**ADIRA ENERGY LTD.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF MARCH 31, 2013**

**UNAUDITED**

**U.S. DOLLARS IN THOUSANDS**

## INDEX



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**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

**U.S. dollars in thousands**

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 1,127 | $ 2,394 |
| Restricted deposits | 1,067 | 1,082 |
| Accounts receivable | - | 360 |
| Other receivables and prepaid expenses | 1,844 | 4,701 |
| Total current assets | 4,038 | 8,537 |
| NON-CURRENT ASSETS: | | |
| Property and equipment, net | 250 | 276 |
| Long - term receivables | - | 640 |
| Exploration and evaluation assets | 6,362 | 5,887 |
| Total non-current assets | 6,612 | 6,803 |
| Total assets | $ 10,650 | $ 15,340 |
| LIABILITIES AND EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | $ 6,511 | $ 5,841 |
| Other accounts payable and accrued liabilities | 1,639 | 1,476 |
| Total current liabilities | 8,150 | 7,317 |
| LONG-TERM LIABILITIES | | |
| Share warrants | 543 | 3,013 |
| Total long-term liabilities | 543 | 3,013 |
| EQUITY: | | |
| Share capital | - | - |
| Additional paid-in capital | 34,041 | 33,966 |
| Accumulated deficit | (32,084) | (28,956) |
| Total equity | 1,957 | 5,010 |
| Total liabilities and equity | $ 10,650 | $ 15,340 |

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

**U.S. dollars in thousands, except share and per share data**

| | Note | Three month ended March 31, 2013 | Three month ended March 31, 2012 | Year ended December 31, 2012 |
|---|---|---|---|---|
| | | Unaudited | Unaudited | Audited |
| Revenues and other income | | $ 13 | $ 660 | $ 1,889 |
| Expenses: | | | | |
| Exploration expenses | 4 | 1,893 | 498 | 1,026 |
| General and administrative expenses | | 1,472 | 1,089 | 5,304 |
| Impairment charge | | 2,243 | 65 | 7,810 |
| Total expenses | | 5,608 | 1,652 | 14,140 |
| Operating loss | | (5,595) | (992) | (12,251) |
| Financing income | | 2,480 | 24 | 2,480 |
| Financing expense | | (13) | - | (745) |
| Loss before income taxes | | (3,128) | (968) | (10,516) |
| Income taxes | | - | - | (41) |
| Net loss and comprehensive loss | | $ (3,128) | $ (968) | $ (10,557) |
| Net loss and comprehensive loss attributed to: | | | | |
| Equity holders of the parent | | $ (3,128) | $ (957) | $ (8,554) |
| Non-controlling interests | | - | (11) | (2,003) |
| | | $ (3,128) | $ (968) | $ (10,557) |
| Basic and diluted net loss per share attributable to equity holders of the parent | | $ (0.02) | $ (0.01) | $ (0.06) |
| Weighted average number of Ordinary shares used in computing basic and diluted net loss per share | | 180,781,093 | 101,768,453 | 132,940,856 |

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

### U.S. dollars in thousands, except share data

| | Number of shares | Share capital | Additional paid in capital | Accumulated deficit | Total | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|
| | | | Attributable to equity holders of the parent | | | | |
| Balance as of January 1, 2012 | 101,768,453 | $ - | $ 27,775 | $ (19,169) | $ 8,606 | $ 220 | $ 8,826 |
| Shares issued in private placement, net | 79,012,640 | - | *) 5,215 | - | 5,215 | - | 5,215 |
| Investment in equity of subsidiary by non-controlling interests | - | - | - | - | - | 550 | 550 |
| Share-based compensation | - | - | 976 | - | 976 | - | 976 |
| Net loss and comprehensive loss | - | - | - | (8,554) | (8,554) | (2,003) | (10,557) |
| Adjustment of non-controlling interests **) | - | - | - | (1,233) | (1,233) | 1,233 | - |
| Balance as of December 31, 2012 | 180,781,093 | - | 33,966 | (28,956) | 5,010 | - | 5,010 |
| Share-based compensation | - | - | 75 | - | 75 | - | 75 |
| Net loss and comprehensive loss | - | - | - | (3,128) | (3,128) | - | (3,128) |
| Balance as of March 31, 2013 (unaudited) | 180,781,093 | $ - | $ 34,041 | $ (32,084) | $ 1,957 | $ - | $ 1,957 |

| | Number of shares | Share capital | Additional paid in capital | Accumulated deficit | Total | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|
| | | | Attributable to equity holders of the parent | | | | |
| Balance as of January 1, 2012 | 101,768,453 | $ - | $ 27,775 | $ (19,169) | $ 8,606 | $ 220 | $ 8,826 |
| Investment by non-controlling interest | - | - | - | - | - | 63 | 63 |
| Share-based compensation | - | - | 257 | - | 257 | - | 257 |
| Net loss and comprehensive loss | - | - | - | (957) | (957) | (11) | (968) |
| Balance as of March 31, 2012 (unaudited) | 101,768,453 | $ - | $ 28,032 | $ (20,126) | $ 7,906 | $ 272 | $ 8,178 |

*) Net of issuance expenses of $791 incurred during 2012.

**) Due to assumption of liabilities of a subsidiary.

The accompanying notes are an integral part of the interim consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

| | Three months ended March 31, 2013 | Three months ended March 31, 2012 | Year ended December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Cash flows from operating activities: | | | |
| Net loss | $ (3,128) | $ (968) | $ (10,557) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Adjustments to the profit or loss items: | | | |
| Exchange rate differences for cash and cash equivalents | 5 | (29) | 68 |
| Depreciation | 26 | 23 | 96 |
| Impairment charge from exploration and evaluation assets | 2,243 | 65 | 7,810 |
| Issuance expenses | - | - | 726 |
| Reevaluation of warrants | (2,470) | - | (2,299) |
| Share-based compensation | 75 | 257 | 976 |
| | (121) | (652) | 7,377 |
| Changes in operating asset and liability items: | | | |
| Decrease (increase) in accounts receivable, other receivables and prepaid expenses | 3,015 | (1,932) | (6,696) |
| Increase in trade payables | 670 | 1,790 | 5,359 |
| Decrease (increase) in long term receivables | 640 | - | (640) |
| Increase in other accounts payable and accrued liabilities | 163 | 302 | 537 |
| | 4,488 | 160 | (1,440) |
| Net cash used in operating activities | 1,239 | (492) | (4,620) |
| Cash flows from investing activities: | | | |
| Expenditures on exploration and evaluation assets | (2,516) | (779) | (10,654) |
| Purchase of property and equipment | - | (48) | (70) |
| Decrease (increase) in restricted cash | 15 | 97 | (639) |
| Net cash used in investing activities | (2,501) | (730) | (11,363) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of warrants, net of issuance expenses | - | - | 4,586 |
| Proceeds from issue of shares, net of issuance expenses | - | - | 5,215 |
| Investment in equity of subsidiary by non-controlling interests | - | 63 | 550 |
| Net cash provided by financing activities | - | 63 | 10,351 |
| Exchange rate differences for cash and cash equivalents | (5) | 29 | (68) |
| Decrease in cash and cash equivalents | (1,267) | (1,130) | (5,700) |
| Cash and cash equivalents at the beginning of the period | 2,394 | 8,094 | 8,094 |
| Cash and cash equivalents at the end of the period | $ 1,127 | $ 6,964 | $ 2,394 |
| Non-Cash Transaction: | | | |
| Provision for costs of exploration and evaluation assets | $ 1,800 | $ - | $ - |

The accompanying notes are an integral part of the interim consolidated financial statements.

## NOTE 1:- GENERAL

a. Nature of operations:

Adira Energy Ltd. and its subsidiaries ("Adira" or "the Company"), is an oil and gas early-stage exploration company. These financial statements have been prepared in a condensed format as of March 31, 2013 and for the three months then ended ("interim consolidated financial statements"). These financial statements should be read in conjunction with the Company's annual financial statements as of December 31, 2012 and for the year then ended and the accompanying notes.

b. Financial position:

As reflected in the consolidated financial statements, as of March 31, 2013, the Company had an accumulated deficit of $32,084. The Company is an early-exploration stage company and its operating revenues are currently insufficient to finance its future operating expenses and exploration funding commitments.

The ability of the Company to continue as 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. There can be no assurance that the Company will be able to continue to raise funds from the aforementioned sources in which case the Company may be unable to meet its obligations. These factors raise substantial doubts about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to the carrying amounts and classifications of assets and liabilities that would result if the Company was unable to continue as a going concern.

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for the preparation of financial statements for interim periods, as prescribed in IAS 34, "Interim Financial Reporting".

The significant accounting policies and methods of computation adopted in the preparation of the interim consolidated financial statements are consistent with those followed in the preparation of the annual consolidated financial statements.

**NOTE 3:- SIGNIFICANT EVENTS DURING REPORTING PERIOD**

Gabriella license:

On June 12, 2012, Adira Energy Israel Ltd., a 100% subsidiary of the Company ("Adira Israel") signed a Memorandum of Understanding ("MOU") with MELP and Brownstone, pursuant to which the parties agreed to authorize MELP to sign the Drilling Contract and Adira Israel agreed to provide its working interest share of the collateral due to Noble Drilling. The MOU provided that if Adira Israel 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.

On July 19, 2012, Adira Israel 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 was terminated on April 2013, required that MELP provide a letter of credit or cash collateral within specified time frames 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 December 21, 2012, Adira Israel 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 ($20,000 by January 3, 2013 (the "First LC Amount") and $13,200 by January 31, 2013 (the "Second LC Amount")) and confirmed a reduction in the daily drilling rate due to Noble Drilling by MELP under the Drilling Contract from $500 per day to $415 per day, and to the extent used, reduction in stand-by rates to between $100 and $300 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 Israel's share of the aggregated letter of credit amounted to $5,000 which was required to be placed by January 31, 2013.

In addition, the parties agreed that: (i) in order to facilitate farm-in transactions to the License, in the event that MELP secures a farm-in partner of its participating interest, Adira Israel will proportionally reduce its Modiin Farmout Rights for up to a maximum of 30% of such participating interest. Adira Israel's proportional reduction obligation will only be applied to partners that have farmed into MELP's participating interest, up to a date that is the earlier of the (a) commencement of the first test of the first well on the Gabriella License; or (b) plugging and abandoning or suspending of the first well on the Gabriella License. Any consideration received by MELP from any farm in partner will be shared equally between Adira Israel and MELP, provided that at a minimum, Adira Israel will receive 50% of past costs incurred by MELP, estimated to be $1,300 per each 10% farmed out, as well as an ORRI of 1.5%,. (ii) Adira Israel will have a 10% tag along rights to farm-

**NOTE 3:- SIGNIFICANT EVENTS DURING REPORTING PERIOD (Cont.)**

out, on the same terms to the farm in partner that farms into MELP's participating interest in the Gabriella License, in the event that such partner complies with certain criterion, (iii) MELP has granted to Adira Israel an irrevocable option to purchase (the "Yam Hadera Option") from MELP a 15% participating interest in the Yam Hadera petroleum license (the "Yam Hadera License") offshore Israel.

On January 3, 2013, MELP announced that the Drilling Contract had been further amended such that the First LC Amount was reduced to $12,000 but the Second LC Amount was increased to $21,000.

As of January 31, 2013, Adira Israel did not place its share of the letter of credit in the amount of $5,000, due to Adira Israel's alleged breaches by MELP of the MOU and the Gabriella 2012 Agreement.

On February 1, 2013, Adira Israel sent a default letter to MELP for its failure to pay the last cash call issued under the Gabriella JOA. This was followed by a second default notice on March 3, 2013.

On February 11, 2013, Adira Israel announced that it suspended operations on the Gabriella License due to lack of funding and lack of reasonable expectation of funding by certain parties sufficient to pursue the current work program; lack of agreement among the license holders regarding how to proceed under the circumstances; and due to the fact that MELP has not met its obligations under the Gabriella JOA or under other agreements in place among the JOA parties.

Due to allegations made by MELP against Adira Israel, alleging Adira Israel's breach of the Gabriella JOA, the MOU and the Gabriella 2012 Agreement and by allegations made by Adira Israel against MELP, both parties assert that the other is in default of various obligations under the Gabriella JOA and other contracts described above. As such, while Adira Israel maintains that its rights under the Gabriella JOA and such other contracts remain valid, there is no assurance that any of the 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 Israel; both MELP and Adira Israel assert that the other has a 0% interest and is obligated to withdraw from the Gabriella JOA and the Gabriella License. The Gabriella license holders have been holding discussions regarding the above matters.

Adira Israel has recorded a provision of approximately $3,500 for a portion of the expenditures incurred in connection with the termination of the Drilling Contract.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 4: EXPLORATION AND EVALUATION ASSETS**

Adira Israel commenced the drilling plan with the first well to be drilled on each of the Gabriella, Yitzhak and Samuel licenses. In accordance with the Company's accounting policy, Adira Israel has capitalized specific expenses in the amount of $3,108 related directly to the drilling phase to Exploration and Evaluation Assets during the three months ended March 31, 2013.

a. Gabriella:

Adira's proportionate share of the Gabriella license is as follows:

| | March 31, 2013 | March 31, 2012 | December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Cash and cash equivalents | $ 203 | $ 253 | $ 475 |
| Prepaid expenses and other receivables | 243 | - | 335 |
| Exploration and evaluation assets | 2,740 | 129 | 2,646 |
| Trade payables and provisions | (4,399) | (145) | (512) |
| | $ (1,213) | $ 237 | $ 2,944 |

| | Three months ended March 31, 2013 | Three months ended March 31, 2012 | Year ended December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Exploration expenses | $ 1,815 | $ 37 | $ 48 |

Following the suspension of the Gabriella License operations, as described in Note 3, Adira Israel recorded a $2,473 non-cash impairment charge in the three months ended March 31, 2013 arising from the write-off of exploration and evaluation assets specifcly related to the drilling of the first well of the Gabriella License.

b. Yitzhak:

Adira's proportionate share of the Yitzhak license is as follows:

| | March 31, 2013 | March 31, 2012 | December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Cash and cash equivalents | $ 22 | $ 1,118 | $ 2 |
| Prepaid expenses and other receivables | - | - | 103 |
| Exploration and evaluation assets | 2,709 | 398 | 2,328 |
| Trade payables | (36) | (481) | (124) |
| | $ 2,695 | $ 1,035 | $ 2,309 |

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 4: EXPLORATION AND EVALUATION ASSETS (Cont.)**

| | Three months ended March 31, 2013 | Three months ended March 31, 2012 | Year ended December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Exploration expenses | $ 1 | $ 91 | $ 113 |

c. Samuel:

Adira's proportionate share of the Samuel license is as follows:

| | March 31, 2013 | March 31, 2012 | December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Cash and cash equivalents | $ 28 | $ 173 | $ 7 |
| Prepaid expenses and other receivables | 301 | 52 | 765 |
| Exploration and evaluation assets | 875 | 252 | 875 |
| Trade payables | (665) | (831) | (1,211) |
| | $ 539 | $ (354) | $ 436 |

| | Three months ended March 31, 2013 | Three months ended March 31, 2012 | Year ended December 31, 2012 |
|---|---|---|---|
| | Unaudited | Unaudited | Audited |
| Exploration expenses | $ 5 | $ 79 | $ 217 |

d. Exploration expenses include also exploration expenses related to the Eitan license and other expenses which were incurred by Adira and were not charged to its license partners, in accordance with the terms and conditions set forth in the partnership agreements. These exploration expenses amounted to $85, $291 and $648 for the three months ended March 31, 2013 (unaudited), March 31, 2012 (unaudited) and for the year ended December 31, 2012, respectively.

**U.S. dollars in thousands, except share and per share data**

**NOTE 5:- EQUITY**

a. Stock Option Plan:

The movement in stock options during the three months ended March 31, 2013 was as follows:

| | Number of options outstanding | Weighted average exercise price |
|---|---|---|
| Balance at December 31, 2012 (audited) | 17,661,109 | 0.34 |
| Options forfeited | (1,860,000) | 0.38 |
| Balance at March 31, 2013 (unaudited) | 15,801,109 | 0.33 |

The following table summarizes information about stock options outstanding and exercisable as of March 31, 2013 (unaudited):

| Grant date | Expiry date | Grant date fair value | Exercise price *) | Number of options outstanding | Number of options exercisable | Average remaining contractual life |
|---|---|---|---|---|---|---|
| August 31, 2009 | August 20, 2014 | $ 0.29 | $ 0.25 | 1,708,000 | 1,668,000 | 1.39 |
| September 23, 2009 | September 23, 2014 | $ 0.22 | $ 0.25 | 400,000 | 400,000 | 1.48 |
| January 28, 2010 | January 27, 2015 | $ 0.56 | $ 0.59 | 970,000 | 958,750 | 1.83 |
| July 22, 2010 | July 21, 2015 | $ 0.25 | $ 0.59 | 250,000 | 250,000 | 2.31 |
| January 11, 2011 | January 10, 2016 | $ 0.66 | $ 0.79 | 1,050,000 | 525,000 | 2.78 |
| March 18, 2011 | March 17, 2016 | $ 0.59 | $ 0.71 | 100,000 | 50,000 | 2.96 |
| May 3, 2011 | May 2, 2016 | $ 0.52 | $ 0.59 | 415,000 | 155,625 | 3.09 |
| June 1, 2011 | May 31, 2016 | $ 0.43 | $ 0.49 | 1,138,109 | 426,791 | 3.17 |
| September 8, 2011 | September 7, 2016 | $ 0.41 | $ 0.49 | 250,000 | 93,750 | 3.33 |
| December 1, 2011 | November 30, 2016 | $ 0.22 | $ 0.39 | 570,000 | 142,500 | 3.67 |
| March 14, 2012 | March 13, 2017 | $ 0.15 | $ 0.25 | 2,000,000 | 500,000 | 3.95 |
| August 22, 2012 | August 21, 2017 | $ 0.07 | $ 0.20 | 6,950,000 | 4,633,333 | 4.39 |
| | | | | 15,801,109 | 9,803,749 | |

*) The exercise price of all options granted from 2011 to 2013 is denominated in Canadian Dollars and was translated to USD in the table above using the exchange rate as of March 31, 2013.

U.S. dollars in thousands, except share and per share data

**NOTE 5:- EQUITY (Cont.)**

b. Share purchase warrants:

The following table summarizes information applicable to warrants and broker warrants entitling the holders to acquire common share outstanding as of March 31, 2013 (unaudited):

| Issue date | Expiry date | Grant date fair value | Exercise price | Number of warrants |
|---|---|---|---|---|
| December 3, 2010 | December 3, 2013 | $ 0.34 | $ 0.55 | 13,750,000 |
| December 3, 2010 | December 3, 2013 | $ 0.35 | $ 0.40 | 1,307,375 |
| August 9, 2012 | August 9, 2015 | $ 0.07 | $ 0.20*) | 79,012,640 |
| August 9, 2012 | August 9, 2014 | $ 0.07 | $ 0.14*) | 3,353,000 |
| | | | | 97,423,015 |

*) The exercise price of warrants granted in 2012 is denominated in Canadian Dollars and was translated to USD in the table above using the exchange rate as of March 31, 2013.

The weighted average exercise price of the outstanding warrants as of March 31, 2013 is $0.25.

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