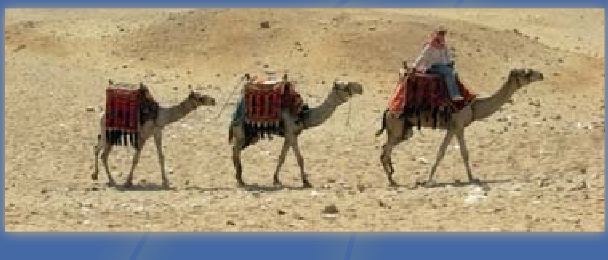
Financial Statements



REPORT OF Management

Management is responsible for the Consolidated Financial Statements.

Management has prepared the Consolidated Financial Statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. If alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has ensured that the Consolidated Financial Statements are presented fairly in all material respects.

The Board of Directors is responsible for reviewing and approving the Consolidated Financial Statements and Management's Discussion and Analysis and, primarily through its Audit Committee, ensures that management fulfills its responsibilities for financial reporting.

The Audit Committee is appointed by the Board of Directors and is composed entirely of unrelated, independent directors. It reviews the Consolidated Financial Statements and the external auditors' report. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or reappointment of the external auditors.

PricewaterhouseCoopers LLP, the external auditors, have audited the Consolidated Financial Statements in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

Said Arrata
Chief Executive Officer

Olivier Serra
Chief Financial Officer

Independent Auditor's REPORT

April 3, 2012

To the Shareholders of
Sea Dragon Energy Inc.

We have audited the accompanying consolidated financial statements of Sea Dragon Energy Inc. ("Sea Dragon") which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated income statements, statements of comprehensive income, statement of changes in equity and statement of cash flows for the years ended December 31, 2011 and December 31, 2010 and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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 International Financial Reporting Standards, 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 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 audits 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 as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

Consolidated Balance Sheets

(thousands of United States dollars)	Note	As at December 31, 2011	As at December 31, 2010	As at January 1, 2010
Assets				
Cash and cash equivalents	7	**6,125**	14,751	1,999
Trade and other receivables	8	**12,230**	6,194	2,282
Deferred transaction costs	12	**370**	–	–
Current assets		**18,725**	20,945	4,281
Restricted cash		**–**	–	310
Acquisition deposit		**–**	–	2,006
Investment		**–**	–	287
Deferred transaction costs	12	**1,390**	–	–
Property, plant and equipment, net	9	**33,609**	43,172	14,356
Intangible exploration and evaluation assets	10	**21,939**	22,165	–
Non-current assets		**56,938**	65,337	16,959
Assets		**75,663**	86,282	21,240
Liabilities				
Bank indebtedness	12	**3,000**	–	–
Trade and other payables	11	**3,786**	5,275	1,014
Current liabilities		**6,786**	5,275	1,014
Equity				
Share capital	13	**119,574**	119,574	53,804
Warrants		**4,122**	4,122	5,392
Contributed surplus		**3,289**	2,581	776
Accumulated other comprehensive loss	4	**(2,477)**	(2,477)	–
Accumulated deficit		**(55,631)**	(42,793)	(39,746)
Equity		**68,877**	81,007	20,226
Equity and liabilities		**75,663**	86,282	21,240

The notes are an integral part of these consolidated financial statements.

Consolidated Income Statements

For the years ended December 31, 2011 and 2010

(thousands of United States dollars, except per share data)	Note	2011	2010
		YEAR ENDED DECEMBER 31	
Oil revenue, net of royalties	*16*	**20,494**	12,529
Other income	*16*	**92**	–
Revenue		**20,586**	12,529
Direct operating expenses		**3,007**	3,424
Exploration and evaluation expense	*10*	**997**	–
Depletion, depreciation and amortization	*9*	**3,859**	4,047
Impairment expense		**13,660**	–
Foreign exchange (gain)/loss		**34**	(1,343)
Stock based compensation		**708**	1,268
General and administrative expenses	*17*	**5,961**	5,023
Operating income/(loss)		**(7,640)**	110
Finance income	*18*	**(25)**	(18)
Finance expense	*18*	**180**	–
Income/(loss) before income taxes		**(7,795)**	128
Current income tax expense	*19*	**5,043**	3,175
Net loss for the year		**(12,838)**	(3,047)
Net loss per share – basic and diluted	*20*	**(0.03)**	(0.01)

The notes are an integral part of these consolidated financial statements.

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2011 and 2010

(thousands of United States dollars)	Note	2011	2010
		YEAR ENDED DECEMBER 31	
Net loss for the year		**(12,838)**	(3,047)
Other comprehensive income			
Foreign currency translation adjustment	*4*	**–**	(2,477)
Total comprehensive loss for the year		**(12,838)**	(5,524)

The notes are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the years ended December 31, 2011 and 2010

(thousands of United States dollars)	Note	YEAR ENDED DECEMBER 31 2011	2010
Share capital			
Balance, beginning of year		**119,574**	53,804
Share issue costs		**–**	(462)
Issue of special warrants		**–**	11,005
Private placement		**–**	53,497
Warrants exercised		**–**	945
Options exercised		**–**	88
Adjustment		**–**	205
Transfer to common shares on exercise of warrants		**–**	492
Balance, end of year		**119,574**	119,574
Warrants			
Balance, beginning of year		**4,122**	5,392
Transfer to contributed surplus on expiration of warrants		**–**	(613)
Warrants exercised		**–**	(37)
Adjustment		**–**	(205)
Transfer to common shares on exercise of warrants		**–**	(415)
Balance, end of year		**4,122**	4,122
Contributed Surplus			
Balance, beginning of year		**2,581**	776
Share based payments	*14*	**708**	1,268
Transfer to share capital on exercise of options		**–**	(76)
Transfer to contributed surplus on expiration of warrants		**–**	613
Balance, end of year		**3,289**	2,581
Accumulated other comprehensive loss			
Balance, beginning of year		**(2,477)**	–
Foreign currency translation adjustment	*4*	**–**	(2,477)
Balance, end of year		**(2,477)**	(2,477)
Accumulated Deficit			
Balance, beginning of year		**(42,793)**	(39,746)
Net income/(loss) for the year		**(12,838)**	(3,047)
Balance, end of year		**(55,631)**	(42,793)
Total Equity		**68,877**	81,007

Consolidated Statement of Cash Flows

For the years ended December 31, 2011 and 2010

(thousands of United States dollars)	Note	YEAR ENDED DECEMBER 31 2011	2010
Cash flows from/(used in) operating activities			
Net loss for the year		**(12,838)**	(3,047)
Adjustments for:			
Depletion, depreciation and amortization	*9*	**3,859**	4,047
Impairment expense	*9*	**13,660**	–
Exploration and evaluation expense	*10*	**294**	–
Unrealized foreign exchange loss		**(58)**	(661)
Stock–based compensation	*14*	**708**	1,268
Operating cash flows before change in non–cash working capital		**5,625**	1,607
Change in non–cash working capital		**(7,525)**	410
Net cash from/(used in) operating activities		**(1,900)**	2,017
Cash flows from/(used in) investing activities:			
Property, plant and equipment expenditures	*9*	**(7,956)**	(12,132)
Property, plant and equipment acquisitions		**–**	(44,501)
Exploration and evaluation expenditures	*10*	**(68)**	–
Acquisition deposit		**–**	2,168
Investment – convertible debenture		**–**	287
Net cash used in investing activities		**(8,024)**	(54,178)
Cash flows from/(used in) financing activities:			
Transaction costs		**(1,760)**	–
Proceeds on issuance of debt		**3,000**	–
Proceeds from issue of share capital		**–**	64,638
Net cash from financing activities		**1,240**	64,638
Change in cash and cash equivalents		**(8,684)**	12,477
Effect of foreign exchange on cash and cash equivalents		**58**	275
Cash and cash equivalents, beginning of year		**14,751**	1,999
Cash and cash equivalents, end of year	*7*	**6,125**	14,751
Supplemental information			
Interest paid	*18*	10	–

(tabular amounts are in thousands of United States dollars except per share data)

Note 1 Reporting entity:

Sea Dragon Energy Inc. ("Sea Dragon" or "the Company") is a company domiciled in Canada. The address of the Company's registered office is 255-5th Avenue SW, Bow Valley Square 3, Suite 2320, Calgary Alberta T2P 3G6. The consolidated financial statements of the Company as at and for the years ended December 31, 2011 and 2010 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 and conducts many of its activities jointly with others; these consolidated 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 preparation:

(a) Statement of compliance:

The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards and interpretations (collectively referred to as "IFRS") as issued by the International Accounting Standards Board ("IASB"). This is the first year in which the Company has prepared its financial statements under IFRS and the comparative information has been restated from Canadian generally accepted accounting principles ("CGAAP") to comply with IFRS. In these financial statements, the term CGAAP refers to Canadian GAAP before the adoption of IFRS. Reconciliations to IFRS from the previously published Canadian GAAP financial statements are shown in Note 27.

The audited consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of financial statements, including IFRS 1 First-time Adoption of International Financial Reporting Standards. Subject to certain transition elections disclosed in Note 27, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 ("date of transition") and throughout all periods presented, as if these policies had always been in effect. Note 27 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010. Comparative figures for 2010 in these financial statements have been restated to give effect to these changes.

The accounting policies that follow set out those policies that apply in preparing the audited consolidated financial statements for the period ended December 31, 2011. The policies applied are based on IFRS issued and outstanding as of April 3, 2012, the date the Board of Directors approved the statements.

Note 27 discloses IFRS information for the year ended December 31, 2010 that is material to an understanding of these consolidated financial statements.

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency:

These audited consolidated financial statements are expressed in United States dollars ($ or US$), which is the Company's functional currency. The change in functional and presentation currency is discussed in note 4.

(d) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates and affect the results reported in these consolidated financial statements. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

In the accounting for property, plant and equipment, amounts recorded for depletion and amounts used for impairment test calculations are based on estimates of oil and gas reserves and cash flows, including development costs, production volumes and oil and gas prices. The fair value of share-based payments expense and deferred tax provisions are also based on estimates. By their nature, the estimates are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

(e) Comparative amounts:

Certain comparative amounts have been reclassified to conform with the current period's presentation.

Note 3 Significant accounting policies:

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements, and have been applied consistently by the Company and its subsidiaries.

(a) Basis of consolidation:

(i) Subsidiaries:

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(ii) Jointly controlled assets:

The Company is engaged in oil and gas exploration, development and production through unincorporated joint ventures ("Joint Ventures"). The Company accounts for its share of the results and net assets of these Joint Ventures as jointly controlled assets. The consolidated interim financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(iii) Transactions eliminated on consolidation:

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions are eliminated in preparing the consolidated financial statements.

(b) Foreign currency:

Transactions in foreign currencies are translated to United States dollars at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period end exchange rate.

(c) Financial instruments:

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, and trade and other payables. Non-derivative financial instruments are recognized initially at fair value. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

Cash and cash equivalents:

Cash and cash equivalents are comprised of cash on hand, term deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are designated as loans and receivables.

Financial assets at fair value through profit or loss:

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition attributable transaction costs are recognized in profit or loss when incurred. Financial instruments are measured at fair value, and changes therein are recognized in profit or loss.

Financial liabilities:

Financial liabilities at amortized costs include trade payables and bank debt. Trade payables are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Trade and other receivables, which are non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the reporting date, which are classified as non-current assets.

Bank debt is recognized initially at fair value, and subsequently at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months. Otherwise they are presented as non-current.

(ii) Equity instruments:

Equity instruments are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects, if any.

(d) Property, plant and equipment and intangible exploration and evaluation assets:

(i) Recognition and measurement:

Development and production costs:

Property, plant and equipment is stated at cost, less accumulated depletion and depreciation and accumulated impairment losses.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of any decommissioning obligation, if any, and, for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Expenditures on major maintenance, inspections or overhauls are capitalized when the item enhances the life or performance of an asset above its original standard. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred. Where an asset or part of an asset that was separately depreciated is replaced and it is probable that future economic benefits associated with the item will flow to the Company, the expenditure is capitalized and the carrying amount of the replaced asset is derecognized. Inspection costs associated with major maintenance programs are capitalized and amortized over the period to the next inspection. All other maintenance expenditures are expensed as incurred.

Intangible exploration and evaluation expenditures:

Pre-licence costs are recognized in the statement of operations as incurred.

Exploration and evaluation expenditures, including the costs of acquiring licences and directly attributable general and administrative costs, geological and geophysical costs, other direct costs of exploration (drilling, trenching, sampling and evaluating the technical feasibility and commercial viability of extraction) and appraisal are accumulated and capitalized as intangible exploration and evaluation ("E&E") assets.

On a quarterly basis, a review of any areas classified and accounted for as E&E is performed to determine whether enough information exists to make a determination of the technical feasibility and commercial viability of the area. Where appropriate, review may indicate that an area should be further sub-divided due to a significant portion having been explored whilst a significant undeveloped portion with different traits (i.e. different zone, technical approach, play type, etc.) remains that requires additional E&E activities to arrive at the point where it can be assessed for technical feasibility and commercial viability.

The assessment of technical feasibility and commercial viability is performed on an area level basis unless further sub-division is merited. Depending on the extent and complexity of the prospective play, many wells may need to be drilled and potentially significant E&E costs accumulated prior to obtaining enough information to make the determination of technical feasibility and commercial viability possible.

E&E costs are not amortized prior to the conclusion of appraisal activities. At the completion of appraisal activities, if technical feasibility is demonstrated and commercial reserves are discovered, then, the carrying value of the relevant E&E asset will be reclassified as a development and production asset ("D&P") into the cash generating unit ("CGU") to which it relates, but only after the carrying value of the relevant E&E asset has been assessed for impairment, and where appropriate, its carrying value adjusted. Typically, technical feasibility and commercial viability of extracting a mineral resource is considered to be demonstrable when proven or probable reserves are determined to exist.

However, if the Company determines the area is not technically feasible and commercially viable, accumulated E&E costs are expensed.

(ii) Depletion and depreciation:

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term.

The estimated useful lives for other assets for the current and comparative years are as follows:

Office equipment	5 – 12 years
Fixtures and fittings	5 – 10 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(e) Impairment:

(i) Financial assets:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

An impairment loss is reversed when there is a significant change in the underlying estimates or other objective evidence. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

(ii) Non-financial assets:

Exploration and evaluation costs are tested for impairment when reclassified to oil and gas properties or whenever facts and circumstances indicate potential impairment. Exploration and evaluation assets are tested separately for impairment. An impairment loss is recognized for the amount by which the exploration and evaluation expenditure's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the exploration and evaluation expenditure's fair value less costs to sell and their value in use.

Values of oil and gas properties and other property, plant and equipment are reviewed for impairment when indicators of such impairment exist. If any indication of impairment exists an estimate of the asset's recoverable amount is calculated. Assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets (the cash generating unit or "CGU"). The recoverable amount of an asset or CGU is the greater of its fair value less costs to sell and its value in use. Where the carrying amount of an asset group exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount. An impairment loss is charged to the income statement. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the asset group and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company makes an estimate of the recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years.

(f) Share based payments:

The grant date fair value of options granted to employees is recognized as compensation expense, within general and administrative expenses, with a corresponding increase in contributed surplus over the vesting period. Each tranche granted is considered a separate grant. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

(g) Segment Reporting:

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker has been identified as the Executive directors that make strategic decisions.

(h) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(i) Decommissioning obligations:

The Company's activities can give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision to the extent the provision was established.

There is no legal or constructive liability in the current country of operation that would require the company to recognize a decommissioning liability.

(j) Revenue:

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline or delivered to the refinery. Revenue is measured net of discounts, customs duties and royalties.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(k) Income tax:

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Pursuant to the terms of the Company's concession agreements, the corporate tax liability of the joint venture partners is paid by the government controlled corporations ("Corporations") out of the profit oil attributable to the Corporations, and not by the Company. For accounting purposes the corporate taxes paid by the Corporations 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 tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized.

(l) Earnings per share:

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

(m) Accounting standards issued but not yet applied:

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, Consolidated Financial Statements (IFRS 10), IFRS 11, Joint Arrangements (IFRS 11), IFRS 12, Disclosure of Interests in Other Entities (IFRS 12), IAS 27, Separate Financial Statements (IAS 27), IFRS 13, Fair Value Measurement (IFRS 13) and amended IAS 28, Investments in Associates and Joint Ventures (IAS 28). Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

The following is a brief summary of the new standards:

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation—Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

IFRS 11 - Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities—Non-monetary Contributions by Venturers.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, Separate Financial Statements (IAS 27), and IAS 28, Investments in Associates and Joint Ventures (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

International Financial Reporting Standard 9, Financial Instruments ("IFRS 9")

IFRS 9 was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income. This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

Note 4 Change in functional and presentation currency:

Change in reporting currency and accumulated other comprehensive income

Effective July 1, 2010, the Company changed its presentation and functional currency from Canadian dollars (CDN$) to US$, as significant portions of the Company's revenues, expenses and cash flows are denominated in US$. The change in presentation currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the international oil and gas industry. Prior to July 1, 2010, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in CDN$. The change in functional currency on July 1, 2010 is appropriate based on the fact that both subsidiaries did not have an available external financing up until June 30, 2010 and both subsidiaries did not have positive cash inflows up until June 30, 2010 and therefore were reliant upon the head office funding for their operation. In addition, the acquisition of the Kom Ombo concession occurred during Q2 2010 which significantly contributed to the cash flows. In making this change in presentation currency, the Company followed the recommendations set out in IAS 21, The Effects of Change in Foreign Exchange Rates. In accordance with IAS 21, the financial statements for all years and periods presented have been translated into the new presentation currency using the current rate method. Under this method, the statement of loss and cash flow statement items for each year and period have been translated into the presentation 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, of which $5.8 million was adjusted for on transition to IFRS (refer to note 27) resulting in a balance of $2.5 million as at July 1, 2010.

Note 5 Determination of fair values:

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The different levels of financial instrument valuation methods have been defined as follows:

Level 1 Fair value measurements are based on unadjusted quoted market prices.

Level 2 Fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.

Level 3 Fair value measurements are based on unobservable information.

The carrying value of cash and cash equivalents, trade and other receivables, trade and other payables, and bank debt included in the consolidated balance sheet approximate fair value due to the short term nature of those instruments.

(a) Stock options:

The fair value of employee stock options is measured using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility based on weighted average historic volatility adjusted for changes expected due to publicly available information, weighted average expected life of the instruments based on historical experience and general option holder behavior, expected dividends, and the risk-free interest rate.

Note 6 Financial risk management:

(a) Overview:

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as:

- credit risk;
- liquidity risk;
- market risk;
- foreign currency risk; and
- other price risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated interim financial statements.

The Board of Directors oversees managements' establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners, oil and natural gas marketers, and cash held with banks. The maximum exposure to credit risk at the end of the period is as follows:

	CARRYING AMOUNT		
	December 30, 2011	December 31, 2010	January 1, 2010
Cash and cash equivalents	**6,125**	14,751	1,999
Trade and other receivables	**12,230**	6,194	2,282
Total	**18,355**	20,945	4,281

Trade and other receivables:

All of the Company's operations are conducted in Egypt. The Company's exposure to credit risk is influenced mainly by the individual characteristics of each counter party.

Receivables relating to oil and gas sales are due from Ganope and EGPC, two Government of Egypt controlled corporations and are normally collected in six to eight months following production. The Company expects to collect the outstanding receivables in the normal course of operations.

The Company does not anticipate any default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. As such a provision for doubtful accounts has not been recorded as at December 31, 2011 and 2010.

The maximum exposure to credit risk for loans and receivables at the reporting date by type of customer was:

	CARRYING AMOUNT		
	December 31, 2011	December 31, 2010	January 1, 2010
Government of Egypt controlled corporations	**11,215**	5,586	2,572
Joint venture partners	**677**	282	(353)
Other	**338**	326	63
Total trade and other receivables	**12,230**	6,194	2,282

The Company's most significant customer, a government controlled corporation in Egypt, accounts for $7.6 million of the trade receivables at December 31, 2011 (December 31, 2010: $4.3 million).

As at December 31, 2011 and 2010, the Company's trade and other receivables is aged as follows:

	2011	2010
Current (less than 90 days)	**7,646**	4,144
Past due (more than 90 days)	**4,584**	2,050
Total	**12,230**	6,194

The balances which are past due are not considered impaired.

Subsequent to December 31, 2011 the Company collected $4.0 million from Government of Egypt controlled corporations.

Cash and cash equivalents:

The Company limits its exposure to credit risk by only investing in liquid securities and only with highly rated counterparties. The Companies cash and cash equivalents are currently held by banks with AA or equivalent credit ratings or better. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

Typically the Company ensures that it has sufficient cash on demand to meet expected operational expenses, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters and political unrest. To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on projects to further manage capital expenditure and has a Board of Director approved signing authority matrix. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue to the extent possible.

As at December 31, 2011, the Company's financial liabilities are due within one year.

(d) Market risk:

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted within risk management tolerances that are reviewed by the Board of Directors.

(e) Foreign currency risk:

Currency risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The reporting and functional currency of the Company is United States dollars US$. Substantially all of the Company's operations are in foreign jurisdictions and as a result, the Company is exposed to foreign currency exchange rate risk on some of its activities primarily on exchange fluctuations between the CDN$ and the US$. The majority of capital expenditures are incurred in US$ and oil revenues are received in US$ therefore reducing the Company's exposure to foreign exchange.

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

	Total per FS[(1)]	US$	EGP	EUR	CAD
As at December 31, 2011				*US$ Equivalent*	
Cash and cash equivalents	6,125	5,777	11	92	245
Trade and other receivables	12,230	12,146	–	13	71
Bank indebtedness	(3,000)	(3,000)	–	–	–
Trade and other payables	(3,786)	(3,007)	–	(66)	(713)
Balance sheet exposure	11,569	11,916	11	39	(397)

[(1)] *denotes Financial Statements*

The average exchange rate during the year ended December 31, 2011 was 1 US$ equals $1.0117CDN$ (2010 – 1 US$: $0.9713 CDN$) and the exchange rate at December 31, 2011 was 1 US$ equals $0.9833 CDN$ (2010 – 1 US$: $1.0054CDN$).

(f) Other price risk:

Other price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the United States dollar and other currencies but also world economic events that impact the perceived levels of supply and demand.

The Company may hedge some oil and natural gas sales through the use of various financial derivative forward sales contracts and physical sales contracts. The Company's production is sold on the daily average price. The Company, however, may give consideration in certain circumstances to the appropriateness of entering into long term, fixed price marketing contracts. The Company will not enter into commodity contracts other than to meet the Company's expected sale requirements.

At December 31, 2011 the Company did not have any outstanding hedges in place.

(g) Capital management:

The Company defines and computes its capital as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Equity	**68,877**	81,007	20,226
Working capital [1]	**(11,939)**	(15,670)	(3,267)
Total capital	**56,938**	65,337	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.

Note 7 Cash and cash equivalents:

	December 31, 2011	December 31, 2010	January 1, 2010
Bank balances	**6,125**	12,620	661
Term deposits	**–**	2,131	1,338
Cash and cash equivalents	**6,125**	14,751	1,999

Cash at banks earn interest at floating rates based on daily bank deposit rates. Short term deposits are made for varying periods of between one day and three months, depending on the cash requirements of the Company, and earn interest at the respective short term deposit rates.

Note 8 Trade and other receivables:

	December 31, 2011	December 31, 2010	January 1, 2010
Current			
Trade receivables	**11,215**	5,586	2,219
Other receivables	**1,015**	608	63
	12,230	6,194	2,282

Current trade and other receivables are unsecured and non-interest bearing. Receivables are normally collected in four to six months following production. Other receivables primarily relate to prepaid rent and receivables due from joint venture partners.

Trade receivables of $9.7 million (December 31, 2010 $4.8 million) are more than thirty days past due but are not considered impaired. The other classes within trade and other receivables do not contain impaired assets.

Note 9 Property, plant and equipment:

	Oil interests	Furniture and Fixtures	Total
Cost:			
Balance at January 1, 2010	**14,348**	**134**	**14,482**
Additions	9,155	235	9,390
Acquisitions	8,677	–	8,677
Transfer from intangible exploration assets	15,769	–	15,769
Disposals	(935)	–	(935)
Balance at December 31, 2010	**47,014**	**369**	**47,383**
Additions	7,935	21	7,956
Balance at December 31, 2011	**54,949**	**390**	**55,339**
Accumulated depletion and depreciation:			
Balance at January 1,2010	**(102)**	**(24)**	**(126)**
Depletion and depreciation for the year	(4,013)	(72)	(4,085)
Balance at December 31, 2010	**(4,115)**	**(96)**	**(4,211)**
Depletion and depreciation for the year	(3,778)	(81)	(3,859)
Impairment for the year	(13,660)	–	(13,660)
Balance at December 31, 2011	**(21,553)**	**(177)**	**(21,730)**
Property, plant and equipment, net	**33,396**	**213**	**33,609**

During the year ended December 31, 2011, the Company capitalized $ 2.0 million of general and administrative costs related to development and production activities in Egypt (December 31, 2010– $0.7 million).

At December 31, 2011, future development costs totaling $28.6 million (2010– $6.6 million) have been included in costs subject to depletion.

At the reporting date, an impairment test was triggered due to reserve revisions in the fourth quarter of 2011. The impairment test was carried out on both the Kom Ombo and NW Gemsa fields in accordance with the accounting policy stated in note 3. The recoverable amounts of the fields have been determined based on value-in-use calculations. These calculations require the use of estimates. The present value of future cash flows was computed by applying forecast prices of oil and gas reserves to estimated future production of proved and probable oil and gas reserves, less estimated future expenditures to be incurred in developing and producing the proved and probable reserves. The present value of estimated future net revenues is computed using a discount factor of 15%. The discount rate used reflects the specific risks relating the underlying cash generating unit. Based on this calculation, there is an impairment recorded for the Kom Ombo field due to both reserve revisions as well as a change in the discount factor applied, and there is no impairment recorded for the NW Gemsa fields.

The value in use calculation assumes Brent oil sales prices in US$/bbl as follows:

2012	2013	2014	2015	2016	2017	2018	2019
$105.61	$101.36	$97.23	$97.41	$101.42	$103.37	$105.43	$107.54
2020	2021	2022	2023	2024	2025	2026	2027
$109.69	$111.89	$114.13	$116.41	$118.74	$121.11	$123.53	$126.00

The current discount factor applied to the Kom Ombo impairment test results in an impairment of the Kom Ombo cash generating unit of $13.7 million. The current discount factor applied to the NW Gemsa impairment test results in an excess of recoverable amount over the carrying value of the NW Gemsa cash generating unit of $23.8 million.

If the discount factor applied to the impairment test were to increase by 5% above the current factor of 15%, the impairment of the carrying value of the Kom Ombo field would be $18.2 million and the excess of recoverable amount over the carrying value of the NW Gemsa field would be $16.8 million.

If the discount factor applied to the impairment test were to decrease by 5% below the current factor of 15%, the impairment of the carrying value of the Kom Ombo field would be $7.3 million and the excess of recoverable amount over the carrying value of the NW Gemsa field would be $33.4 million.

Note 10 Intangible exploration and evaluation assets:

Cost:	
Balance at January 1, 2010	**–**
Acquisitions	35,867
Additions	2,067
Transfers to property, plant and equipment	(15,769)
Balance at December 31, 2010	**22,165**
Additions	68
Exploration and evaluation expense	(294)
Balance at December 31, 2011	**21,939**

Intangible exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. As at December 31, 2011 an amount of $21.9 million (2010– $22.2 million) remains in intangible E&E assets in respect of the Kom Ombo Concession. During the year ended December 31, 2011, the Company determined certain exploration and evaluation costs to be unsuccessful and not recoverable. Accordingly, $0.3 million in capitalized costs were recognized as exploration and evaluation expense for the year ended December 31, 2011 (2010 – Nil). In addition, during the year ended December 31, 2011 the Company incurred $0.7 million in pre-license costs which were expensed (2010 – Nil). The total exploration and evaluation expense incurred during 2011 is $1.0 million (2010 - nil).

Note 11 Trade and other payables:

	December 31, 2011	December 31, 2010	January 1, 2010
Current			
Trade payables	**3,290**	4,872	779
Accruals	**496**	403	235
	3,786	5,275	1,014

Trade payables are non-interest bearing and are normally settled on 30 day terms. Accruals represent mainly professional fees. All current trade and other payables are interest free and payable within 12 months.

Note 12 Loans and borrowings:

On September 23, 2011 the Company entered into a credit agreement with HSBC and BNP Paribas for a 5-year senior secured credit facility (the "Facility") in an amount up to USD $50 million. The Facility is secured by a first charge on the shares, project accounts and interests of certain of the Sea Dragon group of Companies.

The maximum facility amount is calculated as follows:

i) Tranche A borrowing base is determined as a percentage of the specified value of risked 1P estimated future cash flows from certain fields (including NW Gemsa), priced at LIBOR plus 4.75%.

ii) Tranche B borrowing base is determined as 95 percent of the value of existing receivables no more than six months past due from certain fields (including NW Gemsa and Kom Ombo), priced at LIBOR plus 3%.

As at December 31, 2011 this resulted in available borrowings of $12 million under tranche A and $8 million under tranche B. The Facility includes standard borrowing base ratios and other customary covenants. The borrowing base is subject to routine semi-annual re-determination based on updated forecast reserves, production and receivables. All covenant requirements were complied with during the year ended December 31, 2011.

As at December 31, 2011, $3.0 million was drawn on the facility, all of which is classified as current:

	December 30, 2011	December 31, 2010	January 1, 2010
Tranche A	**–**	–	–
Tranche B	**3,000**	–	–
Total	**3,000**	–	–

For the year ended December 31, 2011 there was a total of $1.8 million of transactions costs incurred in order to obtain the credit facility. The deferred transaction costs are being amortized straight line over the term of the loan facility of five years, of which $0.4 million is amortized within the next 12 months and $1.4 million over the remainder of the term. For the year ended December 31, 2011 there has been $47,000 of transaction costs amortized which is included in the finance expenses.

Note 13 Share capital:

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

	Number of Shares *(000's)*	Amount *($)*
Balance, January 1, 2010	**206,131**	**53,804**
Warrants exercised	3,461	909
Options exercised	500	88
Conversion of special warrants, net of share issuance costs	23,867	10,542
Private placement, net of issuance costs	142,500	53,497
Transfer from exercise of warrants	–	657
Transfer from exercise of options	–	77
Balance December 31, 2010	**376,459**	**119,574**
Balance December 31, 2011	**376,459**	**119,574**

Note 14 Stock Options:

The Company has an option program that entitles officers, directors, employees and certain consultants to purchase shares in the Company. Options granted in 2011 are granted at the market price of the shares on the date of grant, have a five year term and vest on a graded basis over three years. Options granted prior to 2011 are granted at the market price of the shares on the date of grant, have a five year term and vest on a graded basis over three years for officers and employees, and vest immediately for directors.

On July 12, 2011 Sea Dragon Energy granted 8,060,000 options to purchase common shares under Sea Dragon's stock option plan, of which 5,950,000 were granted to officers and directors. Each option has an exercise price of $0.13 CDN, vests annually over the next three years and expires on July 8, 2016.

The number and weighted average exercise prices of share options are as follows:

	Number of Shares *(000's)*	Amount *(CDN$)*
Outstanding January 1, 2010	**9,817**	**0.42**
Forfeited during the year	(67)	0.60
Exercised during the year	(500)	0.18
Granted during the year	4,000	0.31
Outstanding December 31, 2010	**13,250**	**0.40**
Outstanding January 1, 2011	**13,250**	**0.40**
Forfeited during the year	(1,300)	0.46
Granted during the year	8,060	0.13
Outstanding December 31, 2011	**20,010**	**0.29**
Exercisable December 31, 2011	**9,600**	**0.43**

The range of exercise prices of the outstanding options is as follows:

	OUTSTANDING OPTIONS		VESTED OPTIONS	
Exercise Price Range	Number of options *(000's)*	Remaining contractual life	Number of options *(000's)*	Remaining contractual life
$0.01 to $0.18	11,060	4.0 years	2,000	2.6 years
$0.19 to $0.39	3,750	3.6 years	1,833	3.6 years
$0.40 to $0.59	1,200	2.9 years	1,000	2.9 years
$0.60 to $0.79	4,000	1.6 years	4,000	1.6 years
	20,010	3.4 years	8,833	2.4 years

The fair value of the options granted during 2010 and 2011 were estimated using Black Scholes model with the following weighted average inputs:

	2011	2010
Fair value at grant date *(CDN)*	**$0.10**	$0.26
Share price *(CDN)*	**$0.13**	$0.31
Exercise price *(CDN)*	**$0.13**	$0.30
Volatility *(%)*	**108**	125
Forfeiture *(%)*	**0.67**	0.67
Option life	**5 years**	5 years
Dividends	**0%**	0%
Risk-free interest rate	**2.10%**	2.23%

Note 15 Warrants:

The following share purchase warrants were outstanding as at December 31, 2011:

	Number of Warrants *(000's)*	Exercise Price *(CDN$)*
Outstanding January 1, 2010	**37,659**	**0.49**
Issued during the year	–	0.34
Exercised during the year	(3,461)	–
Expired during the year	(4,198)	0.53
Outstanding and exercisable, December 31, 2010	**30,000**	**0.50**
Outstanding and exercisable, December 31, 2011	**30,000**	**0.50**

As at December 31, 2011 the Company had 30.0 million warrants with an exercise price of $0.50 CDN per warrant. The warrants expire on November 6, 2012.

Note 16 Revenue:

	Year ended December 31, 2011	Year ended December 31, 2010
Oil revenue	**41,901**	27,400
Royalties	**(21,407)**	(14,871)
Oil revenue, net of royalties	**20,494**	12,529
Other income	**92**	–
Revenue	**20,586**	12,529

Other income for the year ended December 31, 2011 is a result of a gain on sale of assets which were previously written off.

Note 17 General and Administrative expenses

	Year ended December 31, 2011	Year ended December 31, 2010
Wages and employee costs	**1,860**	2,083
Consultants	**1,713**	1,304
Travel	**387**	664
Office expense	**807**	828
Foreign offices	**1,179**	479
Finance/banking	**15**	(335)
Total	**5,961**	5,023

Key management personnel have been identified as the board of directors and the five executive officers of the Company. Details of key management remuneration are shown in note 25.

Note 18 Financing costs

	December 31, 2011	December 31, 2010
Finance income	**(25)**	(18)
Finance expense	**180**	–
Net financing cost	**155**	(18)

The finance income is interest earned on short term deposits and cash at banks. The finance expense consists of transaction costs, interest expense and commitment fees related to the Facility.

Note 19 Deferred Income Tax:

As at December 31, 2011 no deferred tax asset was recognized in the statement of financial position for the following deductible temporary differences:

	2011	2010
Property and equipment	**25,538**	24,337
Non-capital losses	**27,680**	19,321
Share issue costs	**4,090**	5,440
Deferred income tax asset	**57,308**	49,098

The company has non-capital losses of $27.7 million that expire between 2026 and 2031.

Pursuant to the terms of the Company's concession agreements, the corporate tax liability of the joint venture partners is paid by the government controlled corporations ("Corporations") out of the profit oil attributable to the Corporations, and not by the Company. For accounting purposes the corporate taxes paid by the Corporations are included in net oil revenues and deducted as an income tax expense.

The Canadian statutory tax rate decreased to 26.5% in 2011 from 28.0% in 2010 as a result of tax legislation enacted in 2007.

Income taxes vary from the amount that would be computed by applying the Canadian statutory income tax rate of 26.5 % (2010 – 28.0%) to income before taxes as follows:

	2011	2010
Loss before income taxes	**(7,795)**	128
Canadian statutory income tax rate	**26.5%**	28%
Expected income taxes (recovery)	**(2,066)**	36
Adjustments:		
Stock based compensation	**188**	355
Unrecognized income tax benefit	**2,053**	2,216
Foreign tax rate differential	**1,934**	983
Expenses incurred with no recognized tax benefit	**3,672**	894
Change in income tax rates and certain tax balances	**(743)**	(1,130)
Other	**6**	(179)
Current income taxes	**5,043**	3,175

Note 20 Loss per share:

	Year ended December 31, 2011	Year ended December 31, 2010
Net loss for the year	**(12,838)**	(3,047)
Weighted average number of shares *(000's)*		
Basic & Diluted	**376,459**	326,252
Per share amount - basic & diluted	**$ (0.03)**	$ (0.01)

Basic income or loss per share is calculated by dividing the income or loss attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the period. Diluted per share information is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Anti-dilutive incremental options and warrants are excluded from the weighted average number of diluted shares outstanding.

Note 21 Segmental Reporting:

Geographical segments

Management has determined the operating segments based on the reports reviewed by the executive directors that are used to make strategic decisions. The executive directors consider the business from predominantly a geographic perspective. The Company has a corporate office in Canada and operations in Egypt. Set out below is segmented information on a geographic basis.

	YEAR ENDED DECEMBER 31, 2011			YEAR ENDED DECEMBER 31, 2010		
	Canada	Egypt	Total	Canada	Egypt	Total
Segment revenue	**–**	**20,586**	**20,586**	–	12,529	12,529
Segment direct operating expenses	**–**	**3,007**	**3,007**	–	3,424	3,424
Segment exploration and evaluation expense	**–**	**997**	**997**	–	–	–
Segmented depletion, depreciation and amortization	**52**	**3,807**	**3,859**	26	4,021	4,047
Segmented impairment	**–**	**13,660**	**13,660**	–	–	–
Segmented foreign exchange gain	**34**	**–**	**34**	(1,343)	–	(1,343)
Segmented stock based compensation	**708**	**–**	**708**	1,268	–	1,268
Segment general and administrative expenses	**5,425**	**536**	**5,961**	4,576	447	5,023
Segment operating income/(loss)	**(6,219)**	**(1,421)**	**7,640**	(4,527)	4,637	110
Segmented finance income	**(25)**	**–**	**(25)**	(18)	–	(18)
Segmented finance expense	**180**	**–**	**180**	–	–	–
Segmented income/(loss) before income tax	**(6,374)**	**(1,421)**	**(7,795)**	(4,509)	4,637	128
Current income tax expense	**–**	**5,043**	**5,043**	–	3,175	3,175
Net income/(loss) for the year	**(6,374)**	**(6,464)**	**(12,838)**	(4,509)	1,462	(3,047)

The segment assets and liabilities at December 31, 2011 and 2010 and January 1, 2010 are as follows:

	DECEMBER 31, 2011			DECEMBER 31, 2010			JANUARY 1, 2010		
	Canada	Egypt	Total	Canada	Egypt	Total	Canada	Egypt	Total
Segment assets	**6,018**	**69,645**	**75,663**	15,498	70,784	86,282	5,381	15,859	21,240
Segment liabilities	**4,432**	**2,354**	**6,786**	896	4,379	5,275	225	789	1,014

The segment capital expenditures for the year ended December 31, 2011 and 2010 are as follows:

	Year ended December 31, 2011			Year ended December 31, 2010		
	Canada	Egypt	Total	Canada	Egypt	Total
Capital additions	**21**	**8,003**	**8,024**	235	56,398	56,633

Note 22 Commitments:

Pursuant to the 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 following are the anticipated payments under the contracts:

	2011	2010
Less than one year	**750**	1,000
Between one and five years	**–**	–
More than five years	**–**	–
	750	1,000

Operating leases

The Company has office lease commitments in Calgary, Paris and Cairo. Non-cancellable operating lease rentals are payable as follows:

	2011	2010
Less than one year	**465**	397
Between one and five years	**1,429**	1,429
More than five years	**731**	744
	2,625	2,570

Note 23 Contingencies:

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 arbitrator's fees and expenses.

The Company believes this Claim to be without merit and it is not likely that a loss will be incurred, therefore 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 24 Related party transactions:

All subsidiaries are listed below. A list of the investments in subsidiary undertakings (all of whose operations comprise one class of business, being Oil and Gas Exploration, Development and Production), including the name, proportion of ownership interest, country of operation and country of registration, is given below.

Name	Percentage	Country of operation	Country of registration
Sea Dragon Energy (NW Gemsa) B.V.	100%	Egypt	Netherlands
Sea Dragon Energy (Kom Ombo) Ltd.	100%	Egypt	Bermuda
Sea Dragon Energy (France) SAS	100%	France	France
Sea Dragon Holdings Ltd.	100%	Canada	Canada
Sea Dragon Cooperatieve U.A.	100%	Netherlands	Netherlands
Sea Dragon Energy Holding B.V.	100%	Netherlands	Netherlands
Sea Dragon Energy (Kom Ombo) B.V.	100%	Egypt	Netherlands

Note 25 Compensation of key management personnel

The remuneration of directors and other key management personnel during the years ended December 31, 2011 and 2010 was as follows:

	2011	2010
Salaries, incentives and short term benefits	**1,306**	1,153
Stock based compensation	**540**	1,162
Total	**1,846**	2,315

The remuneration of directors and key executives is determined by the board of directors having regard to the performance of individuals and market trends.

Note 26 Subsequent Events

On March 19, 2012 the Company entered into an amended and restated share purchase agreement with Golden Crescent Investments Ltd whereby the Company will acquire, directly or indirectly, National Petroleum Company Egypt Limited ("NPC"). Under the terms of the agreement, the Company will acquire all outstanding shares of NPC in consideration of the issuance of 437.5 million common shares at a deemed price of $0.20 CDN per share and US$60 million of redeemable, convertible at $0.15CDN, non-voting preferred shares to be issued to Golden Crescent upon closing of the acquisition. The closing of this transaction is subject to shareholder approval, as well as certain closing conditions as outlined in the amended and restated share purchase agreement.

Upon closing the acquisition, the Company will become the sole owner and operator of three oil and gas concessions in Egypt, namely South Abu Zenima Concession, Shukheir Marine Concession, and North El Maghara Concession. In addition, the Company will acquire a 12.75% participating interest in the South Ramadan Concession and will hold rights to a 100% participating interest in the East Kheir concession, pending ratification of such concession award and related concession agreement by the People's Assembly of Egypt.

Note 27 Explanation of transition to IFRS

The consolidated financial statements for the year ended December 31, 2011 were prepared under IFRS. The interim consolidated financial statements for the period ended March 31, 2011 were the Company's first financial statements prepared under IFRS. For all accounting periods prior to this, the Company prepared its financial statements under generally accepted accounting principles in Canada.

In accordance with IFRS 1 'First time adoption of IFRS', certain disclosures relating to the transition to IFRS are given in this note. These disclosures are prepared under IFRS as set out in the basis of presentation in note 2.

IFRS 1 allows first time adopters to take advantage of a number of voluntary exemptions from the general principal of retrospective restatement. The Company has taken the following exemptions:

IFRS 3 Business Combinations

This standard has not been applied to acquisitions of subsidiaries that occurred before January 1, 2010, the Company's transition date.

IFRS 2 Share Based Payments

The Company has elected to take this exemption and will not apply the standard to vested share-based payment arrangements prior to the transition date, January 1, 2010.

IFRS 6 Full cost as deemed cost

Under the amendments to IFRS 1 made in July 2009, a first-time adopter using full cost accounting under CGAAP may elect to measure oil and gas assets at the date of transition to IFRS on the amount determined under Canadian GAAP.

IAS 21 Cumulative translation differences

The company has elected to take this exemption, and has reset the foreign currency translation reserve to zero at the transition date.

RECONCILIATION OF EQUITY AS AT JANUARY 1, 2010

	NOTES	AS AT JANUARY 1, 2010 OPENING CANADIAN GAAP	TRANSITION ADJUSTMENT	AS AT JANUARY 1, 2010 OPENING IFRS
Assets				
Cash and cash equivalents		**1,999**	–	1,999
Trade and other receivables		**2,282**	–	2,282
Current assets		**4,281**		4,281
Restricted cash		**310**	–	310
Acquisition deposit		**2,006**	–	2,006
Investment		**287**	–	287
Property and equipment		**14,356**	–	14,356
Assets		**21,240**		21,240
Liabilities				
Trade and other payables		**1,014**	–	1,014
Current liabilities		**1,014**		1,014
Equity				
Share capital		**53,804**	–	53,804
Warrants		**5,392**	–	5,392
Contributed Surplus	*a*	**386**	390	776
Accumulated other comprehensive loss	*b*	**(5,819)**	5,819	–
Accumulated deficit	*c*	**(33,537)**	(6,209)	(39,746)
Equity		**20,226**		20,226
Equity and liabilities		**21,240**		21,240

Note 27.1 Explanation of the effect of the transition to IFRS:

The following explains the material adjustments to the statement of financial position of the Company.

(a) **IFRS 2.** Under CGAAP, the Company recognized an expense related to their share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Company is required to recognize the expense over the individual vesting periods for the graded vesting awards and estimate a forfeiture rate.

Effect – increase contributed surplus and increase accumulated deficit	**390**

(b) **IAS 21.** Under IFRS 1 exemption, the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition.

Effect – decrease accumulated other comprehensive loss and increase accumulated deficit	**5,819**

(**c**)	**The cumulative effect of these transition adjustments on the accumulated deficit as at January 1, 2010 is an increase of:**	**6,209**

RECONCILIATION OF EQUITY AS AT DECEMBER 31, 2010

	NOTES	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
Assets				
Cash and cash equivalents		14,751	–	14,751
Trade and other receivables		6,194	–	6,194
Current assets		20,945		20,945
Intangible exploration and evaluation assets	*a*	–	22,165	22,165
Property and equipment	*a,b*	62,742	(19,570)	43,172
Assets		83,687		86,282
Liabilities				
Trade and other payables		5,275	–	5,275
Current liabilities		5,275		5,275
Equity				
Share capital	*c*	120,036	(462)	119,574
Warrants		4,122	–	4,122
Contributed Surplus	*d*	2,239	342	2,581
Accumulated other comprehensive loss	*e*	(8,296)	5,819	(2,477)
Accumulated deficit	*f*	(39,689)	(3,104)	(42,793)
Equity		78,412		81,007
Equity and liabilities		83,687		86,282

27.2 Explanation of the effect of the transition to IFRS:

The nature of adjustments from CGAAP to IFRS at December 31, 2010 is similar to those at January 1, 2010. Explanations of all other adjustments are disclosed in note 27.1.

(a) **Reclassification of cost from property, plant and equipment to intangible assets.** In accordance with IAS 16, IAS 38 and IFRS 6 the Company reallocated certain costs relating to unproved properties from property, plant and equipment to intangible exploration and evaluation assets as a separate line under IFRS.

Effect – increase in intangible assets and decrease property, plant and equipment	**22,165**

(b) **Reduction in depletion of oil and gas properties.** Each producing field or concession is depreciated separately using the unit of production method based on proved and probable reserves. Under CGAAP depreciation was based on the full cost pool of all proved properties, both producing and non-producing, and calculated on the unit of production method over only the proven reserves

Effect – increase property, plant and equipment and decrease depletion expense	**2,595**

(c) **Share issue costs.** Reduction in the expense recognized for the estimated fair value and corresponding reduction of common shares due to the additional shares on the exercise of the special warrants.

Effect – decrease share capital and decrease additional shares expense	**462**

(d) Adoption of IFRS 2.

Effect – increase contributed surplus and increase accumulated deficit	**342**

(e) IAS 21.

Effect – decrease accumulated other comprehensive loss and increase accumulated deficit	**5,819**
(f) The cumulative effect of these transition adjustments on the accumulated deficit as at December 31, 2010 is an increase of:	**3,104**

RECONCILIATION OF CONSOLIDATED COMPREHENSIVE LOSS STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2010:

	NOTES	CANADIAN GAAP	EFFECTS OF TRANSITION TO IFRS	IFRS
Revenues				
Oil revenue, net of royalties		12,547	–	12,547
Revenue		12,547	–	12,547
Diret operating expenses		3,423	–	3,423
Depletion, depreciation and amortization	*a*	6,642	(2,595)	4,047
Foreign exchange gain		(1,343)	–	(1,343)
Additional shares	*b*	462	(462)	–
Stock based compensation	*c*	1,317	(49)	1,268
General and administrative expenses		5,023	–	5,023
		15,524	–	12,418
Income/(loss) before income tax		(2,977)	–	129
Current income tax expense		(3,175)	–	(3,175)
Net loss for the year		**(6,152)**	**–**	**(3,046)**
Other comprehensive income				
Foreign currency translation adjustment		(2,477)	–	(2,477)
Total comprehensive loss for the year		**(8,629)**	**–**	**(5,523)**

The following explains the material adjustments to the statement of comprehensive income/(loss) of the company.

(a) Reduction in the depletion expense for the year as a result of the transaction adjustment explained in 27.2 (b).

(b) Reduction in the expense recognized for the estimated fair value of the additional shares on the exercise of the special warrants explained in note 27.2 (c).

(c) Decrease in the cost of employee share options for the year as a result of the transition adjustment explained in note 27.1(a).

Restatement of cash flow statement from CGAAP to IFRS

The restatement from CGAAP to IFRS had no significant effect on the reported cash flows generated by the Company. The reconciling items between CGAAP presentation and IFRS presentation have no net effect on the cash flows generated.