



# Management's Discussion and Analysis

For the year ended December 31, 2012

(U.S. Dollars)

## Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") for Greenfields Petroleum Corporation ("Greenfields" or the "Corporation") should be read in conjunction with the audited consolidated financial statements and notes thereto for the years ended December 31, 2012 and 2011. Additional information relating to Greenfields is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Corporation's website at [www.greenfields-petroleum.com](http://www.greenfields-petroleum.com). Unless stated otherwise, all references to monetary values are in the United States dollar. This document is dated May 3, 2013.

The Financial Statements for the year ended December 31, 2011 have been adjusted to reflect an asset impairment expense of \$8.0 million. For additional information, please see "Asset impairment" note contained in this MD&A and note 11 – "Property and Equipment" to the Consolidated Financial Statements for the year ended December 31, 2012.

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain information regarding Greenfields set forth in this report includes forward looking statements. All statements other than statements of historical facts contained in this MD&A, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "should," "plan," "expect" and similar expressions, as they relate to the Corporation, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that the Corporation believes may affect its financial condition, results of operations, business strategy and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions described elsewhere in this report.

Other sections of this report may include additional factors, which could adversely affect our business and financial performance. Moreover, the Corporation operates in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

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 Corporation'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.

The Corporation undertakes no obligation to update publicly or revise any forward-looking statements. Furthermore, the forward-looking statements contained in this report are made as of the date of this report, and the Corporation undertakes no obligation to update publicly or to revise any of the included forward-looking statements unless required by applicable securities laws, whether as a result of new information, future events or otherwise. The forward-looking statements in this report are expressly qualified by this cautionary statement.

### BUSINESS OF THE CORPORATION AND OPERATIONS

The Corporation is a junior oil and natural gas exploration and development corporation focused on the development and production of proven oil and gas reserves principally in the Republic of Azerbaijan ("Azerbaijan"). The board of directors and management of the Corporation are experienced in financing, developing and operating international oil and gas fields, and possess the requisite technical skills and

business acumen to operate in diverse international environments. The Corporation plans to expand its oil and gas assets through further farm-ins and acquisitions of licenses focusing on previously discovered and under-developed international oil and gas fields.

The Corporation's primary focus is Azerbaijan. On December 22, 2009, Bahar Energy Limited ("**Bahar Energy**"), a joint venture in which the Corporation owns a 33.33% interest, entered into an Exploration, Rehabilitation, Development and Production Sharing Agreement ("**ERDPSA**") with the State Oil Company of Azerbaijan ("**SOCAR**") and its affiliate SOCAR Oil Affiliate ("**SOA**") in respect of the offshore block known as the Bahar Project, which consists of the Bahar gas field, the Gum Deniz oil field and the Bahar Exploration area. Bahar Energy has an 80% participating interest and SOA has a 20% participating interest in the ERDPSA (together the "**Contractor Parties**"). Bahar Energy Operating Company Limited ("**BEOC**") was formed for the purpose of acting as Operator of the Bahar Project on behalf of the Contractor Parties under the ERDPSA.

### **2012 Annual and Fourth Quarter operating highlights**

- The Corporation's entitlement sales volumes from production for its net interest in the Bahar ERDPSA averaged 487 bbl/d and 3,928 mcf/d or 1,141 boe/d in the quarter and 430 bbl/d and 3,980 mcf/d or 1,093 boe/d for the year.
- Through its interest in Bahar Energy, the Corporation realized average oil prices of \$105.02 per barrel for the quarter and \$104.35 per barrel year-to-date. Realized gas prices have remained constant during 2012 at \$3.96 per thousand cubic feet.
- In October Bahar Energy completed the Gum Deniz 601 well in the northern area of the field on Gum Island setting casing at 3,557 meters. Initial production rates after clean-up were approximately 90 bbl/d and 800 BWPD. In November the PSG 2 rig began workover operations on platform 196 in the Bahar gas field and in late December the first offshore well, GD 715, was spudded in the Gum Deniz field on platform 2 with the PSG 1 drilling rig.

### **Operating highlights and plans**

- During the year Bahar Energy completed rehabilitation work on platform 2 in the Gum Deniz field and platform 196 in the Bahar field in preparation to receive the PSG 1 drilling rig and PSG 2 workover rig for the respective platforms. These platform upgrades to the existing structures enabled BEOC to spud the Gum Deniz 715 well on platform 2 on December 14, 2012 and begin working over the Bahar 196 well on platform 196 on November 25, 2012. By year end the topsides on platform 208a in the Gum Deniz field had been removed, pile caps fabricated and installed and skid beams readied for installation to accept the PSG 3 drilling rig during 2013.
- A land rig was brought in to drill the Gum Deniz 601 well on Gum Island, which was successfully completed and placed in service with initial production rates of 90 barrels of oil per day and current sustained production rates of 60 – 70 barrels of oil per day. This well appears to have additional potential and is being reviewed for possible recompletion work in late 2013. The offshore drilling program that began in Gum Deniz oil field in December 2012 on platform 2 will continue throughout 2013 and beyond following the success of the first well, Gum Deniz 715, which is currently producing 600 barrels of oil per day.
- Two 14,600 barrel oil storage tanks were constructed and placed into service.
- During 2012 two seismic data acquisition programs, the 140 line kilometer 2D survey in the Gum Deniz field and the 82 square kilometer 3D in the Bahar-2 exploration area were completed. After delays related to vessel suitability and weather, the 2D project was completed in April 2012. The data is of good quality. This data has been processed and interpreted, and integration with the well control for mapping updates is ongoing. The mapping revisions have indicated the possible extension of the Gum Deniz oil field off the eastern boundary. Bahar Energy has made a request to

SOCAR for an extension of the ERDPSA area to capture this possible field extension. The request is presently under SOCAR's review.

The 3D acquisition survey over the Bahar-2 exploration area started in June 2011 and was completed in December 2012 after acquiring 82 square kilometers of 3D data. The data was in processing at year end. After the processing and interpretation are completed, if the interpretation confirms an attractive exploration prospect, Bahar Energy will develop an appropriate drilling strategy to evaluate the commerciality of the prospect.

- Workover and well rehabilitation operations continued throughout 2012. A total of 27 well maintenance jobs and 9 well workovers were performed using the older Soviet-era rigs contracted from SOCAR. This program was successful in performing basic well services, including tubing and gas lift repairs.

Workovers and recompletions performed with these Soviet-era workover rigs are limited to pulling tubing, cleaning out sand and performing wireline work. They are unable to rotate pipe, perform cementing work or do fishing jobs for downhole material. Thus only 9 limited workovers were undertaken during 2012 with 7 being successful, adding 150 barrels of oil per day of new production. These successful workovers have helped maintain field production levels after accounting for well downtimes due to operational and weather issues.

- Bahar Energy plans to upgrade the capability of the Soviet-era workover rigs to allow for more efficient well workover operations by late 2013. Additional options for well service interventions, selected workovers and recompletions will be available once these highly mobile rigs have been upgraded. The upgraded workover rigs will continue to be used for planned workover operations in the Bahar gas field.
- Bahar Energy will continue work in 2013 related to construction, upgrades and expansion of platforms 2, 208a, 209 in the Gum Deniz field and platform 168 in the Bahar field. Areas of focus include platform design and construction for extending platform 2, oil and gas processing facility upgrades, pipeline replacement, water disposal, electric power line installation, support infrastructure and safety monitoring.
- Bahar Energy expects to drill at least 6 wells in the Gum Deniz field and to recomplete approximately 16 wells in Gum Deniz and Bahar fields during 2013. The multi-year drilling program is scheduled to drill 83 new wells in the Gum Deniz field and 7 new wells in the Bahar field. Total planned recompletions include 29 in the Gum Deniz field and 40 in the Bahar field.
- Bahar Energy will focus greater effort in the development of the Gum Deniz oil field during 2013 and plans to have 3 drilling rigs operating in Gum Deniz field by year end. The PSG 2 workover rig currently assigned to the Bahar gas field may undergo modifications to allow it to begin drilling operations later in 2013. This would add a third drilling rig along with the PSG 3 rig presently in preparation to commence drilling and the actively drilling PSG 1 rig.
- To date in 2013 Bahar Energy continues to have success with its workover programs and positive progress with new drilling in the Gum Deniz field. The Bahar 208 gas well on platform 196 was recompleted using the PSG 2 workover rig. The well was re-completed in 8 meters (26 feet) of pay in Zone 1 and has been flowing at an average rate of 1.24 million cubic feet per day. In Gum Deniz field, the 479 well has been recompleted in Zone 10 by perforating 9 meters (29 feet) of pay and is currently producing 220 barrels of oil per day. In addition, the PSG 1 drilling rig has set 13-3/8" surface casing at 450 meters on the Gum Deniz 716 well, the second new well in the field, and is currently drilling at 1,539 meters. A larger electrical submersible pump was installed on the Gum Deniz 473 well after a smaller pump failed which resulted in production increase of 90 barrels of oil per day.

## SELECTED ANNUAL INFORMATION

<i>(US\$000's, except as noted)</i>	Year ended December 31,	
	2012	2011
<b>Financial</b>		
Revenues	26,698	26,801
Net (loss) income	(16,075)	(24,578)
Per share, basic and diluted	(\$1.04)	(\$1.66)
<b>Operating</b>		
Average Entitlement Sales Volumes <sup>(1)</sup>		
Oil and condensate (bbl/d)	430	397
Natural gas (mcf/d)	3,980	4,121
Barrel oil equivalent (boe/d)	1,093	1,084
Average Oil Price		
Oil price (\$/bbl)	\$104.35	\$103.53
Net realization price (\$/bbl)	\$102.23	\$99.67
Brent oil price (\$/bbl)	\$111.64	\$111.26
Natural gas price (\$/mcf)	\$3.96	\$3.96
<b>Capital Items</b>		
Cash and cash equivalents	15,419	25,289
Total Assets	90,315	53,087
Working capital <sup>(2)</sup>	13,377	29,674
Convertible debt and shareholders' equity <sup>(3)</sup>	38,327	28,481

(1) Daily volumes represent the Corporation's share of the Contractor Parties entitlement volumes net of 5% compensatory petroleum and the government's share of profit petroleum.

(2) Working capital, presented here, is current assets net of current liabilities less warrants.

(3) Convertible debt is combined with shareholder's equity due to the Company's right to settle debt by issuing shares

## SUMMARY OF QUARTERLY RESULTS

(US\$000's, except as noted)	IFRS							
	2012				2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>Financial</b>								
<b>Revenues</b>								
Petroleum and natural gas	6,132	5,815	5,396	4,791	5,023	5,172	5,162	5,618
Transportation & storage fees	457	408	418	544	431	582	360	762
Management service fees	830	733	512	662	666	568	2,400	59
	7,419	6,956	6,326	5,997	6,120	6,322	7,922	6,439
Net loss	(5,934)	(482)	(5,155)	(4,504)	(22,584)	(461)	(703)	(831)
Per share, basic and diluted	(\$0.38)	(\$0.03)	(\$0.34)	(\$0.30)	(\$1.52)	(\$0.03)	(\$0.05)	(\$0.06)
<b>Operating</b>								
<b>Average Entitlement Sales Volumes <sup>2</sup></b>								
Oil and condensate (bbl/d)	487	456	442	335	360	388	395	448
Natural gas (mcf/d)	3,928	4,215	3,880	3,899	4,276	4,000	3,862	4,349
Barrel oil equivalent (boe/d)	1,141	1,159	1,089	985	1,072	1,055	1,039	1,172
<b>Prices</b>								
Average oil price (\$/bbl)	\$105.02	\$103.51	\$99.40	\$111.01	\$104.71	\$103.93	\$104.89	\$100.98
Natural gas price (\$/mcf)	\$3.96	\$3.96	\$3.96	\$3.96	\$3.96	\$3.96	\$3.96	\$3.96
<b>Capital Items</b>								
Cash and cash equivalents	15,419	22,594	29,917	13,647	25,289	28,615	30,295	36,328
Total Assets	90,315	101,364	95,900	66,798	53,087	63,094	63,968	62,995
Working capital <sup>(2)</sup>	13,377	23,206	33,961	17,573	29,674	41,040	47,247	48,876
Convertible debt and shareholders' equity <sup>(3)</sup>	38,327	55,014	54,378	35,559	28,481	49,914	49,971	50,230

(1) Daily volumes represent the Corporation's share of the Contractor Parties entitlement volumes sold net of 5% compensatory petroleum and the government's share of profit petroleum.

(2) Working capital, presented here, is current assets net of current liabilities net of warrants.

(3) Convertible debt is combined with shareholder's equity due to the Company's right to settle debt by issuing shares.

## RESULTS OF OPERATIONS

### Revenues

(US\$ 000's)	Three months ended December 31		Year ended December 31	
	2012	2011	2012	2011
Petroleum	4,701	3,465	16,381	15,018
Natural gas	1,431	1,558	5,753	5,956
Total petroleum and natural gas	6,132	5,023	22,134	20,974
Transportation and storage fees	457	431	1,827	2,134
Management service fees	830	666	2,737	3,693
Total revenues	7,419	6,120	26,698	26,801

The petroleum revenues for the three months and year ended December 31, 2012 were \$4.7 million and \$16.4 million, respectively, compared to \$3.5 million and \$15.0 million, respectively, for the same periods in 2011. Natural gas revenues for the three months and year ended December 31, 2012 were \$1.4 million and \$5.8 million, respectively, compared to \$1.6 million and \$6.0 million, respectively, for the same periods in 2011. Petroleum and natural gas revenues were net to the Corporation after deduction of the government's share of profit petroleum revenue and compensatory petroleum production.

The average prices received for crude oil during the three months and year ended December 31, 2012 were \$105.02/bbl and \$104.35/bbl, respectively, compared to average prices of \$104.71/bbl and \$103.53/bbl for the same periods in 2011. The price for natural gas remained contractually constant at \$3.96 per thousand cubic feet.

The crude oil average daily entitlement production for the three months and year ended December 31, 2012 was 487 bbl/d and 430 bbl/d, respectively, a 35% increase when compared to production of 360 bbl/d in same quarter 2011 and an 8% increase year to date when compared to the 397 bbl/d produced for the same period in 2011. Natural gas daily entitlement production for the three months and year ended December 31, 2012 was 3,928 mcf/d and 3,980 mcf/d, respectively, an 8% decrease when compared to the 4,276 mcf/d produced in the same quarter 2011, and a 3% decrease year to date when compared to the 4,121 mcf/d produced in 2011.

In terms of oil equivalent daily production, during the three months and year ended December 31, 2012 the Corporation recorded production of 1,141 boe/d and 1,093 boe/d, respectively, which represented a 6% increase compared to the 1,072 boe/d produced in same quarter 2011 and a 1% increase year to date when compared to the 1,084 boe/d produced in 2011.

### Net realization price for crude oil and natural gas <sup>(1)</sup>

	Three months ended December 31		Year ended December 31	
	2012	2011	2012	2011
\$/bbl				
Average crude oil sales price	105.02	104.71	104.35	103.53
Transportation fees	(1.27)	(2.72)	(1.05)	(2.74)
Marketing fees	(1.10)	(1.06)	(1.07)	(1.07)
Other costs <sup>(2)</sup>	(0.01)	(0.04)	(0.01)	(0.05)
Crude oil	102.64	100.89	102.23	99.67
\$/mcf				
Natural gas	3.96	3.96	3.96	3.96

(1) "Net realization price" is a non-IFRS and non-GAAP measurement. The net realization price for crude oil is calculated by deducting from the average crude oil sales price the average costs per barrel for transportation, marketing, port storage, customs, banking fees and certification fees. There are no deductions from the sales price of natural gas.

(2) Other costs consist of port storage, customs, banking fees and certification fees.

### **Transportation and storage fees**

For the three months and year ended December 31, 2012, the Corporation recognized transportation and storage revenue of \$457 thousand and \$1.8 million, respectively, and \$431 thousand and \$2.1 million, respectively for same periods in 2011. The transportation and storage revenues are based on a fee arrangement to supply excess capacity available in the Bahar facilities to another local producer. The contract was finalized in May 2011 and had a retroactive effective date of October 1, 2010. The above cited revenue of \$2.1 million for the year ended December 31, 2011 includes transportation revenues attributable to the fourth quarter 2010.

### **Management and service fees**

For the three months and year ended December 31, 2012, the Corporation recorded revenue of \$45 thousand and \$180 thousand, respectively, in management fees, compared to \$59 thousand and \$236 thousand, respectively, for same periods in 2011. Management fees relate to a management services agreement with GFPI-USA, LLC. Management fees relate to monthly revenues received under a management services agreement with GFPI-USA, LLC. Agreed monthly management fees in effect for 2012 and 2011 were \$15 thousand and \$19.6 thousand, respectively.

For the three months and year ended December 31, 2012, the Corporation recorded service fee revenue of \$0.7 million and \$2.5 million, respectively, compared to \$0.6 million and \$3.5 million, respectively, for same periods in 2011, in connection with administrative, technical and support assistance provided to BEOC. These services are provided under a Master Service Agreement ("MSA") between the Corporation and BEOC supported by individual Affiliate Services Orders ("ASO") detailing specific services to be provided. During the second quarter 2011 the MSA was finalized resulting in the retroactive billing for services from October 2010 through June 2011.

### **Operating expenses**

For the three months and year ended December 31, 2012, the Corporation recorded operating expenses associated with the Bahar project of \$8.3 million and \$21.2 million, respectively, and \$8.2 million and \$20.4 million, respectively, for the same periods in 2011. The increase in operating expenses experienced in 2012 can be attributed to extreme weather impacting the early months of 2012, workover and well rehabilitation as well as infrastructure maintenance.

Bahar field operations during the first quarter were hampered by severe wind and sub-freezing temperatures which resulted in additional stand-by charges, hindered performance of flow lines and failures in some older equipment. Additional heaters were rented to help maintain crude viscosity in the tanks and flow lines, large quantities of spare parts were replaced, compressors were rented to fill in for down units and employee overtime became the norm. Cost was higher in maintenance, marine transportation stand-by, equipment rentals and payroll.

With respect to workover and well rehabilitation, Bahar completed 27 well maintenance jobs in 2012 compared to 12 jobs in 2011. This increased maintenance activity contributed to higher labor, spare parts, fuel and equipment rental expenses. Bahar also increased the maintenance of equipment and infrastructure activity to sustain and improve the operability of compressors and electrical equipment. Higher expenses were also associated to the maintenance of buildings and surface facilities specifically in labor and construction materials.

## Exploration and evaluation expenses

For the three months and year ended December 31, 2012, the Corporation recorded (\$0.3) million and \$1.7 million, respectively, in exploration and evaluation expenses primarily associated with the 3D seismic program being conducted over the Bahar 2 exploration areas. During the three months and year ended December 31, 2011, the Corporation recorded \$0.4 million and \$1.0 million, respectively, in exploration and evaluation expenses related to 2D seismic work conducted in the producing Bahar gas and Gum Deniz oil fields.

## Asset impairment

During 2012 the Company undertook a review of payments made to certain suppliers by their joint venture. As a result of this review, it was determined that the joint venture was charged amounts in excess of fair market value for certain equipment and supplies. As such, certain assets were deemed to exceed their recoverable amount at the asset level. Asset impairment reflects amounts expensed as a result of these excess amounts. The result of the review also indicated that a significant portion of such excess amounts were related to transactions recorded during the year 2011 that materially affected the financial results reported by the Company for the year ended December 31, 2011. As consequence, the 2011 financial results have been restated as detailed in Note 27 to the Consolidated Financial Statements for the year ended December 31, 2012.

For the year ended December 31, 2012, the Company recorded asset impairment expenses of \$1.8 million (December 31, 2011 \$8.0 million).

## Pre-licensing costs

For the three months and year ended December 31, 2012 the Corporation incurred \$17 thousand and \$613 thousand, respectively, in pre-licensing costs compared to \$1.4 and \$2.6 million for the same periods in 2011. Pre-licensing costs have been associated with other business development activities mainly focused on the prospecting and evaluation of opportunities to acquire working interests in properties located in South America and South East Asia.

<b>Administrative expenses</b>	Three months ended		Year ended	
	December 31		December 31	
<i>(US\$ 000's)</i>	2012	2011	2012	2011
Cash expenses				
Employee wages and benefits	1,552	1,542	5,345	3,782
Professional service costs	1,095	742	3,218	4,076
Office, travel and other	644	417	2,415	1,693
Foreign office costs	3,809	1,632	5,735	4,219
Total cash expenses	7,100	4,333	16,713	13,770
Share-based payment expense	236	197	1,367	1,577
Total gross administrative	7,336	4,530	18,080	15,347
Service fees billed to affiliates	(785)	(607)	(2,557)	(3,457)
Administrative expenses net of service fees	6,551	3,923	15,523	11,890

Administrative expenses for the three months and year ended December 31, 2012, excluding non-cash stock-based compensation, were \$7.1 million and \$16.7 million, respectively, compared to \$4.3 million and \$13.8 million, respectively, for same periods in 2011. Employee wages and benefits increases during

2012 were the result of increased staffing levels in the corporate office and the addition of foreign staff to support the new representative office in Azerbaijan for Greenfields Petroleum International Company, Ltd., which holds the 33.33% interest in Bahar Energy. Professional services were reduced during 2012 as the costs associated with the redomestication of the Corporation in 2011 from the State of Delaware to the Cayman Islands were eliminated. Office, travel and other expenses increased during 2012 due to additional travel costs related to support activities associated with the Bahar project. The majority of increased costs associated with manpower and travel expenses in support of the Bahar project are recovered through billings, at cost, to BEOC on ASO's. See "*Management and Services Fees*" note above for more information on ASO billings.

Foreign office administrative expenses for the three months and year ended December 31, 2012 were \$3.8 million and \$5.7 million, respectively, compared to \$1.6 million and \$4.2 million, respectively, for the same periods in 2011. All foreign office costs are attributable to the administrative functions of the Bahar project reflected by BEOC.

### **Share-based payments**

The share-based payments recorded by the Corporation are associated with share options, restricted share grants and shareholder settled transactions. Share-based payment expenses for the three months and year ended December 31, 2012 were \$0.2 million and \$1.4 million, respectively, compared to \$0.2 million and \$1.6 million, respectively, for same periods in 2011.

### Share Options

The Corporation's Share Option Plan governs the granting of options to employees, officers, directors and certain full time consultants. All options issued by the Corporation permit the holder to purchase a specific number of common shares of the Corporation at a stated exercise price. The Corporation has issued no share options that permit the recipient to receive a cash payment equal to the appreciated value in lieu of shares.

The exercise prices of the share options ranges from CAD\$6.00 to CAD\$14.00 per common share with all options expiring on various dates between years 2016 and 2021. With the exception of the June 2012 150,000 share options award, the share options vest 25% at date of grant and 25% on each of the first, second and third anniversaries of the grant date. The 933,250 exercisable options as at December 31, 2012 have remaining contractual lives ranging from 4.1 to 8.4 years.

The fair value of each option granted is estimated at the time of the grant using the Black-Scholes option pricing model. For the 80,000 share options granted in February 2012 at an exercise price of CAD\$6.00 per common share, the share options were fair valued on the date of grant using the Black-Scholes option pricing model assuming a risk-free interest rate of 0.71%, four years expected life, expected volatility of 40% and forfeiture rate of 4% resulting in a calculated options value of \$0.1 million. The share options will vest 25% at date of grant and 25% each of the first, second and third anniversaries of the indicated grant date. The value associated with the first 25% of options vested on grant date was expensed during the period with the remaining 75% of the value amortized over each of the three vesting periods.

In June 2012 the Corporation completed the award of 150,000 share options at an average exercise price of CAD\$13 per common share. The constructive obligation for this award was established in January 2012 and fair valued accordingly at \$0.1 million using the Black-Scholes option pricing model assuming a risk-free interest rate of 0.71%, four years expected life and expected volatility of 40%. The share options will vest over a 12 month period, 1/12 each month. At December 31, 2012 100% of the award has been expensed.

For the three and year ended December 31, 2012, the Corporation recorded share options expense of \$58 thousand and \$562 thousand, respectively, compared to \$184 thousand and \$1.5 million, respectively, for the same periods in 2011. The reduction in share options expenses when compared to prior year reflect fewer new share options awards during 2012 compared to prior years, reduced expense

amortization from options issued in prior years and share options expense recapture from options forfeitures.

Grant Date	Number Outstanding	Expiry Date	Remaining Contractual Life (years)	Exercise price (CAD\$)	Number Exercisable
Aug. 31, 2010	706,000	Aug. 31, 2020	7.67	6.50	529,500
Nov. 16, 2010	225,000	Nov. 16, 2020	7.88	8.50	168,750
Nov. 16, 2010	30,000	Mar. 14, 2021	7.88	9.50	15,000
May 19, 2011	100,000	May 19, 2021	8.39	9.00	50,000
Feb. 1, 2012	80,000	Feb. 1, 2017	4.09	6.00	20,000
Jan. 31, 2012	150,000	Jan. 31, 2017	4.09	13.00	150,000
	1,291,000				933,250

As at December 31, 2012 the Corporation has a total of 1,291,000 share options outstanding, 933,250 of which are exercisable with remaining contractual lives ranging from 4.09 to 8.39 years. The average exercise price of exercisable share options is CAD\$8.08.

As a provision of the Corporation's Share Option Plan, upon exercising his or her options, an optionee may satisfy his or her tax withholding obligations (i) by surrendering to the Corporation common shares that have been owned by the optionee for more than six months on the date of surrender with a market value equal to the withholding tax obligation or (ii) by electing to have the Corporation withhold from the common shares to be issued upon exercise of the option the number of common shares having a market value equal to the amount required to be withheld.

#### Restricted Share Awards

On February 1, 2012 a 40,000 restricted share grant was awarded and shares issued by the Corporation to a new officer. The shares vested 25% at grant date and vest 25% on the anniversary date thereafter in 2013, 2014 and 2015. The shares were valued at CAD\$6.00, the closing price of the Corporation's share on January 31, 2012, with the 25% vested on grant date included in the Corporation's share-based payments expense for the quarter. The remaining value of the unvested restricted share grant is amortized over the individual vesting periods.

For the three months and year ended December 31, 2012, the Corporation recorded share-based payments expense related to past and current share grants of \$28 thousand and \$110 thousand, respectively, compared to \$13 thousand and \$50 thousand, respectively, for same periods in 2011. Expenses associated with restricted share awards are recorded with an offset to share capital of the Corporation.

#### Share Awards

On August 9, 2012 the Corporation completed a grant of common shares and issued 11,033 common shares to an officer of the Corporation. The shares were valued at the closing price on the TSXV at June 4, 2012, that being CAD\$4.80. For the three months and year ended December 31, 2012, the Corporation recorded share-based payments expense related to this award of \$84 thousand, (2011 - \$nil). The share-based payment expense is offset to share capital of the Corporation.

#### Restricted Cash Bonus Program

In June 2012 the Corporation established a Restricted Cash Bonus Program consisting of two cash settled incentives awarded in bonus units. The first incentive is the Full Value Based Cash Bonus ("FVBCB") with the cash settlement value of a bonus unit equal to the current market price of a common share of the Corporation on specific vesting dates. The second incentive is the Appreciation Based Cash Bonus ("ABCB") which is settled in cash when an awardee makes a call on vested bonus units with the value of the award calculated as the difference between the current market price of a common share of

the Corporation at call date and the original grant price per bonus unit. The program does not grant any entitlement to common shares or other equity interest in the Corporation.

The FVBCB incentive awards vest in three tranches, 1/3 on each January 1 of the year immediately following the grant date and have a cash settlement on such vesting dates. The fair value of FVBCB awards were estimated considering forfeiture rates of 5% and 10% respectively for the second and third year of the award. The estimated FVBCB liability is amortized over the three year vesting period with each vesting tranche fully amortized at vesting date. The liability is also fair valued at each reporting date with adjustments recorded through profit and loss. The estimated FVBCB liability at December 31, 2012 was \$0.3 million.

The ABCB incentive awards vest in four tranches, 25% at grant date and 25% on each of January 1 of the year immediately following the grant date. The ABCB awards have a contractual life of five years and were fair valued using the Black-Scholes option pricing model assuming an average risk-free interest rate of 1.09%, two year expected life from its vesting date, average expected volatility of 58% and average forfeiture rate of 13%. The estimated ABCB liability is amortized over the vesting period and fair valued at each reporting date with the same Black-Scholes pricing model with adjustments recorded through profit and loss. The estimated ABCB liability at December 31, 2012 was \$0.3 million.

Grant Date	FVBCB Units	ABCB Units	ABCB Units			
			Grant Price \$CAD	Exercisable	Expiration Date	Remaining Contractual Life - Years
June 4, 2012	130,000	185,000	4.80	92,500	June 4, 2017	4.4
Sept. 4, 2012	10,000	10,000	5.65	5,000	Sept. 4, 2017	4.7
Oct. 5, 2012	20,000	30,000	5.63	15,000	Oct. 5, 2017	4.8
Dec. 1, 2012	3,600	3,600	4.80	1,800	Dec. 1, 2017	4.9
Dec. 24, 2012	172,500	232,500	3.50	58,125	Dec. 24, 2017	5.0
	336,100	461,100		172,425		

For year ended December 31, 2012, the Corporation recorded restricted cash bonus expense of \$0.6 million (2011 - \$nil).

#### Shareholder Settled Transactions

Under IFRS, when a shareholder transfers its own shares in a manner that benefits the Corporation, the Corporation must give recognition for the value of that transfer over the period which the benefits are received. For the three months and year ended December 31, 2012, the Corporation recorded \$150 thousand and \$550 thousand, respectively, (2011 - \$nil) in share-based expenses for such transactions.

In December 2011 the Corporation recorded a \$1.0 million provision expense associated with a claim shareholders of the Corporation anticipated settling through the transfer of their own shares to the claimant. For the year ended December 31, 2012, the Corporation has recorded a \$125 thousand provision expense recovery to reflect the final settlement amount associated with this shareholder transaction. No treasury shares of the Corporation were issued as part of this settlement.

## Dividends, interest income, other income and interest expense

(US\$000's)	Three Months Ended December 31		Year Ended December 31,	
	2012	2011	2012	2011
Dividend income	(9)	(8)	(9)	(117)
Interest income	(12)	(21)	(60)	(106)
Other income	-	-	-	(6)
Interest income – related party notes	(442)	(114)	(1,373)	(265)
Interest expense – related party notes	441	120	1,390	293
Interest expense – convertible debentures	685	-	1,818	-
	663	(23)	1,766	(201)

For the three months and year ended December 31, 2012, the Corporation recorded \$12 thousand and \$60 thousand respectively, as income from short term investments. Income for the same periods in 2011, were \$21 thousand and \$106 thousand, respectively. This income relates to interest received or accrued from investments in corporate bonds and money market accounts. During the year ended December 31, 2012, some corporate bonds have been called early and others at maturity resulting in gradual decreases of short term investments balance. Also, for the three months and year ended December 31, 2012, the Corporation recorded \$9 thousand as dividend income from distributions in excess of cost made by GFPI-USA, LLC. Dividend income for the three months and year ended December 31, 2011 ended was \$8 thousand and \$117 thousand, respectively.

For the three months and year ended December 31, 2012, the Corporation recorded \$0.4 million and \$1.4 million, respectively, as interest income from notes receivable from a related party compared to \$0.1 million and \$0.3 million for the same periods in 2011. This income relates to interest earned on funds loaned to Bahar Energy under the Common Terms Agreement.

For the three months and year ended December 31, 2012, the Corporation recorded \$0.4 million and \$1.4 million, respectively, as interest expense from notes payable to related parties compared to \$0.1 million and \$0.3 million, respectively, for the same periods in 2011. This interest expense relates to the Corporation 33.33% share of related party notes payable to the shareholders of Bahar Energy for their funding under the Common Terms Agreement.

For the three months and year ended December 31, 2012, the Corporation recorded \$0.7 million and \$1.8 million, respectively, as interest expense from convertible debentures. This expense includes the coupon interest, accretion and amortization of issue costs.

### Impairment of receivables recovery

In December 2011 the Corporation recorded an impairment of related party accounts receivable for \$1.1 million related to pre-effective costs billed to the Bahar project. As result of the Corporation collecting the \$1.1 million in October 2012, a recovery of this prior receivable impairment was recorded in September 2012.

### Change in fair value of derivative liability

For the three months and year ended December 31, 2012, the Corporation recorded \$2.8 million and \$2.6 million, respectively, in gains resulting from the December 31, 2012 fair value measurement of the derivative liability associated with the debentures convertible option (December 31, 2011 - \$nil).

## Changes in fair value of warrants

The Corporation issued warrants in conjunction with a private placement in February 2010 which have an exercise price denominated in Canadian dollars whereas the Corporation's functional currency is U.S. dollars. The option to exercise these warrants expired on February 24, 2012 and all warrants were exercised.

Under IFRS, the warrants are considered a derivative financial liability due to "foreign currency" fluctuations and the resulting variable proceeds the Corporation will realize for each share issued if such warrants are exercised, and because they were not offered pro rata to all existing owners of the same class of shares. A derivative financial liability is measured at fair value on each balance sheet date with changes in fair value recognized in profit or loss.

At December 31, 2011 the derivative financial liability balance for warrants was \$1.0 million. Through the exercise of all outstanding warrants during January and February 2012, before the expiration date on February 24, 2012, the fair value of the warrants was determined to be \$0.6 million. The difference with respect to the balance of the estimated derivative liability at December 31, 2011 and actual determined fair value resulted in a positive adjustment to income of \$0.3 million.

## Income taxes

Currently, the Corporation's primary income producing assets are held through its 33.33% ownership in Bahar Energy. The project, being in the early rehabilitation and development stage, requires significant development funding and re-investment of operating cash flows for the foreseeable future. Earnings from the Bahar project are not taxable to the Corporation in the U.S. until Bahar Energy declares dividends from the surplus funds generated from the ERDPSA. Before Bahar Energy can declare dividends, shareholders' loans must be repaid with accumulated interest payable. The loan principal repaid to the Corporation is non-taxable.

Most of the early funds returned from Bahar Energy being non-taxable loan principal repayments, the future period for the Corporation's potential taxable dividends receipts is beyond a period that is normally allowed under IFRS for recognition of deferred tax assets. As a result, the Corporation has elected to defer recognition of deferred tax benefits and the associated deferred tax asset until such time recovery and offset against future taxable income can be assured. In December 2011 the Corporation derecognized its accumulated deferred tax asset by reversing amounts accumulated in 2010 and for the year ended December 31, 2011.

For the year ended December 31, 2012, the Corporation has unrecognized \$8.1 million of cumulative deferred tax assets and has cumulative loss carryforward of approximately \$20.4 million that will expire between years 2030 and 2032. A detailed discussion of deferred income taxes is included in Note 22 to the Consolidated Financial Statements for the year ended December 31, 2012.

## Per share information

	Three months ended December 31		Year ended December 31	
	2012	2011	2012	2011
Net loss per share, basic and diluted	(\$0.38)	(\$1.52)	(\$1.04)	(\$1.66)

## EQUITY CAPITAL

Authorized capital structure of the Corporation is 49,900,000 common shares and 100,000 preferred shares, each at US dollars \$.001 par value. As of the date of this report, the Corporation had 15,551,387 common shares outstanding and no preferred shares outstanding.

## RISK FACTORS

The following abbreviated "Risk Factors" reflect those risks and uncertainties specific to the Bahar project and are summarized from the more detailed Risk Factor assessment disclosed in the Corporation's Annual Information Form for the year ended December 31, 2012 available on SEDAR.

### **Rehabilitation, Development and Production Risks**

Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. The long term commercial success of a project or the Corporation depends on its ability to find, acquire, license, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, any existing reserves that the Corporation may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in the Corporation's reserves will depend not only on its ability to exploit and develop any properties it may have from time to time, but also on its ability to select, acquire and rehabilitate suitable producing properties or prospects. No assurance can be given that the Corporation will be able to locate and continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, the Corporation may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic. There is no assurance that commercial quantities of oil and natural gas will be discovered or acquired by the Corporation. It is project specific and at times it is difficult to project the costs of implementing or the success of exploration, rehabilitation or development drilling programs due to the inherent uncertainties of drilling in unknown formations, the uncertainty of the condition of existing well bores, the costs associated with encountering various drilling conditions such as over pressurized geological zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

Future oil and natural gas exploration or development may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include but are not limited to delays in obtaining governmental approvals or consents, shut ins of wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. Production delays and declines from normal oilfield operating conditions cannot be eliminated and can be expected to adversely affect revenue, cash flow and financial condition levels to varying degrees.

Oil and natural gas exploration, development, rehabilitation and production operations are subject to all the risks and hazards typically associated with such operations, including but not limited to hazards such as fire, explosion, blowouts, cratering, sour gas releases and spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or personal injury. In accordance with industry practice, the Corporation is not fully insured against all of these risks, nor are all such risks generally insurable. The Corporation will maintain liability insurance in an amount that it considers consistent with industry practice, however, the nature of these risks is such that liabilities could exceed policy limits, in which event the Corporation could incur significant costs that could have a material adverse effect upon its financial condition. Oil and natural gas exploration, development, rehabilitation and production operations are also subject to all the risks typically associated with such operations, including encountering unexpected formations or pressures, premature decline of

reservoirs and the invasion of water into producing formations. Losses resulting from the occurrence of any of these risks could have a material adverse effect on the Corporation and its financial condition.

### **Substantial Capital Requirements**

The Corporation anticipates making substantial capital expenditures for the development, rehabilitation, production and acquisition of oil and natural gas reserves in the future. There can be no assurance that debt or equity financing or cash generated by operations will be sufficient or available to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Corporation. Moreover, future activities may require the Corporation to alter its capitalization. The inability of the Corporation to access sufficient capital for its operations could have a material adverse effect on the Corporation's financial condition and its results of operations.

### **Additional Financing Requirements and Dilution of Investment**

It may take many years and substantial capital expenditures to pursue the exploration and development of the Corporation's existing opportunities, successfully or otherwise. From time to time, the Corporation may require additional financing in order to carry out its oil and natural gas acquisition, rehabilitation and development activities. Failure to obtain such financing on a timely basis could cause the Corporation to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If the Corporation's future revenues from its potential reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect the Corporation's ability to expend the necessary capital to replace its potential reserves or to maintain its production. If the Corporation's cash flow is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on favorable terms. The availability of equity or debt financing is affected by many factors, including world and regional economic conditions; the state of international relations; the stability and the legal, regulatory, fiscal and tax policies of various governments in areas of operation; fluctuations in the world and regional price of oil and gas and in interest rates; the outlook for the oil and gas industry in general and in areas in which the Corporation has or intends to have operations; and competition for investment funds among alternative investment projects. The terms of any such equity financing may be dilutive to holders of Common Shares. Potential investors and lenders will be influenced by their evaluations of the Corporation and its projects, including their technical difficulty, and comparison with available alternative investment opportunities. If adequate funds are not available, the Corporation may be required to scale back or reduce its interest in certain projects. If additional financing is raised by the issuance of shares, control of the Corporation may change and existing shareholders may suffer dilution. In addition, the Corporation may make future property or corporate acquisitions or enter into other transactions involving the issuance of securities of the Corporation which may also be dilutive.

### **Commodity Prices**

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of the Corporation. World prices for oil and natural gas have fluctuated widely in recent years. Prices for oil and natural gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and a variety of additional factors beyond the control of the Corporation. These factors include economic conditions in the United States and Canada, the actions of OPEC, governmental regulation, and political stability in the Middle East and elsewhere, the foreign supply of oil and natural gas, the price of foreign imports and the availability of alternative fuel sources. Any substantial and extended decline in the price of oil and natural gas would have an adverse effect on the Corporation's carrying value of any reserves, borrowing capacity, revenues, profitability and cash flows from operations.

Volatile oil and natural gas prices make it difficult to estimate the long-term value of producing properties for acquisition and often cause disruption in the market for oil and natural gas producing properties, as

buyers and sellers have difficulty agreeing on such value. Price volatility also makes it difficult to budget for and project the return on acquisitions and development and exploitation projects.

In addition, bank borrowings available to the Corporation may in part be determined by the Corporation's oil and gas reserves that form its borrowing base. A sustained material decline in prices from historical average prices could reduce the Corporation's borrowing base, therefore reducing the bank credit available to the Corporation which could require that a portion, or all, of any potential bank debt of the Corporation be repaid. The Corporation has reduced this risk by not carrying any bank debt at this time.

## **Markets and Marketing**

The marketability and price of oil and natural gas that may be acquired or discovered by the Corporation will be affected by numerous factors beyond its control. The Corporation's ability to market any oil and natural gas it discovers or acquires may depend upon its ability to acquire space on pipelines that deliver crude oil and natural gas to commercial markets. The Corporation may also be affected by deliverability uncertainties related to the proximity of any reserves it establishes to pipelines and processing facilities and related to operational problems with such pipelines and facilities as well as extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business.

Both oil and natural gas prices are unstable and are subject to fluctuation. Any material decline in prices could result in a reduction of the Corporation's net production revenue. The economics of producing from some wells may change as a result of lower prices, which could result in a reduction in the volumes of any reserves which the Corporation may establish. The Corporation might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in any net production revenue of the Corporation causing a reduction in its oil and gas acquisition, development, rehabilitation and exploration activities.

The producers of oil are entitled to negotiate sales contracts directly with oil purchasers, with the result that the market determines the price of oil. Oil prices are primarily based on worldwide supply and demand. The specific price depends in part on oil quality, prices of competing fuels, distance to the markets, value of refined products, supply/demand balance, and other contractual terms. In respect of the Bahar Project, sales of natural gas will be governed by the Bahar Gas Sales Agreement for the next five years. The price of natural gas sold from the Bahar PSA is fixed until October 2015 at \$3.96 per mcf. The price of natural gas is then determined by negotiation between buyers and sellers.

Recent gas negotiations continue to be influenced by increasing gas exports from Azerbaijan to Russia, Turkey and throughout the region. Also, negotiations are progressing to export Azerbaijan gas to Europe (Vienna) via the proposed TANAP and Nabucco-West pipelines. These new export routes could dramatically increase the gas price realizations in the region in the next five years.

## **Project Risks**

The Corporation will manage a variety of small and large projects in the conduct of its business. Project delays may delay expected revenues from operations. Significant project cost over runs could make a project uneconomic. The Corporation's ability to execute projects and market oil and natural gas will depend upon numerous factors beyond the Corporation's control, including:

- the availability of processing capacity;
- the availability and proximity of pipeline capacity;
- the availability of storage capacity;
- the supply of and demand for oil and natural gas;
- the availability of alternative fuel services;
- the effects of inclement weather;
- the availability of drilling and related equipment;
- unexpected cost increases;

- accidental events;
- currency fluctuations;
- changes in regulations;
- the availability and productivity of skilled labor;
- the regulation of the oil and natural gas industry by various levels of government and governmental agencies; and
- industry partner conflicts of interest.

As a result of the foregoing factors, the Corporation may be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it produces.

### **Availability of and Access to Drilling and Related Equipment**

Oil and natural gas exploration and development activities are dependent on the availability of drilling, recompletion and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Corporation and may delay exploration, rehabilitation and development activities and affect the Corporation's results of operations. If the demand for, and wage rates of, qualified rig crews and other personnel rise, then the oil and gas industry and the Corporation may experience shortages of qualified personnel to operate drilling rigs and to conduct other work. This may delay the Corporation's exploration, rehabilitation, development and production operations and may adversely affect the Corporation and its results of operations. To the extent the Corporation is not the operator of its oil and gas properties, the Corporation will be dependent on such operators for the timing of activities related to such properties and will be limited in its ability to direct or control the operations.

### **Risk of Foreign Operations**

The Corporation's principal oil and natural gas properties are currently located in Azerbaijan. As such, the Corporation is subject to political, economic, and other uncertainties, including, expropriation of property without fair compensation, changes in energy policies or the personnel administering them, nationalization, currency fluctuations and devaluations, exchange controls and royalty and tax increases and other risks arising out of foreign governmental sovereignty over areas in which the Corporation's operations are conducted, as well as the risks of loss due to civil strife, acts of war, acts of terrorism, guerrilla activities and insurrections. In the event of a dispute arising in connection with the Corporation's operations outside of the United States, the Corporation may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons to the jurisdictions of the courts of the United States or enforcing judgments from the United States in other jurisdictions. The Corporation may also be hindered or prevented from enforcing its rights with respect to a governmental instrumentality because of the doctrine of sovereign immunity. Accordingly, the Corporation's exploration, development and production activities outside of the United States could be substantially impacted by factors beyond the Corporation's control, any of which could have a material impact on the Corporation.

The Corporation's operations may be adversely affected by changes in governmental policies and legislation or social instability and other factors which are not within control of the Corporation including, among other things, a change in crude oil or natural gas pricing policy, the actions of national labor unions, the risks of war, terrorism, abduction, expropriation, nationalization, renegotiation or nullification of existing concessions and contracts, changes in taxation policies, economic sanctions and the imposition of specific drilling obligations and the development and abandonment of oil or natural gas fields.

The Corporation's operations and expenditures are to some extent paid in foreign currencies. As a result, the Corporation is exposed to market risks resulting from fluctuations in foreign currency exchange rates. A material increase or drop in the value of any such foreign currency could result in a material adverse effect on the Corporation's cash flow and revenues. Currently, there are no significant restrictions on the repatriation of capital and distribution of earnings from Azerbaijan to foreign entities. However, there can be no assurance that restrictions on repatriation of capital or distributions of earnings from Azerbaijan will not be imposed in the future.

The Corporation is not currently using exchange rate derivatives to manage exchange rate risks. In addition, the Corporation's results will be reported in United States Dollars and any foreign currency denominated monetary balances could result in gains and losses that may increase the variability of earnings.

### **Risk Factors Relating to Operations in Azerbaijan**

Beyond the risks inherent in the oil and natural gas industry, the Corporation is subject to additional risks resulting from doing business in Azerbaijan. While the Corporation will attempt to reduce many of these risks through agreements with the Government of Azerbaijan and others, no assurance can be given that such risks have been mitigated. The risks include matters arising from the evolving laws and policies of Azerbaijan, the imposition of special taxes or similar charges, oil export or pipeline restrictions, foreign exchange fluctuations and currency controls, the unenforceability of contractual rights or the taking of property without fair compensation, restrictions on the use of expatriates in operations and other matters.

In addition, corruption in Azerbaijan is pervasive at many levels which expose foreign companies like the Corporation to a number of financial and lease risks, all of which are beyond the control of the Corporation.

### **Regulatory Regime**

The Corporation bears the risk that a change of government could occur and a new government may void the contracts, laws and regulations that the Corporation is relying upon for the exploration, rehabilitation, development and production of oil and natural gas and operations relating thereto. Regulations with respect to exploration and production operations may be revised at any time. There can be no assurance that any such regulatory enactments will not have a materially adverse effect on the operations or the revenues generated in Azerbaijan.

### **Legal Risks**

Laws relating to corporate law, tax law, customs law and currency and banking legislation are subject to modifications or revision by Azerbaijan. Noncompliance may have consequences which are out of proportion to the severity of the noncompliance. Contracts may be susceptible to conflicting interpretations, revision or cancellation and legal redress may be uncertain, delayed or unavailable. It is possible that Azerbaijan may make changes to laws, decrees, rules or regulations which may restrict the rights or benefits accruing to the Corporation or which may increase its financial obligations.

### **Regional Risk**

Azerbaijan is located in a region that has, at times, been politically unstable. Regional wars or other forms of instability in the region that may or may not directly involve Azerbaijan could have an adverse impact on Azerbaijan's ability to engage in international trade or the exploration, rehabilitation, development and production of oil and gas assets in Azerbaijan by the Corporation.

### **Conflicting Interests with Partners**

Joint venture, acquisition, financing and other agreements and arrangements must be negotiated with independent third parties and, in some cases, must be approved by governmental agencies. These third parties generally have objectives and interests that may not coincide with the Corporation's interests and may conflict with the Corporation's interests. Unless the parties are able to resolve these conflicting objectives and interests in a mutually acceptable manner, agreements and arrangements with these third

parties will not be consummated, which would likely have a material adverse effect on the Corporation's financial condition and results of operations.

In certain circumstances, the consent of joint venturers may be required for various actions. Other parties influencing the timing of events may have priorities that differ from the Corporation's, even if they generally share the Corporation's objectives. Demands by or expectations of governments, joint venturers, customers, and others may affect the Corporation's strategy regarding the various projects. Failure to meet such demands or expectations could adversely affect the Corporation's participation in such projects or its ability to obtain or maintain necessary licenses and other approvals. If that were to occur, it would likely have an adverse effect on the Corporation's financial condition and results of operations.

### **Expiration of Contract Terms**

The Corporation's property interests are generally expected to be held indirectly in the form of PSAs. If the Corporation or the holder of the interests in the PSA fails to meet the specific requirement(s) of a PSA, the interest or any part thereof may terminate or expire. There can be no assurance that any of the obligations required to maintain each interest in a PSA will be met. The termination or expiration of the Corporation's particular interest in a PSA, including the ERDPSA, will likely have a material adverse effect on the Corporation's financial condition and results of operations.

Under the ERDPSA, Bahar Energy will have the obligation to achieve, not later than three (3) years from the date of SOCAR's approval of the "Rehabilitation and Production Program", an average daily rate of petroleum production from the contract rehabilitation area during ninety (90) consecutive days 150% of the average 2008 production rates. Meeting the 150% production rate will result in the realization of the full 25 year term of the agreement for the Contract Rehabilitation Area. If Bahar Energy fails to meet the 150% production target within the three year timeframe, SOCAR shall have the right to terminate the ERDPSA in relation to the Contract Rehabilitation Area. Approval of the "Rehabilitation and Production Program" was received from SOCAR on June 22, 2011 establishing the start date for the three year period in which the production target must be met.

### **Internal Controls**

Effective internal controls over financial reporting are necessary for the Corporation to provide reliable financial reports and to help prevent fraud. While, the Corporation undertakes a number of procedures in order to help ensure the reliability of its financial reports, including those imposed on it under Canadian securities laws, the Corporation cannot be certain that such measures will ensure that the Corporation will maintain adequate control over financial processes and reporting. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could impact the Corporation's results of operations or impair the ability to meet its reporting obligations. If the Corporation or its independent auditors discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in the Corporation's financial statements.

At the operational level, BEOC is an entity in which the Corporation has an indirect interest through its minority shareholder position in Bahar Energy. As such, the Corporation relies upon certain employees of BEOC for the accumulation and reporting of financial data in respect of the Corporation's interests in Azerbaijan, and on regular physical visits to Azerbaijan by the Corporation's management and Auditors to overview this activity. A major disruption in the flow of information from Bahar Energy and BEOC could impact the accuracy of financial reporting and management information.

The Corporation's ability to affect change within the Bahar Energy and BEOC organizations related to internal controls is related to the Corporation's ability to influence Bahar Energy's board of directors and shareholders. Functionally, unanimous consent of Bahar Energy's board of directors and shareholders is required for most actions. Of key importance is the ability of the Corporation to second personnel into key management positions in the BEOC organization, because even with unanimous board of director

direction there is no guarantee that the recommended changes will be timely and effectively implemented at the BEOC level.

The inability to reach unanimous consent by the board or directors and shareholders of Bahar Energy addressing issues of importance to the Corporation, or the inability to second the Corporation's personnel into key management positions inside BEOC's organization, may materially impact the Corporation's ability to obtain timely and reliable financial reports and the ability to prevent fraud. The failure of Bahar Energy or BEOC to take corrective actions on a timely basis can have a material adverse effect on the Corporation's financial condition and results of operations.

### **Environmental Risks and Regulations**

All phases of the oil and gas industry present environmental risks and are subject to environmental regulation pursuant to a variety of international conventions and local laws and regulations. Such legislation provides for, among other things, restrictions and prohibitions on the release or emission of various substances produced in association with certain oil and gas industry operations. In addition, such legislation requires that well and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable authorities. Compliance with such legislation can require significant expenditures and a breach of such requirements may result in suspension or revocation of necessary licenses and authorizations, civil liability for pollution damage, and the imposition of fines and penalties any of which may materially adversely affect the Corporation's financial condition and results of operations.

Environmental legislation is becoming increasingly stringent and the costs of regulatory compliance are increasing. No assurance can be given that environmental legislation will not result in a curtailment of production or a material increase in the costs of exploration, development or production activities or otherwise adversely affect the Corporation's financial condition, results of operations or prospects.

### **Insurance**

The Corporation's involvement in the exploration for and development of oil and gas properties may result in the Corporation becoming subject to liability for pollution, blow outs, property damage, personal injury or other hazards. The insurance the Corporation maintains may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not be insurable or, in certain circumstances, the Corporation may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to the Corporation. The occurrence of a significant event that the Corporation is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on the Corporation's financial position, results of operations and prospects.

### **Delays in Business Operations**

In addition to the usual delays in payments by purchasers of oil and natural gas to the Corporation, payments to the Corporation may be delayed due to restrictions imposed by lenders, accounting delays, delays in the sale or delivery of products, delays in the connections of wells to a gathering system, adjustment for prior periods, or recovery of expenses incurred in the operation of the properties. Any of these delays could reduce the amount of cash flow available for the Corporation in a given period and expose the Corporation to additional third party credit risks.

### **Third Party Credit Risk**

The Corporation may be exposed to third party credit risk through its contractual arrangements with joint venture partners, with marketers of petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to the Corporation, such failures could have a

material adverse effect on the Corporation and its cash flow from operations. In addition, poor credit conditions in the industry and of joint venture partners of the Corporation may impact a joint venture partner's willingness to participate in the Corporation's ongoing capital program, potentially delaying the program and the results of such program until the Corporation finds a suitable alternative partner.

### **Governmental Regulation**

The petroleum industry is subject to regulation and intervention by governments in such matters as the awarding of exploration and production interests, the imposition of specific drilling obligations, environmental protection controls, control over the development and abandonment of fields (including restrictions on production) and possibly expropriation or cancellation of contract rights. As well, governments may regulate or intervene with respect to price, taxes, royalties and the exportation of oil and natural gas. Such regulations may be changed from time to time in response to economic or political conditions. The implementation of new regulations or the modification of existing regulations affecting the oil and gas industry could reduce demand for natural gas and oil, increase costs and may have a material adverse impact on the Corporation. Export sales are subject to the authorization of provincial and federal government agencies and the corresponding governmental policies of foreign countries. Development of reserves and rates of return are also susceptible to changes in governmental fiscal policy. Generally, government and other regulatory licenses and permits are required to conduct exploration, rehabilitation, development and production activities. The issuance of such licenses and permits is subject to the discretion of the applicable governments or governmental agencies and offices, and there can be no assurance that the Corporation will be able to obtain all necessary licenses and permits that may be required to carry out its exploration, rehabilitation, development and production activities at its properties.

The Corporation must comply with known standards, existing laws and regulations. New laws and regulations, amendments to existing laws and regulations or more stringent enforcement of existing laws and regulations could have a material adverse impact on the Corporation and its results of operations, financial condition and prospects.

Development of the Corporation's properties requires the approval by applicable regulatory authorities of the plans of the Corporation with respect to the drilling and development of such properties. A failure to obtain such approval on a timely basis or the imposition of material conditions by such authority in connection with the approval may materially affect the prospects of the Corporation.

### **Labor**

The Corporation may be dependent on local labor to carry out site work relating to its international operations. The Corporation may directly employ local workers and may be subject to local labor laws. There can be no assurance that labor related disputes, developments or actions, including strikes, may not occur in the future. Such occurrences may have a material adverse impact on the business, operations, prospects and financial condition of the Corporation.

### **Future Financing**

Greenfields may require future financing through the issuance of equity or debt to fund its future exploration, development and operations. There can be no assurance that additional financing will be available to Greenfields when needed or on terms acceptable to Greenfields. In addition, capital markets have been volatile in recent months, and continued volatility could limit Greenfields' ability to obtain new financing, even if Greenfields has positive business results. Greenfields' inability to raise funding to support ongoing operations and to fund capital expenditures or acquisitions may limit Greenfields' growth or may have a material adverse effect upon Greenfields. Greenfields cannot predict the size of future issuances of equity or the issuance of debt or the effect, if any, that future issuances and sales of Greenfields' securities will have on the market price of the Common Shares.

## **Market Conditions**

As a result of the weakened global economic situation and the recent volatility in oil, natural gas and other commodity prices, Greenfields may face reduced cash flow and restricted access to capital until these conditions stabilize. A prolonged period of adverse market conditions may affect Greenfields' financial results and impede Greenfields' ability to finance planned capital expenditures. In addition, a prolonged period of adverse market conditions may impede Greenfields' ability to refinance its credit facilities or arrange alternative financing for operations, capital expenditures and future acquisition opportunities. In each case, Greenfields' ability to maintain and grow its reserves and fully exploit its properties for the benefit of the shareholders could be adversely affected. As well, given the recent volatility in commodity prices and in Canadian and global equity markets, the trading prices of the Common Shares in the future may be subject to considerable volatility. Future trading prices of Greenfields' Common Shares may be significantly below current levels.

## **Negative Operating Cash Flow**

The Corporation has had negative cash flow since inception and projects negative operating cash flow to continue for the near term. The Corporation's failure to achieve profitability and positive operating cash flows could have a material adverse effect on the Corporation's business, financial condition, operating results, ability to access additional equity or bank debt.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become payable. The Corporation's approach to managing liquidity is to ensure, as much as possible, that it will have sufficient cash or cash equivalents to pay its obligations when due, under both normal and unusual conditions and without incurring unacceptable costs, relinquishment of properties or risking harm to the Corporation's reputation.

The Corporation prepares annual and interim period capital expenditures budgets, which are monitored and updated as considered necessary to provide current cash flow estimates. To facilitate the capital expenditure program, the Corporation may raise debt and capital through the issuance of debt or equity securities. Additional financing may be required to complete planned capital programs.

The Corporation's financial liabilities at December 31, 2012 and December 31, 2011 arose from the recognition of its proportionate share of Bahar Energy liabilities for the Azerbaijan project, corporate obligations and convertible debt.

Our cash flows, both in the short-term and long-term, are impacted by highly volatile oil and natural gas prices. Significant deterioration in commodity prices negatively impacts revenues, earnings and cash flows, capital spending, and potentially our liquidity. Sales volumes are substantially impacted by the onset of new production related to the start of drilling and recompletion operations in the fields. Further, the start of these operations is contingent on the fabrication and delivery of new platforms and rigs, the weather in the Caspian Sea and the availability of suitable offshore installation equipment. Delays in this equipment will reduce our earnings and cash flows.

Our long-term cash flows are highly dependent on our success in efficiently developing current reserves and economically finding, developing and monetizing additional recoverable reserves. Cash investments are required continuously to fund exploitation and development projects, which are necessary to offset the inherent declines in production of proven reserves. We may not be able to find, develop or acquire additional reserves to replace our current and future production at acceptable costs, which could materially adversely affect our future liquidity.

Future liquidity will depend on the timing of the drilling and recompletion programs. As favorable product pricing and production results are realized, we will evaluate the available market for additional drilling rigs to accelerate the drilling program as contemplated in the development program and summarized in our NI Form 51-101 disclosures filed on April 30, 2013 and available on [www.sedar.com](http://www.sedar.com). If additional capital resources are needed in 2013 in excess of the operating cash flows from the Bahar project, we will obtain debt financings to fund the project until the project becomes cash flow positive.

In the event that debt financing is not available or unattractive, the Corporation will consider issuing additional equity or divestment of a part of its investments or projects. Although management is confident that the necessary financing or alternatives to financing will be available, there is no certainty that such funding options will be obtained on terms acceptable to management which may cast significant doubt about the Corporation's ability to continue as a going concern.

<b>Capital structure</b>		
<i>(US\$000's)</i>	December 31, 2012	December 31, 2011
Working capital <sup>(1)</sup>	13,377	29,674
Convertible debt and shareholders' equity	38,327	28,481
Ratios of working capital to convertible debt and shareholders' equity <sup>(2)</sup>	35%	104%

(1) Working capital, presented here, is current assets net of current liabilities net of warrants.

(2) Convertible debt is combined with shareholder's equity due to the Company's right to settle debt by issuing shares.

Currently, the Corporation does not have financing or lines of credit arrangements in place to provide project funding. Capital resources of the Corporation consist of existing working capital. The Corporation expects to continue financing its contractual commitments under the ERDPSA with cash on hand, short term investments non-cash working capital, cash from operations and debt. Additional cash flow needs resulting from strategic changes to capital expenditure programs could be raised by issuing additional debt or equity securities or a combination of both.

### **Off-balance sheet arrangements**

The Corporation does not have any special purpose entities, nor is it party to any transactions or arrangements that would be excluded from the Corporation's consolidated statements of financial position.

### **Related party transactions**

A detailed discussion of related party transactions is included in Note 8 to the Consolidated Financial Statements for the year ended December 31, 2012.

## Contractual commitments and contingencies

The following is a summary of the Corporation's contractual obligations and commitments as of December 31, 2012:

<i>(US\$000's)</i>	2013	2014	Thereafter
Operating leases <sup>(1)</sup>	152	-	-
Annual acreage fees	72	-	-
Debentures – Coupon interest payments <sup>(2)</sup>	2,171	2,171	5,427
	2,395	2,171	5,427

<sup>(1)</sup> The Corporation has extended its lease of office space for its corporate headquarters in the United States through December 2013.

<sup>(2)</sup> The coupon interest payments are denominated in Canadian Dollars. The USD value of the scheduled interest payments has been calculated at the December 31, 2012 exchange rate of 0.9949 USD/CAD.

The commitments of the Corporation include a \$52.5 million loan commitment to Bahar Energy for the funding of the deficit cash flows associated with the 2013 Bahar Annual Work Program and Budget (“WP&B”), which is subject to change.

The Corporation's commitments to fund the Bahar project are based on the approved annual WP&B prepared by BEOC. Greenfields' management, through their participation at the project Steering Committee, Management Committee and Bahar Energy board of directors, provides significant input and technical guidance to the proposed annual work plan. Proposed budgets are reviewed and approved by the Management Committee (comprised of representatives from Bahar Energy and SOCAR), Bahar Energy board of directors and Greenfields board of directors. Budget approval by Bahar Energy must be unanimous. Greenfields' Chief Operating Officer currently serves as the Bahar Energy representative on the Management Committee for BEOC.

The annual WP&B is then submitted to SOCAR (the National Oil Company of Azerbaijan) in accordance with ERDPSA contractual requirements for review and approval. It is the responsibility of BEOC to carry out the petroleum operations for the Contractor parties, BEL and SOCAR Oil Affiliate (SOA), in accordance with the SOCAR approved annual WP&B. BEL shareholder commitments to fund petroleum operations are made in the form of loan agreements, which can be called by the BEL President based on valid cash calls submitted by BEOC. The Corporation has signed a 2013 loan agreement with BEL to fund its 33.33% share of deficit cash flows of the Bahar project resulting from capital expenditures and net operating cash flows in the 2013 approved WP&B.

The WP&B is monitored during the year and updated based on the progress of implementing the work plan by BEOC, actual costs incurred and actual production and revenues realized from operating activities. At mid-year (or earlier if required) a revised budget is prepared by BEOC for BEL and its board of directors for review and approval and to submit to the Steering Committee for approval.

Under the ERDPSA, Bahar Energy will have the obligation to achieve, not later than three (3) years from the date of SOCAR's approval of the “Rehabilitation and Production Programme”, an average daily rate of petroleum production from the contract rehabilitation area during ninety (90) consecutive days of 150% of the average 2008 production rates. The average 2008 production rate was the equivalent of 6,944 boe/d. Meeting the 150% production rate will result in the realization of the full 25 year term of the agreement for the Contract Rehabilitation Area. If Bahar Energy fails to meet the 150% production target within the three year timeframe, SOCAR shall have the right to terminate the ERDPSA in relation to the Contract Rehabilitation Area at their option. Approval of the “Rehabilitation and Production Programme” was received from SOCAR on June 22, 2011 establishing the start date for the three year period in which the 150% production rate target must be met.

In addition to the 150% production levels for continuance of the ERDPSA for the 25 year term, Bahar Energy is obligated to carry SOA's 20% share of expenditures in the rehabilitation area until production rates are two times the 2008 production rates, or the equivalent of 9,259 boe/d, at which time SOA

becomes fully responsible for funding their share of expenditures. The SOA carry for the rehabilitation area is reimbursed out of SOA's share of entitlement petroleum or revenues currently produced from the rehabilitation area. Any unrecovered balance is carried forward from one period to the next.

### **Financial instruments**

A detailed summary of the Corporation's financial instruments is included in Note 25 to the Consolidated Financial Statements for the year ended December 31, 2012.

## **SUBSEQUENT EVENTS**

The Corporation has no material subsequent events.

## ABBREVIATIONS

<u>Abbreviation</u>	<u>Description</u>
bbbl	Barrels
boe	barrels of oil equivalent of natural gas and crude oil on the basis of 1 boe for 6 mcf of natural gas
bbbl/d	barrels of oil per day
boe/d	barrels of oil equivalent per day
mbbls	thousand barrels
mcf	thousand cubic feet
mmcf	million cubic feet
mcf/d	thousand cubic feet per day
mmcf/d	million cubic feet per day
bcf	billion cubic feet
km	Kilometer
sq km	square kilometer