

Tethys Petroleum Limited

Annual Financial Information December 31, 2011

The Tethys Petroleum Limited Annual Report and Accounts for 2011 consists of three documents as detailed below:

- 1) Management's Discussion & Analysis: this includes the documents required to be disclosed pursuant to National Instrument 51-102 of Canadian Securities Administrators "Continuous Disclosure Obligations" ("Canadian NI 51-102") in respect of an annual Management's Discussion & Analysis and the documents required to be disclosed pursuant to the UK's Disclosure & Transparency Rules with respect to DTR 4.1 "Annual Financial Report" ("DTR 4.1");
- 2) Annual financial information: this includes the Consolidated Financial Statements, the documents required to be disclosed pursuant to Canadian NI 51-102 with respect to an annual financial report and the documents required to be disclosed pursuant to DTR 4.1, Directors' Responsibility Statement and the Independent Auditor's Report to Tethys Petroleum Limited; and
- 3) The Annual Information Form ("AIF"): this includes the documents required to be disclosed pursuant to Canadian NI 51 – 102 and DTR 4.1 and the statement which is required to be presented in accordance with DTR 7.2 "Corporate Governance Statements".

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Responsibility Statement of the Directors in Respect of the Annual Report and Accounts

The accompanying consolidated financial statements and all the information in the Annual Report and Accounts are the responsibility of The Board of Directors. The consolidated financial statements have been prepared by management, acting on behalf of the Board of Directors, 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 and Accounts 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 is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board of Directors of the Company has established an Audit Committee, consisting of independent non-management directors, to review the 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.

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standard ("IFRSs"), give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Management Discussion & Analysis and the Annual Information Form include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

For and on behalf of the Board

Dr. D. Robson

Chief Executive Officer

March 30, 2012

B. Murphy

Chief Financial Officer

March 30, 2012

Independent Auditor's Report to Tethys Petroleum Limited

We have audited the accompanying consolidated financial statements of Tethys Petroleum Limited ("the Company"), which comprise the consolidated statement of financial position as at 31 December 2011 the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

This report is made solely to the Company in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to the Company those matters we have been engaged to state to it in this report and for no other purpose. We have conferred on the Company's shareholders, as a body, in the engagement terms agreed with the Company, the right to rely on this report and to assert claims in relation thereto, on the basis that such right is enforceable subject to and in accordance with those engagement terms and the Contracts (Rights of Third Parties) Act 1999. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and, on the basis stated above, the Company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

Directors' Responsibility for the Consolidated Financial Statements

The directors are 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 the directors determine 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 audit. We conducted our audit in accordance with International Standards on Auditing. 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 our 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, we consider 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 the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained 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 consolidated financial position of the Company as at 31 December 2011, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matter

The consolidated financial statements of the Company as at and for the year ended 31 December 2010 were audited by another auditor who expressed an unmodified opinion on those statements on 18 March 2011.

KPMG Audit Plc

KPMG Audit Plc

Chartered Accountants

March 30, 2012

15 Canada Square, London, E14 5GL, United Kingdom

Tethys Petroleum Limited
Consolidated Statement of Financial Position
(in US dollars)

As at December 31			
	Note	2011 \$'000	2010 \$'000
Non-current assets			
Intangible assets	12	99,959	16,892
Property, plant and equipment	13	128,918	115,653
Restricted cash	14	1,407	1,015
Prepayments and other receivables	15	10,217	12,320
Loan receivable from jointly controlled entity	16	-	35,460
Investment in jointly controlled entities	17	1,113	-
		<u>241,614</u>	<u>181,340</u>
Current assets			
Inventories	18	2,025	2,121
Trade and other receivables	15	5,478	3,680
Loan receivable from jointly controlled entity	16	2,013	-
Cash and cash equivalents	19	10,746	79,135
Restricted cash	14	885	-
Derivative financial instruments – interest rate swap	20	630	1,472
		<u>21,777</u>	<u>86,408</u>
Total assets		<u>263,391</u>	<u>267,748</u>
Equity attributable to shareholders			
Share capital	23	28,669	26,063
Share premium	23	306,725	297,222
Other reserves	23	38,530	34,261
Accumulated deficit		(144,962)	(118,023)
Non-controlling interest	24	8,918	-
Total equity		<u>237,880</u>	<u>239,523</u>
Non-current liabilities			
Deferred gain on sale of assets to jointly controlled entity	25	-	3,699
Financial liabilities - borrowings	20	1,632	2,853
Deferred taxation	10	2,111	4,070
Trade and other payables	21	547	721
Asset retirement obligations	22	386	192
		<u>4,676</u>	<u>11,535</u>
Current liabilities			
Financial liabilities - borrowings	20	8,396	5,047
Derivative financial instruments - warrants	20	264	405
Derivative financial instruments – foreign currency hedge	20	157	-
Deferred revenue		1,839	2,450
Trade and other payables	21	10,179	8,788
		<u>20,835</u>	<u>16,690</u>
Total liabilities		<u>25,511</u>	<u>28,225</u>
Total shareholders' equity and liabilities		<u>263,391</u>	<u>267,748</u>
Commitments and contingencies	28		

The notes on pages 8 to 61 form part of these consolidated financial statements. The consolidated financial statements were approved by the Board on March 30, 2012 and were signed on its behalf.

Dr. D. Robson

Chief Executive

B. Murphy

Chief Financial Officer

Tethys Petroleum Limited

Consolidated Statement of Comprehensive Income (in US dollars)

		Year ended December 31,	
	Note	2011	2010
	2	(re-presented)	
		\$'000	\$'000
Sales and other operating revenues	6	22,922	14,706
Other operating income	7	7,375	-
Total revenue and other income		<u>30,297</u>	<u>14,706</u>
Production expenditures		(10,785)	(7,076)
Depreciation, depletion and amortization		(13,111)	(5,885)
Impairment charge	12,13	(8,983)	-
Unsuccessful exploration and evaluation expenditures		(1,807)	-
Listing expenses		(606)	(1,288)
Business development expenses		(2,363)	(35)
Administrative expenses	8	(20,549)	(19,520)
Share based payments	9	(3,814)	(5,956)
Foreign exchange gain / (loss) - net		74	(337)
Fair value loss (net) on derivative financial instrument		(625)	(24)
Gain on previously held interest in jointly controlled entity	25	27,381	-
Loss on settlement of pre-existing loan relationship	25	(24,423)	-
Loss from jointly controlled entity	16	(722)	(634)
Finance income / (costs) - net		<u>1,100</u>	<u>(129)</u>
Loss before taxation		(28,936)	(26,178)
Taxation	10	<u>1,947</u>	<u>(3,471)</u>
Loss for the year		<u>(26,989)</u>	<u>(29,649)</u>
Loss attributable to:			
Shareholders		(26,939)	(29,649)
Non-controlling interest		<u>(50)</u>	<u>-</u>
Loss for the year		<u>(26,989)</u>	<u>(29,649)</u>
Loss per share attributable to shareholders			
Basic and diluted	11	<u>(0.10)</u>	<u>(0.15)</u>

No dividends were paid or are declared for the year (2010
– \$Nil).

The notes on pages 8 to 61 form part of these consolidated financial statements.

Tethys Petroleum Limited

Consolidated Statement of Changes in Equity (in US dollars)

	Note	Attributable to shareholders						Non-controlling interest \$'000	Total equity \$'000
		Share capital \$'000	Share premium \$'000	Accumulated deficit \$'000	Option reserves \$'000	Warrant reserves \$'000			
Balance at January 1, 2010	23	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	23	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 January 1, 2011		26,063	297,222	(118,023)	17,706	16,555	-	-	239,523
Comprehensive loss for the year		-	-	(26,939)	-	-	(50)	-	(26,989)
Acquisition of subsidiary with non-controlling interests		-	-	-	-	-	8,968	-	8,968
Transactions with shareholders									
Issue of share capital	23	2,606	10,396	-	-	-	-	-	13,002
Cost of share issue		-	(893)	-	-	-	-	-	(893)
Share-based payments		-	-	-	4,269	-	-	-	4,269
Total transactions with shareholders		2,606	9,503	-	4,269	-	-	-	16,378
At December 31, 2011		28,669	306,725	(144,962)	21,975	16,555	8,918	-	237,880

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 8 to 61 form part of these consolidated financial statements.

Tethys Petroleum Limited
Consolidated Statement of Cash Flows
(in US dollars)

Year ended December 31,

		2011 \$'000	2010 (re-presented) \$'000
	Note		
Cash flow from operating activities			
Loss before taxation		(28,936)	(26,178)
Adjustments for			
Share based payments	9	3,814	5,956
Net finance (income) / cost		(1,100)	112
Unsuccessful exploration and evaluation expenditures	12	1,807	-
Depreciation, depletion and amortization		13,111	5,885
Impairment charge	12,13	8,983	-
Payment of royalties		-	(78)
Loss on disposal of assets		96	-
Fair value loss on derivative financial instrument		625	24
Gain on previously held interest in SSEC	25	(27,381)	-
Loss on settlement of pre-existing loan relationship	25	24,423	-
Listing expenses		-	351
Net unrealised foreign exchange (gain)		(72)	(75)
Loss from jointly controlled entity		722	634
Deferred revenue		(611)	(663)
Other operating income		(7,375)	-
Net change in non-cash working capital	27	(664)	(2,792)
Net cash used in operating activities		<u>(12,558)</u>	<u>(16,824)</u>
Cash flow from investing activities			
Interest received		138	61
Expenditure on exploration and evaluation assets		(11,633)	(31,688)
Expenditures on property, plant and equipment		(30,269)	(6,605)
Investment in restricted cash		(1,277)	(356)
Acquisition of subsidiary, net of cash received		(6,785)	-
Payments made on behalf of jointly controlled entity		(18,292)	(14,070)
Movement in advances to construction contractors		2,490	(3,298)
Movement in value added tax receivable		(2,982)	(4,148)
Net change in non-cash working capital	27	682	3,461
Net cash used in investing activities		<u>(67,928)</u>	<u>(56,643)</u>
Cash flow from financing activities			
Investment in jointly controlled entity		(1,113)	-
Proceeds from issuance of long-term borrowings	20	2,393	1,840
Repayment of long-term borrowings	20	(642)	(4,974)
Interest paid on long-term borrowings and other non-current payables		(356)	(1,036)
Non-current other payables	21	(284)	(296)
Proceeds from issuance of equity, net of issue costs	23	12,109	149,770
Net cash generated from financing activities		<u>12,107</u>	<u>145,304</u>
Effects of exchange rate changes on cash and cash equivalents		(10)	1
Net decrease in cash and cash equivalents		<u>(68,389)</u>	<u>71,838</u>
Cash and cash equivalents at beginning of the year		79,135	7,297
Cash and cash equivalents at end of the year		<u>10,746</u>	<u>79,135</u>

The notes on pages 8 to 61 form part of these consolidated financial statements.

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Notes to Consolidated Financial Statements

(tabular amounts in thousands of US dollars)

1 General information

The principal executive office of Tethys Petroleum Limited and its subsidiaries (collectively “Tethys” or “the Company”) are in Guernsey, British Isles. The domicile of Tethys Petroleum Limited is the Cayman Islands, 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 exploration 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. On July 25, 2011 the Company was admitted to the London Stock Exchange with respect to a Standard Listing. Costs associated with the Standard Listing are disclosed as listing expenses in the consolidated statement of comprehensive income. The comparative 2010 costs relate to the proposed Hong Kong Stock Exchange listing that was subsequently abandoned.

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 profit and 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.

These consolidated financial statements have also been prepared in accordance with the requirements of the Disclosure and Transparency Rules (‘DTR’) of the Financial Services Authority (‘FSA’) in the United Kingdom.

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 are presented in United States Dollars (‘USD’ or ‘\$’). Foreign operations are included in accordance with the policies set out in this note.

Going concern

The directors have considered the Company’s current activities, funding position and projected funding requirements for the period of at least twelve months from the date of approval of the consolidated financial statements, in concluding whether it is appropriate to adopt the going concern basis in preparing the consolidated financial statements for the year ended 31 December 2011. The Company’s activities, together

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(tabular amounts in thousands of US dollars)

with the factors likely to affect its future development, performance and position are set out in the Annual Information Form and Management Discussion & Analysis document. The key issues impacting the cash flows of the Company are the commissioning of the AOT rail terminal due at the beginning of April and receipt of the USD5 million Kazakh bank facility. The financial position of the Company, its cash flows and liquidity position are as set out in the Management Discussion & Analysis document on pages 23 to 26 and in Note 20 to these consolidated financial statements. The Company reports a loss for the year ended 31 December 2011 of USD26.989 million (2010: USD29.649 million). As at 29 February 2012, the Company held cash of USD6.7 million.

The AOT rail terminal at Shalkar has been completed and will allow the Company to increase shipments. Once approved by the local State Commission. The Company believes that the increased oil sales resulting from the production of 4,000 – 6,000 bopd, will generate sufficient levels of cash to fund its ongoing activities and its current capital expenditure plans. Completion of this terminal was originally anticipated to be in the fourth quarter of 2011 but due to adverse weather this was moved back to the first quarter of 2012 and is now due to be commissioned at the beginning of April.

Existing oil operations were disrupted as a result of severe winter weather conditions in Kazakhstan which reduced the sales revenue and so the cash available to the Company. In December 2011 the Company was committed to meet the balloon payments of USD0.7 million due on the expiring Tykhe rig loan and then in the first quarter of 2012 the loans associated with the Uzbekistan NU116 well, drilled in late 2009, were due for settlement with USD4.1 million due in January 2012 and USD3.4 million in March 2012. The Company settled USD1.05 million of the USD4.1 million loan in December 2011 and the remaining funds then rolled over into the new equipment secured loan (see below). All other loan balances were settled on the due dates.

To assist with these commitments, the Company put in place a loan secured against drilling equipment. The total amount of the loan is USD10 million and the first tranche of USD4 million was completed in December 2011, the second tranche of USD3.2 million was completed in February and of the final tranche of USD2.8 million, USD2.3 million has been received and USD0.5 million has been committed.

While as stated above, management is confident that, with the increased production levels at 4,000 – 6,000 bopd, the Company will have sufficient funding for its ongoing activities and its current capital expenditure plans, it is aware that until the terminal is fully commissioned additional funds may be necessary to meet planned outflows. The Company has a number of options with respect to capital expenditure and can defer, delay or cancel several planned capital items. Given the low level of committed capital expenditure, the Directors believe that the Company has sufficient funds but would like to progress other activities if funding allows. For this reason, the Company is exploring a number of alternative funding arrangements including discussions which are close to being finalised with the Company's Kazakh bank with regard to a USD5 million loan facility. In addition, the Company would also like to fund a further USD8 – 10 million of seismic work in Tajikistan, in order to finalise the location of the first deep sub-salt well. This is not a contractual commitment but the Company would like to advance its programme which should assist with bringing in a suitable farm-in partner to fund the drilling of the deep well. The Company is currently adopting a prudent approach to cash management and will proceed with such projects when certain milestones have been met. Discussions have also been initiated with regard to reserve based lending and on other corporate and project related financing options.

With regard to longer term requirements, 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. As at the date of this report, the Company is in discussions with several parties with regard to a potential farm in and/or joint ventures.

The Directors have examined these issues to form a view on the Company's ability to realise its assets and discharge its liabilities in the normal course of business. After making enquiries and considering the

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(tabular amounts in thousands of US dollars)

circumstances referred to above, the Directors have a reasonable expectation that the company has adequate resources and potential to continue operations for at least the next twelve months. For these reasons they continue to adopt the going concern basis of accounting in preparing the consolidated financial statements.

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 presentation

From 1 January 2011, the Company started to present business development expenses and share-based payments separately in the consolidated statement of comprehensive income. The comparative information has been reclassified to conform to the current presentation. Business development expenses are costs associated with identifying new business opportunities for the Company either within countries in which the Company is currently operating, or in new countries. Consequently, management believes that due to the nature of these costs, which were incurred in Afghanistan and Uzbekistan in 2010 and 2011, this presentation provides more relevant and meaningful information about the financial performance of the Company.

New and amended accounting standards adopted by the Company

There were no significant new or amended standards introduced for the current accounting year relevant for the Company for these financial statements.

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, 2012 or later periods, but the Company has not early adopted them:

- IFRS 9 'Financial instruments' – issued in November 2009. This standard is the first step in the process to replace IAS 39, '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, 2015 but is available for early adoption. This standard will have no impact on the Company's consolidated financial statements as currently reported.

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(tabular amounts in thousands of US dollars)

- IFRS 10 'Consolidated Financial Statements' – issued in May 2011. This standard is part of a new suite of standards on consolidation and related standards, replacing the existing accounting for subsidiaries and joint ventures (now joint arrangements), and making limited amendments in relation to associates. It supersedes IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities' (SPEs). It provides a single model to be applied in the control analysis for all investees, including entities that currently are SPEs in the scope of SIC-12. This standard is not applicable until January 1, 2013. The amendments will not result in a material impact on the Company's consolidated financial statements.
- IFRS 11 'Joint Arrangements' – issued in May 2011. This standard is part of a new suite of standards on consolidation and related standards, replacing the existing accounting for subsidiaries and joint ventures (now joint arrangements), and making limited amendments in relation to associates. All parties to a joint arrangement are within the scope of IFRS 11. IFRS 11 carves out from IAS 31 'Interests in Joint Ventures', those cases in which there is a separate vehicle but that separation is overcome by form, contract or other facts and circumstances. It also removes the choice of equity or proportionate accounting for jointly controlled entities. Although this standard is not applicable until January 1, 2013 and is not available for early adoption, the Company has considered the potential impact this standard will have on the accounting for existing jointly controlled entities. There will be no impact as the Company will still be able to account for its existing joint arrangements under equity accounting.
- IFRS 12 'Disclosure of Interests in Other Entities' – issued in May 2011. This standard is part of a new suite of standards on consolidation and related standards, replacing the existing accounting for subsidiaries and joint ventures (now joint arrangements), and making limited amendments in relation to associates. It contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities. This standard is not applicable until January 1, 2013 and will not result in a material impact to the Company's consolidated financial statements.
- IFRS 13 'Fair Value Measurement' – issued in May 2011. There is a new standard to replace existing guidance on fair value measurement in different IFRSs with a single definition of fair value, a framework for measuring fair values and disclosures about fair value measurements. The standard applies to assets, liabilities and an entity's own equity instruments that, under other IFRSs are required or permitted to be measured at fair value or when disclosure of fair value is provided. This standard is not applicable until January 1, 2013 and will not result in a material impact to the Company's consolidated 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.

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Notes to Consolidated Financial Statements

(tabular amounts in thousands of US dollars)

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 consolidated 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 consolidated statement of comprehensive income 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 consolidated statement of financial position. The deferred gain is recognised in the consolidated statement of comprehensive income when the asset is resold or, where 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 that make strategic decisions.

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(tabular amounts in thousands of US dollars)

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'), translated into USD where relevant. These 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 USD 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 consolidated statement of comprehensive income.

Oil and gas exploration and evaluation expenditure

Oil and natural gas exploration and evaluation expenditures are accounted for using the '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. All other associated exploration and evaluation expenditures are carried forward as an intangible asset in the consolidated 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 intangible assets are tested for impairment and transferred to appraisal and development tangible assets i.e. Property, Plant and Equipment ('PPE'). No depreciation and/or amortisation is charged during the exploration and evaluation phase.

Test production and the appraisal and development phase

Test production is production that is generated in the appraisal and development phase before commercial discovery of oil is officially recognised. Revenue generated from test production is credited against the cost of the well until commercial and technical feasibility is established and the project is deemed to have crossed over into the production phase. Revenue and costs generated from a field classified as operating in the production phase is recorded through the income statement.

Oil and gas properties in the production phase

Oil and gas properties within PPE are stated at cost, less accumulated depreciation and accumulated impairment losses.

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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.

Once 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 consolidated statement of comprehensive income.

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

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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 consolidated statement of comprehensive income 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 consolidated statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are

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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.

Restricted cash

Non-current restricted cash comprises 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 consolidated statement of comprehensive income.

Current restricted cash comprises amounts held on deposit with respect to a foreign currency hedge (note 20.4).

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 consolidated 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 the consolidated statement of comprehensive income.

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 consolidated

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statement of comprehensive income 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 consolidated statement of comprehensive income.

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.

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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 the 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 consolidated statement of comprehensive income, 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.

Warrants

Warrants issued to loan holders are regarded as derivative instruments, with a fair value at inception representing the value attributable to the option to convert the warrants into equity of the Company.

IAS 32.11 'Financial Instruments Presentation' states that a derivative contract that will be settled by the equity receiving or delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. It also states that a contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability.

For warrants issued to loan holders by the Company, where there is a difference between the currency in which shares of the parent company are denominated and the functional currency of the Company, the option to convert the warrants is recorded as a derivative liability because it is not a contract to exchange a fixed number of shares for a fixed amount of US dollars. The derivative liability component is separately identified and measured at fair value through the consolidated statement of comprehensive income.

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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 consolidated statement of comprehensive income, 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 and oil sales is recognized when it 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. In Kazakhstan, gas is sold under a two year take or pay contract. Under IFRIC 4 the economic substance of the transaction is considered, despite the absence of a specific lease contract. Implicitly the sales contract gives the customer specific use of gas assets as they take all gas produced by the Akkulka and Kyzylol fields, therefore the revenue from Kazakh gas sales is recognised under IAS 17 'Leases', on a production basis over the lease term. 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

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during the period. All other borrowing costs are recognised in the consolidated statement of comprehensive income 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 consolidated statement of comprehensive income 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. 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 consolidated statement of comprehensive income. 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.

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 through the consolidated statement of comprehensive income.

Amortised Cost

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.

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The Executive Board of Directors has overall responsibility for the Company's management of risk, including the identification and analysis of risks faced by the Company and the consideration of controls that monitor changes in risk and minimise risk wherever possible.

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 loans receivable from jointly controlled entities, 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 2011 \$'000	December 31 2010 \$'000
Trade receivables	837	1,661
Cash and cash equivalents	10,746	79,135
Restricted cash	2,292	1,015
Loans receivable from jointly controlled entities	2,013	35,460
	<u>15,888</u>	<u>117,271</u>

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 these customers 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, 2011 the trade receivable amounted to \$836,837 (2010 - 1,661,015), 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 made use of three 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 majority of counterparty banks used are those with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors). Banks used in Central Asia generally do not have credit ratings assigned by international ratings agencies, however deposits held with these banks are kept to a minimum as far as possible.

The Company is exposed to credit risk in relation to its loans receivable from jointly controlled entities to the extent that the jointly controlled entities fail to meet their contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loans receivable represents the maximum exposure to credit risk at each balance sheet date.

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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, 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 following are the contractual maturities of financial liabilities, including estimated interest payments:

December 31, 2011	Carrying amount	Contractual cash flows	Less than 1 year	1-3 years	4-5 years	Thereafter
Non-derivative financial liabilities	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Trade and other payables	10,726	11,108	10,289	437	382	-
Financial liabilities - borrowings (note 20)	10,028	11,029	9,537	1,492	-	-
	<u>20,754</u>	<u>22,137</u>	<u>19,826</u>	<u>1,929</u>	<u>382</u>	<u>-</u>

December 31, 2011	Carrying amount	Contractual cash flows	Less than 1 year	1-3 years	4-5 years	Thereafter
Derivative financial liabilities	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Foreign currency hedge contracts	157	157	157	-	-	-

The gross cash outflows disclosed in the above table represent the contractual undiscounted cash flows relating to derivative financial liabilities held for risk management purposes and which are not usually closed out prior to contractual maturity. The disclosure shows expected out flow amounts for derivatives that have simultaneous gross cash settlement. These derivatives are foreign currency put options with a clause requiring conversion to a forward should a barrier of 1.5675 be breached. The cash flows may be different from the recorded amount depending on movements in the USD/GBP foreign exchange rate. Should the foreign exchange rate on the date of expiry be above 1.5675 then no payment would be required. Should the rate be above 1.6495 then the options could be exercised at a gain.

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December 31, 2010	Carrying amount	Contractual cash flows	Less than 1 year	1-3 years	4-5 years	Thereafter
Non-derivative financial liabilities	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Trade and other payables	9,509	10,020	8,917	567	536	-
Financial liabilities - borrowings (note 20)	7,900	8,801	1,046	7,755	-	-
	17,409	18,821	9,963	8,322	536	-

December 31, 2010	Carrying amount	Contractual cash flows	Less than 1 year	1-3 years	4-5 years	Thereafter
Derivative financial liabilities	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Foreign currency hedge contracts	-	-	-	-	-	-

It is not expected that the cash flows included in the maturity schedule could occur significantly earlier, or at significantly different amounts.

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 Kyzylol 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.

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Any material decline in oil product prices could result in a reduction of the Company's oil revenues in both Uzbekistan and Kazakhstan.

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 100 basis points in the interest rate would have had a change of \$305,365 in the interest earned in the current year (2010 - \$207,746).

As at the reporting date the Company's interest rate profile was:

	Fixed rate financial instruments \$'000	Variable rate financial instruments \$'000	Total \$'000
At December 31, 2011			
Cash and cash equivalents	3,465	7,281	10,746
Financial liabilities - borrowings	(10,028)	-	(10,028)
Interest rate swap	630	-	630
	<u>(5,933)</u>	<u>7,281</u>	<u>1,348</u>
	Fixed rate financial instruments \$'000	Variable rate financial instruments \$'000	Total \$'000
At December 31, 2010			
Cash and cash equivalents	5,000	74,135	79,135
Financial liabilities - borrowings	(7,900)	-	(7,900)
Interest rate swap	1,472	-	1,472
	<u>(1,428)</u>	<u>74,135</u>	<u>72,707</u>

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

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Company also attempts to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan.

During the year, the Company used an exchange rate derivative to manage its risk as a result of the significant exchange rate fluctuation of the USD against GBP (note 20.4).

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 at December 31, 2011	CAD '000	GBP '000	EUR '000	KZT '000
Cash and cash equivalents	137	810	62	1,647
Trade and other receivables	-	31	42	12,651
Trade and other payables	-	(229)	-	(4,187)
Financial liabilities - borrowings	-	(433)	-	-
Net exposure	137	179	104	10,111

In US\$ equivalent at December 31, 2010	CAD '000	GBP '000	EUR '000	KZT '000
Cash and cash equivalents	1,201	1,123	60	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	6,524

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.

2011 Effect in US\$'000	CAD	GBP	EUR	KZT
Profit or (loss) before tax	14	18	10	1,011
2010 Effect in US\$'000				
Profit or (loss) before tax	120	72	8	652

A 10% strengthening of the US dollar against the currencies above at December 31, 2011 would have had an equal but opposite effect on the amounts shown above, assuming all other variables remained constant.

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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.

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	2011 \$'000	2010 \$'000
Total financial liabilities - borrowings (Note 20)	10,028	7,900
Less: cash and cash equivalents	(11,631)	(79,135)
Net (funds) / debt	(1,603)	(71,235)
Total equity	237,880	239,523
Total capital	236,277	168,288

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 hierarchy

The tables below analyse financial instruments carried at fair value by valuation method. The different levels have been defined as follows:

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.

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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.

December 31, 2011	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Interest rate swap (note 20.3)	-	-	630	630
Total assets	-	-	630	630
Warrants (note 20.2)	-	264	-	264
Foreign currency hedge (note 20.4)	-	157	-	157
Total liabilities	-	421	-	421

December 31, 2010	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Interest rate swap (note 20.3)	-	-	1,472	1,472
Total assets	-	-	1,472	1,472
Warrants (note 20.2)	-	405	-	405
Total liabilities	-	405	-	405

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

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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 December 31 2011, considered circumstances relating to its property plant and equipment and intangible and exploration and evaluation assets and concluded that the further decline in production from the North Urtabulak field to be an indicator of impairment. A impairment test was performed as detailed in notes 12 and 13.

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.

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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 consolidated 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 Kyzylai and Akkulka fields and is undertaking exploration and evaluation activity in the 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. 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 according to operational requirements.

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The segment results for the year ended December 31, 2011 are as follows:

	Kazakhstan	Tajikistan	Uzbekistan	Other and Corporate	Consolidated
	\$'000	\$'000	\$'000	\$'000	\$'000
Gas sales	7,027	-	-	-	7,027
Oil sales	8,130	55	-	-	8,185
Refined product sales	-	-	7,255	-	7,255
Other income	260	-	195	-	455
Other operating income	-	-	-	9,246	9,246
Segment revenue and other income	15,417	55	7,450	9,246	32,168
Inter-segment revenue	(-)	-	-	(1,871)	(1,871)
Segment revenue and other income from external customers	15,417	55	7,450	7,375	30,297
Loss from jointly controlled entity	-	(722)	-	-	(722)
(Loss)/ profit before taxation	(7,563)	2,650	(7,843)	(16,180)	(28,936)
Taxation	1,105	-	843	(1)	1,947
Net (loss)/profit attributable to shareholders	(6,458)	2,650	(7,000)	(16,181)	(26,989)

Sales in the Kazakhstan segment were made to two customers. Sales to those customers representing greater than 10% of total segment revenue were \$7,027,105 and \$8,130,464. Sales in the Uzbekistan segment were to three customers. Sales to two of those customers representing greater than 10% of total segment revenue were \$2,387,530 and \$4,160,777 respectively.

The profit of the Tajik segment was as a result of the net fair value gain arising on the acquisition of Seven Stars Energy Corporation ('SSEC') as detailed in note 25.

Borrowing costs of \$973,506 were incurred during the year. These borrowing costs were capitalised in the Kazakhstan segment.

Amortisation of \$506,120 of assets held in the Corporate segment were capitalised in Kazakhstan.

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Segment results for the year ended December 31, 2010 were as follows:

	Kazakhstan \$'000 re-presented	Tajikistan \$'000 re-presented	Uzbekistan \$'000 re-presented	Other and Corporate \$'000 re-presented	Consolidated \$'000 re-presented
Gas sales	3,767	-	-	-	3,767
Oil sales	748	-	-	-	748
Refined product sales	-	-	9,851	-	9,851
Other income	340	-	-	-	340
Segment revenue and other income from external customers	4,855	-	9,851	-	14,706
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 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.

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The segment assets and liabilities as at December 31, 2011 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	148,844	78,158	7,702	28,687	263,391
Total liabilities	8,074	1,811	4,000	11,626	25,511
Cash expenditure on exploration & evaluation assets, property, plant and equipment	37,020	880	3,772	230	41,902
Depreciation, depletion & amortization	9,418	77	1,058	2,558	13,111

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of \$409,985.

Total assets and liabilities for Tajikistan include the underlying assets of Seven Stars Energy Corporation ('SSEC') and its subsidiaries.

The segment assets and liabilities 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, in the form of a loan (note 17).

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of \$546,982.

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6 Sales and other operating revenues

	Year ended	
	December 31, 2011 \$'000	December 31, 2010 \$'000
Gas sales	7,027	3,767
Oil sales	8,185	748
Refined product sales	7,255	9,851
Other revenue	455	340
	<u>22,922</u>	<u>14,706</u>

Revenue has been grossed up for non-monetary transactions, namely utility services of \$707,018 provided with respect to Uzbekistan (2010: \$809,417). The corresponding expenses are shown within production expenses.

7 Other operating income

	Year ended	
	December 31, 2011 \$'000	December 31, 2010 \$'000
Other operating income	7,375	-
	<u>7,375</u>	<u>-</u>

During 2010 and 2011, a drilling rig together with associated equipment, all owned by the Company, was rented to a subsidiary of Seven Stars Energy Corporation ('SSEC') on commercial terms. In accordance with the shareholders agreement, the amounts receivable on respect of the rental are to be added to the loan due from that entity. When preparing the 2010 annual financial statements and the interim financial statements for Q1 2011 these amounts were eliminated in full rather than proportionate to the Company's equity accounted interest, and no income was recognised. Following progress made on the EOL09 well as set out in more detail on page 9 of the Management's Discussion and Analysis document the directors reconsidered this matter and considered it appropriate that the income be included for the period to December 13, 2011 – the date that SSEC became a subsidiary (note 16).

Accordingly, other operating income for the period to December 13, 2011 includes \$7,374,090 in respect of these transactions, of which \$3,835,320 relates to the year ended December 31, 2010. The invoices have not been settled and there is consequently no impact on the Company's cash flows. There is also no impact on tax expense as a result of this income being recognised.

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8 Administrative expenses

Administrative expenses by nature	Year ended	
	December 31, 2011 \$'000	December 31, 2010 \$'000
Staff expenses	8,751	8,741
Travel expenses	3,700	3,380
Professional fees	2,653	2,577
Office costs	2,634	2,080
Other administrative expenses	2,811	2,742
	<u>20,549</u>	<u>19,520</u>

Key management personnel have been identified as the Board of Directors and ten vice presidents. Details of key management remuneration are shown in note 26.

9 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% (2010: 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.

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.

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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, 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
Outstanding at January 1, 2011	22,263,000	1.65
Granted	6,720,000	0.78
Forfeited	(40,000)	1.56
Exercised	-	n/a
Expired	(20,000)	1.56
Outstanding at December 31, 2011	28,923,000	1.45
Exercisable at December 31, 2011	20,791,000	1.58

In 2010, the weighted average share price at the date of exercise was \$1.62. No options were exercised during 2011.

The following table lists the options outstanding at December 31, 2011 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	2.60	4,603,000	2.60
CAD0.66	6,120,000	2.64	2,040,000	2.64
0.80	3,428,000	3.00	2,272,000	3.00
0.88	120,000	2.84	120,000	2.84
CAD1.60	4,050,000	3.80	2,700,000	3.80
CAD1.72	240,000	4.22	80,000	4.22
2.00	360,000	4.13	120,000	4.13
2.10	3,438,000	3.27	2,292,000	3.27
2.50	2,334,000	3.57	2,334,000	3.57
2.75	4,170,000	2.52	4,170,000	2.52
3.18	60,000	1.11	60,000	1.11
Total	28,923,000	3.00	20,791,000	3.00

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The fair value of the share-based payment grants is estimated using the Black-Scholes pricing model using the following average assumptions:

	December 31, 2011	December 31, 2010
Weighted average fair value	\$0.2825	\$0.9242
Risk free rate	1.6%	1.25%
Expected term	2 years	3 years
Volatility	71.6%	112.8%
Dividend	Nil	Nil
Weighted average share price of options exercised in year	-	CAD1.45

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.

Warrants

The following table summarizes the warrant activity for the years ended December 31, 2011 and December 31, 2010.

	Number of warrants	Weighted average exercise price \$
Outstanding at January 1 and December 31, 2010	7,504,003	5.25
Exercisable at December 31, 2010	7,504,003	5.25
Outstanding at January 1, 2011	7,504,003	5.25
Expired	(2,255,835)	5.50
Outstanding at December 31, 2011	5,248,168	5.14
Exercisable at December 31, 2011	5,248,168	5.14

Of the warrants outstanding and exercisable at the end of the year, 3,748,168 relate to warrants granted to the Company's officers.

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.

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The following table lists the warrants outstanding at December 31, 2011 by exercise price.

Exercise price \$	Warrants outstanding	Weighted average remaining term (in years)	Warrants exercisable	Weighted average remaining term (in years)
2.50	2,090,000	5.44	2,090,000	5.44
6.88	3,158,168	0.99	3,158,168	0.99
Total	5,248,168	2.76	5,248,168	2.76

As at December 31, 2011, there was no unrecognized expense related to unvested warrants.

10 Taxation

Tethys is domiciled in the Cayman Islands which has no Company income tax. The Group also operates in other tax jurisdictions, the most significant of which is Kazakhstan where the tax rate is 20%.

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	December 31, 2011 \$'000
Within one year	-	-	-
One to five years	226	-	226
After five years	-	3,731	3,731
No expiry date	-	-	-
	226	3,731	3,957

The temporary differences comprising the net deferred income tax liability as at December 31, 2011 are as follows:

	December 31, 2011 \$'000	December 31, 2010 \$'000
Capital assets	2,937	5,107
Tax losses	(969)	(1,048)
Other	143	11
Net deferred tax liability	2,111	4,070

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The provision for income taxes is different from the expected provision for income taxes for the following reasons:

	Year ended	
	December 31, 2011 \$'000	December 31, 2010 \$'000
Loss before income taxes	(28,936)	(26,178)
Income tax rate	20%	20%
Expected income tax (recovery)	(5,787)	(5,236)
<i>Increase/ (decrease) resulting from:</i>		
Non-deductible expenses	68	(17)
Impact of effective tax rates in other foreign jurisdictions	2,177	2,525
Reversal of tax losses recognised in prior periods	-	3,638
Losses and tax assets not utilised/recognised	1,629	2,466
Other	(34)	95
	(1,947)	3,471
Deferred tax (benefit) / expense	(1,947)	3,471

11 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, 2011			
Loss attributable to ordinary shareholders – Basic and diluted	(26,989)	262,272	(0.10)
Year ended December 31, 2010			
Loss attributable to ordinary shareholders – Basic and diluted	(29,649)	196,047	(0.15)

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.

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12 Intangible assets

	Other intangible asset	Exploration and evaluation assets	Total
	\$'000	\$'000	\$'000
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)
	4,560	12,332	16,892
Closing net book amount			
At December 31, 2010			
Cost	5,553	12,332	17,885
Accumulated amortisation	(993)	-	(993)
Net book amount	4,560	12,332	16,892
Year ended December 31, 2011			
Opening net book amount	4,560	12,332	16,892
Additions	-	12,737	12,737
Additions through acquisition of subsidiary (note 25)	-	75,096	75,096
Impairment charge	(2,695)	-	(2,695)
Unsuccessful exploration and evaluation expenditure	-	(1,807)	(1,807)
Amortisation	(264)	-	(264)
	1,601	98,358	99,959
Closing net book amount			
At December 31, 2011			
Cost	5,553	98,358	103,911
Accumulated amortisation and impairment	(3,952)	-	(3,952)
Net book amount	1,601	98,358	99,959

Transfers to property, plant & equipment in 2010 consists of the transfer of exploration expenditure related to the Akkulka Deep oil field following the establishment of proved reserves at the year end.

Other intangible assets consist of the fair value of the licence relating to the Production Enhancement Contract ('PEC') for the North Urtabulak field. Amortisation 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 loss

During 2011, due to the further decline in production from the North Urtabulak field, management assessed the recoverable amount of this cash-generating unit (CGU) which is a reportable segment "Uzbekistan". The recoverable amount of the CGU was estimated based on its value in use. Based on the assessment, the carrying

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amount of assets was determined to be \$8,982,793 higher than its recoverable amount, and an impairment loss was recognised (see below).

The impairment loss was allocated pro-rata to the individual assets constituting the CGU as follows:

In \$'000	Original carrying amount	Loss in 2011	Carrying amount after impairment recognised
Intangible assets	4,296	2,695	1,601
Property, plant and equipment (see note 13)	10,765	6,288	4,477
	15,061	8,983	6,078

Key assumptions used in discounted cash flows projection calculations

The value in use calculation is based on assumptions in respect of projections of cash flows approved by management. The cash flow forecast covers the period until 2017.

- Management determined future production based on current production and decline rates and new production to be generated from workovers of 4 wells, using a water flooding technique.
- Sales price growth is assumed to be in line with inflation of 2.5% for the next six years in line with information obtained from external data of forecast growth rates in the Central Asia region.
- Operating costs per barrel in 2012 are based on management's budget and are assumed to increase in line with inflation for the next five years.
- General and administrative costs are projected to reduce in 2013 when it is expected that current project resources will be diverted to new licences in the country.
- The estimate of value in use was determined using a post-tax discount rate of 10%. The discount rate is an estimate which is based on a range of current borrowing costs of Uzbekistan operations and the interest rate at which the Company raised original funds to purchase assets in Uzbekistan.

Sensitivity to changes in assumptions

Management identified one key assumption for which there could be a reasonably possible change that could cause an additional impairment to be recognised. A 10% reduction in projected production volume per year would increase the total impairment calculation from \$8,982,793 to \$10,547,358. This would increase the impairment of the intangible assets and property, plant and equipment by \$469,370 and \$1,095,195 respectively.

Additions through acquisition of subsidiary relate to the intangible assets acquired from SSEC (note 25), including a fair value uplift arising on acquisition of \$8,784,664.

Borrowing costs of \$333,033 (2010 – \$1,943,533) have been capitalised within exploration and evaluation assets during the year. The effective weighted average interest rate of the relevant borrowings was 12% (2010 – 17%).

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The effective interest rate is higher than the nominal rate due to the cost of associated warrants (Note 20.2) and royalties (Note 20.3). For the year ended December 31, 2011 \$520,595 (2010 - \$273,535) was capitalised from staff costs and share-based payment expense.

13 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, 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
Year ended December 31, 2011					
Opening net book amount	90,926	22,123	1,248	1,356	115,653
Additions	30,280	166	813	319	31,578
Additions through acquisition of subsidiary	1,693	-	99	76	1,868
Disposals	-	-	(432)	(218)	(650)
Impairment charge	(6,288)	-	-	-	(6,288)
Depreciation	(9,732)	(2,765)	(883)	(424)	(13,804)
Accumulated depreciation on disposal	-	-	408	153	561
Closing net book amount	106,879	19,524	1,253	1,262	128,918
At December 31, 2011					
Cost	133,322	25,337	2,260	1,978	162,897
Accumulated depreciation	(26,443)	(5,813)	(1,007)	(716)	(33,979)
Net book amount	106,879	19,524	1,253	1,262	128,918
Asset under construction at net book amount included in above					
At December 31, 2011	19,613	-	-	-	19,613
At December 31, 2010	26,612	-	-	-	26,612

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Assets under construction as at December 31, 2011 and December 31, 2010 includes the cost of developing the Akkulka oil concession and are not being depreciated until commencement of production.

Management assessed the recoverable amount of the North Urtabulak cash-generating unit (CGU) following a further decline in production and recorded an impairment adjustment of \$6,287,955. Full details of the impairment test and sensitivities are disclosed in note 12.

Borrowing costs of \$640,473 have been capitalised to oil and gas properties in the current year (2010 - \$nil). The effective weighted average interest rate of the relevant borrowing was 12%, (2010 - 17%). The effective interest rate is higher than the nominal rate due to the cost of associated warrants (note 20.2). For the year ended December 31, 2011 \$1,225,911 (2010 - \$1,238,327) was capitalised from staff costs and share-based payment expense.

14 Restricted Cash

Non Current

	December 31, 2011 \$'000	December 31, 2010 \$'000
Restricted cash	1,407	1,015

Restricted cash consists of interest bearing bank deposits held in Kazakhstan. These deposits have been placed to satisfy local Kazakhstan requirements in respect of asset retirement obligations.

Current

	December 31, 2011 \$'000	December 31, 2010 \$'000
Restricted cash	885	-

Restricted cash consists of monies placed on temporary deposit as a security against a foreign currency hedge, corporate credit cards and a deposit with the Ministry of Finance in Dubai as fixed term deposits with banks.

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15 Trade and other receivables

	December 31, 2011 \$'000	December 31, 2010 \$'000
Other receivables - non-current		
Advances to construction contractors	1,140	3,631
Value added tax receivable	9,077	8,689
	<u>10,217</u>	<u>12,320</u>
Current		
Trade receivables	837	1,661
Prepayments	999	1,092
Other receivables	974	927
Value added tax receivable	2,668	-
	<u>5,478</u>	<u>3,680</u>

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, 2010 – \$nil). 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.

16 Loan receivable from jointly controlled entities

Joint Venture – Seven Stars Energy Corporation

As disclosed in note 24, on December 13, 2011 a wholly owned subsidiary of the Company increased its investment in the ordinary shares of SSEC, whereupon SSEC became a subsidiary and its assets and liabilities were consolidated into the Company's financial statements.

The Company has a loan receivable from SSEC, which up until the date of acquisition was net of the 51% share of loss of the joint venture as calculated using the equity method of accounting. Following the increase in investment and the subsequent consolidation of SSEC into the Company's consolidated financial statements, the loan is eliminated on consolidation.

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The following amounts represent the movements in the loan receivable from January 1 to December 13 2011 and January 1 to December 31, 2010

	December 13, 2011 \$'000	December 31, 2010 \$'000
Balance, beginning of year	35,460	21,727
Share of loss	(722)	(634)
Finance income on loan receivable	1,113	-
Movement in deferred gain	-	40
Increase in loan to jointly controlled entity	29,566	14,327
Removal of unrealised profit from SSEC	(5,706)	-
Loan balance pre-acquisition	59,711	35,460
Add back		
Investment as part of gain on disposal	5,706	
Cumulative losses from jointly controlled entity	1,355	
	66,772	
Loss on settlement of pre-existing relationship	(24,423)	
Settlement of pre-existing loan relationship	(42,349)	
Balance, end of year	-	35,460

The following tables represent the assets and liabilities of the SSEC Group at December 31, 2010 and its results for the year then ended:

	December 31, 2010 \$'000
Assets	
Non-current assets	44,446
Current assets	404
Total assets	44,850
Liabilities	
Non-current liabilities	(43,233)
Trade and other payables	(820)
Total liabilities	(44,053)
Net assets	797
	December 31, 2010 \$'000
Revenue	203
Expenses	(1,445)
Loss before tax	(1,242)
51% share of joint venture loss before tax	(634)

As of December 31, 2011, SSEC is no longer jointly controlled and its assets and liabilities are consolidated into the Company's consolidated financial statements.

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As with operating income (note 7), the Directors have given similar consideration to the position of interest on the loan to jointly controlled entity SSEC with the result that cumulative interest income of \$1,112,995 on the loan of \$65,658,931 as at December 13, 2011 has been recognised for the period from inception to December 13, 2011. Of this amount, \$420,489 relates to the year ended December 31, 2010. This change also has no effect on tax expense or cash flows.

Joint Venture – Aral Oil Terminal (Kazakhstan)

On February 16 2011, the Company signed a Joint Venture agreement with Olisol Investments Limited (note 17) to construct and operate a rail oil loading terminal in Kazakhstan through a separate jointly controlled legal entity, Aral Oil Terminal. The terminal will be used to deliver and sell oil for the Akkulka block. In conjunction with the Company's installation of oil production facilities at the Akkulka field to enable the processing of oil to refinery specification, the project at the Terminal will enhance operations by significantly reducing current trucking operations and enable production to be increased through the development of increased storage capacity and unloading/loading facilities.

The following amounts represent the movements in the loan receivable:

	Year ended December 31, 2011 \$'000
Balance, beginning of year	-
Finance income on loan receivable (at market rate)	13
Increase in loan to jointly controlled entity	2,000
Balance, end of year	<u>2,013</u>

17 Investment in jointly controlled entity

As discussed in note 16, the Company entered into a Joint Venture Agreement with Olisol Investments Limited under which it has a 50% interest in the jointly controlled entity Aral Oil Terminal. Investment in the joint venture was \$1,112,899. The Company's interest is equity accounted, with its 50% share of profit or loss in the jointly controlled entity added to / offset against its investment.

Summary financial information for Aral Oil Terminal is as follows:

	December 31, 2011 \$'000
Assets	\$'000
Non-current assets	3,898
Current assets	473
Total assets	<u>4,371</u>
Liabilities	
Trade and other payables	<u>(4,448)</u>
Total liabilities	<u>(4,448)</u>
Net liabilities	<u>(77)</u>

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	December 31, 2011 \$'000
Revenue	-
Expenses	-
Loss before tax	-
50% share of joint venture loss before tax	-

18 Inventories

	December 31, 2011 \$'000	December 31, 2010 \$'000
Raw materials	851	697
Refined product - Uzbekistan	1,076	1,424
Oil - Kazakhstan	98	-
	<u>2,025</u>	<u>2,121</u>

19 Cash and cash equivalents

	December 31, 2011 \$'000	December 31, 2010 \$'000
Cash at bank and in hand	7,281	28,501
Short-term deposits	3,465	50,634
	<u>10,746</u>	<u>79,135</u>

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.

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20 Financial liabilities

20.1 Borrowings

	Effective interest rate	Maturity date	December 31, 2011 \$'000	December 31, 2010 \$'000
Current				
Rig loans - Tykhe	19.2% p.a.	2011	-	1,000
New well loans - Uzbekistan	7% to 15.36% p.a.	2012	6,360	4,047
Rig loans – Option A	19.95% p.a.	2012	2,036	-
			<hr/> 8,396	<hr/> 5,047
Non-current				
New well loans - Uzbekistan	7% to 15.36% p.a.	2012	-	2,853
Rig loans – Option B	19.54% p.a.	2013	1,632	-
			<hr/> 1,632	<hr/> 2,853
			<hr/> 10,028	<hr/> 7,900

Financial borrowings were put in place to fund the drilling of well NU116 in Uzbekistan, to fund the acquisition of the Tykhe drilling rig and to assist in the financing of construction works.

The loan to fund Tykhe was repaid in full by December 2011 and the security over the shares of AOE Tykhe was lifted.

On October 19, 2009 the Company closed a loan financing for \$4.1million with a group of investors in connection with the drilling of well NU116 in Uzbekistan. A coupon of 10% per annum was due for the first two months, which was the expected drilling time of the well. Thereupon the lenders received a 6% per annum coupon and 6.25% of the revenue received by the Uzbek entity (Baker Hughes Cyprus Limited) from sales of the net production from the new well for every \$1 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 receives only the 6% per annum coupon on the funds invested. \$1.05 million of this loan was repaid early to enable the lenders to participate in the new loan secured against drilling equipment. The royalty entitlement was identified as an embedded derivative and required to be separated from the loan note. Accordingly the royalty entitlement has been accounted for as a derivative financial instrument – interest rate swap (note 20.3).

On December 14, 2009 in connection with the drilling of the above well NU116 in Uzbekistan, the Company approved the issue of loan notes to a maximum value of \$3 million 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, \$1m loan notes had been placed with a further \$2m 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. Accordingly the royalty entitlement has been accounted for as a derivative financial instrument – interest rate swap (note 20.3).

In December 2011 the Company closed on the first tranche of a maximum \$10 million loan facility amounting to US\$3,965,240, which is secured by the ZJ70 and ZJ30 rigs and other equipment. This facility gives lenders the choice of two methods of repayment designated Option A and Option B.

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Under Option A, which has a term of one year, lenders have the option to receive monthly repayments on an interest only basis followed by a single balloon repayment of the principal amount to be paid at the maturity date. Option B, which has a term of two years, gives lenders the right to receive equal monthly instalments, incorporating interest and capital, together with a single balloon repayment of half of the principal amount to be paid at the maturity date. These borrowings are held at amortized cost and their carrying amounts approximate to their fair value at the balance sheet date. The interest payable on the borrowed funds is 12% per annum under both options.

In addition, lenders were granted warrants to acquire ordinary shares of the borrower equal to half of each \$100,000 principal amount of the loan advanced to the Company. As at December 31, 2011, 1,982,620 such warrants have been granted to lenders. Under the \$10 million loan facility, a total of 5 million warrants are issuable.

Such warrants will be exercisable at a 25% premium to the price of the volume weighted average CAD price of the shares on the TSX for the 5-day period prior to the day the borrower receives the funds in its bank account. As at December 31, 2011, 1,982,620 warrants had been issued in connection with the first tranche of the loan. The Company has recorded a discount to the loan in the amount of \$232,746 based on the relative fair value of the warrants. The loan was then amortised using the effective rate interest method. Lenders have security over the shares of Imperial Oilfield Services Limited which has no other assets except the drilling rigs and associated equipment.

Based on the borrowing rates currently available to the Company for long term borrowings with similar terms and average maturities (19.82%), the fair value of the financial borrowings in relation to the drilling rig approximate their carrying value in comparative years. With respect to the loans to fund well NU116 in Uzbekistan, the fair value of the financial liabilities is \$6,282,075 (2010 – \$6,249,979).

20.2 Derivative financial instrument - warrants

	December 31, 2011 \$'000	December 31, 2010 \$'000
Balance, beginning of year	405	1,053
Issued during the year	233	-
Fair value loss / (gain)	(374)	1,815
Exercised during the year	-	(2,463)
Balance, end of year	264	405

The warrant liability represents the financial liability relating to share warrants where the shares 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 20.1.

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 profit and loss.

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The fair value of the liability is estimated using the Black-Scholes pricing model using the following average assumptions:

	December 31, 2011	December 31, 2010
Weighted average fair value	\$0.10	\$0.28
Exercise price	CAD0.77	CAD2.36
Risk free rate	0.92%	1.28%
Expected term	1.11 years	0.56 years
Volatility	56%	64%
Dividend	Nil	Nil

The following table summarizes the warrant activity for the years ended December 31, 2011 and December 31, 2010.

	Number of warrants	Weighted average exercise price \$
Outstanding at January 1, 2010	5,279,452	3.38
Exercised	(2,500,000)	0.60
Outstanding at December 31, 2010	2,779,452	2.36
Exercisable at December 31, 2010	2,779,452	2.36
Outstanding at January 1, 2011	2,779,452	2.36
Granted	1,982,620	0.79
Expired	(2,141,154)	2.80
Outstanding at December 31, 2011	2,620,918	0.79
Exercisable at December 31, 2011	2,620,918	0.79

Of the warrants outstanding and exercisable at the end of the year, 307,620 relate to warrants granted to the Company's officers.

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.

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The following table lists the warrants outstanding at December 31, 2011 by exercise price.

Exercise price \$	Warrants outstanding	Weighted average remaining term (in years)	Warrants exercisable	Weighted average remaining term (in years)
CAD0.58	100,000	1.97	100,000	1.97
CAD0.59	500,000	1.97	500,000	1.97
CAD0.62	632,620	1.16	632,620	1.16
CAD0.61	200,000	0.92	200,000	0.92
CAD0.64	225,000	1.62	225,000	1.62
CAD0.65	325,000	0.94	325,000	0.94
CAD1.25	638,298	0.20	638,298	0.20
Total	2,620,918	1.11	2,620,918	1.11

20.3 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 20.1 completed in 2009. This instrument is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through profit and loss. 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 2010, 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.

	December 31, 2011 \$'000	December 31, 2010 \$'000
Balance, beginning of year	1,472	(95)
Derivative financial instrument entered into	-	(918)
Fair value (loss) / gain	(842)	2,407
Royalty payments	-	78
Balance, end of year	630	1,472

20.4 Derivative financial instruments – foreign currency hedge contracts

On May 12, 2011 the Company took out foreign currency hedge contracts to hedge exposure to the USD/GBP exchange rate. The contracts are in the form of a put option to sell US dollars with a strike price of 1.6495, with a clause that if a barrier level in the foreign currency exchange rate of 1.5675 is breached on the date of expiry, the option converts to a forward contract at the strike price of \$1.6495. The fair value of the foreign

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currency contract was calculated using a valuation technique based on observable market inputs. Should the foreign currency exchange rate on the date of expiry be above the barrier of 1.5675 then no settlement would be required. Should the USD/GBP foreign currency rate be above 1.6495 then the options could be exercised at a gain to the Company.

21 Trade and other payables

	December 31, 2011 \$'000	December 31, 2010 \$'000
Current		
Trade payables	6,065	5,672
Accruals	3,002	2,230
Other creditors	1,112	886
	<u>10,179</u>	<u>8,788</u>
Non-current		
Other non-current payables	<u>547</u>	<u>721</u>

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 Kyzylloi historical costs.

Included within other non-current payables are accruals for non-interest bearing historical costs due to the Government of Kazakhstan on the Kyzylloi and Akkulka contracts in Kazakhstan.

Kyzylloi

The principal amount of the historical cost liability outstanding at December 31, 2011 was \$389,916 (2010 – \$562,172) and this is to be repaid in quarterly instalments by March 2014. 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 \$344,692 (2010 – \$474,957) of which \$143,788 (2010 – \$130,265) is current. Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities (19.82%), the fair value of the liability approximates its carrying value (2010 – \$425,197).

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, 2011 was \$713,197 (2010: \$823,597) and this is to be repaid in quarterly instalments by June 2018. 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 \$375,990 (2010: \$400,248) of which \$30,051 (2010: \$24,258) is current.

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities (19.82%), the fair value of the liability approximates its carrying value (2010 - \$461,838).

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22 Asset retirement obligations

	Year ended	
	December 31, 2011	December 31, 2010
	\$'000	\$'000
At January 1	192	206
Additional obligations incurred	21	15
Additional obligations through acquisition of subsidiary	89	-
Change in estimated cash flow	63	(48)
Unwinding of discount due to passage of time	21	19
	<u>386</u>	<u>192</u>

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 5.4% (2010 – 10%) and discounted at 7.4% (2010 – 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, 2011 is \$472,281 (2010 - \$602,085).

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23 Capital and reserves

Share capital and share premium

		December 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 year for purchase of oil and gas equipment	360,000	36	287
Issued during the year in connection with finance charges	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
At January 1, 2011	260,629,769	26,063	297,222
Issued during the year for cash	26,062,975	2,606	9,503
At December 31, 2011	286,692,744	28,669	306,725

As at December 31 2011, a total of 31,115,572 (December 31, 2010 – 31,115,572) 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 9.

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;

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- 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.

There are currently no preference shares outstanding (2010 – None).

On December 9, 2011 the Company completed a private placement of 26,062,975 Ordinary Shares for gross proceeds of \$13,001,981 million. The net proceeds of the Offering were to enable Tethys to purchase an additional 34% of shares in SSEC and to carry out additional work on the Beshtentak oilfield in Tajikistan.

Other reserves

Other reserves comprise of option reserves and warrant reserves as set out in the Statement of Changes in Equity. The Option and Warrant Reserves relate to stock options and warrants issued to employees under the Long Term Incentive Plan, details of which are discussed in note 9.

24 Non-controlling interest

As a result of the transaction described in note 25 whereby the Company increased its interest from 51% to 85%, thereby gaining overall control of SSEC, a 15% non-controlling interest has arisen as follows:

	December 31, 2011 \$'000
Balance at December 13, 2011	-
Fair value of identifiable net assets	4,888
Fair value uplift arising from debt waiver	4,080
Share of loss for the period to December 31, 2011	(50)
Balance at December 31, 2011	<u>8,918</u>

25 Acquisition of subsidiary

Acquisition

On December 13, 2011 the Company obtained control of Seven Stars Energy Corporation Limited ('SSEC') by acquiring a further 34% of the shares and voting interests in the company. As a result, the Company's equity interest in SSEC increased from 51% to 85%.

Increased control in SSEC will provide the Company with an 85% stake in prospective resources together with increased benefits arising from the Production Sharing Contract.

Between the date of acquisition and the balance sheet date, SSEC contributed \$55,430 to Company revenue and a loss of \$336,549 for the period. If the acquisition of SSEC had been completed on the first day of the financial year, Company revenues for the period would have increased by \$513,135 and the Company loss

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would have been increased by \$693,721. In determining these amounts, management has assumed that the fair value adjustments, determined provisionally, that arose on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2011.

The following summarises the major classes of consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date.

Consideration transferred

	Fair value \$'000
Consideration at December 13, 2011	
Cash consideration	7,000
Non cash consideration	4,080
	<u>11,080</u>

Non cash consideration

At the time of acquisition, SSEC owed the Company \$66,772,000 with respect to a loan (note 16). As part of the arrangement to increase the Company's interest in SSEC, it was agreed to waive an amount of \$49,920,000 with respect to the loan between SSEC and the Company. The fair value of the joint venture partner's benefit from the loan waiver is the fair value of 15% of the amount waived, representing the future benefit that the joint venture partner will now receive from future distributions by SSEC. The Company involved an independent external expert to fair value 15% of the amount of \$49,920,000 that was waived. The fair value of the 15% loan waiver was calculated as \$4,080,000. This was estimated by applying the Tajik specific weighted average cost of capital of 16.39% to the loan repayments based on anticipated future cashflows.

Recognised amounts of identifiable assets acquired and liabilities assumed

	Fair value \$'000
Cash and cash equivalents	215
Intangible assets	75,096
Property, plant and equipment	1,868
Inventory	1
Current trade and other payables	(2,151)
Provision for asset retirement obligation	(89)
	<u>74,940</u>

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The following fair values have been determined on a provisional basis:

- The fair value of intangible assets (SSEC's exploration assets) has been determined provisionally, with the assistance of independent valuation experts.
- SSEC's operations are subject to environmental regulations. The Company has conducted an assessment of site restoration provisions arising from these regulations and has recognised a provisional amount in its initial accounting. However, the Company will continue its review of these matters during the measurement period.

If new information obtained within one year from the acquisition date about facts and circumstances that existed at the acquisition date identifies adjustments to the above amounts, or any additional provisions that existed at the acquisition date, then the acquisition accounting will be revised.

Settlement of pre-existing relationship

At the time of acquisition, SSEC owed the Company \$66,772,000 with respect to a loan (note 16). As per IFRS 3.B52, at the acquisition date this pre-existing loan relationship was effectively terminated as part of the acquisition. The fair value of the loan at the acquisition date was \$42,349,176. The difference of \$24,422,750 between the book value and the fair value was as a result of the below market interest rate charged on the loan. The loss was recognised as a fair value loss on the pre-existing loan relationship in the consolidated financial statements of the Company.

	Fair value \$'000
Cash consideration transferred	7,000
Fair value of loan relationship terminated	42,351
Non cash consideration	4,080
Total consideration	53,431
Non-controlling interest, based on their proportionate interest in the recognised amounts of the asset and liabilities of SSEC	4,888
Fair value of pre-existing interest in SSEC	16,621
Fair value of identifiable net assets	(74,940)
Goodwill	nil

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Gain on disposal

The remeasurement to fair value of the Group's existing 51% interest in SSEC resulted in a gain as follows:

	December 13, 2011
	\$'000
Fair value of 51% in SSEC at December 13, 2011	16,621
Carrying value of investment	10,760
Gain on previously held interest in SSEC	27,381

The fair value of the 51% investment in SSEC at 13 December 2011 is based on the fair value of net identifiable assets at December 13, 2011, after deduction of the fair value of the loan relationship terminated between the Company and SSEC. This gain has been recognised in the consolidated statement of comprehensive income.

Cost of investment

	December 13, 2011
	\$'000
Deferred gain	(3,699)
Unrealised profit on other operating income from SSEC	(5,706)
Cumulative losses from SSEC	(1,355)
Carrying value of investment	(10,760)

The Company had deferred a gain of \$3,699,000 on the disposal of its three Tajik subsidiaries to SSEC. As such this forms part of the net investment in SSEC and is included within the carrying value of the investment. This is presented gross in the 2010 Statement of Financial Position.

During 2010 and 2011, a drilling rig together with associated equipment, all owned by the Company, was rented to a subsidiary of SSEC on commercial terms. In accordance with the shareholder's agreement, the amounts receivable in respect to the rental are to be added to the loan due from that entity. When preparing the 2010 annual financial statements and the interim financial statements for Q1 2011, these amounts were eliminated in full rather than proportionate to the Company's equity accounted interest and no income was recognised. Following progress made on the EOL09 well, as set out in more detail on page 13 of the Management's Discussion and Analysis document, the directors reconsidered this matter at 30 June 2011 and considered it appropriate that the income be included for the period to December 13, 2011 – the date that SSEC became a subsidiary (note 16.)

Accordingly, other operating income for the period to December 13, 2011 includes \$7,374,090 in respect of these transactions, of which \$3,835,320 relates to the year ended December 31, 2010. The invoices have not been settled and there is consequently no impact on the Company's cash flows. There is also no impact on tax expense as a result of this income being recognised.

Tethys Petroleum Limited

Notes to Consolidated Financial Statements

(tabular amounts in thousands of US dollars)

Per IAS 31 'Interests in Joint Ventures', profits on transactions with jointly controlled entities are eliminated to the extent of the investor's interest in the jointly controlled entity. Accordingly the Company eliminated \$5,705,910 against the carrying value of its investment in SSEC.

As per the Production Sharing Contract ('PSC') signed on 13 June 2008, between Kulob Petroleum Limited, a subsidiary of Tethys Petroleum Limited, and the Ministry of Energy and Industry of the Republic of Tajikistan, Kulob Petroleum Limited is not liable for any tax arising on its operations in Tajikistan which are associated with the PSC. Consequently there is no tax impact from this transaction.

26 Related party transactions

All subsidiaries, as listed below, have been consolidated into these consolidated financial statements. A list of the investments in subsidiary undertakings (all of whose operations comprise Exploration, Development, Production, Service or Holding Companies in one class of business – Oil and Gas), including the name, proportion of ownership interest, country of operation and country of registration, is given below.

Subsidiaries	Percentage	Country of registration	Country of operation
Tethys Kazakhstan Limited	100%	Guernsey	Guernsey
Transcontinental Oil Transportation	100%	Belgium	Belgium
Amu Darya Petroleum Limited	100%	BVI	BVI
Pamir Logistics Co. Ltd.	100%	BVI	Tajikistan
Tethys Uzbekistan Ltd.	100%	Cayman Islands	Uzbekistan
TransOxiana Petroleum Ltd.	100%	Cayman Islands	Cayman Islands
Tethys Afghanistan Holdings Ltd.	100%	Cayman Islands	Dormant
Bactria Petroleum Ltd.	100%	Cayman Islands	Cayman Islands
Tethys Production Uzbekistan Ltd.	100%	Cayman Islands	Uzbekistan
Tethys Tajikistan Limited	100%	Cayman Islands	Tajikistan
Imperial Oilfield Services Limited	100%	Cayman Islands	Cayman Islands
Tethyda Limited	100%	Cyprus	Dormant
Baker Hughes (Cyprus) Limited (t/a Tethys Production Uzbekistan Limited)	100%	Cyprus	Uzbekistan
Tethys Aral Gas LLP	100%	Kazakhstan	Kazakhstan
Kul-Bas LLP	100%	Kazakhstan	Kazakhstan
Tethys Munai Gaz LLP	100%	Kazakhstan	Dormant
Tethys Services Kazakhstan LLP	100%	Kazakhstan	Kazakhstan
AOE Tykhe SA	100%	Luxembourg	Dormant
Asia Oilfield Equipment BV	100%	Netherlands	Tajikistan
AOE Telesto BV	100%	Netherlands	Dormant
Tethys Uzbekistan BV	100%	Netherlands	Netherlands
Tethys Services Limited	100%	United Kingdom	United Kingdom
Tethys Petroleum Inc.	100%	USA	USA
Tethys Afghanistan Inc.	100%	USA	Dormant
Seven Stars Energy Corporation	85%	BVI	Tajikistan
Seven Stars Petroleum Products Ltd.	85%	BVI	Tajikistan
Sogdiana Petroleum Ltd.	85%	Cayman Islands	Tajikistan
Kulob Petroleum Ltd.	85%	Cayman Islands	Tajikistan
Tethys Services Tajikistan Ltd.	85%	Tajikistan	Tajikistan
Jointly controlled entities			
Aral Oil Terminal	50%	Kazakhstan	Kazakhstan

Tethys Petroleum Limited

Notes to Consolidated Financial Statements

(tabular amounts in thousands of US dollars)

Subsequent to December 31, 2011, Tethys Kazakhstan Limited became domiciled in Belgium.

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, 2011 was \$3,295,754 (2010 – \$2,525,885).

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 for work on projects in Tajikistan, Kazakhstan and Uzbekistan. Total fees for the year ended December 31, 2011 were \$11,422 (2010 – \$182,470).

OPC participated in the 2011 loan financing described in note 20, advancing \$200,000 under Option B of the facility. As a result, OPC received 100,000 warrants valued at a fair value of \$15,030. The loan was advanced under the same conditions and terms disclosed in note 20.1 afforded to non-related parties.

The remuneration of the key management personnel of the Company is set out below in aggregate.

	Year ended	
	December 31, 2011	December 31, 2010
	\$'000	\$'000
Salaries and short-term employee benefits	4,273	5,439
Share-based payments	3,799	5,642
	<u>8,072</u>	<u>11,081</u>

Two officers of the Company participated in the 2011 loan financing described in note 20 for which they received 75,000 and 232,620 warrants valued at a fair value of \$6,143 and \$21,983 respectively. Loans advanced were USD150,000 and GBP300,000 respectively for a one year term under the same conditions and terms disclosed in note 20.1 afforded to external parties.

Transactions with affiliates or other related parties including management of affiliates are recorded at their exchange amount.

Related party transactions with SSEC are disclosed in note 7 – Other Operating Income.

Tethys Petroleum Limited

Notes to Consolidated Financial Statements

(tabular amounts in thousands of US dollars)

27 Changes in working capital

	Year ended	
	December 31, 2011 \$'000	December 31, 2010 \$'000
Trade and other receivables	(1,798)	(1,368)
Inventories	96	249
Trade and other payables	1,391	2,002
Change in non-cash working capital	(311)	883
Non-cash transactions	329	(214)
Net changes in non-cash working capital	18	669

The principal non-cash transaction is related to the issue of shares as consideration for the acquisition discussed in note 23.

Net changes in non-cash working capital are categorized as follows:

	Year ended	
	December 31, 2011 \$'000	December 31, 2010 \$'000
Operating activities	(664)	(2,792)
Investing activities	682	3,461
Balance	18	669

28 Commitments and contingences

Kazakhstan

Kyzylloi Field and the Kyzylloi Field Licence and Production Contract

With respect to 2011, a minimum work program amounting to \$273,000 was agreed, which has been fulfilled through payments amounting to \$2,731,173 during the year ended December 31, 2011. With respect to 2012, a minimum work program amounting to \$272,000 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. With respect to 2011, a minimum work program amounting to \$3,210,000 was agreed, which has been fulfilled through payments amounting to \$26,689,973 during the year ended December 31, 2011. With respect to 2012, a minimum work program amounting to \$1,680,000 has been agreed.

Tethys Petroleum Limited

Notes to Consolidated Financial Statements

(tabular amounts in thousands of US dollars)

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 \$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.

Kul-Bas Exploration and Production Contract

The Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of \$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 have been paid in full. With respect to 2011, a minimum work program amounting to \$120,000 was agreed, which has been fulfilled through payments amounting to \$9,847,067 during the year ended December 31, 2011. With respect to 2012, a minimum work program amounting to \$3,210,000 has been agreed.

29 Operating leases

Leases as a lessee:

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

December 31, 2011	Total \$'000	Less than 1 year \$'000	1 – 3 years \$'000
Operating leases	1,055	670	290

2011 expenditure on lease commitments included in the consolidated statement of comprehensive income amounted to \$920,117.

December 31, 2010	Total \$'000	Less than 1 year \$'000	1 – 3 years \$'000
Operating leases	666	456	210

2010 expenditure on lease commitments included in the consolidated statement of comprehensive income amounted to \$415,117.

Leases as a lessor:

Under IFRIC 4 'Determining whether an arrangement contains a lease', the Company sells gas in Kazakhstan under a lease arrangement even though the agreement is not in the legal form of a lease (note 2). There are no payments received for non-lease elements within the Kazakh gas sales revenue. There are no non-cancellable lease payments under this take or pay contract.

TETHYS PETROLEUM LIMITED
MANAGEMENT'S DISCUSSION AND ANALYSIS
for the year ended December 31, 2011

Summary of Annual results

(All references to \$ are United States dollars unless otherwise noted)
(Tabular amounts are in thousands, unless otherwise stated.)

	2011	2010	2009
	\$	\$	\$
Revenue	22,922	14,706	8,559
Other operating revenue	7,375	-	-
Total revenue and other income	30,297	14,706	8,559
Net loss	(26,989)	(29,649)	(21,720)
Basic and diluted loss (\$) per share	(0.10)	(0.15)	(0.20)
Capital expenditure *	41,902	38,293	32,221
Total assets	263,391	267,748	137,082
Non-current liabilities	(4,676)	(11,535)	(18,345)
Cash balance	11,631	79,135	7,297
Cash and working capital surplus/(deficiency)	942	69,718	(157)
Common shares outstanding			
Basic and diluted	286,692,744	260,629,769	134,554,769

*The 2009 figure includes Tajikistan capital expenditure while in 2010 and until December 13, 2011 the Tajikistan capital expenditure was included in the jointly controlled entity Seven Stars Energy Corporation ("SSEC").

The following Management's Discussion and Analysis ("MD&A") is dated March 30, 2012 and should be read in conjunction with the Company's Audited Consolidated Financial Statements and related notes for the year ended December 31, 2011. The accompanying consolidated financial statements of the Company have been prepared by management and approved by the Company's Audit Committee and Board of Directors. The annual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and in accordance with the requirements of the Disclosure and Transparency Rules ("DTR") of the Financial Services Authority ("FSA") in the United Kingdom as applicable to annual financial reporting. 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 ("AIF") for the year ended December 31, 2011 including the Glossary of Abbreviations and Technical terms, which is integrated herein by reference.

The Tethys Petroleum Limited Annual Report and Accounts for 2011 consists of three documents as detailed below:

- 1) Management's Discussion & Analysis: this includes the documents required to be disclosed pursuant to National Instrument 51-102 of Canadian Securities Administrators "Continuous Disclosure Obligations" ("Canadian NI 51-102") in respect of an annual Management's Discussion & Analysis and the documents required to be disclosed pursuant to UK's Disclosure & Transparency Rules with respect to DTR 4.1 "Annual Financial Report" (DTR 4.1);
- 2) Annual financial information: this includes the Consolidated Financial Statements, the documents required to be disclosed pursuant to Canadian NI 51-102 with respect to an annual financial report and the

documents required to be disclosed pursuant to DTR 4.1, Directors' Responsibility Statement and the Independent Auditor's Report to Tethys Petroleum Limited; and

- 3) The Annual Information Form ("AIF"): this includes the documents required to be disclosed pursuant to Canadian NI 51 – 102 and DTR 4.1 and the statement which is required to be presented in accordance with DTR 7.2 "Corporate Governance Statements".

Highlights and Significant Transactions

2011

On January 11, 2011, the Company received Kazakh State approval for the Pilot Production Project for the Doris oil discovery in the Akkulka block (the "Pilot Production Project"). This approval gives the Company the right to produce oil from the Doris accumulation during the exploration period and allows for the installation and operation of production facilities for the planned 4,000 barrels of oil per day ("bopd") (Phase 1) production target; currently estimated to commence in April 2012.

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

On February 17, 2011, the Company signed a Joint Venture agreement with Eurasia Gas LLP, subsequently assigned to Olisol Investments Limited, to build a joint venture oil terminal (named the "Aral Oil Terminal" or "AOT") so that oil production from the Akkulka block can be delivered and sold to market more effectively.

On April 17, 2011, the Company announced that it was one of five international companies pre-qualified and selected by the Ministry of Mines of the Afghanistan Government for a tender to explore and develop oil and gas deposits in northern Afghanistan. On September 5, 2011, the Company announced that the Chinese State Oil Company, CNPC, won the tender for the blocks in Afghanistan. The Company considers that the terms it would have needed to offer to win the tender would have made the project non-commercial.

On May 18, 2011, the Company announced it had signed a contract with the Institute of Geology and Prospecting for Oil and Gas Deposits of UNG, the state oil and gas company, to review materials on exploration areas in the Ustyurt region and the Bukhara-Khiva region with a view to applying for suitable projects in these areas.

On May 31, 2011, the Company announced that the AKD03 ("Dione") exploration well in Kazakhstan tested oil from the Cretaceous interval, the uppermost pay zone of the well. The well, which reached a total depth of 3,975 metres (13,041 feet) in the Triassic, tested oil at a rate of some 400 bopd from Jurassic sands and also tested oil from the Cretaceous sandstone.

On July 25, 2011, the Company's entire issued ordinary share capital was admitted to the standard category of the Official List of the Financial Services Authority and commenced trading on the main market of the London Stock Exchange under the ticker symbol "TPL".

On July 26, 2011, the Company announced that, following acidisation, its AKD05 Doris appraisal well in Kazakhstan flowed some 2,088 barrels of fluid per day, of which 1,568 barrels per day was good quality (45° API) oil. The well flowed with good surface pressures although the flow was limited by the surface facilities. Flow data indicated that the well would be capable of flowing around 3,000 barrels per day with reconfiguration of the production facilities.

On August 8, 2011, the Company opened its Doris oil production facilities in Kazakhstan after receiving final Kazakh governmental approvals.

On September 7, 2011, the Company's KBD01 (Kalypso) exploration well on the Kul-Bas Block reached total depth at approximately 4,300 metres in what was interpreted to be rocks of the Carboniferous age. Initial logging results indicate more than 100 metres of gross potential hydrocarbon bearing zones in the well.

On September 12, 2011, the Company announced that its East Olimtoi EOL09 exploration well reached a total depth of 3,765 metres in the Akdzhazhar formation and was flowing a mixture of completion brine and oil from the Upper Alai sandstone interval. The oil was of good quality with an API gravity of 36 degrees. Sections open to testing included the upper Alai sandstone unit (a secondary target) where there was previously a strong flow of live oil to the surface accompanied by 33% gas in the drilling mud, the lower Alai limestone interval and the upper part of the Bukhara formation. There are two further sandstone zones in the Alai formation that appear oil bearing based on wireline logs. The flow testing of the well showed that the formation appeared to have been damaged during the drilling process, when the well required control using heavy drilling mud and further operations are planned to fully evaluate the commerciality of this oil discovery.

On September 12, 2011, the Company announced that the data collection for the gravity, gradiometry and magnetic aerial survey carried out over the Bokhtar PSC Area in Tajikistan was completed and that it would provide additional and more aerially extensive data to complement the existing seismic acquisition with the final processed data.

On October 20, 2011, the Company announced results of a successful workover of well BST20 in the Beshtentak oilfield in Tajikistan. The well tested oil at a rate of 533 bopd, accompanied by 12,500 cubic metres of gas per day on a restricted choke. The oil had an API gravity of 38 degrees and no water was being produced.

On November 15, 2011, the AKD06 Doris appraisal well tested oil at a rate of over 4,300 bopd from the Cretaceous sand interval. The flow was restricted but data indicated that open flow potential was in excess of 6,000 bopd.

On November 18, 2011, the Company signed a Memorandum of Understanding ("MOU") with UNG to establish a programme for Tethys to acquire two new Production Enhancement Contracts ("PECs") for two new existing oilfields in Uzbekistan. The MOU stated an agreed timetable up to May 1, 2012 to negotiate for the PECs. One for the Chegara Group of fields and one for the West Kruk field both located in the same area as North Urtabulak. Subsequently, following technical and commercial evaluation of the West Kruk field, the Company has decided to focus on the Chegara group of fields.

On December 9, 2011, the Company completed a private placement of 26,062,975 Ordinary Shares for gross proceeds of USD13,001,981. The net proceeds of the offering were to enable Tethys to exercise an option to purchase an additional 34% of shares in SSEC and to carry out additional work in Tajikistan.

On December 13, 2011, the Company completed the purchase of 34% of the shares in SSEC from its Tajik joint venture partner Sangam Limited, and increased its shareholding to 85% (from 51%). SSEC is the owner of the rights to the Bokhtar Production Sharing Contract ("Bokhtar PSC") in Tajikistan and is now a subsidiary of the Company. In the two years prior to December 13, 2011, SSEC was a Joint Venture as neither shareholder had control.

On December 19, 2011, the Company announced the initial results of its Persea 1 exploration well in Tajikistan. The well reached a total depth of 2,655 metres and wireline logs show a 50 metre gross zone of possible hydrocarbons within mixed sandstone and carbonate sequence assigned to the Alai formation. Testing is planned to be carried out in the first half of 2012.

2012

On January 30, 2012, the Company announced the official inauguration of AOT - a new storage and rail loading facility for its oil shipments from the Doris oilfield. The AOT is owned and operated through a 50:50 joint venture by Tethys and its Kazakh oil trading partner's company, Olisol Investment Limited (a subsidiary of Eurasia Gas). The Company plans to initially double production to approximately 4,000 bopd. It is planned to expand the capacity of the terminal to more than 12,000 bopd to accommodate future potential production growth dependent upon further drilling results.

On February 1, 2012, the Company announced it had signed an MOU with the Uzbek State oil and gas company, National Holding Company "Uzbekneftegaz" ("UNG"). The objective of this MOU is to provide the framework for a Joint Study and the negotiation process for an Exploration Agreement relating to certain exploration blocks in the North Ustyurt Basin of Uzbekistan.

On February 9, 2012, the Company confirmed the issue of a tender for the final stage of the seismic programme in Tajikistan. The seismic programme will involve the acquisition of approximately 870km of new 2D seismic in two areas; the Dushanbe Step and the Vaksh valley. It is expected that this data will be acquired this summer with initial interpreted results in Q4 2012. When completed, it will identify the location for the first deep pre-salt well to be drilled by Tethys. This seismic data will be used to firm up an initial deep well drilling location to exploit the very significant upside indicated by the gravity, gradiometry and magnetic aerial survey previously carried out.

On March 21, 2012 the company announced Total Net Oil and Gas Reserves (barrels of oil equivalent: BOE) consisting of 1P (Proved reserves) up 96% to 14.5 million BOE and 2P (Proved + Probable reserves) up 45% to 25.3 million BOE.

Total revenue in 2011 at USD30.297 million represented an increase of 106% on the 2010 figure of USD14.706 million while oil and gas revenue in 2011 at USD22.922 million was 56% higher than the oil and gas revenue of USD14.706 million in 2010.

The net loss for 2011 at USD26.989 million represented a reduction of 9% on the 2010 loss of USD29.649 million.

In the year to December 31, 2011, capital expenditure was USD41.902 million compared to USD38.293 million in the year ended December 31, 2010. These figures exclude any capital expenditure by the Joint Venture in Tajikistan in the period from January 1, 2011 to December 13, 2011 or in the twelve months to December 31, 2010.

Production costs in the year to December 31, 2011 were USD10.785 million compared to USD7.076 million in the year ended December 31, 2010 reflecting the additional production costs associated with the enhanced levels of gas and oil production achieved in Kazakhstan.

Administrative costs in the year to December 31, 2011 at USD20.549 million were 5% up on the USD19.520 million incurred in the year to December 31, 2010.

Nature of Business

Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") has its principal executive office in Guernsey, British Isles. The domicile of Tethys Petroleum Limited is the Cayman Islands where it is incorporated. Tethys' principal activity is the exploration for and production of crude oil and natural gas. The Company currently has projects in the Republic of Kazakhstan, the Republic of Tajikistan and the Republic of Uzbekistan.

Financial and Operational Review

Reserves

Following the completion of the audit of the Kazakhstan reserves by an independent auditor, Gustavson & Associates Consultants Limited, independent oil and gas reservoir engineers of Calgary, Alberta, the company announced Total Net Oil and Gas Reserves (barrels of oil equivalent: BOE) consisting of 1P (Proved reserves) up 96% to 14.5 million BOE and 2P (Proved + Probable reserves) up 45% to 25.3 million BOE.

The growth of the Company's reserves is one of the Company's Key Performance Indicators ("KPIs").

Kazakhstan Gas Production (Kyzylai contract)

	2011				2010			
	Mcm	Mcf	Mcm/d ¹	boe/d ²	Mcm	Mcf	Mcm/d ¹	boe/d ²
Q1	28,798	1,016,840	320	1,883	0	0	0	0
Q2	34,225	1,208,471	376	2,214	10,146	358,255	298	1,756
Q3	35,538	1,254,843	386	2,274	44,215	1,561,232	481	2,829
Q4	36,067	1,273,508	394	2,316	41,449	1,463,564	451	2,652
Total	134,628	4,753,662	369	2,171	95,810	3,383,051	439	2,587

Note 1 Mcm/d is thousands of cubic metres per day and in 2010 was calculated based on the actual production days in the quarter or year. In 2011 there were 365 production days while in 2010 there were 218.

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.

- Production commenced from the Kyzylai field in 2007, following the construction of a 56 km, 325 mm diameter export pipeline from the Kyzylai Field gathering station to the main Bukhara–Urals gas trunkline, where a compressor station was constructed at km910 on that trunkline. The gas flows into the main trunkline which is owned by Intergas Central Asia, a division of the Kazakh state natural gas company KazTransGas.
- Initial production from the Kyzylai Field was sold under the long-term take-or-pay contract signed between TAG and gas trading company GazImpex in January 2006. This contract was assigned in December 2007 from GazImpex to the Kazakhstani Petrochemical Company Kemikal LLP, who utilized the gas in the domestic Kazakh market. This contract was further assigned on May 1, 2009 to Asia Gas NG LLP. The contract price is USD32 per Mcm excluding VAT or USD35.84 per Mcm including VAT at the current 12% rate.

In Q1 2011, one of the compressors was out of commission while being repaired. This was the reason that production was slightly lower in the first quarter compared to the other three quarters.

- In contrast to prior years, there were few disruptions to the Kyzylai gas production levels throughout 2011. In 2010, the Bukhara Urals pipeline was closed and did not re-open until May 27, 2010 when volumes through the pipeline were restricted to 360Mcmpd¹. It was not until July 26, 2010 when volumes returned to pre-closure levels of 500Mcmpd.
- As stated above, the Kyzylai Gas Supply Contract has a term until the earlier of the date when 850 MMcm of gas has been sold and 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 is based on a take-or-pay principle and covers all gas produced from the Kyzylai Field Licence and Production Contract area up to the termination

¹Thousand cubic metres

²Thousand cubic feet

of the Gas Supply Contract. To the end of Q4 2011 some 535 MMcm under the Gas Supply Contract had been delivered.

Kazakhstan Gas Production (Akkulka contract)

	2011				2010			
	Mcm ¹	Mcf ²	Mcm/d	boe/d	Mcm ¹	Mcf ²	Mcm/d	boe/d
Q1	17,182	606,693	191	1,124	0	0	0	0
Q2	22,651	799,796	249	1,465				
Q3	22,867	807,430	249	1,463				
Q4	20,204	713,403	220	1,293	24,244	856,056	279	1,640
Total	82,904	2,927,322	227	1,337	24,244	856,056	279	1,640

Note 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 365 production days while in the same period in 2010 there were 87 days.

- On September 16, 2010, the Company commenced the second phase of gas development (referred to as “Phase 2” of the Kyzylloi / Akkulka shallow gas development) with commencement of production from the Akkulka Field on October 6, 2010.
- In Q1 2011, one of the compressors was out of commission while being repaired. This was the reason that production was slightly lower in the first quarter compared to the other three quarters.
- In conjunction with this, the Company entered into a second gas sales contract with Asia Gas NG LLP pursuant to which gas is sold from the Akkulka Field at a price of USD33.93 per Mcm excluding VAT or USD38 per Mcm including VAT. Gas sold under this contract is for domestic sales and, as such, is subject to a Mineral Extraction Tax of approximately 0.5% to the Kazakh State. The Akkulka gas sales contract runs for a period of two years. First deliveries under this contract commenced on October 6, 2010.
- TAG has made eleven shallow gas discoveries in the Akkulka Exploration Licence and Contract area. The Akkulka Production Contract now covers seven of these wells and four are currently producing from a similar horizon to the Kyzylloi Field and are tied into the Company’s existing pipeline infrastructure, with additional compression having been installed at the BCS. The development of the other gas discoveries already made in the Akkulka Block is planned as Phase 3.
- The Company has chosen not to advance both the Kyzylloi and Akkulka gas projects fully due to the relatively low gas prices currently being obtained. The Company is hopeful however that with the completion of the Kazakhstan – China gas pipeline (which the Company understands is scheduled for 2013), better gas prices may be obtained with more competition from gas buyers for supply.

Kazakhstan Oil Production (Akkulka contract)

	2011					2010				
	Gross fluid		Net	Production		Gross fluid		Production		
	<u>m3</u>	<u>Barrels</u>	<u>Barrels</u>	<u>days</u>	<u>bopd</u>	<u>m3</u>	<u>Barrels</u>	<u>days</u>	<u>bopd</u>	
Q1	4,219	32,359	30,030	26	1,155	-	-	-	-	
Q2	10,269	78,143	74,244	52	1,428	-	-	-	-	
Q3	18,622	156,129	144,624	92	1,725	1,393	10,952	21	522	
Q4	21,292	178,493	165,324	92	1,797	5165	39,918	65	614	
Total	54,402	445,124	414,222	262	1,581	6,558	50,870	86	591	

- On September 10, 2010, the Company commenced selling untreated oil at the well site of AKD01 (under test production at a permitted level of up to 750 bopd) to an oil trading company which transports the oil by truck to an oil loading terminal north of the town of Emba, located 450 km to the northeast of the well site, where it is treated before being transported to local refineries. Tethys sold the unprocessed oil at the wellhead at an initial price of USD22/bbl. This test production scheme was implemented to gain reservoir information, realise early cash flow and also to prepare for the higher production and associated logistics for the next stage.
- On January 11, 2011, TAG received Kazakh State approval from MOG for the Pilot Production Project for the Doris oil discovery in the Akkulka Block. This approval granted TAG the right to produce oil from the Doris discovery under the exploration contract and allows the Company to install and operate production facilities for the planned (Phase 2) production target. Once the Pilot Production Project is fully completed, the relevant final reserve calculations will be submitted to MOG to receive a production contract that will allow for full field development and foreign or domestic sales. The Company is expected to apply for a production contract after the appraisal programme for the Doris oil discovery is complete.
- Between January 1, 2011 and March 31, 2011, due to a combination of weather problems and work on building the necessary facilities, only 26 days of pilot production were achieved from well AKD01 on the Doris discovery on the Akkulka contract.
- Between April 1, 2011 and June 30, 2011, due to the ongoing work on building the necessary facilities, only 52 days of pilot production were achieved on the Doris discovery on the Akkulka contract.
- On August 8, 2011, the Company announced the opening of its Doris oil production facilities. With the opening of the new rail-loading facility in April 2012, which will reduce the road trucking distance by half, it is planned to increase production initially to 4,000 bopd although the production facility and terminal are designed for potentially much greater production rates in the future with 5,000 - 6,000 bopd planned for later in the year. Completion of this terminal was originally anticipated to be in the fourth quarter of 2011 but this was subsequently moved back because of the extremely adverse weather conditions and is now anticipated to be completed and commissioned in April 2012.
- Test production from well AKD05 commenced in June and carried on into July 2011. There was then a gap in August and September before commercial production commenced in October 2011.
- In November 2011, commercial production commenced from AKD06.
-

Joint Venture

On February 17, 2011, the Company signed a joint venture agreement to construct and operate AOT, a rail oil loading terminal at Shalkar in Kazakhstan. Transcontinental Oil Transportation ("TOT"), a wholly owned subsidiary of the Company, and Olisol Investments Limited, a local partner with strong experience in the oil distribution business in Kazakhstan each has a 50% interest in the project. With the opening of this new rail-loading facility in April 2012, which will reduce the road trucking distance by half, it is planned to increase production initially to 4,000 bopd although the production facility and terminal are designed for potentially much greater production levels in the future with 5,000 - 6,000 bopd planned for later in the year from existing drilled and tested wells.

Uzbekistan Oil Production (North Urtabulak PEC)

Total Production from TPU under PEC

	Total Production			Total Production		
	<u>Tonnes</u>	<u>Barrels*</u>	<u>bopd</u>	<u>Tonnes</u>	<u>Barrels*</u>	<u>bopd</u>
Three months ended March 31	14,945	115,076	1,278	20,869	160,691	1,785
Three months ended June 30	14,047	108,162	1,189	19,627	151,528	1,660
Three months ended September 30	10,891	83,859	912	17,512	134,842	1,466
Three months ended December 31	<u>9,291</u>	<u>71,542</u>	<u>777</u>	<u>15,048</u>	<u>115,869</u>	<u>1,259</u>
Total production	<u>49,174</u>	<u>378,639</u>	<u>1,037</u>	<u>73,056</u>	<u>562,930</u>	<u>1,541</u>

After State Take

Period	2011 TPU ² Share			2010 TPU Share		
	<u>Tonnes</u>	<u>Barrels*</u>	<u>bopd</u>	<u>Tonnes</u>	<u>Barrels*</u>	<u>bopd</u>
Three months ended March 31	6,430	49,510	550	10,434	80,342	893
Three months ended June 30	5,808	44,720	497	9,814	75,565	830
Three months ended September 30	3,883	29,898	325	7,182	55,301	601
Three months ended December 31	<u>2,629</u>	<u>20,246</u>	<u>220</u>	<u>6,444</u>	<u>49,619</u>	<u>539</u>
Total production	<u>18,750</u>	<u>144,374</u>	<u>396</u>	<u>38,874</u>	<u>260,827</u>	<u>714</u>

* using 7.7 barrels = 1 tonne

- The Company, through Tethys Production Uzbekistan ("TPU"), owns a 100% contractor interest in the North Urtabulak PEC for the North Urtabulak Field, together with subsidiaries of Uzbekneftegaz ("UNG"). This field is located in southern Uzbekistan in the northern portion of the Amu Darya basin. 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.
- Under the North Urtabulak PEC, the contractor receives 50% of all incremental production from each well from the North Urtabulak Field for the first three years of production, with the remaining 50% to be shared between the Uzbek State Partners. For the subsequent five years, the contractor receives 20%, and the Uzbek State Partners 80% of the same.
- As at December 31, 2011, the Company was producing approximately 689 bopd (gross) from 16 wells under the North Urtabulak PEC. Part of the North Urtabulak Field lies under a zone of active salt movement which has had limited production in the past due to drilling difficulties.
- A full-field dynamic reservoir model was completed and interpreted, and further production enhancement operations have been conducted on the North Urtabulak Field – including radial drilling, sidetracking, acid stimulation, water-injection and horizontal drilling but without any significant benefit.
- As a result of the consistent decline in the production levels of the North Urtabulak PEC, the Company carried out an estimate of the asset's recoverable amount. The result of this exercise was that the discounted cash flow indicated a value for the asset at USD6,078,254 while the carrying value of the asset was USD15,061,146 and consequently an impairment adjustment of USD8,982,792 was recorded to bring the carrying value in line with the discounted cash flow. *See Impairment in Uzbekistan below.*

² TPU is Tethys Production Uzbekistan, the Tethys subsidiary which holds the PEC. Tethys Production Uzbekistan is the trading name of Baker Hughes (Cyprus) Limited.

- On November 18, 2011, the Company signed an MOU with UNG to establish a programme for Tethys to acquire two new PECs for two existing oilfields in Uzbekistan. The MOU stated an agreed timetable up to May 1, 2012 to negotiate for the PECs. The Company is currently negotiating for the Chegara Group of fields located in the same area as North Urtabulak. The Chegara Group of fields are producing oilfields but are less developed than North Urtabulak, and Tethys believes that these fields offer significant potential for additional oil production in the short term thereby enhancing its production and cash flow from Uzbekistan.
- The Company intends to focus future efforts in Uzbekistan on developing new contracts such as the Chegara PEC or on potential exploration activities. The North Urtabulak impairment must be taken in the context of the new projects which the Company is now developing in Uzbekistan. The North Urtabulak project is a late stage re-development and incremental production project on an old field, and the Company has used this project as a base to develop additional projects and a significant business presence in Uzbekistan. Currently these new projects include the Chegara PEC (Chegara is a much less developed producing field) and the potential exploration block in the North Ustyurt basin (which is south of the Doris discovery in Kazakhstan and which the Company believes has considerable exploration potential).

Tajikistan Oil Production (Beshtentak field)

		2011					2010			
		Total Production					Total Production			
		<u>Tonnes</u>	<u>Barrels*</u>	<u>Production days</u>	<u>bopd</u>		<u>Tonnes</u>	<u>Barrels*</u>	<u>Production days</u>	<u>bopd</u>
Total		2,481	18,468	76	243		817	5,923	86	592

* using 7.4 barrels = 1 tonne

- In 2010, oil production had re-commenced from the Beshtentak field in Q1, albeit on a small scale, and further work was initiated, aimed at increasing the production but without success.
- Further workovers were carried out in 2010 on other wells in the field but initially without success.
- On October 20, 2011, the Company announced that the Beshtentak well BST20, having been worked over by applying modern perforating and acidisation techniques and applying natural gas lift, tested oil at a rate of 533 bopd accompanied by 12,500 cubic metres (441 thousand cubic feet) of gas per day on a restricted choke (10 mm - 25/64 inch) with a flowing tubing head pressure of 26 atmospheres (377 psi).
- Initial sales agreements were signed and the first payments from oil sales received.

The well was placed on oil production and the gas was tied into the nearby local gas grid but subsequently production performance indicated possible communication with the nearby BST103 well which is producing gas from the field for the city of Kulob, this gas being part of the "base level" production on the field assigned to the Tajik State. As a result, the BST20 production is currently restricted and it is planned to acquire additional data to ascertain the extent of any possible communication. The well is now back on production but at lower rates than previously, currently less than 100 bopd, and the Company believes that this well needs work carried out on zonal isolation to increase production. This work is planned once the current bad weather conditions have improved. Meanwhile, three further workover candidates have been identified in other parts of the field (away from existing producers), which are interpreted to contain remaining bypassed oil and gas and work is progressing to fully assess these interesting opportunities, including potentially the acquisition of downhole seismic data. In addition to conducting recompletion work on these three wells, it is planned in the future to locate potentially one or two new high angle or horizontal crestal development wells, which would have the potential to achieve higher production rates than those obtained from the BST20 well.

- Further wells are available on the field for workover and potential oil production, as well as the possible development of undrained fault compartments in the field.
- Throughout 2010 and until December 13, 2011, Tethys had a 51% shareholding in SSEC but under the terms of a loan agreement with SSEC, Tethys was due to receive all revenues from production sales attributable to SSEC, the jointly controlled entity until the loan was repaid. With effect from December 13, 2011, Tethys increased its shareholding in SSEC to 85%. See *Acquisition of Shares in SSEC* below.

Production Summary

In the year ended December 31, 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	1,581	596	3,508	5,089
Uzbekistan	1,037	-	-	1,037
Tajikistan	243	-	-	243
Total	2,861	596	3,508	6,369

While in the same period of 2010 the figures 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

- Gas production days in the Kyzylol field in Kazakhstan were 365 in 2011 and 218 days in 2010.
- Gas production days in the Akkulka field in Kazakhstan were 365 in 2011 and 87 days in 2010.
- Oil production days in the Akkulka field in Kazakhstan were 262 in 2011 and 86 days in 2010.
- Oil production days in the Beshtentak field in Tajikistan were 76 in 2011 and 86 days in 2010.

The combined boe/d is another of the Company's KPIs.

Financial Review

Loss before tax

The Company recorded a net loss after taxation of USD26.989 million in the year ended December 31, 2011, compared to a net loss of USD29.649 million in the same period of 2010. In the three months to December 31, 2011, the net loss incurred was USD9.424 million compared to USD11.210 million in the same period of 2010.

	Three months ended December 31			Year ended December 31		
	2011	2010	Movement	2011	2010	Movement
	\$	\$		\$	\$	
Sales and other revenues	7,416	3,387	119%	22,922	14,706	56%
Other operating income	747	-	100%	7,375	-	100%
Total revenue and other income	8,163	3,387	141%	30,297	14,706	106%
Production expenses	(3,867)	(2,965)	30%	(10,785)	(7,076)	52%
Depreciation, depletion and amortization	(3,427)	(2,200)	56%	(13,111)	(5,885)	123%
Impairment charge	(8,983)	-	100%	(8,983)	-	100%
Unsuccessful exploration & evaluation expenditure	-	94	-100%	(1,807)	-	100%
Listing expenses	-	(58)	-100%	(606)	(1,288)	-53%
Business development expenses	(437)	(35)	1149%	(2,363)	(35)	6651%
Administrative costs	(5,029)	(6,345)	-21%	(20,549)	(19,520)	5%
Stock-based compensation	(703)	(2,360)	-70%	(3,814)	(5,956)	-36%
Finance income/(loss) net	187	(40)	-568%	1,100	(129)	-953%
Foreign exchange gains/(loss) net	41	-	100%	74	(337)	-122%
Fair value gains/(loss)	(71)	242	-129%	(625)	(24)	2,504%
Gain on previously held equity interest in SSEC	27,381	-	100%	27,381	-	100%
Loss on settlement of pre-existing loan relationship	(24,423)	-	100%	(24,423)	-	100%
Loss from jointly controlled entity	80	(212)	-138%	(722)	(634)	14%
Loss before taxation	(11,088)	(10,492)	6%	(28,936)	(26,178)	11%
Taxation	1,664	(718)	332%	1,947	(3,471)	-156%
Loss for the year	(9,424)	(11,210)	16%	(26,989)	(29,649)	9%
Loss attributable to:						
Shareholders	(9,374)	(11,210)	16%	(26,939)	(29,649)	9%
Non-controlling interest	(50)	-	100%	(50)	-	100%
Loss for the year	(9,424)	(11,210)	15%	(26,989)	(29,649)	9%

Note

Revenue from the oil sales in Tajikistan is included in the financial statements of SSEC. Between December 31, 2009 and December 13, 2011, SSEC was a joint venture and as such its revenue was not included in the Company's consolidated revenue.

Sales and other revenue

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	
	\$	\$	Change	\$	\$	Change
Gas sales	1,800	1,982	-9%	7,027	3,767	87%
Oil sales	3,682	748	392%	8,185	748	994%
Refined product sales	1,869	631	196%	7,255	9,851	-26%
Other revenue	65	26	150%	455	340	34%
	7,416	3,387	119%	22,922	14,706	56%

Note 1 Gas sales in Kazakhstan are reported net of mineral Extraction Tax (MET) which amounted to USD40k in 2011 and USD22k in 2010.

Note 2 Oil sales in Kazakhstan are reported net of water content plus compensation for natural wastage, transportation costs of water from the well head to the terminal at Emba, and MET.

The growth of gas, oil and refined product sales is one of the Company's KPIs.

Gas sales

- The gas sales are generated from both the Kyzylai and the Akkulka contracts in Kazakhstan and, as referred to in *Kyzylai Gas Production* above, are sold to Asia Gas NG LLP at agreed prices of USD32 per Mcm excluding VAT for the Kyzylai gas and USD38 including VAT for the Akkulka gas.
- Gas sales in Kazakhstan in 2010 were affected by stoppages and production restrictions detailed in *Kyzylai Gas Production* above. In 2011, there were no such disruptions and steady sales were achieved throughout the year reflecting the consistent production levels of approximately 600Mcm/d.
- Total volumes sold in the year to December 31, 2011 were 134.2MMcm (2010: 94.5MMcm) from Kyzylai and 81.8MMcm (2010: 24.2MMcm) from Akkulka.
- Gas sales for the year to December 31, 2011 were USD7,027,000 compared to USD3,767,000 in the prior year.
- Gas sales for Q4 2011 were USD1,800,000 compared to USD1,982,000 in 2010.
- Total volumes sold in the three months to December 31, 2011 were 36.2MMcm (2010: 40.2MMcm) from Kyzylai and 19.2MMcm (2010: 24.2MMcm) from Akkulka.

Oil sales

- Q4 2010 was the first period in which oil sales were generated by the Company in Kazakhstan. Oil sales achieved in Q4 2011 at USD3,682,000 were significantly higher than the USD748,000 achieved in Q4 2010.
- The volumes of oil sales achieved in 2011 reflected the steady increase in production referred to in *Kazakhstan Oil Production* above.
- Full details of the progress of both sales volumes and prices through the course of 2011 are as follows:

	bbls	Revenue	Price (at the well head)	Compensation	VAT	MET	Net sales
			\$/bbl				
Q1	24,856	598	24.1	26	55	10	507
Q2	63,190	1,503	23.8	231	144	27	1,101
Q3	133,466	3,667	27.5	343	361	68	2,895
Q4	149,322	4,383	29.4	175	444	82	3,682
Total/Avg	370,834	10,151	27.4	775	1,004	187	8,185

Net figures exclude the compensation for water content plus compensation for natural wastage, transportation costs of water from the well head to the terminal at Emba, and MET.

Refined products sales (Uzbekistan)

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Refined product sales	1,869	631	196%	7,255	9,851	-26%

- Refined product sales for the year to December 31, 2011 were USD7,255,000 compared to USD9,851,000 in the same period of 2010. This reduction was a combination of the reduced production levels achieved in 2011 combined with the Company's reduced share of that production with several wells having completed the initial three years of production.
- Under the North Urtabulak PEC, TPU receives 50% of all incremental production from each well from the North Urtabulak Field for the first three years of production, with the remaining 50% to be shared between the Uzbek State Partners. For the subsequent five years, the company receives 20%, and the Uzbek State Partners 80% of the same. As at December 31, 2011 more than half of these wells were past the initial three years of production.
- The sales achieved in the three months to December 31, 2011 were in fact higher than in the same period of 2010 but this was the result of the virtual absence of deliveries from the refinery in the final quarter of 2010.
- Deferred revenue from refined product sales, i.e. goods sold and paid for but awaiting delivery, at December 31, 2011 was USD1,839,000 (2010: USD2,449,856).

Other operating income

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Other operating income	747	-	100%	7,375	-	100%

Since the beginning of 2010, through a wholly owned subsidiary, the Company has leased its ZJ30 drilling rig together with associated equipment to a subsidiary of its jointly controlled entity SSEC in Tajikistan. This rig and equipment was used in Tajikistan in drilling both of the Komsomolsk wells and then to drill the Persea well. The

renting of the equipment is on a full commercial basis and appropriate invoices have been issued to cover the entire rental period. In accordance with the SSEC shareholders agreement, the amounts receivable in respect of the rentals were added to the loan due from that entity. When preparing the 2010 annual financial statements and the interim financial statements for Q1 2011, these amounts were eliminated in full rather than proportionate to the group's equity accounted interest, and no income was recognized.

On May 27, 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 showed oil in the drilling mud at surface together with high gas levels, had not been fully evaluated or tested but the observed oil flow was obviously a positive indication. This was followed on June 9, 2011, by an announcement that electric logs had now been run in the well 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. These positive developments in Tajikistan were further supported by the Beshtentak well announcement on October 20, 2011 and subsequent oil production achieved in the final months of 2011. See *Tajikistan Operations Update* below.

As a result of these developments, which indicated that oil sales would commence in Tajikistan in the future, the directors revisited this matter and considered it appropriate to include that revenue from the rig rentals in the Q2 2011 interim financial statements and subsequent financial statements. Accordingly, 'Other operating income' for the year ended December 31, 2011 includes USD7.374 million in respect of these transactions, of which USD3.835 million relates to the year ended December 31, 2010. The invoices have still to be settled and there is consequently no impact on the Company's cash flows. There is also no impact on tax expense as a result of this income being recognised. Refer to *Note 7 in the Audited Consolidated Financial Statements for the year ending December 31, 2011*.

Following the purchase of 34% of the shares in SSEC from its Tajik joint venture partner Sangam Limited, increasing its shareholding to 85% (from 51%), this income will be eliminated on consolidation when preparing future financial statements.

Operating expenses

	Three months ended December 31			Year ended December 31		
	2011	2010	% Change	2011	2010	% Change
	\$	\$		\$	\$	
Kazakhstan	2,950	1,673	76%	7,429	2,224	234%
Uzbekistan	888	134	563%	3,327	3,238	3%
Other	29	1,158	-97%	29	1,614	-98%
Total	3,867	2,965	30%	10,785	7,076	52%

Kazakhstan

The split between the gas and oil production in Kazakhstan was as follows:

Kazakhstan gas production	USD3,662,000	(2010: USD1,531,000)
Production cost per boe	USD2.86	
Kazakhstan oil production	USD3,767,000	(2010: USD 693,000)
Production cost per barrel	USD8.46	(2010: USD13.621)

The majority of production costs in Kazakhstan are fixed.

Control of the production cost per barrel of oil is another of the Company's KPIs.

Total production costs in Kazakhstan were higher in the year ended December 31, 2011 compared to the same period in 2010 primarily as a result of the increased levels of oil production. There had been no oil production in the first nine months of 2010 and in the final three months of 2010 there was only test production from well AKD01.

A second significant contributory factor in Kazakhstan figures related to the Akkulka gas operating costs in 2011 as production did not commence on the contract until October 2010 meaning that there were no production costs for Akkulka gas in the first nine months of 2010.

In Kazakhstan, the time writing calculations and cost allocation process was reviewed and updated, resulting in a one off cost of USD0.6 million of expenditure being transferred in Q4 2011 from Administrative to gas and oil Production expenses.

Included in the Operating expenses of each contract is a charge for property tax relating to the NBV of the operating assets, which in 2011 amounted to USD0.15 million (2010: USD0.16 million) for the Kyzylai contract, USD0.14 million (2010: USD0.15 million) for the Akkulka gas contract and USD0.18 million (2010: nil) for the Akkulka gas contract.

Each contract also incurred project documentation costs of USD0.13 million in Kyzylai, USD0.11 million in Akkulka gas contract and USD0.8 million in Akkulka oil contract.

Because of the remoteness of the location, the Company has to maintain a fleet of vehicles with the associated fuel costs and because of the terrain the vehicles also incur significant maintenance costs.

Production costs in the three months to December 31, 2011 were also higher in Kazakhstan when compared to the same period of 2010 as a result of the time writing adjustment referred to above.

The other principal factor contributing to the increase in costs in the three months to December 31, 2011 compared to the same period in 2010 was the higher oil production level, with the oil being produced from three wells and 92 days of production as opposed to only AKD01 in 2010 and 65 days of production.

Uzbekistan

Despite the overall production being down from 562,930 bbls in 2010 to 378,639 barrels in 2011 (see *Uzbekistan oil production and Refined product sales* above) there was an increase in the Operating costs from USD3,238,000 in 2010 to USD3,327,000, which was the result of two factors:

- A large proportion of the production costs are fixed and, as such, do not decrease in line with production.
- There was a reduction in the stock of finished goods.

The operating costs in Q4 2011 were significantly higher than in the same period of 2010 because of the reduced level of sales achieved in Q4 2010 which was the result of the virtual absence of deliveries from the refinery in that period.

Depreciation, depletion and amortization expense

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
DD&A costs	3,427	2,200	56%	13,111	5,885	123%
Impairment charge	8,983	-	100%	8,983	-	100%

Impairment in Uzbekistan

As a result of the consistent decline in the production levels of the North Urtabulak PEC, the Company carried out an estimate of the recoverable amount from the contract. The result of this exercise was that the discounted cash flow indicated a value for the asset at USD6,078,254 while the carrying value of the asset was USD15,061,146 and consequently the impairment adjustment of USD8,982,792 was recognised to bring the carrying value in line with the discounted cash flow. See *Uzbekistan Oil Production North Urtabulak PEC* above. Should the actual future

performance of the PEC prove to be better than has been estimated then this impairment adjustment or part thereof could be reversed at a later date.

Unsuccessful exploration and evaluation expenditures

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Unsuccessful exploration and evaluation expenditures	-	(94)	-100%	1,807	-	100%

The costs incurred in Q3 2011 related to two shallow wells drilled on the Kul Bas contract in Kazakhstan.

Listing expenses

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Listing expenses	-	58	-100%	606	1,288	-53%

- The 2011 figures include costs related to the London listing that was completed in July 2011.
- The 2010 figures relate to the aborted listing on the Hong Kong Stock Exchange.

Business development expenses

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Business development expenses	437	35	1,149%	2,363	35	6,651%

- Business development costs relate primarily to costs incurred in the Company's pursuit of new contracts in Central Asia.
- The majority of the costs in 2011 were incurred with respect to the 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 April 17, 2011, the Company announced that it was one of five international companies pre-qualified and selected by the Ministry of Mines of the Afghanistan Government for a tender to explore and develop oil and gas deposits in northern Afghanistan. On September 5, 2011, the Company announced that the Chinese State Oil Company, CNPC, won the tender for the blocks in Afghanistan. The Company considers that the terms it would have needed to offer to win the tender would have made the project non-commercial.
- The Company incurred USD330,000 in connection with a contract with the Institute of Geology and Prospecting for Oil and Gas Deposits (the "Institute") in Uzbekistan to study the potential of two separate prospective areas in Uzbekistan with a view to Tethys applying for suitable projects in these areas. The study involved the assessment of existing data and the oil and gas bearing prospectivity of the areas on the basis to prepare proposals for the Government of Uzbekistan for further exploration activities. Tethys views both areas as having very good oil and gas potential but has chosen to focus on the North Ustyurt area and has now signed an MOU with a view to obtaining an exploration contract for this area.

Administrative costs

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Staff costs	2,356	3,358	-30%	8,751	8,741	-
Travel costs	894	1,034	-14%	3,700	3,380	9%
Office costs	586	369	59%	2,634	2,080	27%
Professional fees	705	727	-3%	2,653	2,577	3%
Marketing costs	155	260	-40%	1,269	835	52%
Other costs	333	597	-44%	1,542	1,907	-19%
	5,029	6,345	-21%	20,549	19,520	5%

General and Administration expenses for the year ended December 31, 2011 were up on the same period of the previous year as a result of the following:

- There was an increase in staff costs in the year to December 31, 2011, as a result of increased levels of staff particularly in Kazakhstan and other operational areas. In 2010, bonuses were paid in relation to the fund raising completed in the first and final quarters of the year.
- Travel costs in the year to December 31, 2011, increased as a result of more staff travelling throughout the area as the Company looks to develop its operations and revenue.
- In Kazakhstan, the time writing calculations, being the staff costs allocated on time sheets completed by the employees, and the cost allocation process was updated and as a result USD0.6 million of expenditure was transferred from G&A to Operating expenses and USD0.3 million to Capital expenditure. (*See Operating Costs above.*) Within the staff costs, some costs were incurred in the final quarter of 2010 in connection with the successful fund raising completed in October 2010.
- Year on year there was little movement in the total expenditure for Professional Fees while certain “one off” computer software costs and legal costs incurred in the early part of the year were offset by savings in the final quarter.
- The principal factor in the increased marketing costs was a number of contributions to various social programmes at a combined cost of USD250,000. These programmes were linked primarily to the development of the Shalkar region in Kazakhstan, where the Company’s projects lie, and were incurred by both of the Company’s subsidiaries, Tethys-Aral-Gaz and Kul Bas. The Company also incurred costs with the contracting of a new company involved in public and governmental relations.

General and Administration expenses for the three months ended December 31, 2011 were up on the same period of the previous year as a result of the following:

- Within staff costs, certain costs were incurred in the final quarter of 2010 in connection with the successful fund raising completed in October 2010.
- In Kazakhstan the time writing calculations and the cost allocation process was updated and as a result USD0.6 million of expenditure was transferred in Q4 2011 from G&A to Operating expenses and USD0.3 million to Capital expenditure
- There was an increase in office costs in Q4 2011 compared to Q4 2010 as a result of an increase in floor space to accommodate the increased staffing levels.

Share based payments

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Share based payments	703	2,360	-70%	3,814	5,956	-36%

- Share based payment expenses relate to stock options and warrants issued in 2011 and prior years. The decrease is due to fewer options issued during 2011 compared with 2010 combined with the fall in the share price.

Finance expenses

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Foreign exchange (gain) / loss	(41)	-	100%	(74)	337	-122%
Fair value loss / (gain)	71	(242)	-129%	625	24	2,504%
Loss from joint venture	(80)	212	-138%	722	634	14%
Finance (income) / costs net	(187)	40	-568%	(1,100)	129	-953%

- 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 and forex hedging.
- In addition to the operating income, the Directors have given similar consideration to the position of interest on the loan to jointly controlled entity SSEC, with the result that cumulative interest income of USD1.113 million on the loan of USD18.443 million as at December 13, 2011 (up until the date SSEC became consolidated into the Company's financial statements) has been recognised for the year to December 31, 2011. Of this amount, USD0.420 million relates to the year ended December 31, 2010. This change also has no effect on tax expense or cash flows. Refer to *Note 16 to the 2011 Audited Consolidated Financial Statements*.

Acquisition of 34% of SSEC

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Gain on previously held interest in SSEC	(27,381)	-	100%	(27,381)	-	100%
Loss on settlement of pre-existing loan relationship	24,423	-	-100%	24,423	-	-100%

- On December 13, 2011, the Company completed the purchase of 34% of the shares in SSEC from its Tajik joint venture partner Sangam Limited, and increased its shareholding to 85% (from 51%). SSEC is the owner of the rights to the Bokhtar PSC in Tajikistan.
- For full details of loss on acquisition of subsidiary see *Acquisition of Shares in SSEC* below and refer to *Note 25 of the 2011 Audited Consolidated Financial Statements*.

Taxation

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Tax	1,664	(718)	-332%	1,947	(3,471)	-156%

The tax charge reflects the change in deferred tax arising as a result of the movement in timing differences between the accounting value of assets and liabilities and their respective values for tax purposes. The recovery in 2011 was due in part to the impairment of Uzbek assets (see *notes 12 and 13 of the Audited Consolidated Financial Statements*) and a favourable increase in asset tax pools in Kazakhstan.

For details as to why the provision for income taxes is different from the expected provision for income refer to *Note 10 of the Audited Consolidated Financial Statements*.

Acquisition of shares in SSEC

The Group, through Tethys Tajikistan Limited (TTL), established the joint venture company SSEC with Sangam to explore for and develop oil and gas resources in Tajikistan, with TTL holding 51% and Sangam holding 49% of SSEC's shares; however with neither party having voting control. The management of Sangam are experienced in operating businesses in Tajikistan and the Company views this experience as being very valuable in assisting SSEC to develop its business in Tajikistan. Operations were managed and directed by TTL. TTL provided the financing for SSEC by way of a shareholder loan from TTL to SSEC. In November 2011, TTL and Sangam concluded an option agreement for TTL to acquire 34% of SSEC (and full control of the company) from Sangam for cash consideration of USD7 million and the waiver of USD49.92m of the outstanding loan between TTL and SSEC, this option to expire on December 31, 2011. At the time of acquisition, SSEC owed TTL USD66,772,000 with respect to the loan. On December 9, 2011, Tethys announced that it had completed the private placement of 26,062,975 Ordinary Shares for gross proceeds of USD13,069,187, with the private placement being primarily to exercise the option to acquire the Sangam interest. On December 13, 2011 the Company announced that the option had been exercised and that TTL now owned 85% of SSEC and controlled the company.

The non-cash consideration part of the purchase involved the Company agreeing to waive an amount of USD49,920,000 with respect to the loan between SSEC and TTL, being the loan balance at April 1, 2011. The fair value of the joint venture partner's benefit from the loan waiver is the fair value of 15% of the amount waived, representing the future benefit that the joint venture partner will now receive from future distributions by SSEC. The Company involved an independent external expert to fair value 15% of the amount of USD49,920,000 that was waived and full details are provided in *Note 25 of the Company's 2011 Audited Consolidated Financial Statements*.

On completion, TTL increased its shareholding from 51% to 85% and holds a controlling interest in SSEC. The shareholder loan was discharged with effect from April 1, 2011 however continues from April 2, 2011 pursuant to which TTL agrees to finance work programmes and field development of its subsidiaries in Tajikistan. The loan bears interest at the rate of the London inter bank offer rate plus 1% . The loan will be repaid by SSEC from free cash flow before any distribution of profit to SSEC's shareholders. TTL will continue to manage SSEC and subsidiaries in all day to day operations in accordance with the Management Agreement as oil and gas experts.

Subsequent to this transaction the Company now holds 85% economic interest in the contractor share of the Bokhtar PSC which covers an area of 34,797.8 km² in the southwest of the country (representing approximately 21.6% of the total land area of Tajikistan). The Bokhtar PSC is for a term of 25 years and covers a large highly prospective region, which has previously produced oil and gas. This transaction has provided the Company with valuable benefits including the acquisition of over 388 million barrels of prospective resources, reducing the interest of a non-funding partner and thereby increasing the Return on Capital Employed going forward, and obtaining control of the Tajikistan joint-venture.

Capital Expenditure

Capital expenditure during the quarter ended December 31, 2011 was USD5.068 million.

	Three months ended December 31			Year ended December 31		
	2011	2010	%	2011	2010	%
	\$	\$	Change	\$	\$	Change
Kazakhstan	4,002	13,794	-71%	37,020	33,058	12%
Uzbekistan	167	1,303	-87%	3,772	4,937	-24%
Other and Corporate	899	(13)	-7,015%	1,110	298	272%
	<u>5,068</u>	<u>15,084</u>	<u>-66%</u>	<u>41,902</u>	<u>38,293</u>	<u>9%</u>

Major items of capital expenditure in the three months to December 31, 2011 were:

Kazakhstan

- Akkulka appraisal wells USD4.22 million
- Shalkar rail terminal USD3.10 million
- Kalypso (Kul Bas) USD1.55 million

Uzbekistan

- Workovers USD0.27 million

Tajikistan

- Well EOL09 USD0.48 million
- Persea well USD1.73 million
- Aeromagnetic survey USD0.27 million

Major items of capital expenditure in the year to December 31, 2011 were:

Kazakhstan

- Doris oil production USD 5.40 million
- Akkulka appraisal wells USD22.02 million
- Kalypso (Kul Bas) USD 7.85 million

Note Through its new Joint Venture in Kazakhstan the Company invested USD3.1 million which was spent on the rail terminal at Shalkar.

Uzbekistan

- Well NU96 USD2.76 million
- Workovers USD1.59million

Tajikistan

- Well EOL09 USD4.98 million
- Persea well USD5.18 million
- Aeromagnetic survey USD3.65 million
- KOM201 well USD1.30 million

Transfer of assets

The Company has established a wholly-owned Cayman subsidiary, Imperial Oilfield Services Limited ("IOSL"), to own some of its drilling rigs and other production equipment. At the end of 2011, the Company restructured the ownership of the rigs Telesto and Tykhe and their respective equipment by transferring them from Asia Oilfield Equipment B.V. and AOE Tyke S.A. to IOSL. These transfers were between wholly owned subsidiaries of Tethys and were carried out at Net Book Value. Lenders participating in the USD10 million loan facility, as detailed in "Liquidity and Capital resources" section below, have security against the shares of Imperial Oilfield Services Limited.

Use of Funds

Set out below are details of the planned use of funds as detailed in the prospectus dated October 4, 2010:

The primary differences were in relation to:

1. The well drilling programme in Kazakhstan is ongoing with a further two appraisal wells planned for 2012 and testing of the exploration well in Kul Bas.
2. Phase 1 of the production and processing infrastructure is almost complete though there is some work ongoing including road improvements.
3. While the Company has incurred USD3,100,000 in relation to the Shalkar rail terminal costs further expenditure will be incurred in 2012.
4. There is no significant production yet in Tajikistan and so few costs have been incurred in relation to Production and Processing infrastructure.
5. In Uzbekistan no seismic work has yet been undertaken.
6. While only one well has been drilled in Uzbekistan there have been a number of workovers.

	Prospectus dated Oct 04, 2010	Incurred to Dec 31, 2011	Balance
<i>Kazakhstan</i>			
Appraisal and Exploration Wells	47,500	34,089	13,411
Production and Processing Infrastructure	19,800	12,650	7,150
Seismic Data	6,000	3,070	2,930
<i>Tajikistan</i>			
Production and Processing Infrastructure	3,760	-	3,760
Seismic Data	3,000	3,000	-
Exploration and Appraisal Drilling Wells	4,000	4,000	-
<i>Uzbekistan</i>			
Seismic Data	2,000	-	2,000
Production Drilling	5,940	2,763	3,177
Total	92,000	59,572	32,428

The primary explanation of the difference between the “Balance” of USD32.4 million per the above table and the cash balance of USD11.6 million per the Company’s financial statements are as follows:

Increased spending on Komsomolsk wells
 Drilling of EOL09 oil discovery exploration well in Tajikistan
 Testing of EOL09
 Reduced cash from 2011 Kazakhstan Revenue primarily due to adverse weather conditions
 Reduced cash from 2011 Uzbek sales
 Business development costs

Set out below are details of the planned use of funds as detailed in the prospectus dated June 11, 2009.

The primary differences were in relation to:

- The Komsomolsk wells KOM 200 and KOM 201, encountered unexpected drilling challenges and cost more than was anticipated and are currently suspended awaiting completion at some future date. As a result the processing plant has not yet been constructed. Additional costs were however incurred on the Beshtentak and Komsomolsk fields.
- Installation of a Gas Lift Compression system in North Urtabulak has now been cancelled following detailed technical and commercial analyses.

	Jun 12, 2009 Prospectus	Incurred Sept 30, 2011	Balance
<i>Tajikistan</i>			
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 Bokhtar PSC	3,660	3,660	-
<i>Uzbekistan</i>			
North Urtabulak Gas Lift Compression System	1,190	-	1,190
North Urtabulak new well. Radial drilling and water injection Workovers	4,000	4,000	-
	<u>17,850</u>	<u>14,660</u>	<u>3,190</u>

Summary of Quarterly Results

	Mar 31 2010	Jun 30 2010	Sep 30 2010	Dec 31 2010	Mar 31 2011	Jun 30 2011	Sep 30 2011	Dec 31 2011
Financials	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	2,116	6,030	3,173	3,387	4,480	9,883	7,771	8,163
Net loss	(7,999)	(3,322)	(7,118)	(11,210)	(6,294)	(2,696)	(8,575)	(9,424)
Basic and diluted loss (\$ per share)	(0.05)	(0.02)	(0.04)	(0.04)	(0.02)	(0.01)	(0.03)	(0.04)
Capital expenditure	4,443	7,316	11,950	14,584	10,852	14,834	11,148	5,068
Total assets	186,405	184,082	182,081	267,748	259,477	261,144	255,066	263,391
Total long term liabilities	(13,419)	(14,938)	(15,963)	(11,535)	(10,492)	(8,434)	(8,295)	(4,676)
Cash balance	48,927	30,232	12,917	79,135	57,400	35,855	18,425	11,631
Cash and working capital surplus/(deficit)	38,372	24,408	6,046	69,718	49,893	24,137	4,893	942

The figures in the table above have been prepared under IFRS requirements.

Significant factors influencing quarterly results:

Oil sales from oil test production from Doris commenced in Q4 2010 resulting in revenue of USD748,000 in Q4 2010, USD507,000 in Q1 2011, USD1,101,000 in Q2 2011, USD2,895,000 in Q3 2011 and USD3,682,000 in Q4 2011. See *Oil Sales* above.

Revenue from rig rentals to the JV in Tajikistan was first included in Q2 2011. See *Other operating income* above.

Refined product shipments were delayed in the first two quarters in 2011. See *Refined product sales (Uzbekistan)* above.

Akkulka gas production commenced in Q4 2010. See *Kazakhstan Gas Production (Akkulka contract)* above

During the course of Q2 2010, a number of Uzbekistan refined product shipments were completed which related to 2009 production resulting in higher revenue recognized in Q2 2010. See *Refined product sales (Uzbekistan)* also above.

In December 2009, the Company's Tajikistan operations were transferred to a jointly controlled venture (SSEC). See *Acquisition in SSEC* above.

Financial position

The following table outlines significant movements in the consolidated balance sheets from December 31, 2010 to December 31, 2011:

	Dec 31, 2011	Dec 31, 2010	Movement	Movement Details
Property, plant and equipment	128,918	115,653	13,265	Continuing investment in Akkulka Deep oil property offset by DD&A
Intangible assets	99,959	16,892	83,067	Expenditure on Kul Bas and acquisition of SSEC assets
Non-current other receivables	10,217	12,320	(2,103)	Partial movement of long term VAT receivable to current
Loan receivable from joint controlled entity	2,013	35,460	(33,447)	Full disclosure in note 16 of the 2011 audited consolidated financial statements
Investment in jointly controlled entity	1,113	-	1,113	Investment in the JV - Aral Oil Terminal
Inventories	2,025	2,121	(96)	Movement in finished product - Uzbekistan
Trade and other receivables	5,478	3,680	1,798	Partial movement of long term VAT receivable to current in anticipation of recovery in 2012.
Cash and cash equivalents	10,746	79,135	(68,389)	Refer to Consolidated Statement of Cash Flows in the annual financial statements
Restricted cash	885	-	885	Required in relation to a hedge on foreign currency plus security against credit cards.
Derivative financial instruments - interest rate swap	630	1,472	(842)	Movement in fair value valuation
Other reserves	38,530	34,261	4,269	Stock based compensation expense for the year to December 31
Accumulated deficit	(144,962)	(118,023)	(26,939)	Loss incurred for the year ended December 31. Refer to Financial Review above
Non-controlling interest	8,918	-	8,918	15% non-controlling interest in SSEC
Non-current financial liabilities - borrowings	1,632	2,853	(1,221)	Movement of older loans to current liabilities less new equipment based loan.
Deferred taxation	2,111	4,070	(1,959)	The deferred tax liability arises in Kazakhstan and Uzbekistan as a result of timing differences between the accounting value of assets and liabilities and their respective values for tax purposes.
Current financial liabilities - borrowings	8,396	5,047	3,349	Movement from long term borrowings plus new equipment based loan.
Derivative financial instruments - warrants	264	405	(141)	Movement in the fair value of the liability together with expiry of some warrants
Derivative financial instruments - forex hedge	157	-	157	Movement in the fair value of a foreign currency hedge
Deferred revenue	1,839	2,450	(611)	Net release of Uzbekistan sales awaiting shipment.
Trade and other payables	10,179	8,788	1,391	Increase in trade payables primarily in Kazakhstan

Contractual obligations and liabilities as at December 31, 2011

The following are the contractual maturities of financial liabilities, including estimated interest payments:

	Carrying amount	Payments Due by Period \$'000s				
		Contractual cash flow	Less than 1 Year	1 - 3 Years	4 - 5 Years	After 5 years
Trade and other payables	10,726	11,108	10,289	437	382	-
Financial borrowings	10,028	11,029	9,537	1,492	-	-
Commitments	5,162	5,162	5,162	-	-	-
Operating leases	1,055	1,055	670	290	95	-
Total	26,971	28,354	25,658	2,219	477	-

The Company is confident that it will satisfy these obligations and liabilities as and when they fall due.

Liquidity and Capital Resources

In December 2011, the Company closed on the first tranche of a maximum USD10 million loan facility amounting to USD3,965,240, which is secured by the ZJ70 and ZJ30 rigs and other equipment. This facility gives lenders the choice of two methods of repayment designated Option A and Option B. Under Option A, which has a term of one year, lenders have the option to receive monthly repayments on an interest only basis followed by a single balloon repayment of the principal amount to be paid at the maturity date. Option B, which has a term of two years, gives lenders the right to receive equal monthly instalments, incorporating interest and capital, together with a single balloon repayment of half of the principal amount to be paid at the maturity date. These borrowings are held at amortized cost and their carrying amounts approximate to their fair value at the balance sheet date. The interest payable on the borrowed funds is 12% per annum under both options.

In addition, lenders were granted warrants to acquire ordinary shares of the borrower equal to half of each USD100,000 principal amount of the loan advanced to the Company. As at December 31, 2011, 1,982,620 such warrants have been granted to lenders. Under the USD10 million loan facility, a total of 5 million warrants are issuable.

Such warrants will be exercisable at a 25% premium to the price of the volume weighted average CAD price of the shares on the TSX for the 5-day period prior to the day the borrower receives the funds in its bank account. As at December 31, 2011, 1,982,620 warrants had been issued in connection with the first tranche of the loan. The Company has recorded a discount to the loan in the amount of USD232,746 based on the relative fair value of the warrants. USD3,611,005 was then amortised using the effective rate interest method. Lenders have security over the shares of IOSL which has no other assets except the drilling rigs and associated equipment.

The Company completed the second tranche of this loan for a further USD3.2 million was completed in February and of the final tranche of USD2.8 million, USD2.3 million has been received and USD0.5 million has been committed.

For details of other avenues that the Company is pursuing to improve liquidity refer to the "Funding" section below.

Cash Flows

The movement in the cash balance during the year to December 31, 2011 compared to what happened in the same period of 2010 can be broken down as follows:

	December 31 2011 \$	December 31 2010 \$	% Change
Net cash used in operating activities	(12,558)	(16,824)	34%
Net cash used in investing activities	(67,928)	(56,643)	20%
Net cash generated from financing activities	12,107	145,304	-92%
Foreign exchange difference	(10)	1	-1,100%
	<u>(68,389)</u>	<u>71,838</u>	<u>5%</u>

Operating activities

The reduction in the Net cash used in operating activities in the year to December 31, 2011 compared to the previous year can be attributed to the increased level of sales achieved in 2011 *See Sales and Other Revenue above.*

Investing activities

The primary items contributing to Net cash used in investment activity are as follows:

- Purchase of 34% of SSEC USD7,000,000
- Increase in payments made on behalf of SSEC USD18,292,000
- Capital expenditure USD41,902,000

Financing activities

Cash generated from financing activities relates to equity based funding in both years.

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 regularly updated forecasts of the expected timing and level of capital and operating expenditure required to meet both 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 borrowings at December 31, 2011 were higher than at the same point in 2010 primarily due to the new drilling equipment loan less the repayments on the Tykhe loan. *See Liquidity and Capital Resources above.*

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, 2011.

	December 31 2011	December 31 2010
	\$	\$
Total financial liabilities - borrowings	10,028	7,900
Less: cash and cash equivalents	(11,631)	(79,135)
Net (funds)	(1,603)	(71,235)
Total equity	237,880	239,523
Total capital	236,277	168,288

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.

Funding

The directors have considered the Company's current activities, funding position and projected funding requirements for the period of at least twelve months from the date of approval of the consolidated financial statements, in concluding whether it is appropriate to adopt the going concern basis in preparing the consolidated financial statements for the year ended 31 December 2011. The Company's activities, together with the factors likely to affect its future development, performance and position are set out in the Annual Information Form and Management Discussion & Analysis document. The key issues impacting the cash flows of the Company are the commissioning of the AOT rail terminal due at the beginning of April and receipt of the USD5 million Kazakh bank facility. The financial position of the Company, its cash flows and liquidity position are as set out in the Management Discussion & Analysis document on pages 23 to 26 and in Note 20 to the 2011 audited consolidated financial statements. The Company reports a loss for the year ended 31 December 2011 of USD26.989 million (2010: USD29.649 million). As at 29 February 2012, the Company held cash of USD6.7 million.

The AOT rail terminal at Shalkar has been completed and will allow the Company to increase shipments once approved by the local State Commission. The Company believes that the increased oil sales resulting from the production of 4,000 – 6,000 bopd, will generate sufficient levels of cash to fund its ongoing activities and its current capital expenditure plans. Completion of this terminal was originally anticipated to be in the fourth quarter of 2011 but due to adverse weather this was moved back to the first quarter of 2012 and is now due to be commissioned at the beginning of April.

Existing oil operations were disrupted as a result of severe winter weather conditions in Kazakhstan which reduced the sales revenue and so the cash available to the Company. In December 2011 the Company was committed to meet the balloon payments of USD0.7 million due on the expiring Tykhe rig loan and then in the first quarter of 2012 the loans associated with the Uzbekistan NU116 well, drilled in late 2009, were due for settlement with USD4.1 million due in January 2012 and USD3.4 million in March 2012. The Company settled USD1.05 million of the USD4.1 million loan in December 2011 and the remaining funds then rolled over into the new equipment secured loan (see below). All other loan balances were settled on the due dates.

To assist with these commitments, the Company put in place a loan secured against drilling equipment. The total amount of the loan is USD10 million and the first tranche of USD4 million was completed in December 2011, the second tranche of USD3.2 million was completed in February and of the final tranche of USD2.8 million, USD2.3 million has been received and USD0.5 million has been committed.

While as stated above, management is confident that, with the increased production levels at 4,000 – 6,000 bopd, the Company will have sufficient funding for its ongoing activities and its current capital expenditure plans, it is aware that until the terminal is fully commissioned additional funds may be necessary to meet planned outflows. The Company has a number of options with respect to capital expenditure and can defer, delay or cancel several planned

capital items. Given the low level of committed capital expenditure, the Directors believe that the Company has sufficient funds but would like to progress other activities if funding allows. For this reason, the Company is exploring a number of alternative funding arrangements including discussions which are close to being finalised with the Company's Kazakh bank with regard to a USD5 million loan facility. In addition, the Company would also like to fund a further USD8 – 10 million of seismic work in Tajikistan, in order to finalise the location of the first deep sub-salt well. This is not a contractual commitment but the Company would like to advance its programme which should assist with bringing in a suitable farm-in partner to fund the drilling of the deep well. The Company is currently adopting a prudent approach to cash management and will proceed with such projects when certain milestones have been met. Discussions have also been initiated with regard to reserve based lending and on other corporate and project related financing options.

With regard to longer term requirements, 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. As at the date of this report, the Company is in discussions with several parties with regard to a potential farm in and/or joint ventures.

The Directors have examined these issues to form a view on the Company's ability to realise its assets and discharge its liabilities in the normal course of business. After making enquiries and considering the circumstances referred to above, the Directors have a reasonable expectation that the company has adequate resources and potential to continue operations for at least the next twelve months. For these reasons they continue to adopt the going concern basis of accounting in preparing the consolidated financial statements.

Off-Balance Sheet arrangements

The Company has no off-balance sheet arrangements.

Stockholder Equity

As at December 31, 2011, the Company had authorized share capital of 700,000,000 Ordinary Shares of which 286,692,744 (2010: 260,629,769) had been issued and 50,000,000 preference shares of which none had 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 9, 2011, the Company completed a previously announced private placement of 26,062,975 Ordinary Shares for gross proceeds of USD13,001,981. The net proceeds of the Offering were to enable Tethys to purchase an additional 34% of shares in SSEC and to carry out additional work on the Beshtentak oilfield in Tajikistan.

As at the date of this report, March 30, 2011, a total of 31,115,572 (2010: 22,100,372) 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 is 28,923,000 and the number of warrants outstanding is 6,903,226.

Auditors

At the AGM held in Grand Cayman on June 27, 2011, KPMG Audit Plc were appointed as auditors of the Company to hold office until the close of the 2012 Annual General Meeting of Shareholders. PriceWaterhouseCoopers had been the previous auditors.

OUTLOOK

The information provided under this heading is considered as forward looking information, as such please refer to *Forward Looking Statements* on page 38 of this MD&A.

The Company's objective is to build a diversified oil and gas exploration and production company with a mixture of short-term cash flow projects and long-term high potential exploration projects focused in the Central Asian region. The Company's approach involves a mix of early cashflow production and development projects, for natural gas and oil, as well as high potential exploration prospects looking to generate significant commercial upside. The Company 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.

While the Company'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 specific focus of management in the short term is to:

- fully appraise the Doris oil field discovery in the Akkulka Block, Kazakhstan;
- increase production from the Doris field to 6,000 bopd.
- test and evaluate the Kalypso (KBD01) exploration well with the aim of producing hydrocarbons, subject to having appropriate governmental permissions and available prioritised cash resources;
- continue exploration drilling and evaluation of the Akkulka and Kul-Bas licence blocks in Kazakhstan;
- acquire contracts on new existing oil fields and exploration acreage in Uzbekistan;
- complete the final stage of the seismic programme in Tajikistan;
- fully test the East Olimtoi EOL09 exploration well in Tajikistan;
- fully test the Persea well –PER01 in Tajikistan subject to available prioritised cash resources; and
- further evaluation and testing of the Beshtentak Field in Tajikistan including construction of additional field facilities, completion of a new geological and reservoir model and plan for further workovers and possible drilling to increase oil and gas production.

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 and is actively pursuing farm outs and similar arrangements on its Tajik and Uzbek assets.

Kazakhstan Operations Update

On November 15, 2011, the AKD06 Doris appraisal well tested oil at a rate of over 4,300 bopd from the Cretaceous sand interval. The flow was restricted but data indicated that open flow potential was in excess of 6,000 bopd. This well commenced production in November and along with wells AKD01 and AKD05 will contribute to the increased production levels when the AOT rail terminal is fully operational.

On January 30, 2012, the Company announced the official inauguration of its AOT terminal – a new storage and rail loading facility for its oil shipments from the Doris oilfield. The AOT is owned and operated through a 50:50 joint venture by Tethys and its Kazakh oil trading partner's company, Olisol Investment Limited. The facilities are fully complete and ready to commence commercial operations and the Company anticipates that these facilities will be fully operational following the visit of a Kazakh governmental State Commission which is planned imminently. The AOT is initially planned to enable the Company to increase production to approximately 4,000 bopd. It is planned to expand the capacity of the terminal to more than 12,000 bopd to accommodate future potential production growth dependent upon further drilling results. Production from Akkulka area is planned to increase to 5,000 - 6,000 bopd later in the year from the existing drilled wells, and further production increases are expected but are dependent on the results of the appraisal / exploration drilling planned for 2012. Further evaluation of the 3D seismic dataset acquired 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.

The next appraisal well, AKD07, is expected to spud in Q2 2012 and will be located to the south-east of the original AKD01 discovery well and will target 3P reserves at the Cretaceous Aptian sand level in what is believed to be a channel sand system, whilst simultaneously targeting an exciting exploration prospect (named "Dyna") that has been identified on the new seismic data from a bright amplitude anomaly at a slightly shallower level and is interpreted to

be part of a different, larger sand fan system. The prospective resource for this new target will be disclosed after the completion of a new independent Kazakhstan Resource Report, which is expected to be issued in Q2 2012.

Additional exploration/appraisal prospects have been identified using the newly interpreted 3D and 2D data. This data has led to the identification of a number of other attractive exploration prospects at the Doris reservoir levels and other horizons. All these will be included in the new resource report.

Tajikistan Operations Update

On October 20, 2011, the Company announced that the Beshtentak well BST20, having been worked over by applying modern perforating and acidisation techniques and applying natural gas lift, tested oil at a rate of 533 bopd accompanied by 12,500 cubic metres (441 thousand cubic feet) of gas per day on a restricted choke (10 mm - 25/64 inch) with a flowing tubing head pressure of 26 atmospheres (377 psi). The oil has an API gravity of 38 degrees.

Initial sales agreements were signed and the first payments from oil sales received. The well was placed on oil production and the gas was tied into the nearby local gas grid but subsequently production performance indicated possible communication with the nearby BST103 well which is producing gas from the field for the city of Kulob, this gas being part of the "base level" production on the field assigned to the Tajik State. As a result the BST20 production is currently restricted and additional data was acquired to ascertain the extent of any possible communication. The well is now back on production but at lower rates than previously and the Company believes that this well needs work carried out on zonal isolation to increase production. This work is planned once the current bad weather conditions have improved. Meanwhile three further workover candidates have been identified in other parts of the field (away from existing producers), which are interpreted to contain remaining bypassed oil and gas and work is progressing to fully assess these interesting opportunities, including potentially the acquisition of downhole seismic data. In addition to conducting recompletion work on these three wells it is planned in the future to locate potentially one or two new high angle or horizontal crestal development wells, which would have the potential to achieve higher production rates than those obtained from the BST20 well.

Testing operations on the East Olimtoi EOL09 exploration well located south of the town of Kulob, some 10 km north of the Afghan border, were initiated in Q3 and Q4. This well reached a total depth of 3,765 metres in the Akdzhar formation in August 2011. The initial results from the raw logs indicated several zones of interest in the Bukhara limestone sequence with potential high oil saturations but testing has shown this reservoir to be unproductive and may require hydraulic fracturing. The Alai formation showed both good oil and gas shows while drilling (with oil and gas to surface) and the electric logs through this interval indicate several hydrocarbon bearing zones with no evidence of any oil-water contact. The well required heavy drilling mud to control the well and it is likely that this has damaged the formation. The well testing programme is planned to be continued in Q2 2012 once specialist equipment is available and operational to stimulate and attempt to establish continual flow of oil from the Alai zone, where oil has been recovered. The EOL 09 well is the first exploration oil discovery in Tajikistan since independence. There are other similar salt swell flank prospects to be explored nearby which was one of the first subjects of the recent deep seismic survey. Some of these salt swells break surface forming "salt mountains" such as the Khoja Mumin salt dome, which has oil and gas prospects around and under it and is located close to East Olimtoi.

The Persea 1 exploration well, located near the town of Kurgon-Teppa in the south-west part of the Bokhtar PSC area, was drilled primarily targeting the Bukhara limestone formation in a four-way dip closed structure with the overlying Alai formation forming a potential secondary target. On December 19, 2011, the Company announced the initial results of its Persea 1 exploration well in Tajikistan. The well reached a total depth of 2,655 metres and wireline logs show a 50 metre gross zone of possible hydrocarbons within mixed sandstone and carbonate sequence assigned to the Alai formation. Testing will be carried out on a cash flow prioritised basis with the cost to be financed by internally generated cash flow.

In 2011, Tethys carried out an aeromagnetic gravimetry survey over more than half of the Bokhtar PSC Area. The initial analysis of the data from the aerial gravimetry survey completed at the end of 2011 has revealed several attractive prospective areas with the potential presence of very large deep sub-salt and sub-thrust prospects within

the Bokhtar PSC Area. This area lies within the Afghan-Tajik basin whose extension, the Amu Darya basin contains some of the world's largest gas and condensate fields, many located in the sub-salt section. No well has ever been drilled through the salt zone to the sub-salt section in the Tajik part of this basin. It is now planned to acquire additional seismic which will target these areas and provide the final data in a comprehensive programme to optimally locate a deep well. It is expected that this data will be acquired this summer with initial interpreted results in Q4 2012. It is also expected that Tethys' large drilling rig "Telesto" will be mobilized to Tajikistan before the end of this year in order to drill this well.

The seismic programme will involve the acquisition of approximately 870km of new 2D seismic in two areas. The programme has been designed to target these areas as the gravimetry survey has identified them to be the most likely to contain large deep prospects including potential Jurassic reefs located on the edge of likely Permian basement high features. Jurassic reefs form some of the most prolific fields in the Amu Darya basin and no wells have ever been drilled through to the Jurassic horizon through the overlying salt layer in Tajikistan to date. The data also reveals significant potential in other parts of the Bokhtar PSC Area, including the Kulob area.

It is planned to carry out a new resource report in 2012 based on the results of this work.

The Company has previously stated that it is seeking a suitable farm-in partner for its exploration programme in Tajikistan and the seismic data are an important part of the information relating to such a potential farm-in. Discussions continue with several parties.

Uzbekistan Operations Update

The Company intends to focus future efforts in Uzbekistan on developing new contracts such as the Chegara PEC or on potential exploration activities. The North Urtabulak impairment (See *Impairment Adjustment in Uzbekistan* above) must be taken in the context of the new projects which the Company is now developing in Uzbekistan. The North Urtabulak project is a late stage re-development and incremental production project on an old field and the Company has used this project as a base to develop additional projects and a significant business presence in Uzbekistan. Currently these new projects include the Chegara PEC (Chegara is a much less developed producing field) and the potential exploration block in the North Ustyurt basin (which is south of the Doris discovery in Kazakhstan and which the Company believes has considerable exploration potential).

In November 2011, the Company announced it had signed an MOU with UNG, establishing a programme for Tethys to obtain a new PEC on an existing oilfield in Uzbekistan. The MOU presented an agreed timetable up to May 1, 2012 to negotiate for a new PEC for the Chegara Group of fields. The Chegara Group of fields is located in the same geographical area as North Urtabulak. The Chegara Group of fields is less developed than North Urtabulak, and Tethys believes that these fields offer significant potential for additional oil production in the short term.

In February 2012, the Company announced it had signed an additional MOU with UNG. The objective of this MOU was to continue providing the framework for a Joint Study and the negotiation process for an Exploration Agreement relating to certain exploration blocks in the North Ustyurt Basin of Uzbekistan.

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 "not for profit flow through" contract from Vazon in the year ended December 31, 2011 was USD3,295,754 (December 31, 2010 USD2,525,885). 34% of the increase was as a result of remuneration increases, 66% as a result of new staff/internal transfers.

Vazon as a Guernsey based company plays, amongst other things, a pivotal role in the obtaining and maintaining of residence licences for senior staff in Guernsey.

Oilfield Production Consultants

Oilfield Production Consultants (OPC) Limited, Oilfield Production Consultants (OPC) Asia LLC and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys for work on projects in Tajikistan, Kazakhstan and Uzbekistan. Total fees for the year ended December 31, 2011 were USD11,422 (December 31, 2010 – USD182,470). OPC participated in the 2011 loan financing described in *Liquidity and Capital Resources* above, advancing USD200,000 under Option B of the facility. As a result, OPC received 100,000 warrants valued at a fair value of USD15,030. The loan was advanced under the same conditions and terms disclosed in note 20.1 afforded to non-related parties.

Two officers of the Company participated in the 2011 loan financing described in *Liquidity and Capital Resources* above, for which they received 75,000 and 232,620 warrants valued at a fair value of USD6,143 and USD21,983 respectively. Loans advanced were USD150,000 and GBP300,000 respectively for a one year term under the same conditions and terms disclosed in note 20.1 afforded to external parties.

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.

Related party transactions with SSEC are disclosed in *Other operating income* above.

There have been no changes in the related parties transactions described in the last annual report.

New and amended accounting standards adopted by the Company

There were no significant new or amended standards introduced for the current accounting year relevant for the Company for these financial statements.

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, 2012 or later periods, but the Company has not early adopted them:

- IFRS 9 'Financial instruments' – issued in November 2009. This standard is the first step in the process to replace IAS 39, '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, 2015 but is available for early adoption. This standard will have no impact on the Company's consolidated financial statements as currently reported.
- IFRS 10 'Consolidated Financial Statements' – issued in May 2011. This standard is part of a new suite of standards on consolidation and related standards, replacing the existing accounting for subsidiaries and joint ventures (now joint arrangements), and making limited amendments in relation to associates. It supersedes IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities' (SPEs). It provides a single model to be applied in the control analysis for all investees, including entities that currently are SPEs in the scope of SIC-12. This standard is not applicable until January 1, 2013. The amendments will not result in a material impact on the Company's consolidated financial statements.
- IFRS 11 'Joint Arrangements' – issued in May 2011. This standard is part of a new suite of standards on consolidation and related standards, replacing the existing accounting for subsidiaries and joint ventures (now joint arrangements), and making limited amendments in relation to associates. All parties to a joint arrangement are within the scope of IFRS 11. IFRS 11 carves out from IAS 31 'Interests in Joint Ventures', those cases in which there is a separate vehicle but that separation is overcome by form, contract

or other facts and circumstances. It also removes the choice of equity or proportionate accounting for jointly controlled entities. Although this standard is not applicable until January 1, 2013 and is not available for early adoption, the Company has considered the potential impact this standard will have on the accounting for existing jointly controlled entities. There will be no impact as the Company will still be able to account for its existing joint arrangements under equity accounting.

- IFRS 12 'Disclosure of Interests in Other Entities' – issued in May 2011. This standard is part of a new suite of standards on consolidation and related standards, replacing the existing accounting for subsidiaries and joint ventures (now joint arrangements), and making limited amendments in relation to associates. It contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities. This standard is not applicable until January 1, 2013 and will not result in a material impact to the Company's consolidated financial statements.
- IFRS 13 'Fair Value Measurement' – issued in May 2011. This is a new standard to replace existing guidance on fair value measurement in different IFRSs with a single definition of fair value, a framework for measuring fair values and disclosures about fair value measurements. The standard applies to assets, liabilities and an entity's own equity instruments that, under other IFRSs are required or permitted to be measured at fair value or when disclosure of fair value is provided. This standard is not applicable until January 1, 2013 and will not result in a material impact to the Company's consolidated financial statements.

RISKS AND UNCERTAINTIES AND OTHER INFORMATION

Tethys' business may be impacted by various risks not all of which are within its control. Readers are encouraged to read and consider the risk factors and additional information regarding the Company, included in its 2011 Annual Information Form filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com. All risks which were detailed at that time have not changed and remain appropriate.

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

The Company has identified its principal risks for 2012 to include:

- Exploration and development expenditures and success rates, though considerable technical work is undertaken to reduce related areas of risk and maximise opportunities.
- Oil and gas sales volumes and prices;
- Retention and extension of existing licences; and
- Liquidity.

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 counterparty is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date was:

	Dec 31, 2011	Dec 31, 2010
	\$	\$
Trade receivables	837	1,661
Cash and cash equivalents	10,746	79,135
Loan receivable from jointly controlled entity	2,013	35,460
Restricted cash	2,292	1,015
	<u>15,888</u>	<u>117,271</u>

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 these customers 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, 2011, the trade receivable balance amounted to USD836,837 (2010 - USD1,661,015), 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.

Included in the restricted cash balance at December 31, 2011 is USD0.885 million security deposit held by HSBC Bank in support of the hedging arrangement put in place in May 2011 and in support of company credit cards. *See Hedging Arrangement below.*

In Uzbekistan, the Company makes use of three customers where 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. In Tajikistan, oil is currently being purchased by two buyers where prepayment in full is also required before delivery.

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 (BBB or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors). Previously the Company's minimum rating for any bank was A- but after careful consideration a decision was taken to place funds with Investec Bank plc which has a BBB rating. Within the Central Asian countries, banks with the international ratings are generally not available.

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, 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. Revenue and expenditure levels, both actual and projected, are reviewed on a regular basis and forecasts updated accordingly. These forecasts enable the Company to identify when additional financing might be needed or expenditure plans adjusted.

The timing of cash outflows relating to financial liabilities and commitments at the reporting date are summarized on page 21 above in *Contractual obligations and liabilities as at December 31, 2011*.

Particularly in the current climate, 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 were available, that it would be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material impact on the Company's financial condition, timing of activities and 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 volatility in market interest rates.

Because of the current level of deposit interest rates on USD 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 a number of 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 USD. A significant portion of expenditures in Kazakhstan are denominated in local currency, the Tenge. There is limited availability in exchange rate derivatives to manage exchange rate risks with this currency.

During the year, the Company used an exchange rate derivative to manage its risk as a result of the significant exchange rate fluctuation of the USD against GBP (note 20.4).

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 USD equivalent at December 31, 2011	CAD '000	GBP '000	EUR '000	KZT '000
Cash and cash equivalents	137	810	62	1,647
Trade and other receivables	-	31	42	12,651
Trade and other payables	-	(229)	-	(4,187)
Financial liabilities - borrowings	-	(433)	-	-
Net exposure	137	179	104	10,111

In USD equivalent at December 31, 2010	CAD '000	GBP '000	EUR '000	KZT '000
Cash and cash equivalents	1,201	1,123	60	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	6,524

The following table details the Company's sensitivity to a 10% movement in USD against the respective foreign currencies, which represents management's assessment of a reasonably likely change in foreign exchange rates.

2011 Effect in USD'000	CAD	GBP	EUR	KZT
Profit or (loss) before tax	14	18	10	1,011
<hr/>				
2010 Effect in USD'000				
Profit or (loss) before tax	120	72	8	652
<hr/>				

A 10% strengthening of the USD against the currencies above at December 31, 2011 would have had an equal but opposite effect on the amounts shown above, assuming all other variables remained constant.

Hedging arrangement

On May 12, 2011 the Company took out foreign currency hedge contracts to hedge exposure to the USD/GBP exchange rate. The contracts are in the form of a put option to sell US dollars with a strike price of 1.6495, with a clause that if a barrier level in the foreign currency exchange rate of 1.5675 is breached on the date of expiry, the option converts to a forward contract at the strike price of USD1.6495. The fair value of the foreign currency contract was calculated using a valuation technique based on observable market inputs. Should the foreign currency exchange rate on the date of expiry be above the barrier of 1.5675 then no settlement would be required. Should the USD/GBP foreign currency rate be above 1.6495 then the options could be exercised at a gain to the Company.

In this arrangement each month up to and including December 2011, the Company could convert up to USD1 million on a set day each month at the lower of the market rate or a maximum secured rate of USD1.6495. From January to April 2012, the sum involved each month reduced to USD0.75 million. In support of this arrangement, the Company has to hold funds in the form of a security deposit with the bank though the balance required reduces during the period of the hedge. At December 31, 2011, this balance was USD0.35 million.

Foreign currency risk

Currently, there are no significant restrictions on the repatriation of capital and distribution of earnings from Kazakhstan or Tajikistan to foreign entities. While there are in fact restrictions on repatriation of capital and distribution of earnings from Uzbekistan to foreign entities, the Company has not been affected by this as it is paid for its refined product sales in US Dollars outside of Uzbekistan. There can be no assurance, that restrictions on repatriation of capital or distributions of earnings from Kazakhstan or Tajikistan 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.

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. 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 risk

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. In Kazakhstan the Company has fixed price gas contracts up to the end of 2012 but its oil contract in Kazakhstan and its refined products in Uzbekistan are subject to commodity price fluctuation and 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. Beyond 2012 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.

As previously stated production from both the Kyzylai 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 is consequently also subject to movements in the oil price.

Sensitivities

The price of gas sales from gas produced from the Kyzylai 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 4,000 bopd (Phase 1) due to commence in April 2012 has yet to be agreed and therefore would be sensitive to movements in the market price. On a production level of 4,000 bopd, a movement of USD1 per barrel on the price received by the Company would result in a plus or minus movement in the sales revenue of USD1,460,000 per annum.

The sales revenue in Uzbekistan is sensitive to fluctuations in the price of oil. At net production levels of 225 bopd, a movement of USD1 per barrel on the price received by the company would result in a maximum plus or minus movement in the sales revenue of USD82,125 per annum.

Environmental

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. In Tajikistan, the Company is subject to environmental regulation and its activities are subject to inspection by the appropriate authority in that country.

At present, the Company believes that it meets satisfactory environmental standards in all material respects in all of the areas in which it operates, 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.

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 Audited Consolidated Financial Statements for the year ended December 31, 2011 *Note 2 Summary of Significant Accounting Policies* for details of the Company’s accounting policies which is accompanied herein by reference.

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, 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 December 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 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 was carried out in Q4 of 2011. Based on this evaluation management concluded that the Company’s internal control over financial reporting was effective as at December 31, 2011. 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, 2011 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.

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 2012 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; sufficiency of capital resources; 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.

Bernard Murphy, Chief Financial Officer