STERLING RESOURCES

2010 ANNUAL REPORT

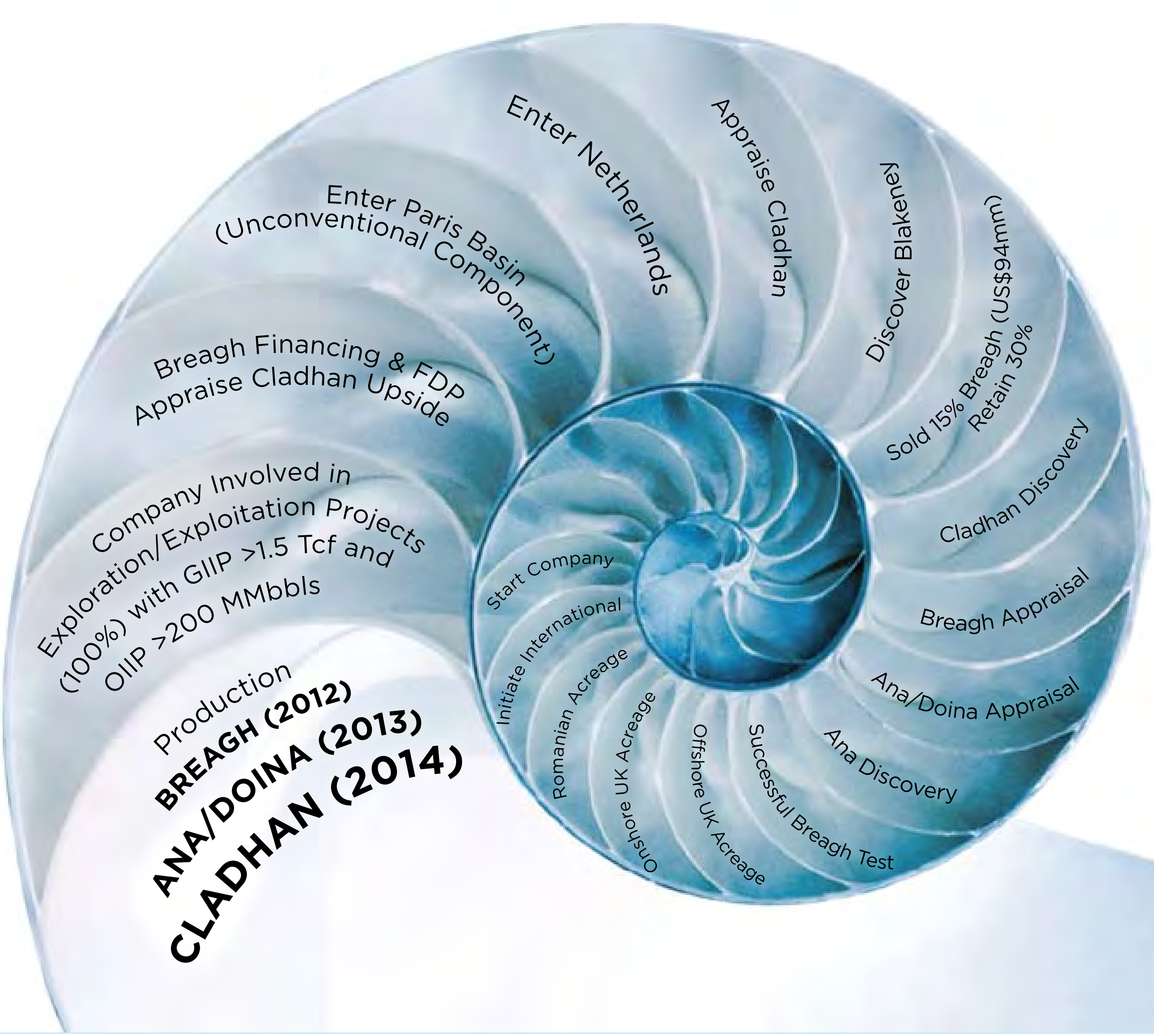
Evolving from pure exploration to international oil and natural gas producer

Contents

Sterling Resources Ltd. is a Calgary, Canada-based energy company engaged in the exploration and development of crude oil and natural gas in the United Kingdom (offshore and onshore), Romania (offshore and onshore), France and the Netherlands. Each country has established hydrocarbon basins, extensive infrastructure and excellent contractual and fiscal terms.

Sterling common shares trade on the TSX Venture Exchange under the symbol SLG.

Sterling milestones



We are evolving in focus countries that offer a rich and balanced portfolio

We are evolving

◯ from exploration-focused to a full-cycle strategy

We are continuing to grow our exploration portfolio, while adding profitable development and production to our achievements.

◯ from a small exploration team to a recognized E&P operator

We have matured from a handful of professionals only a few years ago to competent teams operating various assets throughout Europe.

◯ from a portfolio of opportunities to proven concepts

We have created value from our early opportunities and now have high-quality strategic assets that can provide growth.

◯ from a history of financial discipline for survival to financial strategies that support a larger program of exploration and development

Sterling is financially more stable and is now capable of undertaking ambitious plans whilst maintaining prudent cost management.

and creating shareholder value

well-positioned in multiple basins

Our presence in four European countries with high-quality onshore and offshore assets of oil and natural gas provides a diversity of growth options.

flexible strategies for maximizing value

We can now create value from exploration, development and production.

technical ability to unlock asset potential

Our winning exploration and appraisal track record comes from excellent technical credentials. We will continue with our team to repeat these achievements and can now attract additional high-calibre staff for our future growth plans.

financial discipline

Fundamental to our continued success is the need to live within our means whilst prudently funding our growth program.

PRESIDENT AND CEO'S MESSAGE TO SHAREHOLDERS

This enlarged Cladhan area has now clearly become a prime focus sector for the Company. As operator, with keen and like-minded partners, we plan to move forward to prudently exploit these assets to realize maximum returns for our shareholders and partners.

The theme of our last annual report was "Year of Transition" as Sterling initiated the reorganization and planning needed for asset development and production. I am delighted to report that the 2010 results show the progress we have made during this transition. We have maintained our core strategy of value creation through exploration success founded upon careful technical analysis of opportunities with skilled and dedicated staff. In addition, we are now enhancing our ability to create value through operated as well as non-operated developments with the intention of becoming a production operator of high-quality oil and natural gas assets. This, we believe, makes strategic sense as the Company grows and through successful operatorship naturally becomes exposed to additional opportunities.

Health, Safety and Environment

As an operator of onshore and offshore oil and gas activities we take much pride in our Health, Safety and Environmental (HS&E) performance. I am pleased to report that 2010 was another year in which we had no environmental or lost-time incidents. Our staff and contractors work hard to achieve these results and we are all committed to maintaining our HS&E diligence as we expand our operational activity.

Stronger Financial Capability

Our financial capability was strengthened in 2010 due to the quality of our assets and the subsequent continued support of shareholders, plus interest from new equity investors and banks alike. This is evidenced from results of the two bought-deal financings accomplished in August and December, totalling $120 million. Negotiations are at an advanced stage with a group of 3 banks for provision of a reserves-based loan (RBL) to fund the majority of the remaining development expenditure on the first phase of the Breagh development. In February 2010, credit approvals had been received from those banks for a loan facility of up to £105 million. Since then, the allocation of development wells between Phases 1 and 2 and individual well designs have been optimised partly as a result of the success of the 42/13a-6 well, resulting in a delay to finalisation of the FDP, final approval from the DECC, and hence conclusion of the RBL. However it is still expected that a loan of around £100 million will be agreed, and a facility agreement entered into by early May 2011. Later this year, we also expect to negotiate additional debt financing to fund part of the development costs for Phase 2 of the Breagh development. In the meantime, development of the Breagh field continues on schedule.

After making capital expenditures of $56 million in 2010, we entered 2011 with opening working capital of $138 million, with no financial debt.

Further success at Cladhan, where a development is already envisaged, will require additional funding. A portion of our current working capital will be allocated this year to drilling offshore UK in the Cladhan area, along with a portion of the Breagh Phase 1 development, offshore Netherlands, and offshore and onshore Romania. In addition some funds are allocated to development planning of the Cladhan field and the Ana and Doina fields in Romania.

Cladhan at Centre of 2010 Operations

Sterling's technical activities in 2010 centred on the successful initial appraisal of the Cladhan field. Re-entering the original discovery well and performing two sidetracks in the northern channel revealed a commercial light oil accumulation with Company Interest (P50) Contingent Resources of 11.6 MMbbls and Best Estimate Prospective Resources of 27.9 MMBOE on an unrisked basis. These numbers do not include any revisions based on the results of the early 2011 drilling program, which continues with encouraging results so far. The fact that the reservoir is over-pressured, that we have yet to find an oil/water contact, and that we have not appraised the central and southern channels or the fan system to the east, all give us substantial asset growth opportunity.

Following the successful 2010 work, this March we started a second drilling campaign of up to three wells at Cladhan. The same month we announced a property swap that expands our presence at Cladhan, obtaining an operated 25 percent interest in Blocks 210/29c and 210/30b, which lie adjacent to the blocks in which we are currently drilling. It is our intention to drill an exploration well in these adjacent blocks over the next 12 months. This enlarged Cladhan area has now clearly become a prime focus sector for the Company. As operator, with keen and like-minded partners, we plan to move forward to prudently exploit these assets to realize maximum returns for our shareholders and partners.

The Breagh development program in the UK North Sea gathered pace through 2010 with significant progress made in the project's initial phase. Key contracts have been awarded and various contracting works are well underway for first gas in mid-2012.

Breagh – First Major Development

The Breagh development program in the UK North Sea gathered pace through 2010 with significant progress made in the project's initial phase. This phase involves the placement of a single 12-slot drilling platform, the drilling of up to eight new wells, a 100-km 20" diameter pipeline to shore and processing at the existing Teesside Gas Processing Plant (TGPP). Key contracts have been awarded and various contracting works are well underway for first gas in mid-2012. In March 2011 a successful appraisal well was drilled at East Breagh, some 6 km east of the Breagh Alpha platform location, with the goal of further delineating the field to help plan the continued development. The well encountered the thickest reservoir section to date and the results have consequently accelerated the planning for the Breagh Bravo platform. The overall offshore and onshore system will have the capacity to handle up to 400 MMcf/d, creating the capacity to attract third-party gas. Approval of our initial debt financing and Phase 1 project sanction by the UK's Department of Energy and Climate Change is expected by early May.

First Production from Onshore Kirkleatham Gas Field

Although small by comparison, our 47 percent working interest UK onshore Kirkleatham gas field production commenced on April 19, 2011. This symbolically important first commercial gas production for Sterling is anticipated to be at an initial gross rate of 5 MMcf/d, with the gas being sold to the nearby chemical plant. Based upon field performance, there may eventually be additional drilling opportunities, or possibly the potential to convert the reservoir to a gas storage facility.

Fiscal Changes

During March 2011 the UK Government increased North Sea production taxes unexpectedly in the spring budget, raising the supplemental rate from 20 to 32 percent. This unexpected tax rate increase will impact Sterling less than some of our peers because of our significant tax pools. Oil and Gas UK, an industry body, of which Sterling is a member, is lobbying the UK government for amendments that could potentially exempt gas production from this tax increase.

Romania

In Romania our efforts to advance our offshore exploration program and development activities continue to be frustrated by political hurdles. After unsuccessful efforts during 2010 to obtain licence transfer approval from the Romanian authorities, Sterling elected to allow the farm-in agreement with Melrose Resources PLC, originally put in place in 2008, to expire. Late in 2010 Sterling and its other partners, Petro Ventures Europe BV and Gas Plus International BV, were advised by the Romanian government that licence assignments would be forthcoming early in 2011. Sterling's interest in the offshore blocks would then revert to 65 percent from 100 percent. To date we have not received the assignments to our intended partners.

Having now received environmental approval, however, it is still our intention this year to drill an oil-targeted well at Eugenia in the Pelican Block and possibly a well at Ioana in the gas-prone Midia Block, subject to the approval of construction permit applications, which were requested in March 2011. We remain fully focused on obtaining all necessary approvals to move forward with the development of the Ana and Doina gas discoveries, albeit with the recognition that the process to achieve this remains protracted, with the possible delay in gas production.

Elsewhere in Romania, late in 2009 and early in 2010 three wells were drilled on the onshore Craiova Block. They were unsuccessful in establishing a viable gas reservoir. Following analysis of previous well drilling operations in the area, however, it is now our intention to drill a well on the Craiova Block during the latter half of 2011, targeting Silurian shale gas potential. Whilst it is early in our evaluation, the potential here is significant, making this an ideal high-risk, high-reward play.

Initiatives in France and the Netherlands

During 2010 Sterling expanded its horizons through initiatives in France and the Netherlands. In the Paris Basin, Sterling as operator successfully applied for a total of 9.5 blocks which have been awarded pending final signature. Drilling will not occur before 2012, although a multi-well pilot scheme targeting the same play is scheduled to begin in 2011 on an adjacent licence, and its results will aid our drilling plans.

In 2010, Sterling expanded its horizons with initiatives and operator status in France (9.5 blocks in the Paris Basin) and the Netherlands (five licences).

Left: **John Rapach** Chief Operating Officer
Middle: **Mike Azancot** President and Chief Executive Officer
Right: **David Blewden** Chief Financial Officer

In December 2010, Sterling acquired an operated interest in five licences (shallow horizons) in the F and L quadrants offshore the Netherlands. Sterling holds a significant working interest (50 percent assuming EBN participation) in the blocks, which total more than 400,000 acres gross and contain several oil discoveries. Subject to regulatory approval, the Company could drill a well in the F quadrant late in 2011.

Prudent Planning

We remain cognizant of our status as a pre-production company and, consequently, we maintain cost controls and risk-mitigation measures to ensure finite shareholder resources are utilized wisely. We continue to seek areas of improvement, with plans in place to capitalize upon our attractive asset base with a view to achieving positive operating cash flow over the next two years. As we further develop our asset base we plan to increase our financial capacity and maximize the strength of our capital structure to continue to grow shareholder value after the commencement of production. In spite of ongoing uncertainty in the global markets, we remain committed to the execution of our strategic drilling and development plans.

Significant Growth

I am pleased to report that we have experienced a steady increase in our share price last year. The share price closed out 2009 at $1.97 and exited 2010 at $3.45, representing a 75 percent annual price appreciation. From the low of $0.465 at year-end 2008 Sterling has realised a share price appreciation of 7.4 times. Our successes in Breagh and Cladhan have been key contributors to this appreciation in share price.

I am also delighted to report that once again the strength and growth of our resource base has been recognized by our independent reserves evaluators, RPS Energy. Our Proved plus Probable Reserves as at December 31, 2010 are maintained at 32.8 MMBOE as summarized on page 23, where further details regarding the definitions and risks associated with reserves disclosure can also be found. Continued evaluation of our many prospects and new additions, however, has led to significant increases in the Company interest of reported resources as indicated below:

	Year-End 2010		Year-End 2009	
	Bcf gas	MMbbls oil	Bcf gas	MMbbls oil
P(50) Contingent Resources	310	44	188	7.8
Best Estimate Prospective Resources	1,260	272	916	129

In addition to the above, the unconventional gas potential on our Craiova licence onshore Romania has been evaluated with Company interest, Best Estimate Prospective Resources of 1.5 Tcf on an unrisked basis. Potential for our unconventional oil play in the Paris Basin will be the subject of a study in the early part of 2011.

As stated previously, the significant growth and solid performance of our Company has led to the strategic goal of acquiring a listing on the main board of the London Stock Exchange.

Staff – the Key to Success

I am pleased to say that during 2010, Stewart Gibson, my predecessor, has remained a key member of the management team as Executive Advisor and a member of the Board of Directors. In August 2010 David Blewden replaced Ian Hornby-Smith as CFO, but Ian remains in an advisory accountancy capacity in Canada. Our team is growing as our activity expands, but this is being accomplished sequentially and in a prudent and timely manner whilst we have continued success. The future for all those involved in Sterling is very promising and I look forward to accomplishing our goals and objectives together in this evolving era of the Company.

I would like to express thanks to our shareholders for their ongoing support and to our team of dedicated staff for their efforts and continued significant achievements during the past year

On behalf of the Board of Directors,

(signed) "Mike Azancot"

Mike Azancot
President and Chief Executive Officer
April 19, 2011

HEALTH, SAFETY AND ENVIRONMENT

The year 2010 was exceptional for Sterling with regard to Health, Safety and Environmental (HS&E) performance. There were no environmental or lost-time incidents (LTI) for the year. Since 2006 the Company has accrued 1.5 million man-hours without an LTI or environmental incident. This is an exceptional record for a company which has had extensive onshore and offshore drilling programs in Romania and the United Kingdom, and is also now active in France and the Netherlands.

Performance

Accident and incident statistics remain outstanding for the five-year period of 2006–2010:

- Zero environmental incidents;
- Zero LTI; and
- Over 1.5 million exposure hours.

Sterling is committed to ensuring that it has safe and healthy workplaces and that it conducts all operations with proper regard for the environment. The Company recognises that HS&E is an integral part of its business activities and a fundamental part of efficient operations. This commitment to HS&E was demonstrated by the Company's Chief Executive Officer in his revision and re-issue of both the Company's Health and Safety and Environmental Policies in 2010, and the implementation of these policies by the management team and workforce.

Our Approach

In order to achieve a high level of HS&E performance the Company has a hands-on approach to all operational activities. Throughout 2010 Sterling was heavily involved in planning for its drilling campaigns, with attendance at hazard identification and mitigation workshops and meetings. Sterling's established model is to have a strong core team of staff augmented by long-term contractors to provide expert support.

Sterling has always maintained an open dialogue with government and the regulators appointed by them. This is important to Sterling particularly as it seeks new opportunities with respect to operatorship in the UK, Romania, France and the Netherlands.

Onshore Romania Drilling – 2006

Description of Activity	Man-Hours
Piscu Sadovei seismic shoot	47,920
Piscu Sadovei road construction	720
Piscu Sadovei rig construction	15,048
Piscu Sadovei drilling	1,656
Flounder seismic shoot	43, 700
Total Man-Hours:	**109,044**

Craiova Well, Safety Induction Point
Setting a solid foundation for HS&E performance excellence continues to this day.

Looking Forward

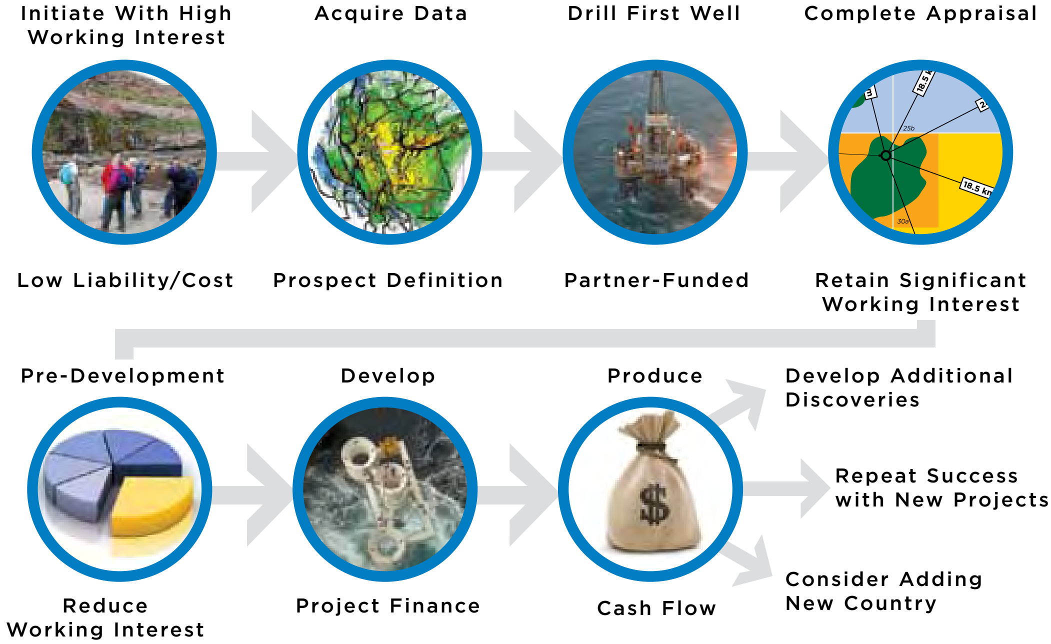
Sterling continues to seek new and better ways to maintain its HS&E performance and remains committed to high ethical values and standards of integrity. Going forward it will use the technical and creative skills of its workforce as it develops the Cladhan discovery in the Northern North Sea, assists its partner RWE Dea as it develops the Sterling-appraised Breagh field in the Southern North Sea and as it seeks opportunities to explore and develop discoveries in the UK, Romania, France and the Netherlands.

EXPLORATION AND OPERATIONS REVIEW

Sterling seeks international projects that have potential for large, low-cost reserves. High working interests are important to controlling the pace of activity. Financial exposure and technical risk are managed by obtaining industry participation.

In 2011 we intend to drill up to 11 wells, continue the development of Breagh, and move forward the developments of Cladhan, Ana and Doina.

Sterling's strategy for creating shareholder value



Sterling's work program will maintain a high level of activity in four countries

		2009	2010				Potential 2011			
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
DEVELOPMENT ACTIVITY	UNITED KINGDOM	BREAGH								
	UNITED KINGDOM								CLADHAN	
	ROMANIA	DOINA / ANA								
APPRAISAL WELLS	UK SNS						EAST BREAGH (1)			
	UK NNS				CLADHAN (2)		CLADHAN (1)	CLADHAN (2)		CLADHAN (2)
CORE AREA EXPLORATION WELLS	UK SNS			AIRIDH (1)	MACANTA (1)		GRIAN (1)			
	UK CNS				BLAKENEY (1)					
	ROMANIA								IOANA (1)	EUGENIA (1)
OTHER EXPLORATION WELLS	UNITED KINGDOM									
	ROMANIA	C1, C2 and C3						CRAIOVA (1)		
	NETHERLANDS								F QUAD (1)	

YEARLY ACTIVITY SETS	2009	2010	Potential 2011
WELLS	2	6	11
SEISMIC		1 (DARACH)	2 (ST LAURENT/MIDIA, PELICAN)
DEVELOPMENTS	0	2	3

United Kingdom

The United Kingdom offshore is a major opportunity base. Highlights include the commercial Cladhan oil discovery, which is undergoing appraisal drilling, and Breagh, which is expected to begin generating cash flow in 2012.

2010 Cladhan Well Testing

First Breagh Well Test at "Commercial" Gas Rate

United Kingdom Offshore

Northern North Sea (NNS)

Cladhan Discovery

The much-awaited appraisal well on the Cladhan oil discovery (Sterling 39.9 percent working interest) commenced in August 2010. The Transocean J.W. McLean rig was used to re-enter the 210/29a-4 well and drill two sidetracks from the existing wellbore, which had been left suspended.

The first sidetrack (210/29a-4Z) drilled an updip location 0.95 km due south of the discovery well. The sidetrack was drilled to a total depth of 11,215 feet measured depth (MD), encountering a gross hydrocarbon column of 159 feet with 102 feet of net hydrocarbon-bearing sandstones. This was a significant improvement to the discovery well, which had 31 feet of net pay. A drill stem test (DST) was conducted by perforating the interval of 10,806 to 10,869 feet MD. The well was flowed for a total of 18.7 hours, of which 13 hours yielded a stabilized average rate of 5,903 bopd of 34° API oil on a 28/64" fixed choke, with a final wellhead pressure of 1,874 psig.

Following this success, work on the second sidetrack well, 210/29a-4Y, commenced in mid-September. It was drilled to a downdip location at 11,530 feet MD approximately 1.04 km southeast of the original well, and about 0.76 km due east of the first sidetrack bottom-hole location. The well encountered more than 60 feet true vertical thickness of net hydrocarbon-bearing sandstones. Analysis of the open-hole logs showed good-quality sands with an average porosity of 20 percent. Most important, the well did not encounter an oil-water contact at this downdip location. This means the lowest known oil occurs at 11,333 feet MD, establishing a minimum oil column at Cladhan of 425 feet.

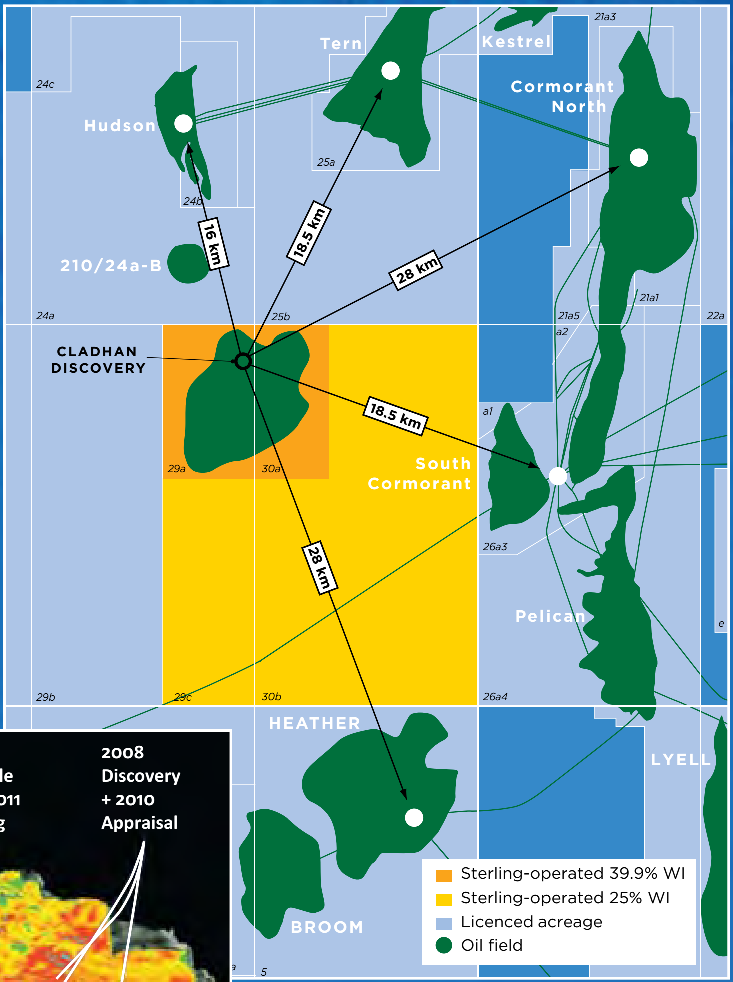
The site surveys, permits and rig selection for the 2011 drilling campaign were completed in only seven months thus allowing for a quick return to appraisal drilling early in 2011. The Transocean Prospect rig has drilled a successful well located 1.1 kilometres southeast of the 210/29a-4Y well to a total depth of 12,252 feet, having encountered two separate reservoir zones. No oil water contact was found and the minimum effective vertical oil column has now increased to 1,228 feet. Sidetrack drilling to the east into the fan system is underway. This will be followed by another sidetrack into the central channel and then a possible vertical well below the current rig position into the southern edge of the northern channel system. The Company intends to provide a revised independent resource evaluation towards the middle of 2011.

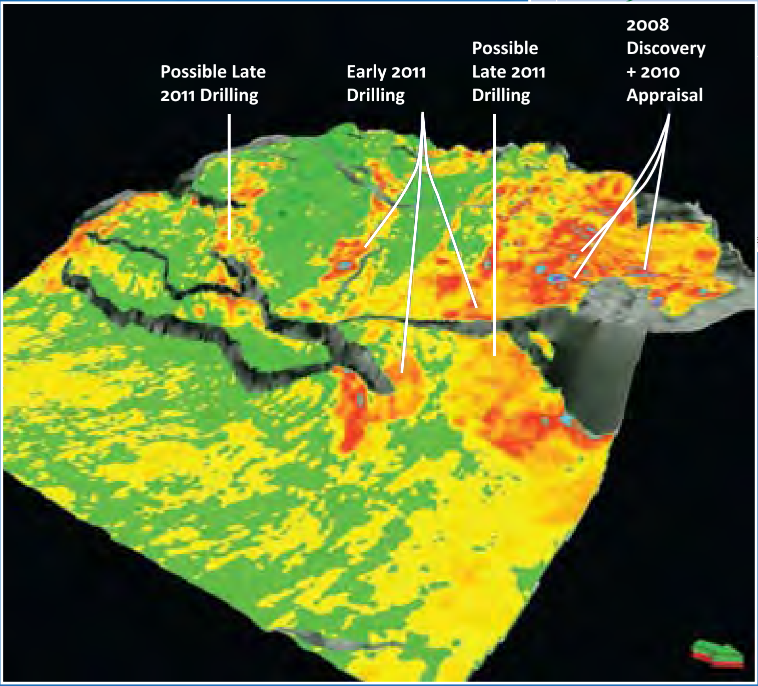
Sterling has expanded its acreage in the Cladhan area by executing reciprocal agreements with Valiant Petroleum PLC to facilitate the exchange of certain North Sea assets, resulting in Sterling acquiring a 25 percent interest and operatorship of Blocks 210/29c and 210/30b immediately south and east of the Cladhan discovery.

Sterling is currently considering various development scenarios for the Cladhan field and South Cladhan prospect. Possible scenarios would be a subsea development of the Cladhan field to nearby infrastructure or a dedicated floating production storage and offloading (FPSO) vessel or fixed platform facility at the Cladhan field. We are setting a target of production from the field to commence as early as 2014.

Sterling's independent reserves evaluators have attributed Company Interest (P50) Contingent Resources of 11.6 MMbbls and Best Estimate Prospective Resources of 27.9 MMbbls on an unrisked basis to the Cladhan discovery as at December 31, 2010.

Cladhan





Drilling Program

Central North Sea (CNS)

Blakeney and Feugh Discoveries Join Sheryl in Awaiting Development

In April 2009, Sterling farmed into licence P1562, Blocks 21/21 and 21/22, and licence P1619, Block 21/27b, which had been awarded to Wintershall (E&P) Limited in the 25th Licensing Round in 2009. Sterling obtained a 25 percent working interest and in July 2010 participated in the drilling of well 21/27b-7 to test the Blakeney prospect. The well encountered a 71-foot net oil column in Eocene Tay Formation sands. Although the well was not tested, two oil samples were obtained that showed an oil gravity of 14–15° API. A previous oil and natural gas discovery, drilled in 1971 (Feugh), confirmed a separate accumulation on Block 21/27b at the same stratigraphic level. Additional prospectivity has been identified in the 21/22 block, which requires further geological evaluation prior to any drilling.

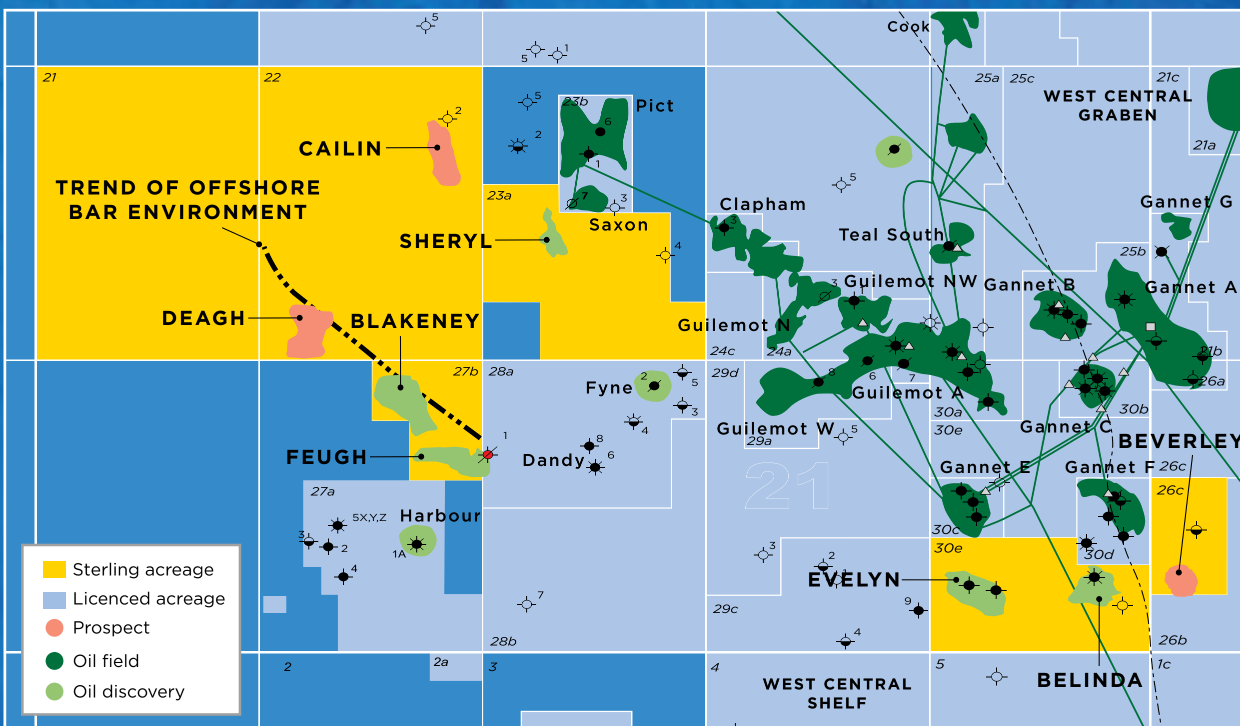
The Sheryl field was discovered in 2006, testing at maximum flow rates of 1,915 bopd of medium gravity 23° API oil. Sterling (35 percent working interest) was re-appointed operator of Block 21/23a in 2009 with Premier Oil as joint-venture partner holding the remaining 65 percent.

The partnership has been seeking offtake routes for tie-back of a one or two-well subsea development of the Sheryl field and has entered into discussions with the Triton owners through the Saxon and Pict subsea developments. Other tie-in possibilities could be with Antrim/Premier Oil or EnQuest via potentially new infrastructure in the nearby acreage. These negotiations have been frustrated by various ownership changes to the infrastructure during the past year. Sterling looks forward to finalizing a tie-in route for Sheryl production during 2011 with development of the field scheduled to take place during 2012.

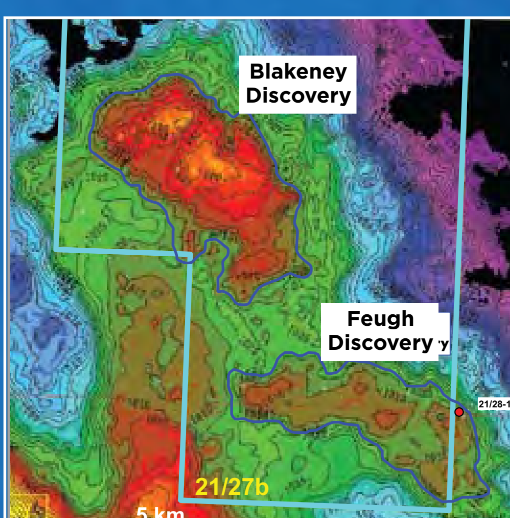
In November 2010 the UK Department of Energy and Climate Change (DECC) announced the 26th Round awards. Sterling was awarded a 100 percent interest in licence P1792 covering Blocks 21/30f and 22/26c. Subsequently, Sterling negotiated a swap deal with Valiant Petroleum that results in a 60 percent/40 percent split for Sterling and Valiant, respectively, in these new blocks.

Sterling's independent reserves evaluators have attributed Company Interest Proved plus Probable Reserves of 1.1 MMbbls plus an additional 0.5 MMbbls Possible Reserves to Sheryl at December 31, 2010 as summarized in the table on page 23. The independent reserves evaluators have also attributed Company Interest (P50) Contingent Resources of 6.2 MMBOE and Best Estimate Prospective Resources of 3.5 MMBOE on a unrisked basis for the P1562 and P1619 licences, and Company Interest (P50) Contingent Resources of 7.3 MMBOE and Best Estimate Prospective Resources of 4.3 MMBOE on an unrisked basis for the newly awarded P1792 licence.

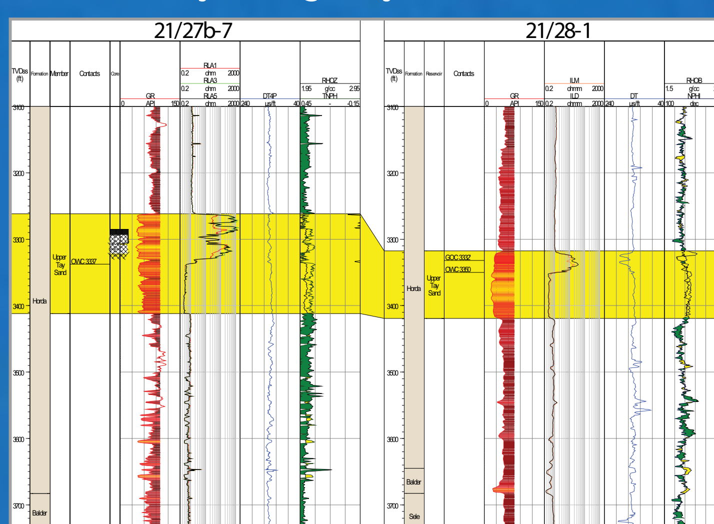
Quad 21 Discoveries and Prospects Awaiting Development



Top Tay Sandstone



Blakeney – Feugh Tay Sand Correlation



Correlation Hung on Depth

Southern North Sea (SNS)

Breagh Natural Gas Field

Following completion of the 2008–2009 appraisal drilling program with Sterling as operator, in August 2009 RWE Dea UK SNS Limited acquired a 70 percent interest in the Breagh field and the surrounding Quad 42 exploration acreage with Sterling retaining the remaining 30 percent. RWE Dea became operator as a condition of the sale.

Following the transaction, development of the Breagh field was Sterling's primary focus for 2009–2010, with finalization of conceptual field development plans and completion of FEED studies for the platform, pipeline and modifications to the gas terminal. The Breagh development concept is a modular design to allow not only expansion of reservoir exploitation within the development area, but to accommodate new natural gas from surrounding prospects and fields and new third-party business from outside the Quad 42 area.

The initial development phase will place the Breagh Alpha platform over the previously drilled wells 42/13-3 and 42/13-5Z. These wells were left suspended after appraisal drilling by Sterling in 2007 and 2008–2009 so that they could be utilized as early development wells. The best of these wells, 42/13-5Z, a well with a 2,500 foot horizontal section, flowed at a maximum rate of 26 MMcf/d in 2009. Up to eight new wells will be drilled to exploit the natural gas from the Breagh Alpha platform. Natural gas will be transported to landfall via a 20" pipeline running approximately 100 km to the shore, where it will be linked to an onshore pipeline running approximately 10 km to the Teesside Gas Processing Plant (TGPP). The TGPP will process the raw natural gas, prior to its entry into the National Transmission System (NTS).

A second platform, Breagh Bravo, is now being considered over the 42/13a-6 well. This well was drilled during the first quarter of 2011, 2.4 km further east of the 42/13-4 well drilled in 2008. The well found the predicted structure and encountered 62 feet of gas-bearing sand, the thickest encountered in the field to date. The well was not tested but an extensive series of open hole logging has confirmed similar permeabilities to the previous wells tested.

Conceptual studies have begun on development of the eastern part of the Breagh field. Further infrastructure will be considered for areas outside the drilling radius of the Breagh Alpha and Breagh Bravo platforms, either as subsea clusters or unmanned installations.

An agreement with Teeside Gas and Liquid Processing (TGLP) for the processing and redelivery of natural gas to be produced from Breagh over its entire field life was concluded in 2010. Among the services TGLP is to provide is the processing of Breagh natural gas production within a dedicated unit at plant, with onward redelivery of gas to the NTS and/or local customers. TGLP will also provide remote operational services to the offshore Breagh Alpha platform facility and will provide ongoing operational and maintenance-related services to the Breagh pipeline's onshore section.

Operations have been progressing to secure all contracts and permitting for the field's development. What are expected to be final drafts of environmental statements for the onshore and offshore segments and the field development program (FDP) have been submitted to the government. The environmental statements are now expected to be approved by early May 2011.

Tendering and contract awards were made for all major elements of the project:

- Heerema Vlissingen B.V. was awarded a contract for the engineering, procurement and construction of a minimum facilities platform. Heerema will construct the jacket, topsides and piles at its

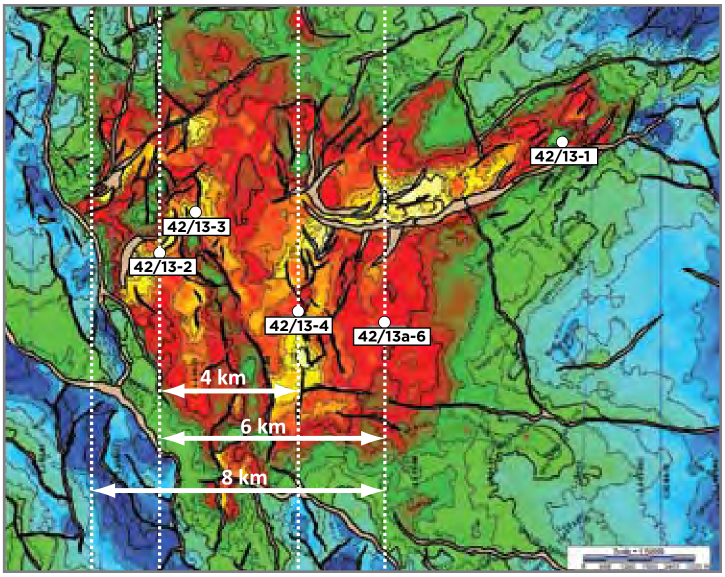
Teesside Gas Processing Plant (TGPP)

Vlissingen yard in the Netherlands. The jacket will be approximately 85 metres tall with a total weight including piles of 4,000 tonnes, while the topsides will weigh approximately 1,400 tonnes;

- Allseas Construction Contractors SA has been awarded the contract for the engineering, installation and pre-commissioning of the offshore pipeline and associated fibre-optic cable. Most of the pipe has been delivered and is now being concrete-coated;
- ENSCO has been awarded the development drilling contract, with drilling expected to commence in October 2011; and
- An agreement with px group provides for the construction and installation of onshore 20" and 3" pipelines and a telemetry system from Coatham Sands, Redcar to the TGPP. In addition to its existing responsibility for operation and management of the TGPP, px will manage onshore pipeline construction.

First gas from the Breagh field from the Breagh Alpha platform is on schedule for July 2012 with the field expected to reach a peak annual rate of 160 MMcf/d in 2013 for the first phase of development. Gas will be sold on a day-ahead or month-ahead spot basis.

Sterling's independent reserves evaluators have attributed Company Interest Proved plus Probable Reserves of 184.8 Bcf of natural gas and (P50) Contingent Resources of a further 37.5 Bcf of natural gas on an unrisked basis to the Breagh field at December 31, 2010. Note that these reported Reserves and Resources pre-date the results of the 42/13a-6 well.



Breagh Field – Channel belt widths demonstrated by appraisal drilling

Quad 42 and the Greater Breagh Area

Sterling holds a 30 percent working interest in the Quad 42 area, which contains numerous mapped prospects. Two of these, Airidh in Block 42/19a and Macanta in Block 42/24, were drilled in 2010 but did not encounter hydrocarbons. In 2010 Sterling also acquired a new 3D seismic survey over the Darach prospect in Block 42/4.

Following the negative drilling results of the Airidh prospect, Blocks 42/19a and 42/24a were relinquished. However, Sterling opted to retain Block 42/20a (100 percent interest), which contains the Ogan prospect, for a further two years.

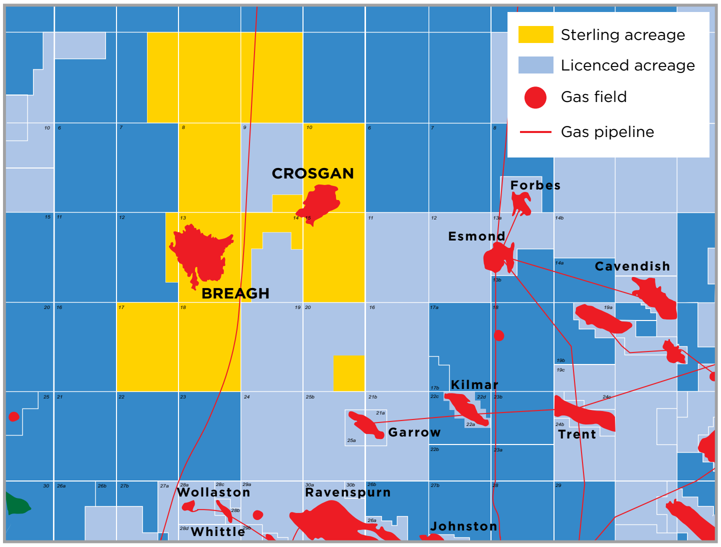
In November 2010 the DECC awarded Sterling additional acreage in Quad 42 south of the Breagh field in Blocks 42/13b, 42/17 and 42/18, the latter containing the Lochran prospect. The licence is operated by RWE Dea and Sterling has a 30 percent working interest. Plans are to acquire 3D seismic over the prospect in 2012 with drilling possibly to begin in 2013.

Crosgan Discovery

Crosgan was discovered in 1990 with the Total-operated well 42/15a-1 and later appraised by Mobil in 1995 with wells 42/10b-2 and 42/10b-2Z. Gas was discovered in the Lower Carboniferous, Whitby sandstone, which tested at 8.6 MMcf/d. However, higher flow rates are expected by using oil-based drilling mud, which reduces formation damage, as Sterling proved at the nearby Breagh field.

The Crosgan field, located in Blocks 42/10 and 42/15, is currently being re-evaluated following the purchase of a new 3D seismic survey. Plans are to drill an appraisal/development well in 2012, based on the new 3D seismic interpretation. Development of the Crosgan field will also be included as part of the East Breagh development, after further appraisal drilling planned for 2012.

Sterling's independent reserves evaluators have attributed Company Interest (P50) Contingent Resources of 32.1 Bcf and Best Estimate Prospective Resources of 61.5 Bcf on an unrisked basis to the acreage in the Quad 42 area, excluding Breagh, as at December 31, 2010.



Quad 48 Area

Grian Prospect

Sterling increased its working interest in Block 48/28a to 57 percent and extended this Promote Licence into the second two-year period with a firm well commitment to drill the Grian prospect. Sterling as operator drilled this exploration well during the first quarter of 2011, and encountered excellent-quality Permian Rotliegendes sandstone, but no hydrocarbons. The well has since been abandoned.

United Kingdom Onshore

Kirkleatham Field

On Petroleum Exploration and Development Licence 068 (Sterling 47 percent working interest), development activities were completed in March 2011 and first gas is expected during the second quarter of 2011. Natural gas will be transported from the wellsite via a 600-metre underground pipeline to the Wilton site boundary, then via an above-ground pipeline to a processing site in Wilton. All water and hydrocarbon liquids will be removed at this 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 steam for site use.

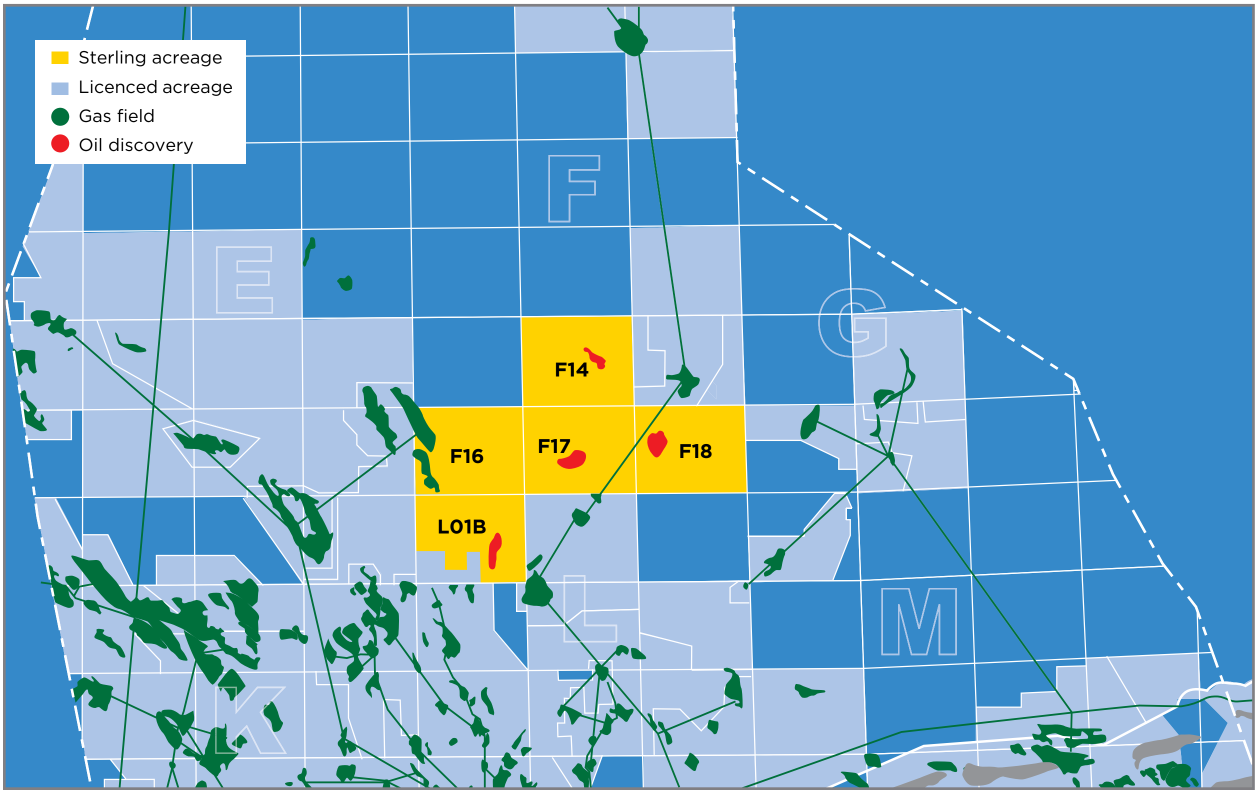
Sterling's independent reserves evaluators have attributed Company Interest Proved plus Probable Reserves of 1.3 Bcf of natural gas effective December 31, 2010.

Wilton processing site

Offshore Netherlands

Late in 2010 Sterling became owner and operator of the shallow horizons (early Cretaceous and Jurassic Period formations) in licences F14, F16 (excluding the F16-E and F16-P production units), F17a, F18 and L1b in the Dutch North Sea. Sterling concurrently established an operating presence in The Hague and relocated a senior manager to the new office to oversee operations. These licences bring a gross 479,000 acres under Sterling's ownership. The Company will hold an 83.33 percent working interest preceding back-in by the state-owned Energie Beheer Nederland B.V. (EBN), or a 50 percent interest following back-in.

The blocks contain four Jurassic oil discoveries with Company interest (P50) Contingent Resources of 15.8 MMbbls on an unrisked basis. Previous wells have tested at flow rates between 2,000 bopd and 4,000 bopd from the principal reservoir when they were tested during appraisal drilling. The wells were all subsequently plugged and abandoned. Sterling is planning to drill a well in 2011 on the largest of the four discoveries. The blocks also offer additional exploration potential with Company Interest Best Estimate Prospective Resources of 26.1 MMBOE on an unrisked basis attributed by Sterling's independent reserves evaluators as at December 31, 2010. With this new country entry, Sterling hopes to grow a successful business leading to production within a short time-frame.



Onshore France

Aquitaine Basin

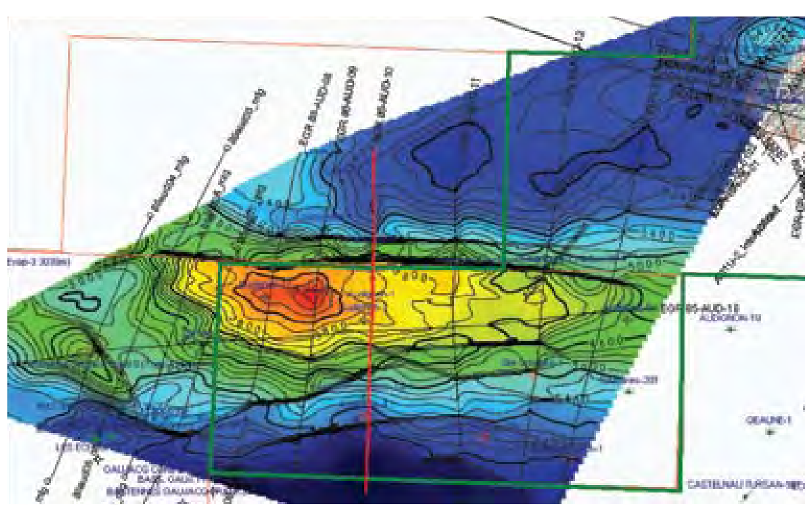
The St. Laurent licence covers 125,280 acres and is located 20 kilometres northwest of the giant Lacq field. There are hydrocarbon occurrences on the St. Laurent licence, including an undeveloped accumulation of heavy oil discovered by the Grenade-sur-l'Adour-1 well in 1975. It encountered a 97-metre-thick column of heavy oil (10-11° API) in a Cretaceous reef carbonate within a stratigraphic trap. The original well produced 70 bopd compared to the 200–300 bopd anticipated from a high-angle well with current technology.

Sterling became involved in the area in 2003 and currently holds a 33.43 percent working interest in the St. Laurent licence. In early 2008 Sterling and its partners drilled the Grenade-sur-l'Adour-3 well to a depth of approximately 2,300 metres on the permit. Unfortunately, the reservoir section lacked adequate porosity and permeability and the well was suspended. Since then the geological model has been re-evaluated to determine an alternate drilling location nearer the original Grenade-sur-l'Adour-1 discovery well. Significant additional exploration potential exists on the block, with the operator having mapped an undrilled Triassic target known as Audignon.

In February 2008 the St. Laurent licence was renewed for a further five-year term, and this was formally approved in March 2010. Future activity will focus on a sidetrack of the Grenade-sur-l'Adour-3 well and the reprocessing and acquisition of new 3D seismic over the Audignon prospect, with the partners hoping to drill in 2012. To complement the St. Laurent acreage, Sterling and its partners in the Aquitaine Basin have been approved by the French Government for the award of the adjacent Donzacq licence, with gazetting expected later in 2011.

Subsequent to year-end, Sterling signed an agreement with partners to increase its working interest to 40 percent and to assume operatorship of the St. Laurent and Donzacq licences.

Sterling's independent reserves evaluators have attributed Company Interest (P50) Contingent Resources of 2.7 MMbbls and Best Estimate Prospective Resources of 24.1 MMBOE on an unrisked basis to the St. Laurent licence as at December 31, 2010.



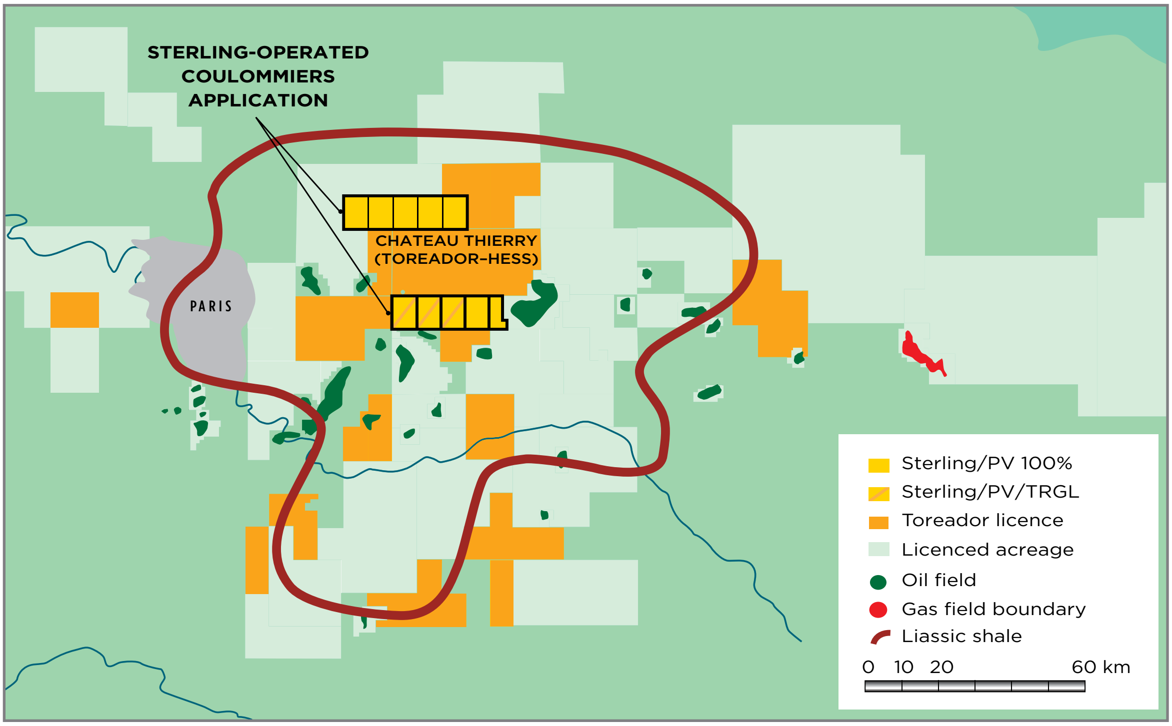
St. Laurent – Audignon Prospect

Onshore France

Paris Basin

Sterling as operator in November 2008 applied for a total of 9.5 blocks in the Paris Basin with working interests ranging from 25 to 50 percent. In November 2010 the applications were approved by France's General Industry and Environment Council and are expected to be gazetted in early 2011. Covering 150,000 acres gross, the blocks offer potential for conventional traps in Jurassic and Triassic-age targets, which are productive in nearby fields. Sterling plans to undertake operations to explore and appraise the conventional prospectivity in the licences during 2012.

The area has also been identified for its potential as an unconventional oil play. Analogous to the Bakken shale in the Williston Basin of North Dakota and Montana, it is predicated on a very thick Liassic section of up to 600 metres thickness, which sits in the oil window beneath approximately 2,000 metres depth. Within the shales are several distinct carbonate, silt and sand units that previous drilling established as oil-bearing. The potential oil-source volumes of the Liassic section are believed to be very significant and analogue well types have had good initial production rates. Toreador-Hess are planning to drill a Liassic test near the boundary of the Coulommiers licence in 2011. Sterling's first drilling on its operated licences could come as early as 2012.



Romania

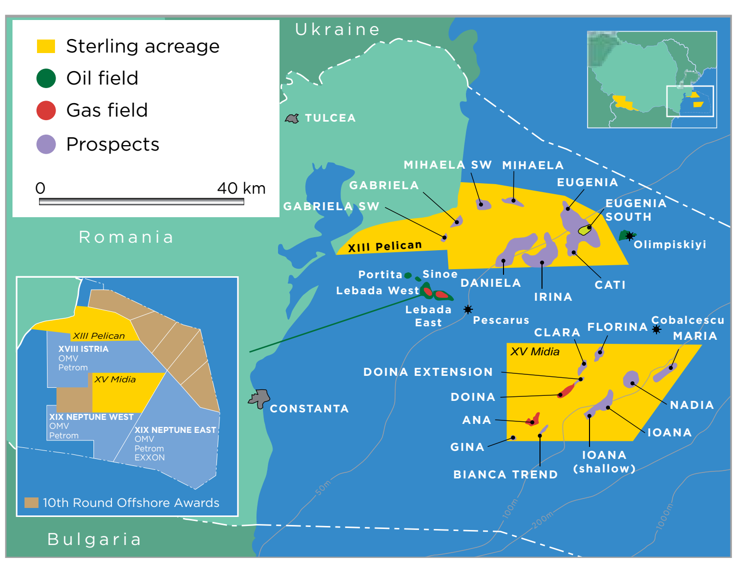
Offshore

The ramifications from the politically motivated challenges to Sterling's offshore licences were felt throughout 2009 and into 2010. Investigations by various agencies thwarted Sterling's efforts to move forward. Sterling's intended partial assignments of its 100 percent interest to Melrose Resources PLC, Petro Ventures Europe BV and Gas Plus International BV were blocked. Sterling was also unable to advance its exploration plans as authorities refused to accept its permit submissions.

Melrose, as the intended development operator, then took a lead role in negotiations without success. In November 2010, Sterling elected not to further extend its farm-out agreement with Melrose and, along with its partners Petro Ventures and Gas Plus, retook the initiative to resolve the impasse. Just before year-end Sterling was promised that the permits for drilling and seismic programs would be approved and the working interest assignments to its two partners would be forthcoming in early 2011. On this basis Sterling would remain as operator with a 65 percent interest while Petro Ventures and Gas Plus will have 20 percent and 15 percent, respectively.

In 2011 Sterling intends to move aggressively to realize the huge potential of these blocks, drilling two exploration wells, acquiring 1,050 linear kilometres of 2D seismic, bringing the Ana and Doina fields to project sanction and ensuring the Company has a more proactive engagement with Romanian agencies, ministries and stakeholders. Although political obstacles remain, encouraging progress was made in early 2011 with the issuance of environmental permits for the 2D acquisition program and the offshore Eugenia exploration well in the Pelican Block. The longer-term plan is to bring Ana and Doina to commercial production within three years, continue to drill exploration wells and appraise and develop expected discoveries. The ability to realize these plans is subject to removal of the political hurdles.

Romania's offshore region remains in a very early stage of maturity, with a total of only 100 exploration wells drilled in the Danube Delta of Ukraine, Romania and Bulgaria, versus over 500,000 in the Mississippi



Romania

Delta of the Gulf of Mexico, which is geologically comparable. Sterling considers the Romanian offshore to be highly prospective and believes that, over time, it could become a significant hydrocarbon-producing region.

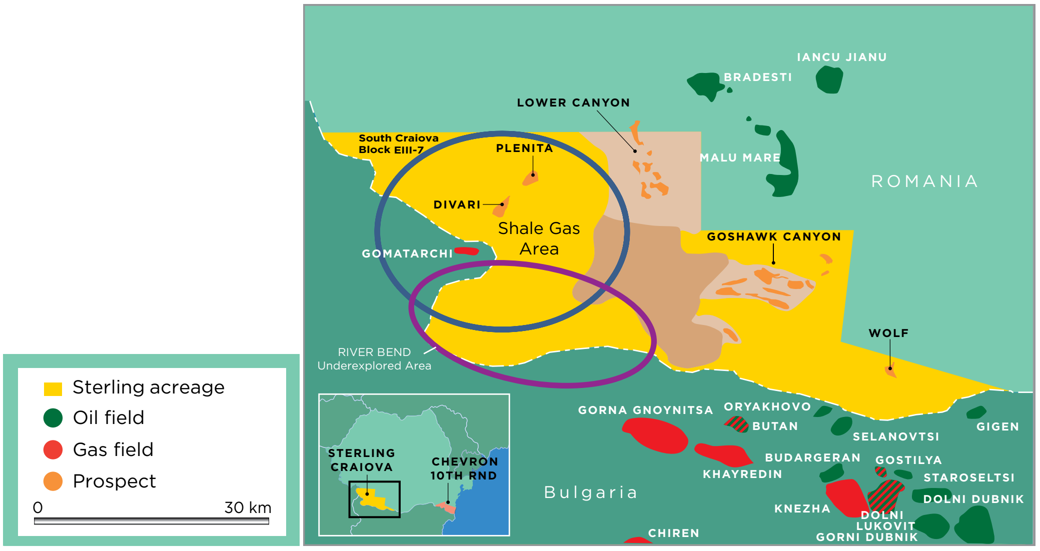
Sterling's independent reserves evaluators have attributed Company Interest (P50) Contingent Resources of 224.3 Bcf and Best Estimate Prospective Resources of 739.7 Bcf and 201.5 MMbbls on an unrisked basis.

Onshore

In 2010 Sterling and its 50-50 joint-venture partner, TransAtlantic Worldwide Petroleum SRL, fulfilled their work commitments under the onshore concession agreement on the 1.5 million acres EIII-7 South Craiova Block. The three Goshawk Canyon play wells, which began drilling in 2009, had gas shows but were abandoned.

Sterling also began evaluating Silurian shale gas potential on the block. Results indicating the Silurian's presence, together with estimates that the Silurian in Poland could yield up to 100 Tcf of reserves, encourage Sterling that this unconventional gas play warrants further evaluation. This year the Company will reprocess existing 2D seismic to identify a drillable location and evaluate re-entering a legacy well that encountered the Silurian.

Sterling's independent reserves evaluators have attributed Company Interest Best Estimate Prospective Resources of 3.9 MMbbls and 112.5 Bcf on an unrisked basis to the conventional prospects on the Craiova block. In addition, their evaluation of the potential for shale gas presence in the western part of the block attributes Company Interest Best Estimate Unconventional Prospective Resources of 1.5 Tcf on an unrisked basis.



RESERVES, CONTINGENT AND PROSPECTIVE RESOURCES

		Company 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%	23.6	31.6	39.0	374.3	479.8	588.5
UK	Kirkleatham (2)	47.0%	0.1	0.2	0.5	3.5	6.9	12.8
UK	Sheryl (3)	35.0%	–	1.1	1.5	–	15.9	22.2
Company Total (5)			23.7	32.8	41.0	377.7	502.6	623.5

		Unrisked Contingent (6)(8) Resources Company Share			Unrisked Prospective (7)(8) Resources Company Share		
		1C (P90) (9)	2C (P50) (9)	3C (P10) (9)	Low Estimate (P90) (9)	Best Estimate (P50) (9)	High Estimate (P10) (9)
Gas	Bcf	240	310	384	766	1260	2267
Oil	MMbbls	33	44	61	145	272	776

		Unrisked Unconventional Contingent Resources Company Share			Unrisked Unconventional Prospective Resources (10) Company Share		
		1C (P90) (9)	2C (P50) (9)	3C (P10) (9)	Low Estimate (P90) (9)	Best Estimate (P50) (9)	High Estimate (P10) (9)
Gas	Bcf	–	–	–	300	1500	7000
Oil	MMbbls	–	–	–	–	–	–

(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 the arithmetic aggregate totals have a much higher than 90% probability of occurring on an unrisked basis. For Proved plus Probable plus Possible (3P) Reserves, these arithmetic aggregate 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) Unconventional Prospective Resources are based on RPS' assessment of Silurian Wenlockian shale gas potential in the Sud Craiova licence. RPS calculates the potential based on mapping of the extent of the Wenlockian shale, geochemical analysis of outcrop shale samples, a well test on licence that produced gas from the shale and comparison with the analogous Haynesville Shale gas reservoirs in the U.S.A. The volumes cited here are unrisked. RPS assigns a geological probability of success of 5% to the prospect.

(11) 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) of the operating results and financial condition of Sterling Resources Ltd. ("Sterling" or the "Company") for the year ended December 31, 2010 is dated April 19, 2011 and should be read in conjunction with Sterling's audited consolidated financial statements and accompanying notes for the years ended December 31, 2010 and 2009.

The MD&A focuses on the Company's long-term vision, strategy and growth opportunities as well as its historical performance over the two years ended December 31, 2010. All financial amounts are expressed in Canadian dollars, except as otherwise indicated. References in text and tables to "2010" and "2009" refer to the years ended December 31, 2010 and 2009, respectively. References to the "current year" refer to 2010, and references to the "prior" or "previous" year refer to 2009.

Business and Strategy

Sterling is a publicly-traded, international energy company engaged in the acquisition of petroleum and natural gas rights, and the exploration for, and the development and production of, crude oil and natural gas. The Company operates primarily in the United Kingdom, Romania, the Netherlands and France, and is headquartered in Calgary, Canada.

The Company's primary strategy for achieving growth is to source and initiate international projects with the potential to yield large, low-cost reserves. It concentrates on accumulating, exploring and exploiting of licences and prospects in selected core areas of the world. Sterling's strategy also targets blocks with high initial working interests where possible. Financial exposure and technical risk are managed by obtaining partner participation through farm-out and other arrangements. Under these arrangements, a portion of the Company's interest is given up in exchange for the partner paying a share of the costs of exploration, appraisal or development of the licence. A secondary strategy is to acquire interests in discoveries where Sterling believes that its technical and operational expertise can accelerate development, especially where there are multiple development candidates or significant exploration prospectivity nearby.

There are many operating and other factors which Company management expects to have a significant impact on its execution of this strategy; however, the current economic environment and changing regulatory landscape, including the impact of climate change regulations and legislation, warrant particular consideration:

(a) The Economic Environment

International financial markets and petroleum commodity prices improved considerably during 2010. The ability of some governments to manage unprecedented levels of debt is still in question, however, and continued recovery from the recession of 2008 and 2009 may not be smooth. As a result, the Company expects some continuing volatility in key areas of the economies in which it operates. This, in turn, may impact its business in a number of ways including its strategy, the underlying value of its assets, its ability to obtain additional financing through equity or debt markets, and its share price. The key factors affecting Sterling's business are as follows:

(I) Product Pricing

Oil prices affect both the anticipated cash flows from the Company's projects and the prices and terms of any interests which it may elect to farm-out or divest. Oil prices have improved steadily from the lows in late 2008 and early 2009 as global demand has recovered, with a continuing expectation of significant long-term growth in demand.

Sterling's first oil production is expected from Cladhan in 2014, so it is the medium and long-term oil price that is most important for the Company. Sterling is optimistic that oil prices will remain strong over the long term.

European natural gas prices remained high relative to North American prices in 2010, but did not rise as much as oil prices during 2010 as the market perception is that supplies are more than sufficient to meet demand in the near term. Sterling expects natural gas prices to grow in the longer term but to remain more volatile than oil prices, especially in the UK.

(II) Capital Expenditures

The weakened global economy following the world-wide financial crisis of 2008/2009 has led to a decrease in the prices of some components of capital expenditure such as construction steel and drilling rig day-rates, from their earlier peaks. Steel prices, drilling rig day rates and the costs of other oil services are now increasing as oil and gas activity picks up and wider economic recovery continues. A large part of Breagh capital costs are already contractually committed, but with material capital outlays required to develop its other projects the Company will be significantly exposed to rising costs over the next few years.

(III) Interest Rates and Liquidity

Sterling currently has no long-term debt, but shortly expects to finalize a senior reserves-based loan for funding part of the Breagh development costs, and will also consider such loans for other development projects. The bank market for such loans is already reasonably healthy and the Company expects the liquidity in the market to improve further as banks strengthen their balance sheets. As global economies recover, Sterling expects that governments will seek to control growing inflationary pressures by raising interest rates. This will impact the interest costs of Sterling's future debt facilities.

(IV) Debt and Equity

Debt and equity financing continues to be readily available for exploration and production companies with a good track record and good future growth prospects. As discussed, Sterling expects to finance the majority of the remaining development costs for its Breagh project from the reserves-based loan currently being finalized, but until it has solid cash-flow from those of its assets which it has brought to production, it may consider further issues of equity to finance a limited portion of its exploration program that is considered accretive to its share price.

(b) Regulatory Environment

During 2010 a number of events drove changes to the regulatory environment, the most notable of these being the tragic blow-out and oil spill in the Gulf of Mexico in April 2010, which was not successfully controlled until July. Although this event took place in American waters, it has increased the environmental scrutiny to which operators such as Sterling are subject in the UK North Sea and Romanian Black Sea. The tougher scrutiny by the UK Department of Energy and Climate Change (DECC), the Ministry of Economic Affairs (MEA) in the Netherlands and the Romanian National Agency for Mineral Resources (NAMR) should not have a severe impact on the Company's operations, although it may lead to some delay in permit approval.

In October 2010 the DECC made changes to the environmental assessment process as part of recent budget constraints in the UK, and announced that it would cut its resources spending by 18 percent and its administration budget by 33 percent by 2015, which could exacerbate approval delays.

Significant emphasis by public policymakers upon climate change and its possible causes continues, although the causes and effects are 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 Sterling operates.

One such example is the concept of carbon emissions trading, which was steadily increasing in volume until the economic recession of 2008 slowed its pace of growth, according to the World Bank's Carbon Finance Unit. There is still no uniformity amongst various jurisdictions, however, regarding the regulations governing a common global carbon emissions trading market and Sterling's management will continue to monitor its evolution.

The Company remains concerned about pending carbon taxes, regulated emissions reduction targets and emissions trading transactions and obligations, and the ability to quantify these factors in 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 the Company 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 in order to protect the well-being of employees, contractors, equipment and the environment.

(II) Risks

In light of greater international awareness of climate change and other environmental issues, public interest could drive significant changes in the regulatory environment. In order to more effectively monitor developments which may affect its operations, the Company has strengthened its focus on environmental protection, health and safety through addition of experienced personnel who will have the specific responsibility to report regularly on any developments to management and the Board of Directors.

(III) Greenhouse Gas Emissions

Management is aware that greenhouse gases are produced partly as a result of the use of hydrocarbons to fuel transportation vehicles, to provide heating and for power generation through the burning of coal, oil and natural gas. Consequently, the future imposition of carbon taxes, emission limitations, or mitigation mandates such as carbon trading would add further costs to the Company's business.

(IV) Financial Impacts

In light of the uncertain regulatory environment and the fact that Sterling does not currently anticipate having significant natural gas production until 2012, it is impossible to quantify the financial impact of climate change regulations in the short term. The Company will continue to closely monitor the regulatory landscape in an effort to 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 for providing the Board with reports dealing with environmental issues and will provide the Board with information detailing the impact upon operations of any climate change initiatives to ensure appropriate governance of this ongoing issue.

2010 Operating Highlights

Selected annual financial information for the three years ended December 31, 2010 is presented below.

For the Year Ended December 31,	**2010**	2009	2008
$000's except share and per share information			
Gain on property disposition	–	72,103	–
Expenses	**(4,982)**	(5,718)	(2,279)
Income taxes	**–**	–	(35)
Net (loss) income	**(4,982)**	66,385	(2,314)
Per common share			
– basic	**$ (0.03)**	$ 0.51	$ (0.02)
– diluted	**$ (0.03)**	$ 0.50	$ (0.02)
Net working capital	**138,410**	72,675	13,967
Petroleum and natural gas properties and equipment additions	**55,977**	21,084	86,967
Dispositions of interests in properties	**554**	89,612	11,973
Total assets, end of year	**330,531**	224,116	167,250
Share capital, end of year	**290,444**	157,643	156,773
Common shares outstanding 000's – basic, end of year	**188,944**	132,174	130,941

The Company has three key projects, none of which is currently generating revenues:

Breagh

Sterling acquired Block 42/13 in the UK Southern North Sea as operator in 2004. Its interest in the Block was reduced to 45 percent after a series of farm-out arrangements and in late 2007 together with partners the Company drilled the 42/13-3 well, which tested gas at rates of up to 17.6 million standard cubic feet per day (MMcf/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 MMcf/d and confirmed the continuity of the reservoir encountered in the 42/13-3 well. In late 2008 Sterling commenced drilling the Breagh 42/13-5 and 5Z horizontal appraisal wells, which were completed and tested in early 2009. The 42/13-5Z well tested natural gas at rates of up to 26 MMcf/d.

After the success of the appraisal drilling program in early 2009, Sterling commenced a process to dispose of a partial interest in the greater Breagh area in order to provide sufficient funds to continue development. In August 2009 the Company completed the sale of one-third of its 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 $103,000,000. Following the disposition, Sterling retained a 30 percent interest in the entire greater Breagh area. The sale also resulted in the purchaser, RWE Dea, becoming operator.

Following the transaction, development of the Breagh field was Sterling's primary focus for 2009–2010, with finalization of conceptual field development plans and completion of preliminary engineering studies for the platform, pipeline and modifications to the gas terminal. The Breagh development concept is a modular design to allow not only expansion of reservoir exploitation within the development area, but to accommodate new natural gas from surrounding prospects and fields and new third-party business from outside the Quad 42 area.

The initial development phase will place the Breagh Alpha platform over the previously drilled wells 42/13-3 and 42/13-5Z. These wells were left suspended after appraisal drilling by Sterling in 2007 and 2008–2009 so that they could be utilized as early development wells. A further 5–8 wells will be drilled from the platform to exploit the natural gas from the West Breagh area. Natural gas will be transported to landfall via a 20" pipeline running approximately 100 kilometres to the shore, where it will be linked to an onshore pipeline running approximately 10 kilometres to the Teesside Gas Processing Plant (TGPP). The TGPP will process the raw natural gas, prior to its entry into the National Transmission System (NTS).

A second platform, Breagh Bravo, is now being considered over the 42/13a-6 well. This well was drilled during the first quarter of 2011, 2.4 kilometres further east of the 42/13-4 well drilled in 2008. The well came in on prognosis regarding the structure, encountering 62 feet of gas-bearing sand, the thickest encountered in the field to date. The well was not tested but extensive open hole logs have confirmed similar permeabilities to the previous wells tested.

Conceptual studies have begun on development of the eastern part of the Breagh field. Further infrastructure will be considered for areas outside the drilling radius of the Breagh Alpha and Breagh Bravo platforms, either as subsea clusters or unmanned installations.

An agreement with the Teeside Gas and Liquids Processing (TGLP) for the processing and redelivery of natural gas to be produced from Breagh over its entire field life was concluded in 2010. Among the services TGLP is to provide is the processing of Breagh natural gas production within a dedicated unit at the plant, with onward redelivery of gas to the NTS and/or local customers. TGLP will also provide remote operational services to the offshore Breagh Alpha platform facility and will provide ongoing operational and maintenance-related services to the Breagh pipeline's onshore section.

Operations have been progressing to secure all contracts and permitting for the field's development. What are expected to be final drafts of environmental statements for the onshore and offshore segments and the field development program (FDP) have been submitted to the government. The environmental statements and FDP are now expected to be approved by early May 2011.

Tendering and contract awards were made for all major elements of the project:

- Heerema Vlissingen B.V. was awarded a contract for the engineering, procurement and construction of a minimum facilities platform. Heerema will construct the jacket, topsides and piles at its Vlissingen yard in the Netherlands. The jacket will be approximately 85 metres tall with a total weight including piles of 4,000 tonnes, while the topsides will weigh approximately 1,400 tonnes. Installation of the platform is expected to take place in the third quarter of 2011;

- Allseas Construction Contractors SA has been awarded the contract for the engineering, installation and pre-commissioning of the offshore pipeline and associated fibre-optic cable. Most of the pipe has been delivered and is now being concrete-coated;

- ENSCO has been awarded the development drilling contract, with drilling expected to commence in October 2011; and

- An agreement with px group provides for the construction and installation of onshore 20" and 3" pipelines and a telemetry system from Coatham Sands, Redcar to the TGPP. In addition to its existing responsibility for operation and management of the TGPP, px will manage onshore pipeline construction.

First gas from the Breagh field from the Breagh Alpha platform is on schedule for July 2012 with the field expected to reach a peak annual rate of 160 MMcf/d in 2013 for the first phase of development. Gas will be sold on a day-ahead or month-ahead spot basis.

Total future capital expenditures of $292,000,000 for the development of Breagh are expected to be incurred between 2011 and 2015.

Corporately, Sterling is focusing on the arrangement of a senior financing facility with a small group of banks, and expects this process to be finalized by early May 2011.

At December 31, 2010 Sterling's independent reserves evaluators have attributed Company Interest Proved plus Probable Reserves of 184.8 Bcf of natural gas and 37.6 Bcf of natural gas (P50) Contingent Resources to Breagh, as well as Company Interest Contingent Resources of 32.1 Bcf of natural gas (P50) and Best Estimate Prospective Resources of 61.5 Bcf of natural gas (P50) on other blocks in the greater Breagh area.

Cladhan

Sterling acquired its interest in Blocks 210/29a and 210/30a in 2003 and reduced its interest to 39.9 percent through a series of farm-out transactions. In late 2008 the Company drilled the Cladhan 210/29-4 discovery well, encountering light oil (34° API) in a Jurassic channel sand structure. In 2010, the well was re-entered and two further sidetrack wells were drilled.

The first sidetrack (210/29a-4Z) drilled an updip location approximately 1 kilometre due south from the discovery well. The sidetrack was drilled to a total depth of 11,215 feet measured depth (MD), a true vertical depth (TVDSS) of 9,561 feet. The well encountered a gross hydrocarbon column of 159 feet with 102 feet of net hydrocarbon-bearing sandstones. This was a significant improvement to the discovery well, which had 31 feet of net pay. A drill stem test (DST) was conducted by perforating the interval of 10,806 to 10,869 feet MD. The well was flowed for a total of 18.7 hours, of which 13 hours yielded a stabilized average rate of 5,903 bopd on a 28/64" fixed choke, with a final wellhead pressure of 1,874 pounds per square inch gauge.

Following this success, 210/29a-4Y was drilled to a downdip location at 11,530 feet MD (9,791 feet TVDSS) approximately 1 kilometre southeast of the original well, and about 1 kilometre due east of the first sidetrack location. The well encountered more than 60 feet true vertical thickness of net hydrocarbon-bearing sandstones. Analysis of the open-hole logs showed good-quality sands with an average porosity of 20 percent. Most importantly, the well did not encounter an oil-water contact at this downdip location. This means the lowest known oil occurs at 11,333 feet MD (9,650 feet TVDSS), establishing a minimum oil column at Cladhan of 425 feet.

The site surveys, permits and rig selection for the 2011 drilling campaign were completed in only seven months. The Transocean Prospect rig has drilled a successful well located 1.1 kilometres southeast of the 210/29a-4Y well to a total depth of 12,252 feet, having encountered two separate reservoir zones. No oil water contact was found and the minimum effective vertical oil column has now increased to 1,228 feet. Sidetrack drilling to the east into the fan system is underway. This will be followed by another sidetrack into the central channel and then a possible vertical well below the current rig position into the southern edge of the northern channel system. The Company intends to provide a revised independent resource evaluation towards the middle of 2011.

In March 2011, Sterling expanded its acreage in the Cladhan area by executing reciprocal agreements with Valiant Petroleum PLC to facilitate the exchange of certain North Sea assets, resulting in the Company acquiring a 25 percent interest and operatorship of Blocks 210/29c and 210/30b immediately south and east of its current licences. An appraisal well here is planned over the next 12 months.

The Company is currently considering various development scenarios for the Cladhan field and South Cladhan prospect. Possible scenarios would be a subsea development of the Cladhan field to nearby infrastructure or a dedicated floating production, storage and offloading unit or fixed platform facility at the Cladhan field. The Company is looking for production from the field to commence as early as 2014.

At December 31, 2010 Sterling's independent reserves evaluators have attributed Company Interest (P50) Contingent Resources of 11.6 MMbbls on an unrisked basis to Cladhan, as well as Best Estimate (P50) Prospective Resources of 27.9 MMbbls on an unrisked basis.

Doina/Ana

In late 2006, Sterling acquired the remaining 80 percent interest providing it with 100 percent working interest and operatorship of the large Pelican and Midia blocks in the Black Sea offshore Romania. Sterling subsequently agreed to farm-out a total of 35 percent of its interest to Petro Ventures International BV and Gas Plus International BV in return for the payment of certain costs. Sterling remained operator and drilled the Ana-1 discovery well on the Doina trend in the Midia block in late 2007, with the well flowing gas at rates up to 19.2 MMcf/d under restricted test conditions.

In 2008, Sterling tested the northeasterly extension of the Doina field with the Doina-4 well, encountering the same quality of 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.

Development of these two natural gas discoveries and continued exploration drilling offshore Romania has been delayed for the past two years owing to an inability to gain governmental approval for a licence assignment.

In early 2009, Sterling entered into a farm-out agreement with Melrose Resources PLC (Melrose) under which Melrose would incur up to US$90,000,000 of costs on behalf of Sterling in return for a 32.5 percent interest in the blocks. The agreement expired on October 31, 2010 without assignments being granted by the government.

Sterling, Petro Ventures and Gas Plus subsequently continued the dialogue with the Romanian government. While the government acknowledges the importance of this project to its country's domestic gas industry, it is still hampered by internal political issues. The final approvals have not yet been obtained and the partnership is considering implementing alternative options to accomplish a resolution that moves the project forward. The Company remains confident of its legal title and no provision for impairment has been made in the December 31, 2010 financial statements.

Sterling's independent reserves evaluators have attributed Company interest (P50) Contingent Resources of 224.3 Bcf of natural gas on an unrisked basis to Doina/Ana at December 31, 2010, as well as Best Estimate Prospective Resources of 739.7 Bcf of natural gas and Best Estimate Prospective Resources of 201.5 MMbbls of oil on an unrisked basis on other prospects on the blocks.

Other Projects

In addition to the major projects discussed above, Sterling has a number of other discoveries and projects on its licences onshore and offshore the UK, Romania, France, and the Netherlands. The Company will be moving forward with these projects in 2011, including an assessment of potential development of the 2006 Sheryl discovery on Block 21/23a in the UK Central North Sea, and the adjacent Blakeney and Feugh discoveries on Block 21/27b. The Kirkleatham gas project onshore UK is expected to come onstream in the second quarter of 2011 and represents a milestone for Sterling as its first producing gas field in the UK.

Sterling has been successful in the UK Continental Shelf 26th Round License Awards in 2010. Blocks 21/30f and 22/26c in the Central North Sea and Blocks 42/13b, 42/17 and 42/18 in the greater Breagh area were granted this year. In addition, Sterling is awaiting news from the DECC on various pending awards that have been withheld due to further analysis.

Accounting Policies and Significant Estimates

It is important to understand the Company's key accounting policies in order to understand its financial results and the extent to which estimates affect them. Sterling's significant accounting policies, as presented in Note 2 to the consolidated 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 GAAP that have a significant impact on its financial results. Significant estimates in the consolidated financial statements include amounts recorded for the provision for future asset retirement obligations, stock-based compensation expense and capital expenditure accruals. In addition, Sterling uses estimates for numerous variables in the assessment of the Company's assets for impairment purposes, including oil and natural 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 its key Breagh property and based on plans for additional activity in the UK, Sterling 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 changed its functional currency prospectively 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, 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 $10,775,000 and an adjustment to retained earnings of $18,673,000.

Accumulated other comprehensive income for 2010 includes a charge of $18,992,000 (2009 – $1,012,000) to reflect the effect of translating Sterling's consolidated financial statements into its reporting currency of Canadian dollars using the current rate method. For reporting purposes, UK pound functional currency assets and liabilities are translated into Canadian dollars at exchange rates in effect at the balance sheet date. Equity transactions, revenues and expenses are translated at historical rates. Unrealized gains and losses resulting from the translation into Canadian dollars are included in other comprehensive income.

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

The Company currently has no commercial production. Any minor pre-commercial production revenues have been netted against related expenses, and the net amount capitalized as test production. Until such time as it generates production income, Sterling's results from operations are not affected by seasonal considerations. The following table summarizes the Company's income statements for the eight most recently completed quarters ended December 31, 2010.

2010 (Quarter Ended)	**Dec. 31**	**Sept. 30**	**June. 30**	**March. 31**	**Total**
	$000's	**$000's**	**$000's**	**$000's**	**$000's**
Expenses					
General and administrative	**3,289**	**985**	**798**	**1,530**	**6,602**
Foreign exchange (gain) loss	**(2,727)**	**1,545**	**345**	**(3,495)**	**(4,332)**
Stock-based compensation	**738**	**603**	**477**	**330**	**2,148**
Accretion	**(9)**	**63**	**58**	**52**	**164**
Depreciation	**26**	**23**	**20**	**20**	**89**
Financing expenses (income)	**(37)**	**(36)**	**55**	**329**	**311**
	1,280	**3,183**	**1,753**	**(1,234)**	**4,982**
Net (loss) income	**(1,280)**	**(3,183)**	**(1,753)**	**1,234**	**(4,982)**
Net (loss) income per common share					
– basic	**$ (0.01)**	**$ (0.02)**	**$ (0.01)**	**$ (0.01)**	**$ (0.03)**
– diluted	**$ (0.01)**	**$ (0.02)**	**$ (0.01)**	**$ (0.01)**	**$ (0.03)**
Comprehensive (loss) income	**(14,924)**	**3,200**	**3,818**	**(16,068)**	**(23,974)**

2009 (Quarter Ended)	Dec. 31	Sept. 30	June. 30	March. 31	Total
	$000's	$000's	$000's	$000's	$000's
Gain on property disposition	–	72,103	–	–	72,103
Expenses					
General and administrative	836	1,408	738	796	3,778
Foreign exchange (gain) loss	(1,331)	(384)	(139)	73	(1,781)
Stock-based compensation	351	319	257	242	1,169
Accretion	40	54	60	60	214
Depreciation	32	12	31	24	99
Financing expenses (income)	623	936	722	(42)	2,239
	551	2,345	1,669	1,153	5,718
Net (loss) income	(551)	69,758	(1,669)	(1,153)	66,385
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	(1,563)	69,758	(1,669)	(1,153)	65,373

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 2010 Results

The net loss for the fourth quarter of 2010 compared to the results of the other seven quarters of 2010 and 2009 has been affected by the following key factors:

- 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 and the expansion of activities in France and the Netherlands. Increased activity in 2010 also resulted in increased recoveries from partners, although this was partially offset by relinquishing operatorship of the Breagh field. In the fourth quarter, general and administrative expenses were also affected by a provision of $1,900,000 relating to the incorrect operation of payroll taxation on the Company stock option plan for UK employees, increased costs of reserve audits and certain non-recurring costs relating to the transition of the management team;
- Foreign exchange gains for the fourth quarter relate primarily to the translation of Canadian and US dollar-denominated cash and cash equivalents originating from the equity issue in late December 2010, 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 changes in the level of working capital and prevailing exchange rates. Foreign exchange losses in the fourth quarter of 2010 were also determined using the UK pound as the functional currency and are partially offset by losses on translation into the reporting currency which flow through other comprehensive income;
- Financing expenses or income in the third and fourth quarters were comprised only of interest income. For the previous six quarters, there was a steady decline in financing costs due to the timing of repayments of the secured notes. These notes were issued in April 2009 and repayments were made in the fourth quarter of 2009 as well as in the first and second quarters of 2010; and
- The third quarter of 2009 includes a one-time gain of $72,103,000 on the disposition of a part-interest in the Breagh Field.

General and Administrative Expenses

The following table details general and administrative expenses for 2010 and 2009:

	2010	2009
	$000's	$000's
Employee costs	**5,324**	2,768
Office rent and expenses	**931**	1,069
Professional and other fees	**2,221**	1,410
Travel	**593**	381
Other	**711**	445
Gross general and administrative expenses	**9,780**	6,073
Recoveries from partners	**(706)**	(475)
Charged to capital projects	**(2,472)**	(1,820)
	6,602	3,778

General and administrative expenses before recoveries from partners and internal capitalization for 2010 increased significantly over 2009 levels. This is mainly due to additional staff as a result of the ongoing increase in operational activity in the UK and Romania, and transitioning to the new management team. Also included in employee costs is a provision of $1,900,000 for an underpayment of employment taxes, associated interest and possible penalties relating to the incorrect operation of the Company's share option plan for UK employees. In addition, professional and other fees increased due to maintenance of environmental, health and safety systems, legal fees relating to farm-out activity, increased costs of the annual reserves audit and recruiting costs for the new management team.

Gross general and administrative expenses recovered from partners increased due to increased operator activity in 2010 and general and administrative expenses allocated to capital projects also increased somewhat, in line with increased activity and gross expenditures.

Foreign Exchange

Following the adoption of the UK pound as the Company's functional currency in 2009, subsequent foreign exchange gains and losses related primarily to working capital and provisions for asset retirement obligations, which are denominated in US or Canadian dollars. Gains or losses may arise as a result of revaluing these items into UK pounds. Previous to the change, gains and losses on UK pound-denominated monetary balances also gave rise to foreign exchange differences. The majority of the net gains of $4,332,000 for 2010 relates to conversion of US dollar cash balances in the first quarter and Canadian dollar balances in the fourth quarter during a period of corresponding weakness in the UK pound.

Stock-Based Compensation

Sterling's stock option program continues to be an important component of the employee and director compensation program.

In 2010, options to purchase 5,805,000 common shares were issued to directors, officers and employees at an average exercise price of $2.42 per share. Stock-based compensation expense of $2,148,000 for 2010 increased from $1,169,000 in 2009 due to the issuance of these options and to the full-year impact of options issued partway through 2009. Stock-based compensation capitalized in 2010 was $1,735,000 (2009 – $907,000).

For 2009, options to purchase 2,825,000 common shares were issued to directors, officers, and employees at an average exercise price of $1.42 under the 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:

	2010	2009
	$000's	$000's
Interest income	**(278)**	(231)
Interest expense	**223**	1,111
Amortization of debt issue costs	**366**	1,359
	311	2,239

Interest income in 2010 did not change materially from 2009 as interest rates remained low and relatively stable, and the corresponding impact of fairly significant fluctuations in average cash balances was minimal.

Interest expense and amortization of debt issuance costs relate exclusively to the issuance of secured notes in April 2009. These notes were repaid in full in three tranches, commencing in the fourth quarter of 2009, and in the first and second quarters of 2010, resulting in a corresponding reduction in interest expense and amortization of debt issuance costs.

Income Taxes

a) Current Income Taxes

From time to time, Sterling may be subject to UK corporate income tax on interest earned on cash and bank deposits and realized foreign exchange gains or losses on cash denominated in foreign currencies which arise from UK sources not related to UK oil and gas exploration and production activities which are ring-fenced for UK tax purposes. However, for 2010 and 2009, no provision for current income taxes was required due to utilization of available loss carry-forwards.

b) Future Income Taxes

The Company does not recognize the tax benefit of losses incurred at this time as it has no significant current production nor regulatory approval for the development of the Breagh or Cladhan fields offshore UK, nor for the Doina/Ana field in the Black Sea offshore Romania. Consequently there is no assurance the tax benefit will be realized.

As at December 31, 2010 the Company had UK tax losses carried forward of approximately £87,874,000 and other capital allowances of approximately $40,221,000 available to reduce future Canadian and Romanian income subject to tax. These losses and allowances are not subject to expiry. In addition, the Company has approximately $15,143,000 of Canadian non-capital losses which are subject to expiry over the next 20 years.

Under current UK tax law, the 2009 gain on the sale of one-third of the Company's 45 percent interest in the Breagh field and varying interests in the surrounding acreage for total proceeds of approximately $103,000,000 is not subject to UK capital gains tax provided that equivalent proceeds are reinvested in eligible expenditures in the UK North Sea sector within three years. Approximately $11,000,000 of the required expenditures were incurred in 2010, and the balance is expected to be incurred in 2011 and 2012 with the construction of the Breagh platform and pipeline ready for the the start-up of production in mid-2012.

On March 23, 2011, the UK Chancellor of the Exchequer announced an increase in the supplementary charge levied on profits from UK oil and gas production to 32 percent from 20 percent. This change has no immediate effect on the Corporation but will impact future cash flows from the Company's offshore UK projects.

Net (Loss) Income

The net loss for 2010 of $4,982,000 ($0.03 per share – basic and diluted) compares to income of $66,385,000 ($0.51 per share – basic; $0.50 per share – diluted) for 2009. The income for 2009 relates primarily to the gain on the disposition of one-third of the Company's interest in Breagh and varying interests in the surrounding blocks. Excluding this gain, the loss in 2010 is broadly comparable to 2009, except as discussed above.

Petroleum and Natural Gas Expenditures

Capital expenditures are categorized as petroleum and natural gas and capitalized in country-by-country cost centres as follows:

	2010	2009
	$000's	$000's
United Kingdom	**49,842**	15,217
Romania	**3,918**	5,765
International	**2,217**	102
Total	**55,977**	21,084
Net proceeds of dispositions of interests in properties	**554**	89,612

In the UK, 2010 net petroleum and natural gas (P&NG) expenditures of $49,842,000 included the following major items:

- At Cladhan, $19,700,000 relating to the successful appraisal drilling program on Block 210/29a in the Northern sector of UK North Sea. Two sidetrack wells were drilled from the 2008 discovery location;
- At Breagh, $11,000,000 for field development;
- On Quad 42, $6,700,000 relating to the Macanta and Airidh exploration wells. These wells did not encounter hydrocarbons and were abandoned;
- Preliminary costs of $4,000,000 relating to the Grian exploration well being drilled in the first quarter of 2011; and
- In the Central North Sea, $3,300,000 relating to the Blakeney well on Block 21/27b. The well encountered oil-bearing sands as anticipated and although the well was not tested, two oil samples showed an oil gravity of 14-15° API.

In addition to these major items, UK capital expenditures were incurred completing additional seismic programs on other licences in the greater Breagh area. Expenditures also included costs associated with maintaining existing licences in good standing and preliminary costs associated with new licensing rounds in the UK.

In Romania, net petroleum and natural gas expenditures of $3,918,000 for 2010 related mainly to internal capitalization of administrative costs related to maintaining an onshore and offshore presence in Romania and to internal costs incurred with respect to the onshore shallow gas drilling program. Despite significant gas shows these wells did not flow gas on test.

Internationally, the Company spent $2,217,000 in 2010, primarily on investigation and analysis relating to the acquisition of interests in five licences in the F-Quad and L-Quad areas offshore the Netherlands and licences in France.

Dispositions of interests of $554,000 in properties for 2010 represent the consideration from disposal of interests in certain UK onshore licences.

During 2009, net P&NG expenditures of $21,084,000 included the following:

- UK expenditures totalling $15,217,000 relating to the completion and testing of the Breagh 42/13-5z horizontal well, a pipeline survey for the proposed route for taking Breagh gas to shore, and various engineering studies, licence fees and new licensing round applications; and
- Romanian expenditures of $5,765,000 relating mainly to a high-resolution seismic program over the Doina trend in the Midia block, and to capitalized internal overhead.

Net proceeds of dispositions of interests in properties of $89,600,000 for 2009 represented the net consideration from the sale of one-third of Sterling's interest in the Breagh field and varying interest in the surrounding acreage.

The Company had invested a total of $182,566,000 in its oil and natural gas properties to December 31, 2010, compared with $137,475,000 to December 31, 2009. Its acreage position underlying these expenditures at December 31, 2010 was as follows:

	Acres 000's	
	Gross	**Net**
United Kingdom	**931**	**332**
Romania	**2,645**	**1,873**
France	**450**	**174**
Netherlands	**479**	**239**
Total	**4,505**	**2,618**

Sterling's net interest of 1,873,000 acres in Romania represents its 50 percent interest in the Craiova Block onshore Romania and its 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, Sterling's interest in the Midia and Pelican blocks will be reduced to 65 percent. Certain licence awards in France are subject to final ratification.

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

Financing, Liquidity and Solvency

Net Working Capital

December 31	**2010**	2009
	$000's	$000's
Cash and cash equivalents	**142,624**	81,799
Restricted cash	**963**	3,147
Accounts receivable and prepaid expenses	**4,157**	1,515
Accounts payable and accrued liabilities	**(9,334)**	(6,105)
Secured notes	**–**	(7,681)
Net working capital	**138,410**	72,675

Cash and cash equivalents at December 31, 2010 include term deposits of $139,238,000 (December 31, 2009 – $77,252,000). Certain of these term deposits have maturities greater than 90 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, 2009 is due to the completion of two issuances of equity in 2010 together with proceeds from the exercise of stock options.

Restricted cash of $963,000 as at December 31, 2010 was comprised of cash held in escrow which was available only for payment of expenditures included in accounts payable relating to the 2010 drilling program. For 2009, restricted cash of $3,147,000 was comprised of cash in escrow available only for settlement of expenditures relating to a well scheduled for drilling in 2010.

Accounts receivable and accounts payable at year-end 2010 both increased from year-end 2009 levels mainly due to the increase in operational activity during the respective periods. Accounts payable also increased due to the provision for interest and penalties described under general and administrative expenses above. As at December 31, 2010, approximately $450,000 of VAT receivable from the Romanian Government was overdue. As any uncollectible amount will be reclassified to property, plant and equipment with the related expenditures, no provision has been made as at December 31, 2010.

The 15 percent secured notes issued in 2009 consisted of a bridging facility of 112 units of US$100,000 each, and were fully repaid on April 20, 2010. Each unit included one common share warrant entitling the holder to acquire 20,000 common shares of the Company at $0.84 per share. Following repayment and a period of 10 consecutive trading days during which the Company's share price traded above $2.00 per share, the Company exercised its right to force conversion of the warrants.

Financing and Farm-Outs

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

In 2010 the Company conducted the following equity financings:

- On August 12, 2010 the Company completed a bought-deal financing agreement with a syndicate of underwriters to issue 23,424,000 common shares at a price of $1.90 per share including exercise in full of an underwriters' over-allotment option of 2,369,000 common shares at the same price. The net proceeds of $41,759,000, after fees and expenses, are intended to be used towards any required equity component of Breagh project financing; and
- On December 22, 2010 the Company completed a bought-deal financing agreement with a syndicate of underwriters to issue 29,921,000 common shares at a price of $3.00 per share including exercise in full of an underwriters' over-allotment option of 3,251,000 common shares at the same price. The net proceeds of $85,100,000, after fees and expenses are intended to be used towards the planned appraisal program on the Cladhan discovery in the first half of 2011; other exploration and appraisal activities in the UK, Romania, France and the Netherlands; initial pre-development work on the offshore Romania gas projects; and for general corporate purposes.

The only financing completed during 2009 was the 15 percent secured note bridging facility discussed under working capital above.

Commitments and Obligations

(a) Long-Term Obligations

Sterling has long-term obligations to remediate or retire assets which result from net ownership interests in petroleum and natural gas exploration activity. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations as at December 31, 2010 to be approximately $6,600,000, all of which will be incurred between 2012 and 2031. A credit-adjusted discount rate of 10 percent and an inflation rate of 4 percent were used to calculate the net present value of asset retirement obligations. A continuity of these obligations is as follows:

	2010	2009
	$000's	$000's
Balance, beginning of the year	**2,199**	2,420
Settlements	**(212)**	–
Disposals	**–**	(201)
Accretion	**164**	214
Revisions to estimates	**(337)**	(234)
Balance, December 31	**1,814**	2,199

(b) Short and Medium-Term Obligations

As at December 31, 2010, short and medium-term commitments and obligations under the terms of Sterling's exploration licences and operating leases for office premises and storage facilities are as follows:

	2011	2012	2013	2014	2015	Total
	$000's	$000's	$000's	$000's	$000's	$000's
Oil and gas drilling	6,177	4,781	14,343	–	–	25,301
Seismic	319	2,391	–	–	–	2,710
Licence fees	1,801	2,961	4,354	5,747	7,140	22,003
Other operating	44	44	44	33	1,721	1,886
Office and other leases	390	75	43	–	–	508
	8,731	10,252	18,784	5,780	8,861	52,408

Of the total oil and natural gas drilling commitments, approximately $13,000,000 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 $103,000,000 as defined under current UK tax law within three years in order to qualify for exemption from UK capital gains taxes associated with the 2009 gain on the disposition of a part interest in the greater Breagh area. Of this amount, $11,000,000 of qualifying expenditures were incurred in 2010, and it is anticipated that with other planned development expenditures for 2011 and 2012, total expenditures will be sufficient to ensure the Company qualifies for the full exemption.

Liquidity and Solvency

As at December 31, 2010, the Company's net working capital totalled $138,410,000.

Following the two equity issuances in 2010, the partial disposition of Breagh in 2009 and assuming finalization of the reserves-based loan for Breagh, the Company believes it has sufficient funding to cover its obligations and commitments for 2011. Beyond this, additional funding will be required for Breagh's second phase and for the development of Cladhan and Doina/Ana. The Company is continuing to negotiate a senior debt facility with a small group of banks and negotiations are progressing with the intention that the facility be fully in place by the time development consent is received from the DECC. Development consent is currently anticipated for the second quarter of 2011.

In addition to the proposed senior debt facility, the Company is considering other contingent financing options including farm-outs. Depending on the levels of senior debt eventually obtained, however, further equity issuances may also be considered to finance a limited portion of the exploration program.

2011 Plans

The Company's key focus in 2011 will be on obtaining field development approval for the Breagh field in the UK North Sea, to appraise further the Cladhan discovery and to move forward with its current initiatives in France, the Netherlands and Romania. In addition, Sterling specifically plans to:

- Drill four development wells on the Breagh field;
- Progress Breagh development towards achieving first gas in 2012;
- Drill at least two follow-up wells to further appraise the Cladhan discovery in the UK Northern North Sea;
- Drill one exploration well on Block 48/28b in the UK Southern North Sea;
- Drill two exploration wells offshore Romania, subject to resolution of negotiations with the government;
- Drill an exploration well on the Craiova block onshore Romania, targeting unconventional Silurian shale gas and a conventional prospect;
- Continue geological and geophysical work on exploration prospects and discoveries on all its licences;
- Bring the Kirkleatham gas project on-stream in the second quarter of 2011; and
- Continue farming out a portion of Company licences in order to manage risks and reduce costs.

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

Corporately, in 2011 Sterling will also be focusing on completing a senior debt facility with a syndicate of lenders and pursuing plans to obtain a listing on the main board of the London Stock Exchange. These plans are not expected to be affected by the planned merger between TMX Group (which operates the Toronto Stock Exchange) and the London Stock Exchange announced in February 2011.

Risks and Uncertainties

The following is a summary of the principal risks facing the Company's business and the strategies it undertakes to mitigate these risks as described in more detail in the Company's Annual Information Form for the year ended December 31, 2010. 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 natural gas industry is exposed to a variety of business risks including, but not limited to, those associated with:

- Operatorship of major exploration and development projects in offshore environments;
- The finding, determination, evaluation, assessment and measurement of oil and natural 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;
- The performance of contractors and consultants;
- Competition from others in obtaining exploration licences or access to drilling equipment;
- Cultural and language barriers associated with conducting business in foreign countries;
- Reliance on key individuals; and
- Title to oil and natural gas interests.

The Company has a growing exploration portfolio and several undrilled prospects. Its ability to grow profitably will depend on its ability to drill successfully and develop these properties, as well as to obtain additional prospects.

Sterling works to mitigate these risks by employing highly skilled personnel, focusing exploration efforts in areas where it has knowledge and expertise and access to additional such knowledge and expertise, and by using current technology to enhance methods and control costs. The Company also maintains a corporate insurance program consistent with industry practice to protect the Company against losses due to accidental destruction of assets, well blowouts or other operating accidents and disruptions.

Financial and Commodity Risks

Financial risks include the impact of fluctuations in commodity prices, foreign exchange rates, interest rates, inflation and credit risk. Financial risks also include the possible impact of delays in obtaining field development approvals, and the amount and timing of financing available under proposed senior loan facilities. These factors also affect:

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

Certain of these risks may be mitigated through the use of commodity and foreign hedging programs and Sterling continually evaluates the cost of these programs relative to their potential benefit.

Political or Government-Related Risks

Sterling explores for oil and natural gas in various international jurisdictions that impose 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 licences are awarded, including related work commitments;
- The risk of required government approvals being delayed, withheld or cancelled;
- Risks associated with the fiscal terms prevailing in the jurisdictions in which Sterling operates; and
- Risks relating to any known or future international border disputes in jurisdictions where the Company is active.

Sterling is also subject to extensive and varying environmental regulations imposed by governments related to environmental protection. Sterling is committed to operating safely, in an environmentally sensitive manner, and to safeguarding the health and welfare of its employees, contractors, suppliers and the public, in every area of operation.

In order to balance its exposure to risk and reward in these areas, the Company conducts its activities in a number of jurisdictions that it considers to range from low to medium-risk.

Further discussion of the risks and uncertainties facing the Company and its business is contained in the Company's Annual Information Form for the year ended December 31, 2010.

Recent Accounting Pronouncements

In 2008, the Accounting Standards Board confirmed that Canadian publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board, in place of Canadian GAAP for interim and annual reporting for fiscal periods beginning on or after January 1, 2011. The Company will be required to report its results in accordance with IFRS starting with the three months ended March 31, 2011, with comparative IFRS information for 2010.

Other recent pronouncements include:

Canadian Institute of Chartered Accountants (CICA) Handbook Section 1582 – Business Combinations introduced revised accounting standards for business combinations with the intent of harmonizing those standards with IFRS. The revised standard requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction, to establish the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed, and to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. These changes are expected to have no impact on the Company's consolidated financial statements.

CICA Section 1601 – Consolidated Financial Statements and Section 1602 – Non-Controlling Interests require all entities to report non-controlling (minority) interests as equity in consolidated financial statements. These changes have no impact on the Company's consolidated financial statements.

Transition to IFRS

IFRS Changeover Plan

As at December 31, 2010 Sterling continued to make significant progress on the changeover plan that was reported in prior quarters and remained on schedule to complete the changeover in time to meet the 2011 financial reporting requirements. The Company has analyzed the major accounting policy alternatives and reporting differences and has drafted its IFRS accounting policies.

Sterling plans to apply for a listing on the main board of the London Stock Exchange, which requires presentation of three years of comparative financial information in the initial offering document. As a result of this, its transition date for changeover to IFRS has been changed to January 1, 2008 from January 1, 2010, as previously reported. The Company has completed the January 1, 2008 IFRS opening balance sheet based upon its draft IFRS accounting policies and detailed analysis and quantification of the policy changes is continuing as the Company analyzes the IFRS adjustments required up to December 31, 2010.

The Company has determined that no significant process or system changes will be required as a result of the changeover to IFRS and it does not expect the transition to result in a significant impact on its business activities or operating cash flows.

Expected Accounting Policy Impacts

Analysis to date has identified that the following areas may have significant impact on the Company's consolidated financial statements; this is not an exhaustive listing of changes on transition to IFRS and the full impact of adopting IFRS is still being determined and will be disclosed in the Company's MD&A for the period ended March 31, 2011:

- Accounting for petroleum and natural gas properties: Under Canadian GAAP, Sterling follows the full cost method of accounting for the exploration and development of natural gas reserves. Under this method all expenditures incurred in connection with the acquisition, exploration, and appraisal of oil and natural gas assets are capitalized. Under IFRS, Sterling plans to account for its petroleum and natural gas properties capitalizing only costs directly attributable to successful wells. Indirect costs as well as costs of unsuccessful wells and geological and geophysical costs not specific to successful wells are expensed in the income statement in the period they are determined to be unsuccessful.

  As a result of application of this change, the Company expects to recognize a charge against retained earnings of approximately $23,000,000 on its IFRS opening balance sheet at January 1, 2008 with a corresponding reduction in capital assets. Additional further adjustments for the years 2008 to 2010 will also be significant;

- Pre-exploration costs: Under IFRS 6, costs incurred prior to receiving the legal right to explore an area being obtained must be expensed in the period incurred. Currently the Company capitalizes these pre-exploration costs. Sterling expects to recognize an additional decrease of approximately $4,000,000 in its exploration and evaluation assets with a corresponding decrease in retained earnings due to the expensing of pre-exploration costs on its opening balance sheet;

- Impairment of petroleum and natural gas properties: Under IFRS, impairment of petroleum and natural gas properties must be calculated at a more granular level than is currently required under Canadian GAAP. Impairment calculations will be performed by comparing the carrying value of each cash generating unit to the higher of its fair value less cost to sell or value in use as defined under IFRS. Impairment tests are required to be performed on initial transition to IFRS and, thereafter, when amounts are transferred to development assets and when indicators exist. As at January 1, 2008 Sterling has determined that no additional impairment to its exploration and evaluation assets is required; and

- Asset retirement obligations: Under Canadian GAAP, anticipated cash expenditures relating to asset retirement obligations are initially measured using risk-adjusted discount rates. Existing liabilities are not re-measured using current discount rates. Under IFRS, asset retirement obligations are measured using current discount rates based on risk-free interest rates applied to risked anticipated cash flow at each re-measurement date. Generally, the change in discount rates results in a balance being added to or deducted from the asset balance. This change is not expected to have a material impact.

IFRS 1 – "First-time Adoption of IFRS"

IFRS 1 provides one-time accounting choices in the form of mandatory and optional exemptions in specific areas, which allow a first-time adopter not to comply with the requirements of applying IFRS retrospectively prior to the entity's transition date. Given the change in transition date to January 1, 2008, Sterling will no longer elect to deem all cumulative translation differences for all foreign operations to be nil at transition as no cumulative translation differences were recognized.

Certain IFRS 1 exemptions available to Canadian listed companies are no longer available to Sterling because of the planned listing on the London Stock Exchange. In particular, the option to value the petroleum and natural gas properties at a deemed cost equivalent to the Canadian GAAP net book value assigned to these assets as at the date of transition is no longer available.

The Company does not anticipate utilizing the decommissioning liability exemption as outlined in Appendix D in IFRS 1, which exempts a company from applying IFRS 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities, for changes that occurred before the date of transition to IFRS. Sterling has re-measured its asset retirement obligations as at the transition date, and the difference to its currently reported liability is not material.

Forward-Looking Statements and Business Risks

Certain statements contained in this MD&A are forward-looking statements. These statements relate to future events or the Company's 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 future.

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

- Commodity prices;
- Sterling's expectations regarding the duration of the economic recovery from the world-wide recession of 2008/2009;
- Expectations regarding the Company's cost structure;
- Factors upon which the Company will decide whether or not to undertake a specific course of action;
- Sterling's expectations regarding interest rates and inflation;
- Sterling's expectations regarding its 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;

- Company expectations regarding the possible impact of changes in government policy with respect to onshore and offshore drilling;
- Company expectations regarding its ability to obtain certain government and regulatory approvals.
- Company expectations regarding tax treatment under foreign government taxation regimes;
- Company expectations regarding its cash requirements and funding for the next year;
- The Company's drilling plans;
- The Company's tax horizon;
- The Company's corporate strategies, the criteria to be considered in connection therewith and the benefits to be derived therefrom;
- The Company's expectations regarding government policies with respect to concerns about climate change and the protection of the environment;
- The Company's plans and expectations that are described on page 41 under "2011 Plans"; and
- The Company's expectations regarding the effect of the transition to IFRS on its consolidated financial statements.

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 Sterling expressly or implicitly.

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, 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 the Company's control, including: political instability in the countries in which it operates, the impact of general economic conditions in the areas in which it operates, 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 natural gas operations. Readers should also carefully consider the matters discussed under "Risks and Uncertainties" on page 42 of this MD&A and "Risk Factors" beginning on page 17 of the Company's Annual Information Form.

With respect to forward-looking statements in this MD&A the Company has 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; and
- Is able to obtain necessary approvals from partners for a particular course of action.

Although Sterling believes that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. The Company cannot guarantee future results, levels of activity, performance, or achievements. Moreover it does not assume any obligation to update forward-looking statements except as required by law.

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 this MD&A.

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 via 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 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 safeguarded and financial records are 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) "Michael J. Azancot"

Michael J. Azancot
President and Chief Executive Officer

(signed) "David Blewden"

David Blewden
Chief Financial Officer

April 19, 2011

AUDITORS' REPORT

To the Shareholders of Sterling Resources Ltd.

We have audited the accompanying consolidated financial statements of Sterling Resources Ltd. (the "Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, comprehensive (loss) income, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management of the Company is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "Ernst & Young LLP"

Calgary, Canada
April 19, 2011

Ernst & Young LLP
Chartered Accountants

CONSOLIDATED BALANCE SHEETS

December 31	**2010**	2009
	$000's	$000's
ASSETS		
Current		
Cash and cash equivalents [note 4]	**142,624**	81,799
Restricted cash [note 5]	**963**	3,147
Accounts receivable [note 15d]	**4,095**	1,462
Prepaid expenses	**62**	53
	147,744	86,461
Property, plant and equipment [note 6]		
Petroleum and natural gas properties and equipment	**182,566**	137,475
Furniture, fixtures and equipment	**221**	180
	182,787	137,655
	330,531	224,116
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**9,334**	6,105
Secured notes [note 7]	**–**	7,681
	9,334	13,786
Asset retirement obligations [note 8]	**1,814**	2,199
Commitments [note 9]		
Shareholders' equity		
Share capital [note 11]	**290,444**	157,643
Contributed surplus	**9,283**	6,858
Retained earnings	**28,885**	33,867
Accumulated other comprehensive (loss) income	**(9,229)**	9,763
	319,383	208,131
	330,531	224,116

See accompanying notes

On behalf of the Board:

(signed) "Robert B. Carter" (signed) " Walter Deboni"

Director Director

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31	2010	2009
	$000's except per share	$000's except per share
GAIN ON PROPERTY DISPOSITION [note 6]	**–**	72,103
EXPENSES		
General and administrative	**6,602**	3,778
Foreign exchange gain	**(4,332)**	(1,781)
Stock-based compensation [note 11]	**2,148**	1,169
Accretion [note 8]	**164**	214
Depreciation	**89**	99
Financing expenses, net	**311**	2,239
	4,982	5,718
Net (loss) income for the year	**(4,982)**	66,385
Net (loss) income per common share [note 13]		
Basic	**$ (0.03)**	$ 0.51
Diluted	**$ (0.03)**	$ 0.50

See accompanying notes

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

Years Ended December 31	**2010**	2009
	$000's	$000's
Net (loss) income for the year	**(4,982)**	66,385
Foreign currency translation into reporting currency [note 3]	**(18,992)**	(1,012)
Comprehensive (loss) income	**(23,974)**	65,373

See accompanying notes

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31	**2010**	2009
	$000's	$000's
Share capital [note 11]		
Balance, at beginning of year	**157,643**	156,773
Issued common shares and warrants	**138,750**	2,050
Common share issue costs	**(7,407)**	2
Transferred from contributed surplus on exercise of options	**1,458**	227
Expiry of warrants [note 11]	**–**	(1,409)
Balance, at end of year	**290,444**	157,643
Contributed surplus		
Balance, at beginning of year	**6,858**	3,600
Stock-based compensation expense	**2,148**	1,169
Stock-based compensation capitalized	**1,735**	907
Transferred to share capital on exercise of options	**(1,458)**	(227)
Expiry of warrants [note 11]	**–**	1,409
Balance, at end of year	**9,283**	6,858
Retained earnings (deficit)		
Balance, at beginning of year	**33,867**	(13,845)
Net (loss) income for the year	**(4,982)**	66,385
Impact of change in functional currency [note 3]	**–**	(18,673)
Balance, at end of year	**28,885**	33,867
Accumulated other comprehensive (loss) income		
Balance, at beginning of year	**9,763**	–
Impact of change in functional currency [note 3]	**–**	10,775
Foreign currency translation into reporting currency	**(18,992)**	(1,012)
Balance, at end of year	**(9,229)**	9,763

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31	**2010**	2009
	$000's	$000's
OPERATING ACTIVITIES		
Net (loss) income for the year	**(4,982)**	66,385
Items not affecting cash used in operating activities:		
Gain on property disposition	**–**	(72,103)
Unrealized foreign exchange gain	**(2,620)**	(1,637)
Stock-based compensation [note 11]	**2,148**	1,169
Accretion [note 8]	**164**	214
Depreciation	**89**	99
Amortization of debt issuance expense [note 7]	**366**	1,359
	(4,835)	(4,514)
Net change in non-cash working capital [note 14]	**136**	41
Cash used in operating activities	**(4,699)**	(4,473)
INVESTING ACTIVITIES		
Decrease in restricted cash	**2,184**	8,123
Petroleum and natural gas properties and equipment additions	**(55,977)**	(21,084)
Net proceeds of disposition of interests in properties [note 6]	**554**	89,612
Furniture and fixture (additions) disposals	**(145)**	25
Net change in non-cash working capital [note 14]	**815**	(6,466)
Cash (used in) provided by investing activities	**(52,569)**	70,210
FINANCING ACTIVITIES		
Issuance of secured notes [note 7]	**–**	11,603
Repayment of secured notes [note 7]	**(7,437)**	(3,922)
Issuance of common shares, exercise of stock options and warrants [note 11]	**131,343**	1,213
Cash provided by financing activities	**123,906**	8,894
Effect of translation on foreign currency cash and cash equivalents	**(5,813)**	(8,602)
Increase in cash and cash equivalents during the year	**60,825**	66,029
Cash and cash equivalents, at beginning of year	**81,799**	15,770
Cash and cash equivalents, at end of year	**142,624**	81,799

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010 and 2009
(Canadian$, except as noted)

1. Description of Business

Sterling Resources Ltd. ("Sterling" or the "Company") is a publicly-traded, international energy company engaged in the acquisition of petroleum and natural gas rights, and the exploration for, and the development and production of, crude oil and natural gas. The Company operates primarily in the United Kingdom, Romania, France and the Netherlands and is headquartered in Calgary, Canada.

Sterling has these active wholly-owned subsidiaries, Sterling Resources (UK) Ltd., incorporated under the laws of England and Wales under the *Companies Act 1985*, Midia Resources SRL, incorporated under the laws of Romania and Sterling Resources Netherlands B.V., incorporated under the laws of the Netherlands.

2. Significant Accounting Policies

2.1 Basis of Presentation

The Company is in the pre-development stage of its operations. These consolidated financial statements have been prepared by management on a going concern basis in accordance with Canadian generally accepted accounting principles (GAAP). 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. All financial numbers are presented in Canadian dollars unless otherwise stated.

2.2 Consolidation

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

2.3 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.

2.4 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.

2.5 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 90 days or less.

2.6 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 centres 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 centre 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.

2.7 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.

2.8 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 using 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.

2.9 Joint Operations

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

2.10 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 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 upon 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.

2.11 Foreign Currency Translation

The Company's operations are considered to be integrated and use the UK pound as the functional currency. Operations are translated into the functional currency using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the consolidated balance sheet dates. 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 thousands of Canadian dollars, with amounts translated from functional currency to Canadian dollars as follows: assets and liabilities at the rate of exchange in effect at the applicable consolidated balance sheet dates 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).

2.12 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 bases of an asset or liability. Future income taxes are measured using income tax rates expected to apply in the years in which those 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 income 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.

2.13 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 income 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.

2.14 Measurement Uncertainty

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, stock-based compensation expense and capital expenditure accruals have been made based on estimates of fair value, using careful judgment. The assumptions used in the determination of potential asset impairments include oil and natural gas prices, exchange rates, cost estimates and production profiles. By their nature, these estimates are subject to measurement uncertainty and the impact on the consolidated financial statements of changes in such estimates in future periods could be material.

2.15 Future Accounting Pronouncements

In 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board, in place of Canadian GAAP for interim and annual reporting for fiscal periods beginning on or after January 1, 2011. The Company will be required to report its results in accordance with IFRS starting with the period ended March 31, 2011, with comparative IFRS information for the 2010 fiscal year.

The Canadian Institute of Chartered Accountants (CICA) issued the following new accounting standards which will become effective for the Company in its 2011 reporting:

CICA Handbook Section 1582 – Business Combinations introduces revised accounting standards for business combinations with the intent of harmonizing those standards with IFRS. The revised standard requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction, to establish the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed, and to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. These changes are expected to have no impact on the Company's consolidated financial statements.

CICA Handbook Section 1601 – Consolidated Financial Statements, and Section 1602 – Non-Controlling Interests, require all entities to report non-controlling (minority) interests as equity in consolidated financial statements. These changes are expected to have no impact on the Company's consolidated 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 $10,775,000 and an adjustment to retained earnings of $18,673,000.

Accumulated other comprehensive (loss) income for 2010 includes a charge of $18,992,000 (2009 – $1,012,000) to reflect the effect of translating the Company's consolidated financial statements into its reporting currency of Canadian dollars using the current rate method. The charge relates primarily to the translation of non-monetary properties and equipment, cash and cash equivalents, and shareholders' equity.

4. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

December 31	**2010**	2009
	$000's	$000's
Cash	**3,386**	4,547
Cash equivalents	**139,238**	77,252
	142,624	81,799
Balances held in:		
Canadian dollars	**92,123**	2,118
US dollars	**35,994**	72,276
UK pounds	**14,445**	7,392
Other	**62**	13
	142,624	81,799

As at December 31, 2010, cash equivalents bore interest at rates between 0.03 percent and 1 percent (December 31, 2009 – between 0.03 percent and 1.0 percent).

5. Restricted Cash

Restricted cash of $963,000 as at December 31, 2010 was comprised of cash in escrow which was available only for payment of expenditures included in accounts payable relating to the 2010 drilling program. For 2009, restricted cash of $3,147,000 was comprised of cash in escrow available only for settlement of expenditures relating to a well scheduled for drilling in 2010.

6. Property, Plant and Equipment

6.1 Petroleum and Natural Gas Properties and Equipment

December 31	**2010**	2009
At cost	**$000's**	$000's
United Kingdom	**127,882**	86,021
Romania	**50,334**	49,085
International	**4,350**	2,369
	182,566	137,475

As the Company is in the pre-development stage and has no production, none of the petroleum and natural gas properties and equipment are subject to depletion.

During the year ended December 31, 2010, the Company capitalized salaries and related benefits, including stock-based compensation, of $4,208,000 (2009 – $2,726,000).

During 2010 the Company sold certain of its UK onshore properties for net proceeds of $554,000. Under the Company's accounting policy for petroleum and natural gas properties and equipment, these proceeds were credited against the UK full cost pool, and no gain or loss was recognized.

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 $103,000,000. 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 $72,103,000 recorded in 2009 represents the excess of the proceeds received over the carrying value of the assets disposed of, the costs of disposition of $800,000 and the repurchase of the pro-rata share ($11,900,000) of the underlying encumbrance entitling a third party to a share of gross production from the Breagh field. Under current 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 three years (see note 9). As this is the Company's intention, no provision has been made for capital gains tax.

6.2 Furniture, Fixtures and Equipment

December 31	**2010**	2009
	$000's	$000's
Furniture, fixtures and equipment	**625**	523
Less accumulated depreciation	**(404)**	(343)
	221	180

7. Secured Notes

On April 20, 2009, the Company completed a US$11,200,000 bridge financing at an interest rate of 15 percent and commissions of 6 percent payable to the underwriters. Each unit of US$100,000 was repayable in three equal instalments six, nine and 12 months from closing. Each unit also included one common share warrant entitling the holder to acquire 20,000 common shares of the Company at $0.84 per share. The notes were repaid in full on April 20, 2010. Following repayment and a period of 10 consecutive trading days during which the Company's share price traded above $2.00 per share, the Company exercised its right to force conversion of the warrants.

	2010	2009
	$000's	$000's
Balance at beginning of year	**7,681**	–
Principal amount of notes issued	**–**	13,582
Debt issuance expenses		
Cash expenses	**–**	(859)
Fair value of warrants	**–**	(839)
	7,681	11,884
Repayment of notes	**(7,437)**	(3,922)
Amortization of debt issuance expense	**366**	1,359
Foreign exchange gain	**(610)**	(1,640)
Balance, at end of year	**–**	7,681

The fair value of the warrants included in debt issuance expenses was determined using the Black-Scholes option pricing model. Debt issuance expenses were amortized over the term of the notes such that the notes accreted 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 exploratory and appraisal stage activity. The Company estimates the total undiscounted cash flows required to settle its asset retirement obligations to be approximately $6,600,000 which will be incurred between 2012 and 2031. A credit-adjusted discount rate of 10 percent and an inflation rate of 4 percent were used to calculate the net present value of asset retirement obligations.

	2010	2009
	$000's	$000's
Balance, at beginning of year	**2,199**	2,420
Settlements	**(212)**	–
Disposals	**–**	(201)
Accretion	**164**	214
Revisions to estimates	**(337)**	(234)
Balance, at end of year	**1,814**	2,199

Revisions to estimates of $337,000 for 2010 relate primarily to foreign exchange revaluation and to re-assessment of costs, and extension of the anticipated useful lives of certain wells. For 2009, revisions to estimates of $234,000 were comprised solely of foreign exchange revaluation.

9. Commitments

As at December 31, 2010 the Company has commitments and obligations under the terms of its petroleum and natural gas licences as well as office leases which are expected to be incurred over the next five years as follows:

	2011	2012	2013	2014	2015	Total
	$000's	$000's	$000's	$000's	$000's	$000's
Oil and gas drilling	6,177	4,781	14,343	–	–	25,301
Seismic	319	2,391	–	–	–	2,710
Licence fees	1,801	2,961	4,354	5,747	7,140	22,003
Other operating	44	44	44	33	1,721	1,886
Office and other leases	390	75	43	–	–	508
	8,731	10,252	18,784	5,780	8,861	52,408

Of the total oil and natural gas drilling commitments, approximately $13,000,000 relates to commitment wells which are subject to farm-out negotiations and may be substantially reduced or eliminated upon conclusion of negotiations.

In addition to these commitments, the Company is required to incur eligible expenditures of approximately $103,000,000 as defined under current UK tax law within three years of the date of disposition in 2009 (note 6), in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a partial interest in the greater Breagh area. Of this amount, $11,000,000 of eligible expenditures were incurred to December 31, 2010, and it is anticipated that with other planned development expenditures for 2011 and 2012, total expenditures will be sufficient to ensure the Company qualifies for the full exemption.

In order to maintain its working interests in its oil and natural 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 for this work or to farm-out any of its existing working interests.

10. Capital Disclosures

The Company defines capital as secured notes, long-term debt and shareholders' equity, which is comprised of retained earnings, share capital, contributed surplus and accumulated other comprehensive income (loss). At December 31, 2010, the Company had no long-term debt and its shareholders' equity as defined was $319,383,000 (December 31, 2009 – $208,131,000). 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 sustain 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 through 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, consequently, does not maintain financial ratios to monitor and manage its capital structure.

11. Share Capital

11.1 Authorized

Unlimited common shares without nominal or par value

11.2 Issued and Outstanding

	2010		2009	
Common Shares	**Thousands of Shares**	**Amount $000's**	Thousands of Shares	Amount $000's
Balance, at beginning of year	**132,175**	**157,126**	130,941	155,364
Issued for cash:				
– public equity issuances	**53,344**	**134,266**	–	–
– exercise of stock options	**2,045**	**3,325**	373	489
– exercise of warrants [note 7]	**1,380**	**1,159**	860	722
Share issuance costs	**–**	**(7,407)**	–	2
Non-cash transfer from warrants	**–**	**517**	–	322
Transferred from contributed surplus on exercise of options	**–**	**1,458**	–	227
Balance, at end of year	**188,944**	**290,444**	132,174	157,126

	2010		2009	
Common Share Warrants	**Thousands of Warrants**	**Amount $**	Thousands of Warrants	Amount $
Balance, at beginning of year	**1,380**	**517**	5,637	1,409
Issued in connection with secured notes [note 7]	**–**	**–**	2,240	839
Exercise of common share warrants [note 7]	**(1,380)**	**(517)**	(860)	(322)
Expired	**–**	**–**	(5,637)	(1,409)
Balance, at end of year	**–**	**–**	1,380	517
Share capital, at end of year	**188,944**	**290,444**	133,554	157,643

On August 12, 2010, the Company completed a bought-deal financing agreement with a syndicate of underwriters for the issuance of 23,424,000 common shares at a price of $1.90 per share including an underwriters' over-allotment option of 2,369,000 common shares at the same price. The net proceeds of $41,759,000, after fees and expenses, are intended for any required equity component of the financing of the Breagh project in the UK North Sea.

On December 22, 2010, the Company completed a bought-deal financing agreement with a syndicate of underwriters to issue 29,921,000 common shares at a price of $3.00 per share including an underwriters' over-allotment option of 3,251,000 common shares at the same price. The net proceeds of $85,100,000, after fees and expenses, are intended for the planned appraisal program on the Cladhan discovery in the first half of 2011; other exploration and appraisal activities in the UK, Romania, France and the Netherlands; initial pre-development work on the offshore Romania gas projects; and for general corporate purposes.

11.3 Stock Options

The Company has established a stock option plan whereby it may grant options to its directors, officers and employees. On December 31, 2010, there were 13,304,000 (December 31, 2009 – 13,217,000) 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. An 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:

	2010		2009	
	Thousands of Options	**Weighted Average Exercise Price $**	Thousands of Options	Weighted Average Exercise Price $
Balance, at beginning of year	**8,627**	**1.90**	6,617	2.10
Granted during the year	**5,805**	**2.42**	2,825	1.42
Exercised during the year	**(2,045)**	**1.63**	(373)	1.31
Expired during the year	**(438)**	**2.45**	(442)	2.41
Balance, at end of year	**11,949**	**2.18**	8,627	1.90
Exercisable, at end of year	**3,390**	**2.09**	3,520	2.01

The following stock options were outstanding at December 31, 2010:

Exercise Price		**Options Outstanding**			**Options Exercisable**		
From	**To**	**Thousands of Options**	**Remaining Contract Life (days)**	**Weighted Average Exercise Price**	**Thousands of Options**	**Remaining Contract Life (days)**	**Weighted Average Exercise Price**
$	**$**						
1.00	**1.49**	**2,589**	**916**	**1.42**	**705**	**518**	**1.42**
1.50	**1.99**	**1,430**	**811**	**1.74**	**755**	**368**	**1.57**
2.00	**2.49**	**2,893**	**1,105**	**2.08**	**363**	**151**	**2.45**
2.50	**2.99**	**3,937**	**786**	**2.59**	**1,567**	**325**	**2.55**
3.00	**3.50**	**1,100**	**1,422**	**3.33**	**–**	**–**	**–**
1.00	**3.50**	**11,949**	**953**	**2.18**	**3,390**	**356**	**2.09**

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

	2010	2009
Risk-free interest rate	**2.21%**	1.96%
Expected hold period to exercise	**3.5 years**	3.5 years
Volatility in the price of the Company's shares	**83.9%**	105.7%
Dividend yield	**0%**	0%

The weighted average fair value of options granted during the year ended December 31, 2010 was $1.40 per share (2009 – $0.91 per share). During the year $3,883,000 (2009 – $2,076,000) of stock-based compensation was recognized of which $1,735,000 (2009 – $907,000) was capitalized and $2,148,000 (2009 – $1,169,000) was expensed.

12. Income Taxes

12.1 Current Income Taxes

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

	2010	2009
	$000's	$000's
(Loss) income before income taxes for the year	**(4,982)**	66,385
Canadian statutory income tax rate	**28.0%**	29.0%
Computed income tax (recovery) expense at the statutory rate	**(1,395)**	19,252
Tax rate differential on foreign operations	**–**	(8)
Non-taxable gain on disposition of UK properties	**–**	(20,910)
Permanent differences	**13**	10
Share issuance costs	**(1,852)**	–
Stock-based compensation	**601**	339
Fair value of warrants expensed	**72**	194
Non-taxable foreign exchange gain on secured notes	**85**	(238)
Rate adjustments	**(326)**	161
Tax losses expired	**62**	69
Eligible ring fence expenditures	**(933)**	(1,711)
Prior year adjustments	**(87)**	–
Other	**(24)**	(52)
Change in valuation allowance	**3,784**	2,894
Income tax expense per financial statements	**–**	–

12.2 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, 2010 and 2009, 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 issuance costs and non-capital losses as follows:

December 31	**2010**	2009
	$000's	$000's
Net book value of property, plant and equipment in exess of tax pools	**(45,030)**	(27,668)
Share issuance costs	**2,055**	932
Domestic and foreign loss carry-forwards	**55,080**	34,771
Asset retirement obligations	**544**	550
Unrealized foreign exchange gains	**(734)**	(458)
	11,914	8,127
Less: valuation allowance	**(11,914)**	(8,127)
Future tax asset	**–**	–

As at December 31, 2010, the Company had UK tax losses carried forward of approximately £87,874,000 (December 31, 2009 - £55,351,000) and other capital allowances of approximately $40,221,000 (December 31, 2009 - $36,303,000) available to reduce future Canadian and Romanian income subject to tax. These losses and allowances are not subject to expiry.

In addition, at December 31, 2010, the Company had non-capital losses available to reduce future Canadian taxable income which expire as follows:

	$000's
2014	524
2015	1,904
2026	235
2027	495
2028	3,530
2029	5,526
2030	2,929
	15,143

Prior year numbers have been restated to reflect the basis on which tax returns have been filed.

13. Net (Loss) Income Per Common Share

The basic net (loss) income per share is calculated based on net (loss) income as the numerator in the calculation and the weighted average number of common shares issued and outstanding during the year ended December 31, 2010 of 143,820,000 (2009 – 131,157,000) 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 outstanding is calculated assuming the proceeds from the exercise of dilutive securities are used to purchase common shares at the average market price as follows:

	2010	2009
Weighted average number of shares outstanding 000's	**143,820**	131,157
Dilution factor 000's	**–**	455
Diluted shares outstanding 000's	**143,820**	131,612
Net (loss) income	**(4,982)**	66,385
Net (loss) income per share		
– basic	**$ (0.03)**	$ 0.51
– diluted	**$ (0.03)**	$ 0.50

As at December 31, 2010 the dilutive effect of the Company's outstanding options was not included in diluted shares outstanding due to the net loss incurred during the year.

14. Working Capital

Changes in the Company's non-cash working capital for the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
	$000's	$000's
OPERATING ACTIVITIES		
Accounts receivable	**(28)**	69
Prepaid expenses	**(9)**	(16)
Accounts payable and accrued liabilities	**173**	(12)
	136	41
INVESTING ACTIVITIES		
Accounts receivable	**(2,606)**	3,662
Accounts payable and accrued liabilities	**3,421**	(10,128)
	815	(6,466)

Included in accounts payable is a provision of $1,900,000 for an underpayment of employment taxes, associated interest and possible penalties relating to the incorrect operation of the Company's share option plan for UK employees.

15. Financial Instruments

The fair values of the Company's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, secured notes and accounts payable and accrued liabilities approximate their carrying values due to their short term to maturity. Financial instruments have been categorized as follows:

(a) Cash and cash equivalents and restricted cash – held for trading;

(b) Accounts receivable – loans and receivables; and

(c) Secured notes and accounts payable and accrued liabilities – 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 is exposed to a number of 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, interest rate risk, liquidity risk and credit risk.

(a) FOREIGN EXCHANGE RATE RISK

The Company's functional currency is the UK pound 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 or Romanian lei into UK pounds. In order to minimize exposure to foreign exchange fluctuations, non-cash working capital is only held in foreign currencies when 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, 2010, a 1 percent fluctuation in the US dollar, Romanian lei or Canadian dollar against the UK pound would impact net income by approximately $220,000, $3,000 and $594,000, respectively.

(b) INTEREST RATE RISK

As at December 31, 2010, the Company had no interest-bearing debt that exposed its cash flows to interest rate risk. The Company may, however, from time-to-time 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, 2010, a 1 percent change in average interest rates would increase or decrease net income by approximately $1,440,000 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 settle its accounts payable and meet its immediate joint-venture commitments and licence 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 natural gas industry. Receivables from partners are secured by the partner's interest in the underlying oil and natural gas properties. This risk is therefore not considered significant. As at December 31, 2010, approximately $450,000 of VAT receivable from the Romanian Government was overdue. As any uncollectible amount will be reclassified to property, plant and equipment with the related expenditures, no provision has been made for impairment as at December 31, 2010.

16. Segmented Information

The Company's activities are conducted in one operating segment and four geographical segments: Corporate, the United Kingdom, Romania and "Other International", which includes operations in France and the Netherlands.

	Corporate	United Kingdom	Romania	Other International	Total
For the Year Ended December 31, 2010	**$000's**	**$000's**	**$000's**	**$000's**	**$000's**
Net (loss) income	**1,227**	**(5,046)**	**(999)**	**(164)**	**(4,982)**
Petroleum and natural gas property additions	**–**	**49,842**	**3,918**	**2,217**	**55,977**
Proceeds from disposition of interests in properties	**–**	**554**	**–**	**–**	**554**
Total assets, end of year	**118,068**	**157,092**	**51,007**	**4,364**	**330,531**
For the Year Ended December 31, 2009					
Net (loss) income	(3,762)	70,885	(734)	(4)	66,385
Petroleum and natural gas property additions	–	15,217	5,765	102	21,084
Proceeds from disposition of interests in properties	–	89,612	–	–	89,612
Total assets, end of year	14,014	157,638	50,095	2,369	224,116

17. Subsequent Events

On March 23, 2011, the UK Chancellor of the Exchequer announced an increase in the supplementary charges levied on profits from UK oil and gas production to 32 percent from 20 percent. Including the supplementary charge, UK oil and gas producers will pay a combined rate of 62 percent effective March 24, 2011. This change has no immediate impact on the Corporation, but will impact future cash flows from the Company's offshore UK projects.

Sterling has continued to pursue debt financing for its Breagh development project in the UK North Sea. A senior reserves-based debt facility of around £100 million is in an advanced state of negotiation with a group of banks and is expected to be signed by early May 2011.

CORPORATE INFORMATION

Sterling Resources Ltd.

Directors

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

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

MICHAEL J. AZANCOT
Farnham, England

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

STEWART G. GIBSON (1)
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

Management

MICHAEL J. AZANCOT
President and Chief Executive Officer

MARK BEACOM
Vice President and General Manager
Romania

DAVID M. BLEWDEN
Chief Financial Officer

STEPHEN BIRRELL
Vice President and General Manager
Netherlands and France

ROBIN M. CLARKSON
Head of Legal and General Counsel

SHERRY L. CREMER
Treasurer and Corporate Secretary

DAVID A. FINDLATER
Vice President Exploration

GEORGE KESTEVEN
Manager, Corporate and Investor Relations

JOHN M. RAPACH
Chief Operating Officer

PATRICK WHITLEY
Vice President Exploration International

Corporate Headquarters

STERLING RESOURCES LTD.
Suite 1450, 736 Sixth Avenue S.W.
Calgary, Alberta, Canada T2P 3T7
Tel: 403-237-9256
Fax: 403-215-9279
E-Mail: info@sterling-resources.com
Website: www.sterling-resources.com

Investor Relations

GEORGE KESTEVEN
Tel: 403-215-9265
Fax: 403-215-9279
E-Mail: george.kesteven@sterling-resources.com

Auditors

ERNST & YOUNG LLP

Banker

THE ROYAL BANK OF CANADA

Legal Counsel

STIKEMAN ELLIOTT LLP
Calgary, Canada

Reserves Evaluators

RPS ENERGY
Henley-on-Thames, UK

Registrar and 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 EXCHANGE
Stock Exchange Trading Symbol: SLG

Sterling Resources (UK) Ltd. (Wholly Owned)

Directors

WALTER DEBONI
Chair
Calgary, Canada

MICHAEL J. AZANCOT
Farnham, England

TECK SOON KONG
London, England

DAVID MILLER
London, England

Management

MICHAEL J. AZANCOT
Managing Director

DAVID BLEWDEN
Chief Financial Officer

ROBIN M. CLARKSON
Head of Legal and General Counsel
and Company Secretary

SHERRY L. CREMER
Assistant Company Secretary

DAVID A. FINDLATER
Vice President Exploration and Business Development

JOHN M. RAPACH
Chief Operating Officer

CHRISTINE SHINNIE
Controller

PATRICK WHITLEY
Vice President Exploration International

United Kingdom Offices

Banchory Business Centre
Burn O'Bennie Road
Banchory, Aberdeenshire
Scotland AB31 5ZU
Tel: 44-13308-26717
Fax: 44-13308-20670

Golden Cross House
8 Duncannon Street
London
England WC2N 4JF
Tel: 44-207-484-8517
Fax: 44-207-484-8517

Banker

BANK OF SCOTLAND

ROYAL BANK OF SCOTLAND

Legal Counsel

PAULL & WILLIAMSONS
Aberdeen, Scotland

PROINVEST CONSULT SRL
Bucharest, Romania

Midia Resources S.R.L.

Romanian Office

Str Andrei Muresanu Poet 11-13
Etaj 1, Apt 2
Sector 1
Bucharest 011841
Romania

MARK BEACOM
Vice President and General Manager
Romania

Tel: 40-212-313256
Fax: 40-212-313312

Sterling Resources Netherlands B.V.

Netherlands Office

J.P. Coenstraat 7
2595 WP, The Hague
Netherlands

STEPHEN BIRRELL
Vice President and General Manager
Netherlands and France

Tel: 31-70-7999163
Fax: 31-70-7999370

Annual General and Special Meeting

May 19, 2011, 10:00 a.m.
The Plaza Room, Metropolitan Conference Centre
333 – 4th Avenue S.W.
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
Mcf/d	thousands of standard cubic feet of gas per day
MMcf/d	millions of standard cubic feet of gas per day
OIIP	oil initially in place
Tcf	trillions cubic feet
Quad	An 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.

Printed in Canada

STERLING RESOURCES

Corporate Headquarters
Suite 1450, 736 Sixth Avenue S.W.
Calgary, Alberta
Canada T2P 3T7

United Kingdom Offices
Banchory Business Centre
Burn O'Bennie Road
Banchory, Aberdeenshire
Scotland AB31 5ZU

Golden Cross House
8 Duncannon Street
London
England WC2N 4JF

Netherlands Office
J.P. Coenstraat 7
2595 WP, The Hague
Netherlands

Romanian Office
Str Andrei Muresanu Poet 11-13
Etaj 1, Apt 2
Sector 1
Bucharest 011841
Romania

www.sterling-resources.com