production revenues are netted against related expenses, and the net amount capitalized as test production. Until such time as we generate production income, our results from operations are not affected by seasonal considerations, as evidenced by the following table of our income statements for the eight quarters ended December 31, 2009.

2009 (Quarter ended)	Dec-31	Sep-30	Jun-30	Mar-31	Total
	$	$	$	$	$
Gain on property disposition	–	72,103,206	–	–	72,103,206
Expenses					
General and administrative	835,815	1,407,477	738,303	796,401	3,777,996
Foreign exchange (gain) loss	(1,330,875)	(384,234)	(139,447)	73,320	(1,781,236)
Stock based compensation	351,351	318,404	257,064	241,819	1,168,638
Accretion	39,791	54,371	60,221	59,900	214,283
Depreciation	31,801	12,610	30,806	24,276	99,493
Financing expenses (income)	623,153	935,699	722,561	(41,916)	2,239,497
	551,036	2,344,327	1,669,508	1,153,800	5,718,671
Net (loss) income before income taxes	(551,036)	69,758,879	(1,669,508)	(1,153,800)	66,384,535
Income taxes	(137)	–	–	137	–
Net (loss) income	(550,899)	69,758,879	(1,669,508)	(1,153,937)	66,384,535
Net (loss) income per common share – basic	(0.00)	0.53	(0.01)	(0.01)	0.51
– diluted	(0.00)	0.53	(0.01)	(0.01)	0.50
Comprehensive (loss) income	(1,562,780)	69,758,879	(1,669,508)	(1,153,937)	65,372,654

2008 (Quarter ended)	Dec-31	Sep-30	Jun-30	Mar-31	Total
	$	$	$	$	$
Expenses					
General and administrative	234,901	398,793	859,528	501,856	1,995,078
Foreign exchange loss (gain)	1,914,603	(1,304,277)	200,482	(463,606)	347,202
Stock based compensation	244,102	241,275	204,788	156,341	846,506
Accretion	55,152	29,248	31,793	31,796	147,989
Depreciation	23,646	20,938	25,674	31,872	102,130
Financing (income) expenses	(244,986)	(380,340)	(320,565)	(214,155)	(1,160,046)
	2,227,418	(994,363)	1,001,700	44,104	2,278,859
Net (loss) income before income taxes	(2,227,418)	994,363	(1,001,700)	(44,104)	(2,278,859)
Income taxes	34,877	–	–	–	34,877
Net (loss) income and comprehensive (loss) income	(2,262,295)	994,363	(1,001,700)	(44,104)	(2,313,736)
Net (loss) income per common share – basic and diluted	(0.02)	0.01	(0.01)	(0.00)	(0.02)

The net income or loss per common share for each quarter is required to be calculated independently of the calculation for the year. Consequently the aggregate of the four quarters may differ from the total for each year.

Fourth Quarter 2009 Results

The net loss for the fourth quarter of 2009 compared to the results of the other seven quarters of 2009 and 2008 have been affected by the following key trends:

- Net general and administrative expenses have trended upwards over the last eight quarters generally due to increased costs associated with operating several projects in the offshore UK environment. Lower activity in 2009 has also resulted in reduced recoveries from our partners, particularly in the third quarter where operational activity was at its lowest level for the year. The third quarter is also higher than other quarters due to the payment of management incentives which had been deferred from the second quarter.

- Foreign exchange gains for the fourth quarter relate primarily to the translation of US dollar denominated cash and cash equivalents as well as working capital and other monetary items denominated in Canadian dollars, US dollars and Romanian lei. Fluctuations in foreign exchange gains and losses arise from both changes in the levels of working capital as well as the changes in the prevailing exchange rates. Foreign exchange losses in the fourth quarter of 2009, were also determined using the UK pound as the functional currency,
- Financing expenses in the fourth quarter are lower than in the second and third quarter mainly because of the timing of the issue and partial repayment of the secured notes. These notes had not been issued in 2008, and financing expenses during the first quarter of 2009 and the four quarters of 2008 were comprised only of interest income.

General and Administrative Expenses

The following table provides a breakdown of general and administrative expenses for 2009 and 2008:

	2009	2008
	$	$
Employee costs	**2,767,568**	2,305,370
Office rent and expenses	**1,068,663**	1,179,775
Professional and other fees	**1,409,887**	1,161,587
Travel	**380,834**	359,433
Other	**445,692**	474,109
Gross general and administrative expenses	**6,072,644**	5,480,274
Recoveries from partners	**(475,101)**	(2,069,111)
Charged to capital projects	**(1,819,547)**	(1,416,085)
	3,777,996	1,995,078

General and administrative expenses before recoveries from partners and internal capitalization for 2009 have increased somewhat over 2008 levels. This is mainly due to additional staff as a result of the ongoing increase in operational activity in the UK and Romania. In addition, professional and other fees have increased due to legal fees associated with environmental health and safety systems, farm-out activity and increased costs of the annual reserves evaluation.

Gross general and administrative expenses allocated to capital projects have also increased somewhat as a result of increased gross expenditures, but recoveries from partners have declined significantly due to lower activity.

Foreign Exchange

Following the adoption of the UK pound as our functional currency, subsequent foreign exchange gains and losses related primarily to working capital and provisions for asset retirement obligations which are denominated in US dollars. Previous to the change, gains and losses on UK pound denominated monetary balances also gave rise to foreign exchange differences. For the first three quarters net gains related mainly from conversion of US dollar and UK pound denominated working capital into Canadian dollars. In the fourth quarter of 2009 and in 2008 gains and losses were comprised mainly of gains on conversion of US dollar denominated working capital into UK pounds.

Stock Based Compensation

It continues to remain our policy that a significant proportion of employee and director remuneration should be geared to the success of our Company, but also should not result in significant depletion of our cash resources. Our stock option program therefore continues to be an important component of our compensation program.

In 2009, options to purchase 2,825,000 common shares were issued to directors, officers and employees at an average exercise price of $1.42 per share. Stock based compensation expense of $1,168,638 for 2009 increased from $846,506 in 2008 due to the issue of these options and to the full year impact of options issued part-way through 2008. Stock based compensation capitalized in 2009 was $906,612 (2008 – $720,043).

For 2008, options to purchase 2,610,000 common shares were issued to directors, officers, and employees at an average exercise price of $2.55 under our stock option plan.

Financing Expenses

Financing expenses are comprised of interest expense and amortization of debt issue costs related to the secured notes, net of interest income earned on funds on deposit as follows:

	2009	2008
	$	$
Interest Income	**(231,125)**	(1,160,046)
Interest expense	**1,111,882**	–
Amortization of debt issue costs	**1,358,740**	–
	2,239,497	(1,160,046)

Interest income in 2009 has declined substantially from 2008 due mostly to the decline in interest rates which approached zero for most of the period following the sale of a part-interest in the greater Breagh field in late August.

Interest expense and amortization of debt issue costs relate exclusively to the issue of the secured notes in April 2009.

Income Taxes

a) Current Income Taxes

No provision for current income taxes was required in 2009. Current income taxes for the year ended December 31, 2008, relate to the 30 percent income tax on United Kingdom non-ring fence activities, including interest on cash and bank deposits as well as foreign exchange gains or losses on cash denominated in foreign currencies.

b) Future Income Taxes

Under present UK tax law, the gain on the sale of one third of our 45 percent interest in the Breagh field and varying interests in the surrounding acreage for total gross proceeds of approximately $103 million is not subject to UK capital gains tax provided that equivalent proceeds are re-invested in eligible expenditures in the UK North Sea sector within a period of three years. We expect that our share of expenditures relating to the development of Breagh alone will meet this requirement.

We do not recognize the tax benefit of losses incurred at this time as we have no significant current production and we do not yet have regulatory approval for the development of Breagh or our other discoveries. Consequently there is no assurance the tax benefit will be realized. As at December 31, 2009, the Company has non-capital losses in Canada of approximately $11.8 million available, but subject to expiry over the next twenty years, to reduce future taxable income, and approximately $5.3 million of subsidiary UK tax losses which are not subject to expiry. In addition, at December 31, 2009, the Company had approximately $139.1 million of deductions available to be claimed against future income taxes which are not subject to expiry.

Net Income (Loss)

The net income of $66,384,535 ($0.51 per share – basic and $0.50 per share – diluted) for 2009 compares to a loss of $2,313,736 ($0.02 per share – basic and diluted) for 2008. The increase in net income relates primarily to the gain on the disposition of a 15 percent interest in Breagh and varying interests in the surrounding blocks. This gain has been partially offset by increased general and administrative expenses and net interest expense relating to the secured notes issued in 2009.

Petroleum Properties Activities and Capital Expenditures

Capital expenditures are categorized as petroleum and natural gas properties and capitalized in country-by-country cost centres. The following is a summary of net capital expenditure additions by cost centre for the years ended December 31, 2009 and 2008:

	2009	2008
	$	$
United Kingdom	**(15,217,336)**	(58,801,466)
Romania	**(5,764,739)**	(26,469,055)
France	**(101,959)**	(1,696,331)
Total petroleum and natural gas properties and equipment	**(21,084,034)**	(86,966,852)
Proceeds of dispositions of interests in properties	**89,612,456**	11,973,047

In the UK, 2009 net petroleum and natural gas (P&NG) expenditures of $15.2 million including expenditures incurred with respect to the interest in Breagh subsequently disposed of included the following major items:

- Approximately $11.8 million relating to the completion of testing of the Breagh 42/13-5z horizontal well early in the year. On test, the well flowed at maximum rates of 26 MMscf/d.
- Approximately $1.0 million relating to a pipeline survey for the proposed route for taking the Breagh gas to shore and for various Breagh engineering studies.
- In addition to these major items, UK capital expenditures were incurred completing additional seismic programs on other licenses in the greater Breagh area. Expenditures also include costs associated with maintaining existing licenses in good standing and preliminary costs associated with new licensing rounds in the UK.

In Romania, net P&NG expenditures of $5.8 million related mainly to the acquisition and interpretation of high-resolution seismic over the Doina trend and the Ioana prospect (formerly Midia SE), as well as internal capitalization of administrative costs related to maintaining our presence in Romania, both onshore and offshore.

Onshore Romania, on the 1.5 million acre Craiova concession we re-acquired the outstanding 40 percent interest held by our former partner Grove Energy (Romania) Limited (Grove), and entered into a new farm-in arrangement under which our new partner, TransAtlantic Worldwide (Romania) Limited (TransAtlantic) acquired a 50 percent share of the license in return for drilling three exploration wells. The first of these wells was spudded in late 2009, and the second and third wells in early 2010. Final results from the drilling program will not be made known until completion of the third well which will be tested in April 2010, however, despite encountering gas shows the first two wells do not indicate the presence of sufficient reservoir.

Dispositions of interests in properties for 2009 of $89.6 million represent the consideration of approximately $103 million less the costs of disposition ($1 million) and the repurchase of related obligations ($12 million) relating to the sale of one third of our interest in the Breagh discovery and varying interests in the surrounding acreage comprising the greater Breagh area.

During 2008, net P&NG expenditures of $87.0 million included the following major items:

- $40.5 million relating to the successful appraisal drilling program at Breagh on Block 42/13 in the UK Southern North Sea;
- $14.3 million for the Cladhan discovery well on block 210/29a (Sterling 39.9 percent) in the UK Northern North Sea;

- $26.5 million for the successful appraisal drilling program on the Doina trend in the Midia Block in the Romanian sector of the Black Sea; and
- $1.7 million on the unsuccessful Grenade-3 well on the St Laurent Block (Sterling 33.4 percent) in southern France.

Dispositions of interests in properties for 2008 of $12.0 million comprise proceeds from financing arrangements which are payable only out of production revenues from the Breagh and Doina fields.

We have now invested a total of $137.5 million, net of the costs related to interests disposed of, in our oil and gas properties to December 31, 2009, compared with $134.7 million as at December 31, 2008. As at December 31, 2009 we had interests in petroleum licenses and contracts as follows:

	Acres	
	Gross	Net
United Kingdom	923,289	293,824
Romania	2,645,000	1,872,500
France	125,280	41,872
	3,693,569	2,208,196

Our net interest of 1,872,500 acres in Romania represents our 50 percent interest in the Craiova Block onshore Romania and our current 100 percent interest in the offshore Midia and Pelican Blocks in the Black Sea. Following completion of farm-out arrangements and satisfaction of related obligations, our interest in the Midia and Pelican Blocks will be reduced to 32.5 percent.

Geological and geophysical work on the properties to date has resulted in many prospects and leads in addition to the discoveries specifically referred to above. Several of these prospects have been brought to the drillable stage, and we continue to pursue our farm-out strategy of bringing in industry partners to manage technical and financial risk.

Financing, Liquidity and Solvency

Net Working Capital

The following is a summary of net working capital as at December 31, 2009 and 2008:

	2009	2008
	$	$
Cash and cash equivalents	**81,798,904**	15,769,514
Restricted cash	**3,147,368**	11,270,280
Accounts receivable and prepaid expenses	**1,514,173**	5,229,141
Accounts payable and accrued liabilities	**(6,104,830)**	(18,301,465)
Secured notes	**(7,680,830)**	–
Net working capital	**72,674,785**	13,967,470

Cash and cash equivalents include term deposits of $77,251,802 (2008 – $5,800,000). Certain of these term deposits have maturities greater than 30 days from inception, but have cashable options and are therefore considered cash equivalents by management. The increase in cash and cash equivalents over balances at December 31, 2008 is due to the proceeds received from the Breagh disposition.

Restricted cash in an escrow account of $3,147,368 at December 31, 2009 was only available for settlement of expenditures relating to the drilling of the proposed Cladhan well on Block 210/29a in the UK Northern North Sea. At December 31, 2008, the balance of $11,270,280 similarly related to the drilling of the 42/13-5 and 5z wells in the UK Southern North Sea.

Accounts receivable and accounts payable have both declined from 2008 levels due to the decline in operational activity during the respective periods. Only minor amounts of receivables are not current.

Secured notes comprise the balance remaining from the US $11.2 million bridge financing facility which we completed earlier in the year The facility consists of 112 units, each consisting of one US $100,000 par value one-year 15% senior secured note and one common share purchase warrant entitling the holder to acquire 20,000 common shares of the Company at $0.84 per share. The notes are repayable in three equal installments 6, 9 and 12 months from closing which took place on April 20, 2009. The first repayment was made on October 30, 2009. The warrants issued pursuant to the bridge financing expire on April 19, 2012. In addition, following full repayment of the secured notes, the Company may force conversion of the warrants in the event the Company's closing share price exceeds $2.00 for 10 consecutive trading days. Debt issue costs totalled $858,678.

Financing and Farm-outs

Managing financial exposure by obtaining partner participation through farm-out and other arrangements is an integral part of our strategy and in the current financial environment remains the most viable option for furthering development of our key projects. Under these arrangements, a portion of our interest is given up in exchange for the partner paying a promoted share of certain of our costs of drilling a well or other programs. Specific terms of each partner's obligations vary.

During 2009, the completion of the key farm-out arrangement with Melrose was delayed due to the license transfer to the farm-in parties requiring government approval, and the unfounded rumours with respect to the legitimacy of the Company's interest in the Midia and Pelican Blocks offshore in the Black Sea. Throughout this period, the Company remained firm that its legal entitlements were well supported in the underlying agreements and that there had been no material breach of any regulations through its past operations.

In October 2009, the coalition government in Romania that had challenged the legitimacy of the Company's interest fell. Following a Presidential election in December, a new government was formed. Relationships with the new government have improved and we are cautiously optimistic that the required license transfers will proceed in the near future. In the event of any further challenge to its license interests the Company intends to vigorously defend its position, if necessary through the European and International courts. The Company has made no provision for impairment in its December 31, 2009 financial statements.

In the fourth quarter of 2009, we re-acquired the outstanding 40 percent interest held by Grove Energy (Romania) Limited, our former partner in the 1.5 million acre Craiova Concession onshore Romania. The transfer of this interest was subsequently approved by the new government. We then entered into a farm-in arrangement under which TransAtlantic Worldwide Romania SRL, a new partner acquired a 50 percent share of the license in return for drilling three exploration wells at no cost to Sterling.

In 2008, we concluded the following equity financings:

- On January 11, 2008 we completed a private placement of 7,109,900 common shares at a subscription price of $2.00 per share. The net proceeds from the issue were $14,178,966.
- On March 13, 2008 we completed a bought deal financing of 16,000,000 common shares at $2.50 per share including an underwriter's over-allotment option. The total gross proceeds were $40 million. After underwriter's commissions and expenses of the issue, net proceeds were $37,387,831.
- On August 6, 2008 we completed a bought deal financing of 11,274,600 units, including an underwriter's over-allotment option. Each unit was comprised of one common share of the Company and one half-warrant at a price of $2.55 per unit. Each full warrant entitled the holder to purchase one common share at a price of $3.25.The warrants expired on August 6, 2009. The net proceeds of the issue after expenses and underwriter's commissions were approximately $27,150,000 of which $1,409,325 was assigned to the value of the warrants based on a Black-Scholes calculation.

During 2008, we also completed three minor farm-outs and raised a further $12 million through financing arrangements which entitle a third party to a share of production from the Breagh and Doina fields.

Commitments and Obligations

a) Long-Term Obligations

We have long-term obligations to remediate or retire assets which result from net ownership interests in petroleum and natural gas exploration stage activity. We estimate the total undiscounted amount of cash flows required to settle our asset retirement obligations to be approximately $7.4 million which will be incurred between 2012 and 2022. A credit adjusted risk-free discount rate of 10 percent and an inflation rate of 4 percent were used to calculate the fair value of asset retirement obligations. A continuity of these obligations is as follows:

	2009	2008
	$	$
Balance, beginning of the year	**2,419,735**	1,249,585
Additions	**–**	1,262,345
Revisions to estimates	**(234,405)**	(240,184)
Disposals	**(201,066)**	–
Accretion	**214,283**	147,989
Balance, December 31	**2,198,547**	2,419,735

b) Short-Term Obligations

Short-term commitments and obligations under the terms of our exploration licenses and operating leases for office premises and storage facilities as follows:

	2010	2011	2012	2013	2014
	$	$	$	$	$
Oil and gas drilling (1)	25,866,000	7,519,000	–	–	–
Seismic	3,342,000	–	–	–	–
License fees	1,282,000	933,000	1,335,000	1,378,000	1,672,000
Other operating	1,544,000	45,000	45,000	45,000	34,000
Office and other leases	418,000	125,000	8,000	–	–
	32,452,000	8,622,000	1,388,000	1,423,000	1,706,000

(1) Oil and gas drilling commitments are subject to reduction through possible farm-out arrangements.

Certain of these commitments contain estimates by management of amounts to be expended under the related contracts. In addition to these commitments, the Company will also be required to incur eligible expenditures of approximately $103 million as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area. Of this amount $22 million of expenditures have been approved for 2010, and it is anticipated that with other planned development and exploration expenditures for 2010 and 2011, total expenditures will be sufficient to ensure we qualify for the full exemption.

Liquidity and Solvency

As at December 31, 2009, our net working capital totalled $72.7 million, sufficient to cover our current obligations and commitments for 2010 which totalled $54.5 million.

Following the issue of the secured notes and the part disposition of Breagh, both referred to above, we believe we have sufficient funding for the next year. Beyond this, additional funding will be required to bring Breagh to first production in 2012. In order to ensure that sufficient funding is in place, we have commenced negotiations for a senior debt facility with the Royal Bank of Scotland (RBS). A draft term sheet has been tabled and negotiations are progressing with the intent that the facility will be fully in place by the time development consent is received from the UK Department of Energy and Climate Change (DECC). Development consent is currently anticipated for the second quarter of 2010. The recently announced selection of RBS, a domestic UK lender with global operations, as lead is consistent with recent UK government initiatives encouraging the financing of oil and gas projects designed to further expand domestic UK petroleum supplies.

In addition to the proposed senior debt facility, we are also considering other contingent financing options including possible disposition of non-core assets and further farm-out arrangements. However, depending on the levels of senior debt eventually accessed, an issue of equity may be considered.

Future Plans

For 2010 our key focus will be on obtaining Field Development Approval for the Breagh field in the UK Southern North Sea, and to conclude the Melrose farm-out arrangement and license transfers such that we can proceed to prepare application for development approval from the Romanian authorities for the Doina/Ana field offshore Romania in the Black Sea. In addition we specifically plan to:

- Drill two exploration wells on prospects in the greater Breagh area;
- Progress Breagh development towards achieving first gas in 2012.
- Drill and test one follow-up well to the 2008 Cladhan discovery on Block 210/29a in the UK Northern North Sea.
- Drill one exploration well on Block 48/28b in the UK Southern North Sea.
- Drill one exploration well offshore Romania assuming government approval of working interest assignments to partners.
- Complete the three-well exploration program at Craiova, onshore Romania.
- Continue geological and geophysical work to evaluate our licenses offshore UK and Romania;
- Bring our Kirkleatham gas project on stream by the end of 2010.
- Continue our strategy of farming out a portion of our licenses in order to reduce costs.

Corporately, we will also be focusing on completing a senior debt facility with a syndicate of lenders led by the Royal Bank of Scotland.

These plans are contingent on partner approval and, more importantly upon availability of suitable financing and farm-out partners.

Risks and Uncertainties

The following is a summary of the principal risks facing our business, and the strategies we take to mitigate these risks as described in more detail in our Annual Information Form for the year ended December 31, 2009. It should not be assumed that this list is exhaustive or that material loss could not materialize as a result of other unforeseen risks.

Operational Risks

The international oil and gas industry is exposed to a variety of business risks, including, but not limited to:

- The finding, determination, evaluation, assessment and measurement of oil and gas deposits or reserves.
- Developing those reserves and finding markets for them.

- Potential delays or changes in plans with respect to exploration or development projects or capital expenditures.
- The availability and performance of joint venture partners with whom we conduct our business.
- The performance of contractors and consultants that we engage.
- Competition from others in obtaining exploration licenses or access to drilling equipment.
- Cultural and language barriers associated with conducting business in foreign countries.
- Reliance on key individuals.
- Title to oil and gas interests.

We also have a growing exploration portfolio and several undrilled prospects. Our ability to grow profitably will depend on our ability to drill successfully and develop these properties, as well as to obtain additional prospects.

We work to mitigate these risks by employing highly skilled personnel, focusing exploration efforts in areas where we have existing knowledge and expertise and access to such knowledge and expertise and by using current technology to enhance methods and control costs. We also maintain a corporate insurance program consistent with industry practice to protect the Company against losses due to accidental destruction of assets, well blowouts and other operating accidents and disruptions.

Financial Risks

Financial risks include the impact of fluctuations in commodity prices, foreign exchange rates, interest rates, inflation and credit risk as further described under recent accounting pronouncements below. These factors also affect:

- Anticipated future cash flows.
- The fair value of our oil and gas reserves and assets.
- The availability and cost of financing for our projects.
- The economics underlying our project decisions.
- The underlying value of the business on which our share price is based.

Political or Government Risks

We explore for oil and gas in various international jurisdictions with varying degrees of political or governmental risk including:

- The risk of changes in government policy, regulation or fiscal terms.
- The risk of changes in conditions under which exploration licenses are awarded, including related work commitments.
- The risks of required government approvals being delayed or withheld.
- Risks associated with the fiscal terms prevailing in the jurisdictions in which we operate.
- Risks relating to any known or future international border disputes in jurisdictions where we are active.

We are also subject to extensive and varying environmental regulations imposed by governments related to the protection of the environment. We are committed to operate safely in an environmentally sensitive manner and to safeguard the health and welfare of our employees, contractors, suppliers and the public, in every area of operation.

In order to balance our exposure to risk and reward in these areas, we conduct our activities in a number of jurisdictions that we consider to range from low to medium risk.

Further discussion of the risks and uncertainties facing our Company and our business is contained in the Company's Annual Information Form for the year ended December 31, 2009.

Recent Accounting Pronouncements

The Canadian Institute of Chartered Accountants (CICA) issued the following new accounting standards which became effective for the Company for 2009 reporting:

CICA 3064 – Goodwill and Intangible Assets contains recommendations relating to the recognition, measurement and disclosure of goodwill and intangible assets. These recommendations have no impact on the Company's consolidated financial statements.

CICA 3862 – Financial Instruments Presentation and Disclosure was amended in 2009 to include a hierarchy concept in measuring financial instruments, a requirement to provide disclosure relative to the fair value measurements of assets and liabilities for each level in the hierarchy and amendments to the liquidity disclosure requirements. Management has reviewed these requirements and have provided any additional disclosure required.

CICA Emerging Issues Committee Abstract 173 – Credit Risk and Fair Value of Financial Assets and Liabilities was issued effective January 1, 2009. This new policy requires an entity to assess its own credit risk and the credit risk of the counterparty when determining the fair value of financial instruments. The adoption of this pronouncement had no effect on the Company's financial position or results of operations.

Transition to International Financial Reporting Standards (IFRS)

In 2008, the CICA Accounting Standards Board (AScB) confirmed that Canadian publicly accountable enterprises will be required to adopt IFRS, as issued by the International Accounting Standards Board (IASB), in place of Canadian GAAP for interim and annual reporting for fiscal periods beginning on or after January 1, 2011. Therefore Sterling will be required to report its results in accordance with IFRS starting in 2011, with comparative IFRS information for the 2010 fiscal year.

We commenced our IFRS conversion project in 2008. The project consists of three phases: diagnostic, design and planning and implementation and training.

We have completed the diagnostic phase during which the preliminary identification and assessment of the accounting and reporting differences under IFRS compared to Canadian GAAP was completed. The analysis identified that the areas with the highest impact on our financial statements will be the accounting for petroleum and natural gas properties as well as the assessment of impairment for these properties. Under present IFRS standards there is no equivalent of the full cost method of accounting for petroleum and natural gas properties permitted under Canadian GAAP, which we currently follow.

We are now in the design and planning phase. As part of this phase we have evaluated the impact of exemptions available to first-time IFRS adopters which give relief from retrospective application of IFRS. We are currently working on the determination of cash generating units and are evaluating and drafting accounting policies; however at this time, the full impact of adopting IFRS on the Company's future results of operations or future financial position is not reasonably estimable or determinable.

During the implementation and training phase activities will include executing the required changes to accounting systems, operational information systems and disclosure controls and internal controls over financial reporting, executing training and compiling IFRS compliant financial statements.

Forward-Looking Statements and Business Risks

Certain statements contained in this MD&A are forward-looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue", or the negative of these terms or other comparable terminology. In addition, statements relating to reserves or resources are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions that the reserves and resources described can be profitably produced in the future.

Forward-looking statements in this MD&A include, but are not limited to, statements with respect to:

- Commodity prices.
- Our expectations regarding the duration of the economic recovery from the world-wide recession of 2008/2009.
- Our expectations regarding our cost structure.
- Factors upon which we will decide whether or not to undertake a specific course of action.
- Our expectations regarding interest rates and inflation.
- Our expectations regarding our ability to raise capital or bank debt and the currency of any such capital or bank debt.
- The sale, farming-in, farming-out or development of certain exploration properties.
- The realization of anticipated benefits of acquisitions and dispositions.
- Our expectations regarding our ability to obtain certain government and regulatory approvals.
- Our expectations regarding tax treatment under foreign government taxation regimes.
- Our expectations regarding our cash requirements and funding for the next year.
- Our drilling plans.
- Our tax horizon.
- Our corporate strategies, the criteria to be considered in connection therewith and the benefits to be derived therefrom.
- Our future plans and expectations that are described on page 26 under the "Future Plans".

These statements are only predictions. Actual events or results may differ materially. In addition, this MD&A may contain forward-looking statements attributed to third party industry sources, which sources are not endorsed or adopted by us expressly or impliedly.

Undue reliance should not be placed on these forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By its nature, forward-looking information involves numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will prove inaccurate. Certain of these risks are beyond our control, including: political instability in the countries in which we operate, the impact of general economic conditions in the areas in which we operate, civil unrest, industry conditions, changes in laws and regulations including the adoption of new environmental laws and regulations and changes in how they are interpreted and enforced, increased competition, the lack of availability of qualified personnel or management, fluctuations in commodity prices, foreign exchange or interest rates, stock market volatility and obtaining required approvals of regulatory authorities. In addition there are risks and uncertainties associated with oil and gas operations. Readers should also carefully consider the matters discussed under the heading "Risk Factors" in our Annual Information Form beginning on page 11.

With respect to forward-looking statements in this MD&A we have assumed, among other things, that the Company:

- Operates in an environment of fiscal and political stability.
- Operates in an environment of increasing competition.

- Is able to obtain additional financing or farm-out additional interests on satisfactory terms.
- Is able to continue to attract and retain qualified personnel.
- Is able to obtain necessary approvals from partners for a particular course of action.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. We cannot guarantee future results, levels of activity, performance, or achievements.

Our actual results and future plans could differ materially from those anticipated in similar forward-looking statements in this MD&A as a result of the risks described above. These statements speak only as of the date of the MD&A. The Company does not intend and does not assume any obligation to update these forward looking statements except as required by law.

The forward-looking statements contained in this MD&A are expressly qualified by the foregoing cautionary statement. Financial outlook information contained in this MD&A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. Readers are cautioned that such financial outlook information contained in this MD&A should not be used for purposes other than for which it is disclosed herein.

Additional Information

Additional information about Sterling Resources Ltd. and its business activities, including Sterling's Annual Information Form, is available on SEDAR at www.sedar.com.

Management's Report

The accompanying consolidated financial statements and all information in the annual report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles outlined in the notes to the consolidated financial statements. Other financial information appearing throughout the report is presented on a basis consistent with the consolidated financial statements.

Management maintains appropriate systems of internal controls. Policies and procedures are designed to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the presentation of financial statements.

Ernst & Young LLP, an independent firm of Chartered Accountants, has been engaged, as approved by the shareholders, to examine the consolidated financial statements in accordance with auditing standards generally accepted in Canada and to provide an independent professional opinion.

The Audit Committee and the Board of Directors have reviewed the consolidated financial statements with management and with Ernst & Young LLP. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

[Signed]	[Signed]
Stewart G. Gibson Chief Executive Officer	Ian Hornby-Smith Chief Financial Officer

April 20, 2010

Auditors' Report

To the Shareholders of Sterling Resources Ltd.

We have audited the consolidated balance sheets of Sterling Resources Ltd. as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

[Signed]

Calgary, Canada
April 20, 2010

Ernst & Young LLP
Chartered Accountants

Consolidated Balance Sheets

	2009	2008
		Restated [note 6]
	$	$
ASSETS		
Current		
Cash and cash equivalents [note 4]	**81,798,904**	15,769,514
Restricted cash [note 5]	**3,147,368**	11,270,280
Accounts receivable	**1,461,663**	5,192,297
Prepaid expenses	**52,510**	36,844
	86,460,445	32,268,935
Property, plant and equipment [note 6]		
Petroleum and natural gas properties and equipment	**137,474,996**	121,948,262
Furniture, fixtures and equipment	**180,093**	262,132
	137,655,089	122,210,394
Assets held for sale [note 6]	**–**	12,770,217
	224,115,534	167,249,546
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**6,104,830**	18,301,465
Secured notes [note 7]	**7,680,830**	–
	13,785,660	18,301,465
Asset retirement obligations [note 8]	**2,198,547**	2,419,735
Commitments [note 9]	**–**	–
Shareholders' equity		
Share capital [note 11]	**157,642,776**	156,773,276
Contributed surplus	**6,857,698**	3,599,783
Retained earnings (deficit)	**33,867,374**	(13,844,713)
Accumulated other comprehensive income	**9,763,479**	–
	208,131,327	146,528,346
	224,115,534	167,249,546

See accompanying notes.

On behalf of the Board:

[Signed] [Signed]

Director Director

Consolidated Statements of Operations

	2009	2008
	$	$
GAIN ON PROPERTY DISPOSITION [note 6]	**72,103,206**	–
EXPENSES		
General and administrative	**3,777,996**	1,995,078
Foreign exchange (gain) loss	**(1,781,236)**	347,202
Stock based compensation [note 11]	**1,168,638**	846,506
Accretion [note 8]	**214,283**	147,989
Depreciation	**99,493**	102,130
Financing expenses (income)	**2,239,497**	(1,160,046)
	5,718,671	2,278,859
Income (loss) before income taxes	**66,384,535**	(2,278,859)
Current income taxes [note 12]	**–**	34,877
Net income (loss) for the year	**66,384,535**	(2,313,736)
Net income (loss) per common share [note 13]		
Basic	**0.51**	(0.02)
Diluted	**0.50**	(0.02)

See accompanying notes.

Consolidated Statements of Comprehensive Income (Loss)

	2009	2008
	$	$
Net income (loss)	**66,384,535**	(2,313,736)
Foreign currency translation into reporting currency [note 3]	**(1,011,881)**	–
Comprehensive income (loss)	**65,372,654**	(2,313,736)

See accompanying notes.

Consolidated Statements of Changes in Shareholders' Equity

	2009	2008
	$	$
Share capital [note 11]		
Balance at beginning of year	**156,773,276**	76,900,308
Issued common shares	**1,211,168**	82,509,247
Common share issue costs	**1,522**	(4,443,520)
Transferred from contributed surplus on exercise of options and warrants	**226,660**	397,916
Issued warrants	**839,475**	1,409,325
Expiry of warrants	**(1,409,325)**	–
Balance at end of year	**157,642,776**	156,773,276
Contributed surplus		
Balance at beginning of year	**3,599,783**	2,431,150
Stock based compensation expense	**1,168,638**	846,506
Stock based compensation capitalized	**906,612**	720,043
Transferred to share capital on exercise of options	**(226,660)**	(397,916)
Expiry of warrants [note 11]	**1,409,325**	–
Balance at end of year	**6,857,698**	3,599,783
Retained earnings (deficit)		
Balance at beginning of year	**(13,844,713)**	(11,530,977)
Net income (loss)	**66,384,535**	(2,313,736)
Impact of change in functional currency [note 3]	**(18,672,448)**	–
Balance at end of year	**33,867,374**	(13,844,713)
Accumulated other comprehensive income		
Balance at beginning of year	**–**	–
Impact of change in functional currency [note 3]	**10,775,360**	–
Foreign currency translation into reporting currency	**(1,011,881)**	–
Balance at end of year	**9,763,479**	–

See accompanying notes.

Statements of Cash Flows

	2009	2008
	$	$
OPERATING ACTIVITIES		
Net income (loss) for the year	**66,384,535**	(2,313,736)
Items not affecting cash used in operating activities		
Gain on property disposition	**(72,103,206)**	–
Unrealized foreign exchange gain	**(1,637,335)**	(1,135,843)
Stock based compensation [note 11]	**1,168,638**	846,506
Accretion [note 8]	**214,283**	147,989
Depreciation	**99,493**	102,130
Amortization of debt issue expenses [note 7]	**1,358,740**	–
	(4,514,852)	(2,352,954)
Change in non-cash working capital [note 14]	**41,118**	119,807
Cash used in operating activities	**(4,473,734)**	(2,233,147)
INVESTING ACTIVITIES		
Decrease (increase) in restricted cash	**8,122,912**	(5,653,020)
Petroleum and natural gas properties and equipment additions	**(17,360,714)**	(86,966,852)
– additions on property held for resale	**(3,723,320)**	–
Net proceeds from disposition of interests in properties [note 6]	**89,612,456**	11,973,047
Disposals of furniture, fixtures and equipment	**25,448**	(191,478)
Change in non-cash working capital [note 14]	**(6,466,452)**	9,403,826
Cash provided by (used in) investing activities	**70,210,330**	(71,434,477)
FINANCING ACTIVITIES		
Issue of secured notes	**11,603,047**	–
Repayment of secured notes	**(3,922,217)**	
Issue of common shares, exercise of stock options and warrants	**1,212,688**	79,475,052
Cash provided by financing activities	**8,893,518**	79,475,052
Foreign currency adjustments not affecting cash used in operating activities	**(8,600,724)**	(346,278)
Increase in cash and cash equivalents during the year	**66,029,390**	5,461,150
Cash and cash equivalents, beginning of year	**15,769,514**	10,308,364
Cash and cash equivalents, end of year	**81,798,904**	15,769,514

See accompanying notes.

Notes to Consolidated Financial Statements

1. Description of Business

Sterling Resources Ltd. (the "Company") is a publicly traded energy company engaged in the exploration, appraisal and development of crude oil and natural gas in selected areas of the world.

2. Significant Accounting Policies

Basis of Presentation

These consolidated financial statements have been prepared by management on a going concern basis in accordance with Canadian generally accepted accounting principles. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions have been eliminated.

Revenue Recognition

The Company recognizes revenues from petroleum and natural gas assets when title passes to the customer and at such time as a project becomes commercially viable and development approval is received. Prior to this stage, any production is considered test production and related revenue is capitalized net of applicable costs.

Per Share Amounts

The Company follows the treasury stock method for the computation of diluted per share amounts. Under this method, the diluted weighted average number of common shares is calculated assuming the proceeds from the exercise of dilutive securities are used to purchase common shares at the average market price.

Cash and Cash Equivalents

Cash and cash equivalents include term deposits, guaranteed investment certificates and operating bank accounts with maturities from inception or cashable options, if applicable, of 30 days or less.

Petroleum and Natural Gas Properties and Equipment

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs relating to the acquisition of, exploration for and development of, petroleum and natural gas properties and equipment are capitalized in cost centres on a country-by-country basis. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals, and costs of drilling and equipping productive and non-productive wells.

All cost centers are in the exploration, appraisal or "pre-development" stage and as such the costs in each centre are not subject to depletion. An impairment review is performed at every reporting date to determine whether the aggregate net costs in each pre-development stage cost center are recoverable. Recoverability is determined by comparing capitalized costs for each cost centre with estimated future net revenues using estimated future prices and costs and internal estimates of recoverable reserves or resources. Sensitivity to key assumptions is also tested using a range of values. Costs which are unlikely to be recovered are written off. The recovery of the costs incurred to date is ultimately dependent upon production of commercial quantities of hydrocarbons or the sale of the related asset. The likelihood of such production is not assured at this time.

Furniture, Fixtures and Equipment

Furniture, fixtures and equipment are carried at cost less accumulated depreciation. Depreciation is calculated on a declining balance basis at an annual rate of 30 percent.

Asset Retirement Obligations

The Company recognizes the fair value of an asset retirement obligation (ARO) in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value is determined through a review of engineering studies, industry guidelines and management's estimate on a site-by-site basis. The fair value is recorded as a liability with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount is expensed during the period. Actual costs incurred upon the settlement of the ARO are charged against the liability.

Joint Operations

Substantially all of the Company's exploration activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Cash and Cash Equivalents

Cash and cash equivalents include term deposits, guaranteed investment certificates and operating bank accounts with maturities from inception or cashable options, if applicable, of 30 days or less.

Financial Instruments

Financial instruments are categorized as held-for-trading, available-for-sale, held-to-maturity, loans and receivables or other. Those financial instruments categorized as held-for-trading or available-for-sale would be subsequently measured at their fair value at each reporting period. Subsequent gains or losses arising from the change in fair value on held-for-trading financial instruments would be recognized in net income (loss) while those categorized as available-for-sale would be recognized in comprehensive income (loss). Those financial instruments categorized as held-to-maturity, loans and receivables or other would be initially recorded at fair value and subsequently measured at amortized cost using the effective interest rate method. As new financial instruments are acquired an evaluation of management's intent and the nature of the item is performed to determine the correct financial instrument categorization and subsequent measurement of any gains or losses.

The fair value of a financial instrument is the amount that would be agreed on in an arm's-length transaction between knowledgeable, willing parties who are under no obligation to act. Fair values can be determined by reference to prices for a financial instrument in active markets to which the Company has access. In the absence of an active market, the Company would determine fair values based on valuation models or by reference to other similar products in active markets.

Foreign Currency Translation

The Company's foreign operations are considered to be integrated operations and are translated using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Gains and losses on translation are reflected in income when incurred.

The Company's financial results have been reported in Canadian dollars, with amounts translated to Canadian dollars as follows: assets and liabilities at the rate of exchange in effect at the applicable balance sheet date and revenues and expenses at the average exchange rates for the periods. The Company's share capital accounts, including its common shares and contributed surplus, are translated at rates in effect at the time of issuance. Unrealized gains and losses resulting from the translation to Canadian dollars are included in accumulated other comprehensive income (loss).

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, the Company records future income taxes for the effect of any differences between the accounting and income tax basis of an asset or liability. Future income taxes are measured using income tax rates expected to apply in the years in which differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in net income (loss) in the period in which the change is substantively enacted. Future income tax assets are calculated, and if realization is not considered to be "more likely than not", a valuation allowance is provided.

Stock Based Compensation

Under the Company's stock option plan, options to purchase common shares are granted to directors, officers and employees at then current market prices. Options issued by the Company are accounted for in accordance with the fair value method of accounting for stock based compensation, and as such the cost of the options is charged to operations over the vesting period, with an offsetting amount recorded to contributed surplus, based on an estimate of the fair value of the options at the grant date determined using the Black-Scholes option pricing model. At the time of exercise, the related amounts previously credited to contributed surplus are transferred to share capital together with any consideration received from the option holder.

Measurement Uncertainty

A precise determination of many assets and liabilities is dependent upon future events, and consequently the preparation of financial statements involves the use of estimates and approximations. The amounts recorded for asset retirement obligations and stock based compensation have been made based on estimates of fair value, using careful judgment. The assumptions used in the determination of potential asset impairments are also based on estimates of future net revenues using estimated future prices and costs and internal estimates of recoverable reserves or resources. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of changes in such estimates in future periods could be material.

Recent Accounting Pronouncements

The Canadian Institute of Chartered Accountants (CICA) issued the following new accounting standards which became effective for the Company for 2009 reporting:

CICA 3064 – Goodwill and Intangible Assets contains recommendations relating to the recognition, measurement and disclosure of goodwill and intangible assets. These recommendations have no impact on the Company's consolidated financial statements.

CICA 3862 – Financial Instruments Presentation and Disclosure was amended in 2009 to include a hierarchy concept in measuring financial instruments, a requirement to provide disclosure relative to the fair value measurements of assets and liabilities for each level in the hierarchy and amendments to the liquidity disclosure requirements. Management has reviewed these requirements and has provided any additional disclosure required.

CICA Emerging Issues Committee Abstract 173 – Credit Risk and Fair Value of Financial Assets and Liabilities was issued effective January 1, 2009. This new policy requires an entity to assess its own credit risk and the credit risk of the counterparty when determining the fair value of financial instruments. The adoption of this pronouncement had no effect on the Company's financial position or results of operations.

Transition to International Financial Reporting Standards (IFRS)

In 2008, the CICA Accounting Standards Board (AScB) confirmed that Canadian publicly accountable enterprises will be required to adopt IFRS, as issued by the International Accounting Standards Board (IASB), in place of Canadian GAAP for interim and annual reporting for fiscal periods beginning on or after January 1, 2011. Therefore Sterling will be required to report its results in accordance with IFRS starting in 2011, with comparative IFRS information for the 2010 fiscal year. The Company commenced its IFRS conversion project in 2008. The project consists of three phases: diagnostic, design and planning and implementation and training.

The Company has completed the diagnostic phase during which the preliminary identification and assessment of the accounting and reporting differences under IFRS compared to Canadian GAAP was completed. The analysis identified that the areas with the highest impact on the Company's financial statements will be the accounting for petroleum and natural gas properties as well as the assessment of impairment for these properties. Under present IFRS standards there is no equivalent of the full cost method of accounting for petroleum and natural gas properties permitted under Canadian GAAP, and currently followed by the Company.

The Company is currently in the design and planning phase. As part of this phase the Company has evaluated the impact of exemptions available to first-time IFRS adopters which give relief from retrospective application of IFRS. The Company is currently working on the determination of cash generating units and is evaluating and drafting accounting policies; however at this time, the full impact of adopting IFRS on the Company's future results of operations or future financial position is not reasonably estimable or determinable.

During the implementation and training phase activities will include executing the required changes to accounting systems, operational information systems and disclosure controls and internal controls over financial reporting, executing training and compiling IFRS compliant financial statements.

3. Change in Functional Currency

On October 1, 2009, following the disposition of a partial interest in its key Breagh property and based on plans for additional activity in the UK, the Company determined that the UK pound better reflected the overall functional currency of its operations as future revenues and expenditures will be predominantly denominated in UK pounds. Accordingly, the Company prospectively changed its functional currency to the UK pound from the Canadian dollar. Prior to October 1, 2009, its operations were measured in Canadian dollars. The Canadian dollar has been retained as the Company's reporting currency.

As a result of this change, the Company's non-monetary assets and liabilities were re-measured at the October 1, 2009 UK pound to Canadian dollar exchange rate of 1.7283 resulting in an increase in other comprehensive income of $10,775,360 and an adjustment to retained earnings of $18,672,448.

Accumulated other comprehensive income includes the adjustment above of $10,775,360 partially offset by a charge of $1,011,881 to reflect the effect of translating the Company's consolidated financial statements into the reporting currency of Canadian dollars using the current rate method. For reporting purposes, UK pound functional currency balances are similarly translated into Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. Unrealized gains and losses resulting from the translation into Canadian dollars are included in other comprehensive income (loss).

4. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	2009	2008
	$	$
Cash	**4,547,102**	9,969,514
Cash equivalents	**77,251,802**	5,800,000
	81,798,904	15,769,514
Balances held in:		
Canadian dollars	**2,118,691**	5,906,699
US dollars	**72,275,613**	6,947,855
UK pounds	**7,392,094**	2,914,069
Other	**12,506**	891
	81,798,904	15,769,514

As at December 31, 2009, cash equivalents carried interest at rates between 0.3 percent and 1.0 percent (2008 – 1.5 percent).

5. Restricted Cash

Restricted cash of $3,147,368 as at December 31, 2009 comprised cash in an escrow account which was available only for settlement of expenditures relating to the drilling of one UK offshore well scheduled for 2010. For 2008, restricted cash of $11,270,280 was similarly comprised of cash in escrow available only for settlement of expenditures relating to a well which was completed in 2009.

6. Property, Plant and Equipment

a) Petroleum and Natural Gas Properties and Equipment

	2009	2008
	$	$
United Kingdom	**86,020,962**	73,916,403
Romania	**49,084,858**	45,683,548
France	**2,369,176**	2,348,311
	137,474,996	121,948,262

During the year ended December 31, 2009, the Company capitalized salaries and related benefits, including stock based compensation, of $2,726,159 (2008 – $2,136,129).

On August 26, 2009 the Company disposed of one third of its interest in the Breagh field and varying interests in the surrounding exploration blocks for consideration of approximately $103 million. Following the sale, the Company retained a 30 percent interest in the Breagh field and the surrounding blocks which comprise the greater Breagh area.

The net gain on disposition of $72,103,206 represents the excess of the proceeds received over the carrying value of the assets disposed of, the costs of disposition of $0.8 million and the repurchase of the pro-rata share of the underlying encumbrance entitling a third party to a share of gross production from the Breagh field ($11.9 million). Under present UK tax law, the gain on the disposition is not subject to UK capital gains tax provided that equivalent proceeds are re-invested in the UK North Sea sector within a period of three years. As this is the Company's intent, no provision has been made for capital gains tax. The comparative balance sheet as at December 31, 2008 has been restated to show the net book value of these assets of $12,770,217 as held for sale.

During 2008, the Company sold interests in certain of its UK and Romania offshore properties for net proceeds of $9,732,360 and $2,240,687 respectively. These interests entitle the owner to payments equal to a share of gross production from the fields.

b) Furniture, Fixtures and Equipment

	2009	2008
	$	$
Furniture, fixtures and equipment	**522,954**	566,403
Less accumulated depreciation	**(342,861)**	(304,271)
	180,093	262,132

7. Secured Notes

On April 20, 2009 the Company completed a bridge financing for gross proceeds of US $11.2 million. The facility consists of 112 units, each consisting of one US $100,000 par value one-year 15% senior secured note and one common share purchase warrant entitling the holder to acquire 20,000 common shares of the Company at $0.84 per share. The notes are repayable in three equal installments 6, 9 and 12 months from closing which took place on April 20, 2009. The first repayment was made on October 30, 2009. The warrants issued pursuant to the bridge financing expire on April 19, 2012. In addition, following full repayment of the secured notes, the Company may force conversion of the warrants in the event the Company's closing share price exceeds $2.00 for 10 consecutive trading days. Debt issue costs totaled $858,678.

	2009	2008
	$	$
Principal amount of notes	**13,582,343**	–
Debt issue expenses		
Cash expenses	**(858,678)**	–
Fair value of warrants	**(839,475)**	–
	11,884,190	–
Repayment of notes	**(3,922,217)**	
Amortization of debt issue expenses	**1,358,740**	–
Foreign exchange	**(1,639,883)**	–
Balance, December 31	**7,680,830**	–

The fair value of the warrants included in debt issue expenses was determined using the Black-Scholes option pricing model. Debt issue expenses are amortized over the term of the notes such that the notes will accrete to the full principal amount at redemption.

8. Asset Retirement Obligations

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas exploration stage activity. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately $7.4 million which will be incurred between 2012 and 2022. A credit adjusted risk-free discount rate of 10 percent and an inflation rate of 4 percent were used to calculate the fair value of asset retirement obligations.

	2009	2008
	$	$
Balance, beginning of the year	**2,419,735**	1,249,585
Additions	**–**	1,262,345
Revisions to estimates	**(234,405)**	(240,184)
Disposals	**(201,066)**	–
Accretion	**214,283**	147,989
Balance, December 31	**2,198,547**	2,419,735

Revisions to estimates of $234,405 (2008 – $240,184) relate primarily to foreign exchange revaluation for 2009, and for 2008, to the extension of anticipated field lives as a result of the respective drilling programs.

9. Commitments

The Company has commitments and obligations under the terms of its petroleum and natural gas licenses as well as office leases which are expected to be incurred over the next five years as follows:

	2010	2011	2012	2013	2014
	$	$	$	$	$
Oil and gas drilling	25,866,000	7,519,000	–	–	–
Seismic	3,342,000	–	–	–	–
License fees	1,282,000	933,000	1,335,000	1,378,000	1,672,000
Other operating	1,544,000	45,000	45,000	45,000	34,000
Office and other leases	418,000	125,000	8,000	–	–
	32,452,000	8,622,000	1,388,000	1,423,000	1,706,000

Of the total oil and gas drilling commitments, approximately $17.7 million relates to commitment wells which are subject to farm-out negotiations, and may be substantially reduced or eliminated upon conclusion of negotiations.

Certain of these commitments contain estimates by management of amounts to be expended under the related contracts. In addition to these commitments, the Company will also be required to incur eligible expenditures of approximately $103 million as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area. Of this amount $22 million of expenditures have been approved for 2010, and it is anticipated that with other planned development and exploration expenditures for 2010 and 2011, total expenditures will be sufficient to ensure the Company qualifies for the full exemption.

In order for the Company to maintain its working interests in its oil and gas properties in the pre-development stage, the Company has commitments to complete various seismic, geological, geophysical and other exploration drilling and work programs, none of which are of a material amount except those disclosed above. The continuation of this work is dependent upon the ability of the Company to obtain continued financing or farm-out any of its existing working interests.

10. Capital Disclosures

The Company defines capital as secured notes, long-term debt and shareholders' equity, comprised of retained earnings, share capital, contributed surplus and accumulated other comprehensive income. At December 31, 2009, the Company had no long-term debt and its shareholders' equity as defined was $208 million. The Company's primary capital management objective is to maintain a strong balance sheet to give the financial flexibility to balance growth through exploration, appraisal and development as well as continued access to capital markets. Currently, exploration activity is financed primarily through available cash resources or equity financings, and senior debt facilities are being sought for development project financing. There are no external restrictions on the Company's share capital.

The Company currently manages its capital structure by close monitoring of its working capital and by regular budgeting and forecasting of future cash requirements. The Company adjusts discretionary capital spending, issues new shares or disposes of, or farms-out, interests in properties to meet cash requirements. At present, the Company is entirely funded by equity and short-term debt and consequently does not maintain financial ratios to monitor and manage its capital structure.

11. Share Capital

Authorized

Unlimited common shares without nominal or par value

Issued and Outstanding

	2009		2008	
Common shares	Number of shares	Amount $	Number of shares	Amount $
Balance at beginning of the year	**130,941,472**	**155,363,951**	95,766,968	76,900,308
Issued for cash:				
– private placement issue	**–**	**–**	7,109,900	14,219,800
– public equity issues	**–**	**–**	27,274,600	67,340,905
– exercise of stock options	**373,334**	**488,768**	790,004	948,542
– exercise of warrants	**860,000**	**722,400**	–	–
Share issue costs	**–**	**1,522**	–	(4,443,520)
Non-cash transfer from warrants	**–**	**322,298**	–	–
Transferred from contributed surplus on exercise of options	**–**	**226,660**	–	397,916
Balance at the end of year	**132,174,806**	**157,125,599**	130,941,472	155,363,951

Common share warrants	2009 Number of warrants	2009 Amount $	2008 Number of warrants	2008 Amount $
Balance at beginning of the year	**5,637,300**	**1,409,325**	–	–
Issued for cash – public equity issue	**–**	**–**	5,637,300	1,409,325
Issued in connection with secured notes [note 7]	**2,240,000**	**839,475**	–	–
Exercise of common share warrants	**(860,000)**	**(322,298)**	–	–
Expired	**(5,637,300)**	**(1,409,325)**	–	–
Balance at the end of year	**1,380,000**	**517,177**	5,637,300	1,409,325
Share capital at the end of the year	**133,554,806**	**157,642,776**	136,578,772	156,773,276

Stock Options

The Company has established a stock option plan whereby it may grant options to its directors, officers, employees and consultants. On December 31, 2009 there were 13,217,480 (2008 – 10,000,000) common shares reserved for issuance under the plan. The exercise price of each option equals the market price of the Company's shares on the date of the grant. The option's maximum term is five years, with the minimum vesting period to be 18 months. Stock options currently issued vest over the initial three years. The following is a continuity of outstanding stock options:

	2009 Number of options	2009 Weighted Average Exercise Price	2008 Number of options	2008 Weighted Average Exercise Price
		$		$
Outstanding, January 1	**6,616,663**	**2.10**	5,223,334	1.70
Granted during the year	**2,825,000**	**1.42**	2,610,000	2.55
Exercised during the year	**(373,334)**	**1.31**	(790,004)	1.20
Forfeited during the year	**–**	**–**	(154,999)	1.86
Expired during the year	**(441,669)**	**2.41**	(271,668)	1.45
Outstanding, December 31	**8,626,660**	**1.90**	6,616,663	2.10

The following stock options were outstanding at December 31, 2009:

Exercise Price	Number Outstanding	Number Exercisable	Weighted Average Contract Life (Days)
1.42	2,825,000	–	1,247
1.44	629,997	629,997	166
1.46	76,666	76,666	317
1.57	1,581,666	1,040,003	513
1.68	26,666	26,666	248
2.45	876,665	876,665	333
2.50	350,000	116,667	841
2.56	2,260,000	753,340	878
	8,626,660	3,520,004	816

The Company uses the fair value method of accounting for all stock options granted to directors, officers and employees. Fair value is determined using the Black-Scholes option pricing model using the following weighted average assumptions:

	2009	2008
Risk-free interest rate	**1.96%**	3.2%
Expected hold period to exercise	**3.5 years**	3.5 years
Volatility in the price of the Company's shares	**105.7%**	49.0%
Dividend yield	**0%**	0%

The weighted average fair value of options granted during the year ended December 31, 2009 was $0.91 (2008 – $0.98). During the year $2,075,250 (2008 – $1,566,549) of stock based compensation was recognized of which $906,612 (2008 – $720,043) was capitalized and $1,168,638 (2008 – $846,506) was expensed.

12. Income Taxes

Current Income Taxes

Current income taxes of $34,877 for the year ended December 31, 2008 relate to the 30 percent income tax on United Kingdom non-ring fence activities, including interest on cash and bank deposits as well as foreign exchange gains or losses on cash denominated in foreign currencies.

Income taxes differ from the amounts that would be obtained by applying the Canadian statutory income tax rate to income (loss) before income taxes as follows:

	2009	2008
	$	$
Net income (loss) before income taxes for the year	**66,384,535**	(2,278,859)
Canadian statutory income tax rate	**29.00%**	29.50%
Computed income tax expense (recovery) at the statutory rate	**19,251,515**	(672,263)
Tax rate differential on foreign operations	**(8,308)**	2,440
Gain on disposition of UK properties	**(20,909,930)**	–
Permanent differences	**10,141**	8,186
Stock based compensation	**338,905**	249,719
Fair value of warrants expensed	**194,789**	–
Non-taxable foreign exchange gain on secured notes	**(237,783)**	–
Rate adjustments	**161,609**	79,622
Tax losses expired	**68,646**	115,767
Other	**(52,357)**	(39,097)
Change in valuation allowance	**1,182,773**	290,503
Income tax expense per financial statements	**–**	34,877

Future Income Taxes

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. As at December 31, 2009 and 2008, the Company has recognized a full valuation allowance against a future income tax asset arising from tax pools in excess of the net book value of property, plant and equipment, share issue costs and non-capital losses as follows:

	2009	2008
	$	$
Tax pools in excess of net book value of property, plant and equipment	**852,594**	396,341
Share issue costs	**932,375**	1,150,206
Domestic and foreign non-capital losses	**4,539,462**	3,755,177
Asset retirement obligations	**120,333**	60,710
Unrealized foreign exchange gain	**(458,454)**	(978,241)
	5,986,310	4,384,193
Less: valuation allowance	**(5,986,310)**	(4,384,193)
Future tax asset	**–**	–

The Company's non-capital losses available to reduce future Canadian taxable income expire as follows:

	$
2010	247,282
2014	524,380
2015	1,903,865
2026	234,590
2027	494,829
2028	3,530,400
2029	4,900,810
	11,836,156

The Company's UK tax losses carried forward of approximately $5,282,933 (2008 – $6,646,290), are not subject to expiry.

13. Net Income (Loss) Per Common Share

The basic net income (loss) per share is calculated based on net income (loss) as the numerator in the calculation and the weighted average number of shares issued and outstanding during the year ended December 31, 2009 of 131,156,550 (2008 – 120,459,791) as the denominator.

The Company follows the treasury stock method for the computation of diluted per share amounts. Under this method, the diluted weighted average number of common shares is calculated assuming the proceeds from the exercise of dilutive securities are used to purchase common shares at the average market price as follows:

	2009	2008
Weighted average shares outstanding	**131,156,550**	120,459,791
Dilution factor	**455,033**	–
Diluted shares outstanding	**131,611,583**	120,459,791
Net income (loss)	**$66,384,535**	$(2,313,736)
Net income (loss) per share		
– basic	**$0.51**	$(0.02)
– diluted	**$0.50**	$(0.02)

14. Working Capital

Changes in the Company's non-cash working capital for the years ended December 31, 2009 and 2008 are as follows:

	2009	2008
	$	$
OPERATING ACTIVITIES		
Accounts receivable	**68,773**	(38,833)
Prepaid expenses	**(15,666)**	40,003
Accounts payable and accrued liabilities	**(11,989)**	118,637
	41,118	119,807
INVESTING ACTIVITIES		
Accounts receivable	**3,661,741**	2,005,744
Accounts payable and accrued liabilities	**(10,128,193)**	7,398,082
	(6,466,452)	9,403,826

15. Financial Instruments

The Company's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, secured notes and accounts payable, approximate their carrying values. Financial instruments have been categorized as follows:

Cash and cash equivalents and restricted cash – held-for-trading;

Accounts receivable – loans and receivables; and

Secured notes and accounts payable – other financial liabilities.

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. The Company characterizes inputs used in determining fair value using a hierarchy that prioritizes inputs depending on the degree to which they are observable.

The Company is exposed to a number of different financial risks arising from normal course business exposures, as well as the Company's use of financial instruments. These risk factors include market risks relating to foreign exchange rate fluctuations and interest rate risk, as well as liquidity risk and credit risk.

(A) FOREIGN EXCHANGE RATE RISK

The Company's functional currency is UK pounds and foreign exchange gains and losses can occur as a result of translating working capital and other monetary items denominated in Canadian dollars, US dollars and Romanian lei into UK pounds. In order to minimize exposure to foreign exchange fluctuations, non-cash working capital is only held in foreign currencies where it is required for operating activities and cash is converted into foreign currencies for known or anticipated expenditures within the near term. Based on net foreign currency monetary items at December 31, 2009, a one percent fluctuation in the US dollar, Romanian lei or Canadian dollar against the UK pound would impact net income by approximately $638,000, $2,000 and $19,000 respectively.

(B) INTEREST RATE RISK

The Company's secured notes carry a fixed interest rate and therefore do not expose the Company's cash flows to interest rate risk. However, from time to time the Company may have significant cash or cash equivalent balances invested at prevailing short-term interest rates. Accordingly cash flows are sensitive to changes in interest rates on these investments. Based on total cash and cash equivalents and restricted cash at December 31, 2009, a one percent change in average interest rates would increase or decrease net income by approximately $830,000 over a full year.

(C) LIQUIDITY RISK

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. At present the Company has sufficient cash to repay the secured notes and to settle its accounts payable and meet its immediate joint venture commitments and license obligations.

(D) CREDIT RISK

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due causing a financial loss. The Company's accounts receivable are primarily with governments for recoverable amounts of value added taxes (VAT) or joint venture partners in the oil and gas industry. Receivables from partners are secured by the partner's interest in the underlying oil and gas properties. This risk is therefore not considered significant. As at December 31, 2009 no material outstanding receivables were overdue, and no provision has been made for impairment as all amounts have been subsequently collected or are adequately secured by partner's interests.

16. SEGMENTED INFORMATION

The Company's activities are conducted in one operating segment and four geographic segments: Canada, the United Kingdom, Romania and other international locations which include operations in France.

	Canada	United Kingdom	Romania	France	Total
December 31, 2009	$	$	$	$	$
Net (loss) income	**(3,762,706)**	**70,885,497**	**(734,195)**	**(4,061)**	**66,384,535**
Petroleum and natural gas property additions	**–**	**(15,217,336)**	**(5,764,739)**	**(101,959)**	**(21,084,034)**
Dispositions of interests in properties	**–**	**89,612,456**	**–**	**–**	**89,612,456**
Total assets	**14,013,565**	**157,637,885**	**50,094,908**	**2,369,176**	**224,115,534**
December 31, 2008					
Net (loss) income	(2,663,136)	55,879	293,650	(129)	(2,313,736)
Petroleum and natural gas property additions	–	(59,501,922)	(25,823,264)	(1,641,666)	(86,966,852)
Dispositions of interests in properties	–	9,732,360	2,240,687	–	11,973,047
Total assets	6,138,288	110,625,113	48,137,481	2,348,664	167,249,546

Corporate Information

Sterling Resources Ltd.

Directors

WALTER DEBONI (1) (5) (6)
Chair
Calgary, Canada

RAJ K. AGRAWAL (1) (2) (5)
Calgary, Canada

ROBERT B. CARTER (3) (4) (5)
Calgary, Canada

STEWART G. GIBSON
Aboyne, Scotland

TECK SOON KONG (3)
London, England

GRAEME G. PHIPPS (1) (3)
St. Helier, Jersey

(1) Reserves Committee
(2) Chair Reserves Committee
(3) Audit Committee
(4) Chair Audit Committee
(5) Governance and Compensation Committee
(6) Chair Governance and Compensation Committee

Officers

STEWART G. GIBSON
Chief Executive Officer
(retiring May 27, 2010)

MICHAEL J. AZANCOT
President & Chief Executive Officer
(effective May 27, 2010)

DAVID A. FINDLATER
Vice President Exploration

JOHN RAPACH
Vice President Operations

STEPHEN BIRRELL
Vice President Romanian Operations

IAN C. HORNBY-SMITH
Chief Financial Officer

SHERRY L. CREMER
Treasurer & Corporate Secretary

Corporate Headquarters

STERLING RESOURCES LTD.
Suite 1450, 736 Sixth Avenue S.W.
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Investor Relations

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Tel: (403) 215-9265
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Auditors

ERNST & YOUNG LLP

Banker

THE ROYAL BANK OF CANADA

Legal Counsel

STIKEMAN ELLIOTT LLP
Calgary, Canada

Reserves Auditor

RPS ENERGY
Henley-on-Thames, UK

Registrar & Transfer Agent

Inquiries regarding change of address, registered shareholdings, stock transfers or lost certificates should be directed to:

COMPUTERSHARE INVESTOR SERVICES INC.
9th Floor, 100 University Avenue
Toronto, Ontario, Canada M5J 2Y1
Tel: (800) 564-6253
Fax: (888) 453-0330/(416) 263-9394
E-Mail: service@computershare.com

Stock Exchange Listing

THE TSX VENTURE
Stock Exchange Trading Symbol: SLG

STERLING RESOURCES (UK) LTD. (WHOLLY OWNED)

Directors

WALTER DEBONI
Chair
Calgary, Canada

STEWART G. GIBSON
Aboyne, Scotland

TECK SOON KONG
London, England

DAVID MILLER
London, England

Officers

STEWART G. GIBSON
Managing Director &
Company Secretary

DAVID A. FINDLATER
Vice President Exploration &
Business Development

PATRICK WHITLEY
Vice President Exploration (International)

JOHN RAPACH
Vice President Operations

IAN C. HORNBY-SMITH
Vice President Finance

CHRISTINE SHINNIE
Controller

SHERRY L. CREMER
Assistant Company Secretary

United Kingdom Office

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Burn O'Bennie Road
Banchory
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Scotland AB31 5ZU
Tel: 44-13308-26717
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Banker

BANK OF SCOTLAND

ROYAL BANK OF SCOTLAND

Legal Counsel

PAULL & WILLIAMSONS
Aberdeen, Scotland

PROINVEST CONSULT SRL
Bucharest, Romania

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