FINANCIAL STATEMENTS

Independent Auditor's Report
To the Shareholders of Sea Dragon Energy Inc.:

We have audited the accompanying consolidated financial statements of Sea Dragon Energy Inc., which comprise the balance sheet as at December 31, 2010 and the consolidated statements of operations and deficit, comprehensive loss and cumulative other comprehensive loss and cash flows for the year then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

Management 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.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 auditor's 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 Sea Dragon Energy Inc. as at December 31, 2010 and the results of their operations and their cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Other matters

The consolidated financial statements of Sea Dragon Energy Inc. for the year ended December 31, 2009, were audited by another auditor who expressed an unmodified opinion on those statements on April 29, 2010.

As part of our audit of the 2010 consolidated financial statements, we also audited the adjustments described in Note 4 that were applied to retrospectively change the reporting currency of the 2009 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2009 consolidated financial statements of the company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2009 consolidated financial statements taken as a whole.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

March 29, 2011

CONSOLIDATED BALANCE SHEETS

(THOUSANDS OF UNITED STATES DOLLARS)

	DECEMBER 31 2010	DECEMBER 31 2009
		(restated Note 4)
Assets		
Current		
Cash and cash equivalents	**14,751**	1,999
Accounts receivable *(Note 5)*	**6,082**	2,266
Prepaid expenses	**112**	16
	20,945	4,281
Restricted cash *(Note 15)*	**–**	310
Acquisition deposit *(Note 6)*	**–**	2,006
Investment *(Note 7)*	**–**	287
Property and equipment *(Note 8)*	**62,742**	14,356
	83,687	21,240
Liabilities and Shareholders' Equity		
Liabilities		
Current		
Accounts payable and accrued liabilities	**5,275**	1,014
Shareholders' Equity		
Common shares *(Note 9)*	**120,036**	53,804
Warrants *(Note 9)*	**4,122**	5,392
Contributed surplus *(Note 9)*	**2,239**	386
Accumulated other comprehensive loss *(Note 4)*	**(8,296)**	(5,819)
Deficit	**(39,689)**	(33,537)
	78,412	20,226
	83,687	21,240

Basis of presentation *(Note 2)*

Significant accounting policies *(Note 3)*

Commitments *(Note 11)*

Contingency *(Note 12)*

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

(THOUSANDS OF UNITED STATES DOLLARS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 31 2010	YEAR ENDED DECEMBER 31 2009
		(restated Note 4)
Revenue		
Oil sales, net of royalties	**12,529**	180
Interest income and other	**18**	157
	12, 547	337
Expenses		
Operating	**3,423**	37
General and administrative	**5,023**	3,827
Foreign exchange (gain)/loss	**(1,343)**	1,097
Stock-based compensation	**1,317**	371
Additional shares *(Note 9)*	**462**	–
Impairment of oil and gas properties *(Note 8)*	**–**	8,933
Depletion and depreciation *(Note 8)*	**6,642**	123
	15,524	14,388
Loss before income taxes	**(2,977)**	(14,051)
Income taxes - current *(Note 10)*	**(3,175)**	(29)
Net loss for the year	**(6,152)**	(14,080)
Deficit, beginning of year	**(33,537)**	(19,457)
Deficit, end of year	**(39,689)**	(33,537)
Basic and diluted loss per share	**(0.02)**	(0.09)
Weighted average common shares outstanding *(000's)*	**326,252**	153,717

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS AND ACCUMULATED OTHER COMPREHENSIVE LOSS

(THOUSANDS OF UNITED STATES DOLLARS)

	YEAR ENDED DECEMBER 31 2010	YEAR ENDED DECEMBER 31 2009
		(restated Note 4)
Net loss for the year	**(6,152)**	(14,080)
Other comprehensive (loss)/income		
Foreign exchange adjustment (loss)/gain on change in reporting currrency *(Note 4)*	**(2,477)**	1,551
Comprehensive loss for the year	**(8,629)**	(12,529)
Cumulative other comprehensive loss, beginning of the year	**(5,819)**	(7,370)
Other comprehensive (loss)/income	**(2,477)**	1,551
Cumulative other comprehensive loss, end of year	**(8,296)**	(5,819)

See accompanying notes to the consolidated financial statements.

(THOUSANDS OF UNITED STATES DOLLARS)

	YEAR ENDED DECEMBER 31 2010	YEAR ENDED DECEMBER 31 2009
		(restated Note 4)
Cash provided by (used in)		
Operating activities		
Net loss for the year	**(6,152)**	(14,080)
Non cash items		
Stock-based compensation	**1,317**	371
Depletion and depreciation	**6,642**	123
Impairment of oil and gas properties	**–**	8,933
Unrealized exchange (gain)/loss	**(661)**	73
Additional shares	**462**	–
	1,608	(4,580)
Net change in non-cash working capital	**(6,092)**	2,130
	(4,484)	(2,450)
Financing activities		
Proceeds from issuance of shares, net of costs	**64,638**	13,931
	64,638	13,931
Investing activities		
Property and equipment expenditures	**(12,132)**	(9,743)
Property and equipment acquisitions	**(44,501)**	(14,760)
Restricted cash	**310**	9,336
Acquisition deposit	**2,168**	(1,987)
Investment – convertible debenture	**287**	–
Change in non-cash working capital	**6,501**	(5,789)
	(47,367)	(22,943)
Change in cash and cash equivalents	**12,787**	(11,462)
Effect of foreign exchange on cash and cash equivalents	**(35)**	(203)
Cash and cash equivalents, beginning of year	**1,999**	13,664
Cash and cash equivalents, end of year	**14,751**	1,999
Supplemental cash flow information		
Interest paid	**–**	108

See accompanying notes to the consolidated financial statements.

NOTE 1 – **DESCRIPTION OF BUSINESS**

Sea Dragon Energy Inc. and its wholly owned subsidiaries hereafter referred to as the "Company" or "Sea Dragon" is headquartered in Calgary, Alberta. The consolidated financial statements of the Company as at and for the twelve months ended December 31, 2010 and 2009 comprise the Company and its wholly owned subsidiaries. The Company is engaged in the exploration for and development and production of oil and natural gas. The Company conducts many of its activities jointly with others; these financial statements reflect only the Company's proportionate interest in such activities. The Company's principle properties are located in the Arab Republic of Egypt.

The Company is listed on the Toronto Venture Stock Exchange (TSX-V) and trades under the symbol SDX.

NOTE 2 – **BASIS OF PRESENTATION**

The audited consolidated financial statements of Sea Dragon have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates. Unless otherwise indicated, all financial amounts are reported in thousands of United States dollars.

NOTE 3 – **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

(a) Petroleum and natural gas properties:

(i) Capitalized costs:

The Company follows the full cost method of accounting for its petroleum and natural gas properties. Under this method, all costs related to the exploration for, and development of, oil and natural gas reserves are capitalized in cost centres on a country-by-country basis. Costs include lease acquisition costs, geological and geophysical expenses, overhead directly related to exploration and development activities, and costs of drilling both productive and non-productive wells. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion and depreciation by 20 percent or more.

(ii) Depletion and depreciation:

Depletion of oil and natural gas properties and depreciation of production equipment is provided by using the unit-of-production method based upon estimated proven oil and natural gas reserves, before royalties, on a cost centre basis. The costs of significant unevaluated properties and major development projects are excluded from costs subject to depletion. For depletion and depreciation purposes, relative volumes, before royalties, of oil and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

(iii) Asset retirement obligation ("ARO"):

The fair value of the statutory, contractual or legal liability associated with the retirement and reclamation of tangible long-lived assets is recognized when incurred. The asset retirement cost, equal to the estimated fair value of the ARO, is capitalized as part of the cost of the related long-lived asset. Asset retirement costs for the crude oil assets are amortized using the unit-of-production method.

The ARO liabilities are carried on the Consolidated Balance Sheets at their discounted present value and are accreted over time for the change in present value, with the accretion charge included in depreciation, depletion and accretion.

Actual expenditures incurred are charged against the accumulated obligation.

Sea Dragon does not have any ARO as there is no legal obligation for the Company in Egypt.

(iv) Impairment tests:

In following the full cost method, an impairment loss is recognized when the carrying amount of the petroleum and natural gas properties of a cost centre is not recoverable and exceeds its fair value. The carrying amounts are assessed to be unrecoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market value of unproved properties and the cost of major development projects are less than the carrying amount of the cost centre. In determining the amount of impairment, the carrying amount of oil and gas properties capitalized in a cost centre is compared to the fair value of the associated proved and probable reserves and the lower of cost and market value of any unproved properties which are subject to a separate test for impairment. In determining the fair value of the proved and probable reserves, the Company uses cash flows based upon oil and gas prices as quoted in the futures market where obtainable, adjusted for quality differences, transportation and other relevant factors. These cash flows are then discounted using a risk-free interest rate. If the carrying value of the oil and gas properties is in excess of its fair value (the "ceiling test"), the excess is charged against earnings as additional depletion and depreciation.

(iv) Joint activities:

The Company conducts substantially all of its oil and gas exploration and production activities on a joint basis. These financial statements reflect only the Company's proportionate interest in such activities.

(b) Office furniture and equipment:

Depreciation of office furniture and equipment is based on estimates of useful lives and is calculated using the declining balance method at rates ranging from 20 percent to 30 percent per annum.

(c) Foreign currency translation:

The Company translates foreign currency denominated monetary assets and liabilities at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated at historical exchange rates. Revenues and expenses are translated at transaction date exchange rates. Exchange gains or losses are included in the determination of net income as foreign exchange loss/ (gain).

(d) Revenue recognition:

Revenues associated with the sale of crude oil are recorded when title passes to the customer. Revenues from crude production from properties from which the Company has an interest with other producers is recognized on the basis of the Company's net working interest.

(e) Inventory:

Inventories of petroleum products, comprising of crude oil and condensate, are valued at the lower of cost and net realizable values. Cost is determined based upon actual operating, transportation and depletion costs.

(f) Income taxes:

The Company uses the liability method to account for income taxes. Under this method, future income taxes are based on the difference between assets and liabilities reported for financial accounting purposes from those reported for income tax. Future income tax assets and liabilities are measured using the substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The Company's contractual arrangements in foreign jurisdictions stipulate that income taxes are paid by the respective government out of its entitlement share of production sharing oil. Such amounts are included in income tax expense at the statutory rate in effect at the time of production.

(g) Per share data:

Basic per share amounts are computed by dividing net loss from operations by the weighted average number of common shares outstanding for the year. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only options for which the exercise price is less than the market value impact the dilution calculations.

(h) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash, term deposits and other highly liquid investments with an original maturity of three months or less at the time of purchase.

(j) Stock-based compensation:

The Company uses the fair value method for valuing stock options granted as stock-based compensation. Under the fair value method, a compensation cost is measured at fair value for stock options granted at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid together with the amount previously recognized as contributed surplus, is recorded as an increase to share capital.

(j) Financial instruments:

All financial instruments are recorded initially at estimated fair value on the balance sheet except for certain related party transactions and classified into one of five categories: held for trading, held to maturity, available for sale, loans and receivables and other liabilities. Cash and cash equivalents, and investments are classified as held for trading and measured at estimated fair value. Accounts receivable are classified as loans and receivables and measured at amortized cost. Accounts payable is classified as other liabilities and measured at amortized cost.

The Company may enter into derivative contracts (commodity price, interest rate or foreign currency) in order to manage risk. Derivative contracts are marked-to-market at each reporting period with the change in estimated fair value recorded as gain or loss in earnings. The Company does not utilize derivative contracts for speculative purposes, has not designated any derivative contracts as hedges, and has not recorded any assets or liabilities as a result of embedded derivatives.

The estimated fair value of cash and cash equivalents, accounts receivable and accounts payable approximate their carrying amounts due to their short terms to maturity.

NOTE 4 – **CHANGES IN ACCOUNTING POLICIES**

New Accounting Standards Adopted

On January 1, 2010, the Company adopted the following Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

"Business Combinations", Section 1582, which replaces the previous business combinations standard. The standard requires assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies to be measured at their fair values as of the date of acquisition. In addition, acquisition-related and restructuring costs are to be recognized separately from the business combination and included in the statement of earnings. The adoption of this standard has had no material impact on the accounting treatment of business combinations entered into after January 1, 2010.

"Non-Controlling Interests", Section 1602 and Consolidated Financial Statements, Section 1601 were issued in December 2008. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. These standards currently do not impact the Company as it has full controlling interest of all of its subsidiaries.

Change in reporting currency and accumulated other comprehensive income

Effective July 1, 2010, the Company changed its reporting and functional currency from Canadian dollars (CDN$) to United States dollars (US$), as significant portions of the Company's revenues, expenses and cash flows are denominated in US$. The change in reporting currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the international oil and gas industry. Prior to July 1, 2010, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in CDN$. In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants (CICA), set out in EIC-130, Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency. In accordance with EIC-130, the financial statements for all years and periods presented have been translated into the new reporting currency using the current rate method. Under this method, the statements of operations and cash flow statement items for each year and period have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the consolidated balance sheets dates. Shareholders' equity transactions have been translated using the rates of exchange in effect as of the dates of the various capital transactions, while shareholders' equity balances from the translation are included as a separate component of other comprehensive income. All resulting exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US$ and the effect on the consolidated financial statements resulted in an accumulated and other comprehensive income adjustment of $8.3 million as at July 1, 2010.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The Company is exposed to financial risks due to the nature of its business and the financial assets and liabilities that it holds. The following discussion reviews material financial risks, quantifies the associated exposures, and explains how these risks, and the Company's capital, are managed.

a. Market Risk

Changes in foreign currency exchange rates can have an impact on the Company's earnings and value of financial assets and liabilities.

Foreign Currency Exchange Rate Risk - Foreign exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. As the effects of foreign exchange fluctuations are embedded in the Company's results, the total effect of foreign exchange fluctuations are not separately identifiable. The reporting currency of the Company is United States dollars (US$). Substantially all of the Company's operations are in foreign jurisdictions and as a result, the Company is exposed to foreign currency exchange rate risk on some of its activities primarily on exchange fluctuations between the Canadian dollar (CDN$) and the US$. The majority of capital expenditures are incurred in US$ and oil revenues are received in US$ therefore the Company's exposure to foreign exchange is reduced.

The table below shows the Company's exposure to foreign currencies for its financial instruments:

AS AT DECEMBER 31, 2010		US$	EGP	EUR	CAD
	TOTAL PER FS[1]			US$ Equivalent	
Cash and cash equivalents	14,751	9,955	6	22	4,768
Accounts receivable	6,082	6,040	–	4	38
Accounts payable and accrued liabilities	(5,275)	(4,881)	–	(24)	(370)
Balance sheet exposure	15,558	11,114	6	2	4,436

[1] *denotes Financial Statements*

		US$	EGP	EUR	CAD
AS AT DECEMBER 31, 2009 *(restated - note 4)*	TOTAL PER FS [1]			US$ Equivalent	
Cash and cash equivalents	1,999	840	5	–	1,154
Accounts receivable	2,266	2,217	–	–	49
Accounts payable and accrued liabilities	(1,014)	(20)	–	–	(994)
Balance sheet exposure	3,251	3,037	5	–	209

[1] *denotes Financial Statements*

A three percent strengthening of the US$ would result in a change in earnings as follows:

AS AT DECEMBER 31, 2010	EGP	EUR	CAD
		US$ Equivalent	
Decrease in earnings	–	–	133

b. Credit Risk

Credit risk is the risk of a financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligation and arises principally from joint venture partners and oil marketers. The Company is exposed to credit risk in respect to its cash and cash equivalents and accounts receivable.

Cash and cash equivalents are held in operating accounts with major international banks in Canada, Egypt and the United Kingdom, and therefore the Company considers these assets to have negligible credit risk.

The carrying amount of cash and cash equivalents and accounts receivable represents the Company's maximum credit exposure.

At December 31, 2010 the Company had accounts receivable of $6.0 million of which 92 percent was due from two separate entities, both of which are government controlled agencies in Egypt. At December 31, 2009 the Company had accounts receivable of $2.3 million of which 98 percent was due from one entity, which is a government controlled agency in Egypt. The Company expects to collect the outstanding receivables in the normal course of operations.

Accounts receivable are analyzed in the table below. There are no indications as of the reporting date that the debtors will not meet their payment obligations.

ACCOUNTS RECEIVABLE AT DECEMBER 31, 2010	
Total accounts receivable	6,082
Aging:	
0-60 days	3,398
61-90 days	633
Over 90 days	2,050

c. Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity risk is to ensure, to the extent possible, that it will have sufficient cash resources to meet its liabilities when they become due. The Company manages its risk of not meeting its financial obligations through management of its capital structure, annual budgeting of its revenues, expenditures and cash flows. On a monthly basis, internal reporting of actual results is compared to the budget in order to modify budget assumptions, if necessary, to ensure liquidity is maintained.

The Company believes that the current working capital balance and cash flow from operations will be adequate to support the Company's financial liabilities and commitments.

As of December 31, 2010, the Company's financial liabilities are due within one year.

d. Capital Management

The Company defines and computes its capital as follows:

	DECEMBER 31, 2010	DECEMBER 31, 2009 *(restated - note 4)*
Shareholder Equity	78,412	20,226
Working capital [1]	(15,670)	(3,267)
Total capital	62,742	16,959

[1] *Working capital is defined as current assets less current liabilities.*

The Company's objective when managing its capital is to ensure it has sufficient capital to maintain its ongoing operations, pursue the acquisition of interests in producing or near to production oil and gas properties and to maintain a flexible capital structure which optimizes the cost of capital at an acceptable risk. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the exploration and development of its interests in its existing properties and to pursue other opportunities.

Working capital as at December 31, 2010 of $15.7 million has increased from the December 31, 2009 balance of $3.3 million primarily as a result of the Company raising $11.0 million and $53.5 million net of related costs in two private placements during the year ended December 31, 2010 (Note 8). The Company is not subject to externally imposed capital requirements.

e. Financial Instruments

The Company's financial instruments as at December 31, 2010 and 2009 were comprised of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair value of financial assets and financial liabilities that are included on the balance sheet approximate their carrying amounts due to their short term nature.

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Company does not have any financial derivative contracts as at December 31, 2010.

NOTE 6– ACQUISITIONS

Kom Ombo

On December 31, 2009, the Corporation, through its wholly-owned subsidiary, Sea Dragon Energy (Kom Ombo) Ltd., entered into a farmout agreement ("Agreement") with Dana Gas Egypt ("DGE") for the acquisition of a fifty (50%) percent participating interest in the Kom Ombo Concession ("Kom Ombo") in Egypt for aggregate consideration of $44.5 million. The effective date of the Kom Ombo Acquisition was July 1, 2009. On December 30, 2009 the Company transferred $2.0 million to its lawyer to be held in trust as a deposit for the Agreement.

On April 29, 2010, substantially all consideration for the acquisition of Kom Ombo was paid to DGE.

The following table presents the preliminary allocation of the purchase price to the acquired assets and liabilities assumed, based on estimates of fair value:

Consideration:	
Cash	44,501
Allocated to:	
Property and Equipment	44,501

The above amounts are estimates, which were made by management at the time of the preparation of these financial statements based on information available. Amendments may be made to these amounts as values subject to estimate are finalized.

North West Gemsa

On December 21, 2009 Sea Dragon acquired all of the common shares of Premier Oil Egypt (NW Gemsa) B.V. ("POE") for cash consideration of $14.8 million. POE's main asset was a 10 percent working interest in the North West Gemsa oil and gas concession in the Arab Republic of Egypt. The results of POE's operations have been included in the consolidated financial statements since that date. Revenues, expenses and capital expenditures arising between the effective July 1, 2009 date and the closing December 21, 2009 date have been recognized as adjustments to the purchase. Sea Dragon primarily funded the acquisition with the proceeds of the private placement that closed on November 6, 2009.

The acquisition has been accounted for using the purchase method with Sea Dragon as the acquirer. The following table presents the allocation of the purchase price to the acquired assets and liabilities assumed, based on estimates of fair value:

Accounts receivable	1,908
Property and equipment	13,149
Accounts payable and accrued liabilities	(297)
	14,760

NOTE 7 – **INVESTMENT**

On December 12, 2008, the Company purchased a $0.3 million convertible debenture issued by a private Canadian corporation with a joint venture interest in an oil and gas concession in The Republic of the Congo. On January 22, 2010, the Company received full payment of the principal and interest earned to January 22, 2010.

NOTE 8 – **PROPERTY & EQUIPMENT**

	DECEMBER 31 2010	DECEMBER 31 2009 *(restated - note 4)*
Oil and gas properties, at cost	**99,175**	44,344
Accumulated depletion	**(6,710)**	(102)
Accumulated impairment of oil and gas properties	**(29,996)**	(29,996)
	62,469	14,246
Furniture and equipment, at cost	**369**	134
Accumulated depreciation	**(96)**	(24)
	273	110
	62,742	14,356

During year ended December 31, 2010, the Company capitalized $0.7 million of general and administrative costs related to development and production activities in Egypt (2009 - $0.6 million).

At December 31, 2010, expenditures associated with the Company's unproven properties totaling $20.1 million (December 31, 2009 – Nil) have been excluded from depletion. Estimated future development costs of $6.6 million (December 31, 2009 -$3.0 million) have been included in costs subject to depletion.

In 2009 the Company wrote off approximately $8.9 million of costs related to EWA Concession. No additional capital expenditures were incurred during the twelve months ended December 31, 2010 on the EWA property.

The Company performed a ceiling test calculation at December 31, 2010 to assess the recoverable value of property and equipment, which indicated no write down was required. The future commodity prices used in the ceiling test were based on the December 31, 2010 commodity price forecasts of the Company's independent reserve engineers adjusted for differentials specific to the Company's reserves. The following table summarizes the future benchmark prices the Company used in the ceiling test.

	BRENT REFERENCE PRICE	INFLATION RATES	LPG PRICE	GAS PRICE
YEAR	*(US$/Bbl)*	*% Year*	*(US$/Bbl)*	*(US$/Mcf)*
2011	90.15	2.0	54.15	1.00
2012	88.98	2.0	54.14	1.00
2013	88.49	2.0	54.15	1.00
2014	90.20	3.0	55.39	1.00
2015	92.04	2.0	56.52	1.00
Thereafter	+2.0%/Year	+2.0%/Year	+2.0%/Year	1.00

NOTE 9 – **SHARE CAPITAL**

a. Authorized

The Company is authorized to issue unlimited common shares with no-par value and unlimited preferred shares with no-par value.

b. Common shares

	2010		2009	
DECEMBER 31	NUMBER OF SHARES *(000`s)*	AMOUNT	NUMBER OF SHARES *(000`s)*	AMOUNT *(restated - note 4)*
Balance, beginning of year	206,131	53,804	144,509	44,269
Warrants exercised	3,461	908	–	430
Options exercised	500	88	–	–
Conversion of special warrants, net of share issuance costs	23,867	11,005	–	–
Private placement, net of issuance costs	142,500	53,497	60,000	8,923
Transfer from exercise of warrants	–	657	1,622	183
Transfer from exercise of options	–	77	–	–
Balance, end of year	376,459	120,036	206,131	53,804

During the year ended December 31, 2010 the Company issued 3.5 million common shares upon the exercise of warrants at an average price of $0.35 CDN per common share for total proceeds on exercise of $0.9 million.

During the year ended December 31, 2010 the Company issued 0.5 million common shares upon the exercise of stock options at an average price of $0.18 CDN per common share for total proceeds on exercise of $88.

On April 13, 2010 the Company converted 22.7 million special warrants that were issued on January 25, 2010. Each special warrant entitled the holder thereof to receive one common share on the exercise of the special warrant for no additional consideration, subject to an adjustment whereby if the Company was not qualified to issue the common shares under the original offering by April 1, 2010, each warrant would be exercisable for 1.05 common shares (the "Additional Shares") for no additional consideration. The Company qualified to issue the common shares on April 13, 2010 and as a result on April 13, 2010, 23.8 million common shares were issued upon the exercise of the special warrants. The Company recognized an expense of $0.5 million for the estimated fair value of the Additional Shares on the exercise of the special warrants. The net proceeds to the Company were $11.0 million.

On April 19, 2010 the Company completed an issuance of 142.5 million common shares on a bought deal basis pursuant to a short form prospectus at a price of $0.40 CDN per common share for net proceeds to the Company of $53.5 million. Proceeds of this offering were used to pay the balance of the consideration due for the acquisition of a fifty percent participating interest in the Kom Ombo Concession (Note 5).

Throughout the year ended December 31, 2009 the Company issued 1.6 million shares upon the exercise of 1.6 million warrants at an average price of $0.29 CDN per share for total proceeds on exercise of $0.2 million.

On November 6, 2009 the Company completed a private placement and issued 60 million Units for $0.25 CDN per unit. Each unit consisted of one common share and one half warrant. One full warrant is convertible into one common share of Sea Dragon Energy Inc. at a price of $0.50 CDN per share until the expiry date of November 6, 2012. Proceeds of the placement were $13.3 million, net of costs. The fair value of the warrants was estimated to be $4.4 million or $0.15 CDN per full warrant based on the relative fair value of a common share and a full warrant using the Black Scholes pricing model with the following assumptions: average risk free rate – 2%, expected life – 3 years, expected volatility rate - 159% and expected dividend yield of 0.00%. Directors and Officers of the Company purchased 1.5 million units of this offering.

c. Stock option plan

	2010		2009	
STOCK OPTIONS	NUMBER OF OPTIONS *(000's)*	WEIGHTED AVERAGE EXERCISE PRICE *(CDN)*	NUMBER OF OPTIONS *(000's)*	WEIGHTED AVERAGE EXERCISE PRICE *(CDN)*
Outstanding, beginning of year	9,817	$ 0.42	4,700	$0.60
Granted	4,000	$ 0.31	5,250	$0.29
Exercised	(500)	$ 0.18	–	–
Forfeited	(67)	$ 0.60	(133)	$0.60
Outstanding, end of year	13,250	$ 0.40	9,817	$0.42
Exercisable, end of year	6,167	$ 0.43	1,500	$0.43

The following summarizes details about the Company's stock options as at December 31, 2010:

	OUTSTANDING OPTIONS		VESTED OPTIONS	
EXERCISE PRICE RANGE	NUMBER OF OPTIONS	REMAINING CONTRACTUAL LIFE	NUMBER OF OPTIONS	REMAINING CONTRACTUAL LIFE
$0.00 to $0.19	3,000,000	3.6 years	999,998	3.6 years
$0.20 to $0.39	4,000,000	4.6 years	1,250,000	4.7 years
$0.40 to $0.59	1,750,000	2.0 years	650,002	1.9 years
$0.60 to $0.79	4,500,000	2.6 years	3,266,664	2.6 years
	13,250,000	3.4 years	6,166,664	3.1 years

During the year the Company granted 2.7 million options that vest over three years to employees and officers at a weighted average price of $0.32 CDN. In addition, the Company granted 1.3 million options that vest immediately to directors at a weighted average price of $0.27 CDN.

The weighted average assumptions and resultant fair values for stock options granted during the years ended December 31, 2010 and 2009 were as follows:

	2010	2009
Risk Free Rate *(%)*	**2.23**	2.58
Expected Life *(years)*	**5**	5
Expected Volatility *(%)*	**125**	155
Dividend per Share *(%)*	**–**	–
Weighted Average Fair Value *(CDN$)*	**0.26**	0.26

d. Warrants

The following share purchase warrants were outstanding as at December 31, 2010:

	2010		2009	
	NUMBER OF WARRANTS (000s)	EXERCISE PRICE (CDN)	NUMBER OF WARRANTS (000s)	EXERCISE PRICE (CDN)
Outstanding, beginning of year	37,659	$ 0.49	9,281	$ 0.41
Issued	–	$ 0.34	30,000	$ 0.50
Exercised	(3,461)		(1,622)	$ 0.29
Expired	(4,198)	$ 0.53	–	–
Outstanding and exercisable, end of year	30,000	$ 0.50	37,659	$0.49

DECEMBER 31	2010	2009 (restated - note 4)
Balance, beginning of year	5,392	1,217
Fair value of warrants issued	–	4,357
Transfer to common shares on exercise of warrants	(657)	(182)
Transfer to contributed surplus on expiration of warrants	(613)	–
Balance, end of year	4,122	5,392

On March 2, 2010 the Company informed holders of certain outstanding warrants that early termination provisions were being exercised by the Company and the warrants would expire within 30 days of such notice. On April 1, 2010, 1.0 million unexercised warrants expired.

e. Contributed surplus

DECEMBER 31	2010	2009 (restated - note 4)
Balance, beginning of year	386	15
Stock-based compensation expense	1,317	371
Transfer on expiration of warrants	613	–
Transfer on exercise of options	(77)	–
Balance, end of year	2,239	386

NOTE 10 – FUTURE INCOME TAXES

The following income tax assets at December 31, 2010 and 2009 are comprised of the tax effect of temporary differences as follows:

	2010	2009 (restated - note 4)
Differences related to:		
Property and equipment	6,084	3,068
Non-capital losses	4,830	5,422
Share issue expenses	1,359	692
Unrealized foreign exchange losses	–	55
	12,273	9,237
Valuation allowance for future income tax assets	(12,273)	(9,237)
Future income tax asset	–	–

The Company has non-capital losses of $19.3 million that expire between 2026 and 2030.

Pursuant to the terms of NW Gemsa and Kom Ombo concession agreements, the corporate tax liability of the joint venture partners is paid by the Egyptian General Petroleum Corporation (the "EGPC") for NW Gemsa and by Ganoub El Wadi Petroleum Holding Company ("Ganope") for Kom Ombo, out of the profit oil attributable to the EGPC and Ganope, and not by the Company. For accounting purposes the corporate taxes paid by the EGPC and Ganope are treated as a benefit earned by the Company; the amount is included in net oil revenues and deducted as an income tax expense.

Income taxes vary from the amount that would be computed by applying the Canadian statutory income tax rate of 28.0% (2009 – 29.5%) to income before taxes as follows:

	2010	2009 *(restated - note 4)*
Loss before income taxes	(2,977)	(16,056)
Canadian statutory income tax rate	28.0%	29.5%
Expected income taxes (recovery)	(834)	(4,737)
Adjustments:		
Stock based compensation	369	118
Change in valuation allowance, net of foreign exchange	2,017	4,061
Foreign tax rate differential	983	703
Expenses incurred with no recognized tax benefit	1,492	–
Change in income tax rates and certain tax balances	(668)	–
Other	(184)	(116)
Current income taxes	3,175	29

NOTE 11 – **COMMITMENTS**

Pursuant to concession agreements in Egypt, the Company is required to perform certain minimum exploration activities that include the drilling of exploration wells. These obligations have not been provided for in the financial statements.

The Company has office lease commitments in Calgary, Paris and Cairo. The following are the anticipated payments under the contracts:

FISCAL YEAR	CONCESSION AGREEMENTS	OFFICE LEASES	TOTAL
2011	1,000	420	1,420
2012	–	397	397
2013	–	357	357
2014	–	357	357
2015	–	357	357

Sea Dragon may be required to provide a Letter of Guarantee ("Letter") not exceeding $4.5 million for the Kom Ombo concession that will secure its share of the concession work commitment. The Letter has not yet been issued and has not been provided for in the financial statements.

NOTE 12 – **CONTINGENCY**

On April 16, 2010, a statement of claim (the "Claim") was filed in the province of Alberta against the Company in which the plaintiffs allege, among other things, that the actions of the Company contributed to the plaintiffs not being recognized for a 25% interest in the EWA Concession Agreement. The plaintiffs seek injunctions and damages of $32.0 million as compensation. On February 3, 2011, the Alberta Court of Queen's Bench granted an application by the Company to stay the Court proceedings in respect of this Claim, on the grounds that the Claim is subject to an arbitration agreement and an arbitration tribunal has previously been appointed to adjudicate the same subject matter as the Claim. The arbitration has itself been stayed since April 2009, due to the failure by the plaintiffs to pay a deposit required by the arbitration tribunal for the arbitrators' fees and expenses.

The Company believes this Claim to be without merit and will vigorously defend itself against the claim. As an assessment of the likelihood of loss is indeterminable at this time, no provision has been made in the financial statements for this claim. Any such loss will be recognized in the period it becomes likely to occur.

NOTE 13 – **GEOGRAPHIC SEGMENTATION**

The Company has a corporate office in Canada and operations in Egypt. Set out below is segmented information on a geographic basis.

	TWELVE MONTHS ENDED DECEMBER 31, 2010			TWELVE MONTHS ENDED DECEMBER 31, 2009		
	CANADA	EGYPT	TOTAL	CANADA *(restated)*	EGYPT *(restated)*	TOTAL *(restated)*
Oil sales, net of royalties	–	12,529	12,529	–	180	180
Interest and other income	18	–	18	157	–	157
Net Income/(Loss)	(5,961)	(191)	(6,152)	(4,707)	(9,372)	(14,080)
Capital Expenditures	(134)	(56,499)	(56,633)	(183)	(24,320)	(24,503)
Total Assets, end of year	21,003	62,684	83,687	6,890	14,350	21,240

Sales to EGPC and Ganope for the twelve months ended December 31, 2010 account for 70 percent and 30 percent respectively, of total oil sales, net of royalties. For the twelve months ended December 31, 2009, oil sales were 100% to EGPC.

NOTE 14 – **COMPARATIVE AMOUNTS**

Certain comparative information has been restated to conform to the presentation of the December 31, 2010 information.

NOTE 15 – **RESTRICTED CASH**

Restricted cash consists of cash on deposit that secure a letter of credit, and a minimum cash balance that secures corporate credit cards.