

**ADIRA ENERGY LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2013**

**U.S. DOLLARS IN THOUSANDS**

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## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

### **To the Board of Directors and Shareholders of**

#### **ADIRA ENERGY LTD.**

We have audited the accompanying consolidated balance sheets of Adira Energy Ltd. ("the Company") and its subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive loss, changes in equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2013 and 2012 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

As described in Note 1b to the financial statements, as of December 31, 2013, the Company has an accumulated deficit of \$34.6 million and a negative cash flow from operations of \$2 million for the year ended December 31, 2013. The Company is an oil and gas exploration company and its existing funds and operating revenues are currently insufficient to finance its future and current operating expenses and its exploration funding commitments. These matters and other matters discussed in Note 1b, raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Tel-Aviv, Israel  
April 30, 2014

**KOST FORER GABBAY & KASIERER**  
A Member of Ernst & Young Global

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

U.S. dollars in thousands

	Note	December 31,	
		2013	2012
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	4	\$ 617	\$ 2,394
Restricted deposits	5	35	1,082
Accounts receivable	6	-	360
Other receivables and prepaid expenses	7	2,513	4,701
Total current assets		3,165	8,537
<b>NON-CURRENT ASSETS:</b>			
Property and equipment, net	8	61	276
Long - term receivables	9b (2)	-	640
Exploration and evaluation assets	9	-	5,887
Total non-current assets		61	6,803
Total assets		\$ 3,226	\$ 15,340
<b>LIABILITIES AND EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Trade payables	10	\$ 2,817	\$ 5,841
Other accounts payable and accrued liabilities	11	986	1,476
Total current liabilities		3,803	7,317
<b>LONG-TERM LIABILITIES</b>			
Share warrants	14b	-	3,013
Total long-term liabilities		-	3,013
<b>EQUITY (DEFICIT):</b>			
Share capital	14	-	-
Additional paid-in capital		34,023	33,966
Accumulated deficit		(34,600)	(28,956)
Total equity (deficit)		(577)	5,010
Total liabilities and equity		\$ 3,226	\$ 15,340

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

Approved on Behalf of the Board:

April 30, 2014	<i>/s/ Dennis Bennie</i>	<i>/s/ Alan Friedman</i>
Date of approval of the financial statements	Dennis Bennie Chairman of the board of directors	Alan Friedman Director

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

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

	Note	Year ended December 31,		
		2013	2012	2011
Revenues and other income	17	\$ 17	\$ 1,889	\$ 1,323
Expenses:				
Exploration expenses	9	677	1,026	5,018
General and administrative expenses	18	2,813	5,304	5,031
Impairment charge	9	5,168	7,810	1,226
Total expenses		8,658	14,140	11,275
Operating loss		(8,641)	(12,251)	(9,952)
Financing income	19	3,027	2,480	43
Financing expense	19	(30)	(745)	(109)
Loss before income taxes		(5,644)	(10,516)	(10,018)
Income taxes	13	-	(41)	(33)
Net loss and comprehensive loss		<u>\$ (5,644)</u>	<u>\$ (10,557)</u>	<u>\$ (10,051)</u>
Net loss and comprehensive loss attributed to:				
Equity holders of the parent		\$ (5,644)	\$ (8,554)	\$ (9,489)
Non-controlling interests		-	(2,003)	(562)
		<u>\$ (5,644)</u>	<u>\$ (10,557)</u>	<u>\$ (10,051)</u>
Basic and diluted net loss per share attributable to equity holders of the parent		<u>(0.09)</u>	<u>(0.19)</u>	<u>(0.29)</u>
Weighted average number of ordinary shares used in computing basic and diluted net loss per share		<u>60,260,363</u>	<u>44,313,618</u>	<u>33,271,111</u>

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

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIT)**

U.S. dollars in thousands, except share data

	Number of shares	Share capital	Attributable to equity holders of the parent			Non- controlling interests	Total Equity (deficit)
			Additional paid in capital	Accumulated deficit	Total		
Balance as of January 1, 2011	30,046,667	\$ -	\$ 20,286	\$ (9,680)	\$ 10,606	\$ 631	\$ 11,237
Shares issued in private placement, net (Note 14b(ii))	3,494,623	-	*6,152	-	6,152	-	6,152
Exercise of warrants and options	381,527	-	314	-	314	-	314
Investment in equity of subsidiary by non-controlling interests	-	-	-	-	-	151	151
Share-based compensation	-	-	1,023	-	1,023	-	1,023
Net loss	-	-	-	(9,489)	(9,489)	(562)	(10,051)
Balance as of December 31, 2011	33,922,817	-	27,775	(19,169)	8,606	220	8,826
Shares issued in private placement, net (Note 14b(iii))	26,337,546	-	*5,215	-	5,215	-	5,215
Investment in equity of subsidiary by non-controlling interests	-	-	-	-	-	550	550
Share-based compensation	-	-	976	-	976	-	976
Net loss	-	-	-	(8,554)	(8,554)	(2,003)	(10,557)
Adjustment of non-controlling interests **)	-	-	-	(1,233)	(1,233)	1,233	-
Balance as of December 31, 2012	60,260,363	-	33,966	(28,956)	5,010	-	5,010
Share-based compensation	-	-	57	-	57	-	57
Net loss	-	-	-	(5,644)	(5,644)	-	(5,644)
Balance as of December 31, 2013	60,260,363	\$ -	\$ 34,023	\$ (34,600)	\$ (577)	\$ -	\$ (577)

\*) Net of issuance expenses of \$472 and \$791 in the years 2011, and 2012, respectively.

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

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

U.S. dollars in thousands

	Year ended December 31,		
	2013	2012	2011
<u>Cash flows from operating activities:</u>			
Net loss	\$ (5,644)	\$ (10,557)	\$ (10,051)
Adjustments to reconcile net loss to net cash used in operating activities:			
Adjustments to the profit or loss items:			
Exchange rate differences for cash and cash equivalents	18	68	138
Depreciation	88	96	80
Impairment charge	5,168	7,810	1,226
Issuance expenses	-	726	-
Revaluation of warrants	(3,013)	(2,299)	-
Share-based compensation	57	976	1,023
	<u>2,318</u>	<u>7,377</u>	<u>2,467</u>
Changes in operating asset and liability items:			
Decrease (increase) in accounts receivable, other receivables and prepaid expenses	4,847	(6,696)	7,122
Increase (decrease) in trade payables	(3,024)	5,359	(6,611)
Increase (decrease) in other accounts payable and accrued liabilities	(490)	537	659
	<u>1,333</u>	<u>(800)</u>	<u>1,170</u>
Net cash used in operating activities	<u>(1,993)</u>	<u>(3,980)</u>	<u>(6,414)</u>
<u>Cash flows from investing activities:</u>			
Expenditures on exploration and evaluation assets	(2,636)	(10,654)	(923)
Purchase of property and equipment	-	(70)	(297)
Proceeds from sale of exploration and evaluation assets	1,823	-	-
Increase (decrease) in long term receivables	-	(640)	-
Decrease (increase) in restricted cash	1,047	(639)	563
Net cash provided by (used in) investing activities	<u>234</u>	<u>(12,003)</u>	<u>(657)</u>
<u>Cash flows from financing activities:</u>			
Proceeds from issuance of warrants, net of issuance expenses	-	4,586	-
Proceeds from issue of shares, net of issuance expenses	-	5,215	6,152
Investment in equity of subsidiary by non-controlling interests	-	550	151
Proceeds from exercise of warrants and options to employees	-	-	314
Net cash provided by financing activities	<u>-</u>	<u>10,351</u>	<u>6,617</u>
Exchange rate differences for cash and cash equivalents	<u>(18)</u>	<u>(68)</u>	<u>(138)</u>
Decrease in cash and cash equivalents	(1,777)	(5,700)	(592)
Cash and cash equivalents at the beginning of the year	<u>2,394</u>	<u>8,094</u>	<u>8,686</u>
Cash and cash equivalents at the end of the year	<u>\$ 617</u>	<u>\$ 2,394</u>	<u>\$ 8,094</u>

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 1:- GENERAL**

## a. Nature of operations:

Adira Energy Ltd. and its subsidiaries ("Adira" or "the Company"), is an oil and gas exploration company. Adira is a limited company, incorporated on April 8, 2009, and domiciled in Toronto, Ontario, Canada. The Company's shares are currently traded on the OTC market in the U.S. and the TSX Venture Exchange in Canada. The consolidated financial statements of the Company for the year ended December 31, 2013 were authorized for issue in accordance with a resolution of the directors on April 30, 2014.

The Company has been granted two offshore petroleum licenses in Israel. The Company's wholly-owned Canadian subsidiary, Adira Energy Holdings Corp. owns three wholly owned Israeli subsidiaries as follows as of December 31, 2013: (i) Adira Energy Israel Limited ("Adira Israel"), which holds two offshore petroleum licenses being the "Gabriella License No. 378" ("Gabriella") of which it owns a 15% interest (see also Note 9b(1)) and the "Yitzhak License No. 380" ("Yitzhak") of which it owns 70% interest (see also Notes 9.b(2)); (ii) Adira Oil Technologies Limited ("AOT") was granted a 23.25% interest in one offshore petroleum license, the "Samuel License No. 388" ("Samuel"), which was returned to the Ministry of Energy and Water of the State of Israel (the "Ministry") in October 2013 (see also Note 9b(3)) (Gabriella, Yitzhak and Samuel - collectively the "Offshore Licenses") and (iii) Adira Energy Israel Services Ltd. provided services in respect of the entities described above. Adira Energy Holdings Corp. also owns 60% of the subsidiary, Adira Geo Global Limited ("AGG"), which owned a 30% interest in Samuel.

Adira Energy Israel Limited is the operator of Gabriella, a co-operator of Yitzhak and AGG was the operator of Samuel. As the operator, the Company has established Unincorporated Joint Ventures ("UJV's") to manage the exploration activities of each of the offshore licenses. The Company receives consulting and operator fees in accordance with the terms of Joint Operating Agreements signed between the Company and each of its consortium partners in the UJV's.

## b. Going Concern:

As reflected in the consolidated financial statements, as of December 31, 2013, the Company has an accumulated deficit of \$34,600 and in 2013; the Company had negative cash flows from operations of \$1,993. The Company is an early exploration stage company and its existing funds and operating revenues are currently insufficient to finance its future and current operating expenses and exploration funding commitments.

In 2013, as a result of challenging markets and difficulty in raising funds to drill multi well program, the Company significantly reduced its activity and returned the Samuel license to the Ministry, ceased operation in Gabriella due to lack of funding from the partners of the Gabriella license, and there was no exploration activity in the Yitzhak license in 2013 (See also Note 9b).

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 1:- GENERAL (Cont.)**

The ability of the Company to continue as a going concern depends upon the discovery of economically recoverable reserves, the ability of the Company to obtain financing to complete development, and upon future profitable operations from the properties or proceeds from their disposition.

There can be no assurance that the Company will be able to continue to raise funds from the aforementioned sources in which case the Company may be unable to meet its obligations. These matters raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

**NOTE 2:- BASIS OF PREPARATION**

- a. Basis of preparation of the financial statements:

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. These Standards comprise:

1. International Financial Reporting Standards (IFRS).
2. International Accounting Standards (IAS).
3. Interpretations issued by the IFRIC and by the SIC.

- b. The consolidated financial statements have been prepared on a historical cost basis, and are presented in U.S. dollars and all values are rounded to the nearest thousand (\$ 000), except when otherwise indicated.

**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES**

The following are the significant accounting policies applied by the Company in preparing its consolidated financial statements for all periods presented unless otherwise stated.

- a. Significant judgments, estimates and assumptions used in the preparation of the financial statements:

The preparation of the financial statements requires management to make judgments, estimates and assumptions that have an effect on the application of the accounting policies and on the reported amounts of assets, liabilities, revenues and expenses. These estimates and underlying assumptions are reviewed regularly. Changes in accounting estimates are reported in the period of the change in estimate.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In the process of applying the significant accounting policies, the Company has made the following judgments which have a significant effect on the amounts recognized in the financial statements:

- Determining the fair value of share-based payment transactions:

The fair value of share-based payment transactions is determined using an acceptable option-pricing model. The assumptions made by management and used in the model include expected volatility, expected life and expected dividend. Changes in assumptions could affect the estimates of fair values.

The key assumptions made in the financial statements concerning uncertainties at the end of the reporting period and the critical estimates computed by the Company that may result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

- Impairment of Exploration and Evaluation Assets:

The Company reviews its Exploration and Evaluation Assets for impairment at least once a year and when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. This requires management to make judgments, estimates and assumptions with respect to the probability that the carrying amount of the exploration and evaluation asset will be recovered in full from successful development or by sale. See Note 9 for further details.

- b. Consolidated financial statements:

The consolidated financial statements comprise the financial statements of companies that are controlled by the Company (subsidiaries). Control is achieved when the Company is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Potential voting rights are considered when assessing whether an entity has control. The consolidation of the financial statements commences on the date on which control is obtained and ends when such control ceases.

The financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods. The consolidated financial statements are prepared using uniform accounting policies by all companies in the Group. Significant intragroup balances and transactions and gains or losses resulting from intragroup transactions are eliminated in full in the consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Non-controlling interests in subsidiaries represent the equity in subsidiaries not attributable, directly or indirectly, to a parent. Non-controlling interests are presented in equity separately from the equity attributable to the equity holders of the Company. Profit or loss and components of other comprehensive income are attributed to the Company and to non-controlling interests. Losses are attributed to non-controlling interests even if they result in a negative balance of non-controlling interests in the consolidated statement of financial position.

The disposal of a subsidiary that does not result in a loss of control is recognized as a change in equity. Upon the disposal of a subsidiary resulting in loss of control, the Company:

- derecognizes the subsidiary's assets (including goodwill) and liabilities.
- derecognizes the carrying amount of non-controlling interests.
- derecognizes the adjustments arising from translating financial statements carried to equity.
- recognizes the fair value of the consideration received.
- recognizes the fair value of any remaining investment.
- reclassifies the components previously recognized in other comprehensive income on the same basis as would be required if the subsidiary had directly disposed of the related assets or liabilities.
- recognizes any resulting difference (surplus or deficit) as gain or loss.

c. Unincorporated joint oil and gas ventures:

The Company conducts petroleum and natural gas exploration activities jointly with other partners who each have direct ownership in the assets and each are directly obligated for the liabilities of the ventures. Consequently, these financial statements reflect only the Company's proportionate interest in such activities.

The Company accounts for its share of the joint venture's assets, liabilities it has incurred, income from the sale or use of its share of the joint venture's output, together with its share of the expenses incurred by the joint venture and any expenses it incurs in relation to its interest in the joint venture.

d. Farm-out arrangements in the exploration and evaluation phase:

A farm-out is the transfer of part of an oil and gas interest in consideration for an agreement by the transferee ("farmee") to meet, absolutely, certain expenditures which would otherwise have to be undertaken by the owner ("farmor"). Farm-out transactions generally occur in the exploration or development phase and are characterized by the transferor (i.e. farmor) giving up future economic benefits, in the form of reserves, in exchange for a reduction in future funding obligations.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Accordingly, the farmee recognizes its expenditure under the arrangement in respect of its interest and that retained by the farmor, as and when the costs are incurred.

The Company (farmor) accounts for the farm-out arrangement as follows:

- The farmor does not record any expenditure made by the farmee on its behalf;
- The farmor does not recognize a gain or loss on the farm-out arrangement, but rather redesignates any costs previously capitalized in relation to the whole interest as relating to the partial interest retained; and
- any cash consideration received is credited against costs previously capitalized in relation to the whole interest with any excess accounted for by the farmor as a gain on disposal.

e. Functional currency and foreign currency:

1. Functional currency and presentation currency:

The functional currency, which is the currency that best reflects the economic environment in which the Company operates and conducts its transactions, is separately determined for the Company and each of its subsidiaries, and is used to measure the financial position and operating results. The functional currency of the Company and its subsidiaries is the U.S. dollar.

The presentation currency of the financial statements is the U.S. dollar.

2. Transactions, assets and liabilities in foreign currency:

Transactions denominated in foreign currency (other than the functional currency) are recorded on initial recognition at the exchange rate at the date of the transaction. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at the end of each reporting period into the functional currency at the exchange rate at that date. Exchange differences, are recognized in profit or loss. Non-monetary assets and liabilities measured at cost are translated at the exchange rate at the date of the transaction.

f. Cash equivalents:

Cash equivalents are considered as highly liquid investments, including unrestricted short-term bank deposits with an original maturity of three months or less from the date of acquisition or with a maturity of more than three months, but which are redeemable on demand without penalty and which form part of the Company's cash management.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- g. Allowance for doubtful accounts:

The allowance for doubtful accounts is determined in respect of specific debts whose collection, in the opinion of the Company's management, is doubtful. No allowance for doubtful account exists as of December 31, 2013 and 2012.

- h. Financial instruments:

1. Financial assets:

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs.

The Company has receivables that are financial assets (non-derivative) with fixed or determinable payments that are not quoted in an active market. Short-term receivables (such as trade and other receivables) are measured based on their terms, normally at face value. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the systematic amortization process. As for recognition of interest income, see q. below.

2. Financial liabilities measured at amortized cost:

Interest-bearing loans and borrowings are initially recognized at fair value less directly attributable transaction costs (such as loan raising costs). After initial recognition, loans, including debentures, are measured based on their terms at amortized cost using the effective interest method taking into account directly attributable transaction costs. Short-term credit (such as trade and other payables) are measured based on their terms, normally at face value. Gains and losses are recognized in profit or loss when the financial liability is derecognized as well as through the systematic amortization process.

3. Financial liabilities at fair value through profit or loss:

Financial liabilities at fair value through profit or loss include financial liabilities classified as held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company assesses the existence of an embedded derivative and whether it is required to be separated from a host contract when the Company first becomes party to the contract. Reassessment of the need to separate an embedded derivative only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

A liability may be designated upon initial recognition at fair value through profit or loss, subject to the provisions of IAS 39.

4. Derecognition of financial instruments:

a) Financial assets:

A financial asset is derecognized when the contractual rights to the cash flows from the financial asset expire or the Company has transferred its contractual rights to receive cash flows from the financial asset or assumes an obligation to pay the cash flows in full without material delay to a third party and has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

If the Company transfers its rights to receive cash flows from an asset and neither transfer nor retains substantially all the risks and rewards of the asset nor transfers control of the asset, a new asset is recognized to the extent of the Company's continuing involvement in the asset. When continuing involvement takes the form of guaranteeing the transferred asset, the extent of the continuing involvement is the lower of the original carrying amount of the asset and the maximum amount of consideration received that the Company could be required to repay.

b) Financial liabilities:

A financial liability is derecognized when it is extinguished, that is when the obligation is discharged or cancelled or expires. A financial liability is extinguished when the debtor:

- discharges the liability by paying in cash, other financial assets, goods or services; or
- is legally released from the liability.

5. Impairment of financial assets:

The Company assesses at the end of each reporting period whether there is any objective evidence of impairment of a financial asset or group of financial assets carried at amortized cost as follows:

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

An objective evidence of impairment of debt instruments and receivables exists as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulty and default in interest or principal payments. The amount of the loss recorded in profit or loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred) discounted at the financial asset's original effective interest rate (the effective interest rate computed at initial recognition). If the financial asset has a variable interest rate, the discount rate is the current effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account (see allowance for doubtful accounts above). In a subsequent period, the amount of the impairment loss is reversed if the recovery of the asset can be related objectively to an event occurring after the impairment was recognized. The amount of the reversal, up to the amount of any previous impairment, is recorded in profit or loss.

6. Classification of rights issues:

Rights, options or warrants to acquire a fixed number of the Company's equity instruments for a fixed amount of any currency are classified as equity instruments if the Company offers the rights, options or warrants pro rata to all of its existing owners of the same class of its non-derivative equity instruments.

7. Issue of a unit of securities:

The issue of a unit of securities involves the allocation of the proceeds received (before issue expenses) to the components of the securities issued in the unit based on the following order: financial derivatives and other financial instruments measured at fair value in each period. Then fair value is determined for financial liabilities and compound instruments (such as convertible debentures) that are presented at amortized cost. The proceeds allocated to equity instruments are the residual amount calculated as the difference between the total proceeds and the proceeds allocated as above. Issue costs are allocated to each component pro rata to the amounts determined for each component in the unit.

i. Property and equipment:

Property and equipment are measured at cost, including directly attributable costs, less accumulated depreciation. Cost includes spare parts and auxiliary equipment that can be used only in connection with the machinery and equipment.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Depreciation is calculated on a straight-line basis over the useful life of the assets at annual rates as follows:

	%
Drilling rig and related equipment	10
Office furniture and equipment	10
Computers and peripheral equipment	33

The useful life, depreciation method and residual value of an asset are reviewed at least each year-end and any changes are accounted for prospectively as a change in accounting estimate.

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. An asset is derecognized on disposal or when no further economic benefits are expected from its use. The gain or loss arising from the derecognition of the asset (determined as the difference between the net disposal proceeds and the carrying amount in the financial statements) is included in profit or loss when the asset is derecognized.

j. Impairment of non-financial assets:

The Company evaluates the need to record an impairment of the carrying amount of non-financial assets whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of fair value less costs of sale and value in use. In measuring value in use, the expected future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in profit or loss.

k. Exploration and evaluation assets:

*Pre-license costs:*

Pre-license costs are expensed in the period in which they are incurred.

*Exploration and evaluation costs:*

Oil and natural gas exploration and development expenditure is accounted for using the successful efforts method of accounting.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

During the geological and geophysical exploration phase, costs are charged against income as incurred. Costs directly associated with an exploration well in its drilling phase, for which it has not yet been determined whether there are proved reserves or it is not commercially viable, are capitalized as exploration and evaluation intangible assets until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration, materials and fuel used, rig costs and payments made to contractors. If no reserves are found, the exploration asset is tested for impairment. If extractable hydrocarbons are found and, subject to further appraisal activity (e.g., by drilling further wells), are likely to be developed commercially, the costs continue to be carried as an intangible assets while sufficient and continued progress is made in assessing the commerciality of the hydrocarbons. All such costs are subject to technical, commercial and management review as well as review for impairment at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off. When proved reserves of oil are determined and development sanctioned, the relevant expenditure is transferred to oil and gas properties after impairment is assessed and any resulting impairment loss is recognized.

1. Taxes on income:

Taxes on income in the consolidated statement of comprehensive loss comprise current and deferred taxes. Current or deferred taxes are recognized in profit or loss, except to the extent that the tax arises from items which are recognized directly in other comprehensive income or in equity. In such cases, the tax effect is also recognized in the relevant item.

1. Current taxes:

The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the end of reporting period as well as adjustments required in connection with the tax liability in respect of previous years.

2. Deferred taxes:

Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes. Deferred taxes are recognized directly in other comprehensive income or in equity if the tax relates to those items.

Deferred taxes are measured at the tax rates that are expected to apply to the period when the taxes are reversed in profit or loss, comprehensive income or equity, based on tax laws that have been enacted or substantively enacted by the end of the reporting period.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is not probable that they will be utilized. Also, temporary differences (such as carry-forward losses) for which deferred tax assets have not been recognized are reassessed and deferred tax assets are recognized to the extent that their recoverability has become probable. Any resulting reduction or reversal is recognized in the line item, "taxes on income".

m. Share-based payment transactions:

The Company's employees and other service providers are entitled to remuneration in the form of equity-settled share-based payment transactions.

The cost of equity-settled transactions with employees is measured at the fair value of the equity instruments granted at grant date. Fair value measurement of all options and warrants granted is determined using an appropriate pricing model. As for other service providers, the cost of the transactions is measured at the fair value of the goods or services received as consideration for equity instruments. In cases where the fair value of the goods or services received as consideration of equity instruments cannot be measured, they are measured by reference to the fair value of the equity instruments granted.

The cost of equity-settled transactions is recognized in profit or loss, together with a corresponding increase in equity, during the period which the performance and service conditions are to be satisfied, ending on the date on which the relevant employees become fully entitled to the award ("the vesting period"). The cumulative expense recognized for equity-settled transactions at the end of each reporting period until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The expense or income recognized in profit or loss represents the movement in the cumulative expense recognized at the end of the reporting period. No expense is recognized for awards that do not ultimately vest.

If the Company modifies the conditions on which equity-instruments were granted, an additional expense is recognized for any modification that increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee/other service provider at the modification date.

If a grant of an equity instrument is cancelled, it is accounted for as if it had vested on the cancellation date, and any expense not yet recognized for the grant is recognized immediately. However, if a new grant replaces the cancelled grant and is identified as a replacement grant on the grant date, the cancelled and new grants are accounted for as a modification of the original grant, as described above.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- n. Employee benefit liabilities:

The Company has several employee benefit plans:

1. Short-term employee benefits:

Short-term employee benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus is recognized when the Company has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

2. Post-employment benefits:

The Company's plan in Israel is financed by contributions to insurance companies and is classified as a defined contribution plan, pursuant to Section 14 of the Severance Pay Law.

The Company pays fixed contributions and has no legal or constructive obligation to pay further contributions if the insurance company does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods; therefore, upon release of the policy to the employee, no additional liability exists between the parties regarding the matter of severance pay and no additional payments shall be made by the Company to the employee. Accordingly, severance liability and deposits on behalf of such liability are not presented on the balance sheet, as the Company has no further obligation to these employees once the deposits have been paid.

- o. Revenue recognition:

Revenues are recognized in the statement of comprehensive loss when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Company's revenues are derived from:

*Operator fees* - the Company acts as the operator on the Offshore Licenses and is entitled to operator fees at a fixed rate of 7.5% of the total exploration costs incurred by the respective UJV's or at a rate ranging from 1.2%-4.8% of the total exploration costs incurred by the respective UJV's depending on the annual expenditures in the UJV. Revenues from operator fees are recognized in accordance with the terms of the Joint Operating Agreements, as exploration costs are incurred in the UJV's.

*Consulting fees* - The Company provides consulting services in respect of the Offshore Licenses on a "time and materials" basis. Consulting fees are recognized as revenues as the services are rendered to the respective UJV's.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## p. Finance income and expenses:

Finance income comprises interest income on cash, cash equivalents and restricted cash and exchange rate gains and losses.

Gains and losses on exchange rate differences are reported on a net basis.

## q. Loss per share:

Loss per share is calculated by dividing the net loss attributable to equity holders of the Company by the weighted number of Ordinary shares outstanding during the period. Basic loss per share only includes shares that were actually outstanding during the period. Potential Ordinary shares (warrants and employee options) are only included in the computation of diluted loss per share when their conversion decreases earnings per share or increases loss per share from continuing operations. Further, potential Ordinary shares that are converted during the period are included in diluted earnings per share only until the conversion date and from that date in basic earnings per share.

All share options and warrants outstanding for all periods presented have not been included in the calculation of diluted loss per share, as they are antidilutive.

## r. Decommissioning liability:

Decommissioning liability is recognized when the Company has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. A corresponding amount equivalent to the provision is also recognized as part of the cost of the related property and equipment. The amount recognized is the estimated cost of decommissioning, discounted to its present value. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to property and equipment. The unwinding of the discount on the decommissioning provision is included as a finance cost.

## s. Presentation of statement of comprehensive loss:

The Company has elected to present a single statement of comprehensive loss which includes both the items of the statement of operation and the items of other comprehensive loss.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

## t. Reclassification:

Certain amounts have been reclassified in comparative data in order to conform to current year's presentation.

## u. Change in accounting policy:

Commencing from January 1, 2011, the Company applies retrospectively IFRS 10, "Consolidated Financial Statements", IFRS 11, "Joint Arrangements", IFRS 12, "Disclosure of Interests in Other Entities" and IAS 27R (Revised 2011), "Separate Financial Statements" and IAS 28R (Revised 2011), "Investments in Associates and Joint Ventures". The application of these standards did not result in a material effect on the consolidated financial statements.

## v. Disclosure of new IFRSs in the period prior to their adoption:

*IAS 32 - Financial Instruments: Presentation and IFRS 7 - Financial Instruments: Disclosure:*

The IASB issued certain amendments to IAS 32 ("the amendments to IAS 32") regarding the offsetting of financial assets and liabilities. The amendments to IAS 32 clarify, among others, the meaning of "currently has a legally enforceable right of set-off" ("the right of set-off").

The amendments to IAS 32 are to be applied retrospectively commencing from the financial statements for periods beginning on January 1, 2014, or thereafter. Earlier application is permitted.

The Company estimates that the amendments to IAS 32 are not expected to have a material impact on its financial statements.

*IFRS 9 - Financial Instruments:*

The IASB issued IFRS 9, "Financial Instruments", the first part of Phase 1 of a project to replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 (the "Standard") focuses mainly on the classification and measurement of financial assets and it applies to all financial assets within the scope of IAS 39.

Amendments regarding derecognition and financial liabilities (Phase 2) have also been issued. According to those amendments, the provisions of IAS 39 will continue to apply to derecognition and to financial liabilities for which the fair value option (designated as measured at fair value through profit or loss) has not been elected; that is, the classification and measurement provisions of IAS 39 will continue to apply to financial liabilities held for trading and financial liabilities measured at amortized cost.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 3: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In November 2013, the IASB issued a new version of IFRS 9 (IFRS 9 (2013)) which includes the new hedge accounting requirements and related amendments to IFRS 9, IFRS 7 and IAS 39.

IFRS 9 (2013) does not have a mandatory effective date, but it is available for adoption now.

The Company is evaluating the possible impact of IFRS 9 but is presently unable to assess its effect, if any, on the financial statements.

*Amendments to IAS 36, "Impairment of Assets":*

In May 2013, the IASB issued amendments to IAS 36, "Impairment of Assets" ("the amendments") regarding the disclosure requirements of fair value less costs of disposal. The amendments include additional disclosure requirements of the recoverable amount and fair value. The additional disclosures include the fair value hierarchy, the valuation techniques and changes therein, the discount rates and the principal assumptions underlying the valuations.

The amendments are effective for annual periods beginning on January 1, 2014 or thereafter. Earlier application is permitted.

The appropriate disclosures will be included in the Company's financial statements upon the first-time adoption of the amendments.

**NOTE 4:- CASH AND CASH EQUIVALENTS**

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
In US Dollars	\$ 436	\$ 2,205
In Canadian Dollars	126	73
In NIS	55	116
	<u>\$ 617</u>	<u>\$ 2,394</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 5:- RESTRICTED CASH**

Short-term restricted cash of \$25 and \$67 as of December 31, 2013 and 2012 relates to cash held by a financial institution as a guarantee for the Company's Israeli office and the land lease on the Eitan license that was released during 2014.

Short-term restricted cash of \$10 and \$100 as of December 31, 2013 and 2012 relates to deposits held by a financial institution as security in connection with a guarantee against the Company's credit facility.

Short-term restricted cash of \$915 as of December 31, 2012 relates to cash held by a financial institution as security in connection with the guarantee in favor of the customs.

**NOTE 6:- ACCOUNTS RECEIVABLE**

Accounts receivable are non-interest bearing and are generally on 30-90 days terms. The Company has no past due or impaired trade receivables as of December 31, 2013 and 2012.

**NOTE 7:- OTHER RECEIVABLES AND PREPAID EXPENSES**

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
Receivable from UJVs	\$ 2,292	\$ 3,563
Government authorities	108	889
Prepaid expenses	86	175
Other receivables	27	26
Consumables	-	48
	<u>\$ 2,513</u>	<u>\$ 4,701</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 8:- PROPERTY AND EQUIPMENT, NET

Composition and movement:

2013

	<b>Drilling rig and related equipment</b>	<b>Office furniture and equipment</b>	<b>Computer and peripheral equipment</b>	<b>Total</b>
	<b>U.S. dollars in thousands</b>			
Cost:				
Balance at January 1, 2013	\$ 426	\$ 83	\$ 285	\$ 794
Disposals during the year	(426)	(78)	-	(504)
Balance at December 31, 2013	-	5	285	290
Accumulated depreciation:				
Balance at January 1, 2013	348	30	140	518
Depreciation for the year **)	-	3	85	88
Disposals during the year	(348)	(29)	-	(377)
Balance at December 31, 2013	-	4	225	229
Depreciated cost at December 31, 2013	\$ -	\$ 1	\$ 60	\$ 61

2012

	<b>Drilling rig and related equipment</b>	<b>Office furniture and equipment</b>	<b>Computer and peripheral equipment</b>	<b>Total</b>
	<b>U.S. dollars in thousands</b>			
Cost:				
Balance at January 1, 2012	\$ 426	\$ 83	\$ 215	\$ 724
Purchases during the year	-	-	70	70
Balance at December 31, 2012	426	83	285	794
Accumulated depreciation:				
Balance at January 1, 2012	191	14	60	265
Additions during the year:				
Depreciation for the year **)	-	16	80	96
Provision for impairment *)	157	-	-	-
Balance at December 31, 2012	348	30	140	518
Depreciated cost at December 31, 2012	\$ 78	\$ 53	\$ 145	\$ 276

\*) Following the Eitan license relinquishment in 2011 (See Note 9a), an impairment loss of \$157 was recognized in the Statement of Comprehensive Loss for 2012.

\*\*\*) On January 2012, the Company activated a program for the sale of the drilling rig and related equipment and commenced marketing the equipment for sale. Accordingly, the equipment was accounted for as held for sale under IFRS 5 and therefore was not depreciated during 2012 and 2013.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 9: EXPLORATION AND EVALUATION ASSETS**

The following is a description of activities in respect of the Company's licenses:

a. Eitan:

The Eitan License comprises an area of approximately 31,060 acres in the Hula Valley in Northern Israel. The Eitan License was awarded in December 2008 for a term of three years which expired in December 2011. The Company had a 100% working interest in the license.

The Company commenced drilling its first well ("Eitan # 1") in January 2011. In accordance with the Company's accounting policy, the Company capitalized \$935 to Exploration and Evaluation Assets during 2011.

Following a review and further analysis by the Company's geoscientists, in consultation with outside consultants, management concluded in November 2011 that commercial quantities of hydrocarbons were not present in the Eitan 1 well. In December 2011, the Company notified the Ministry that it is relinquishing the license and in December 2012, the Company received a final confirmation from the Ministry approving the surrender of the Eitan License.

As a result of the above, the Company recorded in 2011 \$1,226 non-cash impairment charge arising from the write-off of exploration and evaluation assets, as well as inventory and equipment related to onshore drilling in the statement of comprehensive loss. In 2012, the Company decided to sell the remaining inventory and equipment and recorded a \$214 non-cash impairment charge arising from the write-off of exploration and evaluation assets as well as inventory and equipment related to onshore drilling in the statement of comprehensive loss. In 2013, the Company sold the remaining inventory and equipment (See also Note 7 and 8).

The exploration expenses relating to the Eitan license that were not capitalized are as follows:

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>U.S. dollars in thousands</b>		
Exploration expenses	\$ 20	\$ 116	\$ 784



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

b. Off-shore licenses:

(1) Gabriella:

The Gabriella License was awarded to the Company in July 2009 and covers 97,000 acres (392 sq. km.) and is located approximately 10 km offshore Israel between Netanya and Ashdod. The license was issued for an initial three year period and may be renewed upon fulfillment of certain conditions for a further four year period with a further renewal option of two years in case of a reserve discovery. As of December 31, 2013, the Company had received a renewal of the Gabriella license to September 2014, with a corresponding extension of certain milestones.

As of December 31, 2013, the Company has a 15% working interest in Gabriella.

In January 2010, Adira Energy Israel Ltd., signed an agreement (the "Gabriella 2010 Agreement") with Modiin Energy Limited Partnership ("MELP") and Modiin Energy General Partners ("MEGP") (collectively "Modiin") to facilitate the full initial funding of the Gabriella License. Under the terms of the Gabriella 2010 Agreement, Modiin acquired 70% of the rights of participation in the Gabriella License (the "Gabriella Project"). Brownstone Ventures Inc ("Brownstone") has a 15% participating interest in the Gabriella License. Brownstone's working interest is registered in the Company's name. Transfer of the beneficial ownership is subject to the approval of the Ministry. Until such time, these participating interests are held in trust by the Company. Modiin agreed to fund its 70% share, as well as the Company's 15% share of the work program up to a total of \$8,000 (i.e. \$1,200). Modiin completed this funding commitment in 2011.

In addition, Modiin agreed to pay Adira: 1) a monthly management fee of \$ 12.5 for a period of two years commencing February 1, 2010, 2) one half of the management fees MEGP receives from MELP (3.75% of 7.5% management fees) in respect to this license, for a period of 24 months, commencing February 1, 2010, after which the amount increases to 4.25% (the "Modiin Management Fees"); and 3) a royalty of 2.25% from both MELP and MEGP each from any resources extracted until Modiin recovers its costs incurred, after which the royalty increases to 5.25% (the "Modiin Royalty" and together with the Modiin Buy Back Option and Modiin Management Fees, the "Modiin Farmout Rights"). Due to the uncertainty of receipt of these fees and royalties in the event of the termination of the exploration program, these fees and royalties were only recorded as income upon receipt. However, pursuant to the Settlement Agreement (as defined below), as of January 1, 2013, Adira ceased to receive the Management Fees and the Modiin Royalty.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

The Company has an option to purchase 15% of the Gabriella License from Modiin (or 21.43% of MELP's 70% interest) at any time until the earlier of six months after a discovery or seven years from July 2009 ("Modiin Buy Back Option"). The exercise price for this option is the actual costs incurred by Modiin on the 15% interest up until the exercise date.

All exploration and extraction activity on the Gabriella License, and the relationship of the participating interest holders, is governed by a joint operating agreement or "JOA" (the "Gabriella JOA"). The Gabriella JOA parties paid the Company an operating fee equal to 7.5% of the cumulative, direct costs incurred to operate the Gabriella License until January 26, 2012. Commencing January 27, 2012, the Gabriella License participants paid a new operator fee of (i) an amount of - \$25 per month, plus (ii) an additional sliding-scale percentage of exploration expenses incurred, ranging from 4.8% of annual exploration expenses (if less than \$2,000) down to 1.2% of annual exploration expenses (if over \$6,000) ("Operator Fee"). However, pursuant to the Settlement, as of January 1, 2013, Adira ceased to receive the Operating Fee.

Between July 2012 and January 2013, various agreements have been entered into on the Gabriella License for the purpose of drilling the first exploration well, including a drilling contract (the "Drilling Contract") between MELP and Noble International Ltd ("Noble Drilling") to secure access to a drilling unit rig (the "Rig"), a Memorandum of Understanding ("MOU") between Adira Israel and MELP, pursuant to which the Adira Israel agreed to provide its working interest share of the collateral due to Noble Drilling, and an agreement between Adira Israel, MELP and Brownstone Energy Inc ("Brownstone") (the "Gabriella 2012 Agreement" and together with the Drilling Contract and the MOU, the "Gabriella Drilling Agreements"), wherein certain terms regarding the parties' use of the Rig were revised. The attempted drilling of the first exploration well, however, was not accomplished. Adira Israel and MELP had similarly alleged that the other was in default of various obligations under the Gabriella JOA and certain Gabriella Drilling Agreement. Accordingly, on February 11, 2013, Adira Israel, in its capacity as operator under the Gabriella JOA, suspended operations on the Gabriella License due to lack of funding and lack of reasonable expectation of funding to meet certain work program obligations.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

Effective July 8, 2013 (the "Settlement Agreement Effective Date"), Adira Israel entered into a settlement and release agreement (the "Settlement Agreement") with MELP and Brownstone to resolve the abovementioned disputes and the related suspension of operations on the Gabriella License. Pursuant to the Settlement Agreement, the Gabriella License participants have agreed to waive and release each other from any claims and demands that they may have had against each other with respect to the Gabriella License. The Agreement further provides that the Gabriella License participants will fund their proportionate share of costs incurred in connection with the attempted drilling of the first exploration well. As of June 30, 2013, Adira Israel's net share of the costs totaled approximately US\$3.3 million (the "Settlement Costs") and was payable in stages over a 60-90 day period from the Settlement Agreement Effective Date. Additionally, Adira Israel agreed to relinquish several entitlements, including, but not limited to, its management fee. Adira Israel also agreed to reduce its overriding royalty interest ("ORRI") from 5.25% to 2.625%.

The Settlement Agreement preserves the option granted to MELP to purchase from Adira Israel a 15% participating interest in the Yitzhak License and Adira Israel's option to acquire a 15% participating interest in the Yam Hadera License from MELP pursuant to the Gabriella 2012 Agreement.

Pursuant to the Settlement Agreement, in the event that Adira Israel does not pay the Settlement Costs, at MELP's request, Adira Israel may withdraw from the Gabriella JOA, assign its participating interest in the Gabriella License to the remaining Gabriella License participants and relinquish its remaining ORRI.

As of the date of these financial statements, the Company was unable to meet its obligations under the Settlement Agreement and, as discussed above, may, at the request of Modi'in, be required to relinquish its interest in the Gabriella License.

As of the date the financial statements were approved, such request has not been made.

On October 16, 2013, Adira Israel received an extension of the expiration of the Gabriella license from the Ministry until September 1, 2014. The extended work program for the Gabriella license requires the Company, and the other participants on the Gabriella license, to submit a request to the Ministry for the approval of a new operator that complies with Ministry regulations by February 28, 2014, to execute a drilling contract by April 30, 2014, to complete an Antisotropic PSDM and coherent sub surface model by July 31, 2014, and to spud a well by August 31, 2014. In connection with extension of the work program, Adira Israel has agreed to resign as the operator of the Gabriella License. As of the date the financial statements were approved, Adira Israel and the other Gabriella License participants have missed the deadline to request approval of a new operator from the Ministry.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

In addition, pursuant to the Settlement Agreement, the parties agreed to sell the assets associated with the Gabriella licenses in order to pay the outstanding obligations in respect to this project.

The Company believes that based on the events described above, there are indicators of impairment of the Gabriella license and there is a low probability of realization of the asset from either the successful development or sale of the Gabriella license in the near future. For the year ended December 31, 2013, the Company recorded a \$2,951 non-cash impairment charge arising from the write-off of exploration and evaluation assets in the statement of comprehensive loss.

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

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
Cash and cash equivalents	\$ -	\$ 475
Other receivables and prepaid expenses	2,292	335
Exploration and evaluation assets	-	(*)2,646
Trade payables	<u>(2,392)</u>	<u>(512)</u>
	<u>\$ (100)</u>	<u>\$ 2,944</u>

(\*) This amount primarily includes \$1,597 relating to tangibles (piping tubes, etc.), \$240 relating to a seabed survey and \$580 relating to project management costs (including well design).

	<b>Year ended</b>		
	<b>December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>U.S. dollars in thousands</b>		
Exploration expenses	\$ 353	\$ 48	\$ 13

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

## (2) Yitzhak:

The Yitzhak license was awarded to the Company in October 2009 and covers 31,555 acres (127.7 sq.km) and is located approximately 9 km offshore Israel between Hadera and Netanya, directly to the North of and contiguous to Gabriella. The license was issued for an initial three year period and may be renewed upon fulfillment of certain conditions for a further four year period with a further renewal option of two years in case of a reserve discovery. As of December 31, 2012, the Company had received a renewal of the Yitzhak license to December 2013, including extension of certain milestones.

In 2011, the Company had 85% working interest in this license. Brownstone has a 15% participating interest in the Yitzhak license. In addition, until January 1, 2012, the Company was the operator of the Yitzhak License and was entitled to receive a 7.5% operating fee on all its expenditures.

In November 2011, an agreement was signed between Adira Israel and Ellomay Oil and Gas 2011 LP ("Ellomay"), whose general partner is a wholly owned subsidiary of Ellomay Capital Ltd. ("Ellomay Capital") for the transfer of rights in the Yitzhak license (the "Agreement") according to which Ellomay would receive 20% (out of 100%) participation rights in the Yitzhak License (the "Transferred Rights"), in consideration for reimbursement of the expenses paid by Adira until the date of execution of the Agreement in respect of the Transferred Rights plus interest of Libor + 1%. Therefore, following the closing in February 2012 (See below), Ellomay paid Adira approximately \$361, which was recognized as income in 2012.

In addition, on November 29, 2011 the Company entered into an agreement with AGR Petroleum Services Holding AS ("AGR PSH"), a related party, AGR Group ASA ("AGR") whereby AGR PSH would act as chief operator in the Yitzhak License, and would receive 5% (out of 100%) participation rights in the Yitzhak License. Adira Israel will act as a joint operator, in accordance with the provisions of the JOA agreement and/or a services agreement to be signed and/or another agreement to be signed between the parties. All the partners (Ellomay, Brownstone and Adira) undertook to bear their proportionate share in AGR's expenses (5%) from the date of execution of the Agreement until the date of approval of a development plan by the Ministry ("Coverage of Expenses"). From the date of approval of the work plan as aforesaid, AGR shall bear its expenses according to its proportionate share in the participation rights (5%). AGR's income from the production of gas and petroleum in accordance with its proportionate share in its participation rights in the license shall be used to repay the Coverage of Expenses plus interest of Libor + 1%.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

On January 9, 2012, the Ministry approved the farm-out of an aggregate of 25% of its interest in the Yitzhak License to the two new partners, 5% to AGR and 20% to Ellomay. Accordingly, as of December 31, 2013, the Company has a 60% interest in the Yitzhak License, Brownstone has a 15% working interest in the license, AGR has a 5% working interest in the license and Ellomay has a 20% working interest in the license. AGR PSH is designated the lead operator in accordance with Israeli regulations defining "Operator", with a continued involvement of Adira Israel as "co-operator". The Company, Brownstone, AGR and Ellomay signed a joint operating agreement to regulate their commercial relationship in respect of the Yitzhak License on September 11, 2012 (the "Yitzhak JOA"). The Yitzhak JOA incorporated the terms of the AGR Farm-Out Agreement and the Ellomay Farm-Out Agreement. The Company does not expect to receive material operator fees from on account of the Yitzhak License.

Until reimbursement of all the expenses incurred by AGR and Ellomay in connection with the license, AGR and Ellomay shall pay Adira Israel overriding royalties at the rate of 3% of their full share in income deriving from petroleum and/or gas and/or other valuable materials actually produced and extracted from the license. After reimbursement of the expenses as aforesaid, AGR and Ellomay shall pay Adira Israel overriding royalties at the rate of 4.5% of their full share in rights in petroleum and/or gas and/or other valuable materials actually produced and extracted from the license.

According to the Ellomay Farm-Out Agreement and the Yitzhak JOA, Ellomay could elect not to fund the Yitzhak license and be subject to dilution for no consideration (i.e. the diluted interest would be transferred to Adira without cost), or it could transfer one-half of its 20% interest to a third party on negotiated terms. On October 29, 2012, Ellomay advised the Company of its intention to decrease Ellomay's interest in the Yitzhak License from 20% to 10% by paying decreased operating costs pursuant to the terms of the Yitzhak JOA. As of December 31, 2012, the Company expended \$640 on behalf of Ellomay in respect of the Yitzhak License for which the Company was entitled to be reimbursed by a third party if the 10% interest was transferred. This amount was recorded as a long-term receivable as of December 31, 2012. In 2013 Ellomay failed to transfer timely its interest to a third party, and therefore one-half of its 20% interest was transferred back to the Company without cost and therefore as of December 31, 2013 the Company has a 70% interest in the Yitzhak License, Brownstone has a 15% interest, AGR has a 5% interest and Ellomay a 10% interest in the license. The new holdings have not yet been approved by the Ministry.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

On June 13, 2012, pursuant to an MOU with MELP (see Note 9b(1)), Adira granted MELP, an option to purchase ("MELP Yitzhak Option") from Adira a 15% participating interest in the Yitzhak License (the "MELP Yitzhak Option Interest"). MELP may exercise the MELP Yitzhak Option until the later of (a) December 31, 2012, and (b) the 30th day from the date Adira notifies MELP of the execution of an agreement with a drilling contractor in relation to the Yitzhak License. The Gabriella 2012 Agreement amends the exercise date until 14 days before signing of the rig contract for the Yitzhak License. If MELP exercises the MELP Yitzhak Option, then it must reimburse Adira for expenditures in respect of the MELP Yitzhak Option Interest incurred up to the date of transfer of the MELP Yitzhak Option Interest. MELP must also issue to Adira an ORRI of 3% with respect to all oil and gas (including any distillate and condensate) produced, saved and marketed from the area covered by Yitzhak License that is attributable to the MELP Yitzhak Option Interest, before payout, and 4.5% after payout. The transfer of the MELP Yitzhak Option Interest is subject to the approval of the Ministry.

On October 16, 2013, Adira Israel received an extension of the expiration of the Yitzhak license from the Ministry for the Yitzhak license until October 15, 2014. The extended work program for the Yitzhak license requires the Company, and the other participants on the Yitzhak license, to submit an Environmental Impact Assessment to the Central District Planning Committee of the State of Israel by January 1, 2014, and to execute a drilling contract by September 30, 2014. As of the date of the approval of these financial statements, the Company met the requirement of the work program, as described above.

The Company believes that despite the extension received from the Ministry, there is a low probability of realization of the asset from either the successful development or sale of the license in the near future. For the year ended December 31, 2013, the Company recorded a \$2,862 non-cash impairment charge arising from the write-off of exploration and evaluation assets in the statement of comprehensive loss.

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

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
Cash and cash equivalents	\$ 1	\$ 2
Prepaid expenses and other receivables	-	103
Exploration and evaluation assets	-	(*) 2,328
Trade payables	(574)	(428)
	<u>\$ (573)</u>	<u>\$ 2,005</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)

- (\*) This amount primarily includes \$1,017 relating to a seabed survey and \$795 relating to project management costs (including well design).

	Year ended December 31,		
	2013	2012	2011
	U.S. dollars in thousands		
Exploration expenses	\$ -	\$ 113	\$ 433

- (3) Samuel:

The Samuel license was issued in August 2010 and covers 88,708 acres (361 sq. km) approximately 17 km offshore Israel adjacent to the shoreline between Ashkelon and Palmachim. The license was issued to a consortium led by the Company (through the Company's subsidiaries, AOT and AGG). As of December 31, 2012, the Company has a working interest of 41.25% in this license. In accordance with the Joint Operating Agreement, AGG is the operator of the Samuel License and is entitled to receive a 7.5% operating fee on all its expenditures. AGG is also entitled to a 3% overriding royalty. The operator fee and ORRI are shared equally between Adira and Geo Global Resources Inc. ("GGRI").

On October 26, 2012, Emanuelle Energy Limited ("Emanuelle") exercised an option to acquire a 7.13% interest in the Samuel License from GGRI and became a signatory to the Samuel JOA thereby reducing GGRI's interest in the Samuel License to 22.88%.

As of December 31, 2012, Adira paid \$3,000 of operating costs on behalf of GGRI and Emmanuelle, which are holding a total of 42% of the Samuel License. GGRI's obligation arises from GGRI's direct interest in the license and indirectly through GGRI's 40% in Adira GeoGlobal.

As of December 31, 2012, the Company based on events described above including the lack of available funding from the license partners sufficient to meet the current milestones timetable, believed that there were indicators of impairment of the Samuel license and that there was a low probability of realization of the asset from either the successful development or sale of the license in the near future. For the year ended December 31, 2012, the Company recorded a \$7,596 non-cash impairment charge arising from the write-off of exploration and evaluation (including uncollected receivables from GGRI and Emmanuelle) assets in the statement of comprehensive loss. For the year ended December 31, 2013 the Company recorded impairment income of \$717, arising from collection of receivable balances that were not expected to be realizable as of December 31, 2012.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 9: EXPLORATION AND EVALUATION ASSETS (Cont.)**

On October 14, 2013, Adira GeoGlobal Ltd ("AGG"), a subsidiary of the Company, relinquished the Samuel license, offshore Israel, back to the State of Israel, as a result of challenging markets and difficulty in raising significant funds to drill multi well programs.

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

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
Cash and cash equivalents	\$ 1	\$ 7
Prepaid expenses and other receivables	62	765
Exploration and evaluation assets	-	(*) 875
Trade payables	(25)	(1,211)
	<u>\$ 38</u>	<u>\$ 436</u>

(\*) This amount includes the estimated net realizable value of the tangible equipment for offshore drilling (piping tubes, etc.)

	<b>Year ended</b>		
	<b>December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>U.S. dollars in thousands</b>			
Exploration expenses	\$ -	\$ 217	\$ 3,163

## (4) Yam Hadera:

Pursuant to the Gabriella 2012 Agreement and the Settlement Agreement, the Company has an option (the "Yam Hadera Option") to acquire up to a 15% participating interest in the Yam Hadera petroleum license (the "Yam Hadera License"), located 30 kilometers offshore Israel, between Hadera and Haifa and North West of Adira's Yitzhak license. The Yam Hadera Option is exercisable until 14 days prior to the signing of a rig contract for the Yam Hadera License.

- (5) The Company has recognized exploration expenses for which it has not charged its license partners, in accordance with the terms and conditions set forth in the partnership agreements. These exploration expenses amounted to \$304, \$532 and \$625 for the years ended December 31, 2013, 2012 and 2011, respectively.

**NOTE 10:- TRADE PAYABLES**

Trade payables are non-interest bearing and are normally settled on 60-day terms.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 11:- OTHER ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
Employees in respect of payroll	\$ 346	\$ 201
Accrued expenses	603	1,239
Other	37	36
	<u>\$ 986</u>	<u>\$ 1,476</u>

Accounts payable are non-interest bearing and have an average term of 30 days.

**NOTE 12:- FINANCIAL INSTRUMENTS**

The Company's activities expose it to various financial risks, such as market risks (foreign currency risk, consumer price index risk, interest risk and price risk), credit risk and liquidity risk. The Company's comprehensive risk management program focuses on actions to minimize potential adverse effects on the Company's financial performance.

a. Credit risk:

Concentration of credit risk exists with respect to the Company's cash and cash equivalent balances and receivables. The Company's exposure is for cash held in bank accounts, including restricted deposits, in the amount of \$652 and \$3,476 as of December 31, 2013 and December 31, 2012, respectively, and on accounts and other receivables in the sum of \$2,513 and \$5,061 on December 31, 2013 and December 31, 2012, respectively.

The Company manages credit risk, in respect of cash and cash equivalents, and restricted cash, by holding them at major Canadian and Israeli financial institutions in accordance with the Company's investment policy. The Company places its temporary cash and cash equivalents with high credit quality financial institutions. The Company regularly monitors credit extended to customers and their general financial condition. The Company historically has not had significant past-due receivables.

b. Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in obtaining funds to meet current obligations and future commitments. The Company's approach to managing liquidity risk is to forecast cash requirements to determine whether it will have sufficient funds to meet its current liabilities when due. As of December 31, 2013, the Company had cash and cash equivalents and restricted cash of \$652, and accounts and other receivables of \$2,513 against trade and other payables in the amount of \$3,803.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 12:- FINANCIAL INSTRUMENTS (Cont.)**

As of December 31, 2012, the Company had cash and cash equivalents and restricted cash of \$3,476 and accounts and other receivables of \$5,061 against trade and other payables in the amount of \$7,317.

## c. Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of two types of risk: interest rate risk and foreign currency risk.

## 1. Interest rate risk:

The Company is not exposed to significant interest rate risk due to the short-term maturity of its cash equivalents.

## 2. Foreign currency risk:

The Company is exposed to financial risk related to the fluctuation of foreign exchange rates. The Company operates in Israel. Most of the Company's monetary assets are held in U.S. dollars and most of the Company's expenditures are made in U.S. dollars. However, the Company also has expenditures in new Israeli shekels ("NIS") and Canadian dollars. The Company has not hedged its exposure to currency fluctuations. An increase or decrease of 5% of the NIS relative to the U.S. or the Canadian dollar would not have a significant effect on the Company.

**NOTE 13:- TAXES ON INCOME**

## a. Tax rates applicable to the Company:

1. The corporate tax rate in Canada in 2013 is 15% (2012 – 15%), and the Ontario tax rate in 2013 is 11.5% (2012 - 11.5%).
2. The Israeli corporate tax rate was 24% in 2011 and 25% in 2012 and 2013.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Tax Burden Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Tax Burden Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 13:- TAXES ON INCOME (Cont.)**

On August 5, 2013, the "Knesset" issued the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 ("the Budget Law"), which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years.

These changes include, among others, increasing the corporate tax rate from 25% to 26.5%, cancelling the reduction in the tax rates applicable to privileged enterprises (9% in development area A and 16% elsewhere) and, in certain cases, increasing the rate of dividend withholding tax within the scope of the Law for the Encouragement of Capital Investments to 20% effective from January 1, 2014. There are also other changes such as taxation of revaluation gains effective from August 1, 2013. The provisions regarding revaluation gains will become effective only after the publication of regulations defining what should be considered as "retained earnings not subject to corporate tax" and regulations that set forth provisions for avoiding double taxation of overseas assets. As of the date of approval of these financial statements, these regulations have not been issued.

3. On April 12, 2010, the Minister of Finance appointed the Committee for Examination of the Fiscal Policy on Petroleum and Gas Resources in Israel (the "Sheshinski Committee"). The Committee was charged with examining the fiscal system prevailing in Israel with regard to petroleum and gas resources, and proposing an updated fiscal policy.

On January 3, 2011, the Sheshinski Committee submitted its final recommendations to the Minister of Finance. On January 23, 2011 the Government adopted the Sheshinski Committee's report and recommendations, and on March 30, 2011 the Knesset adopted the Petroleum Profits Taxation Law, 5771-2011 (the "Law"). The Law was published in the Official Gazette on April 10, 2011. The main recommendations of the Committee and provisions of the Law are as follows:

- a) Leaving the rate of royalties to the State unchanged (12.5%).
- b) Cancelling the depletion deduction.
- c) Imposing a petroleum and gas profits levy:

The levy will be calculated according to a proposed R-factor mechanism, according to the ratio between the net cumulative income from the project and the cumulative investments as defined in the Law. A minimum levy of 20% will be charged from the stage at which the R-factor ratio reaches 1.5, and when the ratio increases, the levy is progressively raised up to a maximum rate of 50%, when the ratio reaches 2.3.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 13:- TAXES ON INCOME (Cont.)**

Further provisions were also set forth regarding the levy, including that the levy will be recognized as an expense for income tax calculation; the borders of the levy will not include export facilities; the levy will be calculated and imposed in respect of each reservoir separately (ring fencing); payment by a petroleum right holder which is calculated as a percentage of the petroleum extracted, the payment recipient will be liable for payment of a levy in accordance with the amount of the payment received thereby, which amount will be deducted from the levy amount for which the petroleum right holder is liable.

- d) Accelerated depreciation will be granted for the investments at the rate of 10%, with a possibility of electing depreciation up to the amount of the taxable income in that year.
- e) Taxation of a petroleum partnership - the Law sets forth provisions regarding the manner of calculation and reporting of the profits of the partners in partnerships engaging in oil exploration, including the manner of calculation and payment of the tax arising from such profits.
- f) The following transition provisions were set forth:
  - i) A petroleum venture in respect of which the date of commencement of commercial production occurs before the commencement date, the provisions of this Law shall apply with the following modifications:
    - If such venture is subject to a levy payment duty in the tax year in which the date of commencement occurs, the levy rate in that tax year shall be one half the rate of the levy which would have been imposed on the petroleum profits but for the provisions of this paragraph, and no more than 10%.
    - If the levy coefficient in the tax year in which the commencement date occurs exceeds 1.5, rules are determined for the manner of calculation of the levy coefficient in each subsequent tax year.
    - The levy rate imposed on the petroleum profits of the venture in each of the tax years 2012 to 2015 will be equal to one half the levy rate which would have been imposed on the petroleum profits as aforesaid, but for the provisions of this paragraph.
  - ii) A venture in respect of which the date of commencement of commercial production occurs in the period from the date of commencement until January 1, 2014, shall be subject, *inter alia* to the following provisions:
    - The minimal levy coefficient shall be 2 instead of 1.5, and the maximum - 2.8 instead of 2.3.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 13:- TAXES ON INCOME (Cont.)**

- The depreciation rate for an asset acquired in the years 2011 to 2013 shall be 15% instead of 10%.
- g) An Amendment to the Income Tax Regulations (Deductions from the Income of Petroleum Rights Holders) (Amendment), 5771-2011, cancelled the recognition as a current expense of development expenses in respect of reservoirs, commercial production from which shall commence after January 1, 2014, and they shall be subject to the depreciation rules set forth in the Law. It is stated that the depletion deduction was canceled in the Amendment to the Income Tax Regulations (Deductions from the Income of Petroleum Rights Holders) (Amendment), 5771-2011, effective May 1, 2011. The provisions regarding the imposition of the petroleum and gas profits levy are effective from April 10, 2011, and the provision regarding the taxation of a petroleum partnership (Section above) is effective from the tax year 2011. The cancellation of the gradual reduction in the corporate tax rate, as described in a(2) above, will decrease the levy per the Petroleum Taxation law from 2016 and thereafter to a maximum rate of 44.56% from the Company's oil and gas revenue.

At this time, the expected implications of the Law on the Company's business cannot be fully estimated. However, it may already be estimated that the implementation of the Law could significantly increase the tax burden and adversely affect the Company's business and activity, as compared with the situation before the Law took effect.

b. Tax assessments:

The Company's and its subsidiaries have not yet received final tax assessments since their incorporation.

c. Carryforward losses for tax purposes and other temporary differences:

As of December 31, 2013, carryforward losses in Canada are approximately \$4.7 million expiring through 2032. As of December 31, 2013, carryforward losses in Israel are approximately \$27.1 million and may be carried forward indefinitely.

Net deferred tax assets relating to carryforward operating losses and other temporary differences of approximately \$7,700 were not recognized because their utilization in the foreseeable future is not probable.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 13:- TAXES ON INCOME (Cont.)**

- d. Taxes on income included in the statements of comprehensive loss:

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>U.S. dollars in thousands</b>			
Current taxes	\$ -	\$ 3	\$ 13
Taxes in respect of prior years	-	38	20
	<u>\$ -</u>	<u>\$ 41</u>	<u>\$ 33</u>

- e. Theoretical tax:

A reconciliation between the tax expense, assuming that all the income and expenses, gains and losses in the statement of comprehensive loss were taxed at the statutory tax rate and the taxes on income recorded in the statement of comprehensive loss is as follows:

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>U.S. dollars in thousands</b>			
Loss before income taxes	<u>\$ (5,644)</u>	<u>\$ (10,516)</u>	<u>\$ (10,018)</u>
Statutory tax rate	<u>26.5%</u>	<u>26.5%</u>	<u>28.25%</u>
Tax benefit computed at the statutory tax rate	\$ (1,496)	\$ (2,787)	\$ (2,830)
Increase in taxes on income resulting from the following factors:			
Taxes in respect of prior years	-	38	20
Increase in tax due to tax rate differences in Israel	134	149	240
Non-deductible expenses (non-taxable income)	(925)	179	224
Non-recognition of tax benefit in respect of losses	<u>2,287</u>	<u>2,462</u>	<u>2,379</u>
Taxes on income	<u>\$ -</u>	<u>\$ 41</u>	<u>\$ 33</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 14:- SHARE CAPITAL**

## a. Authorized:

Unlimited number of Common shares without nominal or par value.

## b. Issued and outstanding Common shares:

i. On February 16, 2011, the Company issued 3,494,318 common shares at CAD \$1.86 per share for net proceeds of \$6,152.

ii. On August 9, 2012, the Company completed a prospectus offering of 26,337,546 units for gross proceeds of \$11,099 (before issuance expenses of \$1,298 including the fair value of broker warrants \$ 219). Each unit was priced at CAN\$0.42 and consists of one Common Share and one warrant. Each warrant is exercisable to acquire one Common Share at a price of CAN\$0.60 per Common Share until August 9, 2015.

The warrants are denominated in Canadian dollars, while the functional currency of the Company is US dollars; therefore the fair value of the warrants was classified as a financial liability and the fair value of the warrants on the date of issuance was approximately \$5,312. This financial liability is remeasured to fair value at the end of each period and changes in fair value is recorded in profit or loss. Therefore, the Company recorded a gain in financing income of \$3,013 during the year ended December 31, 2013, as a result of remeasuring the fair value of the warrants to their fair value of zero as of December 31, 2013.

As part of the offering, a total of 1,117,667 broker warrants were issued. Each broker warrant is exercisable for one Common Share at an exercise price of CAN\$0.42 per Common Share until August 9, 2014. The fair value of the warrants on the date of issuance was \$219, which was included in offering expenses in statement of changes in equity.

iii. On August 9, 2013, the Company completed a consolidation of the Company's Common Shares on the basis of one post-consolidation Common Share for every three pre-consolidation Common Shares (the "Consolidation"). All share and per share data for all periods presented have been adjusted to reflect the decrease in number of shares outstanding after the Consolidation. In addition, every three previously issued warrants will be convertible into one Common Share of the Company.

## c. Stock Option Plan:

Under the Company's August 31, 2009 Stock Option Plan ("the Incentive Stock Option Plan"), options may be granted to employees, officers, consultants, service providers and directors of the Company or its subsidiaries.

Stock options may be issued up to 10% of the Company's outstanding Common shares at a term and an exercise price to be determined by the Company's Board of Directors. The maximum term of the options is ten years from the date of grant.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 14:- SHARE CAPITAL (Cont.)

As of December 31, 2013, an aggregate of 2,733,370 of the Company's options were still available for future grant.

The Company typically grants stock options with vesting periods of between two to four years, generally with the exercise price at the closing price of the stock on the date of the grant and an expiration date of five years from the date of grant.

A summary of the stock option plan and changes during the years ended December 31, 2013, 2012 and 2011 were as follows:

	<u>Number of options outstanding</u>	<u>Weighted average exercise price</u>
Balance, January 1, 2011	1,886,333	1.17
Options granted	1,902,073	1.86
Options exercised	(175,937)	0.75
Options forfeited	(484,396)	1.47
Balance, January 1, 2012	3,128,073	1.56
Options granted	3,376,667	0.63
Options forfeited	(617,703)	1.68
Balance, December 31, 2012	5,887,037	1.02
Options forfeited	(2,594,372)	0.98
Balance, December 31, 2013	<u>3,292,665</u>	<u>1.09</u>

The following tables summarize information about stock options outstanding and exercisable as of December 31, 2013:

<u>Grant date</u>	<u>Expiry date</u>	<u>Grant date fair value</u>	<u>Exercise price *)</u>	<u>Number of options outstanding</u>	<u>Number of options exercisable</u>	<u>Average remaining contractual life</u>
August 31, 2009	August 20, 2014	\$ 0.87	\$ 0.75	569,333	569,125	0.64
September 23, 2009	September 23, 2014	\$ 0.66	\$ 0.75	133,333	133,333	0.73
January 28, 2010	January 27, 2015	\$ 1.68	\$ 1.83	323,333	321,979	1.08
July 22, 2010	July 21, 2015	\$ 0.75	\$ 1.83	83,333	83,333	1.56
January 11, 2011	January 10, 2016	\$ 1.98	\$ 2.40	350,000	235,417	2.03
March 18, 2011	March 17, 2016	\$ 1.77	\$ 2.40	33,333	20,833	2.21
May 3, 2011	May 2, 2016	\$ 1.56	\$ 1.80	133,333	83,333	2.34
September 8, 2011	September 7, 2016	\$ 1.23	\$ 1.50	83,333	41,667	2.58
December 1, 2011	November 30, 2016	\$ 0.66	\$ 1.50	126,667	62,708	2.92
August 22, 2012	August 21, 2017	\$ 0.21	\$ 0.60	<u>1,456,667</u>	<u>971,112</u>	3.64
				<u>3,292,665</u>	<u>2,522,840</u>	

\*) The exercise price of all options granted in 2011, 2012 is denominated in Canadian Dollars and was translated to USD in the table above using the exchange rate as of December 31, 2013.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 14:- SHARE CAPITAL (Cont.)**

Stock options granted are expensed as share-based payments. For grants made until December 31, 2011, the Company uses the Black-Scholes option pricing model to value stock options granted. For grants made from January 1, 2012, the Company uses the Binominal option pricing model to value stock options granted.

The fair value of options granted is amortized over their vesting period and estimated at the date of grant with the following assumptions:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Dividend yield	-	0%	0%
Expected volatility	-	80%-104%	112%-115%
Risk-free interest	-	1%-1.8%	1.3%-2.6%
Forfeiture rate	-	0%-5%	0%-5%
Expected life	-	5	5

Expected volatility is based on historical volatility of comparable companies, as the Company does not have sufficient history to determine the expected volatility of its shares. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk free interest rate is based on the yield of Canadian Treasury bonds with equivalent terms. The dividend yield is based on the Company's historical and future expectation of dividends payouts. The Company has not

paid cash dividends historically and has no plans to pay cash dividends in the foreseeable future.

d. Share purchase warrants:

The Company has share purchase warrants outstanding entitling the holders to acquire Common shares as follows:

	<u>Number of warrants (*)</u>	<u>Weighted average exercise price</u>
Balance as of January 1, 2011	19,558,145	\$ 0.52
Warrants Grated	(616,770)	\$ 0.30
Warrants Expired	<u>(3,884,000)</u>	<u>\$ 0.50</u>
Balance as of January 1, 2012	15,057,375	\$ (**0.54
Warrants Grated	<u>82,365,640</u>	<u>\$ (**0.20</u>
Balance as of December 31, 2012	97,423,015	\$ 0.25
Warrants Expired	<u>(15,057,375)</u>	<u>\$ 0.54</u>
Balance as of December 31, 2013	<u><u>82,365,640</u></u>	<u><u>\$ 0.20</u></u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 14:- SHARE CAPITAL (Cont.)**

The following tables summarize information applicable to warrants outstanding as of December 31, 2013:

<u>Issue date</u>	<u>Expiry date</u>	<u>Grant date fair value</u>	<u>Exercise Price **)</u>	<u>Number of warrants</u>
August 9, 2012	August 9, 2015	\$ 0.07	\$ 0.20	79,012,640
August 9, 2012	August 9, 2014	\$ 0.07	\$ 0.14	3,353,000
				<u>82,365,640</u>

\*) Following the Consolidation, every three previously issued warrants will be convertible into one Common Share of the Company (see Note 14b(iii)).

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

e. Capital management in the Company:

The Company is in the early stage of gas and petroleum exploration. The Company has negative cash flows from current operations. The Company's primary source of funds comes from the issuance of share capital. The Company does not use other sources of financing that require fixed payments of interest and principal and is not subject to any externally imposed capital requirements.

The Company defines its capital as share capital. To effectively manage the Company's capital requirements, the Company has a planning and budgeting process in place. The Company supervises the actual expenditure against the budget to manage its costs and commitments.

The Company's capital management objective is to maximize investment returns for shareholders within the context of relevant opportunities and risks associated with the Company's operating segment. Achieving this objective requires management to consider the underlying nature of exploration activities, availability of capital, the cost of various capital alternatives and other factors. Establishing and adjusting capital requirements is a continuous administrative process.

Although the Company has been successful at raising funds in the past through the issuance of share capital, it is uncertain whether it will continue to raise this financing due to uncertain economic conditions.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 15:- RELATED PARTY TRANSACTIONS**

- a. For the year ended December 31, 2013, the Company recognized \$386 for advisory fees and operating expenses to private companies controlled by the directors or by officers of the Company (2012 - \$357).

These transactions are in the ordinary course of business and are measured at the amount of consideration set and agreed by the related parties.

- b. Compensation to directors and key management personnel:

The CEO, CFO, COO, V.P. Business Development, Head Geologist, V.P. Contracts and Regulation, and the directors are considered key management personnel.

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>U.S. dollars in thousands</b>		
Short-term employee benefits	\$ 1,133	\$ 1,071	\$ 911
Share based compensation	16	613	850
	<u>\$ 1,149</u>	<u>\$ 1,684</u>	<u>\$ 1,761</u>
Number of people	<u>6</u>	<u>7</u>	<u>7</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 15:- RELATED PARTY TRANSACTIONS (Cont.)**

Benefits in respect of key management persons (including directors) who are not employed by the Company:

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>U.S. dollars in thousands</b>		
Share based compensation	\$ 32	\$ 298	\$ 206
Number of people	3	4	5

**NOTE 16:- COMMITMENTS AND CONTINGENCIES**

## a. Leases:

The Company has an agreement for the lease of the offices in Toronto, Canada for a period ending in 2014. In 2013, the lease agreement for the Company's office in Ramat Gan, Israel expired and the Company leases an office in Herzelia, Israel. Future minimum lease payments under non-cancelable operating leases are as follows:

	<b>Year ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>U.S. dollars in thousands</b>	
Within one year	\$ 29	\$ 187
After one year but not more than five years	-	44
	<b>\$ 29</b>	<b>\$ 231</b>

## b. Licenses:

The Company has commitments to the Ministry to complete the work programs on all of the Company's licenses. Based on the current commitments, the consortium for the Yitzhak license are required to sign a drilling contract by September 30, 2014, and the consortium on the Gabriella licenses are required to submit a request to the Ministry for the approval of a new operator that complies with Ministry regulations by February 28, 2014 and sign a drilling contract by April 30, 2014 (See also Note 9b(1)). The validity of the petroleum licenses of the Company are conditional upon fulfillment of certain obligations on dates set in the conditions of the petroleum assets (See also Note 20a). In the event of non-fulfillment of the conditions, the petroleum rights are subject to cancellation. As of the date of the approval of the financial statements, the Company has severe doubts as to its ability, or the ability of the Yitzhak and Gabriella consortiums to comply with the conditions and obligations above.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data**

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**NOTE 16:- COMMITMENTS AND CONTINGENCIES (Cont.)**

## c. Joint venture commitments:

The JOA's of each of the joint ventures in which the Company has a participating interest require that the Company commit to fund its proportionate share of the approved budget or work programs.

As there is currently no activity in any of the Company's licenses, the Company's share of the remaining contractual commitments as of December 31, 2013, for the Offshore Licenses is Nil.

## d. Legislative limitations:

## 1. The Petroleum Law, 5712-1952 and regulations enacted by virtue thereof:

Petroleum and gas exploration and production in Israel are regulated mainly by the Petroleum Law and the regulations enacted by virtue thereof and by the Natural Gas Sector Law, 5762-2002. The Petroleum Law includes stringent conditions for the submission of applications for receipt of petroleum assets and transfer of rights in petroleum assets in accordance with the Petroleum Law.

## 2. The Natural Gas Sector Law, 5762-2002

The purpose of the Natural Gas Sector Law is to create conditions for the development of the natural gas sector and carrying out of competition therein and regulating the activity in the natural gas sector. The law, and the regulations enacted thereunder, prescribe provisions regarding storage, transmission, distribution and marketing of natural gas in Israel, including the construction and operation of a transmission system, a distribution network, a Liquid Natural Gas (LNG) facility, and a natural gas storage facility in Israel which require the receipt of a license from the Minister of Energy and Water Resources.

## 3. At the beginning of 2011, the Ministry of Environmental Protection published directives for the protection of the environment regarding new and existing gas and petroleum drillings (for all stages, including trial, development, production) in order to prevent land, unsaturated zone and water source contamination.

## e. On July 1, 2013, the Company signed a non-brokered private placement (the "Private Placement") agreement for the sale of 61,728,395 post-Consolidation) Common Shares with Pelagic Investments Limited ("PI") for gross proceeds of \$5,000. The Private Placement was expected to close on or about August 30, 2013.

On September 11, 2013 the Company announced that PI had breached the subscription agreement (the "Subscription Agreement") between PI and the Company by failing to submit the subscription funds to Adira. As a result, the Private Placement was terminated.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 16:- COMMITMENTS AND CONTINGENCIES (Cont.)**

On October 25, 2013 Adira filed a Statement of Claim in the Superior Court of Justice (Ontario) naming as defendants, PI. and its principal, Prentis B. Tomlinson Jr. The Company is seeking damages for breach of contract, intentional interference with economic relations and intentional misrepresentation.

As of the date of the approval of these financial statements, the final outcome of the litigation cannot be predicted with certainty, and therefore, management cannot assess whether or not the results of this litigation will have a material effect on the financial statements of the Company.

**NOTE 17:- REVENUES AND OTHER INCOME**

- a. The Company operates in one segment, the oil and gas business and conducts its operations in Israel with its head office in Canada. Details of the Company's revenues and other income (all of which are derived from Israel) are as follows:

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>U.S. dollars in thousands</b>			
Consulting	\$ 7	\$ 455	\$ 771
Operator fees	5	544	312
Income from farm-out	-	890	240
Other income	5	-	-
	<u>\$ 17</u>	<u>\$ 1,889</u>	<u>\$ 1,323</u>

- b. Revenues from major customers (UJVs), each one of which exceeds 10% of the consolidated revenues, as of the years ended December 31, 2013, 2012 and 2011 are as follows:

	<b>Year ended December 31</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>U.S. dollars in thousands</b>			
Customer A	\$ -	\$ 461	\$ 591
Customer B	12	529	449
Customer C	-	529	150
Customer D	-	370	-
	<u>\$ 12</u>	<u>\$ 1,889</u>	<u>\$ 1,190</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 18:- GENERAL AND ADMINISTRATIVE EXPENSES**

	<b>Year ended December 31</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>U.S. dollars in thousands</b>		
Payroll and related payments	\$ 945	\$ 759	\$ 543
Share-based compensation	32	887	1,023
Professional fees	968	2,397	2,068
Rent and office expenses	280	287	370
Depreciation	88	96	80
Travel	18	350	529
Insurance	48	31	97
Others	434	497	321
	<u>\$ 2,813</u>	<u>\$ 5,304</u>	<u>\$ 5,031</u>

**NOTE 19:- FINANCING INCOME AND EXPENSE**

Financing income in 2013 includes \$3,013 in respect of the remeasurement of warrants to their fair value. See note 14b(ii).

**NOTE 20:- SUBSEQUENT EVENTS**

- a. On February 16, 2014, the Ministry published new guidelines in respect of security guarantee payments ("Security Deposit") for offshore licenses that require each license consortium to deposit \$2,500 per offshore license with the Ministry by March 31, 2014. On March 27, 2014, the Ministry announced that it has extended the deadline for the Security Deposit until May 15, 2014. As of the date of the approval of these financial statements, the Company does not have sufficient funds to make its pro-rate share of the Security Deposit. The Company is currently examining the consequences of the above mentioned guidelines on the Company's operations, including the possibility of taking legal action. However, should the consortium on each license not meet these requirements, the Ministry will view this as a failure to meet a license milestone and will have the right to terminate the license.
- b. As of the date of the approval of these financial statements, Adira Israel settled most of the amounts owed as of December 31, 2013 to its creditors. In 2014, a claim was raised by one of its creditors against Adira Israel in the approximate amount of \$750 with respect to payments made to certain creditors in 2014 following these settlements and the Company is currently negotiating a settlement agreement regarding this claim. The Company has rejected the claim and is presently unable to estimate the final outcome of this claim and whether it will result in any liability in 2014.

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