This document comprises a prospectus relating to Tethys Petroleum Limited (the "**Company**") prepared in accordance with the Prospectus Rules of the Financial Services Authority made under section 73A of the Financial Services and Markets Act 2000. This prospectus will be made available to the public in accordance with the Prospectus Rules. If you are in any doubt about the contents of this document you should consult your stockbroker, bank manager, solicitor, accountant or other financial adviser. It should be remembered that the price of securities and the income from them can go up as well as down.

The Company and its Directors (whose names appear on page 89 of this document) accept responsibility for the information contained in this document. To the best of the knowledge of the Company and the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and contains no omission likely to affect its import.

Application has been made to the Financial Services Authority for all of the Ordinary Shares to be admitted to the standard category of the Official List and to the London Stock Exchange for such Ordinary Shares to be admitted to trading on the London Stock Exchange's main market for listed securities (together "**Admission**"). Shares of the same class as the Ordinary Shares are already traded on the Toronto Stock Exchange (the "**TSX**") and on the Kazakhstan Stock Exchange ("**KASE**"). It is expected that Admission will become effective and that unconditional dealings will commence in the Ordinary Shares at 8.00 a.m. on 25 July 2011 (ISIN: KYG876361091).

The Company is applying for listing pursuant to Chapter 14 of the Listing Rules and consequently the eligibility requirements and continuing obligations set out in Chapters 6 to 13 inclusive of the Listing Rules will not apply to the Company. See the section headed "Consequences of a standard listing" on page 25 of this document.

**For a discussion of certain risk and other factors that should be considered in connection with an investment in the Ordinary Shares, see "Risk Factors" set out on pages 7 to 30 of this document.**

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# Tethys Petroleum Limited

(*a company continued under the laws of the Cayman Islands with registered number OG-214254*)

## Introduction to the Official List
## and to trading on the London Stock Exchange

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**Expected share capital immediately following Admission**

| Authorised | | Issued and fully paid |
|---|---|---|
| **700,000,000** | **Ordinary Shares of US$ 0.10** | **260,629,769** |

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This document does not constitute an offer to sell, or the solicitation of an offer to subscribe for or buy, any Ordinary Shares and, subject to certain exceptions to any person is not for distribution in or into the United States, Australia, Japan or South Africa. In particular, the Ordinary Shares have not been and will not be registered under the US Securities Act of 1933, as amended, with any securities regulatory authority of any state or other jurisdiction of the United States or under the applicable securities laws of Australia, Japan or South Africa and, subject to certain exceptions, may not be offered or sold directly, or indirectly in or into the United States, Australia, Japan or South Africa.

This Prospectus has not been, and is not required to be, filed with any governmental or other authority in the Cayman Islands. No governmental or other authority in the Cayman Islands has approved this Prospectus nor passed upon or endorsed the accuracy or adequacy of this Prospectus. The activities of the Company will not be regulated or otherwise overseen by any Cayman Islands authority. Any representation to the contrary is unlawful. No offering of Ordinary Shares is being made by this Prospectus to the public in the Cayman Islands.

**Investors should rely only on the information contained in this document and any supplementary prospectus produced to supplement the information contained in this document. No person has been authorised to give any information or to make any representations other than those contained in this document and, if given or made, such information or representations must not be relied upon as having been authorised by or on behalf of the Company. Without prejudice to any obligation of the Company to publish a supplementary prospectus pursuant to section 87G(1) of FSMA and Rule 3.4 of the Prospectus Rules, neither the delivery of this document nor any subscription or sale made under this document shall, under any circumstances, create any implication that there has been no change in the business or affairs of the Company or of the Group taken as a whole since the date of this document or that the information contained herein is correct as of any time subsequent to the date of this document.**

The contents of this document are not to be construed as legal, business or tax advice. Each prospective investor should consult its own lawyer, financial adviser or tax adviser for legal, financial or tax advice in relation to the purchase of Ordinary Shares.

The contents of the Company's website or any website directly or indirectly linked to the Company's website do not form part of this document and investors should not rely on it.

## TABLE OF CONTENTS

# SUMMARY INFORMATION

**This summary should be read as an introduction to this prospectus. Any decision to invest in the Ordinary Shares should be based on a consideration of this prospectus as a whole. Where a claim relating to the information contained in this Prospectus is brought before a court, a plaintiff investor may, under the national legislation of a EEA state, have to bear the costs of translating this prospectus before legal proceedings are initiated. Civil liability attaches to the persons responsible for this summary, including any translation to this summary, but only if the summary is misleading, inaccurate or inconsistent when read with other parts of this prospectus.**

(*Defined terms: Certain terms used in this document, including certain capitalised terms and certain technical and other items, are defined and explained in Part 8: "Definitions and Glossary of Technical Terms" on pages 361 to 373 of this document.*)

## 1. INFORMATION ON THE COMPANY

Tethys is an independent oil and gas exploration and production company. Through its subsiduaries, the Company is engaged in the exploration for, and the acquisition, development and production of oil and natural gas resources. The Company has an exclusive focus on projects in Central Asia, and currently holds assets in Kazakhstan, Tajikistan and Uzbekistan. The Company also has a drilling and oilfield service business unit which provides equipment for use of the Company's assets in Central Asia.

The Company was incorporated in Guernsey in 2003, but moved its domicile to the Cayman Islands in 2008. The Company is listed on the TSX and the KASE.

## 2. COMPANY STRENGTHS

The Company's principal competitive advantages relate to its commercial, operational and geological expertise, access to capital markets and an exclusive focus on Central Asia.

## 3. STRATEGY

The Company's objective is to continue to grow as an independent oil and gas company and to build a diversified oil and gas exploration and production company with a mixture of short-term cashflow projects and long-term high potential exploration projects focused in the Central Asian region.

## 4. RISK FACTORS

There is a risk that the Company's exploration and/or production rights contracts will not be renewed or extended.

The Company is subject to risks associated with the Kazakh Subsurface Law and the Kazakh regulatory authorities.

Kazakhstan's Local Content Rules are currently difficult to comply with which poses a risk to the Company.

The Company competes with other companies which have greater financial, technical and operational resources.

The Company's products face competition from alternative energy sources.

The marketability of oil and gas acquired or discovered is affected by numerous factors beyond the Company's control.

Oil and gas prices are unstable and subject to fluctuation.

Investment in the Company should be considered speculative due to its involvement in oil and natural gas exploration in Central Asia.

The Company is dependent on the pipeline from the Kyzyloi Field.

Loss of capacity or delaying in truck or rail shipments would negatively impact on the Company's revenue.

The departure of any executive officer or key employee may negatively impact the Company.

The Company requires substantial capital expenditure to implement its strategy.

The Company is subject to the risks associated with international operations.

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates.

The oil and gas industry is subject to the risks posed by extensive and potentially costly government policies and regulations.

The Company is subject to legal systems and regulatory requirements of several jurisdictions with implications for the Company's shareholders.

There is no assurance that sufficient drilling and completion equipment, services and supplies will be available to the Company when needed.

Oil and gas exploration, development and production operations are subject to substantial risks and hazards, not all of which are insurable.

The level of activity in the Central Asia oil and gas industry is influenced by seasonal and unexpected weather patterns which may cause declines in production and exploration activity.

The Company is subject to the risks associated with environmental safety and health and sanitary regulations.

The Company is dependent on third party operators.

There can be no assurances that the Company will be able to respond to rapid technological advances in the oil and gas industry.

Delays in obtaining governmental approvals to commence or increase production could reduce the Company's revenues and income below those anticipated.

The Company's controls and procedures cannot always guarantee that timely decisions can be made regarding disclosure.

The Company (or its subsidiaries) is contractually required to relinquish certain exploration rights pursuant to several exploration and production contracts.

The increasing prices for oil, natural gas and other commodities may benefit the Company in the short term, however, there is no certainty as to this market condition's duration.

The Group's future production is dependent upon the ability to develop its existing reserve base and find or acquire additional reserves.

There is potential for social, political, economic, legal and fiscal instability in Kazakhstan, Tajikstan and Uzbekistan.

Kazakhstan's laws are developing and uncertain. Despite the Company's best efforts, it may not always comply with applicable laws.

Tax legislation in Kazakhstan is evolving and is subject to changing interpretations and inconsistent enforcement.

Bokhtar PSC is the first to be adopted under Tajikstan's new regulatory regime and could be challenged as the regulatory framework in Tajikstan develops.

The taxation system of Tajikstan is at an early development stage and the tax risks and problems with respect to its operations and investment in Tajikstan may be significant.

The Group is subject to the lack of infrastructure in Tajikstan.

Uzbekistan's laws are developing and uncertain. Despite the Company's best efforts, it may not always comply with applicable laws.

The terms of the North Urtabulak PEC may be challenged or additional taxes imposed.

The lack of infrastructure in Uzbekistan could lead to problems bringing in equipment, material and services.

The UK Companies Act 2006 does not apply to the Company and Cayman Islands law does not provide equivalent shareholder protections (including pre-emption rights).

The Company is subject to Canadian rules on takeovers.

The market price of the Ordinary Shares may be volatile and subject to wide fluctuations.

The Company has not paid and does not anticipate paying any dividends in the foreseeable future due to the Company's stage of development.

There can be no assurance that an active trading market will develop on the London Stock Exchange, or, if one does, that it will be maintained.

## 5. SELECTED FINANCIAL INFORMATION

The following selected financial information has been extracted without material adjustment from the historical financial information in Part 4 of this document. All figures in this paragraph 5 are stated in '000 US$.

### Consolidated Statement of Financial Position

| | Financial year ended 31 December | | | Three months ended 31 March | |
|---|---|---|---|---|---|
| | **IFRS 2008** | **IFRS 2009** | **IFRS 2010** | **IFRS 2010** | **IFRS 2011** |
| **Non-current assets** | | | | | |
| Property, plant and equipment | 65,422 | 73,171 | 115,653 | 75,356 | 122,250 |
| Intangible assets | 16.105 | 24,378 | 16,892 | 26,186 | 18,738 |
| Investments | 587 | 659 | 1,015 | 687 | 1,017 |
| Prepaids and other receivables | 6,357 | 5,171 | 12,320 | 6,491 | 14,937 |
| Loan receivable from jointly controlled entity | - | 21,727 | 35,460 | 23,897 | 38,179 |
| | 88,471 | 125,106 | 181,340 | 132,617 | 195,121 |
| **Current assets** | | | | | |
| Inventories | 213 | 2,368 | 2,121 | 2,439 | 2,452 |
| Trade and other receivables | 2,664 | 2,311 | 3,680 | 2,422 | 3,230 |
| Cash and cash equivalents | 22,200 | 7,927 | 79,135 | 48,927 | 57,400 |
| Derivative financial instruments – interest rate swap | - | - | 1,472 | - | 1,274 |
| | 25,077 | 11,976 | 86,408 | 53,788 | 64,356 |
| **Total assets** | 113,548 | 137,082 | 267,748 | 186,405 | 259,477 |
| **Equity attributable to shareholders** | | | | | |
| Share capital | 6,639 | 13,455 | 26,063 | 18,717 | 26,063 |
| Share premium | 138,598 | 153,748 | 297,222 | 206,258 | 297,222 |
| Other reserves | 25,147 | 27,775 | 34,261 | 28,968 | 35,555 |
| Accumulated deficit | (66,654) | (88,374) | (118,023) | (96,373) | (124,318) |
| **Total equity** | 103,730 | 106,604 | 239,523 | 157,570 | 234,522 |

| | | | | | |
|---|---|---|---|---|---|
| **Non-current liabilities** | | | | | |
| Deferred gain on sale of assets to jointly controlled entity | - | 3,659 | 3,699 | 3,698 | 3,699 |
| Financial liabilities – borrowings | 5,096 | 9,324 | 2,853 | 8,031 | 1,950 |
| Shares to be issued | - | 3,750 | | - | 0 |
| Deferred taxation | - | 598 | 4,070 | 692 | 3,956 |
| Trade and other payables | 523 | 808 | 721 | 838 | 679 |
| Asset retirement obligations | 465 | 206 | 192 | 160 | 208 |
| | 6,084 | 18,345 | 11,535 | 13,419 | 10,492 |
| **Current liabilities** | | | | | |
| Financial liabilities – borrowings | 853 | 1,086 | 5,047 | 3,789 | 6,005 |
| Derivative financial instruments – warrants | 146 | 1,053 | 405 | 3,405 | 214 |
| Derivative financial instruments – interest rate swap | - | 95 | | 292 | - |
| Deferred revenue | - | 3,113 | 2,450 | 2,204 | 27 |
| Trade and other payables | 2,735 | 6,786 | 8,788 | 5,726 | 8,217 |
| | 3,734 | 12,133 | 16,690 | 15,416 | 14,463 |
| **Total liabilities** | 9,818 | 30,478 | 28,225 | 28,835 | 24,955 |
| **Total shareholders' equity and liabilities** | 113,548 | 137,082 | 267,748 | 186,405 | 259,477 |

## Consolidated Statement of Comprehensive Loss

| | **Financial year ended 31 December** | | | **Three months ended 31 March** | |
|---|---|---|---|---|---|
| | **IFRS 2008** | **IFRS 2009** | **IFRS 2010** | **IFRS 2010** | **IFRS 2011** |
| Sales and other operating revenues | 5,360 | 8,559 | 14,706 | 2,116 | 4,480 |
| Final income | 832 | 76 | 61 | 3 | 32 |
| Total revenue and other income | 6,192 | 8,635 | 14,767 | 2,119 | 4,512 |
| Production expenditures | (1,334) | (3,405) | (7,076) | (974) | (1,752) |
| Depreciation, depletion and amortisation | (4,333) | (3,238) | (5,885) | (692) | (2,612) |
| Exploration and evaluation expenditure written off | (2,292) | (887) | - | - | - |
| Listing expenses | - | (1,652) | (1,228) | (626) | (6) |
| Administrative expenses | (17,915) | (16,880) | (25,511) | (4,775) | (6,484) |
| Foreign exchange gains (net) | (3,060) | (2,397) | (337) | 14 | 200 |
| Fair value loss on derivative financial instrument | 929 | (479) | (24) | (2,501) | (8) |
| Loss from jointly controlled entity | - | (1,000) | (634) | (150) | (209) |
| Finance costs | (371) | (203) | (190) | (321) | (39) |
| **Loss before taxation** | (22,184) | (21,506) | (26,178) | (7,906) | (6,398) |
| Taxation | - | (214) | (3,471) | (93) | 103 |
| **Net loss and comprehensive loss for the period attributable to shareholders** | (22,184) | (21,720) | (29,649) | (7,999) | (6,295) |
| **Loss per share attributable to shareholders** | | | | | |
| Basic and diluted | (0.40) | (0.20) | (0.15) | (0.05) | (0.02) |

## Consolidated Statement of Cash Flows

| | **Financial year ended 31 December** | | | **Three months ended 31 March** | |
|---|---|---|---|---|---|
| | **IFRS 2008** | **IFRS 2009** | **IFRS 2010** | **IFRS 2010** | **IFRS 2011** |
| **Cash flow from operating activities** | | | | | |
| Loss before taxation for the period | (22,184) | (21,506) | (26,178) | (7,906) | (6,398) |
| Adjustments for | | | | | |
| Share based payments | 4,419 | 2,628 | 5,956 | 1,193 | 1,193 |
| Net finance cost (income) | (461) | 127 | 112 | 309 | 7 |
| Unsuccessful exploration and evaluation exp | 2,292 | 887 | - | - | - |
| Depreciation, depletion and amortisation | 4,333 | 3,238 | 5,885 | 692 | 2,612 |
| Payment of Royalties | - | - | (78) | - | - |
| Fair value loss on derivative financial instrument | (929) | 479 | 24 | 2,501 | 8 |
| Listing expenses | - | - | 351 | 351 | - |
| Net unrealised foreign exchange loss | 1,277 | 1,120 | (75) | 33 | 43 |
| Loss from jointly controlled entity | - | 1,000 | 634 | 150 | 209 |
| Deferred revenue | - | 3,113 | (663) | (909) | (2,422) |
| Net change in non-cash capital | (844) | (1,160) | (2,792) | (1,786) | (322) |
| **Net cash used in operating activities** | (12,097) | (10.074) | (16,824) | (5,372) | (5,070) |
| **Cash flow from investing activities** | | | | | |
| Interest received | 832 | 76 | 61 | 3 | 32 |
| Expenditure on exploration and evaluation assets | (6,519) | (22,648) | (31,688) | (1,770) | (1,866) |
| Expenditure on property, plant and equipment | (36,288) | (9,573) | (6,605) | (2,673) | (8,986) |
| Investment in restricted cash | (269) | (72) | (356) | (28) | (2) |
| Payments made on behalf of jointly controlled entity | - | - | (14,070) | (2,280) | (2,878) |
| Acquisition of subsidiary, net of cash received | - | 532 | - | - | - |
| Sale of subsidiaries, net of cash disposed | - | (112) | - | - | - |

| | Financial year ended 31 December | | | Three months ended 31 March | |
|---|---|---|---|---|---|
| | IFRS 2008 | IFRS 2009 | IFRS 2010 | IFRS 2010 | IFRS 2011 |
| **Cash flow from operating activities** | | | | | |
| Movement in advances to construction contractors | 1,548 | 829 | (3,298) | (1,027) | (1,827) |
| Value added tax receivable | (2,091) | (670) | (4,148) | (451) | (905) |
| Net change in non-cash working capital | (217) | 1,273 | 3,461 | (10) | (52) |
| **Net cash used in investing activities** | (43,004) | (30,365) | (56,643) | (8,236) | (16,484) |
| **Cash flow from financing activities** | | | | | |
| Proceeds from issuance of short-term borrowings | - | 2,500 | - | - | - |
| Repayment of short-term borrowings | - | (2,500) | - | - | (86) |
| Proceeds from issuance of long-term borrowings | 7,430 | 5,020 | 1,840 | 1,840 | - |
| Repayment of long-term borrowings | (579) | (856) | (4,974) | (347) | - |
| Interest paid on long-term borrowings and other non-current payables | (380) | (152) | (1,036) | (193) | (100) |
| Other non-current liabilities | (253) | (109) | (296) | (70) | (76) |
| Proceeds related to shares to be issued | - | 3,750 | - | - | - |
| Proceeds from issuance of equity, net of issue costs | 45,754 | 17,906 | 149,770 | 54,022 | - |
| **Net cash generated from financing activities** | 51,972 | 25,559 | 145,304 | 55,252 | (262) |
| Effects of exchange rate changes on cash and cash equivalents | (1,363) | (23) | 1 | (14) | 81 |
| **Net increase/(decrease) in cash and cash equivalents** | (4,492) | (14,903) | 71,838 | 41,630 | (21,735) |
| Cash and cash equivalents at begging of the period | 26,692 | 22,200 | 7,297 | 7,297 | 79,135 |
| **Cash and cash equivalents at end of the period** | 22,200 | 7,297 | 79,135 | 48,927 | 57,400 |

## Consolidated Statement of Changes in Equity

| | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|
| | Share capital $ | Share premium $ | Accumulated deficit $ | Options reserves $ | Warrants reserves $ | Total equity $ |
| **At January 1, 2008** | 4,511 | 94,972 | (44,470) | 4,173 | 16,555 | 75,741 |
| Comprehensive loss for the year | - | - | (22,184) | - | - | (22,184) |
| **Transaction with shareholders** | | | | | | |
| Issue of share capital | 2,128 | 47,872 | - | - | - | 50,000 |
| Cost of share issue | | (4,246) | - | - | - | (4,246) |
| Share-based payments | | | - | 4,419 | | 4,419 |
| **Total transactions with shareholders** | 2,128 | 43,626 | - | 4,419 | - | 50,173 |
| **Balance at January 1, 2009** | **6,639** | **138,598** | **(66,654)** | **8,592** | **16,555** | **103,730** |
| Comprehensive loss for the year | - | - | (21,720) | - | - | (21,720) |
| **Transaction with shareholders** | | | | | | |
| Issue of share capital | 6,816 | 17,245 | - | - | - | 24,061 |
| Cost of share issue | - | (2,095) | - | - | - | (2,095) |
| Share-based payments | - | - | - | 2,628 | - | 2,628 |
| | 6,816 | 15,150 | - | 2,628 | - | 24,594 |
| **Balance at January 1, 2010** | **13,455** | **153,748** | **(88,374)** | **11,220** | **16,555** | **106,604** |
| Comprehensive loss for the period | - | - | (29,649) | - | - | (29,649) |
| **Transactions with shareholders** | | | | | | |
| Issue of share capital | 12,322 | 147,780 | - | - | - | 160,102 |
| Cost of share issue | - | (8,274) | - | - | - | (8,274) |
| Share-based payments | - | - | - | 6,585 | - | 6,585 |
| Exercise of warrants | 250 | 3,681 | - | - | | 3,931 |
| Exercise of options | 36 | 287 | - | (99) | - | 224 |
| **Total transactions with shareholders** | 12,608 | 143,474 | - | 6,486 | - | 162,568 |
| **Balance at December 31, 2010** | **26,063** | **297,222** | **(118,023)** | **17,706** | **16,555** | **239,522** |
| Comprehensive loss for the period | - | - | (6,295) | - | - | (6,295) |
| | - | - | - | - | - | - |
| **Transactions with shareholders** | - | - | - | - | - | - |
| Issue of share capital | - | - | - | - | - | - |
| Cost of share issue | - | - | - | - | - | - |
| Share-based payments | - | - | - | 1,294 | - | 1,294 |
| Exercise of warrants | - | - | - | - | - | - |
| Exercise of options | - | - | - | - | - | - |
| **Total transactions with shareholders** | - | - | - | 1,294 | - | 1,294 |
| **Balance at March 31, 2011** | **26,063** | **297,222** | **(124,318)** | **19,000** | **16,555** | **234,522** |

## 6. CURRENT TRADING AND PROSPECTS

From 31 March 2011 to 18 July 2011 (being the last practicable date prior to the publication of this document) the Group has continued to trade in line with the Director's expectations.

## 7. REASONS FOR LISTING

The Directors believe that the Company will be better placed to improve liquidity in its shares when they are admitted to the Official List and to trading on the main market of the London Stock Exchange.

## 8. DIVIDEND POLICY

The Company has not paid and does not anticipate paying any dividends in the foreseeable future due to the stage of development of the Company.

# RISK FACTORS

Any investment in the Ordinary Shares is subject to a number of risks. Before making any investment decision, prospective investors should carefully consider all the information contained in this document, including in particular, the risk factors described below. Some of the following factors relate principally to the Group's business and the sector in which it operates. Other factors relate principally to an investment in the Ordinary Shares. The risks and uncertainties described below are not intended to be exhaustive and are not the only ones facing the Group. Additional risks and uncertainties not currently known to the Company, or that the Company currently deems immaterial, may also have an adverse effect on the Group's business, financial condition and results of operations.

## RISKS RELATING TO THE GROUP

### Property Interests and Governmental Approvals

The Company's subsidiaries obtain their exploration and/or production rights in Kazakhstan, Uzbekistan and Tajikistan through entering into various contracts with governmental agencies in such countries (the "**Company Contracts**"). Ownership of the land covered by the Company Contracts usually remains with the relevant state and/or state-owned companies, with the Company only obtaining land use rights as necessary for their operations. The Company's subsidiaries are required to obtain other specific operational licences, permits and authorisations in order to carry out their exploration and/or production activities. While the Company believes that it currently holds and is materially in compliance with the Company Contracts and the licences, permits and authorisations necessary for it to carry out its exploration and production activities under the Company Contracts, if the Company were to fail to comply with the conditions of any of these Company Contracts, licences, permits or authorisations in the future, there is a risk that such Company Contract, licence, permit or authorisation may be suspended or terminated. The Company Contracts and the associated licences, permits and authorisations are also typically subject to periodic renewal and extensions. There can be no guarantee that such periodic renewals and extensions will be granted to the Company in the future, and if such periodic renewals and extensions are granted, that they will be granted on a timely basis and on terms satisfactory to the Company. Furthermore, there can be no guarantee that the Company will be granted the necessary operational licences, permits and authorisations in connection with any future proposed production and/or exploration activities.

Regulatory authorities in Kazakhstan, Uzbekistan and/or Tajikistan exercise considerable discretion in the interpretation of local law and regulations. At times, authorities may use their discretion to enforce rights in a manner that is inconsistent with the Company's interpretation of the relevant legislation, particularly with respect to licensing issuance and renewal. Requirements imposed by regulatory authorities may be costly and time-consuming and may result in delays in the commencement or continuations of operations. The licensing process may also be influenced by outside commentary and political pressure. A competing applicant for certain land use rights or a particular licence may bring a direct claim against the relevant authority if the applicant believes that the contract or licence was issued in violation of applicable law or regulation. If successful, such proceedings and claims may result in the revocation or invalidation of the contract or licence, the refusal to renew a contract or licence or the issuance or renewal of a contact or licence in an untimely fashion or with conditions that impair the Group's ability to conduct its operations profitably.

The Company's business depends on the continuing validity of the Company Contracts and certain permits, licences and authorisations, the renewal of the Company Contracts and certain permits, licences and authorisations and the Company's compliance with the terms of the Company Contracts and certain permits, licences and authorisations. If any of the Company Contracts or certain permits, licences or authorisations are deemed invalid or are not renewed on terms satisfactory to the Company, or if the Company is unable to comply with the conditions attached to the Company Contracts or certain permits, licences or authorisations, this could have a material adverse effect on the Company's business, results of operations, operations and/or prospects.

**Risks Associated with the Kazakh Subsurface Law**

The Kazakh Contracts are subject to the Subsurface Law, among other laws. Pursuant to the Subsurface Law, the objects associated with subsoil use rights include, in addition to contracts with Kazakh governmental agencies, the following:

- participatory interests or shares in a legal entity holding the subsoil use right, as well as a legal entity which may directly and/or indirectly determine and/or influence decisions adopted by a subsoil user if the principal activity of such subsoil user is related to subsoil use in Kazakhstan; and

- securities confirming title to shares or securities convertible to shares of a subsoil user as well as a legal entity who may directly and/or indirectly determine the decisions and/or influence the decisions adopted by such a subsoil user if such a legal entity's main activities are associated with subsoil use in Kazakhstan

(the "**User Rights**").

The Subsurface Law provides the Kazakh State with a statutory pre-emption right (the **"Subsurface Pre-emption Right"**), exercisable in the event of transfer of an interest in a legal entity that has subsoil use rights and/or User Rights if such legal entity's main activity is related to subsoil use in Kazakhstan.

In addition, under the Subsurface Law, any transfer or alienation of subsoil use rights and/or User Rights to any third party, in whole or in part, may only be made with the prior consent (**"Subsurface Consent"**) of the competent authority in Kazakhstan (the **"Competent Authority"**), if the main activity of that legal entity is related to subsoil use in Kazakhstan. Under the Subsurface Law, transactions requiring Subsurface Consent include:

- the issuance of shares for circulation on an organized market by an entity whose main activity is related to subsoil use in Kazakhstan;

- foreclosure of subsoil use rights and User Rights;

- transfer of subsoil use rights and User Rights to the third parties' charter capital;

- transfer of subsoil use rights and User Rights in the course of bankruptcy proceedings;

- obtaining a right to a participatory interest in a subsoil user or its parent company if such right arises as a result of charter capital increase or by accession of a new participant to such legal entity;

- the initial public offering on an organized market of a subsoil user or its parent companies' securities;

- a pledge of participatory interests (shares) in a subsoil user;

- the transfer of subsoil use rights or User Rights due to the reorganization of a subsoil user or its parent companies.

The Subsurface Law also provides for certain exemptions from the provisions applicable to the transfer or alienation of subsoil rights and User Rights in the following instances:

- public market transactions that take place on a recognized securities exchange and are in respect of securities already listed and in circulation, notwithstanding the fact that these transactions would otherwise be subject to the pre-emptive right of the Kazakh State;
- the transfer, in full or in part, of subsoil use rights or objects associated with subsoil use rights to a subsidiary of a subsoil user in which not less than 99 per cent. of the equity of such subsidiary is owned directly or indirectly by the subsoil user, provided that such subsidiary is not registered in a country with a preferential tax regime;
- the transfer, in full or in part, of subsoil use rights or objects associated with subsoil use rights between legal entities in which not less than 99 per cent. of the equity of both parties is owned directly or indirectly by the same entity, provided that the acquiring entity is not registered in a country with a preferential tax regime;
- transactions involving the purchase or sale of securities that would otherwise be subject to the pre-emptive right, but which would result in the transfer of less than 0.1 per cent. of the equity of the acquirer.

The Subsurface Law does not have a definition of main activity related to subsurface use in Kazakhstan. In April 2009, MEMR took a preliminary, non-binding view that the Company's main activity was subsoil use rights in Kazakhstan. The Company sent its objection to this view in May 2009, providing additional information about the Company's assets in Uzbekistan and Tajikistan, as well as its drilling and production business unit, as an explanation as to why its main activity should not be considered to be subsoil use rights in Kazakhstan, but MEMR never responded. The current Competent Authority, MOG, has not taken a formal position on this issue and has not indicated to the Company a time within which it will come to a formal view, if at all. Having consulted its local legal counsel in Kazakhstan, the Company's position is strongly that its main activity is not subsoil use rights in Kazakhstan. However, there can be no certainty that the Competent Authority will not take a contrary view.

Should the Competent Authority decide that the Company's main activity is subsoil use rights in Kazakhstan, then the Kazakh State would have the Subsurface Pre-emption Right and the Company would be required to obtain the Subsurface Consent in respect of certain transactions. In such circumstances, the Company would seek to obtain Subsurface Consent whenever necessary, however there can be no guarantee that such consent would be forthcoming. Were the Company not to obtain Subsurface Consent and/or in the event the Company does not comply with these provisions of the Subsurface Law, the Competent Authority may have the right to terminate the one or more of the Kazakh Contracts. If one or more of the Kazakh Contracts were terminated by the Competent Authority, the Company would lose its subsurface use rights in the Kazakh Contract(s) in question and any revenue generated from the particular contract(s), which could have an adverse effect on the Company's business, financial conditions, results of operations and prospects. In addition, the Subsurface Law provides that any transaction involving the transfer of subsoil use interests which are subject to the Subsurface Law without Subsurface Consent is invalid.

Although the Company is strongly of the view that its main activity is not subsoil use in Kazakhstan, if the Competent Authority were to take a contrary view, the Company would be subject to the Subsurface Pre-emption Right and the requirements to obtain Subsurface Consent in connection with various transactions. Whilst the Company would seek to obtain Subsurface Consent and comply with the relevant provisions of the Subsurface Law, were it unable to obtain such consent and/or were it to breach any provision of the Subsurface Law in respect of one or more of the Kazakh Contracts, this could have an adverse effect on the Company's business, financial conditions, results of operations and prospects.

The Company is also not aware of any instances to date when the Kazakh State has not waived its Subsurface Pre-emption Right to purchase, nor is it aware of any instances when the Kazakh State has terminated a subsoil use contract when a transfer occurred without Subsurface Consent. The Company has also received several extensions to its Kazakh Contracts, including extensions effective since the adoption of the Subsurface Law.

**Kazakhstan Local Content Rules**

On 20 September 2010, the New Local Content Rules were adopted. Under the Subsurface Law, all subsoil users must give preference to local companies when procuring goods, works and services for subsoil use operations. The New Local Content Rules provide formulae for local content calculation in supply and service contracts as well as customer purchases.

In January 2011, the Company, as well as many other subsoil users, were notified by the MOG that they were in violation of certain provisions of the New Local Content Rules.

The New Local Content Rules, which provide stringent rules and regulations governing supply and service contracts as well as customer purchases, are extremely difficult to comply with at this time given the shortage of available local services in several parts of Kazakhstan. It is generally understood that the vast majority of Kazakh subsoil users are in technical violation of the New Local Content Rules. The Company believes that it was in compliance with the New Local Content Rules for Q1 2011 and continues to take all necessary steps to remain compliant. Any breach of the New Local Content Rules by the Company could lead to termination of a subsoil use contract pursuant to the procedures set out in Kazakh legislation, which could have a material adverse effect on the business, operations and prospects of the Company and in particular its operations in Kazakhstan.

**Competition**

The oil and gas industry is intensely competitive. Competition is particularly intense in the acquisition of prospective oil properties and oil and gas reserves. The Company's competitive position depends on its geological, geophysical and engineering expertise, its financial resources, its ability to develop its properties and its ability to select, acquire and develop proved reserves. The Company competes with a substantial number of other companies which have a larger technical staff and greater financial and operational resources. Many such companies not only engage in the acquisition, exploration, development and production of oil and gas reserves, but also carry on refining operations and market refined products. The Company also competes with major and independent oil and gas companies and other industries supplying energy and fuel in the marketing and sale of oil and gas to transporters, distributors and end users, including industrial, commercial and individual consumers. The Company also competes with other oil and gas companies in attempting to secure drilling rigs and other equipment necessary for drilling and completion of wells and to construct production and transmission facilities. Such equipment may be in short supply from time to time. Finally, companies not previously investing in oil and gas may choose to acquire reserves to establish a firm supply or simply as an investment. Such companies will also provide competition for the Company. Such competition in the oil and gas industry could have a material adverse effect on the Company's financial condition, results of operations or prospects.

**Substitute Energy Sources**

As with any other product, the Company's production of oil and gas is subject to substitution. Alternative energy sources such as renewable electricity (for example, wind power or hydroelectric power), nuclear power, liquefied natural gas, biofuel or biomass and other alternative forms of energy for usage in transport, heating and power generation all represent competing sources of energy to the Company's products. If the prices of these forms of energy fall and/or the prices of the Company's products rise dramatically, then the Company's products will face substitution as economic agents look for cheaper forms of energy. The Company currently produces low-cost forms of energy (i.e. onshore oil and gas). There is no guarantee that the Company's products will remain competitive in the future marketplace due to changes in technology, governmental regulations, economic and taxation or other as yet unforeseen scenarios. Further, the continuous call from the international community for a reduction in the use of fossil fuels may have an impact upon oil and gas companies of all sizes operating world-wide in being required to reduce production or output or lacking market for their product. The demand for alternative sources of energy, particularly renewables, could affect the Company's production of oil or gas or sale of its products, which may in turn materially adversely affect the business, financial condition, results of operation and prospects of the Company.

## Marketability of Production

The marketability and ultimate commerciality of oil and gas acquired or discovered is affected by numerous factors beyond the control of the Company. These factors include reservoir characteristics, market fluctuations, the proximity and capacity of oil and gas pipelines and processing equipment and government regulation. The Company currently produces gas into the transcontinental gas trunkline system which ultimately supplies gas to Russia and Europe. Political issues, system capacity constraints, export issues and possible competition with Russian gas supplies may in the future cause problems with marketing production, particularly for export. Oil and gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. Restrictions on the ability to market the Company's production could have a material adverse effect on the Company's revenues and financial position.

## Commodity Price Fluctuations

Oil and gas prices are unstable and are subject to fluctuation. Any material decline in oil and/or natural gas prices could result in a reduction of the Company's net production revenue and overall value and could result in ceiling test write downs. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in the volumes and value of the Company's reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities. As such, fluctuations in oil and gas prices could materially and adversely affect the Company's business, financial condition, results of operation and prospects. There is no government control over the oil and gas price in the countries where the Company operates.

Although the Company believes that the medium to long term outlook for oil and gas prices in the region is good, the recent events in Africa and the Middle East demonstrate the volatility and uncertainties of the oil and gas industry. Also, there needs to be consideration of production and other factors such as OPEC, refinery shut-ins and inventory. Any discussion of price or demand is subjective and as such there are many differing opinions on the cause of recent price changes.

Production from both the Kyzyloi and Akkulka contracts in Kazakhstan are sold at fixed prices, at least until the end of 2012, and so the fluctuation in world commodity prices should have no effect on the Company's revenue from the Kazakh gas operations. In Uzbekistan, the Company sells refined petroleum products on a monthly basis and are consequently also subject to movements in the oil price. The price of oil sales from the Doris discovery commencing in the latter part of 2011 has yet to be agreed and therefore would be sensitive to movements in the market price.

## Nature of the Oil and Gas Business

An investment in the Company should be considered speculative due to the nature of the Company's involvement in the exploration for, and the acquisition, development and production of, oil and natural gas in Central Asia. The volume of production from oil and natural gas properties generally declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. The Company's proved reserves will decline as reserves are produced from its properties unless it is able to acquire or develop new reserves. The business of exploring for, developing or acquiring reserves is capital intensive. To the extent cash flow from operations is reduced and external sources of capital become limited or unavailable, the Company's ability to make the necessary capital investment to maintain or expand the Company's asset base of oil and natural gas reserves will be impaired. In addition, there can be no assurance that even if the Company is able to raise capital to develop or acquire additional properties to replenish the Company's reserves, the Company's future exploration, development and acquisition activities will result in additional proved reserves or that the Company will be able to drill productive wells at acceptable costs.

The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or cancelled as a result of a variety of factors, including unexpected drilling conditions, pressure or irregularities in formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

**Dependence on Gas Pipelines**

The Company is dependent on a pipeline, constructed by the Company in 2007, from the Kyzyloi Field to a booster compression station constructed at km910 on the Bukhara-Urals gas trunkline as this pipeline carries the gas produced from both the Kyzyloi and Akkulka contracts. The Company is then also dependent upon the onward Bukhara-Urals trunkline because if anything adverse should happen to either of these pipelines then the gas sales revenue would be suspended or cease. The Company considers revenue from gas production through these pipelines of approximately US$550k per month during the first half of 2011 (representing approximately 35 per cent. of the Company's revenue depending on production) to be material to the Company's current level of operations and therefore prolonged interruption to the pipelines could have a material adverse effect on the Company's results in the current year. Going forward, the Directors believe that as the revenues increase from other sources, notably oil production from Doris, then the impact of any such interruption should become less material to the Company.

Any problems with the Company's own pipeline would be treated urgently with a view to minimizing any interruption. Bukhara-Urals trunkline is owned by Intergas Central Asia, currently a Kazakh State company, and no problems are currently envisaged with respect to exporting the Company's gas through this system, it may be that in the future the trunkline owners refuse to take the Company's gas, impose excessively high transportation charges, or that the trunkline capacity may be reached. The trunkline carries gas from Central Asia through Kazakhstan and into the Russian export system and consequently as any problems would have adverse implications for the economies of Uzbekistan and Kazakhstan in particular and to a lesser extent the Russian economy, it is anticipated that there would be significant efforts to minimize any break in supply. However external factors may effect this. For example between December 2008 to January 2009 a dispute between GazProm and Ukraine resulted in a temporary closure of the Russian gas export system to Europe which, although not directly affecting the Company, did have a significant knock-on effect of the whole export system, including gas flowing through the Central Asian gas trunkline network. Problems with closure of the pipeline and reduced production levels were encountered in both 2009 and 2010. Although the Kazakh-China gas pipeline is planned, which may allow for an alternative export route for the Company's gas, there is no guarantee that this pipeline will ultimately be completed, or that Tethys will be able to access this line.

**Dependence on Refinery and Transportation Facilities**

On 17 February 2011 the Company signed a 50/50 joint venture agreement with Eurasia Gas Group LLP to construct and operate a rail oil loading terminal. Pending the construction of such terminal, oil is shipped by truck. Any loss of capacity or delay in truck or rail shipments may negatively affect the Company's oil sales revenue from the Pilot Production Project which could have a material adverse effect on the Companies business, financial condition and results of operation.

**Management Services Provided by Vazon and Dependence on Key Personnel**

The services of the Company's Chairman, President and Chief Executive Officer, Chief Financial Officer, Chief Administrative Officer and Corporate Secretary, Chief Operating Officer, Vice President Commercial and Head of Kazakhstan Business Unit, and Vice President Finance are provided under the terms of two management services agreements with a corporate entity, Vazon. As a result, these executive officers of the Company, although officers of the Company, are not employed directly by the Company but rather by Vazon. Vazon is a corporation wholly-owned by Dr. David Robson, the Company's Chairman, President and Chief Executive Officer. Either management services agreement may be terminated on up to six months' notice by Vazon or the Company. Should Vazon (acting through Dr. Robson) determine to terminate either or both management services agreements, the Company would be required to enter into an employment or other relationship directly with these executive officers or, failing which, would be required to retain the services of alternate executive officers. There is no certainty that the Company would be able to attract and retain suitable candidates should either of the management services agreements be terminated and the executive officers choose not to be employed or retained by the Company. Any such termination may materially and adversely affect the Company. Moreover, the Company is dependent on its fourteen executive officers to manage its affairs and operations and upon other key employees. The departure of any one executive officer or key employee may negatively impact on certain of the Company's operations until a suitable replacement candidate is appointed. The Company faces significant competition for skilled personnel, in particular to certain areas where the oil and gas industry is less developed. The Company's inability to retain and recruit sufficient skilled personnel may cause delays in completing certain exploration and production projects on time or within the budgeted costs. There is no assurance that the Company will successfully attract and retain personnel required to continue to expand its business strategy.

The Company does not carry key man insurance on any of its executives as at the date hereof. The role of Dr. Robson is clearly instrumental and critical to the Group and its continual growth and success. The loss of Dr. Robson would likely have a significant impact upon the Group until a suitable replacement could be found. The expertise and knowledge of Dr. Robson is an extremely valuable asset to the Group and not one that is easily found in a potential successor or replacement. In the event that the Company is unable to attract, retain and train key personnel, the Group's business, operations and prospects could be materially and adversely affected.

**Financial Resources**

The oil and gas business is capital intensive and the exploration and production of oil and gas over the longer term may be dependent upon the Company's ability to obtain financing through the raising of additional equity or debt financing or other means.

The Group's net cash reserves are sufficient to fund current and anticipated capital expenditure requirements until the beginning of 2013. The Company has committed capital expenditure of approximately US$23.8 million during the next 18 months consisting primarily of work on the Doris production facilities, its current drilling operations in Kazakhstan and Tajikistan plus ongoing workovers in Uzbekistan. During this period, the Company anticipates additional capital expenditure of approximately US$14.3 million consisting primarily of Aeromagnetic and Gravit survey plus further work on the Komsomolske wells in Tajikistan, a further appraisal well on Doris, radial drilling, completion of the rail terminal and additional production related equipment. Beyond this period, the Company will continue to have committed capital expenditure. Given the Company's nature as an exploration company, a substantial proportion of its future capital expenditure on various projects is discretionary and will be subject to the results of the Company's ongoing exploration and production activities.

The Company's implementation of projects requiring such capital expenditure involves risks associated with such projects such as cost over-runs, delays in implementation, technical and economic viability risks and changes in market conditions. Accordingly, the Company in the longer term may elect to raise funds through the issuance of equity securities or the issuance of debt securities or other securities convertible into Ordinary Shares. Any such additional equity financing may be dilutive to Shareholders, and debt financing if available, may involve restrictions on financing and operating activities. Whilst the Company has been successful in raising equity and debt funding in the past, there can be no assurance that additional funding required by the Company will be made available to it in the future, and, if such funding is available, that it will be offered to it on acceptable terms. If the Company is unable to obtain additional financing as needed, it may be required to reduce the scope of its exploration and production activities, operations or anticipated expansion, which may have a material adverse effect on the Company's business, revenues, financial condition, results of operations or prospects or the trading price of the Ordinary Shares. The Company cannot predict the size of future issuances of equity securities or the issuance of debt instruments or other securities convertible into Ordinary Shares or the effect, if any, that future issuances and sales of the Company's securities will have on the market price of the Ordinary Shares.

**International Operations**

International operations are subject to political, economic and other uncertainties, including but not limited to, risk of terrorist activities, revolution, border disputes, expropriation, renegotiations or modification of existing contracts, import, export and transportation regulations and tariffs, taxation policies, including royalty and tax increases and retroactive tax claims, exchange controls, limits on allowable levels of production, currency fluctuations, labour disputes and other uncertainties arising out of foreign government sovereignty over the Group's international operations. The Group is subject to risks related to its operations in or interests relating to Kazakhstan, Tajikistan and Uzbekistan, including those related to the exploration, development, production, marketing, transportation of natural gas, taxation and environmental and safety matters. The Group's operations may also be adversely affected by applicable laws and policies of Kazakhstan, Tajikistan, Uzbekistan or other countries in which it operates in the future, the effect of which could have a negative impact on the Company.

In particular, Uzbekistan and Tajikistan border Afghanistan. Afghanistan is currently in a situation of instability. Such stability and security issues may have an adverse effect on the ability of the Group to gain access to equipment and personnel. In addition, any particular domestic or international incidents in the region may have an adverse effect on the sentiment of the market towards energy companies that operate in Central Asia, as well as an adverse effect on the willingness of lenders and new investors to provide financing to the Group. Currently, the Group is not subject to any foreign investment restrictions is Kazakhstan, Tajikistan and Uzbekistan.

The government of the Russian Federation and Russian oil and gas companies may exert a significant degree of influence in the region. Russian regulations and policies may have a significant impact on the market prices of natural gas in the Company's current markets. Actions taken by Russian authorities and companies may also have an impact on the Company's ability to provide its products to market although this is mitigated by the Group's oil product exports to other markets and the planned natural gas pipelines from Central Asia to the People's Republic of China. Actions taken by the Russian government and competitors in Russia may be unpredictable and would be out of the Group's control. There is no guarantee that actions taken by Russian and other foreign entities will not have a material adverse effect on the Company's prospects and the trading price of the Ordinary Shares.

**Foreign Currency and Fiscal Matters**

While the Company is exposed to risks resulting from fluctuations in foreign currency exchange rates it should be noted that all revenue contracts are either in US$ or linked directly to it and most capital purchases or contracts placed outside Central Asia are priced in US$. A material change in the value of any such foreign currency could result in an adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions are denominated in a currency other than the U.S. Dollar. A significant portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. There is limited availability in exchange rate derivatives to manage exchange rate risks with these currencies and so the Company looks to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan. The Company also incurs expenditure in Pounds Sterling on a regular basis and looks to manage this exchange rate at least in the short term by forward purchasing.

While the Company holds the majority of its cash and cash equivalents in U.S. Dollars it does hold other balances, mainly Pounds Sterling and Canadian Dollars, to meet the requirements to fund ongoing general and administrative and other spending requirements in these currencies.

There are laws restricting foreign exchange in Uzbekistan. However, they currently have limited impact on TPU as all sales are settled in accounts located outside of Uzbekistan. However, there can be no assurance that such arrangement will not be prohibited as the relevant laws and requirements may change in the future to prohibit the Company from freely exporting oil and settling sales through overseas accounts despite the fact that TPU's North Urtabulak PEC specifically states that products should be sold on the export market.

Currently, there are no significant restrictions on the repatriation of capital and distribution of earnings from Kazakhstan, Tajikistan or Uzbekistan to foreign entities. There can be no assurance, however, that restrictions on repatriation of capital or distributions of earnings from Kazakhstan, Tajikistan or Uzbekistan will not be imposed in the future. Moreover, there can be no assurance that the Tenge, Somoni or Soum will continue to be exchangeable into U.S. Dollars or that the Company will be able to exchange sufficient amounts of Tenge, Somoni or Soum into U.S. Dollars or Pounds Sterling to meet its foreign currency obligations.

**Political and Regulatory**

The oil and gas industry in general is subject to extensive government policies and regulations, which result in additional cost and risk for industry participants. Environmental concerns relating to the oil and gas industry's operating practices are expected to increasingly influence government regulation and consumption patterns which favour cleaner burning fuels such as natural gas. The Company is uncertain as to the amount of operating and capital expenses that will be required to comply with enhanced environmental regulation in the future. The Company is also subject to changing and extensive tax laws, the effects of which cannot be predicted. Among other things, the Company and TKL are subject to regulatory filings with respect to the repatriation of funds to its shareholders which must be complied with to avoid sanctions. Legal requirements are frequently changed and subject to interpretation, and the Company is unable to predict the ultimate cost of compliance with these requirements or their effect on its operations. Existing laws or regulations, as currently interpreted or reinterpreted in the future, or future laws or regulations may change in the future and materially adversely affect the Company's results of operations and financial condition.

The Company is conducting exploration and development activities in Kazakhstan, Tajikistan and Uzbekistan, and is dependent on receipt of government approvals or permits to develop its properties. Based on past performance, the Company believes that the governments of Kazakhstan, Tajikistan and Uzbekistan support the exploration and development of their oil and gas properties by foreign companies. Nevertheless, there is no assurance that future political conditions in Kazakhstan, Tajikistan and/or Uzbekistan will not result in their respective governments adopting different policies respecting foreign development and ownership of oil and gas, environmental protection and labour relations. This may affect the Company's ability to undertake exploration and development activities in respect of present and future properties, as well as its ability to raise funds to further such activities. Any delays in receiving government approvals or permits or no objection certificates may delay the Company's operations or may affect the status of the Company's contractual arrangements or its ability to meet its contractual obligations. Similar risks apply in other countries in which the Company may operate in the future.

**Legal Systems**

The Company is governed by the laws of the Cayman Islands and the Company's principal subsidiaries are incorporated under the laws of Guernsey, Jersey, Kazakhstan, Tajikistan, British Virgin Islands, Delaware, Cyprus, England and the Netherlands. The Company, through its subsidiaries, carries on operations in Kazakhstan and Tajikistan and, through the North Urtabulak PEC, in Uzbekistan. Accordingly, the Company is subject to the legal systems and regulatory requirements of a number of jurisdictions with a variety of requirements and implications for shareholders of the Company. Shareholders of the Company will not have rights identical to those available to shareholders of a corporation incorporated under the laws of England and Wales. Moreover, in certain circumstances, the Company may require a shareholder to divest itself of its Ordinary Shares if the ownership or holding of such Ordinary Shares would be in breach of laws or a legal requirement of any country or if such shareholder is not qualified to hold the Ordinary Shares and if such ownership or holding would in the reasonable opinion of the Board cause a pecuniary or tax disadvantage to the Company or any other shareholder.

Exploration and development activities may require protracted negotiations with host governments, national oil and gas companies and third parties. Foreign government regulations may favour or require the awarding of drilling contracts to local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. If a dispute arises with foreign operations, the Company may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons, especially foreign oil and gas ministries and national oil and gas companies, to the jurisdiction of England and Wales.

Kazakhstan, Tajikistan and Uzbekistan may have less developed legal systems than jurisdictions with more established economies, which may result in risks such as:

(i) effective legal redress in the courts of such jurisdictions, whether in respect of a breach of law or regulation or in an ownership dispute, being more difficult to obtain;

(ii) a higher degree of discretion on the part of governmental authorities;

(iii) the lack of judicial or administrative guidance on interpreting applicable rules and regulations;

(iv) inconsistencies or conflicts between and within various laws, regulations, decrees, orders and resolutions; or

(v) relative inexperience of the judiciary and courts in such matters. In certain jurisdictions the commitment of local business people, government officials and agencies and the judicial system to abide by legal requirements and negotiated agreements may be more uncertain, creating particular concerns with respect to licences and agreements for business. These may be susceptible to revision or cancellation and legal redress may be uncertain or delayed. There can be no assurance that joint ventures, licences, licence applications or other legal arrangements will not be adversely affected by the actions of government authorities or others and the effectiveness of and enforcement of such arrangements in these jurisdictions cannot be assured.

The Company is subject to risks related to its operations in Kazakhstan, Tajikistan and Uzbekistan, including those related to the development, production, marketing, transportation of natural gas, taxation and environmental and safety matters. The Company may be adversely affected by changes in governmental policies or social instability or other political or economic developments in Kazakhstan, Tajikistan and/or Uzbekistan that are outside the Company's control including among other things, expropriation, risks of war and terrorism, foreign exchange and repatriation restrictions, changing political conditions and monetary fluctuations and changing governmental policies including taxation policies.

**Availability of Equipment and Access Restrictions**

Oil and gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities. There can be no assurance that sufficient drilling and completion equipment, services and supplies will be available when needed. Shortages could delay the Company's proposed exploration, development, and sales activities and could have a material adverse effect on the Company's financial condition. If the demand for, and wage rates of, qualified rig crews rise in the drilling industry then the oil and gas industry may experience shortages of qualified personnel to operate drilling rigs. This could delay the Company's drilling operations and adversely affect the Company's financial condition and results of operations. To the extent that the Company is not the operator of its oil and gas properties, the Company will be dependent on such operators for the timing of activities related to such properties and will be largely unable to direct or control the activities of the operators.

**Operating Hazards and Limited Insurance Coverage**

Oil and gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts and oil spills, each of which could result in substantial damage to oil wells, production facilities, other property and the environment or in personal injury and/or death and/or interruption of operations. Due to the nature of its business, the Company has to handle highly inflammable, explosive and toxic materials and other dangerous articles. The Company has implemented safety precautions and measures for the safety operation and maintenance of its operational facilities; however, there can be no assurance that industry-related accidents will not occur during the operation of the Company. Significant operating hazards and in some cases natural disasters may cause partial interruptions to the Company's operations and environmental damage that could have an adverse impact on the financial condition of the Company. In accordance with industry practice, the Company is not fully insured against all of these risks, nor are all such risks insurable. Although the Company maintains liability insurance in an amount that it considers adequate and consistent with industry practice, the nature of these risks is such that liabilities could exceed policy limits, in which event the Company could incur significant costs that could have a material adverse effect upon its financial condition. Oil and gas production operations are also subject to all the risks typically associated with such operations, including premature decline of reservoirs and the invasion of water into producing formations.

**Seasonality and Weather Patterns**

The level of activity in the Central Asia oil and gas industry is influenced by seasonal and unexpected weather patterns which may lead to declines in production and exploration activity. Harsh winter conditions may impede access to remote locations and drilling activities and limit the Company's ability to perform maintenance on equipment. Also, certain oil and gas producing areas may be located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. Moreover, wet weather and spring thaw may make the ground unstable. Consequently, the movement of rigs and other heavy equipment may be restricted, thereby reducing activity levels. As an example, extreme weather conditions in the Kazakh production area during the construction phase of the pipelines and compressors did cause some delays and excess muddy conditions in spring may cause delays in construction and the transport of equipment. In addition, the Group is susceptible to the risks of unexpected weather changes that may cause delay in its oil and gas exploration and production activities.

**Environmental, Safety and Health and Sanitary**

The Company's operations are subject to environmental, safety and health and sanitary regulations in the jurisdictions in which it operates. Whilst the Company believes that it carries out its activities and operations in material compliance with these environmental, safety and health and sanitary regulations, there can be no guarantee that this is the case. In Kazakhstan, quarterly reports are required to be submitted by the Company to the Shalkar (Bozoi) Tax Committee. The Company is also required to prepare reports on any pollution of air, toxic waste and current expenses on environmental protection which have been made by the Company and which are submitted to the appropriate Kazakh authorities. Reports are submitted on a semi-annual basis for information purposes and no payments are applicable.

At present, the Company believes that it meets all applicable environmental standards and regulations, in all material respects, and has included appropriate amounts in its capital expenditure budget to continue to meet its current environmental obligations. However, the discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require the Company to incur significant costs to remedy such discharge. No assurance can be given that changes in environmental laws or their application to the Company's operations will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Company's financial condition, results of operations or prospects.

**Reliance on Third Party Operators**

Where the Company is not the operator of its properties (Uzbekistan), the Company will be dependent upon other operators, contractors or third parties' operations for the timing of activities and will be largely unable to control the activities of such operators. Where the timing and quality of services provided by these third party operators do not meet the expectation of the Company, this may have a material adverse effect on the business, operations, financial condition and prospects of the Company.

**Cost of New Technologies**

The oil and gas industry is characterized by rapid and significant technological advancements and introductions of new products and services utilising new technologies. Other oil and gas companies may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before the Company does. There can be no assurance that the Company will be able to respond to such competitive pressures and implement such technologies on a timely basis or at an acceptable cost. One or more of the technologies currently utilized by the Company or implemented in the future may become obsolete. In such case, the Company's business, financial condition and results of operations could be materially adversely affected. If the Company is unable to utilize the most advanced commercially available technology, the Company's business, financial condition, results of operations and prospects could be materially adversely affected.

**Production Delays**

There is a possibility of delays in obtaining the necessary governmental approvals to commence or increase production. Any such delays could reduce the Company's revenues and income below those anticipated in the Company's business plan. Unanticipated delays in drilling or production could materially and adversely affect the Group's business, financial condition, results of operation and prospects.

**Disclosure Controls and Procedures; Internal Controls Over Financial Reporting**

Disclosure controls and procedures have been designed by the Company's management to ensure that information required to be disclosed by the Company is accumulated, recorded, processed and reported to the Company's management as appropriate to allow timely decisions regarding disclosure. While the Company's management has concluded that the Company's disclosure controls and procedures are sufficiently effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is communicated to them as appropriate to allow timely decisions regarding required disclosure this cannot be guaranteed and changes may be required to ensure their effectiveness.

The Company's management designed and implemented a system of internal controls over financial reporting as of 31 December 2010 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with IFRS. While these controls will be updated during the course of 2011 and management believe that these controls are effective for a company of its size there can be no guarantee that errors will not occur and additionally as the Company grows there will be increases in the administrative burden and expense. Notwithstanding the above, the Directors believe that the Company's financial systems are sufficient to ensure compliance with the Disclosure Rules and Transparency Rules as an entity listed on the main market of the London Stock Exchange.

**Relinquishment of Exploration Rights**

The Company is contractually required to relinquish certain exploration rights pursuant to several of the exploration and production contracts to which the Company (or its subsidiaries) is a party. There are mandatory relinquishments under the Kul-Bas Exploration and Production Contract which requires the Company to relinquish contract areas annually, except for areas in which a discovery is made. As of 31 December 2010, 30 per cent. of the total contract area has been relinquished. The contract was amended in February 2011, and the Company has received an approval for the extension of the exploration period to 11 November 2013. This further relinquishment was agreed with the Kazakh State to be made by the end of exploration period on 11 November 2013.

In addition, there are also mandatory relinquishments under the Bokhtar PSC in Tajikistan after seven contract years. Save as aforesaid, the Group is not subject to relinquishment of exploration rights under any of its other contracts. A relinquishment of exploration rights may affect the Group's exploration prospects and its ability to expand production in the relevant contract areas.

## Current Market Conditions

The increasing prices for oil, natural gas and other commodities may benefit the Company in the short term, however there is no certainty as to how long this market condition will last. Along with other oil and gas issuers, the Company faces the potential that the demand and prices for oil and gas may fall, perhaps significantly, which may impact on future revenues received by the Company for its oil and natural gas. Adverse conditions in global commodities markets and credit markets may negatively affect the Company's ability to maintain and grow its reserves and fully exploit its properties for the benefit of the Shareholders.

## Potential Declines in Reserves

The Group intends to continue to explore for further reserves in its contract areas and seek to add new reserves to its reserve base. However, the Group cannot assure that its exploration programs will be successful. Except to the extent the Group completes successful exploration and development projects or acquires properties containing proved reserves, or both, the Group's reserves will decline as its natural gas and liquid hydrocarbons are produced and its reserves are depleted. The Group's future production is highly dependent upon the Group's ability to develop its existing reserve base and, in the longer term, finding or acquiring additional reserves. If the Group is unsuccessful in developing its current reserve base and if the Group fails to add new reserves through exploration or acquisitions, its total proved reserves will decline, which would adversely affect the Group's business, financial condition, prospects or the market price of the Ordinary Shares. In addition, the volume of production from oil and natural gas fields generally declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. This may cause unit production cost to increase. As production efficiency decreases, the Group's business and results of operations could be adversely affected.

# RISKS RELATED TO THE REPUBLICS OF KAZAKHSTAN, TAJIKISTAN AND UZBEKISTAN

## Political, Economic, Legal and Fiscal Instability

Kazakhstan, Tajikistan and Uzbekistan are former constituent republics of the Soviet Union. At the time of their respective independence in 1991, each became a member of the CIS. Because Kazakhstan, Tajikistan and Uzbekistan have a relatively short history of political stability as independent nations and have experienced significant change in adapting to a market oriented economy, there is significant potential for social, political, economic, legal and fiscal instability. These risks include, among other things:

- local currency devaluation;
- civil disturbances;
- exchange controls or availability of hard currency and other banking restrictions;
- changes in crude oil and natural gas export and transportation regulations;
- changes with respect to taxes, royalty rates, import and export tariffs, and withholding taxes on distributions to foreign investors;
- changes in legislation applicable to oil and gas exploration, development, acquisition and investment activities;
- restrictions, prohibitions or imposition of additional obligations on investors;
- nationalisation or expropriation of property; and
- interruption or blockage of oil or natural gas exports.

The occurrence of any of these factors could have a material adverse affect on the Company's business, financial condition and results of operations. In addition, adverse economic conditions in Kazakhstan, Tajikistan or Uzbekistan could have a material adverse affect on the Company's business, financial condition and results of operations.

Further, Kazakhstan, Tajikistan and Uzbekistan also depend on neighbouring states to access world markets for a number of their exports, including oil and gas. Kazakhstan, Tajikistan and Uzbekistan are thus dependent upon good relations with their neighbours to ensure their ability to export. Although one of the aims of economic integration within the CIS is to assure continued access to export routes, should access to those routes be materially impaired, this could adversely impact the economies of Kazakhstan, Tajikistan and Uzbekistan.

Since its independence from the former Soviet Union, Tajikistan suffered a destructive civil war which not only caused significant damage to the infrastructure and industry of the country, but also led to regional and ethnic rivalries. Although the situation has stabilized since 1997, there is still the potential for instability, particularly with respect to these regional rivalries, and the potential for the emergence of radical Islamist groups, although the Tajik Government is pursuing a policy of national unity. Tajikistan is the poorest country in Central Asia, and this poverty may lead to further civil unrest and potential disruption to the Company's business. Tajikistan's proximity to Afghanistan may lead to further instability dependent on the situation in that country. Certain areas of the country are still military exclusion zones, especially towards the Afghanistan border, and in some areas there may be uncleared landmines, a product of both the civil war and the troubles in Afghanistan.

While rich in natural resources, Uzbekistan is a developing country. Uzbekistan's political and economic climate, similar to other developing countries in Central Asia, may lead to potential disruptions to the Group's business. Although currently stable, Uzbekistan has seen civil disturbance in the past, most notably the disturbances in the eastern part of the country in 2005. However, the government enforces a strict policy of national unity and no significant disturbances have taken place since then.

Like other countries in Central Asia, Kazakhstan, Tajikistan and Uzbekistan could be affected by military action taken in the region, including in Afghanistan, and the effect such military action may have on the world economy and political stability of other countries. In particular, countries in Central Asia, such as Kazakhstan, Tajikistan and Uzbekistan, whose economies and state budgets rely in part on the export of oil, gas and other commodities, the import of capital equipment and significant foreign investments in infrastructure projects, could be adversely affected by any resulting volatility in oil, gas and other commodity prices and by any sustained fall in them or by the frustration or delay of any infrastructure projects caused by political or economic instability in countries engaged in such projects. In addition, instability in other countries, such as Russia, has affected in the past, and may materially affect in the future, economic conditions in Kazakhstan, Tajikistan and Uzbekistan.

The transition of Kazakhstan, Tajikistan and Uzbekistan to market oriented economies was marked in the earlier years by political uncertainty and tension, a recessionary economy marked by high inflation and instability of the local currency and rapid, but incomplete, changes in the legal environment. Although reforms designed to establish a free market economy have been adopted, there can be no assurance that such reforms will continue or that such reforms will achieve all or any of their intended aims.

**Legal and Regulatory Environment in Kazakhstan**

Kazakhstan's foreign investment, petroleum, subsoil use, licensing, corporate, tax, customs, currency, banking and antimonopoly laws and legislation are still developing and uncertain. From time to time, including the present, draft laws on these subjects are prepared by government ministries and some have been submitted to the Kazakh parliament for approval. Legislation in respect of some or all of these areas could be passed. Currently, the regulatory system contains many inconsistencies and contradictions. Many of the laws are structured to provide substantial administrative discretion in their application and enforcement. In addition, the laws are subject to changing and different interpretations. These factors mean that even the Company's best efforts to comply with applicable law may not always result in compliance. Non-compliance may have consequences disproportionate to the violation. The uncertainties, inconsistencies and contradictions in Kazakh laws and their interpretation and application could have a material adverse affect on the Company's business and results of operations.

The judicial system in Kazakhstan may not be fully independent of outside social, economic and political forces, and court decisions can be difficult to predict. In addition, senior Kazakh government officials may not be fully independent of outside economic forces owing to the underdeveloped regulatory supervision system enabling improper payments to be made without detection. Both

Kazakhstan and TAG are signatories to the Extractive Industries Transparency Initiative promoted by the UK government. This initiative supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil and gas and which also works to build multi-stakeholder partnerships in developing countries in order to increase the accountability of governments. In addition, the government of Kazakhstan has stated that it believes in continued reform of the corporate governance processes and will ensure discipline and transparency in the corporate sector to promote growth and stability. However, there can be no assurance that the Kazakh State will continue such policy, or that such policy, if continued, will ultimately prove to be successful. Therefore, it is not possible to predict the effect of future legislative developments on the Company's business and prospects.

The Company's exploration and production licences, hydrocarbon contracts and other agreements may be susceptible to revision or cancellation, and legal redress may be uncertain, delayed or unavailable. In addition, it is often difficult to determine from governmental records whether statutory and corporate actions have been properly completed by the parties or applicable regulatory agencies. Ensuring the Company's ongoing rights to licences and its hydrocarbon contracts will require a careful monitoring of performance of the terms of the licences and hydrocarbon contracts, and monitoring their evolution under Kazakh laws and licensing practices.

In March 2010, the Kazakh State announced a restructuring of MEMR to create MOG. In addition, the new subsoil use law has been adopted and came into force on 24 June 2010 under the registration number 291-IV.

**Taxation Risks and Issues in Kazakhstan**

Tax legislation in Kazakhstan is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels and consequently tax risks and problems with respect to its operations and investment in Kazakhstan are significant. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies and accordingly, few precedents with regard to issues have been established.

Tax declarations, together with other legal compliance areas (for example, customs and currency control matters) are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges. These facts create tax and other risks in Kazakhstan substantially more significant than typically found in countries with more developed tax systems. In addition, any amendments to current Kazakhstan taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on the Company.

In the case of oil exports, rent tax on oil exports is set at a rate from 0 per cent. to 32 per cent., depending on the market price for oil, without taking into consideration transportation costs or other deductions. Kazakhstan may increase the export customs rate in the future.

Whilst the Company is not currently aware of any material tax liability arising from its operation in Kazakhstan, the uncertainty of application and the evolution of tax laws creates a risk of additional payment of tax by the Company, which could have a material adverse affect on the business, financial condition and results of operations of the Company.

**Legal and Regulatory Framework in Tajikistan**

Tajikistan introduced production sharing legislation in 2007, with some amendments in 2008, and the Bokhtar PSC is the first to be adopted under the new regulatory regime. As the legal and regulatory framework for oil and gas is emerging in Tajikistan, it is possible that the terms of such a PSC may be challenged, additional taxes may be imposed, or may be found to conflict with other Tajik laws and regulations. There is no assurance that the terms of the Bokhtar PSC will not be challenged and that no claims will be made against the Group resulting in a material adverse effect. In addition, these inconsistencies may lead to potential disputes with the relevant tax authorities, resulting in a material adverse effect on the financial performance of the Group. There may also be problems with repatriation of currency from Tajikistan, and in the use of the banking system.

**Taxation Risks and Issues in Tajikistan**

Although under the Bokhtar PSC all of KPL's tax obligations are covered through the Tajik State's share of production, the taxation system in Tajikistan is at an early stage of development and the tax risks and problems with respect to its operations and investment in Tajikistan may be significant. Tax legislation is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies and accordingly, few precedents with regard to issues have been established.

Tax declarations, together with other legal compliance areas are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges. These facts create tax and other risks in Tajikistan substantially more significant than typically found in countries with more developed tax systems. In addition, amendments to current Tajikistan taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on the Company.

Whilst the Company is not currently aware of any material tax liability arising from its operation in Tajikistan, the uncertainty of application and the evolution of tax laws creates a risk of additional payment of tax by the Company, which could have a material adverse affect on the business, financial condition and results of operations of the Company.

**Lack of Infrastructure in Tajikistan**

Tajikistan depends on neighbouring countries to access world markets, and this could lead to problems bringing in equipment and services to the country, as well as exporting products. There are only limited oil refining facilities in Tajikistan, and as such any crude oil will require export, either to regional refineries or to world markets. There are no guarantees that this export will be allowed by the surrounding countries, and/or additional taxes or levies imposed, or prices offered being substantially less than world market prices. Similarly the gas infrastructure is poorly developed and maintained in Tajikistan, and although pipelines exist, it is possible that such infrastructure would not be available to the Company on commercially attractive terms, or may be unsuitable. Similarly export of gas to world markets would require access to pipelines and infrastructure in neighbouring countries and such access may not be given, or not be given on commercially attractive terms.

**Legal and Regulatory Environment in Uzbekistan**

Uzbekistan's foreign investment, petroleum, subsoil use, licensing, corporate, tax, customs, currency, banking and antimonopoly laws and legislation are still developing and uncertain. Legislation in respect of some or all of these areas could be passed. Currently, the regulatory system contains many inconsistencies and contradictions. Many of the laws are structured to provide substantial administrative discretion in their application and enforcement. In addition, the laws are subject to change and different interpretations. These factors mean that even the Group's best efforts to comply with applicable laws may not always result in compliance. Non-compliance may have consequences disproportionate to the violation. The uncertainties, inconsistencies and contradictions in Uzbek laws and their interpretation and application could have a material adverse effect on the Group's business and results of operations. For example, under the terms of the North Urtabulak PEC, the acquisition of TPU did not require the consent of the Uzbek State Partners or the other contracting parties under the North Urtabulak PEC, nor is there any requirement under the laws of Uzbekistan for such consent by government authorities. However, there is no certainty that other parties or the authorities will not take a contrary view notwithstanding the terms of the North Urtabulak PEC or the legislation in Uzbekistan and there is a risk that any change of control of the ownership interest in TPU could be a political basis for authorities to claim breach or otherwise find a basis not to recognise the interests of TPU under the North Urtabulak PEC. Moreover, the volume of hydrocarbons produced for export to date under the North Urtabulak PEC exceeds the target volume initially referred to in the Uzbek State decree concluding the terms of the North Urtabulak PEC. As a result, the Uzbek State may seek to deny TPU the benefit of certain tax and customs exemptions and privileges initially contemplated in connection with production under the North Urtabulak PEC. The jurisdiction system in Uzbekistan may not be fully independent of outside social, economic and political forces, and court decisions can be difficult to predict.

**Taxation Risks and Issues in Uzbekistan**

As the legal and regulatory framework for oil and gas is emerging in Uzbekistan, it is possible that the terms of the North Urtabulak PEC may be challenged, additional taxes may be imposed, or may be found to be in conflict with other Uzbek laws and regulations. In particular, certain customs duty exemptions and privileges under the North Urtabulak PEC which were approved by the government by way of a government decree contradict certain provisions under the Customs Code of Uzbekistan. These contradictions may lead to potential disputes with the relevant tax authorities and certain customs duty exemptions and privileges may no longer be recognised or available resulting in a material adverse effect on the financial performance of the Group. Presidential Edict No. UP-4116, dated 17 June 2009 ("**Edict 4116**"), extended the validity of TPU's tax and customs exemptions and privileges under clause 3 of Decree 322 for an unspecified period of time, although it terminated certain tax exemptions and privileges available to other legal persons and groups of entities. While the tax and customs exemptions and privileges provided to TPU remain valid, there is no guarantee that such exemptions and privileges will not be changed in the future.

As with Tajikistan the taxation system in Uzbekistan is at an early stage of development and the tax risks and problems with respect to its operations and investment in Uzbekistan may be significant. Tax legislation is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies, therefore, regulations are often unclear, contradictory or nonexistent. Accordingly, few precedents with regard to these types of issues have been established. Tax declarations, together with other legal compliance areas are subject to review and investigation by a number of authorities, which are enabled by law to impose fines, penalties and interest charges. These factors create tax and other risks in Uzbekistan more significant than typically found in countries with more developed tax systems. In addition, amendments to current Uzbekistan taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on the Company.

Whilst the Company is not currently aware of any material tax liability arising from its operation in Uzbekistan, the uncertainty of application and the evolution of tax laws creates a risk of additional payment of tax by the Company, which could have a material adverse affect on the business, financial condition and results of operations of the Company.

**Lack of Infrastructure in Uzbekistan**

Uzbekistan depends on neighbouring countries to access world markets, and this could lead to problems bringing in equipment, material and services to the country, as well as exporting products. Although there are two large refineries in Uzbekistan, there is potentially a limited internal market for refined oil products. Currently this poses no issues for the Company as its share of refined products from the North Urtabulak Field is exported under the terms of the North Urtabulak PEC. The previous limits to the volumes of refined products which could be exported from Uzbekistan has been addressed by construction of new product pipelines direct to the People's Republic of China and upgrading of export terminals. The Company is now more freely exporting products from Uzbekistan to regional and world markets. There are no guarantees that this export will be allowed by the neighbouring countries, and/or additional taxes or levies imposed, or prices offered being substantially less than world market prices.

**RISKS RELATING TO CAYMAN ISLANDS INCORPORATION AND THE APPLICATION OF CANADIAN TAKEOVER BID RULES**

**Shareholders of Cayman Islands incorporated companies may not have the same protections (including protections against takeovers) which are equivalent to shareholders of a company incorporated in England.**

As the Company is incorporated in the Cayman Islands it is subject to the laws of that jurisdiction. The UK Companies Act 2006 does not apply to the Company and Cayman Islands law does not provide identical shareholder protections to those contained in the UK Companies Act 2006. Set out below is a description of certain differences between companies incorporated in England and the Cayman Islands:

(a) ***Pre-emption Rights*** – Shareholders do not have statutory pre-emption rights under the Cayman Companies Law over further issues of shares in the Company. Certain restrictions on the ability of the Company's Directors to allot shares are contained in the Company's Articles, which may be amended by a special resolution of shareholders.

(b) ***Takeovers*** – Cayman Islands companies law does not contain provisions similar to those in the City Code which oblige a person or persons acquiring at least 30 per cent. of voting rights in a company to which the City Code applies to make an offer to acquire the remainder of the shares in such company. The Company's shares are subject to the compulsory acquisition ("**Squeeze Out**") provisions set out in section 88 of the Cayman Islands Companies Law and pursuant to Article 29 of the Company's Articles. Under these provisions, any offeror making a takeover offer which, within four months of making the offer, has been approved by the holders of not less than 90 per cent. in value of the shares to which the offer relates, is entitled to acquire compulsorily from shareholders dissenting from or not accepting the takeover offer those shares which have not been acquired or contracted to be acquired on the same terms as under the offer.

(c) ***Disclosure of interests in shares*** – The rules on disclosure by shareholders of interests in a company under sections 793 and related sections of the UK Companies Act 2006 are not applicable to the Company. Under the Companies Law, shareholders are not obliged to disclose their interests in the Company in the same way as shareholders of a company governed by the UK Companies Act 2006 although shareholders will be subject to the provisions of the Disclosure Rules and Transparency Rules as such rules apply to companies incorporated outside the United Kingdom with a listing on the Official List (standard category) whose shares are admitted to trading on the main market of the London Stock Exchange.

**Risks relating to the application of Canadian takeover bid rules**

As the Company is a reporting issuer under the securities laws of a number of Canadian provinces, certain offers to purchase outstanding shares of the Company may be subject to the application of Canadian securities laws which require the making of an offer on identical terms to all shareholders in Canada. Such rules are not necessarily equivalent to the rules under the UK City Code on Takeovers and Mergers which would apply to the Company it were incorporated in the U.K. Moreover, such laws may not necessarily apply where an offer is not made to a shareholder in Canada.

Canadian securities laws provide that a person or company (the “offeror”) that offers to purchase equity or voting securities (such as the Company’s ordinary shares) of a reporting issuer from security holders in Canada and resulting in an offeror owning or exercising control or direction, directly or indirectly, over equity or voting securities representing 20 per cent. or more of the outstanding securities of the class (including securities that the person or company has the right or obligation to acquire within 60 days, with or without conditions) must, subject to certain exemptions, make the offer, on identical terms, to all security holders in Canada in accordance with a number of requirements (referred to as “Canadian takeover bid rules”).

Exemptions from the Canadian takeover bid rules are available in certain circumstances, including in the case of certain private transactions involving five or fewer vendors where the purchase price does not exceed 115 per cent. of the market price of the shares. Another exemption is available in the case of purchases on the open market where the aggregate number of share pursuant to this exemption together with other acquisitions does not exceed 5 per cent. of the issued and outstanding shares over a twelve month period.

The Canadian takeover bid rules apply where purchases are made from shareholders in Canada. Although Canadian securities regulatory authorities do have discretion to commence regulatory proceedings on the basis of public interest notwithstanding the fact that the relevant parties are not residents of Canada, the purchase and sale of securities shareholders who are not in Canada may not necessarily be afforded the protection of the Canadian takeover bid rules.

## RISKS RELATING TO THE ORDINARY SHARES

### The value of the Ordinary Shares may decrease as well as increase

The market price of the Ordinary Shares may be volatile and subject to wide fluctuations as a result of a variety of factors, including period-to-period variations in operating results or changes in turnover or profit estimates by the Company, industry participants or financial analysts. The price could also be adversely affected by developments unrelated to the Group's operating performance such as: the operating and share price performance of other companies that investors may consider comparable to the Company; speculation about the Company in the press or the investment community; strategic actions by competitors, such as acquisitions and restructurings; changes in market conditions and regulatory changes; and perceived changes in the outlook for the Republics of Kazakhstan, Tajikistan and Uzbekistan.

### There are no guarantees that the Company will pay dividends or the level of any such dividends.

The Company has not declared or paid any distributions on the Ordinary Shares to date. The payment of dividends or distributions in future is dependent on the Company's earnings, financial condition and such other factors as the Board of Directors considers appropriate. The Company currently does not anticipate paying any dividends in the foreseeable future due to the stage of development of the Company.

The Company might not pay dividends in future if the Directors believe this would cause any Group member to be less than adequately capitalised (including taking into account any regulatory restrictions that may be applicable), or if for any other reason the Directors conclude it would not be in the best interests of the Company. Future dividends will depend on, amongst other things, Tethys' future profits, financial position, regulatory capital requirements, accounting changes, general economic conditions and other factors that the Directors deem significant from time to time. There can be no assurance that Tethys will pay dividends or if it does pay dividends, regarding the amount of such dividends and consequently therefore Shareholders may not receive their anticipated income stream.

### There is no assurance that an active trading market will develop on the London Stock Exchange

As there has been no public trading market for the Ordinary Shares on the London Stock Exchange, there can be no assurance that an active trading market will develop on the London Stock Exchange or, if one does develop, that it will be maintained.

## CONSEQUENCES OF A STANDARD LISTING

Application has been made for the Ordinary Shares to be admitted to a listing on the Official List pursuant to Chapter 14 of the Listing Rules, which sets out the requirements for standard category listings.

The Company is not required to comply with the eligibility requirements for a premium listing on the Official List set out in Chapter 6 of the Listing Rules or the Listing Principles set out in Chapter 7 of the Listing Rules. In addition, the Company is not required, and does not intend, to appoint a listing sponsor under Chapter 8 of the Listing Rules to guide the Company in understanding and meeting its responsibilities under the Listing Rules. Neither is the Company required, nor does it intend, to comply with: Chapter 9 of the Listing Rules relating to certain continuing obligations; Chapter 10 of the Listing Rules relating to significant transactions; Chapter 11 of the Listing Rules relating to transactions with related parties; Chapter 12 of the Listing Rules relating to purchases by the Company of its own shares; and Chapter 13 of the Listing Rules relating to the content of Company circulars.

**It should be noted that the Ordinary Shares are, and will continue to be, listed and posted for trading on the Toronto Stock Exchange and the Kazakhstan Stock Exchange and consequently obligations arising from applicable securities and corporate legislation in Canada and Kazakhstan, as well as the rules of the Toronto Stock Exchange and the Kazakhstan Stock Exchange, will continue to apply to the Company.**

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## DIRECTORS, SECRETARY, REGISTERED OFFICE AND ADVISERS

**DIRECTORS**

Dr David Robson (Chairman, Chief Executive Officer and President)
Bernard Murphy (Chief Financial Officer)
Elizabeth Landles (Executive Director and Chief Administrative Officer)
Rt. Hon. Peter Lilley MP (Vice Chairman and Non-Executive Director)
Russ Hammond (Non-Executive Director)
Piers Johnson (Non-Executive Director)
James Rawls (Non-Executive Director)
Marcus Rhodes (Non-Executive Director)

**Chief Financial Officer**
Bernard Murphy

**Corporate Secretary**
Elizabeth Landles

**HEAD OFFICE AND DIRECTORS' ADDRESS**

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## FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION

This document includes statements that are, or may be deemed to be "forward-looking statements". The words "believe," "anticipate," "expect," "intend," "aim," "plan," "predict," "continue," "assume," "positioned," "may," "will," "should," "shall," "risk" and other similar expressions that are predictions of or indicate future events and future trends identify forward-looking statements. These forward-looking statements include all matters that are not historical facts. In particular, the statements under the headings "Summary," "Risk factors," "Business" and "Operating and financial review" regarding the Company's strategy, plans, objectives, goals and other future events or prospects are forward-looking statements. An investor should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are in many cases beyond the Company's control. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. The Company cautions investors that forward-looking statements are not guarantees of future performance and that its actual results of operations, financial condition, and the development of the industry in which it operates, may differ materially from those made in or suggested by the forward-looking statements contained in this document. The cautionary statements set forth above should be considered in connection with any subsequent written or oral forward-looking statements that the Company, or persons acting on its behalf, may issue. Factors that may cause the Company's actual results to differ materially from those expressed or implied by the forward-looking statements in this document include but are not limited to the risks described under "Risk Factors". Subject to its legal and regulatory obligations (including the requirements of the Prospectus Rules, the Listing Rules and the Disclosure Rules and Transparency Rules), the Company does not intend and does not assume any obligation, to update or revise any forward looking statements in this document that may occur due to any change in the Company's expectations or to reflect events or circumstances after the date of this document.

### *Presentation of financial and statistical information*

Financial information in relation to the Group means, for the purposes of this paragraph, the information in this document which has been extracted without material adjustment from "Part 5 – Financial Information". Financial information extracted from "Part 5 – Financial Information" is to be found in the "Summary Information", "Part 1 – Information on the Group", "Part 4 – Operating and Financial Review" and "Part 7 – Capitalisation and Indebtedness" sections of this document. Investors should ensure that they read the whole of this document and not just rely on key information summarised within it.

The consolidated financial statements in "Part 5 – Financial Information" for the two years ended 31 December 2010 and 2009 have been prepared in accordance with the IFRS. Investors should note that the consolidated financial statements for the year ended 31 December 2009 contain comparative 2008 figures which have been re-stated from US GAAP to IFRS. Note 26 of the consolidated financial statements for the year ended 31 December 2009 provide a reconciliation between the 2008 US GAAP figures and the 2008 IFRS figures.

Investors should note that financial information for years prior to the financial year ended 31 December 2008 (which are not presented in this document) were prepared in accordance with US GAAP.

### *Currencies*

All references in this document to "C$", "Cdn$", "CA$" or "Canadian cents" are to the lawful currency of Canada. All references in this document to "euro" are to the lawful single currency of member states of the European Union that adopt or have adopted the euro as their currency in accordance with the legislation of the European Union relating to European Monetary Union. All references in this document to "pounds sterling", "pounds", "£", "p" or "pence" are to the lawful currency of the United Kingdom. All references in this document to "$", "Dollars", "dollar(s)", "US$" and "US cent(s)" are to the lawful currency of the United States. The Company prepares its consolidated financial information in US Dollars.

*Percentages*

Percentages in tables have been rounded and accordingly may not add up to 100 per cent. Certain financial data has been rounded. As a result of this rounding, the totals of data presented in this document may vary slightly from the actual arithmetic totals of such data.

*Non-financial operating information*

Non-financial operating information in relation to the Group's business is derived from the following sources: (i) periodic accounts for the relevant periods presented; and (ii) internal reporting systems.

Operating information derived from periodic accounts or internal reporting systems in relation to the Group's business is to be found principally in the "Part 4 – Operating and Financial Review" section of this document.

*Presentation of reserves and resources*

The standard adopted for the reporting of Oil and Gas Reserve and Resource statements for the Group's hydrocarbon assets is that defined by the terms and conditions given in the 2003 Amended National Instrument 51–101 ("**NI-51-101**"), published by the Canadian Securities Administrators ("**CSA**"); and in accordance with the standards set out in the Canadian Oil and Gas Evaluation Handbook ("**COGEH**").

*Distribution restrictions*

The distribution of this document in certain jurisdictions may be restricted by law. No action has been or will be taken by the Company to permit a public offering of the Ordinary Shares or to permit the possession or distribution of this document in any jurisdiction where action for that purpose may be required. Accordingly, this document may only be distributed in any jurisdiction in circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities law of any such jurisdictions.

*Settlement and dealings*

CREST is a paperless settlement system enabling securities to be evidenced otherwise than by a certificate and transferred otherwise than by a written instrument. Securities issued by non-UK companies, such as the Company, cannot be held or transferred in the CREST system. As a result, CREST depository interests will be established to allow trading and settlement of the shares of non-UK companies in CREST. Further details of the CREST depositary instruments can be found in Part 6 of this document.

*The Articles permit the holding of Ordinary Shares by way of CREST depository interests*

The Ordinary Shares will not themselves be admitted to CREST. Instead, investors who hold their Ordinary Shares through CREST will receive their interest in the Company by means of the CREST International Settlement Links Service and will be issued with CREST depository interests. CREST depository interests are dematerialised depository interests representing entitlements to Ordinary Shares and are independent securities constituted under English law which may be held or transferred through the CREST system. The CREST depository interests will have the same security code ISIN: KYG876361091 as the underlying Ordinary Shares and will not require a separate listing on the Official List.

**PART 1 - INFORMATION ON THE GROUP**

## 1. INTRODUCTION

Tethys is an international independent oil and gas exploration and production company with its own drilling and equipment business, originally incorporated in 2003 in Guernsey, now redomiciled to the Cayman Islands. Through its subsidiaries, the Company is engaged in the exploration for, and the acquisition, development and production of oil and natural gas resources. The Company has an exclusive focus on projects in Central Asia, and currently holds assets in Kazakhstan, Tajikistan and Uzbekistan. The Company also has a drilling and equipment business unit which provides equipment for use of the Company's assets in Central Asia.

In Kazakhtstan, the Company's assets are located in three contiguous blocks in an area to the west of the Aral Sea in a geological region known as the North Ustyurt basin. In Tajikistan, the Company's production sharing contract asset is located in the south-west of the country, in a geological region known as the Afghan-Tajik portion of the Amu Darya basin. In Uzbekistan, the Company's asset is located in the south-east of the country in a geological region known as the Amu Darya basin. The Company also considers investments in other geographical jurisdictions, geological regions and energy assets as part of its growth strategy.

The Company is currently listed on both the TSX and KASE and it will maintain these listings after admission to the Official List and to trading on the main market of the London Stock Exchange.

## 2. INDUSTRY OVERVIEW

***Oil and Gas Market in 2010***

World oil and gas supply is diversified across a variety of jurisdictions, with the Russian Federation as the leading oil producing country and the USA as the leading gas producing country at the end of 2010[1]. The former Soviet Union (including Russia and Central Asia) as a region produced around 16.8% of the world's oil and 23.7% of the world's natural gas in 2010[2]. Of the Central Asian republics, Kazakhstan, was the largest oil producer with production of 1,757 mbbl/d at the end of 2010 and Uzbekistan was the largest gas producer with production of 59.1 bcm/y at the end of 2010[3].

During the first ten months of 2010, Brent crude oil prices remained relatively stable, trading in the $70 - $80/bbl range[4]. Brent crude oil prices began to appreciate markedly from October to December 2010, with prices increasing by 11% in the final three months of the year; closing at $93.23/bbl on 31 December 2010[5]. The rise in Brent crude prices in the fourth quarter of 2010 was primarily a result of falling production of Brent blend crude (a specific grade of crude oil), falling supply of global crude oil supplies generally, falling OECD oil and oil product inventories, rising oil demand and robust economic growth in East Asia, as well as political upheaval in some oil producing countries[6].

Global oil production rose by 2.2% in 2010 from a 2009 figure of 80.29 mmbbl/d to 82.10 mmbbl/d in 2010[7], with production from both OPEC and non–OPEC sources increasing[8]. Owing primarily to strong East Asian economic growth and a colder-than-expected winter across much of the northern

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1 BP Statistical Review 2011, pp. 22.

2 BP Statistical Review 2011, pp. 8, 22.

3 BP Statistical Review 2011 pp. 8, 22.

4 Derived from Energy Information Administration statistics; http://tonto.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RBRTE&f=D.

5 Derived from Energy Information Administration statistics; http://tonto.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RBRTE&f=D.

6 International Energy Agency, Oil Market Report 18th Jan 2011; http://omrpublic.iea.org/archiveresults.asp?formsection=full+issue&formdate=2011&Submit=Submit.

7 BP Statistical Review 2011 pp. 8.

8 International Energy Agency, Oil Market Report 18th Jan 2011; http://omrpublic.iea.org/archiveresults.asp?formsection=full+issue&formdate=2011&Submit=Submit, pp. 16.

hemisphere, oil demand rose by 3.1% globally, with a 0.9% increase in OECD markets and a 10.6% increase in the People's Republic of China[9].

In 2011, the International Energy Agency expects global crude oil supply to increase slightly (by 0.8 mmbbl/d); even accounting for the recent fall in oil production from Libya[10]. The IEA is also forecasting a rise in global oil demand of 1.5% in 2011, with the majority of increased demand coming from non – OECD sources[11] However, the IEA also notes potential downside risks to global oil demand owing to the high oil prices exhibited in the first quarter of 2011[12] (Brent average of $104.96/bbl)[13].

The increasing economic development of the People's Republic of China and East Asia in general has been a key driver for increased world oil consumption over the past ten to twenty years. Whilst oil demand in OECD economies has fallen by 3.51% between 2000 and 2010, demand in the People's Republic of China has increased by 47.38% over the same period[14]. The People's Republic of China is now the second largest oil consuming country in the world, with a 10.6% share of global demand in 2010; behind the USA with a 21.1% share during the same year[15]. The Asia Pacific region as a whole accounted for 31.5% of world oil consumption in 2010[16]. Oil consumption in the FSU has also increased over the last decade (an increase of 13.93% 2000 - 2010)[17].

Over the longer term, the IEA predicts global supply of oil will increase at an average annual compound rate of 1% between 2008-2030 to 103 mmbbl[18] and demand to increase at the same rate to 105.2 mmbbl/d[19]. The IEA also suggest that OECD demand will fall and that the primary area of oil demand growth will come from the People's Republic of China, India and the Middle East[20].

At the end of 2010, global gas production stood at 3,193.3 bcmy (representing a 7.3% increase compared to 2009)[21]; with the USA the largest producer with a share of 19.3% of the world's supply[22]. The largest Central Asian producer was Uzbekistan, which produced 59.1 bcmy or 1.8% of global gas supply[23]. Global gas consumption grew by 7.4% between 2009 and 2010 to a total of 3,169.0 bcmy[24]. Chinese gas demand increased by 3.4% between 2009 - 2010 and has increased by 77.5% between 2000 and 2010[25].

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9 BP Statistical Review 2011, pp. 9.

10 International Energy Agency, Oil Market Report 12th May 2011, http://omrpublic.iea.org/archiveresults.asp?formsection=full+issue&formdate=2011&Submit=Submit pp. 1.

11 International Energy Agency, Oil Market Report 12th May 2011, http://omrpublic.iea.org/archiveresults.asp?formsection=full+issue&formdate=2011&Submit=Submit pp. 6.

12 International Energy Agency, Oil Market Report 12th May 2011, http://omrpublic.iea.org/archiveresults.asp?formsection=full+issue&formdate=2011&Submit=Submit pp. 1.

13 Derived from Energy Information Administration Statistics, http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=pet&s=rbrte&f=m

14 Derived from BP Statistical Review 2011, pp. 9.

15 BP Statistical Review 2011, pp. 9.

16 BP Statistical Review, pp. 9.

17 Derived from BP Statistical Review 2011, p 9.

18 IEA, World Energy Outlook 2009, pp. 84.

19 IEA, World Energy Outlook 2009, pp.81.

20 IEA, World Energy Outlook 2009, pp.74.

21 BP Statistical Review 2011, pp. 22.

22 BP Statistical Review 2011, pp. 22.

23 BP Statistical Review 2011, pp. 22.

24 BP Statistical Review 2011, pp. 23.

25 BP Statistical Review 2011, pp. 23.

The IEA predicts that 2008-2030 will see an average annual compound rate of increase in global gas demand of 1.5%, from 3,194 bcm in 2008 to 4,310 in 2030; with the majority of increased gas consumption coming from the People's Republic of China and the Middle East[26].

## 3. HISTORY AND DEVELOPMENT OF THE GROUP

***Company History***

Tethys was incorporated under the Companies (Guernsey) Laws, 1994 to 1996 with the name Tethys Petroleum Investments Limited in Guernsey on 12 August 2003. The Company changed its name to Tethys Petroleum Limited on 22 September 2006. The Company was a wholly owned subsidiary of CanArgo Energy Corporation, a company then listed on the Oslo Stock Exchange and the American Stock Exchange in New York until the first quarter of 2007. CanArgo Energy Corporation made a decision to spin-out the Company and the Kazakh assets then held. The Company underwent an IPO and was accepted onto the TSX in June 2007, having ticker "TPL" with its former parent ceasing to be a shareholder thereafter. On 17 July 2008, the Company moved its domicile from Guernsey to the Cayman Islands and was continued as an exempted company with limited liability under the Companies Law.

In 2008 the Company's shares were admitted to trading on the Kazakhstan Stock Exchange under the symbol "GG TPL".

A description of the significant events that have occurred in the Company's history since 2007 that have influenced the general development of the business are set out below:

***Significant Events of 2007***

In June 2007, Tethys, through its wholly-owned subsidiary TKL, acquired the 30% of TAG that it did not already own for a consideration of Ordinary Shares, thereby making TAG an indirect wholly-owned subsidiary of Tethys.

On 27 June 2007, the Company completed its IPO on the TSX and the Ordinary Shares commenced trading on the TSX.

The Company commenced commercial gas production in December 2007 from its initial project at the Kyzyloi gas field in Kazakhstan, after concluding a domestic gas sales agreement with GazImpex S.A.

***Significant Events of 2008***

In March 2008, the Company's wholly-owned subsidiary TPI secured loan financing from a group of accredited investors for the amount of $5,300,000 to fund the purchase of a new ZJ-70 drilling rig (named "Telesto") from a Chinese factory for use on the Company's projects.

On 28 March 2008, the Company announced that its Ordinary Shares had been approved for listing on the KASE. This listing is secondary to the Company's primary listing on the TSX.

On 13 June 2008, the Company's then wholly-owned subsidiary KPL entered into the Bokhtar PSC with the government of Tajikistan, represented by the MEI.

On 27 June 2008, the Company completed a public offering of 21,276,596 Ordinary Shares for gross proceeds of $50,000,000.

***Significant Events of 2009***

On 9 January 2009, the Company completed the purchase of a second drilling rig (a ZJ-30 unit named "Tykhe"). The purchase of Tykhe was financed in part through a $2,100,000 loan from a group of accredited investors.

On 21 January 2009, the Company acquired a workover coiled tubing unit. Part of the acquisition price was funded by the issue of 1,400,000 Ordinary Shares.

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[26] IEA, World Energy Outlook 2009, pp.88.

In April 2009, the Company completed an acquisition from the Isle of Man company, Rosehill Energy plc, of its wholly-owned subsidiary BHCL which held the entire interest of the North Urtubulak PEC in Uzbekistan. BHCL was subsequently given the trading name TPU. The consideration for the purchase of BHCL was settled by the issue of 15,000,000 Ordinary Shares.

On 19 June 2009, the Company completed a public offering of 51,680,000 new Ordinary Shares for gross proceeds of $20,000,000. The proceeds from the offering were used to fund the Company's capital expenditures and project development.

In October 2009, the Company completed a project financing of $4,100,000. The funds raised were exclusively used by TPU to drill a development well on the North Urtubulak Field in Uzbekistan.

On 9 December 2009, TAG and the MEMR signed amendment agreement no. 7 for an extension of the exploration period of the Akkulka Exploration Licence and Contract from 17 September 2009 to 10 March 2011. Amendment agreement no. 7 also stipulated a commitment by TAG to spend $850,000 on exploration activities over the 18 month period extension period.

On 14 December 2009, the Company executed an agreement with Cornhill Capital and Cornhill Capital Asset Management Limited for the provision of up to $3,000,000 of debt finance by way of the issue by the Company, of unsecured discounted loan notes related to the North Urtabulak PEC. The full amount of the facilities has been drawn down.

On 19 December 2009, the Company signed a private placement agreement to issue 10,000,000 Ordinary Shares to two accredited investors at $0.50 per share for gross proceeds of $5,000,000. These Ordinary Shares were issued on 4 January 2010. The proceeds of the private placement were used to fund the Company's drilling activities, capital expenditures, project development and for general corporate purposes.

On 23 December 2009, TAG and MEMR signed the Akkulka Production Contract entitling TAG to exclusive rights to produce gas from the Akkulka Gas Field for an initial period of nine years.

On 30 December 2009, the Company's wholly-owned subsidiary, Tethys Tajikistan Limited completed an agreement to enter into a 51-49 Joint Venture with private investment company, Sangam Limited, to hold the Company's assets in Tajikistan. Tethys Tajikistan Limited transferred several of its Tajikistan business related subsidiaries to the Joint Venture company SSEC. The Company also executed a loan agreement to provide funds to SSEC to finance work programmes and field development plans in Tajikistan.

***Significant Events of 2010***

In January 2010, the Company completed a private placement of 12,615,000 Ordinary Shares for gross proceeds of $10,000,000. The Ordinary Shares were placed at a price of C$0.82 each. The net proceeds of the offering were used by the Company for capital expenditures and general corporate purposes.

On 7 February 2010, the Company announced the initial results of testing of the AKD-01 ("Doris") exploration oil discovery on the Akkulka Exploration Contract Area in Kazakhstan. The well flowed oil at a combined rate in excess of 6,800 bopd from two zones.

On 1 March 2010, the Company announced that it had completed a private placement of 30,000,000 Ordinary Shares for gross proceeds of $46,500,000. The Ordinary Shares were placed at a price of C$1.55 each. The net proceeds of the offering were used by the Company for capital expenditures and general corporate purposes.

In June 2010, the Company announced that its wholly-owned subsidiary, TAG, had received permission from the MOG to extend the Akkulka Exploration Contract for a further two years: from 10 March 2011 to 10 March 2013. MOG extended the Akkulka Licence and Exploration Contract to enable detailed appraisal of the commercial discovery of oil at the Doris prospect, along with further exploration in the area.

On 20 August 2010, MOG agreed to extend the exploration period for the Company's Kul-Bas Exploration and Production Contract by an additional two years from: 11 November 2011 to 11 November 2013 (for the exploration phase). The production phase of the contract expires in November

2032. The extension to the exploration period enabled the Company to optimize its exploration and appraisal programme on both the Akkulka and Kul-Bas blocks. In February 2011, the Company announced that the amendments to the Kul-Bas Exploration and Production Contract had been completed and incorporated into the contract.

On 8 September 2010, the Company signed an MOU with UNG. The MOU states that Tethys and UNG will conduct joint studies to determine the possibility of improving hydrocarbon recovery on certain existing fields in Uzbekistan with a view to entering a new contract; most likely under a similar arrangement as the Company's existing North Urtubulak PEC.

On 10 September 2010, the Company commenced selling untreated ('raw') oil at the well site of AKD01 ("Doris") to an oil trading company. The oil trading company then began transporting the oil by truck to an oil facility near to the town of Emba (located approximately 450 km to the north-east). The oil was sold for a 90 day period as part of a test production programme (as permitted by Kazakh law).

On 16 September 2010, the Company entered into a gas sales contract with Asia Gas LLP for domestic gas sales from the Akkulka Gas Production Contract.

On 20 October 2010, the Company completed a public offering of 70,600,000 Ordinary Shares for gross proceeds of $100,000,000. The Ordinary Shares were placed at a price of C$1.45 each. The net proceeds of the offering are being used by the Company to fund a work programme on its assets in Central Asia.

On 25 October 2010, the Company announced that it had received Kazakhstan State approved oil reserves for its Doris oil discovery on the Akkulka block, Kazakhstan.

In November 2010, the Company announced that it had obtained a stable flow of gas from the Jurassic interval in the East Komsomolsk KOM201 well in Tajikistan. Further work is ongoing to establish whether or not commercial gas flow can be achieved from this interval.

In December 2010, the Company announced that it had commenced the drilling of the KBD-01 ("Kalypso") exploration well on the Kul-Bas block in Kazakhstan.

***Significant Events of 2011***

On 11 January 2011, the Company received Kazakh State approval for the Pilot Production Project for the Doris oil discovery in the Akkulka block. This approval gives the Company the right to produce oil from the Doris well during the exploration period and allows for the installation and operation of production facilities for the planned 3,000-4,000 bopd (Phase 2) production target; currently estimated to commence in the near future.

On 7 February 2011, the Company announced that the proposed amendments to the Kul-Bas Exploration and Production Contract had been incorporated into the contract by the MOG, granting an extension to the exploration period by a further two years until 11 November 2013.

On 17 February 2011, the Company announced that its wholly owned subsidiary, TMG, had signed a Joint Venture agreement with Eurasia Gas LLP to build a joint venture oil terminal so that oil production from the Akkulka block can be sent, traded and sold to market.

Also in February 2011, the Company announced the initial results of testing on the NUR92-H2 horizontal development well at the North Urtubulak field in Uzbekistan. The well tested at over 1,100 bopd and is currently on production.

In April 2011, the Company announced the initial results of testing on the AKD-03 exploration well ("Dione") on the Akkulka block in Kazakhstan. The well tested oil from a secondary target in the Jurassic at a rate of over 400 bopd. Additional testing of the primary targets is ongoing.

Also in April 2011, the Company announced that it had pre-qualified for a tender held by the government of Afghanistan for an Exploration and Production Sharing Contract relating to three exploration/development areas located in the north of the country within the Amu Darya basin.

On 27 May 2011, the Company issued a holding statement with regard to oil being encountered in its Tajik exploration well East, Olimtoi EOL09, noting that the interval, which produced oil, has not been fully evaluated either with wireline logs or production testing and that as such there could be no guarantee that this zone would produce commercial hydrocarbons when properly tested but the observed oil flow is obviously a positive indication.

On 9 June 2011, by way of an updated on developments at the Tajik exploration well East, Olimtoi EOL09, the Company announced that electric logs had now been run in the well over the Alai interval (a secondary target) which confirmed the probable presence of moveable hydrocarbons in the interval from 3,341 to 3,500 metres. Independent petrophysical interpretation indicated up to 32 metres of net hydrocarbon bearing pay in the section with porosities of up to 17%. No oil-water contact was interpreted in this section of the well.

On 7 July 2011, the Company announced initial results of the AKD-04 and AKD-05 appraisal wells on the Doris discovery. The AKD-05 well flowed clean oil at a stable rate of approximately 520 bopd from the Upper Jurassic Carbonate Zone. The AKD-04 well Upper Jurassic Carbonate interval was targeted to evaluate the oil-water contact which is separate from the Doris structure by a fault. The test showed a mixture of oil and water so further work has been carried out on the 3D seismic data which resulted in an additional refinement of the sand fan model for the Lower Cretaceous Sands and the likelihood that the oil deposits are primarily stratigraphically trapped. Based on this 3D mapping the location of the next Doris area well (AKD-06) has been chosen and the well is expected to commence operations in the near future.

The Kalypso (KBD-01) wildcat exploration well which is targeting primarily a large potential structural closure at carboniferous level is currently at a depth of 3,064 metres.

Work is now almost compete on the second phase of the Doris Pilot Production facilities and is awaiting final Kazakh government approvals. Oil production for the sales under phase one continues to rise with over 1,200 bopd being produced in June 2011 and with further increases planned after commissioning of the facilities and the imminent delivery of a further order of new trucks. The oil rail-loading terminal is currently scheduled to be completed and operational by Q4 2011.

## 4. COMPANY STRENGTHS

The Company's principal competitive advantages relate to its commercial, operational and geological expertise as well as access to capital markets and an exclusive focus on Central Asia.

### *Commercial, Operational and Geological Strength*

Senior management of the Company have a combined experience of 198 years in the oil and gas industry and 97 years in Central Asia. Through this experience, management have developed a thorough understanding of the commercial, operational and geological specifics of the oil and gas industry in Central Asia and have a strong understanding of the challenges and opportunities that exist in the industry and region.

### *Access to Capital Markets*

As a publicly listed issuer, the Company has certain competitive advantages over other unlisted foreign entities operating in Kazakhstan, Tajikistan and Uzbekistan in terms of access to capital to fulfil work programmes and asset development as well as the greater transparency and creditability with shareholders owing to the rules and regulations the Company must comply with to maintain its public listings. A combination of these factors allows the Company to pursue opportunities that may not be open to other entities operating in the Company's area of operations.

### *Exclusive Focus on Central Asia*

The Directors believe that the Company's exclusive focus on the Central Asian region grants it certain competitive advantages over other foreign entities operating in Central Asian jurisdictions. A solid understanding of the social, cultural, economic and political situation of the region in combination with a specific focus on the geology of the region grants the Company an advantage in pursuing and developing assets. Extensive management experience in the region combined with a high percentage of local staff and specialists affords the Company an ability to capitalise on opportunities as and when they occur. In addition, the Company's Central Asian focus, in combination with its exploration and development success, has delivered a good commercial, operational and business reputation in the Central Asian region – further enhancing the Company's ability to successfully compete for opportunities in the Central Asian energy sector.

5. **STRATEGY**

The Group's objective is to build a diversified oil and gas exploration and production company with a mixture of short-term cashflow projects and long-term high potential exploration projects focused in the Central Asian region; building on the strengths of the Company as outlined in paragraph 4 of "Company Strengths" of this document.

The Group's approach involves a mix of early cashflow production and development projects, for both natural gas and oil, as well as high potential exploration prospects looking to generate significant commercial upside. The Group's current projects are strategically located with respect to the existing as well as planned hydrocarbon infrastructure; in particular natural gas export routes to Russia, Europe and the People's Republic of China.

The Group produces both oil and natural gas in order to balance its product portfolio, and operates in three separate jurisdictions in Central Asia in order to mitigate the political, fiscal and taxation risk that would be inherent with operations solely conducted in one jurisdiction.

When conducting operations in the Central Asian Republics, the Group has a policy of principally employing local staff and specialists, utilizing locally produced goods and services (where they meet the standards required for international petroleum operations) and working closely with national, regional and community governmental organizations. This strategy positions the Group towards being a 'local' company: with local people and communities as 'stakeholders' in the success of the venture.

The Group's integrated approach to the development of existing and high potential hydrocarbon resources in the Central Asian region is, in the opinion of management, the key to success in this exciting region; particularly for a smaller independent oil and gas company. In the longer term, the strategic decisions that the Group has made with respect to geography, business conduct and local engagement should help to cement the Group's position in a highly prospective region with transcontinental export routes positioned with access to both the developed markets of Europe and the growing economies of East Asia. The Group's long-term ambition is to occupy a significant role in the production and delivery of hydrocarbons from the Central Asian region to local and global markets.

The Company aims to continue to rapidly grow as an independent international oil and gas company by implementing the following strategies :

- continued focused appraisal and exploration on the Akkulka and Kul-Bas blocks in Kazakhstan;
- increased exploration on the Bokhtar PSC area in Tajikistan;
- further development of the Company's position in Uzbekistan with potentially the acquisition of additional production projects and exploration concessions;
- continued development of existing producing projects in a rapid, cost-effective and timely manner;
- exploit the Group's ownership of oilfield service equipment and oil and gas sales infrastructure;
- develop the Company's producing assets in conjunction with the exploration programme;
- utilize the Company's experience and expertise in Central Asia to acquire new projects in the area (such as potentially those in northern Afghanistan);
- look for ways to maximise shareholder value by selected disposals and acquisitions of assets at appropriate stages of development;

- seek out value-orientated acquisition and other opportunities.

In particular, the specific focus of management in 2011 is to:

- appraise the Doris oil field discovery in the Akkulka Block, Kazakhstan;
- increase oil production from the Doris oilfield and complete the installation of phase two production and sales facilities;
- continue exploration drilling on the Akkulka and Kul-Bas licence blocks in Kazakhstan;
- acquire new existing oil fields and exploration acreage in Uzbekistan;
- acquire more geophysical data to firm up the location of a deep exploration well in Tajikistan;
- drill a mid-depth exploration well in Tajikistan;
- potentially acquire new assets in Afghanistan.

In common with many oil and gas companies, in implementing its strategies, the Company regularly considers farm-out/farm-in and joint venture opportunities as a means of developing its business and sharing financial and/or commercial risks.

## 6. CURRENT TRADING AND PROSPECTS

From 31 March 2011 to 18 July 2011 (being the last practicable date prior to the publication of this document) the Group has continued to trade in line with the Director's expectations. Please refer to "Section A - 'Management's Discussion and Analysis for the First Quarter Ended 31 March 2011" of Part 3 "Operating and Financial Review" of this document for a full description of the Director's explanations.

## 7. SELECTED FINANCIAL INFORMATION

The tables below set out the Company's summary financial information for the periods indicated. The data has been extracted without material adjustment from the historical financial information in Part 4 of this document. As this is only a summary, investors are advised to read the whole of this document and not rely on just the key or summarised information. All figures in this paragraph 7 are stated in '000 US$.

### Consolidated Statement of Financial Position

| | **Financial year ended 31 December** | | | **Three months ended 31 March** | |
|---|---|---|---|---|---|
| | **IFRS 2008** | **IFRS 2009** | **IFRS 2010** | **IFRS 2010** | **IFRS 2011** |
| **Non-current assets** | | | | | |
| Property, plant and equipment | 65,422 | 73,171 | 115,653 | 75,356 | 122,250 |
| Intangible assets | 16.105 | 24,378 | 16,892 | 26,186 | 18,738 |
| Investments | 587 | 659 | 1,015 | 687 | 1,017 |
| Prepaids and other receivables | 6,357 | 5,171 | 12,320 | 6,491 | 14,937 |
| Loan receivable from jointly controlled entity | - | 21,727 | 35,460 | 23,897 | 38,179 |
| | 88,471 | 125,106 | 181,340 | 132,617 | 195,121 |
| **Current assets** | | | | | |
| Inventories | 213 | 2,368 | 2,121 | 2,439 | 2,452 |
| Trade and other receivables | 2,664 | 2,311 | 3,680 | 2,422 | 3,230 |
| Cash and cash equivalents | 22,200 | 7,927 | 79,135 | 48,927 | 57,400 |
| Derivative financial instruments – interest rate swap | - | - | 1,472 | - | 1,274 |
| | 25,077 | 11,976 | 86,408 | 53,788 | 64,356 |
| **Total assets** | 113,548 | 137,082 | 267,748 | 186,405 | 259,477 |
| **Equity attributable to shareholders** | | | | | |
| Share capital | 6,639 | 13,455 | 26,063 | 18,717 | 26,063 |
| Share premium | 138,598 | 153,748 | 297,222 | 206,258 | 297,222 |
| Other reserves | 25,147 | 27,775 | 34,261 | 28,968 | 35,555 |
| Accumulated deficit | (66,654) | (88,374) | (118,023) | (96,373) | (124,318) |
| **Total equity** | 103,730 | 106,604 | 239,523 | 157,570 | 234,522 |

| | | | | | |
|---|---|---|---|---|---|
| **Non-current liabilities** | | | | | |
| Deferred gain on sale of assets to jointly controlled entity | - | 3,659 | 3,699 | 3,698 | 3,699 |
| Financial liabilities – borrowings | 5,096 | 9,324 | 2,853 | 8,031 | 1,950 |
| Shares to be issued | - | 3,750 | - | - | 0 |
| Deferred taxation | - | 598 | 4,070 | 692 | 3,956 |
| Trade and other payables | 523 | 808 | 721 | 838 | 679 |
| Asset retirement obligations | 465 | 206 | 192 | 160 | 208 |
| | 6,084 | 18,345 | 11,535 | 13,419 | 10,492 |
| **Current liabilities** | | | | | |
| Financial liabilities – borrowings | 853 | 1,086 | 5,047 | 3,789 | 6,005 |
| Derivative financial instruments – warrants | 146 | 1,053 | 405 | 3,405 | 214 |
| Derivative financial instruments – interest rate swap | - | 95 | | 292 | - |
| Deferred revenue | - | 3,113 | 2,450 | 2,204 | 27 |
| Trade and other payables | 2,735 | 6,786 | 8,788 | 5,726 | 8,217 |
| | 3,734 | 12,133 | 16,690 | 15,416 | 14,463 |
| **Total liabilities** | 9,818 | 30,478 | 28,225 | 28,835 | 24,955 |
| **Total shareholders' equity and liabilities** | 113,548 | 137,082 | 267,748 | 186,405 | 259,477 |

## Consolidated Statement of Comprehensive Loss

| | **Financial year ended 31 December** | | | **Three months ended 31 March** | |
|---|---|---|---|---|---|
| | **IFRS 2008** | **IFRS 2009** | **IFRS 2010** | **IFRS 2010** | **IFRS 2011** |
| Sales and other operating revenues | 5,360 | 8,559 | 14,706 | 2,116 | 4,480 |
| Final income | 832 | 76 | 61 | 3 | 32 |
| Total revenue and other income | 6,192 | 8,635 | 14,767 | 2,119 | 4,512 |
| Production expenditures | (1,334) | (3,405) | (7,076) | (974) | (1,752) |
| Depreciation, depletion and amortisation | (4,333) | (3,238) | (5,885) | (692) | (2,612) |
| Exploration and evaluation expenditure written off | (2,292) | (887) | - | - | - |
| Listing expenses | - | (1,652) | (1,228) | (626) | (6) |
| Administrative expenses | (17,915) | (16,880) | (25,511) | (4,775) | (6,484) |
| Foreign exchange gains (net) | (3,060) | (2,397) | (337) | 14 | 200 |
| Fair value loss on derivative financial instrument | 929 | (479) | (24) | (2,501) | (8) |
| Loss from jointly controlled entity | - | (1,000) | (634) | (150) | (209) |
| Finance costs | (371) | (203) | (190) | (321) | (39) |
| **Loss before taxation** | (22,184) | (21,506) | (26,178) | (7,906) | (6,398) |
| Taxation | - | (214) | (3,471) | (93) | 103 |
| **Net loss and comprehensive loss for the period attributable to shareholders** | (22,184) | (21,720) | (29,649) | (7,999) | (6,295) |
| **Loss per share attributable to shareholders** | | | | | |
| Basic and diluted | (0.40) | (0.20) | (0.15) | (0.05) | (0.02) |

## Consolidated Statement of Cash Flows

| | **Financial year ended 31 December** | | | **Three months ended 31 March** | |
|---|---|---|---|---|---|
| | **IFRS 2008** | **IFRS 2009** | **IFRS 2010** | **IFRS 2010** | **IFRS 2011** |
| **Cash flow from operating activities** | | | | | |
| Loss before taxation for the period | (22,184) | (21,506) | (26,178) | (7,906) | (6,398) |
| Adjustments for | | | | | |
| Share based payments | 4,419 | 2,628 | 5,956 | 1,193 | 1,193 |
| Net finance cost (income) | (461) | 127 | 112 | 309 | 7 |
| Unsuccessful exploration and evaluation exp | 2,292 | 887 | - | - | - |
| Depreciation, depletion and amortisation | 4,333 | 3,238 | 5,885 | 692 | 2,612 |
| Payment of royalties | - | - | (78) | - | - |
| Fair value loss on derivative financial instrument | (929) | 479 | 24 | 2,501 | 8 |
| Listing expenses | - | - | 351 | 351 | - |
| Net unrealised foreign exchange loss | 1,277 | 1,120 | (75) | 33 | 43 |
| Loss from jointly controlled entity | - | 1,000 | 634 | 150 | 209 |
| Deferred revenue | - | 3,113 | (663) | (909) | (2,422) |
| Net change in non-cash capital | (844) | (1,160) | (2,792) | (1,786) | (322) |
| **Net cash used in operating activities** | (12,097) | (10.074) | (16,824) | (5,372) | (5,070) |
| **Cash flow from investing activities** | | | | | |
| Interest received | 832 | 76 | 61 | 3 | 32 |
| Expenditure on exploration and evaluation assets | (6,519) | (22,648) | (31,688) | (1,770) | (1,866) |
| Expenditure on property, plant and equipment | (36,288) | (9,573) | (6,605) | (2,673) | (8,986) |
| Investment in restricted cash | (269) | (72) | (356) | (28) | (2) |
| Payments made on behalf of jointly controlled entity | - | - | (14,070) | (2,280) | (2,878) |
| Acquisition of subsidiary, net of cash received | - | 532 | - | - | - |
| Sale of subsidiaries, net of cash disposed | - | (112) | - | - | - |

| | Financial year ended 31 December | | | Three months ended 31 March | |
|---|---|---|---|---|---|
| | IFRS 2008 | IFRS 2009 | IFRS 2010 | IFRS 2010 | IFRS 2011 |
| **Cash flow from operating activities** | | | | | |
| Movement in advances to construction contractors | 1,548 | 829 | (3,298) | (1,027) | (1,827) |
| Value added tax receivable | (2,091) | (670) | (4,148) | (451) | (905) |
| Net change in non-cash working capital | (217) | 1,273 | 3,461 | (10) | (52) |
| **Net cash used in investing activities** | (43,004) | (30,365) | (56,643) | (8,236) | (16,484) |
| **Cash flow from financing activities** | | | | | |
| Proceeds from issuance of short-term borrowings | - | 2,500 | - | - | - |
| Repayment of short-term borrowings | - | (2,500) | - | - | (86) |
| Proceeds from issuance of long-term borrowings | 7,430 | 5,020 | 1,840 | 1,840 | - |
| Repayment of long-term borrowings | (579) | (856) | (4,974) | (347) | - |
| Interest paid on long-term borrowings and other non-current payables | (380) | (152) | (1,036) | (193) | (100) |
| Other non-current liabilities | (253) | (109) | (296) | (70) | (76) |
| Proceeds related to shares to be issued | - | 3,750 | - | - | - |
| Proceeds from issuance of equity, net of issue costs | 45,754 | 17,906 | 149,770 | 54,022 | - |
| **Net cash generated from financing activities** | 51,972 | 25,559 | 145,304 | 55,252 | (262) |
| Effects of exchange rate changes on cash and cash equivalents | (1,363) | (23) | 1 | (14) | 81 |
| **Net increase/(decrease) in cash and cash equivalents** | (4,492) | (14,903) | 71,838 | 41,630 | (21,735) |
| Cash and cash equivalents at begging of the period | 26,692 | 22,200 | 7,297 | 7,297 | 79,135 |
| **Cash and cash equivalents at end of the period** | 22,200 | 7,297 | 79,135 | 48,927 | 57,400 |

## Consolidated Statement of Changes in Equity

| | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|
| | Share capital $ | Share premium $ | Accumulated deficit $ | Options reserves $ | Warrants reserves $ | Total equity $ |
| **At January 1, 2008** | 4,511 | 94,972 | (44,470) | 4,173 | 16,555 | 75,741 |
| Comprehensive loss for the year | | | (22,184) | | | (22,184) |
| **Transaction with shareholders** | | | | | | |
| Issue of share capital | 2,128 | 47,872 | - | - | - | 50,000 |
| Cost of share issue | - | (4,246) | - | - | - | (4,246) |
| Share-based payments | - | - | - | 4,419 | - | 4,419 |
| **Total transactions with shareholders** | 2,128 | 43,626 | 0 | 4,419 | 0 | 50,173 |
| **Balance at January 1, 2009** | **6,639** | **138,598** | **(66,654)** | **8,592** | **16,555** | **103,730** |
| Comprehensive loss for the year | 0 | - | (21,720) | - | - | (21,720) |
| **Transaction with shareholders** | | | | | | |
| Issue of share capital | 6,816 | 17,245 | - | - | - | 24,061 |
| Cost of share issue | - | (2,095) | - | - | - | (2,095) |
| Share-based payments | - | - | - | 2,628 | - | 2,628 |
| | 6,816 | 15,150 | - | 2,628 | - | 24,594 |
| **Balance at January 1, 2010** | **13,455** | **153,748** | **(88,374)** | **11,220** | **16,555** | **106,604** |
| Comprehensive loss for the period | - | - | (29,649) | - | - | (29,649) |
| **Transactions with shareholders** | | | | | | |
| Issue of share capital | 12,322 | 147,780 | - | - | - | 160,102 |
| Cost of share issue | 0 | (8,274) | - | - | - | (8,274) |
| Share-based payments | 0 | - | - | 6,585 | - | 6,585 |
| Exercise of warrants | 250 | 3,681 | - | - | - | 3.931 |
| Exercise of options | 36 | 287 | - | (99) | - | 224 |
| **Total transactions with shareholders** | 12,608 | 143,474 | - | 6,486 | - | 162,568 |
| **Balance at December 31, 2010** | **26,063** | **297,222** | **(118,023)** | **17,706** | **16,555** | **239,522** |
| Comprehensive loss for the period | # | - | (6,295) | - | - | (6,295) |
| | - | - | - | - | - | - |
| **Transactions with shareholders** | - | - | - | - | - | - |
| Issue of share capital | - | - | - | - | - | - |
| Cost of share issue | - | - | - | - | - | - |
| Share-based payments | - | - | - | 1,294 | - | 1,294 |
| Exercise of warrants | - | - | - | - | - | - |
| Exercise of options | - | - | - | - | - | - |
| **Total transactions with shareholders** | - | - | - | 1,294 | - | 1,294 |
| **Balance at March 31, 2011** | **26,063** | **297,222** | **(124,318)** | **19,000** | **16,555** | **234,522** |

## 8. THE BUSINESS AND ITS ASSETS

### 8.1 General

- In summary the Company's current assets comprise:
- Two producing gas fields in Kazakhstan (Akkulka and Kyzyloi);
- A producing oilfield in Kazkhstan currently in the appraisal stage (Doris);
- Two exploration blocks in Kazkhstan (Akkulka and Kul-Bas);
- A PSC in Tajikistan (The Bokhtar Area);
- A PEC in Uzbekistan (North Urtubulak);
- Gas processing and sales infrastructure in Kazakhstan (the BCS and associated pipelines);
- A range of oilfield equipment for the Company's exclusive usage (Asia Oilfield Equipment BV).

Tabulated, the Company's current assets in Kazakhstan, Tajikistan and Uzbekistan comprise:

**COMPANY ASSETS**

| Asset | Asset Type | Holding Subsidiary | Group Equity | Gross Area | Expires |
|---|---|---|---|---|---|
| ***Kazakhstan*** | | | | | |
| Akkulka Exploration Licence and Contract | Exploration and Oilfield Appraisal | TethysAralGaz LLP | 100% | 1,380.5 $km^2$ | March 2013 |
| Akkulka[(1)] Production Contract | Gas Field | TethysAralGaz LLP | 100% | 109.5 $km^2$ | December 2018 |
| Kul-Bas[(2)] Exploration and Production Contract | Exploration | Kul-Bas LLP | 100% | 7,632 $km^2$ | November 2032 |
| Kyzyloi Field Licence and Production Contract | Gas Field | TethysAralGaz LLP | 100% | 287.2 $km^2$ | June 2014 |
| BCS | Gas Processing and Sales Infrastructure | TethysAralGaz LLP | 100% | n/a | n/a |
| ***Tajikistan*** | | | | | |
| Bokhtar PSC | Exploration; Limited Oil and Gas Production | Kulob Petroleum Limited (which is held by the Company through the joint venture 'parent' Seven Stars Energy Corporation | 51% | 34,785 $km^2$ | June 2033 |
| ***Uzbekistan*** | | | | | |
| North Urtubulak PEC[(3)] | Oil Production | Baker Hughes (Cyprus) Limited | 100% | 5 $km^2$ | Eight years from the date of the first incremental production from the final well |

| Asset | Asset Type | Holding Subsidiary | Group Equity | Gross Area | Expires |
|---|---|---|---|---|---|
| ***Corporate drilling equipment*** | | | | | |
| Telesto, Tykhe, Thoe, Pasithoe, Meliete. | Oilfield Equipment | Asia Oilfield Equipment BV | 100% | n/a | n/a |

Notes:

(1) The Akkulka Production Contract lies wholly within the Akkulka Exploration Licence and Contract area.

(2) Following the first contractual relinquishment as confirmed by the Kazakh authorities in December 2008, a further contractual relinquishment has been agreed with the Kazakh authorities which reduced the area to 7,632 km2 effective November 2009 and was confirmed by the Kazakh authorities in December 2010.

(3) TPU operates as contractor/service provider for the Uzbek State Partners under the North Urtabulak PEC. The North Urtabulak PEC does not confer ownership of the North Urtabulak Field to TPU and no reserves or resources have been attributed to TPU's interest under the North Urtabulak PEC to date.

The Company is currently producing gas from the Kyzyloi Field License and Production Contract and the Akkulka Production Contract, oil from the Akkulka Exploration License (under a pilot oil production licence), oil from the North Urtubulak PEC and small quantities of oil from the Bokhtar PSC.

As at 31 December 2010, the Company reported total gross proven hydrocarbon reserves of 7.8 million barrels of oil equivalent (MMboe), total proven and probable reserves of 19.4 MMboe and total proved plus probable plus possible reserves of 48.5 MMboe. Full details on the Company's reserves and resources (including methodologies and assumptions) can be found in Part 2 "Statement of Reserves Policies and Oil and Gas Data" of this document.

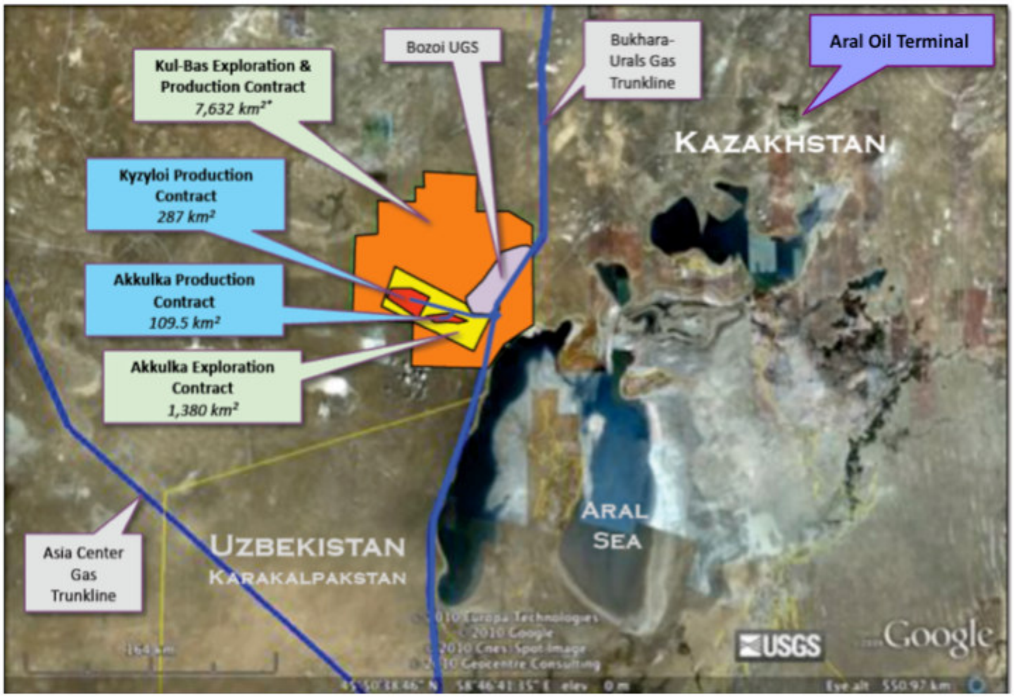
8.2 **Detailed Asset Descriptions**

(a) ***Kazakhstan***

Kazakhstan is an independent Republic, and the largest country in Central Asia by area (ninth largest in the world). The country has a population of approximately 15.5 million and borders the Russian Federation to the north, the People's Republic of China to the east and Kyrgyzstan, Turkmenistan and Uzbekistan to the south. Kazazkhstan possesses substantial hydrocarbon reserves, mainly located in the west of the country in a geological basin known as the Pre-Caspian basin.

Kazakhstan achieved independence from the USSR in 1991 and since that time has made efforts to liberalise the economic and political spheres in the country. Privatisation began in 1991/2 with the "*Law of Destatisation and Privitisation*" and "*the Programme of Destatisation and Privitisation*" regarded as key steps in the transition of Kazakhstan's economy from the Soviet command model. Currently, Kazakhstan operates a mixed economy model, with private ownership in assets permitted (governed by a series of laws, regulations and obligations) along with State-owned enterprises operating in the same sphere. In the oil and gas sphere, participation involves large foreign private companies (such as Chevron and British Gas), smaller foreign independent companies (such as Max Petroleum and Tethys Petroleum), private local companies and the State oil company (KazMunaiGaz). Politically, Kazakhstan is developing democracy with regular Parliamentary and Presidential elections and held the Chairmanship of the OSCE in 2010. The country is administered on the basis of fifteen administrative regions (*oblasts*).

The Company currently owns and operates five assets in Kazakhstan, namely: the Akkulka Production Contract, the Akkulka Exploration License and Contract, the Kyzyloi Field License and Production Contract, the Kul-Bas Exploration and Production Contract, the BCS and will own 50% of AOT (a joint venture oil rail loading terminal). All of the Company's assets are located in the Aktobe Oblast of western Kazakhstan; with the town of Bozoi representing the closest settlement to the Company's assets (with the exception of AOT, where the closest settlement is the town of Shalkar).




(*Location of the Company's Main Assets in Kazakhstan. Source: Tethys Petroleum Limited*)

The Company's assets are located in an eco region classified as Paeleartic with temperate grasslands, savannas and shrublands covering the entire area. In the vernacular, the terrain is known as 'Steppe'. The climate is semi-arid continental, with temperatures ranging from around -40°C in January to around +40°C in July and high winds sweep across the Steppe from time-to-time. Average annual precipitation is around 327 mm, with average monthly precipitation ranging from 14 mm in February to 50 mm in July. The Aral Sea is located to the south–east of the Company's assets. Geologically, this region is known as the *North Ustyurt* basin.

*Akkulka Production Contract*

The Akkulka Production Contract refers to a 109.5 $km^2$ area located entirely within the Akkulka Exploration Licence and Contract Area. The Company, through its subsiduary TAG, holds a 100% interest in the Akkulka Production Contract. Currently, the Company produces natural gas from the Akkulka Production Contract.

After a series of exploration successes targeting shallow gas reservoirs on the Akkulka Exploration License and Contract Area, the Company (through its subsidiary TAG) signed the Akkulka Production Contract with the MEMR on 23 December 2009 granting TAG exclusive rights to produce gas from the Akkulka Production Contract for an initial period of nine years. The Akkulka Production Contract currently expires in December 2018.

Geologically, the Akkulka Production Contract produces gas from sandstones of Eocene age at depths between 300 and 600 metres.

Currently, there are five producing wells located on the Akkulka Production Contract, all of which are tied in to the Company's BCS for processing and sale into the Bukhara-Urals pipeline. Commercial production of gas under the Akkulka Production Contract commenced on October 6 2010, after the conclusion of a two-year gas sales agreement with Asia Gas NG LLP, the "**Akkulka Gas Supply Contract**". Gas is currently being sold into the domestic market for a price of $33.95/mcm net of VAT ($38/mcm including VAT) and the price is due for reassesement in October 2011. TAG sold 24.2 mmcm to Asia Gas N6 LLP under the Akkulka Gas Supply Contract for the year ended December 31 2010.

The Akkulka Production Contract is subject to MET, which replaced royalties in 2009. MET is calculated at a rate between 0.5% to 1.5% of the value of annual gas production for domestic sales and 10% for exported sales. MET currently payable on the Akkulka Production Contract is 0.5%. Upon commencement of commercial production from the Akkulka Production Contract, a total amount of $3,500,000 was due to the Kazakh State as a reimbursement for historical costs previously incurred in relation to the Akkulka block. For the Akkulka Production Contract area, staged payments totalling approximately $930,997 will be due to the Kazakh State, payable over a period of nine years.

According to the McDaniel Reserve Report, effective 31 December 2010, total gas Reserves in the Akkulka Block (which includes reserves across five producing and a further six discovered gas wells in the wider Akkulka Exploration License and Contract) Proved plus Probable plus Possible net to the Company's interest are: 38.6 Bcf (1.09 Bcm) with Proved plus Probable Reserves being 26.1 Bcf (0.7 Bcm) and Total Proved Reserves being 13.8 Bcf (0.4 Bcm). Development of these reserves by expansion of the Kyzyloi gas development program began in 2008 with the tying in of the Akkulka Production Contract wells to the existing BCS export infrastructure and with the installation of an additional 1,046 hp (780 kW) of compression at the BCS to significantly increase overall gas production. This work was completed in the third quarter of 2009.

In addition to gas production on the Akkulka Production Contract area, the Company has recently identified a number of additional shallow gas prospects and leads based upon existing data and recently acquired 2D and 3D seismic.

*Akkulka Exploration Licence and Contract*

The Akkulka Exploration Licence and Contract covers an area of some 1,380.5 km$^2$ area. The Company, through its subsidiary TAG, holds a 100% interest in the Akkulka Exploration Licence and Contract. Currently, there is one producing well located on the Akkulka Exploration License and Contract.

The Akkulka Exploration License and Contract was entered into between the Kazakh State Committee of Investments and TAG on 17 November 1998 and the Akkulka Exploration License and Contract was valid from that date until 17 November 2003. On 5 July 2004, the license was extended under Addition #2 (State Registration #1447) to the Akkulka Exploration License and Contract until 17 September 2005. The Akkulka Exploration License and Contract was then extended a further four times:

(i) on 26 June 2006 from 17 September 2005 to 17 September 2007 under Addition #3 (State Registration #2082);

(ii) on 8 November 2006 from 17 September 2007 to 17 September 2009 under Addition #4 (State Registration #2481);

(iii) on 9 December 2010 from 17 September 2009 to 10 March 2011 under Addition #7 (State Registration #3463); and

(iv) on 17 November 2010 from 10 March 2011 to 10 March 2013 under Addition #8 (State Registration #3622).

Owing to the large number of prospective hydrocarbon deposits contained within the Akkulka Exploration License and Contract, the Company has named each of the prospects.

The producing well, Doris, was discovered in February 2010 and initial production under a test production programme commenced in September 2010. Oil was sold to local traders at the wellhead. In January 2011, the Company received approval from MOG for the Pilot Production Project for the Doris discovery on the Akkulka Exploration License and Contract, which permits TAG to produce oil up to an initial rate of 4,247 bopd maximum average daily rate of oil production under current permissions during the exploration phase of the Akkulka Exploration License and Contract. In addition, TAG is installing production facilities for the planned 3,000-4,000 bopd production target. After the installation of these facilities, oil will be cleaned and then sold to Eurasia Gas Group LLP, a Kazakh oil trading group who will partner with the Company on a new rail loading terminal for oil. A production contract (a full field development programme including Kazakh State reserves and the right to export produced oil) will be applied for once the initial Doris discovery (and possible satellites) has been fully appraised. The total production during the 86 day test production period (September 2010 – November 2010) from the Doris well was 50.87 mbbl.

Besides the installation of the initial production facilities at the Doris well, the Company has an extensive geophysical and drilling appraisal and exploration programme underway on the Akkulka Exploration License and Contract. The Company is either drilling or testing the following wells on the Akkulka Exploration License and Contract: AKD02, AKD03, AKD04, AKD05 and G6-RE. AKD06 is planned to spud later in 2011. In addition to this drilling work, the Company has completed 2D and 3D seismic and other forms of geological analysis. A further exploration oil discovery has now been made in a secondary target where Jurassic sandstones produced dry oil at a rate in excess of 400 bopd on the Dione prospect.

According to the McDaniel Reserve Report, effective 31 December 2010, total oil Reserves in the Akkulka Block (Proved plus Probable plus Possible) net to the Company's interest are 24.98 mmbbls with Proved plus Probable Reserves being 7.75 mmbbls and Total Proved Reserves being 2.78 mmbbls. The Company believes that these test results, including pressure transient analysis ("**PTA**"), indicate that the Doris well is tied into a reservoir in respect of which the volume of oil will be significantly in excess of reported reserves as at 31 December 2010 if the volume is proved to be principally oil.

Geologically, the Doris discovery produces oil from sandstones of Lower Creteacous age at approximately 2,200 metres and from Jurassic carbonates at approximately 2,500 metres.

*Kyzyloi Field License and Production Contract*

The Kyzyloi Field License and Production Contract refers to a 287.2 $km^2$ area, extending vertically from the surface to the base of the Paleogene sequence (approximately 750 meters in depth).

The Kyzyloi Field License and Production Contract for production of gas on the Kyzyloi field was initially issued by the Kazakh State to the State holding Company KazakhGaz on 12 June 1997 and was transferred to TAG on 15 May 2001. The contract was entered into between TAG and MEMR on 5 May 2005, initially until 12 June 2007. However, in January 2005, MEMR agreed to extend the contract until June 2014, subject to certain contract amendments, which the Company finalized in 2007 by signing Addition #1 on 8 November 2007 (State Registration #2480). Gas production from the Kyzyloi Field License and Production Contract commenced in December 2007, after the conclusion of a gas sales contract with GazImpex S.A.

Currently, the Company is producing gas from the Kyzyloi field and processing and transporting it to the Bukhara Urals pipeline for sale. Gas is sold under a long-term take-or-pay contract with Asia Gas NG LLP, which expires on 1 December 2012 or when 850 mmcm of gas is delivered (whichever is the earlier). Gas is sold for a price of $35.84/mcm including VAT at the current 12% rate or $32/mcm excluding VAT. The Company has the ability to offset VAT levied on the sale of gas from the Kyzyloi Field License and Production Contract against VAT costs on the Kyzyloi Field License and Production Contract.

Current production from the Kyzyloi Field License and Production Contract is around 308.8 mcm (average April 2011), and total yearly production for the period ended December 31 2010 was 393.4 mmcm.

According to the McDaniel Reserve Report, effective 31 December 2010, total gas Reserves in the Kyzyloi Field and License Area Proved plus Probable plus Possible net to the Company's interest are 36.45 Bcf (1.03 Bcm) with Proved plus Probable Reserves being 32.29 Bcf (0.9 Bcm) and Total Proved Reserves being 13.97 Bcf (0.39 Bcm). Development of these reserves began in 2007 with the Kyzyloi wells being tied-into the Company's BCS for processing and sale into the Bukhara-Urals pipeline.

Geologically, the Kyzyloi Filed License and Production Contract produces gas from a sandstone of Eocene age at around 400 metres.

*Kul-Bas Exploration and Production Contract*

The Kul-Bas Exploration and Production Contract refers to a 7,632 $km^2$ area surrounding the Kyzyloi and Akkulka blocks.

The Kul-Bas Exploration and Production Contract was signed between Kul-Bas LLP, a wholly-owned subsidiary of the Company, and MEMR on 11 November 2005. This contract, which was initially granted for a period of 25 years with an initial six-year exploration period and a 19-year production period, grants Kul-Bas LLP the exploration and production rights over an original 2,688,695 acres (10,881 $km^2$) surrounding the Akkulka and Kyzyloi Blocks. The contract was amended in February 2011, and the Company has received approval for the extension of the exploration period to 11 November 2013. Pursuant to the Kul-Bas Exploration and Production Contract, 20% of the area is to be relinquished at the end of the second year of the contract, with 20% to be relinquished annually thereafter up to the end of the exploration period, except with respect to combined exploration and production contracts (which mainly only contain a work program for exploration and not production) for areas where commercial discovery is made. This contract grants Kul-Bas LLP an exclusive right to proceed to the production period where it has made a commercial discovery. The first relinquishment was made in November 2007 and was confirmed by the Kazakh authorities on 21 December 2008. A further relinquishment reduced the area to 7,632 $km^2$ effective November 2009. Kazakh authorities confirmed this in December 2010. In order to allow the Company time to effectively explore Kul-Bas Block, an application was made by the Company to reduce and/or extend the relinquishments on it. On 27 April 2009, Amendment 1 to the Kul-Bas Exploration and Production Contract was signed, according to which 20% is relinquished by the end of contract year 2 (completed), 0% in contract year 3 (2008), 10% by the end of contract year 4 (completed), 20% by the end of year 5 (2010) and all remaining contract area, outside commercial discovery areas, by the end of year 6 (2011). Effective 29 November 2009, a relinquishment was agreed with the Kazakh authorities to be made by the end of the exploration period, 11 November 2013.

On 20 August 2010, MOG agreed to extend the exploration period for the Company's Kul-Bas Exploration and Production Contract for two years from 11 November 2011 to 11 November 2013. The extension to the exploration period gives the Company an additional two years to explore this area that has several prospects and leads and with a proved oil system in the Akkulka Block which is surrounded by the Kul-Bas area.

Provided that certain standards and requirements are satisfied, sub-contractors, goods and materials (50%), works (70%) and/or services (70%) used in Kul-Bas operations under this contract must be of Kazakh origin, and Kazakh specialists must comprise not less than 95% of the total number of Kul-Bas LLP employees. On an annual basis, Kul-Bas LLP must contribute not less than 1% of its investments to the professional education of Kazakh personnel involved in the project during exploration and not less than 0.1% of the operational costs during production. Kul-Bas LLP is also required to establish a fund for reclamation of the contract area; contributions to this fund are required to be made annually and must be equal to 1% of the total investment expenses incurred during exploration and 0.1% of the total amount of operational costs during production.

Following exploration success at deeper levels in the Akkulka Block, the Company considers the much larger Kul-Bas block to also have significant oil and gas potential in deeper horizons ranging from the Carboniferous through to the Cretaceous. The target reservoir units are considered to be Jurassic marine carbonates and clastics and Cretaceous marine sandstones as demonstrated by AKD-01 (on the Akkulka block) and also deeper levels Triassic and Permo Carboniferous. The most likely source rocks for both plays would be the Jurassic as in AKD-01 or lacustrine Triassic age sediments

The acquisition of new 2D seismic by TAG in 2007 and the seismic reprocessing of the JNOC dataset across Kul-Bas completed in 2009 was aimed at both shallow gas prospects and to highlight deeper plays. In 2010, further 2D seismic was specifically targeted at deep prospects identified. Based on this confirmatory dataset, the Company spudded KBD01, a well with a planned total depth of 4,000 m (13,120 ft) on the "Kalypso" prospect, in December 2010 to test a sizeable oil prospect but with significant exploration risk remaining at present (although recently reduced by the AKD01 and AKD03 oil discoveries). KBD01 is due for completion in the third quarter of 2011. Further exploration prospects have been identified for future drilling.

The seismic acquisition in 2007 and 2010, the reprocessing in 2009, and the drilling of three shallow gas exploration wells in 2008 plus the deep well now spudded, has more than fulfilled the relevant license work obligations to date.

There are currently no proven reserves on the Kul-Bas block.

*Aral Oil Terminal*

On 17 February 2010, the Company announced that its wholly owned subsidiary, TMG, had signed a Joint Venture agreement with Eurasia Gas LLP to construct and operate a rail oil loading terminal in Kazakhstan.

The terminal is currently in the initial planning and registration stages.

*Booster Compressor Station*

The Booster Compressor Station (or BCS) refers to the Company's gas processing and sales infrastructure, currently being used to deliver gas from the Akkulka Production Contract and the Kyzyloi Field License and Production Contract to market.

The BCS includes:

- A 56 km long, 325 mm in diametre gas pipeline from the Kyzyloi field to the main Bukhara-Urals trunk pipeline;
- Five gas compressors;
- Gas cleaning and processing units;
- Control, monitoring and metering systems
- Pipelines to gather gas from wells on the Akkulka and Kyzyloi fields for transportation to the gathering and processing facility.
- The Company constructed the BCS in 2007, upgraded it in 2009 and the asset has been used since that time exclusively for the gathering, processing and transport of the Company's gas production for sale under the Akkulka and Kyzyloi gas contracts.

(b) ***Tajikistan***

Tajikistan is an independent Central Asian Republic of approximately seven million people, located on the fringe of the Central Asian sedimentary basin, bordered by the Pamir and Tien-Shien mountains. The country borders Uzbekistan, Kyrgyzstan, the People's Republic of China and Afghanistan. Tajikistan's geography is primarily mountainous, but also has extensive farmed valleys and hills. Oil was first discovered in 1909 in the north (the Fergana valley) but exploration and development of oil and gas resources was limited during the Soviet period.

After achieving independence in 1991, the country experienced a civil war lasting from 1992-1997; severely limiting economic and political development. As such, infrastructure remains poor and the economy remains depressed (although there has been an increase in domestic and international investment in recent years). The oil and gas industry has suffered from extreme under-investment and basic modern oilfield equipment and infrastructure is lacking, with drilling rigs and other equipment being of 1960-1970s vintage. At present, as far as the Company is aware only Gazprom and the Company are actively exploring for hydrocarbons in the Tajikistan.

Politically, Tajikistan is a Presidential Republic with a multi-party Parliamentary system and frequent elections.

The Company currently owns one asset in Tajikistan: the Bokhtar PSC, which covers an area of 34,785 $km^2$ from Dushanbe in the north to the border with Afghanistan in the south. Geologically, this region is known as the Afghan-Tajik portion of the Amu Dayra basin.

*The Bokhtar PSC*

The Bokhtar PSC refers to a 34,785 km$^2$ area in the south-west of Tajikistan.


(*The Bokhtar PSC Area. Source: Tethys Petroleum Limited*)

The Bokhtar PSC was originally signed on 13 June 2008 by the government of Tajikistan and KPL. The PSC grants exclusive rights to KPL to explore for, develop and produce hydrocarbon resources in the area for a twenty-five year period. Under the terms of the agreement, KPL is able to recover 100% of cost incurred during hydrocarbon operations from 70% of hydrocarbon production. The remaining production is then shared between KPL and the State with 70% to KPL and 30% to the State.

Prior to KPL signing the Bokhtar PSC in 2008 a joint venture agreement was put in place to own KPL. However it was not until 30 December 2009, that the Joint Venture agreement was completed between TTL and Sangam Limited, creating a new entity, SSEC. Following this KPL and TSTL were transferred to SSEC, and currently the Company holds a 51% equity stake in SSEC whilst Sangam holds a 49% stake with TTL having management control of the joint venture. Hydrocarbon operations under the Bokhtar PSC are conducted by TSTL, a wholly-owned subsidiary of SSEC. The Company has operational control of the Bokhtar PSC. In addition to the creation of the SSEC Joint Venture, the Company also executed a loan agreement to provide funds to SSEC to finance work programs and field development plans in Tajikistan.

Work programmes and other operational commitments are decided at a joint level between the Company and the government of Tajikistan through a committee known as the "Co-ordination Committee". Both sides involved with the Co-ordination Committee have a right to appoint representatives to discuss forward work programmes and the general development of the Bokhtar PSC area (three representatives each). Decisions reached by the Co-ordination Committee are made by a majority vote; and in the event of the Co-ordination Committee being unable to reach a decision, the Company's view shall prevail.

Under the terms of the Bokhtar PSC, the Company must propose, commit to and fund a minimum work programme for the development of hydrocarbon resources on a regular basis. Initially, under the "Phase 1" portion of the minimum work programme (2007-2009), the Company committed to gathering, reprocessing and interpreting geological and geophysical data, both new and Soviet vintage, to inform the exploration work to be undertaken on the Bokhtar Area. The Phase 1 portion was completed in 2009. The second work programme, Phase 2, was agreed and took effect from December 2009. Under the terms of this second work programme, the Company has committed to further 2D seismic, an aeromagnetic gravity survey and a 3,000 m exploration well.

Under the Bokhtar PSC, any development plan for a particular development area should include an abandonment and site restoration program together with a funding procedure for such program. All funds collected pursuant to the funding procedure should be allocated to site restoration and abandonment and be placed in a special interest bearing account by KPL which shall be held in the joint names of the State of Tajikistan and KPL or their respective nominees, or its designee. KPL's responsibilities for environmental degradation, site restoration and well abandonment obligations, and any other actual contingent and potential activity associated with the environmental status of a particular development area shall be limited to the obligation to place the necessary funds in the approved account. In addition any relinquished areas must be brought into the same condition as they were prior to their transfer to KPL (soil fertility condition, quality of the ground and environment). All expenditures incurred in abandonment and site restoration are cost recoverable. An independent environmental base line study was carried out on the Beshtentak Field.

In addition to preparatory exploration work on the Bokhtar PSC, the Company has also undertaken a programme of field redevelopment and rehabilitation on the Beshentak, Komsomolsk and Khoja Sartez fields; and is currently drilling an exploration well on the East Olimtoi prospect.

According to the TRACS Reserve and Resource Report, effective 31 December 2010, total oil and gas Reserves in the Bokhtar PSC area Proved plus Probable plus Possible net to the Company's interest are 7.00Bcf (0.204 BCM) and 0.0607 mmbbls oil and condensate with Proved plus Probable Reserves being 3.5 Bcf (0.105BCM) plus 0.0354mmbbls oil and condensate and Total Proved Reserves being 1.3 Bcf (0.037BCM) and 0.0038mmbbls oil and condensate.

TRACS AGR audit also confirms unrisked exploration leads with a possible potential of 1132 Mmboe.

(c) ***Uzbekistan***

Uzbekistan is the most populous country in Central Asia, with a population of approximately 27 million. Uzbekistan is the world's second-largest cotton exporter and also exports significant quantities of gold and natural gas.

Uzbekistan is a primarily dry country, with intensively cultivated irrigated river valleys and semi-arid desert. The Fergana valley in the east of the country is primarily mountainous and has a temperate climate. Oil production began in the early 1900s and has developed since then, with intensive activity during the Soviet period. Currently, the oil and gas industry in Uzbekistan is managed by UNG, and there have been a handful of blocks awarded to large (normally State-owned) international oil companies. Uzbekistan is the largest exporter of gas in Central Asia.

The Company owns one asset in Uzbekistan, the PEC of the North Urtabulak oilfield; which is located in the south-east of the country. Geologically, this region is known as the Amu Darya basin.

*North Urtabulak PEC*

The North Urtabulak PEC refers specifically to the North Urtabulak oil field, a 5 km2 area located in the south-east of the country.


(*Location of the North Urtubulak PEC. Source: Tethys Petroleum*)

The North Urtabulak PEC is held by BHCL trading under the name TPU a wholly-owned subsiduary of the Company. The North Urtabulak PEC is a form of service contract, under which the Company performs advanced oilfield recovery and field optimisation techniques in order to increase oil production over and above a predetermined baseline. The PEC has a contractual cumulative quantity of oil that UNG expects the Company contractually to produce. Notwithstanding this amount having been exceeded, UNG continues to provide new work under the PEC for the Group as the work programme and budget under the North Urtabulak PEC is approved by an operation committee which is jointly run by TPU and Uznaltegazdoycha. Reservoir modelling recently completed by OPC on behalf of TPU suggests that there may still be significant quantities of oil to be realised from the North Urtabulak reservoir. The Company and the Directors concur with this view. Any production from an individual well that achieves production higher than the baseline (**"Incremental Production"**) is split 50:50 with UNG for the first three years of production and 20:80 (in favour of UNG) for the remaining five years of production. After the eight year period has expired, the well is returned to UNG unless substantial additional work (such as sidetracking) is conducted. In the event of such additional work being carried out on a well, the production sharing clock is effectively reset and the initial three year period recommences. The PEC has successfully been in operation since 1999 and has to date produced over 765,000 tonnes of incremental oil. The PEC continues for an indefinite term and terminates after eight years from the date of the first incremental production (of oil) from the final well drilled by or used by TPU.

Within the North Urtabulak PEC, in the event that TPU advises the operating committee that it no longer intends to perform any operating services on a well then it is required to plug and abandon such well at its own expense or the State gas company shall immediately assume responsibility for such well. In the latter event TPU shall have no responsibility with regard to plugging and abandoning the well. While operating the well TPU is required to observe all environmental laws of Uzbekistan.

As of 31 December 2010, there were 117 wells on the North Urtabulak field, of which TPU was producing from 16. As of that date, total gross field production was approximately 2,800 bopd, of which 1,178 bopd was net to TPU. Since acquiring the North Urtabulak PEC in April 2009, TPU has completed a full field reservoir model, optimised field development, drilled two new wells (including one horizontal sidetrack) and has conducted an ongoing programme of complex workovers, routine interventions and radial drilling. The most recent well (NUR96-H2) tested at an initial rate of 1,107 bopd in February 2011.

Geologically, the North Urtabulak field produces oil from a carbonate reservoir of Jurassic age, and from a depth of approximately 2,500m.

Under the terms of the PEC, TPU receives an allocation of incremental crude oil which is then transported to the Fergana refinery at UNG's cost. After refining, TPU receives an allocation of refined petroleum products, which are then sold to marketing agents for export. Notwithstanding any loss of capacity at the Fergana refinery, the Uzbek State would still be obligated under the North Urtabulak PEC to provide this allocation of refined petroleum products. Refined product sales in 2010 generated approximately $9,800,000 in revenue for TPU.

Under the terms of the PEC, and following regulatory rules, currently no reserves are attributed to the Company due to the nature of the contract.

In addition to the Company's North Urtubulak PEC, the Company is looking to acquire new exploration acerage under a PSC or other arrangement and/or a new oilfield under a similar relationship to the existing PEC. Further to this, on 8 September 2010, the Company signed an MOU with UNG to conduct joint studies to determine the possibility of improving hydrocarbon recovery on certain existing fields in Uzbekistan with a view to entering a new contract; most likely under a similar arrangement to the Company's existing North Urtubulak PEC. Progress with UNG is ongoing.

### 8.3 Rigs and Equipment

The Company sees significant benefit both operationally and from a cost perspective in owning and operating its own drilling and production equipment. In the areas in which the Company operates, it is often difficult and expensive to source third party drilling and related contractors, and this not only has cost implications but also has the potential for delays and lack of flexibility. It is not the Company's strategy to become a service provider – its equipment is primarily for its own projects. However, if the equipment is not being utilised for the Company's operations, then such equipment may be hired out to third parties.

The Company has established a wholly-owned Dutch subsidiary, Asia Oilfield Equipment B.V. ("**AOE**") to own some of its drilling rigs and other production equipment. A wholly-owned Luxembourg subsidiary , AOE Tykhe S.A., was established to own the ZJ30 "**Tykhe**" rig.

Currently the main pieces of equipment which are owned by the Company are as follows:

| | |
|---|---|
| Rig "Telesto" | ZJ70/4500L 2,000 hp (1,470 kW) 450 tonne hookload diesel mechanical drilling rig which was constructed for the Company at the Sichuan Honghua Petroleum Equipment Co., Ltd. factory in Chengdu, China. This has a nominal drilling depth of over 7,000 m (23,000 ft) and is one of the largest rigs in Central Asia. Telesto is currently in Kazakhstan. |
| Rig "Tykhe" | ZJ30/1700 CZ 1,080 hp (792 kW) 180 tonne hookload diesel truck mounted mechanical drilling rig, which was constructed for the Company at the factory in Nanyang, China. This rig has a nominal drilling depth of approximately 3,000 m (9,843 ft). Tykhe is currently in Tajikistan. |
| Rig "Thoe" | UP60/80 400 hp (294 kW) 80 tonne hookload diesel truck mounted mechanical drilling rig with a nominal drilling depth of 2,000 m (6,562 ft) (with 24 kg/m drilling pipes) and workover depth of 4,000 m (13,123 ft) (with 14 kg/m pipes). Thoe is currently in Kazakhstan. |
| Rig "Pasithoe" | A50 330 hp (243 kW) 50 tonne hookload diesel truck mounted mechanical drilling/workover rig. Pasithoe is currently in Tajikistan. |
| Rig "Melite" | A37, 37 tonne diesel truck mounted workover rig primarily used for pulling tubing and light workovers in the Kyzyloi/Akkulka area. |
| In addition, the Group owns additional equipment such as a workover coiled tubing unit, 25 and 50 tonne cranes, GJC40-17 Cementing Unit, forklifts, trucks, and pipeline welding equipment. | |

## 9. RESERVES DATA AND OTHER RELATED INFORMATION

As at 31 December 2010, the Company reported total gross proven hydrocarbon reserves of 7.8 million barrels of oil equivalent (MMboe), total proven and probable reserves of 19.4 MMboe and total proved plus probable plus possible reserves of 48.5 MMboe, in respect of its operations in Kazakhstan and

Tajikistan. For the reasons set out in Part 2 of this document, the Company does not currently attribute any reserves to its operations in Uzbekistan.

Details of the Company's oil and gas reserves and certain other related information can be found in "Part 2 – Statement of Reserves Data and other Oil and Gas Information".

## 10. DIVIDEND POLICY

The Company has not declared or paid any dividends or distributions on the Ordinary Shares to date. The payment of dividends or distributions in the future are dependent on the Company's earnings, financial condition and such other factors as the Board of Directors considers appropriate. The Company currently does not anticipate paying any dividends in the foreseeable future due to the stage of development of the Company. The Articles state, subject to the Cayman Companies Law, the Directors may declare dividends in accordance with the respective rights of the members and authorise the payment of the same out of funds of the Company lawfully available therefore; and the Company may by ordinary resolution declare dividends in accordance with the respective rights of the members but no dividend shall exceed the amount recommended by the Directors.

## 11. REASONS FOR LISTING

The Group has grown significantly since admission to the TSX in 2007 and the Board considers a listing on the Official List to be a significant stepping stone to help to further grow and develop the Company.

Furthermore, the Directors believe that due to the high number of institutional investors (and specifically the number of institutional investors required exclusively to trade in Official List companies), as well as the high profile of Official List companies, the Company will be better placed to improve liquidity in the Ordinary Shares when they are admitted to the Official List and to trading on the main market of the London Stock Exchange.

## 12. ENVIRONMENTAL AND SOCIAL RESPONSIBILITY

***Environmental Responsibility***

The Company's operations are subject to environmental regulations in the jurisdictions in which it operates and the Company carries out its activities and operations in material compliance with all relevant and applicable environmental regulations and pursuant to best industry practices.

In Kazakhstan, quarterly environmental compliance reports are required to be submitted by the Company to relevant government authorities. The Company may be required to make payments to the Kazakh State in respect of certain emissions. Prior to the introduction of enhanced environmental regulations in 2010, the payments made by the Company in terms of environmental issues were quite small. In respect of the Kazakh operations, the Group's annual cost of compliance of environmental obligations amounted to approximately 2.1 million Tenge in 2007 ($14,000), 4.9 million Tenge in 2008 ($32,666) and 1.9 million Tenge ($12,666) in 2009.

In 2010, the Kazakh State introduced enhanced environmental regulations which included relevant payments and costs for emissions, industrial wastes, environmental monitoring and implementation of nature-conservative measure plans together with an additional payment for each well drilled. These new regulations included the depth and amount of waste produced during drilling and the amount of gas that may be flared. The payment cannot be calculated in advance, or even projected, as it depends on the Group's geological and engineering team during the drilling. The figure for which the Company was liable in 2010 was 65 million Tenge ($433,333).

In Tajikistan, under the Bokhtar PSC, any development plan must also include an abandonment and site restoration program together with a funding procedure for such program. All funds collected pursuant to the funding procedure shall be allocated to site restoration and abandonment and will be placed in a special interest bearing account by KPL which shall be held in the joint names of the Tajik State and KPL or their respective nominees, or its designee. KPL's responsibilities for environmental degradation, site restoration and well abandonment obligations, and any other actual contingent and potential activity associated with the environmental status of the development area is limited to the obligation to place the necessary funds in the approved account. In addition any areas relinquished must be restored to the same environmental condition as they were prior to the date of the Bokhtar PSC (soil fertility condition, quality of the ground and environment). All expenditures incurred in abandonment and site restoration are cost recoverable. An independent environmental base line study was been carried out on the Beshtentak Field.

The Company's operations in Uzbekistan are required to be in compliance with both the terms of the North Urtabulak PEC and with the environmental legislation of Uzbekistan and TPU shall use reasonable endeavours, so far as consistent with performing the services in accordance with international oil industry standards, to protect natural resources and to avoid pollution and damage to the environment. The North Urtabulak PEC states that TPU shall have no liability for any environmental claim arising from the transportation or refining of hydrocarbons produced from the North Urtabulak Field. TPU, as the contractor, shall indemnify and hold harmless Uzneftegazdobycha, the refining agent and the marketing agent for control and removal of pollution or contamination which originates above the surface of the land from spills of oils, lubricants, motor oils, normal water based drilling fluids and attendant cuttings, pipe dope, paints, solvents, ballast, bilge and garbage wholly in TPU's possession and control and directly associated with TPU's equipment and facilities. Other than this, TPU shall have no liability for any environmental claims arising in connection with the services provided under the North Urtabulak PEC and Uzneftegazdobycha shall indemnify and hold harmless TPU against any such environmental claims. An environmental baseline study and aerial survey of the North Urtabulak Field was conducted prior to the commencement of field rehabilitation operations. Throughout the ten year history of drilling and work program operations at the North Urtabulak Field, TPU has been in complete compliance with all relevant environmental legislation. Uzneftegazdobycha will promptly reimburse TPU for any environmental claim that it may suffer or incur. TPU's drilling and work program operations are carried out in strict compliance with the Uzbek environmental protection legislation, and with Group corporate policy to minimize the environmental impact of the operations.

All senior office and field personnel have previously worked for major western oil and gas operators and are familiar with western standards of environmental protection and legislation. To the Company's knowledge, no new technology has been used, nor has any research and development been undertaken to reduce the environmental impact of the work program and drilling operations on the North Urtabulak Field as the existing system is adequate. Potential risks to the environment resulting from work program and drilling operations on the North Urtabulak Field are addressed through the existing environmental impact procedures of TPU, via environmental impact assessments and via pre-job safety meetings, at which potential environmental risks are discussed. In the oil and gas industry, Uzbek legislation is enforced by a government body known as Gosgortechnadzor. Representatives of Gozgortechnadzor perform routine inspections of the North Urtabulak Field operations to ensure compliance with these regulations.

At present, the Company believes that it meets all applicable environmental standards and regulations, in all material respects, and has included appropriate amounts in its capital expenditure budget to continue to meet its environmental obligations.

***Social Responsibility***

The Company's social responsibility strategies include environmental compliance and the promotion of fundamental relationships with local communities in the areas in which the Company operates and also with the provincial and national authorities of such areas. Local employment is promoted by identifying, providing and supporting job opportunities within the Company's operating areas. In the opinion of management, this has been well received by the local communities and has contributed to maintaining a positive relationship in and around the Company's areas of operation. The Company contributes part of its annual expenditure to education and training programs in the regions in which it operates.

In Kazakhstan, in line with its subsurface use contracts, Tethys is required to invest $90,000 annually (Kyzyloi Production – $30,000; Akkulka Exploration – $20,000; Akkulka Production – $30,000 and Kul-Bas Exploration and Production Contract – $10,000) into the socio-economic development of the Aktobe region in co-ordination with the local government. Provided that certain standards and requirements are satisfied, sub-contractors, goods, materials and/or services used in the operations of TAG and Kul-Bas under its subsurface use contracts must be of Kazakh origin. TAG as well as Kul-Bas must also give preference to Kazakh personnel and, on an annual basis, must contribute not less than 1% of its investment capital costs to the professional education of Kazakh personnel involved in operations being conducted in connection with the contract. Both subsurface use companies are also required to establish a fund for reclamation (liquidation fund) of the contract area. Contributions to this fund are required annually and must be in an amount equal to 1% of the total investment capital costs incurred during the life of the contract. The Company is also encouraged to make further voluntary payments for participation in the social development of the Aktobe region.

According to the Bokhtar PSC, KPL has an obligation to invest in the socio-economic development of the Bokhtar Area annually. KPL has already contributed to several social programs in Tajikistan, for example in June 2010, KPL constructed replacement housing in the town of Kulob, Khatlon Region, South Tajikistan, to benefit the population in an area suffering from catastrophic flooding and also had previously offered provisions of generators to local maternity hospitals. The socio-economic budget for each year is proposed and approved at the Coordinating Committee of the Bokhtar PSC but no minimum amount is provided in the Bokhtar PSC. The funds invested under such programs are fully cost recoverable. Under the Bokhtar PSC, KPL or the operator has the obligation, where employees have the appropriate experience and skills, to engage employees who are citizens of Tajikistan with the aim of these employees ultimately making up at least 70% of the total employees engaged in the implementation of the work programs under the Bokhtar PSC. However, this is with the proviso that foreign employees and specialists will be employed where necessary for the effective operation of work programs under this contract or due to the unavailability of suitably trained and qualified local staff. In addition, KPL has an unquantified obligation to implement appropriate training programs for Tajik staff with the intention of replacing foreign staff with suitably trained and experienced local specialists.

Whilst there are no formal or legislative regulations with regard to the socio-economic obligations of the Company in Uzbekistan, the Company does endeavour to make its best efforts to integrate into and to assist the local community wherever possible. Historically, small gifts of equipment and educational materials have been made to local hospitals and community associations. Furthermore, English lessons have been provided for all local employees, and several of the Company's more academically-able local employees have been sponsored to pursue distance learning courses at both Karshi and Tashkent Oil and Gas Institutes. A number of the Company's technical staff have attended specialist technical training courses in the U.K, U.S., Kazakhstan and Russia.

Similarly, whilst there is presently no legislation in Uzbekistan with regard to local employee content in foreign companies, the Uzbek operation comprises approximately 95% local content.

***Health and Safety***

The Company has implemented a health, safety and environment HSE policy and SSOW (Safe System of Work) policy based on Western industry norms and compatible with the laws used in Central Asia. The Company applies in-house health and safety policies, as well as complying with all relevant government legislation and regulations. The Company has established a health and safety department, tasked with implementing health and safety policies that best suit the varied working and operational environments on the Company's assets with regular reporting to senior management.

The Company places health, safety and preservation of the environment as its primary objective. The philosophy is that the well-being of the Company and clients is dependent on the health and safety of the Company's workforce. The Directors promising that every precaution reasonable in all circumstances will be taken for the protection of all workers. No job is to be regarded so urgent that time cannot be taken to do it in a safe manner.

The Company is committed to preventing the accidental loss of any of its resources, including employees and physical assets.

In fulfilling this commitment to protect both people and property, management provides and maintains a safe and healthy work environment, in accordance with industry standards and in compliance with legislative requirements. The Company strives to eliminate any foreseeable hazards which may result in personal injury/illness, accidents and property damage.

The Company recognises that responsibility for health and safety is shared. All employees will be equally responsible for minimizing accidents within the Company's facilities and on work sites. Safe work practices and job procedures are clearly defined in the Company's Health and Safety Manual which all employees are contractually required to follow.

Accidental loss can be controlled through good management in combination with active employee involvement. Safety is the direct responsibility of all managers, supervisors, employees, and contractors.

The Company's management comply with Company safety requirements as they relate to planning, operation and maintenance of facilities and equipment. All employees perform their jobs properly in accordance with established procedures and safe work practices.

All of the Company's work locations have emergency plans in place pertinent to the nature of the operations and location risks. These plans are updated, as required, and communicated and practiced on a regular basis. Responsibility for the management of security emergencies lies with the appropriate country management in line with the Company's security policy.

## PART 2 - STATEMENT OF RESERVES DATA AND OTHER OIL AND GAS INFORMATION

***The following information has been extracted from the Annual Information Form which is available on the Company's website at www.tethyspetroleum.com. For the purposes of this Part 2 please see the Glossary of Terms, Glossary of Technical Terms, Currency and Exchange Rates and Conversion table contained on pages 80 to 88 of this Part 2. Defined terms contained in this Part 2 may differ from those contained in the other parts of this document including Part 8 "Definition and Glossary of Technical Terms". The standard adopted for the reporting of oil and gas reserve and resources statements for the Group's hydrocarbon assets is that defined by the terms and conditions given in the NI 51-101 published by the CSA and in accordance with the standards set out in the COGEH. These standards are similar although not the same as those of the Petroleum Resources Management System. This Part 2 contains a statement of the reserves data for the Company's operations in Kazakhstan and Tajikistan as at 31 December 2010. For the reasons set out in this Part 2, the Company does not currently attribute any reserves to its operations in Uzbekistan.***

The following is a statement of reserves data presented for Kazakhstan and Tajikistan. The Company engaged McDaniel to evaluate the Company's oil and natural gas reserves in Kazakhstan. For Tajikistan, the Company engaged TRACS AGR to evaluate its oil and gas reserves attributable to Beshtentak and Komsomolsk fields, located within the Tajikistan Contract Area. In connection therewith, McDaniel and TRACS AGR prepared independent evaluations of the Company's natural gas reserves in respect of Kazakhstan and Tajikistan. For Kazakhstan, the Statement of Reserves Data and Other Oil and Gas Information was prepared on and is dated March 18, 2011 (the "**Kazakh Statement**"). The effective date of the Kazakh Statement is December 31, 2010. For Tajikistan, the Statement of Reserves Data and Other Oil and Gas Information was prepared on and is dated March 18, 2011 (the "**Tajik Statement**"). The effective date of the Tajik Statement is December 31, 2010. The Kazakh Statement and Tajik Statement have been prepared in accordance with NI 51-101.

**Disclosure of Reserves Data**

*Kazakhstan*

The Company engaged McDaniel to evaluate the Company's crude oil and natural gas reserves as at December 31, 2010, and in connection therewith, McDaniel prepared the McDaniel Reserve Report evaluating the Company's crude oil and natural gas reserves as at December 31, 2010.

The reserves data set forth below is based upon evaluations by McDaniel with an effective date of December 31, 2010. The reserves data summarizes the crude oil and natural gas reserves of the Company and the net present values of future net revenue for these reserves using forecast prices and costs. The reserves data set forth complies with the requirements of NI 51-101. Additional information not required by NI 51-101 has been presented to provide continuity and additional information which the Company believes is important to the readers of this information. McDaniel was engaged by the Company to provide evaluations of proved, probable and possible crude oil and natural gas reserves.

In preparing the McDaniel Reserve Report, basic information was obtained from Tethys, which included land data, well information, geological information, reservoir studies, estimates of on-stream dates, contract information, current hydrocarbon product prices, operating cost data, capital budget forecasts, financial data and future operating plans. Other engineering, geological or economic data required to conduct the evaluations and upon which the McDaniel Reserve Report are based was obtained from public records, other operators and from McDaniel non confidential files. The extent and character of ownership and the accuracy of all factual data supplied for the independent evaluation, from all sources, was accepted by McDaniel as represented.

Estimated future net revenue based on the McDaniel Reserve Report is presented in U.S. Dollars. All evaluations and reviews of future net cash flow are stated prior to any provision for interest costs or general and administrative costs (other than Kazakhstan-related general and administrative costs) and after the deduction of estimated future capital expenditures for wells to which reserves have been assigned. It should not be assumed that the estimated future net cash flow shown below is representative of the fair market value of the Company's properties. There is no assurance that such price and cost assumptions will be attained and variances could be material. The recovery and reserve estimates of crude oil and natural gas reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. Actual crude oil and natural gas reserves may be greater than or less than the estimates provided herein.

*Tajikistan*

The Company engaged TRACS AGR to evaluate the Company's gas reserves and resources as at December 31, 2010, and in connection therewith, TRACS AGR prepared the TRACS Reserve and Resource Report evaluating the Company's gas reserves and resources as at December 31, 2010.

The tables below are a summary of the oil and gas reserves attributable to the Beshtentak and Komsomolsk fields and the net present value attributable to such reserves as evaluated in the TRACS Reserve and Resource Report, based on forecast prices and costs assumptions. See "*Pricing and Inflation Rate Assumptions - Tajikistan*" for a summary of the pricing and inflation rate assumptions with respect to the reserves information contained in this Annual Information Form. No reserves have been attributed to the Khoja Sartez field. The tables summarize the data in the TRACS Reserve and Resource Report and, as a result, may contain slightly different numbers than the report due to rounding. Also, due to rounding, certain columns may not add exactly.

The estimated future net revenue figures contained in the following tables do not necessarily represent the fair market value of the reserves attributable to the Beshtentak and Komsomolsk fields. There is no assurance that the forecast price and cost assumptions contained in the TRACS Reserve and Resource Report will be attained and variances could be material. Other assumptions relating to costs and other matters are included in the TRACS Reserve and Resource Report. The reserves estimates attributable to the Beshtentak and Komsomolsk fields described herein are estimates only. The actual reserves attributable to the Beshtentak and Komsomolsk fields may be greater or less than those calculated. A reader should note that the estimates of reserves and future net reserves for individual properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties, due to the effects of aggregation.

Throughout the following summary tables differences may arise due to rounding.

## Summary of Oil and Natural Gas Reserves As of December 31, 2010
## Forecast Prices and Costs(1)(2)(3)(4)(5)(6)

| Reserves Category | Light and Medium Crude Oil Gross (Mbbl) | Light and Medium Crude Oil Net (Mbbl) | Natural Gas Gross (Bcf) | Natural Gas Net (Bcf) | Total Gross (MMBoe) | Total Net (MMBoe) |
|---|---|---|---|---|---|---|
| **KAZAKHSTAN** | | | | | | |
| **Proved** | | | | | | |
| Developed Producing | 1,311 | 1,271 | 17.6 | 17.5 | 4.3 | 4.2 |
| Developed Non-Producing | - | - | 9.2 | 9.2 | 1.5 | 1.5 |
| Undeveloped | 1,619 | 1,509 | 1.1 | 1.1 | 1.8 | 1.7 |
| **Total Proved** | **2,930** | **2,780** | **27.9** | **27.8** | **7.6** | **7.4** |
| Probable | 5,313 | 4,975 | 35.4 | 30.6 | 11.2 | 10.1 |
| **Total Proved Plus Probable** | **8,242** | **7,756** | **63.4** | **58.4** | **18.8** | **17.5** |
| Possible | 18,779 | 17,228 | 18.5 | 16.6 | 21.9 | 20.0 |
| **TAJIKISTAN** | | | | | | |
| **Proved** | | | | | | |
| Developed Producing | - | - | - | - | | |
| Developed Non-Producing | 1.0 | 0.9 | 0.4 | 0.3 | 0.06 | 0.05 |
| Undeveloped | 3.1 | 2.8 | 1.1 | 1.0 | 0.19 | 0.18 |
| **Total Proved** | **4.1** | **3.8** | **1.4** | **1.3** | **0.25** | **0.23** |
| Probable | 34.8 | 31.6 | 2.5 | 2.2 | 0.46 | 0.42 |
| **Total Proved Plus Probable** | **38.9** | **35.4** | **3.9** | **3.5** | **0.72** | **0.64** |
| Possible | 27.8 | 25.3 | 3.8 | 3.5 | 0.68 | 0.63 |
| **TOTAL** | | | | | | |
| **Proved** | | | | | | |
| Developed Producing | 1,311 | 1,271 | 17.6 | 17.5 | 4.3 | 4.2 |
| Developed Non-Producing | 1.0 | 0.9 | 9.6 | 9.5 | 1.6 | 1.6 |
| Undeveloped | 1,622 | 1,512 | 2.2 | 2.1 | 2.0 | 1.9 |
| **Total Proved** | **2,934** | **2,784** | **29.3** | **29.1** | **7.9** | **7.6** |
| Probable | 5,348 | 5,007 | 37.9 | 32.8 | 11.7 | 10.5 |
| **Total Proved Plus Probable** | **8,281** | **7,791** | **67.3** | **61.9** | **19.5** | **18.1** |
| Possible | 18,807 | 17,253 | 22.3 | 20.1 | 22.6 | 20.6 |

**Notes:**

(1) Under the Bokhtar PSC, KPL will: (i) recover 100% of its costs from the Cost Production; and (ii) receive 70% of the Profit Production. The Tajik State's share of production includes all taxes, levies and duties.

(2) Light and medium crude oil includes condensate.

(3) Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. There is a 90%. probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

(4) Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. There is a 50% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable reserves.

(5) Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

(6) With respect to the reserves attributable to the Company in Tajikistan, forecast prices and costs are presented on the same basis as constant prices and costs as the net revenues and reserves presented assume no escalation in prices and costs. See "*Pricing and Inflation Rate Assumptions- Tajikistan*".

## Summary of Net Present Values of Future Net Revenue As of December 31, 2010
## Forecast Prices and Costs(1)(2)(3)(4)(5)(6)(7)(8)(9)

| Reserves Category | Before Income Taxes Discounted at (%/year) | | | | | After Income Taxes Discounted at (%/year) | | | | | Unit Value Before Income Taxes Discounted at 10%/ year |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0 | 5 | 10 | 15 | 20 | 0 | 5 | 10 | 15 | 20 | ($/boe) |
| | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | |
| **KAZAKHSTAN** | | | | | | | | | | | |
| **Proved** | | | | | | | | | | | |
| Developed Producing | 26.9 | 24.5 | 22.5 | 20.8 | 19.4 | 26.9 | 24.5 | 22.5 | 20.8 | 19.4 | 5.36 |
| Developed Non-Producing | 2.2 | 1.8 | 1.5 | 1.2 | 1.0 | 2.2 | 1.8 | 1.5 | 1.2 | 1.0 | 0.97 |
| Undeveloped | 64.6 | 53.8 | 45.3 | 38.6 | 33.2 | 49.6 | 40.6 | 33.6 | 28.2 | 23.8 | 26.79 |
| **Total Proved** | **93.7** | **80.1** | **69.3** | **60.6** | **53.5** | **78.6** | **66.9** | **57.6** | **50.2** | **44.1** | **9.35** |
| Probable | 315.1 | 243.3 | 192.2 | 154.9 | 126.9 | 210.1 | 159.4 | 123.9 | 98.4 | 79.5 | 19.09 |
| **Total Proved Plus Probable** | **408.7** | **323.4** | **261.5** | **215.5** | **180.5** | **288.8** | **226.3** | **181.5** | **148.5** | **123.6** | **14.96** |
| Possible | 886.3 | 623.0 | 455.9 | 344.9 | 268.1 | 565.1 | 390.0 | 281.1 | 209.9 | 161.4 | 22.79 |
| **TAJIKISTAN** | | | | | | | | | | | |
| **Proved** | | | | | | | | | | | |
| Developed Producing | - | - | - | - | - | - | - | - | - | - | - |
| Developed Non-Producing | 0.7 | 0.6 | 0.5 | 0.4 | 0.3 | 0.7 | 0.6 | 0.5 | 0.4 | 0.3 | 8.9 |
| Undeveloped | 2.7 | 2.1 | 1.7 | 1.3 | 1.0 | 2.7 | 2.1 | 1.7 | 1.3 | 1.0 | 10.1 |
| **Total Proved** | **3.4** | **2.7** | **2.1** | **1.7** | **1.3** | **3.4** | **2.7** | **2.1** | **1.7** | **1.3** | **9.8** |
| Probable | 11.8 | 9.5 | 8.0 | 6.8 | 5.9 | 11.8 | 9.5 | 8.0 | 6.8 | 5.9 | 19.2 |
| **Total Proved Plus Probable** | **15.2** | **12.2** | **10.1** | **8.5** | **7.3** | **15.2** | **12.2** | **10.1** | **8.5** | **7.3** | **16.3** |
| Possible | 19.4 | 14.9 | 11.9 | 9.9 | 8.4 | 19.4 | 14.9 | 11.9 | 9.9 | 8.4 | 19.2 |
| **TOTAL** | | | | | | | | | | | |
| **Proved** | | | | | | | | | | | |
| Developed Producing | 26.9 | 24.5 | 22.5 | 20.8 | 19.4 | 26.9 | 24.5 | 22.5 | 20.8 | 19.4 | 5.36 |
| Developed Non-Producing | 2.9 | 2.4 | 2.0 | 1.6 | 1.3 | 2.9 | 2.4 | 2.0 | 1.6 | 1.3 | 1.29 |
| Undeveloped | 67.3 | 55.9 | 47.0 | 39.9 | 34.2 | 52.3 | 42.7 | 35.3 | 29.5 | 24.8 | 25.0 |
| **Total Proved** | **97.1** | **82.8** | **71.4** | **62.3** | **54.8** | **82.0** | **69.6** | **59.7** | **51.9** | **45.4** | **9.36** |
| Probable | 326.9 | 252.8 | 200.2 | 161.7 | 132.8 | 221.9 | 168.9 | 131.9 | 105.2 | 85.4 | 19.0 |
| **Total Proved Plus Probable** | **423.9** | **335.6** | **271.6** | **224.0** | **187.8** | **304.0** | **238.5** | **191.6** | **157.0** | **130.9** | **15.0** |
| Possible | 905.7 | 637.9 | 467.8 | 354.8 | 276.5 | 584.5 | 404.9 | 293.0 | 219.8 | 169.8 | 22.7 |

**Notes:**

(1) Under the Bokhtar PSC, KPL will: (i) recover 100% of its costs from the Cost Production; and (ii) receive 51% of the Profit Production. The Tajik State's share of the production includes all taxes, levies and duties.

(2) In determining the aggregate future net revenue from a property, TRACS AGR estimated and deducted future well abandonment costs.

(3) Abandonment and reclamation costs are included in the calculation of the net present value of future net revenue relating to the Beshtentak and Komsomolsk fields.

(4) As the Tajik State's share of production includes all taxes, levies and duties, the net present value of future net revenue after income taxes equals the net present value of future net revenue before income taxes. Accordingly, information is only presented on a before income taxes basis.

(5) With respect to the reserves attributable to the Company in Tajikistan, forecast prices and costs are presented on the same basis as constant prices and costs as the net revenues and reserves presented assume no escalation in prices and costs. See "Pricing and Inflation Rate Assumptions- Tajikistan".

(6) The unit value for Kazakhstan, Tajikistan and Total is presented in $/boe.

(7) Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. There is a 90%. probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

(8) Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. There is a 50% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable reserves.

(9) Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

## Total Future Net Revenue (Undiscounted)
## As of December 31, 2010
## Forecast Prices and Costs(1)(2)(3)(4)(5)(6)(7)

| | Revenue | Royalties | Export Rent Tax | Operating Costs | Develop-ment Costs | Abandon ment and Reclama-tion Costs | Other Expenses | Future Net Revenue Before Income Taxes | Income Taxes | Future Net after Revenue Income Taxes |
|---|---|---|---|---|---|---|---|---|---|---|
| | (MM$) | (MM$) | | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) | (MM$) |
| **KAZAKHSTAN** | | | | | | | | | | |
| Total Proved | 194.5 | 9.4 | 24.9 | 35.1 | 27.5 | 0.7 | 3.3 | 93.6 | 15.5 | 78.1 |
| Total Proved Plus Probable | 716.5 | 49.9 | 91.3 | 85.1 | 76.6 | 1.1 | 3.8 | 408.7 | 133.1 | 275.6 |
| **TAJIKISTAN** | | | | | | | | | | |
| Total Proved | 7.7 | | - | 0.8 | 3.1 | 0.1 | - | 3.7 | - | 3.4 |
| Total Proved Plus Probable | 22.8 | - | - | 1.7 | 4.3 | 0.1 | - | 16.7 | - | 15.2 |
| **TOTAL** | | | | | | | | | | |
| Total Proved | 202.2 | 9.4 | 24.9 | 35.9 | 30.6 | 0.8 | 3.3 | 97.3 | 15.5 | 81.5 |
| Total Proved Plus Probable | 739.3 | 49.9 | 91.3 | 86.8 | 80.9 | 1.2 | 3.8 | 425.4 | 133.1 | 290.8 |

**Notes:**

(1) "Other expenses" refers to the repayment of historical costs and the commercial discovery bonus.

(2) "Royalties" include the Mineral Extraction Tax.

(3) With respect to Tajikistan, under the Bokhtar PSC, KPL will: (i) recover 100% of its costs from the Cost Production; and (ii) receive 51% of the Profit Production. The Tajik State's share of production includes all taxes, levies and duties.

(4) With respect to the reserves attributable to the Company in Tajikistan, forecast prices and costs are presented on the same basis as constant prices and costs as the net revenues and reserves presented assume no escalation in prices and costs. See "*Pricing and Inflation Rate Assumptions- Tajikistan*".

(5) Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. There is a 90%. probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

(6) Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. There is a 50% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable reserves.

(7) Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

## Future Net Revenue By Production Group As of December 31, 2010
## Forecast Prices and Costs(1)(2)(3)(4)(5)

| Reserves Category | Production Group | Future Net Revenue Before Income Taxes (discounted at 10%/year) | Unit Value |
|---|---|---|---|
| | | (MM$) | ($/Mcf) ($/bbl) |
| **TOTAL PROVED** | Light and Medium Crude Oil | | |
| | Kazakhstan | 60.1 | 21.63 |
| | Tajikistan | 0.1 | 0.0 |
| | Associated Gas and Non-Associated Gas | | |
| | Kazakhstan | 9.2 | 0.33 |
| | Tajikistan | 2.1 | 1.57 |
| **TOTAL PROVED PLUS PROBABLE** | Light and Medium Crude Oil | | |
| | Kazakhstan | 190.9 | 24.62 |
| | Tajikistan | 0.4 | 3.8 |
| | Associated Gas and Non-Associated Gas | | |
| | Kazakhstan | 70.6 | 1.21 |
| | Tajikistan | 9.7 | 2.82 |

**Notes:**

(1) See table below "Summary of Pricing and Inflation Rate Assumptions" for pricing assumptions.

(2) With respect to the reserves attributable to the Company in Tajikistan, forecast prices and costs are presented on the same basis as constant prices and costs as the net revenues and reserves presented assume no escalation in prices and costs. See "*Pricing and Inflation Rate Assumptions- Tajikistan*".

(3) Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. There is a 90%. probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

(4) Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. There is a 50% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable reserves.

(3) Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

## Pricing and Inflation Rate Assumptions

### Summary of Pricing and Inflation Rate Assumptions As of December 31, 2010
### Forecast Prices and Costs(1)(2)

| | KAZAKHSTAN | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Oil | | | | | Natural Gas | | |
| | **Brent Crude Oil Price ($/bbl)** | **Akkulka Export Crude Oil Price ($/bbl)** | **PP Akkulka Domestic Crude Oil Price ($/bbl)** | **1P/2P/3P Akkulka Domestic Crude Oil Price ($/bbl)** | **1P Kyzyloi Existing Gas Sales Contract Price ($/Mcf)** | **1P Akkulka Existing Gas Sales Contract Price ($/Mcf)** | **2P/3P Kyzyloi Existing Gas Sales Contract Price ($/Mcf)** | **2P/3P Akkulka Existing Gas Sales Contract Price ($/Mcf)** | **Inflation rate %/year** |
| **Historical** | | | | | | | | | |
| 2010 | N/A | | | | 0.90 | | | N/A | N/A |
| **Forecast** | | | | | | | | | |
| 2011 | 85.00 | 65.00 | 22.00 | 28.50 | 0.90 | 0.96 | 0.90 | 0.96 | 2.00 |
| 2012 | 87.70 | 67.30 | 22.44 | 35.70 | 0.90 | 0.96 | 0.90 | 0.96 | 2.00 |
| 2013 | 90.50 | 69.69 | 22.89 | 36.41 | 1.00 | 1.00 | 2.22 | 2.22 | 2.00 |
| 2014 | 93.40 | 72.18 | 23.35 | 37.14 | 1.02 | 1.02 | 2.75 | 2.75 | 2.00 |
| 2015 | 96.30 | 74.65 | 23.81 | 37.89 | 1.04 | 1.04 | 3.25 | 3.25 | 2.00 |
| 2016 | 99.40 | 77.32 | 24.29 | 38.64 | 1.06 | 1.06 | 3.74 | 3.74 | 2.00 |
| 2017 | 101.40 | 78.88 | 24.78 | 39.42 | 1.08 | 1.08 | 4.09 | 4.09 | 2.00 |
| 2018 | 103.40 | 80.43 | 25.27 | 40.20 | 1.10 | 1.10 | 4.41 | 4.41 | 2.00 |
| 2019 | 105.40 | 81.97 | 25.78 | 41.01 | 1.12 | 1.12 | 4.72 | 4.72 | 2.00 |
| 2020 | 107.60 | 83.70 | 26.29 | 41.83 | 1.15 | 1.15 | 5.02 | 5.02 | 2.00 |
| 2021 | 109.70 | 85.32 | 26.82 | 42.66 | 1.17 | 1.17 | 5.30 | 5.30 | 2.00 |
| 2022 | 111.90 | 87.03 | 27.35 | 43.52 | 1.19 | 1.19 | 5.57 | 5.57 | 2.00 |
| 2023 | 114.10 | 88.74 | 27.90 | 44.39 | 1.22 | 1.22 | 5.82 | 5.82 | 2.00 |
| 2024 | 116.40 | 90.53 | 28.46 | 45.28 | 1.24 | 1.24 | 6.06 | 6.06 | 2.00 |
| 2025 | 118.80 | 92.41 | 29.03 | 46.18 | 1.27 | 1.27 | 6.21 | 6.21 | 2.00 |
| 2026 | 121.18 | 94.26 | 29.61 | 47.11 | 1.29 | 1.29 | 6.35 | 6.35 | 2.00 |
| 2027 | 123.60 | 96.14 | 30.20 | 48.05 | 1.32 | 1.32 | 6.50 | 6.50 | 2.00 |
| 2028 | 126.07 | 98.07 | 30.81 | 49.01 | 1.34 | 1.34 | 6.65 | 6.65 | 2.00 |
| 2029 | 128.59 | 100.03 | 31.42 | 49.99 | 1.37 | 1.37 | 6.80 | 6.80 | 2.00 |
| 2030 | 131.16 | 102.03 | 32.05 | 50.99 | 1.40 | 1.40 | 6.96 | 6.96 | 2.00 |
| **Thereafter** | 2% | | 2% | 2% | 2% | 2% | 2% | 2% | 2% |

**Notes:**

(1) The un-contracted gas price was calculated by McDaniel for the McDaniel Reserve Report based on gas sales in the Central Asia and European markets.

(2) The Term of the Kazakh Gas Supply Contract ends on December 1, 2012 (or earlier if the agreed volumes of gas have been delivered). Accordingly, gas delivered after December 1, 2012 will not be subject to the price of the Kazakh Gas Supply Contract (being $0.90 per Mcf plus VAT for the Kyzyloi Field and being $0.96 per Mcf for the Akkulka Field).

## Summary of Pricing and Inflation Rate Assumptions As of December 31, 2010
## Forecast Prices and Costs[1]

| | TAJIKISTAN | | | |
|---|---|---|---|---|
| | Oil | | Natural Gas | |
| | Brent Crude Oil Price ($/bbl) | Field Crude Crude Oil ($/bbl) | Sales Price ($/Mcf) | Inflation rate %/year %/year |
| **Historical** | | | | |
| 2010 | | | | N/A |
| **Forecast** | | | | |
| 2011 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2012 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2013 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2014 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2015 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2016 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2017 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2018 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2019 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2020 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2021 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2022 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2023 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2024 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2025 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2026 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2027 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2028 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2029 | 75.00 | 49.00 | 5.38 | 0.00 |
| 2030 | 75.00 | 49.00 | 5.38 | 0.00 |
| **Thereafter** | 0% | 0% | 0% | 0% |

**Note:**

(1) With respect to the reserves attributable to the Company in Tajikistan, forecast prices and costs are presented on the same basis as constant prices and costs as the net revenues and reserves presented assume no escalation in prices and costs. Tajik gas price for Komsomolsk is set at $190/MCM, approximately 75% of the 2010 import parity price of $250 per thousand cubic metres. Crude price assumption for project evaluation reference a Mid Case price set of $75/bbl.

## Reserves Reconciliation

### *Kazakhstan*

The following table sets forth a reconciliation of Tethys' total gross proved, probable and proved plus probable reserves as at December 31, 2010, against such reserves as at December 31, 2009, based on forecast prices and cost assumptions.

| | **Light and Medium Crude Oil** | | | **Associated and Non-Associated Natural Gas** | | |
|---|---|---|---|---|---|---|
| **Factors** | **Gross Proved (Mbbl)** | **Gross Probable (Mbbl)** | **Gross Proved Plus Probable (Mbbl)** | **Gross Proved (Bcf)** | **Gross Probable (Bcf)** | **Gross Proved Plus Probable (Bcf)** |
| December 31, 2009(1)(2)(3) | - | - | - | 37.6 | 29.8 | 67.4 |
| Extensions and Improved Recovery | - | - | - | - | - | - |
| Technical Revisions | - | - | - | - | - | - |
| Discoveries | 2,981 | 5,312 | 8,293 | - | - | - |
| Acquisitions | - | - | - | - | - | - |
| Dispositions | - | - | - | - | - | - |
| Economic Factors | - | - | - | (5.6) | 5.6 | - |
| Production | (51) | - | (51) | (4.2) | - | (4.2) |
| December 31, 2010 | **2,930** | **5,312** | **8,242** | **27.9** | **35.4** | **63.4** |

### *Tajikistan*

The following table sets forth a reconciliation of Tethys' total gross proved, probable and proved plus probable reserves as at December 31, 2010, against such reserves as at December 31, 2009, based on forecast prices and cost assumptions.

| | **Associated and Non-Associated Gas** | | |
|---|---|---|---|
| Factors | **Gross Proved (Bcf)** | **Gross Probable (Bcf)** | **Gross Proved Plus Probable (Bcf)** |
| December 31, 2009[(1)] | 0.6 | 1.8 | 2.4 |
| Extensions and Improved Recovery | - | - | - |
| Technical Revisions | 0.8 | 0.8 | 1.5 |
| Discoveries | - | - | - |
| Acquisitions | - | - | - |
| Dispositions | - | - | - |
| Economic Factors | - | - | - |
| Production | 0 | 0 | 0 |
| December 31, 2010 | 1.4 | 2.6 | 3.9 |

**Note:**

(1) Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. There is a 90%. probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

(2) Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. There is a 50% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable reserves.

(3) Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

| | **Light and Medium Crude Oil and Condensate** | | |
|---|---|---|---|
| Factors | **Gross Proved (Mbbl)** | **Gross Probable (Mbbl)** | **Gross Proved Plus Probable (Mbbl)** |
| December 31, 2009[(1)] | 6.4 | 56.0 | 62.4 |
| Extensions and Improved Recovery | - | - | - |
| Technical Revisions | 4.1 | -21.3 | -17.2 |
| Discoveries | - | - | - |
| Acquisitions | - | - | - |
| Dispositions | - | - | - |
| Economic Factors | - | - | - |
| Production | 6.3 | 0 | 6.3 |
| December 31, 2010 | 4.1 | 34.8 | 38.9 |

## Additional Information Relating to Reserves Data

### *Undeveloped Reserves*

The following tables disclose the volumes of Proved and Probable Undeveloped Reserves as at the dates noted therein. The references to "First Attributed" refer to Proved or Probable Undeveloped Reserves as at the earliest date in the relevant year when such Undeveloped Reserves were first attributed to the Company. Undeveloped Reserves are those Reserves that are expected to be recovered from known accumulations where a significant expenditure is required to render them capable of production.

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| | **Associated and Non-Associated Gas[(1)]** | | **Light and Medium Crude Oil** | |
|---|---|---|---|---|
| **Proved Undeveloped** | **First Attributed (Bcf)** | **Total at Year End (Bcf)** | **First Attributed (Mbbl)** | **Total at Year End (Mbbl)** |
| Prior | 16.3 | 16.3 | - | - |
| 2008 | - | 5.0 | - | - |
| 2009 | - | 4.3 | - | - |
| 2010 | - | 1.1 | 1.7 | 1.7 |
| **Probable Undeveloped** | **First Attributed (Bcf)** | **Total at Year End (Bcf)** | **First Attributed (Mbbl)** | **Total at Year End (Mbbl)** |
| Prior | 13.5 | 13.5 | - | - |
| 2008 | 1.1 | 7.1 | - | - |
| 2009 | - | 7.0 | - | - |
| 2010 | - | 7.0 | 4.2 | 4.2 |

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| | **Associated and Non-Associated Gas[(1)]** | | **Light and Medium Crude Oil** | |
|---|---|---|---|---|
| **Proved Undeveloped** | **First Attributed (Bcf)** | **Total at Year End (Bcf)** | **First Attributed (Mbbl)** | **Total at Year End (Mbbl)** |
| Prior | - | - | | - |
| 2007 | - | - | | - |
| 2008 | - | - | | - |
| 2009 | 3.25 | - | | - |
| 2010 | 1.00 | 1.00 | 2.8 | 2.8 |
| **Probable Undeveloped** | **First Attributed (Bcf)** | **Total at Year End (Bcf)** | **First Attributed (Mbbl)** | **Total at Year End (Mbbl)** |
| Prior | - | - | | - |
| 2007 | - | - | | - |
| 2008 | - | - | | - |
| 2009 | 2.65 | 1.76 | 13.6 | 56.0 |
| 2010 | 2.20 | 2.20 | 31.6 | 31.6 |

**Note:**

(1) Based on the forecast prices and costs evaluations carried out, with respect to Kazakhstan, by McDaniel and reflected in the McDaniel Reserve Report, and with respect to Tajikistan, by TRACS AGR and reflected in the TRACS Reserve and Resource Report.

With respect to the Company's undeveloped reserves in Kazakhstan, the Company is currently in the process of finalizing its plans with regard to developing its proved undeveloped and probable undeveloped reserves. For the shallow gas, the Company plans further development (Phase 3) from the end of 2012 onwards. For the oil reserves, a full field development program will be finalised at the end of 2011 based on the current appraisal well program but the construction of pilot production facilities will be completed in 2011, In Tajikistan, the Company plans to complete well KOM201 in 2011 and to develop the reserves and resources in the Komsomolsk Field with KOM200 in 2012. In order to develop the Beshtentak Field a series of radial drilling wells will be completed in H2 2011 with conventional workovers later in 2011 and into 2012, with the possibility of implementing a water-injection program.

### *Significant Factors or Uncertainties*

## Kazakhstan

There are numerous uncertainties inherent in estimating quantities of proved reserves, including many factors beyond the control of the Company. The reserve data included herein represents estimates only. In general, estimates of economically recoverable gas reserves and the future net cash flows there from are based upon a number of variable factors and assumptions, such as test rate production from the properties, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary considerably from actual results. The actual production, revenues, taxes and development and operating expenditures of the Company with respect to these reserves will vary from such estimates, and such variances could be material.

Estimates with respect to proved reserves that may be developed and produced in the future are often based upon volumetric calculations and upon analogy to similar types of reserves rather than actual production history. Estimates based on these methods are generally less reliable than those based on actual production history. Subsequent evaluation of the same reserves based upon production history will result in variations, which may be substantial, in the estimated reserves.

Consistent with the securities disclosure legislation and policies of Canada, the Company has used forecast prices and costs in calculating reserve quantities included herein. Actual future net cash flows also will be affected by other factors such as actual production levels, supply and demand for gas, curtailments or increases in consumption by gas purchasers, changes in governmental regulation or taxation, currency exchange rates and the impact of inflation on costs. TAG has a contractual obligation to sell approximately 30 Bcf (0.85 Bcm) of gas at prices believed to be substantially below those that could be realized but for this contractual obligation. See "*Description of the Business — Marketing*".

**Tajikistan**

The process of evaluating reserves is inherently complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. These estimates may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change. The reserves estimates contained herein are based on current production forecasts, geological evaluation, engineering data, prices and economic conditions. These reserves estimates have been evaluated by TRACS AGR. These factors and assumptions include among others: (i) historical production in the area compared with production rates from analogous producing areas; (ii) initial production rates; (iii) production decline rates; (iv) ultimate recovery of reserves; (v) success of future development activities; (vi) marketability of production; (vii) effects of government regulations; and (viii) other government levies imposed over the life of the reserves.

As circumstances change and additional data becomes available, reserves estimates also change. Estimates are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions. Revisions to reserves estimates can arise from changes in year-end prices, reservoir performance and geologic conditions or production. These revisions can be either positive or negative.

For additional details of significant economic factors and uncertainties affecting the reserves, see "Risk Factors".

***Future Development Costs***

The following table sets forth the estimated future development costs based upon the McDaniel Reserve Report and the TRACS Reserve and Resource Report. Future development costs are expected to be funded by internally generated cash flow from production and/or through equity financing or debt issuance. Future development costs are associated with reserves as disclosed in the McDaniel Reserve Report and TRACS Reserve and Resource Report and do not necessarily represent the Company's full exploration and development budget.

| Year | Total Proved Estimated Using Forecast Prices and Costs[(2)] (MM$) | Total Proved Plus Probable Estimated Using Forecast Prices and Costs[(3)] (MM$) |
|---|---|---|
| **KAZAKHSTAN** | | |
| 2011 | 18.5 | 21.6 |
| 2012 | 6.9 | 17.6 |
| 2013 | 1.5 | 23.2 |
| 2014 | 0.2 | 9.9 |
| 2015 | 0.2 | 1.5 |
| Thereafter | 0.2 | 2.8 |

| Year | Total Proved Estimated Using Forecast Prices and Costs[2] (MM$) | Total Proved Plus Probable Estimated Using Forecast Prices and Costs[3] (MM$) |
|---|---|---|
| Total for all years undiscounted[1] | **27.5** | **76.6** |
| | | |
| **TAJIKISTAN** | | |
| 2010 | 3.62 | 3.62 |
| 2011 | 0.27 | 0.55 |
| 2012 | 0.00 | 0.00 |
| 2013 | 0.00 | 0.00 |
| 2014 | 0.00 | 0.00 |
| Thereafter | 0.00 | 0.00 |
| Total for all years undiscounted[1] | **3.89** | **4.17** |

**Notes:**

(1) With respect to the reserves attributable to the Company in Tajikistan, forecast prices and costs are presented on the same basis as constant prices and costs as the net revenues and reserves presented assume no escalation in prices and costs.

(2) Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. There is a 90%. probability that the quantities actually recovered will exceed the estimated proved reserves.

(3) Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. There is a 50% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable reserves.

(4) Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

## Other Oil and Gas Information

### *Oil and Gas Properties*

### Kazakhstan

The Company's assets in Kazakhstan are presently located in three contiguous blocks in an area of Kazakhstan to the west of the Aral Sea, in a geological area known as the North Ustyurt basin, which lies on the southeastern edge of the prolific Pre-Caspian sedimentary basin.

As a result of its interest in TAG, the Company currently has a 100% interest in, and is operator of, a proven shallow gas field (the Kyzyloi Field). TAG also has a 100% interest in the surrounding Akkulka Exploration Licence and Contract area and the Akkulka Production Contract, and a 100% interest in the Kul-Bas Exploration and Production Contract area. All of the Company's properties are onshore. The Company's developed properties are described in further detail below.

The Kyzyloi Field was first discovered in 1967 with additional seismic being shot in the 1990s. It was not previously developed due to the then low gas price. An increase in the gas price has made it possible to extract the gas commercially.

On December 23, 2009, TAG and MEMR signed the Akkulka Production Contract giving TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years. An initial five of the seven wells assigned to the Akkulka Production Contract were already tied into the Company's existing Kyzyloi pipeline infrastructure and additional compression had already been installed and tested at the BCS on the Bukhara-Urals gas trunkline. Production of gas from the Akkulka Block under the Akkulka Production Contract commenced in October 2010 as the gas sales agreement was signed with Asia Gas NG LLP in September 2010 and Intergas Central Asia allocated the space in the pipeline system. There are no mandatory relinquishments, surrenders, back-ins or changes in ownership in respect of the Kyzyloi or Akkulka production contract areas. There are certain relinquishment requirements under the Kul-Bas Exploration and Production Contract. See "*Description of the Business – Kazakhstan - Kul-Bas Block and Kul-Bas Exploration and Production Contract*".

The Company has constructed a 56 km 325 mm diameter pipeline from its Kyzyloi Field and compressor station to tie-in to the Bukhara-Urals pipeline, which is a gas trunkline transporting gas from Central Asia into Russia and on into Europe.

**Tajikistan**

In Tajikistan, the Bokhtar PSC Area is located in the Afghan-Tajik basin, the eastern part of the prolific Amu Darya sedimentary basin.

Under the Bokhtar PSC, the Tajikistan Contract Area covers approximately is 34,750 km2 and includes 130 identified prospective structures/fields. To date, the Company has been operating in East Olimtoi, Beshtentak and Khoja Sartez and Komsomolsk areas.

The East Olimtoi exploration well EOL09 is targeting an attractive prospect on the edge of a salt induced structure some 40 km south-west of the city of Kulob. Operations on the well were suspended for some time waiting on the arrival of specialist equipment (which required permits) from the United States. This equipment arrived in September 2010 and the drilling rig has now been upgraded to enable operations to proceed more effectively. The well is currently at a depth of 2,901 m and is targeting a Palaeogene reservoir prognosed at a depth of 3,800 m.

In 2009, work over operations were performed in the well BST20 of Beshtentak Field comprising drilling out of rock material and metal junk blocking the wellbore to a depth of 1,785 m. The well commenced producing in January 2010 but the production is only approximately 16 bopd.

In 2009, work over operations were performed in the well BST20 of Beshtentak Field comprising drilling out of rock material and metal junk blocking the wellbore to a depth of 1,785 m. The well has recently had radial drilling technology applied.

In 2009, gas production was achieved at Khoja Sartez Field. On March 14, 2009 the well stopped flowing due to water ingress (thought to be coming from a lower zone due to a poorly cemented casing). The total amount of gas supplied to Kulob town during the operating period was 480 Mcm.

The drilling of Komsomolsk well KOM200 commenced in August 2009. Drilling had reached a total depth of 2,024 m within the Jurassic sequence as at the end of March 2010, however due to the drilling string becoming stuck, the well was temporarily suspended. The Company has a plan to potentially sidetrack this well in 2011. An open hole flowback test achieved a stable gas flow prior to the temporary suspension.

In May 2010, the Company commenced drilling of the directional KOM201 well on the eastern part of the Komsomolsk Field under Dushanbe. The well reached a total depth of 2,456 m and encountered a 310 metre column of Jurassic limestone with wireline logs and drilling data indicating that it is gas-bearing. Testing commenced in January 2011 with gas flow being obtained from the well on an open hole test. Production casing has been run and preparations are underway to apply radial drilling in an attempt to stimulate the well and obtain commercial gas flow. Wireline logs indicate hydrocarbons may be present in the secondary targets of the Cenomanian, Hauterivian and Bukhara.

There are mandatory relinquishments for the Bokhtar PSC, starting in the seventh year of the contract (i.e. 2015) and at 5-year intervals after that. There are no surrenders, back-ins or changes in ownership in respect of the Tajikistan Contract Area.

**Uzbekistan**

In Uzbekistan, the Group operates as the contractor/services provider for the Uzbek State Partners under the North Urtabulak PEC which gives incremental production rights to increase production of oil from wells in the North Urtabulak Field in the Amu Darya Basin. The Company's subsidiary TPU operates the North Urtabulak PEC with Uzbekneftegaz, the national oil company of Uzbekistan. Whilst a number of fields were awarded under this contract, drilling and work program operations are currently focused on the North Urtabulak Field in Southern Uzbekistan.

The North Urtabulak Field is located in the Northern portion of the Amu Darya basin and produces oil from a Jurassic age reef structure from a depth of approximately 2,500 m.

The North Urtabulak Field is approximately 5 km2 in areal extent and was discovered in 1972. To date, 115 wells have been drilled in the field, of which TPU currently operates a total of 20 wells, of which 15 wells are producing. As at December 31, 2010, no reserves have been assigned to / attributed to the Company in Uzbekistan.

### *Oil and Gas Wells*

The number of producing and non-producing wells in which the Company had an interest as of December 31, 2010 is presented in the table below. The number of net wells corresponds to the number of gross wells as the Company has a 100% working interest in each well, subject to revenue sharing and royalties under the relevant contracts.

| | **Natural Gas** | | | |
|---|---|---|---|---|
| | **Producing** | | **Non-Producing**(1) | |
| *Kazakhstan* | **Gross** | **Net** | **Gross** | **Net** |
| Kyzyloi Field | 8 | 8 | 1 | 1 |
| Akkulka Block | 4 | 4 | 7(2) | 7(2) |
| *Tajikistan* | | | | |
| Khoja Sartez | 0 | 0 | 0 | 0 |
| Uzbekistan | | | | |
| North Urtabulak | 0 | 0 | 0 | 0 |
| **Total** | 12 | 12 | 8 | 8 |

**Notes:**

(1) "Non-Producing" wells means wells which are not producing but which are considered capable of production.

(2) Part of the Akkulka Proved and Probable Reserves were developed-non producing as at December 31, 2010 as some are out of the current Akkulka production contract area.

| | **Light and Medium Crude Oil** | | | |
|---|---|---|---|---|
| | **Producing** | | **Non-Producing**(1) | |
| *Kazakhstan* | **Gross** | **Net** | **Gross** | **Net** |
| Kyzyloi Field | 0 | 0 | 0 | 0 |
| Akkulka Block | 1(2) | 1(2) | 0 | 0 |
| *Tajikistan* | | | | |
| Beshtentak | 0 | 0 | 1 | 1 |
| Uzbekistan | | | | |
| North Urtabulak | 16 | 16 | 5 | 5 |
| **Total** | 17 | 17 | 6 | 6 |

Notes:

(1) "Non-Producing" wells means wells which are not producing but which are considered capable of production.

(2) This is well AKD01.

### *Properties with No Attributed Reserves*

Undeveloped land holdings of the Company consist of the Kul-Bas Exploration and Production Contract area in Kazakhstan and the majority of the Tajikistan Contract Area in Tajikistan. The following table sets forth the Company's undeveloped land position in Kazakhstan and Tajikistan as at December 31, 2010.

| **Area** | **Gross Acres** | **Net Acres**(1) |
|---|---|---|
| **Kazakhstan** | | |
| Kul-Bas Exploration and Production Contract | 1,885,104 | 1,885,104 |
| **Tajikistan** | | |
| Tajikistan Contract Area (Bokhtar PSC) | 8,586,725 | 8,586,725 |
| **Uzbekistan** | | |
| North Urtabulak PEC | 1,235(2) | 1,235(2) |

**Notes:**

(1) "Net Acres" is considered to be the same as "Gross Acres" as KPL's interest under the Bokhtar PSC is not subject to any royalties. Under the Bokhtar PSC, KPL will: (i) recover 100% of its costs from Cost Production; and (ii) receive 35.7% of the Profit Production.

(2) TPU is a contractor and accordingly, reserves are not attributed to TPU.

## Kazakhstan

The Kul-Bas Exploration and Production Contract area originally comprised 2,688,695 acres (10,881 $km^2$) (gross and net) in area. The Kul-Bas Exploration and Production Contract was signed between Kul-Bas and the MEMR on November 11, 2005 and is valid for a period of 25 years (unless extended by mutual agreement of the parties), with an initial six year exploration period and a 19 year production period. 20% of the contract area is to be relinquished at the end of the second year of the contract, with 20% to be relinquished annually thereafter up to the end of the six year exploration period, except with respect to combined exploration and production contracts (which mainly only contain a work program for exploration and not production) for areas in which a commercial discovery is made as this contract grants Kul-Bas an exclusive right to proceed to the production period where it has made a commercial discovery. The first relinquishment was made in November 2007 and ratified in December 2008 by the Kazakh authorities. The relinquishments were reduced and changed in February 2009 and the Company relinquished approximately 851 $km^2$ (210,304 acres) in December 2010 (leaving an area of 7,632 $km^2$ (1,885,104 acres).

The work program on this area amounted to a total of approximately $7,773,500 over the initial six-year exploration period. The remaining commitment of $2,894,000 relating to the contractual territory is required to be satisfied by November 11, 2011 and is included within the 2010 work program of $3,045,150. As at December 31, 2010, this requirement had been satisfied by the expenditure of $3,039,150.

The royalty payable was expected to range from 4% to 6% depending on the size of the deposit and set 30 days before production commenced but this is likely to be replaced by the Mineral Extraction Tax at 0.5% for domestic gas sales or 10% for exports. For oil sales, the Company would anticipate a MET rate on domestic sales of approximately 3.5%. See "*Tax Horizons*" below. Pursuant to the contract, Kul-Bas must also reimburse the Kazakh State for approximately $3,280,000 in equal portions on a quarterly basis over the first ten years of any commercial production. In addition, 1% of the total investment incurred during exploration and 0.1% of the total amount of operational costs during production are payable by Tethys for the training of Kazakh specialists, and $10,000 per year for socio-economic development programs. See "*Description of the Business - Kul-Bas Block and Kul-Bas Exploration and Production Contract*".

## Tajikistan

The Bokhtar PSC in Tajikistan gives KPL the exclusive right, as contractor under the Bokhtar PSC, to conduct certain oil and gas operations in the Tajikistan Contract Area during the term of the Bokhtar PSC and to receive the Company's share of production from the Tajikistan Contract Area. The Tajikistan Contract Area is approximately 8.6 million acres (34,750 km2) and is located in the southwestern part of Tajikistan. The Tajikistan Contract Area includes over 130 different prospective structures and several existing oil and gas fields, including the Beshtentak, Khoja Sartez and Komsomolsk fields. The Tajikistan Contract Area specifically excludes certain structures on which licences have previously been issued to other entities. Under the Bokhtar PSC, KPL will recover 100% of its costs from up to 70% of total production from oil and natural gas, the maximum allowed under the Production Sharing Law. The remaining Profit Production will then be split in accordance with a fixed formula between KPL and the Tajik State. The Tajik State's share of the costs includes all taxes, levies and duties. Under the Bokhtar PSC, KPL has the right to sell its share of Profit Production to any third party, whether a resident of Tajikistan or not, at a price determined by KPL. The Operator under the Bokhtar PSC is TSTL, a wholly-owned subsidiary of TTL.

The terms of the Bokhtar PSC are fixed over the life of the Bokhtar PSC, which has a term of 25 years. If in respect of any development area, commercial production remains possible beyond the Initial Term, the Bokhtar PSC may be extended with respect to such development area for an additional term of not less than five years or to the end of the producing life of the development area.

Pursuant to the Bokhtar PSC, KPL, as contractor, is required to select and relinquish portions of the Tajikistan Contract Area with the first relinquishment being after seven contract years in respect of 25% of the Tajikistan Contract Area (less any development areas) and at five year intervals thereafter in respect of 50% of the then remaining Tajikistan Contract Area (less any development areas).

KPL is not required to relinquish any portion of the original Tajikistan Contract Area containing a development area or an area containing a declared commercial discovery for which a development plan has been sought and is awaiting approval by the Tajik State.

A Coordination Committee established by KPL and MEI is responsible for the overall supervision of oil and gas operations conducted under the Bokhtar PSC. The Coordination Committee is comprised of a total of six representatives, six of whom have been appointed by the MEI and three of whom have been appointed by KPL with KPL providing the Chairman of the Committee. Decisions of the Coordination Committee are made by majority decision of the representatives present and entitled to vote. KPL and the MEI shall endeavour to reach agreement on all matters presented to the Coordination Committee. In the event that on any matter the Coordination Committee are unable to reach agreement then KPL's point of view shall prevail. However if the MEI is reasonably of the view that the proposed action would result in serious permanent damage to that field or reservoir which would materially reduce economic recovery of petroleum from the field or reservoir then the matter will be referred to an internationally recognized independent expert appointed by KPL and the MEI whose decision on accepted international Petroleum Industry practice shall be final and binding.

Pursuant to the Bokhtar PSC, KPL is required to fund a minimum work program (previously defined as the "**Work Program**") in respect of the Tajikistan Contract Area. The proposed Work Program is designed to provide additional data for a focused exploration of the Tajikistan Contract Area and will involve the acquisition of additional seismic data, gravity and magnetic data and exploration drilling. The proposed Work Program will be carried out in two phases. Phase I, to be completed within 18 months from the effective date of the Bokhtar PSC, is expected to consist of: (i) geological studies; (ii) reprocessing of existing seismic and other geophysical data; (iii) acquisition of seismic and other geophysical data; and (iv) initial rehabilitation activities on the Beshtentak and Khoja Sartez fields. The total minimum cost of Phase I was approximately $3,000,000. Upon completion of Phase I, KPL has decided to proceed with Phase II. Phase II, which is to be completed within 18 months of the completion of Phase I, is expected to involve the commencement of the drilling of an exploration well to determine the oil and gas potential of the Bukhara formation and to perform additional rehabilitation activities if economically justified. The total minimum cost of the activities planned in Phase I and Phase II is estimated to be approximately $5,000,000. To date over $47 million has been spent on activities under the Bokhtar PSC well exceeding the financial commitments under the PSC.

**Uzbekistan**

The North Urtabulak Field has no attributed reserves however the Company produces oil under the North Urtabulak PEC.

***Forward Contracts***

**Kazakhstan**

TAG is a party to the Kazakh Gas Supply Contract which was entered into in January 2006 and was assigned to PCK in December 2007. The Kazakh Gas Supply was further assigned to Asia Gas NG LLP with effect from May 1, 2009. The Kazakh Gas Supply Contract is for a maximum of 850,000 Mcm (approximately 30 Bcf) at a fixed price of $32.00 per Mcm excluding VAT. The term of the Kazakh Gas Supply Contract expires on the earlier of (i) the date when the maximum volume provided under the Kazakh Gas Supply Contract (850 MMcm (30 Bcf)) has been delivered or (ii) December 1, 2012, the date on which all contracts and licences pursuant to which the gas to be delivered under the Kazakh Gas Supply Contract terminate. A second gas sales contract was entered into with Asia Gas NG LLP, pursuant to which gas will be sold at a price of $38/Mcm (including VAT). Gas sold under this contract is for domestic sales and as such, is subject to a 0.5% MET payment to the Kazakh State. The new gas sales contract runs for a period of two years and the parties have agreed to assess the price after one year. The nature of the Company's natural gas operations exposes the Company to risks associated with fluctuations in commodity prices and foreign currency exchange rates. To date, the Company has not utilized derivative instruments to manage these risks.

**Tajikistan**

In January 2009, KPL began supplying small amounts of gas to the town of Kulob in southern Tajikistan at a price of 300 Somoni (approximately $86) per Mcm. This gas supply terminated in March 2009 pending well rehabilitation.

On March 17, 2010, Tethys announced that an oil sales contract has been signed for the sale of crude oil from its Beshtentak Field in the Baljuvon region. Contracts with two other suppliers were signed in 2010 with similar terms and the ability to review pricing on a three month rolling basis.

The nature of the Company's natural gas operations exposes the Company to risks associated with fluctuations in commodity prices and foreign currency exchange rates. To date, the Company has not utilized derivative instruments to manage these risks.

**Uzbekistan**

The Company sells to independent marketing agents but has no obligation to sell them the products and therefore there are no forward contracts in place.

***Abandonment and Reclamation Costs***

The Company estimates well abandonment and reclamation costs area by area by taking into consideration the costs associated with remediation, decommissioning, abandonment and reclamation, as well as salvage values of existing equipment. These costs are adjusted to reflect working interests held and are time discounted in accordance with NI 51-101.

**Kazakhstan**

The Company may become responsible for costs associated with abandoning and reclaiming wells, processing facilities and pipelines which it may use for production of hydrocarbons. Abandonment and reclamation of such facilities and the costs associated therewith is often referred to as "decommissioning". The Company pays 1% of its total annual investments into an abandonment fund and the costs of decommissioning are expected to be paid from these proceeds. Abandonment and reclamation costs were estimated for all legal obligations associated with the retirement of long lived tangible assets such as wells, facilities and plants based on market prices or on the best information available where no market price was available. The asset retirement obligation is recorded at fair value and accretion expense, recognized over the life of the property, increases the liability to its expected settlement value. If the fair value of the estimated asset retirement obligation changes, an adjustment is recorded for both the asset retirement obligation and the asset retirement cost. The Company's asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment and site restoration on oil and gas properties. The Company has estimated the costs to be $5,000 per shallow well and $7,000 per deep well.

The Company makes provision for these future costs of decommissioning on a discounted basis. Costs are expected to be incurred between 2012 and 2022. The provision has been estimated using existing technology at current prices, escalated at an inflation rate and discounted back at a discount rate appropriate to the region.

The Company's estimate of abandonment and reclamation costs, net of estimated salvage value, for surface leases, wells, facilities and pipelines, undiscounted and discounted at 11%, are $602,085 and $192,220, respectively. In the next three years, no abandonment and reclamation costs are expected to be incurred.

**Tajikistan**

As of December 31, 2010, the Company had approximately 8 net wells for which abandonment and reclamation costs are expected to be incurred in respect of the Tajikistan Contract Area. The estimate of abandonment and reclamation costs, net of estimated salvage value, for surface leases, wells, facilities and pipelines, undiscounted and discounted at 11%, are $53,240 and $41,425 respectively, which are separately accounted for in the financial statements of SSEC. All of these wells will be remediated by December 31, 2012.

The Company will be liable for its share of ongoing environmental obligations and for the ultimate reclamation of the properties held by it upon abandonment. Ongoing environmental obligations are expected to be funded out of cash flow from operations of the Company.

Under the Bokhtar PSC, any development plan in Tajikistan must also include an abandonment and site restoration program together with a funding procedure for such program. All funds collected pursuant to the funding procedure shall be allocated to site restoration and abandonment and will be placed in a special interest bearing account by KPL which shall be held in the joint names of the State and KPL or their respective nominees, or its designee. KPL's responsibilities for environmental degradation, site restoration and well abandonment obligations, and any other actual contingent and potential activity associated with the environmental status of the development area shall be limited to the obligation to place the necessary funds in the approved account. In addition any areas relinquished areas must be brought into the same condition as they were prior to their transfer to KPL (soil fertility condition, quality of the ground and environment). All expenditures incurred in abandonment and site restoration are cost recoverable.

**<u>Uzbekistan</u>**

Pursuant to the North Urtabulak PEC, in the event that TPU advises the operating committee that it no longer intends to perform any Operating Services on a Contractor Well, TPU is required to plug and abandon such well at its own expense. If TPU does not comply with such provisions, Uzgeoneftegazdobycha is required to immediately assume responsibility for such well.

In the eleven year history of the project, TPU has never been required to plug and abandon a well. In every instance where a well was deemed by TPU to be unsuitable for further production enhancement operations, the well was simply returned to Uzbekneftegaz as per the terms of the PEC. As such, no abandonment costs have been incurred.

***Tax Horizon***

**<u>Kazakhstan</u>**

The tax system applied to the Company's operations in subsoil activity in Kazakhstan is mainly based on a combination of MET, corporate income tax and excess profit tax.

Capital equipment and wells are depreciated at various rates, and corporate income tax is applied at the rate of 20% on the taxable income.

In 2010, the excess profit tax was calculated using as the tax base the part of net income of the subsoil user in excess of 25% of the subsoil user's deductions. Tax rates are established on a sliding scale ranging from 0% to 60%.

The MET, which the Company is subject to, ranges from 0.5% to 1.5% of the value of produced volumes of natural gas being sold to domestic market, and at a rate of 10% of the value of produced gas volumes being sold for export. Currently on Kyzyloi and Akkulka gas domestic sales the MET rate is 0.5%.

MET for crude oil will be differentiated not only by production volumes but also by type of sales. For 2010, MET is expected to range between 6%-19% and in 2011 from 7%-20%. Much lower revenues from domestic deliveries will be taxed at half the international sales rates. Additionally the tax base for volumes sold domestically will not be linked to the international oil price but rather to the domestic price. On this basis the Company would anticipate a MET rate on its domestic sales in 2011 to be 3.5%.

**<u>Tajikistan</u>**

Under the Bokhtar PSC, the Tajik State's share of petroleum production includes all taxes, levies and duties which would otherwise be payable. (See "*Description of the Business – Tajikistan - Bokhtar PSC – Exploration and Appraisal Potential*" for a description of the revenue sharing provisions of the Bokhtar PSC). Accordingly, the Company does not expect that additional corporate income tax will become due on any net revenue earned in Tajikistan under the Bokhtar PSC.

## Uzbekistan

In Uzbekistan, TPU operates in accordance with the Decree of the Cabinet of Ministers of Uzbekistan #322 of July 2, 1999 (the "**Decree**") and North Urtabulak PEC. The tax system which applies to the Company's operations in Uzbekistan is based on the Decree.

To permit TPU to carry forward losses of the current period to the future period for the purposes of their deduction from the taxable base, it was established that:

- the income of TPU on this project to be received from sale of its own part of liquid hydrocarbons, shall be subject only to a profit tax at the rate 16% and TPU has no other obligation in Uzbekistan on taxes and payments, including customs duties to the imported equipment;
- the foreign subcontractors of TPU, engaged implementation of the project, shall be exempted from all taxes, duties, fees and other mandatory payments, levied on the territory of the Uzbekistan;
- on payment of profit tax by TPU to deduct from the taxable base the amount of all expenses related to its activity under the project, including the amount of payment of interest on loans of banks and other organizations; and
- Uzgeoneftegazdobycha and Uzneftepererabotka shall pay all taxes and deductions to the centralized and local budgets of the Uzbekistan from the whole volume of enhanced production, except profit tax on the part of liquid hydrocarbons is being paid by TPU.

Under the North Urtabulak PEC, TPU receives 50% of the oil and its partner takes the remaining 50%. A 16% profit tax is due once all TPU accumulated costs are recovered.

***Costs Incurred***

The following table summarizes capital expenditures related to the Company's activities for the year ended December 31, 2010:

| | Year December 31, 2010(1) (M$) | | | |
|---|---|---|---|---|
| | **Kazakhstan** | **Tajikistan** | **Uzbekistan** | **Total** |
| **Property Acquisition Costs** | | | | |
| Proved Properties | 0 | 0 | 0 | 0 |
| Unproved Properties | 0 | 0 | 0 | 0 |
| **Exploration Costs** | 31,688 | 19,900 | 0 | 51,588 |
| **Development Costs** | 1,370 | 0 | 4,937 | 6,307 |
| **Total[1]** | **33,058** | **19,900** | **4,937** | **57,895** |

**Note:**
(1) Does not include the costs incurred in respect of the acquisition of the drilling rigs and ancillary equipment.
(2) The Tajikistan figures represent the total expenditure incurred by the joint venture and not Tethy's 51% share.

***Exploration and Development Activities***

The following table summarizes the gross and net exploration and development wells in which the Company participated during the year ended December 31, 2010 in Kazakhstan, Tajikistan and Uzbekistan.

**Year Ended December 31, 2010**

| *Exploration Wells* | Kazakhstan Gross | Kazakhstan Net | Tajikistan Gross | Tajikistan Net | Uzbekistan Gross | Uzbekistan Net |
|---|---|---|---|---|---|---|
| Natural Gas | 0 | 0 | 2 | 2 | 0 | 0 |
| Oil | 3 | 3 | 2 | 2 | 0 | 0 |
| Service | 0 | 0 | 0 | 0 | 0 | 0 |
| Dry Holes | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total Exploration Wells** | **3** | **3** | **3** | **3** | **0** | **0** |
| | | | | | | |
| ***Development Wells*** | | | | | | |
| Natural Gas | 0 | 0 | 0 | 0 | 0 | 0 |
| Oil | 0 | 0 | 2 | 2 | 6 | 6 |
| Service | 0 | 0 | 0 | 0 | 0 | 0 |
| Dry Holes | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total Development Wells** | **0** | **0** | **2** | **2** | **6** | **6** |

In Kazakhstan, there were no new development wells drilled during that period and they are therefore not included in the above table. See "*Description of the Business*" for a discussion of the Company's development and exploration plans.

In Tajikistan, during the year up to December 31, 2010, a further two wells were re entered for development, namely numbers BST92 and 85 in Beshtentak Field. Well numbers BST 92 and 85 were worked over and whilst 20 in Beshtentak is undergoing radial drilling to enhance oil production. KOM200 was spudded in August 2009 in order to access evaluated gas reserves in Komsomolsk and was completed in March 2010 whilst KOM201 was spudded in May 2010 and drilling finished in November 2010 with testing currently ongoing.

In Uzbekistan, a total of six development wells were participated in during the year up to December 31, 2010, new well NU116, sidetracking of the NU96 well (NU96H2) plus the radial drilling of four other wells 44, 79, 87, 92 (as well as radial drilling on 116).

***Production Estimates***

The following discloses the estimated production of Tethys in 2011 by product type associated with the future net revenue estimates reported in the McDaniel Reserve Report and the TRACS Reserve and Resource Report update.

| | **Natural Gas (Bcf)** | **Crude Oil (Mbbl)** |
|---|---|---|
| **Kazakhstan** | | |
| Gross Proved | 7.6 | 570 |
| Gross Proved plus Probable | 8.0 | 684 |
| **Tajikistan** | | |
| Gross Proved | 0.19 | 0.6 |
| Gross Proved plus Probable | 0.39 | 14.1 |

The following table sets forth the volume of production estimated in the McDaniel Reserve Report for the Kyzyloi and Akkulka Fields and estimated in the TRACS Reserve and Resource Report for the Komsomolsk and Beshtentak Fields, being fields that account for 100% of the estimated production disclosed under the above table, for the year ending December 31, 2011:

| **Reserves Category** | **Natural Gas (Bcf)** | **Light and Medium Crude Oil (Mbbl)** |
|---|---|---|
| *Kyzyloi, Kazakhstan* | | |
| Gross Proved | 4.8 | - |
| Gross Proved plus Probable | 4.8 | - |
| *Akkulka, Kazakhstan* | | |
| Gross Proved | 2.8 | 570 |
| Gross Proved plus Probable | 3.2 | 684 |
| *Komsomolsk, Tajikistan* | | |
| Gross Proved | 0.19 | 0.55 |
| Gross Proved plus Probable | 0.38 | 1.1 |

| Reserves Category | Natural Gas (Bcf) | Light and Medium Crude Oil (Mbbl) |
|---|---|---|
| *Beshtentak, Tajikistan* | | |
| Gross Proved | 0.00 | 0.00 |
| Gross Proved plus Probable | 0.00 | 13.00 |

***Production History***

**Kazakhstan**

The following table shows the Company's average daily sales production volume, before deduction of royalties, payable to others by major producing region for each of the last four fiscal quarters and the year ended December 31, 2010.

| 2010(1)(3) | Natural Gas | Light and Medium Crude Oil |
|---|---|---|
| Daily Production Volume | | |
| (Gross Mcm for natural gas and gross bbl for oil) | | |
| ▪ Year Ended December 31, 2010 | 551 | 591 |
| ▪ Quarter ended March 31, 2010 | - | - |
| ▪ Quarter ended June 30, 2010 | 298 | - |
| ▪ Quarter ended September 30, 2010 | 481 | - |
| ▪ Quarter ended December 31, 2010 | 729 | 591(2) |
| Prices Received(4) | $33.03 | $21.50 |
| Royalties Paid(4) | $1.65 | $1.08 |
| Production Costs(4) | $7.62 | $18.91 |
| Resulting Netback(4) | $23.76 | $1.51 |

**Notes:**

(1) Kyzyloi and Akkulka were the only producing fields in Kazakhstan in 2010.

(2) Between September 10 and December 1, 2010, the Company carried out a period of test production of 86 days on the Doris discovery on the Akkulka Field.

(3) The annual average value is based on production days.

(4) $/Mcm for natural gas and $/bbl for oil.

**Tajikistan**

| 2010(1) | Natural Gas | Light and Medium Crude Oil |
|---|---|---|
| Daily Production Volume | | |
| (Gross Mcm for gas or gross bopd for oil) | | |
| ▪ Year Ended December 31, 2010 | 0 | 24 |
| ▪ Quarter ended March 31, 2010 | 0 | 22 |
| ▪ Quarter ended June 30, 2010 | 0 | 16 |
| ▪ Quarter ended September 30, 2010 | 0 | 10 |
| ▪ Quarter ended December 31, 2010 | 0 | - |
| Prices Received(2) | 0 | $37.50 |
| Royalties Paid(2) | 0 | $3.37 |
| Production Costs(2) | 0 | $13.03 |
| Resulting Netback(2) | 0 | $21.10 |

**Notes:**

(1) BST 20 was the only well on production in Tajikistan in 2010.

(2) $/Mcm for natural gas and $/bbl for oil.

**Uzbekistan**

| 2010(1)(2) | Natural Gas | Light and Medium Crude Oil |
|---|---|---|
| Daily Production Volume | | |
| (Gross Mcm for gas or gross bopd for oil) | | |
| ▪ Year Ended December 31, 2010 | 0 | 1,541(1) |
| ▪ Quarter ended March 31, 2010 | 0 | 1,785(2) |

| | | |
|---|---|---|
| ▪ Quarter ended June 30, 2010 | 0 | 1,660 |
| ▪ Quarter ended September 30, 2010 | 0 | 1,466 |
| ▪ Quarter ended December 31, 2010 | 0 | 1,259 |
| Prices Received(3) | 0 | $37.75 |
| Royalties Paid(3) | 0 | - |
| Production Costs(3) | 0 | $5.75 |
| Resulting Netback(3) | 0 | $32.00 |

**Notes:**

(1) North Urtabulak was the only field in production in Uzbekistan in 2010.
(2) This figure is derived from sales from January 2010 up to October 2010, which was the last sale in 2010.
(3) $/Mcm for natural gas and $/bbl for oil.

***Production Volume By Field***

The following table indicates the Company's total production for the year ended December 31, 2010 from each important field (before taxes and royalties, unless otherwise noted):

| **2010** | **Natural Gas (Mcm)** | **Light and Medium Crude Oil (bbl)** |
|---|---|---|
| Kyzyloi, Kazakhstan | 95,810 | 0 |
| Akkulka, Kazakhstan | 24,244(1) | 50,870(2) |
| Komsomolsk, Tajikistan | 0 | 0 |
| Beshtentak, Tajikistan | 0 | 5,390(3) |
| North Urtabulak, Uzbekistan | 0 | 260,830(4) |
| Total | 120,054(5) | 317,090(5) |

**Notes:**

(1) First delivery of gas commenced on October 6, 2010.
(2) Reflecting 86 days of test production for the Doris discovery.
(3) Net to SSEC, after royalties. SSEC is 51% owned by the Company.
(4) Net to TPU, after royalties. TPU is 100% owned by the Company.
(5) The average oil and gas production per production day for the fourth quarter of 2010 was 6.158 boepd.

## Tajikistan Resources Information

*Overview*

The Company engaged TRACS AGR to evaluate the contingent and prospective resources of the Company attributable to the Tajikistan Contract Area. In connection therewith, the TRACS Reserve and Resource Report provides the Company with an independent evaluation of the contingent and prospective resources of the Company. Certain terms used herein have the meanings attributed to such terms in the Canadian Oil and Gas Evaluation ("**COGE**") Handbook, which is referenced by the Canadian Securities Administrators in NI 51-101.

Estimates of resources always involve uncertainty, and the degree of uncertainty can vary widely between accumulations and projects and over the life of a project. Consequently, estimates of resources should generally be quoted as a range according to the level of confidence associated with the estimates. The range of uncertainty of estimated recoverable volumes may be represented by either deterministic scenarios or by a probability distribution. Resources should be provided as low, best and high estimates as follows:

> **Low Estimate:** This is considered to be a conservative estimate of the quantity that will actually be recovered. It is likely that the actual remaining quantities recovered will exceed the low estimate. If probabilistic methods are used, there should be at least a 90% probability (P90) that the quantities actually recovered will equal or exceed the low estimate.
>
> **Best Estimate:** This is considered to be the best estimate of the quantity that will actually be recovered. It is equally likely that the actual remaining quantities recovered will be greater or less than the best estimate. If probabilistic methods are used, there should be at least a 50% probability (P50) that the quantities actually recovered will equal or exceed the best estimate.

**High Estimate:** This is considered to be an optimistic estimate of the quantity that will actually be recovered. It is unlikely the actual remaining quantities recovered will exceed the high estimate. If probabilistic methods are used, there should be at least a 10% probability (P10) that the quantities actually recovered will equal or exceed the high estimate.

*Contingent Resources*

A summary of the contingent crude oil, condensate and natural gas resources for each of the Komsomolsk, Beshtentak and Khoja Sartez fields within the Tajikistan Contract Area is set forth below.

**Contingent Resources as at December 31, 2010(1)(2)**

| | **Gross** | | | **Net** | | |
|---|---|---|---|---|---|---|
| | **Low Estimate** | **Best Estimate** | **High Estimate** | **Low Estimate** | **Best Estimate** | **High Estimate** |
| **Komsomolsk Field** | | | | | | |
| Gas Condensate Resources, Mbbl | 37.4 | 74.2 | 134.6 | 34.0 | 67.5 | 122.5 |
| Natural Gas Resources, Bcf | 12.6 | 25.1 | 45.5 | 11.5 | 22.8 | 41.4 |
| boe Resources, Mbboe | 2,208.4 | 4,398.9 | 7,974.3 | 2,010 | 4,003 | 7,257 |
| **Beshtentak Field** | | | | | | |
| Crude Oil Resources, Mbbl | 63.0 | 536.0 | 4,202 | 57.3 | 487.8 | 3,823.8 |
| Natural Gas Resources, Bcf | 3.3 | 4.9 | 7.9 | 3.0 | 4.4 | 7.2 |
| boe Resources, Mbboe | 631.6 | 1,371.7 | 5,564.9 | 574.8 | 1,248.2 | 5,064.0 |
| **Khoja Sartez Field** | | | | | | |
| Natural Gas Resources, Bcf | 0.00 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| boe Resources, Mbboe | 0.00 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Total Company – Bokhtar PSC** | | | | | | |
| Crude Oil Resources, Mbbl | 63.0 | 536.0 | 4,202 | 57.3 | 487.8 | 3,823.8 |
| Gas Condensate Resources, Mbbl | 37.4 | 74.2 | 134.6 | 34.0 | 67.5 | 122.5 |
| Natural Gas Resources, Bcf | 15.9 | 30.0 | 53.4 | 14.5 | 27.3 | 48.6 |
| boe Resources, Mbboe | 2,840.0 | 5,770.6 | 13,539.1 | 2,584.4 | 5,251.2 | 12,320.6 |

Notes:

(1) Based on an arithmetic aggregation of the individual fields.

(2) Low, best and high estimates follow the COGE Handbook Section 5 resources definitions and guidelines for prospective resources. The resource range presented above is "unrisked" meaning that it is valid in the event of successfully finding hydrocarbons in each and every prospect. In this case, the possible range of recoverable resources would likely lie in the range between the low estimate and the high estimate. Tethys is entitled to 100% of contractor's share of cost/profit oil until a $42.7 million intercompany loan has been recovered and Tethys net entitlement has been calculated at 91% to reflect this.

There is no certainty that it will be commercially viable to produce any portion of the contingent resources from any Komsomolsk or Beshtentak Fields. In respect of the Komsomolsk and Beshtentak resources, the main contingency is based upon the distribution of the hydrocarbons within the structures, which will only be defined by a new work program or drilling activity, although the size of the hydrocarbons for both structures is well defined.

There are numerous uncertainties inherent in estimated resources, including many factors beyond the Company's control, and no assurance can be given that the indicated level of resources or recovery of natural gas and crude oil will be realized. In general, estimates of recoverable natural gas and crude oil resources are based upon a number of factors and assumptions made as of the date on which the resource estimates were determined, such as geological and engineering estimates which have inherent uncertainties and the assumed effect of regulation by governmental agencies and estimates of future commodity prices and operating costs, all of which may vary considerably from actual results. All such estimates are, to some degree, uncertain and classifications of resources are only attempts to define the degree of uncertainty involved. For these reasons, estimates of the recoverable natural gas and crude oil, the classification of such resources based on risk of recovery, prepared by different engineers or by the same engineers at different times, may vary substantially.

*Prospective Resources*

A summary of the prospective crude oil and natural gas resources for each of the Beshtentak Fields and within the Tajikistan Contract Area is presented below:

| | Prospective Resources as at December 31, 2010[(1)(2)(3)(4)] | | | | | |
|---|---|---|---|---|---|---|
| | | Gross | | | Net | |
| | Low Estimate | Best Estimate | High Estimate | Low Estimate | Best Estimate | High Estimate |
| **Prospects** | | | | | | |
| ***Beshtentak Field*** | | | | | | |
| Crude Oil Resources, Mbbl | 6.6 | 11.7 | 17.7 | 6.0 | 10.7 | 16.1 |
| Natural Gas Resources, Bcf | 9.1 | 16.1 | 27.7 | 8.3 | 14.7 | 25.2 |
| boe Resources, Mbbl | 8,168 | 14,474 | 22,473 | 7,433 | 13,171 | 20,450 |
| ***Total Prospects*** | | | | | | |
| MMBOE | **8,168** | **14,474** | **22,473** | **7,433** | **13,171** | **20,450** |
| **Leads** | | | | | | |
| Lead Resources MMboe | - | 1,131.7 | - | - | 404.0 | - |
| **Total Bokhtar PSC Leads and Prospects MMboe** | **-** | **1.146.2** | **-** | **-** | **417.2** | **-** |

**Notes:**

(1) Based on an arithmetic aggregation of the individual prospects.

(2) Each prospect has its own estimated probability of geological success.

(3) Low, best and high estimates follow the COGE Handbook Section 5 resources definitions and guidelines for prospective resources.

(4) Tethys is entitled to 100% of contractor's share of cost/profit oil until a $42.7 million intercompany loan has been recovered and Tethys net entitlement has been calculated at 91% to reflect this.

There is no certainty that any portion of the prospective resources identified in the TRACS Reserve and Resource Report will be discovered. If discovered, there is no certainty that it will be commercially viable to produce any portion of the resources. A total of 133 prospective structures have been delineated in the Tethys acreage. Due to constraints of data and time, TRACS AGR were unable to confirm the presence of these structures. TRACS AGR estimate that 35 structures have a prospective resource greater than 10 MMbbl of oil. The current lack of data means that it is not possible to estimate the probability of success for the prospects. In addition, a major unknown is the number of structures that have previously been drilled and hence is no longer a valid prospect as mapped. Very limited data used on previous studies in the area showed that at least 26 of the structures have been drilled, some with up to five well penetrations. As a result, TRACS AGR believe that the total "best estimate" prospective oil resources may be optimistic; however, it is also recognized that many if not most of these wells did not access deeper plays and that these may also hold additional gas resources.

There are numerous uncertainties inherent in estimated resources, including many factors beyond the Company's control, and no assurance can be given that the indicated level of resources or recovery of natural gas and crude oil will be realized. In general, estimates of recoverable natural gas and crude oil resources are based upon a number of factors and assumptions made as of the date on which the resource estimates were determined, such as geological and engineering estimates which have inherent uncertainties and the assumed effect of regulation by governmental agencies and estimates of future commodity prices and operating costs, all of which may vary considerably from actual results. All such estimates are, to some degree, uncertain and classifications of resources are only attempts to define the degree of uncertainty involved. For these reasons, estimates of the recoverable natural gas and crude oil, the classification of such resources based on risk of recovery, prepared by different engineers or by the same engineers at different times, may vary substantially.

## GLOSSARY OF TERMS

## (FOR USE IN PART 2 ONLY)

In this Part 2, the capitalized terms set forth below have the following meanings:

"**Akkulka**", "**Akkulka Block**" or "**Akkulka Field**" means the area that is subject to the Akkulka Exploration Licence and Contract in Kazakhstan;

"**Akkulka Exploration Licence and Contract**" means the exploration licence and contract of TAG in respect of the Akkulka Block;

"**Akkulka Production Contract**" means the Akkulka Production Contract dated December 23, 2009 between TAG and MEMR which gives TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years;

"**Annual Information Form**" means the annual information form of the Company dated March 23, 2011;

"**BCS**" means booster compression station, a compressor station constructed by TAG at km910 on the Bukhara Urals gas trunkline for the export of natural gas production from the Kyzyloi Field and the Akkulka Block;

"**Beshtentak Field**" means an area that forms part of the Tajikistan Contract Area;

"**Board of Directors**" means the board of directors of the Company, as constituted from time to time;

"**Bokhtar PSC**" means the production sharing contract entered into between KPL and the Government of Tajikistan, represented by MEI, on June 13, 2008 covering the Bokhtar area of southwest Tajikistan;

"**CanArgo**" means CanArgo Energy Corporation, formerly a US public oil and gas company;

"**C$**" or "**Canadian Dollar**" means Canadian dollars, the lawful currency of Canada;

"**CIS**" means the Commonwealth of Independent States which is a regional organization made up of certain countries of the former Soviet Union;

"**Company**" or "**Tethys**" means Tethys Petroleum Limited and includes, except where the context otherwise requires, the Company's direct and indirect wholly-owned subsidiaries;

"**GazImpex**" means GazImpex S.A., an unaffiliated company registered in the British Virgin Islands;

"**GazProm**" means OAO GazProm, a major Russian gas company majority owned by the government of the Russian Federation;

"**Georgia**" means the Republic of Georgia;

"**Group**" means the Company, its subsidiaries and interests in limited liability partnerships, including for the avoidance of doubt the subsidiaries set out herein under the heading "Corporate Structure";

"**IFRS**" means International Financial Reporting Standards;

"**IPO**" means the initial public offering of the Company of 18,181,818 Ordinary Shares at a price of $2.75 per Ordinary Share for gross proceeds of $50,000,000, which closed on June 27, 2007;

"**JNOC**" means Japanese National Oil Company;

"**KASE**" means the Kazakhstan Stock Exchange;

"**Kazakh Gas Supply Contract**" means the gas supply contract originally entered into between TAG and GazImpex on January 5, 2006 in relation to the supply of natural gas produced from the Kyzyloi Field;

“**Kazakhstan**” means the Republic of Kazakhstan;

“**Kazakh State**” means the government of Kazakhstan;

“**Khoja Sartez Field**” means an area that forms part of the Tajikistan Contract Area;

“**KPL**” means Kulob Petroleum Limited, a company incorporated in Jersey and a 100% subsidiary of SSEC;

“**Komsomolsk Field**” means an area that forms part of the Tajikistan Contract Area;

“**Kul-Bas**” means Kul-Bas LLP, a limited liability partnership registered in Kazakhstan in which the Company through TKL has a 100% interest;

“**Kul-Bas Block**” means the area that is subject to the Kul-Bas Exploration and Production Contract in Kazakhstan;

“**Kul-Bas Exploration and Production Contract**” means Kul-Bas’ exploration licence and production contract in respect of the Kul-Bas Block;

“**Kyzyloi**” or “**Kyzyloi Field**” means the area that is subject to the Kyzyloi Field Licence and Production Contract in Kazakhstan;

“**Kyzyloi Field Licence and Production Contract**” means the Company’s field licence and production contract in respect of the Kyzyloi Field;

“**McDaniel**” means McDaniel & Associates Consultants Ltd., independent oil and gas reservoir engineers of Calgary, Alberta;

“**McDaniel Reserve Report**” means the independent engineering evaluation of the Company’s crude oil and natural gas reserves prepared by McDaniel, dated March 18, 2011 and effective December 31, 2010;

“**MEI**” means the Ministry of Energy and Industry of the Republic of Tajikistan;

“**MEMR**” means the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan;

“**MET**” or “**Mineral Extraction Tax**” means the mineral extraction tax payable to the Kazakh State in respect of oil and gas production in Kazakhstan;

“**MOG**” means the Ministry of Oil and Gas of the Republic of Kazakhstan;

“**NI 51-101**” means National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities of the Canadian Securities Administrators;

“**NI 51-102**” means National Instrument 51-102 – Continuous Disclosure Obligations of the Canadian Securities Administrators;

“**NI 52-110**” means National Instrument 52-110 Audit Committees of the Canadian Securities Administrators;

“**North Urtabulak Field**” means the area which is subject to the North Urtabulak PEC in Uzbekistan;

“**North Urtabulak PEC**” means the production enhancement contract dated August 19, 1999 entered into among TPU, joint-stock companies Uzneftegazdobycha (formerly known as Uzgeoneftegazdobycha) and Uznefteproduct (formerly known as Uzneftepererabotka) in respect of the North Urtabulak Field as amended by supplementary agreements dated September 13, 2004, November 30, 2006 and December 19, 2007, which is for an indefinite term;

“**Ordinary Shares**” means the ordinary shares of $0.10 par value in the share capital of the Company;

“**PCK**” means Kazakhstani Petrochemical Company Kemikal LLP;

"**Pound Sterling**" or "**£**" means British pounds sterling;

"**SSEC**" means Seven Stars Energy Corporation, a 51% owned subsidiary of Tethys Tajikistan Limited;

"**Somoni**" means the Tajik Somoni, the lawful currency of Tajikistan;

"**Soum**" means the Uzbek Soum, the lawful currency of Uzbekistan;

"**TAG**" means TethysAralGaz LLP (formerly known as BN Munai LLP), a limited liability partnership registered in Kazakhstan in which the Company, through TKL, has a 100% interest;

"**Tajikistan**" means the Republic of Tajikistan;

"**Tajikistan Contract Area**" means the total net area covered by the Bokhtar PSC, as further described under "Description of the Business- Overview of Land Holdings-Tajikistan";

"**Tajik State**" means the government of Tajikistan;

"**Tenge**" means the Kazakh Tenge, the lawful currency of Kazakhstan;

"**TKL**" means Tethys Kazakhstan Limited, a wholly-owned subsidiary of the Company;

"**TMG**" means TethysMunaiGaz LLP, a limited liability partnership registered in Kazakhstan in which the Company, through TKL, has a 100% interest;

"**TPI**" means Tethys Petroleum Incorporated, a wholly-owned subsidiary of the Company;

"**TPU**" means Tethys Production Uzbekistan, the trading name of Baker Hughes (Cyprus) Limited, a company incorporated in Cyprus and a wholly-owned subsidiary of the Company;

"**TRACS AGR**" means TRACS International Consultancy Ltd., independent oil and gas reservoir engineers of U.K.;

"**TRACS Reserve and Resource Report**" means for reserves, the independent evaluation report of the Group's oil and gas reserves attributable to the Beshtentak Field and the Komsomolsk Field; for resources, the independent evaluation report of the contingent and/or prospective resources of the Group attributable to the Beshtentak Field and the Komsomolsk Field prepared by TRACS AGR dated March 18, 2011 and effective as of December 31, 2010;

"**TSK**" means Tethys Services Kazakhstan LLP, a limited liability partnership registered in Kazakhstan in which the Company, through TKL, has a 100% interest;

"**TSTL**" means Tethys Services Tajikistan Limited, a wholly-owned subsidiary of SSEC;

"**TSX**" means the Toronto Stock Exchange;

"**TTL**" means Tethys Tajikistan Limited, a wholly-owned subsidiary of the Company;

"**UNG**" means the Uzbek State oil and gas company, National Holding Company "Uzbekneftegaz";

"**United States**" or "**U.S.**" means the United States of America;

"**U.S. Dollar**" or "**$**" means U.S. dollars, the lawful currency of the United States of America;

"**Uzbekistan**" means the Republic of Uzbekistan;

"**Uzbek State**" means the government of Uzbekistan;

"**Uzbek State Partners**" means Uznefteproduct and Uzneftegazdobycha, each an associated entity (as defined in the North Urtabulak PEC) of UNG;

"**Uzneftegazdobycha**" means the Uzbek joint-stock company that is an associated entity of UNG;

"**Uznefteproduct**" means the Uzbek joint-stock company that is an associated entity of UNG;

"**VAT**" means value added tax; and

"**Vazon**" means Vazon Energy Limited, a company incorporated in Guernsey that is owned by the President and Chief Executive Officer of the Company.

## GLOSSARY OF ABBREVIATIONS AND TECHNICAL TERMS

## (FOR USE IN PART 2 ONLY)

In this Part 2, the abbreviations and technical terms set forth below have the following meanings:

“**2D**” means seismic data recorded along discrete tracks;

“**Albian**” means a geological stage of the Cretaceous period from 112.0 to 99.6 million years ago;

“**API**” means American Petroleum Institute, but is generally referred to as a degree of gravity that provides a relative measure of crude oil density;

“**Aptian**” means a geological stage of the Cretaceous period from 125.0 to 112.0 million years ago;

“**atm**” means atmospheres, a measurement of pressure equivalent to 102.667 kilopascals;

“**AVO**” means amplitude versus offset, a specialist seismic processing technique used in the detection of hydrocarbons;

“**Barremian**” means a geological stage of the Cretaceous period from 130.0 to 125.0 million years ago;

“**bbl**” means barrel;

“**Bcf**” means billion cubic feet;

“**Bcfpd**” means billion cubic feet per day;

“**Bcm**” means billion cubic metres;

“**Bcmpd**” means billion cubic metres per day;

“**boe**” means barrels of oil equivalent;

“**boepd**” means barrels of oil equivalent per day;

“**bopd**” means barrels of oil per day;

“**Carboniferous**” means the geological period from 359.2 to 299 million years ago;

“**Cenomanian**” means a geological stage of the Cretaceous period from 99.6 to 93.5 million years ago;

“**Cenozoic**” means the geological era from 65.5 million years ago to the present time which includes the Paleogene and the Neogene periods;

“**cf**” means cubic feet;

“**cm**” means cubic metres;

“**COGE Handbook**” means the Canadian Oil and Gas Evaluation Handbook prepared jointly by the Society of Petroleum Evaluation Engineers (Calgary Chapter) and the Canadian Institute of Mining, Metallurgy and Petroleum (Petroleum Society), as amended from time to time;

“**Cretaceous**” means the geological period from 145.5 to 65.5 million years ago;

“**°C**” means degrees Celsius;

“**Devonian**” means the geological period from 416 to 359.2 million years ago;

“**Eocene**” means the geological epoch from 55.8 to 33.9 million years ago within the Paleogene system of the Cenozoic era immediately after the Paleocene;

“**ft**” means feet;

"**gross**" means:

(i) in relation to the Company's interest in production or reserves, its "company gross reserves", which represent the Company's working interest (operating or non-operating) share of gross reserves before deduction of royalties and MET, and without including any royalty interests of the Company;

(ii) in relation to wells, the total number of wells obtained by aggregating the Company's current working interest in each of its gross wells; and

(iii) in relation to the Company's interest in properties, the total area of properties in which the Company has an interest multiplied by the working interest owned by the Company;

"**Hauterivian**" means a geological stage of the Cretaceous period from 136.4 to 130 million years ago;

"**hp**" means horsepower;

"**Jurassic**" means the geological period from 199.6 to 145.5 million years ago;

"**km**" means kilometre;

"**km$^2$**" means square kilometres;

"**kW**" means kilowatt;

"**Kyzyloi Sandstones**" or "**Kyzyloi Sand**" means Eocene age fine to very fine grained sandstone, sheet type and non-marine in origin, with typical gas saturated thicknesses of between 2 m to 6 m that are generally found in the interval between 400 m to 600 m below surface and have a high porosity range (26% to 35%) with a high bound-water content;

"**m**" means metres;

"**M$**" means thousands of U.S. dollars;

"**Mbbl**" means thousands of barrels;

"**Mbblpd**" means thousands of barrels per day;

"**Mboe**" means thousand barrels of oil equivalent;

"**Mcf**" means thousand cubic feet;

"**Mcfpd**" means thousand cubic feet per day;

"**Mcm**" means thousand of cubic metres;

"**Mcmpd**" means thousand cubic metres per day;

"**MD**" means millidarcies;

"**Mesozoic**" means the geological era from 248 to 65 million years ago which lies between the Paleozoic and Cenozoic eras;

"**millidarcy or (mD)**" means one thousandth of a darcy, a unit of measure of permeability;

"**mm**" means millimetre;

"**MM$**" means millions of U.S. dollars;

"**MMbbl**" means million barrels;

"**MMboe**" means million barrels of oil equivalent;

"**MMcf**" means million cubic feet;

"**MMcfpd**" means million cubic feet per day;

"**MMcm**" means million cubic metres;

"**MMcmpd**" means million cubic metres per day;

"**MMstb**" means million stock tank barrels;

"**Neogene**" means a geological period of the Cenozoic era, from 23.03 to 5.33 million years ago, which followed the Paleogene period;

"**net**" means:

(i) in relation to the Company's interest in production or reserves, its working interest (operating or non-operating) share after deduction of amounts payable in respect of the Mineral Extraction Tax;

(ii) in relation to wells, the number of wells obtained by aggregating the Company's current working interest in each of its gross wells; and

(iii) in relation to the Company's interest in a property, the total area in which the Company has an interest multiplied by the working interest owned by the Company;

"**NGL**" means natural gas liquids including condensate, propane, butane and ethane;

"**Paleocene**" means the lower most epoch within the Paleogene period, from 65.5 to 61.7 million years ago, immediately after the Cretaceous period;

"**Paleogene**" means the geological period from 65.5 to 23 million years ago;

"**Paleozoic**" means the geological era from 542 to 251 million years, which includes the Devonian, Carboniferous and Permian periods;

"**Permian**" means the geological period from 299 to 251 million years ago and it is the last period of the Paleozoic era;

"**PNN logging**" means pulsed neutron-neutron logging, a modern wireline logging technique which can be used in cased hole and subject to interpretation may indicate the presence of hydrocarbons;

"**psi**" means pounds per square inch, a measure of pressure and equivalent to 0.068 atm;

"**super giant**" means the estimated ultimate recoverable reserves of 5 billion bbl of oil or 30 TCF (0.85 TCM) of natural gas;

"**syn-rift**" means rocks deposited during an extensional geological regime (i.e. where rocks are under tension) which results in the general widening and deepening of sedimentary basins and allows significant infilling of sediments from the edges of the basin;

"**Tasaran**" or Tasaran Sand" means Eocene age continental to non-marine fine to very fine grained sandstone, with some significant clay content, slightly stratigraphically older than the Kyzyloi Sandstone that are generally found in the interval between 500 m to 600 m (1,641 ft to 1,969 ft) below surface;

"**Tcf**" means trillion cubic feet;

"**Tcm**" means trillion cubic metres;

"**Tertiary**" means the geological period from 65 to 1.8 million years ago; and

"**Triassic**" means the geological period from 251 to 199.6 million years ago.

**Presentation of Oil and Gas Information**

In this Part 2, unless the context otherwise requires, the following terms have the meanings set forth below (as described in sections 5.4.1 and 5.4.2 of COGEH).

"**Reserves**" are the estimated remaining quantities of oil and natural gas and related substances anticipated to be recoverable from known accumulations, as of a given date, based on: analysis of drilling, geological, geophysical and engineering data; the use of established technology; and specified economic conditions, which are generally accepted as being reasonable. Reserves are classified according to degree of certainty associated with the estimates.

"**Proved Reserves**" are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated Proved Reserves.

"**Probable Reserves**" are those additional reserves that are less certain to be recovered than Proved Reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated Proved Plus Probable Reserves.

"**Possible Reserves**" are those additional reserves that are less certain to be recovered than Probable Reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated Proved Plus Probable Plus Possible Reserves.

"**Developed Reserves**" are those reserves that are expected to be recovered from existing wells and installed facilities or, if facilities have not been installed, that would involve a low expenditure (e.g. when compared to the cost of drilling a well) to put the reserves on production. The developed category may be subdivided into producing and non-producing.

"**Developed Producing Reserves**" are those reserves that are expected to be recovered from completion intervals open at the time of the estimate. These reserves may be currently producing or, if shut-in, they must have previously been on production, and the date of resumption of production must be known with reasonable certainty.

"**Developed Non-Producing Reserves**" are those reserves that either have not been on production, or have previously been on production, but are shut-in, and the date of resumption of production is unknown.

"**Undeveloped Reserves**" are those reserves expected to be recovered from known accumulations where a significant expenditure (e.g. when compared to the cost of drilling a well) is required to render them capable of production. They must fully meet the requirements of the reserves classification (proved, probable, possible) to which they are assigned.

**Section 5.4.3 of COGEH provides the following guidance on the levels of certainty for reported reserves**:

"The qualitative certainty levels contained in the definition in Section 5.4.1 are applicable to "individual reserves entities," which refers to the lowest level at which reserves calculations are performed, and to "reported reserves," which refers to the highest level sum of individual entity estimates for which reserves estimates are presented. Reported reserves should target the following levels of certainty under a specific set of economic conditions:

- at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated proved reserves,
- at least a 50 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated proved + probable reserves,
- at least a 10 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated proved + probable + possible reserves.

A quantitative measure of the certainty levels pertaining to estimates prepared for the various reserves categories is desirable to provide a clearer understanding of the associated risks and uncertainties.

However, the majority of reserves estimates are prepared using deterministic methods that do not provide a mathematically derived quantitative measure of probability. In principle, there should be no difference between estimates prepared using probabilistic or deterministic methods."

Certain other technical terms used in this Part 2 but not defined herein are defined in NI 51 101 and, unless the context otherwise requires, shall have the same meanings herein as in NI 51-101. See "*Statement of Reserves Data and Other Oil and Gas Information*". Unless otherwise stated, all gas and oil volumes are expressed as at standard conditions of temperature and pressure (temperature = 15 °C and pressure = 1 atm).

The estimates of reserves and future net revenue for individual properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties, due to the effects of aggregation.

In this Part 2 where amounts are expressed on a boe basis, natural gas volumes have been converted to oil equivalence at 6 Mcf:l bbl (170 cm: 1bb). The term boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf:l bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Unless otherwise specified, references to oil include oil and NGLs.

## CURRENCY AND EXCHANGE RATES

All references in this Part 2 to dollar amounts are to U.S. Dollars unless otherwise noted.

While the Company reports its results of operations in U.S. Dollars, its expenditures are paid and its income earned to a significant extent in foreign currencies. Moreover, the Ordinary Shares of the Company are listed on the TSX and trade in Canadian Dollars. Set out below is certain 2010 exchange rate data for the Tenge, Somoni, Soum, Pound Sterling and Canadian Dollar relative to the U.S. Dollar.

**Canadian Dollar:**

Highest rate in 2010: $1 = C$0.9931
Lowest rate in 2010: $1 = C$1.0848
Rate as of December 31, 2010: $1 = C$0.9946

*Source: Bank of Canada*

**British Pound Sterling:**

Highest rate in 2010: $1 = £0.6108
Lowest rate in 2010: $1 = £0.6991
Rate as of December 31, 2010: $1 = £0.6388

*Source: Bank of England*

**Kazakhstan Tenge:**

Highest rate in 2010: $1 = 146.41 Tenge
Lowest rate in 2010: $1 = 148.46 Tenge
Rate as of December 31, 2010: $1 = 147.40 Tenge

*Source: National Bank of Kazakhstan*

**Tajikistan Somoni:**

Highest rate in 2010: $1 = 4.3666 Somonis
Lowest rate in 2010: $1 = 4.4033 Somonis
Rate as of December 31, 2010: $1 = 4.4031 Somonis

*Source: National Bank of Tajikistan & OANDA Corporation*

**Uzbekistan Soum:**

Highest rate in 2010: $1 = 1511.4 Soum
Lowest rate in 2010: $1 = 1650.0 Soum
Rate as of December 31, 2010: $1 = 1640.0 Soum

*Source: OANDA Corporation*

## PART 3 - MANAGEMENT

1. **DIRECTORS AND SENIOR MANAGEMENT**

1.1 **Directors**

| Name | Position | Age |
|---|---|---|
| Dr David Robson | Chairman, President and Chief Executive Officer | 53 |
| Elizabeth Landles | Executive Director, Chief Administrative Officer and Corporate Secretary | 50 |
| Bernard Murphy | Chief Financial Officer | 57 |
| Rt. Hon. Peter Lilley MP | Vice Chairman and Non-Executive Director | 67 |
| Russ Hammond | Non-Executive Director | 69 |
| Piers Johnson | Non-Executive Director | 53 |
| James Rawls | Non-Executive Director | 58 |
| Marcus Rhodes | Non-Executive Director | 50 |

**Dr. David Robson**
**Chairman, President and Chief Executive Officer**

Dr Robson's career has been primarily in operating oil and gas companies. He has been Chairman, President and Chief Executive Officer, of Tethys Petroleum Group of Companies, since 2007. Tethys Petroleum Limited was formerly a wholly owned subsidiary of CanArgo Energy Corporation which was founded by Dr David Robson in 1997 where he served as Chairman and CEO until bringing Tethys Petroleum public. He was Chief Executive Officer and one of the founders of the London Stock Exchange listed company JKX Oil & Gas plc and prior to this he was employed in technical and commercial positions in Britoil plc, Hamilton Oil and Mobil. Trained as a geologist with a First Class B.Sc (Hons) degree in Geology and PhD in Geochemistry, Dr. Robson also holds an MBA from the University of Strathclyde.

Dr Robson has worked on oil and gas projects in the former Soviet Union since 1990 in areas such as Siberia, Sakhalin, Murmansk, and the Caspian region. He has a number of "firsts" such the establishment of the first non-state gas development project in Ukraine, the first non-state drilling in the fSU Black Sea, the first non-state exploration and development wells in Georgia and negotiation of the first EBRD loan to a private sector project in Ukraine. He is a Fellow of the Geological Society ("**FGS**"), a member of the Society of Petroleum Engineers ("**SPE**"), and Member of European Association of Geoscientists and Engineers. Dr Robson holds the Honour for services to the Georgian hydrocarbon extraction industry and was made a Freeman of the ancient Georgian city of Telavi. He was formerly the Energy Sector Representative on the UK Government's East European Trade Council ("**EETC**"). Dr Robson has spoken at numerous International conferences on fSU oil, gas and energy and is one of the Company's representatives on the Pacific Basin Economic Forum ("**PBEC**").

**Elizabeth Landles**
**Executive Director and Chief Administrative Officer**

Ms. Landles is a highly experienced administrator and is currently Executive Director, Chief Administrative Officer and Corporate Secretary of the Company. She is also Director of many of the Company's subsidiaries and is responsible for human resources. Ms. Landles has over 12 years of experience in the oil and gas sector and was Executive Vice President and Corporate Secretary of CanArgo Energy Corporation. She has been an Executive Director of Tethys Petroleum since its incorporation in 2003. Ms. Landles holds an Advanced Diploma in Business Administration from the Institute of Business Administration and Management (an operating division of the Institute of Chartered Secretaries and Administrators in the UK) and is a Fellow of The Institute of Business

Administration (F.Inst.BA). Ms. Landles is also a member of The Association of International Petroleum Negotiators ("**AIPN**") and is one of the Company's representatives on the PBEC. She is a member of the Executive Board of the Company. Prior to working in the oil and gas sector Ms. Landles worked in finance for several years.

**Bernard Murphy**
**Finance Director and Chief Financial Officer**

Mr. Murphy is a Fellow of the Chartered Institute of Management Accountants (FCMA) and prior to joining the Company worked in a network providing accounting and finance services to SMEs. He has 30 years experience as a management accountant having previously worked for Courtaulds, BOC, BICC and for HSBC Actuaries and Consultants Limited as Finance Director, and in insurance with HSBC and Royal & Sun Alliance. Prior to his finance career he was awarded a B.Sc. (Hons) degree in Civil Engineering from Glasgow University. He is a member of the Executive Board of the Company.

**Rt. Hon. Peter Lilley MP**
**Vice Chairman and Non-Executive Director**

Mr. Lilley was educated at Clare College, Cambridge, where he studied natural science and economics. He was a Director of Greenwell Montagu Securities (1986-87) where he headed the oil investment department and which he joined in 1972. He is Non-Executive Director of IDOX plc and was previously a Non-Executive Director of Melchior Japan Investment Trust plc. He is currently MP for Hitchin & Harpenden as well as Vice-Chairman of the All Party Parliamentary Group on Central Asia.

He was Parliamentary Private Secretary to the Chancellor of the Exchequer, Nigel Lawson (1984-1987). His first ministerial appointment was as Economic Secretary to the Treasury (June 1987), then Financial Secretary to the Treasury (July 1989). He joined Mrs. Thatcher's Cabinet as Secretary of State for Trade and Industry 1990-1992. Secretary of State for Social Security 1992-1997. Shadow Chancellor and Deputy Leader of the Conservative Party responsible for overseeing renewal of policy until June 1999. He was an election observer for the 2005 Kazakhstan presidential elections.

**Russ Hammond**
**Non-Executive Director**

Mr. Hammond was educated at St. Catherine's College, Cambridge, where he obtained a Bachelor's degree in Economics. Previously, he was Managing Director of Greenwell-Montagu Securities. Mr. Hammond was a Non-executive Director of CanArgo Energy Corporation between July 1998 and December 2008. Mr. Hammond has been Non-Executive Chairman of Terrenex Acquisition Corporation, an oil and gas and joint venture company, from 1995 to 2008, and a Non-Executive Director of Questerre Energy Corporation, an oil and gas exploration and production company listed on the TSX, since 2000. He holds the Order of Honour for services to the Georgian hydrocarbon extraction industry.

**Piers Johnson**
**Non-Executive Director**

Mr. Johnson is an experienced oilfield engineer with nearly 30 years experience. He holds a B.Sc.(Hons) degree in Mechanical Engineering from Nottingham University and is a Chartered Engineer with the Institution of Mechanical Engineers. He is past Chairman of the London Section of the SPE, a Member of the petroleum Exploration Society of Great Britain and a member of the Institute of Energy.

He is the founder and Managing Director of Oilfield Production Consultants (OPC) Limited ("**OPC**"), a petroleum and reservoir engineering consultancy specialising in operational procedures, integrated studies, wellsite supervision and well test analysis and prior to this he worked for Flopetrol Johnston Schlumberger as Well Test Supervisor, Location manager and District Sales Engineer (Asia). He has experience of oil and gas operations and field evaluations worldwide and is also a Visiting Lecturer in Petroleum Engineering at the Institute Français du Petrol in Paris.

**James Rawls**
**Non-Executive Director**

Mr. James Rawls is a registered Petroleum Engineer with over 35 years industry experience in engineering and finance. He is currently the owner and manager of Rawls Resources, Inc., a private oil and gas exploration company. Mr. Rawls worked for Exxon Company USA in onshore and offshore development as a Senior Project Engineer, and later went on to a successful 12 year career in banking as Manager of the of Deposit Guarantee National Bank. In the early 1990s, he moved back into oil and gas exploration as president of Hughes-Rawls Corporation. Since that time, both in association with others as well as in entities owned individually, Mr. Rawls, has been involved in drilling oil and gas wells both onshore and offshore, in the United States and elsewhere. He is currently involved both in exploration and private investments.

Mr. Rawls serves or has served on the public company boards of Redcliffe Exploration Inc., Harcor Energy., Tikal Resources Corporation, and Aquest Energy Ltd. as well as on the boards of numerous private companies, professional and philanthropic organisations. He holds a BS degree (distinction) in Petroleum Engineering from Mississippi State University and was named a Distinguished Fellow of the Bagwell School of Engineering in 2007.

**Marcus Rhodes**
**Non-Executive Director**

Mr. Marcus Rhodes is a Chartered Accountant and experienced auditor. He spent seventeen years working in Eastern Europe and the former Soviet Union, most recently as an Audit Partner with Ernst & Young in their Moscow office.

Mr. Rhodes has worked with a wide variety of clients in many industry sectors including retail and consumer products, paper and pulp, pharmaceuticals, hotels, iron & steel manufacture, aluminium manufacture and mining, as Audit Partner, Head of the Audit Practice, Head of Retail and Consumer Products and Advisory Partner in respect of structural and reporting issues relating to audit committees. He was also the Partner responsible for establishing the Arthur Andersen practice in Uzbekistan and has worked on and been responsible Audit Partner on a number of Russian related IPOs and advised on Eurobond and Russian bond issues. Mr. Rhodes is currently an independent consultant and also serves as Head of the Audit Committee and non-executive director for three leading Russian companies in the food, beverage and restaurant sectors, these companies being listed on the New York Stock Exchange and London Stock Exchange.

He holds a B.Sc. (Hons) degree in Economics and Economic History from Loughborough University (England), and is a Member of the Institute of Chartered Accountants of England & Wales.

1.2 **Senior Management**

| Name | Position | Age |
|---|---|---|
| Julian Hammond | Deputy Chief Executive Officer and Chief Commercial Officer | 41 |
| Graham Wall | Chief Operating Officer | 39 |
| Ian Philliskirk | Vice President and General Counsel | 49 |

**Julian Hammond**
**Deputy Chief Executive Officer and Chief Commercial Officer**

Mr. Hammond is currently the Deputy Chief Executive Officer and Chief Commercial Officer for the Company. In the role of Deputy CEO Mr. Hammond assumes any duties of the CEO that the CEO delegates under the normal course of business. Mr. Hammond is also responsible for the commercial activities and development of the business of the Company, including financing the companies activities through instruments including equity, debt and trade finance and also negotiating any new Contracts or Licences associated with new business. His role includes being in overall charge of all sales contracts and off-take agreements for oil and gas produced by the Company. He also has overall management responsibility for the Company's business in Uzbekistan. Prior to joining the Company, Mr. Hammond worked for CanArgo Energy Corporation in various positions including Business Development Manager and Commercial Manager where he managed an oil refinery in Georgia and lead the establishment of a retail chain of gasoline stations that became the market leader in the capital city, Tbilisi. Previously Mr. Hammond worked for Credit Suisse First Boston in London and Montgomery Securities in San Francisco. Mr. Hammond holds a BA degree in Economics from the University of Colorado. Mr. Hammond is the son of Mr. Russ Hammond a Director of the Company.

**Graham Wall**
**Chief Operating Officer**

Mr. Wall is the Chief Operating Officer of the Company, being appointed in 2010. Previously Mr. Wall held the position of Vice President Technical, which he had held since July 2006. He has overall responsibility for all operational and production activities of the Company including drilling and testing, production optimisation, reservoir and field development and reserve determination and development planning. Mr. Wall previously worked for CanArgo Energy Corporation, in various positions including Senior Geologist, Head of Regional Exploration and Reserve Determination, and Exploration Manager. He started his career as a minerals geologist working in gold projects in Australia and was a mineral exploration geologist of ACA Howe International Ltd, UK working in Burkina Faso, Greece, Ghana, Russia (Siberia), UK and Georgia. Mr. Wall holds a BSc (Hons) degree in exploration and mining geology, from the University of Wales, College of Cardiff. He is a Fellow of the Geological Society ("**FGS**"), a member of the Petroleum Exploration Society of Great Britain ("**PESGB**") a member of the American Association of Petroleum Geologists ("**AAPG**") and a member of the SPE.

**Ian Philliskirk**
**Vice President and General Counsel**

Mr. Philliskirk was appointed Vice President and General Counsel of Tethys Petroleum Limited in February 2009 and is responsible for all legal and associated matters within the Tethys Petroleum Group, including current and future exploration and development contracts, sales contracts, acquisitions and disposals, financings and corporate compliance. Prior to joining the Tethys team, Mr. Philliskirk was a Director of UK law firm Pinsent Masons LLP. Mr. Philliskirk graduated in 1992 with an LL.B (Hons) Degree from University College London and is a Barrister of Lincoln's Inn, having been called to the Bar in 1993. He subsequently held legal positions with UK Government departments including the Treasury Solicitor before spending ten years in Dubai, including seven years as Group Legal Manager and Company Secretary of Dubai's national oil company Emirates National Oil Company Limited (ENOC) LLC ("**ENOC**"). During this time he was also Legal Adviser and Company Secretary to Dragon Oil plc, (majority owned by ENOC) who operate in Central Asia.

## 2. CORPORATE GOVERNANCE

### 2.1 General

The oil and gas industry is vital to the functioning of modern society. As an industry participant, the Company is extremely conscious of its social responsibilities to the community at large. This means not only complying with relevant corporate governance guidelines and environmental protection requirements, but working hard to be a good corporate and local citizen.

The Board believes that sound corporate governance practices are essential to the well being of the Company and its shareholders and that these practices should be reviewed regularly to ensure that they are appropriate. The Company complies with the corporate governance principles applicable to Cayman Islands incorporated companies, being its Articles and Cayman Islands law. The Company is also required to provide prescribed disclosure relating to its corporate governance practices on an annual basis in its management information circular in accordance with National Instrument 58-101, adopted by the Canadian Securities Administrators, and also follows those corporate governance guidelines outlined by the TSX.

The Board of Directors is committed to a high standard of corporate governance practices. The Board believes that this commitment is not only in the best interests of Shareholders but that it also promotes effective decision making at Board level. The Board is of the view that its approach to corporate governance is appropriate and continues to work to align its approach with the recommendations currently in effect and contained in NI 58-201. In summary, National Instrument 58-201 recommends that:

(a) the Board should be composed of a majority of independent directors;

(b) the Board should adopt a written mandate which acknowledges certain specified responsibilities;

(c) the Board should develop clear position descriptions for the Chair and for the CEO;

(d) the Board should ensure that all new directors receive a comprehensive orientation;

(e) the Board should adopt a written code of business conduct and ethics;

(f) the Board should appoint a nominating committee composed entirely of independent directors, and that the committee should have a written charter that clearly establishes its responsibilities;

(g) the Board should appoint a compensation committee composed entirely of independent directors, and that the committee should have a written charter that clearly establishes its responsibilities; and

(h) the Board, its committees and each individual director should be regularly assessed.

The Board monitors and considers for implementation the corporate governance standards which are proposed by various Canadian regulatory authorities. The Company has in place a Code of Ethics, a Share Trading Policy and appropriate Health, Safety and Environment ("**HSE**") procedures, both corporately and at local level.

**Board of Directors**

The Board of Directors is responsible for overseeing the conduct of the business of the Company and supervising management, who are responsible for the daily conduct of the business of the Company. The Board of Directors is currently comprised of eight directors. A director is “independent” within the meaning of Section 1.4 of National Instrument 52-110 - *Audit Committees* (**“NI 52-110”**) if he or she does not have any direct or indirect material relationship with the Company which, in the view of the Board of Directors, could reasonably interfere with the exercise of the member’s independent judgement. In addition, under NI 52-110, certain individuals are deemed to have a “material relationship” with the Company, including any individual whose immediate family member is, or has recently been, an executive officer of the Company. Based on the foregoing definition, the Board currently has 4 independent directors and 4 directors who are not independent:

**Independence Status of Directors**

| Name | Management | Independent | Not Independent | Reason for Non-Independent Status |
|---|---|---|---|---|
| Russ Hammond | | | √ | Mr. Hammond is the father of Julian Hammond, the Deputy Chief Executive Officer, Chief Commercial Officer of the Company |
| Piers Johnson | | √ | | N/A |
| Elizabeth Landles | √ | | √ | Ms. Landles is Chief Adminstrative Officer and Corporate Secretary of the Company |
| Peter Lilley | | √ | | N/A |
| Bernard Murphy | √ | | √ | Mr. Murphy is the Chief Financial Officer and Finance Director of the Company |

| Independence Status of Directors | | | | |
|---|---|---|---|---|
| **Name** | **Management** | **Independent** | **Not Independent** | **Reason for Non-Independent Status** |
| James Rawls | | √ | | N/A |
| Marcus Rhodes | | √ | | N/A |
| Dr. David Robson | √ | | √ | Dr. Robson is the President and Chief Executive Officer of the Company |

Although the Board of Directors is not comprised of a majority of independent directors, the Board has concluded that the Board of Directors has functioned and can continue to function independently as required. The independent members of the Board of Directors do not hold regularly scheduled meetings at which the non-independent directors and members of management are not in attendance, however, the Board provides an opportunity to hold such meetings at the request of an independent director in order to facilitate the exercise of the directors' independent judgement. In addition, the Board holds "*in-camera*" sessions for independent members during each Board meeting to facilitate open and candid discussion amongst the independent directors.

The Chairman of the Board of Directors, Dr. Robson, is not an independent director as he is the President and Chief Executive Officer of the Company. In order to provide leadership for the independent directors, the Board encourages communication among the independent directors with the Vice Chairman, Peter Lilley, being the leading independent director providing guidance to the other independent directors.

### Board Mandate

The Board adopted a formal written charter (the **"Board Charter"**) in November of 2010. The mandate of the Board is to supervise the management of the Company and to be the steward of the Company with a view to the best interests of the Company.

Under the Board Charter, the Board's terms of reference include the following:

- Review and approve strategic, business and capital plans for the Company.
- Review the principal risks of the Company's business and monitor the implementation by management of appropriate systems to manage such risks.
- Review recent developments that may impact the Company's growth strategy.
- Develop and implement programs for management and Board succession planning including development within the organization.
- Review, approve and amend as required, the Corporate Disclosure Policy and monitor the practices of management to ensure appropriate, fair and timely communication of information concerning the Company.
- Ensure specific and relevant corporate measurement systems are developed and adequate internal controls and management information systems are in place with regard to business performance and the integrity thereof.
- Review and approve corporate governance guidelines applicable to the Company and in accordance with statutory and regulatory requirements.
- Review compliance by the Company and its subsidiaries with their constituent documents and with the laws and regulations of their incorporating jurisdictions and other applicable laws and regulations including those of any stock exchanges on which the Company's securities may be listed.
- Approve the interim and annual financial statements.

- Responsible for, to the extent feasible, satisfying itself as to the integrity of the Chief Executive Officer and the other executive officers and that the Chief Executive Officer and the other executive officers create a culture of integrity throughout the organisation.

The Board believes management is responsible for the effective, efficient and prudent management of the Company's day-to-day operation subject to the Board's stewardship.

**Position Descriptions**

The Board Charter provides a position description for the Chairman of the Board. The Chairman is responsible for leadership of the Board, for the efficient organization and conduct of the Board's function and for the briefing of all Directors in relation to issues arising at Board meetings. The Chairman is also responsible for shareholder communication and arranging Board performance evaluation.

The Board has not developed written position descriptions for the Chairman of the respective Board committees. During the fiscal year ended 31 December 2010, the Board had four standing committees, the majority of which were composed of independent directors, with the exception of the Executive Board (Executive Committee). The Board has delegated certain responsibilities to each of its committees, and they report to and make recommendations to the Board on a regular basis. The Chair of each committee is expected to be responsible for ensuring that the written terms of reference of the committee for which he or she serves as Chair is adhered to and that the objectives of each committee are accomplished.

The Board has established the following standing committees comprised of the members and chaired by the individuals set out in the following table.

| **Committee** | **Members** | **Independent** |
|---|---|---|
| Audit Committee | Marcus Rhodes, Chair | Yes |
| | Peter Lilley | Yes |
| | James Rawls | Yes |
| Compensation and Nomination Committee | Peter Lilley, Chair | Yes |
| | Piers Johnson | Yes |
| Reserves Committee | Piers Johnson, Chair | Yes |
| | Peter Lilley | Yes |
| | James Rawls | Yes |
| | Dr. David Robson | No |
| Executive Board (Executive Committee) | Dr. David Robson | No |
| | Bernard Murphy | No |
| | Elizabeth Landles | No |

The Board and the President and Chief Executive Officer have established a position description for the Company's President and Chief Executive Officer. The Chief Executive Officer's prime responsibility is to lead the Company. The Chief Executive Officer formulates company policies and proposed action plans in conjunction with the officers of the Company and presents the same to the Board for approval. The Board approves the goals, the objectives and policies within which the Company is managed and then reviews and evaluates performance against these objectives. Reciprocally, the Chief Executive Officer keeps the Board fully informed of the progress of the Company towards achievement of its established goals and of all material deviations.

## Orientation and Continuing Education

*Director Orientation*

Under the Board Charter, the Chairman and Corporate Secretary are responsible for providing an induction program for new Directors and for periodically providing materials for all Directors on subjects that would assist them in discharging their duties. When a new Director is elected to the Board, he or she will be given a letter of appointment outlining his or her duties, responsibilities, remuneration and an induction package including material that will assist with the familiarization of the Director with the Company. Within three months of appointment to the Board, each new Director shall spend time visiting the Company's operations for a personal briefing by the executive on the Company's values, operations, corporate interests, strategic plans, financial statements and key policies.

*Continuing Education of Directors*

Under the Board Charter, the Corporate Secretary shall alert Directors to opportunities to better understand their corporate governance responsibilities through continuing education programs. In addition, directors are encouraged to visit the Company's facilities, to interact with management and employees and to stay abreast of industry developments and the evolving business of the Company.

## Ethical Business Conduct

The Company has adopted a written Code of Business Conduct and Ethics (the **"Code"**) which applies to the Company's directors, officers and employees, a copy of which can be obtained under the Company's profile on SEDAR at www.sedar.com. The Company expects all Directors, officers and employees to act ethically at all times in accordance with the Code.

The Board of Directors takes reasonable steps to monitor compliance with the Code by requiring employees, on the commencement of employment and as otherwise directed by management, to sign a copy of the Code acknowledging that the employee has read, understood and will comply with the Code. The Code encourages that an employee report to their supervisor or the Board possible unethical conduct and breaches of the Code. The Company's Corporate Secretary acts as a Compliance Monitor with respect to such matters.

In addition to the Code, the Company has adopted an Audit Committee Charter and a Whistleblower Policy with respect to accounting and auditing irregularities. The Policy gives Directors, officers and employees a confidential independent "hot line" to report any concerns with respect to the Company's financial matters. Details of the Policy have been distributed to employees and the "hot line" operates in both English and Russian languages. In the event that an individual does not wish to use this system they may and should forward any accounting and auditing concerns to the Corporate Secretary on an anonymous basis. The Company has also adopted a disclosure and insider trading policy to ensure the communications to the investing public about the Company are timely, factual and accurate in accordance with applicable legal and regulatory requirements and to help ensure that the directors, officers and other insiders of the Company understand and comply with the insider trading restrictions under applicable securities legislation.

Since the beginning of the Company's most recently completed financial year, no material change reports have been filed that pertain to any conduct of a director or executive officer that constitutes a departure from the Code.

The Board encourages and promotes a culture of ethical business conduct by appointing directors who demonstrate integrity and high ethical standards in their business dealings and personal affairs. Directors are required to abide by the Code and are expected to make responsible and ethical decisions in discharging their duties, thereby setting an example of the standard to which management and employees should adhere.

The Board requires that the Chief Executive Officer and other executive officers are acting with integrity and fostering a culture of integrity throughout the Company. The Board is responsible for reviewing departures from the Code, reviewing and either providing or denying waivers from the Code, and disclosing any waivers that are granted in accordance with applicable law. In addition, the Board is responsible for responding to potential conflict of interest situations, particularly with respect to considering existing or proposed transactions and agreements in respect of which directors or executive officers advise they have a material interest. Directors and executive officers are required to disclose any interest and the extent, no matter how small, of their interest in any transaction or agreement with the Company, and that directors excuse themselves from both Board deliberations and voting in respect of transactions in which they have an interest. By taking these steps the Board strives to ensure that directors exercise independent judgement, unclouded by the relationships of the directors and executive officers to each other and the Company, in considering transactions and agreements in respect of which directors and executive officers have an interest.

**Nomination of Directors and Compensation**

The Compensation and Nomination Committee is composed entirely of independent directors and is responsible for identifying new candidates to join the Board of Directors. The Committee is responsible for identifying qualified candidates, recommending nominees for election as directors and appointing directors to committees. The Compensation and Nomination Committee is requested to objectively consider, among other things, a candidate's independence, financial and technical acumen, skills, ethical standards, career experience, financial responsibilities and risk profile, understanding of fiduciary duty and available time to devote to the duties of the Board of Directors in making their recommendations for nomination to the Board of Directors. The Committee reviews the composition and size of the Board of Directors and tenure of directors in advance of annual general meetings when directors are most ordinarily elected by the Company's shareholders, as well as when individual directors indicate that their terms may end or that their status may change. The Compensation and Nomination Committee encourages all directors to participate in considering the need for and in identifying and recruiting new nominees for the Board of Directors. In doing so, the directors are requested by the Compensation and Nomination Committee to have regard to the skill sets which are deemed, from time to time, to be most desired in proposed nominees for the Board of Directors.

With respect to compensation, the Compensation and Nomination Committee reviews and approves corporate goals and objectives relevant to the Chief Executive Officer's compensation, evaluates the Chief Executive Officer's performance in the light of those corporate goals and objectives and determines or makes recommendations to the Board of Directors with respect to the Chief Executive Officer's compensation level based on this evaluation. This committee also considers and, if deemed appropriate, approves the Chief Executive Officer's recommendations for compensation for executive officers of the Company and incentive compensation plans of the Company. This includes the review of the Company's executive compensation and other human resource philosophies and policies, the review and administration of the Company's bonuses, stock options and share purchase plan and the preparation and submission of a report for inclusion in annual continuous disclosure documents, as required.

The Compensation and Nomination Committee is comprised of non-management members of the Board of Directors and is required to convene at least two times each year. The Board of Directors has determined that Mr. Lilley's position as Vice Chairman and the fact that Mr. Johnson is Managing Director of Oilfield Production Consultants (OPC) Ltd. and Oilfield Production Consultants (OPC) USA LLC, who provide the Company with technical services, are not reasonably expected to interfere with the exercise of their independent judgement as members of the Compensation and Nomination Committee.

**Other Board Committees**

The Company's four standing committees are the Audit Committee, the Compensation and Nomination Committee, the Reserves Committee and the Executive Committee (Executive Board). The function of the Compensation and Nomination Committee is set out above under "Nomination of Directors and Compensation", and the function of the Audit Committee, Reserves Committee and Executive Board are set out or referred to below.

**Audit Committee**

The Audit Committee of the Company is responsible for reviewing the Company's financial reporting procedures, internal controls and the performance of the external auditors. The Audit Committee Charter of Tethys is set forth as Appendix D of this Annual Information Form.

The current members of the Audit Committee are Marcus Rhodes (Chairman), Rt. Hon. Peter Lilley and James Rawls. All members of the committee are considered independent and financially literate within the meaning of NI 52-110. The Audit Committee has a defined mandate and is responsible for reviewing and overseeing the external audit function, recommending the external auditor and the terms of such appointment or discharge, reviewing external auditor reports and significant findings and reviewing and recommending for approval to the Board of Directors all public financial information such as financial statements, management's discussion and analysis, annual information forms and prospectuses. The Audit Committee also pre-approves all non-audit services to be conducted by the external auditors and ensures that management has effective internal control systems, investigates any recommendations for improvement of internal controls and meets at least annually with the Company's external auditors without management present and at least quarterly with management present. The Company does not have internal auditors and given the size of the Company, the Company considers this to be practical and appropriate. The Audit Committee convenes no less than four times each year and as circumstances otherwise warrant.

James Rawls was appointed as a member of the Audit Committee and Piers Johnson resigned as a member of the Audit Committee on May 1, 2010. As described under his biography below, Piers Johnson was not considered independent within the meaning of NI 52-110.

**Reserves Committee**

The function of the Reserves Committee is to recommend the engagement of a reserves evaluator, ensure the reserves evaluator's independence, review the procedures for disclosure of reserves evaluation, meet independently with the reserves evaluator to review the scope of the annual review of reserves, discuss findings and disagreements with management, annually assess the work of the reserves evaluator and approve the Corporation's annual reserve report and consent forms of management and the reserves evaluator thereto.

**Executive Board (Executive Committee)**

In February 2008, the Board approved the formation of an "Executive Board" (which functions as an executive committee). The Executive Board comprises of Dr. David Robson, Mr. Bernard Murphy and Ms. Elizabeth Landles, each of whom is an executive officer of the Company. The purpose of the Executive Board is to allow the Board of Directors to delegate to the Executive Board the authority to respond to day-to-day or time sensitive matters where it is impractical to call a full meeting of the Board of Directors. The Executive Board makes a report to the Board of Directors of its meetings and actions at subsequent meetings of the Board of Directors.

**Assessments**

Currently the Board, its Committees and individual directors are not regularly assessed with respect to their effectiveness and contribution as the Board believes that such assessments are generally more appropriate for corporations of significantly larger size and complexity than the Company and which may have significantly larger Boards of Directors. However, the Chairman of the Board meets at least annually with the individual Directors to discuss any concerns they may have on the operation of the Board and its Committees as well as individual Board members. These are informal discussions and, if any points are highlighted, they are brought to the attention of the appropriate Committee Chairman or Director. To date there have been no such issues raised.

The Vice Chairman (Leading Non Executive Director) meets with the Chairman at least annually to discuss his performance and any improvement which might be appropriate and the Executive Board (Executive Committee), which meets regularly, brings to the Chairman any issues which might require attention with respect to individual Directors, the Compensation and Nomination Committee, the Audit Committee and the Reserves Committee. To date no issues have been raised but if such were to arise, the Chairman would discuss these in the first instance with the Vice Chairman (Leading Non Executive Director).

The Executive Board regularly reviews the performance of the Officers of the Company and, should any issues arise, the Chairman would then discuss any issues with the Compensation and Nomination Committee.

**PART 4 - OPERATING AND FINANCIAL REVIEW**

**SECTION A**

**MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE MONTHS ENDED 31 MARCH 2011**

*The following is the full text of the "Management's Discussion and Analysis for the three months ended March 31, 2011" which was filed on 13 May 2011 with the Securities Commissions in Ontario, British Columbia and Alberta and the Authorité de Marchés Financiers du Qúebec.*

**TETHYS PETROLEUM LIMITED**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**for the three months ended March 31, 2011**

**The three months ended March 31, 2011 compared to March 31, 2010**

(All references to $ are United States dollars unless otherwise noted)
(Tabular amounts are in thousands, unless otherwise stated.)

| | 2011 | 2010 | % Change |
|---|---|---|---|
| **Revenue** | 4,480 | 2,116 | 112% |
| **Net Loss** | (6,295) | (7,999) | -21% |
| **Basic and diluted loss ($) per share** | (0.02) | (0.05) | |
| **Capital expenditure** | 10,852 | 4,443 | 144% |
| **Total Assets** | 259,477 | 186,405 | 39% |
| **Non-current Liabilities** | (10,492) | (13,419) | -22% |
| **Cash and working capital surplus** | 49,893 | 38,372 | 30% |
| **Common shares outstanding** | | | |
| Basic and diluted | 260,629,769 | 187,169,769 | |

The following Management's Discussion and Analysis ("MD&A") is dated May 13, 2011 and should be read in conjunction with the Company's unaudited Interim Consolidated Financial Statements and related notes for the period ended March 31, 2011 as well as the audited Consolidated Financial Statements and the MD&A for the year ended December 31, 2010. The accompanying financial statements of the Company have been prepared by management and approved by the Company's Audit Committee and Board of Directors. These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. Additional information relating to the Company can be found on the SEDAR website at *www.sedar.com*. Readers should also read the "Forward-Looking Statements" legal advisory contained at the end of this MD&A and also the Company's AIF.

Highlights and Significant Transactions

The Company received State approval for a Pilot Production Project for the Doris oil discovery on the Akkulka field. This approval grants the right for oil production on the Akkulka field during the exploration period and allows the Company to install and operate production facilities for the planned 3,000-4,000 barrels of oil per day ("bopd") production target planned for the end of the second quarter of 2011.

The Company signed a joint venture agreement to construct and operate a rail oil loading terminal. It is intended that this terminal will take crude oil from the Pilot Production Project and will be owned

50/50 with a new local partner, Eurasia Gas LLP, who have strong experience in the oil distribution business in Kazakhstan. Once appraisal and additional exploration of the deposit is completed the Company will be in a position to apply to the Ministry of Oil and Gas of the Republic of Kazakhstan ("MOG") for a Production Contract that will allow for full field development and foreign or domestic sales. The Company is expected to apply for such a Production Contract after the appraisal programme for the Doris oil discovery is complete which is currently forecast for the first half of 2012.

The Company was granted an extension to the Kul Bas Exploration Period by the MOG for a further two years until November 11, 2013.

With sales of US$4.48 million in the three months ended March 31, 2011 the Company achieved a 112% increase on the same period of 2010 where sales were US$2.12 million. In 2011 gas sales of US$1.49 million (2010: nil) and oil sales of US$ 0.50 million (2010: nil) were achieved in Kazakhstan while refined product sales in Uzbekistan were US$2.42 million (2010:US$2.03 million) and sundry income was US$0.07 million (2010: US$0.09 million).

The Company recorded a net loss of US$6.30 million in the three months ended March 31, 2011 compared to a net loss of US$8.00 million in the three months ended March 31, 2010.

Capital expenditure, excluding the joint venture in Tajikistan, in the three months ended March 31, 2011 was US$10.85 compared to US$4.44 million in the three months ended March 31, 2010.

Production costs in the three months ended March 31, 2011 were US$1.75 million compared to US$0.97 million in the three months ended March 31, 2010 reflecting the additional production costs from the gas and oil production in Kazakhstan.

Administrative costs in the three months ended March 31, 2011 were US$6.48 million compared to US$4.78 million in the three months ended March 31, 2010.

**Nature of Business**

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") has its principle executive office in Guernsey, British Isles. The domicile of Tethys Petroleum Limited was moved from Guernsey, British Isles, to the Cayman Islands on July 17, 2008, where it is incorporated. Tethys is an oil and gas exploration and production company with projects currently in the Republic of Tajikistan, Republic of Uzbekistan and the Republic of Kazakhstan. Tethys' principal activity is exploration for and production of crude oil and natural gas.

**Financial and Operational Review**

**Kazakhstan Gas Production (Kyzyloi contract)**

| Period ending | 2011 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Mcm[1] | Mcf[2] | Mcm/d | boe/d | Mcm[1] | Mcf[2] | Mcm/d | boe/d |
| March 31 | 28,797.5 | 1,016,840 | 320 | 1,883 | 0 | 0 | 0 | 0 |

Note 1 Mcmpd is thousands of cubic metres per day and has been calculated based on the actual production days in the quarter. In 2011 there were 90 production days while in 2010 there were nil.

Note 2 boe is barrel of oil equivalent. A boe conversion ratio of 6,000 cubic feet (169.9 cubic metres) of natural gas = 1 barrel of oil has been used and is based on the standard energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

- The Company is constantly monitoring the gas production levels with a view to maximizing the commercial benefit from both the Kyzyloi and Akkulka contracts.
- In 2010 the Bukhara Urals pipeline was closed throughout all of the first quarter and so there were no sales from the Kyzyloi field in that period.
- On January 5, 2006 Tethys' Kazakh subsidiary, TAG, executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from TAG's Kyzyloi field in Kazakhstan at an agreed price of $32 per thousand cubic metres ("Mcm") or $0.90 per thousand cubic feet ("Mcf") excluding value added tax ("VAT"). On May 1, 2009, this contract was further assigned to Asia Gas NG LLP.
- The Gas Supply Contract, which has a term until the earlier of December 1, 2012, the date on which all contracts and licences pursuant to which the gas to be delivered under the Gas Supply Contract terminate, or when 850 thousand cubic metres (Mcm) has been delivered, is based on a take–or–pay principle and covers all gas produced from the Kyzyloi Field Licence and Production Contract area up to termination.
- To the end of Q1 2011 some 428,517 Mcm (approximately 15.1 Bcf) or 50% of the maximum contract volume under the Gas Supply Contract had been delivered.

**Kazakhstan Gas Production (Akkulka contract)**

| Period ending | 2011 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Mcm[1] | Mcf[2] | Mcm/d | boe/d | Mcm[1] | Mcf[2] | Mcm/d | boe/d |
| March 31 | 17,181.9 | 606,693 | 191 | 1,124 | 0 | 0 | 0 | 0 |

Note 1 Mcm/d is thousands of cubic metres per day and has been calculated based on the actual production days in the quarter. In 2011 there were 90 production days while in 2010 there were nil.

- As with Kyzyloi the Company is constantly monitoring the gas production levels with a view to maximizing the commercial benefit from the Akkulka contract. The compressor related problems being experienced in the final quarter of 2010 were remedied in January 2011.
- On September 16, 2010 the Company announced that it had signed a contract with Asia Gas NG LLP priced at US$38 per Mcm (including VAT). Gas sold under this contract would be for domestic sales and as such is subject to a small (0.05%) royalty payment to the Kazakh State. The new Akkulka contract runs for a period of 2 years with the parties agreeing to assess the price after one year.

**Kazakhstan Oil Production (Akkulka contract)**

| | Total Production | | |
|---|---|---|---|
| | Tonnes | Barrels* | bopd |
| 26 days to March 31, 2011 | **4,219** | **32,355** | **1,244** |

** using 7.67 barrels = 1 tonne*

- Between January 1, 2011 and March 31, 2011 because of a combination of weather problems and work on building the necessary facilities only 26 days of pilot production were achieved on the Doris discovery on the Akkulka contract.
- In October the Company had commenced selling the untreated oil at the well site of AKD01 to an oil trading company which transported the oil by truck to a location north of the town of Emba, 450 km to the north-east, where it is treated before being transported to local refineries.
- The untreated oil produced was being sold at the wellhead at an initial price of US$22/bbl.

**Uzbekistan Oil Production (North Urtabulak PEC)**

***Total Production from TPU under PEC***

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Total Production | | | Total Production | | |
| | Tonnes | Barrels* | bopd | Tonnes | Barrels* | bopd |
| Three months ended March 31 | 15,130 | 116,501 | 1,294 | 20,869 | 160,691 | 1,785 |

***After State Take***

| | TPU[1] Share | | | TPU Share | | |
|---|---|---|---|---|---|---|
| | Tonnes | Barrels* | bopd | Tonnes | Barrels* | bopd |
| Three months ended March 31 | 6,799 | 52,352 | 582 | 10,434 | 80,342 | 893 |

** using 7.7 barrels = 1 tonne*

- Production is under a Production Enhancement Contract ("PEC") for the North Urtabulak oilfield with subsidiaries of the Uzbek State oil and gas company NHC Uzbekneftefgas.
- On October 28, 2010, the Company began operations on the NUR96H2 horizontal development well on the North Urtabulak Field. The well was subsequently completed in February 2011 and in March achieved production of 468 bopd.
- Well NU115, which had previously been producing in the region of 600 bopd completed three years' production in June 2010 and so from July the Company's share of its output reduced from 50% to 20% in line with the terms of the PEC. The production from this well dropped further in the final quarter of 2010 which continued into Q1 2011 thus further reducing overall production levels.
- Drilling of a new well, NUR116 was completed in the first quarter of 2010 and production commenced in March 2010. While the well initially tested at a rate of up to 600 bopd after a short period production decreased significantly. It is believed that the location chosen in the reservoir was a locally less permeable part of the reefal reservoir than nearby.
- The Company has been investigating alternative methods to increase production and a programme of radial drilling was carried out in Q4 2010 as well as reconfiguring of the water injection scheme.

[1] TPU is Tethys Production Uzbekistan, the Tethys subsidiary which holds the PEC. Tethys Production Uzbekistan is the trading name of Baker Hughes (Cyprus) Limited.

**Tajikistan Oil Production (Beshtentak field)**

There was minimal oil production in Tajikistan in the three months to March 31, 2011 while in the same period of 2010 there was production of 2,500 barrels.

## Production Summary

In the first quarter of 2011 the oil and gas production levels achieved (before the deduction of local governments share or taxation) were as follows:

| Country | Oil | Gas | | Combined |
|---|---|---|---|---|
| | bopd | Mcm/d | boe/d | boe/d |
| Kazakhstan | 591 | 511 | 3,007 | 3,598 |
| Uzbekistan | 1,294 | - | - | 1,294 |
| Tajikistan | - | - | - | - |
| **Total** | **1,885** | **511** | **3,007** | **4,892** |

Note As indicated in the sections above the Akkulka oil production figures included in the Kazakhstan figures have been calculated based on the actual production days in the quarter and not the total number of days in the quarter.

## Financial Review

**Loss before tax**

The Company recorded a net loss after taxation of US$6.43 million in the quarter ended March 31, 2011 compared to a net loss of US$7.91 million in the same period of 2010. The principal differences between the two periods were as follows:

| | 2011 | 2010 | Movement |
|---|---|---|---|
| Sales and other operating revenues | 4,480 | 2,116 | 2,364 |
| Finance income | 32 | 3 | 29 |
| Total revenue and other income | 4,512 | 2,119 | 2,393 |
| Production expenses | (1,752) | (974) | (778) |
| Depreciation, depletion and amortization | (2,612) | (692) | (1,920) |
| Listing expenses | (6) | (626) | 620 |
| G & A costs | (5,291) | (3,581) | (1,710) |
| Stock-based compensation | (1,193) | (1,193) | - |
| Finance costs | (47) | (2,822) | 2,775 |
| Foreign exchange gains (loss) net | 200 | 14 | 186 |
| Loss from jointly controlled entity | (209) | (150) | (59) |
| **Loss before taxation** | **(6,398)** | **(7,906)** | **1,508** |

**Revenue**

**Note**

Revenue from the oil sales in Tajikistan is included in the financial statements of SSEC the Company's 51% owned joint venture in that country, and is not included in the Company's consolidated revenue figures

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| Gas sales | 1,491 | 0 | - |
| Oil sales | 501 | 0 | - |
| Refined product sales | 2,422 | 2,027 | 19% |
| Other revenue | 66 | 89 | -26% |
| | 4,480 | 2,116 | 112% |

- As stated above the Company is constantly monitoring the gas production levels with a view to maximizing the commercial benefit from both the Kyzyloi and Akkulka contracts. Actual levels achieved were 511 Mcm/d resulting in revenue of US$1.49 million.
- The gas sales generated from both the Kyzyloi and the Akkulka contracts in Kazakhstan as referred to above are sold to Asia Gas NG LLP at agreed prices of $32 per Mcm excluding VAT for the Kyzyloi gas and $38 including VAT for the Akkulka gas.
- There were no gas sales in the three months to March 31, 2010 because of pipeline closure.
- Also as stated above the untreated oil produced under the pilot production was being sold at the wellhead at an initial price of US$22/bbl which resulted in revenue of US$0.50 million (2010: nil).
- The Refined product sales are the result of oil production in Uzbekistan which resulted in revenue in the quarter of US$2.42 million (2010: US$2.02 million). The refined product revenue achieved in the first quarter of 2011 related to 2010 production. The 2011 production will be recognised as revenue when it has been both sold and delivered.

**Operating expenses**

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| Operating and Production costs | 1,752 | 974 | 80% |

- Production costs in Kazakhstan were higher in the three months to March 31, 2011 compared to the same period in 2010 primarily as a result of the oil production but also as a result of the Akkulka gas production.
- There was a slight increase in the production costs of the refined products in Uzbekistan as a result of the increase in sales.

**Depreciation, depletion and amortization expense**

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| DD & A costs | 2,612 | 692 | 277% |

- The DD&A in the three months to March 31, 2011 were a combination of the gas and oil production related figures in Kazakhstan and the refined product production in Uzbekistan.
- The absence of production in Kazakhstan in Q1 2010 resulted in no depreciation of oil and gas properties in that country during that period. The DDA charge in Q1 2010 was simply based on the refined product production in Uzbekistan which explains why the charge in Q1 2010 was significantly less than the Q1 2011 figure.

**Administrative expenses**

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| Staff costs | 2,065 | 1,316 | 57% |
| Travel costs | 961 | 619 | 55% |
| Office costs | 577 | 372 | 55% |
| Professional fees | 684 | 453 | 51% |
| Marketing costs | 318 | 203 | 57% |
| Other costs | 686 | 619 | 11% |
| | 5,291 | 3,582 | 48% |
| Stock based compensation | 1,193 | 1,193 | 0% |
| | 6,484 | 4,775 | 36% |

General administration and selling expenses for the quarter ended March 31, 2011 were up on the same period of the previous year as a result of the following:

- Primary factors in the increase in the staff costs were increased levels of staff particularly in Kazakhstan but also in other areas of operations plus there was a salary review completed in Q2 2010. This salary review was the first in two years,
- One area of increased staff costs in Kazakhstan was necessitated by the development requirements of the "Doris" discovery plus the increased administrative burden in Kazakhstan associated with new government regulatory requirements.
- Travel costs were up as a result of increased staff travelling throughout the three countries in which the Company currently operates combined with the pursuit of new contracts both within these countries and others in Central Asia.
- Professional fees were up as a result of a number of "one off" costs including computer software, legal costs associated with new offices and larger than anticipated disbursements associated with both audit and legal fees.

Stock based compensation

- Stock based compensation expenses relate to stock options issued in Q1 2011 and options and warrants issued in prior years.

**Finance expenses**

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| Foreign exchange gains-net | (200) | (14) | 1329% |
| Fair value loss | 8 | 2,501 | -100% |
| Loss from joint venture | 209 | 150 | 39% |
| Finance Income | (32) | (3) | 966% |
| Finance costs | 39 | 321 | -88% |

- The Fair Value gain or loss on derivative financial instruments reflects the movement in the fair value of warrants issued by the Company that are denominated in a currency other than the Company's functional currency for financial reporting purposes and the impact of interest rate swaps.
- Loss from the jointly controlled joint venture represents the Company's 51% share in the loss incurred by SSEC.
- Finance costs consist primarily of interest costs.

**Taxation**

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| Tax | 103 | (93) | 100% |

There was a slight movement in the deferred tax position in Q1 2011 as a result of the capital expenditure in Kazakhstan.

**Capital Expenditure**

Capital expenditure during the quarter ended March 31, 2011 was US$10.85 million while a further US$1.83million of prepayments on capital projects was also incurred.

| | Three months ended March 31 | | |
|---|---|---|---|
| | **2011** | 2010 | Change |
| Kazakhstan | 8,045 | 2,140 | 276% |
| Uzbekistan | 2,777 | 2,261 | 23% |
| Other and Corporate | 30 | 42 | 100% |
| | 10,852 | 4,443 | 144% |

Major items of capital expenditure in the three months to March 31, 2011 were:

*Kazakhstan*

- Doris oil production US$2.50 million
- G6 well US$0.50 million
- Akkulka appraisal wells US$5.00 million
- Kalypso (Kul Bas) US$1.40 million

*Uzbekistan*

- Well NU96 US$2.67 million

*Tajikistan*

Capital expenditure in Tajikistan incurred via its jointly controlled entity Seven Stars Energy Corporation (SSEC) in the three months to March 31, 2011 was US$3.00 million compared to US$2.28 million in the same period of 2010 funded directly by the Company.

**Summary of Quarterly Results**

The figures in the table below have been prepared under IFRS requirements.

| In the three months ending | Jun 30 2009 | Sept 30 2009 | Dec 31 2009 | Mar 31 2010 | Jun 30 2010 | Sept 30 2010 | Dec 31 2010 | Mar 31 2011 |
|---|---|---|---|---|---|---|---|---|
| **Financials** ($000's) | | | | | | | | |
| Revenue | 2,797 | 2,426 | 2,807 | 2,116 | 6,030 | 3,173 | 3,387 | 4,480 |
| Net loss | (5,593) | (3,944) | (6,166) | (7,999) | (3,322) | (7,118) | (11,210) | (6,295) |
| Basic and diluted loss ($) per share | (0.06) | (0.03) | (0.05) | (0.05) | (0.02) | (0.04) | (0.04) | (0.02) |
| | | | | | | | | |
| Capital expenditure | 4,778 | 8,337 | 8,868 | 4,443 | 7,316 | 11,950 | 14,584 | 10,852 |
| Total assets | 127,577 | 124,627 | 137,082 | 186,405 | 184,082 | 182,081 | 267,748 | 259,477 |
| Total non-current liabilities | (5,299) | (4,997) | (18,345) | (13,419) | (14,938) | (15,963) | (11,535) | (10,492) |
| Cash and working capital surplus | 17,351 | 6,369 | (157) | 38,372 | 24,408 | 6,046 | 69,718 | 49,893 |

Significant factors influencing quarterly results

- There were stoppages in Kyzyloi gas production in the quarters ending, December 31, 2009, March 31, 2010 and June 30, 2010 plus a period of reduced production in the quarters ending June 30, and September 30, 2009.
- The TPU operation in Uzbekistan was acquired by the Company in April 2009.
- During the course of the Q2 2010 a number of Uzbekistan refined product shipments were completed which relate to 2009 production. The consequence of this was that the refined product revenue recognized in Q2 2010 was significantly higher than if it was linked purely to Q2 2010 and previous quarters were lower than if they matched the associated quarter's production.
- Akkulka gas production commenced in Q3 2010. Oil sales from oil test production from Doris commenced in Q4 2010 resulting in revenue of US$748,000 in Q4 2010 and $501,000 in Q1 2011.
- The Company raised $20,000,000 (gross) in June 2009, $15,000,000 (gross) in January 2010, C$46,500,000 (gross) in March 2010 and $100 million (gross) in October 2010. All of these funds were the result of the issue of equity.

- In December 2009 the Company's Tajikistan operations were transferred to a jointly controlled venture (SSEC).
- From Q4 2009 the non-current liabilities included the "Deferred gain on assets transferred to jointly controlled entity". There was also an increase in long term borrowings of $4,100,000 in Q4 2009 in connection with the drilling of NU116 in Uzbekistan. In Q4 2010 the loan related to the Telesto rig plus a portion of the Tykhe loan were repaid early.

**Financial position**

The following table outlines significant movements in the consolidated balance sheets from December 31, 2010 to March 31, 2011:

| | Mar 31, 2011 | Dec 31, 2010 | Movement | Movement Details |
|---|---|---|---|---|
| Property, plant and equipment | 122,250 | 115,653 | 6,597 | Continuing investment in Akkulka Deep oil property, offset by DD&A plus the drilling of well NU96 in Uzbekistan. |
| Intangible assets | 18,738 | 16,892 | 1,846 | Expenditure on Kul Bas and Akkulka exploration in Kazakhstan. |
| Non-current other receivables | 14,937 | 12,320 | 2,617 | Increase in VAT balance in Kazakhstan plus increase in prepayments to contractors. |
| Loan receivable from joint controlled entity | 38,179 | 35,460 | 2,719 | Funds provided to SSEC to cover capital and company costs of Tajikistan subsidiaries. |
| Inventories | 2,452 | 2,121 | 331 | Movement in levels of finished product in Uzbekistan offset by a reduction in the level of spares in Kazakhstan. |
| Trade and other receivables | 3,230 | 3,680 | (450) | Reduction in Kazakh trade debtors and prepayments |
| Cash and cash equivalents | 57,400 | 79,135 | (21,735) | Refer to *Cash Flows* on the following page. |
| Derivative financial instruments - interest rate swap | 1,274 | 1,472 | (198) | Movement in fair value valuation of the anticipated liability. |
| Other reserves | 35,555 | 34,261 | 1,294 | Stock based compensation expense in the three months to March 31, 2011. |
| Accumulated deficit | (124,318) | (118,023) | (6,295) | Loss incurred for the quarter ended March 31, 2011. |
| Non-current financial liabilities - borrowings | 1,950 | 2,853 | (903) | Decrease as a result of the transfer to short term liabilities |
| Deferred taxation | 3,956 | 4,070 | (114) | Movement in deferred tax liability of Kazakhstan and Uzbekistan less a small income tax expense. |
| Current financial liabilities - borrowings | 6,005 | 5,047 | 958 | Movement from long term liabilities and the amortization of the debt discount. |
| Derivative financial instruments - warrants | 214 | 405 | (191) | Movement in the fair value of the liability together with expiry of some warrants |
| Deferred revenue | 27 | 2,450 | (2,423) | Reduction as a result of Uzbek product invoiced in 2010 delivered in Q1 2011. |
| Trade and other payables | 8,217 | 8,788 | (571) | Decrease in trade payables primarily in Kazakhstan |

**Contractual obligations and liabilities as at March 31, 2011**

| Contractual Obligations | Total | Payments Due by Period $'000s<br>Less than 1 Year | 1 - 3 Years | 4 - 5 Years | After 5 years |
|---|---|---|---|---|---|
| Financial borrowings | $7,955 | $6,005 | $1,950 | - | - |
| Operating leases | $759 | $433 | $326 | - | - |
| Trade and other payables | $8,896 | $8,217 | $679 | | |
| Commitments | $8,896 | $6,196 | $2,700 | - | - |
| **Total contractual obligations** | **$26,506** | **$20,851** | **$5,655** | **$0** | **$0** |

The Company is confident that it will satisfy these commitments as and when they fall due.

**Liquidity and Capital Resources**

As at March 31, 2011 the Company had a working capital surplus, including cash, of $49,893,000 while at December 31, 2010 the Company had a working capital surplus, including cash, of $69,309,000. The primary cause of this movement was a reduction in the cash balance from $79.1 million to $57.4 million in the first quarter of 2011 a movement of $21.7 million.

***Cash Flows***

The movement in the cash balance during the three months to March 31, 2011 compared to what happened in the same period of 2010 can be broken down as follows:

| | 31 March 2011 | 31 March 2010 | % Change |
|---|---|---|---|
| Net cash used in operating activities | (5,070) | (5,372) | -6% |
| Net cash used in investing activities | (16,484) | (8,236) | 100% |
| Net cash generated from financing activities | (262) | 55,252 | -100% |
| Foreign exchange effect on cash | 81 | (14) | |
| Net increase/(decrease) in cash and cash equivalents | (21,735) | 41,630 | 152% |

***Operating activities***

While the revenue in 2011 at $4,480,000 showed an encouraging increase on the 2010 figure of $2,116,000 this increase was offset by an increase in total costs plus a reduction in deferred revenue to give a reduction of some $300,000 in terms of cash used in operating activities on the same period in the prior year at $5,070,000 (2010: $5,372,000).

*Investing activities*

In the three months to March 31, 2011, due primarily to the Akkulka oil development, there was a significant increase in capital expenditure of $10,852,000 (2010:$4,442,000) and prepayments to contractors of $1,827,000 (2010: $1,027,000). A further $2,878,000 (2010: $2,280,000) was made in payments made on behalf of the jointly controlled entity which was primarily capital expenditure. A further increase in the VAT receivable of $905,000 (2010: $451,000) combined with the total capital expenditure to give a total for net cash used in investing activities of $16,484,000 (2010:$8,236,000)

*Financing activities*

There were no financing activities completed in Q1 2011 while three private placements generating gross receipts of $61,000,000 were completed in Q1 2010.

**Capital management**

The Company's capital structure is comprised of shareholders' equity and debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its capital expenditures from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt. There was no net debt at March 31, 2011.

| | March 31, 2011 | March 31, 2010 |
|---|---|---|
| | $ | $ |
| Total financial liabilities - borrowings | 7,955 | 11,820 |
| Less: cash and cash equivalents | (57,400) | (48,927) |
| Net debt / (funds) | (49,445) | (37,107) |
| Total equity | 234,522 | 157,570 |
| **Total capital** | 185,077 | 120,463 |

If the Company was in a net debt position, the Company would assess whether the projected cash flow was sufficient to service this debt and support ongoing operations. Consideration would be given to reducing the total debt or raising funds through an alternative route such as the issuing of equity.

**Use of Funds**

**Set out below are details of the planned use of funds as detailed in the prospectus dated October 4, 2010:**

| | Per October 4, 2010 Prospectus | Incurred to March 31, 2011 | To be Spent |
|---|---|---|---|
| *Kazakhstan* | | | |
| Appraisal and Exploration Wells | 47,500 | 7,365 | 40,135 |
| Production and Processing Infrastructure | 19,800 | 4,930 | 14,870 |
| Seismic Data | 6,000 | 3,040 | 2,960 |
| *Tajikistan* | | | |
| Production and Processing Infrastructure | 3,760 | - | 3,760 |
| Seismic Data | 3,000 | 350 | 3,000 |
| Exploration and Appraisal Drilling Wells | 4,000 | - | 4,000 |
| *Uzbekistan* | | | |
| Seismic Data | 2,000 | - | 2,000 |
| Production Drilling | 5,940 | 2,670 | 3,270 |
| **Total** | 92,000 | 18,355 | 73,645 |

**Set out below are details of the planned use of funds to as detailed in the prospectus dated June 11, 2009.**

The primary differences were in relation to:

- The Komsomolsk well, KOM200, encountered unexpected drilling challenges and cost more than was anticipated and is not yet fully completed. As a result the processing plant has not yet been constructed.
- A decision on installation of the Gas Lift Compression system is waiting on the results of the revised water injection programme.

| | Per June 12, 2009 Prospectus | Incurred to March 31, 2011 | To be Spent |
|---|---|---|---|
| *Tajikistan* | | | |
| East Komsomolsk - KOM 200 appraisal well Phase 1 | 3,500 | 3,500 | - |
| Infrastructure - Komsomolsk gas Processing plant | 2,000 | | 2,000 |
| East Komsomolsk - gas development well KOM 201 | 3,500 | 3,500 | - |
| Additional seismic on Bokhtar PSC | 3,660 | 3,660 | - |

| | | | |
|---|---|---|---|
| *Uzbekistan* | | | |
| North Urtabulak Gas Lift Compression System | 1,190 | | 1,190 |
| North Urtabulak new well. | 4,000 | 4,000 | - |
| Workovers | | | |
| | 17,850 | 14,660 | 3,190 |

**Stockholder Equity**

As at March 31, 2011 the Company had authorized share capital of 700,000,000 Ordinary Shares of which 260,629,769 (2010: 187,169,769) had been issued and 50,000,000 preference shares of which none had yet been issued. The preference shares have the rights as set out in the Memorandum and Articles of Association approved at the AGM on April 24, 2008.

As at the date of this report, May 13, 2011, a total of 31,275,572 (2010: 27,990,455) ordinary shares were reserved under the Company's Long Term Stock Incentive Plan and Warrants granted by the Company. The number of options outstanding as at the date of this report, May 13, 2011, is 22,713,000 and the number of warrants outstanding is 9,488,455 .

**OUTLOOK**

The Company does not anticipate that the recent developments in the Middle East and Libya will have a significant impact on its operations, other than there may be some benefit from higher oil prices on its existing oil sales in Uzbekistan and its anticipated oil sales in Kazakhstan in the second half of 2011.

With its projects in Kazakhstan, Uzbekistan and Tajikistan giving a balance of short-term cash flow and upside potential the Company is looking to capitalize on its "Doris" commercial oil discovery in Kazakhstan, its strong business position in Uzbekistan and Tajikistan combined with the recent increase in energy prices. The Company's gas production in Kazakhstan is currently being sold at relatively low prices on the domestic market but with the planned Kazakhstan – China gas pipeline, which the Company understands will become operational in 2013, and liberalization of the Kazakh gas market, there is potential for significant increases in gas prices, given China's ongoing demand for gas. Higher oil prices have not yet being fully realized in Central Asia but if world prices remain high it is likely that increased Central Asian prices will follow in due course. The placements of equity completed in the course of 2010 have provided the Company with the resources it needs to advance its operating plans, in particular the Doris oil appraisal, development and additional exploration. The Company believes that having received approval for the Pilot Production Scheme this should result in significant additional oil production in Kazakhstan and further work on the Company's existing and potential assets in Uzbekistan should also help strengthen the Company's cash flow.

On April, 17, 2011 the Government of the Republic of Afghanistan announced that the Company is one of five international companies who have pre-qualified for a tender to explore and develop oil and gas deposits in northern Afghanistan. The process represents the first round of the Afghan Government's plan to issue licenses to foreign energy companies.

**Kazakhstan Operations Update**

The AKD04 (Dero) appraisal well has now reached total depth of 2,566 metres and electric logging has been carried out. This well is located on the separate Dero part of the structure to the east of the AKD01 Doris oil discovery and was designed to ascertain the potential in the Upper Jurassic carbonate zone and the edge of the Lower Cretaceous (Aptian) sandstone in this area. Interpretation of the well data shows both the Jurassic carbonate and the Aptian sand to be present in the well with both showing indications of hydrocarbons. These two horizons were the zones that tested oil in the AKD01 well. Production casing has now been run which will be followed by an appropriate testing programme - following receipt of the usual consents from Kazakh authorities.

In the AKD05 Doris appraisal well, the 9 5/8" casing has been set and it is drilling ahead. This well is currently on prognosis and should reach planned total depth of 2,500 metres by the end of this month.

Further evaluation of the recently acquired 3D seismic dataset using state of the art processing and interpretation techniques is revealing the probable presence of sand fans in the Cretaceous sandstone sequence and these data are being integrated with the results of the well data to plan future appraisal well locations in the greater Doris area.

Testing of the AKD03 (Dione) exploration well continues after the successful test of a new sandstone zone in the Upper Jurassic, which flowed dry oil at over 400 barrels per day. The company believes that a significantly higher flow rate may be achieved with a horizontal or high angle completion, and will determine optimized well designs as part of the overall development plan following completion of the appraisal and exploration programme. The overlying Upper Jurassic carbonate has now been tested but no commercial oil flow was obtained. Testing will now be undertaken on the good quality potentially oil-bearing Cretaceous sandstone interval (which is similar to the main reservoir zone in the AKD01 well) and which shows the best reservoir properties of the zones being tested. The extent and potential of this Dione flank structure is currently being evaluated using the new 3D seismic dataset.

The KBD01 (Kalypso) wildcat exploration well is currently at a depth of 2,498 metres. This well is being drilled on a large structure some 50 km to the north west of the Doris discovery with its primary target being at approximately 4,000 metres and with secondary targets above this. Seismic shows this prospect to have up to 400 metres of potential vertical closure. Hydrocarbon shows have been observed in the drilled section. It is expected that this well will reach total depth in July 2011.

**Tajikistan Drilling Update**

The Company's regional seismic acquisition programme was completed with 693 km of data being acquired and processing and interpretation continues, these data being primarily aimed at identifying further exploration potential. Based on these data the Company is planning to drill a new exploration well to a depth of up to 3,000 m using its ZJ30 rig Tykhe. This well is expected to commence operations in Q2 2011.

The Company has previously stated that it is seeking a suitable farm-in partner for its exploration programme in Tajikistan and these geophysical data are an important part of the information relating to such a potential farm-in. Discussions with several parties are ongoing.

The KOM201 well which lies adjacent to Dushanbe reached a total measured depth of 2,456 metres in November 2010 in what is interpreted to be the Triassic sequence. Gas flow was obtained from the Jurassic sequence and testing commenced in January 2011. Radial drilling was initiated to increase production rates but so far without success. Further testing of the Jurassic is underway at present. Wireline logs had indicated hydrocarbons may be present in the secondary, overlying targets of the Cenomanian, Hauterivian and Bukhara and it is planned to test these zones once testing of the Jurassic is complete.

The East Olimtoi exploration well EOL09 is targeting an attractive prospect on the edge of a salt induced structure some 40 km south-west of the city of Kulob. Operations on the well recommenced in September 2010 and it is currently at a depth of 3,064 meters targeting a Palaeogene reservoir prognosed at a depth of 3,800 metres. The rig has been significantly upgraded and the well is expected to reach target depth at the end of Q2 2011.

**Uzbekistan Drilling Update**

In November 2010, operations began on the NUR96H2 horizontal development well on the North Urtabulak Field. In February 2011, the Company announced the initial results of testing on the NUR96H2 horizontal development well at the North Urtabulak field in Uzbekistan. The well tested successfully at over 1,100 bopd and is now producing 460 bopd. This well reached a total depth of 3,060 metres with a producing section of 437 metres of lateral hole within this section.

The Company has started the process to import jet-pumping equipment in order to evaluate its suitability to the Jurassic carbonate reservoirs present in Uzbekistan and optimise production at North Urtabulak, results are expected in Q3 2011.

The Company also continues to and intends to carry out further production enhancement techniques on North Urtabulak including radial drilling, revised water injection, and the drilling of new wells, to capitalise on the relatively high world oil prices and increasing short-term cash flow through increasing production.

**Transactions with Related Parties**

Vazon Energy Limited

Vazon Energy Limited ("Vazon") is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services under a 'flow through" contract from Vazon in the period ended March 31, 2011 was $765,362 (March 31, 2010 – $541,849). Some 50% of the increase was the result of remuneration increases, some 35% the result of new staff and remainder office related costs.

Oilfield Production Consultants

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to compression optimization and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the period ended March 31, 2011 were $11,422 (March 31, 2010 – $27,000).

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions.

**RISKS AND UNCERTAINTIES AND OTHER INFORMATION**

Readers are encouraged to read and consider the risk factors and additional information regarding the Company, included in its 2010 Annual Information Form filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

**Financial Risk Management**

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk, interest rate risk and foreign exchange. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

*Credit risk*

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's cash and cash equivalents and accounts receivable balances.

With respect to the Company's financial assets the maximum exposure to credit risk due to default of the counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is:

| | Mar 30, 2011 | Dec 31, 2010 |
|---|---|---|
| | **$** | **$** |
| Trade receivables | 1,310 | 1,661 |
| Cash and cash equivalents | 57,400 | 79,135 |
| Investments | 1,017 | 1,015 |
| Loan receivable from jointly controlled entity | 38,179 | 35,460 |
| | 97,906 | 117,271 |

Concentration of credit risk associated with the above trade receivable balances in Kazakhstan is as a result of contracted sales to only one customer during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales in Kazakhstan commenced in December 2007 and the Company has not experienced any credit loss to date.

In Uzbekistan, the Company makes use of two customers. Full payment is in US Dollars and is required before delivery of the oil and therefore there is limited exposure to credit risk in this country.

Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss as the majority of the counterparties are banks with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors). Within the Central Asian countries banks with these ratings are generally not available.

The Company is exposed to credit risk in relation to its loan receivable from a jointly controlled entity to the extent that the jointly controlled entity fails to meet its contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loan receivable represents the maximum exposure to credit risk.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. Since inception, the Company has incurred significant consolidated losses from operations and negative cash flows from operating activities, and has an accumulated deficit at March 31, 2011.

The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets, co-ordinating and authorizing project expenditures and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company seeks additional financing based on the results of these processes.

The timing of cash outflows relating to financial liabilities and commitments at the reporting date are summarized on page 12 above in *Contractual obligations and liabilities as at March 31, 2011.*

There can be no assurance that debt or equity financing will be available or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

*Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

Because of the current level of interest rates being less than 1% the Company's exposure to interest rate risk on short term deposits is minimal

*Foreign exchange risk*

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions are denominated in a currency other than the US$. A significant portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. There is limited availability in exchange rate derivatives to manage exchange rate risks with these currencies and so the Company looks to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan. The Company also incurs expenditure in GBP on a regular basis and looks to manage this exchange rate at least in the short term by forward purchasing.

While the Company holds the majority of its cash and cash equivalents in U.S. dollars it does hold other balances, mainly British Pounds Sterling ("GBP") and Canadian dollars ("CDN"), to meet the requirements to fund ongoing general and administrative and other spending requirements in these currencies. In addition a significant portion of the funds received in the fund raising completed in 2010 were received in CDN. With regard to the GBP, had the $ changed by 10% at March 31, 2011 with all other variables held constant, the Company's foreign exchange gain or loss would have been affected by $101,000, for CDN had the $ changed by 10% the exchange gain or loss would have been affected by $120,000 and for the Kazakhstan Tenge (KZT) it would have been affected by $652,000.

**Market risk**

Market risk is the risk of loss that may arise from changes in market factors such as marketability of production and commodity prices.

*Marketability of Production*

The marketability and ultimate commerciality of oil and gas acquired or discovered is affected by numerous factors beyond the control of the Company. These factors include reservoir characteristics, market fluctuations, the proximity and capacity of oil and gas pipelines and processing equipment and government regulation. Tethys produces gas into the transcontinental gas trunkline system which ultimately supplies gas to Russia and Europe. Political issues, system capacity constraints, export issues and possible competition with Russian gas supplies may in the future cause problems with marketing production, particularly for export. Oil and gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. Restrictions on the ability to market the Company's production could have a material adverse effect on the Company's revenues and financial position.

*Commodity price risk*

Oil and gas prices are unstable and are subject to fluctuation. Any material decline in natural gas prices could result in a reduction of the Company's net production revenue and overall value and could result in ceiling test write downs. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in the volumes and value of the Company's reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities. A substantial material decline in prices from historical average prices could reduce the Company's ability to borrow funds. As such, fluctuations in oil and gas prices could materially and adversely affect the Company's business, results of operation and prospects. There is no government control over the oil and gas price in the countries where the Company operates.

Although the Company believes that the medium to long term outlook for gas prices in the region is good, the recent fall in both prices and demand caused by the recent economic slowdown in Europe and the FSU has lead to significant uncertainties as to the price of and demand for Central Asian gas which may continue to have an impact on the pricing and demand for Kazakh gas in the short term.

The impact on demand for oil and gas of the economic downturn is not uniform. For example, demand has risen in China but fallen in the U.S. Also, there needs to be consideration of production and other factors such as OPEC, refinery shut-ins and inventory. Any discussion of price or demand is subjective and as such there are many differing opinions on the cause of recent price changes.

This impact of fluctuations in oil and gas prices in 2010 and early 2011 on the Company's operations was only evident in the operations in Uzbekistan. Production from both the Kyzyloi and Akkulka contracts in Kazakhstan are sold at fixed prices, at least until the end of 2012, and so the fluctuation in world commodity prices had no effect on the Company's monthly revenue from the Kazakh gas operations. In Uzbekistan, the Company sells refined petroleum products on a monthly basis, and the fall in the oil price in the first and second quarters of 2009 reduced monthly revenue. Should the oil production in Kazakhstan comes on stream in Q2 at a rate of 3,000-4,000 bopd as planned then a fall in oil prices will result in lower than anticipated revenue.

The Bukhara-Urals trunkline carries gas from Central Asia through Kazakhstan and into the Russian export system and consequently any problems would have adverse implications for the economy of Uzbekistan in particular and to a lesser extent the Russian and Kazakh economies, it is anticipated that there would be significant efforts to minimize any disruption in supply. Problems with closure of the pipeline and reduced production levels were encountered in both 2009 and 2010.

***Sensitivities***

The price of gas sales from gas produced from the Kyzyloi gas field under the Gas Supply Contract is fixed in US dollars until December 1, 2012 and the Akkulka gas field under the Gas Supply Contract is fixed in US dollars until September, 2012 and consequently there is no sensitivity to currency movements or market movements in the gas price.

The price of oil sales from the Doris discovery planned at 3,000-4,000 bopd (Phase 2) commencing in the second quarter of 2011 has yet to be agreed and therefore would be sensitive to movements in the market price. On a production level of 3,000 bopd a movement of $1 per barrel on the price received by the Company would result in a plus or minus movement in the sales revenue of $1,095,000 per annum.

The sales revenue in Uzbekistan is sensitive to fluctuations in the price of oil. At gross production levels of 1,250 bopd the movement of $1 per barrel on the price received by the company would result in a maximum plus or minus movement in the sales revenue of $228,125 per annum.

**Environmental**

The Company's operations are subject to environmental regulations in the jurisdictions in which it operates and the Company carries out its activities and operations in material compliance with all relevant and applicable environmental regulations and pursuant to best industry practices. In Kazakhstan, quarterly reports are required to be submitted by the Company to the Shalkar (Bozoi) Tax Committee. Payments from the Company for 2010 amount to $444,000, which covered a payment per well on the Doris discovery, plus waste removal and gas firing. The Company is also required to prepare reports on any pollution of air, toxic waste and current expenses on environmental protection which have been made by the Company and which are submitted to the appropriate Kazakh authorities. Reports are submitted on a semi-annual basis for information purposes and no payments are applicable.

Under the Bokhtar PSC in Tajikistan, any Development Plan should include an abandonment and site restoration programme together with a funding procedure for such programme. All funds collected pursuant to the funding procedure should be allocated to site restoration and abandonment and be placed in a special interest bearing account by KPL which shall be held in the joint names of the State and KPL or their respective nominees, or its designee. KPL's responsibilities for environmental degradation, site restoration and well abandonment obligations, and any other actual contingent and potential activity associated with the environmental status of the Development Area shall be limited to the obligation to place the necessary funds in the approved account. In addition any relinquished areas must be brought into the same condition as they were prior to their transfer to KPL (soil fertility condition, quality of the ground and environment). All expenditures incurred in abandonment and site restoration are cost recoverable. An independent environmental base line study has been carried out on the Beshtentak oilfield.

Within the PEC in Uzbekistan in the event that the Company advises the Operating Committee that it no longer intends to perform any Operating Services on a well then it is required to plug and abandon such well at its own expense or the State gas company shall immediately assume responsibility for such well. In the latter such event the Company shall have no responsibility with regard to plugging and abandoning the well. While operating the well the Company is required to observe all environmental laws of the Republic of Uzbekistan.

At present, the Company believes that it meets all applicable environmental standards and regulations, in all material respects, and has included appropriate amounts in its capital expenditure budget to continue to meet its current environmental obligations.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The annual and interim consolidated financial statements of the Company are prepared in accordance with International Financial Reporting Standards ("IFRSs") and IFRIC Interpretations issued by the IFRS Interpretations Committee.

Please refer to the annual consolidated financial statements for the year ended December 31, 2010 Note 2 *Summary of Significant Accounting Policies* for details of the Company's accounting policies.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of Tethys are responsible for establishing and maintaining internal control over financial reporting (ICFR) as that term is defined in National Instrument 52-109 – Certification of Disclosure in Annual and Interim Filings. The CEO and the CFO of Tethys are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with IFRS.

Management of Tethys has designed and implemented, under the supervision of its CEO and CFO, a system of internal controls over financial reporting as of March 31, 2011 which it believes is effective for a company of its size. Management of Tethys has not identified any material weaknesses relating to the design of the internal controls over financial reporting as at March 31, 2011. The Company's control system and procedures are reviewed periodically and adjusted or updated as necessary. In addition where any new or additional risks have been identified then the management of Tethys has put in place appropriate procedures to mitigate these risks.

Under the supervision of the CEO and the CFO, an evaluation was conducted of the effectiveness of internal control over financial reporting based on "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2010. No material weakness relating to the design of the Company's system of ICFR or relating to the Company's operations as at December 31, 2010 have been identified. A similar exercise will be carried out in the course of 2011.

## DISCLOSURE CONTROLS AND PROCEDURES

The CEO and the CFO are responsible for establishing and maintaining disclosure controls and procedures (DC+P) as that term is defined in NI 52-109. Disclosure controls and procedures have been designed by the Tethys Management, under the supervision of the CEO and CFO, to ensure that information required to be disclosed by the Company is accumulated, recorded, processed and reported to the Company's management as appropriate to allow timely decisions regarding disclosure.

**FORWARD-LOOKING STATEMENTS**

In the interest of providing Tethys' shareholders and potential investors with information regarding the Company and its subsidiaries, including management's assessment of Tethys' and its subsidiaries' future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively referred to herein as "forward-looking statements") within the meaning of the "safe harbour" provisions of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project" or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements in this MD&A include, but are not limited to, statements with respect to: the projected 2011 capital investments projections, and the potential source of funding therefore. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks, uncertainties and assumptions include, among other things: volatility of and assumptions regarding oil and gas prices; fluctuations in currency and interest rates; ability to successfully complete proposed equity financings; product supply and demand; market competition; ability to realise current market gas prices; risks inherent in the Company's and its subsidiaries' marketing operations, including credit risks; imprecision of reserve estimates and estimates of recoverable quantities of oil and natural gas and other sources not currently classified as proved; the Company's and its subsidiaries' ability to replace and expand oil and gas reserves; unexpected cost increases or technical difficulties in constructing pipeline or other facilities; unexpected delays in its drilling operations; delays in the delivery of its drilling rigs; unexpected difficulties in, transporting oil or natural gas; risks associated with technology; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and the costs of well and pipeline construction; the Company's and its subsidiaries' ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; political and economic conditions in the countries in which the Company and its subsidiaries operate; the risk of international war, hostilities, civil insurrection and instability affecting countries in which the Company and its subsidiaries operate and terrorist threats; risks associated with existing and potential future lawsuits and regulatory actions made against the Company and its subsidiaries; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Tethys.

With regard to forward looking information contained in this MD&A, the Company has made assumptions regarding, amongst other things, the continued existence and operation of existing pipelines; future prices for natural gas; future currency and exchange rates; the Company's ability to generate sufficient cash flow from operations and access to capital markets to meet its future obligations; the regulatory framework representing mineral extraction taxes, royalties, taxes and environmental matters in the countries in which the Company conducts its business: gas production levels; and the Company's ability to obtain qualified staff and equipment in a timely and cost effective manner to meet the Company's demands. Statements relating to "reserves" or "resources" or "resource potential" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described exist in the quantities predicted or estimated, and can be profitably produced in the future. Although Tethys believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A, and except as required by law Tethys does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

## SECTION B

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEAR ENDED 31 DECEMBER 2010

*The following is the full text of the "Management's Discussion and Analysis for the year ended December 31, 2010" which was filed on 21 March 2011 with the Securities Commissions in Ontario, British Columbia and Alberta and the Authorité de Marchés Financiers du Qúebec.*

**TETHYS PETROLEUM LIMITED**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**for the year ended December 31, 2010**

**Summary of Annual Results**

(All references to $ or US$ are United States dollars unless otherwise noted)
(Tabular amounts are in thousands, unless otherwise stated.)

Summary of Annual Results

| | **2010** | **2009** | **2008** |
|---|---|---|---|
| **Revenue** | 14,706 | 8,559 | 5,360 |
| **Net Loss** | (29,649) | (21,720) | (22,184) |
| **Basic and diluted loss ($) per share** | (0.15) | (0.20) | (0.40) |
| **Capital expenditure *** | 14,584 | 32,221 | 42,807 |
| **Total Assets** | 267,748 | 137,082 | 113,548 |
| **Non-current Liabilities** | (11,535) | (18,345) | (6,084) |
| **Cash and working capital surplus/(deficiency)** | 69,718 | (157) | 21,343 |
| **Common shares outstanding** | | | |
| Basic and diluted | 260,629,769 | 134,554,769 | 66,393,292 |

*The 2009 figure includes Tajikistan capital expenditure while in 2010 this is included in the joint controlled entity Seven Stars Energy Corporation ("SSEC").

The following Management's Discussion and Analysis ("MD&A") dated March 21, 2011 of Tethys Petroleum limited (referred to with its subsidiaries as "Tethys" or the "Company") should be read in conjunction with the Company's audited Annual Consolidated Financial Statements and related notes for the year ended December 31, 2010. The accompanying financial statements of the Company have been prepared by management and approved by the Company's Audit Committee and Board of Directors. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. Additional information relating to the Company can be found on the SEDAR website at *www.sedar.com*. Readers should also read the "Forward-Looking Statements" legal advisory wording contained at the end of this MD&A and also the Company's Annual Information Form for the year ended December 31, 2010 ("AIF") including the Glossary of Abbreviations and Technical terms, which is integrated herein by reference.

**IFRS accounting**

The Accounting Standards Board ("AcSB") confirmed in February 2008 that IFRS will be used for Canadian publicly accountable enterprises for financial periods beginning on and after January 1, 2011. As a foreign issuer, Tethys elected early adoption for periods beginning January 1, 2009, with a transition date of January 1, 2008 and consequently prepared its first interim consolidated financial statements in accordance with IFRS for the three month period ended March 31, 2009. The consolidated financial statements for the year ended December 31, 2009 were the Company's first set of annual consolidated financial statements prepared under IFRS as issued by the International Accounting Standards Board. For all accounting periods ended prior to March 31, 2009 the Company prepared its financial statements under accounting principles generally accepted in the United States of America ("US GAAP").

Highlights and Significant Transactions during the year ended December 31, 2010

- In February 2010, the Company announced the initial results of testing on the upper zone of the AKD01 ("Doris") oil discovery in the Akkulka Block in Kazakhstan. The upper zone flowed oil at a restricted rate of over 5,400 bopd. Combined with the testing on the lower zone in the well announced in December 2009, the well flowed oil at a combined rate in excess of 6,800 bopd. Well AKD01 encountered two oil-bearing zones, the lower zone being a Jurassic carbonate sequence at approximately 2,355 m and the upper zone, being a Cretaceous sandstone at approximately 2,174 m.
- In March 2010, the Company announced that it completed a private placement of 30,000,000 Ordinary Shares for gross proceeds of $46.5 million. The Ordinary Shares were placed at a price of C$1.55 each. The net proceeds of the offering were used by the Company for capital expenditures and general corporate purposes.
- In June 2010, the Company announced that its wholly owned Kazakh subsidiary, TAG received permission from the Ministry of Oil and Gas of the Republic of Kazakhstan ("MOG") to extend the Akkulka Licence and Exploration Contract for another two years, from March 10, 2011 to March 10, 2013, MOG extended the Akkulka Licence and Exploration Contract to enable detailed appraisal of the commercial discovery of oil at Doris along with further exploration in the contract area.
- In August 2010, MOG agreed to extend the exploration period for the Company's Kul-Bas Exploration and Production Contract for two years from November 11, 2011 to November 11, 2013, The extension to the exploration period gives the Company an additional two years to explore this area that has several prospects and leads and with a proved oil system in the Akkulka Block which is surrounded by the Kul-Bas area. In February 2011, the Company announced that the amendments to the Kul-Bas Exploration and Production Contract have been completed and incorporated into the contract.
- In September 2010, the Company commenced selling untreated oil at the well site of AKD01 to an oil trading company which began transporting the oil by truck to a location to the north of the town of Emba, located 450 km to the northeast.
- In September 2010, the Company entered into a second gas sales contract with Asia Gas NG LLP for domestic gas sales from the Akkulka Gas Field.
- In September 2010, the Company signed a Memorandum of Understanding ("MOU") with the Uzbek State oil and gas company, National Holding Company "Uzbekneftegaz" ("UNG"). The MOU states that Tethys and UNG will conduct joint studies to determine the possibilities of improving hydrocarbon recovery on certain long-term production fields in Uzbekistan in order to then sign a contract in accordance with the applicable legislation of Uzbekistan. The Company expects that such contract would be a similar contractual arrangement to the Company's North Urtabulak PEC in Uzbekistan.
- On October 20, 2010, the Company completed a public offering of 70,600,000 Ordinary Shares for gross proceeds of $100 million. The Ordinary Shares were placed at a price of C$1.45 each. The net proceeds of the offering are being used by Tethys to fund work on the Company's existing properties in Central Asia
- On October 25, 2010 the Company announced that it had received Kazakh State approved oil reserves for its Doris (AKD01) oil discovery in Kazakhstan.

- On October 28, 2010, the Company began operations on the NUR96H2 horizontal development well on the North Urtabulak Field. The well was subsequently completed in February 2011 and tested at rates in excess of 1,100 bopd.
- On November 17, 2010, the Company announced that it had obtained a stable flow of gas from the Jurassic interval in the East Komsomolsk KOM201 well in Tajikistan. Further work will be necessary to establish whether or not commercial gas flow can be obtained from this interval.
- On December 6, 2010, the Company announced that it had commenced drilling of the KBD01 (Kalypso) exploration well on the Kul-Bas Block in Kazakhstan.
- In January 2011 the Company received Kazakh State approval for the Pilot Production Project for the Doris oil discovery in the Akkulka Block. This approval gives the right to produce oil from the Akkulka Field during the exploration period and allows the Company to install and operate production facilities for the planned 3,000-4,000 bopd (Phase 2) production target targeted for the end of the second quarter of 2011. In order to advance this project on February 17, 2011, the Company signed a joint venture agreement to construct and operate a rail oil loading terminal. It is intended that this terminal will take crude oil from the Pilot Production Project and will be owned 50/50 with a new local partner, Eurasia Gas LLP, who have strong experience in the oil distribution business in Kazakhstan. Once appraisal and additional exploration of the deposit is completed the Company will be in a position to apply for to MOG for a production contract that will allow for full field development and foreign or domestic sales. The Company is expected to apply for a such a production contract after the appraisal program for the Doris oil discovery is complete which is forecast for the end of 2011 / Q1 2012.
- The Company generated revenues from refined product, oil and gas sales of US$14.70 million during the year ended December 31, 2010 compared to US$8.6m in the year ended December 31, 2009. As in the previous year the gas production in Kazakhstan in 2010 was significantly lower than anticipated due to closures in the first half of the year together with a period of reduced production in the second half. *See Kazakhstan Gas Production*
- Capital expenditure, excluding the joint venture in Tajikistan, in the year ended December 31, 2010 was US$38.66 million compared to US$32.22 million in the year ended December 31, 2009 which included capital expenditure in Tajikistan of US$16.94 million, as this expenditure pre-dated the joint venture.
- Capital expenditure in Tajikistan incurred by the Company's jointly controlled entity Seven Stars Energy Corporation (SSEC) in the year ended December 31, 2010 was US$19.9 million compared to US$16.9 million in the same period of 2009. The capital expenditure incurred in 2009 was funded directly by the Company. Funding of SSEC is provided under the terms of a loan agreement with the Company's subsidiary Tethys Tajikistan Limited, and if this is taken into account the total capital expenditure funded by the Company in 2010 was US$58.65 million.

**Nature of Business**

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") is a Cayman Island incorporated limited liability company with its principal executive office being in Guernsey, British Isles. Tethys is an oil and gas exploration and production company currently operating within the Republic of Kazakhstan, Republic of Uzbekistan and the Republic of Tajikistan. Tethys' principal activity is exploration for and production of crude oil and natural gas. Tethys is currently listed on the main board of the Toronto Stock Exchange ("TSX") in Canada and also has a secondary listing on the Kazakhstan Stock Exchange ("KASE") in Almaty, Kazakhstan.

## Operational Review

### Kazakhstan Gas Production (Kyzyloi contract)

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Mcm[1] | Mcf[2] | Mcm/d | boe/d | Mcm | Mcf | Mcm/d | boe/d |
| Q1 | 0 | 0 | 0 | 0 | 15,602 | 550,907 | 600 | 3,532 |
| Q2 | 10,146 | 358,255 | 298 | 1,756 | 36,809 | 1,299,726 | 404 | 2,381 |
| Q3 | 44,215 | 1,561,232 | 481 | 2,829 | 38,755 | 1,368,439 | 421 | 2,479 |
| Q4 | 41,449 | 1,463,564 | 451 | 2,652 | 27,766 | 980,417 | 514 | 3,026 |
| **Total** | **95,810** | **3,383,051** | **439** | **2,587** | **118,932** | **4,199,489** | **452** | **2,662** |

Note 1 Mcmpd is thousands of cubic metres per day and has been calculated based on the actual production days in the quarter or year and not the total number of days in the quarter or year. In 2010 there were 218 production days while in 2009 there were 263.

Note 2 boe is barrel of oil equivalent. A boe conversion ratio of 6,000 cubic feet (169.9 cubic metres) of natural gas = 1 barrel of oil has been used and is based on the standard energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

- The Bukhara Urals pipeline, through which the gas output flows, was closed at the beginning of 2010 and did not re-open until May 27, 2010 when volumes through the pipeline were restricted to 360Mcmpd[1]. It was not until July 26, 2010 when volumes returned to pre-closure levels of 500Mcmpd.
- In the prior year the Bukhara Urals pipeline had also been closed from November 28, 2008 but re-opened on March 5, 2009. Then from the middle of May 2009, because of restrictions further up in the Bukhara-Urals Gas line, the Kyzyloi gas output was temporarily reduced to approximately half of its full production capacity. Full production did not recommence until the August 1, 2009 before closing again (as above) on November 24, 2009.
- It was on January 5, 2006 that Tethys' wholly owned Kazakh subsidiary, TethysAralGaz LLP ("TAG"), executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from TAG's Kyzyloi field in Kazakhstan at an agreed price of $32 per Mcm excluding value added tax ("VAT"). On May 1, 2009, this contract was assigned to Asia Gas NG LLP.
- The Kyzyloi Gas Supply Contract, which has a term until the earlier of December 1, 2012, the date on which all contracts and licences pursuant to which the gas to be delivered under the Gas Supply Contract terminate, or when 850 MMcm[2] has been delivered, is based on a take–or–pay principle and covers all gas produced from the Kyzyloi Field Licence and Production Contract area up to the termination of the Gas Supply Contract.
- To the end of Q4 2010 some 393,377 Mcm or 46.3% of the maximum contract volume under the Gas Supply Contract had been delivered.

[1] Thousand cubic feet per day
[2] Million cubic metres

**Kazakhstan Gas Production (Akkulka contract)**

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Mcm[1] | Mcf[2] | Mcm/d | boe/d | Mcm | Mcf | Mcm/d | boe/d |
| Q4 | 24,244 | 856,056 | 279 | 1,640 | 0 | 0 | 0 | 0 |
| **Total** | **24,244** | **856,056** | **279** | **1,640** | **0** | **0** | **0** | **0** |

Note 1 Mcmpd is thousands of cubic metres per day and has been calculated based on the actual production days in the quarter or year and not the total number of days in the quarter or year. In 2010 there were 87 production days while in 2009 there were nil.

- On September 16, 2010 the Company announced that it had signed a gas sales contract for the initial sales of gas from the Akkulka gas field in Kazakhstan. First deliveries under this contract commenced on October 6, 2010.
- Compressor related problems in the final quarter of 2010 resulted in a reduced level of Akkulka production being achieved.

**Kazakhstan Oil Production (Akkulka contract)**

| | Total Production | | |
|---|---|---|---|
| | Tonnes | Barrels ("bbl") | barrels per day ("bbl/d") |
| 86 days to December 1, 2010 | **6,558** | **50,870*** | **591** |

- Between September 10 and December 1, 2010 a period of test production consisting of 86 days was carried out on the Doris discovery on the Akkulka contract.
- The Company commenced selling the untreated oil at the well site of AKD01 to an oil trading company which transported the oil by truck to a location north of the town of Emba, 450 km to the north-east, where it is treated before being transported to local refineries.
- The untreated oil produced was being sold at the wellhead at an initial price of US$22/bbl.
- This test production was implemented to gain reservoir information, realise early cash flow and to prepare for the higher production and associated logistics for the next stage.

** using 7.757 barrels = 1 tonne*

**Uzbekistan Oil Production (North Urtabulak PEC)**
**Total Production from TPU under PEC**

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | Total Production | | | Total Production | | |
| | Tonnes | Barrels* | bopd | Tonnes | Barrels* | bopd |
| Three months ended March 31 | 20,869 | 160,691 | 1.785 | 20,909 | 160,999 | 1,789 |
| Three months ended June 30 | 19,627 | 151,128 | 1,660 | 22,755 | 175,214 | 1,925 |
| Three months ended Sept. 30 | 17,512 | 134,842 | 1,466 | 24,697 | 190,167 | 2,067 |
| Three months ended Dec. 31 | 15,048 | 115,869 | 1,259 | 21,710 | 167,167 | 1,817 |
| **Total production** | **73,056** | **562,530** | **1,541** | **90,071** | **693,547** | **1,765** |

***After State Take***

| | TPU[3] Share | | | TPU Share | | |
|---|---|---|---|---|---|---|
| | Tonnes | Barrels* | bopd | Tonnes | Barrels* | bopd |
| Three months ended March 31 | 10,434 | 80,342 | 893 | 10,454 | 80,495 | 894 |
| Three months ended June 30 | 9,814 | 75,565 | 830 | 11,377 | 87,603 | 927 |
| Three months ended Sept. 30 | 7,182 | 55,301 | 601 | 12,348 | 95,080 | 1,033 |
| Three months ended Dec.31 | 6,444 | 49,619 | 539 | 10,855 | 77,612 | 844 |
| **Total production** | **33,874** | **260,830** | **714** | **45,034** | **322,000** | **882** |

** using 7.7 barrels = 1 tonne*

- The Company acquired its interest in the North Urtabulak PEC with effect from April 9, 2009 and had no rights to the production prior to that date. Production is under a Production Enhancement Contract ("PEC") for the North Urtabulak oilfield with subsidiaries of the Uzbek State oil and gas company NHC Uzbekneftefgas.
- Well NU115 completed three years' production in June 2010 and so from July the Company's share of its output reduced from 50% to 20% in line with the terms of the PEC. The reduced share from this well was the primary contributory factor to the reduction in production from the previous quarter in 2010. The actual production from this well dropped in the final quarter thus further reducing production.
- Drilling of a new well, NUR116 was completed in the first quarter of 2010 and production commenced in March 2010. While the well initially tested at a satisfactory rate of up to 600 bopd after a short period production decreased significantly. It is believed that the location chosen in the reservoir was a locally less permeable part of the reefal reservoir than nearby.
- On October 28, 2010, the Company began operations on the NUR96H2 horizontal development well on the North Urtabulak Field. The well was subsequently completed in February 2011 and tested at rates in excess of 1,100 bopd.
- The Company has been investigating alternative methods to increase production and a programme of radial drilling was carried out in Q4 2010 as well as reconfiguring of the water injection scheme. See *Uzbekistan Drilling Update* on page 21.

**(Update** In the 24 hours to 8.00 am on March 21, 2011 Total Production was 1,416 bopd and TPU share 652 bopd.)

**Tajikistan Oil Production (Beshtentak field)**

| | Total Production | | SSEC Share (after State Take) | |
|---|---|---|---|---|
| | Tonnes | Barrels | Tonnes | Barrels |
| Year ended December 31, 2010 | **817** | **5,923** | **744** | **5,390** |

- Oil production commenced from the Beshtentak field in Q1, albeit on a small scale, and further work is underway aimed at increasing this production.
- The oil is being produced from well BST20 which is an existing well and the production is as a result of a workover. Further workovers are planned on other wells in the field.
- Tethys has a 51% shareholding in SSEC but under the terms of a loan agreement with SSEC currently receives all revenues from production sales attributable to SSEC; a jointly controlled entity

[3] TPU is Tethys Production Uzbekistan, the Tethys subsidiary which holds the PEC. Tethys Production Uzbekistan is the trading name of Baker Hughes (Cyprus) Limited.

## Production Summary

In the final quarter of 2010 the following oil and gas production levels were achieved (before the deduction of local governments share or taxation) were as follows:

| Country | Oil | Gas | | Combined |
|---|---|---|---|---|
| | bopd | Mcm/d | boe/d | boe/d |
| Kazakhstan | 591 | 730 | 4,292 | 4,883 |
| Uzbekistan | 1,259 | - | - | 1,259 |
| Tajikistan | 16 | - | - | 16 |
| **Total** | **1,866** | **730** | **4,292** | **6,158** |

**Note** As indicated in the sections above the Akkulka gas and oil production figures included in the Kazakhstan figures have been calculated based on the actual production days in the quarter and not the total number of days in the quarter.

## Financial Review

### Loss after tax

The Company recorded a net loss after taxation of US$29.31 million in the year ended December 31, 2010 compared to a net loss of US$21.72 million in the year ended December 31, 2009. The principal differences between the two years were as follows:

| | 2010 | 2009 | Movement |
|---|---|---|---|
| Revenue | 14,767 | 8,635 | 6,132 |
| Operating expenses | (7,076) | (3,405) | (3,671) |
| DD & A | (5,885) | (3,238) | (2,647) |
| Exploration expenditure written off | - | (887) | 887 |
| Listing expenses | (1,288) | (1,652) | 364 |
| G &A costs | (19,555) | (14,252) | (5,303) |
| Share based costs | (5,956) | (2,628) | (3,328) |
| Finance costs | (214) | (682) | 91 |
| Foreign exchange | (337) | (2,397) | 2,060 |
| Loss from jointly controlled entity | (634) | (1,000) | 366 |
| Loss before tax | **(29,649)** | **(21,720)** | **(8,306)** |

### Revenue

**Note**

Revenue from the oil sales in Tajikistan is included in the financial statements of SSEC the Company's 51% owned joint venture in that country, and is not included in the Company's consolidated revenue figures.

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| Gas sales | 1,982 | 931 | 113% | 3,767 | 3,828 | -2% |
| Oil sales | 748 | 0 | -* | 748 | 0 | -* |
| Refined product sales | 631 | 1,901 | -67% | 9,851 | 4,731 | 108% |
| Other revenue | 26 | (25) | -204% | 340 | 0 | -* |

* (-) undefined value

- The gas sales are generated from both the Kyzyloi and the Akkulka contracts in Kazakhstan and as referred to in *Kyzyloi Gas Production* above are sold to Asia Gas NG LLP at agreed prices of $32 per Mcm excluding VAT for the Kyzyloi gas and $38 including VAT for the Akkulka gas.
- Gas sales in Kazakhstan in both 2010 and 2009 were affected by stoppages and production restrictions detailed in *Kyzyloi Gas Production* above. The stoppages in 2010 were longer than in 2009 and so despite Akkulka gas coming on stream in October 2010 the revenue generated from gas sales was consequently lower than in 2009.
- Gas sales for Q4 2010 were $1,982,000, made up of Kyzyloi and Akkulka sales, compared to $931,000 in 2009 purely relating to Kyzyloi sales.
- Gas sales for the year to December 31, 2010 were $3,767,000 compared to $3,828,000 in the same period of 2009.
- While oil sales from the Doris discovery actually began in September 2010 the revenue from test production in Q3 was booked against capital assets as required by IFRS. Revenue from oil sales in Q4 was booked as Company revenue and amounted to $748,000.
- Refined product sales for the year to December 31, 2010 were $9,851,000 compared to $4,731,000 in the same period of 2009 being a reflection of the fact that the Uzbekistan operation was only acquired in April 2009 and so the sales were only over a nine month period. Also during the course of 2010, a number of Uzbekistan refined product shipments were completed that related to 2009 production though this surplus from 2009 was at least in part offset by the absence of deliveries from the refinery in the final quarter of 2010.
- Deferred revenue from refined product sales, i.e. goods paid for awaiting delivery, at December 31, 2010 was $2,449,856.

**For the three months ended December 31, 2010**

- Gas sales for Q4 2010 were $1,982,000, made up of Kyzyloi and Akkulka sales, compared to $931,000 in 2009 purely relating to Kyzyloi sales.
- The Akkulka gas First deliveries under this contract commenced on October 6, 2010 but because of compressor related problems in the final quarter of 2010 resulted in a reduced level of Akkulka production being achieved
- Akkulka oil sales in Q4 2010 were $748,000 resulting from the selling of untreated oil at the well site of AKD01 to an oil trading company which began transporting the oil by truck to a location to the north of the town of Emba. Sales ceased on December 1, 2010 when the test production period ended.

- Refined product sales in Uzbekistan in Q4 2010 were $631,000 compared to $1,901,000 in Q4 2009 as a result of a delay on deliveries from the refinery. These deliveries should be completed in 2011.

**Operating expenses**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| Operating costs | 2,965 | 1,416 | 109% | 7,076 | 3,405 | 108% |

- Total operating costs for the year to December 31, 2010 were $7,076,000 (2009: 3,405,000) made up as follows:

| | |
|---|---|
| Kazakhstan gas production | $1,531,000 (2009:$1,092,000) |
| Kazakhstan oil production | $ 693,000 (2009: nil) |
| Uzbekistan refined products | $3,238,000 (2009: $2,313,000) |
| Rigs and drilling equipment | $1,419,000 (2009: nil). |

- In Kazakhstan while the Kyzyloi gas revenue in the year to December 31, 2010 was lower than in 2009 there was little change in the operating costs as even during the closure periods the labour force had to be maintained and was used on the monitoring of wells plus maintenance of the existing compressors.
- The introduction of Akkulka production from October 2010 saw an increase in gas operating costs in the final quarter. In addition there were property taxes of $327,000.
- Operating costs of the oil production in Kazakhstan included the start up costs for this new project.
- As stated above shipments in Uzbekistan in the year to December 31, 2010 were significantly higher than in the same period of 2009 which explains the higher level of operating costs. The purchase of spare parts for the drilling rigs plus repairs to other drilling equipment were incurred in Q4 2010.

**For the three months to December 31, 2010**

- Operating costs in the three months to December 31, 2010 were $1,413,000 (2009: $243,000) for Kazakhstan, $133,000 (2009: $1,173,000) in Uzbekistan and $1,419,000 on the rigs and drilling equipment.
- The significant increase in Kazakhstan operating costs in Q4 2010 while partially the result of the Akkulka gas coming on line in October was primarily the result of costs associated with the oil test production plus the property taxes.
- The reduction in Uzbekistan costs in Q4 2010 compared to Q4 2009 is the result of the low level of deliveries completed in that period. See *Uzbekistan Oil Production* above.
- The purchase of spare parts for the drilling rigs plus repairs to other drilling equipment were incurred in Q4 2010.

**Depreciation, depletion and amortization expense**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| DD & A costs | 2,200 | 203 | 984% | 5,885 | 3,238 | 82% |

- The increase in the DD&A charge in the year ended December 31, 2010 at $5,885,000 (2009: $3,238,000) was primarily the result of a significant increase in the drilling days for the Tykhe rig and associated equipment.
- The increase in DD&A charge in the three months to December 31, 2010 at $2,200,000 (2009: $203,000) was primarily the result of a higher level of depreciation of the Tykhe drilling rigs and ancillary equipment plus the fact that the Q4 2009 figure encompassed a correction to a previous quarter overstatement in 2009.

**Listing costs**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| Listing costs | 58 | 1,652 | -96% | 1,288 | 1,652 | -22% |

- These costs relate primarily to the possible secondary listing of the Company's ordinary shares on the Hong Kong Stock Exchange, a course of action which the Company has since decided not to pursue.

**Administrative expenses**

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| | $000 | $000 | $000 | $000 |
| Staff costs | 3,358 | 1,536 | 8,741 | 5,467 |
| Travel costs | 1,034 | 807 | 3,380 | 2,590 |
| Office costs | 369 | 468 | 2,080 | 1,835 |
| Professional fees | 727 | 589 | 2,577 | 1,909 |
| Marketing costs | 260 | 228 | 835 | 704 |
| Other costs | 632 | 670 | 1,942 | 1,728 |
| | 6,380 | 4,298 | 19,555 | 14,233 |
| Stock based compensation | 2,360 | 240 | 5,956 | 2,628 |
| | 8,740 | 4,538 | 25,511 | 16,861 |

General administration and selling expenses for the year ended December 31, 2010 were up on the same period as a result of the following:

- Primary factors in the increase in the staff costs were costs associated with fund raising in the first and final quarters of the year, a company-wide salary review in April, the first in two years, and increased activity in the Company's areas of operations,
- A primary area of increased staff costs was Kazakhstan which was necessitated by the development requirements of the "Doris" discovery plus the increased administrative burden in Kazakhstan associated with new procurement rules.
- Travel costs were up as a result of the fund raising activities, the fact that the Company operates in three countries plus the pursuit of further contracts throughout Central Asia.

Professional fees were up as a result of an increased need for legal, accounting and tax consultancy in the countries in which the Company operates.

For the three months to December 31, 2010

- The primary cause of the increase in costs in Q4 2010 at $6,380,000 (2009: $4,298,000) were increased staff and travel costs associated with the successful fund raising of $100 million completed in October 2010 plus the higher level of staff recruited to cope with the increased activity in Kazakhstan.

Stock based compensation

- Stock based compensation expenses relate to stock options and warrants issued in 2010 and prior years. The increase in 2010 on the 2009 figure reflects an increase in the number of options and an increase in the Company's share price.

**Finance expenses**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| Foreign exchange (gain)/loss - net | 0 | 122 | -100% | 337 | 2,397 | -86% |
| Fair value gain/(loss) | (242) | 258 | -194% | 24 | 479 | -95% |
| Loss from joint venture | 212 | 1,000 | -79% | 634 | 1,000 | -37% |
| Finance Income | (16) | (27) | -41% | (61) | (76) | -20% |
| Finance costs | 56 | (1,150) | -105% | 190 | 203 | -6% |

- There was a reduction in the foreign exchange loss as the 2009 loss was primarily the result of the movement in the Kazakhstan Tenge ("KZT") against the $ resulting from the Kazakhstan central bank's decision to stop supporting the Tenge against the $ and the rate moved from approximately KZT123 to KZT150 to the US$. At December 31, 2010 the rate was KZT147.40 to the US$.
- The fair value gain or loss on derivative financial instruments reflects the movement in the fair value of warrants issued by the Company that are denominated in a currency (Canadian dollars or C$) other than the Company's functional currency (US$) for financial reporting purposes plus the impact of interest rate swaps.
- Loss from the jointly controlled joint venture represents the Company's 51% share in the loss incurred by SSEC.
- Finance costs consist primarily of interest costs. The negative figure indicated in Q4 2009 was the result of the capitalisation of interest charged to finance costs in previous quarters.

**Taxation**

The taxation charge refers to a deferred taxation liability. For further details refer to the *Audited Consolidated Financial Statements for the year ending December 31, 2010*

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| Tax | 718 | 214 | 236% | 3,471 | 214 | 1522% |

Tethys is domiciled in the Cayman Islands which has no Company income tax.

Tax expense for the year ended December 31, 2010 increased compared to the prior year as a result of the Company incurring non-capital tax losses in certain jurisdictions for which no related tax assets have been recognized. Also, in relation to the Company's operations in Kazakhstan, tax expense increased as a result of the derecognition of certain tax benefits which had been recognized in prior years. See *Note 9 of the 2010 Audited Consolidated Financial Statements* for more details.

**Capital Expenditure**

Capital expenditure during the year ended December 31, 2010 was $38,293,000 while a further $3,298,000 of prepayments on capital projects was also incurred.

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2010** | 2009 | Change | **2010** | 2009 | Change |
| Kazakhstan | 13,294 | 2,080 | 539% | 33,058 | 8,553 | 287% |
| Uzbekistan | 1,303 | 2,482 | -48% | 4,937 | 3,709 | 100% |
| Other and Corporate | (13) | 4,306 | -100% | 298 | 19,959 | -99% |
| | 14,584 | 8,868 | 64% | 38,293 | 32,221 | 19% |

Major items of capital expenditure in 2010 were:

| | Three months ended Dec 31, 2010 | Year ended Dec 31, 2010 |
|---|---|---|
| *Kazakhstan* | | |
| • AKD01plus oil production facilities | 2,660 | 4,290 |
| • Akkulka appraisal wells | 1,715 | 7,960 |
| • Akkulka deep exploration well | 2,280 | 8,760 |
| • Akkulka re-entry deep well | 1,995 | 3,254 |
| • Akkulka drilling and related equipment | 1,180 | 2,390 |
| • Akkulka 3D and 2D seismic | 3,040 | 5,325 |
| • Kul Bas seismic and geological works | 2,145 | 3,315 |
| *Uzbekistan* | | |
| • Well workovers | 778 | 2,385 |
| • NUR116 development well | - | 1,805 |
| • Radial drilling | 485 | 485 |

*Tajikistan*

Capital expenditure in Tajikistan incurred via its jointly controlled entity Seven Stars Energy Corporation (SSEC) in the year to December 31, 2010 was US$19.9 million compared to US$16.9 million in the same period of 2009 funded directly by the Company:

| | Three months ended Dec 31, 2010 | Year ended Dec 31, 2010 |
|---|---|---|
| • Seismic exploration including processing | 215 | 1,950 |
| • Komsomolsk appraisal well plus base | 175 | 2,920 |
| • Komsomolsk exploration well | 3,760 | 12,105 |
| • Well rehabilitation and workovers | 250 | 1,300 |
| • East Olimtoi exploration well | 690 | 1,095 |

**Summary of Quarterly Results**

The figures in the table below have been prepared under IFRS requirements.

| | **Mar 31 2009** | **Jun 30 2009** | **Sept 30 2009** | **Dec 31 2009** | **Mar 31 2010** | **Jun 30 2010** | **Sept 30 2010** | **Dec 31 2010** |
|---|---|---|---|---|---|---|---|---|
| **Financials** ($000's) | | | | | | | | |
| Revenue | 529 | 2,797 | 2,426 | 2,807 | 2,116 | 6,030 | 3,173 | 3,387 |
| Net loss | (6,016) | (5,593) | (3,944) | (6,166) | (7,991) | (21,658) | (7,118) | (11,210) |
| Basic and diluted loss ($) per share | (0.09) | (0.06) | (0.03) | (0.05) | (0.05) | (0.06) | (0.04) | (0.04) |
| | | | | | | | | |
| Capital expenditure | 10,237 | 4,778 | 8,337 | 8,868 | 4,443 | 7,316 | 11,950 | 14,584 |
| Total assets | 108,201 | 127,577 | 124,627 | 137,082 | 186,405 | 184,082 | 182,081 | 267,748 |
| Total long term liabilities | (5,595) | (5,299) | (4,997) | (18,345) | (13,419) | (14,938) | (15,963) | (11,535) |
| Cash and working capital surplus | 7,947 | 17,351 | 6,369 | (157) | 38,372 | 24,408 | 6,046 | 69,718 |

Significant factors influencing quarterly results

- There were stoppages in Kyzyloi gas production in the quarters ending, March 31, 2009, December 31, 2009, March 31, 2010 and June 30, 2010 plus a period of reduced production in the quarters ending June 30, and September 30, 2009.
- The TPU operation in Uzbekistan was acquired by the Company in April 2009.
- During the course of the Q2 2010 a number of Uzbekistan refined product shipments were completed which relate to 2009 production. The consequence of this was that the refined product revenue recognized in Q2 2010 was significantly higher than if it was linked purely to Q2 2010 and previous quarters were lower than if they matched the associated quarter's production.
- The Company raised $20,000,000 (gross) in June 2009, $15,000,000 (gross) in January 2010, C$46,500,000 (gross) in March 2010 and $100 million in October 2010. All of these funds were the result of the issue of equity.
- In December 2009 the Company's Tajikistan operations were transferred to a jointly controlled venture (SSEC).
- From Q4 2009 the non-current liabilities included the "Deferred gain on assets transferred to jointly controlled entity". There was also an increase in long term borrowings of $4,100,000 in Q4 2009 in connection with the

drilling of NU116 in Uzbekistan. In Q4 2010 the loan related to the Telesto rig plus a portion of the Tykhe loan were repaid early.

**Financial position**

The significant movements in the balance sheets were as follows:

| | Dec 31, 2010 | Dec 31, 2009 | Movement | Movement Details |
|---|---|---|---|---|
| Intangible assets | 16,892 | 24,378 | (7,486) | Expenditure on Akkulka Dee and Kul Bas less transfer of expenditure of Akkulka Deep appraisal and exploration wells to Property, Plant and Equipment. |
| Property, plant and equipment | 115,653 | 73,171 | 42,482 | Primarily consisting of the transfer of Akkulka Deep from exploration expenditure in Kazakhstan plus expenditure on wells in Uzbekistan less the DD&A charge for the year. |
| Non-current other receivables | 12,320 | 5,171 | 7,149 | Increase in VAT balance in Kazakhstan plus increase in prepayments to contractors. |
| Loan receivable from joint controlled entity | 35,460 | 21,727 | 13,733 | Funds provided to SSEC to cover costs in Tajikistan for seismic survey, KOM200, KOM201, EOL09 etc. |
| Inventories | 2,121 | 2,368 | (247) | Movement in cost of spares |
| Trade and other receivables | 3,680 | 2,311 | 1,369 | Build up of trade debtors in Kazakhstan plus increase in prepayments. |
| Cash and cash equivalents | 79,135 | 7,297 | 71,838 | Refer to Consolidated Statement of Cash Flows in the annual financial statements |
| Derivative financial instruments - interest rate swap | 1,472 | (95) | 1,567 | Movement in fair value valuation of the expected liability |
| Share capital | 323,285 | 167,203 | 156,082 | Equity was increased during as a result of 2 private placements totaling 22.615m shares, a public placement of 110.6m shares and the exercise of warrants and options amounting to 2.86m shares less associated costs |
| Other reserves | 34,261 | 27,775 | 6,486 | Stock based compensation expense in the twelve months to December 31, 2010. |
| Accumulated deficit | (118,023) | (88,374) | (29,649) | Loss incurred for the year ended December 31 |
| Non-current financial liabilities - borrowings | 2,853 | 9,324 | (6,471) | Decrease as a result of early repayment of the Telesto rig loan plus the transfer of remaining Tykhe loan balances to short term liabilities |
| Advanced Equity Subscriptions | - | 3,750 | (3,750) | Funds received in advance of January 2010 completion of a $5 million private placement |

| | | | | |
|---|---|---|---|---|
| Deferred taxation | 4,070 | 598 | 3,472 | Movement in deferred tax liability since December 31, 2009 |
| Current financial liabilities - borrowings. | 5,047 | 1,086 | 3,961 | Movement from long term liabilities and partial early repayment of the Tykhe loan |
| Derivative financial instruments - warrants | 405 | 1,053 | (648) | Movement in the fair value of the liability following issue of CD$ warrants in connection with short term loan |
| Deferred revenue | 2,450 | 3,113 | (663) | Reduction in Uzbekh product awaiting delivery |
| Trade and other payables | 8,788 | 6,786 | 2,002 | Increase in trade payables primarily in Kazakhstan as a result of capital expenditure invoices received in December. |

**Contractual obligations and liabilities as at December 31, 2010**

| | Payments Due by Period $'000s | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 Year** | **1 - 3 Years** | **4 - 5 Years** | **After 5 years** |
| Financial borrowings | $7,900 | $5,047 | $2,853 | - | - |
| Operating leases | $666 | $456 | $210 | - | - |
| Trade and other payables | $9,509 | $8,788 | $458 | $128 | $135 |
| Commitments | $8,896 | $6,196 | $2,700 | - | - |
| **Total contractual obligations** | **$26,971** | **$20,487** | **$6,221** | **$128** | **$135** |

The Company is confident that it will satisfy these commitments in full.

**Liquidity and Capital Resources**

As at December 31, 2010, the Company had a working capital surplus, including cash, of $69,309,000. The position at the end of December represented a significant improvement from the position at December 31, 2009, when there was a deficit of $157,000, which was primarily the result of the following actions taken by the Company:

- On October 20, 2010 the Company completed an equity issue of 70.6 million shares raising gross proceeds of US$100 million.
- The private placement of 10,000,000 shares for gross proceeds of $5,000,000 of which $3,750,000 had been received before December 31, 2009 was successfully completed in January 2010.
- A second private placement was successfully completed in January 2010 consisting of 12,615,000 shares for gross proceeds of $10,000,000.
- A further private placement was completed in March 2010 consisting of 30,000,000 shares for gross proceeds CAD$46,500,000.

The Company is confident that with its current level of funds plus the anticipated revenue from Kazakhstan and Uzbekistan that it will be able to achieve its capital expenditure plans for 2011.

**Cash flows**

| | **2010** | **2009** | **Change** |
|---|---|---|---|
| Net cash used in operating activities | (16,824) | (10,074) | 67% |
| Net cash used in investing activities | (56,643) | (30,365) | 87% |
| Net cash generated from financing activities | 145,304 | 25,559 | 469% |
| Foreign exchange difference | 1 | (23) | |
| | 71,838 | (14,903) | 582% |

Operating activities

While the revenue in 2010 at $14,706,000 showed an encouraging increase on the 2009 figure of $8,559,000 this was offset by an increase in total costs plus an increase in non-cash working capital to give an increase in terms of cash used in operating activities at $16,824,000 (2009:$10,074,000). The increase was driven by the higher loss for the year, offset by increased depreciation, depletion and amortisation and share based payment charges. The increase in non-cash working capital was the result of increased levels of activity.

Investing activities

In 2010, due primarily to the Akkulka oil development, there was a significant increase in capital expenditure of $38,293,000 (2009:$32,221,000). A further $14,070,000 (2009: nil) was made in payments made on behalf of the jointly controlled entity which was primarily capital expenditure. A further increase in the VAT receivable of $4,148,000 (2009: $670,000) combined with the total capital expenditure to give a total for net cash used in investing activities of $56,643,000 (2009:$30,365)

Financing activities

From several private placements in Q1 2010 and a public offering in October 2010 the Company raised net proceeds of $149,770,000 (2009: $17,906,000) which together with a small increase in the form of debt of $1,840,000 (2009: $5,020,000) linked to the Uzbekistan well less the repayment of the Telesto loan and partial repayment of the Tykhe loan resulted in a net inflow of funds of $145,304,000 (2009: $25,559,000).

**Capital management**

The Company's capital structure is comprised of shareholders' equity and debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its capital expenditures from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt. There was no net debt at December 31, 2010.

| | Dec 31, 2010 | Dec 31, 2009 |
|---|---|---|
| | **$** | **$** |
| Total financial liabilities - borrowings | 7,900 | 10,410 |
| Less: cash and cash equivalents | (79,135) | (7,297) |
| Net debt / (funds) | (71,235) | 3,113 |
| Total equity | 323,285 | 106,604 |
| **Total capital** | 252,050 | 109,717 |

If the Company was in a net debt position, the Company would assess whether the projected cash flow was sufficient to service this debt and support ongoing operations. Consideration would be given to reducing the total debt or raising funds through an alternative route such as the issuing of equity.

**Use of Funds**

**Set out below are details of the planned use of funds as detailed in the prospectus dated October 4, 2010:**

The majority of this expenditure is anticipated to be incurred in 2011.

| | Per October 4, 2010 Prospectus | Incurred to Dec 31, 2010 | To be Spent |
|---|---|---|---|
| *Kazakhstan* | | | |
| Appraisal and Exploration Wells | 47,500 | 465 | 47,035 |
| Production and Processing Infrastructure | 19,800 | 2,430 | 17,370 |
| Seismic Data | 6,000 | 3,040 | 2,960 |
| *Tajikistan* | | | |
| Production and Processing Infrastructure | 3,760 | - | 3,760 |
| Seismic Data | 3,000 | - | 3,000 |
| Exploration and Appraisal Drilling Wells | 4,000 | - | 4,000 |
| *Uzbekistan* | | | |
| Seismic Data | 2,000 | - | 2,000 |
| Production Drilling | 5,940 | - | 5,940 |
| **Total** | 92,000 | 5,935 | 86,065 |

**Set out below are details of the planned use of funds to as detailed in the prospectus dated June 12, 2009.**

The primary differences were in relation to:

- The Tajik processing plant is not yet required and will be constructed in the future.
- A decision on installation of the Gas Lift Compression system in Uzbekistan still to be made based on field performance.

| | **Per June 12, 2009 Prospectus** | **Incurred to Dec 31, 2010** | **To be Spent** |
|---|---|---|---|
| *Tajikistan* | | | |
| East Komsomolsk - KOM 200 appraisal well Phase 1 | 3,500 | 3,500 | - |
| Infrastructure - Komsomolsk gas Processing plant Phase 1 | 2,000 | | 2,000 |
| East Komsomolsk - gas development well KOM 201 Phase 2 | 3,500 | 3,500 | - |
| Additional seismic on Bokhara PSC | 3,660 | 3,660 | - |
| *Uzbekistan* | | | |
| North Urtabulak Gas Lift Compression System | 1,190 | | 1,190 |
| North Urtabulak new well. | 4,000 | 4,000 | - |
| Workovers | | | |
| | 17,850 | 14,660 | 3,190 |

**Stockholder Equity**

As at December 31, 2010 the Company had authorized share capital of 700,000,000 Ordinary Shares of which 260,629,769 had been issued and 50,000,000 preference shares of which none had yet been issued. The preference shares have the rights as set out in the Memorandum and Articles of Association approved at the AGM on April 24, 2008.

On December 21, 2009 the Company announced a non-brokered private placement of 10,000,000 Ordinary Shares for gross proceeds of US$5 million subject to regulatory approval. The sum of $3,750,000 was received in December 2009 with the balance of $1,250,000 received in January 2010. The Ordinary Shares were placed at a price of US$0.50 (C$0.53) each. The placement was completed in January 2010.

On January 11, 2010 the Company further announced a non-brokered private placement of 12,615,000 Ordinary Shares for gross proceeds of US$10 million subject to regulatory approval. The Ordinary Shares were placed at a price of C$0.82 each. The placement was completed in January 2010.

On February 12, 2010 the Company announced a private placement of 30,000,000 Ordinary Shares for gross proceeds of C$46.5 million subject to regulatory approval. The Ordinary Shares were placed at a price of C$1.55 each. The placement was completed on March 1, 2010.

On October 20, 2010 the Company completed a public equity issue of 70,600,000 Ordinary Shares for gross proceeds of US$100 million. The Ordinary Shares were placed at a price of C$1.45 each.

As at the date of this report, March 21, 2011, a total of 31,275,572 (December 31, 2009 – 24,489,455) ordinary shares were reserved under the Company's Long Term Stock Incentive Plan and Warrants granted by the Company. The number of options outstanding as at the date of this report, March 21, 2011, is 22,263,000 (2009:11,706,000) and the number of warrants outstanding is 10,283,455 (2009:12,783,455).

## OUTLOOK

The Company does not anticipate that the recent developments in the Middle East and Libya will have a significant impact on its operations, other than there may be some benefit from higher oil prices on its existing oil sales in Uzbekistan and its anticipated oil sales in Kazakhstan in the coming months.

With its projects in Kazakhstan, Uzbekistan and Tajikistan giving a balance of short-term cash flow and upside potential the Company believes that it is in a good position to capitalize on its recent Doris commercial oil discovery in Kazakhstan, its strong business position in Uzbekistan and Tajikistan, and even before the recent events in the Middle East and Libya, the recent increase in energy prices. The Company's gas production in Kazakhstan is currently being sold at relatively low prices on the domestic market but with the planned Kazakhstan – China gas pipeline, which the Company understands will become operational in 2013, and liberalization of the Kazakh gas market, there is potential for significant increases in gas prices, given China's projected increase in gas demand. Current higher oil prices are not yet being fully realized in Central Asia but if prices remain high it is likely that increased Central Asian prices will result. The recent placements of equity have given the Company the resources it needs to advance its current activities, in particular the Doris oil appraisal, development and additional exploration. The Company believes that having now received approval for the Pilot Production Scheme this should result in significant additional oil production in Kazakhstan and further work on the Company's existing and potential assets in Uzbekistan should also help strengthen cash flow.

### Kazakhstan Drilling Update

The Company completed drilling of its first "deep" exploration well in the area, well AKD01 ("Doris") on the Akkulka Block in December 2009. The upper zone flowed oil at a restricted rate of over 5,400 bopd. Combined with the lower zone, well AKD01 has flowed oil at a combined rate in excess of 6,800 bopd. The two reservoir zones are in the Jurassic and lower Cretaceous sequences at depths of approximately 2,355 m and 2,174 m respectively. Thus far the Company has drilled one appraisal well (AKD02) in proximity to the Doris oil discovery that was spudded in April 2010 with preliminary results announced in June 2010.

The AKD02 well is approximately 4 km to the northwest of the AKD01 well. Despite the fact that oil shows were observed in the core, the lower Cretaceous zone showed low hydrocarbon saturation, possibly due to a fault between two wells. The Jurassic carbonate zone appeared to be oil bearing but the reservoir quality was not as good as in the AKD01 well. Further testing is planned utilising radial drilling in an attempt to establish commercial production. The AKD03 ("Dione") exploration well, which is located approximately 10 km to the southwest of the AKD01 Doris discovery well (on a separate prospect), reached its targeted depth at 3,975 m in January 2011. A comprehensive testing program commenced in March 2011 upon approval by the Kazakh State on up to eight separate zones that have been identified on logs. A further potential hydrocarbon bearing sand (possibly Triassic in age) was identified at the base of the well, but due to challenging drilling conditions in this area the Company decided to stop and test the zones already identified. Furthermore the 3D seismic data that has recently been interpreted indicates that the deeper zones might be exploited better through a future sidetrack of AKD03 or potentially of well G6, where similar sand was encountered or a new well designed primarily to evaluate this deeper zone. A decision in this respect will be made after the AKD03 testing program is complete and the 3D seismic interpretation fully completed. The ZJ70 rig "Telesto" was moved from AKD03 to KBD01 (Kalypso) in January 2011 to continue drilling this well to its targeted depth while a testing rig is carrying out the smaller program on AKD03.

The G6 well, which is located approximately 16 km to the west of the AKD01 well, was originally drilled in 2001 by the then contractor on the Akkulka Block and was abandoned without running casing or testing. The re-entry of well G6 (named well G6RE, on the separate Dodone prospect) was drilled to a depth of 2,835 m in order to test a deeper potential oil bearing zone identified from the wireline logs in the original G6 hole. A possibly Triassic sand interval was encountered in this well which appears to be hydrocarbon bearing and is similar to the interval encountered in well AKD03. This interval is at a higher reservoir pressure and the well configuration prevented testing of this zone. The Jurassic carbonate zone encountered in well AKD01 is also present in this well and appears to be hydrocarbon bearing but not of as good a quality as in well AKD01. Further testing is planned utilising radial drilling in an attempt to establish commercial production. In November 2010, both the 3D and 2D seismic acquisition programs on the Doris oil discovery and surrounding exploration area had been completed and first data has been interpreted. The next two wells to be drilled on the Doris oil discovery have been identified. Drilling of the first well is planned to commence during the first quarter of 2011 with an already contracted ZJ30 rig. As well as providing more detailed information on the discovered field, the seismic program has identified several new exploration targets at various depths in the vicinity.

Two appraisal wells were located in January 2011 based upon the mapping of the 3D seismic and incorporating results from the pressure transient analysis of the testing on the Cretaceous horizon in AKD01. A tender process has just been completed for the drilling of the wells and they are expected to be spudded in the near future. AKD05 will be drilled immediately up-dip of the AKD01 whilst AKD04 ("Dero") will be drilled to the east of the Doris crest in order to test the continuation of the structure there, both wells will target both the lower Cretaceous sandstones and Jurassic carbonates that were successfully tested in AKD01 as well as a possible third, overlying, horizon in the Albian sandstone horizon.

In December 2010, the Company commenced drilling of the KBD01 ("Kalypso") exploration well located approximately 50 km to the northwest of the Doris oil discovery and has a planned total depth of 4,000 m. This well is targeting potential reservoirs at several stratigraphic levels from the Cretaceous to the Permo-Carboniferous Initially spudded with an available ZJ30 rig, drilling of the well is now continuing with the Company's ZJ70 rig Telesto. Currently the well is at a depth of approximately 900 metres. The KBD01 well is the first deep exploration well to be drilled by the Company on the Kul-Bas Block, which also contains several other attractive prospects.

**Kazakhstan Second Phase Gas Production (Akkulka Gas Production Contract)**

The Company's second gas development project in Kazakhstan (Akkulka) ties-in some of the shallow gas discoveries made in the Akkulka Block to the existing infrastructure, and was completed and certified by the State Commission in Kazakhstan in August 2010. Six shallow gas wells in the Akkulka Block have been completed and tied-in to the Company's pipeline. Gas produced from the Company's Kyzyloi and Akkulka fields is separately metered and flows along the company-built 56 km pipeline to Tethys' booster compressor station ("BCS") adjacent to the tie-in point to the major Bukhara-Urals export trunkline system where gas-fired reciprocating compressors compress the gas into the trunkline. As part of the Akkulka (Phase 2) gas development two additional compressors were installed at the BCS. A further five shallow dry gas discoveries remain to be tied in to the gas development.

In September 2010, the Company entered into a second gas sales contract with Asia Gas NG LLP pursuant to which gas from the Akkulka Gas Production Contract is being sold at a price of US$38/Mcm (including value added tax ("VAT") which can be recovered by the Company). Gas sold under this contract is for domestic sales and as such, is subject to a 0.5% royalty payment to the Kazakh State. The new gas sales contract runs for a period of two years and the parties have agreed to assess the price after one year. Kyzyloi field (Phase 1) gas production is currently also being sold under the long-term take-or-pay contract with Asia Gas NG LLP at a price of US$36/Mcm (including VAT which can be recovered by the Company). Both contracts should have terminated before the end of 2013. Supplies of gas under the Akkulka gas supply contract commenced on October 7, 2010. Production from both Kyzyloi and Akkulka was expected to total some 1,000 Mcmpd however a mechanical failure on one of the Company's compressors at the BCS and workover activity on the field wells restricted production to some 730 Mcmpd. These technical issues had not been resolved before the end of 2010.

**Tajikistan Drilling Update**

In May 2010, the Company commenced drilling of the directional KOM201 well on the eastern part of the Komsomolsk Field under Dushanbe. The well reached a total depth of 2,456 m and encountered a 310 metre column of Jurassic limestone with wireline logs and drilling data indicating that it is gas-bearing. Testing commenced in January 2011 with gas flow being obtained from the well on an open hole test. Production casing has been run and preparations are underway to apply radial drilling in an attempt to stimulate the well and obtain commercial gas flow. Wireline logs indicate hydrocarbons may be present in the secondary targets of the Cenomanian and Hauterivian.

The KOM201 well was drilled adjacent to Dushanbe where there is a high demand for gas by local industry and the population. Currently the vast majority of gas consumed is being imported and the current price is $227 per Mcm ($6.42 per Mcf). One of the largest cement plants in the region lies above the field, and just to the west of Dushanbe is one of the largest aluminium plants in the former Soviet Union as well as gas fired power generation thus giving a good market at potentially good prices and with existing infrastructure. Tajik State owned and operated gas pipelines are close to the Company's well sites in the Komsomolsk Field. The Group also has access to separator facilities.

The East Olimtoi exploration well EOL09 is targeting an attractive prospect on the edge of a salt induced structure some 40 km south-west of the city of Kulob. Operations on the well were suspended for some time waiting on the arrival of specialist equipment (which required permits) from the United States. This equipment arrived in September 2010 and the drilling rig has now been upgraded to enable operations to proceed more effectively. The well is currently at a depth of 2,901 m and is targeting a Palaeogene reservoir prognosed at a depth of 3,800 m.

Limited oil production commenced on the Beshtentak Field in January 2010. This production was achieved through simple workovers on existing wells. Work on the field resulting from the full field computer modelling carried out by the UK engineering company OPC suggests that additional oil could be recovered from the field and studies are underway to look at the viability of a new well – probably inclined or horizontal. Meanwhile, given the technical success of the radial drilling program which the Company has recently undertaken on the North Urtabulak Field in Uzbekistan a program of radial drilling has commenced on Beshtentak, this being the first time such technology has been applied in Tajikistan.

**Uzbekistan Drilling Update**

In May 2010, Tethys announced that it had tested and put on production the NUR116 well at the North Urtabulak Field in Uzbekistan with a test rate of some 610 Bopd after acidisation. However, later the well declined due to it being in a less permeable area of the field and is not producing. The well was drilled to a total depth of 2,484 m (8,150 ft) into the Jurassic reef carbonate reservoir.

In November 2010, the Company successfully completed a radial drilling program on five wells on the North Urtabulak Field, with four of the wells having four laterals, and one with eight laterals. The radial drilling was successful with horizontal lateral bores up to 100 metres being achieved in the reservoir and a significant increase in oil production. The Company plans to expand its program of radial drilling on additional suitable deposits.

In November 2010, operations began on the NUR96H2 horizontal development well on the North Urtabulak Field. This well, which twinned a previous well that produced over 2,000 Bopd prior to a mechanical failure in that well, was drilled in the most prolific part of the reservoir. In February 2011, the Company announced the initial results of testing on the NUR96H2 horizontal development well at the North Urtabulak field in Uzbekistan. The well tested at over 1,100 Bopd and is on production. This well reached a total depth of 3,060 m (10,039 ft) with a producing section of 437 m (1,434 ft) of lateral hole within this section.

There are a number of other fields in the area and the Company is in discussions with Uzbekneftegas on possible participation in these. The Company opened a representative office in Tashkent and is discussing not only these projects but broader co-operation with Uzbekneftegas in both exploration and development in Uzbekistan.

**Uzbekistan MOU**

In September 2010, the Company signed a Memorandum of Understanding ("**MOU**") with the Uzbek State oil and gas company, National Holding Company "Uzbekneftegaz" ("**UNG**"). The MOU states that Tethys and UNG will conduct joint studies to determine the possibilities of improving hydrocarbon recovery on certain long-term production fields in the Republic of Uzbekistan in order to then sign a contract in accordance with the applicable legislation of the Republic of Uzbekistan.

The Company expects that such contract would be a similar contractual arrangement to the Production Enhancement Contract ("**North Urtabulak PEC**") that a subsidiary of the Company has over the North Urtabulak Field in Uzbekistan that has operated successfully for some 10 years. Under this contract, the Company's subsidiary is allocated refined products for the oil it produces and sells these on the export market in United States dollars.

**Transactions with Related Parties**

Vazon Energy Limited

Vazon Energy Limited ("Vazon") is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the year ended December 31, 2010 was $2,525,885 (2009 – $1,677,113).

Oilfield Production Consultants

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to compression optimization in Kazakhstan and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the year ended December 31, 2010 were $182,740 (2009 – $497,697).

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions.

## RISKS AND UNCERTAINTIES AND OTHER INFORMATION

Readers are encouraged to read and consider the risk factors described below and the risk factors and additional information regarding the Company, included in its 2010 Annual Information Form filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

### Financial Risk Management

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk, interest rate risk and foreign exchange. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

*Credit risk*

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's cash and cash equivalents and accounts receivable balances.

With respect to the Company's financial assets the maximum exposure to credit risk due to default of the counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is:

| | **Dec 31, 2010** | **Dec 31, 2009** |
|---|---|---|
| | **$** | **$** |
| Trade receivables | 1,661 | 905 |
| Cash and cash equivalents | 79,135 | 7,297 |
| Investments | 1,015 | 659 |
| Loan receivable from jointly controlled entity | 35,460 | 21,727 |
| | 117,271 | 30,588 |

Concentration of credit risk associated with the above trade receivable balances in Kazakhstan is as a result of contracted sales to two customers during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales in Kazakhstan commenced in December 2007 and the Company has not experienced any credit loss to date.

In Uzbekistan, the Company makes use of two customers. Full payment is in US Dollars and is required before delivery of the oil and therefore there is limited exposure to credit risk in this country.

Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss as the majority of the counterparties are banks with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors). Within the Central Asian countries banks with these ratings are generally not available.

The Company is exposed to credit risk in relation to its loan receivable from a jointly controlled entity to the extent that the jointly controlled entity fails to meet its contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loan receivable represents the maximum exposure to credit risk.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. Since inception, the Company has incurred significant consolidated losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2010.

The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets and forecasts, co-ordinating and authorizing project expenditures and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company may seek additional financing based on the results of these processes.

The timing of cash outflows relating to financial liabilities and commitments at the reporting date are summarized on page 15 above in *Contractual obligations and liabilities as at December 31, 2010.*

There can be no assurance that debt or equity financing will be available when required or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

*Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

The Company is exposed to interest rate risk on short term deposits to the extent that the significant reductions in market interest rates would result in a decrease in the interest earned by the Company and indeed this is what has happened in the last eighteen month period. In terms of the sums available for deposit a change of 1% in the interest rate would have been $207,746 in the current year (2009 - $ 38,250).

*Foreign exchange risk*

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions are denominated in a currency other than the US$. A significant portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. There is limited availability in exchange rate derivatives to manage exchange rate risks with these currencies and so the Company looks to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan. The Company also incurs expenditure in GBP on a regular basis and looks to manage this exchange rate at least in the short term by forward purchasing.

While the Company holds the majority of its cash and cash equivalents in U.S. dollars it does hold other balances, mainly British Pounds Sterling ("GBP") and Canadian dollars ("CDN"), to meet the requirements to fund ongoing general and administrative and other spending requirements in these currencies. In addition a significant portion of the funds received in the fund raising completed in 2010 were received in CDN. With regard to the GBP, had the $ changed by 10% at December 31, 2010 with all other variables held constant, the Company's foreign exchange gain or loss would have been affected by $101,000, for CDN had the $ changed by 10% the exchange gain or loss would have been affected by $120,000 and for the Kazakhstan Tenge (KZT) it would have been affected by $652,000. Please refer to *Note 3 of the 2010 audited consolidated financial statements*.

**Market risk**

Market risk is the risk of loss that may arise from changes in market factors such as marketability of production and commodity prices.

*Marketability of Production*

The marketability and ultimate commerciality of oil and gas acquired or discovered is affected by numerous factors beyond the control of the Company. These factors include reservoir characteristics, market fluctuations, the proximity and capacity of oil and gas pipelines and processing equipment and government regulation. Tethys produces gas into the transcontinental gas trunkline system which ultimately supplies gas to Russia and Europe. Political issues, system capacity constraints, export issues and possible competition with Russian gas supplies may in the future cause problems with marketing production, particularly for export. Oil and gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. Restrictions on the ability to market the Company's production could have a material adverse effect on the Company's revenues and financial position.

*Commodity price risk*

Oil and gas prices are unstable and are subject to fluctuation. Any material decline in natural gas prices could result in a reduction of the Company's net production revenue and overall value and could result in ceiling test write downs. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in the volumes and value of the Company's reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities. A substantial material decline in prices from historical average prices could reduce the Company's ability to borrow funds. As such, fluctuations in oil and gas prices could materially and adversely affect the Company's business, results of operation and prospects. There is no government control over the oil and gas price in the countries where the Company operates.

Although the Company believes that the medium to long term outlook for gas prices in the region is good, the recent fall in both prices and demand caused by the recent economic slowdown in Europe and the FSU and in particular the gas dispute between OAO GazProm and Ukraine described below has lead to significant uncertainties as to the price of and demand for Central Asian gas which may continue to have an impact on the pricing and demand for Kazakh gas in the short term.

The impact on demand for oil and gas of the economic downturn is not uniform. For example, demand has risen in China but fallen in the U.S. Also, there needs to be consideration of production and other factors such as OPEC, refinery shut-ins and inventory. Any discussion of price or demand is subjective and as such there are many differing opinions on the cause of recent price changes.

This impact of fluctuations in oil and gas prices in 2010 on the Company's operations was only evident in the operations in Uzbekistan. Production from both the Kyzyloi and Akkulka contracts in Kazakhstan are sold at fixed prices, at least until the end of 2012, and so the fluctuation in world commodity prices had no effect on the Company's monthly revenue from the Kazakh gas operations. In Uzbekistan, the Company sells refined petroleum products on a monthly basis, and the fall in the oil price in the first and second quarters of 2009 reduced monthly revenue. Should the oil production in Kazakhstan comes on stream in Q2 at a rate of 3,000-4,000 bopd as planned then a fall in oil prices will result in lower than anticipated revenue.

The Bukhara-Urals trunkline carries gas from Central Asia through Kazakhstan and into the Russian export system and consequently any problems would have adverse implications for the economy of Uzbekistan in particular and to a lesser extent the Russian and Kazakh economies, it is anticipated that there would be significant efforts to minimize any disruption in supply. Problems with closure of the pipeline and reduced production levels were encountered in both 2009 and 2010.

***Sensitivities***

The price of gas sales from gas produced from the Kyzyloi gas field under the Gas Supply Contract is fixed in US dollars until December 1, 2012 and the Akkulka gas field under the Gas Supply Contract is fixed in US dollars until September, 2012 and consequently there is no sensitivity to currency movements or market movements in the gas price.

The price of oil sales from the Doris discovery planned at 3,000-4,000 bopd (Phase 2) commencing in the second quarter of 2011 has yet to be agreed and therefore would be sensitive to movements in the market price. On a production level of 3,000 bopd a movement of $1 per barrel on the price received by the Company would result in a plus or minus movement in the sales revenue of $1,095,000.

The sales revenue in Uzbekistan is sensitive to fluctuations in the price of oil. At gross production levels of 1,250 bopd the movement of $1 per barrel on the price received by the company would result in a maximum plus or minus movement in the sales revenue of $228,125 per annum.

**Environmental**

The Company's operations are subject to environmental regulations in the jurisdictions in which it operates and the Company carries out its activities and operations in material compliance with all relevant and applicable environmental regulations and pursuant to best industry practices. In Kazakhstan, quarterly reports are required to be submitted by the Company to the Shalkar (Bozoi) Tax Committee. Payments due from the Company for 2010 amount to $444,000, which cover a payment per well on the Doris discovery, plus waste removal and gas firing. The Company is also required to prepare reports on any pollution of air, toxic waste and current expenses on environmental protection which have been made by the Company and which are submitted to the appropriate Kazakh authorities. Reports are submitted on a semi-annual basis for information purposes and no payments are applicable.

Under the Bokhtar PSC in Tajikistan, any Development Plan should include an abandonment and site restoration programme together with a funding procedure for such programme. All funds collected pursuant to the funding procedure should be allocated to site restoration and abandonment and be placed in a special interest bearing account by KPL which shall be held in the joint names of the State and KPL or their respective nominees, or its designee. KPL's responsibilities for environmental degradation, site restoration and well abandonment obligations, and any other actual contingent and potential activity associated with the environmental status of the Development Area shall be limited to the obligation to place the necessary funds in the approved account. In addition any relinquished areas must be brought into the same condition as they were prior to their transfer to KPL (soil fertility condition, quality of the ground and environment). All expenditures incurred in abandonment and site restoration are cost recoverable. An independent environmental base line study has been carried out on the Beshtentak oilfield.

Within the PEC in Uzbekistan in the event that the Company advises the Operating Committee that it no longer intends to perform any Operating Services on a well then it is required to plug and abandon such well at its own expense or the State gas company shall immediately assume responsibility for such well. In the latter such event the Company shall have no responsibility with regard to plugging and abandoning the well. While operating the well the Company is required to observe all environmental laws of the Republic of Uzbekistan.

At present, the Company believes that it meets all applicable environmental standards and regulations, in all material respects, and has included appropriate amounts in its capital expenditure budget to continue to meet its current environmental obligations.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The annual and interim consolidated financial statements of the Company are prepared in accordance with International Financial Reporting Standards ("IFRSs") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations issued by the International Accounting Standards Boards ("IASB").

Please refer to the annual consolidated financial statements for the year ended December 31, 2010 Note 2 *Summary of Significant Accounting Policies* for details of the Company's accounting policies.

Changes in accounting policy and disclosures.

*(a) New and amended standards adopted by the Company*

The following new and amended accounting standards are mandatory and relevant for the Company for the first time for these financial statements:

- IFRS 3 'Business Combinations' - the Company has adopted the revised version of this standard, with effect from January 1 2010. The revised standard still requires the purchase method of accounting to be applied to business combinations but introduces some changes to the accounting treatment. Assets and liabilities arising from business combinations that occurred before January 1, 2010 were not required to be re-stated and thus there was no effect on the company's reported income or net assets on adoption.

- IAS 27 'Consolidated and Separate Financial Statements' - the Company has adopted the amended version of IAS 27, also with effect from January 1, 2010. This requires the effects of all transactions with minority interests to be recorded in equity if there is no change in control. When control is lost, any remaining interest in the entity is re-measured to fair value and a gain or loss recognized in profit or loss. There was no effect on the Company's reported income or net assets on adoption.

- IAS 38 'Measurement of non-current assets (or disposal groups) classified as held for sale' – the Company has adopted the amendment to this standard, with effect from January 1, 2010, which clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination and it permits grouping of intangible assets as a single asset if each asset has similar useful economic lives. There was no effect on the Company's reported income or net assets on adoption.

*(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company*

- IFRS 9 'Financial instruments' – issued in November 2009. This standard is the first step in the process to replace IAS39, 'Financial instruments: recognition and measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets, which may affect the Company's accounting for its financial assets. The standard is not applicable until January 1 2013 but is available for early adoption. The Company is yet to assess the full impact of IFRS 9.

**Fair value estimation**

Effective January 1, 2009, the Company adopted the amendment to IFRS 7 for financial instruments that are measured in the reporting date at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities. The Company does not have any assets or liabilities that require Level 1 inputs.

Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly. For the Company, Level 2 inputs include prices that can be corroborated with other observable inputs for substantially the complete term of the contract.

Level 3: Unobservable inputs. The Company does not use Level 3 inputs for any of its recurring fair-value measurements.

As at December 31, 2010 the Company's only financial liabilities measured at fair value on a recurring basis were the warrant liability and interest rate swap described in Note 18 of the audited consolidated financial statements for 2010, the measurement inputs of which is designated as Level 2 and Level 3 respectively.

At December 31, 2010, the interest rate swap described in Note 18 is classified as Level 3 in the fair value hierarchy. The inputs required to measure the fair value of the interest rate swap include production and price assumptions that are reliant on adjustments or interpolation made by management to an otherwise standard valuation model. A reconciliation from the beginning balance to the ending balance of the interest rate swap has been included at Note 18 of the audited consolidated financial statements.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of Tethys are responsible for establishing and maintaining internal control over financial reporting ("ICFR") as that term is defined in National Instrument 52-109 – Certification of Disclosure in Annual and Interim Filings. The CEO and the CFO of Tethys are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with IFRS.

Management of Tethys has designed and implemented, under the supervision of its CEO and CFO, a system of internal controls over financial reporting as of December 31, 2010 which it believes is effective for a company of its size. Management of Tethys has not identified any material weaknesses relating to the design of the internal controls over financial reporting as at December 31, 2010. The Company's control system and procedures are reviewed periodically and adjusted or updated as necessary. In addition where any new or additional risks have been identified then the management of Tethys has put in place appropriate procedures to mitigate these risks.

Under the supervision of the CEO and the CFO, an evaluation was conducted on the effectiveness of internal control over financial reporting based on "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2010. While no material weaknesses relating to the design of the Company's system of ICFR or relating to the Company's operations as at December 31, 2010 were identified a revised copy of the Company's accounting policy was issued. A new self assessment control process was introduced which will be tested in 2011.

## DISCLOSURE CONTROLS AND PROCEDURES

The CEO and the CFO are responsible for establishing and maintaining disclosure controls and procedures (DC+P) as that term is defined in NI 52-109. Disclosure controls and procedures have been designed by the Tethys Management, under the supervision of the CEO and CFO, to ensure that information required to be disclosed by the Company is accumulated, recorded, processed and reported to the Company's management as appropriate to allow timely decisions regarding disclosure.

**FORWARD-LOOKING STATEMENTS**

In the interest of providing Tethys' shareholders and potential investors with information regarding the Company and its subsidiaries, including management's assessment of Tethys' and its subsidiaries' future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively referred to herein as "forward-looking statements") within the meaning of the "safe harbour" provisions of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project", "prognosed" or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements in this MD&A include, but are not limited to, statements with respect to: the projected 2011 capital investments projections, and the potential source of funding therefore; drilling targets and objectives. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks, uncertainties and assumptions include, among other things: volatility of and assumptions regarding oil and gas prices; fluctuations in currency and interest rates; ability to successfully complete required equity or debt financings if any; product supply and demand; market competition; ability to realise current market gas prices; risks inherent in the Company's and its subsidiaries' marketing operations, including credit risks; imprecision of reserve estimates and estimates of recoverable quantities of oil and natural gas and other sources not currently classified as proved; the Company's and its subsidiaries' ability to replace and expand oil and gas reserves; unexpected cost increases or technical difficulties in constructing pipeline or other facilities; unexpected delays in its drilling operations; delays in the delivery of its drilling rigs; unexpected difficulties in, transporting oil or natural gas; risks associated with technology; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and the costs of well and pipeline construction; the Company's and its subsidiaries' ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; political and economic conditions in the countries in which the Company and its subsidiaries operate; the risk of international war, hostilities, civil insurrection and instability affecting countries in which the Company and its subsidiaries operate and terrorist threats; risks associated with existing and potential future lawsuits and regulatory actions made against the Company and its subsidiaries; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Tethys.

With regard to forward looking information contained in this MD&A, the Company has made assumptions regarding, amongst other things, the continued existence and operation of existing pipelines; future prices for natural gas; future currency and exchange rates; the Company's ability to generate sufficient cash flow from operations and access to capital markets to meet its future obligations; the regulatory framework representing mineral extraction taxes, royalties, taxes and environmental matters in the countries in which the Company conducts its business: gas production levels; and the Company's ability to obtain qualified staff and equipment in a timely and cost effective manner to meet the Company's demands that the Company expects to apply to MOG for a construction contract; that the China gas pipeline will become operational in 2013; that the Company will be able to achieve its capital expenditure plans; that China's projected increase in gas demand will potentially increase gas prices; that Central Asian gas prices will increase; that the approval of the Pilot Production Scheme could result in additional oil production in Kazakhstan and further work on the Company's existing and potential assets in Uzbekistan could help strengthen cash flow; that the Company plans to expand its program of radial drilling on additional deposits; the Company's expectation that the contract contemplated by the MOU with UNG will be similar to the North Urtabulak PEC contract; the Company's expectations with respect to gas prices and demand. Statements relating to "reserves" or "resources" or "resource potential" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described exist in the quantities predicted or estimated, and can be profitably produced in the future. Although Tethys believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A, and except as required by law Tethys does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

## SECTION C

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED 31 DECEMBER 2009

*The following is the full text of the "Management's Discussion and Analysis for the year ended December 31, 2009, which was filed on 31 March 2010 with the Securities Commissions in Ontario, British Columbia and Alberta and the Authorité de Marchés Financiers du Qúebec.*

**TETHYS PETROLEUM LIMITED**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**for the year ended December 31, 2009**

## Summary of Annual Results

(All references to $ are United States dollars unless otherwise noted)
(Tabular amounts are in thousands, unless otherwise stated.)

| **Summary of Annual Results**<br>($000s, except where noted) | **2009** | **2008** | **2007** |
|---|---|---|---|
| **Revenue** | 8,559 | 5,360 | 194 |
| **Net Loss** | (21,720) | (22,184) | (41,779) |
| **Basic and diluted loss ($) per share** | (0.20) | (0.40) | (1.26) |
| | | | |
| **Capital expenditure** | 32,221 | 42,807 | 23,001 |
| **Total Assets** | 137,082 | 113,548 | 71,656 |
| **Long Term Liabilities** | (17,100) | (6,084) | (1,437) |
| **Cash and working capital surplus/(deficit)** | (157) | 21,343 | 25,773 |
| | | | |
| **Common shares outstanding** | | | |
| Basic | 134,554,769 | 66,393,292 | 45,116,696 |

*Note. The 2007 comparative figures in the table above have been prepared under US GAAP while the 2008 and 2009 figures comply with IFRS requirements.*

The following Management's Discussion and Analysis ("MD&A") is dated March 31, 2010 and should be read in conjunction with the Company's audited Consolidated Financial Statements and related notes for the year ended December 31, 2009. The accompanying financial statements of the Company have been prepared by management and approved by the Company's Audit Committee and Board of Directors. These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. Additional information relating to the Company can be found on the SEDAR website at *www.sedar.com*. Readers should also read the "Forward-Looking Statements" legal advisory contained at the end of this MD&A and also the Company's AIF.

## IFRS accounting

The Accounting Standards Board ("AcSB") confirmed in February 2008 that International Financial Reporting Standards ("IFRS") will be used for Canadian publicly accountable enterprises for financial periods beginning on and after January 1, 2011. As a foreign issuer, Tethys elected early adoption for periods beginning January 1, 2009, with a transition date of January 1, 2008 and consequently prepared its first interim consolidated financial statements in accordance with IFRS for the three month period ended March 31, 2009. The audited consolidated financial statements for the year ended December 31, 2009 are the Company's first set of annual consolidated financial statements prepared under IFRS as issued by the International Accounting Standards Board. For all accounting periods prior to March 31, 2009 the Company prepared its financial statements under accounting principles generally accepted in the United States of America ('US GAAP'). *See Changes to Accounting Policies on page 22*

Highlights and Significant Transactions

- The Company completed the acquisition of BHCL in Uzbekistan on April 9, 2009 in exchange for 15 million shares. This acquisition resulted in revenue of $4,731,000 being recorded in 2009.
- On June 19, 2009 the Company completed a public offering raising gross proceeds of $20,000,000 (net proceeds to the Company were $17,906,000 after deduction of transaction fees).
- An extension to the Akkulka Exploration Contract to March 2011 was approved by the Kazakhstan authorities on December 9, 2009.
- On December 24, 2009, final governmental approval was received for the Akkulka Gas Production Contract (Phase 2 of the Kyzyloi/Akkulka gas development) giving TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years.
- On October 19, 2009, the Company executed a project financing in the amount of $4.1 million for drilling a new development well by BHCL at the North Urtabulak Oil Field in Uzbekistan and then in December 2009 executed an agreement with Cornhill Capital and Cornhill Capital Asset Management Limited for the provision of up to $3 million of debt finance by way of the issuance by the Company of unsecured discounted loan notes.( All funds had been received by the date of this MD&A.)
- On December 19, 2009, the Company signed a private placement agreement to issue 10 million Ordinary Shares to two investors at $0.50 per Share for proceeds of $5 million. The said Ordinary Shares were issued on January 4, 2010. The proceeds of the private placing is to be used to fund the Company's drilling activities and for general corporate purposes for project development and capital expenditures.
- On December 22, 2009 the Company announced that the lower zone of the AKD01 Exploration well in Kazakhstan had flowed at over 2,800 barrels per day ("bpd"), with 1,373 barrels of oil per day ("bopd") after acidisation. Further testing was ongoing. (*See "Outlook" where well in February 2010 flowed in excess of 6,800 barrels per day.)*
- On December 30, 2009, final agreement was reached on the joint venture relating to the Company's Tajik projects, previously announced in December 2007. As a result the Company's interests in Tajikistan have been transferred to Seven Stars Energy Corporation ("SSEC") in which Tethys holds a 51% interest with its Tajik partner holding the remaining 49%. SSEC will be financed through a loan from Tethys and managed by Tethys in accordance with the terms of a shareholders' agreement.
- The gas production in Kazakhstan was significantly lower than anticipated due to closures in the Bukhara Urals pipeline at the beginning and end of the year together with a period of reduced production in the middle of the year as a result of problems further up the pipeline.
- Capital expenditure of $32,221,000 was incurred in the twelve months to December 31, 2009 compared to $42,807,000 for the same period in 2008.

**Nature of Business**

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") are headquartered in Guernsey, British Isles. The domicile of Tethys Petroleum Limited was moved from Guernsey, British Isles, to the Cayman Islands on July 17, 2008, where it is incorporated. Tethys is an oil and gas company operating within the Republic of Kazakhstan, Republic of Uzbekistan and the Republic of Tajikistan. Tethys' principal activity is exploration for and production of crude oil and natural gas.

**Financial and Operational Review**

**Kyzyloi Gas Production**

| | 2009 | | 2008 | | Change |
|---|---|---|---|---|---|
| | Mcm | Mcf | Mcm | Mcf | % |
| Three months to March 31 | 15,602 | 550,907 | 44,985 | 1,588,420 | (65) |
| Three months to June 30 | 36,809 | 1,299,726 | 51,002 | 1,800,881 | (28) |
| Three months to September 30 | 38,755 | 1,368,440 | 48,003 | 1,694,986 | (19) |
| Three months to December 31 | 27,766 | 980,418 | 28,521 | 1,007,077 | (3) |
| Annual production | 118,932 | 4,199,491 | 172,511 | 6,091,364 | (31) |

- On January 5, 2006 Tethys' Kazakh subsidiary, TAG, executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from TAG's Kyzyloi field in Kazakhstan at an agreed price of $32 per thousand cubic metres ("Mcm") or $0.90 per thousand cubic feet ("Mcf") excluding value added tax ("VAT").
- In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP ("KNK"), who utilise the gas in the domestic Kazakh market.
- On May 1, 2009, this contract was further assigned to Asia Gas NG LLP.
- The Gas Supply Contract, which has a term until the earlier of December 1, 2012, the date on which all contracts and licences pursuant to which the gas to be delivered under the Gas Supply Contract terminate, or when 850 thousand cubic metres (Mcm) (approximately 30 billion cubic feet ("Bcf")) has been delivered, is based on a take–or–pay principle and covers all gas produced from the Kyzyloi Field Licence and Production Contract area up to termination.
- Production was initially from six wells but during the course of 2009 a further two wells were added.
- To the end of Q4 2009 some 297,567 Mcm (approximately 10.5 Bcf) or 35% of the maximum contract volume under the Gas Supply Contract had been delivered.
- In an independent reserve report prepared by McDaniel & Associates as at December 31, 2009 the projected Proved plus Probable reserves to the end of field life for the Kyzyloi field was 1,080,320 Mcm (approximately 38.146 Bcf).
- The Bukhara Urals pipeline, through which the gas output flows, was closed for the period November 28, 2008 to March 5, 2009 and again from November 24, 2009. Additionally from the middle of May 2009 because of restrictions further up in the Bukhara-Urals Gas line the Kyzyloi gas output was temporarily reduced to approximately half of its full production capacity. Full production did not recommence until August 1, 2009. These closures and production restrictions explain the reduced production achieved in 2009.

**Uzbekistan Oil Production (North Urtabulak PEC)**

| | Total Production | | BHCL Share | |
|---|---|---|---|---|
| | Tonnes | Barrels* | Tonnes | Barrels* |
| Three months to March 31 , 2009 | 20,909 | 149,499 | 10,454 | 74,746 |
| Three months to June 30, 2009 | 22,755 | 162,698 | 11,377 | 81,346 |
| Three months to September 30, 2009 | 24,697 | 176,584 | 12,349 | 88,295 |
| Three months to December 3, 2009 | 21,710 | 155,227 | 10,855 | 77,613 |
| Annual production | 90,071 | 644,008 | 45,035 | 322,000 |

** using 7.15 barrels = 1 tonne*

- The Company acquired BHCL with effect from April 9, 2009 and so had no rights to the production prior to that date. Production is under a Production Enhancement Contract ("PEC") for the North Urtabulak oilfield with subsidiaries of the Uzbek State oil and gas company NHC Uzbekneftefgas. The Q1 figures are provided to give complete figures for the year.
- Drilling of a new well, NUR116, commenced in November 2009. Production commenced in March 2010.
- Production in Q4 2009was less than in Q3 2009 mainly because of increased watercut in wells, drop in volumes of fluid produced and workovers like acid jobs and water shutoffs.

**Revenue**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Gas Sales | 907 | 878 | 3% | 3,828 | 5,360 | -29% |
| Refined Products sales | 1,900 | 0 | 100% | 4,731 | 0 | 100% |

- The gas sales are generated from the Kyzyloi contract in Kazakhstan and as referred to in *Kyzyloi Gas Production* above are sold to KNK at an agreed price of $32 per Mcm ($0.90 per Mcf) excluding VAT.
- Gas sales in Q4 2009 were much the same as Q4 2008 but 29% down on the year because of the stoppages and production restrictions detailed in *Kyzyloi Gas Production* above.
- The Refined product sales are the result of oil production in Uzbekistan which the Company only acquired in April 2009 and so there is no prior year data.

**Production expenses**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Production costs | 1,416 | 797 | 78% | 3,405 | 1,334 | 155% |

- Kazakhstan production costs to December 31, 2009 were $1,092,000 ($9.18 per Mcm or $0.26 per Mcf) compared to $1,334,000 ($7.73 per Mcm or $0.22 per Mcf) in 2008. The unit figures are somewhat distorted due to the periods when the field was shut in as most of the operating costs are fixed.
- Uzbekistan production costs to December 31, 2009 were $2,313,000 ($3.59 per barrel).
- Production costs in the three months to December 31, 2009 were $243,000 for Kazakhstan and $1,173,000 in Uzbekistan.
- The Q4 2008 Kazakhstan figure included work done on two wells in the Kyzyloi field in anticipation of them commencing production in early 2009 plus $312,000 of costs directly attributable to the Akkulka contract, encompassing well insurance and property tax.

**Depreciation, depletion and amortization expense**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| DD & A costs | 203 | 725 | -72% | 3,238 | 4,333 | -25% |

- The primary reason that the 2009 DD&A charge is less than that for 2008 is that production in Kazakhstan in 2009 was down by 29% on that for 2008 and DD&A for producing Kazakhstan gass fields is calculated on a unit of production basis.
- The high level of inventory being held in Uzbekistan at December 31, 2009 reduced the DD&A charge for Uzbekistan.

**Exploration and evaluation expenditure**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Exploration and evaluation | 747 | 1,951 | -62% | 887 | 2,292 | -61% |

- The exploration costs written off in 2009 consist primarily of work done on a number of wells in Tajikistan..
- The exploration costs written off in 2008 consisted of various pre-contract costs plus two wells on the Kul-Bas contract.

**Listing costs**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Listing costs | 1,652 | 0 | 100% | 1,652 | 0 | 100% |

- These are legal and costs that relate to the planned possible secondary listing of the Company's ordinary shares on the Hong Kong Stock Exchange.

**Administrative expenses**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Gen admin & selling costs | 4,519 | 3,874 | 17% | 14,252 | 13,496 | 6% |
| Stock based compensation | 240 | 764 | -69% | 2,628 | 4,419 | -41% |
| | 4,759 | 4,638 | -3% | 16,880 | 17,915 | -6% |

- Staff expenses were up on 2009 as a result of new costs in both of the new Uzbekistan subsidiariesBHCL and Tethys Uzbekistan B.V. plus some additional costs in the parent company and Asia Oilfield Equipment BV (AOE) that own and leases the rigs and drilling equipment to other subsidiaries.

- Travel costs were down in 2009 compared to 2008.
- Other costs including office costs and professional fees showed a slight increase on 2008 because of the new operating companies in Uzbekistan.
- Stock based compensation expenses relate to stock options and warrants. The calculation of this non-cash expense is based on the fair value of stock options and warrants granted, amortised over the vesting period of the option or warrant.

**Finance expenses**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Foreign exchange loss | 122 | 1,669 | -93% | 2,397 | 3,060 | -22% |
| Fair value (gain)/loss on derivative financial instruments | 258 | (271) | -195% | 479 | (929) | -152% |
| Loss from jointly controlled entity | 1,000 | - | 100% | 1,000 | - | 100% |
| Interest | (201) | (391) | -49% | 203 | 371 | -45% |

- The foreign exchange loss in 2009 was primarily the result of the movement in the Kazakhstan Tenge against the $ as opposed to 2008 when the loss was caused by the movement of the $ against the Euro and the Canadian dollar (CD$). In February 2009, the Kazakhstan central bank took the decision to stop supporting the Tenge against the $ and the rate moved from approximately KZT123 to KZT150 to the $. At the end of 2009 the rate was KZT148 to the $.
- The Fair Value gain or loss on derivative financial instruments reflects the movement in the fair value of warrants issued by the Company that are denominated in a currency other than the Company's functional currency for financial reporting purposes..
- Loss from the jointly controlled joint venture represents the Company's 51% share in the loss incurred by SSEC.
- Interest charges include historical costs interest.

**Taxation**

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Taxation | (214) | 0 | 100% | (214) | 0 | 100% |

Tethys is domiciled in the Cayman Islands which has no Company income tax.

The Company's deferred tax liability relates to the Uzbekistan operation. There are sufficient loss carry forwards in Kazakhstan and Tajikistan that no deferred tax liability has been provided in relation to those countries.

### Capital Expenditure

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | Change | **2009** | 2008 | Change |
| Kazakhstan | 2,080 | 10,411 | -80% | 8,553 | 21,604 | -60% |
| Tajikistan | 4,911 | 430 | 1,042% | 16,942 | 2,633 | 543% |
| Uzbekistan | 2,482 | - | 100% | 3,709 | - | 100% |
| Corporate and other | (605) | 4,709 | - | 3,017 | 18,570 | -84% |
| | 8,868 | 15,550 | -43% | 32,221 | 42,807 | -25% |

Major items of capital expenditure in 2009 were:

*Kazakhstan*

- Akkulka deep exploration well (AKD01) $4,650,000
- Phase 2 compressor station $1,040,000
- Seismic costs and drilling in Kul-Bas $750,000

*Tajikistan*

- Seismic exploration in $6,600,000
- Komsomolsk appraisal well (KOM200) $6,887,000
- Well rehabilitation and workovers $2,000,000
- East Olimtoi (EOL09) exploration well $625,000
- Transportation $550,000

*Uzbekistan*

- Well workovers $1,650,000
- Initial payment for drilling new NUR116 development well $2,000,000

*Corporate and other*

- Ancillary rig equipment $633,000
- Progress payment on ZJ30 rig $2,384,00

### Summary of Quarterly Results

The 2009 comparative figures in the table below have been prepared under IFRS while the 2008 figures have been restated to comply with IFRS requirements.

| | **March 31 2008** | **June 30 2008** | **Sept 30 2008** | **Dec 31 2008** | **March 31 2009** | **June 30 2009** | **Sept 30 2009** | **Dec 31 2009** |
|---|---|---|---|---|---|---|---|---|
| **Financials** ($000's) | | | | | | | | |
| Revenue | 1,431 | 1,566 | 1,485 | 878 | 529 | 2,797 | 2,426 | 2,807 |
| Net loss | (4,611) | (5,023) | (4,964) | (7,645) | (6,016) | (5,594) | (3,946) | (6,166) |
| Basic and diluted loss ($) per share | (0.10) | (0.11) | (0.07) | (0.13) | (0.09) | (0.06) | (0.03) | (0.05) |
| Capital Expenditure | 3,541 | 9,565 | 14,152 | 15,085 | 10,237 | 4,778 | 8,337 | 8,868 |
| Total Assets | 82,043 | 124,968 | 119,326 | 113,548 | 108,201 | 127,577 | 124,627 | 137,082 |
| Total long Term Liabilities | 5,960 | 5,611 | 5,413 | 6,084 | 5,595 | 5,299 | 4,997 | 18,345 |
| Cash and working capital surplus | 22,824 | 56,719 | 36,598 | 21,343 | 7,947 | 17,351 | 6,369 | (157) |

Significant factors influencing quarterly results

There were stoppages in Kyzyloi gas production in the quarters ending December 31, 2008, March 31, 2009 and December 31, 2009 plus a period of reduced production in the quarters ending June 30, and September 30, 2009.

The BHCL operation in Uzbekistan was acquired by the Company in April 2009.

The Company raised $50,000,000 (gross) in June 2008 and $20,000,000 (gross) in June 2009.

In Q4 2009 the long term liabilities include a new loan for $4,100,000, a deferred gain of $3,657,000 following the transfer of the Tajikstan subsidiaries and $3,750,000 received in anticipation of the private placement completed on January 4, 2010.

**Financial position**

The significant movements in the balance sheets were as follows:

| | **Dec 31, 2009** | **Dec 31, 2008** | **Movement** | **Movement Details** |
|---|---|---|---|---|
| Intangible assets | 24,378 | 16,105 | 8,273 | Purchase of the PEC in Uzbekistan plus expenditure on the Kul Bas contract plus the drilling of the Akkulka deep well less transfer of Tajikistan costs to the Joint Venture. |
| Property, plant and equipment | 73,171 | 65,422 | 7,749 | Phase 2 compressor station in Kazakhstan plus purchase of coiled tubing unit and stage payments on the drilling rigs less depreciation. |
| Non-current other receivables | 5,171 | 6,357 | (1,186) | Primarily because of the movement in VAT balance (including the impact of the exchange movement between the $/Kazak Tenge) plus part of contractors prepayments balance being transferred to P,P&E on completion of work on the compressor station. |
| Loan receivable from joint controlled entity | 21,727 | - | 21,727 | Loan due from SSEC |
| Inventories | 2,368 | 213 | 2,155 | Build up in the stock in Uzbekistan that had yet to be delivered to customers. |
| Cash and cash equivalents | 7,297 | 22,200 | (14,903) | See cash flow statement |
| Share capital | 167,203 | 145,237 | 21,966 | Public offering in June 2009, the acquisition of BHCL for shares and the issue of shares as part purchase of a coiled tubing unit. |
| Other reserves | 27,775 | 25,147 | 2,628 | Stock based compensation expense in 2009. |
| Accumulated deficit | (88,374) | (66,654) | (21,720) | Loss incurred in year to December 31, 2009 |

| | | | | |
|---|---|---|---|---|
| Deferred gain on of assets to jointly controlled venture | 3,659 | - | 3,659 | Gain on sale of assets to SSEC |
| Non-current financial liabilities - borrowings | 9,324 | 5,096 | 4,228 | Receipt of loan associated with new well in Uzbekistan less capital repayments on ZJ70 drilling rig ("Telesto") loan plus part of ZJ30 drilling rig ("Tykhe") loan moving to current liabilities. |
| Advanced Equity Subscriptions | 3,750 | - | 3,750 | Funds received in advance of January 2010 completion of a $5 million private placement. |
| Deferred taxation | 598 | - | 598 | Deferred tax liability at December 31, 2009 |
| Non - current Trade and other payables | 808 | 523 | 285 | Historic costs now includes Akkulka in addition to Kyzyloi after issue of the Akkulka Production Contract. |
| Financial liabilities - borrowings. | 1,086 | 853 | 233 | Impact of part of capital of loan on the Tykhe rig now due in less than twelve months. |
| Warrants | 1,053 | 146 | 907 | Movement in the liability following issue of CD$ warrants in connection with short term loan. |
| Deferred revenue | 3,113 | - | 3,113 | BHCL figures including $3.1 million of cash paid but delivery not completed. |
| Trade and other payables | 6,786 | 2,735 | 4,051 | Inclusion of BHCL figures but build up of liabilities in line with company growth. |

**Contractual obligations and liabilities as at December 31, 2009 ($,000)**

| **Contractual Obligations** | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 1 - 3 Years | 4 - 5 Years | After 5 years |
| Long term debt | $10,410,000 | $1,086,000 | $9,324,000 | - | - |
| Operating leases | $778,000 | $415,000 | $363,000 | - | - |
| Trade and other payables | $7,594,000 | $6,786,000 | $808,000 | - | - |
| Purchase obligations | $8,563,000 | $5,790,000 | $173,000 | $2,600,000 | - |
| Joint venture purchase commitments | $2,137,000 | $2,137,000 | - | - | - |
| Total contractual obligations | $29,482,000 | $16,214,000 | $10,668,000 | $2,600,000 | - |

The Company is confident that it will satisfy these commitments in full.

**Liquidity and Capital Resources**

As at December 31, 2009, the Company had a working capital deficit of $157,000 while at December 31, 2008 it was a working capital surplus of $21,343,000. Subsequent to December 31, 2009 the Company took the following actions which resulted in a significant improvement in its liquidity position:

- The private placement of 10 million shares for gross proceeds of $5,000,000 of which $3,750,000 had been received before December 31, 2009 was successfully completed in January 2010.
- A second private placement was successfully completed in January 2010 consisting of 12,615,000 shares for gross proceeds of $10,000,000.
- A further private placement was completed in March 2010 consisting of 30,000,000 shares for gross proceeds CD$46,500,000.

Capital Management

The Company's capital structure is comprised of shareholders' equity and debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its expenditures on commitments from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

The Company is engaged in acquiring properties and exploring for crude oil and natural gas but it does not as yet have sufficient revenue generating activities to fund all of the Company's commitments. The Company is therefore required to fund a significant portion of its commitments from existing cash and cash equivalent balances or seek additional financing through debt issuances or equity markets.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Debt levels are monitored by using the non-GAAP financial metric of Net Debt to Book Capitalisation. Net Debt is calculated as the sum of long term debt balances (including the current portion) less the balance of cash and cash equivalents. The Net Debt at December 31, 2009 was $3,113,,000 and Net Debt to Capitalisation was 2%.

**Set out below is a comparison of the actual use of funds to date and remaining to be expended against what was projected in the prospectus dated June 18, 2007.**

The primary differences were in relation to:

- No suitable property with proven reserves has yet been identified for acquisition although the Company continues to look for suitable opportunities.

| | Per June 18, 2007 Prospectus | Incurred To Dec 31, 2009 | To be Spent |
|---|---|---|---|
| *Kazakhstan* | | | |
| Shallow drilling plan, compressors for Phase 2, exploration well, acquisition opportunities, Aral Vostochniy and well workovers | 28,000 | 28,010 | - |
| New projects | 5,000 | - | - |
| *Tajikistan* | | | |
| Seismic surveys, well rehabilitation and Olimtoi exploration well | 7,500 | 7,225 | 275 |
| Repayment of Short Term Loan | 5,000 | 5,000 | - |
| Working Capital | 500 | 500 | - |
| | 46,000 | 40,735 | 275 |

**Set out below is a comparison of the actual use of funds to date and remaining to be expended against what was projected in the prospectus dated June 19, 2008.**

The primary differences were in relation to:

- The purchase of two drilling rigs and associated equipment.
- Further drilling and related equipment was purchased for use on the shallow drilling and production programme in Kazakhstan and in Tajikistan.
- Unplanned expenditure on a supply and storage base at Bozoi, Kazakhstan, and additional capital spares.
- Although new projects have been considered none has yet been considered suitable.

| | Per June 19, 2008 Prospectus | Incurred to Dec 31, 2009 | To be Spent |
|---|---|---|---|
| *Kazakhstan* | | | |
| Shallow Wells and Tie-Ins, deep well, additional seismic and infrastructure | 28,100 | 14,000 | 14,100 |
| *Tajikistan* | | | |
| Horizontal drilling, seismic, deepening potential gas exploration well plus infrastructure | 8,415 | 7,642 | 773 |
| Drilling rigs plus ancillary equipment | 5,000 | 17,663 | - |
| New Projects | 3,500 | 500 | - |
| Working Capital and General Corporate Purposes | 1,385 | 1,385 | - |
| | 46,400 | 41,190 | 14,873 |

**Set out below are details of the planned use of funds to as detailed in the prospectus dated June 11, 2009.**

The primary differences were in relation to:

- The Komsomolsk well, KOM200, encountered unexpected drilling challenges and is costing more than was anticipated and is not yet completed. As a result the processing plant has not yet been constructed and well KOM201 not drilled.
- The new North Urtabulak well was drilled on a turnkey contract with 50% payment at the beginning of the contract and the other 50% due on completion. A decision on installation of the Gas Lift Compression system is waiting on completion of the current dynamic field model.

| | **Per June 12, 2009 Prospectus** | **Incurred to Dec 31, 2009** | **To be Spent** |
|---|---|---|---|
| *Tajikistan* | | | |
| East Komsomolsk - KOM 200 appraisal well Phase 1 | 3,500 | 3,500 | - |
| Infrastructure - Komsomolsk gas Processing plant Phase 1 | 2,000 | - | 2,000 |
| East Komsomolsk - well KOM 201 Phase 2 | 3,500 | - | 3,500 |
| Additional seismic on Bokhtar PSC | 3,660 | - | 3,660 |
| *Uzbekistan* | | | |
| North Urtabulak Gas Lift Compression System | 1,190 | - | 1,190 |
| North Urtabulak new well. | 4,000 | 2,000 | 2,000 |
| | 17,850 | 5,500 | 12,350 |

**Stockholder Equity**

As at March 31, 2010 the Company had authorized share capital of 700,000,000 Ordinary Shares of which 187,169,769 had been issued and 50,000,000 preference shares of which none had yet been issued. The preference shares have the rights as set out in the Memorandum and Articles of Association approved at the AGM on April 24, 2008.

On December 21, 2009 the Company announced that it would complete a non-brokered private placement of 10,000,000 Ordinary Shares for gross proceeds of US$5 million subject to regulatory approval. The sum of $3,750,000 was received in December 2009 with the balance of $1,250,000 received in January 2010. The Ordinary Shares were placed at a price of US$0.50 (CAD$0.53) each. The placement was completed in January 2010.

On January 11, 2010 the Company further announced that it would complete a non-brokered private placement of 12,615,000 Ordinary Shares for gross proceeds of US$10 million subject to regulatory approval. The Ordinary Shares were placed at a price of CAD$0.82 each. The placement was completed in January 2010.

On February 12, 2010 the Company announced an additional private placement of 30,000,000 Ordinary Shares for gross proceeds of CAD$46.5 million subject to regulatory approval. The Ordinary Shares were placed at an average price of CAD$1.55 each. The placement was completed on March 2, 2010.

As at December 31, 2009 a total of 24,489,455 (December 31, 2008 – 18,311,596) ordinary shares were reserved under the Company's Long Term Stock Incentive Plan and Warrants granted by the Company. Details of the options and warrants are given in note 8 to the Audited consolidated financial statements for the period ended December 31, 2009.

At the AGM held on May 7, 2009 a resolution was passed whereby the number of shares which are reserved for issuance under the Stock Incentive Plan was altered to 12% of the number of Ordinary Shares outstanding at the time of the grant of options rather than the fixed figure of 7,511,760 shares.

**OUTLOOK**

In previous MD&A's it was stated that Management had reviewed the impact of the recent significant changes in the world economic situation, including the significant decline in energy prices and the decline in the market price for the Company's shares, on its current and planned projects and that it had no plans to curtail any project that had commenced in the course of 2009 or that were included in the commitment capital expenditure listings above, following this assessment. Following the fund raising completed on June 19, 2009 the focus of the short-term capital expenditure programs had remained on both meeting the expenditure plans set out in the short form prospectus issued on June 11, 2009 and on development and production enhancement projects that will enhance short to medium term cash flow.

The Akkulka Production Contract was finally approved by the Kazakhstan authorities in December 2009 and the Company believes that when Phase 2 gas from Akkulka comes on stream then together with the Kyzyloi production and the PEC in Uzbekistan it will be in a position to finance its minimum work programme and operating and G&A costs from these operations. However in order not only to maintain the Company's current capacity but to meet the Company's planned growth objectives, which include funding planned development activities, the Company would require additional capital. Possible sources of funding include an issue of new shares, including the possibility now being pursued of a possible secondary listing on the Hong Kong Stock Exchange.

The Company is aware, particularly in the current market conditions, that there can be no assurances that the equity or debt financing would be available when required or available on terms that is acceptable to the Company and its shareholders. While the funds raised in the first quarter of 2010 enable the Company to pursue its existing plans, in the longer term the inability of the Company to access sufficient capital for its growth objectives would impact on the Company's preferred planned growth targets.

While the Company acknowledges that current market conditions are undoubtedly more challenging than in previous years it believes that there remain fund raising opportunities that it could pursue to fund growth objectives which the Company believes could add additional cash flow.

The Company is actively seeking partners in certain projects, preferably strategic partners who may bring capital into specific projects, or purchase significant interests in existing projects and assist the Company in building its business in Central Asia. Farm outs and possible asset sales are also being considered as part of an overall strategy to balance risk and optimise the Company's portfolio in order to bring available capital to bear on the most significant projects. No agreements have been entered into as at the date of this MD&A.

Following the announcement on February 8, 2010 that the testing of the Akkulka exploration well AKD01 had flowed oil at a combined rate in excess of 6,800 barrels per day the Company outlook changed, with what might potentially be a significant oil discovery. On February 12, 2010 the Company announced a private placement of 30 million shares raising CD$46.5 million and then on February 23, 2010 the Company announced that it now planned to drill at least two appraisal wells on the AKD01 (now named "Doris") oil discovery to evaluate and establish the size and potential of the discovery and provide the necessary data to obtain a production contract. These wells will be extensively evaluated with coring, detailed geophysical logging and testing. A further appraisal well may also be drilled if deemed necessary after evaluating the results of the first two wells. In addition TAG plans to carry out a 3D seismic survey over the Doris discovery and shoot additional targeted 2D seismic lines to firm up further potential in the area. TAG has issued tenders for both the drilling and seismic acqusition and received a number of tender bids. The drilling contractor has now been selected and the first appraisal well (AKD02) is expected to commence drilling in April 2010. The seismic programme is also expected to commence in Q2 2010 and will be targeted to provide additional data for the second appraisal well which should commence drilling in the summer.

The Company has identified several other prospects in the area which appear similar to the Doris oil discovery and now that a hydrocarbon system has been proven at the deeper levels the risk on these prospects is reduced significantly. Tethys demobilised its ZJ70 rig "Telesto" from the AKD01 location and is mobilising the rig to a prospect located in a similar structural position to the southwest which has been named "Dione". This well is expected to commence operations in late April and is planned to target the Cretaceous, Jurassic, Triassic and Permo-Carboniferous intervals. Further exploration drilling on other identified prospects in the area is then planned.

In Tajikistan, the Company has now commenced oil production from the Beshtentak field and is carrying out further work aimed at increasing this production. The Komsomolsk KOM200 gas appraisal well reached the top of the Jurassic sequence. However the drillstring then became stuck, probably due to differential pressures, and to date the Company has not been successful in retrieving the string. Hydrocarbons were indicated both whilst drilling and on electric logs, and an open hole flowback test was carried out which resulted in a stable gas flow, albeit accompanied by water from water bearing zones in the large open hole section. Work is now underway on preparations for a possible sidetrack of this well as well as the possibility of drilling a new well (KOM201) to the north east of KOM200. Work on the East Olimtoi exploration well EOL09 is currently suspended whilst additional equipment is mobilised to Tajikistan to continue drilling to the target zone which is some 1,000 metres (3,280 feet) from the current depth. Recent seismic data has confirmed the exploration potential of this prospect which the Company regards as a possible high impact well if successful. The Company is continuing with its seismic survey programme in Tajikistan with the aim of identifying other targets and is looking at other drilling possibilities. As stated above the Company is actively seeking partners in certain projects, preferably strategic partners, and has begun a farm-out process with respect to certain of its Tajik assets having opened a data room for interested parties.

In Uzbekistan the Company has now drilled a new development well, NUR116, which is currently producing and contributing to an average gross production in March 2010 for the PEC of 1,860 bopd. A dynamic field reservoir model is now close to completion and based on this a more optimised field development will be planned. Further drilling opportunities are being explored together with a programme of acidisation and radial drilling to further enhance existing production. The Company is looking at other opportunities in Uzbekistan, both in additional field redevelopment and in exploration but these are subject to reaching agreement with the Uzbek government on such projects.

Farm outs (such as the possible farm out of certain of the Company's Tajik assets) and possible asset sales are also being considered as part of an overall strategy to balance risk and optimise the Company's portfolio in order to bring available capital to bear on the most significant projects.

**Sensitivities**

The price of gas sales from gas produced from the Kyzyloi gas field under the Gas Supply Contract is fixed in US dollars until December 1, 2012 and consequently there is no sensitivity to currency movements or market movements in the gas price. The price of Phase 2 gas sales from gas produced from the Akkulka Block has yet to be agreed and therefore could be sensitive to movements in the market price of gas.

The sales revenue in Uzbekistan is sensitive to fluctuations in the price of oil. At gross production levels of1,860 bopd the movement of $1 per barrel on the price received by the company would result in plus or minus movement in the sales revenue of $339,450 per annum.

## Transactions with Related Parties

Vazon Energy Limited ("Vazon") is a corporation organised under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the year ended December 31, 2009 was $1,677,113 (2008 – $1,405,028).

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to the optimisation of compression on Kyzyloi and Akkulka .[and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the year ended December 31, 2009 were US$497,697 (2008 – $422,770).

Kraken Financial Group (KFG) had a common director with the Company up until 1 September 2009. In 2008, KFG was engaged by the Company to assist in obtaining loan financing in relation to the purchase of both Telesto and Tykhe drilling rigs. As a result of the services provided in connection with the Telesto transaction, KFG received 6% commission of the funds it was responsible for introducing to the Company. This commission was to be taken in the form of 81,477 shares, which were issued in 2009 amounting to $234,000 (which had been recognised as a liability at the end of 2008). No further services were provided by KFG during 2009 (December 31, 2008 - $21,000).

During the year ended December 31, 2008, KFG had acted as broker for Tethys in the placement of various insurance policies, including Directors and Officers, for which the combined annual premiums were $112,615. This service was not provided in 2009.

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions.

## Financial Risk Management

The Company's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

Summarized below are risks which may be material to the Company's future performance. See also "*Risks and Uncertainties*".

## Financial risk factors

*Credit risk*

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's cash and cash equivalents and accounts receivable balances.

With respect to the Company's financial assets the maximum exposure to credit risk due to default of the counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is:

| | December 31 2009 $ | December 31 2008 $ |
|---|---|---|
| Trade receivables | 905 | 1,124 |
| Cash and cash equivalents | 7,297 | 22,200 |
| Investments | 659 | 587 |
| Loan receivable from jointly controlled entity | 21,727 | - |
| | 30,588 | 23,911 |

Concentration of credit risk associated with the above trade receivable balances in Kazakhstan is as a result of contracted sales to only one customer during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales in Kazakhstan commenced in December 2007 and the Company has not experienced any credit loss to date. At December 31, 2009 the trade receivable amounted to $905,000, none of which was greater than 60 days overdue. The Company has therefore not recorded a provision against this amount as it does not consider the balance to be impaired.

In Uzbekistan, the Company makes use of five customers. Full payment is required before delivery of the oil and therefore there is limited exposure to credit risk in this country.

Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss as the counterparties are banks with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors).

The Company is exposed to credit risk in relation to its loan receivable from a jointly controlled entity to the extent that the jointly controlled entity fails to meet its contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loan receivable represents the maximum exposure to credit risk.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. Since inception, the Company has incurred significant consolidated losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2009.

The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets, co-ordinating and authorizing project expenditures and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company seeks additional financing based on the results of these processes.

The timing of cash outflows relating to financial liabilities and commitments at the reporting date are summarized on page 10 above in *Contractual obligations and liabilities as at December 31,2009.*

There can be no assurance that debt or equity financing will be available or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

*Market risk*

Market risk is the risk of loss that may arise from changes in market factors such as commodity prices, interest rate and foreign exchange rates.

*Commodity price risk*

Commodity price risk arises from the effect that fluctuations of future commodity process may have on the price received for sales of gas and refined oil products. The marketability and price of natural gas and oil that is produced and may be discovered by the Company will be affected by numerous factors that are beyond the control of the Company.

Natural gas prices are subject to wide fluctuations, the Company has entered into a fixed price contract for sales of gas from the Kyzyloi field. However, any material decline in natural gas prices could result in a reduction of Tethys' future net production revenues and impact on the commercial viability of the Company's existing and future oil and gas discoveries. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in volumes and the value of Tethys' gas reserves, if the Company elected not to produce from certain wells at lower prices.

Any material decline in refined oil product prices could result in a reduction of the Company's Uzbekistan net production revenue.

All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities.

*Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

The Company is exposed to interest rate risk on short term deposits to the extent that the significant reductions in market interest rates would result in a decrease in the interest earned by the Company. A change of 1% in the interest rate would have had an immaterial change in the interest earned both in the current or prior year.

As at the reporting date the Company's interest rate profile was:

| | Fixed rate financial instruments | Floating rate financial instruments | **Total** |
|---|---|---|---|
| At December 31, 2009 | **$** | **$** | **$** |
| Cash and cash equivalents | - | 7,297 | 7,297 |
| Financial liabilities - borrowings | 10,410 | - | 10,410 |
| Interest rate swap | 95 | - | 95 |
| | 10,505 | 7,297 | 17,802 |

| At December 31, 2008 | Fixed rate financial instruments<br>$ | Floating rate financial instruments<br>$ | Total<br>$ |
|---|---|---|---|
| Cash and cash equivalents | 1,832 | 20,368 | 22,200 |
| Financial liabilities - borrowings | 5,949 | - | 5,949 |
| | 7,781 | 20,368 | 28,149 |

*Foreign exchange risk*

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions denominated in a currency other than the US dollar. In addition, a significant portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. The Company is not currently using exchange rate derivatives to manage exchange rate risks but is attempting to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan.

The Company holds the majority of its cash and cash equivalents in US dollars. However, the Company does maintain deposits in other currencies, as disclosed in the following table, in order to fund ongoing general and administrative activity and other expenditure incurred in these currencies.

The carrying amounts of the Company's significant foreign currency denominated monetary assets and liabilities at the reporting dates are as follows:

| **In US$ equivalent 2009** | **CAD** | **GBP** | **EUR** | **SOMONI** | **KZT** |
|---|---|---|---|---|---|
| Cash and cash equivalents | 52 | 132 | 83 | 11 | 187 |
| Trade and other receivables | - | 34 | 2 | - | 5,393 |
| Trade and other payables | (35) | (318) | - | - | (561) |
| Financial liabilities - borrowings | - | (383) | - | - | - |
| **Net exposure** | **17** | **(535)** | **85** | **11** | **5,019** |

| **In US$ equivalent 2008** | **CAD** | **GBP** | **EUR** | **SOMONI** | **KZT** |
|---|---|---|---|---|---|
| Cash and cash equivalents | 3,514 | 2,859 | 162 | 19 | 193 |
| Trade and other receivables | - | - | - | - | 5,967 |
| Trade and other payables | (40) | (240) | (5) | - | (344) |
| Financial liabilities - borrowings | - | (365) | - | - | - |
| **Net exposure** | **3,474** | **2,254** | **157** | **19** | **5,816** |

The following table details the Company's sensitivity to a 10% weakening in US dollars against the respective foreign currencies, which represents management's assessment of a reasonable change in foreign exchange rates.

| | CAD | GBP | EUR | SOMONI | KZT |
|---|---|---|---|---|---|
| **2009 Effect in US$'000** | | | | | |
| Profit or (loss) before tax | - | (20) | 10 | - | 500 |
| | | | | | |
| **2008 Effect in US$'000** | | | | | |
| Profit or (loss) before tax | 340 | 260 | 20 | - | 580 |

A 10% weakening of the US dollar against the currencies above at December 31, 2009 would have had an equal but opposite effect on the amounts shown above, assuming all other variables remained constant.

**Capital risk management**

The Company's capital structure is comprised of shareholders' equity and debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its expenditures on commitments from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt.

| At December 31 | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Total financial liabilities - borrowings (Note 17) | 10,410 | 5,949 |
| Less: cash and cash equivalents | (7,297) | (22,200) |
| Net debt / (funds) | 3,113 | (16,251) |
| Total equity | 167,203 | 145,237 |
| **Total capital** | 170,316 | 128,986 |

The Company is not currently subject to any externally imposed capital restrictions.

### Fair value estimation

Effective January 1, 2009, the Company adopted the amendment to IFRS 7 for financial instruments that are measured in the reporting date at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities. The Company does not have any assets or liabilities that require Level 1 inputs.

Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly. For the Company, Level 2 inputs include prices that can be corroborated with other observable inputs for substantially the complete term of the contract.

Level 3: Unobservable inputs. The Company does not use Level 3 inputs for any of its recurring fair-value measurements.

As at December 31, 2009 the Company's only financial liabilities measured at fair value on a recurring basis were the warrant liability and interest rate swap described in Note 17, the measurement inputs of which is designated as Level 2 and Level 3 respectively.

At December 31, 2009, the interest rate swap described in Note 17 is classified as Level 3 in the fair value hierarchy. The inputs required to measure the fair value of the interest rate swap include production and price assumptions that are reliant on adjustments or interpolation made by management to an otherwise standard valuation model. A reconciliation from the beginning balance to the ending balance of the interest rate swap has been included at Note 17 of the audited consolidated financial statements.

## RISKS AND UNCERTAINTIES AND OTHER INFORMATION

Readers are encouraged to read and consider the risk factors and additional information regarding the Company, included in its 2009 Annual Information Form filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com

### Environmental

The Company's operations are subject to environmental regulations in the jurisdictions in which it operates and the Company carries out its activities and operations in material compliance with all relevant and applicable environmental regulations and pursuant to best industry practices. In Kazakhstan, quarterly reports are required to be submitted by the Company to the Shalkar (Bozoi) Tax Committee. Payments made by the Company to date have been very small. The Company is also required to prepare reports on any pollution of air, toxic waste and current expenses on environmental protection which have been made by the Company and which are submitted to the appropriate Kazakh authorities. Reports are submitted on semi-annual basis for information purposes and no payments are applicable.

Under the Bokhtar PSC in Tajikistan, any Development Plan shall also include an abandonment and site restoration programme together with a funding procedure for such programme. All funds collected pursuant to the funding procedure shall be allocated to site restoration and abandonment and will be placed in a special interest bearing account by KPL which shall be held in the joint names of the State and KPL or their respective nominees, or its designee. KPL's responsibilities for environmental degradation, site restoration and well abandonment obligations, and any other actual contingent and potential activity associated with the environmental status of the Development Area shall be limited to the obligation to place the necessary funds in the approved account. In addition any relinquished areas must be brought into the same condition as they were prior to their transfer to KPL (soil fertility condition, quality of the ground and environment). All expenditures incurred in abandonment and site restoration are cost recoverable. An independent environmental base line study has been carried out on the Beshtentak oilfield.

Within the PEC in Uzbekistan in the event that the Company advises the Operating Committee that it no longer intends to perform any Operating Services on a well then it is required to plug and abandon such well at its own expense or the State gas company shall immediately assume responsibility for such well. In the latter such event the

Company shall have no responsibility with regard to plugging and abandoning the well. While operating the well the Company is required to observe all environmental laws of the Republic of Uzbekistan.

At present, the Company believes that it meets all applicable environmental standards and regulations, in all material respects, and has included appropriate amounts in its capital expenditure budget to continue to meet its environmental obligations.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements for the year ended December 31, 2009 have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee (IFRC) are in accordance with IFRS 1 - First-time Adoption of IFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

Please refer to the audited consolidated financial statements for the year ended December 31, 2009 Note 2 *Summary of Significant Accounting Policies* for details of the Company's accounting policies and to Note 26 Transition to IFRS for the reconciliations of the changes resulting from this transition. See also *Changes to Accounting Policies* below.

The following is a discussion of those accounting policies and estimates that are considered critical in the determination of the Company's financial results.

### Financial instruments

Financial assets and financial liabilities are recognised on the Company's statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognised when the contractual rights to the cashflows from the financial asset expire or when the contractual rights to those assets are transferred. Financial liabilities are de-recognised when the obligation specified in the contract is discharged, cancelled or expired.

*Investments*
Investments comprise restricted current balances that are held on deposit with banks in the Republic of Kazakhstan in respect of the Company's asset retirement obligations (ARO) in this country and are classified as non-current. They are carried at fair value with gains or losses taken to the statement of comprehensive loss.

*Trade receivables, loans and other receivables*
Trade receivables, loans and other receivables, which are non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the reporting date, which are classified as non-current assets. The Company's loans and receivables comprise trade and other receivables in the statement of financial position.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method, net of any impairment.

A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 60 days overdue) are considered indicators that the trade receivable is impaired.

The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the statement of comprehensive loss. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables.

*Cash and cash equivalents*
Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. These are carried at fair value with gains or losses recognized through statement of comprehensive loss.

*Financial liabilities - borrowings*
Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of comprehensive loss when the liabilities are derecognised as well as through the amortisation process.

*Trade payables*
Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are measured at amortised cost using the effective interest method.

*Equity instruments*
Equity instruments issued by the Company are recorded at the proceeds received net of direct issue costs.

*Derivative financial instruments*
Derivative financial instruments are initially recognized at fair value on the date a derivative contract was entered into and are subsequently remeasured at their fair value with changes in the fair value immediately recognised in the statement of comprehensive loss.
Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract. Contracts are assessed for embedded derivatives when the Company becomes a party to them, including at the date of a business combination.

*Derivative contracts qualifying for the 'own-use' treatment*
An 'own-use' contract is one that was entered into and continues to be held for the purpose of the receipt or delivery of the non financial item in accordance with the entity's expected purchase, sale or usage requirements. Contracts that are for the Company's own use are exempt from the requirements of IAS39.

**Inventories**
Inventories consist of refined oil products, spare parts and consumable materials and are shown at the lower of cost and net realisable value. Cost is determined on a weighted average cost method for refined oil products and the first-in-first-out method for spare parts and consumable materials inventories.

**Taxation including deferred taxation**
The tax expense represents the sum of current tax expense and deferred tax.

Current tax expense is based on the taxable profits for the year. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss. Deferred income tax assets are recognised to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilised, otherwise a valuation allowance is provided for deferred tax assets if management consider it is more likely than not that these items will either expire before the Company is able to realise the benefit, or that future deductibility is uncertain.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred tax asset is realised or the deferred income tax liability settled.

**Share–based payments**

The Company operates a number of equity-settled, share-based compensation plans, under which the entity receives services from employees as consideration for equity instruments (options and warrants) of the Company. The fair value of the employee options and warrants granted in exchange for the employee services, is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted, excluding the impact of any non-market service and performance vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. When options vest in instalments over the vesting period, each instalment is accounted for as a separate arrangement. At each reporting date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the statement of comprehensive loss, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital when the options are exercised.

**Provisions**

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. The increase in the provision due to passage of time is recognised as interest expense.

**Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of natural gas and oil products in the ordinary course of the Company's activities and is recognized when the amount can be reliably measured, it is probable that future economic benefits will flow to the entity, and when specific criteria have been met for each of the Company's activities as described below. Revenue is shown after eliminating sales within the Company.

Revenue from natural gas sales is recognized when the gas has been lifted and the risk of loss transferred to a third-party purchaser and is shown net of royalties, Mineral Extraction Tax (MET) and value-added tax. Revenue from refined product sales is recognized upon delivery and is shown net of value-added tax. All payments received before delivery are recorded as deferred revenue until delivery has occurred.

The Company recognises finance income earned on the Company's cash and cash equivalents and short term investments on an accrual basis.

**Barter transactions**

Where goods or services are exchanged for goods or services of a dissimilar nature, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of cash or cash equivalents received or paid. If the fair value of the goods or services received cannot be reliably measured, the revenue is measured at the fair value of the goods or services given up, again adjusted by the amount of cash or cash equivalents received.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying capital asset or project under construction are capitalised and added to the asset or project cost during construction until such time as the asset or project is substantially ready for its intended use. Where funds are specifically borrowed to finance an asset or project, the amount capitalised represents the actual amount of borrowing cost incurred. Where funds used to finance an asset or project form part of general borrowings, the amount capitalised is calculated by using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

**Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

**Business combinations**

Business combinations are accounted for using the purchase method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose identified according to operation segment.

**Fair value**

The fair value of investments, accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the short term maturity of the instruments. Long term debt and other non-current liabilities have been recorded at amortised cost using the effective interest rate method.

**Segment reporting**

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

**Foreign currency translation**

The consolidated financial statements are presented in US Dollars, which is the Company's functional and reporting currency.

All monetary assets and liabilities denominated in foreign currencies are translated into US dollars at the rate of exchange in effect at the balance sheet date. Non-monetary assets are translated at historical exchange rates.

Revenue and expense items (excluding depreciation and amortisation which are translated at the same rates as the related assets) are translated at the average rate of exchange.

Exchange gains and losses arising on translation are taken to the statement of comprehensive loss.

**Oil and gas exploration and evaluation expenditure**
Oil and natural gas exploration and evaluation expenditures are accounted for using a modified 'successful efforts' method of accounting. Costs are accumulated on a field-by-field basis. Exploration and evaluation expenditures, including license acquisition costs, are capitalised as exploration and evaluation assets when incurred. Expenditure directly associated with an exploration well is capitalised until the determination of reserves is evaluated. If reserves are not identified, these costs are charged to expense. All other associated exploration and evaluation expenditures are carried forward as an asset in the balance sheet where the rights of tenure of the property are current and it is considered probable that the costs will be recouped through successful development of the property, or alternatively by its sale. Capitalised exploration and evaluation expenditure is written down to its recoverable amount where the above conditions are no longer satisfied.

If it is determined that a commercial discovery has not been achieved in relation to the property, all other associated costs are written down to their recoverable amount. If commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development tangible and intangible assets. No depreciation and/or amortisation is charged during the exploration and evaluation phase.

**Oil and gas properties**

Oil and gas properties are stated at cost, less accumulated depreciation and accumulated impairment losses.

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalised within oil and gas properties, as long as the facts and circumstances indicate that the field has commercially viable reserves.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the asset retirement obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within property, plant and equipment.

Where commercial production in an area of interest has commenced, oil and gas properties are depreciated on a unit-of-production basis over the proved and probable reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proved and probable reserves of the relevant area. The unit-of-production rate for the amortisation of field development costs takes into account expenditures incurred to date, together with future development expenditure to develop the proved and probable reserves. Changes in factors such as estimates of proved and probable reserves that affect unit-of-production calculations do not give rise to prior year financial period adjustments and are dealt with on a prospective basis.

**Other property, plant and equipment**
Property, plant and equipment are carried at cost less accumulated depreciation. Depreciation is charged so as to write off the cost of these assets less residual value over their estimated useful economic lives, for the following classes of assets:

| | |
|---|---|
| Drilling rigs and related oil and gas equipment | Unit of production 3,650 days operating days |
| Smaller rig related equipment | Straight line 6 – 8 years |
| Motor vehicles | Straight line 4 years |
| Computer equipment | Straight line 3 years |
| Office equipment | Straight line 5 years |

**Reserve Estimates**
The Company engaged McDaniel to evaluate the Company's oil and natural gas reserves in Kazakhstan. For Tajikistan, the Company engaged TRACS to evaluate its oil and natural gas reserves attributable to Beshtentak and Komsomolsk fields, located within the Tajikistan Contract Area. In connection therewith, McDaniel and TRACS

prepared independent evaluations of the Company's natural gas reserves in respect of Kazakhstan and Tajikistan. For Kazakhstan, the Statement of Reserves Data and Other Oil and Gas Information was prepared on and is dated March 17, 2010 (the "Kazakh Statement"). The effective date of the Kazakh Statement is December 31, 2009. For Tajikistan, the Statement of Reserves Data and Other Oil and Gas Information was prepared on and is dated March 24, 2010 (the "Tajik Statement"). The effective date of the Tajik Statement is December 31, 2009. The Kazakh Statement and Tajik Statement have been prepared in accordance with NI 51-101.

The process of estimating reserves requires significant judgment based on available geological, geophysical, engineering, and economic data, projected rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to interpretation and uncertainty. Reserve estimates can impact net Revenue through depletion expense and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on net Revenue and can impact the carrying amount of capital assets.

**Business Combinations**

Business combinations are accounted for using the purchase method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Goodwill represents the excess of the cost of an acquisition over the fair value of the group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose identified according to operating segment.

**Intangible assets**

**Production enhancement contracts**

Production enhancement contracts are stated at cost less accumulated amortisation and have a finite useful life. Amortization is calculated using a unit-of-production basis over the estimated incremental production entitlement expected to be received over the life of the contract.

**Impairment of non-financial assets**

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

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

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the income statement so as to reduce the carrying amount to its recoverable amount (i.e. the higher of fair value less cost to sell and value in use).

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

**Asset retirement obligation (ARO)**

Provision is made for the present value of the future cost of abandonment of oil and gas wells and related facilities. This provision is recognised when a legal or constructive obligation arises.

The estimated costs, based on engineering cost levels prevailing at the reporting date, are computed on the basis of the latest assumptions as to the scope and method of abandonment. Provisions are measured at the fair value of the expenditures expected to be required to settle the obligation using a pre-tax rate, updated at each reporting date that reflects current market assessments of the time value of money and the risks specific to the obligation. The corresponding amount is capitalised as part of exploration and evaluation expenditure or oil and gas properties and is amortised on a unit-of-production basis as part of the depreciation, depletion and amortisation charge. Any adjustment arising from the reassessment of estimated cost of ARO is capitalised, whilst the charge arising from the accretion of the discount applied to the ARO is treated as a component of finance costs.

**Changes in accounting policy and disclosures**

*(a)Recent and amended standards adopted by the Company*

The following new and amended accounting standards are mandatory and relevant for the Company for the first time for the financial year beginning January 1, 2009:

- IFRS 7 'Financial instruments – Disclosures' (amendment). This amendment requires enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy.

- IFRS 8, 'Operating segments'. IFRS 8 replaces IAS 14, 'Segment reporting'. It requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes.

- IAS 23 (amendment), 'Borrowing costs' requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs has been removed. This has no impact on the Company as its policy has always been to capitalise borrowing cost on qualifying assets.

- IFRS 2 (amendment), 'Share-based payment'. The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amended standard does not have a material impact on the Company's financial statements.

*(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company*

The following standards and amendments to existing standards have been published and are mandatory for the Company's accounting periods beginning on or after January 1, 2010 or later periods:

- IFRS 2, 'Share-based payments' – provides further guidance on determining the classification of share based payment awards in consolidated and separate financial statements and is linked to the application of IFRS 3 (revised). The amendments are effective for annual periods beginning on or after July 1, 2009. The amendment will not result in a material impact on the Company's financial statements.
- IFRS 3 (revised) 'Business combinations' is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after July 1, 2009.

  The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the statement of comprehensive loss. There is a choice on an acquisition-by-acquisition basis to measure the minority interest in the acquiree either at fair value or at the minority interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. The Company will apply IFRS 3 (revised) to all business combinations from January 1, 2010.
- IFRS 8, 'Operating Segments' which provides further requirements for disclosure of information about segment assets and is effective for periods beginning on or after January 1, 2010 has no impact on disclosure of segment assets currently reported by the Company.
- IFRS 9, 'Financial Instruments' was issued in November 2009 as the first step in its project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets that must be applied starting January 1, 2013, with early adoption permitted. The IASB intends to expand IFRS 9 during the intervening period to add new requirements for classifying and measuring financial liabilities, de-recognition of financial instruments, impairment and hedge accounting. The Company is currently assessing the impact of this standard.
- IAS 27 (revised) 'Consolidated and Separate Financial Statements'; requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies when control is lost. Any remaining interest in the entity is remeasured to fair value, and a gain or loss is recognised in profit or loss. The Company will apply this standard prospectively to transactions with non-controlling interests from January 1, 2010. The amendment will not result in a material impact on the Company's financial statements.
- IAS 38 (amendment), 'Measurement of non-current assets (or disposal groups) classified as held-for-sale'. The amendment is part of the IASB's annual improvements project published in April 2009 and the Company will apply IAS 38 (amendment) from the date IFRS 3 (revised) is adopted. The amendment clarifies guidance in measuring fair value of an intangible asset acquired in a business combination and it permits the grouping of intangible assets as a single asset if each asset has similar

useful economic lives. The amendment will not result in a material impact on the Company's financial statements.

- IFRIC 17, 'Distributions of non-cash assets to owners', clarifies how an entity should measure distributions of assets, other than cash, when it pays dividends to its owners and is effective for annual periods beginning on or after July 1, 2009. The amendment will not result in a material impact on the Company's financial statements.

**Explanation of transition to IFRS**

The consolidated financial statements for the year ended December 31, 2009 are the Company's first financial statements prepared under IFRS. For all accounting periods prior to this, the Company prepared its financial statements under generally accepted accounting principles in the United States of America ('US GAAP'). In accordance with IFRS 1 'First time adoption of IFRS', certain disclosures relating to the transition to IFRS are given in this note. These disclosures are prepared under IFRS as set out in the basis of preparation in note 2 of the audited consolidated financial statements.

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

**IFRS 3 Business combinations**

This standard has not been applied to acquisitions of subsidiaries that occurred before January 1, 2008 the Company's transition date.

**IFRIC 1 Changes in existing decommissioning, restoration and similar liabilities**

The Company has elected to apply exemption from full retrospective application of Asset retirement obligations as allowed under IFRS 1. As such the Company has re-measured the provisions as at January 1, 2008 [2009?] under IAS 37, estimated the amount to be included in the cost of the related asset by discounting the liability to the date at which the liability first arose using best estimates of the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation, and recalculated the accumulated depreciation, depletion and amortisation under IFRS.

Please refer to Note 26 in the audited consolidated financial statements for the year ended December 31, 2009 for US GAAP to IFRS reconciliations.

**Accounting systems**
The Company makes use of Sun Systems accounting software package to meet its accounting requirements. This is a well established package which will enable the Company to meet all of the accounting requirements under IFRS.

**INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of Tethys are responsible for establishing and maintaining internal control over financial reporting (ICFR) as that term is defined in National Instrument 52-109 – Certification of Disclosure in Annual and Interim Filings. The CEO and the CFO of Tethys are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with IFRS.

Management of Tethys has designed and implemented, under the supervision of its CEO and CFO, a system of internal controls over financial reporting as of December 31, 2009 which it believes is effective for a company of its size. There were no changes in Tethys' internal control over financial reporting that occurred during the year ended December 31, 2009 that has materially affected or that is reasonably likely to affect, Tethys' control over financial reporting. The Company's control system and procedures are reviewed periodically and adjusted or updated as necessary. In addition where any new or additional risks have been identified by Company personnel then the management of Tethys has put in place appropriate procedures to mitigate these risks.

Under the supervision of the CEO and the CFO, an evaluation was conducted of the effectiveness of internal control over financial reporting based on "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2009. No material weakness relating to the design of the Company's system of ICFR or relating to the Company's operations as at December 31, 2009 have been identified.

## DISCLOSURE CONTROLS AND PROCEDURES

The CEO and the CFO are responsible for establishing and maintaining disclosure controls and procedures (DC+P) as that term is defined in NI 52-109. Disclosure controls and procedures have been designed by the Tethys Management, under the supervision of the CEO and CFO, to ensure that information required to be disclosed by the Company is accumulated, recorded, processed and reported to the Company's management as appropriate to allow timely decisions regarding disclosure. The Company's CEO and CFO have concluded, based on their evaluation as of the end of the period covered by this MD&A, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the company, including its consolidated subsidiaries, is communicated to them as appropriate to allow timely decisions regarding required disclosure.

An evaluation was performed under the supervision of the CEO and CFO, of the effectiveness of the Company's disclosure controls as defined in Multilateral Instrument 52-109. Based on that evaluation the CEO and CFO concluded that the design and operation of the Company's disclosure controls and procedures were effective as at December 31, 2009.

## FORWARD-LOOKING STATEMENTS

In the interest of providing Tethys' shareholders and potential investors with information regarding the Company and its subsidiaries, including management's assessment of Tethys' and its subsidiaries' future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively referred to herein as "forward-looking statements") within the meaning of the "safe harbour" provisions of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project" or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements in this MD&A include, but are not limited to, statements with respect to: the projected 2010 capital investments projections, and the potential source of funding therefor. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks, uncertainties and assumptions include, among other things: volatility of and assumptions regarding oil and gas prices; fluctuations in currency and interest rates; ability to successfully complete proposed equity financings; product supply and demand; market competition; ability to realise current market gas prices; risks inherent in the Company's and its subsidiaries' marketing operations, including credit risks; imprecision of reserve estimates and estimates of recoverable quantities of oil and natural gas and other sources not currently classified as proved; the Company's and its subsidiaries' ability to replace and expand oil and gas reserves; unexpected cost increases or technical difficulties in constructing pipeline or other facilities; unexpected delays in its drilling operations; delays in the delivery of its drilling rigs; unexpected difficulties in, transporting oil or natural gas; risks associated with technology; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and the costs of well and pipeline construction; the Company's and its subsidiaries' ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; political and economic conditions in the countries in which the Company and its subsidiaries operate; the risk of international war, hostilities, civil insurrection and instability affecting countries in which the Company and its subsidiaries operate and terrorist threats; risks associated with existing and potential future lawsuits and regulatory actions made against the Company and its subsidiaries; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Tethys.

With regard to forward looking information contained in this MD&A, the Company has made assumptions regarding, amongst other things, the continued existence and operation of existing pipelines; future prices for natural gas; future currency and exchange rates; the Company's ability to generate sufficient cash flow from operations and access to capital markets to meet its future obligations; the regulatory framework representing mineral extraction taxes, royalties, taxes and environmental matters in the countries in which the Company conducts its business: gas production levels; and the Company's ability to obtain qualified staff and equipment in a timely and cost effective manner to meet the Company's demands. Statements relating to "reserves" or "resources" or "resource potential" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described exist in the quantities predicted or estimated, and can be profitably produced in the future. Although Tethys believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A, and except as required by law Tethys does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

## PART 5 - FINANCIAL INFORMATION

## FINANCIAL INFORMATION FOR THE THREE FINANCIAL YEARS ENDED 31 DECEMBER 2008, 2009 AND 2010 AND THE THREE MONTHS ENDED 31 MARCH 2011

***The financial statements and audit reports contained in this Part 5 have been reproduced without adjustment from those public reports previously published by the Company and filed with SEDAR which can be located at the Company's website www.tethyspetroleum.com.***

## SECTION A

## INTERIM CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED 31 MARCH 2011 (UNAUDITED)

# Tethys Petroleum Limited

Interim Consolidated Financial Statements
(Unaudited)
**March 31, 2011**

# Tethys Petroleum Limited

Consolidated Statement of Financial Position

(Unaudited)

(in USD dollars)

| | | As at | |
|---|---|---|---|
| | | **March 31, 2011** | **December 31, 2010** |
| | **Note** | **$'000** | **$'000** |
| **Non-current assets** | | | |
| Property, plant and equipment | 7 | 122,250 | 115,653 |
| Intangible assets | 8 | 18,738 | 16,892 |
| Investments | | 1,017 | 1,015 |
| Prepaids and other receivables | | 14,937 | 12,320 |
| Loan receivable from jointly controlled entity | 9 | 38,179 | 35,460 |
| | | 195,121 | 181,340 |
| **Current assets** | | | |
| Inventories | | 2,452 | 2,121 |
| Trade and other receivables | | 3,230 | 3,680 |
| Cash and cash equivalents | | 57,400 | 79,135 |
| Derivative financial instruments – interest rate swap | | 1,274 | 1,472 |
| | | 64,356 | 86,408 |
| **Total assets** | | 259,477 | 267,748 |
| **Equity attributable to shareholders** | | | |
| Share capital | 11 | 26,063 | 26,063 |
| Share premium | 11 | 297,222 | 297,222 |
| Other reserves | | 35,555 | 34,261 |
| Accumulated deficit | | (124,318) | (118,023) |
| **Total equity** | | 234,522 | 239,523 |
| **Non-current liabilities** | | | |
| Deferred gain on sale of assets to jointly controlled entity | | 3,699 | 3,699 |
| Financial liabilities - borrowings | 10 | 1,950 | 2,853 |
| Deferred taxation | 5 | 3,956 | 4,070 |
| Trade and other payables | | 679 | 721 |
| Asset retirement obligations | | 208 | 192 |
| | | 10,492 | 11,535 |
| **Current liabilities** | | | |
| Financial liabilities - borrowings | 10 | 6,005 | 5,047 |
| Derivative financial instruments - warrants | | 214 | 405 |
| Deferred revenue | | 27 | 2,450 |
| Trade and other payables | | 8,217 | 8,788 |
| | | 14,463 | 16,690 |
| **Total liabilities** | | 24,955 | 28,225 |
| **Total shareholders' equity and liabilities** | | 259,477 | 267,748 |
| Commitments and contingencies | 14 | | |

The notes on pages 1 to 14 form part of these interim consolidated financial statements. The interim consolidated financial statements were approved by the Board on May 13, 2011 and were signed on its behalf.

*Dr. D. Robson* Director *B. Murphy* Director

# Tethys Petroleum Limited

## Consolidated Statement of Comprehensive Loss

(Unaudited)
For the three months ended March 31
(in US Dollars)

| | Note | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|---|
| Sales and other operating revenues | | 4,480 | 2,116 |
| Finance income | | 32 | 3 |
| Total revenue and other income | | 4,512 | 2,119 |
| Production expenditures | | (1,752) | (974) |
| Depreciation, depletion and amortization | | (2,612) | (692) |
| Listing expenses | | (6) | (626) |
| Administrative expenses | | (6,484) | (4,775) |
| Foreign exchange gains (net) | | 200 | 14 |
| Fair value loss on derivative financial instrument | | (8) | (2,501) |
| Loss from jointly controlled entity | | (209) | (150) |
| Finance costs | | (39) | (321) |
| **Loss before taxation** | | (6,398) | (7,906) |
| Taxation | 5 | 103 | (93) |
| **Net loss and comprehensive loss for the period attributable to shareholders** | | (6,295) | (7,999) |
| **Loss per share attributable to shareholders** | | | |
| Basic and diluted | 6 | (0.02) | (0.05) |

No dividends were paid or are declared for the period (2010 – $Nil).

The notes on pages 1 to 14 form part of these interim consolidated financial statements.

# Tethys Petroleum Limited

Consolidated Statement of Changes in Equity

(Unaudited)

(in US dollars)

| | | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|---|
| | Note | Share capital $'000 | Share premium $'000 | Accumulated deficit $'000 | Option reserves $'000 | Warrant reserves $'000 | Total equity $'000 |
| **Balance at January 1, 2010** | | 13,455 | 153,748 | (88,374) | 11,220 | 16,555 | 106,604 |
| Comprehensive loss for the period | | - | - | (7,999) | - | - | (7,999) |
| **Transactions with shareholders** | | | | | | | |
| Issue of share capital | | 5,262 | 54,663 | - | - | - | 59,925 |
| Cost of share issue | | - | (2,153) | - | - | - | (2,153) |
| Share-based payments | | - | - | - | 1,193 | - | 1,193 |
| **Total transactions with shareholders** | | 5,262 | 52,510 | - | 1,193 | - | 58,965 |
| **Balance at March 31, 2010** | | 18,717 | 206,258 | (96,373) | 12,413 | 16,555 | 157,570 |
| Comprehensive loss for the period | | - | - | (21,650) | - | - | (21,650) |
| **Transactions with shareholders** | | | | | | | |
| Issue of share capital | | 7,060 | 93,117 | - | - | - | 100,177 |
| Cost of share issue | | - | (6,121) | - | - | - | (6,121) |
| Share-based payments | | - | - | - | 5,392 | - | 5,392 |
| Exercise of warrants | | 250 | 3,681 | - | - | - | 3,931 |
| Exercise of options | | 36 | 287 | - | (99) | - | 224 |
| **Total transactions with shareholders** | | 7,346 | 90,964 | - | 5,293 | - | 103,603 |
| **Balance at December 31, 2010** | | 26,063 | 297,222 | (118,023) | 17,706 | 16,555 | 239,523 |
| Comprehensive loss for the period | | - | - | (6,295) | - | - | (6,295) |
| **Transactions with shareholders** | | | | | | | |
| Share-based payments | 4 | - | - | - | 1,294 | - | 1,294 |
| **Total transactions with shareholders** | | - | - | - | 1,294 | - | 1,294 |
| **Balance at March 31, 2011** | | **26,063** | **297,222** | **(124,318)** | **19,000** | **16,555** | **234,522** |

The option reserve and warrant reserve are denoted together as "other reserves" on the interim consolidated statement of financial position. These reserves are non distributable.

The notes on pages 1 to 14 form part of these interim consolidated financial statements.

# Tethys Petroleum Limited

Consolidated Statement of Cash Flows
(Unaudited)
For the three months ended March 31
(in USD dollars)

| | Note | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Loss before taxation for the period | | (6,398) | (7,906) |
| Adjustments for | | | |
| Share based payments | | 1,193 | 1,193 |
| Net finance cost | | 7 | 309 |
| Depreciation, depletion and amortization | | 2,612 | 692 |
| Fair value loss on derivative financial instrument | | 8 | 2,501 |
| Listing expenses | | - | 351 |
| Net unrealised foreign exchange loss | | 43 | 33 |
| Loss from jointly controlled entity | | 209 | 150 |
| Deferred revenue | | (2,422) | (909) |
| Net change in non-cash working capital | 13 | (322) | (1,786) |
| **Net cash used in operating activities** | | (5,070) | (5,372) |
| | | | |
| **Cash flow from investing activities** | | | |
| Interest received | | 32 | 3 |
| Expenditure on exploration and evaluation assets | | (1,866) | (1,770) |
| Expenditures on property, plant and equipment | | (8,986) | (2,673) |
| Investment in restricted cash | | (2) | (28) |
| Payments made on behalf of jointly controlled entity | | (2,878) | (2,280) |
| Movement in advances to construction contractors | | (1,827) | (1,027) |
| Value added tax receivable | | (905) | (451) |
| Net change in non-cash working capital | 13 | (52) | (10) |
| **Net cash used in investing activities** | | (16,484) | (8,236) |
| | | | |
| **Cash flow from financing activities** | | | |
| Proceeds from issuance of long term borrowings | | - | 1,840 |
| Repayment of long-term borrowings | | (86) | (347) |
| Interest paid on long-term borrowings and other non-current payables | | (100) | (193) |
| Other non-current liabilities | | (76) | (70) |
| Proceeds from issuance of equity, net of issue costs | | - | 54,022 |
| **Net cash generated from financing activities** | | (262) | 55,252 |
| | | | |
| Effects of exchange rate changes on cash and cash equivalents | | 81 | (14) |
| | | | |
| **Net increase / (decrease) in cash and cash equivalents** | | (21,735) | 41,630 |
| Cash and cash equivalents at beginning of the period | | 79,135 | 7,297 |
| **Cash and cash equivalents at end of the period** | | 57,400 | 48,927 |

The notes on pages 1 to 14 form part of these interim consolidated financial statements.

## 1 General information

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") are headquartered in Guernsey, British Isles. The domicile of Tethys Petroleum Limited was moved from Guernsey, British Isles to the Cayman Islands on July 17, 2008, where it is incorporated. The address of the Company's registered office is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands. Tethys is an oil and gas Company operating within the Republic of Kazakhstan, Republic of Uzbekistan and the Republic of Tajikistan. Tethys' principal activity is the acquisition of and development of crude oil and natural gas fields.

The Company has its primary listing on the Toronto Stock Exchange (TSX) and a secondary listing on the Kazakhstan Stock Exchange (KASE) in Almaty.

## 2 Basis of preparation and accounting policies

The annual consolidated financial statements of the Company are prepared in accordance with International Financial Reporting Standards (IFRSs) and IFRIC interpretations issued by the IFRS Interpretations Committee.

These unaudited interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" and do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the annual consolidated financial statements reported for the year ended December 31, 2010. Certain comparative figures have been re-classified to conform with current year presentation.

The accounting policies adopted in the preparation of the unaudited interim consolidated financial statements are consistent with those followed in the preparation of the Company's annual financial statements for the year ended December 31, 2010.

## 3 Segmental Reporting

### Geographical segments

Management has determined the operating segments based on the reports reviewed by the executive directors that are used to make strategic decisions. Reports provided to the executive directors with respect to segment information are measured in a manner consistent with that of the financial statements. The assets and liabilities are allocated based on the operations of the segment and for assets, the physical location of the asset.

The executive directors consider the business from predominantly a geographic perspective and the Company currently operates in three geographical markets: Kazakhstan, Tajikistan and Uzbekistan.

In Kazakhstan, the Company is producing gas from the Kyzyloi and Akkulka fields and is undertaking exploration and evaluation activity in the Kulbas fields. In addition the Company is producing oil from the Akkulka field. In Tajikistan, the Company is currently undertaking exploration and evaluation activity and in Uzbekistan, the Company operates under the North Urtabulak Production Enhancement Contract, which gives incremental production rights to increase the production volume of oil from wells on the North Urtabulak Oil Field.

(tabular amounts in thousands of US dollars)

The Company also operates a corporate segment which acquired a number of drilling rigs and related oil and gas equipment which are utilised in Kazakhstan, Tajikistan, and Uzbekistan and possibly throughout the rest of Central Asia.

The segment results for the period ended March 31, 2011 are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Interim consolidated $'000 |
|---|---|---|---|---|---|
| Refined product sales | - | - | 2,422 | - | 2,422 |
| Gas sales | 1,491 | - | - | - | 1,491 |
| Oil sales | 501 | - | - | - | 501 |
| Other income | 66 | - | - | 144 | 210 |
| Finance income | - | - | - | 32 | 32 |
| **Segment revenue and other income** | **2,058** | **-** | **2,422** | **176** | **4,656** |
| Inter-segment revenue | - | - | - | (144) | (144) |
| **Segment revenue and other income from external customers** | **2,058** | **-** | **2,422** | **32** | **4,512** |
| Loss from jointly controlled entity | - | (209) | - | - | (209) |
| **(Loss)/ profit before taxation** | **(2,131)** | **(272)** | **1,339** | **(5,334)** | **(6,398)** |
| Taxation | - | - | (249) | 352 | 103 |
| **Net (loss)/profit attributable to shareholders** | **(2,131)** | **(272)** | **1,090** | **(4,982)** | **(6,295)** |

Borrowing costs of $250,920 were capitalised in the Kazakh segment during the period. Amortisation of $161,524 of assets held in the Corporate segment were also capitalised in the Kazakh segment during the period.

(tabular amounts in thousands of US dollars)

The segment assets at March 31, 2011 and capital expenditures for the period then ended are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Interim consolidated $'000 |
|---|---|---|---|---|---|
| Total assets | 128,462 | 38,395 | 17,033 | 75,587 | 259,477 |
| Cash expenditure to exploration & evaluation assets, property, plant and equipment | 8,045 | - | 2,777 | 30 | 10,852 |

Total assets for Tajikistan include the Company's investment in a joint venture as disclosed in Note 15 of the annual consolidated financial statements at December 31, 2010.

The segment results for the period ended March 31, 2010 are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Interim consolidated $'000 |
|---|---|---|---|---|---|
| Refined product sales | - | - | 2,027 | - | 2,027 |
| Other income | 62 | - | - | 100 | 162 |
| Finance income | 28 | - | - | 2 | 30 |
| **Segment revenue and other income** | **90** | **-** | **2,027** | **102** | **2,219** |
| Inter-segment revenue | - | - | - | (100) | (100) |
| **Segment revenue and other income from external customers** | **90** | **-** | **2,027** | **2** | **2,119** |
| Loss from jointly controlled entity | - | (150) | - | - | (150) |
| **(Loss)/ profit before taxation** | **(589)** | **(231)** | **556** | **(7,642)** | **(7,906)** |
| Taxation | 4 | - | (97) | - | (93) |
| **Net (loss)/profit attributable to shareholders** | **(585)** | **(231)** | **459** | **(7,642)** | **(7,999)** |

Borrowing costs of $189,193 were capitalised in the Kazakh segment during the period. Amortisation of $121,576 of assets held in the Corporate segment were also capitalised in the Kazakh segment during the period.

(tabular amounts in thousands of US dollars)

The segment assets at December 31, 2010 and capital expenditures for the 3 months ended 31 March 2010 are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Interim consolidated $'000 |
|---|---|---|---|---|---|
| Total assets | 117,144 | 35,683 | 14,203 | 100,718 | 267,748 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 2,140 | 2 | 2,261 | 40 | 4,443 |

The segment assets attributable to the Tajikistan segment consist mainly of the loan receivable from the Joint Venture. The segment assets attributable to the Uzbekistan segment consist mainly of well costs related to the North Urtabulak field.

The other and corporate segment assets consist mainly of oil and gas equipment such as drilling rigs and related equipment and cash and cash equivalents. The other and corporate segment liabilities consist mainly of the loans obtained to finance the purchase of two drilling rigs.

## 4 Share-based payments

*Share options*

Full details of the share options and stock incentive plan are outlined in the Company's annual consolidated financial statements for the year ended December 31, 2010. The options under the plan vest in three tranches with one third vesting immediately, one third after 12 months and one third after 24 months. These options are equity settled share based payment transactions.

The following tables summarize the stock option activity under the 2007 Long Term Stock Incentive Plan.

| | Number of options | Weighted average exercise price $ |
|---|---|---|
| Outstanding at January 1, 2011 | 22,263,000 | 1.65 |
| Granted | 450,000 | 1.95 |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | - | n/a |
| Outstanding at March 31, 2011 | 22,713,000 | 1.66 |
| Exercisable at March 31, 2011 | 14,564,000 | 1.79 |

(tabular amounts in thousands of US dollars)

| | Number of options | Weighted average exercise price $ |
|---|---|---|
| Outstanding at January 1, 2010 | 11,706,000 | 1.75 |
| Granted | 3,552,000 | 0.83 |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | (51,000) | 0.90 |
| Outstanding at March 31, 2010 | 15,207,000 | 1.54 |
| Exercisable at March 31, 2010 | 8,612,000 | 2.02 |

A charge for the value of services of $1,293,566 (2010 - $1,193,658) was recorded for the period.

*Warrants*

The following tables summarize the warrant activity for the period ended March 31, 2011 and March 31, 2010.

| | Number of warrants | Weighted average exercise price $ |
|---|---|---|
| Outstanding at January 1, 2011 | 10,283,455 | 4.48 |
| Granted | - | n/a |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | (795,000) | C$3.25 |
| Outstanding at March 31, 2011 | 9,488,455 | 4.59 |
| Exercisable at March 31, 2011 | 9,488,455 | 4.59 |
| Outstanding at January 1, 2010 | 12,783,455 | 3.73 |
| Granted | - | n/a |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | - | n/a |
| Outstanding at March 31, 2010 | 12,783,455 | 3.73 |
| Exercisable at March 31, 2010 | 12,783,455 | 3.73 |

There are no performance conditions attached to the warrants and all the granted warrants were immediately vested. Warrants are equity settled share based payment transactions.

(tabular amounts in thousands of US dollars)

## 5 Taxation

Tethys is domiciled in the Cayman Islands which has no Company income tax.

The temporary differences comprising the net deferred income tax liability are as follows:

| | March 31, 2011 $'000 | December 31, 2010 $'000 |
|---|---|---|
| Capital assets | 5,094 | 5,107 |
| Tax losses | (1,123) | (1,048) |
| Other | (15) | 11 |
| | 3,956 | 4,070 |

The provision for income taxes is different from the expected provision for income taxes for the following reasons:

| | March 31, 2011 $'000 | March 31, 2010 $'000 |
|---|---|---|
| Loss before income taxes | (6,398) | (7,906) |
| Income tax rate | 20% | 20% |
| Expected income tax (recovery) | (1,280) | (1,581) |
| *Increase / (decrease) resulting from:* | | |
| Non-deductible expenses | 279 | 160 |
| Impact of effective tax rates in other foreign jurisdictions | 779 | 1,257 |
| Losses and tax assets not utilised/recognised | 75 | 250 |
| Other | 44 | 7 |
| | (103) | 93 |
| Current income tax expense | 11 | - |
| Deferred tax (recovery) / expense | (114) | 93 |
| | (103) | 93 |

(tabular amounts in thousands of US dollars)

## 6 Loss per share

**Basic and diluted loss per share**

| | Loss for the period $'000 | Weighted average number of shares (thousands) | Per share amount $ |
|---|---|---|---|
| **Period ended March 31, 2011** | | | |
| Loss attributable to ordinary shareholders | | | |
| – Basic and diluted | (6,295) | 260,630 | (0.02) |
| **Period ended March 31, 2010** | | | |
| Loss attributable to ordinary shareholders | | | |
| – Basic and diluted | (7,999) | 163,543 | (0.05) |

Basic loss per share is calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the period. Diluted per share information is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares including share options and warrants, are considered to be anti-dilutive and have therefore been excluded from the diluted per share calculation.

(tabular amounts in thousands of US dollars)

## 7 Property, plant and equipment

| | Oil and gas properties $'000 | Oil and gas equipment $'000 | Vehicles $'000 | Office and computer equipment $'000 | Total $'000 |
|---|---|---|---|---|---|
| **At December 31, 2010** | | | | | |
| Cost | 101,349 | 25,171 | 1,780 | 1,801 | 130,101 |
| Accumulated depreciation | (10,423) | (3,048) | (532) | (445) | (14,448) |
| **Net book amount** | 90,926 | 22,123 | 1,248 | 1,356 | 115,653 |
| **Period ended March 31, 2011** | | | | | |
| Opening net book amount | 90,926 | 22,123 | 1,248 | 1,356 | 115,653 |
| Additions | 8,526 | 166 | 792 | 94 | 9,578 |
| Disposals | - | - | (29) | (200) | (229) |
| Depreciation charge | (1,698) | (694) | (353) | (69) | (2,814) |
| Accumulated depreciation on disposal | - | - | 5 | 57 | 62 |
| **Closing net book amount** | 97,754 | 21,595 | 1,663 | 1,238 | 122,250 |
| **At March 31, 2011** | | | | | |
| Cost | 109,875 | 25,337 | 2,543 | 1,695 | 139,450 |
| Accumulated depreciation | (12,121) | (3,742) | (880) | (457) | (17,200) |
| **Net book amount** | 97,754 | 21,595 | 1,663 | 1,238 | 122,250 |
| Assets under construction at net book amount included in above: | | | | | |
| At March 31, 2011 | 32,296 | - | - | - | 32,296 |
| At December 31, 2010 | 26,612 | - | - | - | 26,612 |

(tabular amounts in thousands of US dollars)

## 8 Intangible assets

| | Other intangible asset $'000 | Exploration and evaluation assets $'000 | Total $'000 |
|---|---|---|---|
| **At December 31, 2010** | | | |
| Cost | 5,553 | 12,332 | 17,885 |
| Accumulated amortisation and impairment | (993) | - | (993) |
| **Net book amount** | 4,560 | 12,332 | 16,892 |
| **Period ended March 31, 2011** | | | |
| Opening net book amount | 4,560 | 12,332 | 16,892 |
| Additions | - | 1,940 | 1,940 |
| Amortisation charge | (94) | - | (94) |
| **Closing net book amount** | 4,466 | 14,272 | 18,738 |
| **At March 31, 2011** | | | |
| Cost | 5,553 | 14,272 | 19,825 |
| Accumulated amortisation and impairment | (1,087) | - | (1,087) |
| **Net book amount** | 4,466 | 14,272 | 18,738 |

(tabular amounts in thousands of US dollars)

## 9 Loan receivable from jointly controlled entity

The loan receivable from the jointly controlled entity is net of the share of loss of the joint venture as calculated using the equity method of accounting:

| | March 31, 2011 $'000 | December 31, 2010 $'000 |
|---|---|---|
| Balance, beginning of year | 35,460 | 21,727 |
| Share of loss | (209) | (634) |
| Movement in deferred gain | - | 40 |
| Contributions made on behalf of jointly controlled entity | 2,928 | 14,327 |
| Balance, end of period / year | 38,179 | 35,460 |

## 10 Financial liabilities – borrowings

| | Effective interest rate % | Maturity date | March 31, 2011 $'000 | December 31, 2010 $'000 |
|---|---|---|---|---|
| **Current** | | | | |
| Short-term portion of long-term loans | 19 – 23 p.a. | 2011 | 6,005 | 5,047 |
| **Non-current** | | | | |
| Long-term loans | 19 – 23 p.a. | 2012 | 1,950 | 2,853 |
| | | | 7,955 | 7,900 |

| | $'000 |
|---|---|
| Balance at January 1, 2011 | 7,900 |
| Movement in exchange | 11 |
| Principal repayments | (86) |
| Amortisation of debt discount during the period | 130 |
| Balance at March 31, 2011 | 7,955 |

On December 14, 2009, in connection with the drilling of a new well in Uzbekistan, the Company further approved the issue of loan notes to a maximum value of $3,000,000 at an issue rate of $0.88 per note and redemption value of $1, resulting in an effective rate of 6.5%.

(tabular amounts in thousands of US dollars)

By the end of December 2009, $1,000,000 loan notes had been issued. During the period to March 31, 2010, a further $2,000,000 loan notes had been placed. A royalty of 11.25% is payable to the loan note holders calculated on sales of net production from the new well. The royalty entitlement was identified as an embedded derivative and required to be separated from the loan note. The royalty entitlement has been accounted for as a derivative financial instrument – interest rate swap, full details of which are explained in Note 18.3 of the Company's annual consolidated financial statements for the year ended December 31, 2010.

Issue of the loan notes was completed via a broker to whom a royalty commission is payable at 4.5% for every $1.0 million placed. The fair value of the commission payable at March 31, 2011 is $nil (2010 – $262,467). The Company measured the fair value of the commission payable by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the royalty entitlement. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%). The fair value associated with the royalty entitlement has been recognised as a transaction cost and presented as a direct reduction to the face value of the borrowing with the effective interest rate method being used to amortise the cost over the life of the loan. The commission liability has been included in current trade and other payables.

## 11 Share capital

| | March 31, 2011 Number | December 31, 2010 Number |
|---|---|---|
| **Authorized** | | |
| Ordinary shares with a par value of $0.10 each | 700,000,000 | 700,000,000 |
| Preference shares with a par value of $0.10 each | 50,000,000 | 50,000,000 |

| **Ordinary equity share capital Allotted and fully paid** | **Number** | **Share capital $'000** | **Share premium $'000** |
|---|---|---|---|
| **At January 1, 2010** | 134,554,769 | 13,455 | 153,748 |
| Issued during the period in connection with the exercise of share options | 360,000 | 36 | 287 |
| Issued during the in connection with the exercise of warrants | 2,500,000 | 250 | 2,711 |
| Issued during the period for cash | 123,215,000 | 12,322 | 140,476 |
| **At December 31, 2010 and at March 31, 2011** | 260,629,769 | 26,063 | 297,222 |

(tabular amounts in thousands of US dollars)

## 12 Related party transactions

Transactions between the Company's subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Vazon Energy Limited

Vazon Energy Limited ("Vazon") is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the period ended March 31, 2011 was $765,362 (March 31, 2010 – $541,849).

Oilfield Production Consultants

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to compression optimization and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the period ended March 31, 2011 were $11,422 (March 31, 2010 – $27,000).

## 13 Changes in working capital

| | Period ended | |
|---|---|---|
| | **March 31, 2011 $'000** | **March 31, 2010 $'000** |
| Trade and other receivables | 450 | (111) |
| Inventories | (331) | (71) |
| Trade and other payables | (571) | (1,060) |
| Change in non-cash working capital | (452) | (1,242) |
| Non-cash transactions | 78 | (554) |
| Net changes in non-cash working capital | (374) | (1,796) |

Net changes in non-cash working capital are categorized as follows:

| | Period ended | |
|---|---|---|
| | **March 31, 2011 $'000** | **March 31, 2010 $'000** |
| Operating activities | (322) | (1,786) |
| Investing activities | (52) | (10) |
| Balance | (374) | (1,796) |

## 14 Commitments and contingencies

### Kazakhstan

*Kyzyloi Field and the Kyzyloi Field Licence and Production Contract*

The Kyzyloi Field Licence and Production Contract grants TAG exploration and production rights over an area of approximately 70,967 acres (287.2 km$^2$) and extends down to the base of the Paleogene sequence. Pursuant to the contract, TAG must reimburse the Kazakh government for approximately $1,211,000 in historical costs, to be paid in equal quarterly instalments from the commencement of production until full reimbursement. Under the latest extension of the Kyzyloi Field Licence and Production Contract, TAG has committed to spending approximately $2,700,000 for a workover program over the seven year period until 2014. With respect to 2011, a work program amounting to $120,000 has been agreed, which has been fulfilled through payments amounting to $513,473 during the 3 months ended March 31, 2011.

*Akkulka Exploration Licence and Contract*

The Akkulka Exploration Licence and Contract was entered into between the Kazakh State Committee of Investments and TAG on September 17, 1998. On November 19, 2010, the Ministry of Oil and Gas approved an extension to the exploration period until March 10, 2013. With respect to 2011, a work program amounting to $3,210,000 has been agreed, which has been fulfilled through payments amounting to $5,151,238 during the 3 months ended March 31, 2011.

*Akkulka Production Contract*

On December 23, 2009, TAG and MEMR signed the Akkulka Production Contract giving TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years. Contingent upon commencement of commercial production on the Akkulka contractual territory, an amount of US$2,698,531 will be due to the Kazakhstan Government as a reimbursement of historical costs previously incurred by the Government in relation to the contractual territory, payable upon signature of the Akkulka oil production contract. For that part of the contractual territory from which production commenced in 2010, staged payments over a period of nine years totalling approximately $933,997 will also be due to the Kazakh government for the reimbursement of historical costs. There are no contractual commitments regarding production in 2011.

*Kul-Bas Exploration and Production Contract*

The Kul-Bas Exploration and Production Contract was signed between Kul-Bas and the MEMR on November 11, 2005. This contract, which is for a period of 25 years (unless extended by mutual agreement of the parties), with an initial six-year exploration period and a 19-year production period, grants Kul-Bas exploration and production rights over an original 2,688,695 acres (10,881 km$^2$) surrounding the Akkulka Block. Pursuant to the original contract, 20% of the area was to be relinquished at the end of the second year of the contract, with 20% to be relinquished annually thereafter up to the end of the six year exploration period. However, in response to an application on behalf of the Company, on April 27, 2009, Amendment 1 to the Kul-Bas Exploration and Production Contract was signed, according to which 20% is relinquished by the end of contract year 2 (completed), 0% in contract year 3 (2008), 10% by the end of contract year 4 (2009), 20% by the end of year 5 (2010) and all remaining contract area, outside commercial discovery areas, by the end of year 6 (2011).

(tabular amounts in thousands of US dollars)

On December 23, 2010 an extension of the exploration period for a further 2 years to November 11, 2013 was agreed by the Ministry of Oil and Gas.

The work program on this area amounted to a total of approximately $7,773,500 over the initial six-year exploration period. The remaining commitment of $2,894,000 relating to the contractual territory is required to be satisfied by November 11, 2011 and is included within the 2010 work program of $3,045,150. As at December 31, 2010, this requirement had been satisfied by the expenditure of $3,039,150. In addition to the minimum work program commitments, the Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of US$3,275,780. The Company has previously paid an amount of $49,137 in relation to this balance. If and when commercial production commences, $88,666 is due in quarterly instalments until the remaining historical costs of $3,226,643 has been paid in full. With respect to 2011, a work program amounting to $273,000 has been agreed, which has been fulfilled through payments amounting to $1,497,988 during the 3 months ended March 31, 2011.

**Operating leases**

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

| | **Total** | **Less than 1 year** | **1 – 3 years** |
|---|---|---|---|
| | **$'000** | **$'000** | **$'000** |
| Operating leases | 759 | 433 | 326 |

## SECTION B

## CONSOLIDATED FINANCIAL STATEMENTS AND AUDIT REPORT FOR THE YEAR ENDED 31 DECEMBER 2010

# Tethys Petroleum Limited

Consolidated Financial Statements
**December 31, 2010**

**Management Report**

The accompanying consolidated financial statements and all the information in the annual report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies described in the notes to the consolidated financial statements. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards, appropriate in the circumstances, as issued by the International Accounting Standards Board. The consolidated financial information contained elsewhere in the annual report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management has developed and maintains systems of internal accounting controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguarding of assets.

External auditors, appointed by the shareholders of the Company, have examined the consolidated financial statements and have expressed an opinion on the consolidated statements. Their report is included with the consolidated financial statements.

The Board of Directors of the Company has established an Audit Committee, consisting of independent non-management directors, to review consolidated financial statements with management and the auditors. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

| | |
|---|---|
| *"Dr. D. Robson"* | *"B. Murphy"* |
| Chief Executive | Chief Financial Officer |

March 18, 2011

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers LLP**
**Chartered Accountants**
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**Independent Auditor's Report**

**To the Shareholders of Tethys Petroleum Limited**

We have audited the accompanying consolidated financial statements of Tethys Petroleum Limited which comprise the consolidated statements of financial position as at December 31, 2010 and December 31, 2009 and the consolidated statements of comprehensive loss, changes in equity and cash flow for the years then ended, and the related notes including a summary of significant accounting policies.

**Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Tethys Petroleum Limited as at December 31, 2010 and December 31, 2009 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

**Chartered Accountants**

March 18, 2011
Calgary, Alberta

# Tethys Petroleum Limited

Consolidated Statement of Financial Position
(in US dollars)

| | Note | As at December 31 2010 $'000 | 2009 $'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 11 | 16,892 | 24,378 |
| Property, plant and equipment | 12 | 115,653 | 73,171 |
| Investments | 13 | 1,015 | 659 |
| Other receivables | 14 | 12,320 | 5,171 |
| Loan receivable from jointly controlled entity | 15 | 35,460 | 21,727 |
| | | 181,340 | 125,106 |
| **Current assets** | | | |
| Inventories | 16 | 2,121 | 2,368 |
| Trade and other receivables | 14 | 3,680 | 2,311 |
| Cash and cash equivalents | 17 | 79,135 | 7,297 |
| Derivative financial instruments – interest rate swap | 18 | 1,472 | - |
| | | 86,408 | 11,976 |
| **Total assets** | | 267,748 | 137,082 |
| **Equity attributable to shareholders** | | | |
| Share capital | 21 | 26,063 | 13,455 |
| Share premium | 21 | 297,222 | 153,748 |
| Other reserves | | 34,261 | 27,775 |
| Accumulated deficit | | (118,023) | (88,374) |
| **Total equity** | | 239,523 | 106,604 |
| **Non-current liabilities** | | | |
| Deferred gain on sale of assets to jointly controlled entity | 15 | 3,699 | 3,659 |
| Financial liabilities - borrowings | 18 | 2,853 | 9,324 |
| Shares to be issued | | - | 3,750 |
| Deferred taxation | 9 | 4,070 | 598 |
| Trade and other payables | 19 | 721 | 808 |
| Asset retirement obligations | 20 | 192 | 206 |
| | | 11,535 | 18,345 |
| **Current liabilities** | | | |
| Financial liabilities - borrowings | 18 | 5,047 | 1,086 |
| Derivative financial instruments - warrants | 18 | 405 | 1,053 |
| Derivative financial instruments – interest rate swap | 18 | - | 95 |
| Deferred revenue | | 2,450 | 3,113 |
| Trade and other payables | 19 | 8,788 | 6,786 |
| | | 16,690 | 12,133 |
| **Total liabilities** | | 28,225 | 30,478 |
| **Total shareholders' equity and liabilities** | | 267,748 | 137,082 |
| Commitments and contingencies | 25 | | |

The notes on pages 1 to 47 form part of these consolidated financial statements. The financial statements were approved by the Board on 18 March 2011 and were signed on its behalf.

*"Dr. D. Robson"*
Chief Executive

*"B. Murphy"*
Chief Financial Officer

# Tethys Petroleum Limited

Consolidated Statement of Comprehensive Loss
(in US dollars)

| | Note | Year ended December 31, 2010 $'000 | 2009 $'000 |
|---|---|---|---|
| Sales and other operating revenues | 6 | 14,706 | 8,559 |
| Finance income | | 61 | 76 |
| Total revenue and other income | | 14,767 | 8,635 |
| | | | |
| Production expenditures | | (7,076) | (3,405) |
| Depreciation, depletion and amortization | | (5,885) | (3,238) |
| Exploration and evaluation expenditure written off | | - | (887) |
| Listing expenses | | (1,288) | (1,652) |
| Administrative expenses | 7 | (25,511) | (16,880) |
| Foreign exchange loss - net | | (337) | (2,397) |
| Fair value loss (net) on derivative financial instrument | | (24) | (479) |
| Loss from jointly controlled entity | 15 | (634) | (1,000) |
| Finance costs | | (190) | (203) |
| | | | |
| **Loss before taxation** | | **(26,178)** | **(21,506)** |
| | | | |
| Taxation | 9 | (3,471) | (214) |
| | | | |
| **Net loss and comprehensive loss for the year attributable to shareholders** | | **(29,649)** | **(21,720)** |
| | | | |
| **Loss per share attributable to shareholders** | | | |
| | | | |
| Basic and diluted | 10 | (0.15) | (0.20) |

No dividends were paid or are declared for the year (2009 – $Nil).

The notes on pages 1 to 47 form part of these consolidated financial statements.

# Tethys Petroleum Limited

Consolidated Statement of Changes in Equity
(in US dollars)

| | | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|---|
| | Note | Share capital $'000 | Share premium $'000 | Accumulated deficit $'000 | Option reserves $'000 | Warrant reserves $'000 | Total equity $'000 |
| **Balance at January 1, 2009** | 21 | 6,639 | 138,598 | (66,654) | 8,592 | 16,555 | 103,730 |
| Comprehensive loss for the year | | - | - | (21,720) | - | - | (21,720) |
| **Transactions with shareholders** | | | | | | | |
| Issue of share capital | 21 | 6,816 | 17,245 | - | - | - | 24,061 |
| Cost of share issue | | - | (2,095) | - | - | - | (2,095) |
| Share-based payments | | - | - | - | 2,628 | - | 2,628 |
| **Total transactions with shareholders** | | 6,816 | 15,150 | - | 2,628 | - | 24,594 |
| **Balance at January 1, 2010** | | 13,455 | 153,748 | (88,374) | 11,220 | 16,555 | 106,604 |
| Comprehensive loss for the year | | - | - | (29,649) | - | - | (29,649) |
| **Transactions with shareholders** | | | | | | | |
| Issue of share capital | 21 | 12,322 | 147,780 | - | - | - | 160,102 |
| Cost of share issue | | - | (8,274) | - | - | - | (8,274) |
| Share-based payments | | - | - | - | 6,585 | - | 6,585 |
| Exercise of warrants | | 250 | 3,681 | - | - | - | 3,931 |
| Exercise of options | | 36 | 287 | - | (99) | - | 224 |
| **Total transactions with shareholders** | | 12,608 | 143,474 | - | 6,486 | - | 162,568 |
| **At December 31, 2010** | | **26,063** | **297,222** | **(118,023)** | **17,706** | **16,555** | **239,523** |

The option reserve and warrant reserve are denoted together as "other reserves" on the consolidated statement of financial position. These reserves are non distributable.

The notes on pages 1 to 47 form part of these consolidated financial statements.

# Tethys Petroleum Limited

Consolidated Statement of Cash Flows
(in US dollars)

| | Note | Year ended December 31, 2010 $'000 | 2009 $'000 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Loss before taxation | | (26,178) | (21,506) |
| Adjustments for | | | |
| Share based payments | 7 | 5,956 | 2,628 |
| Net finance cost | | 112 | 127 |
| Unsuccessful exploration and evaluation expenditures | 11 | - | 887 |
| Depreciation, depletion and amortization | | 5,885 | 3,238 |
| Payment of royalties | | (78) | - |
| Fair value loss on derivative financial instrument | | 24 | 479 |
| Listing expenses | | 351 | - |
| Net unrealised foreign exchange (gain)/loss | | (75) | 1,120 |
| Loss from jointly controlled entity | | 634 | 1,000 |
| Deferred revenue | | (663) | 3,113 |
| Net change in non-cash working capital | 24 | (2,792) | (1,160) |
| **Net cash used in operating activities** | | (16,824) | (10,074) |
| | | | |
| **Cash flow from investing activities** | | | |
| Interest received | | 61 | 76 |
| Expenditure on exploration and evaluation assets | | (31,688) | (22,648) |
| Expenditures on property, plant and equipment | | (6,605) | (9,573) |
| Investment in restricted cash | | (356) | (72) |
| Acquisition of subsidiary, net of cash received | | - | 532 |
| Sale of subsidiaries, net of cash disposed | | - | (112) |
| Payments made on behalf of jointly controlled entity | | (14,070) | - |
| Movement in advances to construction contractors | | (3,298) | 829 |
| Value added tax receivable | | (4,148) | (670) |
| Net change in non-cash working capital | 24 | 3,461 | 1,273 |
| **Net cash used in investing activities** | | (56,643) | (30,365) |
| | | | |
| **Cash flow from financing activities** | | | |
| Proceeds from issuance of short-term borrowings | 18 | - | 2,500 |
| Repayment of short-term borrowings | | - | (2,500) |
| Proceeds from issuance of long-term borrowings | 18 | 1,840 | 5,020 |
| Repayment of long-term borrowings | 18 | (4,974) | (856) |
| Interest paid on long-term borrowings and other non-current payables | | (1,036) | (152) |
| Other non-current liabilities | 19 | (296) | (109) |
| Proceeds related to shares to be issued | | - | 3,750 |
| Proceeds from issuance of equity, net of issue costs | 21 | 149,770 | 17,906 |
| **Net cash generated from financing activities** | | 145,304 | 25,559 |
| | | | |
| Effects of exchange rate changes on cash and cash equivalents | | 1 | (23) |
| | | | |
| **Net decrease in cash and cash equivalents** | | 71,838 | (14,903) |
| Cash and cash equivalents at beginning of the year | | 7,297 | 22,200 |
| **Cash and cash equivalents at end of the year** | | 79,135 | 7,297 |

The notes on pages 1 to 47 form part of these consolidated financial statements.

(tabular amounts in thousands of US dollars)

## 1 General information

The principal executive offices of Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") are in Guernsey, British Isles. The domicile of Tethys Petroleum Limited was moved from Guernsey, British Isles to the Cayman Islands on July 17, 2008, where it is incorporated. The address of the Company's registered office is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands. Tethys is an oil and gas company operating within the Republic of Kazakhstan, Republic of Uzbekistan and the Republic of Tajikistan. Tethys' principal activity is the acquisition of and development of crude oil and natural gas fields.

The Company has its primary listing on the Toronto Stock Exchange (TSX) and a secondary listing on the Kazakhstan Stock Exchange (KASE) in Almaty.

### Statement of compliance

These consolidated financial statements have been prepared on a going concern basis under the historical cost convention except as modified by the revaluation of available for sale financial assets, and financial assets and financial liabilities at fair value through the statement of comprehensive loss and are in accordance with International Financial Reporting Standards ("IFRSs") and IFRIC interpretations issued by the IFRS Interpretations Committee and effective or issued and early adopted as at the time of preparing these consolidated financial statements.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Areas where estimates are significant to the consolidated financial statements are disclosed in note 4.

## 2 Summary of significant accounting policies

### Basis of preparation

The consolidated financial statements for the year ended December 31, 2010 have been prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRIC Interpretations. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

The consolidated financial statements are presented in United States Dollars. Foreign operations are included in accordance with the policies set out in this note.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

**Foreign Operations**

Tethys' future operations and earnings will depend upon the results of Tethys' operations in the Republic of Kazakhstan, Uzbekistan and Tajikistan. There can be no assurance that Tethys' will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on Tethys' financial position, results of operations and cash flows. Also, the success of Tethys' operations will be subject to numerous contingencies, some of which are beyond management control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competitions and changes in regulation. Since Tethys' is dependent on international operations, Tethys' will be subject to various additional political, economic and other uncertainties. Among other risks, Tethys' operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

**Changes in accounting policy and disclosures**

*(a) New and amended standards adopted by the Company*

The following new and amended accounting standards are mandatory and relevant for the Company for the first time for these financial statements:

- IFRS 3 'Business Combinations' - the Company has adopted the revised version of this standard, with effect from January 1 2010. The revised standard still requires the purchase method of accounting to be applied to business combinations but introduces some changes to the accounting treatment. Assets and liabilities arising from business combinations that occurred before January 1, 2010 were not required to be re-stated and thus there was no effect on the company's reported income or net assets on adoption.

- IAS 27 'Consolidated and Separate Financial Statements' - the Company has adopted the amended version of IAS 27, also with effect from January 1, 2010. This requires the effects of all transactions with minority interests to be recorded in equity if there is no change in control. When control is lost, any remaining interest in the entity is re-measured to fair value and a gain or loss recognized in profit or loss. There was no effect on the Company's reported income or net assets on adoption.

- IAS 38 'Measurement of non-current assets (or disposal groups) classified as held for sale' – the Company has adopted the amendment to this standard, with effect from January 1, 2010, which clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination and it permits grouping of intangible assets as a single asset if each asset has similar useful economic lives. There was no effect on the Company's reported income or net assets on adoption.

*(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company*

- IFRS 9 'Financial instruments' – issued in November 2009. This standard is the first step in the process to replace IAS39, 'Financial instruments: recognition and measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities, which may affect the Company's accounting for its financial assets. The standard is not applicable until January 1 2013 but is available for early adoption. The Company is yet to assess the full impact of IFRS 9.

**Basis of consolidation**

*Subsidiaries*
Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Company.

The acquisition method of accounting is used to account for business combinations. The cost of acquisition is measured at the fair value of assets given, equity instruments issued and debt incurred or assumed at the date of acquisition, being the date on which the Company gains control. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred. The excess of the cost over the fair value of the Company's share of identifiable net assets acquired is recorded as goodwill. If the cost is less than the fair value of net assets acquired, the difference is recognised directly in the statement of comprehensive loss. All subsidiaries, as listed in note 23, have been consolidated into the Company's consolidated financial statements.

Inter-Company transactions, balances and unrealised gains or losses between subsidiaries are eliminated. The financial statements of the subsidiaries are prepared using consistent accounting policies and reporting date as of the Company.

*Joint ventures*

The Company's interests in jointly controlled entities are accounted for using the equity method of accounting. Under the equity method, the investment in a jointly controlled entity is carried in the statement of financial position at cost plus post-acquisition changes in the Company's share of net assets of the jointly controlled entity, less distributions received and less any impairment in value of the investment. The Company's statement of comprehensive loss reflects the Company's share of the results after tax of the jointly controlled entity.

When the Company's share of losses in the jointly controlled entity equals or exceeds its interest in the entity, including any other unsecured receivables, the Company does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity. Financial statements of jointly controlled entities are prepared for the same reporting year as the Company.

The Company recognises the portion of gains or losses on the sale of assets by the Group to the joint venture that is attributable to the other parties in the joint venture. The Company does not recognise its share of profits or losses that results from the purchase of assets by the Group from the joint venture until when the asset is resold or, where relevant, as the asset is depreciated by the jointly controlled entity.

In circumstances where the significant risks and rewards of ownership of non-monetary assets transferred have not been transferred to the jointly controlled entity, the associated gain or loss is unrealised and , thus, not recognised in profit or loss but recognised as a deferred gain on the statement of financial position. The deferred gain is recognised in the statement of comprehensive loss when the asset is resold or, where to relevant, as the asset is depreciated by the jointly controlled entity.

Accounting policies of the joint venture are consistent with accounting policies adopted by the Company.

**Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-makers have been identified as the Executive Directors (i.e. Chief Executive Officer, Chief Financial Officer and Executive Vice President) that make strategic decisions.

**Foreign currency translation**

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). All entities within the Company have a USD functional currency. The consolidated financial statements are presented in USD dollars, which is the Company's presentation currency.

All monetary assets and liabilities denominated in foreign currencies are translated into US dollars at the rate of exchange in effect at the reporting date. Non-monetary assets are translated at historical exchange rates.

Revenue and expense items (excluding depreciation and amortization which are translated at the same rates as the related assets) are translated at the average rate of exchange.

Exchange gains and losses arising on translation are taken to the statement of comprehensive loss.

**Oil and gas exploration and evaluation expenditure**

Oil and natural gas exploration and evaluation expenditures are accounted for using a modified 'successful efforts' method of accounting. Costs are accumulated on a field-by-field basis. Exploration and evaluation expenditures, including license acquisition costs, are capitalised as exploration and evaluation assets when incurred. Expenditure directly associated with an exploration well is capitalised until the determination of reserves is evaluated. If reserves are not identified, these costs are charged to expense. All other associated exploration and evaluation expenditures are carried forward as an asset in the statement of financial position where the rights of tenure of the property are current and it is considered probable that the costs will be recouped through successful development of the property, or alternatively by its sale. Capitalised exploration and evaluation expenditure is written down to its recoverable amount where the above conditions are no longer satisfied.

If it is determined that a commercial discovery has not been achieved in relation to the property, all other associated costs are written down to their recoverable amount. If commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development tangible and intangible assets. No depreciation and/or amortisation is charged during the exploration and evaluation phase.

**Oil and gas properties**

Oil and gas properties are stated at cost, less accumulated depreciation and accumulated impairment losses.

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalised within oil and gas properties, as long as the facts and circumstances indicate that the field has commercially viable reserves.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the asset retirement obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within property, plant and equipment.

Where commercial production in an area of interest has commenced, oil and gas properties are depleted on a unit-of-production basis over the proved and probable reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proved and probable reserves of the relevant area. The unit-of-production rate for the depletion of field development costs takes into account expenditures incurred to date, together with future development expenditure to develop the proved and probable reserves. Changes in factors such as estimates of proved and probable reserves that affect unit-of-production calculations do not give rise to prior year financial period adjustments and are dealt with on a prospective basis.

**Other property, plant and equipment**

Property, plant and equipment are carried at cost less accumulated depreciation. Depreciation is charged so as to write off the cost of these assets less residual value over their estimated useful economic lives, for the following classes of assets:

| | | |
|---|---|---|
| Drilling rigs and related oil and gas equipment | Unit of production | 3,650 operating days |
| Smaller rig related equipment | Straight line | 6 – 8 years |
| Vehicles | Straight line | 4 years |
| Computer equipment | Straight line | 3 years |
| Office equipment | Straight line | 5 years |

Gains and losses on disposal are determined by comparing the proceeds with the carrying amount and are recognised within the statement of comprehensive loss.

**Other intangible assets**

Production enhancement contracts are stated at cost less accumulated amortisation and have a finite useful life. Amortization is calculated using a unit-of-production basis over the estimated incremental production entitlement expected to be received over the life of the contract.

**Impairment of non-financial assets**

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

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

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of comprehensive loss so as to reduce the carrying amount to its recoverable amount (i.e. the higher of fair value less costs to sell and value in use).

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

**Asset retirement obligation (ARO)**

Provision is made for the present value of the future cost of abandonment of oil and gas wells and related facilities. This provision is recognised when a legal or constructive obligation arises.

The estimated costs, based on engineering cost levels prevailing at the reporting date, are computed on the basis of the latest assumptions as to the scope and method of abandonment. Provisions are measured at the fair value of the expenditures expected to be required to settle the obligation using a pre-tax risk free rate, updated at each reporting date that reflects current market assessments of the time value of money and the risks specific to the obligation. The corresponding amount is capitalised as part of exploration and evaluation expenditure or oil and gas properties and is amortised on a unit-of-production basis as part of the depreciation, depletion and amortisation charge. Any adjustment arising from the reassessment of estimated cost of ARO is capitalised, whilst the charge arising from the accretion of the discount applied to the ARO is treated as a component of finance costs.

**Financial instruments**

Financial assets and financial liabilities are recognised on the Company's statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognised when the contractual rights to the cashflows from the financial asset expire or when the contractual rights to those assets are transferred. Financial liabilities are de-recognised when the obligation specified in the contract is discharged, cancelled or expired.

*Investments*

Investments comprise restricted current balances that are held on deposit with banks in the Republic of Kazakhstan in respect of the Company's asset retirement obligations (ARO) in this country and are classified as non-current. They are carried at fair value with gains or losses taken to the statement of comprehensive loss.

*Trade receivables, loans and other receivables*

Trade receivables, loans and other receivables, which are non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the reporting date, which are classified as non-current assets. The Company's loans and receivables comprise trade and other receivables in the statement of financial position.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method, net of any impairment.

A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the statement of comprehensive loss. When a trade receivable is not collectable, it is written off against the allowance account for trade receivables.

*Cash and cash equivalents*

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. These are carried at fair value with gains or losses recognized through statement of comprehensive loss.

*Financial liabilities - borrowings*

Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of comprehensive loss when the liabilities are derecognised as well as through the amortisation process.

*Trade payables*

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are measured at amortised cost using the effective interest method.

*Equity instruments*

Equity instruments issued by the Company are recorded at the proceeds received net of direct issue costs.

*Derivative financial instruments*

Derivative financial instruments are initially recognized at fair value on the date a derivative contract was entered into and are subsequently remeasured at their fair value with changes in the fair value immediately recognised in the statement of comprehensive loss.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract. Contracts are assessed for embedded derivatives when the Company becomes a party to them, including at the date of a business combination.

*Derivative contracts qualifying for the 'own-use' treatment*

An 'own-use' contract is one that was entered into and continues to be held for the purpose of the receipt or delivery of the non financial item in accordance with the entity's expected purchase, sale or usage requirements. Contracts that are for the Company's own use are exempt from the requirements of IAS 39.

**Inventories**

Inventories consist of refined oil products, spare parts and consumable materials and are shown at the lower of cost and net realisable value. Cost is determined on a weighted average cost method for refined oil products and the first-in-first-out method for spare parts and consumable materials inventories.

**Taxation including deferred taxation**

The tax expense represents current tax and deferred tax.

Current tax is based on the taxable profits for the year. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date in the countries where the Company and its subsidiaries operate and generate taxable income.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss. Deferred income tax assets are recognised to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilised and the carry forward of unused tax credits and unused tax losses can be utilised.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred tax asset is realised or the deferred income tax liability settled.

**Share–based payments**

The Company operates share-based compensation plans, under which the entity receives services from employees as consideration for equity instruments (options and warrants) of the Company. The fair value of the employee options and warrants granted in exchange for the employee services is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted, excluding the impact of any non-market service and performance vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. When options vest in instalments over the vesting period, each instalment is accounted for as a separate arrangement. At each reporting date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the statement of comprehensive loss, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital and share premium when the options are exercised.

**Provisions**

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive loss, net of any reimbursement. The increase in the provision due to passage of time is recognized as interest expense.

**Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of natural gas and oil products in the ordinary course of the Company's activities and is recognized when the amount can be reliably measured, it is probable that future economic benefits will flow to the entity, and when specific criteria have been met for each of the Company's activities as described below. Revenue is shown after eliminating sales within the Company.

Revenue from natural gas sales is recognized when the gas has been lifted and the risk of loss transferred to a third-party purchaser and is shown net of royalties, Mineral Extraction Tax (MET) and value-added tax. Revenue from refined product sales is recognized upon delivery and is shown net of value-added tax. All payments received before delivery are recorded as deferred revenue until delivery has occurred.

The Company recognises finance income earned on the Company's cash and cash equivalents and short term investments on an accrual basis.

**Barter transactions**

Where goods or services are exchanged for goods or services of a dissimilar nature, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of cash or cash equivalents received or paid. If the fair value of the goods or services received cannot be reliably measured, the revenue is measured at the fair value of the goods or services given up, again adjusted by the amount of cash or cash equivalents received.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying capital asset or project under construction are capitalised and added to the asset or project cost during construction until such time as the asset or project is substantially ready for its intended use. Where funds are specifically borrowed to finance an asset or project, the amount capitalised represents the actual amount of borrowing cost incurred. Where funds used to finance an asset or project form part of general borrowings, the amount capitalised is calculated by using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognised in the statement of comprehensive loss in the period in which they are incurred.

**Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive loss on a straight-line basis over the period of the lease.

**Business combinations**

Business combinations are accounted for using the acquisition method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognized as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statement of comprehensive loss. Acquisition related costs are expensed as incurred.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose identified according to operation segment.

**Fair value**

The fair value of investments, trade and other receivables, trade and other payables approximate their carrying amounts due to the short term maturity of the instruments. Derivative financial instruments are recorded at fair value with movements in fair value recognised in the statement of comprehensive loss. Loan receivables, long term debt and other non-current liabilities have been recorded at amortized cost using the effective interest rate method.

## 3 Financial risk management

The Company's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

### a) Financial risk factors

*Credit risk*

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's loan receivable from the jointly controlled entity, cash and cash equivalents and accounts receivable balances.

With respect to the Company's financial assets the maximum exposure to credit risk due to default of the counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is:

(tabular amounts in thousands of US dollars)

| | December 31 2010 $'000 | December 31 2009 $'000 |
|---|---|---|
| Trade receivables | 1,661 | 905 |
| Cash and cash equivalents | 79,135 | 7,297 |
| Investments | 1,015 | 659 |
| Loan receivable from jointly controlled entity | 35,460 | 21,727 |
| | 117,271 | 30,588 |

Concentration of credit risk associated with the above trade receivable balances in Kazakhstan is as a result of contracted sales to three customers during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales in Kazakhstan commenced in December 2007 and the Company has not experienced any credit loss to date. At December 31, 2010 the trade receivable amounted to $1,661,015 (2009 - $905,000), none of which was greater than 30 days overdue. The Company has therefore not recorded a provision against this amount as it does not consider the balance to be impaired.

In Uzbekistan, the Company makes use of two customers. Full payment is required before delivery of the oil and therefore there is limited exposure to credit risk in this country.

Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss as the counterparties are banks with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors).

The Company is exposed to credit risk in relation to its loan receivable from a jointly controlled entity to the extent that the jointly controlled entity fails to meet its contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loan receivable represents the maximum exposure to credit risk.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. Since inception, the Company has incurred significant consolidated losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2010.

The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets, co-ordinating and authorizing project expenditures and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company seeks additional financing based on the results of these processes.

(tabular amounts in thousands of US dollars)

The timings of cash outflows relating to financial liabilities and commitments at the reporting date are summarized below.

| | Less than 1 year $'000 | 1-3 years $'000 | 4-5 years $'000 | Thereafter $'000 | Total $'000 |
|---|---|---|---|---|---|
| Trade and other payables | 8,788 | 458 | 128 | 135 | 9,509 |
| Financial liabilities - borrowings (note 17) | 5,047 | 2,853 | - | - | 7,900 |
| Commitments (note 25) | 6,196 | 2,700 | - | - | 8,896 |
| Operating lease commitments (note 25) | 456 | 210 | - | - | 666 |
| Total expected cash outflow | 20,487 | 6,221 | 128 | 135 | 26,971 |

There can be no assurance that debt or equity financing will be available or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

*Market risk*

Market risk is the risk of loss that may arise from changes in market factors such as commodity prices, interest rate and foreign exchange rates.

*Commodity price risk*

Commodity price risk arises from the effect that fluctuations of future commodity process may have on the price received for sales of gas and refined oil products. The marketability and price of natural gas and oil that is produced and may be discovered by the Company will be affected by numerous factors that are beyond the control of the Company.

Natural gas prices are subject to wide fluctuations: the Company has therefore entered into a fixed price contract for sales of gas from the Kyzyloi field in Kazakhstan. However, any material decline in natural gas prices could result in a reduction of Tethys' future net production revenues and impact on the commercial viability of the Company's existing and future oil and gas discoveries. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in volumes and the value of Tethys' gas reserves, if the Company elected not to produce from certain wells at lower prices.

Any material decline in refined oil product prices could result in a reduction of the Company's Uzbekistan net production revenue.

All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities.

The impact of changes in commodity price is assessed in note 4.

(tabular amounts in thousands of US dollars)

*Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

The Company is exposed to interest rate risk on short term deposits to the extent that the significant reductions in market interest rates would result in a decrease in the interest earned by the Company. A change of 1% in the interest rate would have had a change of $207,746 in the interest earned in the current year (2009 - $38,250).

As at the reporting date the Company's interest rate profile was:

| At December 31, 2010 | Fixed rate financial instruments $'000 | Floating rate financial instruments $'000 | Total $'000 |
|---|---|---|---|
| Cash and cash equivalents | 5,000 | 74,135 | 79,135 |
| Financial liabilities - borrowings | (7,900) | - | (7,900) |
| Interest rate swap | 1,472 | - | 1,472 |
| | (1,428) | 74,135 | 72,707 |

| At December 31, 2009 | Fixed rate financial instruments $'000 | Floating rate financial instruments $'000 | Total $'000 |
|---|---|---|---|
| Cash and cash equivalents | - | 7,297 | 7,297 |
| Financial liabilities - borrowings | (10,410) | - | (10,410) |
| Interest rate swap | (95) | - | (95) |
| | (10,505) | 7,297 | (3,208) |

*Foreign exchange risk*

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions denominated in a currency other than the US dollar. In addition, a portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. The Company is not currently using exchange rate derivatives to manage exchange rate risks but is attempting to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan.

The Company holds the majority of its cash and cash equivalents in US dollars. However, the Company does maintain deposits in other currencies, as disclosed in the following table, in order to fund ongoing general and administrative activity and other expenditure incurred in these currencies.

(tabular amounts in thousands of US dollars)

The carrying amounts of the Company's significant foreign currency denominated monetary assets and liabilities at the reporting dates are as follows:

| **In US$ equivalent at December 31, 2010** | **CAD ’000** | **GBP ’000** | **EUR ’000** | **SOMONI ’000** | **KZT ’000** |
|---|---|---|---|---|---|
| Cash and cash equivalents | 1,201 | 1,123 | 60 | 7 | 492 |
| Trade and other receivables | - | 19 | 24 | - | 10,434 |
| Trade and other payables | (1) | (131) | - | - | (4,402) |
| Financial liabilities - borrowings | - | (287) | - | - | - |
| **Net exposure** | **1,200** | **724** | **84** | **7** | **6,524** |

| **In US$ equivalent at December 31, 2009** | **CAD ’000** | **GBP ’000** | **EUR ’000** | **SOMONI ’000** | **KZT ’000** |
|---|---|---|---|---|---|
| Cash and cash equivalents | 52 | 132 | 83 | 11 | 187 |
| Trade and other receivables | - | 34 | 2 | - | 5,393 |
| Trade and other payables | (35) | (318) | - | - | (561) |
| Financial liabilities - borrowings | - | (383) | - | - | - |
| **Net exposure** | **17** | **(535)** | **85** | **11** | **5,019** |

The following table details the Company's sensitivity to a 10% movement in US dollars against the respective foreign currencies, which represents management's assessment of a reasonably likely change in foreign exchange rates.

| **2010 Effect in US$’000** | **CAD** | **GBP** | **EUR** | **SOMONI** | **KZT** |
|---|---|---|---|---|---|
| Profit or (loss) before tax | 120 | 73 | 8 | 1 | 652 |
| **2009 Effect in US$’000** | | | | | |
| Profit or (loss) before tax | - | (20) | 10 | - | 500 |

A 10% strengthening of the US dollar against the currencies above at December 31, 2010 would have had an equal but opposite effect on the amounts shown above, assuming all other variables remained constant.

**b) Capital risk management**

The Company's capital structure is comprised of shareholders' equity and net debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

(tabular amounts in thousands of US dollars)

The Company funds its expenditures on commitments from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt.

| At December 31 | **2010** | **2009** |
|---|---|---|
| | **$'000** | **$'000** |
| Total financial liabilities - borrowings (Note 17) | 7,900 | 10,410 |
| Less: cash and cash equivalents | (79,135) | (7,297) |
| Net (funds) / debt | (71,235) | 3,113 |
| Total equity | 323,285 | 167,203 |
| **Total capital** | 252,050 | 170,316 |

If the Company is in a net debt position, the Company will assess whether the projected cash flow is sufficient to service this debt and support ongoing operations. Consideration will be given to reducing the total debt or raising funds through an alternative route such as the issuing of equity.

### c) Fair value estimation

Effective January 1, 2009, the Company adopted the amendment to IFRS 7 for financial instruments that are measured at the reporting date at fair value. This requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities. The Company does not have any assets or liabilities that require Level 1 inputs.

Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly. For the Company, Level 2 inputs include prices that can be corroborated with other observable inputs for substantially the complete term of the contract.

Level 3: Unobservable inputs. For the Company, Level 3 inputs include production and price assumptions that are not based on observable market data (unobservable inputs) or are reliant on adjustments or interpolations are made by management to an otherwise standard valuation model.

As at December 31, 2010 the Company's only financial instruments measured at fair value on a recurring basis were the warrant liability and interest rate swap described in Note 18.3, the measurement inputs of which is designated as Level 2 and Level 3 respectively.

At December 31, 2010, the interest rate swap described in Note 18.3 is classified as Level 3 in the fair value hierarchy. The inputs required to measure the fair value of the interest rate swap include production and price assumptions that are reliant on adjustments or interpolation made by management to an otherwise standard valuation model. A reconciliation of the movement in the balance of the interest rate swap has been included at Note 18.3.

## 4 Critical judgements and accounting estimates

The preparation of financial statements requires management to make certain judgements, accounting estimates and assumptions that affect the amounts reported for assets and liabilities as at the reporting date and the amounts reported for revenues and expenses during the year. The nature of estimation means that actual outcomes could differ from those estimates. Accordingly, the impact of these estimates, assumptions and judgments on the consolidated financial statements in future periods could be material. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are discussed below.

**Recoverability of asset carrying values**

The Company assesses its property, plant and equipment, including intangible exploration and evaluation assets, for possible impairment if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable, or at least at every reporting date. Such indicators include changes in the Company's business plans, changes in commodity prices, evidence of physical damage and, for oil and gas properties, significant downward revisions of estimated recoverable volumes or increases in estimated future development expenditure.

If there are low oil prices or natural gas prices during an extended period the Company may need to recognize significant impairment charges. The assessment for impairment entails comparing the carrying value of the cash-generating unit with its recoverable amount, that is, value in use. Value in use is usually determined on the basis of discounted estimated future net cash flows. Determination as to whether and how much an asset is impaired involves management estimates on highly uncertain matters such as future commodity prices, the effects of inflation on operating expenses, discount rates, production profiles and the outlook for regional market supply-and-demand conditions for crude oil, natural gas and refined products.

At the reporting date, an impairment test was carried out on the Akkulka gas field in accordance with the accounting policy stated in note 2. The recoverable amount of the field has been determined based on value in use calculations. These calculations require the use of estimates. The present value of future cash flows was computed on an pre-tax basis by applying forecast prices of gas reserves to estimated future production of proved and probable gas reserves, less estimated future expenditures to be incurred in developing and producing the proved and probable reserves. The present value of estimated future net revenues is computed using a discount factor of 16%. The discount rate used is pre-tax and reflects the specific risks relating to the underlying cash generating unit.

(tabular amounts in thousands of US dollars)

The value in use calculation assumes natural gas sales prices in US$/Mcf as follows:

| | 2011 $ | 2012 $ | 2013 $ | 2014 $ | 2015 $ | 2016 $ | 2017 $ | 2018 $ | 2019 $ | 2020 $ | 2021 $ | 2022 $ | 2023 $ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Natural gas US$/Mcf | | | | | | | | | | | | | |
| Akkulka | 0.95 | 0.95 | 2.22 | 2.75 | 3.25 | 3.74 | 4.09 | 4.42 | 4.72 | 5.03 | 5.30 | 5.57 | 5.82 |

The above price estimates are lower than those previously expected by the Company, which is a reflection of the current gas market uncertainty in Central Asia. As at the reporting date and at the date of approval of these consolidated financial statements, the gas price remains the subject of negotiations which have not been finalised. This is a source of measurement uncertainty in the Company's impairment test since there can be no assurance as to what price will be achieved.

If the forecast prices applied to the Akkulka impairment test were to reduce from 2013 per year by US$0.10 per Mcf below the assumed price, the excess of recoverable amount over the carrying value of the Akkulka gas field would be reduced by approximately $3.172m.

**Oil and gas reserves**

Proved and probable oil and gas reserves are used in the units of production calculation for depletion as well as the determination of the timing of well closure costs and impairment analysis. There are numerous uncertainties inherent in estimating oil and gas reserves. Assumptions that are valid at the time of estimation may change significantly when new information becomes available. Changes in the forecast prices of commodities, exchange rates, production costs or recovery rates may change the economic status of reserves and may ultimately result in the reserves being restated.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Such estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

**Asset retirement obligation**

Provisions for environmental clean-up and remediation costs associated with the Company's drilling operations are based on current legal or constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, prices, discovery and analysis of site conditions and changes in clean-up technology.

**Income taxes**

The Company is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Company recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

**Fair value of derivative and other financial instruments**

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

**Other significant areas of judgement**

The estimates, assumptions and judgments made in relation to the fair value of stock based compensation and warrants and the associated expense recognition are subject to measurement uncertainty. The estimated fair values of financial assets and liabilities, by their very nature, are subject to measurement uncertainty.

## 5 Segmental Reporting

**Geographical segments**

Management has determined the operating segments based on the reports reviewed by the executive directors that are used to make strategic decisions. Reports provided to the executive directors with respect to segment information are measured in a manner consistent with that of the financial statements. The assets and liabilities are allocated based on the operations of the segment and for assets, the physical location of the asset.

The executive directors consider the business from predominantly a geographic perspective and the Company currently operates in three geographical markets: Kazakhstan, Tajikistan and Uzbekistan.

In Kazakhstan, the Company is producing oil and gas from the Kyzyloi and Akkulka fields and is undertaking exploration and evaluation activity in the Kulbas fields. In Tajikistan, the Company is mainly undertaking exploration and evaluation activity and in Uzbekistan, the Company operates under the North Urtabulak Production Enhancement Contract, which gives incremental production rights to increase the production volume of oil from wells on the North Urtabulak Oil Field.

The Company also operates a corporate segment which acquired a number of drilling rigs and related oil and gas equipment which will be utilised in Kazakhstan, Tajikistan, and Uzbekistan and possibly throughout the rest of Central Asia.

(tabular amounts in thousands of US dollars)

The segment results for the year ended December 31, 2010 are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Consolidated $'000 |
|---|---|---|---|---|---|
| Gas sales | 3,767 | - | - | - | 3,767 |
| Oil sales | 748 | - | - | - | 748 |
| Refined product sales | - | - | 9,851 | - | 9,851 |
| Other income | 3,122 | - | - | 539 | 3,661 |
| Finance income | 1 | 1 | - | 59 | 61 |
| **Segment revenue and other income** | **7,638** | **1** | **9,851** | **598** | **18,088** |
| Inter-segment revenue | (2,782) | - | - | (539) | (3,321) |
| **Segment revenue and other income from external customers** | **4,856** | **1** | **9,851** | **59** | **14,767** |
| Loss from jointly controlled entity | - | (634) | - | - | (634) |
| **(Loss)/ profit before taxation** | **(4,251)** | **(923)** | **3,350** | **(24,354)** | **(26,178)** |
| Taxation | (2,080) | - | (1,383) | (8) | (3,471) |
| **Net (loss)/profit attributable to shareholders** | **(6,331)** | **(923)** | **1,967** | **(24,362)** | **(29,649)** |

Sales in the Kazakhstan segment were made to three customers. Sales to those customers representing greater than 10% of total segment revenue were $3,836,361 and $931,357. Sales in the Uzbekistan segment were to two customers. Sales to one of those customers representing greater than 10% of total segment revenue were $8,970,182.

Borrowing costs of $1,943,533 were incurred during the year. These borrowing costs were capitalised in the Kazakhstan segment.

Amortisation of $514,283 of assets held in the Corporate segment were capitalised in Kazakhstan.

(tabular amounts in thousands of US dollars)

Segment results for the year ended December 31, 2009 were as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Consolidated $'000 |
|---|---|---|---|---|---|
| Gas sales | 3,828 | - | - | - | 3,828 |
| Refined product sales | - | - | 4,731 | - | 4,731 |
| Other income | - | - | - | 800 | 800 |
| Finance income | 29 | 2 | - | 45 | 76 |
| **Segment revenue and other income** | **3,857** | **2** | **4,731** | **845** | **9,435** |
| Inter-segment revenue | - | - | - | (800) | (800) |
| **Segment revenue and other income from external customers** | **3,857** | **2** | **4,731** | **45** | **8,635** |
| Loss from jointly controlled entity | - | (1,000) | - | - | (1,000) |
| **Loss before taxation** | **(5,165)** | **(3,040)** | **478** | **(13,779)** | **(21,506)** |
| Taxation | (64) | - | (145) | (5) | (214) |
| **Net loss attributable to shareholders** | **(5,229)** | **(3,040)** | **333** | **(13,784)** | **(21,720)** |

Sales in the Kazakhstan segment were made to a single customer. Sales in the Uzbekistan segment were to five customers. Sales to three of those customers representing greater than 10% of total segment revenue were $2,600,000, $763,000 and $712,000.

Borrowing costs of $2,100,503 were incurred during the year. These borrowing costs were capitalised in the Tajikistan segment ($1,387,702), Kazakhstan segment ($356,173) and Uzbekistan segment ($154,270). The remaining $202,358 was expensed through the statement of comprehensive loss.

Amortisation of $1,106,830 of assets held in the Corporate segment were capitalised in Kazakhstan: $460,451 and Tajikistan: $646,379.

(tabular amounts in thousands of US dollars)

The segment assets and liabilities as at December 31, 2010 and capital expenditures for the year then ended are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Consolidated $'000 |
|---|---|---|---|---|---|
| Total assets | 117,144 | 35,683 | 14,203 | 100,718 | 267,748 |
| Total liabilities | 8,543 | (7,732) | 6,478 | 20,936 | 28,225 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 33,058 | 2 | 4,937 | 296 | 38,293 |
| Depreciation, depletion & amortization | 2,929 | 69 | 1,570 | 1,317 | 5,885 |

Total assets for Tajikistan include the Company's investment in the joint venture (note 15).

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of $546,982.

The segment assets and liabilities at December 31, 2009 and capital expenditures for the year then ended are as follows:

| | Kazakhstan $'000 | Tajikistan $'000 | Uzbekistan $'000 | Other and Corporate $'000 | Consolidated $'000 |
|---|---|---|---|---|---|
| Total assets | 72,152 | 21,984 | 11,015 | 31,931 | 137,082 |
| Total liabilities | 1,914 | 3,759 | 6,992 | 17,813 | 30,478 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 8,553 | 16,942 | 3,709 | 3,017 | 32,221 |
| Depreciation, depletion & amortization | 2,497 | 138 | 603 | - | 3,238 |

Total assets for Tajikistan include the Company's investment in the joint venture (note 15).

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of $411,202.

(tabular amounts in thousands of US dollars)

## 6 Sales and other operating revenues

| | Year ended | |
|---|---|---|
| | December 31, 2010 $'000 | December 31, 2009 $'000 |
| Gas sales | 3,767 | 3,828 |
| Oil sales | 748 | - |
| Refined product sales | 9,851 | 4,731 |
| Other revenue | 340 | - |
| | 14,706 | 8,559 |

Revenue has been grossed up for non-monetary transactions, namely marketing commission of $nil (2009: $141,426) and utility services of $809,417 provided with respect to Uzbekistan (2009: $752,807). The corresponding expenses are shown within administrative and production expenses respectively.

## 7 Administrative expenses

| Administrative expenses by nature | Year ended | |
|---|---|---|
| | December 31, 2010 $'000 | December 31, 2009 $'000 |
| Staff expenses | 8,741 | 5,469 |
| Share-based payments | 5,956 | 2,628 |
| Travel expenses | 3,380 | 2,590 |
| Professional fees | 2,577 | 1,909 |
| Office costs | 2,080 | 1,835 |
| Other administrative expenses | 2,777 | 2,449 |
| | 25,511 | 16,880 |

Key management personnel have been identified as the Board of Directors and nine vice presidents. Details of key management remuneration are shown in note 23.

## 8 Share-based payments

The Company has adopted a stock incentive plan referred to as the "2007 Long Term Stock Incentive Plan" pursuant to which the Company may grant stock options to any director, employee or consultant of the Company, or any subsidiary or Vazon Energy Limited (collectively, "Service Providers").

The maximum number of Ordinary Shares reserved for issuance under the plan equals 12 % (2009: 12%) of the outstanding Ordinary Shares. The plan is administered by the Compensation and Nomination Committee of the Board of Directors. Options may be granted pursuant to recommendations of the Compensation and Nomination Committee. The Compensation and Nomination Committee may determine the vesting schedule and term, provided that options may not have a term exceeding ten years. Subject to any resolution passed by the Compensation and Nomination Committee, options will terminate three months after an option holder ceases to be a Service Provider.

(tabular amounts in thousands of US dollars)

The exercise price of options granted under the plan may not be less than the closing price of Ordinary Shares on the principal stock exchange where the Ordinary Shares are listed as of the date of the option grant. The plan contains amendment provisions which allow amendments to the plan by the Board of Directors, without shareholder approval, for amendments of a "housekeeping" nature, changes to vesting or termination provisions, and discontinuance of the plan. The plan also provides that outstanding options will vest immediately on the occurrence of a "change of control" (as defined in the plan). Options granted under the plan are only assignable to certain related entities of an option holder or otherwise with the consent of the Company.

Under the plan, the options vest in three tranches with one third vesting immediately, one third after one year and one third after two years. These options are equity settled share based payment transactions.

*Stock options*

The following table summarizes the stock option activity under the 2007 Long Term Stock Incentive Plan.

| | **Number of options** | **Weighted average exercise price $** |
|---|---|---|
| Outstanding at January 1, 2009 | 6,675,000 | 2.67 |
| Granted | 5,808,000 | 0.71 |
| Forfeited | (281,000) | 0.94 |
| Exercised | - | n/a |
| Expired | (496,000) | 2.43 |
| Outstanding at December 31, 2009 | 11,706,000 | 1.75 |
| Exercisable at December 31, 2009 | 7,325,666 | 2.20 |
| Outstanding at January 1, 2010 | 11,706,000 | 1.75 |
| Granted | 11,100,000 | 1.49 |
| Forfeited | (80,000) | 0.65 |
| Exercised | (360,000) | 0.62 |
| Expired | (103,000) | 1.02 |
| Outstanding at December 31, 2010 | 22,263,000 | 1.65 |
| Exercisable at December 31, 2010 | 13,148,000 | 1.86 |

The weighted average share price at the date of exercise was $1.62.

(tabular amounts in thousands of US dollars)

The following table lists the options outstanding at December 31, 2010 by exercise price.

| **Exercise price $** | **Options outstanding** | **Weighted average remaining term (in years)** | **Options exercisable** | **Weighted average remaining term (in years)** |
|---|---|---|---|---|
| 0.60 | 4,603,000 | 3.60 | 2,982,000 | 3.60 |
| 0.80 | 3,428,000 | 4.00 | 1,116,000 | 4.00 |
| 0.88 | 120,000 | 3.84 | 80,000 | 3.84 |
| C1.60 | 4,110,000 | 4.80 | 1,370,000 | 4.80 |
| 2.10 | 3,438,000 | 4.27 | 1,146,000 | 4.27 |
| 2.50 | 2,334,000 | 4.57 | 2,224,000 | 4.55 |
| 2.75 | 4,170,000 | 3.53 | 4,170,000 | 3.53 |
| 3.18 | 60,000 | 3.93 | 60,000 | 3.93 |
| Total | 22,263,000 | 4.08 | 13,148,000 | 3.96 |

The fair value of the share-based payment grants is estimated using the Black-Scholes pricing model using the following average assumptions:

| | **December 31, 2010** | **December 31, 2009** |
|---|---|---|
| Weighted average fair value | $0.9242 | $0.2841 |
| Risk free rate | 1.25% | 1.74% |
| Expected term | 3 years | 3 years |
| Volatility | 112.8% | 97.9% |
| Dividend | Nil | Nil |
| Weighted average share price | C$1.45 | C$0.51 |

In estimating expected volatility, the Company considers the historical volatility of its own share price over the most recent period that is commensurate with the expected option term.

(tabular amounts in thousands of US dollars)

*Warrants*

The following table summarizes the warrant activity for the years ended December 31, 2010 and December 31, 2009.

| | **Number of warrants** | **Weighted average exercise price $** |
|---|---|---|
| Outstanding at January 1, 2009 | 11,636,956 | 4.44 |
| Granted | 2,500,000 | 0.60 |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | (1,353,501) | 4.13 |
| Outstanding at December 31, 2009 | 12,783,455 | 3.73 |
| Exercisable at December 31, 2009 | 12,783,455 | 3.73 |
| Outstanding at January 1, 2010 | 12,783,455 | 3.73 |
| Granted | - | n/a |
| Forfeited | - | n/a |
| Exercised | (2,500,000) | 0.60 |
| Expired | - | n/a |
| Outstanding at December 31, 2010 | 10,283,455 | 4.48 |
| Exercisable at December 31, 2010 | 10,283,455 | 4.48 |

During the year ended December 31, 2010, there were no further warrant issues. During the year ended December 31,2009 2,500,000 warrants were issued in connection with loan financing (note 18.2).

Of the warrants outstanding at the beginning of the year, 7,504,003 relate to warrants granted to the Company's executive officers. These warrants remain outstanding and exercisable at December 31, 2010.

There are no performance conditions attached to the warrants and all the granted warrants were immediately vested. Warrants are equity settled share based payment transactions.

In estimating expected volatility, the Company considers the historical volatility of its own share price over the most recent period that is commensurate with the expected warrant term.

(tabular amounts in thousands of US dollars)

The following table lists the warrants outstanding at December 31, 2010 by exercise price.

| Exercise price $ | Warrants outstanding | Weighted average remaining term (in years) | Warrants exercisable | Weighted average remaining term (in years) |
|---|---|---|---|---|
| 1.25 | 638,298 | 1.21 | 638,298 | 1.21 |
| 2.50 | 3,436,154 | 4.18 | 3,436,154 | 4.18 |
| 3.25 | 795,000 | 0.27 | 795,000 | 0.27 |
| 5.50 | 2,255,835 | 0.49 | 2,255,835 | 0.49 |
| 6.88 | 3,158,168 | 1.99 | 3,158,168 | 1.99 |
| Total | 10,283,455 | 2.21 | 10,283,455 | 2.21 |

As at December 31, 2010, there was no unrecognized expense related to unvested warrants.

## 9 Taxation

Tethys is domiciled in the Cayman Islands which has no Company income tax.

The Company had the following balances of non-capital losses in respect of which no deferred tax asset has been recognized:

| | Kazakhstan $'000 | Netherlands $'000 | United States $'000 | December 31, 2010 $'000 |
|---|---|---|---|---|
| Within one year | - | - | - | - |
| One to five years | 125 | - | - | 125 |
| After five years | - | 3,456 | 4,329 | 7,785 |
| No expiry date | - | - | - | - |
| | 125 | 3,456 | 4,329 | 7,910 |

The temporary differences comprising the net deferred income tax liability as at December 31, 2010 are as follows:

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Capital assets | 5,107 | 1,078 |
| Tax losses | (1,048) | (325) |
| Other | 11 | (155) |
| Net deferred tax liability | 4,070 | 598 |

(tabular amounts in thousands of US dollars)

The provision for income taxes is different from the expected provision for income taxes for the following reasons:

| | Year ended December 31, 2010 $'000 | Year ended December 31, 2009 $'000 |
|---|---|---|
| Loss before income taxes | (26,178) | (21,506) |
| Income tax rate | 20% | 20% |
| Expected income tax (recovery) | (5,236) | (4,301) |
| *Increase/ (decrease) resulting from:* | | |
| Non-deductible expenses | (17) | 535 |
| Impact of effective tax rates in other foreign jurisdictions | 2,525 | 2,755 |
| Reversal of tax losses recognised in prior periods | 3,638 | - |
| Losses and tax assets not utilised/recognised | 2,466 | 1,155 |
| Other | 95 | 70 |
| | 3,471 | 214 |
| Deferred tax expense | 3,471 | 214 |

## 10 Loss per share

**Basic and diluted loss per share**

| | Loss for the year $'000 | Weighted average number of shares (thousands) | Per share amount $ |
|---|---|---|---|
| **Year ended December 31, 2010** | | | |
| Loss attributable to ordinary shareholders – Basic and diluted | (29,649) | 196,047 | (0.15) |
| **Year ended December 31, 2009** | | | |
| Loss attributable to ordinary shareholders – Basic and diluted | (21,720) | 106,450 | (0.20) |

Basic loss per share is calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the year. Diluted per share information is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares including share options and warrants, are considered to be anti-dilutive and have therefore been excluded from the diluted per share calculation.

(tabular amounts in thousands of US dollars)

## 11 Intangible assets

| | Other intangible asset | Exploration and evaluation assets | Total |
|---|---|---|---|
| | $'000 | $'000 | $'000 |
| **Year ended December 31, 2009** | | | |
| Opening net book amount | - | 16,105 | 16,105 |
| Additions through acquisition of subsidiary | 5,553 | - | 5,553 |
| Additions | - | 23,289 | 23,289 |
| Disposal of subsidiaries at book amount | - | (19,176) | (19,176) |
| Amounts written off to exploration and evaluation costs | - | (887) | (887) |
| Amortisation charge | (506) | - | (506) |
| **Closing net book amount** | 5,047 | 19,331 | 24,378 |
| **At December 31, 2009** | | | |
| Cost | 5,553 | 19,331 | 24,884 |
| Accumulated amortisation and impairment | (506) | - | (506) |
| **Net book amount** | 5,047 | 19,331 | 24,378 |
| **Year ended December 31, 2010** | | | |
| Opening net book amount | 5,047 | 19,331 | 24,378 |
| Additions | - | 34,467 | 34,467 |
| Transfers to property, plant and equipment | - | (41,466) | (41,466) |
| Amortisation charge | (487) | - | (487) |
| **Closing net book amount** | 4,560 | 12,332 | 16,892 |
| **At December 31, 2010** | | | |
| Cost | 5,553 | 12,332 | 17,885 |
| Accumulated amortisation and impairment | (993) | - | (993) |
| **Net book amount** | 4,560 | 12,332 | 16,892 |

Transfers to property, plant & equipment consists of the transfer of exploration expenditure related to the Akkulka Deep oil field following the establishment of proved reserves at the year end.

Borrowing costs of $1,943,533 (2009 – $1,387,000) have been capitalised within exploration and evaluation assets during the year. The effective weighted average interest rate of the relevant borrowings was 17% (2009 – 22%).

The effective interest rate is higher than the nominal rate due to the cost of associated warrants (Note 18.2) and royalties (Note 18.3). For the year ended December 31, 2010 $273,535 (2009 - $779,389) was capitalised from staff costs and share-based payment expense.

(tabular amounts in thousands of US dollars)

## 12 Property, plant and equipment

| | Oil and gas properties $'000 | Oil and gas equipment $'000 | Vehicles $'000 | Office and computer equipment $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Year ended December 31, 2009** | | | | | |
| Opening net book amount | 43,442 | 19,968 | 1,201 | 811 | 65,422 |
| Additions | 6,908 | 4,853 | 98 | 155 | 12,014 |
| Additions through acquisition of subsidiary | - | - | - | 117 | 117 |
| Disposal of subsidiaries at book amount | - | - | (162) | (140) | (302) |
| Depreciation charge | (2,823) | (1,033) | (117) | (107) | (4,080) |
| **Closing net book amount** | 47,527 | 23,788 | 1,020 | 836 | 73,171 |
| **At December 31, 2009** | | | | | |
| Cost | 54,462 | 24,893 | 1,324 | 1,099 | 81,778 |
| Accumulated depreciation | (6,935) | (1,105) | (304) | (263) | (8,607) |
| **Net book amount** | 47,527 | 23,788 | 1,020 | 836 | 73,171 |
| **Year ended December 31, 2010** | | | | | |
| Opening net book amount | 47,527 | 23,788 | 1,020 | 836 | 73,171 |
| Additions | 5,420 | 278 | 476 | 730 | 6,904 |
| Transfers from intangible assets | 41,466 | - | - | - | 41,466 |
| Disposals | - | - | (20) | (28) | (48) |
| Depreciation charge | (3,487) | (1,943) | (238) | (197) | (5,865) |
| Accumulated depreciation on disposal | - | - | 10 | 15 | 25 |
| **Closing net book amount** | 90,926 | 22,123 | 1,248 | 1,356 | 115,653 |
| **At December 31, 2010** | | | | | |
| Cost | 101,349 | 25,171 | 1,780 | 1,801 | 130,101 |
| Accumulated depreciation | (10,423) | (3,048) | (532) | (445) | (14,448) |
| **Net book amount** | 90,926 | 22,123 | 1,248 | 1,356 | 115,653 |
| | | | | | |
| Asset under construction at net book amount included in above | | | | | |
| **At December 31, 2010** | 26,612 | - | - | - | 26,612 |
| At December 31, 2009 | 25,858 | - | - | - | 25,858 |

Assets under construction as at December 31, 2010 includes the cost of developing the Akkulka oil concession and are not being depreciated until commencement of production. Assets under construction as at December 31, 2009 includes the cost of developing the Akkulka gas concession and tie-in pipeline and are not being depreciated until commencement of production.

(tabular amounts in thousands of US dollars)

Borrowing costs of $nil have been capitalised to oil and gas properties in the current year (2009 - $513,000). The effective weighted average interest rate of the relevant borrowing was 17%, (2009 19.58 %). The effective interest rate is higher than the nominal rate due to the cost of associated warrants (note 18.2). For the year ended December 31, 2010 $1,238,327 (2009 - $438,584) was capitalised from staff costs and share-based payment expense.

## 13 Investments

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Restricted cash | 1,015 | 659 |

Restricted cash at December 31, 2010 and December 31, 2009 consisted of interest bearing bank deposits held in Kazakhstan. These deposits have been placed to satisfy local Kazakhstan requirements in respect of asset retirement obligations. Of the balance held at December 31, 2010 $929k was held on deposit in USD and the remaining balance held in KZT (2009 - $604k held on deposit in USD and the remaining balance held in KZT).

## 14 Trade and other receivables

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| **Current** | | |
| Trade receivables | 1,661 | 905 |
| Prepayments | 1,092 | 502 |
| Other receivables | 927 | 904 |
| | 3,680 | 2,311 |
| **Other receivables - non-current** | | |
| Advances to construction contractors | 3,631 | 333 |
| Hong Kong Stock Exchange (HKSE) deferred offering costs | - | 352 |
| Value added tax receivable | 8,689 | 4,486 |
| | 12,320 | 5,171 |
| | 16,000 | 7,482 |

Current trade and other receivables are unsecured and non-interest bearing. Normal payment terms for the Company are 30 days. Prepayments primarily relate to prepaid insurance and other corporate operating expense items.

There are no trade receivables overdue past thirty days (December 31, 2009 – $905,000). The other classes within trade and other receivables do not contain impaired assets.

Non-current advances to construction contractors relate to suppliers who were paid in advance for materials and services relating to both the Akkulka and the Kul-Bas contracts. For the Akkulka contract, the prepayments relate to the drilling of a new well and payments on compressors, pipes and associated construction work that will constitute phase two of the Company's gas production plan. For Kul-Bas the prepayment related primarily to the drilling of a new well.

(tabular amounts in thousands of US dollars)

## 15 Investment in Joint Venture

The Company has a 51% interest in a jointly controlled entity, Seven Stars Energy Corporation Limited (SSEC). On December 30, 2009 the Company transferred ownership of its three Tajik subsidiaries to SSEC. At December 31, 2010 the Company's investment in the joint venture was $nil (2009: $nil).

The consideration received by Tethys from SSEC was a note receivable in the amount of $21,727,000, which represents Tethys' book value of assets transferred plus an amount for certain costs previously expensed by Tethys which are recoverable from SSEC.

This transaction resulted in a gain of $4,699,000, which has been deferred on the statement of financial position. This amount has been recorded as a reduction of the investment account in the amount of $1,040,000 (which has reduced the investment account to $nil as at December 31, 2009), with the remaining balance of $3,659,000 being recorded as a deferred gain. The deferred gain will be recognised in the statement of comprehensive loss when realised.

The following amounts represent the movements in the loan receivable

| | Year ended December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Balance, beginning of year | 21,727 | - |
| Share of loss | (634) | (1,000) |
| Movement in deferred gain | 40 | - |
| Contributions made on behalf of jointly controlled entity | 14,327 | 22,727 |
| Balance, end of year | 35,460 | 21,727 |

The purpose of the loan, which is interest bearing, is to enable the jointly controlled entity to finance work programs and field development plans of any of its subsidiaries in Tajikistan. Repayments shall commence during the calendar quarter during which the first revenues are generated from production sharing oil and/or gas sales under any production sharing contracts in Tajikistan. The majority of properties in Tajikistan are still currently in the exploration phase.

(tabular amounts in thousands of US dollars)

The following tables represent the assets and liabilities of the jointly controlled entity at the year end and its results for the year to December 31.

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| **Assets** | | |
| Non-current assets | 44,446 | 24,173 |
| Current assets | 404 | 113 |
| Total assets | 44,850 | 24,286 |
| **Liabilities** | | |
| Non-current liabilities | (43,233) | (21,727) |
| Accruals | (820) | (519) |
| Total liabilities | (44,053) | (22,246) |
| **Net assets** | 797 | 2,040 |

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Revenue | 203 | - |
| Expenses | (1,445) | (1,960) |
| Loss before tax | (1,242) | (1,960) |
| 51% share of joint venture loss before tax | (634) | (1,000) |

## 16 Inventories

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Raw materials | 697 | 443 |
| Finished goods | 1,424 | 1,925 |
| | 2,121 | 2,368 |

## 17 Cash and cash equivalents

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Cash at bank and in hand | 28,501 | 6,788 |
| Short-term deposits | 50,634 | 509 |
| | 79,135 | 7,297 |

(tabular amounts in thousands of US dollars)

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

## 18 Financial liabilities

### 18.1 Borrowings

| | Effective interest rate % | Maturity date | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|---|---|
| **Current** | | | | |
| Short-term portion of long-term loans | 19 – 23 p.a. | 2010 | - | 1,086 |
| | | 2011 | 5,047 | 8,199 |
| **Non-current** | | | | |
| Long-term loans | 19 – 23 p.a. | 2012 | 2,853 | 1,125 |
| | | | 7,900 | 10,410 |

Financial borrowings relate to financing arrangements that were put in place to fund the acquisition of the Telesto deep drilling rig (Telesto) and the Tykhe drilling rig (Tykhe) in 2008 and the drilling of a new well in Uzbekistan in 2009. The Telesto loan was repaid early, in full at the end of 2010.

Principal repayments for the loans are as follows:

| | | Drilling rig loans $'000 | Uzbekistan loans $'000 | Total $'000 |
|---|---|---|---|---|
| To December 31, | 2011 | 1,164 | 4,100 | 5,264 |
| | 2012 | - | 3,408 | 3,408 |
| Remaining principal payments | | 1,164 | 7,508 | 8,672 |
| Less: unamortised debt discount | | (164) | (608) | (772) |
| Balance, end of year | | 1,000 | 6,900 | 7,900 |
| | Current | 1,000 | 4,047 | 5,047 |
| | Non-current | - | 2,853 | 2,853 |

The loan to fund Telesto bears interest at a nominal rate of 12%. In addition 795,000 warrants to purchase Tethys shares at CAD$3.25 with a term of three years were issued to lenders. The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt, with the effective interest rate method being used to amortise the discount over the life of the loan. Lenders have security over the shares of Tethys Petroleum Inc. which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys. The debt was repaid, early, at the end of the financial year.

The loan to fund Tykhe bears interest at a nominal rate of 15%. In addition 638,298 warrants to purchase Tethys shares at CAD$1.25 with a term of three years were issued to lenders.

The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt, with the effective interest rate method being used to amortise the discount over the life of the loan. Lenders have security over the shares of AOE Tykhe BV which has no other assets except the drilling rig and in addition a corporate guarantee is being provided by Tethys.

Based on the borrowing rates currently available to the Company for long term borrowings with similar terms and average maturities (17%), the fair value of the financial borrowings in relation to the drilling rigs approximate their carrying value in both current and comparative years. With respect to the new well in Uzbekistan the fair value of the financial borrowings is $6,249,979 (2009 – approximates carrying value).

On October 19, 2009 Tethys closed a loan financing for $4.1 million with a group of investors in connection with the drilling of a new well in Uzbekistan. A coupon of 10% per annum is due for the first two months, which is the expected drilling time of the well. Thereupon the lenders will receive 6% per annum coupon and 6.25% of the revenue received by BHCL from sales of the net production from the new well for every $1.0 million invested, calculated monthly and payable quarterly in arrears over a period of up to 24 months. If the well does not produce the investor will receive only the 6% per annum coupon on the funds invested.

On December 14, 2009 in connection with the drilling of the above new well in Uzbekistan the Company further approved the issue of loan notes to a maximum value of $3,000,000 at an issue rate of $0.88 per note and redemption value of $1, resulting in an effective rate of 6.5%. By December 31, 2009, $1,000,000 loan notes had been placed. A further $2,000,000 loan notes were placed in February 2010. A royalty of 11.25% is payable to the loan note holders calculated on sales of net production from the new well. The royalty entitlement was identified as an embedded derivative and required to be separated from the loan note. The royalty entitlement has been accounted for as a derivative financial instrument – interest rate swap. Refer to note 18.

Issue of the loan notes was completed via a broker to whom a royalty commission is payable at 4.5% for every $1.0 million placed. The total fair value of the commission payable on these loan notes was $371,924. The Company measured the fair value of the commission payables by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the royalty entitlement. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%). The fair value associated with the royalty entitlement has been recognised as a transaction cost and presented as a direct reduction to the face value of the borrowing with the effective interest rate method being used to amortise the cost over the life of the loan. By the end of 2010, the well associated with this loan was no longer producing and therefore the fair value of the commission liability is $nil at December 31, 2010 (2009 - $42,333).

(tabular amounts in thousands of US dollars)

### 18.2 Derivative financial instrument - warrants

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Balance, beginning of year | 1,053 | 146 |
| Issued during the year | - | 422 |
| Fair value loss / (gain) | 1,815 | 485 |
| Exercised during the year | (2,463) | - |
| Balance, end of year | 405 | 1,053 |

The warrant liability represents the financial liability relating to share warrants that are denominated in a currency that is not the Company's functional currency. These warrants were issued in connection with the two rig loans described in note 18.1.

The liability was initially recognised at fair value. As the warrants are denominated in foreign currency, there is a written option for the holder to exchange the foreign currency denominated warrant for a fixed number of functional currency denominated shares. This option is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income.

The fair value of the liability is estimated using the Black-Scholes pricing model using the following average assumptions:

| | December 31, 2010 | December 31, 2009 |
|---|---|---|
| Weighted average fair value | $0.30 | $0.29 |
| Exercise price | C$2.36 | $1.24 |
| Risk free rate | 1.66% | 1.46% |
| Expected term | 0.56 years | 1.18 years |
| Volatility | 57% | 87% |
| Dividend | Nil | Nil |

The weighted average share price of exercised warrants was $1.57.

### 18.3 Derivative financial instruments - interest rate swap

The interest rate swap represents the derivative financial instrument entered into in connection with the Uzbekistan loan financing disclosed in note 18.1 completed in the year. This instrument is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income. The Company measured the fair value of the liability by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the instrument. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%). During the year, a significant fluctuation occurred in the fair value of the interest rate swaps due to a significant decline in expected production from well NUR 116, which resulted in a fair value gain as disclosed below. The asset balance at the end of the year represents the saving in interest expense.

(tabular amounts in thousands of US dollars)

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Balance, beginning of year | (95) | - |
| Derivative financial instrument entered into | (918) | (101) |
| Fair value (loss) / gain | 2,407 | 6 |
| Royalty payments | 78 | - |
| Balance, end of year | 1,472 | (95) |

## 19 Trade and other payables

| | December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| **Current** | | |
| Trade payables | 5,672 | 4,236 |
| Accruals | 2,230 | 1,997 |
| Payables to related parties | - | 35 |
| Other creditors | 886 | 518 |
| | 8,788 | 6,786 |
| **Non-current** | | |
| Other non-current payables | 721 | 808 |

Trade payables are non-interest bearing and are normally settled on 30 day terms. Accruals represent mainly fees outstanding to the drilling contractor in Uzbekistan and professional fees. Other current creditors consist mainly of local taxes in the Republic of Kazakhstan and the current portion of the Kyzyloi historical costs. All current trade and other payables are interest free and payable within 12 months.

Included within other non-current payables are accruals for historical costs due to the Government of Kazakhstan on the Kyzyloi and Akkulka contracts in Kazakhstan.

**Kyzyloi**

The principal amount of the historical cost liability outstanding at December 31, 2010 was $562,172 (2009 – $735,053) and this is to be repaid in quarterly instalments by March 2014. The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method, using an assumed market rate of interest (10%) on initial recognition. The carrying value of the liability is $474,957 (2009 – $510,455) of which $130,265 (2009 – $101,955) is current, leaving a non-current balance of $344,692 (2009 – $408,500). Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities (17%), the fair value of the liability relating to historic costs is $425,197 (2009 – $510,455).

(tabular amounts in thousands of US dollars)

**Akkulka**

Upon signature of the Akkulka gas production contract on December 23, 2009, the historical cost liability in relation to this field became due. The principal amount of the historical cost liability outstanding at December 31, 2010 was $823,597 (2009: $933,997) and this is to be repaid in quarterly instalments by June 2018. The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method, using an assumed market rate of interest (22%) on initial recognition. The carrying value of the liability is $400,248 (2009: $414,437) of which $24,258 (2009: $19,581) is current, leaving a non-current balance of $375,990 (2009: $394,856).

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities (17%), the fair value of the liability relating to historic costs is $461,838 (2009 - approximates its carrying value).

Principal repayments for both contracts are as follows:

| | | $'000 |
|---|---|---|
| To December 31, | 2011 | 283 |
| | 2012 | 283 |
| | 2013 | 283 |
| | 2014 | 154 |
| | 2015 and thereafter | 383 |
| Remaining principal payments | | 1,386 |
| Less: unamortised debt discount | | (511) |
| Balance, end of year | | 875 |
| | Current | 154 |
| | Non-current | 721 |
| | | 875 |

## 20 Asset retirement obligations

| | Year ended December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| At January 1 | 206 | 465 |
| Additional obligations incurred | 15 | 77 |
| Change in estimated cash flow | (48) | (358) |
| Unwinding of discount due to passage of time | 19 | 22 |
| **At December 31** | 192 | 206 |

The Company makes provision for the future cost of decommissioning oil and gas production facilities and pipelines on a discounted basis. These costs are expected to be incurred between 2012 and 2022. The provision has been estimated using existing technology at current prices, escalated at 10% (2009 – 10%) and discounted at 11% (2009 – 11%). The economic life and the timing of the asset retirement obligation are dependent on Government legislation, commodity prices and the future production profiles of the project. In addition, the estimated cash outflows are subject to inflationary and/or deflationary pressures in the cost of third party service provision. The undiscounted amount of liability at December 31, 2010 is $602,085 (2009 - $571,094).

(tabular amounts in thousands of US dollars)

## 21 Share capital

| | Number | December 31, 2010 Number | December 31, 2009 Number |
|---|---|---|---|
| **Authorized** | | | |
| Ordinary shares with a par value of $0.10 each | | 700,000,000 | 700,000,000 |
| Preference shares with a par value of $0.10 each | | 50,000,000 | 50,000,000 |

The preference shares have the rights as set out in the Memorandum and Articles of Association approved at

| **Ordinary equity share capital Allotted and fully paid** | Number | Share capital $'000 | Share premium $'000 |
|---|---|---|---|
| At January 1, 2009 | 66,393,292 | 6,639 | 138,598 |
| Issued during the year for purchase of oil and gas equipment | 1,400,000 | 140 | 701 |
| Issued during the year in connection with finance charges | 81,477 | 8 | 226 |
| Issued during the year for purchase of a subsidiary | 15,000,000 | 1,500 | 1,487 |
| Issued during the year for cash | 51,680,000 | 5,168 | 12,736 |
| **At December 31, 2009** | 134,554,769 | 13,455 | 153,748 |
| **At January 1, 2010** | 134,554,769 | 13,455 | 153,748 |
| Issued during the year in connection with the exercise of stock options | 360,000 | 36 | 287 |
| Issued during the year in connection with the exercise of warrants | 2,500,000 | 250 | 2,711 |
| Issued during the year for cash | 123,215,000 | 12,322 | 140,476 |
| **At December 31, 2010** | 260,629,769 | 26,063 | 297,222 |

the AGM on April 24, 2008. Significant terms related to preference shares are summarised below:

- May be issued in one or more series;
- Are entitled to any dividends in priority to the ordinary shares;
- Confer upon the holders thereof rights in a winding-up priority to the ordinary shares;
- And may have such other rights, privileges and conditions (including voting rights) as the Board may determine prior to the first allotment of any series of preference shares, provided that if a series of preference shares has no or limited voting rights it shall be designated as such by the Board.

As at December 31, 2010 a total of 31,275,572 (December 31, 2009 – 24,489,455) ordinary shares are reserved under the Company's Long Term Stock Incentive Plan and Warrants granted by the Company. Details of the options and warrants are given in note 8.

There are currently no preference shares outstanding (2009 – None).

## 22 Business combination

During 2010 there were no business combinations.

On April 9, 2009 the Company acquired 100% of the issued share capital in Baker Hughes (Cyprus) Limited (BHCL), a Company incorporated in Cyprus, which operates under a production enhancement contract relating to the North Urtabulak field in Uzbekistan. Tethys issued 15,000,000 ordinary shares as purchase consideration in the acquisition. The acquisition agreement places a trading restriction on the shares as follows: 7,500,000 cannot be resold until 6 months from the date of issue and the remaining 7,500,000 cannot be resold until 12 months from the date of issue.

During 2009, the acquired business contributed revenues of $4,731,000 and a net profit before taxation of $477,000 to the Company for the period from April 9, 2009 to December 2009 (note 5). If the acquisition had occurred on January 1, 2009 the revenue of the Company would have been $1,017,371 higher (unaudited) and the net profit before taxation would have been $112,000 higher (unaudited). These amounts have been calculated using the Company's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from January 1, 2009.

The fair value of the shares issued was based on the published price of the shares on the date of acquisition. As the shares were issued with a trading restriction, this resulted in a marketability discount being applied to the published price to arrive at the fair value. The marketability discount was valued using the Black Scholes Option Pricing Model using the following assumptions: dividend yield of 0%; expected term of 0.75 years; a risk free interest rate of 0.60% and expected volatility of 121%. This resulted in an adjustment of $2,344,484 to the purchase consideration.

(tabular amounts in thousands of US dollars)

| | Fair value $ |
|---|---|
| **Consideration at April 9, 2009** | |
| Equity instruments (15,000,000 ordinary shares) | 2,987 |
| Direct costs related to the acquisition | 57 |
| **Total consideration transferred** | 3,044 |
| | |
| **Recognised amounts of identifiable assets acquired and liabilities assumed** | |
| Cash and cash equivalents | 532 |
| Trade and other receivables | 502 |
| Intangible asset | 3,820 |
| Property, plant and equipment | 118 |
| Inventory | - |
| Deferred revenue | - |
| Current trade and other payables | (1,928) |
| Deferred income tax liability | - |
| **Total identifiable net assets** | 3,044 |

Assets and liabilities acquired in a business combination are required to be recognised at fair value. In the absence of an active market for the North Urtabulak Field Production Enhancement Contract, the Company measured the fair value of the asset by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the asset. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the asset and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows.

(tabular amounts in thousands of US dollars)

## 23 Related party transactions

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

| Subsidiaries | Percentage | Country of operation | Country of registration |
|---|---|---|---|
| Tethys Uzbekistan BV | 100% | Netherlands | Netherlands |
| Tethys Petroleum Inc. | 100% | USA | USA |
| Tethys Afghanistan Inc. | 100% | Dormant | USA |
| Tethys Kazakhstan Limited | 100% | Guernsey | Guernsey |
| Tethys Aral Gas LLP | 100% | Kazakhstan | Kazakhstan |
| Kul-Bas LLP | 100% | Kazakhstan | Kazakhstan |
| Tethys Munai Gaz LLP | 100% | Dormant | Kazakhstan |
| Tethys Services Kazakhstan LLP | 100% | Kazakhstan | Kazakhstan |
| Asia Oilfield Equipment BV | 100% | Kazakhstan/ Tajikistan | Netherlands |
| Tethys Europa BV | 100% | Dormant | Netherlands |
| AOE Telesto BV | 100% | Dormant | Netherlands |
| AOE Tykhe BV | 100% | Dormant | Netherlands |
| AOE Tykhe SA | 100% | Dormant | Luxemburg |
| Tethys Services Limited | 100% | United Kingdom | United Kingdom |
| Tethys Caspian Limited | 100% | Dormant | Cyprus |
| Tethys Tajikistan Limited | 100% | Tajikistan | Cayman Islands |
| Imperial Drilling Services Limited | 100% | Cayman Islands | Cayman Islands |
| Amu Darya Petroleum Limited | 100% | BVI | BVI |
| Tethyda Limited | 100% | Dormant | Cyprus |
| Baker Hughes (Cyprus) Limited (t/a Tethys Production Uzbekistan Limited) | 100% | Uzbekistan | Cyprus |
| Rosehill Energy Limited | 100% | Uzbekistan | Cayman Islands |
| **Jointly controlled entities** | | | |
| Seven Stars Energy Corporation | 51% | Tajikistan | BVI |

The Company has an indirect shareholding of the following companies through its share of Seven Stars Energy Corporation:

| | | | |
|---|---|---|---|
| Tethys Services Tajikistan Ltd. | 51% | Tajikistan | Tajikistan |
| Kulob Petroleum Ltd. | 51% | Tajikistan | Jersey |
| Sogdiana Petroleum Ltd. | 51% | Tajikistan | Cayman Islands |

(tabular amounts in thousands of US dollars)

Other

Vazon Energy Limited ("Vazon") is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director.

Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the year ended December 31, 2010 was $2,525,885 (2009 – $1,677,113).

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to the optimization of the existing compressors and those to be installed as part of Phase 2 gas production from Akkulka, and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the year ended December 31, 2010 were $182,470 (2009 – $497,697).

The remuneration of the key management personnel of the Company is set out below in aggregate.

| | Year ended | |
|---|---|---|
| | **December 31, 2010 $'000** | **December 31, 2009 $'000** |
| Salaries and short-term employee benefits | 5,439 | 3,026 |
| Share-based payments | 5,642 | 2,071 |
| | 11,081 | 5,097 |

Transactions with affiliates or other related parties including management of affiliates are recorded at their exchange amount.

(tabular amounts in thousands of US dollars)

## 24 Changes in working capital

| | Year ended December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Trade and other receivables | (1,368) | 353 |
| Inventories | 249 | (2,155) |
| Trade and other payables | 2,002 | 4,051 |
| Change in non-cash working capital | 883 | 2,249 |
| Non-cash transactions | (214) | (2,136) |
| Net changes in non-cash working capital | 669 | 113 |

The principal non-cash transaction is related to the issue of shares as consideration for the acquisition discussed in note 22.

Net changes in non-cash working capital are categorized as follows:

| | Year ended December 31, 2010 $'000 | December 31, 2009 $'000 |
|---|---|---|
| Operating activities | (2,792) | (1,160) |
| Investing activities | 3,461 | 1,273 |
| Balance | 669 | 113 |

## 25 Commitments and contingencies

### Kazakhstan

*Kyzyloi Field and the Kyzyloi Field Licence and Production Contract*

The Kyzyloi Field Licence and Production Contract grants TAG exploration and production rights over an area of approximately 70,967 acres (287.2 km$^2$) and extends down to the base of the Paleogene sequence. Pursuant to the contract, TAG must reimburse the Kazakh government for approximately $1,211,000 in historical costs, to be paid in equal quarterly instalments from the commencement of production until full reimbursement. Under the latest extension of the Kyzyloi Field Licence and Production Contract, TAG has committed to spending approximately $2.7 million for a workover program over the seven year period until 2014. In November 2009, the Company finalised and agreed the 2010 work program with a commitment of $136,350. As at December 31, 2010, this requirement had been satisfied by the expenditure of some $343,000. With respect to 2011, a work program amounting to $120,000 has been agreed.

*Akkulka Exploration Licence and Contract*

The Akkulka Exploration Licence and Contract was entered into between the Kazakh State Committee of Investments and TAG on September 17, 1998. On November 19, 2010, the Ministry of Oil and Gas approved an extension to the exploration period until March 10, 2013. Under the previous amendment agreement (to March 10,2011) TAG committed to spending an additional $850,000 over the 18 month period and the 2010 work program for Akkulka was agreed with a capital commitment of $676,700. As of March 2010, a revised Annual Work Program for Akkulka Exploration was approved which committed the Company to spend $11,190,000 in 2010 which has been satisfied through payments incurred by December 31, 2010 in excess of $33,000,000. With respect to 2011, a work program amounting to $3,210,000 has been agreed.

*Akkulka Production Contract*

On December 23, 2009, TAG and MEMR signed the Akkulka Production Contract giving TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years. Contingent upon commencement of commercial production on the Akkulka contractual territory, a total amount of US$3,500,000 will be due to the Kazakhstan Government as a reimbursement of historical costs previously incurred by the Government in relation to the contractual territory. For that part of the contractual territory from which production will commence in 2010 staged payments over a period of nine years totalling approximately $933,997 will also be due to the Kazakh government for the reimbursement of historical costs (note 18). The 2010 minimum work program was agreed with a capital commitment of $90,900. As at December 31, 2010, this requirement had been satisfied by the expenditure of $109,300. There are no contractual commitments regarding production in 2011.

*Kul-Bas Exploration and Production Contract*

The Kul-Bas Exploration and Production Contract was signed between Kul-Bas and the MEMR on November 11, 2005. This contract, which is for a period of 25 years (unless extended by mutual agreement of the parties), with an initial six-year exploration period and a 19-year production period, grants Kul-Bas exploration and production rights over an original 2,688,695 acres (10,881 $km^2$) surrounding the Akkulka Block. Pursuant to the original contract, 20% of the area was to be relinquished at the end of the second year of the contract, with 20% to be relinquished annually thereafter up to the end of the six year exploration period. However, in response to an application on behalf of the Company, on April 27, 2009, Amendment 1 to the Kul-Bas Exploration and Production Contract was signed, according to which 20% is relinquished by the end of contract year 2 (completed), 0% in contract year 3 (2008), 10% by the end of contract year 4 (2009), 20% by the end of year 5 (2010) and all remaining contract area, outside commercial discovery areas, by the end of year 6 (2011). On December 23, 2010 an extension of the exploration period for a further 2 years to November 11, 2013 was agreed by the Ministry of Oil and Gas.

The work program on this area amounted to a total of approximately $7,773,500 over the initial six-year exploration period. The remaining commitment of $2,894,000 relating to the contractual territory is required to be satisfied by November 11, 2011 and is included within the 2010 work program of $3,045,150. As at December 31, 2010, this requirement had been satisfied by the expenditure of $3,039,150. In addition to the minimum work program commitments, the Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of US$3,275,780. The Company has previously paid an amount of $49,137 in relation to this balance. If and when commercial production commences, $88,666 is due in quarterly instalments until the remaining historical costs of $3,226,643 has been paid in full. With respect to 2011, a work program amounting to $273,000 has been agreed.

(tabular amounts in thousands of US dollars)

**Uzbekistan**

On August 11, 2010 a turnkey contract was signed for the provision of sidetracking equipment and associated services with a total commitment of $2,592,550, of which $388,883 had been accrued for work performed under this contract prior to the year end. The full commitment was paid on February 28, 2011.

**Operating leases**

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

| | **Total $'000** | **Less than 1 year $'000** | **1 – 3 years $'000** |
|---|---|---|---|
| Operating leases | 666 | 456 | 210 |

2010 expenditure on lease commitments included in the statement of comprehensive loss amounted to $415,117 (2009 - $480,552).

## SECTION C

## CONSOLIDATED FINANCIAL STATEMENTS AND AUDIT REPORT FOR THE YEAR ENDED 31 DECEMBER 2009

# Tethys Petroleum Limited

Consolidated Financial Statements
**December 31, 2009**
(in thousands of US dollars)

## Management Report

The accompanying consolidated financial statements and all the information in the annual report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies described in the notes to the financial statements. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards, appropriate in the circumstances, as issued by the International Accounting Standards Board. The consolidated financial information contained elsewhere in the annual report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management has developed and maintains systems of internal accounting controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguarding of assets.

External auditors, appointed by the shareholders of the Company, have examined the consolidated financial statements and have expressed an opinion on the consolidated statements. Their report is included with the consolidated financial statements.

The Board of Directors of the Company has established an Audit Committee, consisting of independent non-management directors, to review consolidated financial statements with management and the auditors. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

| | |
|---|---|
| *"Dr. D. Robson"* | *"B. Murphy"* |
| Chief Executive | Chief Financial Officer |

March 31, 2010

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers LLP**
**Chartered Accountants**
111 5 Avenue SW, Suite 3100
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Facsimile +1 403 781 1825

March 31, 2010

**AUDITORS' REPORT**

**To the Shareholders of**
**Tethys Petroleum Limited**

We have audited the consolidated statements of financial position of Tethys Petroleum Limited as at December 31, 2009, December 31, 2008 and January 1, 2008 and the consolidated statements of comprehensive loss, changes in equity and cash flows for each of the years ended December 31, 2009 and 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009, December 31, 2008 and January 1, 2008 and the results of its operations and its cash flows for each of the years ended December 31, 2009 and 2008 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

# Tethys Petroleum Limited
Consolidated Statement of Financial Position

(in thousands of US dollars)

| | Note | As at December 31 2009 $ | As at December 31 2008 $ | As at January 1 2008 (note 26) $ |
|---|---|---|---|---|
| **Non-current assets** | | | | |
| Property, plant and equipment | 12 | 73,171 | 65,422 | 38,327 |
| Intangible assets | 11 | 24,378 | 16,105 | 7,335 |
| Investments | 13 | 659 | 587 | 318 |
| Trade and other receivables | 14 | 5,171 | 6,357 | 5,814 |
| Loan receivable from jointly controlled entity | 15 | 21,727 | 0 | 0 |
| | | 125,106 | 88,471 | 51,794 |
| **Current assets** | | | | |
| Inventories | | 2,368 | 213 | - |
| Trade and other receivables | 14 | 2,311 | 2,664 | 1,360 |
| Cash and cash equivalents | 16 | 7,297 | 22,200 | 26,692 |
| | | 11,976 | 25,077 | 28,052 |
| **Total assets** | | 137,082 | 113,548 | 79,846 |
| **Equity attributable to shareholders** | | | | |
| Share capital | 20 | 13,455 | 6,639 | 4,511 |
| Share premium | 20 | 153,748 | 138,598 | 94,972 |
| Other reserves | | 27,775 | 25,147 | 20,728 |
| Accumulated deficit | | (88,374) | (66,654) | (44,470) |
| **Total equity** | | 106,604 | 103,730 | 75,741 |
| **Non-current liabilities** | | | | |
| Deferred gain on sale of assets to jointly controlled entity | 15 | 3,659 | - | - |
| Financial liabilities - borrowings | 17 | 9,324 | 5,096 | - |
| Shares to be issued | | 3,750 | - | - |
| Deferred taxation | 9 | 598 | - | - |
| Trade and other payables | 18 | 808 | 523 | 776 |
| Asset retirement obligations | 19 | 206 | 465 | 1,050 |
| | | 18,345 | 6,084 | 1,826 |
| **Current liabilities** | | | | |
| Financial liabilities - borrowings | 17 | 1,086 | 853 | - |
| Derivative financial instruments - warrants | 17 | 1,053 | 146 | - |
| Derivative financial instruments – interest rate swap | 17 | 95 | - | - |
| Deferred revenue | | 3,113 | - | - |
| Trade and other payables | 18 | 6,786 | 2,735 | 2,279 |
| | | 12,133 | 3,734 | 2,279 |
| **Total liabilities** | | 30,478 | 9,818 | 4,105 |
| **Total shareholders' equity and liabilities** | | 137,082 | 113,548 | 79,846 |
| Commitments and contingencies | 25 | | | |

The notes on pages 1 to 58 form part of these consolidated financial statements. The financial statements on pages 1 to 63 were approved by the Board on 31 March 2010 and were signed on its behalf.

*"Dr. D. Robson"*
Chief Executive

*"B. Murphy"*
Chief Financial Officer

# Tethys Petroleum Limited

Consolidated Statement of Comprehensive Loss

(in thousands of US dollars, except for per share amounts)

| | Note | Year ended December 31, 2009 $ | 2008 $ |
|---|---|---|---|
| Sales and other operating revenues | 6 | 8,559 | 5,360 |
| Finance income | | 76 | 832 |
| Total revenue and other income | | 8,635 | 6,192 |
| Production expenditures | | (3,405) | (1,334) |
| Depreciation, depletion and amortization | | (3,238) | (4,333) |
| Exploration and evaluation expenditure written off | | (887) | (2,292) |
| Listing expenses | | (1,652) | - |
| Administrative expenses | 7 | (16,880) | (17,915) |
| Foreign exchange gains (loss) net | | (2,397) | (3,060) |
| Fair value gain / (loss) on derivative financial instrument | | (479) | 929 |
| Loss from jointly controlled entity | 15 | (1,000) | - |
| Finance costs | | (203) | (371) |
| **Loss before taxation** | | **(21,506)** | **(22,184)** |
| Taxation | 9 | (214) | - |
| **Net loss and comprehensive loss for the year attributable to shareholders** | | **(21,720)** | **(22,184)** |
| **Loss per share attributable to shareholders** | | | |
| Basic and diluted | 10 | (0.20) | (0.40) |

No dividends were paid or are declared for the year (2008 – $Nil).

The notes on pages 1 to 58 form part of these consolidated financial statements.

# Tethys Petroleum Limited

Consolidated Statement of Changes in Equity
(in thousands of US dollars)

| | Note | Share capital $ | Share premium $ | Accumulated deficit $ | Option reserves $ | Warrant reserves $ | Total equity $ |
|---|---|---|---|---|---|---|---|
| | | Attributable to shareholders | | | | | |
| **Balance at January 1, 2008** | 20 | 4,511 | 94,972 | (44,470) | 4,173 | 16,555 | 75,741 |
| Comprehensive loss for the year | | - | - | (22,184) | - | - | (22,184) |
| **Transactions with shareholders** | | | | | | | |
| Issue of share capital | 20 | 2,128 | 47,872 | - | - | - | 50,000 |
| Cost of share issue | | - | (4,246) | - | - | - | (4,246) |
| Share-based payments | | - | - | - | 4,419 | - | 4,419 |
| **Total transactions with shareholders** | | 2,128 | 43,626 | - | 4,419 | - | 50,173 |
| **Balance at January 1, 2009** | | 6,639 | 138,598 | (66,654) | 8,592 | 16,555 | 103,730 |
| Comprehensive loss for the year | | - | - | (21,720) | - | - | (21,720) |
| **Transactions with shareholders** | | | | | | | |
| Issue of share capital | 20 | 6,816 | 17,245 | - | - | - | 24,061 |
| Cost of share issue | | - | (2,095) | - | - | - | (2,095) |
| Share-based payments | | - | - | - | 2,628 | - | 2,628 |
| **Total transactions with shareholders** | | 6,816 | 15,150 | - | 2,628 | - | 24,594 |
| **At December 31, 2009** | | 13,455 | 153,748 | (88,374) | 11,220 | 16,555 | 106,604 |

The option reserve and warrant reserve are denoted together as “other reserves” on the consolidated statement of financial position. These reserves are non distributable.

The notes on pages 1 to 58 form part of these consolidated financial statements.

# Tethys Petroleum Limited

Consolidated Statement of Cash Flows

(in thousands of US dollars)

| | Note | Year ended December 31, 2009 $ | 2008 $ |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Loss before taxation | | (21,506) | (22,184) |
| Adjustments for | | | |
| Share based payments | 8 | 2,628 | 4,419 |
| Net finance cost (income) | | 127 | (461) |
| Unsuccessful exploration and evaluation expenditures | 11 | 887 | 2,292 |
| Depreciation, depletion and amortization | 12 | 3,238 | 4,333 |
| Fair value gain (loss) on derivative financial instrument | | 479 | (929) |
| Net unrealised foreign exchange loss | | 1,120 | 1,277 |
| Loss from jointly controlled entity | | 1,000 | - |
| Deferred revenue | | 3,113 | - |
| Net change in non-cash working capital | 24 | (1,160) | (844) |
| **Net cash used in operating activities** | | (10,074) | (12,097) |
| | | | |
| **Cash flow from investing activities** | | | |
| Interest received | | 76 | 832 |
| Expenditure on exploration and evaluation assets | | (22,648) | (6,519) |
| Expenditures on property, plant and equipment | | (9,573) | (36,288) |
| Investment in restricted cash | | (72) | (269) |
| Acquisition of subsidiary, net of cash received | | 532 | - |
| Sale of subsidiaries, net of cash disposed | | (112) | - |
| Movement in advances to construction contractors | | 829 | 1,548 |
| Value added tax receivable | | (670) | (2,091) |
| Net change in non-cash working capital | 24 | 1,273 | (217) |
| **Net cash used in investing activities** | | (30,365) | (43,004) |
| | | | |
| **Cash flow from financing activities** | | | |
| Proceeds from issuance of short-term borrowings | 17 | 2,500 | - |
| Repayment of short-term borrowings | | (2,500) | - |
| Proceeds from issuance of long-term borrowings | 17 | 5,020 | 7,430 |
| Repayment of long-term borrowings | 17 | (856) | (579) |
| Interest paid on long-term borrowings and other non-current payables | | (152) | (380) |
| Other non-current liabilities | 18 | (109) | (253) |
| Proceeds related to shares to be issued | | 3,750 | - |
| Proceeds from issuance of equity, net of issue costs | 20 | 17,906 | 45,754 |
| **Net cash generated from financing activities** | | 25,559 | 51,972 |
| | | | |
| Effects of exchange rate changes on cash and cash equivalents | | (23) | (1,363) |
| | | | |
| **Net decrease in cash and cash equivalents** | | (14,903) | (4,492) |
| Cash and cash equivalents at beginning of the year | | 22,200 | 26,692 |
| **Cash and cash equivalents at end of the year** | | 7,297 | 22,200 |

The notes on pages 1 to 58 form part of these consolidated financial statements.

(tabular amounts in thousands of US dollars)

## 1 General information

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") are headquartered in Guernsey, British Isles. The domicile of Tethys Petroleum Limited was moved from Guernsey, British Isles to the Cayman Islands on July 17, 2008, where it is incorporated. The address of the Company's registered office is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands. Tethys is an oil and gas Company operating within the Republic of Kazakhstan, Republic of Uzbekistan and the Republic of Tajikistan. Tethys' principal activity is the acquisition of and development of crude oil and natural gas fields.

The Company has its primary listing on the Toronto Stock Exchange (TSX).

**Statement of compliance**

These consolidated financial statements have been prepared on a going concern basis under the historical cost convention except as modified by the revaluation of available for sale financial assets, and financial assets and financial liabilities at fair value through the statement of comprehensive loss and are in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) interpretations issued by the International Accounting Standards Boards ("IASB") and effective or issued and early adopted as at the time of preparing these financial statements.

The March 31, 2009 interim consolidated financial statements were the Company's first interim financial statements prepared under IFRS, with a transition date to IFRS of January 1, 2008. Consequently the comparative figures for 2008 and the Company's statement of financial position as at January 1, 2008 have been restated from accounting principles generally accepted in the United States of America ('US GAAP') to comply with IFRS. The reconciliations to IFRS from the previously published US GAAP financial statements are explained in note 26 of these financial statements by the IASB.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Areas where estimates are significant to the consolidated financial statements are disclosed in note 4.

## 2 Summary of significant accounting policies

**Basis of preparation**

The consolidated financial statements for the year ended December 31, 2009 have been prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRIC Interpretations and are in accordance with IFRS 1 - First-time Adoption of IFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

The consolidated financial statements are presented in United States Dollars and all amounts are rounded to the nearest thousand (US$'000) except where otherwise indicated. Foreign operations are included in accordance with the policies set out in this note.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Since inception, the Company has incurred significant losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2009. The Company has significant short-term and longer term contractual commitments that will necessitate cash outflows. In the first three months of 2010 the Company raised in $58.35 million. In the longer term, the ability of the Company to successfully carry out its business plan will be dependent upon its ability not only to maintain the current level of gas and oil production but also to achieve further production of commercial oil and gas and to control the costs of operating and capital expenditures. The Company completed an Initial Public Offering (IPO) of equity securities on the Toronto Stock Exchange (TSX) on June 27, 2007. The Company subsequently issued additional capital for gross proceeds of $50 million on June 27, 2008 and $20 million on June 19, 2009 that generated sufficient funds to secure its future at least in the short term. If in the future, the Company is unable to generate significant revenues and cash flows from operations it may need to seek further funding from its shareholders or alternative sources. There can be no assurances that management will be successful with these initiatives. While these factors create doubt about the Company's ability to continue as a going concern, management is confident of achieving the Company's short term plans.

The financial statements have been prepared on the basis that the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. These financial statements do not reflect adjustments in the carrying values of assets and liabilities reported, revenue or expenses and the classification used on the statement of financial position, that would be necessary if the going concern assumption was not appropriate. Such adjustments could be material.

**Foreign Operations**

Tethys' future operations and earnings will depend upon the results of Tethys' operations in the Republic of Kazakhstan, Uzbekistan and Tajikistan. There can be no assurance that Tethys' will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on Tethys' financial position, results of operations and cash flows. Also, the success of Tethys' operations will be subject to numerous contingencies, some of which are beyond management control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competitions and changes in regulation. Since Tethys' is dependent on international operations, Tethys' will be subject to various additional political, economic and other uncertainties. Among other risks, Tethys' operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

**Changes in accounting policy and disclosures**

*(a) New and amended standards adopted by the Company*

The following new and amended accounting standards are mandatory and relevant for the Company for the first time for these financial statements:

- IFRS 7 'Financial instruments – Disclosures' (amendment). This amendment requires enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy.

- IFRS 8, 'Operating segments'. IFRS 8 replaces IAS 14, 'Segment reporting'. It requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes.

- IAS 23 (amendment), 'Borrowing costs' requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs has been removed. This has no impact on the Company as its policy has always been to capitalise borrowing cost on qualifying assets.

- IFRS 2 (amendment), 'Share-based payment'. The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amended standard does not have a material impact on the Company's financial statements.

*(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company*

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

- IFRS 2, 'Share-based payments' – provides further guidance on determining the classification of share based payment awards in consolidated and separate financial statements and is linked to the application of IFRS 3 (revised). The amendments are effective for annual periods beginning on or after July 1, 2009. The amendment will not result in a material impact on the Company's financial statements.

(tabular amounts in thousands of US dollars)

- IFRS 3 (revised) 'Business combinations' is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after July 1, 2009.

  The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the statement of comprehensive loss. There is a choice on an acquisition-by-acquisition basis to measure the minority interest in the acquiree either at fair value or at the minority interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. The Company will apply IFRS 3 (revised) to all business combinations from January 1, 2010.

- IFRS 8, 'Operating Segments' which provides further requirements for disclosure of information about segment assets and is effective for periods beginning on or after January 1, 2010 has no impact on disclosure of segment assets currently reported by the Company.

- IFRS 9, 'Financial Instruments' was issued in November 2009 as the first step in its project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets that must be applied starting January 1, 2013, with early adoption permitted. The IASB intends to expand IFRS 9 during the intervening period to add new requirements for classifying and measuring financial liabilities, de-recognition of financial instruments, impairment and hedge accounting. The Company is currently assessing the impact of this standard.

- IAS 27 (revised) 'Consolidated and Separate Financial Statements'; requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies when control is lost. Any remaining interest in the entity is remeasured to fair value, and a gain or loss is recognised in profit or loss. The Company will apply this standard prospectively to transactions with non-controlling interests from January 1, 2010. The amendment will not result in a material impact on the Company's financial statements.

- IAS 38 (amendment), 'Measurement of non-current assets (or disposal groups) classified as held-for-sale'. The amendment is part of the IASB's annual improvements project published in April 2009 and the Company will apply IAS 38 (amendment) from the date IFRS 3 (revised) is adopted. The amendment clarifies guidance in measuring fair value of an intangible asset acquired in a business combination and it permits the grouping of intangible assets as a single asset if each asset has similar useful economic lives. The amendment will not result in a material impact on the Company's financial statements.

- IFRIC 17, 'Distributions of non-cash assets to owners', clarifies how an entity should measure distributions of assets, other than cash, when it pays dividends to its owners and is effective for annual periods beginning on or after July 1, 2009. The amendment will not result in a material impact on the Company's financial statements.

**Basis of consolidation**

*Subsidiaries*
Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Company.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Company. The cost of acquisition is measured at the fair value of assets given, equity instruments issued and debt incurred or assumed at the date of acquisition, being the date on which the Company gains control. The excess of the cost over the fair value of the Company's share of identifiable net assets acquired is recorded as goodwill. If the cost is less than the fair value of net assets acquired, the difference is recognised directly in the statement of comprehensive loss. All subsidiaries, as listed in note 23, have been consolidated into the Company's consolidated financial statements.

Inter-Company transactions, balances and unrealised gains or losses between subsidiaries are eliminated. The financial statements of the subsidiaries are prepared using consistent accounting policies and reporting date as of the Company.

*Joint ventures*

The Company's interests in jointly controlled entities are accounted for using the equity method of accounting. Under the equity method, the investment in a jointly controlled entity is carried in the statement of financial position at cost plus post-acquisition charges in the Company's share of net assets of the jointly controlled entity, less distributions received and less any impairment in value of the investment. The Company's statement of comprehensive loss reflects the Company's share of the results after tax of the jointly controlled entity.

When the Company's share of losses in the jointly controlled entity equals or exceeds its interest in the entity, including any other unsecured receivables, the Company does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity. Financial statements of jointly controlled entities are prepared for the same reporting year as the Company.

The Company recognises the portion of gains or losses on the sale of assets by the Group to the joint venture that is attributable to the other parties in the joint venture. The Company does not recognise its share of profits or losses that results from the purchase of assets by the Group from the joint venture until when the asset is resold or, where relevant, as the asset is depreciated by the jointly controlled entity.

In circumstances where the significant risks and rewards of ownership of non-monetary assets transferred have not been transferred to the jointly controlled entity, the associated gain or loss is unrealised and , thus, not recognised in profit or loss but recognised as a deferred gain on the statement of financial position. The deferred gain is recognised in the statement of comprehensive loss when the asset is resold or, where to relevant, as the asset is depreciated by the jointly controlled entity.

Accounting policies of the joint venture are consistent with accounting policies adopted by the Company.

**Segment reporting**

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

**Foreign currency translation**

The consolidated financial statements are presented in US Dollars, which is the Company's functional and reporting currency.

All monetary assets and liabilities denominated in foreign currencies are translated into US dollars at the rate of exchange in effect at the reporting date. Non-monetary assets are translated at historical exchange rates.

Revenue and expense items (excluding depreciation and amortization which are translated at the same rates as the related assets) are translated at the average rate of exchange.

Exchange gains and losses arising on translation are taken to the statement of comprehensive loss.

**Oil and gas exploration and evaluation expenditure**

Oil and natural gas exploration and evaluation expenditures are accounted for using a modified 'successful efforts' method of accounting. Costs are accumulated on a field-by-field basis. Exploration and evaluation expenditures, including license acquisition costs, are capitalised as exploration and evaluation assets when incurred. Expenditure directly associated with an exploration well is capitalised until the determination of reserves is evaluated. If reserves are not identified, these costs are charged to expense. All other associated exploration and evaluation expenditure are carried forward as an asset in the statement of financial position where the rights of tenure of the property are current and it is considered probable that the costs will be recouped through successful development of the property, or alternatively by its sale. Capitalised exploration and evaluation expenditure is written down to its recoverable amount where the above conditions are no longer satisfied.

If it is determined that a commercial discovery has not been achieved in relation to the property, all other associated costs are written down to their recoverable amount. If commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development tangible and intangible assets. No depreciation and/or amortisation is charged during the exploration and evaluation phase.

**Oil and gas properties**

Oil and gas properties are stated at cost, less accumulated depreciation and accumulated impairment losses.

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalised within oil and gas properties, as long as the facts and circumstances indicate that the field has commercially viable reserves.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the asset retirement obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within property, plant and equipment.

Where commercial production in an area of interest has commenced, oil and gas properties are depreciated on a unit-of-production basis over the proved and probable reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proved and probable reserves of the relevant area. The unit-of-production rate for the amortisation of field development costs takes into account expenditures incurred to date, together with future development expenditure to develop the proved and probable reserves. Changes in factors such as estimates of proved and probable reserves that affect unit-of-production calculations do not give rise to prior year financial period adjustments and are dealt with on a prospective basis.

**Other property, plant and equipment**

Property, plant and equipment are carried at cost less accumulated depreciation. Depreciation is charged so as to write off the cost of these assets less residual value over their estimated useful economic lives, for the following classes of assets:

| | | |
|---|---|---|
| Drilling rigs and related oil and gas equipment | Unit of production | 3,650 operating days |
| Smaller rig related equipment | Straight line | 6 – 8 years |
| Vehicles | Straight line | 4 years |
| Computer equipment | Straight line | 3 years |
| Office equipment | Straight line | 5 years |

**Intangible assets**

*Production enhancement contracts*

Production enhancement contracts are stated at cost less accumulated amortisation and have a finite useful life. Amortization is calculated using a unit-of-production basis over the estimated incremental production entitlement expected to be received over the life of the contract.

**Impairment of non-financial assets**

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

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

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of comprehensive loss so as to reduce the carrying amount to its recoverable amount (i.e. the higher of fair value less cost to sell and value in use).

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

***Asset retirement obligation (ARO)***

Provision is made for the present value of the future cost of abandonment of oil and gas wells and related facilities. This provision is recognised when a legal or constructive obligation arises.

The estimated costs, based on engineering cost levels prevailing at the reporting date, are computed on the basis of the latest assumptions as to the scope and method of abandonment. Provisions are measured at the fair value of the expenditures expected to be required to settle the obligation using a pre-tax rate, updated at each reporting date that reflects current market assessments of the time value of money and the risks specific to the obligation. The corresponding amount is capitalised as part of exploration and evaluation expenditure or oil and gas properties and is amortised on a unit-of-production basis as part of the depreciation, depletion and amortisation charge. Any adjustment arising from the reassessment of estimated cost of ARO is capitalised, whilst the charge arising from the accretion of the discount applied to the ARO is treated as a component of finance costs.

**Financial instruments**

Financial assets and financial liabilities are recognised on the Company's statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognised when the contractual rights to the cashflows from the financial asset expire or when the contractual rights to those assets are transferred. Financial liabilities are de-recognised when the obligation specified in the contract is discharged, cancelled or expired.

*Investments*

Investments comprise restricted current balances that are held on deposit with banks in the Republic of Kazakhstan in respect of the Company's asset retirement obligations (ARO) in this country and are classified as non-current. They are carried at fair value with gains or losses taken to the statement of comprehensive loss.

*Trade receivables, loans and other receivables*

Trade receivables, loans and other receivables, which are non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the reporting date, which are classified as non-current assets. The Company's loans and receivables comprise trade and other receivables in the statement of financial position.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method, net of any impairment.

A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 60 days overdue) are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the statement of comprehensive loss. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables.

*Cash and cash equivalents*

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. These are carried at fair value with gains or losses recognized through statement of comprehensive loss.

*Financial liabilities - borrowings*

Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of comprehensive loss when the liabilities are derecognised as well as through the amortisation process.

*Trade payables*

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are measured at amortised cost using the effective interest method.

*Equity instruments*

Equity instruments issued by the Company are recorded at the proceeds received net of direct issue costs.

*Derivative financial instruments*

Derivative financial instruments are initially recognized at fair value on the date a derivative contract was entered into and are subsequently remeasured at their fair value with changes in the fair value immediately recognised in the statement of comprehensive loss.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract. Contracts are assessed for embedded derivatives when the Company becomes a party to them, including at the date of a business combination.

*Derivative contracts qualifying for the 'own-use' treatment*

An 'own-use' contract is one that was entered into and continues to be held for the purpose of the receipt or delivery of the non financial item in accordance with the entity's expected purchase, sale or usage requirements. Contracts that are for the Company's own use are exempt from the requirements of IAS39.

**Inventories**

Inventories consist of refined oil products, spare parts and consumable materials and are shown at the lower of cost and net realisable value. Cost is determined on a weighted average cost method for refined oil products and the first-in-first-out method for spare parts and consumable materials inventories.

**Taxation including deferred taxation**

The tax expense represents current tax and deferred tax.

Current tax is based on the taxable profits for the year. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss. Deferred income tax assets are recognised to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilised and the carry forward of unused tax credits and unused tax losses can be utilised.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred tax asset is realised or the deferred income tax liability settled.

**Share–based payments**

The Company operates a number of equity-settled, share-based compensation plans, under which the entity receives services from employees as consideration for equity instruments (options and warrants) of the Company. The fair value of the employee options and warrants granted in exchange for the employee services, is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted, excluding the impact of any non-market service and performance vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. When options vest in instalments over the vesting period, each instalment is accounted for as a separate arrangement. At each reporting date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the statement of comprehensive loss, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital and share premium when the options are exercised.

**Provisions**

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive loss, net of any reimbursement. The increase in the provision due to passage of time is recognized as interest expense.

**Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of natural gas and oil products in the ordinary course of the Company's activities and is recognized when the amount can be reliably measured, it is probable that future economic benefits will flow to the entity, and when specific criteria have been met for each of the Company's activities as described below. Revenue is shown after eliminating sales within the Company

Revenue from natural gas sales is recognized when the gas has been lifted and the risk of loss transferred to a third-party purchaser and is shown net of royalties, Mineral Extraction Tax (MET) and value-added tax. Revenue from refined product sales is recognized upon delivery and is shown net of value-added tax. All payments received before delivery are recorded as deferred revenue until delivery has occurred.

The Company recognises finance income earned on the Company's cash and cash equivalents and short term investments on an accrual basis.

**Barter transactions**

Where goods or services are exchanged for goods or services of a dissimilar nature, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of cash or cash equivalents received or paid. If the fair value of the goods or services received cannot be reliably measured, the revenue is measured at the fair value of the goods or services given up, again adjusted by the amount of cash or cash equivalents received.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying capital asset or project under construction are capitalised and added to the asset or project cost during construction until such time as the asset or project is substantially ready for its intended use. Where funds are specifically borrowed to finance an asset or project, the amount capitalised represents the actual amount of borrowing cost incurred. Where funds used to finance an asset or project form part of general borrowings, the amount capitalised is calculated by using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognised in the statement of comprehensive loss in the period in which they are incurred.

**Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive loss on a straight-line basis over the period of the lease.

**Business combinations**

Business combinations are accounted for using the purchase method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognized as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statement of comprehensive loss.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose identified according to operation segment.

(tabular amounts in thousands of US dollars)

**Fair value**

The fair value of investments, trade and other receivables, trade and other payables approximate their carrying amounts due to the short term maturity of the instruments. Loan receivables, long term debt and other non-current liabilities have been recorded at amortized cost using the effective interest rate method.

## 3 Financial risk management

The Company's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

### a) Financial risk factors

*Credit risk*

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's cash and cash equivalents and accounts receivable balances.

With respect to the Company's financial assets the maximum exposure to credit risk due to default of the counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is:

| | **December 31 2009 $** | **December 31 2008 $** |
|---|---|---|
| Trade receivables | 905 | 1,124 |
| Cash and cash equivalents | 7,297 | 22,200 |
| Investments | 659 | 587 |
| Loan receivable from jointly controlled entity | 21,727 | - |
| | 30,588 | 23,911 |

Concentration of credit risk associated with the above trade receivable balances in Kazakhstan is as a result of contracted sales to only one customer during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales in Kazakhstan commenced in December 2007 and the Company has not experienced any credit loss to date. At December 31, 2009 the trade receivable amounted to $905,000, none of which was greater than 60 days overdue. The Company has therefore not recorded a provision against this amount as it does not consider the balance to be impaired.

(tabular amounts in thousands of US dollars)

In Uzbekistan, the Company makes use of five customers. Full payment is required before delivery of the oil and therefore there is limited exposure to credit risk in this country.

Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss as the counterparties are banks with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors).

The Company is exposed to credit risk in relation to its loan receivable from a jointly controlled entity to the extent that the jointly controlled entity fails to meet its contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loan receivable represents the maximum exposure to credit risk.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. Since inception, the Company has incurred significant consolidated losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2009.

The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets, co-ordinating and authorizing project expenditures and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company seeks additional financing based on the results of these processes.

| | Less than 1 year | 1-3 years | 4-5 years | Thereafter | Total |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Trade and other payables | 6,786 | 808 | - | - | 7,594 |
| Financial liabilities - borrowings (note 17) | 1,086 | 9,324 | - | - | 10,410 |
| Commitments (note 25) | 5,790 | 173 | 2,600 | - | 8,563 |
| Share of purchase commitments related to joint venture (note 15) | 2,137 | - | - | - | 2,137 |
| Operating lease commitments (note 25) | 415 | 363 | | - | 778 |
| Total expected cash outflow | 16,214 | 10,668 | 2,600 | - | 29,482 |

The timing of cash outflows relating to financial liabilities and commitments at the reporting date are summarized below:

There can be no assurance that debt or equity financing will be available or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

*Market risk*

Market risk is the risk of loss that may arise from changes in market factors such as commodity prices, interest rate and foreign exchange rates.

*Commodity price risk*

Commodity price risk arises from the effect that fluctuations of future commodity process may have on the price received for sales of gas and refined oil products. The marketability and price of natural gas and oil that is produced and may be discovered by the Company will be affected by numerous factors that are beyond the control of the Company.

Natural gas prices are subject to wide fluctuations, the Company has entered into a fixed price contract for sales of gas from the Kyzyloi field in Kazakhstan. However, any material decline in natural gas prices could result in a reduction of Tethys' future net production revenues and impact on the commercial viability of the Company's existing and future oil and gas discoveries. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in volumes and the value of Tethys' gas reserves, if the Company elected not to produce from certain wells at lower prices.

Any material decline in refined oil product prices could result in a reduction of the Company's Uzbekistan net production revenue.

All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities.

The impact of changes in commodity price is assessed in note 4.

*Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

The Company is exposed to interest rate risk on short term deposits to the extent that the significant reductions in market interest rates would result in a decrease in the interest earned by the Company. A change of 1% in the interest rate would have had an immaterial change in the interest earned both in the current or prior year.

(tabular amounts in thousands of US dollars)

As at the reporting date the Company's interest rate profile was:

| At December 31, 2009 | Fixed rate financial instruments $ | Floating rate financial instruments $ | **Total** $ |
|---|---|---|---|
| Cash and cash equivalents | - | 7,297 | 7,297 |
| Financial liabilities - borrowings | 10,410 | - | 10,410 |
| Interest rate swap | 95 | - | 95 |
| | 10,505 | 7,297 | 17,802 |

| At December 31, 2008 | Fixed rate financial instruments $ | Floating rate financial instruments $ | Total $ |
|---|---|---|---|
| Cash and cash equivalents | 1,832 | 20,368 | 22,200 |
| Financial liabilities - borrowings | 5,949 | - | 5,949 |
| | 7,781 | 20,368 | 28,149 |

*Foreign exchange risk*

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions denominated in a currency other than the US dollar. In addition, a significant portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. The Company is not currently using exchange rate derivatives to manage exchange rate risks but is attempting to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan.

The Company holds the majority of its cash and cash equivalents in US dollars. However, the Company does maintain deposits in other currencies, as disclosed in the following table, in order to fund ongoing general and administrative activity and other expenditure incurred in these currencies.

The carrying amounts of the Company's significant foreign currency denominated monetary assets and liabilities at the reporting dates are as follows:

| **In US$ equivalent 2009** | **CAD** | **GBP** | **EUR** | **SOMONI** | **KZT** |
|---|---|---|---|---|---|
| Cash and cash equivalents | 52 | 132 | 83 | 11 | 187 |
| Trade and other receivables | - | 34 | 2 | - | 5,393 |
| Trade and other payables | (35) | (318) | - | - | (561) |
| Financial liabilities - borrowings | - | (383) | - | - | - |
| **Net exposure** | **17** | **(535)** | **85** | **11** | **5,019** |

(16)

(tabular amounts in thousands of US dollars)

| **In US$ equivalent 2008** | **CAD** | **GBP** | **EUR** | **SOMONI** | **KZT** |
|---|---|---|---|---|---|
| Cash and cash equivalents | 3,514 | 2,859 | 162 | 19 | 193 |
| Trade and other receivables | - | - | - | - | 5,967 |
| Trade and other payables | (40) | (240) | (5) | - | (344) |
| Financial liabilities - borrowings | - | (365) | - | - | - |
| **Net exposure** | **3,474** | **2,254** | **157** | **19** | **5,816** |

The following table details the Company's sensitivity to a 10% weakening in US dollars against the respective foreign currencies, which represents management's assessment of a reasonable change in foreign exchange rates.

| | **CAD** | **GBP** | **EUR** | **SOMONI** | **KZT** |
|---|---|---|---|---|---|
| **2009 Effect in US$'000** | | | | | |
| Profit or (loss) before tax | - | (20) | 10 | - | 500 |
| **2008 Effect in US$'000** | | | | | |
| Profit or (loss) before tax | 340 | 260 | 20 | - | 580 |

A 10% strengthening of the US dollar against the currencies above at December 31, 2009 would have had an equal but opposite effect on the amounts shown above, assuming all other variables remained constant.

**b) Capital risk management**

The Company's capital structure is comprised of shareholders' equity and debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its expenditures on commitments from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt.

(tabular amounts in thousands of US dollars)

| At December 31 | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Total financial liabilities - borrowings (Note 17) | 10,410 | 5,949 |
| Less: cash and cash equivalents | (7,297) | (22,200) |
| Net debt / (funds) | 3,113 | (16,251) |
| Total equity | 167,203 | 145,237 |
| **Total capital** | 170,316 | 128,986 |

If the Company is in a net debt position, the Company will assess whether the projected cash flow is sufficient to service this debt and support ongoing operations. Consideration will be given to reducing the total debt or raising funds through an alternative route such as the issuing of equity.

The Company is not currently subject to any externally imposed capital restrictions.

### c) Fair value estimation

Effective January 1, 2009, the Company adopted the amendment to IFRS 7 for financial instruments that are measured in the reporting date at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities. The Company does not have any assets or liabilities that require Level 1 inputs.

Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly. For the Company, Level 2 inputs include prices that can be corroborated with other observable inputs for substantially the complete term of the contract.

Level 3: Unobservable inputs. For the Company, Level 3 inputs include production and price assumptions that are not based on observable market data (unobservable inputs) or are reliant on adjustments or interpolations are made by management to an otherwise standard valuation model.

As at December 31, 2009 the Company's only financial liabilities measured at fair value on a recurring basis were the warrant liability and interest rate swap described in Note 17, the measurement inputs of which is designated as Level 2 and Level 3 respectively.

At December 31, 2009, the interest rate swap described in Note 17 is classified as Level 3 in the fair value hierarchy. The inputs required to measure the fair value of the interest rate swap include production and price assumptions that are reliant on adjustments or interpolation made by management to an otherwise standard valuation model. A reconciliation from the beginning balance to the ending balance of the interest rate swap has been included at Note 17.

(tabular amounts in thousands of US dollars)

## 4 Critical judgements and accounting estimates

The preparation of financial statements requires management to make certain judgements, accounting estimates and assumptions that affect the amounts reported for assets and liabilities as at the reporting date and the amounts reported for revenues and expenses during the year. The nature of estimation means that actual outcomes could differ from those estimates. Accordingly, the impact of these estimates, assumptions and judgments on the consolidated financial statements in future periods could be material. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are discussed below.

**Going Concern**

The assessment of the Company's ability to execute its strategy by funding future working capital requirements involves judgement. The Directors monitor future cash requirements to assess the Company's ability to meet these future funding requirements. Further information regarding going concern is outlined in note 2.

**Recoverability of asset carrying values**

The Company assesses its property plant and equipment, including intangible exploration and evaluation assets, for possible impairment if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable, or at least at every reporting date. Such indicators include changes in the Company's business plans, changes in commodity prices, evidence of physical damage and, for oil and gas properties, significant downward revisions of estimated recoverable volumes or increases in estimated future development expenditure.

If there are low oil prices or natural gas prices during an extended period the Company may need to recognize significant impairment charges. The assessment for impairment entails comparing the carrying value of the cash-generating unit with its recoverable amount, that is, value in use. Value in use is usually determined on the basis of discounted estimated future net cash flows. Determination as to whether and how much an asset is impaired involves management estimates on highly uncertain matters such as future commodity prices, the effects of inflation on operating expenses, discount rates, production profiles and the outlook for regional market supply-and-demand conditions for crude oil, natural gas and refined products.

At the reporting date, an impairment test was carried out on the Akkulka and Kyzyloi, gas fields in accordance with the accounting policy stated in note 2. The recoverable amounts of the fields have been determined based on value in use calculations. These calculations require the use of estimates. The present value of future cash flows was computed on an pre-tax basis by applying forecast prices of gas reserves to estimated future production of proved and probable gas reserves, less estimated future expenditures to be incurred in developing and producing the proved and probable reserves. The present value of estimated future net revenues is computed using a discount factor of 10%.  The discount rate used is pre-tax and reflects the specific risks relating to the underlying cash generating unit.

The value in use calculation assumes natural gas sales prices in US$/Mcf as follows:

(tabular amounts in thousands of US dollars)

| | 2010 $ | 2011 $ | 2012 $ | 2013 $ | 2014 $ | 2015 $ | 2016 $ | 2017 $ | 2018 $ | 2019 $ | 2020 $ | 2021 $ | 2022 $ | 2023 $ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Natural gas US$/Mcf | | | | | | | | | | | | | | |
| Kyzyloi | 0.90 | 0.90 | 0.90 | 4.41 | 4.91 | 5.37 | 5.62 | 5.84 | 6.04 | 6.25 | 6.45 | 6.63 | 6.81 | 7.0 |
| Akkulka | 0.90 | 3.38 | 3.90 | 4.41 | 4.91 | 5.37 | 5.62 | 5.84 | 6.04 | 6.25 | 6.45 | 6.63 | - | - |

The above price estimates are lower than those previously expected by the Company, which is a reflection of the current gas market uncertainty in Central Asia. As at the reporting date and at the date of approval of these consolidated financial statements, the gas price remains the subject of negotiations which have not been finalised. This is a source of measurement uncertainty in the Company's impairment test since there can be no assurance as to what price will be achieved.

The current price estimates for the Kyzyloi field results in an excess of recoverable amount over the carrying value of the Kyzyloi cash generating unit of $13.3 million. The current price estimates for the Akkulka field results in excess of recoverable amount over the carrying value of the Akkulka cash generating unit of $17.6 million.

If the forecast prices applied to the Kyzyloi impairment test were to reduce by US$0.10 per Mcf below the assumed price of US$4.41 (from 2013) per Mcf, the excess of recoverable amount over the carrying value of the Kyzyloi field would be reduced by approximately $639,000 for each $US 0.10 diminution of actual price realised.

If the forecast prices applied to the Akkulka impairment test were to reduce by US$0.10 per Mcf below the assumed price of US$3.38 per Mcf, the excess of recoverable amount over the carrying value of the Akkulka field would be reduced by approximately $883,000 for each $US 0.10 diminution of actual price realised.

**Oil and gas reserves**

Proved and probable oil and gas reserves are used in the units of production calculation for depletion as well as the determination of the timing of well closure costs and impairment analysis. There are numerous uncertainties inherent in estimating oil and gas reserves. Assumptions that are valid at the time of estimation may change significantly when new information becomes available. Changes in the forecast prices of commodities, exchange rates, production costs or recovery rates may change the economic status of reserves and may ultimately result in the reserves being restated.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Such estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

**Asset retirement obligation**

Provisions for environmental clean-up and remediation costs associated with the Company's drilling operations are based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, prices, discovery and analysis of site conditions and changes in clean-up technology.

**Income taxes**

The Company is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Company recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

**Fair value of derivative and other financial instruments**

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

**Other significant areas of judgement**

The estimates, assumption and judgments made in relation to the fair value of stock based compensation and warrants and the associated expense recognition is subject to measurement uncertainty. The estimated fair value of financial assets and liabilities, by their very nature, are subject to measurement uncertainty.

## 5 Segmental Reporting

**Geographical segments**

Management has determined the operating segments based on the reports reviewed by the executive directors that are used to make strategic decisions. Reports provided to the executive directors with respect to segment information are measured in a manner consistent with that of the financial statements. The assets and liabilities are allocated based on the operations of the segment and for assets, the physical location of the asset.

The executive directors consider the business from predominantly a geographic perspective and the Company currently operates in three geographical markets: Kazakhstan, Tajikistan and Uzbekistan.

In Kazakhstan, the Company is producing gas from the Kyzyloi field and is undertaking exploration and evaluation activity in the Akkulka and Kulbas fields. In Tajikistan, the Company is currently undertaking exploration and evaluation activity and in Uzbekistan, the Company operates under the North Urtabulak Production Enhancement Contract, which gives incremental production rights to increase the production volume of oil from wells on the North Urtabulak Oil Field.

(tabular amounts in thousands of US dollars)

The Company also operates a corporate segment which acquired a number of drilling rigs and related oil and gas equipment which will be utilised in Kazakhstan, Tajikistan, and Uzbekistan and possibly throughout the rest of Central Asia.

The segment results for the year ended December 31, 2009 are as follows:

| | Kazakhstan $ | Tajikistan $ | Uzbekistan $ | Other and Corporate $ | Consolidated $ |
|---|---|---|---|---|---|
| Gas sales | 3,828 | - | - | - | 3,828 |
| Refined product sales | - | - | 4,731 | - | 4,731 |
| Other income | 3,230 | - | - | 1,824 | 5,054 |
| **Segment revenue** | **7,058** | **-** | **4,731** | **1,824** | **13,613** |
| Inter-segment revenue | (3,230) | - | - | (1,824) | (5,054) |
| **Revenue from external customers** | **3,828** | **-** | **4,731** | **-** | **8,559** |
| Loss from jointly controlled entity | - | (1,000) | - | - | (1,000) |
| **(Loss)/ profit before taxation** | **(5,165)** | **(3,040)** | **478** | **(13,779)** | **(21,506)** |
| Taxation | (64) | - | (145) | (5) | (214) |
| **Net (loss)/profit attributable to shareholders** | **(5,229)** | **(3,040)** | **333** | **(13,784)** | **(21,720)** |

Sales in the Kazakhstan segment were made to a single customer. Sales in the Uzbekistan segment were to five customers. Sales to three of those customers representing greater than 10% of total segment revenue were \$2,600,000, \$763,000 and \$712,000.

Borrowing costs of \$2,100,503 were incurred during the year. These borrowing costs were capitalised in the Tajikistan segment (\$1,387,702), Kazakhstan segment(\$356,173) and Uzbekistan segment (\$154,270). The remaining \$202,358 was expensed through the statement of comprehensive loss.

Amortisation of \$1,106,830 of assets held in the Corporate segment were capitalised in Kazakhstan: \$460,451 and Tajikistan: \$646,379.

(tabular amounts in thousands of US dollars)

Segment results for the year ended December 31, 2008 are as follows:

| | Kazakhstan $ | Tajikistan $ | Uzbekistan $ | Other and Corporate $ | Consolidated $ |
|---|---|---|---|---|---|
| Gas sales | 5,360 | - | - | - | 5,360 |
| Refined product sales | - | - | - | - | - |
| Other income | 4,210 | - | - | 2,115 | 6,325 |
| **Segment revenue** | **9,570** | **-** | **-** | **2,115** | **11,685** |
| Inter-segment revenue | (4,210) | - | - | (2,115) | (6,325) |
| **Revenue from external customers** | **5,360** | **-** | **-** | **-** | **5,360** |
| **Loss before taxation** | **(9,450)** | **(629)** | | **(12,105)** | **(22,184)** |
| Taxation | - | - | - | - | - |
| **Net loss attributable to shareholders** | **(9,450)** | **(629)** | **-** | **(12,105)** | **(22,184)** |

Sales in the Kazakhstan segment were made to a single customer.

No borrowing costs incurred on loans within the Corporate segment were capitalised between segments.

No amortisation of assets held in the Corporate segment were capitalised between segments.

The segment assets and liabilities as at December 31, 2009 and capital expenditures for the year then ended are as follows:

| | Kazakhstan $ | Tajikistan $ | Uzbekistan $ | Other and Corporate $ | Consolidated $ |
|---|---|---|---|---|---|
| Total assets | 72,152 | 21,984 | 11,015 | 31,931 | 137,082 |
| Total liabilities | 1,914 | 3,759 | 6,992 | 17,813 | 30,478 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 8,553 | 16,942 | 3,709 | 3,017 | 32,221 |
| Depreciation, depletion & amortization | 2,497 | 138 | 603 | - | 3,238 |

Total assets for Tajikistan include the Company's investment in the joint venture (note 15).
Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of $411,202.

(tabular amounts in thousands of US dollars)

The segment assets and liabilities at December 31, 2008 and capital expenditures for the year ended December 31, 2008 are as follows:

| | **Kazakhstan** | **Tajikistan** | **Uzbekistan** | **Other and Corporate** | **Consolidated** |
|---|---|---|---|---|---|
| | **$** | **$** | **$** | **$** | **$** |
| Total assets | 68,240 | 2,801 | - | 42,507 | 113,548 |
| Total liabilities | 1,844 | 154 | - | 7,820 | 9,818 |
| Cash expenditure on exploration & evaluation assets, property, plant and equipment | 21,604 | 2,633 | - | 18,570 | 42,807 |
| Depreciation, depletion & amortization | 4,182 | 51 | - | 100 | 4,333 |

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of $33,618.

The segment assets and liabilities at January 1, 2008 are as follows:

| | **Kazakhstan** | **Tajikistan** | **Uzbekistan** | **Other and Corporate** | **Consolidated** |
|---|---|---|---|---|---|
| | **$** | **$** | **$** | **$** | **$** |
| Total assets | 50,737 | 207 | - | 28,902 | 79,846 |
| Total liabilities | 2,321 | - | - | 1,784 | 4,105 |

The segment assets attributable to the Kazakhstan segment consist mainly of capital additions related to the Kyzyloi and Akkulka fields, including the installation of pipelines linking these fields to the Bhukara-Urals trunk line, as well as the costs of exploration pending determination of the Kul-Bas field.

The segment assets attributable to the Tajikistan segment consist of the costs of exploration pending determination of the Tajikistan production sharing contract.

The segment assets attributable to the Uzbekistan segment consist mainly of well costs related to the North Urtabulak field. These other intangible assets have been recognized at provisional fair value as described in note 21.

The other and corporate segment assets consist mainly of oil and gas equipment such as drilling rigs and related equipment and cash and cash equivalents. The other and corporate segment liabilities consist mainly of the loans obtained to finance the purchase of two drilling rigs, more fully disclosed in note 17.

(tabular amounts in thousands of US dollars)

## 6 Revenue

| | Year ended | |
|---|---|---|
| | December 31, 2009 $ | December 31, 2008 $ |
| Gas sales | 3,828 | 5,360 |
| Refined product sales | 4,731 | - |
| | 8,559 | 5,360 |

Revenue has been grossed up for non-monetary transactions, namely marketing commission of $141,426 (2008: nil) and utility services of $752,807 provided with respect to Uzbekistan (2008: nil). The corresponding expenses are shown within administrative and production expenses respectively.

## 7 Administrative expenses

| Administrative expenses by nature | Year ended | |
|---|---|---|
| | December 31, 2009 $ | December 31, 2008 $ |
| Staff expenses | 5,469 | 4,517 |
| Share-based payments | 2,628 | 4,419 |
| Travel expenses | 2,590 | 3,099 |
| Professional fees | 1,909 | 1,695 |
| Office costs | 1,835 | 2,311 |
| Other administrative expenses | 2,449 | 1,874 |
| | 16,880 | 17,915 |

Key management personnel have been identified as the board of directors and eight senior managers. Details of key management remuneration are shown in note 23.

## 8 Share-based payments

The Company has adopted a stock incentive plan referred to as the “2007 Long Term Stock Incentive Plan” pursuant to which the Company may grant stock options to any director, employee or consultant of the Company, or any subsidiary or Vazon Energy Limited (collectively, “Service Providers”).

The maximum number of Ordinary Shares reserved for issuance under the plan equals 12% (2008 – a specific number of shares: 7,511,670) of the outstanding Ordinary Shares. The plan is administered by the Compensation and Nomination Committee of the Board of Directors. Options may be granted pursuant to recommendations of the Compensation and Nomination Committee. The Compensation and Nomination Committee may determine the vesting schedule and term, provided that options may not have a term exceeding ten years. Subject to any resolution passed by the Compensation and Nomination Committee, options will terminate three months after an option holder ceases to be a Service Provider.

(tabular amounts in thousands of US dollars)

The exercise price of options granted under the plan may not be less than the closing price of Ordinary Shares on the principal stock exchange where the Ordinary Shares are listed as of the date of the option grant. The plan contains amendment provisions which allow amendments to the plan by the Board of Directors, without shareholder approval, for amendments of a "housekeeping" nature, changes to vesting or termination provisions, and discontinuance of the plan. The plan also provides that outstanding options will vest immediately on the occurrence of a "change of control" (as defined in the plan). Options granted under the plan are only assignable to certain related entities of an option holder or otherwise with the consent of the Company.

Under the plan, the options vest in three tranches with one third vesting immediately, one third after one year and one third after two years. These options are equity settled share based payment transactions.

*Stock options*

The following table summarizes the stock option activity under the 2007 Long Term Stock Incentive Plan.

| | Number of options | Weighted average exercise price $ |
|---|---|---|
| Outstanding at January 1, 2008 | 4,497,000 | 2.76 |
| Granted | 2,274,000 | 2.51 |
| Forfeited | (96,000) | 2.75 |
| Exercised | - | n/a |
| Expired | - | n/a |
| Outstanding at December 31, 2008 | 6,675,000 | 2.67 |
| Exercisable at December 31, 2008 | 3,692,000 | 2.71 |
| Outstanding at January 1, 2009 | 6,675,000 | 2.67 |
| Granted | 5,808,000 | 0.71 |
| Forfeited | (281,000) | 0.94 |
| Exercised | - | n/a |
| Expired | (496,000) | 2.43 |
| Outstanding at December 31, 2009 | 11,706,000 | 1.75 |
| Exercisable at December 31, 2009 | 7,325,666 | 2.20 |

(tabular amounts in thousands of US dollars)

The following table lists the options outstanding at December 31, 2009 by exercise price.

| | Exercise price $ | Options outstanding | Weighted average remaining term (in years) | Options exercisable | Weighted average remaining term (in years) |
|---|---|---|---|---|---|
| | 0.60 | 5,056,000 | 4.72 | 1,685,333 | 4.68 |
| | 0.88 | 120,000 | 4.84 | 40,000 | 4.84 |
| | 2.50 | 2,330,000 | 5.58 | 1,443,333 | 5.53 |
| | 2.75 | 4,182,000 | 4.53 | 4,139,000 | 4.52 |
| | 3.18 | 18,000 | 4.93 | 18,000 | 4.93 |
| Total | | 11,706,000 | 4.81 | 7,325,666 | 4.76 |

The fair value of the liability is estimated using the Black-Scholes pricing model using the following average assumptions:

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| Weighted average fair value | $0.2841 | $1.5493 |
| Risk free rate | 1.74% | 3.32% |
| Expected term | 3 years | 4 years |
| Volatility | 97.9% | 73.5% |
| Dividend | Nil | Nil |
| Weighted average share price | $0.51 | $2.66 |

In estimating expected volatility, the Company considers the historical volatility of the share price of similar entities over the most recent period that is commensurate with the expected option term.

(tabular amounts in thousands of US dollars)

*Warrants*

The following table summarizes the warrant activity for the year ended December 31, 2009.

| | Number of warrants | Weighted average exercise price $ |
|---|---|---|
| Outstanding at January 1,2008 | 10,203,658 | 4.73 |
| Granted | 1,433,298 | 2.33 |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | - | n/a |
| Outstanding at December 31, 2008 | 11,636,956 | 4.43 |
| Exercisable at December 31, 2008 | 11,636,956 | 4.43 |
| Outstanding at January 1, 2009 | 11,636,956 | 4.44 |
| Granted | 2,500,000 | 0.60 |
| Forfeited | - | n/a |
| Exercised | - | n/a |
| Expired | (1,353,501) | 4.13 |
| Outstanding at December 31, 2009 | 12,783,455 | 3.73 |
| Exercisable at December 31, 2009 | 12,783,455 | 3.73 |

During the year ended December 31, 2009, there were 2,500,000 (2008 – 1,433,298) warrants issued in connection with loan financing (note 17.2).

Of the warrants outstanding at the beginning of the year, 8,857,504 relate to warrants granted to the Company's executive officers. 7,504,003 of these warrants remain outstanding and exercisable at December 31, 2009.

There are no performance conditions attached to the warrants and all the granted warrants were immediately vested. Warrants are equity settled share based payment transactions.

In estimating expected volatility, the Company considers the historical volatility of the share price of similar entities over the most recent period that is commensurate with the expected warrant term.

(tabular amounts in thousands of US dollars)

The following table lists the warrants outstanding at December 31, 2009 by exercise price.

| Exercise price $ | Warrants outstanding | Weighted average remaining term (in years) | Warrants exercisable | Weighted average remaining term (in years) |
|---|---|---|---|---|
| 1.25 | 638,298 | 1.94 | 638,298 | 1.94 |
| 2.50 | 3,436,154 | 8.82 | 3,436,154 | 8.82 |
| 3.25 | 795,000 | 1.20 | 795,000 | 1.20 |
| 5.50 | 2,255,835 | 1.49 | 2,255,835 | 1.49 |
| 6.88 | 3,158,168 | 2.99 | 3,158,168 | 2.99 |
| 0.60 | 2,500,000 | 0.96 | 2,500,000 | 0.96 |
| Total | 12,783,455 | 3.73 | 12,783,455 | 3.73 |

As at December 31, 2009, there was no unrecognized compensation expense related to unvested warrants.

## 9 Taxation

Tethys is domiciled in the Cayman Islands which has no Company income tax.

At December 31, 2009, in Kazakhstan the Company had $10.3 million (2008 $4.1 million) and in Uzbekistan $2.0 million (2008 $2.2 million) of tax carry – forward losses, that would be available to offset against any future taxable profit. No deferred tax asset has been recognised in respect of $10.3 million of losses in Kazakhstan (2008 - $4.1 million). In 2009 the Company has not been able to utilise any of the losses in Kazakhstan, previously unrecognised, through the statement of comprehensive loss. Of the $10.3 million losses in Kazakhstan with no deferred tax asset, substantially all expire in various amounts from 2012 to 2016. Uzbekistan tax carry - forward losses of $2.0 million have no fixed expiry date.

The temporary differences comprising the net deferred income tax liability as at December 31, 2009 are as follows:

| | December 31, 2009 $ |
|---|---|
| Capital assets | (1,078) |
| Tax losses | 325 |
| Other | 155 |
| Net deferred tax liability | (598) |

(tabular amounts in thousands of US dollars)

The provision for income taxes is different from the expected provision for income taxes for the following reasons:

| | $ |
|---|---|
| Loss before income taxes | (21,506) |
| Income tax rate | 20% |
| Expected income tax expense (recovery) | (4,301) |
| | |
| *Increase (decrease) resulting from:* | |
| Non-deductible expenses | 535 |
| Impact of effective tax rates in other foreign jurisdictions | 2,616 |
| Rate reduction on future income taxes | 139 |
| Losses and tax assets not utilised/recognised | 1,155 |
| Other | 70 |
| | 214 |
| | |
| Current income tax expense (recovery) | - |
| Deferred tax expense (recovery) | 214 |
| | 214 |

## 10 Loss per share

**Basic and diluted loss per share**

| | Loss for the year $ | Weighted average number of shares (thousands) | Per share amount $ |
|---|---|---|---|
| **Year ended December 31, 2009** | | | |
| Loss attributable to ordinary shareholders – Basic and diluted | (21,720) | 106,450 | (0.20) |
| **Year ended December 31, 2008** | | | |
| Loss attributable to ordinary shareholders – Basic and diluted | (22,184) | 55,988 | (0.40) |

Basic loss per share is calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the year. Diluted per share information is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares including share options and warrants, are considered to be anti-dilutive and have therefore been excluded from the diluted per share calculation.

Subsequent to the year end, the Company issued further shares as disclosed in note 22.

(tabular amounts in thousands of US dollars)

## 11 Intangible assets

| | Other intangible asset $ | Exploration and evaluation assets $ | Total $ |
|---|---|---|---|
| **At January 1, 2008** | | | |
| Cost | - | 7,335 | 7,335 |
| Accumulated amortisation and impairment | - | - | - |
| **Net book amount** | - | 7,335 | 7,335 |
| **Year ended December 31, 2008** | | | |
| Opening net book amount | - | 7,335 | 7,335 |
| Additions | - | 10,622 | 10,622 |
| Amounts written off to exploration and evaluation costs | - | (1,852) | (1,852) |
| Amortisation charge | - | - | - |
| **Closing net book amount** | - | 16,105 | 16,105 |
| **At December 31, 2008** | | | |
| Cost | - | 16,105 | 16,105 |
| Accumulated amortisation and impairment | - | - | - |
| **Net book amount** | - | 16,105 | 16,105 |
| **Year ended December 31, 2009** | | | |
| Opening net book amount | - | 16,105 | 16,105 |
| Additions through acquisition of subsidiary | 5,553 | - | 5,553 |
| Additions | - | 23,289 | 23,289 |
| Disposal of subsidiaries at book amount | - | (19,176) | (19,176) |
| Amounts written off to exploration and evaluation costs | - | (887) | (887) |
| Amortisation charge | (506) | - | (506) |
| **Closing net book amount** | 5,047 | 19,331 | 24,378 |
| **At December 31, 2009** | | | |
| Cost | 5,553 | 19,331 | 24,884 |
| Accumulated amortisation and impairment | (506) | - | (506) |
| **Net book amount** | 5,047 | 19,331 | 24,378 |
| Asset retirement obligation asset at net book amount included in above | | | |
| At December 31, 2009 | - | 47 | 47 |
| At December 31, 2008 | - | 126 | 126 |
| At January 1, 2008 | - | - | - |

Borrowing costs of $1,387,000 (2008 – nil) have been capitalised within exploration and evaluation assets during the year. The effective weighted average interest rate of the relevant borrowings was 22% (2008 – nil). The effective interest rate is higher than the nominal rate due to the cost of associated warrants (Note 17.2) and royalties (Note 17.3). For the year ended December 31, 2009 $779,389 (2008 - $371,716) was capitalised from administrative expenses.

(tabular amounts in thousands of US dollars)

## 12 Property, plant and equipment

| | Oil and gas properties $ | Oil and gas equipment $ | Vehicles $ | Office and computer equipment $ | Total $ |
|---|---|---|---|---|---|
| **At January 1, 2008** | | | | | |
| Cost | 35,499 | 2,057 | 579 | 386 | 38,521 |
| Accumulated depreciation | (143) | - | (19) | (32) | (194) |
| **Net book amount** | 35,356 | 2,057 | 560 | 354 | 38,327 |
| **Year ended December 31, 2008** | | | | | |
| Opening net book amount | 35,356 | 2,057 | 560 | 354 | 38,327 |
| Additions | 12,495 | 17,983 | 809 | 581 | 31,868 |
| Deletions | (440) | - | - | - | (440) |
| Depreciation charge | (3,969) | (72) | (168) | (124) | (4,333) |
| **Closing net book amount** | 43,442 | 19,968 | 1,201 | 811 | 65,422 |
| **At December 31, 2008** | | | | | |
| Cost | 47,554 | 20,040 | 1,388 | 967 | 69,949 |
| Accumulated depreciation | (4,112) | (72) | (187) | (156) | (4,527) |
| **Net book amount** | 43,442 | 19,968 | 1,201 | 811 | 65,422 |
| **Year ended December 31, 2009** | | | | | |
| Opening net book amount | 43,442 | 19,968 | 1,201 | 811 | 65,422 |
| Additions | 6,908 | 4,853 | 98 | 155 | 12,014 |
| Additions through acquisition of subsidiary | - | - | - | 117 | 117 |
| Disposal of subsidiaries at book amount | - | - | (162) | (140) | (302) |
| Depreciation charge | (2,823) | (1,033) | (117) | (107) | (4,080) |
| **Closing net book amount** | 47,527 | 23,788 | 1,020 | 836 | 73,171 |
| **At December 31, 2009** | | | | | |
| Cost | 54,462 | 24,893 | 1,324 | 1,099 | 81,778 |
| Accumulated depreciation | (6,935) | (1,105) | (304) | (263) | (8,607) |
| **Net book amount** | 47,527 | 23,788 | 1,020 | 836 | 73,171 |

(tabular amounts in thousands of US dollars)

| | Oil and gas properties $ | Oil and gas equipment $ | Vehicles $ | Office and computer equipment $ | Total $ |
|---|---|---|---|---|---|
| Asset retirement obligation at net book amount included in above: | | | | | |
| At December 31, 2009 | 18 | - | - | - | 18 |
| At December 31, 2008 | 175 | - | - | - | 175 |
| At January 1, 2008 | 918 | - | - | - | 918 |

| | Oil and gas properties $ | Oil and gas equipment $ | Vehicles $ | Office and computer equipment $ | Total $ |
|---|---|---|---|---|---|
| Asset under construction at net book amount included in above | | | | | |
| **At December 31, 2009** | 25,858 | - | - | - | 25,858 |
| At December 31, 2008 | 23,251 | 3,210 | - | - | 26,461 |
| At January 1, 2008 | 17,105 | 1,879 | - | - | 18,984 |

Assets under construction as at December 31, 2009 and December 31, 2008 includes the cost of developing the Akkulka concession and tie-in pipeline and are not being depreciated until commencement of production.

Borrowing costs of $513,000 have been capitalised to oil and gas properties in the current year (2008 - $712,000). The effective weighted average interest rate of the relevant borrowing was 19.58%, (2008 22.7 %). The effective interest rate is higher than the nominal rate due to the cost of associated warrants (note 17.2). For the year ended December 31, 2009 $438,584 (2008 - $41,239) was capitalised from administrative expenses.

## 13 Investments

| | December 31, 2009 $ | December 31, 2008 $ | January 1, 2008 $ |
|---|---|---|---|
| Restricted cash | 659 | 587 | 318 |

Restricted cash at December 31, 2009, December 31, 2008, and January 1, 2008 consisted of interest bearing bank deposits held in Kazakhstan. These deposits have been placed to satisfy local Kazakhstan requirements in respect of asset retirement obligations.

(tabular amounts in thousands of US dollars)

## 14 Trade and other receivables

| | December 31, 2009 $ | December 31, 2008 $ | January 1, 2008 $ |
|---|---|---|---|
| **Current** | | | |
| Trade receivables | 905 | 1,124 | 219 |
| Prepayments | 502 | 900 | 351 |
| Other receivables | 904 | 640 | 790 |
| | 2,311 | 2,664 | 1,360 |
| **Non-current** | | | |
| Advances to construction contractors | 333 | 1,514 | 3,062 |
| Hong Kong Stock Exchange (HKSE) deferred offering costs | 352 | - | - |
| Value added tax receivable | 4,486 | 4,843 | 2,752 |
| | 5,171 | 6,357 | 5,814 |
| | 7,482 | 9,021 | 7,174 |

Current trade and other receivables are unsecured and non-interest bearing. Normal payment terms for the Company are 30 days. Prepayments primarily relate to prepaid insurance and other corporate operating expense items.

Trade receivables of $905,000 (December 31, 2008 – $1,124,000) are more than thirty days past due but are not considered impaired. The other classes within trade and other receivables do not contain impaired assets.

Non-current advances to construction contractors relate to suppliers who were paid in advance for materials and services relating to both the Akkulka and the Kul-Bas contracts. For the Akkulka contract, the prepayments relate to the drilling of a new well and payments on compressors, pipes and associated construction work that will constitute phase two of the Company's gas production plan. For Kul-Bas the prepayment related primarily to the drilling of a new well.

## 15 Investment in Joint Venture

The Company has a 51% interest in a jointly controlled entity, Seven Stars Energy Corporation Limited (SSEC). On December 30, 2009 the Company transferred ownership of its three Tajik subsidiaries to SSEC. At December 31, 2009 the Company's investment in the joint venture was $nil.

The consideration received by Tethys' from SSEC was a note receivable in the amount of $21,727,000, which represents Tethys' book value of assets transferred plus an amount for certain costs previously expensed by Tethys' which are recoverable from SSEC.

This transaction resulted in a gain of $4,699,000, which has been deferred on the statement of financial position. This amount has been recorded as a reduction of the investment account in the amount of $1,040,000 (which has reduced the investment account to $nil as at December 31, 2009), with the remaining balance of

(tabular amounts in thousands of US dollars)

$3,659,000 being recorded as a deferred gain. The deferred gain will be recognised in the income when realised.

The following amounts represent the movements in the investment account during the year:

| | December 31, 2009 $ |
|---|---|
| Balance, beginning of year | - |
| Contributions | 2,040 |
| Share of losses from jointly controlled entity | (1,000) |
| Deferred gain on assets sold to jointly controlled entity | (1,040) |
| Balance, end of year | - |

The following tables represent the assets and liabilities of the jointly controlled entity at the year end and its results for the year to December 31, 2009.

| | December 31, 2009 $ |
|---|---|
| **Assets** | |
| Non-current assets | 24,173 |
| Current assets | 113 |
| Total assets | 24,286 |
| **Liabilities** | |
| Non-current liabilities | (21,727) |
| Accruals | (519) |
| Total liabilities | (22,246) |
| **Net assets** | 2,040 |

| | December 31, 2009 $ |
|---|---|
| Revenue | - |
| Expenses | (1,960) |
| Loss before tax | (1,960) |
| 51% share of joint venture loss before tax | (1,000) |

(tabular amounts in thousands of US dollars)

**Commitments**

On June 13, 2008, the Company's wholly owned subsidiary, Kulob Petroleum Limited ("KPL"), signed a Production Sharing Contract ("PSC") with the Government of the Republic of Tajikistan. Under the PSC, KPL will recover 100% of its costs from up to 70% of total production (the maximum allowed under the newly approved production sharing legislation of Tajikistan) and the remaining production (termed "Profit Oil and Gas") will be shared 70% to KPL and 30% to the Government whose share includes all taxes, levies and duties. The terms are fixed over the life of the PSC which is a minimum of 25 years.

Pursuant to the PSC, Tethys has committed to funding a work program designed to provide data for a focused exploration of the Contract Area and which will be carried out in two stages (the "Work Program"). The first phase of the Work Program will include geological studies, reprocessing of existing seismic and other geophysical data, acquisition of seismic and other geophysical data and the commencement of initial rehabilitation activities on the Beshtentak and Khoja Sartez fields. The minimum spend commitment under Phase 1 of the contract is US$3,000,000. This expenditure was required to be met within 18 months of the effective date of the contract, which is December 13, 2009. This commitment was satisfied through the payment on January 2, 2009 of $4,925,000 for a contract agreed on November 14, 2008 relating to a seismic survey work program.

The total cost of the seismic work program agreement is $9,850,600, which can be unilaterally terminated at any point by the Company with immediate repayment of amounts remitted in advance of the fulfilled scope of works at the moment of termination, provided the Contractor has reached Stage One Completion. By December 31, 2009, a total of $5,659,652 had been advanced (including the $4,925,000 above). Phase 2 of the seismic survey commenced in October 2009.

The Company's share of Phase 2 commitment is $2,137,383.

## 16 Cash and cash equivalents

| | **December 31, 2009 $** | **December 31, 2008 $** | **January 1, 2008 $** |
|---|---|---|---|
| Cash at bank and in hand | 6,788 | 19,868 | 983 |
| Short-term deposits | 509 | 2,332 | 25,709 |
| | 7,297 | 22,200 | 26,692 |

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

(tabular amounts in thousands of US dollars)

## 17 Financial liabilities

### 17.1 Borrowings

| | Effective interest rate % | Maturity date | December 31, 2009 $ | December 31, 2008 $ | January 1, 2008 $ |
|---|---|---|---|---|---|
| **Current** | | | | | |
| Short-term portion of long-term loans | 19 – 23 p.a. | 2010 | 1,086 | 853 | - |
| **Non-current** | | | | | |
| Long-term loans | 19 – 23 p.a. | 2011 | 8,199 | 5,096 | - |
| | | 2012 | 1,125 | - | - |
| | | | 10,410 | 5,949 | - |

Financial borrowings relate to financing arrangements that were put in place to fund the acquisition of the Telesto deep drilling rig (Telesto) and the Tykhe drilling rig (Tykhe) in 2008 and the drilling of a new well in Uzbekistan in 2009.

Principal repayments for the loans are as follows:

| | | Drilling rig loans $ | Uzbekistan loans $ | Total $ |
|---|---|---|---|---|
| To December 31, | 2010 | 1,464 | - | 1,464 |
| | 2011 | 4,577 | 4,100 | 8,677 |
| | 2012 | - | 1,136 | 1,136 |
| Remaining principal payments | | 6,041 | 5,236 | 11,277 |
| Less: unamortised debt discount | | (503) | (364) | (867) |
| Balance, end of year | | 5,538 | 4,872 | 10,410 |
| | Current | 1,086 | - | 1,086 |
| | Non-current | 4,452 | 4,872 | 9,324 |

The loan to fund Telesto bears interest at a nominal rate of 12%. In addition 795,000 warrants to purchase Tethys shares at CAD$3.25 with a term of three years were issued to lenders. The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt, with the effective interest rate method being used to amortise the discount over the life of the loan. Lenders have security over the shares of Tethys Petroleum Inc. which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys.

The loan to fund Tykhe bears interest at a nominal rate of 15%. In addition 638,298 warrants to purchase Tethys shares at CAD$1.25 with a term of three years were issued to lenders. The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt, with the effective interest rate method being used to amortise the discount over the life of the loan. Lenders have security over the shares of AOE Tykhe BV which has no other assets except the drilling rig and in addition a corporate guarantee is being provided by Tethys.

During the year the Company obtained a short term loan of $2,500,000 which was fully repaid by June 30, 2009. In connection with the loan financing, 2,500,000 warrants to purchase Tethys shares at CAD$0.60 with a term of 18 months were issued to lenders. The loan was initially measured at fair value and subsequently measured at amortized cost using the effective interest rate method. The fair value of $421,370 associated with the warrants issued has been fully amortised with the effective interest rate method during the year (note 17.2).

Based on the borrowing rates currently available to the Company for long term borrowings with similar terms and average maturities (22%), the fair value of the non-current financial borrowings in relation to the drilling rigs and new well in Uzbekistan approximates its carrying value.

On October 19, 2009 Tethys closed a loan financing for $4.1 million with a group of investors in connection with the drilling of a new well in Uzbekistan. A coupon of 10% per annum is due for the first two months, which is the expected drilling time of the well. Thereupon the lenders will receive 6% per annum coupon and 6.25% of the revenue received by BHCL from sales of the net production from the new well for every $1.0 million invested, calculated monthly and payable quarterly in arrears over a period of up to 24 months. If the well does not produce the investor will receive only the 6% per annum coupon on the funds invested.

On December 14, 2009 in connection with the drilling of the above new well in Uzbekistan the Company further approved the issue of loan notes to a maximum value of $3,000,000 at an issue rate of $0.88 per note and redemption value of $1, resulting in an effective rate of 6.5%. By December 31, 2009, $1,000,000 loan notes had been placed. A royalty of 11.25% is payable to the loan note holders calculated on sales of net production from the new well. The royalty entitlement was identified as an embedded derivative and required to be separated from the loan note. The royalty entitlement has been accounted for as a derivative financial instrument – interest rate swap. Refer to note 17.

Issue of the loan notes was completed via a broker to whom a royalty commission is payable at 4.5% for every $1.0 million placed. The fair value of the commission payable at December 31, 2009 was $42,333. The Company measured the fair value of the commission payables by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the royalty entitlement. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%). The fair value associated with the royalty entitlement has been recognised as a transaction cost and presented as a direct reduction to the face value of the borrowing with the effective interest rate method being used to amortise the cost over the life of the loan. The commission liability has been included in current trade and other payables.

(tabular amounts in thousands of US dollars)

### 17.2 Derivative financial instrument - warrants

| | December 31, 2009 $ | December 31, 2008 $ | January 1, 2008 $ |
|---|---|---|---|
| Balance, beginning of year | 146 | - | - |
| Issued during the year | 422 | 1,163 | - |
| Fair value loss / (gain) | 485 | (929) | - |
| Adjustment | - | (88) | - |
| Balance, end of year | 1,053 | 146 | - |

The warrant liability represents the financial liability relating to share warrants that are denominated in a currency that is not the Company's functional currency. These warrants were issued in connection with the two rig loans described in note 17.1.

The liability was initially recognised at fair value. As the warrants are denominated in foreign currency, there is a written option for the holder to exchange the foreign currency denominated warrant for a fixed number of functional currency denominated shares. This option is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income.

The fair value of the liability is estimated using the Black-Scholes pricing model using the following average assumptions:

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| Weighted average fair value | $0.29 | $0.15 |
| Exercise price | $1.24 | $3.25 |
| Risk free rate | 1.46% | 2.41% |
| Expected term | 1.18 years | 2.56 years |
| Volatility | 87% | 85% |
| Dividend | Nil | Nil |

### 17.3 Derivative financial instruments - interest rate swap

The interest rate swap represents the derivative financial instrument entered into in connection with the Uzbekistan loan financing disclosed in note 17.1 completed in the year. This instrument is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income. The Company measured the fair value of the liability by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the instrument. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%).

(tabular amounts in thousands of US dollars)

| | December 31, 2009 $ | December 31, 2008 $ |
|---|---|---|
| Balance, beginning of year | - | - |
| Derivative financial instrument | 101 | |
| Gain recognised in the statement of comprehensive loss | (6) | - |
| Balance, end of year | 95 | - |

## 18 Trade and other payables

| | December 31, 2009 $ | December 31, 2008 $ | January 1, 2008 $ |
|---|---|---|---|
| **Current** | | | |
| Trade payables | 4,236 | 1,117 | 1,183 |
| Accruals | 1,997 | 414 | 643 |
| Payables to related parties | 35 | 489 | 453 |
| Other creditors | 518 | 715 | - |
| | 6,786 | 2,735 | 2,279 |
| **Non-current** | | | |
| Other non-current payables | 808 | 523 | 776 |

Trade payables are non-interest bearing and are normally settled on 30 day terms. Accruals represent mainly fees outstanding to the drilling contractor in Uzbekistan, drilling related fees in Tajikistan and professional fees. Other current creditors consist mainly of local taxes in the Republic of Kazakhstan and the current portion of the Kyzyloi historical costs. All current trade and other payables are interest free and payable within 12 months.

Included within other non-current payables are accruals for historical costs due to the Government of Kazakhstan on the Kyzyloi and Akkulka contracts in Kazakhstan.

**Kyzyloi**

The principal amount outstanding at December 31, 2009 was $735,053 (2008 – $908,098) and this is to be repaid in quarterly instalments by March 2014. The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method. The net present value of liability using an assumed rate of interest of 10% (2008 – 10%) is $510,455 (2008 – $680,000) of which $101,955 (2008 – $157,000) is current, leaving a non-current balance of $408,500 (2008 – $523,000). The fair value of the liability approximates its carrying value, (2008 - $508,441).

**Akkulka**

Upon signature of the Akkulka gas production contract on December 23, 2009, the historical cost liability in relation to this field became due. The principal amount outstanding at December 31, 2009 was $933,997 and this is to be repaid in quarterly instalments by June 2018. The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method. The net present value of liability using an assumed rate of interest of 22% is $414,437 of which $19,581 is current, leaving a non-current balance of $394,856.

(tabular amounts in thousands of US dollars)

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities, the fair value of the non-current liability relating to historic costs approximates its carrying value.

Principal repayments for both contracts are as follows:

| | | $ |
|---|---|---|
| To December 31, | 2010 | 283 |
| | 2011 | 283 |
| | 2012 | 283 |
| | 2013 | 283 |
| | 2014 | 283 |
| | 2015 and thereafter | 260 |
| Remaining principal payments | | 1,675 |
| Less: unamortised debt discount | | (745) |
| Balance, end of year | | 930 |
| | Current | 122 |
| | Non-current | 808 |
| | | 930 |

## 19 Asset retirement obligations

| | Year ended December 31, 2009 $ |
|---|---|
| At January 1, 2009 | 465 |
| Additional obligations incurred | 77 |
| Change in estimated cash flow | (358) |
| Unwinding of discount due to passage of time | 22 |
| **At December 31, 2009** | 206 |

The Company makes provision for the future cost of decommissioning oil and gas production facilities and pipelines on a discounted basis. These costs are expected to be incurred between 2012 and 2022. The provision has been estimated using existing technology at current prices, escalated at 10% (2008 – 10%) and discounted at 11% (2008 – 11%). The economic life and the timing of the asset retirement obligation are dependent on Government legislation, commodity price and the future production profiles of the project. In addition, the estimated cash outflows are subject to inflationary and/or deflationary pressures in the cost of third party service provision.

(tabular amounts in thousands of US dollars)

## 20 Share capital

| | December 31, 2009 Number | December 31, 2008 Number | January 1, 2008 Number |
|---|---|---|---|
| **Authorized** | | | |
| Ordinary shares with a par value of $0.10 each | 700,000,000 | 700,000,000 | 500,000,000 |
| Preference shares with a par value of $0.10 each | 50,000,000 | 50,000,000 | - |

| **Ordinary equity share capital** | **Number** | **Share capital** | **Share premium** |
|---|---|---|---|
| **Allotted and fully paid** | | **$** | **$** |
| At January 1, 2008 | 45,116,696 | 4,511 | 94,972 |
| Issued during the year for cash | 21,276,596 | 2,128 | 43,626 |
| **At December 31, 2008** | 66,393,292 | 6,639 | 138,598 |
| **At January 1, 2009** | 66,393,292 | 6,639 | 138,598 |
| Issued during the year for purchase of oil and gas equipment | 1,400,000 | 140 | 701 |
| Issued during the year in connection with finance charges | 81,477 | 8 | 226 |
| Issued during the year for purchase of a subsidiary | 15,000,000 | 1,500 | 1,487 |
| Issued during the year for cash | 51,680,000 | 5,168 | 12,736 |
| **At December 31, 2009** | 134,554,769 | 13,455 | 153,748 |

The preference shares have the rights as set out in the Memorandum and Articles of Association approved at the AGM on April 24, 2008. Significant terms related to preference shares are summarised below:

- May be issued in one or more series;
- Are entitled to any dividends in priority to the ordinary shares;
- Confer upon the holders thereof rights in a winding-up priority to the ordinary shares;
- And may have such other rights, privileges and conditions (including voting rights) as the Board may determine prior to the first allotment of any series of preference shares, provided that if a series of preference shares has no or limited voting rights it shall be designated as such by the Board.

On January 13, 2009, 1,400,000 ordinary shares were issued to a supplier as partial consideration for the purchase of a coil tubing unit. The fair value of the shares issued was determined by reference to the fair value of the goods received at the measurement date.

On April 9, 2009, the Company issued 15,000,000 ordinary shares to Rosehill Energy Limited as consideration for the acquisition of its wholly owned subsidiary. Details of this transaction are disclosed in note 21.

On April 27, 2009, the Company issued 81,477 ordinary shares to Kraken Financial Group Limited, a related party, as consideration for services rendered in connection with the placement of shares of the Company in 2008. The fair value of the shares issued was determined by reference to the fair value of the services received at the measurement date.

On June 19, 2009, the Company issued 51,680,000 ordinary shares for consideration of $17,906,000, net of transaction costs.

As at December 31, 2009 a total of 24,489,455 (December 31, 2008 – 18,311,596) ordinary shares are reserved under the Company's Long Term Stock Incentive Plan and Warrants granted by the Company. Details of the options and warrants are given in note 8.

There are currently no preference shares outstanding (2008 – None).

## 21 Business combination

On April 9, 2009 the Company acquired 100% of the issued share capital in Baker Hughes (Cyprus) Limited (BHCL), a Company incorporated in Cyprus, which operates under a production enhancement contract relating to the North Urtabulak field in Uzbekistan. Tethys issued 15,000,000 ordinary shares as purchase consideration in the acquisition. The acquisition agreement places a trading restriction on the shares as follows: 7,500,000 cannot be resold until 6 months from the date of issue and the remaining 7,500,000 cannot be resold until 12 months from the date of issue.

The acquired business contributed revenues of $4,731,000 and a net profit before taxation of $477,000 to the Company for the period from April 9, 2009 to December 2009 (note 5). If the acquisition had occurred on January 1, 2009 the revenue of the Company would have been $1,017,371 higher (unaudited) and the net profit before taxation would have been $112,000 higher (unaudited). These amounts have been calculated using the Company's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from January 1, 2009.

The fair value of the shares issued was based on the published price of the shares on the date of acquisition. As the shares were issued with a trading restriction, this resulted in a marketability discount being applied to the published price to arrive at fair value. The marketability discount was valued using the Black Scholes Option Pricing Model using the following assumptions: dividend yield of 0%; expected term of 0.75 years; a risk free interest rate of 0.60% and expected volatility of 121%. This resulted in an adjustment of $2,344,484 to the purchase consideration.

(tabular amounts in thousands of US dollars)

The provisional fair values of identifiable assets and liabilities of BHCL as at the date of acquisition were:

| | **(Unaudited) Acquiree carrying value $** | **Preliminary provisional fair value $** | **As at December 31, 2009, provisional fair value $** |
|---|---|---|---|
| **Consideration at April 9, 2009** | | | |
| Equity instruments (15,000,000 ordinary shares) | | 2,987 | 2,987 |
| Direct costs related to the acquisition | | 57 | 57 |
| **Total consideration transferred** | | 3,044 | 3,044 |
| | | | |
| **Recognised amounts of identifiable assets acquired and liabilities assumed** | | | |
| Cash and cash equivalents | 532 | 532 | 532 |
| Trade and other receivables | 502 | 502 | - |
| Intangible asset | - | 3,820 | 5,553 |
| Property, plant and equipment | 9,373 | 118 | 117 |
| Inventory | - | - | 753 |
| Deferred revenue | - | - | (1,594) |
| Current trade and other payables | (1,928) | (1,928) | (1,933) |
| Deferred income tax liability | - | - | (384) |
| **Total identifiable net assets** | 8,479 | 3,044 | 3,044 |

Assets and liabilities acquired in a business combination are required to be recognised at fair value. In the absence of an active market for the North Urtabulak Field Production Enhancement Contract, the Company measured the fair value of the asset by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the asset. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the asset and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows.

Changes recognised in the provisional fair value balances during the year were due to new information obtained about facts and circumstances that existed as of the acquisition date which, if known, would have affected the measurement of the amounts at that date.

The fair value of the acquired assets relating to the Production Enhancement Contract (PEC) for the North Urtabulak field of $5,553,000 is provisional pending completion of the final valuation report for those assets.

There were no business combinations in the year ended December 31, 2008.

## 22 Events occurring after the reporting period

On November 9, 2009, Tethys announced its submission of a Form A1 listing application to the Hong Kong Stock Exchange (HKSE) with respect to a possible secondary listing of its ordinary shares on the main board of the HKSE estimated to be completed in the first half of 2010. No definite timetable nor the amount of any placement has yet been finalised and there is no guarantee that the Company's application will be successful.

On December 19, 2009 the Company entered into agreements for a non-brokered private placement of 10,000,000 Ordinary Shares for gross proceeds of US$5 million subject to regulatory approval. The sum of $3,750,000 was received on December 22, 2009 with the balance of $1,250,000 received on January 7, 2010. The Ordinary Shares were placed at a price of US$0.50 (CAD$0.53) each. The placements were completed on January 4, 2010.

On January 11, 2010 the Company further announced that it would complete a non-brokered private placement of 12,615,000 Ordinary Shares for gross proceeds of US$10 million subject to regulatory approval. The Ordinary Shares were placed at a price of CAD$0.82 (US$0.79) each. The placement was completed on January 25, 2010.

On February 4, 2010 the Company placed an additional $2 million in loan notes approved by the Company on December 10, 2009 (Note 17.1). These loan notes were in connection with the drilling of the new well in Uzbekistan.

On February 12, 2010 the Company announced an additional private placement of 30,000,000 Ordinary Shares for gross proceeds of CAD$46.5 (US$45.1) million. The Ordinary Shares were placed at an average price of CAD$1.55 (US$0.79) (US$1.50) each. The placement was completed on March 1, 2010.

On February 15, 2010 the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan confirmed its approval of the transfer of 100% of the participatory interest of TethysAralgas LLP in the charter capital of Kul-Bas LLP in favour of its parent Company, Tethys Kazakhstan Limited.

(tabular amounts in thousands of US dollars)

## 23 Related party transactions

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

| | Percentage | Country of operation | Country of registration |
|---|---|---|---|
| Tethys Uzbekistan BV | 100% | Netherlands | Netherlands |
| Tethys Petroleum Inc. | 100% | USA | USA |
| Tethys Afghanistan Inc. | 100% | Dormant | USA |
| Tethys Kazakhstan Limited | 100% | Guernsey | Guernsey |
| Tethys Aral Gas LLP | 100% | Kazakhstan | Kazakhstan |
| Kul-Bas LLP | 100% | Kazakhstan | Kazakhstan |
| Tethys Munai Gaz LLP | 100% | Dormant | Kazakhstan |
| Tethys Services Kazakhstan LLP | 100% | Kazakhstan | Kazakhstan |
| Asia Oilfield Equipment BV | 100% | Kazakhstan/ Tajikistan | Netherlands |
| Tethys Europa BV | 100% | Dormant | Netherlands |
| AOE Telesto BV | 100% | Dormant | Netherlands |
| AOE Tyke BV | 100% | Dormant | Netherlands |
| AOE Tyke SA | 100% | Dormant | Luxemburg |
| Tethys Services Limited | 100% | United Kingdom | United Kingdom |
| Tethys Caspian Limited | 100% | Dormant | Cyprus |
| Tethys Tajikistan Limited | 100% | Tajikistan | Jersey |
| Imperial Drilling Services Limited | 100% | Cayman Islands | Cayman Islands |
| Seven Stars Energy Corporation | 51% | Tajikistan | BVI |
| Tethyda Limited | 100% | Dormant | Cyprus |
| Baker Hughes (Cyprus) Limited | 100% | Uzbekistan | Cyprus |
| Rosehill Energy Limited | 100% | Uzbekistan | Cayman Islands |

The Company has an indirect shareholding of the following companies through its share of Seven Stars Energy Corporation:

| | | | |
|---|---|---|---|
| Tethys Services Tajikistan Ltd. | 51% | Tajikistan | Tajikistan |
| Kulob Petroleum Ltd. | 51% | Tajikistan | Jersey |
| Sogdiana Petroleum Ltd. | 51% | Tajikistan | Cayman Islands |

Other

Vazon Energy Limited ("Vazon") is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr.

(tabular amounts in thousands of US dollars)

Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the year ended December 31, 2009 was $1,677,113 (2008 – $1,405,028).

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to the optimization of the existing compressors and those to be installed as part of Phase 2 gas production from Akkulka, and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the year ended December 31, 2009 were $497,697 (2008 – $422,770).

Kraken Financial Group (KFG) had a common director with the Company up until 1 September 2009. In 2008, KFG was engaged by the Company to assist in obtaining loan financing in relation to the purchase of both Telesto and Tykhe drilling rigs. As a result of the services provided in connection with the Telesto transaction, KFG received 6% commission of the funds it was responsible for introducing to the Company. This commission was to be taken in the form of 81,477 shares, which were issued in 2009 amounting to $234,000 (which had been recognized as a liability at the end of 2008). No further services were provided by KFG during 2009 (December 31, 2008 - $21,000).

During the year ended December 31, 2008, KFG had acted as broker for Tethys in the placement of various insurance policies, including Directors and Officers, for which the combined annual premiums were $112,615. This service was not provided in 2009.

The remuneration of the key management personnel of the Company, which includes both directors and other officers, is set out below in aggregate.

| | Year ended December 31, 2009 | Year ended December 31, 2008 |
|---|---|---|
| Salaries and short-term employee benefits | 3,026 | 2,926 |
| Share-based payments | 2,071 | 3,062 |
| | 5,097 | 5,988 |

Transactions with affiliates or other related parties including management of affiliates are recorded at their exchange amount.

(tabular amounts in thousands of US dollars)

## 24 Changes in working capital

| | Year ended December 31, 2009 | December 31, 2008 |
|---|---|---|
| Trade and other receivables | 353 | (1,304) |
| Inventories | (2,155) | (213) |
| Trade and other payables | 4,051 | 456 |
| Change in non-cash working capital | 2,249 | (1,061) |
| Non-cash transactions | (2,136) | - |
| Net changes in non-cash working capital | 113 | (1,061) |

The principal non-cash transaction is related to the issue of shares as consideration for the acquisition discussed in note 21.

Net changes in non-cash working capital are categorized as follows:

| | Year ended December 31, 2009 | December 31, 2008 |
|---|---|---|
| Operating activities | (1,160) | (844) |
| Investing activities | 1,273 | (217) |
| Balance | 113 | (1,061) |

## 25 Commitments and contingencies

### Kazakhstan

*Kyzyloi Field and the Kyzyloi Field Licence and Production Contract*

The Kyzyloi Field Licence and Production Contract for production of gas on the Kyzyloi Field was initially issued by the Kazakh government to the state holding Company Kazakhgas on June 12, 1997 and was transferred to Tethys Aral Gas (TAG) on May 15, 2001. The contract was entered into between the MEMR and TAG on May 5, 2005, initially until June 12, 2007. However, in January 2005, the Ministry of Energy and Mineral Resources (MEMR) agreed to extend the contract until June 2014. Gas production commenced under the contract in December 2007.

The Kyzyloi Field Licence and Production Contract grants TAG exploration and production rights over an area of approximately 70,967 acres (287.2 km$^2$) and extends down to the base of the Paleogene sequence. Pursuant to the contract, TAG must reimburse the Kazakh government for approximately $1,211,000 in historical costs, to be paid in equal quarterly instalments from the commencement of production until full reimbursement. Under the latest extension of the Kyzyloi Field Licence and Production Contract, TAG has committed to spending approximately $2.7 million for a workover program over the seven year period until 2014. In November 2009, the Company finalised and agreed the 2010 work program with a commitment of $100,000.

*Akkulka Exploration Licence and Contract*

The Akkulka Exploration Licence and Contract was entered into between the Kazakh State Committee of Investments and TAG on September 17, 1998. The Akkulka Exploration Licence initially granted TAG exploration rights for a period of five years and both the Akkulka Exploration Licence and Contract were valid until September 17, 2003. On December 9, 2009, TAG entered into an amendment agreement with the MEMR to extend the period of the Akkulka Exploration Licence and Contract from September 17, 2009 until March 10, 2011. Under the amendment agreement, TAG has committed to spending an additional $850,000 over the 18 month period and the 2010 work program for Akkulka was agreed with a capital commitment of $676,700.

*Akkulka Production Contract*

On December 23, 2009, TAG and MEMR signed the Akkulka Production Contract giving TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years. Contingent upon commencement of commercial production on the Akkulka contractual territory, a total amount of US$3,500,000 will be due to the Kazakhstan Government as a reimbursement of historical costs previously incurred by the Government in relation to the contractual territory. For that part of the contractual territory from which production will commence in 2010 staged payments over a period of nine years totalling approximately $933,997 will also be due to the Kazakh government for the reimbursement of historical costs (note 18). The 2010 minimum work program was agreed with a capital commitment of $141,400.

*Kul-Bas Exploration and Production Contract*

The Kul-Bas Exploration and Production Contract was signed between Kul-Bas and the MEMR on November 11, 2005. This contract, which is for a period of 25 years (unless extended by mutual agreement of the parties), with an initial six-year exploration period and a 19-year production period, grants Kul-Bas with exploration and production rights over an original 2,688,695 acres (10,881 km$^2$) surrounding the Akkulka Block. Pursuant to the original contract, 20% of the area was to be relinquished at the end of the second year of the contract, with 20% to be relinquished annually thereafter up to the end of the six year exploration period. However, in response to an application on behalf of the Company, on April 27, 2009, Amendment 1 to the Kul-Bas Exploration and Production Contract was signed, according to which 20% is relinquished by the end of contract year 2 (completed), 0% in contract year 3 (2008), 10% by the end of contract year 4 (2009), 20% by the end of year 5 (2010) and all remaining contract area, outside commercial discovery areas, by the end of year 6 (2011).

The work program on this area amounted to a total of approximately $7,773,500 over the initial six-year exploration period. The remaining commitment of $2,894,000 relating to the contractual territory is required to be satisfied by November 11, 2011 and is included within the 2010 work program of $3 million which is outlined for one new 4,000 meters exploration well. In addition to the minimum work program commitments, the Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of US$3,275,780. The Company has previously paid an amount of US$49,137 in relation to this balance. If and when commercial production commences, US$88,666 is due in quarterly instalments until the remaining historical costs of US$3,226,643 has been paid in full.

(tabular amounts in thousands of US dollars)

**Tajikistan**

Per *Note 15 Investment in Joint Venture* above the Company's share of seismic contract commitment is $2,137,383.

**Uzbekistan**

In connection with the drilling of a new well (NU116), the Company entered into a Turnkey contract with a fixed commitment of $3,943,976, of which $2,071,988 had been paid prior to the year end. The outstanding balance of $1,871,988 would be paid upon completion of the well which was anticipated to be February 2010.

**Operating leases**

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

| | **Total** $ | **Less than 1 year** $ | **1 – 3 years** $ |
|---|---|---|---|
| Operating leases | 779 | 415 | 364 |

2009 expenditure on lease commitments included in the statement of comprehensive loss amounted to $480,552, (2008 - $801,213).

## 26 Explanation of transition to IFRS

The consolidated financial statements for the year ended December 31, 2009 are the Company's first financial statements prepared under IFRS. For all accounting periods prior to this, the Company prepared its financial statements under generally accepted accounting principles in the United States of America ('US GAAP'). In accordance with IFRS 1 'First time adoption of IFRS', certain disclosures relating to the transition to IFRS are given in this note. These disclosures are prepared under IFRS as set out in the basis of preparation in note 2.

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

**IFRS 3 Business combinations**

This standard has not been applied to acquisitions of subsidiaries that occurred before January 1, 2008, the Company's transition date.

**IFRIC 1 Changes in existing decommissioning, restoration and similar liabilities**

The Company has elected to apply exemption from full retrospective application of Asset retirement obligations as allowed under IFRS 1. As such the Company has re-measured the provisions as at January 1, 2008 under IAS 37, estimated the amount to be included in the cost of the related asset by discounting the liability to the date at which the liability first arose using best estimates of the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation, and recalculated the accumulated depreciation, depletion and amortisation under IFRS.

(tabular amounts in thousands of US dollars)

| **26.1** | | **Reconciliation of equity as at January 1, 2008** | | |
|---|---|---|---|---|
| | **Notes** | **US GAAP $** | **Effect of transition to IFRS $** | **IFRS $** |
| **Assets** | | | | |
| **Non-current assets** | | | | |
| Intangible assets | a | - | 7,335 | 7,335 |
| Property, plant and equipment | b | 37,472 | 855 | 38,327 |
| Investments | | 318 | - | 318 |
| Trade and other receivables | | 5,814 | - | 5,814 |
| | | 43,604 | 8,190 | 51,794 |
| **Current assets** | | | | |
| Trade and other receivables | | 1,360 | - | 1,360 |
| Cash and cash equivalents | | 26,692 | - | 26,692 |
| | | 28,052 | - | 28,052 |
| **Total assets** | | 71,656 | 8,190 | 79,846 |
| **Equity and Liabilities** | | | | |
| **Equity attributable to shareholders** | | | | |
| Share capital | | 4,511 | - | 4,511 |
| Share premium | | 94,972 | | 94,972 |
| Other reserves | c | 20,082 | 646 | 20,728 |
| Accumulated deficit | e | (51,625) | 7,155 | (44,470) |
| | | 67,940 | 7,801 | 75,741 |
| **Non-current liabilities** | | | | |
| Trade and other payables | | 776 | - | 776 |
| Asset retirement obligations | d | 661 | 389 | 1,050 |
| | | 1,437 | 389 | 1,826 |
| **Current liabilities** | | | | |
| Trade and other payables | | 2,279 | - | 2,279 |
| | | 2,279 | - | 2,279 |
| Total liabilities | | 3,716 | 389 | 4,105 |
| **Total shareholders’ equity and liabilities** | | 71,656 | 8,190 | 79,846 |

(tabular amounts in thousands of US dollars)

**Explanation of the effect of the transition to IFRS**

The following explains the material adjustments to the statement of financial position as at January 1, 2008:

| | | $ |
|---|---|---|
| (a) | Reclassification of cost from property, plant and equipment to intangible assets. In accordance with IAS 16, IAS 38 and IFRS 6 the Company reallocated certain costs relating to unproved properties from property, plant and equipment to intangible assets. | 7,661 |
| | Expense pre licence expenditure. On discontinuance of the policy of full cost accounting, expenditure incurred prior to the date on which the Company obtaining legal title to the relevant licences or concessions to explore and develop areas of interest, previously capitalised within the full cost pool, is written off. | (326) |
| | Net effect –increase in intangible assets | 7,335 |
| (b) | Reclassification of cost from property plant and equipment to intangible assets. | (7,661) |
| | Reverse impairment loss. On transition to IFRS, a previous impairment loss recognised for Kazakhstan oil and gas properties in the year ended December 31, 2007 was reversed. US GAAP establishes a 'cost ceiling' for each cost center which limits the amount of costs that can be capitalized in each cost center. If a cost center's unamortized capitalized costs exceed the ceiling, the net capitalized costs must be written down to the ceiling. In calculating the ceiling limit under US GAAP, the present value of estimated future net revenues is computed by applying current prices of oil and gas reserves to estimated future production of proved oil and gas reserves, less estimated future expenditures to be incurred in developing and producing the proved reserves. The present value of estimated future net revenues is computed using a discount factor of 10% and assuming continuation of existing economic conditions. At the date of transition to IFRS, all CGUs were assessed for impairment by comparing the carrying value of the CGU to the recoverable amount. Recoverable amount was determined as value in use and was calculated as the present value of future cash flows expected to be derived from the CGU. The present value of future cash flows was computed on a pre-tax basis by applying forecast prices of oil and gas reserves to estimated future production of proved and probable oil and gas reserves, less estimated future expenditures to be incurred in developing and producing the proved and probable reserves. The present value of estimated future net revenues is computed using a discount factor of 8%. | 12,800 |
| | Expense unsuccessful exploration and evaluation cost. On the discontinuance of full cost accounting, drilling expenditures associated with unsuccessful exploration wells drilled prior to December 31, 2007 were expensed. These costs were previously included in the carrying value of the full cost pool. | (3,799) |

(53)

(tabular amounts in thousands of US dollars)

| | | $ |
|---|---|---|
| | Expense pre licence expenditure. On discontinuance of the policy of full cost accounting, expenditure incurred prior to the date on which the Company obtaining legal title to the relevant licences or concessions to explore and develop areas of interest, which were previously capitalised within the full cost pool, is written off. | (907) |
| | Increase the carrying value of oil and gas assets due to restatement of the asset retirement obligation. The discounted value of the future cash flows related to funding the Company's asset retirement obligation in relation to oil and gas properties is increased due to a change in the discount rate applied from a risk adjusted rate as required by US GAAP to a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. This results in an addition to the carrying value of oil and gas properties. This increase in carrying value is depreciated over the remaining life of the relevant field in accordance with the Company's depreciation policy. | 389 |
| | Reduction in depreciation of oil and gas properties. Each producing field or concession is depreciated separately using the unit of production method based on proved and probable reserves. Under US GAAP depreciation was based on the countrywide full cost pool of all proved properties, both producing and non-producing, and calculated on the unit of production method over only the proved reserves. | 33 |
| | Net effect – increase in property, plant and equipment | 855 |
| (c) | Adoption of IFRS 2. The expense relating to employee options is recognised individually for each vesting tranche over the applicable vesting period, as opposed to on a straight line method over the total requisite service period as permitted by US GAAP. | 646 |
| | Effect - increase option reserve | 646 |
| (d) | Increase in asset retirement provision. The provision relating to the cost of future restoration cost of oil and gas properties increases in line with the increase noted in (b) above. | 389 |
| | Effect – increase in provisions for asset retirement obligations. | 389 |
| (e) | **The cumulative effect of these transition adjustments on the accumulated deficit as at January 1, 2008 is a decrease of:** | **7,155** |

(tabular amounts in thousands of US dollars)

**26.2** **Reconciliation of equity as at December 31, 2008**

| | Notes | US GAAP $ | Effect of transition to IFRS $ | IFRS $ |
|---|---|---|---|---|
| **Assets** | | | | |
| **Non-current assets** | | | | |
| Intangible assets | a | - | 16,105 | 16,105 |
| Property, plant and equipment | b | 73,793 | (8,371) | 65,422 |
| Investments | | 587 | - | 587 |
| Trade and other receivables | | 6,357 | - | 6,357 |
| | | 80,737 | 7,734 | 88,471 |
| **Current assets** | | | | |
| Inventories | | 213 | - | 213 |
| Trade and other receivables | | 2,664 | - | 2,664 |
| Cash and cash equivalents | | 22,200 | - | 22,200 |
| | | 25,077 | - | 25,077 |
| **Total assets** | | 105,814 | 7,734 | 113,548 |
| **Equity and Liabilities** | | | | |
| **Equity attributable to shareholders** | | | | |
| Share capital | | 6,639 | - | 6,639 |
| Share premium | | 138,598 | | 138,598 |
| Other reserves | c | 25,189 | (42) | 25,147 |
| Accumulated deficit | f | (74,252) | 7,598 | (66,654) |
| | | 96,174 | 7,556 | 103,730 |
| **Non-current liabilities** | | | | |
| Financial liabilities - borrowings | | 5,096 | - | 5,096 |
| Trade and other payables | | 523 | - | 523 |
| Asset retirement obligations | d | 433 | 32 | 465 |
| | | 6,052 | 32 | 6,084 |
| **Current liabilities** | | | | |
| Financial liabilities – borrowings | | 853 | - | 853 |
| Derivative financial instruments – warrants | e | - | 146 | 146 |
| Trade and other payables | | 2,735 | - | 2,735 |
| | | 3,588 | 146 | 3,734 |
| Total liabilities | | 9,640 | 178 | 9,818 |
| **Total shareholders' equity and liabilities** | | 105,814 | 7,734 | 113,548 |

(tabular amounts in thousands of US dollars)

The nature of adjustments from US GAAP to IFRS at December 31, 2008 is similar to those at January 1, 2008.

| | | $ |
|---|---|---|
| (a) | Reclassification of cost from property, plant and equipment to intangible assets | 18,272 |
| | Expense pre licence expenditure | (715) |
| | Expense unsuccessful exploration cost. On the discontinuance of full cost accounting, drilling expenditures associated with unsuccessful exploration wells drilled during the prior from January 1, 2008 to December 31, 2008 were expensed. These costs were previously included in the carrying value of the full cost pool. | (1,464) |
| | Increase the carrying value of oil and gas assets due to restatement of the asset retirement obligation on exploration well drilled during the prior from January 1, 2008 to December 31, 2008 due to reduction in the discount rate as described in note 26.1b. | 12 |
| | Net effect – increase in intangible assets | 16,105 |
| (b) | Reclassification of cost from property plant and equipment to intangible assets | (18,272) |
| | Reverse impairment loss | 12,800 |
| | Expense unsuccessful exploration cost | (3,799) |
| | Expense pre licence expenditure | (1,347) |
| | Increase the carrying value of oil and gas assets due to restatement of the asset retirement obligation. | 98 |
| | Reduction of depreciation, depletion and amortisation of oil and gas properties | 2,149 |
| | Net effect –decrease in Property, plant and equipment | (8,371) |
| (c) | Adoption of IFRS 2 | 1,121 |
| | Adoption of IAS 32. | (1,163) |
| | Net effect –decrease in other reserves | ( 42) |
| (d) | Increase in asset retirement obligation. Effect – increase in provision for asset retirement obligation. | 32 |
| (e) | Adoption of IAS 32. Effect – increase in Derivative financial instruments – warrants. | 146 |
| (f) | **The cumulative effect of these transition adjustments on the accumulated deficit as at December 31, 2008 is a decrease of:** | **7,598** |

(tabular amounts in thousands of US dollars)

**26.3**

| | Notes | Consolidation reconciliation of comprehensive loss for the year ended December 31, 2008 | | |
|---|---|---|---|---|
| | | **US GAAP** **$** | **Effect of transition to IFRS** **$** | **IFRS** **$** |
| Sales and other operating revenue | | 5,360 | - | 5,360 |
| Finance income | | 832 | - | 832 |
| Total revenue and other income | | 6,192 | | 6,192 |
| Production expenditures | | (1,334) | - | (1,334) |
| Depreciation, depletion and amortization | a | (6,449) | 2,116 | (4,333) |
| Exploration and evaluation expenditure written off | b | - | (2,292) | (2,292) |
| Administrative expenses | d | (17,527) | (388) | (17,915) |
| Foreign exchange gains (loss) net | | (3,060) | | (3,060) |
| Fair value gains (loss) on derivative financial instrument | c | - | 929 | 929 |
| Interest | e | (449) | 78 | (371) |
| **Loss before taxation** | | **(22,627)** | **443** | **(22,184)** |
| Taxation | | - | - | - |
| **Net loss and comprehensive loss for the year attributable to shareholders** | | **(22,627)** | **(443)** | **(22,184)** |
| **Loss per share attributable to shareholders** | | | | |
| Basic and diluted | | (0.40) | | (0.40) |

The nature of the adjustments are explained as follows:

| | | $ |
|---|---|---|
| (a) | Reduction in the depletion expense for the year | 2,116 |
| (b) | Expense unsuccessful exploration wells drilled during the year (note 26.2a) | (1,464) |
| | Expense pre licence expenditure incurred during the year (note 26.1a) | (388) |
| | Expense pre licence expenditure incurred during the year (note 26.1b) | (440) |
| | Net effect – increase in exploration and evaluation expenditure written off | (2,292) |
| (c) | Fair value gains on derivative financial instrument | 929 |
| (d) | Increase in the cost of employee share options for the year | (388) |

(57)

| | | |
|---|---|---|
| (e) | Decrease in the accretion charge on the Company's asset retirement obligation due to the transition adjustment (note 26.1d) | 78 |

**Restatement of cash flow statement from US GAAP to IFRS**

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

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## PART 6 – CREST, DEPOSITORY INTERESTS AND DEED POLL

The Company will, prior to Admission, enter into depository arrangements to enable investors to settle and pay for interests in the Ordinary Shares through the CREST system. CREST is a paperless settlement system allowing securities to be transferred from one person's CREST account to another without the need to use share certificates or written instruments of transfer. Securities issued by non-U.K. incorporated companies, such as the Company, cannot be held electronically (i.e. in uncertificated form) or transferred in the CREST system. However, depository interests allow securities to be dematerialized and settled electronically. Pursuant to arrangements to be put in place by the Company, a depository will hold the Ordinary Shares and issue dematerialised depository interests representing the underlying Ordinary Shares which will be held on trust for the holders of the depository interests.

The Depository will issue the dematerialised depository interests (the **"Depository Interests"**). The Depository Interests will be independent securities constituted under English law which may be held and transferred through the CREST system.

The Depository Interests will be created pursuant to and issued on the terms of a deed poll expected to be executed by the Depository prior to Admission in favour of the holders of the Depository Interests from time to time (the **"Deed Poll"**). Prospective holders of Depository Interests should note that they will have no rights in respect of the underlying Ordinary Shares or the Depository Interests representing them against Euroclear U.K. & Ireland or its subsidiaries.

Ordinary Shares will be registered in the name of the Depository's nominated custodian (the **"Custodian"**) and the Depository will issue Depository Interests to participating members. Although the Company's register shows the Custodian as the legal holder of the Ordinary Shares, the beneficial interest in the Ordinary Shares remains with the Depository Interest holder, who has the benefit of all the rights attaching to the Ordinary Shares as if the Depository Interest holder were named on the certificated Ordinary Share register itself.

Each Depository Interest will be treated as one Ordinary Share for the purposes of determining, for example, eligibility for any dividends. The Depository Interests will have the same security code (the **"ISIN number"**) as the underlying Ordinary Shares and will not require a separate listing on the Official List. The Depository Interests can then be traded and settlement will be within the CREST system in the same way as any other CREST securities.

Application has been made for the Depository Interests to be admitted to CREST with effect from Admission.

### 1. TERMS OF THE DEED POLL

Shareholders are referred to the Deed Poll available for inspection at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2HA. In summary, the Deed Poll contains, inter alia, provisions to the following effect, which are binding on Depository Interest holders:

(a) The Depository will hold (itself or through the Custodian), as bare trustee, the underlying securities issued by the Company and all and any rights and other securities, property and cash attributable to the underlying securities pertaining to the Depository Interests for the benefit of the holders of the relevant Depository Interests.

(b) Holders of the Depository Interests warrant, inter alia, that the securities in the Company transferred or issued to the Custodian on behalf of the Depository/Custodian are free and clear of all liens, charges, encumbrances or third party interests and that such transfers or issues are not in contravention of the Company's constitutional documents or any contractual obligation, law or regulation. The Depository will pass on to holders of Depository Interests any stock or cash benefits received by it as holder of the Ordinary Shares on trust for such Depository Interest holder. Depository Interest holders will also be able to receive notices of meetings of holders of Ordinary Shares and other notices issued by the Company to its shareholders.

(c) The Depository and any Custodian must pass on to Depository Interest holders and, so far as they are reasonably able, exercise on behalf of Depository Interest holders all rights and entitlements received or to which they are entitled in respect of the underlying securities which are capable of being passed on or exercised. Rights and entitlements to cash distributions, to information, to make 176 choices and elections and to call for, attend and vote at meetings shall, subject to the Deed Poll, be passed on immediately in the form which they are received together with amendments and additional documentation necessary to effect such passing-on, or, as the case may be, exercised in accordance with the Deed Poll.

(d) The Depository will be entitled to cancel Depository Interests and withdraw the underlying securities in certain circumstances including where a Depository Interest holder has failed to perform any obligation under the Deed Poll or any other agreement or instrument with respect to the Depository Interests.

(e) The Deed Poll contains provisions excluding and limiting the Depository's liability. For example, the Depository shall not be liable to any Depository Interest holder or any other person for liabilities in connection with the performance or non-performance of obligations under the Deed Poll or otherwise except as may result from its negligence or wilful default or fraud or that of any person for whom it is vicariously liable, provided that the Depository shall not be liable for the negligence, wilful default or fraud of any Custodian or agent which is not a member of its group unless it has failed to exercise reasonable care in the appointment and continued use and supervision of such Custodian or agent. Furthermore, except in the case of personal injury or death, the Depository's liability to a holder of Depository Interests will be limited to the lesser of: (a) the value of the Ordinary Shares and other deposited property properly attributable to the Depository Interests to which the liability relates; and (b) that proportion of £10 million which corresponds to the portion which the amount the Depository would otherwise be liable to pay to the Depository Interest holder bears to the aggregate of the amounts the Depository would otherwise be liable to pay to all such holders in respect of the same act, omission or event or, if there are no such amounts, £10 million.

(f) The Depository is entitled to charge holders of Depository Interests fees and expenses for the provision of its services under the Deed Poll.

(g) If and to the extent that SDRT is not payable on agreements to transfer Depository Interests, it is the responsibility of the holder of the Depository Interest to ensure that Depository Interests acquired or disposed of in CREST are exempt. If SDRT is payable, the holder of Depository Interests must notify Euroclear U.K. & Ireland and the Depository and must pay to Euroclear U.K. & Ireland any SDRT and interest, charges or penalties thereon and indemnify the Depository in respect thereof.

(h) Each holder of Depository Interests is liable to indemnify the Depository and any Custodian (and their agents, officers and employees) against all liabilities arising from or incurred in connection with, or arising from any act related to, the Deed Poll so far as they relate to the property held for the account of Depository Interests held by that holder, other than those resulting from the wilful default, negligence or fraud of the Depository or the Custodian or any agent if such Custodian or agent is a member of the Depository's group or if not being a member of the same group, the Depository shall have failed to exercise reasonable care in the appointment and continued use and supervision of such Custodian or agent.

(i) The Depository may terminate the Deed Poll by giving 30 days' notice. During such notice period holders may cancel their Depository Interests and withdraw their deposited property and, if any Depository Interests remain outstanding after termination, the Depository must, among other things, deliver the deposited property in respect of the Depository Interests to the relevant Depository Interest holders or, at its discretion, sell all or part of such deposited property. It shall, as soon as reasonably practicable, deliver the net proceeds of any such sale, after deducting any sums due to the Depository together with any other cash held by it under the Deed Poll pro rata to holders of Depository Interests in respect of their Depository Interests.

(j) The Depository or the Custodian may require from any holder information as to the capacity in which Depository Interests are owned or held and the identity of any other person with any interest of any kind in such Depository Interests or the underlying Ordinary Shares in the Company and holders are bound to provide such information requested. Furthermore, to the extent that inter alia, the Company's constitutional documents require disclosure to the Company of, or limitations in relation to, beneficial or other ownership of, or interests of any kind whatsoever, in the Ordinary Shares, the holders of Depository Interests are to comply with such provisions and with the Company's instructions with respect thereto.

It should also be noted that holders of Depository Interests may not have the opportunity to exercise all of the rights and entitlements available to holders of Ordinary Shares in the Company including, for 177 example, the ability to vote on a show of hands. In relation to voting, it will be important for holders of Depository Interests to give prompt instructions to the Depository or its nominated Custodian, in accordance with any voting arrangements made available to them, to vote the underlying Ordinary Shares on their behalf or, to the extent possible, to take advantage of any arrangements enabling holders of Depository Interests to vote such shares as a proxy of the Depository or its nominated Custodian.

## 2. DEPOSITORY AGREEMENT

The terms of the depository agreement to be entered into prior to Admission between the Company and the Depository (the "**Depository Agreement**") under which the Company appoints the Depository to constitute and issue from time to time, upon the terms of the Deed Poll (summarised above), Depository Interests representing Ordinary Shares and to provide certain other services in connection with such Depository Interests are summarised below.

The Depository agrees that it will comply, and will procure that certain other persons comply, with the terms of the Deed Poll and that it and they will perform their obligations in good faith and with all reasonable skill and care. The Depository assumes certain specific obligations including, for example, to arrange for the Depository Interests to be admitted to CREST as participating securities and to provide copies of and access to, the register of Depository Interests. The Company agrees to provide such assistance, information and documentation to the Depository as is reasonably required by the Depository for the purposes of performing its duties, responsibilities and obligations under the Deed Poll and the Depository Agreement. In particular, the Company is to supply the Depository with all documents it sends to its shareholders so that the Depository can distribute the same to all holders of Depository Interests. The Depository Agreement sets out the procedures to be followed where the Company is to pay or make a dividend or other distribution.

The Depository is to indemnify the Company against claims made against any of them by any holder of Depository Interests or any person having any direct or indirect interest in any such Depository Interests or the underlying securities which arises out of any breach or alleged breach of the terms of the Deed Poll, or the terms of the Depository Agreement, or any trust declared or arising thereunder. The agreement is to remain in force unless or until terminated by either party in accordance with the agreement. The Company may terminate the appointment of the Depository if an Event of Default (as defined in the Depository Agreement) occurs in relation to the Depository or if it commits an irremediable material breach of the agreement or the Deed Poll or any other material breach which is not remedied within 30 days. The Depository has the same termination rights in respect of Events of Default (as defined in the Depository Agreement) occurring or any irremediable breach or material breach, which is not remedied within 30 days, by the Company. Either of the parties may terminate the Depository's appointment by giving not less than 90 days' written notice. If the appointment is terminated on an Event of Default, an irremediable breach, a material breach which is not remedied within 30 days or on 90 days' written notice, the Depository must serve notice to terminate the Deed Poll by giving 14 days' notice to all holders of Depository Interests.

The Company is to pay certain fees and charges including, inter alia, an annual fee, a fee based on the number of Depository Interests per year and certain CREST related fees. The Depository is also entitled to recover reasonable out-of-pocket fees and expenses.

## PART 7 - CAPITALISATION AND INDEBTEDNESS

The following table, extracted without material adjustment from the Company's consolidated financial statements for the year ended 31 December 2010, shows the consolidated capitalisation of the Group as at 31 December 2010.

**Capitalisation**

| | **As at 31 December 2010** |
|---|---|
| | **($ in thousands)** |
| **Shareholders' equity** | |
| Share capital.................... | 26,063 |
| Share premium account... | 297,222 |
| Option and warrant reserves | 34,261 |
| **Capital and reserves**...... | **357,546** |

The following table, extracted without material adjustment from the Company's internal accounting records, shows the Company's unaudited gross indebtedness as at 31 May 2011.

**Gross indebtedness**

| | **As at 31 May 2011** |
|---|---|
| | **($ in thousands)** |
| **Total current debt** | |
| Secured.............................................................................. | 886 |
| Unguaranteed/unsecured........................................................ | 7,104 |
| Guaranteed ........................................................................ | - |
| | 7,990 |
| **Total non-current debt (excluding current portion of long-term debt)** | |
| Secured.............................................................................. | - |
| Unguaranteed/unsecured........................................................ | - |
| Guaranteed ........................................................................ | - |
| | - |

The following table, extracted without material adjustment from the Company's internal accounting records, shows the unaudited net financial indebtedness of the Group as at 31 May 2011.

**Net financial indebtedness**

| | **As at 31 May 2011** |
|---|---|
| | **($ in thousands)** |
| Cash ....................................................... | 43,221 |
| Cash equivalents .................................... | - |
| Trading Securities.................................. | - |
| | |
| **Liquidity** | |
| Current financial debt ............................ | 7,990 |
| Current portion of non current debt ........ | - |
| **Current financial debt**.......................... | 7,990 |
| **Net current financial surplus**............... | 35,231 |
| Non current bank debt............................ | - |
| Bonds issued .......................................... | - |
| Other non-current financial debt............. | - |
| **Non-current financial surplus**............. | - |
| **Net financial surplus**............................ | - |

As at 31 May 2011, the Group had no material indirect and contingent indebtedness. As at the date of this document, there has been no material change to the capitalisation of the Group since 31 December 2010.

***Existing liquidity & anticipated sources of funds needed to fulfil commitments***

There has been no significant change in capital commitments of the Company since 31 March 2011. It was stated in the MD&A published at the end of Q1 2011 that the placements of equity completed in the course of 2010 had provided the Company with the resources it needed to advance its operating plans, in particular those relating to the Doris oil appraisal, development and additional exploration. This remains the Company view and it will revisit the position of funding future developments when the results of the appraisal wells on Doris and both the EOL09 and Persea wells in Tajikistan have been reviewed and evaluated.

***Level of borrowings & maturity profile***

There have been no new borrowings since 31 March 2011. As of the end of May the indebtedness of the Company was made up of the following three loans, all of which were fully drawn down:

| | | |
|---|---|---|
| Rig loan | US$ 886,185 | Secured on the Tykhe rig repayable in December 2011 |
| Salt well loan | US$4,068,919 | Unsecured, repayable December in 2011 |
| UK Bond | US$3,035,312 | Unsecured, repayable in March 2012 |

The Company had a bank balance of approximately US$45 million at the end of May.

## PART 8 - ADDITIONAL INFORMATION

### 1. RESPONSIBILITY

The Company and its Directors (whose names appear in paragraph 1.1 of Part 3 of this document) accept responsibility for the information contained in this document. To the best of the knowledge of the Company and the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and contains no omission likely to affect its import.

### 2. INCORPORATION

The Company was incorporated in Guernsey on 12 August 2003 under the Companies (Guernsey) Laws, 1994 to 1996 with the name Tethys Petroleum Investments Limited. It changed its name to Tethys Petroleum Limited on 22 September 2006. The Company was a wholly owned subsidiary of CanArgo until the first quarter of 2007. CanArgo made a decision to spin-out the Company and the Kazakh assets then held, and the Company underwent an IPO and was accepted onto the TSX in June 2007, having ticker "TPL". On 17 July 2008, the Company moved its domicile from Guernsey to the Cayman Islands and was continued as an exempted company with limited liability under the Cayman Islands Companies Law and, therefore operates subject to Cayman law. The Company's registered number is carried under OG-214254 in the Cayman Islands. The registered office of the Company is at 89 Nexus Way, Camana Bay, Grand Cayman, KY1-9007 Cayman Islands.

The principal place of business of the Company is at P.O. Box 524, St Peter Port, Guernsey GY1 6EL, British Isles (telephone number 01481 725911 or, if dialling from outside the United Kingdom, +44 1481 725911).

PricewaterhouseCoopers LLP, whose registered address is at 111 5 Avenue SW, Suite 3100, Calgary, Alberta, Canada T2P 5L3 were the auditors of the Company from its incorporation up to the financial year ended 31 December 2010. From 13 May 2011 the auditors of the Company have been KPMG Audit Plc of 15 Canada Square, Canary Wharf, London E14 5GL

### 3. SHARE CAPITAL

The authorised capital of the Company consists of 700,000,000 Ordinary Shares of $0.10 par value and 50,000,000 Preference Shares of $0.10 par value. Only registered holders of the Ordinary Shares are entitled to attend and vote at any meetings of the shareholders of the Company. As at 18 July 2011, there were 260,629,769 Ordinary Shares issued and outstanding. As at 18 July 2011, no Preference Shares have been issued.

During the period covered by the historical financial information and up to 18 July 2011 (being the last practicable date prior to the publication of this document), the following changes were made in the issued share capital of the Company:

As at 1 January 2008, there were 45,116,696 Ordinary Shares issued and outstanding. No Preference Shares had been issued. The following table details all those share issuances since 1 January 2008:

| Date | Securities | Price per security | Number of securities | Details |
|---|---|---|---|---|
| 27 June 2008 | Ordinary Shares | $2.35 | 21,276,596 | On 27 June 2008, the Company issued 21,276,596 Ordinary Shares at a price of $2.35 (or C$2.39) each for gross proceeds of $50 million in connection with a public offering. |
| 22 January 2009 | Ordinary Shares | C$0.52 | 1,400,000 | On 22 January 3009, the Company issued 1,400,000 Ordinary Shares at a price of $0.43 (or C$0.52) each as part payment of the purchase of a Coiled Tubing Unit. |

| Date | Securities | Price per security | Number of securities | Details |
|---|---|---|---|---|
| 9 April 2009 | Ordinary Shares | $0.32 | 15,000,000 | On 9 April 2009 the Company issued 15,000,000 Ordinary Shares in connection with the Acquisition of BHCL using a reference price of $0.32 per share. |
| 24 April 2009 | Ordinary Shares | C$2.80 | 81,477 | On 24 April 2009, the Company issued 81,477 Ordinary Shares at a price of $2.87 (or C$2.80) as payment of a fundraising fee to Kraken Group Limited. |
| 12 June 2009 | Ordinary Shares | $0.387 | 51,680,000 | On 12 June 2009, the Company issued 51,680,000 Ordinary Shares at a price of $0.387 in connection with a public offering. |
| 4 January 2010 | Ordinary Shares | C$0.53 | 10,000,000 | On 4 January 2010, the Company issued 10,000,000 Ordinary Shares at a price of $0.50 (or C$0.53) each for gross proceeds of $5 million, to be used to fund the Company's drilling activities and for general corporate purposes for project development and capital expenditures. |
| 25 January 2010 | Ordinary Shares | C$0.82 | 12,615,000 | On 25 January 2010, the Company issued 12,615,000 Ordinary Shares at a price of $0.79273 (or C$0.82) each for gross proceeds of $10 million, to be used for project development and capital expenditures. |
| 1 March 2010 | Ordinary Shares | C$1.55 | 30,000,000 | On 1 March 2010, the Company issued 30,000,000 Ordinary Shares at a price of $1.475 (or C$1.55) each for gross proceeds of $46.5 million, to be used for capital expenditures and general corporate purposes. |
| 20 April 2010 | Ordinary Shares | C$0.60 | 60,000 | On April 20, 2010, the Company issued 60,000 Ordinary Shares as a result of an option exercise. |
| 26 May 2010 | Ordinary Shares | C$0.60 | 100,000 | On 26 May 2010, the Company issued 100,000 Ordinary Shares as a result of an option exercise. |
| 26 May 2010 | Ordinary Shares | C$0.80 | 40,000 | On 26 May 2010, the Company issued 40,000 Ordinary Shares as a result of an option exercise. |
| 25 August 2010 | Ordinary Shares | C$0.80 | 600,000 | On 25 August 2010, the Company issued 600,000 Ordinary Shares as a result of a warrant exercise. |
| 20 October 2010 | Ordinary Shares | C$1.41 | 70,600,000 | On October 20, 2010, the Company issued 70,600,000 Ordinary Shares at a price of $1.417 (or C$1.45) in connection with a public offering. |

| Date | Securities | Price per security | Number of securities | Details |
|---|---|---|---|---|
| 27 November 2010 | Ordinary Shares | C$0.60 | 100,000 | On 27 November 2010, the Company issued 100,000 Ordinary Shares as a result of an option exercise. |
| 27 November 2010 | Ordinary Shares | C$0.60 | 1,400,000 | On 27 November 2010, the Company issued 1,400,000 Ordinary Shares as a result of a warrant exercise. |
| 13 December 2010 | Ordinary Shares | C$0.60 | 60,000 | On 13 December 2010, the Company issued 60,000 Ordinary Shares as a result of an option exercise. |
| 15 December 2010 | Ordinary Shares | C$0.60 | 500,000 | On 15 December 2010, the Company issued 500,000 Ordinary Shares as a result of a warrant exercise. |
| **Total Ordinary Shares issued between 27 June 2008 and 15 December 2010:** | | | **215,513,073** | |

The following table shows the existing authorised and issued share capital of the Company as at the date of this document and the authorised and issued share capital as it is expected to be immediately following Admission.

| Authorised | | Issued and fully paid |
|---|---|---|
| **700,000,000** | **Ordinary Shares of US$ 0.10** | **260,629,769** |
| **50,000,000** | **Preference Shares of US$ 0.10** | **-** |

There are no provisions for pre-emptive rights under the Articles of the Company or the laws of the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

The principal attributes of the Ordinary Shares and Preference Shares are summarized below. In addition, the Company adopted the Shareholder Rights Plan in 2008, details of which are also summarized below.

**Ordinary Shares**

The holders of Ordinary Shares are entitled to receive such dividends as the Directors may from time to time declare. In the event of the winding-up or dissolution of the Company, whether voluntary or involuntary or for the purpose of a reorganization or otherwise or upon any distribution of capital, the holders of Ordinary Shares are entitled to the surplus assets of the Company in proportion to their respective shareholdings and generally will be entitled to enjoy all of the rights attaching to shares of the Company. At a general meeting, holders of Ordinary Shares are entitled on a show of hands to one vote and on a poll to one vote for every share held.

**Preference Shares**

The Preference Shares are issuable in series. Subject to the Articles, the Board is authorised to fix, before issuance, the designation, rights, privileges, restrictions and conditions (including voting rights) attaching to each series. The Preference Shares, when issued, will rank prior to the Ordinary Shares with respect to dividends and return of capital on winding up as the holders of Preference Shares are not entitled to vote at meetings of shareholders.

**Shareholder Rights Plan**

The Board and the shareholders of the Company approved a shareholder rights plan in 2008. The terms of the Shareholder Rights Plan are such that, subject to certain exceptions, if a person acquires 20 per cent. of the outstanding Ordinary Shares, a takeover bid must be made for all Ordinary Shares and must be open for 60 days after the bid is made. If more than 50 per cent. of the Ordinary Shares held by persons independent of the acquiror are deposited or tendered pursuant to the bid, and not withdrawn, the acquiror may take up and pay for such shares. The bid must then remain open for a further period of ten business days on the same terms.

In the event a takeover bid is made that does not adhere with the above terms, the rights attaching to each Ordinary Share pursuant to the Shareholder Rights Plan will separate from the Ordinary Share and become exercisable 10 trading days after the earlier of: (a) a person having acquired 20 per cent. or more of the Ordinary Shares, or (b) the commencement or announcement in respect of a takeover bid to acquire 20 per cent. or more of the Ordinary Shares. Prior to such separation event, the rights are not transferable separately from the Ordinary Shares. After such separation, rights will be evidenced by certificates which are transferable and will be traded separately from the Ordinary Shares.

The rights, when exercisable, permit the holder to purchase, for the exercise price, one Ordinary Share for each right. The exercise price of the rights will be equal to three times the prevailing market price at the time the rights separated from the Ordinary Shares pursuant to the Shareholder Rights Plan. Rights that are beneficially owned by the person making the takeover bid which does not adhere to the above terms shall become null and void.

The shareholders approved and renewed the Shareholder Rights Plan of the Company on 10 February 2011. The Shareholder Rights Plan must be reconfirmed and approved by a resolution passed by an Ordinary Resolution of the shareholders at a shareholders' meeting to be held in the year ended 31 December 2014 and at such a meeting to be held every three years thereafter. If the Shareholder Rights Plan is not so reconfirmed and approved or is not presented for reconfirmation at any such meeting, the Shareholder Rights Plan and all outstanding rights shall terminate.

Save as disclosed in this Part 8:

(a) there has been no change in the amount of the share or loan capital of the Company and no material change in the amount of the share or loan capital of any of its subsidiaries (other than intra group issues by wholly owned subsidiaries) in the three years preceding the date of this document;

(b) no commissions, discounts, brokerages or other special terms have been granted by the Company or any of its subsidiaries in connection with the allotment of any share or loan capital of the Company or any of its subsidiaries in the three years preceding the date of this document; and

(c) no share or loan capital of the Company or any of its subsidiaries is under option or is agreed, conditionally or unconditionally, to be put under option.

## 4. EMPLOYEES

The table below sets out the average number of people (full-time equivalents) employed by the Group in each of the last three financial years:

| | | Financial year ended | |
|---|---|---|---|
| | **31 December 2010** | **31 December 2009** | **31 December 2008** |
| Kazakhstan | 148 | 88 | 103 |
| Tajikistan | 161 | 131 | 27 |
| Uzbekistan | 43 | 24 | 26 |
| Total | 352 | 243 | 156 |

## 5. COMPANY SHARE SCHEMES

### 5.1 Stock Incentive Plan

The Company has adopted a stock incentive plan referred to as the "*2007 Long Term Stock Incentive Plan*" (as amended effective 24 April 2008 and 7 May 2009) (the "**Stock Incentive Plan**") pursuant to which the Company may grant stock options to any director, officer, employee or consultant of the Company, Subsidiary of the Company or Vazon (collectively, "**Service Providers**"). The purpose of the Stock Incentive Plan is to secure for the Company and its shareholders the benefits of incentives inherent in share ownership by Service Providers who, in the judgment of the Board of Directors, will be largely responsible for the Company's future growth and success. The Stock Incentive Plan was adopted prior to the Company's IPO and amendments thereto were approved by shareholders of the Company at the 2008 and 2009 annual shareholders' meetings. The amendment to the Stock Incentive Plan approved by shareholders of the Company on 7 May 2009 provided that the aggregate number of Ordinary Shares reserved for issuance under the Stock Incentive Plan is equal to 12 per cent. of the number of Ordinary Shares outstanding at the time of the grants of the options.

The Stock Incentive Plan is administered by the Compensation and Nomination Committee of the Board of Directors. Options may be granted pursuant to recommendations of the Compensation and Nominations Committee. The Compensation and Nomination Committee may determine the vesting schedule and term, provided that options may not have a term exceeding ten years.

The exercise price of options granted under the Stock Incentive Plan is determined by the Compensation and Nomination Committee at the time of each grant based on the market price of the Ordinary Shares on the TSX, provided that it may not be less than the closing price of the Ordinary Shares on the TSX as at the date of the option grant. Subject to any resolution of the Compensation and Nomination Committee, the Stock Options will cease to be exercisable three months after an optionee ceases to be a director, officer, employee or consultant of the Company, subsidiary of the Company, or Vazon, subject to earlier termination in the event of termination for cause. The Stock Incentive Plan contains amendment provisions which allow amendments to the Stock Incentive Plan by the Board of Directors, without shareholder approval, for amendments of a "housekeeping" nature, changes to vesting or termination provisions, and discontinuance of the Stock Incentive Plan. The Stock Incentive Plan also provides that outstanding Stock Options will vest immediately on the occurrence of a "change in control" (as defined in the Stock Incentive Plan). Options granted under the Plan are only assignable to certain related entities of an optionee or otherwise with the consent of the Company.

The Stock Incentive Plan contains provisions for adjustment in the number of Ordinary Shares issuable thereunder in the event of a subdivision, consolidation or reclassification of the Ordinary Shares, the payment of stock dividends by the Company (other than dividends in the ordinary course) or other relevant changes in the capital stock of the Company.

The exercise price of options granted under the Stock Incentive Plan may not be less than the closing price of the Ordinary Shares on the TSX as at the date of the option grant. Presently there are, in aggregate, 22,863,000 stock options which have previously been awarded pursuant to the Stock Incentive Plan and remain outstanding.

### 5.2 **Performance Warrants**

In connection with the closing of the Company's IPO which was completed on 27 June 2007, the Company granted to its executive officers warrants ("**Performance Warrants**") to acquire an aggregate of 6,767,504 Ordinary Shares. Performance Warrants to acquire an aggregate of 1,353,501 Ordinary Shares were exercisable at US$4.125 until 27 December 2009 but have now expired, Performance Warrants to acquire an aggregate of 2,255,835 Ordinary Shares were exercisable at US$5.50 until 27 June 2011 but have now expired and Performance Warrants to acquire an aggregate of 3,158,168 Ordinary Shares are exercisable at US$6.875 until 27 December 2012. As at the date of this document, no Performance Warrants have been exercised.

### 5.3 **2017 Warrants**

On 14 February 2007 the Company agreed to issue and on 8 June 2007 the Company issued certain warrants (the "**2017 Warrants**") to purchase an aggregate of 2,090,000 Ordinary Shares. The 2017 Warrants are exercisable at a price of US$2.50 per share and expire ten years from the date of issuance. 2017 Warrants to acquire an aggregate of 190,000 Ordinary Shares were granted to certain of the Directors and Senior Managers of the Company who are **'Named Executive Officers'** for the purposes of TSX requirements. The 2017 Warrants were granted in connection with a private placement completed in January 2007. As at the date of this document, no 2017 Warrants have been exercised.

Other than the Stock Incentive Plan, the Performance Warrants and the 2017 Warrants, at the date of this document the Company does not have any other share schemes in existence.

| Share Scheme | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans |
|---|---|---|
| Stock Incentive Plan | Options: 22,863,000 | Options: 9,012,572 |
| Performance Warrants | Performance Warrants: 5,414,003 | Performance Warrants: Nil |
| 2017 Warrants | 2017 Warrants: 2,090,000 | 2017 Warrants: Nil |

## 6. SUMMARY OF THE MEMORANDUM AND ARTICLES OF ASSOCIATION

The Company was incorporated in Guernsey on 12 August 2003 and redomiciled to the Cayman Islands on 17 July 2008 as an exempted company with limited liability under the Cayman Islands Companies Law. The Memorandum and the original articles, which are the constitution of the Company, were approved by the shareholders of the Company at the Company's 24 April 2008 Annual General Meeting. The articles of association approved at that meeting were amended at an extraordinary meeting of the Company held on 10 February 2011. The following is the summary of some key provisions of the Memorandum and Articles.

### 6.1 The Memorandum

(a) The Memorandum provides that:

(i) the liability of members of the Company is limited to the amount, if any, for the time being unpaid on the Shares respectively held by them;

(ii) the objects for which the Company is established are unrestricted and the Company shall have full power and authority to carry out any object not prohibited by law as provided by Section 7(4) of the Companies Law (Revised);

(iii) the Company shall have and be capable of exercising all the functions of a natural person of full capacity irrespective of any question of corporate benefit, as provided in section 27(2) of the Companies Law. However, nothing in the preceding sentence permits the Company to carry on the business of a bank or trust company without being licensed in that behalf under the Banks and Trust Companies Law (Revised) of the Cayman Islands or to carry on insurance business from within the Cayman Islands or the business of an insurance manager, agent, sub-agent or broker without being licensed in that behalf under the Insurance Law (Revised) of the Cayman Islands or to carry on the business of company management without being licensed in that behalf under the Companies Management Law (Revised) of the Cayman Islands; and

as the Company is an exempted company under the Companies Law, the Company will not trade in the Cayman Islands with any person, firm or corporation except in furtherance of the business of the Company carried on outside the Cayman Islands.

(b) As provided for in the Companies Law, the Company may by special resolution alter the Memorandum with respect to any objects, powers or other matters specified therein.

### 6.2 The Articles

(a) ***Directors***

(i) *Power to allot and issue shares and warrants*

Subject to the provisions of the Companies Law, the Memorandum, the Articles and any direction that may be given to the Company in a general meeting, all unissued shares in the Company shall be at the disposal of the Directors, who may offer, allot, grant options over or otherwise dispose of them to such persons, at such times, for such consideration and on such terms and conditions as it in its absolute discretion thinks fit, but so that no shares shall be issued at a discount.

The Directors may issue warrants conferring the right upon the holders thereof to subscribe for any class of shares or securities in the capital of the Company on such terms as it may from time to time determine.

Neither the Company nor the Directors shall be obliged, when making or granting any allotment of, offer of, option over or disposal of shares, to make, or make available, any such allotment, offer, option or shares to existing members or others with registered addresses in any particular territory or territories.

(ii) *Power to dispose of the assets of the Company or any subsidiary*

Except with respect to a sale, lease or exchange of all or substantially all of the assets of the Company other than in the ordinary course of business, which must be approved by a special resolution, there are no specific provisions in the Articles relating to the disposal of the assets of the Company or any of its subsidiaries. The Directors have the general authority to deal with the Company's assets pursuant to their general authority to manage the affairs of the Company.

(iii) *Compensation or payments for loss of office*

Pursuant to the Articles, payments to any Director or past Director of any sum by way of compensation for loss of office or as consideration for or in connection with his retirement from office (not being a payment to which the Director is contractually entitled) must be approved by the Company in a general meeting.

(iv) *Loans and provision of security for loans to Directors*

There are provisions in the Articles that prohibit the Company from making loans to Directors if such loans are prohibited by the rules of a stock exchange on which the Shares are listed.

(v) *Disclosure of interests in contracts with the Company or any of its subsidiaries*

Provided that a Director has disclosed to the other Directors the nature and extent of any material interest, a Director, notwithstanding holding such office: may be a party to or otherwise interested in, any transaction with the Company or in which the Company is otherwise interested; may be or become a director or other officer of, or otherwise interested in, any company promoted by the Company or any other company in which the Company may be interested, and shall not, by reason of his office, be accountable to the for any benefit which he derives from any such office or employment or from such transaction or arrangement or from any interest in any such body corporate and no such transaction or arrangement shall be liable to be avoided on the ground of any such interest or benefit.

A Director shall not vote (nor be counted in the quorum) on any resolution of the board approving any contract or arrangement or other proposal in which he or any of his associates is materially interested, but this prohibition shall not apply to any of the following matters:

(A) any contract or arrangement for giving to such Director or his associate(s) any security or indemnity in respect of money lent by him or any of his associates or obligations incurred or undertaken by him or any of his associates at the request of or for the benefit of the Company or any of its subsidiaries;

(B) any contract or arrangement for the giving of any security or indemnity to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which the Director or his associate(s) has himself/themselves assumed responsibility in whole or in part whether alone or jointly under a guarantee or indemnity or by the giving of security;

(C) any contract or arrangement concerning an offer of shares or debentures or other securities of or by the Company or any other company which the Company may promote or be interested in for subscription or purchase, where the Director or his associate(s) is/are or is/are to be interested as a participant in the underwriting or sub-underwriting of the offer;

(D) any contract or arrangement in which the Director or his associate(s) is/are interested in the same manner as other holders of shares or debentures or other securities of the Company by virtue only of his/their interest in shares or debentures or other securities of the Company;

(E) any contract or arrangement concerning any other company in which the Director or his associate(s) is/are interested only, whether directly or indirectly, as an officer or executive or a shareholder or in which the Director and any of his associates are not in aggregate beneficially interested in 5 percent or more of the issued shares or of the voting rights of any class of shares of such company (or of any third company through which his interest or that of any of his associates is derived); or

(F) any proposal or arrangement concerning the adoption, modification or operation of a share option scheme, a pension fund or retirement, death, or disability benefits scheme or other arrangement which relates both to Directors, his associates and employees of the Company or of any of its subsidiaries and does not provide in respect of any Director, or his associate(s), as such any privilege or advantage not accorded generally to the class of persons to which such scheme or fund relates.

(vi) *Remuneration*

The ordinary remuneration of the Directors shall from time to time be determined by the Directors, such sum to be divided amongst the Directors in such proportions and in such manner as the board may agree or, failing agreement, equally. The Directors shall also be entitled to be repaid all travelling, hotel and incidental expenses reasonably expected to be incurred or incurred by them in attending any board meetings, committee meetings or general meetings or separate meetings of any class of shares or of debentures of the Company or otherwise in connection with the discharge of their duties as Directors.

Any Director who, by request, goes or resides abroad for any purpose of the Company, makes a special journey or who performs services which in the opinion of the board go beyond the ordinary duties of a Director may be paid such extra remuneration (whether by way of salary, commission, participation in profits or otherwise) as the board may determine and such extra remuneration shall be in addition to or in substitution for any ordinary remuneration as a Director. An executive Director appointed to be a managing director, joint managing director, deputy managing director or other executive officer shall receive such remuneration (whether by way of salary, commission or participation in profits or otherwise or by all or any of those modes) and such other benefits (including pension and/or gratuity and/or other benefits on retirement) and allowances as the board may from time to time decide. Such remuneration may be either in addition to or in lieu of his remuneration as a Director.

(vii) *Retirement, appointment and removal*

At each annual general meeting, all of the Directors for the time being will retire from office. Any retiring director shall be eligible for re-election if qualified. Prior to each general meeting where directors are being elected, the Directors shall determine the number of vacancies for director to be filled at the meeting which, unless the Directors otherwise determine, shall be equal to the number of Directors then in office.

Where permitted by applicable law, at a general meeting where directors are being elected the ordinary resolution for the election of each nominee as director must only provide the option for Members to vote in favour of the resolution or to withhold their votes with respect to the resolution. After all resolutions for election of directors have been voted on, the nominees receiving the highest number of votes in favour of their election shall be elected to fill the number of vacancies for director to be filled at such meeting.

The Directors have the power from time to time and at any time to appoint any person as a Director either to fill a casual vacancy on the board or as an addition to the existing board. Any Director appointed to fill a casual vacancy shall hold office until the first general meeting of members after his appointment and be subject to re-election at such meeting and any Director appointed as an addition to the existing board shall hold office only until the next following annual general meeting of the Company and shall then be eligible for re-election. Neither a Director nor an alternate Director is required to hold any shares in the Company by way of qualification.

A Director may be removed by an ordinary resolution of the Company before the expiration of his period of office (but without prejudice to any claim which such Director may have for damages for any breach of any contract between him and the Company) and may by ordinary resolution appoint another in his place. Unless otherwise determined by the Company in general meeting, the number of Directors shall not be less than two. There is no maximum number of Directors. At no time shall a majority of the Directors be resident in the United Kingdom.

The office or director shall be vacated:

(A) if he resigns his office by notice in writing delivered to the Company at the registered office of the Company for the time being or tendered at a meeting of the Board;

(B) where he has been appointed for a fixed term, the term expires;

(C) if he ceases to be or is prohibited from being a director by virtue of any provision of law or is removed from office pursuant to the Articles;

(D) if he becomes bankrupt or has a receiving order made against him or suspends payment or compounds with his creditors;

(E) he is or has been suffering from mental ill health or becomes a patient for the purpose of any statute relating to mental health or any court claiming jurisdiction on the ground of mental disorder (however stated) makes an order for his detention or for the appointment of a guardian, receiver or other person (howsoever designated) to exercise powers with respect to his property or affairs, and in any such case the Board resolves that his office be vacated;

(F) both he and his alternate director appointed pursuant to the provisions of the Articles (if any) are absent, without the permission of the Board, from Board meetings for six consecutive months and the Board resolves that his office be vacated; or

(G) if he becomes resident in the United Kingdom and as a result thereof a majority of the Directors are resident in the United Kingdom.

The board may from time to time appoint one or more of its body to hold any other employment or executive office with the Company for such period and upon such terms as the board may determine and the board may revoke or terminate any of such appointments. The board may delegate any of its powers, authorities and discretions to committees consisting of such Director or Directors and other persons as the board thinks fit, and it may from time to time revoke such delegation or revoke the appointment of and discharge any such committees either wholly or in part, and either as to persons or purposes, but every committee so formed shall, in the exercise of the powers, authorities and discretions so delegated, conform to any regulations that may from time to time be imposed upon it by the board.

(viii) *Borrowing powers*

The board may exercise all the powers of the Company to raise or borrow money, to mortgage or charge all or any part of the undertaking, property and assets (present and future) and uncalled capital of the Company and, subject to the Companies Law, to issue debentures, bonds and other securities of the Company, whether outright or as collateral security for any debt, liability or obligation of the Company or of any third party. These provisions, in common with the Articles in general, can be varied with the sanction of a special resolution of the Company.

(ix) *Proceedings of the Board*

The board may meet for the despatch of business, adjourn and otherwise regulate their meetings as they think fit. Questions arising at any meeting shall be determined by a majority of votes. In the case of an equality of votes, the chairman of the meeting shall not have an additional or casting vote, and the question shall be considered again at the next meeting of the Board.

(x) *Register of Directors and Officers*

The Companies Law and the Articles provide that the Company is required to maintain at its registered office a register of directors and officers which is not available for inspection by the public. A copy of such register must be filed with the Registrar of Companies in the Cayman Islands and any change must be notified to the Registrar within thirty (30) days of any change in such directors or officers.

(xi) *Indemnification*

Without prejudice to any indemnity to which he may otherwise be entitled, every person who is or was a Director, or secretary of the Company and their respective heirs and executors shall be entitled to be indemnified (to the extent permitted by the Companies Law) out of the assets and profits of the Company from and against all actions, expenses and liabilities which they or their respective heirs or executors may incur by reason of any contract entered into or any act in or about the execution of their respective offices or trusts except such (if any) as they may incur by or through their own wilful act, neglect or default respectively and none of them shall be answerable for the acts, receipts, neglects or defaults of the others of them or for joining in any receipt for the sake of conformity or for any bankers or other person with whom any moneys or assets of the Company may be lodged or deposited for safe custody or for any bankers or other persons into whose hands any money or assets of the Company may come or for any defects of title of the Company to any property purchased or for insufficiency or deficiency of or defect in title of the Company to any security upon which any moneys of the Company shall be placed out or invested or for any loss, misfortune or damage resulting from any such cause as aforesaid or which may happen in or about the execution of their respective offices or trusts except should the same happen by or through their own wilful act, neglect or default.

The Directors may exercise all the powers of the Company to purchase and maintain insurance for the benefit of a person who is or was a Director, secretary or auditor of the Company or of a company which is or was a subsidiary undertaking of the Company or in which the Company has or had an interest (whether direct or indirect), indemnifying him against liability for negligence, default, breach of duty or breach of trust or other liability which may lawfully be insured against by the Company, (including, without prejudice to the generality of the foregoing, insurance against any costs, charges, expenses, losses or liabilities suffered or incurred by such persons in respect of any act or omission in the actual or purported execution and/or discharge of their duties and/or the exercise or purported exercise of their powers and discretions and/or otherwise in relation to or in connection with their duties, powers or offices in relation to the Company or any such other body).

(b) ***Alterations to Constitutional Documents***

The Company may by special resolution amend any provision of the Memorandum or Articles.

(c) ***Alteration of capital***

The Company may from time to time by special resolution in accordance with the relevant provisions of the Companies Law:

(i) increase its capital by such sum, to be divided into shares of such amounts as the resolution shall prescribe;

(ii) reduce its authorised share capital as set out in the Articles; or

(iii) create new classes of shares.

The Company may also, by ordinary resolution:

(iv) consolidate and divide all or any of its capital into shares of larger amount than its existing shares;

(v) sub-divide its shares or any of them into shares of smaller amount than is fixed by the Memorandum, subject nevertheless to the provisions of the Companies Law, and so that the resolution whereby any share is sub-divided may determine that, as between the holders of the shares resulting from such sub-division, one or more of the shares may have any such preferred or other special rights, over, or may have such deferred rights or be subject to any such restrictions as compared with the others as the Company has power to attach to unissued or new shares;

(vi) convert all or any of its fully paid shares the nominal amount of which is expressed in a particular currency into fully paid shares of a nominal amount of a different currency, the conversion being effected at the rate of exchange (calculated to not less than three significant figures) current on the date of the resolution or on such other date as may be specified therein; or

(vii) where its share capital is expressed in a particular currency, denominate or redenominate it, whether by expressing its amount in units or subdivisions of that currency, or otherwise.

The Company may subject to the provisions of the Companies Law reduce its share capital or any capital redemption reserve or other undistributable reserve in any way by special resolution.

(d) ***Variation of rights of existing shares or classes of shares***

All or any of the rights attached to the shares or any class of shares may (unless otherwise provided for by the terms of issue of that class) be varied, modified or abrogated either with the consent in writing of the holders of not less than three-fourths in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of that class. To every such separate general meeting the provisions of the Articles relating to general meetings will mutatis mutandis apply, but so that the necessary quorum (other than at an adjourned meeting) shall be two persons holding or representing by proxy not less than one-third in nominal value of the issued shares of that class and at any adjourned meeting two holders present in person or by proxy whatever the number of shares held by them shall be a quorum. Every holder of shares of the class shall be entitled on a poll to one vote for every such share held by him, and any holder of shares of the class present in person or by proxy may demand a poll.

The rights conferred upon the holders of any shares or class of shares shall not, unless otherwise expressly provided in the rights attaching to the terms of issue of such shares, be deemed to be varied by the creation or issue of further shares ranking pari passu therewith or by the purchase or redemption by the Company of its own shares in accordance with the Companies Law and the Articles.

(e) ***Ordinary and special resolutions and notice for general meetings***

Pursuant to the Articles, a special resolution of the Company must be passed by a majority of not less than two-thirds of the votes cast by such members as, being entitled to do so, vote in person or, in the case of such members as are corporations, by their duly authorised representatives or by proxy. Except with respect to the election of Directors and auditors, an ordinary resolution is defined in the Articles to mean a resolution passed by a simple majority of the votes of such members of the Company as, being entitled to do so, vote in person or, in the case of corporations, by their duly authorised representatives or by proxy at a general meeting held in accordance with the Articles.

A general meeting shall be called by not less than twenty-one (21) and not more that sixty (60) days' notice, provided that if it is so agreed by all of the members having a right to attend and vote at such meeting, a resolution may be proposed and passed at a meeting of which less than twenty-one (21) clear days' notice has been given.

The notice of meeting shall specify:

(i) whether the meeting is an annual general meeting or an extraordinary general meeting;

(ii) the place, the date and the time of the meeting;

(iii) the particulars with respect to the nature of the business to be conducted and the resolutions to be considered at the meeting;

(iv) if the meeting is convened to consider a special resolution, the intention to propose the resolution as such; and

(v) with reasonable prominence, that a member entitled to attend and vote may appoint one or more proxies to attend and, on a poll, vote instead of him and that a proxy need not also be a member.

The notice of meeting shall be given to all the members entered on the Company's Register of Members as of such date prior to the date that the notice of meeting is to be sent to members as determined by the Directors. Notice of the meeting shall also be sent to the Company's auditor and each Director. The notice of meeting may also specify a time (which shall not be more than 48 hours before the time fixed for the meeting) by which a person must be entered on the Company's Register of Members in order to have the right to attend or vote at the meeting. Changes to entries on the Company's Register of Members after the time so specified in the notice shall be disregarded in determining the rights of any person to so attend or vote.

The accidental omission to send a notice of meeting or any document relating to the meeting or the non-receipt of any such notice or document by a person entitled to receive any such notice or document shall not invalidate the proceedings at that meeting.

A copy of any special resolution must be forwarded to the Registrar of Companies in the Cayman Islands within fifteen (15) days of being passed.

(f) ***Voting rights (generally and on a poll) and right to demand a poll***

Subject to any special rights or restrictions as to voting for the time being attached to any shares by or in accordance with the Articles, at any general meeting on a show of hands, every member who is present in person or by proxy or being a corporation, is present by its duly authorised representative shall have one vote and on a poll every member present in person or by proxy or, in the case of a member being a corporation, by its duly authorised representative shall have one vote for every fully paid share of which he is the holder but so that no amount paid up or credited as paid up on a share in advance of calls or instalments is treated for the foregoing purposes as paid up on the share. Notwithstanding anything contained in the Articles, where more than one proxy is appointed by a member which is a clearing house (or its nominee(s)), each such proxy shall have one vote on a show of hands. On a poll, a member entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way.

At any general meeting a resolution put to the vote of the meeting is to be decided on a show of hands unless voting by way of a poll is demanded by:

(i) the chairman of the meeting;

(ii) at least five members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy for the time being entitled to vote at the meeting;

(iii) any member or members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy and representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or

(iv) a member or members present in person or, in the case of a member being a corporation, by its duly authorised representative or by proxy and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

(g) ***Requirements for annual general meetings***

An annual general meeting of the Company must be held in each year provided that not more than 15 months shall elapse between one annual general meeting and the next. Annual general meetings shall take place at such time and place as may be determined by the Directors, provided that the annual general meeting shall not be in the United Kingdom.

(h) ***Accounts and audit***

The Directors shall cause proper books of account to be kept with respect to all the transactions, assets and liabilities of the Company in accordance with the Companies Law, which shall be kept at the Company's registered office or at such other place as the Directors shall think fit and shall at all times be open to the inspection of the Directors. The Directors shall determine whether and to what extent and at what times and places and under what conditions the accounts books and documents of the Company shall be open to inspection and no person other than a Director or the Company's auditor or other person whose duty requires and entitles him to do so shall have any right of inspecting any account or book or document except as provided by the Companies Law or authorised by the Directors or by the Company in general meeting.

A balance sheet shall be laid before the Company at its annual general meeting in each year and such balance sheet shall contain a general summary of the assets and liabilities of the Company. The balance sheet shall be accompanied by a report of the Directors as to the state of the Company as to the amount (if any) which they recommend to be paid by way of dividend and the amount (if any) which they have carried or propose to carry to reserve. The auditors' report shall be attached to the balance sheet or there shall be inserted at the foot of the balance sheet a reference to the report.

A copy of every profit and loss account and balance sheet and of all documents annexed thereto including the reports of the Directors and the Company's auditors shall, at the time the notice of meeting for the annual meeting is delivered to Members, be delivered or sent by post to each Member and to the Company's auditors.

Except in limited circumstances, a person other than a retiring auditor shall not be capable of being appointed auditor at an ordinary general meeting unless notice of intention to nominate that person as auditor has been given by a member to the Company not less than thirty days before the meeting and the Directors shall send a copy of any such notice to the retiring auditor and shall give notice to the members not less than seven days before the meeting.

The first auditors shall be appointed by the board before the first general meeting and they shall hold office until the first ordinary general meeting unless previously removed in which case the Members at such meeting may appoint the auditors.

Where permitted by applicable law, at a general meeting where auditors are being elected the ordinary resolution for the election of auditor shall provide the option for Members to vote in favour of the resolution or to withhold their votes with respect to the resolution. After all resolutions for election of auditors have been voted on, the nominee receiving the highest number of votes in favour of their election shall be elected as auditor.

The board may fill any casual vacancy in the office of auditor but while any such vacancy continues the surviving or continuing Auditors (if any) may act.

The remuneration of the auditors shall be fixed by the Company in general meeting or in such manner as the Company may determine except that the remuneration of any auditors appointed by the board shall be fixed by the Directors.

Every auditor shall have a right of access at all times to the books accounts and documents of the Company. The auditors shall make a report to the members on the accounts examined by them and the report shall state whether in their opinion the accounts give a true and fair view of the state of the Company's affairs and whether they have been prepared in accordance with the Companies Law.

(i) ***Transfer of shares***

A member may generally transfer all or any of his shares by instrument of transfer in writing in any usual form or in any other form approved by the Board, and the instrument shall be executed by or on behalf of the transferor and (in the case of a transfer of a share which is not fully paid) by or on behalf of the transferee. Every instrument of transfer in respect of a share shall be left at such place as the board may prescribe with the certificate of every share to be transferred and such other evidence as the board may reasonably require to prove the title of the transferor or his right to transfer the shares; and the transfer and certificate (if any) shall remain in the custody of the board but shall be at all reasonable times produced at the request and expense of the transferor or transferee or their respective representatives. A new certificate shall be delivered free of charge to the transferee after the transfer is completed and registered on his application and when necessary a balance certificate shall be delivered if required by him in writing.

In exceptional circumstances approved by each recognised investment exchange on which the Company's shares are listed from time to time, the Directors may refuse to register a transfer of shares provided that such refusal would not disturb the market in those shares[*]. Subject to the requirements of any such recognised investment exchange, the board may, in its absolute discretion and without giving a reason, refuse to register the transfer of a share which is not fully paid or the transfer of a share on which the Company has a lien.

If the board refuses to register any transfer of a share it shall, within two months after the date on which the share transfer form was lodged with the Company, send notice of the refusal to the transferee. An instrument of transfer which the Board refuses to register shall (except in the case of suspected fraud) be returned to the person depositing it. The Company may retain all instruments of transfer which are registered.

If it shall come to the notice of the Directors that any shares are or may be owned or held directly or beneficially by any person in breach of any law or requirement of any country or by virtue of which such person is not qualified to own those shares and, in the sole and conclusive determination of the Directors, such ownership or holding or continued ownership

[*] In connection with the introduction of the entire issued share capital of the Company to the Official List, the Board has confirmed in writing to the FSA that, it will, at the earliest possible convenience, seek approval from Shareholders for an appropriate amendment to the Articles to clarify that the Directors of the Company shall not have the power to disapprove any transfer of shares unless the FSA is satisfied that this power would not disturb the market in those shares. The Company has also provided an undertaking to the FSA that, for as long as the Ordinary Shares of the Company are admitted to the Official List, it will contact the FSA should the Directors wish to refuse any transfer of shares.

or holding of those shares (whether on its own or in conjunction with any other circumstance appearing to the Directors to be relevant) would, in the reasonable opinion of the board, cause a pecuniary or tax disadvantage to the Company or any other holder of shares or other securities of the Company which it or they might not otherwise have suffered or incurred the board may require the holder of such shares to transfer (and/or procure the disposal of interests in) such shares to another person.

Subject to compliance with the provisions of the Articles, if, in relation to a takeover offer, a person has acquired or contracted to acquire not less than nine-tenths in value of the Shares of any class to which the takeover offer relates he may give notice to the holder of any Shares of that class which he has not acquired or contracted to acquire that he desires to acquire those shares and shall thereafter be entitled and bound to acquire those Shares on the terms of the takeover offer.

(j) ***Power for the Company to purchase its own shares***

The Company is empowered by the Companies Law and the Articles to purchase its own Shares subject to certain restrictions and the Board may only exercise this power on behalf of the Company subject to any applicable requirements imposed from time to time by any recognised investment exchange.

(k) ***Power for any subsidiary of the Company to own shares in the Company***

There are no provisions in the Articles relating to ownership of shares in the Company by a subsidiary.

(l) ***Dividends and other methods of distribution***

Subject to the Cayman Islands Companies Law, the Directors may declare dividends in accordance with the respective rights of the members and authorize the payment of the same out of the funds of the Company lawfully available therefore; and the Company may by ordinary resolution declare dividends in accordance with the respective rights of the members, but no dividend shall exceed the amount recommended by the Directors.

Except as otherwise provided by the rights attached to, or the terms of issue of, shares a dividend shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is declared and paid and dividends shall be apportioned and paid proportionately to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid.

Except as otherwise provided by the rights attached to Shares, dividends may be declared or paid in any currency. The board may agree with any member that dividends which may at any time or from time to time be declared or become due on his shares in one currency shall be paid or satisfied in another, and may agree the basis of conversion to be applied and how and when the amount to be paid in the other currency shall be calculated and paid and for the Company or any other person to bear any costs involved.

The Company may pay any dividend, interest or other amount payable in respect of a share: in cash; by cheque, warrant or money order made payable to or to the order of the person entitled to the payment; by a bank or other funds transfer system to an account designated in writing by the person entitled to the payment; if the board so decides, by means of a relevant system in respect of an uncertificated share, subject to any procedures established by the board to enable a holder of uncertificated shares to elect not to receive dividends by means of a relevant system and to vary or revoke any such election; or by such other method as the person entitled to the payment may in writing direct and the board may agree.

Where a Share is held jointly or two or more persons are jointly entitled by transmission to a share the Company may pay any dividend, interest or other amount payable in respect of that share to any one joint holder, or any one person entitled by transmission to the share, and in either case that holder or person may give an effective receipt for the payment; and the Company may rely, in relation to a share, on the written direction or designation of any one joint holder of the share, or any one person entitled by transmission to the share.

The Board may withhold payment of a dividend (or part of a dividend) payable to a person entitled by transmission to a share until he has provided any evidence of his right that the Board may reasonably require.

No dividend or other amount payable by the Company on or in respect of a share bears interest as against the Company unless otherwise provided by the rights attached to the share.

The Board may deduct from any dividend or other amounts payable to a person in respect of a share all sums of money (if any) due from him to the Company on account of a call or otherwise in relation to a share.

Any unclaimed dividend, interest or other amount payable by the Company in respect of a share may be invested or otherwise made use of by the Board for the benefit of the Company until claimed. A dividend unclaimed for a period of 12 years from the date it was declared or became due for payment is forfeited and ceases to remain owing by the Company.

If, in respect of a dividend or other amount payable in respect of a share, on any two consecutive occasions a cheque, warrant or money order is returned undelivered or left uncashed; or a transfer made by a bank or other funds transfer system is not accepted, and reasonable enquiries have failed to establish another address or account of the person entitled to the payment, the Company is not obliged to send or transfer a dividend or other amount payable in respect of that share to that person until he notifies the Company of an address or account to be used for that purpose. If the cheque, warrant or money order is returned undelivered or left uncashed or transfer not accepted on two consecutive occasions, the Company may exercise this power without making any such enquiries.

Subject to the specific provisions contained in the Articles, the board may, direct that payment of a dividend may be satisfied wholly or in part by the distribution of specific assets and in particular of paid-up shares or debentures of another company. Subject to the Companies Law, the board may, with the prior authority of an ordinary resolution of the Company, allot to those holders of a particular class of shares who have elected to receive them further shares of that class or ordinary shares in either case credited as fully paid instead of cash in respect of all or part of a dividend or dividends specified by the resolution, subject to any exclusions, restrictions or other arrangements the board may in its absolute discretion deem necessary or expedient to deal with legal or practical problems under the laws of, or the requirements of a recognised regulatory body or a stock exchange in, any territory.

No dividend or other monies payable by the Company on or in respect of any share shall bear interest against the Company unless otherwise provided by the rights attached to the Share.

(m) ***Proxies***

Any member of the Company entitled to attend and vote at a meeting of the Company is entitled to appoint another person as his proxy to attend and vote instead of him. A member who is the holder of two or more shares may appoint more than one proxy to represent him and vote on his behalf at a general meeting of the Company or at a class meeting. A proxy need not be a member of the Company and shall be entitled to exercise the same powers on behalf of a member who is an individual and for whom he acts as proxy as such member could exercise. In addition, a proxy shall be entitled to exercise the same powers on behalf of a member which is a corporation and for which he acts as proxy as such member could exercise if it were an individual member. On a poll or on a show of hands, votes may be given either personally (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy.

(n) ***Lien on shares***

The Company has a first and paramount lien on all partly paid shares for an amount payable in respect of the share, whether the due date for payment has arrived or not. The lien applies to all dividends from time to time declared or other amounts payable in respect of the share. For the purpose of enforcing such lien, the Directors may sell any shares subject to the lien in such manner as it may decide provided that: the due date for payment of the relevant amounts has arrived; and the board has served a written notice on the Member concerned (or on any person who is entitled to the shares by transmission or by operation of law) stating the amounts due, demanding payment thereof and giving notice that if payment has not been made within 14 clear days after the service of the notice that the Company intends to sell the Shares.

The net proceeds of such sale, after payment of the Company's costs of the sale, shall be applied in or towards satisfaction of the amount in respect of which the lien exists. Any residue shall (on surrender to the Company for cancellation of any certificate for the shares sold, or the provision of an indemnity as to any lost or destroyed certificate required by the Board and subject to a like lien for amounts not presently payable as existed on the shares before the sale) be paid to the member (or person entitled to the shares) immediately before the sale.

(o) ***Inspection of register of members***

Pursuant to the Articles, if required by a recognised investment exchange, the register and branch register of members shall be open to inspection upon the terms required by such recognised investment exchange.

(p) ***Quorum for meetings and separate class meetings***

No business shall be transacted at any general meeting unless a quorum is present when the meeting proceeds to business, but the absence of a quorum shall not preclude the appointment of a chairman.

Save as otherwise provided by the Articles the quorum for a general meeting shall be two members present in person (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy and entitled to vote. In respect of a separate class meeting (other than an adjourned meeting) convened to sanction the modification of class rights the necessary quorum shall be two persons holding or representing by proxy not less than one-third in nominal value of the issued shares of that class.

## 7. INFORMATION ON THE DIRECTORS AND SENIOR MANAGERS

The Directors and Senior Managers:

(a) other than in respect of companies in the Group, are or have been directors or partners of the following companies and partnerships at any time in the previous five years:

***External Directorships***

| **Director/Senior Manager** | **Position** | **Company/Partnership** | **Position currently held** | **Service Contract with the Company** |
|---|---|---|---|---|
| Russ Hammond | Chairman | Terrenex Acquisition Corporation | No | No |
| | Non-executive director | Questerre Energy Corporation | Yes | No |
| | Non-executive director | CanArgo | No | No |
| Piers Johnson | Non – executive director | Apollo Studio Residents Association Limited | Yes | No |
| | Non – executive director | Cravenhill Publishing Limited | Yes | No |
| | Managing director | Oilfield Production Consultants (OPC) Ltd. | Yes | Yes |
| | Managing director | Oilfield Production Consultants (OPC) USA LLC | Yes | No |
| | Managing director | Oilfield Production Consultants Asia (OPC) LLP | Yes | No |
| | Company secretary | Well Test Solutions Limited | Yes | No |
| Elizabeth Landles | Executive vice president and Corporate secretary | CanArgo | No | No |
| | Secretary | Vazon | Yes | Yes |
| Rt. Hon Peter Lilley M.P. | Non-executive director | IDOX Plc | Yes | No |
| | Non-executive director | Melchior Japan Investment Trust Plc | No | No |
| | Non-executive director | JP Morgan Claverhouse Investment Trust plc | No | No |

| Director/Senior Manager | Position | Company/Partnership | Position currently held | Service Contract with the Company |
|---|---|---|---|---|
| James Rawls | Non – executive director | Anderson Exploration | Yes | No |
| | President | Rawls Resources Inc | Yes | No |
| | Non – executive director | Skyhawke Technology | Yes | No |
| | Non-executive director | Radcliffe Exploration Inc. | No | No |
| | Director | Rawls Royalty, LLC | Yes | No |
| | Director | MELCAMAR, LLC | Yes | No |
| | Director | Rawls Energy, LLC | Yes | No |
| | Director | Turnagain, LLC | Yes | No |
| | Director | Greenwater Land, LLC | Yes | No |
| Marcus Rhodes | Independent director | Cherkizovo Group | Yes | No |
| | Independent director | OJSC Cherkisovo Group | Yes | No |
| | Independent director | Rusargo Group | Yes | No |
| | Director; audit committee member | Wimm-Bill-Dann Foods OJSC | Yes | No |
| Dr. David Robson | Chairman and Chief Executive Officer | CanArgo | No | No |
| | Director | Vazon | Yes | Yes |
| Ian Philliskirk | Director | Model Railways Limited | Yes | No |

(b) have no convictions relating to fraudulent offences within the last five years;

(c) have not within the previous five years been directors or senior managers of any company at the time of any bankruptcy, receivership or liquidation;

(d) have not within the previous five years received any official public incrimination and/or sanction by any statutory or regulatory authorities (including designated professional bodies) and have not been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of a company.

(e) Save as disclosed below, none of the Directors or Senior Managers has any potential conflicts of interests between their duties to the Company and their private interests or other duties:

Certain officers and Directors of the Company are also officers and/or directors of other companies engaged in the oil and gas business generally. As a result, situations may arise where the interests of such Directors and officers, as they relate to the Company, conflict with their interests as directors and officers of other companies. The resolution of such conflicts is governed by the applicable laws of the Cayman Islands, which require that the directors act honestly, in good faith and with a view to the best interests of the Company. Conflicts, if any, will be handled in a manner consistent with the procedures and remedies set forth in such laws. The Memorandum and Articles provide that in the event that a Director has an interest in a proposed transaction or agreement, the Director shall disclose in good faith the material facts of his or her interest in such proposed transaction and his or her interest in or relationship to any other party to the transaction or agreement. Such Director is not entitled to vote in respect of matters in which he has a material interest or relate to his appointment as the holder of an office or place of profit with the Company.

Vazon is a corporation organised under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, is the sole owner and managing director. The Company has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson, other services and other Vazon employees are provided to the Company. The total cost charged to the Company for services from Vazon in the year ended December 31, 2010 was $2,525,885 (2009 – $1,677,113).

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, Mr. Piers Johnson, have charged the Company a monthly retainer fee for engineering expertise, provided services relating to the optimization of the existing compressors and those to be installed as part of Phase 2 gas production from Akkulka, and has consulted on well test analysis and on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the year ended December 31, 2010 were $182,470 (2009 – $497,697).

## 8. EXECUTIVE REMUNERATION AND BENEFITS

### Remuneration of Directors and Senior Managers

The following table sets out the remuneration payable and benefits in kind granted for the financial year ended 31 December 2010 to those of the Directors and Senior Managers for whom such information is required to be made public pursuant to Canadian and/or Cayman Islands reporting requirements. Such information is not required to be made public in respect of Graham Wall and Julian Hammond. The aggregate of remuneration and benefits paid and granted to these two Senior Managers is contained in note 9 of the below table:

| Name and Principal Position | Year | Salary paid in UK£ conv to (US$) | Share-based awards (US$) | Option-based awards (US$)(1) | Non-equity incentive plan compensation (US$) | | Pension value (US$) | All other compen-sation (US$)(2) | Total compen-sation (US$)(6) (7) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Annual Incentive plans | Long-term Incentive plans | | | |
| Dr. David Robson(3) (4)<br>Chairman, President and Chief Executive Officer | 2010 | 542,643 | N/A | 841,549 | 454,464 | N/A | N/A | 101,652 | 1,940,308 |
| Bernard Murphy(4) (5)<br>Finance Director and Chief Financial Officer | 2010 | 301,976 | N/A | 445,519 | 65,255 | N/A | N/A | 69,096 | 881,846 |
| Elizabeth Landles(4) (5)<br>Chief Administrative Officer and Corporate Secretary | 2010 | 302,030 | N/A | 445,519 | 173,392 | N/A | N/A | 49,036 | 969,977 |
| Ian Philliskirk<br>Vice President and General Counsel | 2010 | 303,969 | N/A | 335,897 | 115,255 | N/A | N/A | 27,961 | 783,082 |
| Russ Hammond(8) | 2010 | 53,107 | N/A | 193,188 | N/A | N/A | N/A | Nil | 246,295 |
| Piers Johnson (8) | 2010 | 64,975 | N/A | 206,082 | N/A | N/A | N/A | Nil | 271,057 |
| Peter Lilley (8) | 2010 | 72,980 | N/A | 194,350 | N/A | N/A | N/A | Nil | 267,330 |
| James Rawls (8) | 2010 | 58,633 | N/A | 189,021 | N/A | N/A | N/A | Nil | 247,654 |
| Marcus Rhodes (8) | 2010 | 59,005 | N/A | 189,021 | N/A | N/A | N/A | Nil | 248,026 |

**Notes:**

(1) Represents the grant date fair value of Stock Options granted to 2010 based on a weighted average fair value on the date of grant, estimated using the Black-Scholes option pricing model of US$0.9242 per option, using the following weighted average assumptions: dividend yield of 0%; expected term of 3.0 years; a risk free interest rate of 1.25%; and an expected volatility of 112.8%.

(2) The amounts shown in this column reflect for each senior manager and Director:
- (i) the Company's contribution equal to 9% of their annual personal pension requirements;
- (ii) permanent health insurance (including family healthcare premiums);
- (iii) life insurance premiums;
- (iv) critical illness premiums; and/or
- (v) income protection premiums.

(3) Represents amounts paid to Vazon under the terms of the CEO Services Agreement (as defined below) in respect of services of the President and Chief Executive Officer. See "*Management and Employment Agreements*".

(4) Dr. Robson, Mr. Murphy and Ms. Landles are also members of the Board. However, no additional compensation is paid to them in respect of their duties as directors.

(5) Represents amounts paid to Vazon under the terms of the Umbrella Services Agreement (as defined below) in respect of the services of Mr. Murphy and Ms. Landles. See "*Management and Employment Agreements*" below.

(6) Amounts paid in respect of the services of the senior mangers and Directors were paid in pounds sterling (£). These amounts were converted into US$ for the purposes of the above table at an average rate of UK£1.00 = US$0.6469, based on the exchange rate quoted by fxtop.com on the applicable payment date through the course of the year.

(7) Total compensation for the year represents the sum of all cash compensation paid and the value of option-based awards granted in the year. Total cash compensation, excluding the grant date fair value of option-based awards (which value is not a cash amount), was as follows in 2010:

| | | |
|---|---|---|
| (i) | Dr. David Robson: | US$1,098,759 |
| (ii) | Bernard Murphy: | US$436,327 |
| (iii) | Elizabeth Landles | US$524,458 |
| (iv) | Ian Philliskirk: | US$447,185 |
| (v) | Russ Hammond: | US$53,107 |
| (vi) | Piers Johnson: | US$64,975 |
| (vii) | Peter Lilley: | US$72,980 |
| (viii) | James Rawls: | US$58,633 |
| (ix) | Marcus Rhodes | US$59,005 |

(8) For the purposes of the above table, the annual fee paid to Directors for services rendered is expressed in the "Salary" column.

(9) The aggregate remuneration paid or granted to the two Senior Managers not contained in the above table was US$1,425,883, comprising of US$485,458 in salary, US$ nil in share based awards, US$765,032 in option based awards, US$120,000 in non-equity incentive plan compensation, US$ nil in pension value and US$55,393 in all other compensation. For the value of the option based awards for these Senior Managers please see note (1) above.

### Management and Employment Agreements

The compensation paid in respect of the services of Dr. Robson, Mr. Murphy, Ms. Landles and Mr. Philliskirk were paid in accordance with the management and employment agreements described below. The Company and Vazon Energy Limited ("**Vazon**") entered into a management services agreement dated 8 June 2007 (the "**Umbrella Management Services Agreement**") providing for, among other services, the services of Vazon and the services of Bernard Murphy as Chief Financial Officer, Elizabeth Landles as Chief Administrative Officer and Corporate Secretary, Graham Wall as Vice President, Technical, George Mirtskhulava as Vice President Commercial and Head of Kazakhstan Business Unit and Denise Lay as Vice President Finance. The Umbrella Management Services Agreement requires that the Company pay Vazon a monthly fee which was £110,615 as at 31 December 2010 (including contributions towards personal pension requirements), plus any required local or similar taxes (payable by the Company), for their services. In addition, the Umbrella Management Services Agreement provides for the provision of other services including office accommodation, corporate, administrative, financial, treasury, accounting, technical, information technology and human resources. The Company will also be required to reimburse Vazon for expenses incurred by Vazon's employees in connection with the services provided to the Company. The Umbrella Management Services Agreement may be terminated on six months' notice from either party. The Company is not required to make any payment upon termination, other than the payment of amounts due to the effective date of termination. The Umbrella Management Services Agreement was extended by a Deed of Guarantee and Indemnity on 10 December 2009.

*Dr. David Robson*

The Company and Vazon entered into a management services agreement dated 10 May 2007 (the "**CEO Services Agreement**") providing for, among other services, the services of Dr. David Robson as Chairman of the Board of Directors and as President and Chief Executive Officer of the Company. Dr. Robson is the owner and Managing Director of Vazon. The CEO Services Agreement requires that the Company pay Vazon a monthly fee of £26,976 from 1 January 2010 to 31 March 2010 and £33,608 monthly thereafter for these services, plus a further 9% of this sum as a contribution to Dr. Robson's personal pension requirements. The agreement also provides for the possibility of a bonus payable to Vazon, at the discretion of the Compensation and Nomination Committee, if the work carried out by Vazon and Dr. Robson contributes significantly to the business progress of the Company. No further cash compensation is provided to Dr. Robson by the Company. The agreement further provides that the Company will maintain specified insurance policies (life, health, disability and travel) for Dr. Robson and provide for other customary non-cash benefits. The CEO Services Agreement may be terminated on six months' notice from either party and the Company is not required to make any payment upon termination, other than the payment of amounts due to the effective date of termination.

*Bernard Murphy*

Bernard Murphy and the Company's wholly-owned subsidiary, Tethys Services Limited ("**TSL**"), are parties to an employment agreement dated 2 May 2007, pursuant to which Mr. Murphy is employed as

Finance Director and Chief Financial Officer of the Company (the "**CFO Agreement**"). The CFO Agreement was novated to Vazon on 28 August 2009. The CFO Agreement does not have an express term and may be terminated by the Company as well as by Mr. Murphy with six months' notice. Effective 1 April 2010, the annual compensation payable to Mr. Murphy is £206,505, plus £18,585 annually in respect of personal pension requirements. From 1 January 2010 to 31 March 2010 the annual compensation payable to Mr. Murphy was £161,865, plus £14,568 annually in respect of personal pension requirements. The Company has also agreed to pay for certain premiums for health and life insurance. Mr. Murphy is eligible to participate in the Stock Incentive Plan and any bonus plan the Company may adopt.

*Elizabeth Landles*

Elizabeth Landles and Vazon are parties to an employment agreement dated 26 July 2006 pursuant to which Ms. Landles is employed as Executive Vice President and Corporate Secretary of the Company (the "**CAO and Corporate Secretary Agreement**"). The CAO and Corporate Secretary Agreement does not have an express term and may be terminated by the Company as well as by Ms. Landles with six months' notice. Effective 1 April 2010, the annual compensation payable to Ms. Landles is £207,135, plus £17,955 annually in respect of personal pension requirements. From 1 January 2010 to 31 March 2010 the annual compensation payable to Ms. Landles was £162,635, plus £13,950 annually in respect of personal pension requirements. The Company has also agreed to pay for certain premiums for health and life insurance. Ms. Landles is eligible to participate in the Stock Incentive Plan and any bonus plan the Company may adopt.

*Ian Philliskirk*

Ian Philliskirk and TSL are parties to an employment agreement effective 1 February 2009, pursuant to which Mr. Philliskirk is employed as Vice President and General Counsel of the Company (the "**VP and General Counsel Agreement**"). The "VP and General Counsel Agreement was novated to the Company on 28 August 2009. The VP and General Counsel Agreement does not have an express term and may be terminated by the Company as well as by Mr. Philliskirk with six months' notice. Effective 1 April 2010, the annual compensation payable to Mr. Philliskirk is £199,500, plus £17,955 annually in respect of personal pension requirements. From 1 January 2010 to 31 March 2010 the annual compensation payable to Mr. Philliskirk was £190,000, plus £17,100 annually in respect of personal pension requirements. The Company has also agreed to pay for certain premiums for health and life insurance. Mr. Philliskirk is eligible to participate in the Stock Incentive Plan and any bonus plan the Company may adopt. The VP and General Counsel Agreement was novated to the Company on 26 August 2009.

**Termination and Change of Control Benefits**

The Umbrella Management Services Agreement, the CEO Services Agreement, the CFO Agreement, the CAO and Corporate Secretary Agreement and the VP and General Counsel Agreement (collectively the "**Management Agreements**") may be terminated by either the Company or the relevant Director or Senior Manager on six months' notice. None of the Management Agreements provides for payment upon a change of control of the Company.

The Stock Incentive Plan provides that, in the event of a "Change of Control" (as defined therein), all outstanding stock options will immediately vest and become exercisable. Had such "Change of Control" occurred as at 31 December 2010, the value of Stock Options vested upon such occurrence (calculated as the difference between the market price of the Ordinary Shares on the TSX on 31 December 2010 and the exercise price of the Stock Options) would have been US$7,784,307.

The Company's directors who are not also executive officers are entitled to receive an annual retainer of £35,000 and receive additional annual fees ranging from £1,000 to £2,000 for serving as a member of, and holding the position of chairman of, a committee of the Board of Directors. Mr. Lilley receives an extra £5,000 a year as a result of being the Vice Chairman of the Company.

In addition, in 2010 each director who was not a member of management was awarded options to acquire certain Ordinary Shares in accordance with the terms of the Stock Incentive Plan as detailed in the following table.

| Number of Options granted | Option Exercise Price per Ordinary Share |
|---|---|
| 90,000 | $0.80 |
| 108,000 | $2.10 |
| 120,000 | C$1.60 |

The appointment of each director who is not also an executive officer (a "**non-executive director**") is confirmed under the terms of an appointment letter. Such appointment letter provides that non-executive directors will be indemnified by the Company from and against all actions, expenses and liabilities incurred in the execution of his or her functions, subject to such limitations which may apply at law.

The total amount set aside or accrued by the Group to provide pension, retirement or other benefits to the Directors and Senior Managers is US$0.

## 9. DIRECTORS' AND OTHER INTERESTS

As at 18 July 2011 (being the latest practicable date prior to the publication of this document), the Directors and Senior Managers held the following numbers of Ordinary Shares and stock option and awards over Ordinary Shares in the Company:

| Name | Number of securities underlying unexercised options | Option exercise price per share | Option expiration date | No. of Ordinary Shares held |
|---|---|---|---|---|
| Dr. David Robson [(1)] | 900,000 | $2.75 | 25 June 2014 | 751,800 |
| | 300,000 | $2.50 | 26 June 2015 | |
| | 810,000 | $0.60 | 4 August 2014 | |
| | 420,000 | $0.80 | 31 December 2014 | |
| | 420,000 | $2.10 | 8 April 2015 | |
| | 477,000 | C$1.60 | 19 October 2015 | |
| | 884,288 | $6.88 | 25 December 2012 | |
| Bernard Murphy [(2)] | 450,000 | $2.75 | 25 June 2014 | 30,000 |
| | 180,000 | $2.50 | 26 June 2015 | |
| | 420,000 | $0.60 | 4 August 2014 | |
| | 210,000 | $0.80 | 31 December 2014 | |
| | 210,000 | $2.10 | 8 April 2015 | |
| | 285,000 | C$1.60 | 19 October 2015 | |
| | 60,000 | C$1.72 | 10 April 2016 | |
| | 568,470 | $6.88 | 25 December 2012 | |
| | 190,000 | $2.50 | 7 June 2017 | |
| Elizabeth Landles[(3)] | 450,000 | $2.75 | 25 June 2014 | 42,000 |
| | 180,000 | $2.50 | 26 June 2015 | |
| | 420,000 | $0.60 | 4 August 2014 | |
| | 210,000 | $0.80 | 31 December 2014 | |
| | 210,000 | $2.10 | 8 April 2015 | |
| | 285,000 | C$1.60 | 19 October 2015 | |
| | 60,000 | C$1.72 | 10 April 2016 | |
| | 568,470 | $6.88 | 25 December 2012 | |
| The Rt. Hon. Peter Lilley MP[(4)] | 150,000 | $2.75 | 25 June 2014 | 15,000 |
| | 45,000 | $2.50 | 26 June 2015 | |
| | 120,000 | $0.60 | 4 August 2014 | |
| | 90,000 | $0.80 | 31 December 2014 | |

| Name | Number of securities underlying unexercised options | Option exercise price per share | Option expiration date | No. of Ordinary Shares held |
|---|---|---|---|---|
| | 108,000 | $2.10 | 8 April 2015 | |
| | 120,000 | C$1.60 | 19 October 2015 | |
| | 120,000 | $2.50 | 7 June 2017 | |
| Russ Hammond(5) | 129,000 | $2.75 | 25 June 2014 | 0 |
| | 45,000 | $2.50 | 26 June 2015 | |
| | 108,000 | $0.60 | 4 August 2014 | |
| | 90,000 | $0.80 | 31 December 2014 | |
| | 108,000 | $2.10 | 8 April 2015 | |
| | 120,000 | C$1.60 | 19 October 2015 | |
| Piers Johnson(6) | 129,000 | $2.75 | 25 June 2014 | 81,500 |
| | 45,000 | $2.50 | 26 June 2015 | |
| | 108,000 | $0.60 | 4 August 2014 | |
| | 90,000 | $0.80 | 31 December 2014 | |
| | 108,000 | $2.10 | 8 April 2015 | |
| | 120,000 | C$1.60 | 19 October 2015 | |
| James Rawls(7) | 108,000 | $0.60 | 31 August 2014 | 118,000 |
| | 90,000 | $0.80 | 31 December 2014 | |
| | 108,000 | $2.10 | 8 April 2015 | |
| | 120,000 | C$1.60 | 19 October 2015 | |
| Marcus Rhodes(8) | 108,000 | $0.60 | 31 August 2014 | 0 |
| | 90,000 | $0.80 | 31 December 2014 | |
| | 108,000 | $2.10 | 8 April 2015 | |
| | 120,000 | C$1.60 | 19 October 2015 | |
| Julian Hammond(9) | 450,000 | $2.75 | 25 June 2014 | 25,000 |
| | 180,000 | $2.50 | 26 June 2015 | |
| | 140,000 | $0.60 | 4 August 2014 | |
| | 180,000 | $0.80 | 31 December 2014 | |
| | 195,000 | $2.10 | 8 April 2015 | |
| | 195,000 | C$1.60 | 19 October 2015 | |
| | 90,000 | C$1.72 | 13 February 2016 | |
| | 568,470 | $6.88 | 27 December 2012 | |
| Graham Wall(10) | 237,000 | $2.75 | 25 June 2014 | 20,000 |
| | 180,000 | $2.50 | 26 June 2015 | |
| | 270,000 | $0.60 | 4 August 2014 | |
| | 210,000 | $0.80 | 31 December 2014 | |
| | 195,000 | $2.10 | 8 April 2015 | |
| | 195,000 | C$1.60 | 19 October 2015 | |
| | 284,235 | $6.88 | 27 December 2012 | |
| | 140,000 | $2.50 | 2 June 2017 | |
| Ian Philliskirk(11) | 300,000 | $2.50 | 31 January 2016 | 20,000 |
| | 270,000 | $0.60 | 4 August 2014 | |
| | 180,000 | $0.80 | 31 December 2014 | |
| | 180,000 | $2.10 | 8 April 2015 | |
| | 180,000 | C$1.60 | 19 October 2015 | |

**Notes:**

(1) The unexercised options consist of 3,327,000 Stock Options, 1,515,923 Performance Warrants and 0 2017 Warrants.
(2) The unexercised options consist of 1,815,000 Stock Options, 974,520 Performance Warrants and 190,000 2017 Warrants.
(3) The unexercised options consist of 1,815,000 Stock Options, 974,520 Performance Warrants and 0 2017 Warrants.
(4) The unexercised options consist of 633,000 Stock Options, 0 Performance Warrants and 120,000 2017 Warrants.
(5) The unexercised options consist of 600,000 Stock Options, 0 Performance Warrants and 0 2017 Warrants.
(6) The unexercised options consist of 600,000 Stock Options, 0 Performance Warrants and 0 2017 Warrants.
(7) The unexercised options consist of 426,000 Stock Options, 0 Performance Warrants and 0 2017 Warrants.
(8) The unexercised options consist of 426,000 Stock Options, 0 Performance Warrants and 0 2017 Warrants.
(9) The unexercised options consist of 1,430,000 Stock Options, 974,520 Performance Warrants and 0 2017 Warrants.
(10) The unexercised options consist of 1,287,000 Stock Options, 487,260 Performance Warrants and 140,000 2017 Warrants.
(11) The unexercised options consist of 1,110,000 Stock Options, 0 Performance Warrants and 0 2017 Warrants.
(12) The unexercised options consist of 1,296,000 Stock Options, 0 Performance Warrants and 0 2017 Warrants.

Save as disclosed in this paragraph 9, none of the Directors has any interest in the share capital of the Company.

## 10. MAJOR SHAREHOLDERS

So far as the Company is aware, as at 18 July 2011 (being the latest practicable date prior to the publication of this document), the following persons (other than the Directors) had notifiable interests in five per cent. or more of the issued share capital of the Company:

| **Shareholder** | **No. of Ordinary Shares held** | **Percentage of the total issued share capital of the Company** |
|---|---|---|
| Pope Asset Management LLC | 47,354,092 | 18.17 |

Save as set out in this paragraph, the Company is not aware of any person who has or will immediately following Admission have a notifiable interest in five per cent. or more of the issued share capital of the Company.

The Company is not aware of any person who either as at the date of this document or immediately following Admission exercises, or could exercise, directly or indirectly, jointly or severally, control over the Company.

None of the major shareholders of the Company set out above has different voting rights from any other holder of Ordinary Shares in respect of any Ordinary Share held by them.

## 11. PENSIONS

The Company did not have any defined benefit (or actuarial plans) or defined contribution plan during the financial year ended 31 December 2010.

Although the Company does not provide any of its Directors, Senior Managers or other employees with a pension plan, the Company pays a monthly contribution of 9 per cent. of the Directors' and Senior Managers' and certain other employees' basic salary or base management fee as a contribution towards their pension requirements. Payments made to the Directors, Senior Managers and certain other employees with relation to pension provisions are made on the basis that such persons decide how to direct these payments in accordance with their own pension requirements and objectives.

## 12. WORKING CAPITAL

The Company is of the opinion that, taking into account available bank facilities, the Group has sufficient working capital for its present requirements, that is, for at least the next 12 months from the date of this document.

## 13. TAXATION

### 13.1 Certain Cayman Islands Tax Considerations

The laws of the Cayman Islands do not impose taxes on profits, income or dividends, nor is there any capital gains tax, estate duty or death duty.

Stamp duty is not chargeable in respect of the incorporation, registration or licensing of an exempted company, nor subject to certain minor exceptions, on their transactions if the documents are not executed in, brought to or produced before a court in the Cayman Islands. Accordingly, generally no stamp duty will be payable on the issue or transfer of the share capital of the Company.

### 13.2 Certain United Kingdom Tax Considerations

The following comments are intended only as a general guide to certain United Kingdom tax considerations based on current UK legislation and what is understood to be the current practice of the United Kingdom HM Revenue & Customs both of which may change, and possibly with retroactive effect. They apply only to Shareholders who are resident, and in the case of individuals, ordinarily resident and domiciled for tax purposes in the United Kingdom (except insofar as express reference is made to the tax treatment of non-residents), who hold their Ordinary Shares or Depositary Interests as an investment. The following statements may not apply to certain categories of Shareholder to whom special rules apply, such as persons who acquire their Ordinary Shares or Depositary Interests in connection with employment, dealers in securities and insurance companies. Any person who is in doubt as to his tax position is strongly recommended to consult his own professional tax adviser.

**Taxation of Dividends**

(a) ***The Company***

Dividend payments will be made without withholding or deduction for or on account of United Kingdom income tax.

(b) ***UK Resident Individual Shareholders***

An individual resident in the UK for taxation purposes who holds less than 10 per cent. of the Company's issued ordinary share capital will generally be liable to income tax on the aggregate amount of any dividend received and a tax credit equal to 10 per cent. of the gross dividend (or one-ninth of the dividend received). For example, on a dividend received of £90, the tax credit would be £10, and an individual would be liable to income tax on £100.

Taking the tax credit into account, therefore, no further income tax is payable in respect of the dividend by UK resident individuals who are liable to income tax only at the basic rate.

UK resident individuals who are subject to tax at the higher rate are subject to tax on dividends at the dividend upper rate (currently 32.5 per cent.) but are entitled to offset the ten per cent. tax credit against such liability. For example, on a dividend received of £90 such a taxpayer would have to pay additional tax of £22.50 (representing 32.5 per cent. of the gross dividend less the ten per cent. credit) which is equal to an effective rate of income tax of 25 per cent. of the net dividend. UK resident individuals who receive taxable income in excess of £150,000 are subject to tax on dividends at the dividend additional rate (currently 42.5 per cent), but are entitled to offset the ten per cent. tax credit against such liability. For example, on a dividend received of £90 such a taxpayer would have to pay additional tax of £32.50 (representing 42.5 per cent of the gross dividend less the ten per cent. tax credit) which is equal to an effective rate of income tax of 36.11 per cent. For this purpose dividends are treated as the top slice of an individual's income.

If an individual Shareholder holds 10 per cent. or more of the Company's issued ordinary share capital their entitlement to a United Kingdom tax credit in respect of dividends paid on the Ordinary Shares will depend upon whether the source country has a double tax treaty with the United Kingdom which contains a non-discrimination clause.

No repayment of the tax credit in respect of dividends paid by the Company (including in respect of any dividend paid where the Ordinary Shares or Depositary Interests are held in a personal equity plan or in an individual savings account) can be claimed by a United Kingdom resident shareholder (including pension funds and charities).

(c) ***UK Resident Corporate Shareholders***

Subject to certain exceptions for traders in securities and insurance companies, and provided that certain anti-avoidance provisions do not apply, a corporate Shareholder resident in the United Kingdom for tax purposes will generally not be subject to corporation tax or income tax on dividends received from the Company.

**Taxation of Chargeable Gains**

(a) ***UK Resident Shareholders***

A disposal (or deemed disposal) of the Ordinary Shares or Depositary Interests by a Shareholder who is (at any time in the relevant United Kingdom tax year) resident or, in the case of an individual, ordinarily resident in the United Kingdom for tax purposes, may give rise to a chargeable gain or an allowable loss for the purposes of United Kingdom taxation of chargeable gains, depending on the Shareholder's circumstances and subject to any available exemption or relief.

(b) ***Non-resident Shareholders***

A Shareholder who is not resident in the United Kingdom for tax purposes but who carries on a trade, profession or vocation in the United Kingdom through a branch or agency (or, in the case of a non-UK resident corporate Shareholder, a permanent establishment) to which the Ordinary Shares or Depositary Interests are attributable will be subject to the same rules which apply to United Kingdom resident Shareholders.

A Shareholder who is an individual and who has ceased to be resident or ordinarily resident for tax purposes in the United Kingdom for a period of less than five years of assessment and who disposes of the Ordinary Shares or Depositary Interests during that period may also be liable, on his return, to United Kingdom taxation on chargeable gains (subject to any available exemption or relief).

**Stamp Duty and Stamp Duty Reserve Tax ("SDRT")**

The following comments do not (except in so far as express reference is made) relate to persons to whom special rules apply, such as market makers, brokers, dealers, intermediaries, persons connected with depositary receipt arrangements or clearance services or persons who enter into sale and repurchase transactions in respect of the Ordinary Shares or Depositary Interests.

No United Kingdom stamp duty or SDRT will be payable on the issue by the Company of the Ordinary Shares direct to persons acquiring those Ordinary Shares or to the Depositary or on the issue of Depositary Interests by the Depositary.

United Kingdom stamp duty and SDRT will not normally be payable in connection with a transfer or agreement to transfer the Ordinary Shares in certificated form, provided that the instrument of transfer is executed outside the United Kingdom by the transferor or transferee and provided that no register of members is kept in the United Kingdom by or on behalf of the Company.

No United Kingdom SDRT will be payable in respect of any transfer or agreement to transfer Depositary Interests, provided that the Ordinary Shares are not registered in a register kept in the United Kingdom by or on behalf of the Company, the Company is not centrally managed and controlled in the United Kingdom, and any such transfer is effected electronically within the CREST system.

13.3 **Taxation Issues in Kazakhstan**

Tax legislation in Kazakhstan is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels and consequently tax risks and problems with respect to its operations and investment in Kazakhstan are significant. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies and accordingly, few precedents with regard to issues have been established.

Tax declarations, together with other legal compliance areas (for example, customs and currency control matters) are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax and other risks in Kazakhstan substantially more significant than typically found in countries with more developed tax systems. In addition, amendments to current Kazakhstan taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on the Company.

All legal entities carrying on activities in Kazakhstan must be registered with the local tax committee. Taxes in Kazakhstan include income tax, value added tax, excise tax, social tax, land tax, property tax, transport tax, as well as required contributions to various funds, duties and fees for licences. In addition, the Company has, through its various operations, been making and expects to continue to make, contributions to various social and environmental funds.

Additional payments, such as signing bonuses, commercial discovery bonuses, mineral extraction taxes and excess profit taxes, may be required from oil and gas companies and other subsoil users. A signing bonus is a one-time payment for the rights to explore and/or develop and produce resources. A commercial discovery bonus is a one-time payment for each commercial discovery and is payable once a discovery of commercial value is made in a contract territory as well as for any increase in reserves.

The Tax Code was adopted for Kazakhstan effective as of 1 January 2009. Subject to limited exceptions which do not apply to the Company's subsidiaries, the tax provisions previously applicable to subsurface use contracts were not "stabilised" and accordingly, taxes are payable under the Tax Code in respect of the Group's operations in Kazakhstan.

Under the Tax Code, subsurface users (including the Company's subsidiaries) are subject to, among others, the following taxes to the extent applicable: (i) special subsurface users payments (which include a signature bonus, commercial discovery bonus and payment for reimbursement of historical costs); (ii) MET; (iii) excess profit tax: (iv) corporate income tax; and (v) rent tax on exports, as further described below:

- a signature bonus for a production contract is required to be negotiated, with the minimum amount calculated equal to the aggregate of 0.04 per cent. of the total value of proved reserves and 0.01 per cent. of the total value of estimated reserves (in each case, as approved by the authorised state agency) and is payable within 30 days after entering into the production contract;

- a commercial discovery bonus is payable for each commercial discovery at a rate of 0.1 per cent. of the calculation base and is based on the volume of recoverable reserves (as approved by the authorised state agency);

- an amount of historical costs determined by the authorised state agency to compensate the Kazakhstan State's exploration and related expenditures incurred before the conclusion of the subsurface use contract, is payable during the production stage in quarterly instalments in accordance with a negotiated payment schedule, not to exceed 10 years;

- MET for oil and gas condensate is payable at fixed rates, determined on a sliding scale, based on the actual production levels at rates ranging from 5 per cent. to 18 per cent. from 1 January 2009 until 1 January 2013 (from 6 per cent. to 19 per cent. from 1 January 2013 until 1 January 2014, and from 7 per cent. to 20 per cent. from 1 January 2014);

- MET for natural gas is payable at rates ranging from 0.5 per cent. to 1.5 per cent. of the value of annual produced gas for domestic sales and 10 per cent. for exports;

- excess profit tax is payable based on the contractor's net disposable income with the rates varying from 0 per cent. to 60 per cent., as the profits exceed pre-set profit thresholds; and

- corporate income tax is payable at a rate of 20 per cent. from 1 January 2009 until 1 January 2013, 17.5 per cent. from 1 January 2013 until 1 January 2014 and 15 per cent. from 1 January 2014.

In addition, in the case of oil exports, rent tax on oil exports is set at a rate from 0 per cent. to 32 per cent., depending on the market price for oil, without taking into consideration transportation costs or other deductions.

Kazakhstan may increase the export customs rate in the future. The uncertainty of application and the evolution of tax laws creates a risk of additional payment of tax by the Company, which could have a material adverse affect on the business, financial condition and results of operations of the Company.

### 13.4 Taxation Issues in Tajikistan

Although under the Bokhtar PSC all of KPL's tax obligations are covered through the Tajik State's share of production, the taxation system in Tajikistan is at an early stage of development and the tax risks and problems with respect to its operations and investment in Tajikistan may be significant. Tax legislation is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies and accordingly, few precedents with regard to issues have been established.

Tax declarations, together with other legal compliance areas are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax and other risks in Tajikistan substantially more significant than typically found in countries with more developed tax systems. In addition, amendments to current Tajikistan taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on the Company.

In general terms, taxes in Tajikistan include income tax, value added tax, excise tax, social tax, land tax, property tax, transport tax, as well as fees for licences. Profits are taxed at a rate of 25 per cent. of taxable income (calculated as revenue less permitted deductions). VAT at a rate ranging to 20 per cent. is imposed on goods produced in Tajikistan and goods imported into Tajikistan. Payments due to state agencies in respect of oil and gas production are determined under the particular terms of production sharing contracts of which the Bokhtar PSC is an example. Under the Bokhtar PSC, the Tajik State's share of production covers all of the Company's taxes, levies and duties in respect of production thereunder.

### 13.5 Taxation Issues in Uzbekistan

As the legal and regulatory framework for oil and gas is emerging in Uzbekistan, it is possible that the terms of the North Urtabulak PEC may be challenged, additional taxes may be imposed, or may be found to be in conflict with other Uzbek laws and regulations. In particular, certain customs duty exemptions and privileges under the North Urtabulak PEC which were approved by the government by way of a government decree contradict certain provisions under the Customs Code of Uzbekistan. These contradictions may lead to potential disputes with the relevant tax authorities and certain customs duty exemptions and privileges may no longer be recognised or available resulting in a material adverse effect on the financial performance of the Group. Presidential Edict No. UP-4116, dated 17 June 2009 ("**Edict 4116**"), extended the validity of TPU's tax and customs exemptions and privileges under clause 3 of Decree 322 for an unspecified period of time, although it terminated certain tax exemptions and privileges available to other legal persons and groups of entities. While the tax and customs exemptions and privileges provided to TPU remain valid, there is no guarantee that such exemptions and privileges will not be changed in the future.

As with Tajikistan the taxation system in Uzbekistan is at an early stage of development and the tax risks and problems' with respect to its operations and investment in Uzbekistan may be significant. Tax legislation is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies, therefore, regulations are often unclear, contradictory or nonexistent. Accordingly, few precedents with regard to these types of issues have been established. Tax declarations, together with other legal compliance areas are subject to review and investigation by a number of authorities, which are enabled by law to impose severe fines, penalties and interest charges. These factors create tax and other risks in Uzbekistan more significant than typically found in countries with more developed tax systems. In addition, amendments to current

Uzbekistan taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on the Company.

All legal entities carrying on activities in Uzbekistan must be registered with the local tax committee. Taxes in Uzbekistan include income tax, value added tax, excise tax, social tax, land tax, property tax, transport tax, as well as customs duties and payments, contributions to various funds, duties and fees for licences. Currently, the income tax applicable to the Group's operations on the North Urtabulak PEC is 16 per cent. as was set by a government decree in 1999. Elsewhere in Uzbekistan, the income tax rate is less, 10 per cent. in 2009 and 9 per cent. in 2010. In 2008, the Uzbek State introduced an excess profit tax but this does not apply to the North Urtabulak PEC which is covered by the government decree.

## 14. MATERIAL CONTRACTS

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by members of the Group (a) in the two years immediately preceding the date of this document and are, or may be, material or (b) contain provisions under which any member of the Group has any obligation or entitlement which is material to the Group as at the date of this Prospectus:

### (a) *Bokhtar PSC*

The Bokhtar PSC was originally signed on June 13 2008 by the government of Tajikistan and KPL. The PSC grants exclusive rights to KPL to explore for, develop and produce hydrocarbon resources in the area for a twenty-five year period. Under the terms of the agreement, KPL is able to recover 100% of cost incurred during hydrocarbon operations from 70% of hydrocarbon production. The remaining production is then shared between KPL and the State 70% to KPL and 30% to the State.

### (b) *Management Services Agreement – Chairman*

The management services agreement dated May 10, 2007 between the Company and Vazon providing for, among other things, the services of Dr. David Robson as Chairman of the Board of Directors, and as President and Chief Executive Officer of the Company;

### (c) *Management Services Agreement – Executive Officers*

The management services agreement dated June 8, 2007 between the Company and Vazon providing for, among other things, the services of Vazon and the services of Mr. Bernard Murphy, Ms. Elizabeth Landles, Mr. Graham Wall, Mr. George Mirtskhulava and Ms. Denise Lay as executive officers of the Company.

### (d) *Kyzyloi Field Licence and Production Contract*

The Kyzyloi Field Licence and Production Contract refers to a 287.2 $km^2$ area, extending vertically from the surface to the base of the Paleogene sequence (approximately 750 meters in depth).

The Kyzyloi Field License and Production Contract for production of gas on the Kyzyloi field was initially issued by the Kazakh State to the State holding Company KazakhGaz on 12 June 1997 and was transferred to TAG on 15 May 2001. The contract was entered into between TAG and MEMR on 5 May 2005, initially until 12 June 2007. However, in January 2005, MEMR agreed to extend the contract until June 2014, subject to certain contract amendments, which the Company finalized in 2007 by signing Addition #1 on 8 November 2007 (State Registration #2480). Gas production from the Kyzyloi Field License and Production Contract commenced in December 2007.

### (e) *Akkulka Production Contract*

The Akkulka Production Contract refers to a 109.5 $km^2$ area located entirely within the Akkulka Exploration Licence and Contract Area. The Company, through its subsiduary TAG, holds a 100% interest in the Akkulka Production Contract;

(f) ***North Urtabulak PEC***

The North Urtabulak PEC is held by BHCL a wholly-owned subsiduary of the Company. The North Urtabulak PEC is a form of service contract, under which the Company performs advanced oilfield recovery and field optimisation techniques in order to increase oil production over and above a predetermined baseline. Any production from an individual well that achieves production higher than the baseline (**"Incremental Production"**) is split 50:50 with UNG for the first three years of production and 20:80 (in favour of UNG) for the remaining five years of production. After the eight year period has expired, the well is returned to UNG unless substantial additional work (such as sidetracking) is conducted. In the event of such additional work being carried out on a well, the production sharing clock is effectively reset and the initial three year period recommences. The PEC has successfully been in operation since 1999 and has to date produced over 765,000 tonnes of incremental oil.

## 15. RELATED PARTY TRANSACTIONS

Save as disclosed:

(a) in the section entitled "Transactions with Related Parties" of the Management's Discussion and Analysis for the three months ended 31 March 2011 contained on page 115 of this document;

(b) in note 23 "Related Party Transactions" of the audited financial statements for the year ended 31 December 2010 contained on page 252 of this document;

(c) in note 23 "Related Party Transactions" of the audited financial statements for the year ended 31 December 2009 contained on page 310 of this document;

and otherwise than as set out in this paragraph 15, there were no transactions between the Company and its related parties during the period from 1 January 2008 to 18 July 2011, being the last practicable date prior to the publication of this document.

**Vazon Energy Limited**

Vazon is a corporation organised under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. The Company has a management services contract with Vazon that came into effect from 27 June 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to the Company for services under a 'flow through' contract from Vazon in the period between 31 March 2011 and the date of this document was £497,942.74.

**Oilfield Production Consultants**

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged the Company a monthly retainer fee for engineering expertise, provided services relating to compression optimization and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbetistan. No fees were paid under this consultancy during the period between 31 March 2011 and the date of this document.

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions.

## 16. TAKEOVERS

As the Company is incorporated in the Caymen Islands, the City Code will not apply to the Company.

Cayman Islands companies law does not contain provisions similar to those in the City Code which oblige a person or persons acquiring at least 30 per cent. of voting rights in a company to which the City Code applies to make an offer to acquire the remainder of the shares in such company. The Company's shares are subject to Squeeze Out provisions of the Companies Law. Under these provisions, any offeror making a takeover offer which, within four months of making the offer, has been approved by the holders of not less than 90 per cent. in value of the shares to which the offer relates, is entitled to acquire compulsorily from dissenting shareholders those shares which have not been acquired or contracted to be acquired on the same terms as under the offer.

17. **LITIGATION**

There have been no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company is aware) which may have, or have had during the 12 months prior to the date of this document, a significant effect on the Company's and/or the Group's financial position or profitability of the Company and/or Group.

18. **SUBSIDIARIES**

The Company acts as the holding company of the Group, the principal activities of which are oil and gas exploration and production. The Company has the following significant subsidiary undertakings all of which are incorporated in the countries specified below.

| **Name** | **Country of incorporation** | **Proportion of ownership interest** | **Principal activity** |
|---|---|---|---|
| Tethys Services Limited | England | 100% | Employs U.K. personnel |
| Tethys Kazakhstan Limited | Guernsey | 100% | Investment holding of Kazakhstan assets |
| Tethys Petroleum Incorporated | Delaware, USA | 100% | Employs U.S. based personnel |
| Tethys Uzbekistan B.V. | Netherlands | 100% | Employs Uzbekistan based personnel |
| Baker Hughes (Cyprus) Limited | Cyprus | 100% | Contractor to the Uzbek production and enhancement contract |
| Tethys Tajikistan Limited | Cayman Islands | 100% | Investment holding of Tajikistan assets |
| Seven Stars Energy Corporation | British Virgin Islands | 51% | Investment holding by Tajik asset |
| Tethys Services Tajikistan Limited | Tajikistan | 51% | Operator of Bokhtar PSC; employs Tajikistan based staff |
| Kulob Petroleum Limited | Jersey | 51% | Contractor under the Bokhtar PSC |
| Asia Oilfield Equipment B.V. | Netherlands | 100% | Ownership of oilfield equipment |
| Tethys Services Kazakhstan LLP | Kazakhstan | 100% | Employs Kazakhstan based personnel |
| TethysAralGaz LLP | Kazakhstan | 100% | Oil and gas exploration and production |
| Kul-Bas LLP | Kazakhstan | 100% | Oil and gas exploration and production |
| AOE Tykhe S.A. | Luxemburg | 100% | Ownership of oilfield equipment |

19. **PROPERTY**

As at 18 July 2011, the Group held eleven leased properties, of which two are in each of Kazakhsatan, Tajikistan and Uzbekistan, and one is in each of the U.K., U.S., Turkey, Dubai and the Netherlands. These leases have terms expiring within three years. These leased properties are used for general corporate and management purposes. The Group also has been renting serviced offices in the U.S.

In addition, TAG owns a production base in the Shallkarskiy region of Kazakhstan with a gross floor area of 0.3 hectares mainly used as office and storage of its equipment. TAG acquired the land pursuant to an agreement dated 19 September 2006 at a consideration of Tenge 240,000 (equivalent to approximately US$1,600 on that date).

20. **NO SIGNIFICANT CHANGE**

There has been no significant change in the financial or trading position of the Group since 31 March 2011, being the date of the last unaudited financial information of the Group, contained in Part 5 of this document.

21. **MISCELLANEOUS**

The total costs and expenses of, and incidental to, Admission payable by the Company, is estimated to amount to £340k (excluding VAT).

The information sourced from third parties has been accurately reproduced and so far as the Company is aware and has been able to ascertain from information published by such third party, no facts have been omitted which would render the reproduced information inaccurate or misleading.

The Ordinary Shares are in registered form and will, on Admission, be capable of being held in uncertificated form. The Ordinary Shares will be admitted with the ISIN KYG876361091.

None of the Ordinary Shares have been marketed or are available in whole or in part to the public in conjunction with the application for the Ordinary Shares to be admitted to the Official List.

## 22. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection during normal business hours on any weekday (Saturday, Sundays and public holidays excepted) at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2HA up to and including Admission:

(a) the Memorandum and Articles;

(b) the audited consolidated financial statements (including the audit reports from PricewaterhouseCoopers LLP) of the Group for the financial years ended 31 December 2008, 31 December 2009 and 31 December 2010, as set out in Part 5 of this document;

(c) the unaudited interim consolidated financial statements for the three months ended 31 March 2011;

(d) the Management's Discussion and Analysis for the three months ended 31 March 2011;

(e) the Management's Discussion and Analysis for the years ended 31 December 2008, 31 December 2009 and 31 December 2010; and

(f) the TRACS Reserve and Resource Report and the McDaniel Reserve Report; and

(g) this document.

Dated 20 July 2011

## PART 9 - DEFINITIONS AND GLOSSARY OF TECHNICAL TERMS

### DEFINITIONS

The following definitions apply throughout this document, unless the context otherwise requires:

| | |
|---|---|
| "**Admission**" | the admission of the Ordinary Shares to the Official List and to trading on the London Stock Exchange's market for listed securities becoming effective; |
| "**Akkulka**", "**Akkulka Block**" or "**Akkulka Field**" | the area that is subject to the Akkulka Exploration Licence and Contract in Kazakhstan; |
| "**Akkulka Exploration Licence and Contract**" | the exploration licence and contract of TAG in respect of the Akkulka Block. This contract has been extended five times, more particularly described on page 44 of this document; |
| "**Akkulka Gas Supply Contract**" | the Akkulka Gas Supply Contract as more particularly described on page 43 of this document; |
| "**Akkulka Production Contract**" | the Akkulka Production Contract dated December 23, 2009 between TAG and MEMR which gives TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years; |
| "**Annual Information Form**" | the annual information form of the Company dated 23 March 2011; |
| "**Articles**" | the articles of association of the Company to take effect from Admission; |
| "**atm**" | atmospheres, a measure of pressure equivalent to 102.667 kilopascals; |
| "**bbl**" | barrel; |
| "**Bcm**" | billion cubic metres; |
| "**bcm/y**" or "**bcmy**" | billion cubic metres per year; |
| "**Beshtentak Field**" | an area that forms part of the Tajikstan Contract Area; |
| "**Board**" or "**Directors**" or "**Board of Directors**" | the directors of the Company as at the date of this document whose names are set out on page 89 of this document; |
| "**boe**" | barrels of oil equivalent; |
| "**boepd**" | barrels of oil equivalent per day; |
| "**bopd**" | barrels of oil per day; |
| "**Bokhtar PSC**" | the production sharing contract entered into between KPL and the Government of Tajikistan, represented by MEI, on June 13, 2008 covering the Bokhtar area of southwest Tajikistan; |
| "**CanArgo**" | CanArgo Energy Corporation, formerly a US public oil and gas company; |
| "**C$**", **Cdn$**", "**CA$**" or "**Canadian cents**" | are the lawful currency of Canada; |

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| "**CIS**" | the Commonwealth of Independent States which is a regional organisation made up of certain countries of the former Soviet Union; |
| "**City Code**" | the UK City Code on Takeovers and Mergers; |
| "**cm**" | cubic metres; |
| "**Code of Ethics**" | the code of ethnics of the Company as described more particularly on page 93 of this document; |
| "**COGEH**" | the Canadian Oil and Gas Evaluation Handbook prepared jointly by the Society of Petroleum Evaluation Engineers (Calgary Chapter) and the Canadian Institute of Mining, Metallurgy and Petroleum (Petroleum Society), as amended from time to time; |
| "**Company Contracts**" | contracts with governmental agencies in those jurisdictions in which the Company operates pursuant to which it is granted production and/or explorations rights; |
| "**Company**" or "**Tethys**" | means Tethys Petroleum Limited and includes, except where the context otherwise requires, the Company's direct and indirect wholly-owned subsidiaries; |
| "**Companies (Guernsey) Law**" | the Company (Guernsey) Law 1994 to 1996, as amended; |
| "**Companies Law**" | the Companies Law of the Cayman Islands, as amended, re-enacted, revised and consolidated from time to time; |
| "**Compensation and Nomination Committee**" | the Company's compensation and nomination committee; |
| "**Competent Authority**" | the Kazakh authority more particularly described on page 8 of this document; |
| "**CREST**" | the computerised settlement system operated by Euroclear UK & Ireland Limited to facilitate the transfer of title to shares in uncertificated form; |
| **"CSA"** | Canadian Securities Administrators; |
| "**Custodian**" | the custodian nominated by the Depository; |
| "**Decree**" | the Uzbek decree more particularly described on page 74; |
| "**Deed Poll**" | a deed poll to be executed by the Depository prior to Admission in favour of the holders of Depository Interests from time to time; |
| "**Depository**" | Capita IRG Trustees Limited; |
| "**Depository Interests"** or **"DIs**" | The dematerialised depository interests in respect of the Ordinary Shares issued or to be issued by the Depository; |
| "**Developed Non-Producing Reserves**" | those reserves that either have not been on production, or have previously been on production, but are shut-in, and the date of resumption of production is unknown; |
| "**Developed Producing Reserves**" | those reserves that are expected to be recovered from completion intervals open at the time of the estimate. These reserves may be currently producing or, if shut-in, they must have previously been on production, and the date of resumption of production must be known with reasonable certainty; |

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| "**Developed Reserves**" | those reserves that are expected to be recovered from existing wells and installed facilities or, if facilities have not been installed, that would involve a low expenditure (e.g. when compared to the cost of drilling a well) to put the reserves on production. The developed category may be subdivided into producing and non-producing; |
| "**Disclosure Rules and Transparency Rules**" | the rules made by the FSA under Part VI of FSMA relating to the disclosure of information (as amended from time to time); |
| "**Edict 4116**" | the Uzbek edict more particularly described on page 23 of this document; |
| "**EEA**" or "**European Economic Area**" | the European Union, Iceland, Norway and Lichtenstein;; |
| "**EU**" | the European Union; |
| "**Euro or €**" | the lawful single currency of member states of the European Union that adopt or have adopted the euro in accordance with the legislation of the EU relating to the European Monetary Union; |
| "**Executive Board**" | the Company board made up of the Audit Committee, the Compensation and Nomination Committee, the Reserves Committee and the Executive Committee; |
| "**Extractive Industries Transparency Initiative**" | the UK initiative more particularly described on page 21 of this document; |
| "**Financial Services Authority**" or "**FSA**" | the Financial Services Authority of the UK in its capacity as the competent authority for the purposes of Part VI of FSMA and in the exercise of its functions in respect of admission to the Official List otherwise than in accordance with Part VI of FSMA; |
| "**FSU**" | the Former Soviet Union Oil and Gas Monitor; |
| " **FSMA**" | The Financial Services and Markets Act 2000 of England and Wales, as amended; |
| "**ft**" | feet; |
| "**GazImpex**" | GazImpex S.A., an unaffiliated company registered in the British Virgin Islands; |
| "**GazProm**" | OAO GazProm, a major Russian gas company majority owned by the government of the Russian Federation; |
| "**Georgia**" | the Republic of Georgia; |
| "**gross**" | (i) in relation to the Company's interest in production or reserves, its "company gross reserves", which represent the Company's working interest (operating or non-operating) share of gross reserves before deduction of royalties and MET, and without including any royalty interests of the Company;<br>(ii) in relation to wells, the total number of wells obtained by aggregating the Company's current working interest in each of its gross wells; and |

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| | (iii) in relation to the Company's interest in properties, the total area of properties in which the Company has an interest multiplied by the working interest owned by the Company; |
| "**Group**" | the Company and its subsidiary undertakings; |
| "**hp**" | horsepower; |
| "**HSE**" | Health Safety and Environment |
| "**IEA**" | The International Energy Agency; |
| "**IFRS**" | International Financial Reporting Standards; |
| "**Incremental Production**" | any production from an individual well that achieves production higher than a pre-determined baseline; |
| "**Intergas Central Asia**" | Intergas Central Asia, a division of the Kazakh state natural gas company KazTransGaz; |
| "**IPO**" | the initial public offering of the Company of 18,181,818 Ordinary Shares at a price of $2.75 per Ordinary Share for gross proceeds of $50,000,000, which closed on 27 June 2007; |
| "**ISIN**" | International Security Identification Number; |
| "**JNOC**" | Japanese National Oil Company; |
| "**KASE**" | the Kazakhstan Stock Exchange; |
| "**Kazakh Contracts**" | the Company Contracts relating to the Company's operations in Kazakhstan; |
| "**Kazakh Gas Supply Contract**" | the gas supply contract originally entered into between TAG and GazImpex on January 5, 2006 in relation tot eh supply of natural gas produced from the Kyzyloi Field; |
| "**Kazakhstan**" | the Republic of Kazakhstan; |
| "**Kazakh State**" | the government of Kazahkhstan; |
| "**Kazakh Statement**" | the Statement on reserves more particularly described on page 56 of this document; |
| "**Khoja Sartez Field**" | an area that forms part of the Tajikistan Contract Area; |
| "**km**" | kilometre; |
| "**km2**" | square kilometres; |
| "**KPL**" | Kulob Petroleum Limited, a company incorporated in Jersey and a 100 per cent. subsidiary of SSEC; |
| "**Komsomolsk Field**" | an area that forms part of the Tajikistan Contract Area; |
| "**Kul-Bas**" | Kul-Bas LLP, a limited liability partnership registered in Kazakhstan in which the Company through TKL has a 100 per cent. interest; |
| "**Kul-Bas Block**" | the area that is subject to the Kul-Bas Exploration and Production Contract in Kazakhstan; |

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| "**Kul-Bas Exploration and Production Contract**" | Kul-Bas' exploration licence and production contract in respect of the Kul-Bas Block; |
| "**kW**" | kilowatt; |
| "**Kyzyloi**" or "**Kyzyloi Field**" | the area that is subject to the Kyzyloi Field Licence and Production Contract in Kazakhstan; |
| "**Listing Rules**" | the listing rules made by the FSA under Part VI of FSMA (as amended from time to time); |
| "**London Stock Exchange**" | the London Stock Exchange plc; |
| "**m**" | metres; |
| "**Mbbl**" | thousands of barrels; |
| "**Mbblpd**" or "**Mbbl/d**" | thousands of barrels per day; |
| "**Mboe**" | thousand barrels of oil equivalent; |
| "**MMboe**" | million barrels of oil equivalent; |
| "**McDaniel**" | McDaniel & Associates Consultants Ltd., independent oil and gas reservoir engineers of Calgary, Alberta; |
| "**McDaniel Reserve Report**" | the independent engineering evaluation of the Company's crude oil and natural gas reserves prepared by McDaniel, dated March 18. 2011 and effective December 31, 2010; |
| "**Mcf**" | thousand cubic feet; |
| "**Mcfpd**" | thousand cubic feet per day; |
| "**Mcm**" | thousand of cubic metres; |
| "**Mcmpd**" | thousand cubic metres per day; |
| "**MD**" | millidarcies; |
| "**MEI**" | the Ministry of Energy and Industry of the Republic of Tajikistan; |
| "**MEMR**" | the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan; |
| "**MET**" or "**Mineral Extraction Tax**" | the mineral extraction tax payable to the Kazakh State in respect of oil and gas production in Kazakhstan; |
| "**millidarcy or (MD)**" | one thousandth of a darcy, a unit of measure of permeability; |
| "**MOG**" | the Ministry of Oil and Gas of the Republic of Kazakhstan; |
| "**MOU**" | Memorandum of Understanding; |
| "**mm**" | millimetre; |
| "**MM$**" | millions of U.S. dollars; |
| "**MMbbl**" | million barrels; |
| "**MMboe**" | million barrels of oil equivalent; |
| "**MMcf**" | million cubic feet; |

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| "**MMcfpd**" | million cubic feet per day; |
| "**MMcm**" | million cubic metres; |
| "**MMcmpd**" | million cubic metres per day; |
| "**MMstb**" | million stock tank barrels; |
| "**Named Executive Officers**" | officers more particularly described on page 333; |
| "**New Local Content Rules**" | The new local content rules approving a uniform procedure for calculating local content in relation to the purchase of goods, works and services in Kazakhstan; |
| "**NGL**" | natural gas liquids including condensate, propane, butane and ethane; |
| "**NI 51-101**" | National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities of the Canadian Securities Administrators*; |
| "**NI 51-102**" | National Instrument 51-102 – *Continuous Disclosure Obligations of the Canadian Securities Administrators*; |
| "**NI 52-110**" | National Instrument 52-110 *Audit Committees of the Canadian Securities Administrators*; |
| "**North Urtabulak Field**" | the area which is subject to the North Urtabulak PEC in Uzbekistan; |
| "**OECD**" | Organisation for Economic Co-operation and Development; |
| "**Official List**" | the Official List of the Financial Services Authority; |
| "**OPEC**" | the Organisation of the Petroleum Exporting Countries; |
| "**Ordinary Shares**" | the ordinary shares of $0.10 par value in the share capital of the Company and/or, where the context so requires, the DIs; |
| "**PCK**" | Kazakhstani Petrochemical Company Kemikal LLP; |
| **"PEC"** | production exploration contract; |
| "**Performance Warrants**" | the performance warrants more particularly described in paragraph 5.2 of Part 8 of this document; |
| "**Petroleum Resources Management System**" | the Petroleum Resources Management System as jointly published by the Society of Petroleum Engineers, the World Petroleum Council, the American Association of Petroleum Geologists and the Society of Petroleum Evaluation Engineers, as amended; |
| "**Pilot Production Project**" | the Kazakh State approved project as more particularly described on page 35 of the document, under Significant Events of 2011; |
| "**Possible Reserves**" | those additional reserves that are less certain to be recovered than Probable Reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated Proved Plus Probable Plus Possible Reserves; |
| "**Pound Sterling**", "**pounds**", "**£**", "**p**" or "**pence**" | the lawful currency of the United Kingdom; |

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| "**Preference Shares**" | the preference shares of $0.10 par value in the share capital of the Company; |
| "**Prior Law**" | the prior law on sub surface and sub surface use in Kazakhstan which was replaced in July 2010 by the Subsurface Law; |
| "**Probable Reserves**" | means those additional reserves that are less certain to be recovered than Proved Reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated Proved Plus Probable Reserves; |
| "**Prospectus**" | this document; |
| "**Prospectus Rules**" | the rules made by the FSA under Part VI of FSMA in relation to offers of transferable securities to the public and admission of transferable securities to trading on a regulated market (as amended from time to time); |
| **"PSC"** | production sharing contract; |
| "**Proved Reserves**" | those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated Proved Reserves; |
| "**psi**" | the pounds per square inch, a measure of pressure and equivalent to 0.068 atm; |
| "**PTA**" | Pressure Transient Analysis; |
| "**Registrar**" | Equity Financial Trust Company, 200 University Avenue, Suite 400, Toronto, Ontario M5H 4HI; |
| "**Regulations**" | the Uncertificated Securities Regulation 2001, as amended; |
| **"Regulatory Information Service"** | A Regulatory Information Service that is approved by the FSA and that is on the list of Regulatory Information Service providers maintained by the FSA; |
| "**Reserves**" | the estimated remaining quantities of oil and natural gas and related substances anticipated to be recoverable from known accumulations, as of a given date, based on: analysis of drilling, geological, geophysical and engineering data; the use of established technology; and specified economic conditions, which are generally accepted as being reasonable. Reserves are classified according to degree of certainty associated with the estimates; |
| "**SEC**" | the US Securities and Exchange Commission; |
| "**SEDAR**" | System for Electronic Document Analysis and Review, www.sedar.com; |
| "**SDRT**" | Stamp Duty and Stamp Duty Reserve Tax; |
| "**Senior Managers**" | the senior managers of the Company as set out in paragraph 1.2 of Part 3 this document, namely Julian Hammond, Graham Wall and Ian Philliskirk; |

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| "**Shareholder Rights Plan**" | the shareholder rights plan of the Company described in paragraph 3 of Part 7 of this document, requiring that, subject to certain exemptions, if a person acquires 20 per cent. of the Outstanding Ordinary Shares of the Company, a takeover bid must be made for all of the Ordinary Shares and must be open for 60 days after the bid is made; |
| "**Shareholders**" | holders of Ordinary Shares; |
| "**Share Schemes**" | the Stock Incentive Plan, the Performance Warrants and the 2017 Warrants together; |
| "**Share Trading Policy**" | the share trading policy of the Company; |
| "**Somoni**" | the Tajik Somoni, the lawful currency of Tajikistan; |
| "**Soum**" | the Uzbek Soum, the lawful currency of Uzbekistan; |
| **"Squeeze Out"** | the compulsory acquisition provisions set out in section 88 of the Companies Law and pursuant to Article 29 of the Company's Articles, as more particularly described on page 24 or this document; |
| **"Stock Incentive Plan"** | the stock incentive plan adopted by the Company in 2007, as more particularly described in paragraph 5.1 of Part 8 of this document; |
| "**SSEC**" | Seven Stars Energy Corporation, a 51 per cent. owned subsidiary of Tethys Tajikistan Limited; |
| "**SSOW**" | Safe System of Work; |
| "**Subsurface Law**" | the new law on subsurface and subsurface use in Kazakhstan which was introduced by the Kazakh State to replace the Prior Law with effect from July 2010; |
| "**TAG**" | TethysAralGaz LLP (formerly known as BN Munai LLP) a limited liability partnership registered in Kazakhstan in which the Company, through TKL, has a 100 per cent. interest; |
| "**Tajikistan**" | the Republic of Tajikstan; |
| "**Tajikistan Contract Area**" | the total net area covered by the Bokhtar PSC, as further described under "Description of the Business – Overview of Land Holdings-Tajikistan"; |
| "**Tajik State**" | the government of Tajikistan; |
| "**Tajik Statement**" | statement of reserves more particularly described on page 56 of this document; |
| "**Tax Code**" | the Kazakh Tax Code, as adopted in Kazakhstan effective as of 1 January 2009; |
| "**Tcf**" | trillion cubic feet; |
| "**Tcm**" | trillion cubic metres; |
| "**Tenge**" | the Kazakh Tenge, the lawful currency of Kazakhstan; |
| "**Tertiary**" | the geological period from 65 to 1.8 million years ago; |
| "**TKL**" | Tethys Kazakhstan Limited, a wholly-owned subsidiary of the Company; |

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| "**TMG**" | TethysMunaiGaz LLP, a limited liability partnership registered in Kazakhstan in which the Company, through TKL, has a 100 per cent. interest; |
| "**TPI**" | Tethys Petroleum Incorporated, a wholly-owned subsidiary of the Company; |
| "**TPU**" | Tethys Production Uzbekistan, the trading name of Baker Hughes (Cyprus) Limited, a company incorporated in Cyprus and a wholly-owned subsidiary of the Company; |
| "**TRACS AGR**" | TRACS International Consultancy Ltd., independent oil and gas reservoir engineers of UK; |
| "**TRACS Reserve and Resource Report**" | for reserves, the independent evaluation report of the Group's oil and gas reserves attributable to the Beshtentak Field and the Komsomolsk Field; fro resources, the independent evaluation report of the contingent and/or prospective resources of the Group attributable to the Beshtentak Field and the Komsomolsk Field prepared by TRACS AGR dated March 18, 2011 and effective as of December 31, 2010; |
| "**TSK**" | Tethys Services Kazakhstan LLP, a limited liability partnership registered in Kazakhstan in which the Company, through TKL, has a 100 per cent. interest; |
| "**TSTL**" | Tethys Services Tajikistan Limited, a wholly-owned subsidiary of SSEC; |
| "**TSX**" | the Toronto Stock Exchange; |
| "**TTL**" | Tethys Tajikistan Limited, a wholly-owned subsidiary of the Company; |
| "**UK**" | the United Kingdom of Great Britain and Northern Ireland; |
| "**UK Corporate Governance Code**" | the UK Corporate Governance Code on Corporate Governance (as amended from time to time); |
| "**Undeveloped Reserves**" | those reserves expected to be recovered from known accumulations where a significant expenditure (e.g. when compared to the cost of drilling a well) is required to render them capable of production. They must fully meet the requirements of the reserves classification (proved, probable, possible) to which they are assigned; |
| "**UNG**" | the Uzbek State oil and gas company, National Holding Company "Uzbekneftegaz"; |
| "**United States**" or "**U.S.**" | the United States of America; |
| "**U.S. Dollar**, "**Dollars**", "**dollar(s)**", "**US$**" and "**US cent(s)**" | the lawful currency of the United States of America; |
| "**US GAAP**" | United States generally accepted accounting principles; |
| "**US Securities Act of 1933**" | the US Securities Act of 1933, as amended; |

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| "**User Rights**" | participatory interests or shares in a legal entity holding the subsoil use right, as well as a legal entity which may directly and/or indirectly determine and/or influence decisions adopted by a subsoil user if the principal activity of such subsoil user is related to subsoil use in Kazakhstan; and |
| | securities confirming title to shares or securities convertible to shares of a subsoil user as well as a legal entity who may directly and/or indirectly determine the decisions and/or influence the decisions adopted by such a subsoil user if such a legal entity's main activities are associated with subsoil use in Kazakhstan; |
| "**Uzbekistan**" | the Republic of Uzbekistan; |
| "**Uzbek State**" | the government of Uzbekistan; |
| "**Uzbek State Partners**" | Uznefteproduct and Uzneftegazdobycha, each an associated entity (as defined in the North Urtabulak PEC) of UNG; |
| "**Uzneftegazdobycha**" | the Uzbek joint-stock company that is an associated entity of UNG; |
| "**Uznefteproduct**" | the Uzbek joint-stock company that is an associated entity of UNG; |
| "**VAT**" | value added tax; |
| "**Vazon**" | Vazon Energy Limited, a company incorporated in Guernsey that is owned by the President and Chief Executive Officer of the Company; |
| "**2017 Warrants**" | the warrants in the Company to purchase an aggregate of 2,090,000 Ordinary Shares issued on 8 June 2007 and as more particularly described on page 333 of this document; |
| "**Work Program**" | a minimum work program more particularly described on page 71 of this document. |

## GLOSSARY OF TECHNICAL TERMS

In this Prospectus, the capitalized terms set forth below have the following meanings:

"**2D**" means seismic data recorded along discrete tracks;

"**°C**" means degrees Celsius;

"**Albian**" means a geological stage of the Cretaceous period from 112.0 to 99.6 million years ago;

"**Aptian**" means a geological stage of the Cretaceous period from 125.0 to 112.0 million years ago;

"**AVO**" means amplitude versus offset, a specialist seismic processing technique used in the detection of hydrocarbons;

"**Barremian**" means a geological stage of the Cretaceous period from 130.0 to 125.0 million years ago;

"**BCS**" means booster compression station, a compressor station constructed by TAG at km910 on the Bukhara Urals gas trunkline for the export of natural gas production from the Kyzyloi Field and the Akkulka Block;

"**Carboniferous**" means the geological period from 359.2 to 299 million years ago;

"**Cenomanian**" means a geological stage of the Cretaceous period from 99.6 to 93.5 million years ago;

"**Cenozoic**" means the geological era from 65.5 million years ago to the present time which includes the Paleogene and the Neogene periods;

"**Cretaceous**" means the geological period from 145.5 to 65.5 million years ago;

"**Devonian**" means the geological period from 416 to 359.2 million years ago;

"**Eocene**" means the geological epoch from 55.8 to 33.9 million years ago within the Paleogene system of the Cenozoic era immediately after the Paleocene;

"**Hauterivian**" means a geological stage of the Cretaceous period from 136.4 to 130 million years ago;

"**Jurassic**" means the geological period from 199.6 to 145.5 million years ago;

"**Kyzyloi Sandstones**" or "**Kyzyloi Sand**" means Eocene age fine to very fine grained sandstone, sheet type and non-marine in origin, with typical gas saturated thicknesses of between 2 m to 6 m that are generally found in the interval between 400 m to 600 m below surface and have a high porosity range (26% to 35%) with a high bound-water content;

"**Mesozoic**" means the geological era from 248 to 65 million years ago which lies between the Paleozoic and Cenozoic eras;

"**Neogene**" means a geological period of the Cenozoic era, from 23.03 to 5.33 million years ago, which followed the Paleogene period;

"**North Urtabulak PEC**" means the production enhancement contract dated August 19, 1999 entered into among TPU, joint-stock companies Uzneftegazdobycha (formerly known as Uzgeoneftegazdobycha) and Uzneftеproduct (formerly known as Uzneftepererabotka) in respect of the North Urtabulak Field as amended by supplementary agreements dated September 13, 2004, November 30, 2006 and December 19, 2007, which is for an indefinite term;

"**Paleocene**" means the lower most epoch within the Paleogene period, from 65.5 to 61.7 million years ago, immediately after the Cretaceous period;

"**Paleogene**" means the geological period from 65.5 to 23 million years ago;

"**Paleozoic**" means the geological era from 542 to 251 million years, which includes the Devonian, Carboniferous and Permian periods;

"**Permian**" means the geological period from 299 to 251 million years ago and it is the last period of the Paleozoic era;

"**PNN logging**" means pulsed neutron-neutron logging, a modern wireline logging technique which can be used in cased hole and subject to interpretation may indicate the presence of hydrocarbons;

"**super giant**" means the estimated ultimate recoverable reserves of 5 billion bbl of oil or 30 TCF (0.85 TCM) of natural gas;

"**syn-rift**" means rocks deposited during an extensional geological regime (i.e. where rocks are under tension) which results in the general widening and deepening of sedimentary basins and allows significant infilling of sediments from the edges of the basin;

"**Tasaran**" or "**Tasaran Sand**" means Eocene age continental to non-marine fine to very fine grained sandstone, with some significant clay content, slightly stratigraphically older than the Kyzyloi Sandstone that are generally found in the interval between 500 m to 600 m (1,641 ft to 1,969 ft) below surface;

"**Triassic**" means the geological period from 251 to 199.6 million years ago.

## CONVERSION

The following table sets forth certain standard conversions from Standard Imperial Units to the International Syste of Units (or metric units):

| To Convert From | To | Multiply By |
|---|---|---|
| Inches | Mm | 0.0394 |
| Ft | m | 0.305 |
| miles | km | 3.281 |
| km | miles | 1.610 |
| Acres | $km^2$ | 0.004 |
| $km^2$ | Acres | 247.1 |
| bbl | cubic metres | 0.159 |
| cm | bbl | 6.290 |
| Mcf | Mcm | 0.0283 |
| Mcm | Mcf | 35.315 |
| Bcf | Bcm | 0.0283 |
| Bcm | Bcf | 35.315 |
| Tcf | Tcm | 0.0283 |
| Atm | psi | 14.697 |
| Mcf | boe | 0.1667 |
| Mcm | Boe | 5.885 |

**Presentation of Oil and Gas Information**

"**Reserves**" are the estimated remaining quantities of oil and natural gas and related substances anticipated to be recoverable from known accumulations, as of a given date, based on: analysis of drilling, geological, geophysical and engineering data; the use of established technology; and specified economic conditions, which are generally accepted as being reasonable. Reserves are classified according to degree of certainty associated with the estimates.

"**Proved Reserves**" are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated Proved Reserves.

"**Probable Reserves**" are those additional reserves that are less certain to be recovered than Proved Reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated Proved Plus Probable Reserves.

"**Possible Reserves**" are those additional reserves that are less certain to be recovered than Probable Reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated Proved Plus Probable Plus Possible Reserves.

"**Developed Reserves**" are those reserves that are expected to be recovered from existing wells and installed facilities or, if facilities have not been installed, that would involve a low expenditure (e.g. when compared to the cost of drilling a well) to put the reserves on production. The developed category may be subdivided into producing and non-producing.

"**Developed Producing Reserves**" are those reserves that are expected to be recovered from completion intervals open at the time of the estimate. These reserves may be currently producing or, if shut-in, they must have previously been on production, and the date of resumption of production must be known with reasonable certainty.

"**Developed Non-Producing Reserves**" are those reserves that either have not been on production, or have previously been on production, but are shut-in, and the date of resumption of production is unknown.

"**Undeveloped Reserves**" are those reserves expected to be recovered from known accumulations where a significant expenditure (e.g. when compared to the cost of drilling a well) is required to render them capable of production. They must fully meet the requirements of the reserves classification (proved, probable, possible) to which they are assigned.

Certain other technical terms used in this document but not defined herein are defined in NI 51 101 and, unless the context otherwise requires, shall have the same meanings herein as in NI 51-101. Unless otherwise stated, all gas and oil volumes are expressed as at standard conditions of temperature and pressure (temperature = 15 °C and pressure = 1 atm).

The estimates of reserves and future net revenue for individual properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties, due to the effects of aggregation.

In this document where amounts are expressed on a boe basis, natural gas volumes have been converted to oil equivalence at 6 Mcf:l bbl (170 cm: 1bb). The term boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf:l bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Unless otherwise specified, references to oil include oil and NGLs.