



Madagascar Oil Limited

Consolidated Financial Statements
Year Ended December 31, 2009

Madagascar Oil Limited

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Madagascar Oil Limited

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Independent Auditor's Report

Board of Directors
Madagascar Oil Limited
Houston, Texas

We have audited the accompanying consolidated statement of financial position of Madagascar Oil Limited and subsidiaries ("the Company") as of December 31, 2009 and the related consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Company declined to present comparative financial information for the year ended December 31, 2008 which is required by International Financial Reporting Standards.

In our opinion, except for the omission of comparative financial information noted above, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Madagascar Oil Limited at December 31, 2009 and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations and has a lack of liquidity that raise significant doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We also have audited the adjustments described in Note 3 that were applied to restate certain balances as of December 31, 2008 to correct for errors. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the Company's consolidated financial statements for any period prior to 2009 other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the Company's consolidated financial statements for any such previous period.

BDO USA, LLP

September 30, 2010

Consolidated Financial Statements

Madagascar Oil
Consolidated Statement of Financial Position

<i>As of December 31,</i>	2009
	<i>\$(000)</i>
Assets	
Non-Current Assets	
Property, plant and equipment (Note 15)	\$ 456
Exploration and evaluation assets (Note 16)	88,941
Other intangible assets	370
Non-current tax assets (Note 14)	1,570
Financial assets (Note 19)	11
Restricted cash (Note 20)	3,508
Total non-current assets	94,856
Current Assets	
Other assets (Note 18)	451
Cash and cash equivalents (Note 20)	2,901
Total current assets	3,352
	\$ 98,208
Equity and Liabilities	
Capital and reserves	
Issued capital (Note 21)	\$ 111,419
Equity-settled transactions reserve (Note 25)	141,911
Accumulated deficit (Note 22)	(156,540)
Total equity	96,790
Non-Current Liabilities	
Provisions (Note 23)	603
Total non-current liabilities	603
Current Liabilities	
Trade and other payables (Note 24)	723
Provisions (Note 23)	92
Total current liabilities	815
	\$ 98,208

See accompanying notes to consolidated financial statements.

Madagascar Oil

Consolidated Statement of Comprehensive Income

<i>For the Year Ended December 31,</i>	2009
	\$(000)
Revenue	\$ —
Operating expenses	
Salaries and employee benefits expense (Note 12)	(7,224)
Depreciation and amortization expense (Note 13)	(373)
Consulting expense (Note 10)	(639)
Production sharing and contractual fees (Note 11)	(1,272)
Other expenses (Note 9)	(1,818)
Net foreign exchange loss (Note 6)	(198)
Current operating loss	(11,524)
Loss on Disposals	(91)
Non-Current Oil Activities Income (Note 30)	7,798
Operating Loss	(3,817)
Finance Income, net (Note 7)	13
Loss before taxes	(3,804)
Income Tax Expense (Note 8)	(49)
Net Loss	\$ (3,853)

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Cash Flows

<i>For the Year Ended December 31,</i>	2009
	\$(000)
Cash Flows From Operating Activities:	
Net Loss	\$ (3,853)
Income tax expense recognized in net loss	49
Finance income, net	(13)
Loss on disposals	91
Depreciation and amortization of non-current assets	373
Non-current oil activities income	(7,798)
Net foreign exchange loss	198
Expense recognized in loss in respect of equity-settled share-based payments	5,054
	(5,899)
Movements in working capital	
Decrease in other assets	284
Decrease in trade and other payables	(1,578)
Decrease in provisions	(1,000)
Interest paid	—
Income taxes paid	(62)
Net cash used in operating activities	(8,255)
Cash Flows From Investing Activities	
Interest received	7
Payments for equipment and intangible assets	(11)
Proceeds from disposal of property, plant and equipment	193
Exploration and evaluation costs paid	(4,297)
Net cash used in investing activities	(4,108)
Cash Flows From Financing Activities	
Proceeds from issues of equity shares	5,820
Restricted cash	3,051
Net cash provided by financing activities	8,871
Net decrease in cash and cash equivalents	(3,492)
Cash and cash equivalents at beginning of year	6,392
Cash and cash equivalents at end of year	\$ 2,901
Non-cash Investing and Financing Activities:	
Warrants liability reclassified to equity	\$ 9,656

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Changes in Equity

<i>For the Year Ended December 31, 2009</i>	Share Capital	Share Premium	Equity- Settled Transactions Reserves	Accumulated Deficit	Total
	\$(000)	\$(000)	\$(000)	\$(000)	\$(000)
Balance at December 31, 2008 (as reported)	\$ 116	\$ 105,175	\$ 140,440	\$ (151,065)	\$ 94,666
Prior period adjustment (Note 3)	—	—	(13,257)	(1,622)	(14,879)
Balance at December 31, 2008 (as restated)	\$ 116	\$ 105,175	\$ 127,183	\$ (152,687)	\$ 79,787
Loss for the period	—	—	—	(3,853)	(3,853)
Issue of ordinary shares to shareholders	12	5,808	—	—	5,820
Issue of ordinary shares under employee share option plan	1	—	274	—	275
Issue of ordinary shares to Directors	1	—	135	—	136
Recognition of equity-settled transactions under employee share option plan	—	—	4,643	—	4,643
Issue of ordinary shares to Credit Suisse	1	305	—	—	306
Reclassification of warrants issued	—	—	9,676	—	9,676
Balance at December 31, 2009	\$ 131	\$ 111,288	\$ 141,911	\$ (156,540)	\$ 96,790

	Voting Shares	Non-Voting Shares	Total
Balance at December 31, 2008	10,317,947	1,304,000	11,621,947
Shares granted to Directors	50,000	—	50,000
Shares granted to personnel	192,299	—	192,299
Shares granted to shareholders	1,244,223	—	1,244,223
Shares granted to others	61,358	—	61,358
Balance at December 31, 2009	11,865,827	1,304,000	13,169,827

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

1. General Information

Madagascar Oil Limited (Bermuda) (the "Company") is an exempted limited liability company incorporated in Bermuda with registration number 37901. The address of its registered office is Canon's Court 22 Victoria Street - Hamilton HM12 Bermuda.

Madagascar Oil Limited and its affiliates (collectively, the "Group") commenced business in 2004 by entering into 6 production sharing contracts ("PSC") for oil exploration and production in Madagascar with the Republic of Madagascar. The Production Sharing Contracts are held in two wholly owned subsidiaries, Madagascar Oil SA ("MOSA") and Majunga Oil SARL ("Majunga") registered under the Laws of the Republic of Madagascar.

On March 17, 2006 an internal reorganization took place in order to improve the visibility of the structure of the Group: a share exchange agreement (the "Share Exchange Agreement") was entered into between all of the shareholders of Madagascar Oil Limited of Mauritius ("MOM") and the Company which was created for this purpose.

Under the Share Exchange Agreement all of the shareholders in MOM agreed to transfer their shares in MOM to the company in exchange for Common Shares or Non-Voting Shares of the Company. Pursuant to the Share Exchange Agreement, among other things (a) each shareholder agreed to waive and/or to procure the waiver of all pre-emption and similar rights over the shares in MOM in relation to the sale and purchase contemplated by the Share Exchange Agreement; (b) each shareholder agreed to waive any and all provisions of any contract or arrangement under which it was required to give his consent for the transactions contemplated by the Share Exchange Agreement; (c) each shareholder agreed that any breach by MOM or another shareholder of the constitution of MOM as set out in the Second Schedule of the Companies Act of Mauritius 2001 (pre-emption on transfer) was ratified, and that it had no claim against MOM or any other shareholder for any such breach; (d) all existing shareholder agreements and contractual investor rights terminated; (e) relevant options issued by MOM converted into options over Common Shares in the capital of the company or (in one instance) into options over Non-Voting Shares in the Company on the same terms; and (f) relevant warrants issued by MOM converted into warrants over Common Shares in the Company on the same terms.

The principal activities of the Group are described in Note 5.

MOSA holds Production Sharing Contracts for the onshore license blocks 3102, 3104, 3105, 3106 and 3107 all of which are geographically contiguous on the west part of the island:

- Block 3102 Bemolanga is 7,175 km² (2,770 sq. mi.) in size and hosts the Bemolanga ultra heavy oil field. It was granted on August 17, 2004.
- Block 3104 Tsimiroro is 6,670 km² (2,575 sq. mi.) in size and hosts the Tsimiroro heavy oil field. It was granted on August 17, 2004.
- Block 3105 Manambolo is 5,325 km² (2,056 sq. mi.) in size and was granted on December 14, 2004. Surrendered 25% to 3,994km² on April 3, 2007.
- Block 3106 Morondava is 9,100 km² (3,514 sq. mi.) in size and was granted on December 14, 2004. Surrendered 25% to 6,825 km² on April 3, 2007.
- Block 3107 Manandaza is 8,775 km² (3,388 sq. mi.) in size and was granted on December 14, 2004. Surrendered 25% to 6,581 km² on April 3, 2007.

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Majunga also held one production sharing contract for Block 2103 that was surrendered in 2009. Block 2103 Majunga is 11,930 km² (4,606 sq. mi.) in size and was granted on December 14, 2004. It was surrendered to the Madagascar government effective July 27, 2009.

On September 17, 2008, the Malagasy government approved a 60% farm out and transfer of operatorship of Block 3102 Bemolanga to an affiliate of TOTAL S.A. ("TOTAL"). MOSA has also transferred to TOTAL the operatorship of the license.

In addition to the 4 blocks held 100% and operated by the Group and the 40% non-operated share in the 3102 Bemolanga block, the Group entered into an Agreement in December 2006 with Tullow Oil, Plc ("Tullow") for the exploration of the onshore block 3109 Mandabe (11,050 km² in size). The Office des Mines Nationales et des Industries Strategiques ("OMNIS") approved the transfer to Majunga on December 20, 2006 of a 50% interest in the block. Tullow is operating the block. In September 2008 Majunga withdrew from the Joint Operating Agreement and the Production Sharing Contract as of October 31, 2008. See Note 17.

The exploration period under the production sharing contracts generally consist of 3 phases of 2 years, 2 years and 4 years respectively. An extension of 2 years maximum can also be granted by the OMNIS at the end of the 3rd phase of the Exploration Period.

Per amendments to the applicable PSC's in June 2009, the split of the different phases composing the exploration period has been modified for the licenses 3105, 3106, 3107. The total duration of the Exploration Period was not modified.

At December 31, 2009, the:

- 3102 and 3104 blocks held by Madagascar Oil SA are in the 3rd of the 3 phases constituting the Exploration Period
- 3105, 3106, 3107 blocks held by Madagascar Oil SA are in the 2nd of the 3 phases constituting the Exploration Period

2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied from those used in prior years, unless otherwise stated.

Standards, amendment and interpretations effective in 2009

IFRS 8 'Operating Segments' (effective date January 1, 2009) – IFRS 8 sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.

Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after January 1, 2010 or later periods, but the Group has not early adopted them:

- IAS 27 Consolidated and Separate Financial Statements (Amendment)
- IFRS 2 Share-Based Payments (Amendment)
- IAS 1 Presentation of Financial Statements (Amendment)

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- IAS 7 Statement of Cash Flows (Amendment)
- IAS 17 Leases (Amendment)
- IAS 18 Revenue (Amendment)
- IAS 32 and 39 Financial Investments (Amendments)
- IAS 24 Related Parties (Amendment)
- IFRS 9 Financial Instruments
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- IFRIC 18 Transfers of Assets from Customers
- IFRIC 17 Distributions of Non-Cash Assets to Owners

Interpretations to existing standards that are effective in 2009 but not relevant for the Group's operations

The following interpretations to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after January 1, 2009 or later periods but are not relevant for the Group's operations:

IFRIC 15 'Agreements for the Construction of Real Estate' (effective date January 1, 2009) – IFRIC 15 applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.

IFRIC 16 'Hedges of Net Investment in a Foreign Operation' (effective January 1, 2009) – IFRIC 16 applies to an entity that hedges the foreign currency risk arising from its net investment in foreign operations and wishes to qualify for hedge accounting under IAS 39.

Basis of Preparation and Going Concern Assumption

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). They have been prepared on the historical cost basis except for the revaluation of financial instruments.

As of December 31, 2009, The Group has \$2,901k of cash and cash equivalents and \$3,508K of restricted cash. In 2010 the Group has raised \$2,870K of cash through convertible notes and \$10.0M through a stock sale (see Note 32). Management of the Group estimates that it will need additional sources of funding to meet its capital and operational obligations and is pursuing all sources of funding. There is no certainty that there will be funds in the amounts and timing sufficient to meet liquidity requirements in the future. At September 30, 2010, management estimates that additional sources of liquidity will be required over the next twelve months of approximately \$15.0M in order to meet its minimum business objectives and between \$28.0M and \$35.0M to fully realize its business objectives over that period of time.

These consolidated financial statements have been prepared on the going concern basis, which presumes the Group will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As a start-up company without a current course of operating revenues, the Group's ability to continue as a going concern is dependent on its ability to secure additional sources of financing and on the continued support of its lenders, creditors and shareholders, as referred to above. Even if management is confident of the ability to raise additional liquidity, the outcome of such matters cannot be predicted at this time. The consolidated financial statements do not reflect adjustments to the carrying values and classification of assets and liabilities that might be necessary should the Group be unable to continue its operations.

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Management has concluded that the US dollar is the functional currency of each entity of the Group due mainly to the facts that the US dollar is the currency in which:

- Most of the expenses of the entities of the Group are denominated
- Oil sales are always denominated on the international markets
- And funds from financing activities (debt or equity instruments) are generated

The consolidated financial statements are presented in US dollars.

Basis of consolidation

Subsidiaries

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiaries. Subsidiaries are those entities controlled by the company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The following companies have been consolidated within the company financial statements:

Name of Subsidiary	Registered	Holding	Voting power held	Principal activity
		%	%	
Madagascar Oil Ltd	Mauritius	100	100	Investment
Madagascar Oil SA	Madagascar	100	100	Oil exploration and production
Majunga Oil SARL	Madagascar	100	100	Oil exploration and production
Madagascar Oil (USA) LLC	United States of America	100	100	Administration and Technical Support

Transactions eliminated upon consolidation

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group. All intra-group transactions, balances, income and expenses are eliminated in full on consolidation. There is no non-controlling interest in any of the subsidiaries of the Group.

Joint venture operations

It is standard industry practice to conduct petroleum operations jointly with other exploration and production companies.

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity that is subject to joint control, that is when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of the parties sharing control (venturers).

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Where a group entity undertakes its activities under joint venture arrangements directly, the Group's share of jointly controlled assets and any liabilities incurred jointly with other venturers are recognized in the financial statements of the relevant entity and classified according to their nature. Liabilities and expenses incurred directly in respect of interests in jointly controlled assets are accounted for on an accrual basis. Income from the sale or use of the Group's share of the output of jointly controlled assets, and its share of joint venture expenses, are recognized when it is probable that the economic benefits associated with the transactions will flow to/from the Group and their amount can be measured reliably.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Sale of goods

Since its creation, the Group has recognized no revenue due to the fact that the Group is in the exploration phase of its projects and has not reached commercial operations as of December 31, 2009.

Non-current oil activities

The Group recognizes the proceeds of farm-out transactions and the reversal of impairments and provisions as non-current oil activities income.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are initially recognized as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are related to non-qualifying assets and charged directly to profit and loss. Contingent rentals are recognized as expenses in the periods in which they are incurred.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

Foreign currencies

The individual financial statements of each entity of the Group are presented in the currency of the primary economic environment that the entity operates (its functional currency). On consolidation the results and financial position of each entity are expressed in US dollar (USD), which is both the functional and presentation currency of the Group.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the average of the official bid and offered exchange rates as published by the Central Bank of Madagascar on the first day of the

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month in which the expenses are recorded in order to comply with the regulation stated in the Production Sharing Contracts signed by the Group with Malagasy authorities. At each statement of financial position date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the statement of financial position date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Actual exchange differences are recognized in profit or loss in the period in which they arise. Exchange differences resulting from the retranslation of monetary items at the rates prevailing at the statement of financial position date are recognized in profit or loss at each statement of financial position date.

Share-based payments

The Group issues equity-settled share-based payments to some of their employees through stock options plans or restricted shares. According to IFRS 2, these plans are measured at fair value on the grant date and are accounted for as an employee expense on a straight-line basis over the vesting period of the plans. The fair value of granted options is determined based on a lattice model in order to take into account all the characteristics of these instruments.

The Group issues equity-settled share-based payments to certain members of its Board through stock options plans or restricted shares or warrants. According to IFRS 2, these plans are measured at fair value on the grant date and are accounted for as a director fee expense on a graded vesting for each tranche over the vesting period of the plans. The fair value of granted options and warrants is determined based on a lattice model in order to take into account all the characteristics of these instruments.

The Group may also issues equity instruments as a counterpart of goods and services received from financial institutions and other intermediaries. According to IFRS 2, these instruments (warrant) are accounted for as an expense on the basis of the market value of goods and services received.

For cash-settled share-based payments, a liability equal to the portion of the goods or services received is recognized at the current fair value determined at each statement of financial position date.

The proceeds received net of any directly attributable costs are credited to share capital (nominal value) and share premium.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the statement of financial position date.

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Deferred tax

Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit and is accounted for using the statement of financial position liability method.

Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the statement of financial position date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or to settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax are recognized as an expense or income in profit or loss, except when they relate to items credited or debited directly to equity, in which case the tax is also recognized directly in equity.

Property, plant and equipment

Fixtures and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the cost or valuation of assets over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

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Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease. Useful lives used by the Group are the following:

	Useful Lives (Years)
Installations and equipment	10
Machinery	10
Vehicles	5
Furniture, fittings and equipment	5
IT equipments	5

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

Intangible assets

Intangible assets acquired separately are reported at cost less accumulated amortization and accumulated impairment losses. Amortization is charged on a straight-line basis over their estimated useful lives of 4 years and recorded in the statement of comprehensive income as depreciation and amortization expense. The estimated useful life and amortization method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Exploration and evaluation assets

The Group applies the full cost method of accounting for exploration and evaluation costs. Under the full cost method, costs directly associated with exploring for and evaluating oil and gas properties are accumulated and capitalized. However, they do not include costs incurred prior to having obtained the legal rights to explore an area, which are expensed directly to the income statement of operations as they are incurred. Once commercial reserves are found, exploration and evaluation assets are tested for impairment. No amortization or depletion is charged during the Exploration and Evaluation Phase. Management believes that the carrying value of these costs will be recovered from future operations.

If the exploration and development is ceased or if it is determined that the carrying value cannot be supported by future production or sale, the excess of the carrying value above recoverable value will be charged against operations in the period that the determination of an impairment is made. Where an impairment subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

Impairment

Tangible and intangible assets excluding exploration and evaluation assets

At each statement of financial position date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

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Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an assets (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in statement of comprehensive income as non-current activities income.

Exploration and evaluation assets

Impairment tests are performed when the Group identifies facts or circumstances implying a possible impairment in accordance with IFRS 6.

Decommissioning costs

When the Group is legally, contractually or constructively required to restore a site, the estimated costs of site restoration are accrued. The estimated future costs for known restoration requirements are determined on a field by field basis and are calculated based on the present value of estimated future costs. When the Group does not have a reliable reversal time or when the effect of the passage of time is not material, the provision is calculated based on undiscounted cash flows.

Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the statement of financial position date, taking into account the risks and uncertainties surrounding the obligation.

Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

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Financial assets

Investments are recognized and derecognized on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Cash and cash equivalents

Cash and cash equivalents consist of cash and time deposits. Time deposits are used to guaranty the Bank Letters of Guarantee submitted to the Malagasy State as per Production Sharing Contracts' requirements during Exploration Period.

Other financial assets

Other financial assets consist of deposit paid under lease agreements. These assets are stated at the carrying value, as it approximates fair-value due to the short-term maturity of these instruments.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at each statement of financial position date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account.

When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be rebated objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Financial liabilities and equity instruments issued by the Group

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Trade payables

Trade payables are stated at their carrying value, as it approximates fair value due to the short-term maturity of these instruments.

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Notes to Consolidated Financial Statements

Financial liabilities

Financial liabilities consist of trade and other payables and borrowings.

Financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period. The effective interest method is always considered but not applied when its impact is negligible.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

3. Prior Period Adjustments

Prior period balances as of December 31, 2008 have been adjusted for the following errors:

The equity settled transactions reserve was reduced and accumulated deficit reduced by \$3,581k for the correction of errors related to the vesting term and modifications associated with various options, warrants and restricted shares granted in 2007 and 2008.

The equity settled transactions reserve was reduced and a warrant liability was increased in 2007 by \$9,676k related to the reclassification of warrants issued to Credit Suisse that were incorrectly treated as equity. This amount has been reclassified to equity in 2009 as the terms of the warrant were settled.

Exploration and evaluation assets were reduced and accumulated deficit increased by \$5,203k to correct write off the costs in 2008 related to the sale of 60% of TOTAL Block 3102.

4. Critical Accounting Judgments and Key Sources of Estimation Uncertainty

In the application of the Group's accounting policies, which are described in Note 2, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Such disclosures are included in the relevant asset and liability notes or as part of the relevant accounting policy disclosures. The estimates used by management relate to the decommissioning costs, impairments and share-based transactions.

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Notes to Consolidated Financial Statements

The estimates and underlying assumptions are based on the best possible review and interpretation of the petroleum and general regulations applicable to the Group in the countries where it operates in accordance with international industry standards.

5. Business and Geographical Segments

Business segment

The Group is engaged in oil and gas exploration and production which represent its only activity as of December 31, 2009; all its operations are in the Exploration Period of the Production Sharing Contracts signed by its subsidiaries with the Republic of Madagascar.

Geographical segment

The Group only operates in Madagascar where it holds all its licenses. The primary segment of the Group is the business segment and its secondary segment is the geographical segment.

6. Net Foreign Exchange Losses

The net foreign exchange loss booked is not significant and mainly the consequence of the erratic movements of the Malagasy currency as well as the ones of other currencies against the US dollar during the year 2009. For information 1 USD = 1954.64 MGA as of December 31, 2009 versus 1 USD = 1,860.36 MGA as of December 31, 2008.

7. Finance Costs

<i>Year Ended December 31,</i>	2009
	\$(000)
Time deposits investments ⁽ⁱ⁾	\$ 8
Interest on borrowings ⁽ⁱⁱ⁾	(307)
Unwinding of discount ⁽ⁱⁱⁱ⁾	312
Total finance income, net	13

⁽ⁱ⁾ Available cash represents the amount of funds raised by the Company to finance its operations but not yet used. This cash is invested in time deposits with an international bank of first rank at short term.

⁽ⁱⁱ⁾ At December 31, 2009, interests on borrowings are composed of the value of shares issued to Credit Suisse in 2009 in settlement of terms of a warrant contract (Note 25).

⁽ⁱⁱⁱ⁾ Unwinding of discount represents the change in the expected VAT receivable to be credited to the Group (Note 14).

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Notes to Consolidated Financial Statements

8. Income Taxes

The tax expense for the Group is:

<i>Year Ended December 31,</i>	2009
	\$(000)
The minimum tax liability payable by Madagascar Oil SA	—
The minimum tax liability payable by Majunga Oil SARLU	—
The tax liability due by Madagascar Oil (USA) LLC	49
	49

The Group did not recognize any deferred tax in accordance with IAS12 for 2009.

9. Other Expenses

<i>Year Ended December 31,</i>	2009
	\$(000)
Rentals	397
Auditors Fees and Expenses	141
Services from related parties ⁽ⁱ⁾	839
Travel and telecommunications	94
Other general and administrative expenses ⁽ⁱⁱ⁾	347
	1,818

⁽ⁱ⁾ In 2009 services from related parties constitute contracts with Mark Weller, Jim Lederhos, Jim Collins and Gil Melman. See Note 26 Related Parties.

⁽ⁱⁱ⁾ Other general and administrative expenses are constituted of recruitment fees, public relations, insurance, contracted personnel, security expenses, office running costs and bank commissions.

10. Consulting Expenses

The consulting expenses relate to the legal, fiscal and financial advices provided to the Group related to its activities in Bermuda, Madagascar and Mauritius, as follows, secretary fees in Bermuda and Mauritius \$24K, corporate and employment fees \$259K, legal and fiscal advisors related to the regulations in Madagascar \$8K and in Houston \$348K. See Note 26 about legal advisors from related parties.

11. Production Sharing Contractual Fees

<i>Year Ended December 31,</i>	2009
	\$(000)
Administrative fees	944
Training fees	328
	1,272

Amounts represent the contractual charges for all licenses under the Production Sharing Contracts signed with the Republic of Madagascar.

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Notes to Consolidated Financial Statements

12. Salaries and Employee Benefits Expenses

<i>Year Ended December 31,</i>	2009
	\$(000)
Wages, salaries and incentives	2,141
Social security costs	29
Share-based payments	5,054
	7,224

See Note 25 Share-based payment for more details.

13. Depreciation and Amortization Expenses

<i>Year Ended December 31,</i>	2009
	\$(000)
Depreciation of tangible assets	208
Amortization of intangible assets	165
	373

14. Non-Current Tax Assets

<i>As of December 31,</i>	2009
	\$(000)
VAT credit	1,570
	1,570

The amount corresponds to the VAT receivable after a change in discount of \$312K for 2009, (Note 6) and shall be recovered when the Company begins collecting VAT on sales of crude oil.

15. Property, Plant and Equipment

Cost

	Vehicles	Equipment	Other	Total
	<i>\$(000)</i>	<i>\$(000)</i>	<i>\$(000)</i>	<i>\$(000)</i>
Balance at January 1, 2009	188	784	350	1,322
Additions	—	2	4	6
Disposals	(45)	(30)	(244)	(319)
Balance at December 31, 2009	143	756	110	1,009

Accumulated depreciation

	Vehicles	Equipment	Other	Total
	<i>\$(000)</i>	<i>\$(000)</i>	<i>\$(000)</i>	<i>\$(000)</i>
Balance at January 1, 2009	(104)	(288)	(66)	(458)
Depreciation expense	(34)	(152)	(22)	(208)
Disposals	29	22	62	113
Balance at December 31, 2009	(109)	(418)	(26)	(553)

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Notes to Consolidated Financial Statements

16. Exploration and Evaluation Assets

During the Exploration Period of the existing Production Sharing Contracts the Group considers as intangible assets:

- The exploration works performed in the licenses 3102 Bemolanga, 3104 Tsimiroro, 3105 Manambolo, 3106 Morondava and 3107 Manandaza
- The consumable costs included in the pilot project costs implemented in the license 3104 Tsimiroro

During the Exploration Period of the Production Sharing Contracts the Group considers as tangible assets the capital costs included in the licenses.

Cost	Intangibles \$(000)	Tangibles \$(000)	Total \$(000)
Balance at January 1, 2009	56,457	25,113	81,570
Movements	4,289	(22)	4,267
Reversal of impairment at December 31, 2009 ⁽ⁱ⁾	3,104	—	3,104
Balance at December 31, 2009 after impairment	63,850	25,091	88,941

The detail of the exploration works by license as explained in Note 1 is:

Year Ended December 31,	2009 \$(000)
License 3102 Bemolanga (operated by TOTAL) ⁽ⁱⁱ⁾	—
License 3104 Tsimiroro (operated)	82,377
Environmental assessment	508
Pilot project	
Tangibles	25,826
Intangibles	52,913
Studies and other exploration expenses	2,594
Exploration wells	1,279
Impairment - tangibles	(743)
License 3105 Manambolo (operated)	1,843
Geochemistry	344
Environmental assessment	95
Studies and other exploration expenses	350
Seismic acquisition	
Tangibles	2
Intangibles	1,052
Impairment ⁽ⁱ⁾	—
License 3106 Morondava (operated)	2,472
Environmental assessment	148
Geochemistry	380
Seismic acquisitions	
Tangibles	2
Intangibles	1,079
Rock physics	199
Studies and other exploration expenses	
Tangibles	2
Intangibles	662
Impairment ⁽ⁱ⁾	—

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License 3107 Manandaza (operated)	2,249
Airborne magnetic	214
Environmental assessment	132
Seismic acquisitions	
Tangibles	2
Intangibles	1,217
Rock physics	197
Studies and other exploration expenses	487
Impairment ⁽ⁱ⁾	—
Total of exploration works	88,941

⁽ⁱ⁾ Management reversed the 2008 impairment of these assets in accordance with decisions of the Board made in 2009 and instead to pursue additional work in these blocks in 2009 and 2010. Although the Group is seeking partners for its 100% held exploration blocks (3105, 3106 and 3107), if it is unable to obtain partners, the Group may elect to return the blocks to the government in 2011 which may result in the forfeiture of \$1.5 million USD of bank guarantees pursuant to the production sharing contracts.

⁽ⁱⁱ⁾ All historical costs related to the Bemolanga block were recovered through the sale of 60% of the interest to TOTAL in 2008.

The Group has the intention to continue to operate Tsimiroro block and has no reason to believe that any impairment other than the impairment related to the 120 man camp that is provided for in these consolidated financial statements, should be considered on the related Tsimiroro assets recorded by the company.

17. Joint Venture Operations

License 3109 Mandabe

Joint Venture Operations

Majunga and Tullow were 50/50 parties to a joint operating agreement dated December 7, 2005 for Production Sharing Contract No. 3109 (the "Tullow JOA"). Tullow and Majunga did not agree on a 2008 work program by the deadline required under the Tullow JOA and Tullow also unilaterally extended the PSC with OMNIS without the consent of Majunga. Majunga withdrew from the Tullow JOA in September 2008 due to the dramatic increase in cost of obtaining seismic in that region. Both Tullow and OMNIS have acknowledged and accepted Majunga's withdrawal from the Tullow Joint Venture. Majunga extended an offer to turn over its share of the bank guarantees in favor of OMNIS which represented approximately US\$1.5 million in exchange for a full release by Tullow but Tullow never accepted such offer. The bank guarantee was released by the government in 2009 and subsequently returned by Credit Suisse to the Company. Since that time, there has been no communication between the parties. Tullow apparently requested and received another one year extension of the exploration period under the PSC in November 2009. Management's interpretation of the terms of the Tullow JOA is such that Majunga has no liability for expenditures incurred without its prior approval nor does Majunga have any obligation to fund any work incurred during the extensions of the PSC that it did not approve and that occurred subsequent to Majunga's withdrawal. In the event that Tullow were to make a claim against Majunga, management believes that in the unlikely event that such claim were successful, the claim would be limited to the amount of the original guarantee (US\$1.5 million). Tullow's sole recourse under the Tullow JOA is to Majunga which is an entity that currently holds no assets.

License 3102 Bemolanga

Since September 17, 2008 the Group holds a 40% interest in a joint venture with the group TOTAL for the license 3102 Bemolanga. Under the signed farm-out agreement TOTAL has become the operator.

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Notes to Consolidated Financial Statements

The Group is entitled to a proportionate share of the rental income received and bears a proportionate share of the expenses.

The following amounts are included in the consolidated financial statements as a result of the share of the Group in the joint venture operations:

<i>Year Ended December 31,</i>	<i>2009</i>
	<i>\$(000)</i>
Non-current assets (Note 16)	—
Current liability (Note 24)	(52)
Expenses	(52)

18. Other Assets

Prepayments correspond to payments made to OMNIS as per Production Sharing Contracts signed for periods covering 2010 and 2009 and to payments for insurance policies.

19. Financial Assets

Deposits are for the rental of offices and equipment.

20. Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents include cash on hand and in banks and investments in time deposits, net of outstanding bank overdrafts. Cash and cash equivalents at the end of the financial year as shown in the cash flow statement can be reconciled to the related items in the statement of financial position as follows:

<i>As of December 31,</i>	<i>2009</i>
	<i>\$(000)</i>
Cash and bank balances	6,409
Restricted cash ⁽ⁱ⁾	(3,508)
Net cash available	2,901

⁽ⁱ⁾Cash collateral of \$3,508K in 2009, corresponds to 111% of guarantees provided by the bank on the behalf of the Group. See Note 30 Commitments for expenditure - bank guarantees for more details about the guarantees provided.

21. Issued Capital

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximizing the return to stockholders through the optimization of the debt and equity balance. The Group's overall strategy remains unchanged from 2006.

The capital structure of the Group consists of debt (when any), cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and accumulated deficit as disclosed in Notes 21, 22 and 25 respectively.

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Notes to Consolidated Financial Statements

The gearing ratio at the year-end was as follows:

<i>As of December 31,</i>	2009
	\$(000)
Debt ⁽ⁱ⁾	—
Cash and cash equivalents ⁽ⁱⁱ⁾	(2,901)
Net debt	(2,901)
Equity ⁽ⁱⁱⁱ⁾	96,790
Net debt to equity ratio	—%

⁽ⁱ⁾Debt is defined as long- and short-term borrowings from financial institutions.

⁽ⁱⁱ⁾Only non-restricted cash and cash equivalents.

⁽ⁱⁱⁱ⁾Equity includes all capital and reserves of the Group including accumulated deficit.

In 2009 the Company completed a consolidation of its stock of 1:100: All share, option and warrant amounts, prices and fair values have been adjusted retrospectively accordingly.

Details of the Share Capital of the Company as of December 31, 2009 are:

<i>As of December 31,</i>	2009
Fully paid common shares	11,865,827
Fully paid non-voting shares	1,304,000
Total number of shares fully paid	13,169,827
Par value per share in USD	0.01

<i>As of December 31,</i>	2009
	\$(000)
Share capital	131
Share premium	111,288
Total issued capital	111,419

	Number of Shares	Share Capital	Share Premium
	\$(000)	\$(000)	\$(000)
Balance, January 1, 2009	11,621,947	116	105,175
Issue of shares	1,305,581	13	6,113
Shares granted to personnel for free (Note 25)	192,299	1	—
Shares granted to Directors for free (Note 25)	50,000	1	—
Balance, December 31, 2009	13,169,827	131	111,289

No new financial instruments were issued during 2009. At December 31, 2009 the detail of financial instruments in issue is:

Total number of warrants in issue	386,037
Warrants at \$150 per share	3,000
Warrants at \$100 per share	139,006
Warrants at \$1 per share	244,031

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Notes to Consolidated Financial Statements

Total number of options in issue		30,000
Options at \$150 per share	13,000	
Options at \$130 per share	4,000	
Options at \$100 per share	11,000	
Options for Non-Voting shares at \$130 per share	2,000	

The valuation of the warrants and options granted is described in Note 25 Share-based payments except:

- 135K warrants granted to shareholders in connection with equity investment in the Company: Under IAS 32.22 these warrants are an equity instrument booked for its selling value at its grant date which is zero. Because these warrants are equity instruments their change in fair value over the time is not recognized in the financial statements.
- 12,000 options which vest upon a change of control of the Company.

22. Accumulated Deficit and Dividends

<i>Year Ended December 31,</i>	2009
	<i>\$(000)</i>
Balance at beginning of the year (as restated)	(152,687)
Net loss	(3,853)
	(156,540)

Since its creation no equity of the Group has proposed, declared nor distributed any dividend.

23. Provisions

	Current	Non-Current
	December 31, 2009	
	<i>\$(000)</i>	<i>\$(000)</i>
Employee Benefits ⁽ⁱ⁾	92	—
Decommissioning costs ⁽ⁱⁱ⁾	—	603
	92	603

⁽ⁱ⁾ Provision for employee benefits represents annual leave accrued.

⁽ⁱⁱ⁾ The provision for decommissioning costs represents management's best estimate for the plugging and abandonment costs associated with the core holes drilled to date on the license 3102 Bemolanga, with the cores holes, the cyclical steam simulation (CSS) wells and the exploration wells drilled to date on the license 3104 Tsimiroro and with the production facilities installed in relation with the production test conducted on the license 3104 Tsimiroro.

24. Trade and Other Payables

<i>As of December 31,</i>	2009
	<i>\$(000)</i>
Trade payables ⁽ⁱ⁾	622
Other payables ⁽ⁱⁱ⁾	49
Partner operator ⁽ⁱⁱⁱ⁾	52
	723

⁽ⁱ⁾As of December 31, 2009 trade payables include Malagasy suppliers for US \$291K and non-Malagasy

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Notes to Consolidated Financial Statements

suppliers for US \$432K.

⁽ⁱⁱ⁾Other payables as of December 31, 2009 include dues to personnel and other taxes.

⁽ⁱⁱⁱ⁾Amount due to TOTAL under the joint venture agreements in place at December 31, 2009.

25. Share-Based Payments

All amounts stated are after consideration of consolidation of the Company's stock of 1:100 which took place in 2009.

Credit Suisse Agreement

In July 2009, the Company issued Credit Suisse International 6,135,771 common shares (61,358 shares post-consolidation) in settlement of a dispute over whether certain share issuances during 2008 constituted dilutive events under Credit Suisse's warrant agreement.

Stock options granted to management and employees

The Group issued several stock options in 2006 and 2007 but no options were granted in 2008 and 2009. The main characteristic of the options are summarized in the following table:

Option	Grant Dates	Exercise Price	First Exercise Date	Last Exercise Date	Estimated Fair Value of Option	Options Granted	Options Cancelled	Options Exercised	Outstanding Options
SO1	03/27/2006	150 USD	03/27/2006	03/27/2011	50 USD	2,500	(2,500)	0	0
SO2	03/27/2006	130 USD	03/27/2006	See *	60 USD	12,000	(6,000)	0	6,000
SO3	03/27/2006	150 USD	03/27/2006	03/27/2011	50 USD	8,500	(8,500)	0	0
SO4	07/27/2006	150 USD	Various	07/27/2016	70 USD	40,000	(40,000)	0	0
SO5	08/15/2006	150 USD	08/15/2006	08/15/2011	50 USD	500	(500)	0	0
SO6	11/01/2006	150 USD	Various	11/01/2011	110 USD	8,000	(8,000)	0	0
SO7	07/27/2006	150 USD	07/27/2006	07/27/2009	40 USD	10,000	(10,000)	0	0
SO8	06/15/2006	150 USD	06/15/2007	03/27/2011	50 USD	3,500	(2,500)	0	1,000
SO9	07/17/2007	100 USD	07/17/2007	07/17/2010	30 USD	1,000	0	0	1,000
SO10	07/27/2007	100 USD	07/27/2008	07/27/2017	50 USD	10,000	0	0	10,000

**for option no. SO2, the last exercise date is three years after the Company's admission to a recognized stock exchange.*

Plans SO1, SO3, SO4, SO5, SO6 and SO7 were fully surrendered in 2007 and replaced by restricted shares; plans SO2 and SO8 were partially surrendered in 2007. No options were exercised in 2009.

In order to determine the fair value of each option granted, the following parameters were considered:

- Share prices at grant date were determined based on the last known share price for capital increase
- Volatility was estimated based on a suitable peer group of companies listed in the Toronto stock exchange. This analysis led to volatility estimate of almost 30%
- Risk free rates based on zero coupon Canadian government bonds
- No forfeiture rate was recognized
- No expected dividends were considered

The expense recognized in the 2009 income statement related to outstanding stock options plans granted to management and employees was zero.

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Notes to Consolidated Financial Statements

Shares granted to management and employees

The Group granted restricted shares in 2006, 2007, 2008 and 2009. The main features of the plans are summarized in the following table.

Plan	Grant Dates	Vested Date	Estimated Fair Value of Shares	Shares Granted	Shares Cancelled	Shares Vested	Shares Non-Vested
S1	07/27/2006	12/31/2006	150 USD	7,000	0	7,000	0
S1	07/27/2006	07/27/2007	150 USD	10,000	0	10,000	0
S1	07/27/2006	07/27/2009	150 USD	10,000	0	10,000	0
S2	12/18/2006	12/31/2006	175 USD	2,623	0	2,623	0
S2	12/18/2006	12/31/2007	175 USD	2,623	(1,026)	1,597	0
S2	12/18/2006	12/31/2008	175 USD	2,623	(1,477)	1,146	0
S3	02/07/2007	See *	100 USD	67,500	(15,750)	0	51,750
S4	01/19/2007	01/19/2007	100 USD	2,500	0	2,500	0
S5	02/28/2007	02/28/2007	100 USD	1,681	0	1,681	0
S6	05/11/2007	05/11/2007	100 USD	667	0	667	0
S7	06/01/2007	06/01/2007	100 USD	1,000	0	1,000	0
S8	08/16/2007	08/16/2007	100 USD	1,500	0	1,500	0
S9	05/03/2007	05/03/2007	100 USD	200	(200)	0	0
S10	05/11/2007	See *	100 USD	4,500	(4,500)	0	0
S11	06/01/2007	06/01/2007	100 USD	2,000	(1,000)	1,000	0
S12	11/27/2007	11/27/2007	40 USD	3,333	0	3,333	0
S13	11/05/2007	11/05/2009	40 USD	2,500	0	2,500	0
S14	11/27/2007	11/27/2009	40 USD	6,667	(6,667)	0	0
S15	01/18/2008	01/18/2011	40 USD	56,882	(9,798)	15,789	31,295
S16	08/07/2008	08/07/2011	10 USD	594,725	(64,590)	135,473	394,662
S17	10/07/2008	10/07/2008	2 USD	6,500	0	6,500	0
S18	07/10/2008	07/10/2011	10 USD	6,051	(5,500)	0	551
S19	02/22/2008	02/22/2008	40 USD	300	0	300	0
S20	07/16/2008	07/16/2008	10 USD	368	0	368	0
S20	07/16/2008	07/16/2011	10 USD	2,250	0	0	2,250
S21	10/14/2008	10/14/2011	2 USD	100,000	0	0	100,000
S22	10/28/2008	10/28/2009	2 USD	150,000	0	150,000	0
S23	12/31/2008	12/31/2008	2 USD	4,908	0	4,908	0
S24	01/20/2009	01/20/2012	2 USD	137,500	0	0	137,500
S25	06/19/2009	06/19/2010	5 USD	50,000	0	50,000	0
S26	12/18/2009	See *	5 USD	54,799	0	0	54,799

**for plan nos. S3, S10 and S26, the vesting date is the Company's admission date to a recognized stock exchange.*

The Group granted restricted shares to Management (plan S1) on July 27, 2006: 27,000 shares were granted at a per share value of USD 150. Of these, 4,500 vested in 2006, 6,500 in July 2007 and 6,500 vested in July 2009. Share price at grant date was determined based on the last known share price for capital increase.

The Group also granted a total of 7,869 shares (plan S2) to some employees on December 18, 2006 as a bonus for the year 2006. The share price at grant date was determined based on the management best estimate of fair value. These shares were fully vested by December 31, 2008.

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Notes to Consolidated Financial Statements

Some options (78,000) and warrants (12,000) granted in 2006 were surrendered in 2007 and replaced by restricted shares (plan S3) vested at the Company's admission date to a recognized stock exchange. The share price at grant date was determined based on management best estimate of fair value. The total fair value of options and warrants surrendered and the increase in fair value for the restricted shares granted were recognized at the date of surrender.

Other shares (plans S4 to S14) were granted in 2007 to management and employees: the fair value of these plans was determined based on the estimated share price at grant date.

Plans S15 to S23 were granted in 2008: some plans vested at grant date, others were supposed to vest after 3 years. Furthermore, several beneficiaries left the Company as "good leavers", under the plan, thus they vested immediately.

Plans S24 to S26 were granted in 2009. Vesting periods ranged from one to three years with certain shares vesting upon initial public offering or change of control.

The expense recognized in the 2009 consolidated statement of operations related to shares granted to management and employees is \$5.1 million.

Warrants plans issued to management

The Group issued several warrants in 2006 and 2007 but no warrants were issued in 2008 or 2009. The primary terms of such warrants are summarized in the following table:

Plan	Grant Dates	Exercise Price	First Exercise Date	Last Exercise Date	Estimated Fair Value of Warrant	Warrants Granted	Warrants Cancelled	Warrants Exercised	Outstanding Warrants
W1	06/15/2006	150 USD	06/15/2006	04/30/2009	40 USD	10,000	(10,000)	0	0
W2	06/15/2006	130 USD	06/15/2006	06/15/2012	60 USD	3,000	0	0	3,000
W3	06/15/2006	150 USD	06/15/2006	06/15/2012	60 USD	3,000	(3,000)	0	0
W4	07/13/2006	150 USD	07/13/2007	07/12/2012	60 USD	3,000	(3,000)	0	0
W5	08/15/2006	150 USD	08/15/2007	08/14/2012	60 USD	4,000	(4,000)	0	0
W6	06/30/2007	100 USD	06/30/2007	06/30/2012	30 USD	4,003	0	0	4,003

Among options granted through plan W1, 8,000 options were cancelled in 2007 and the remaining 2,000 options were surrendered and replaced by restricted shares. Plans W3, W4, and W5 were fully surrendered in 2007 and replaced by restricted shares. No warrants were exercised in 2008 and 2009.

In order to determine the fair value of each option granted, following parameters were considered:

- Share prices at grant date were determined based on the last known share price for capital increase
- Volatility was estimated based on a suitable peer group of companies listed in the Toronto stock exchange. This analysis led to volatility estimate of almost 30%
- Risk free rates based on zero coupon Canadian government bonds
- No forfeiture rate was considered
- No expected dividends were considered

No expense was recognized in 2009.

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Other share based payments

The Group issued in 2005, 2006 and in 2007 equity instruments (warrants and options) for the payment of goods and services to financial institutions. Main features of the plans are summarized in the following table:

Plan	Grant Dates	Number of Options and Warrants	Exercise Price	First Exercise Date	Last Exercise Date	Estimated Fair Value of Warrant	Options and Warrants Cancelled	Options and Warrants Exercised	Outstanding Options and Warrants
TP1	09/12/2006	75,000	150 USD	03/27/2006	04/30/2009	20 USD	(75,000)	0	0
TP2	09/12/2006	75,000	150 USD	12/31/2006	04/30/2009	20 USD	(75,000)	0	0
TP3	03/27/2006	5,000	250 USD	03/27/2006	04/30/2009	20 USD	(5,000)	0	0
TP4	03/27/2006	1,000	100 USD	03/27/2006	04/30/2009	20 USD	(1,000)	0	0
TP5	03/27/2006	3,490	130 USD	03/27/2006	04/30/2009	20 USD	(3,490)	0	0
TP6	03/27/2006	417	150 USD	03/27/2006	04/30/2009	20 USD	(417)	0	0
TP7	03/28/2007	244,030	1 USD	03/28/2007	03/28/2012	40 USD	0	0	244,030
TP8	03/28/2007	200,769	100 USD	04/30/2008	09/01/2008	40 USD	(200,769)	0	0

The warrants issued in Plans TP1 and TP2 below were issued as partial consideration to the Company's placement agent in connection with its October 2005 and March 2006 financing. The placement agent received part cash and part warrants as compensation for its services. The value of the warrants was derived by taking the fair market value of the placement agent's services minus the cash component of the consideration for placement agent services. This valuation methodology was applied to Plans TP3 - TP6.

For plans TP7 and TP8, the fair value was determined based on a lattice model using the assumptions applied for options and warrants granted to management and employees.

No expense was recorded in 2009 related to share based payments granted to third parties.

26. Related Party Transactions

Transactions between the Company and its subsidiaries which are related parties of the Company have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Company and other related parties are disclosed below.

Trading transactions

During the year ended December 31, 2009, Group entities entered into the following trading transactions with related parties that are not members of the Group:

Party	Transaction/Contract	Term	2009 Payments in USD \$(000)
Directors			
Laurie Hunter	Board Acceptance Letter	10/28/2008 to Present	116
Gene Davis-Pirinate Consulting	Consulting Agreement	10/28/2008 to 4/30/10	60

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Party	Transaction/Contract	Term	2009 Payments in USD \$(000)
Gil Melman-Phillips & Reiter	Phillips & Reiter	On request	128
Gil Melman-Selman Munson	Selmun Munson	On request	100
Jim Collins	Consulting Agreement	On request	109
Jim Dorman-Dtex	Consulting Agreement	On request	50
Jim Lederhos	Consulting Agreement	On request	114
Mark Weller	Consulting Agreement	On request	240
Michael McGown-CFO & Consultant	Consulting Agreement & Employee	On request	98
Matthew Meyer	Consulting Agreement	On request	—

Outstanding amounts are unsecured. No guarantees have been given or received. No expense has been recognized in the period for bad or doubtful debts in respect of the amounts owed to related parties.

Compensation of key management personnel

Key management personnel of the Group is composed of the Chairman, the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer and the Members of the Board.

The remuneration of directors and other members of key management during the year was as follows:

<i>Year Ended December 31,</i>	2009 \$(000)
Share-based payments	274
Board members fees and other services	176
	450

27. Operating Lease Arrangements

Leasing arrangements

Operating leases relate to:

- Office facilities and equipments with lease terms not over 5 years with options to renew for up to 5 years
- Housing facilities and equipments for expatriates with lease terms not over 1 year with monthly renewal options
- Air charter with lease term not over 1 year with option for annual renewal

All operating lease contracts contain market review clauses in the event that the Company exercises its option to renew. The Company does not have an option to purchase the leased assets at the expiry of the lease period.

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Payments recognized as an expense

<i>As of December 31,</i>	2009
	<i>\$(000)</i>
Minimum lease payments	306

Non-cancellable operating lease commitments

<i>Year Ended December 31,</i>	2009
	<i>\$(000)</i>
Not longer than 1 year	—
Longer than 1 year and not longer than 5 years	159
	159

The Group has no contingent rentals and does not receive any sublease payments as of December 31, 2009.

28. Commitments For Expenditure

Commitments

The Group has no commitment for expenditures with any of its consultants and advisors except in the case of fund raising (equity and debt) for which agreements have been signed with its usual financial institution partner and other intermediaries.

Except for the finance lease and the operating leases mentioned in this document, the Group has no other pluri-annual commitment with private companies.

The Production Sharing Contracts signed with the Malagasy authorities includes the following annual fees:

- Administrative fees
 - * Licenses 3102 (no longer operated since September 17 2008) and 3104: \$250,000 per year per license as of second phase of Exploration Period only during Exploration Period
 - * Other operated licenses: \$162,500 per year per license only during Exploration Period
- Training fees
 - * Licenses 3102 and 3104: \$100,000 per year for the life of the contract
 - * All other licenses: \$50,000 per year for the life of the contract

Bank guarantees

In favor of OMNIS in order to guaranty the execution of the minimum exploration works as per article 8 of the Production Sharing Contracts signed

Expiration Date	Guarantor	Beneficiary	In Force at December 31, 2009
December 31, 2010	Madagascar Oil Ltd (Bermuda)	Exploration Period Phase 2 OMNIS	\$3,000,000
			\$3,000,000

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29. Financial Instruments

(A) Fair value of financial instruments

Recognition and measurement principles regarding financial assets and liabilities are defined in IAS 32 and IAS 39. The classification of financial instruments into specific categories is described in Note 2.

	2009 Carrying Amount	Amortized Cost	Loans and Receivables	Fair Value Through Income	2009 Fair Value
Assets					
Non-current financial assets	11	-	11	11	11
Restricted cash	3,508	-	-	3,508	3,508
Current financial assets	—	-	-	-	-
Cash and cash equivalents	2,901	-	-	2,901	2,901
Liabilities					
Accounts and other payables	723	723	-	-	723

(B) Risk management policy

In the context of its industrial activity, the Group operates in an international environment in which it is confronted with market risks, specifically foreign currency risk and interest rate risk. It does not use derivatives to manage and reduce its exposure to changes in foreign exchange rates and interest rates.

Cash and cash equivalents are kept in the Group currency except for an amount corresponding to the needs of the local subsidiaries. The policy of the Group is to have a balance in the currency of the local subsidiaries not higher than the expected needs in local currency for one month.

In addition to market risks, the Group is also exposed to liquidity risk and financial instrument counterparty risk.

Exposure to foreign currency risk

The Group has a very limited exposure to foreign exchange risk arising from transactions in currencies other than their functional currency since such transactions are either not material or very short term transactions.

Based on notional amounts, most of the Group's net exposure to foreign currency risk arises on the following currencies (excluding entities functional currencies):

	USD	GBP	MGA	2009
Financial Assets	-	-	11	11
Restricted cash equivalents	3,508	-	—	3,508
Cash	2,869	12	20	2,901
Exposure (Assets)	6,377	12	31	6,420
Trade and other payables	432	—	291	723
Exposure (Liability)	432	—	291	723
Gross exposure in statement of financial position	5,945	12	(260)	5,697
Forecasted disbursements	-	-	-	-
Forecasted sales	-	-	-	-
Net Exposure	5,945	12	(271)	5,697

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Interest rate risk

Exposure to interest rate risk - Cash and cash equivalents are invested in short-term variable-rate instruments. There is no long-term debt at December 31, 2009.

Analysis of the sensitivity to interest rate risk - At December 31, 2009 100% of short-term investments is at variable rates.

The maximum impact on consolidated net loss before tax of a sudden 1% rise in short-term interest rates applied to financial assets and liabilities at variable rates is a loss of \$65K.

Similarly, a sudden 1% fall in short-term interest rates would have a positive \$65K impact on consolidated income before tax.

Liquidity risk

The Group aims to maximize operating cash flows in order to be in a position to finance the investments required for its development.

The Group's strategy also aims to ensure that it has the cash resources necessary to meet all circumstances. See discussion in Note 2.

Residual contractual maturities of financial liabilities can be analyzed as follows:

	2009	Less than 1 Year	1 to 5 Years	More than 5 years
Non-derivatives	(723)	(723)	-	-
Credit facilities			-	-
Debts related to finance leases	-	-	-	-
Trade and other payables	(723)	(723)	-	-
Derivatives	-	-	-	-
Total	(723)	(723)	-	-

30. Non-Current Oil Activity Operations

Non-Current Income

During 2009, per the strategy of its Board, the Group has reversed the impairment of the exploration works performed (\$3,104K) (see Note 16 Exploration and evaluation assets) and reversed the provision for the letters of credit related to the minimum work commitments for the licenses 3105 Manambolo, 3106 Morondava and 3107 Manandaza for \$4,694K.

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31. Contingent Liabilities and Contingent Assets

Taxe Forfaitaire sur les Transferts (TFT) (See Note 32)

During 2009 the Group received a notification from the Malagasy Tax Administration that it should apply the TFT to the services rendered by foreign suppliers. The Group believed that it is exempted from this tax as per applicable regulations. The Group challenged this interpretation of the Tax Administration which was contradicting the implementation of the TFT for many years and received confirmation in 2007 from the Minister of Finance that TFT was not applicable to petroleum industry transactions. Accordingly, TFT has been cancelled in subsequent Malagasy budgets.

In July 2010, the Group received a notification from the Malagasy tax administration claiming the payment of VAT and income tax on services rendered by foreign suppliers, with interests on delayed payment and penalties. The adjustments relate to fiscal year 2007 and 2008.

The Group believes it complied with the applicable regulations and the practice of all oil companies in Madagascar. Therefore, the Group has challenged the proposed tax adjustment and submitted the case to the Appeal commission (CFRA) for review and opinion.

In its letter addressed to the Appeal commission dated August 30, 2010, the tax administration dismissed the claims on income tax, but maintained its position on the VAT adjustment. The amount claimed relating to VAT is US \$6,790K (consisting of VAT of US \$3,990K, interest on delayed payment of US \$980K and penalty of US \$1,820K).

The case is being processed by the Appeal commission. Whatever the opinion of the Appeal commission, the tax administration has the ability to maintain the tax adjustment. The appeal ruling is not expected until 2011. If the appeal ruling is not in favor of the Group, the Group has the possibility to bring the matter before the Council of State. This procedure does not suspend the payment of the claimed tax (US \$3,990K), nevertheless the group can request to pay only 50% of the claimed tax (US \$1,995K) pending the decision of the Council of State, but the authorities have the ability to refuse this request. Efforts are also underway to modify the Madagascar Petroleum Code to specifically exempt the disputed taxes, both retroactively and prospectively.

32. Events After the Statement of Financial Position Date

Taxe Forfaitaire sur les Transferts (TFT)

In July 2010, the Group received a notification from the Malagasy tax administration claiming the payment of VAT and income tax on services rendered by foreign suppliers, with interests on delayed payment and penalties. See discussion in Note 31.

Issuance of Shares

In July 2010, the Company sold \$2.87 million of its convertible notes due December 31, 2010 to its three largest shareholder groups. The notes are convertible into common shares of the Company at a conversion ratio of \$15.00. 71,843 warrants with a one year term and a strike price of \$20.00 per share were issued to such shareholders as a part of this financing.

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Bridge Financing

In August 2010 the Company issued 666,667 of its common shares at a subscription price of \$15.00 per share for total proceeds of US \$10 million to a group of related investors. As a part of such financing, the Company agreed to use reasonable endeavors to list the Company's shares on a recognized stock exchange and to issue additional shares to the investors as a make whole if an initial public offering of the Company is priced below the subscription price.

Non-Voting Shares

Subsequent to year end, the non-voting shareholder sold a significant portion of its non-voting interest to another shareholder. Pursuant to a share exchange agreement dated September 30, 2010, the non-voting shareholder has also agreed to exchange the remaining 261,836 non-voting shares held for the equivalent number of the Company's voting common stock.

33. Approval of Financial Statements

The financial statements were reviewed by the Audit Committee, approved by the Board of Directors and authorized for issue on September 30, 2010.