

**Adira Energy Ltd.**  
**MANAGEMENT DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**For the year ended December 31, 2012**

*The following is a discussion and analysis of the activities, consolidated results of operations and financial condition of Adira Energy Ltd. (“Adira”, “we”, “our”, “us”, or the “Company”) for the year ended December 31, 2012, which has been prepared on the basis of information available up until April 30, 2013. Management’s Discussion and Analysis should be read in conjunction with the Company’s annual consolidated financial statements and related notes for the year ended December 31, 2012 and in conjunction with the Company’s financial statements and Management’s Discussion and Analysis for the year ended December 31, 2011, together with the notes thereto. These documents are available under the Company’s profile on the System for Electronic Document Analysis and Retrieval (SEDAR) website at [www.sedar.com](http://www.sedar.com).*

***All monetary amounts are reported in United States dollars and in accordance with IFRS unless otherwise noted.***

### **Forward-Looking Statements**

*This Management’s Discussion and Analysis of Financial Conditions and Results of Operations contains certain forward-looking statements. All statements other than statements of historical fact that address activities, events or developments that the Company believes, expects or anticipates will or may occur in the future are forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as “seek”, “anticipate”, “contemplate”, “target”, “believe”, “plan”, “estimate”, “expect” and “intend” and statements that an event or result “may”, “will”, “can”, “should”, “could” or “might” occur or be achieved and other similar expressions. These statements are based upon certain assumptions and analyses made by management in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors management believes are appropriate in the circumstances. However, whether actual results and developments will conform with management’s expectations is subject to a number of risks and uncertainties, including the considerations discussed herein and in other documents filed from time to time by the Company with Canadian security regulatory authorities, general economic, market or business conditions, the opportunities (or lack thereof) that may be presented to and pursued by management, competitive actions by other companies, changes in laws or regulations and other factors, many of which are beyond the Company’s control. These factors may cause the actual results of the Company to differ materially from those discussed in the forward-looking statements and there can be no assurance that the actual results or developments anticipated by management will be realized or, even if substantially realized, that they will have the expected results on Adira Energy Ltd. All of the forward-looking statements made herein are qualified by the foregoing cautionary statements. The Company expressly disclaims any obligation to update or revise any such forward-looking statements.*

#### **1.1 Date**

The effective date for this report is April 30, 2013.

#### **1.2 Overall Performance**

#### **Information on the Company**

Adira is an oil and gas early-stage exploration company.

The Company has been granted three petroleum licenses in Israel being the license No. 378 (the “**Gabriella License**”), the license No. 380 (the “**Yitzhak License**”) and the license No. 388 (the “**Samuel License**” and together with the Gabriella License and the Yitzhak License, the “**Licenses**”). The Company also previously held one onshore petroleum license in Israel, License No. 356 (the “**Eitan License**”), which was relinquished in December 2011 and surrendered to the Ministry of Energy and Water Resources (formerly the Ministry of National

Infrastructures) of the State of Israel (the “**Ministry**”) in December 2012 after it was determined that exploration work was not warranted.

The Company’s current trading symbol on the TSX Venture exchange (the “**Exchange**”) is “ADL”. The Company also trades on the OTCBB with the trading symbol “ADENF” and on the Frankfurt Stock Exchange with the trading symbol “AORLB8”.

### **Significant Developments**

On February 27, 2012, Jeffrey Walter was appointed the Company’s Chief Executive Officer and on March 14, 2012, the Company issued 2,000,000 share options to purchase common shares at a price of CAD\$ 0.25 per share.

On August 9, 2012, the Company completed a prospectus offering of 79,012,640 units (each, a “**Unit**”) for gross proceeds of \$11.1 million (before issuance expenses of \$1.5 million, including the fair value of the broker warrants) (the “**August Offering**”). Each Unit was priced at CAD\$0.14 and consists of one Common Share and one warrant. Each warrant is exercisable to acquire one Common Share at a price of CAD\$0.20 per Common Share until August 9, 2015. As part of the August Offering, a total of 3,353,000 broker warrants (each, a “**Broker Warrant**”) were issued. Each Broker Warrant is exercisable for one Common Share at an exercise price of CAD\$0.14 per Common Share until August 9, 2014.

On August 22, 2012, Amos Lasker was appointed the Co-Chairman of the Company.

Also on August 22, 2012, the Company granted 8,110,000 options to directors, officers and employees. The options vest equally over two years with the first third vesting immediately, and have an exercise price of CAD\$0.20.

Following the August Offering and changes in share options, a total of 180,781,093 Common Shares 97,423,015 warrants and 17,661,109 options are now outstanding. During the year ended December 31, 2012, 1,853,109 share options were forfeited.

### **Business Overview**

The following developments have taken place on the Company’s licenses during 2012:

#### *Gabriella License*

The Gabriella License covers 97,000 acres (392 square kilometers) and is approximately 10 kilometers offshore Israel between Netanya and Ashdod. The Gabriella License was issued to the Company on July 15, 2009 for an initial three year exploration period, subject to renewal for an additional period of four years and a second additional period of two years in the case of a discovery. Thereafter, a 30-50 year lease maybe granted if a “discovery” (as defined in the Israeli Petroleum Law 5712 & 1952 and the regulations promulgated thereunder (“**Israeli Petroleum Law**”)) is made. On February 23, 2012, the Petroleum Commissioner of Israel (the “**Commissioner**”) approved an extension of the expiration of the Gabriella License to February 28, 2013, and on June 11, 2012, the Commissioner approved the extension of the expiration to September 1, 2013, with a corresponding extension of certain milestones.

The following table sets out the work program that must be completed in order to maintain the Gabriella License:

Gabriella Work Program	Milestone Dates
1. Spud the first well	June 30, 2013
2. Prepare a summary report of the first well and transfer of all of the findings, including tests, samples, logs (if taken), electrical logs and results of tests (if performed).	Within three months from completion of the drilling in 2013
3. Submit a work plan for continuation of the work in the license.	Within four months from completion of the drilling in 2013

In January 2010, the Company, through its subsidiary Adira Energy Israel Ltd. (“**Adira Israel**”), entered into an agreement with Modi’in Energy Limited Partnership (“**MELP**”) and Modi’in Energy Management (1992) Ltd. (“**MEGP**”) to transfer 70% of its participating interests in the Gabriella License to MELP (the “**Gabriella 2010 Agreement**”). In January 2010, a subsidiary of Brownstone Energy Inc. (“**Brownstone**”) exercised its option to purchase 15% of the participating interests in the Gabriella License. To date, Brownstone’s interest in the Gabriella License has not been registered with the Ministry; however Adira Israel holds Brownstone’s 15% interest in trust on behalf of Brownstone pursuant to an agreement dated July 7, 2011. Adira asserts that the parties to the Gabriella License are: Adira 15%, Brownstone 15% and MELP 70%.

Adira Israel has the option to reacquire from MELP a 15% participating interest in the Gabriella License at any time until the earlier of (a) six months after a discovery and (b) the end of the license period, including all renewals. This option is not registered with the Ministry, but exists by private contract with MELP.

All exploration and extraction activity on the Gabriella License, and the relationship of the participating interest holders, is governed by a joint operating agreement (the “**Gabriella JOA**”). Pursuant to the Gabriella JOA, Adira Israel is the operator of the Gabriella License. The Gabriella JOA parties paid the Company an operating fee equal to 7.5% of the cumulative, direct costs incurred to operate the Gabriella License, through January 26, 2012. Commencing January 27, 2012, the Gabriella License participants began paying a new operator fee of (i) a \$25,000 per month, plus (ii) an additional sliding-scale percentage of exploration expenses incurred, ranging from 4.8% of annual exploration expenses (if less than \$2 million) down to 1.2% of annual exploration expenses (if over \$6 million).

According to the Gabriella JOA, Adira may be removed as the operator of the license. Adira has a right of first refusal to match proposals generated from third party operators; however Adira does not currently meet the definition of an operator under recent amendments to the Israeli law, and therefore, it is unlikely that Adira would be positioned to bid for this work. These amendments do not impact our current position as operator until a third party bids for this role. The other Gabriella JOA parties may remove Adira as operator if Adira is declared bankrupt, becomes insolvent, dissolves or liquidates, or upon the vote of two or more non-operators holding a combined interest of at least 75% of the working interests.

Adira previously received a monthly fee of \$12,500 from MELP, pursuant to the Gabriella 2010 Agreement; however those payments ended on February 1, 2012. Adira is entitled to receive: (a) 4.25% of the 7.5% management fees payable by MELP to MEGP; and (b) a royalty in the aggregate amount of 4.5% (2.25% from each of MELP and MEGP) from any resources extracted from the Gabriella License until MELP recovers the pro rata exploration expenditures incurred by it, after which time the royalty increases to an aggregate of 10.5% (5.25% from each of MELP and MEGP).

On July 19, 2012, the Company announced that MELP executed a drilling contract with Noble International Ltd (“**Noble Drilling**”) to secure access to the Noble Homer Farrington drilling unit rig for a minimum of 75 days to

drill one well, and possibly one sidetrack, on behalf of the Gabriella License (the “**Drilling Contract**”). The Drilling Contract, which, has since been terminated, required that MELP provide a letter of credit or cash collateral within specified timeframes outlined in the Drilling Contract. Pursuant to the Drilling Contract, the parties determined that a letter of credit will be issued to secure the Drilling Contract.

On June 12, 2012, Adira signed a Memorandum of Understanding (“**MOU**”) with MELP, pursuant to which the Company agreed to provide its working interest share of the collateral due to Noble Drilling. The MOU provided that if Adira failed to pay its share of the collateral, then it would: (a) withdraw from the Gabriella JOA; (b) assign its participating interest in the Gabriella License to the other participants in proportion to their holdings; and (c) relinquish all back-in rights, overriding royalty interests (“**ORRI**”) and management fees, rights of first refusal and co-sale rights to MELP. Pursuant to the MOU, Adira Israel has also granted MELP the MELP Yitzhak Option (as described below).

On December 21, 2012, the Company entered into an agreement with MELP and Brownstone (the “**Gabriella 2012 Agreement**”), wherein certain terms regarding the parties’ use of the Noble Drilling unit were revised to require MELP to provide a letter of credit to Noble Drilling in two phases (\$20 million by January 3, 2013 (the “**First LC Amount**”) and \$13.2 million by January 31, 2013 (the “**Second LC Amount**”). The Gabriella 2012 Agreement also confirmed a reduction in the daily drilling rate due to Noble Drilling by MELP under the Drilling Contract from \$500,000 per day to \$415,000 per day and, to the extent used, the reduction in stand-by rates to an amount that between \$100,000 and \$300,000 per day. The parties also agreed to take possession of the Homer Ferrington drilling unit in direct continuation from its then current drilling program, which meant the parties would need to accelerate, by up to three months, the program previously contemplated for the Gabriella License. According to the Gabriella 2012 Agreement, Adira's share of the aggregated letter of credit amounted to \$5 million, which was required to be placed by January 31, 2013. On January 3, 2013, MELP announced that the Drilling Contract had been further amended such that the First LC Amount was reduced to \$12 million, but the Second LC Amount was increased to \$21.2 million.

The Gabriella 2012 Agreement, also provided that if MELP secures a farm-in participant for a portion of its participating interest, than Adira may agree to farm-down a portion of its participating interest, subject to a maximum of 30% of such participating interest. Adira’s proportional reduction obligation only apply to participants that farm into MELP’s participating interest, up to a date that is was the earlier of the (a) commencement of the first test of the first well on the Gabriella License; and (b) plugging and abandoning or suspending of the first well on the Gabriella License. Any consideration received by MELP from any farm-in participant will be shared equally between Adira and MELP, provided that at a minimum, Adira will receive 50% of past costs incurred by MELP, estimated to be \$1.3 million per each 10% farmed out, as well as an ORRI of 1.5%. Additionally, Adira has a 10% tag along right to farm-out, on the same terms as MELP, in the event that MELP farms down its participating interest and such participant complies with certain criterion.

Finally in Gabriella 2012 Agreement, MELP granted to Adira an option to acquire a 15% participating interest in the Yam Hadera License (as defined below). See "Yam Hadera Option" below.

On January 31, 2013, the Company announced that Adira Israel did not place its share of First LC Amount due to allegations by Adira Israel that MELP is in default of various obligations under the Gabriella JOA and other contracts described above. On February 11, 2013, the Company announced that it suspended operations on the Gabriella License. MELP similarly alleges that Adira Israel is in default of various obligations under the Gabriella JOA and other contracts described above. Thus far, accusations to and from MELP have been in the form of letters and oral communications, not legal action.

Notwithstanding the allegations made by MELP against Adira, and by allegations made by Adira against MELP, the Company maintains that its rights under the Gabriella JOA and the other contracts described above remain valid. However, there is no assurance that any of these rights could effectively be pursued and realized. Additionally, while the working interest percentage ownership of the participants remains 70% MELP, 15% Brownstone and 15% Adira; both MELP and Adira assert that the other has a 0% interest and is obligated to withdraw from the Gabriella JOA and the Gabriella License.

### *Yitzhak License*

The Yitzhak License covers 31,555 acres (127.7 sq. km) and is located approximately 9 km offshore and is contiguous to the Gabriella License. The Yitzhak License was issued in October 2009 to Adira Energy (85% working interest) and Brownstone (15% working interest) for an initial three year exploration period and may be renewed upon fulfillment of certain conditions for an additional four year period plus an additional 2 year renewal option in the case of a reserve discovery. Thereafter, a 30-50 year lease may be pursued if a “discovery” (as defined in the Israeli Petroleum Law) is made. During 2012, the Commissioner approved an extension of the expiration of the Yitzhak License to December 1, 2013, including the extension of certain milestones.

The following table sets out the work program that must be completed to maintain the Yitzhak License:

<b>Yitzhak Work Program</b>	<b>Milestone Dates</b>
1. Execute a contract with a drilling contractor.	June 30, 2013
2. Spud the first well.	October 30, 2013
3. Prepare a summary report of the first well and transfer of all of the findings, including tests, samples, logs (if taken), electrical logs and results of tests (if performed).	Within three months from completion of the drilling
4. Submit a work plan for continuation of the work in the license.	Within four months from completion of the drilling

On January 9, 2012, the Company received approval from the Commissioner to farm-out a 25% working interest in the Yitzhak License to two new participants, thereby reducing its working interest from 85% to 60%. The Company transferred a 5% carried working interest to AGR Group ASA (“**AGR**”) and a 20% working interest (subject to dilution explained below) to Ellomay Oil and Gas 2011 LP, a limited partnership (“**Ellomay**”) whose general partner is a wholly-owned subsidiary of Ellomay Capital Ltd. (“**Ellomay Capital**”). Following those transfers, the Company held a 60% working interest in the Yitzhak License, Brownstone a 15% working interest, AGR a 5% working interest and Ellomay a 20% working interest. The Company and AGR Petroleum Services Holdings AS are the co-operators of the Yitzhak License, and AGR is the statutory operator of record.

The farm-out agreement between the Company and AGR dated November 29, 2011 (the “**AGR Farm-Out Agreement**”) provides, among other things, that: (a) AGR’s 5% working interest is carried by the remaining holders of the Yitzhak License through the exploration period; (b) AGR issued to the Company a 3% ORRI on AGR’s share of production, until repayment of AGR’s expenditures in the work program and a 4.5% ORRI from that point forward; (c) AGR will be designated lead operator in accordance with Israeli regulations defining “Operator”, with the continued involvement of the Company as “co-operator” which is a construction of private contract; and (d) AGR will be appointed as engineering services contractor on the Yitzhak License with continued involvement of the Company as part of the core professional team led by AGR.

The farm-out agreement between the Company and Ellomay dated November 29, 2011 (the “**Ellomay Farm-Out Agreement**”) provides, among other things, that: (a) Ellomay will reimburse the Company for its proportionate share of the costs incurred by the Company on the Yitzhak License, plus interest at LIBOR plus 1%; and (b) Ellomay will issue to the Company a 3% ORRI on Ellomay’s share of production, until repayment of Ellomay’s expenditures in the work program and a 4.5% ORRI from that date forward.

The Company, Brownstone, AGR and Ellomay signed a joint operating agreement on September 11, 2012, to regulate their commercial relationship in respect of the Yitzhak License (the “**Yitzhak JOA**”). The Yitzhak JOA incorporated the terms of the AGR Farm-Out Agreement and the Ellomay Farm-Out Agreement.

According to the Ellomay Farm-Out Agreement and the Yitzhak JOA, Ellomay could elect not to fund and be subject to dilution for no consideration (i.e. the diluted interest would be transferred to Adira without cost), or it could transfer one-half of its 20% interest to a third party on negotiated terms. On October 29, 2012, Ellomay advised the Company of its intention to decrease Ellomay’s interest in the Yitzhak License from 20% to 10% by paying decreased operating costs pursuant to the terms of the Yitzhak JOA. As of December 31, 2012, the Company expended \$640 thousand on behalf of Ellomay in respect of the Yitzhak License for which the Company was entitled to be reimbursed by a third party if the 10% interest was transferred. This amount was recorded as a long-term receivable as of December 31, 2012. Subsequent to balance sheet date, Ellomay failed to transfer its interest to a third party, and therefore one-half of its 20% interest was transferred back to the Company without cost. In the Company’s 2013 financial statements, the receivable will be classified as an additional investment in the exploration and evaluation assets in respect of the Yitzhak License. As a result of the foregoing, as of the date hereof, the Company has a 70% interest in the Yitzhak License, Brownstone has a 15% interest, AGR has a 5% interest and Ellomay a 10% interest in the license. The new holdings have not yet been approved by the Commissioner.

On June 13, 2012, pursuant to the MOU (see “Gabriella License” above), Adira granted MELP an option (“**MELP Yitzhak Option**”) to purchase from Adira a 15% participating interest in the Yitzhak License (the “**MELP Yitzhak Option Interest**”). Pursuant to the MOU, MELP was able to exercise the MELP Yitzhak Option until the earlier of (a) December 31, 2012, and (b) the 30th day from the date Adira notifies MELP of the execution of an agreement with a drilling contractor in relation to the Yitzhak License. The Gabriella 2012 Agreement amends the exercise date until 14 days before signing of the rig contract for the Yitzhak License. If MELP exercises the MELP Yitzhak Option, then it must reimburse Adira for expenditures in respect of the MELP Yitzhak Option Interest incurred up to the date of transfer of the MELP Yitzhak Option Interest. MELP must also issue to Adira an ORRI of 3% with respect to all oil and gas (including any distillate and condensate) produced, saved and marketed from the area covered by Yitzhak License that is attributable to the MELP Yitzhak Option Interest, before payout, and 4.5% after payout. The transfer of the MELP Yitzhak Option Interest is subject to the approval of the Commissioner. As described above, allegations have been made by MELP against Adira, and by Adira against MELP, that the other is in default of various obligations under the Gabriella JOA and other contracts on the Gabriella License, including the MOU. As such, MELP’s ability to exercise the MELP Yitzhak Option is not assured.

*Samuel License*

The Samuel License covers 88,708 acres (361 sq. km) and is located approximately 17 km offshore Israel. The Samuel License was issued on August 1, 2010 to Adira Geo Global Ltd. (“**Adira GeoGlobal**”) (30% interest), Geo Global Resources (India) Inc. (“**GGRI**”) (30% interest), Adira Oil Technologies Ltd. (“**Adira Oil**”) (23.25% interest), Pinetree Capital Ltd. (“**Pinetree**”) (10% interest) and Brownstone (6.75% interest) for an initial three year exploration period. The Samuel License may be renewed for an additional four years and a second additional period of two years in the case of a discovery. Thereafter, a 30-50 year lease may be granted if a “discovery” (as defined in the Israeli Petroleum Law) is made. On July 2, 2012, the Commissioner approved an extension of certain milestones associated with the Samuel License.

The following table sets out the work program that must be completed to maintain the Samuel License:

Samuel Work Program	Milestone Dates
1. Execute a contract with a drilling contractor.	March 31, 2013 <sup>(1)</sup>
2. Spud the first well.	April 30, 2013 <sup>(2)</sup>
3. Prepare a summary report of the first well and transfer of all of the	Within three months from

Samuel Work Program	Milestone Dates
findings, including tests, samples, logs (if taken), electrical logs and results of tests (if performed).	completion of the drilling
4. Submit a work plan for continuation of the work in the license.	Within four months from completion of the drilling

Notes:

- (1) On March 27, 2013, Adira submitted a request to the Ministry to extend the milestone date to March 31, 2014. As of the date hereof, we are waiting for a formal response.
- (2) On March 27, 2013, Adira submitted a request to the Ministry to extend the milestone date to September 30, 2014. As of the date hereof, we are waiting for a formal response.

The exploration and extraction activity in the Samuel License is to be performed within the framework of a joint operating agreement (the “**Samuel JOA**”) between GGRI, Adira Geo Global, Adira Oil, Brownstone and Pinetree, whereby Adira GeoGlobal is the designated operator of the Samuel License. Adira Geo Global is owned 60% by the Company and 40% by GGRI. In accordance with the Samuel JOA, Adira Geo Global is entitled to receive 7.5% of the cumulative direct costs to operate the Samuel License and one-half of a 3% ORRI. According to a cooperation agreement signed between Adira and GGRI on August 20, 2010, GGRI is entitled to 50% of the operator fee received by Adira Geo Global. Adira Geo Global may be removed as the operator if it is declared bankrupt, insolvent, dissolved or liquidated or if two or more of the total number of non-operators holding a combined interest of at least 51% agree to the removal.

On October 26, 2012, Emanuelle Energy Limited (“**Emanuelle**”) exercised an option to acquire a 7.13% interest in the Samuel License from GGRI and became a signatory to the Samuel JOA thereby reducing GGRI’s direct interest in the Samuel License to 22.88%.

Adira is owed an aggregate of \$3 million of operating costs on the Samuel License from GGRI and Emmanuelle under the Samuel JOA, made up as follows: Emanuelle and GGRI owe an aggregate of \$2.8 million as a result of their direct interest in the license, as Samuel JOA signatories and GGRI owes an additional \$0.2 million, indirectly, through its 40% interest in Adira GeoGlobal. The three parties are currently discussing a plan to ensure the reimbursement to Adira for such costs. If GGRI and Emanuelle do not repay Adira for the costs owed through their direct interest in the Samuel License, then in accordance with the Samuel JOA, Adira may seek reimbursement of these costs from the other Samuel License participants in proportion to their respective interests in the Samuel License, and all of the participants, including Adira, will each receive a proportionate increase in their interests in the Samuel License. In addition, if GGRI does not repay Adira for the costs owed through GGRI’s 40% ownership interest in Adira GeoGlobal, Adira may have to seek reimbursement through continued negotiation or litigation.

*Myra and Sara Option*

The Company has an option (the “**Myra and Sara Option**”) to acquire up to a 5% participating interest in each of two deep water licenses offshore Israel, namely the Myra License and the Sara License (collectively, the “**Myra and Sara Licenses**”). The Myra and Sara Licenses are located offshore Israel approximately 40 km west of the City of Hadera. These license areas total 800 sq. km. The Company currently ascribes no value to the Myra and Sara Licenses and as such does not consider the Myra and Sara Options to be material to its operations.

*Yam Hadera Option*

Pursuant to the Gabriella 2012 Agreement, the Company has an option (the “**Yam Hadera Option**”) to acquire up to a 15% participating interest in the Yam Hadera License, located 30 kilometers offshore Israel, between Hadera and Haifa and North West of Adira’s Yitzhak license. The Yam Hadera Option is exercisable until 14 days prior to the signing of a rig contract for the Yam Hadera License.

As discussed above, due to allegations made by MELP against Adira, and by allegations made by Adira against MELP, both parties assert that the other is in default of various obligations under the Gabriella JOA and other

contracts, including the Gabriella 2012 Agreement. Accordingly, there is no assurance that the Company will be able to exercise the Yam Hadera Option.

#### *Onshore Licenses*

We relinquished our interest in the Eitan License, onshore, and we waived our right to farm into the Notera License, onshore. We notified the Commissioner of our surrender of the Eitan License on December 15, 2011, pursuant to the Israeli Petroleum Law. By August 2012, we had plugged and abandoned the Eitan #1 Well, and on December 5, 2012, we received final confirmation from the Ministry approving the surrender of the Eitan License.

#### **Capital Expenditures and Divestitures**

During the year ended December 31, 2012, the Company incurred capital expenditures of approximately \$10.6 million which relates to costs incurred in the planning and development of the three offshore wells. We have now plugged and abandoned the Eitan #1 Well, and we have surrendered the Eitan License in accordance with the Israeli Petroleum Law. During the year ended December 31, 2012, the Company did not make any capital divestitures.

The Company's planned capital expenditures for the next twelve months will include the Company's drilling program in connection with its Licenses.

#### **1.3 Selected Annual Information**

The following table show selected summary consolidated financial information which has been derived from the interim consolidated financial statements of the Company as at December 31, 2012:

	<b>Year ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>U.S. dollars in thousands, except per share data</b>		
	<b>Audited</b>		
Revenues	<u>\$ 1,889</u>	<u>\$ 1,323</u>	<u>\$ 1,707</u>
Net loss and comprehensive loss for the period	<u>\$ 10,557</u>	<u>\$ 10,051</u>	<u>\$ 3,004</u>
Basic and diluted net loss per share	<u>\$ 0.06</u>	<u>\$ 0.10</u>	<u>\$ 0.05</u>
Total assets	<u>\$ 15,340</u>	<u>\$ 10,247</u>	<u>\$ 18,610</u>
Total liabilities	<u>\$ 10,330</u>	<u>\$ 1,421</u>	<u>\$ 7,373</u>
Dividends	<u>-</u>	<u>-</u>	<u>-</u>

The Company has provided details of the above mentioned movements in sections 1.4 through 1.7 of this document.



**Additional disclosure for venture issuers without significant revenues:**

	<b>Year ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>U.S. dollars in thousands</b>		
	<b>Audited</b>		
Capitalized and expensed Exploration costs	\$ 11,680	\$ 5,018	\$ 1,624
General and administrative expenses (including share based compensation)	<u>\$ 5,304</u>	<u>\$ 5,031</u>	<u>\$ 3,067</u>

**1.4 Discussion of Operations**

The following table show selected summary consolidated results of operations which have been derived from the interim consolidated financial statements of the Company at December 31, 2012:

	<b>Year ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>U.S. dollars in thousands, except per share data</b>		
	<b>Audited</b>		
Revenues and other income	<u>1,889</u>	<u>1,323</u>	<u>1,707</u>
Expenses:			
Exploration expenses	1,026	5,018	1,624
General and administrative expenses	5,304	5,031	3,067
Impairment charge	<u>7,810</u>	<u>1,226</u>	<u>-</u>
Total expenses	<u>14,140</u>	<u>11,275</u>	<u>4,691</u>
Operating loss	(12,251)	(9,952)	(2,984)
Financing income	2,480	43	-
Financing expense	<u>(745)</u>	<u>(109)</u>	<u>(5)</u>
Loss before income taxes	(10,516)	(10,018)	(2,989)
Income taxes	<u>(41)</u>	<u>(33)</u>	<u>(15)</u>
Net loss and comprehensive loss	<u>(10,557)</u>	<u>(10,051)</u>	<u>(3,004)</u>
Net loss and comprehensive loss attributed to:			
Equity holders of the parent	(8,554)	(9,489)	(2,958)
Non-controlling interests	<u>(2,003)</u>	<u>(562)</u>	<u>(46)</u>

	<u>(10,557)</u>	<u>(10,051)</u>	<u>(3,004)</u>
Basic and diluted net loss per share attributable to equity holders of the parent	<u>(0.06)</u>	<u>(0.10)</u>	<u>(0.05)</u>
Weighted average number of Ordinary shares used in computing basic and diluted net loss per share	<u>132,940,856</u>	<u>99,813,334</u>	<u>65,653,700</u>

### Year ended December 31, 2012 compared to Year ended December 31, 2012

#### Revenues and Other Income

	<b>Year ended</b>	
	<b>December 31,</b>	
	<u>2012</u>	<u>2011</u>
	<u>U.S. dollars in thousands</u>	
Consulting	\$ 455	\$ 771
Operator fees	544	312
Income from farm-out	<u>890</u>	<u>240</u>
	<u>\$ 1,889</u>	<u>\$ 1,323</u>

Consulting fees relates to consulting services in respect of the Offshore Licenses on a “time and materials” basis. For the year ended December 31, 2012, the Company earned consulting fees of \$455,000, as compared to \$771,000 for the year ended December 31, 2011. In 2012, following the appointment of AGR as the joint operator on the Yitzhak license, the Company ceased to charge consulting fees, and, therefore, the consulting fees earned in 2012 relate to Gabriella and Samuel only. In addition, the Company revised the operator fee structure on the Gabriella License, which fixed the consulting fee at \$25,000 per month, which is lower than the average monthly fee earned in 2011.

Operator fees relate to fees we received as the operator on our three Offshore Licenses, at a fixed rate of the total exploration costs incurred by the respective Unincorporated Joint Ventures (“UJVs”). For the year ended December 31, 2012 the Company earned operator fees of \$544,000, as compared to \$312,000 for the year ended December 31, 2011. The increase is due to the increase exploration activity that took place in 2012.

Income from farm-out relates mainly to fees received from MELP and MEGP, in respect of our agreement with them relating to the farm out of 70% of the Company’s interest in the Gabriella License as well as the reimbursement of prior costs incurred on the Yitzhak License relating to the Company’s farm out of 20% of the Yitzhak License in January 2012.

#### Expenses

##### Exploration Expenses

For the year ended December 31, 2012, exploration expenses amounted to \$1,026,000 as compared to \$5,018,000 for year ended December 31, 2011. The decrease in exploration expenses in 2012 is due to the advancement of the Company's drilling plan on its three Offshore Licenses, and as such, exploration costs are being capitalized to Exploration and Evaluation Assets, thus reducing the amount of costs being expensed. In 2011, the Company

incurred expenses in connection with the execution of the 3D seismic program on the Gabriella License, Yitzhak License and Samuel License.

#### General and Administrative Expenses

For the year ended December 31, 2012, general and administrative expenses amounted to \$5,304,000 as compared to \$5,031,000 for year ended December 31, 2011. The increase in operating expenses resulted primarily from increased legal and accounting expenses relating to planned capital raises that were not completed in 2012, increased activity in Israel, including the hiring of additional staff in the second half of 2011 and during 2012. The increase in the general and administrative expenses is offset by the decrease in share based compensation (\$1,023,000 in 2011 as compared to \$887,000 in 2012). The decrease is mainly due to the fact that most of the Company's options that were granted in prior years are now either fully vested or expired.

#### Impairment Charge

For the year ended December 31, 2012, the impairment charge amounted to \$7,810,000 as compared to \$1,226,000 for the year ended December 31, 2011. The impairment in 2012 relates primarily to the Company's decision to record an impairment charge of \$7,596,000 in respect of the Samuel license. The Company believes that there is a low probability of realization of the asset from either the successful development or sale of the Samuel license in the near future. The impairment in 2011 is in respect of the Company's Eitan #1 well and consumables and equipment related to the Eitan License relinquished in 2011.

#### Financing Income/Expense

For the year ended December 31, 2012, financing income amounted to \$2,480,000 as compared to \$43,000 for the year ended December 31, 2011, and financing expenses of \$745,000 of the year ended December 31, 2012 as compared to \$109,000 in the year ended December 31, 2011. The primary reason for the increase in financing expenses is the inclusion of offering expenses in the amount of \$726,000 in financing expenses. This amount represents offering costs incurred in the August Offering relating to the portion of the offering that was classified as financial liability.

The warrants issued in the August offering are denominated in Canadian dollars, while the functional currency of the Company is US dollars; therefore the fair value of the warrants are classified as a financial liability which is remeasured to fair value at the end of each period. The changes in fair value are included in financing income/expenses. For the year ended December 31, 2012, the amount is income of \$2,299,000.

In addition, the Company is exposed to financial risk related to the fluctuation of foreign exchange rates. The Company operates in Israel. Most of the Company's monetary assets are held in U.S. dollars and most of the Company's expenditures are made in U.S. dollars. However, the Company also has expenditures in NIS and Canadian dollars. The Company has not hedged its exposure to currency fluctuations.

#### **Net Loss**

The Company reported a net loss and comprehensive loss for the year ended December 31, 2012 of \$10.6 million as compared to a net loss and comprehensive loss of \$10 million for year ended December 31, 2011. The primary reason for the loss in 2012 is as a result of an impairment charge in respect of the Samuel License.

#### **Inflation**

During the years ended December 31, 2012 and 2011, inflation has not had a material impact on our operations.

#### **Government Regulation**

The Offshore Licenses held by us have been granted to us by the State of Israel under the Israeli Petroleum Law, and our evaluation and exploration activities in the areas covered by the Offshore Licenses must be undertaken in compliance with work plans approved by the Commissioner.

## 1.5 Summary of Quarterly results

	<b>QTR 4 2012</b>	<b>QTR 3 2012</b>	<b>QTR 2 2012</b>	<b>QTR 1 2012</b>	<b>QTR 4 2011</b>	<b>QTR 3 2011</b>	<b>QTR 2 2011</b>	<b>QTR 1 2011</b>
	<b>U.S dollars in thousands, except per share data</b>							
Revenues	\$ 318	\$ 422	\$ 489	\$ 660	\$ 236	\$ 335	\$ 245	\$ 507
Net Loss	\$ 7,264	\$ 1,460	\$ 865	\$ 968	\$ 2,170	\$ 3,999	\$ 2,126	\$ 1,756
Net Loss per share*	\$ 0.05	\$ 0.01	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.04	\$ 0.02	\$ 0.02

\*Attributable to equity holders of the Company

Net loss per quarter is a function of the exploration and operational activity during that quarter. There is no seasonal trend. Net losses increased from Q3 2010 through to Q4 2011 as a result of increased exploration activities on the Company's three offshore licenses. From Q1 2012, the Company commenced the capitalization of most of its exploration expenses to the Company's Statement of Financial Position as they relate directly to the execution of the drilling plan on the Company's Offshore Licenses, which has resulted in a decrease in the net loss per quarter.

## 1.6 Liquidity

Liquidity is a measure of a Company's ability to meet potential cash requirements. The Company has historically met its capital requirements through the issuance of common shares.

The Company has an accumulated deficit of \$29 million as of December 31, 2012 (\$19.2 million as at December 31, 2011), and the Company had negative cash flows from operations of \$4 million the year ended December 31, 2012 (\$6.4 million the year ended December 31, 2011). The ability of the Company to continue a going concern depends upon the discovery of economically recoverable reserves, the ability of the Company to obtain financing to complete development, and upon future profitable operations from the properties or proceeds from their disposition. The Company is an exploration stage company and has not earned any revenues from its oil and gas properties to date.

There can be no assurance that the Company will be able to continue to raise funds in which case the Company may be unable to meet its obligations. The Company is considering various alternatives with respect to raising additional capital to remedy any future shortfall in capital, but to date has made no specific plans or arrangements. Because of the early stage of the Company's operations and the Company's absence of any material oil and natural gas reserves, there can be no assurance this capital will be available and if it is not, the Company may be forced to substantially curtail or cease exploration, appraisal and development expenditures.

During the year ended December 31, 2012, the Company's overall position of cash and cash equivalents decreased by \$5,700,000. This decrease in cash can be attributed to the following activities:

The Company's net cash used in operating activities during the year ended December 31, 2012 was \$3,980,000 as compared to \$6,414,000 for the year ended December 31, 2011. This decrease is due to the fact that most of the Company's exploration activities are capitalized to Exploration and Evaluation Assets and are therefore included in investment activities.

Cash used in investing activities during the year ended December 31, 2012 was \$12,003,000 as compared to cash used in investing activities of \$657,000 during the year ended December 31, 2011. The investment in 2012 relates primarily to the capitalization of drilling costs in respect of the Offshore Licenses.

Cash provided by financing activities for the year ended December 31, 2012 was \$10,351,000 as compared to \$6,617,000 during the year ended December 31, 2011. The cash provided in 2012 is primarily as a result of the completion of a public offering of shares and warrants for the net proceeds of \$9,801,000. Cash provided in 2011 is as a result of a private placement for net proceeds of \$6,152,000, and the exercise of warrants and employee stock options during the period.

There are no legal restrictions on transferring funds between Canada and Israel.

## 1.7 Capital resources

At December 31, 2012, the Company's cash and cash equivalents were \$2.4 million (December 31, 2011 - \$8 million). The majority of these funds are held in US Dollars. As at December 31, 2012, the Company had working capital of \$1.2 million as compared to \$8 million at December 31, 2011.

### Commitments

The Company has commitments to the Ministry to complete the work programs on all of the Company's licenses. Based on the current commitments, the Company is required to spud at least one well on the Samuel License by April 30, 2013 (we have applied to Ministry to extend this milestone), the Gabriella License by June 30, 2013 and the Yitzhak License by October 30, 2013.

#### *Approved Expenditures Relating to the Gabriella, Yitzhak and Samuel Licenses*

The remaining approved expenses as of December 31, 2012 for the advance of the drilling programs on each of the Offshore Licenses is approximately \$197 thousand. These expenses have not been paid to date. The total amount of approved expenditures will increase as the Company and its licenses partners approve additional expenses and will decrease as such approved expenditures are spent.

In order to maintain its current licenses the Company will be required to expend additional amounts in respect of exploration expenditure. The Company intends to meet all of its drilling and related expenditures as they become due to maintain the Company's interests in its oil and gas properties. As of the date hereof, we have missed two Ministry milestones on the Samuel License; namely we have not signed a drilling contract by March 31, 2013, and we have not spud a well by April 30, 2013. We have requested an extension of both milestones and await a formal response from the Ministry. There is no assurance that the Ministry will grant our requests. These oil and gas expenditure obligations are not fixed and cannot be pre-determined with certainty. Failure to meet the obligations may result in the loss of the Company's ownership interests.

### Management of Capital

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
	<b>U.S. dollars in thousands</b>	
	<b>Audited</b>	
<b>EQUITY</b>		
Share capital	\$ -	\$ -
Additional paid-in capital	33,966	27,775
Accumulated deficit	<u>(28,956)</u>	<u>(19,169)</u>
Equity attributable to equity holders of the parent	5,010	8,606
Non-controlling interests	<u>-</u>	<u>220</u>
Total equity	<u>\$ 5,010</u>	<u>\$ 8,826</u>

The Company is an early-stage exploration company and currently does not generate significant cash flows from operations. The Company's primary source of funds comes from the issuance of share capital. The Company does not use other sources of financing that require fixed payments of interest and principal and is not subject to any externally imposed capital requirements.

The Company defines its capital as share capital plus warrants. To effectively manage the Company's capital requirements, the Company has a planning and budgeting process in place to ensure that adequate funds are available to meet its strategic goals. The Company monitors actual expenses to budget to manage its costs and commitments.

The Company's capital management objective is to maximize investment returns to its equity-linked stakeholders within the context of relevant opportunities and risks associated with the Company's operations. Achieving this objective requires management to consider the underlying nature of exploration activities, availability of capital, the cost of various capital alternatives and other factors. Establishing and adjusting capital requirements is a continuous management process.

Although the Company has been successful at raising funds in the past through the issuance of share capital, there can be no assurance that future financings will be successful.

### **1.8 Off-Balance Sheet arrangements**

See "Commitments" above.

### **1.9 Transactions with Related Parties**

No director or senior officer of the Company, and no associate or affiliate of the foregoing persons, and no insider has or has had any material interest, direct or indirect, in any transactions, or in any proposed transactions, which in either such case has materially affected or will materially affect the Company or the Company's predecessors since the beginning of the Company's last completed fiscal year except as follows:

During the year ended December 31, 2012, the Company incurred \$357 thousand in consulting fees and operating expenses to private companies which are controlled by directors or officers of the Company (year ended December 31, 2011 - \$906 thousand).

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### **1.10 Fourth Quarter**

During the Fourth quarter of 2012, the Company was focused primarily on the preparation for the drilling of three wells on each of its Offshore Licenses. Such preparations included, securing shipyard storage and quay facilities, the ordering of long lead items, detailed well designed, and rig searches.

### **1.11 Proposed Transactions**

There are currently no proposed transactions that are expected to affect the financial condition, results of operations and cash flows of the Company

### **1.12 Critical Accounting Policies and Estimates**

Our results of operation and financial condition are based on our consolidated financial statements, which are presented in accordance with IFRS. Certain accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at that time. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the

financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies and estimates that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Exploration and evaluation assets;
- Share-based payment transactions;
- Joint oil and gas ventures;
- Farm out arrangements in the exploration and evaluation phase;
- Impairment of financial assets; and
- Revenue recognition.

The key assumptions made in the financial statements concerning uncertainties at the end of the reporting period and the critical estimates computed by the Group that may result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

### ***Exploration and evaluation assets***

#### *Prelicense costs*

Pre-license costs are expensed in the period in which they are incurred.

#### *Exploration and evaluation costs*

Oil and natural gas exploration and development expenditure is accounted for using the successful efforts method of accounting.

During the geological and geophysical exploration phase, costs are charged against income as incurred. Costs directly associated with an exploration well in its drilling phase, for which it has not yet been determined whether there are proved reserves or it is not commercially viable, are capitalized as exploration and evaluation intangible assets until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration, materials and fuel used, rig costs and payments made to contractors. If no reserves are found, the exploration asset is tested for impairment. If extractable hydrocarbons are found and, subject to further appraisal activity (e.g., by drilling further wells), are likely to be developed commercially, the costs continue to be carried as an intangible assets while sufficient and continued progress is made in assessing the commerciality of the hydrocarbons. All such costs are subject to technical, commercial and management review as well as review for impairment at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off. When proved reserves of oil are determined and development sanctioned, the relevant expenditure is transferred to oil and gas properties after impairment is assessed and any resulting impairment loss is recognized.

As of December 31, 2012, Adira has paid and aggregate of \$3 million of operating costs on the Samuel License on behalf of GGRI and Emanuelle, made up as follows: Emanuelle and GGRI owe an aggregate of \$2.8 million through their direct interest in the license, as Samuel JOA signatories and GGRI owes an additional \$0.2 million, indirectly, through its 40% interest in Adira GeoGlobal. . Subsequent to balance sheet date, Adira issued a default letter to GGRI and Emanuelle in accordance with the Samuel JOA. The three parties are currently discussing a plan to ensure the reimbursement to Adira for such costs. If GGRI and Emanuelle do not repay Adira for the costs owed through their direct interest in the Samuel License, then in accordance with the Samuel JOA, Adira may seek reimbursement of these costs from the other Samuel License participants in proportion to their respective interests in the Samuel License, and all of the participants, including Adira, will each receive a proportionate increase in their interests in the Samuel License. In addition, if GGRI does not repay Adira for the costs owed through GGRI's 40% ownership interest in Adira GeoGlobal, Adira may have to seek reimbursement through continued negotiation or litigation.

In addition, the Company did not sign a drilling contract for the Samuel license by March 31, 2013, nor has it spud a well by April 30, 2013, as required by the Ministry. Adira is currently in the process of requesting extensions for both milestones from the Ministry, but it is uncertain that such extensions will be received. The Company believes that, as of December 31, 2012, the events described above, including the lack of available funding from other license participants sufficient to meet the current milestones on the Samuel License, are indicators of impairment of the Samuel license and there is a low probability of realization of the asset from either the successful development or sale of the license in the near future. Accordingly, the Company recorded an impairment charge of \$7.6 million on the exploration and evaluation assets (including uncollected receivables from GGRI and Emanuelle) in respect of the Samuel license for the year ended December 31, 2012.

### ***Share-based payment transactions***

The Company's employees and other service providers are entitled to remuneration in the form of equity-settled share-based payment transactions.

The cost of equity-settled transactions with employees is measured at the fair value of the equity instruments granted at grant date. The fair value is determined using an appropriate pricing model. As for other service providers, the cost of the transactions is measured at the fair value of the goods or services received as consideration for equity instruments. In cases where the fair value of the goods or services received as consideration of equity instruments cannot be measured, they are measured by reference to the fair value of the equity instruments granted.

The cost of equity-settled transactions is recognized in profit or loss, together with a corresponding increase in equity, during the period which the performance and service conditions are to be satisfied, ending on the date on which the relevant employees become fully entitled to the award (the “**vesting period**”). The cumulative expense recognized for equity-settled transactions at the end of each reporting period until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The expense or income recognized in profit or loss represents the movement in the cumulative expense recognized at the end of the reporting period.

If the Company modifies the conditions on which equity-instruments were granted, an additional expense is recognized for any modification that increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee/other service provider at the modification date. If a grant of an equity instrument is cancelled, it is accounted for as if it had vested on the cancellation date, and any expense not yet recognized for the grant is recognized immediately. However, if a new grant replaces the cancelled grant and is identified as a replacement grant on the grant date, the cancelled and new grants are accounted for as a modification of the original grant, as described above.

### ***Joint oil and gas ventures***

The Company conducts petroleum and natural gas exploration activities jointly with other partners who each have direct ownership in the assets and each are directly obligated for the liabilities of the ventures. Consequently, these financial statements reflect only the Company's proportionate interest in such activities.

The Company accounts for its share of the joint venture's assets, liabilities it has incurred, income from the sale or use of its share of the joint venture's output, together with its share of the expenses incurred by the joint venture and any expenses it incurs in relation to its interest in the joint venture.

### ***Farm-out arrangements in the exploration and evaluation phase***

A farm out is the transfer of part of oil and gas interest in consideration for an agreement by the transferee (the “**farmee**”) to meet, absolutely, certain expenditures which would otherwise have to be undertaken by the owner (the “**farmor**”). Farm-out transactions generally occur in the exploration or development phase and are characterized by the transferor (i.e. farmor) giving up future economic benefits, in the form of reserves, in exchange for a reduction in future funding obligations.



Accordingly, the farmee recognizes its expenditure under the arrangement in respect of its interest and that retained by the farmor, as and when the costs are incurred.

The Company, as the farmor, accounts for the farm-out arrangement as follows:

- the Company does not record any expenditure made by the farmee on its behalf;
- the Company does not recognize a gain or loss on the farm out arrangement, but rather redesignates any costs capitalized in relation to the whole interest as relating to the partial interest retained; and
- any cash consideration received is credited against costs previously capitalized in relation to the whole interest with any excess accounted for by the farmor as a gain on disposal.

### **Impairment of financial assets**

At the end of each reporting period, the Company assesses whether there is objective evidence of impairment of a financial asset or group of financial assets carried at amortized cost.

As of the date hereof, there is objective evidence of impairment of debt instruments and receivables as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulty and default in interest or principal payments. The amount of the loss recorded in profit or loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred) discounted at the financial asset's original effective interest rate (the effective interest rate computed at initial recognition). If the financial asset has a variable interest rate, the discount rate is the current effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account (see allowance for doubtful accounts above). In a subsequent period, the amount of the impairment loss is reversed if the recovery of the asset can be related objectively to an event occurring after the impairment was recognized. The amount of the reversal, up to the amount of any previous impairment, is recorded in profit or loss.

### ***Revenue recognition***

Revenues are recognized in the statement of comprehensive loss when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Company's revenues are mainly derived from:

1. **Operator fees** - The Company acts as the operator or joint operator on the Offshore Licenses and is entitled to operator fees and revenues are recognized in accordance with the terms of the JOAs, as exploration expenses are incurred in the UJV's.
2. **Consulting fees** – The Company provides consulting services in respect of the Offshore Licenses on a “time and materials” basis. Consulting fees are recognized as revenues as the services are rendered to the respective UJV's.

### **1.13 Disclosure Controls and Procedures and Internal Controls over Financial Reporting**

There were no changes to the Company's internal controls over financial reporting in the year ended December 31, 2012, which have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

As of December 31, 2012, the Company evaluated its disclosure controls and procedures and internal control over financial reporting, as defined by the Canadian Securities Administrators. These evaluations were carried out under the supervision of and with the participation of management, including the Company's president and chief executive officer and the chief financial officer. Based on these evaluations, the president and chief executive officer and the

chief financial officer concluded that the design of these disclosure controls and procedures and internal control over financial reporting were effective.

#### **1.14 Financial Instruments and Other Instruments**

The Company's financial instruments have been designated as follows:

Cash and cash equivalents	- Held-for-trading;
Restricted Cash	- Held-for-trading;
Accounts receivable	- Receivables;
Accounts payable and accrued liabilities	- Other financial liabilities;

The carrying values of cash and cash equivalents, restricted cash and accounts receivable and accounts payable approximate their fair values due to the short-term maturity of these financial instruments.

#### **Risks and Uncertainties**

##### **Credit risk**

The Company manages credit risk, in respect of cash and cash equivalents, and restricted cash, by holding them at major Canadian and Israeli financial institutions in accordance with the Company's investment policy. The Company places its cash and cash equivalents with high credit quality Israeli and Canadian financial institutions.

Concentration of credit risk exists with respect to the Company's cash and cash equivalents and accounts receivable. The Company's exposure is for cash held in bank accounts, including restricted deposit, in the amount of \$3.5 million and on accounts and other receivable of \$5.1 million as of December 31, 2012. None of the Company's accounts receivable is overdue as at December 31, 2012. As of December 31, 2012, the restricted deposits amount to \$1.1 million and relates primarily to a bank guarantee in respect of the Company's Israeli office lease and a guarantee in favor of Israeli Department of Customs and VAT.

##### **Liquidity risk**

Liquidity risk is the risk that the Company will encounter difficulty in obtaining funds to meet current obligations and future commitments. The Company's approach to managing liquidity risk is to forecast cash requirements to provide reasonable assurance that it will have sufficient funds to meet its liabilities when due. As of December 31, 2012, the Company had cash and cash equivalents of \$2.4 million, restricted deposits of \$1.1 million and accounts and other receivables of \$5.1 million against current trade and other payables in the amount of \$7.3 million.

##### **Market risk**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of two types of risk: interest rate risk, and foreign currency risk.

###### **(i) Interest rate risk**

The Company is not exposed to significant interest rate risk due to the short-term maturity of its cash equivalents.

###### **(ii) Foreign currency risk**

The Company is exposed to financial risk related to the fluctuation of foreign exchange rates. The Company operates in Israel. Most of the Company's monetary assets are held in US dollars and most of the Company's expenditures are made in US dollars. However, the Company also has expenditures in NIS and Canadian dollars. The Company has not hedged its exposure to currency fluctuations. An increase or decrease of 5% of the NIS or the Canadian Dollar relative to the U.S dollar would not have a significant effect on the Company.

Environmental regulations affect the cost of exploration and development, as well as future development operations; however, management does not believe that any provision against environmental regulations is currently required.

For a complete discussion on risk factors, please refer to the Company's Form 20-F dated April 30, 2013, filed on [www.sedar.com](http://www.sedar.com).

#### **1.15 Other MD&A Requirements**

##### **(i) Section 5.3 – Additional Disclosure for Venture Issuers without Significant Revenue**

See section 1.3. above.

##### **(ii) Section 5.4 – Disclosure of Outstanding Share Data**

As of the date of this report, the Company has 180,781,093 common shares outstanding, 97,423,015 warrants outstanding and 17,661,109 options granted to directors, officers and employees.

#### **OTHER INFORMATION**

Additional information about the Company is accessible at the Company's website [www.adiraenergy.com](http://www.adiraenergy.com) or through the Company's public filings at [www.sedar.com](http://www.sedar.com).

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