

## **CYGAM ENERGY INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS - PERIOD ENDED SEPTEMBER 30, 2011**

This Management's Discussion and Analysis ("MD&A") is a review of operations, current financial position and outlook for CYGAM Energy Inc. ("CYGAM" or "the Company") and should be read in conjunction with the interim condensed consolidated financial statements (unaudited) for the three and nine months ended September 30, 2011, the interim condensed consolidated financial statements (unaudited) for the three months ended March 31, 2011 and the annual consolidated financial statements as at December 31, 2010 and the annual MD&A. This MD&A is dated as of November 29, 2011.

The condensed interim consolidated financial statements have been prepared by management and approved by CYGAM's Board of Directors. These statements are based on certain estimates and assumptions and involve risks and uncertainties. Actual results may differ materially.

All financial information is reported in Canadian dollars. The condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") in Canadian dollars, which are also generally accepted accounting principles ("GAAP") for publicly accountable enterprises in Canada. For all periods up to and including the year ended December 31, 2010, CYGAM prepared its financial statements in accordance with Canadian generally accepted accounting principles ("previous GAAP" or "CGAAP"). In accordance with the standard related to the first time adoption of IFRS, the transition date to IFRS was January 1, 2011 and comparative information for 2010 has been prepared in accordance with the Company's IFRS accounting policies. Certain amounts in prior years have been reclassified to conform to the current year's IFRS presentation format.

The condensed interim consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Company will be able to continue to finance its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. Refer to the Business Risks section of this MD&A for additional information related to identified risks, estimates and uncertainties.

Natural gas has been converted into barrels of oil equivalent (boe) at 6:1. The abbreviations "boe", "boe/d" and "Mboe" disclosed in this MD&A may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf: 1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Certain financial measures in this MD&A, namely netback, net operating income and funds flow from operations, are not prescribed and do not have a standardized meaning prescribed by IFRS and therefore may not be comparable with the calculation of similar measures by other companies. Netbacks are used by the Company as a key measure of performance and are not intended to represent operating profit nor should they be viewed as an alternative to cash flow provided by operating activities, net earnings or other measures of financial performance calculated in accordance with GAAP. Netbacks are determined by deducting royalties, amounts payable under production sharing agreement and production expenses from oil and gas sales revenue.

## **Cautionary Statement regarding Forward-Looking Information**

Certain statements contained in this MD&A, including statements which contain words such as “anticipate”, “could”, “should”, “expect”, “seek”, “may”, “intend”, “likely”, “will”, “believe” and similar expressions, statements relating to matters that are not historical facts, and statements of our beliefs, intentions and expectations about development, results and events which will or may occur in the future, constitute “forward-looking information” within the meaning of applicable Canadian securities legislation and are based on certain assumptions and analysis made by us derived from our experience and perceptions. Forward-looking information in this MD&A includes, but is not limited to: statements relating to “reserves” and “resources” as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future; expected cash provided by continuing operations; future capital expenditures, including the amount and nature thereof; oil and natural gas prices and demand; expansion and other development trends of the oil and natural gas industry; business strategy and outlook; expansion and growth of our business and operations; the maintenance of existing government, supplier and partner relationships; supply channels; accounting policies; balance sheet financial instruments; credit risks; and other such matters.

All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The risks, uncertainties, and assumptions that may cause actual results to differ materially from the forward looking information are difficult to predict and may affect operations, including, without limitation: the risks associated with foreign operations; foreign exchange fluctuations; commodity prices; equipment and labour shortages and inflationary costs; general economic conditions; industry conditions; changes in applicable environmental, taxation and other laws and regulations as well as how such laws and regulations are interpreted and enforced; the ability of oil and natural gas companies to raise capital; the effect of weather conditions on operations and facilities; the existence of operating risks; volatility of oil and natural gas prices; oil and natural gas product supply and demand; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; increased competition; stock market volatility; opportunities available to or pursued by us and other factors, many of which are beyond our control. The foregoing factors are not exhaustive and are further discussed herein under the heading “Business Risks and Uncertainties”.

Actual results, performance or achievements could differ materially from those expressed in, or implied by, this forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do so, what benefits will be derived therefrom. Except as required by law, CYGAM disclaims any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise.

The forward-looking information contained herein is expressly qualified by this cautionary statement.

## **REVIEW OF OPERATIONS**

### **Activities in Tunisia**

#### *Sud Remada Permit*

The Sud Remada Permit is located onshore Tunisia and encompasses an area of 1,173,215 acres (4,748 km<sup>2</sup>).

In January 2011, the operator of the Sud Remada Permit, Storm Ventures International Inc. (“Storm”), submitted a Plan of Development for the TT structure in the Permit to the Tunisian authorities and became actively engaged with Enterprise Tunisienne d’Activités Pétrolières (“ETAP”) to obtain the granting of the Bir Ben Tartar Production Concession by the Direction Générale de l’Energie (“DGE”). Approval for a 87,000 acre (352 km<sup>2</sup>) Production Concession encompassing the TT structure was received in April 2011.

Since April a fourth appraisal well (TT4) was drilled in the Production Concession and a plan advanced to drill between three and five additional wells on the Production Concession along with the initial design of a production battery and a 140 km sales pipeline.

A four well appraisal drilling program was initiated in the third quarter for the Production Concession. The drilling of two wells, TT5 and TT6, was accomplished in the third quarter while drilling operations on two further wells, TT7 and TT8, continued into the fourth quarter.

A well completion program, entailing fracture stimulation treatments, is expected to be complete by year end. The fourth quarter completion program will be comprised of the four new appraisal wells (TT5, TT6, TT7 and TT8) and workovers on the TT2 and TT4 wells, which are two of the three existing producing wells in the Production Concession.

During the third quarter of 2011, net production from the concession’s three existing producing wells (TT2, TT3 and TT4) averaged approximately 137 barrels of oil per day, with the TT3 well supplying approximately 122 barrels of oil per day to this net production.

Operational and budgetary planning for a 2012 multi-well development program, a field gathering system, a central processing facility and an oil sales line for the Bir Ben Tartar Production Concession is ongoing and subject to regulatory review and partner discussion.

The balance of the Sud Remada Permit will remain intact until year end 2011 when 20 percent of the acreage is expected to be relinquished, and the remaining acreage (approximately 900,000 acres) will advance into a second term (of three years) that will only involve a drilling commitment of one exploration well.

Exploration plans over the next twelve months for the remainder of the permit area are currently expected to include the drilling of at least one undrilled structure (identified with existing seismic). In addition to the 67 km<sup>2</sup> TT structure, nine other structures, including the 74 km<sup>2</sup> El Bell anomaly located approximately 17 km north-east of the TT2 discovery well, and several leads have been identified. CYGAM intends to participate for its 14% direct working interest in all the appraisal, development and exploratory operations on the Sud Remada Permit.

### *Bazma Permit*

The Bazma Permit, located onshore south-central Tunisia, encompasses an area of 1,616 km<sup>2</sup> (399,308 acres). CYGAM holds a 100% in the permit and is seeking companies to participate in the permit on a promoted basis.

In February, CYGAM announced that it received the approval from Tunisian authorities to extend the Bazma Permit for one year (to July 27, 2012) and that one deep Ordovician well would be drilled on that permit in late 2011. Subsequently CYGAM has submitted a request for, and expects to receive, an additional one year extension (to July 27, 2013) which will permit the exploration well to be delayed until late 2012.

### *Sud Tozeur Permit*

The Sud Tozeur Permit, located near the Algerian border and adjacent to the Sabria and El Franig fields, covers an area of 4,380 km<sup>2</sup> (1,082,283 acres) and carries commitments comprising acquiring a 200km<sup>2</sup> seismic survey, and one exploratory well to be followed by an appraisal well in the event of a discovery over a period of four years.

CYGAM holds a 100% working interest in the Permit and is currently discussing arrangements with other companies to participate in the exploration of the permit on a promoted basis. CYGAM received a two-year extension (to May 12, 2013) by committing to acquire a 200 km<sup>2</sup> 3D seismic survey and by committing to drill a 4,500 metre Ordovician exploratory test on the permit. CYGAM after discussions with regulatory authorities will be submitting a request for an additional one year extension (to May 12, 2014) which will permit farm out arrangements to be finalized and a 3D seismic survey to be conducted in 2012. The 3D seismic survey will be conducted immediately north of the El Franig producing field where one Ordovician well increased its productivity to over 5,000 boe/d after successful artificial fracturing operations. It is expected that the 3D seismic survey will enhance the interpretation of a 27 km<sup>2</sup> structure already identified by CYGAM north-east of the El Franig field on the basis of proprietary 2D seismic data.

In August 2011, the Company entered into an agreement (“Agreement”) with an existing partner (“Partner”) to terminate a current Farm Out Agreement and Memorandum of Understanding with respect to the Sud Tozeur and Bazma Permits in Tunisia. Under the Agreement, the Company has agreed to reimburse the Partner for prior costs contributed by the Partner in exchange for the transfer to the Company of all rights or interests held by the Partner in the permits. This effectively returns the Company to a 100% interest in the Sud Tozeur and Bazma Permits and increases flexibility with respect to farmout options relating to these permits. The total amount payable by the Company under the Agreement is \$621,278, payable by way of an initial \$50,000 cash payment and the balance by March 31, 2012. The Agreement includes conditions relating to the cancellation of a deposit paid by the Partner and the sale of marketable securities of the Partner owned by the Company.

### **Activities in Italy**

In August 2010, Legislative Decree (“DL128”) was passed into law, amending the Italian Environmental code by prohibiting, within five miles of the coastline and within twelve miles of

the perimeter of protected marine parks, activities related to the exploration, research or production of liquid hydrocarbons and gases.

#### *B.R268.RG Permit*

For CYGAM's B.R268.RG Permit, the proposed Elsa 2 offshore well location lies within the newly prohibited area as it is approximately 3.8 miles from the coastline. The operator, Petroceltic International plc., has applied for permission to suspend its timing obligations under the Permit in order to extend the well spud date deadline until interpretation issues regarding DL128 are resolved. Several companies are working through Assominerara (the Italian Association of Oil and Gas Companies) to clarify and, if necessary, amend DL128. Assominerara has petitioned the European Union to persuade the Italian Government to annul the bans enacted by DL128.

Late in 2010, CYGAM requested clarification from the Italian authorities regarding the interpretation and validity of DL128 in relation to the Elsa project and submitted an application to the Ministry of Economic Development to "freeze" the Permit and therefore extend its drilling deadline. On March 1, 2011, the Ministry of Economic Development ("MSE") signed a decree suspending the B.R268.RG Permit for a period of six months moving the deadline of the first exploration period to September 20, 2011. The decree was published in the April 2011 edition of the MSE's monthly bulletin. In September 2011 the operator sent a letter to the MSE requesting a formal letter granting the suspension. In addition further appeals have been submitted to the TAR (Regional Administrative Court). All partners in the permit have extended existing agreements pertaining to the farm-out of this Permit.

#### *C.R148.VG Permit*

CYGAM's C.R148.VG Permit, offshore Sicily, is also impacted by DL128 as a portion of the Permit is within a twelve-mile perimeter of an environmentally protected area. The Company made an application on November 15, 2010, calling for the extension of the C.R148.VG Permit from August 26, 2010 until August 26, 2011. The expiration of the Permit was extended to November 27, 2013 by way of a Decree issued in February 2011.

#### *Colle della Guardia Application*

In May 2011, the Company received preliminary approval for an exploration permit called Colle della Guardia. This 81.18 km<sup>2</sup> (20,060 acres) permit is located south-east of the Civitaquana Permit, in the Molise region, adjacent to the coastline. Final award for this 50% working interest permit is expected after ministerial and provincial review of all the necessary environmental reports. Commitments on the permit include re-processing and interpretation of 50 km of existing seismic data which may be followed by an election to drill a 1,500 metre exploratory well. Gas transmission infrastructure is in place in close proximity to the permit.

#### **Activities in Canada**

In March 2011, the board of directors decided that the Company's Canadian properties were no longer strategic assets and made the decision to actively commence a sale process of the properties. Active marketing commenced in the second quarter of 2011 and the properties were sold on August 4, 2011. As a result of the decision to sell the Canadian properties, the financial results relating to these properties are shown as discontinued operations in the interim financial

statements. Results of operations and cash flows from discontinued operations are shown in Note 19 to the September 30, 2011 interim financial statements.

## Corporate

In April and May 2011 the Company restructured the board and management of the Company.

Mr. Gary Hyde was appointed Chief Executive Officer and Chief Operating Officer and was appointed to the Board of Directors. Mr. Brad Goldie was appointed President and Vice President, Business Development. Mr. Alastair Robertson was appointed Chief Financial Officer.

Mr. Giuseppe Rigo, the previous Chief Executive Officer, and Mr. Dario Sodero, the previous President, resigned from their respective positions. Mr. Rigo continued in his role of Executive Chairman of the Board of Directors, and Mr. Sodero continued in his role as a director. Mrs. Neli da Silva Rigo, the widow of Dr. Fabrizio Rigo and the major shareholder of CYGAM, Mr. Derrick Armstrong and Mr. Drew Burgess resigned from the Board of Directors. The Board of Directors now consists of Giuseppe Rigo (Executive Chairman), Dario Sodero, Peter Haverson and Alec Silenzi, who was appointed to the board in March 2011.

On October 28, 2011 the Company announced that Gary Hyde, Chief Executive Officer and Chief Operating Officer and Brad Goldie, President and Vice-President of Business Development, had provided notice of their resignations effective November 30, 2011. Mr. Hyde has also resigned as a member of the Board of Directors effective October 26, 2011. Giuseppe Rigo, Executive Chairman of the Board, will become interim President and CEO upon the departure of Mr. Hyde and Mr. Goldie. In addition, Al Robertson, Chief Financial Officer, indicated that he intends to continue in his role with the company as a consultant, rather than a full time member of management. Mr. Robertson will remain in his role as Chief Financial Officer for a transition period until new management is appointed with the company.

The Board of Directors is actively pursuing a process to identify and appoint a new management team.

## FINANCIAL PERFORMANCE

### Selected Financial Information

	Nine Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
Oil sales - Tunisia	\$ 1,591,396	\$ -	\$ 1,823,722	\$ 143,535
Other income	6,218	27,526	24,482	75,499
	1,597,614	27,526	1,848,204	219,034
Operating costs	412,433	-	545,466	70,546
General and administrative	665,806	222,768	2,337,694	849,285
Stock based compensation	161,501	160,262	778,780	163,972
Financing costs	2,506	923	5,646	3,808
Depletion and depreciation	217,464	8,503	249,954	58,865
	1,459,711	392,456	3,917,540	1,146,476
Income (loss) before the following:	137,903	(364,930)	(2,069,336)	(927,442)
Realized gain (loss) on sale of marketable securities	-	-	84,927	(569,387)
Net income (loss) from continuing operations	137,903	(364,930)	(1,984,409)	(1,496,829)
Net income (loss) from discontinued operations	29,908	(9,428)	(302,915)	(64,448)
Net income (loss)	\$ 167,811	\$ (374,358)	\$ (2,287,324)	\$ (1,561,277)

## Oil and Gas Revenue

Oil and gas revenue comprises oil revenue from the Company's Tunisian operations. Production at Sud Remada, which had commenced in March 2009 with the TT2 well, increased substantially in June when the TT3 and TT4 wells were also placed on production. The TT structure is now part of the Bir Ben Tartar Concession which is governed by a production sharing contract with ETAP, the Tunisian national oil company. Under this contract, the Company receives a share of the production under a sliding scale formula. The calculation includes a cost oil component which enables the Company to recover its costs and a profit sharing component whereby profits are split between the Company and ETAP. Currently the Company receives a 14% working interest in approximately 62% of the production as cost and profit oil with ETAP receiving the remainder of the production. ETAP is responsible for paying all of the royalties and taxes out of its share of production.

### Tunisia Production and Sales Volumes

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
<b>Production</b>				
Total Oil Production ( <i>bbls</i> )	12,558	577	17,765	2,750
Oil ( <i>bbls/d</i> )	136.5	6.3	65	29.9
<b>Sales</b>				
Total Oil Sales ( <i>bbls</i> )	13,955	-	16,030	1,890
Crude oil ( <i>bbls/d</i> )	151.7	-	58.7	6.9

The difference between the Company's Tunisian production and sales volumes results between crude oil wellhead production as measured in the field, versus revenue recognition at the point when crude is loaded onto a tanker after first being transported and stored at a terminal facility at the port in La Skhira. On delivery to the shipping tanker the Company reports revenue.

### Tunisia Oil Revenue

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
Oil Sales	\$ 1,591,396	\$ -	\$ 1,823,722	\$ 143,535
<i>\$/bbl</i>	\$ 114.04	\$ -	\$ 113.77	\$ 75.94

During the three months ended September 30, 2011 oil revenues were \$ 1,591,396 (2010 - \$nil). Production resumed in June from the TT2, TT3 and TT4 wells that had been completed or recompleted during early 2011.

During the nine months ended September 30, 2011, oil revenues were \$1,823,772 (2010 - \$143,535). The increase over 2010 reflects production from the 3 TT wells and also reflects that there was no sale of production in the first quarter of 2010. Production from the TT2 well was limited during the first quarter of 2011 as the well was shut down for almost one month during the quarter in order to conduct fracturing stimulation operations.

## Operating expenses

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
Operating expenses	\$ 412,433	\$ -	\$ 545,466	\$ 70,546
Operating Expenses (\$/boe)	\$ 29.55	\$ -	\$ 34.03	\$ 37.33

Operating costs include all costs in Tunisia associated with the production of oil, which include charges for trucking of oil, road maintenance, local labour and camp expenses, contract operating, property and pipeline taxes, and well maintenance costs.

Operating expenses for the third quarter of 2011 totaled \$412,433 compared to \$nil in the same period last year, when there were no oil sales.

For the nine months ended September 30, 2011, the Company incurred operating expenses of \$545,299 compared to \$70,546 in the corresponding 2010 period.

## Operating netback (1)

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
Oil revenues (net)	\$ 1,591,396	\$ -	\$ 1,823,722	\$ 143,535
Operating costs	\$ (412,433)	\$ -	\$ (545,466)	\$ (70,546)
Net operating income (1)	\$ 1,178,962		\$ 1,278,256	\$ 72,989
Depletion and depreciation	\$ 217,464	\$ 8,503	\$ 249,954	\$ 58,865
Revenue per boe	\$ 114.04	\$ -	\$ 113.77	\$ 75.94
Operating costs per boe	\$ 29.55	\$ -	\$ 34.03	\$ 37.33
Operating income per boe	\$ 84.49	\$ -	\$ 79.74	\$ 38.62

(1) Net operating income and netback is a non-GAAP measure.

The operating netback was \$84.48/boe for the three months ended September 30, 2011. There were no sales in the comparable period in 2010.

For the first nine months of 2011, the Company achieved an operating netback of \$79.74/boe compared to \$38.62/boe in the same period of 2010. The increase is principally due to stronger commodity pricing throughout 2011 and increased volumes.

## Other Revenue

During the three and nine months ended September 30, 2011, other revenue of \$6,216 (2010 - \$27,526) and of \$24,480 (2010 - \$75,499) respectively principally comprises interest income earned on cash balances. The decrease compared to the same period in 2010 reflects that no distributions were received in 2011 from marketable securities as all trust units were sold during the first quarter.

## General and Administrative Expenses (“G&A”)

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
General and administrative expense	\$ 665,806	\$ 222,768	\$ 2,337,694	\$ 849,285

During the three months ended September 30, 2011, G&A expenses were \$665,806 compared to \$222,768 in the same period in 2010. During the quarter the Company incurred higher salary costs due to increased staff levels and increased professional and legal fees compared to 2010.

During the nine months ended September 30, 2011 G&A expenses were \$2,337,694 compared to \$849,285 in 2010. The increase reflects payments totaling \$794,157 with respect to terminated employment contracts relating to two former officers of the Company and higher salary costs and professional fees compared to 2010.

During the three and nine months ended September 30, 2011, the Company capitalized \$73,187 (2010 - \$57,618) and \$214,706 (2010 - \$188,431) respectively of general and administrative expenses that were directly related to the exploration and drilling of oil and gas properties in Italy and Tunisia.

## Stock-based Compensation

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
Stock Based Compensation	\$ 161,501	\$ 160,262	\$ 778,780	\$ 163,972

Share-based compensation expense is a non-cash expense that reflects the amortization over the vesting period of the fair value of stock options granted to the employees, consultants and directors of the Company. During the three months ended September 30, 2011, stock-based compensation was \$161,501 (2010 - \$160,262). The expense in 2011 results from the granting of 3,650,000 stock options to certain directors and officers of the Company in May 2011.

During the nine months ended September 30, 2011 stock-based compensation was \$778,780 (2010 - \$163,972). The increase results from the options granted in the first and second quarters of 2011.

## Depletion and Depreciation

	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
Depletion and Depreciation	\$ 217,464	\$ 8,503	\$ 249,954	\$ 58,865
Depletion and Depreciation (\$/boe)	\$ 17.32	\$ -	\$ 14.07	\$ 21.41

During the three months ended September 30, 2011, depletion and depreciation amounted to \$217,464 (2010 - \$8,503), most of which related to depletion related to oil production in Tunisia. The cost of exploration and evaluation assets of \$6,823,865 was excluded from the depletion calculation and is assessed periodically to ascertain whether impairment has occurred.

During the nine months ended September 30, 2011, depletion and depreciation amounted to \$249,381 (2010 - \$118,890), principally depletion related to oil production in Tunisia. The decrease in depletion on a per barrel basis is due to an increase in proved reserves at December 2011, which impacts the depletion calculation.

#### **Gain or Loss on Marketable Securities**

Management has designated marketable securities as available for sale with the intent to dispose of these units when funds were required for exploration activities. During the quarter ended March 31, 2011 all of the units of a trust company were disposed of resulting in a realized gain of \$84,927 during the quarter (2010 – loss of \$569,387).

#### **Net income (loss) from continuing operations**

For the three months ended September 30, 2011, net income from continuing operations was \$137,903 compared to a loss of \$364,930 in the same period in 2010. This was principally due to increased production and income from Tunisia, offset by increased stock based compensation expense and general and administration costs.

During the nine months ended September 30, 2011, the net loss from continuing operations was \$1,984,409 compared to the loss of \$1,496,829 in the same period in 2010. The increase in the loss reflects increased general and administrative expense and severance amounts, increased stock based compensation expense, increased operating expenses and increased depletion and depreciation expense, offset by increased production and resulting revenue from Tunisia. In 2010, there was a realized loss on sale of marketable securities of \$569,387.

#### **Loss from discontinued operations**

Discontinued operations relate to the Canadian oil and gas interests that were sold on August 4, 2011.

#### *Revenue*

Total revenue for the nine months ended September 30, 2011 comprised approximately 74% natural gas and 26% oil and NGLs, at an average price of \$34.51 per boe (2010 - \$35.56).

#### *Operating expenses*

For the nine months ended September 30, 2011, operating expenses were \$77,711, compared with \$116,019 during the same period in 2010. The decrease reflects the sale of the properties with an effective date of July 1, 2011.

#### *Remeasurement of carrying value/gain on sale*

For the nine months ended September 30, 2011, a remeasurement expense of \$280,000 was recorded in recognition of the expected net proceeds to be received from the sale of the assets. After accounting for the remeasurement loss, a final gain on sale of \$29,886 was recorded upon the sale of the properties in August, 2011.

#### *Net loss*

For the nine months ended September 30, 2011, the net loss from discontinued operations was \$302,915 compared to a loss of \$64,448 during the comparable period in 2010. The increased loss principally reflects the remeasurement expense discussed above.

## SUMMARY OF QUARTERLY INFORMATION

	Note 1 2011 Q3	Note 1 2011 Q2	Note 1 2011 Q1	Note 2 2010 Q4
Oil & gas revenue (net of royalties)	\$ 1,591,396	\$ 153,194	\$ 232,326	\$ 253,744
Other income	6,218	4,349	18,264	29,429
	1,585,178	148,845	250,590	283,173
Expenses	1,459,711	1,908,634	2,457,830	872,655
Income (loss) before items below	137,903	(1,751,091)	(2,207,239)	(589,482)
Impairment on assets	-	-	-	(6,315,804)
Realized gain on sale of marketable securities	-	-	84,927	-
Unrealized gain on marketable securities	-	-	-	175,802
Income (loss) from continuing operations	137,903	(1,751,091)	(2,122,312)	(6,729,484)
Net income (loss) from discontinued operations	29,908	(302,458)	(332,823)	-
Net income (loss)	\$ 167,811	\$ (2,053,548)	\$ (2,455,135)	\$ (6,729,484)
Net loss per share	\$ -	\$ (0.02)	\$ (0.01)	\$ (0.07)

  

	Note 2 2010 Q3	Note 2 2010 Q2	Note 2 2010 Q1	Note 2 2009 Q4
Oil & gas revenue (net of royalties)	\$ 102,014	\$ 226,535	\$ 143,535	\$ 210,182
Other revenue	27,526	23,876	24,097	43,060
	129,540	250,411	167,632	253,242
Expenses	565,338	595,086	1,146,476	665,839
Loss before items below	(435,798)	(344,675)	(978,844)	(412,597)
Impairment on assets	-	-	-	(225,000)
Realized loss on sale of marketable securities	-	-	(569,387)	(974,995)
Unrealized gain on marketable securities	57,806	63,170	-	1,384,189
Net loss	\$ (377,992)	\$ (281,505)	\$ (1,548,231)	\$ (228,403)
Net loss per share	\$ -	\$ -	\$ (0.01)	\$ -

Note 1: Prepared under IFRS.

Note 2: As filed previously under CGAAP.

Revenue from oil and gas sales (net of royalties) fluctuates from quarter to quarter largely due to fluctuations in production and in the price of oil received by the Company. The production increase in the third quarter of 2011 was due to higher production in Tunisia at Sud Remada. Tunisian production from the TT wells is sold when sufficient quantity is gathered for shipment.

## CASH USED IN OPERATIONS <sup>(1)</sup>

	Nine Months ended September 30,	
	2011	2010
Cash used in Continuing Operations	\$ 1,219,962	\$ 1,647,976

During the nine months ended September 30, 2011, the Company used cash in operations totalling \$1,219,962 compared to \$1,647,976 in the comparative period of 2010. The decrease was due to increased cash flow from operations in Tunisia, offset by the significant severance payments made during the second quarter and increased professional fees and salaries compared to 2010.

(1) Cash flow is calculated from cash flow from continuing operations adjusted for changes in non-cash working capital.

## LIQUIDITY AND CAPITAL RESOURCES

The Company had working capital of \$1,006,079 (including cash of \$735,494) as at September 30, 2011 compared to \$5,586,364 as at December 31, 2010. Proceeds of \$1,186,820 from the sale of marketable securities were received during the first quarter of 2011. Net proceeds of \$971,166 from the sale of the Company's Canadian properties were received during the third quarter of 2011.

While these funds are sufficient to continue operations in 2011, the Company will need to consider some form of additional financing to continue to meet exploration commitments and to continue operations beyond mid-2012. The Company has either entered into agreements or has received expressions of interest from third parties to participate in the exploration program on several of the permits. The Company will examine each interest on a permit-by-permit basis to determine the level and amount of participation offered to third parties. Management expects capital expenditures for the next twelve months, net to CYGAM, to be \$15-\$25 million, subject to the level of third party participation.

The Company's management will continue to consider various means of obtaining additional capital, within the context of existing market conditions (equity financings, debt, sale of assets, joint venture agreements or other) to further the exploration and development of the Company's properties and to provide sufficient working capital. However, the ability of the Company to raise funds is dependent on capital market conditions and there can be no certainty that the said plans will be successful.

## CAPITAL EXPENDITURES

The Company incurred the following capital expenditures during the three and nine months ended September 30:

2011	Three Months ended September 30				Nine Months ended September 30			
	Italy	Tunisia	Corporate	Total	Italy	Tunisia	Corporate	Total
Seismic, technical and other	\$ 99,758	\$ 1,267,005	\$ 14,168	\$ 1,380,931	\$ 245,904	\$ 1,267,005	\$ 14,168	\$ 1,527,077
Drilling activities	-	1,448,122	-	1,448,122	-	3,245,054	-	3,245,054
Total	\$ 99,758	\$ 2,715,127	\$ 14,168	\$ 2,829,053	\$ 245,905	\$ 4,512,059	\$ 14,168	\$ 4,772,131

2010	Three Months ended September 30				Nine Months ended September 30			
	Italy	Tunisia	Corporate	Total	Italy	Tunisia	Corporate	Total
Seismic, technical and other	\$ 90,592	\$ 94,312	\$ -	\$ 184,904	\$ 195,361	\$ 267,874	\$ -	\$ 463,235
Drilling activities	-	78,572	-	78,572	-	78,572	-	78,572
Total	\$ 90,592	\$ 172,884		\$ 263,476	\$ 195,361	\$ 346,446	\$ -	\$ 541,807

In the third quarter of 2011, capital spending related primarily to the drilling and completion of the TT5 and TT6 wells and the commencement of drilling of the TT7 and TT8 wells in the Sud Remada Permit in Tunisia. In the second quarter of 2011, capital spending related primarily to the recompletion and completion of the TT2, TT3 and TT4 wells. Drilling tubulars were purchased in Tunisia for later use on either the Sud Tozeur or Bazma permits.

With respect to the Sud Tozeur and Bazma Permits, in the third quarter the Company entered into an agreement with an existing partner (“Partner”) to terminate a current Farm Out Agreement and Memorandum of Understanding with respect to the Sud Tozeur and Bazma Permits in Tunisia. The Company agreed to reimburse the Partner for prior costs contributed by the Partner totalling \$621,278, in exchange for the transfer to the Company of all rights or interests held by the Partner in the permits. This effectively returns the Company to a 100% interest in the Sud Tozeur and Bazma Permits.

#### **Off balance sheet arrangements and financial instruments**

The Company has not entered into any off balance sheet transactions.

#### **SHARE CAPITAL**

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of preferred non-voting shares. To date, no preferred shares have been issued.

The Company’s share capital as at September 30 and November 25, 2011 is outlined below:

	Shares	Amount (\$)
Outstanding common shares at September 30 and November 29, 2011	97,900,937	\$32,424,762

As at September 30, 2011, 9,150,000 stock options were issued and outstanding. During the second quarter of 2011, 3,650,000 stock options were granted to certain officers and a director at a grant price of \$0.48 per common share and stock options to purchase 350,000 common shares expired unexercised. In July 2011, 1,000,000 stock options expired.

#### **RELATED PARTY TRANSACTIONS**

Transactions between the Company and related parties during the period comprised the following:

- (a) Included in the general and administrative expenses are consulting fees of \$975,795 (2010 - \$91,387) paid to companies whose shareholders are directors or former officers of Cygam. \$794,157 of this amount related to payments with respect to terminated

- employment contracts. The Company also capitalized \$88,698 (2010 - \$28,572) of consulting fees paid to a company controlled by a director and officer of the Company.
- (b) During the period ended September 30, 2011, \$57,262 (2010 - \$nil) in legal fees was paid to a legal firm in which a director of the Company is a partner, \$20,810 of which was outstanding at September 30, 2011.
  - (c) During the period ended September 30, 2011, \$16,331 (2010 - \$97,233) in legal fees was incurred to a legal firm in which a former director of the Company is a partner. During 2010 \$88,551 was recorded as share issue costs incurred in connection with the equity financing completed in March 2010.
  - (d) In August 2011, the Company entered into an agreement (“the Agreement”) with an existing partner (“Partner”) to terminate a current Farm Out Agreement and Memorandum of Understanding with respect to the Sud Tozeur and Bazma Permits in Tunisia. Under the Agreement, the Company agreed to reimburse the Partner for prior costs contributed by the Partner in exchange for the transfer to the Company of all rights or interests held by the Partner in the permits. This effectively returned the Company to a 100% interest in the Sud Tozeur and Bazma Permits and increases flexibility with respect to farmout options relating to these permits. The total amount payable by the Company under the Agreement is \$621,278, payable by way of an initial \$50,000 cash payment and the balance by March 31, 2012. The Agreement included the cancellation of a deposit paid by the Partner and the sale of marketable securities of the Partner owned by the Company. The Company’s former President and a director is a director of the joint venture partner.

All such transactions were in respect of technical and specialized services rendered in the normal course of business operations and represent consideration established and agreed to by the related parties which is similar to those negotiated with third parties.

## **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

In the ordinary course of business, the Company and its subsidiaries may enter into contracts which contain indemnification provisions, such as service agreements, leasing agreements, asset purchase and sale agreements, joint venture agreements, operating agreements, land use agreements, etc. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement-by-agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

The Company rents premises in Rome, Italy, and in Tunis, Tunisia, under operating leases that require payments of \$40,370 per annum in Rome and \$30,364 per annum in Tunis.

## **ACCOUNTING POLICIES AND ESTIMATES**

### **Adoption of International Financial Reporting Standards**

The Company’s transition date to IFRS was January 1, 2011 and this quarter represents the second reporting period using its IFRS accounting policies. Accordingly, the comparative

information for 2010 has been prepared in accordance with the Company's IFRS accounting policies. The information below summarizes the significant accounting policies that the Company adopted under IFRS as well as the actual impact of adopting the policies. The Company concluded that the adoption of IFRS did not have a significant impact on any of its internal control processes.

### **Accounting policies**

The Company has prepared its condensed interim consolidated financial statements for the three and nine months ended September 30, 2011 using the IFRS standards that are expected to be effective at the end of 2011. However, the Company's IFRS accounting policies will only be finalized when its first annual IFRS financial statements are prepared for the year ending December 31, 2011 and IFRS standards are potentially subject to change in 2011. Therefore, certain accounting policies that the Company currently expects to follow under IFRS may not be adopted and the application of such policies to certain transactions or circumstances may be modified. As a result, the condensed interim consolidated financial statements for the three and nine months ended September 30, 2011 are subject to change.

The Company's condensed interim consolidated financial statements for the three and nine months ended September 30, 2011 provide reconciliations from previous GAAP to IFRS for equity as at September 30, 2010. Reconciliations are also provided for net loss and comprehensive loss for the three and nine months ended September 30, 2010.

The Company's significant accounting policies adopted in its transition from previous GAAP to IFRS, including the significant elections and exemptions that are allowed upon first time adoption of IFRS, as well as the significant impacts on its net earnings for the three and nine months ended September 30, 2010 and the year ended December 31, 2010, are summarized in the following:

#### **Pre-exploration expense**

Under IFRS, costs incurred prior to obtaining the legal right to explore must be expensed whereas under previous GAAP these costs were capitalized in the full cost pool. The adoption of this policy did not impact the Company's net earnings for the three and nine months ended September 30, 2010 or for the year ended December 31, 2010.

#### **Intangible exploration assets**

Exploration and evaluation costs are incurred when the legal right to explore has been obtained but before technical feasibility and commercial viability have been determined. These costs are capitalized under IFRS as they were under previous GAAP, however, they are separately disclosed on the balance sheet as exploration and evaluation assets. These assets are not depreciated and are carried forward until technical feasibility and commercial viability of the field, area or project is determined. If it is determined that the field, area or project is not technically feasible, commercially viable or if the Company decided not to continue the exploration and evaluation activity, then the accumulated costs are expensed to exploration expense in the period in which the determination is made. Once technical feasibility and commercial viability is established, intangible exploration assets are tested for impairment and transferred to oil and gas properties, net of any impairment loss. There was no impact on the Company's net earnings for the nine month period ended September 30, 2010 or the year ended December 31, 2010 due to the adoption of this policy.

#### Opening Balance Sheet – full cost pool

Under previous GAAP, the Company accounted for its oil and gas properties in one country level cost centre using full cost accounting. IFRS has no equivalent treatment. IFRS 1 permits full cost accounting companies to allocate their existing upstream oil and gas properties net book value (full cost pool) to the unit of account level upon transition to IFRS using reserve information. Applying this exemption, the Company's full cost pool was allocated to its IFRS areas within oil and gas properties using the estimated proved and probable reserve values discounted at 10 percent at the transition date. Impairment reviews were performed on each cash-generating unit and as a result an impairment loss of \$73,783 was recorded at December 31, 2010 with respect to certain cash-generating units in Canada.

#### Oil and gas assets - depletion

Under both IFRS and previous GAAP the depletion and depreciation on the Company's oil and gas assets is calculated using the unit-of production method based on estimated reserves. However, under previous GAAP, the Company calculated its depletion rate using estimated proved reserves and IFRS permits the use of proved and probable reserves. Additionally under previous GAAP the Company calculated its depletion rate at the country cost centre level whereas under IFRS, its depletion rates are calculated at the area level. The adoption of this policy resulted in a \$10,666 and \$11,069 decrease in depletion for the three and nine months ended September 30, 2010 respectively.

#### Asset impairments

Under previous GAAP, property, plant and equipment ("PP&E") was tested for impairment at the country cost centre level. Under IFRS, PP&E assets are tested for impairment at a much more granular level, referred to as a cash-generating unit ("CGU"). A CGU is the smallest identifiable group of assets capable of generating cash inflows that are largely independent of cash inflows from other assets. Under IFRS, assets and CGUs are tested for impairment when facts and circumstances suggest that the carrying amount of an asset or CGU may exceed its recoverable amount. Intangible exploration assets are also tested for impairment immediately before they are transferred to PP&E.

Under previous GAAP, long-lived assets were subject to a two part impairment test. Firstly, a loss was recognized if the carrying value exceeded the undiscounted future cash flows. If a loss was recognized, it was measured as the amount by which the carrying value exceeded its fair value. Under IFRS, an impairment loss is recognized if an asset's or CGU's net book value exceeds its recoverable amount. Recoverable amount is determined as the greater of an asset's or CGU's value-in-use ("VIU") and fair value less costs to sell ("FVLCTS"). VIU is estimated as the discounted present value of the future cash flows expected to arise from the continuing use of an asset or CGU. FVLCTS is estimated as the amount obtainable from the sale of an asset or CGU in an arm's length transaction between knowledgeable, willing parties, which generally reflects current market prices for similar assets or CGUs.

Previous GAAP did not allow for the reversal of impairment losses. Under IFRS, impairment losses recognized in prior periods are assessed at each reporting date for any indicators that the impairment losses may no longer exist or may have decreased, except for goodwill impairments, which are never reversed. In the event that an impairment loss reverses, the carrying amount of the asset or CGU is increased to the revised estimate of its recoverable amount, but only to the extent that the carrying amount does not exceed the amount that would have been determined had no impairment loss been recognized on the asset or CGU in prior periods.

The adoption of these IFRS impairment testing policies had no impact on the Company's opening balance sheet or the net loss for the three and nine months ended September 30, 2010. However an impairment loss of \$73,783 was recorded as at and for the year ended December 31, 2010 with respect to certain cash-generating units in Canada.

#### Asset retirement obligations

Under previous GAAP, the historical credit-adjusted risk-free discount rates used to estimate Company asset retirement obligations were not updated to current market discount rates, while under IFRS, the risk-free discount rate is updated each reporting period. On the date of transition, the Company's discount rate under this IFRS policy was 3.5% and resulted in a \$39,518 increase to the asset retirement obligations and the amount capitalized to PP&E. There was no significant impact on the Company's net earnings for the three and nine month periods ended September 30, 2010 or to the liability at September 30, 2010 as a result of this IFRS policy. At December 31, 2010, the liability increased by \$5,082 with an offsetting increase to PP&E primarily as a result of a change in market discount rates to 3.5%.

#### Compensation plans

Under previous GAAP, the Company recognized an expense related to share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Company is required to recognize the expense over the individual vesting periods for the graded vesting awards and estimate a forfeiture rate. As provided in IFRS 1, the Company elected not to apply IFRS 2 - Share-Based Payments for share-based payments that vested before January 1, 2010. Accordingly, upon transition to IFRS Company recorded an increase to contributed surplus of \$17,605 with a corresponding charge to accumulated deficit. The adoption of this policy did not have a significant impact for the three and nine month periods ended September 30, 2010 and resulted in a decrease in compensation expense of \$64,437 for the year ended December 31, 2010.

#### Business combinations

Under IFRS business combinations are accounted for using the acquisition method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognized as goodwill. As part of its transition to IFRS, the Company elected to use the IFRS exemption not to restate business combinations that occurred prior to January 1, 2010.

#### **Significant accounting estimates and judgments**

The timely preparation of the condensed interim Financial Statements requires that management make estimates and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the condensed interim Financial Statements and the reported amounts of revenue and expenses during the period. Such estimates primarily relate to unsettled transactions and events as at the date of the condensed interim Financial Statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur. Significant estimates and judgements made by management in the preparation of these condensed interim Financial Statements are outlined below.

### Going Concern

These condensed interim financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. However, there are conditions and events that create uncertainty regarding the validity of this assumption.

The Company is an exploration stage company that engages principally in the acquisition, exploration and development of oil and gas properties. As an exploration stage company, it is currently unable to self-finance its operations. The recovery of the Company's investment in its resource properties and attainment of profitable operations, and its ability to continue as a going concern are dependent upon the discovery, development and sale of oil and gas reserves, the ability to attract joint venture partners and the ability to raise sufficient capital to finance its operations.

During the period ended September 30, 2011, the Company had a net loss of \$2.3 million and a deficit of \$20.7 million. As at September 30, 2011, the Company's cash on hand totaled \$735,494 and working capital was \$1.0 million, and the Company has joint venture partners on several properties.

The Company's management will continue to consider various means of obtaining additional capital, within the context of existing market conditions (equity financings, debt, sale of assets, joint venture agreements or other) to further the exploration and development of the Company's properties and to provide sufficient working capital. However, as there can be no certainty that the plans will be successful, there is significant doubt regarding the Company's ability to continue as a going concern. If the going concern assumption were not appropriate for these financial statements, then adjustments would be necessary to the carrying values of assets and liabilities, the reported revenue and expenses and the balance sheet classifications used. These adjustments could be material.

### Other estimates

The petroleum and natural gas reserves used in determining our depletion rates and the assessment of impairments are based upon management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of petroleum and natural gas are examined to determine quantities available for future production, given existing operating and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in crude oil and natural gas prices and costs. Consequently, the reserves are estimates which are subject to variability. We employ the services of independent oil and gas reservoir engineers (DeGolyer and MacNaughton Canada Limited) to assist with the reserve and resource evaluation process for the Canadian properties, and some of the Tunisian and Italian properties.

Estimation of recoverable quantities of proven and probable reserves includes estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the asset retirement obligations, and the amounts reported for depletion and depreciation of oil and gas properties.

Upstream assets are aggregated into CGUs based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's CGUs is subject to management's judgment.

Amounts recorded for asset retirement obligations and the related accretion expense requires the use of estimates with respect to the amount and timing of asset retirements, site remediation and related cash flows, as well as the selection of a risk free discount rate. Other provisions are recognized in the period when it becomes probable that there will be a future cash outflow.

Compensation costs accrued for long-term stock-based compensation plans are subject to the estimation of what the ultimate payout will be using pricing models such as the Black-Scholes model which is based on significant assumptions such as volatility, dividend yield and expected term.

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty. Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

#### Fair Value

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

##### (a) Property and equipment

The recoverable amount of property, plant and equipment is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property, plant and equipment) and intangible exploration assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports using risk-adjusted discount rates specific to the respective assets with reference to general market conditions. The market value of other items of property, plant and equipment is based on the quoted market prices for similar items.

##### (b) Cash, cash equivalents, trade and other receivables and trade and other payables

The fair value of cash and cash equivalents, trade and other receivables and trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At September 30, 2011, January 1, 2010 and December 31, 2010, the fair value of these balances approximated their carrying value, except for accounts payable due to the credit risk of the Company, due to their short term to maturity.

##### (c) Stock options

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted-average historic volatility adjusted for changes expected due to publicly available information), weighted-average expected life of the

instruments (based on historical experience and general option holder behavior), and the risk-free interest rate (based on government bonds).

(d) Asset Retirement Obligations

The fair value of the future retirement obligation is discounted to present value and is recorded as an increase to the related property and equipment with the corresponding balance recorded as a future asset retirement obligation. The increased asset value is amortized according to our policies for property and equipment and the future liability is accreted to expense until the future retirement obligation is expected to be settled.

**Future changes in accounting policies**

The following pronouncements from the IASB will become effective for future financial reporting periods and have not yet been adopted by the Company:

IFRS 9, “Financial Instruments”, is the first phase of the IASB’s project to replace IAS 39, “Financial Instruments: Recognition and Measurement”. IFRS 9 replaces the current multiple classification and measurement models for financial assets with a single model that has only two classification categories: amortized cost and fair value, and provides additional guidance for financial liabilities. The standard may be delayed until 2015. It is currently an exposure draft from the IASB. Portions of the standard remain in development and the full impact of the standard will not be known until the project is complete. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 10 – Consolidation

IFRS 10, issued in May 2011, effective for periods commencing on or after January 1, 2013, requires an entity to consolidate an investee when it 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. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation—Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements. The Company has not evaluated the impact of the new requirements and whether to early adopt this standard.

IFRS 11 - Joint Arrangements

IFRS 11, issued in May 2011, effective for periods commencing on or after January 1, 2013, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities—Non-monetary Contributions. The Company has not evaluated the impact of the new requirements and whether to early adopt this standard.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12, issued in May 2011, effective for periods commencing on or after January 1, 2013, establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that

address the nature of, and risks associated with, an entity's interests in other entities. The Company has not evaluated the impact of the new requirements and whether to early adopt this standard.

#### **IFRS 13 - Fair Value Measurement**

IFRS 13, issued in May 2011, effective for periods commencing on or after January 1, 2013, is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. The Company has not evaluated the impact of the new requirements and whether to early adopt this standard.

### **DISCLOSURE CONTROLS AND PROCEDURES**

The Company did not make any changes to the Company's disclosure controls and internal controls over financial reporting during the most recent reporting period that would have materially affected or would reasonably likely to materially affect the Company's disclosure controls and internal controls over financial reporting. As at September 30, 2011, the Company identified a number of control deficiencies such as segregation of duties, insufficient in-house expertise to deal with complex taxation, accounting and information technology matters. The Company continues to consider cost-effective controls and processes that will mitigate these deficiencies. Management is of the opinion that none of these deficiencies has resulted in a material misstatement of the financial statements due to the significant amount of oversight by senior management and the Board of Directors.

### **OUTLOOK**

CYGAM will remain focused on international oil and natural gas exploration and development. The Company intends to conduct initial exploration programs for its Italian and Tunisian permits as well as evaluating additional exploration and drilling opportunities in Italy, Tunisia and other circum-Mediterranean oil-prone areas.

CYGAM's exploration plans for the remainder of 2011 in Tunisia and Italy include:

#### **Tunisia**

##### **(a) Sud Remada Permit.**

Storm Tunisia, the Operator, has begun civil construction in preparation for the drilling of three additional development wells in the recently awarded Bir Ben Tartar Production Concession. Drilling of the TT5, TT6 and TT7 wells began in the third quarter of 2011, with completion and production activities to follow in fourth quarter of 2011. Two additional contingent development wells have been identified for the remainder of 2011, subject to successful results on the three wells in third quarter of 2011.

On the remainder of Sud Remada Permit, the 3D seismic data (acquired in late 2009) and 2011 drilling results improved the understanding of the TT structure. An additional nine structures (including a 74 km<sup>2</sup> El Bell structure located approximately 17 km north-east of the TT2 discovery well) and several leads have been identified. In the southern half of the Permit, a

Silurian Acacus structure, located near the Libyan border, may also be further investigated. CYGAM will participate for its 14% direct working interest in all the appraisal, development and exploratory operations on the Sud Remada Permit and Bir Ben Tartar Production Concession.

(b) Bazma Permit.

One Ordovician well is planned on a large structure in the Bazma Permit. In addition, CYGAM is currently finalizing the interpretation of a large 2D seismic program to further delineate several deep structures. CYGAM is seeking companies to participate in the Permit on a promoted basis.

(c) Sud Tozeur Permit.

Seismic interpretation and acquisition is expected to continue on the Sud Tozeur Permit with potential target drilling dates in late 2012. CYGAM is seeking companies to participate in the permit on a promoted basis.

## Italy

a) B.R268.RG Permit.

The change in Italian environmental legislation has resulted in an effective ban on all drilling within five nautical miles of the coastline and twelve miles of protected marine areas. This change has prevented the Elsa 2 well from being drilled, and the drilling licence has subsequently been cancelled, pending a revised environmental assessment. This, along with ongoing clarification of the legislation, requires that the Operator and the Company continue to work to preserve the value of the Permit. Although the industry is lobbying the Italian Government to reverse the change in legislation it is unlikely the well will be drilled in the next twelve months.

b) C. R148.VG Permit.

Interpretation of 233 km of 2D marine seismic, acquired in June 2010 was incorporated with older-vintage seismic in 2011 to evaluate the Aretusa structure. In the next few months the Corporation expects to receive a comprehensive regional geological and geophysical assessment of onshore and offshore Sicily. The Company also plans to conduct a detailed seismic interpretation to evaluate a prospect that has been identified on that portion of the permit that lies beyond the limitations outlined in Legislative Decree 128 in the fourth quarter of 2011.

c) Civitaquana Permit.

The assessment of Miocene to Triassic targets has been finalized and a drillable prospect identified in the central part of the permit. Unfortunately an Abruzzi region law issued in December 2010, does not allow the drilling of wells if the target is oil. A one year extension of the drilling deadline will be presented to the Ministry of Economic Development in order to allow the company to conduct a new seismic interpretation of the external part of the block and verify the presence of gas prospect.

d) Montalbano Permit.

Mediterranean Oil and Gas has become the new operator of this permit, and has indicated that it will propose a well pending receipt of necessary government approvals. Concerns exist that the Basilicata region, where the permit is located, may temporarily ban drilling activities. The operator has presented to the Ministry of Economic Development a permit "suspension" application so that operations can be resumed at a later date.

e) Posta Nuova Permit and Masseria Montarozzo Application.

CYGAM will request a consolidation of the 38,155 acre Posta Nuova permit with the adjoining 38,266 acre Masseria Montarozzo exploration permit which had received preliminary approval in

August, 2008. Both permits are owned 100% by the Company and the consolidation will allow geological and geophysical work of a wider regional scope.

f) Colle della Guardia Application.

Final award of this permit is expected in late 2011 or early 2012 after ministerial and provincial review of all the necessary environmental reports. Upon award, CYGAM would have a 50% working interest and it would begin the reprocessing and interpretation of 50 km of existing 2D seismic data.

### **Overall Outlook**

As noted earlier, the Company's cash balances are expected to fund only part of the estimated costs of the first phase of the proposed program and to help cover anticipated general and administrative expenses and working capital provided that CYGAM can farm out portions of its prospective interests in the Italian and Tunisian Permits. Additional funds will have to be raised to proceed with the second phase and to complete the initial phase if farm-outs cannot be arranged. There is no assurance that farm-outs will be arranged or that such additional funds can be raised on reasonable terms, or at all.

CYGAM continues to look for other participation opportunities in the Mediterranean region. Such exposure to multiple international projects would reduce the inherent risk of oil and gas exploration and increase the probability of making one or more significant discoveries.

### **BUSINESS RISKS AND UNCERTAINTIES**

CYGAM is in the business of exploring for, developing and producing oil and natural gas. The Company has production operations in Tunisia, and exploration and development activities in Italy and Tunisia. Along with the competitive nature of the oil and gas industry, risk exposures, some of which are beyond the control of the Company, can be categorized as operational, political, regulatory, environmental and financial. The long-term commercial success of CYGAM depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof. Commodity price fluctuations for crude oil, natural gas and natural gas liquids which are subject to many factors, are outside of the Company's control.

The process of evaluating prospects and estimating oil and natural gas reserves is complex and subject to uncertainty. Actual operating results, including production performance, may vary materially from those estimated. CYGAM manages these risks by having operational control, where possible, and working interests commensurate with the assessed risk in each project and by hiring qualified professionals, including independent reserves engineers, with appropriate industry experience.

The Company focuses the majority of its activities on exploration in Tunisia and Italy and its operations are exposed to other risks including:

- Exchange rate between the Canadian and the US dollar for not only commodity prices but also capital spending and operating expenses;

- Third party credit risk;
- Changes to government fiscal, monetary and other financial policies;
- Evolution of changing domestic and international climate and environmental policies;
- Terrorism or militant targeted protests directed at international operations;
- Political risk;
- Price controls and varying forms of fiscal regimes or changes thereto; and
- Requirement for permits and licenses for operations.

CYGAM's management has considerable expertise operating internationally and has developed solid, long-term relationships within each of the jurisdictions in which it operates. The Company adheres to all governmental and environmental regulations as they apply in each operating jurisdiction. Regulation changes could increase costs of the Company's operations.

CYGAM maintains an insurance program which is consistent with industry practice to provide adequate coverage of drilling, operations, safety and the environment.

Many of these risks and uncertainties and others are discussed in the annual information form of Cygam for the year ended December 31, 2010, available on SEDAR at [www.sedar.com](http://www.sedar.com). Additional risks and uncertainties that management may be unaware of may become important factors which affect Cygam.