# AFRICA OIL CORP.

**Report to Shareholders**

**June 30, 2012**

**AFRICA OIL CORP.**
**MANAGEMENT'S DISCUSSION AND ANALYSIS**
**(Amounts expressed in United States dollars unless otherwise indicated)**
**For the three and six months ended June 30, 2012 and 2011**

Management's discussion and analysis ("MD&A") focuses on significant factors that have affected Africa Oil Corp. and its subsidiaries (the "Company" or "AOC") and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the Company's unaudited interim consolidated financial statements for the three and six months ended June 30, 2012 and 2011 and should also be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2011 and 2010 and related notes thereto.

The financial information in this MD&A is derived from the Company's unaudited consolidated financial statements which have been prepared in United States ("U.S.") dollars, in accordance with International Financial Reporting Standard as issued by the International Accounting Standards Board.

The effective date of this MD&A is August 24, 2012.

Additional information about the Company and its business activities is available on SEDAR at www.sedar.com.

## PROFILE AND STRATEGY

AOC is a Canadian-based company whose common shares are traded on the TSX Venture Exchange and the First North list of the NASDAQ OMX Stock Exchange in Sweden under the symbol "AOI". The Company is an international oil and gas exploration and development company, based in Canada, with oil and gas interests in Kenya, Ethiopia, Puntland (Somalia), and Mali.

AOC's long range plan is to increase shareholder value through the acquisition and exploration of oil and gas assets, located in under-explored geographic areas, in the early phase of the upstream oil and gas life-cycle. The Company is focused on high-impact exploration opportunities and has secured a portfolio of primarily East African oil and gas assets which provide the shareholders exposure to multiple identified prospects and leads, geographically and geologically diversified across multiple countries and four under-explored petroleum systems. AOC's mission is to de-risk this portfolio of oil and gas prospects and leads, while generating additional prospects and leads, through continuous oil and gas exploration activities. The Company is pursuing a farmout strategy aiming to leverage the current working interest holdings in each of its operated blocks. AOC aims to continue to identify additional highly prospective exploration targets in geologically favorable settings. The Company will continue to consider acquisition and merger opportunities with a focus on North Africa and the Middle East. In general, AOC will continue its portfolio approach to exploring a large number of oil and gas opportunities with the goal of increasing shareholder value.

The Company has acquired and commenced exploration activities on multiple exploration blocks in East Africa (refer to table below). The Company announced its first oil discovery during the first quarter of 2012 on Block 10BB with the drilling of the Ngamia-1 exploration well. The East African Rift Basin system is one of the last great rift basins to be explored. The Company acquired its interests in East Africa as several multi-billion barrel oil fields had been discovered in multiple analogous oil fields on all sides of the Company's underexplored land position including the major Tullow Oil plc ("Tullow") Albert Graben oil discovery in neighboring Uganda. Similar to the Albert Graben play model, the Company's concessions have older wells, a legacy database, and host numerous oil seeps indicating a proven petroleum system. Good quality existing seismic show robust leads and prospects throughout AOC's project areas. The Company now holds exploration acreage of over 300,000 km2 (gross) in this exciting new world-class exploration play fairway. The Company aims to have completed significant seismic and drilling programs on the majority of the Company's blocks over the next two years. East Africa is a vastly under-explored region where renewed interest is being shown by a growing number of mid to large sized oil companies wishing to add to their exploration portfolios.

## WORKING INTERESTS

The following table summarizes the Company's net working interests in the various production sharing contracts/agreements, based on working interest ownership:

| Country | Block/Area | Operator | December 31, 2011 Net Working Interest % (1) | June 30, 2012 Net Working Interest % (1) | Interest % (net of proposed / completed transactions) (3) |
|---|---|---|---|---|---|
| Kenya | Block 10A | Tullow | 30% | 30% | 30% |
| Kenya | Block 9 | AOC | 100.0% | 100.0% | 50.0% |
| Kenya | Block 10BB | Tullow | 50% | 50% | 50% |
| Kenya | Block 12A | Tullow | 50% | 50% | 20% |
| Kenya | Block 13T | Tullow | 50% | 50% | 50% |
| Kenya | Block 10BA | Tullow | 50% | 50% | 50% |
| Ethiopia | Blocks 7/8 | AOC (4) | 55% | 55% | 30% |
| Ethiopia | Adigala | AOC (4) | 50% | 50% | 50% |
| Ethiopia | South Omo | Tullow | 30% | 30% | 30% |
| Mali | Block 7 | Heritage | 25% | 25% | 25% |
| Mali | Block 11 | Heritage | 25% | 25% | 25% |
| Puntland, Somalia | Dharoor Valley | AOC | 27% (2) | 27% (2) | 27% (2) |
| Puntland, Somalia | Nugaal Valley | AOC | 27% (2) | 27% (2) | 27% (2) |

Footnotes:

1 Net Working Interests are subject to back-in rights or carried working interests, if any, of the respective governments or national oil companies of the host governments.

2 Represents AOC's Net Working Interest subsequent to the formation of Horn Petroleum Corp. ("Horn"). AOC owns approximately 44.7% of Horn. This figure represents the Company's Net Working Interest in the production sharing agreements, net of the 55.3% minority interest in Horn.

3 Under Recent Developments, see Proposed Farmout Transactions and Completed Farmout Transactions.

4 Under Recent Developments, see Proposed Farmout Transactions. Upon completion of the farmout on Block 7/8, New Age (Africa Global Energy) Limited ("New Age") will become operator of Blocks 7/8 and Adigala.

## OPERATIONS UPDATE

During the second quarter of 2012, the Company together with its partners continued a two-rig drilling campaign with exploratory drilling in Kenya and Puntland (Somalia). In Block 10BB (Kenya), the Company and its partner Tullow completed drilling the Ngamia-1 exploration well to a total depth of 2,340 meters and reported a significant light oil discovery. The Ngamia-1 well encountered over 100 meters of net light oil pay in the Upper Lokhone Sand section and an additional 43 meters of potential oil pay in the lower Lokhone Sandstone section.

With the discovery of Ngamia-1, two additional drilling rigs are currently being mobilized into the Company's areas of operation in Kenya and Ethiopia. One of the rigs will be utilized in Ethiopia, drilling Sabisa-1 which is our first exploration well on the South Omo Block, and the second rig will be mobilized into Kenya to commence drilling operations in Block 10A on the Paipai-1 exploration well. The Company will also continue to actively acquire, process and interpret 2D seismic over Blocks 10BA, 10BB, 12A, 13T and South Omo.

In Puntland (Somalia), the Company, through its 44.7% ownership interest in Horn, completed drilling the Shabeel-1 exploration well and commenced drilling the Shabeel North-1 exploration well in June of 2012. Following the positive indications of hydrocarbons in Shabeel-1, the Shabeel North-1 location was drilled to test an adjacent structural trap. The Shabeel North-1 exploration well encountered oil and gas shows in the Cretaceous-aged Jesomma sandstone section similar to those encountered in the Shabeel-1 well. Following this encouragement an open-hole drill stem test was performed but failed to flow hydrocarbons. Although the test was unsuccessful, the Company and its partners were encouraged by the positive evidence of oil shows and the presence of good quality reservoirs, and as a result, the decision was made to deepen the well in order to evaluate the potential of Lower Cretaceous, Jurassic and Triassic sections. The Shabeel North-1 well has reached a total depth of 3,945 meters and encountered metamorphic basement at a depth of 3,919 meters. The well penetrated 149 meters of interbedded sands and shales of the Triassic Adigrat Formation with no oil or gas shows and only minor porosity exhibited on electric logs. Accordingly, the well is being plugged and abandoned.

**KENYA**

The Company and Tullow, its operating partner in each of the Kenyan blocks other than Block 9, are actively exploring for oil as described below.

Block 10BB

The Company and its operating partner on Block 10BB, Tullow, spudded the partnership's first well, Ngamia-1, on January 24, 2012. The well encountered in excess of 100 meters of net oil pay in multiple reservoir zones over a gross interval of 650 meters of the Upper Lokhone Sandstone interval (855 meters to 1,500 meters). The reservoirs are composed of good quality Tertiary age sandstones. Moveable oil with an API greater than 30 degrees has been recovered to surface from four representative intervals. This oil has similar properties to the light waxy crude which has been discovered in Uganda by Tullow. After testing and evaluation of the Upper Lokhone payzones, the well was drilled through the Lower Lokhone Sandstone interval and encountered an additional 43 meters of potential oil pay based on logs and the recovery of light oil on an MDT sample over a gross interval of 150 meters. The well was drilled to a total depth of 2,340 meters after penetrating the Lower Lokhone objective sequence. The well is now suspended for future flow testing. Testing equipment, including downhole pumps, is being mobilized and the intention is to flow test a number of prospective zones in the Upper and Lower Lokhone Sandstones to confirm the full potential of this discovery.

The positive results of the Ngamia-1 well have led the Company and its operating partner to accelerate the pace of exploration activities along the Ngamia-1 trend in Block 10BB and adjacent Block 13T. The Company and its partner have also elected to accelerate an additional 1,783 kilometers of 2D seismic in Block 10BB with plans to acquire 300 square kilometers of 3D seismic in the first half of 2013.

The drilling of the Ngamia-1 well satisfied the remaining work obligations of the initial exploration period under the Block 10BB PSC. The partnership elected to proceed into the next phase of exploration and have received formal government approval. The next exploration period which expires in July 2014 includes a commitment to drill one exploratory well and acquire 300 square kilometers of 3D seismic.

Block 13T

Following the Ngamia-1 discovery, the Company and its operating partner on Block 13T, Tullow, focused additional efforts to better delineate the prospects along the Ngamia-1 trend northward into Block 13T. Based upon the recently acquired 500 kilometers of 2D seismic data, six additional 'Ngamia-style' prospects were mapped in Block 13T, including the Company and its partner's next exploration well, Twiga South-1, which recently spud in Kenya. The Twiga South-1 well is planned to a total depth of 3,114 meters and targets the same structural trend and reservoirs as the recent Ngamia-1 oil discovery 23 kilometers to the south. An additional 500 kilometers of 2D seismic is now being acquired in conjunction with additional seismic acquisition in Block 10BB to mature further leads into drillable prospects.

With the completion of the original 500 kilometers of 2D seismic, the Company fully satisfied its work obligations for the initial exploration period under the Block 13T PSC. The partnership elected to proceed into the next phase of exploration and have received formal government approval. The next exploration period which expires in September 2014 includes a commitment to drill one exploratory well and acquire 200 square kilometers of 3D seismic.

Block 10A

The Company and its operating partners on Block 10A have agreed on Paipai-1 as the location of the first exploratory well in Block 10A. The Paipai-1 well is planned to a total depth of 4,150 meters, and will test a large four-way closed structure with Cretaceous-age sandstone targets at multiple depths. The Paipai-1 civil works associated with the location have been completed and sufficient materials have been purchased and mobilized to the location for drilling operations. The Company and its partners have awarded a drilling contract to Sakson Drilling. The drilling rig and all third party services are currently in the final stages of mobilizing to site, and the well is scheduled to spud in September 2012. Paipai-1 will fully satisfy the required work obligations for the initial exploration period which was recently extended to April 2013.

Block 10BA

The Company and its operating partner on Block 10BA, Tullow, have completed approximately 40% of the planned 1,350 kilometer 2D seismic program in Block 10BA. The onshore portion of the survey has been completed and the offshore and near shore portions of the 2D program are currently underway. The 2D seismic program which is expected to be complete in the fourth quarter of 2012 will fulfill the work obligations of the initial exploration period under the Block 10BA PSC which expires in April 2013.

Block 12A

Based upon the acquired FTG survey, the Company and its operating partner on Block 12A, Tullow, have determined that the 500 kilometer 2D seismic acquisition obligation will be focused in the Kerio Valley in the southwestern portion of the block. The Block 12A program is scheduled to follow the completion of work in Blocks 10BB and 13T whose programs were expanded after the Ngamia-1 discovery. As a result, the Company and its partner obtained an extension of the initial exploration term to September 2013. The 500 kilometer 2D seismic program will satisfy the work obligations for the initial period under the Block 12A PSC and is expected to commence in fourth quarter of 2012.

Block 9

The Company currently holds a 100% interest and is the operator in Block 9 where a seismic acquisition program of 750 kilometers was completed in 2011. The new data was acquired over the Kaisut sub-basin in the northwestern portion of Block 9. Based upon the new data set, several large prospects have been mapped and resources have been estimated. The Company is currently planning to drill an exploratory well in 2013 that will satisfy the remaining exploration commitment for the second exploration period which expires in December 2013. The Company recently announced plans to farmout a 50% working interest to Marathon Oil Corporation ("Marathon"). Completion of the farmout is subject to government approval.

**Ethiopia**

South Omo Block

The Company and its joint operating partners on the South Omo Block have substantially completed a 1,046 kilometer 2D seismic program in the western portion of the South Omo Block. A number of interesting prospects and leads have been identified and some infill seismic data has already been acquired to mature leads into drillable prospects. The Company and its partners have selected Sabisa-1 as the first drilling location in the South Omo Block. Civil works associated with the Sabisa-1 location have recently commenced, and the Company and its partners are in the final stages of rig contract negotiations with spud of Sabisa-1 expected late in the fourth quarter of 2012. The seismic acquired to date and drilling of Sabisa-1 will satisfy the remaining work obligations for the initial exploration period which expires in January 2013. An additional 500 kilometers of 2D seismic is planned for the eastern portion of the South Omo Block (Chew B'hir Sub-Basin) beginning in late 2012.

Ogaden Blocks 7/8

The Company and its partners continue their focus on the El Kuran oil accumulation in Block 8, discovered in the early 1970's. After completing reservoir characterization studies, the Company focused efforts on testing and completion strategies for producing commercial quantities of oil and gas. During the second quarter of 2012, the Company received and began evaluating tenders for drilling and third party services for a proposed well in the El Kuran field. The Company also received formal approval for a one year extension of the initial exploration period to July 2013. The Company recently announced plans to farmout 25% of its 55% working interest and operatorship to New Age. Completion of the farmout is subject to government approval.

Adigala Block

As part of work obligations for the second exploration period which expires July 2013, the Company and its partner worked during the second quarter to incorporate newly acquired FTG gravity data with seismic data to improve the subsurface interpretation of the block. The Company also integrated results of recent surface geological studies and began reprocessing data acquired in 2009 with the goal of improving the data quality.

Rift Valley Joint Study Block

The Company completed the acquisition of high resolution gravity and magnetic data over the Rift Valley Block as part of a Joint Study Agreement with Ministry of Mines in Ethiopia. This block is on trend with highly prospective blocks in the Tertiary rift valley such as Ethiopian South Omo Block, and Kenyan Blocks 10BA, 10BB, 13T, and 12A. The Company has submitted an application to convert the Rift Valley Block to a formal production sharing agreement.

**PUNTLAND (SOMALIA)**

Dharoor Valley and Nugaal Valley Blocks

In the first half of the year, the Company drilled the Shabeel-1 exploration well to a total depth of 3,470 meters before ending in metamorphic basement. The well encountered significant oil and gas shows in the Upper Cretaceous Jesomma Sandstones and Jurassic and Triassic sandstones deeper in the wellbore, but failed to encounter Lower Cretaceous sandstone reservoirs that were considered a primary objective. Petrophysical analysis indicated that potential hydrocarbon pay zones in the Jurassic and Triassic sandstones are thin and did not warrant further testing and the well was suspended pending further consideration of the Jesomma sandstone section.

Following results of the Shabeel-1 well, which provided evidence for a working petroleum system, the Sakson drilling rig was relocated 3.5 kilometers north of the Shabeel-1 well to test an adjacent structural trap, Shabeel North-1. The Shabeel North-1 exploration well was spud in June 2012 and encountered oil and gas shows in the Upper Cretaceous Jesomma sandstone section from 1,905 meters to 2,095 meters, similar to those encountered in the Shabeel-1 exploration well. An open-hole drill stem test was performed but failed to flow hydrocarbons. Although the test was unsuccessful, the Company and its partners were encouraged by the positive evidence of oil shows and the presence of good quality reservoirs and decided to deepen the well in order to evaluate the potential of the Lower Cretaceous, Jurassic and Triassic sections. The Shabeel North-1 well has reached a total depth of 3,945 meters and encountered metamorphic basement at a depth of 3,919 meters. The well penetrated 149 meters of interbedded sands and shales of the Triassic Adigrat Formation with no oil or gas shows and only minor porosity exhibited on electric logs. Accordingly, the well is being plugged and abandoned.

As the Upper Cretaceous Jesomma sands in Shabeel North-1, which exhibited porosity and hydrocarbon shows but produced only fresh water on a drill stem test, were similar to the Jesomma sands encountered in the previously drilled Shabeel-1 well in respect of log response and oil and gas shows, the Company and its partners have determined that additional testing of these zones in the previously drilled Shabeel-1 well is also not warranted.

While the Company was disappointed that the first two exploration wells in Puntland (Somalia) did not flow oil, the Company remains highly encouraged that all of the critical elements exist for oil accumulations, namely a working petroleum system, good quality reservoirs and thick seal rocks. Based on the encouragement provided by the Shabeel wells, the Company and its partners plan to enter the next exploration period in both the Dharoor Valley and Nugaal Valley PSAs which carry a commitment to drill one well in each block within an additional three year term. The current operational plan would be to contract a seismic crew to acquire additional data in the Dharoor Valley block and to hold discussions with the Puntland Government regarding drill ready prospects in the Nugaal Valley block. The focus of the Dharoor Valley block seismic program will be to delineate new structural prospects for the upcoming drilling campaign.

**MALI**

Blocks 7 and 11
Recent security issues in Mali are being closely monitored, but currently the operational areas are not accessible. The Company's share of costs for initial seismic and the drilling of the first exploratory well are fully carried by its single partner and operator, Heritage. During the first quarter of 2012, the Company impaired $3.1 million of capitalized intangible exploration assets due to security concerns in Mali which has halted operations on the Company's blocks.

## RECENT DEVELOPMENTS

### Proposed Farmout Transactions

Marathon Oil Corporation

In July 2012, the Company signed a definitive farmout agreement with Marathon whereby Marathon will acquire the rights to obtain an interest in two of the Company's Kenyan exploration blocks.

Under the terms of the farmout agreement, Marathon will acquire a 50% interest in Block 9 and a 15% interest in Block 12A, both in Kenya. The Company will maintain operatorship in Block 9, but Marathon has the right to assume operatorship if a commercial discovery is made. In addition, the Company and Marathon have agreed to jointly pursue exploration activities on an additional exploration area in Ethiopia. The above transactions are all subject to host country Government approvals.

In consideration for the assignment of these interests, Marathon will pay the Company an entry payment of $35.0 million which includes prior expenditures, and has agreed to fund the Company's working interest share of future joint venture expenditures anticipated to be spent over the next three years up to a maximum of $43.5 million.

New Age (Africa Global Energy) Limited

In July 2012, the Company entered into a definitive agreement with New Age whereby New Age will acquire an additional 25% interest in the Company's Blocks 7 & 8 in Ethiopia, together with operatorship of Blocks 7 & 8 and the Adigala Area. In consideration of the assignment of the interest, New Age will pay to the Company $1.5 million in consideration of past costs.

This transaction is subject to host government approvals, the waiver of preemption rights by AOC's partners and the satisfaction of any applicable regulatory requirements.

## Completed Farmout Transactions

Tullow Oil plc

In July 2012, the Company completed an additional farmout transaction with Tullow. Under the Tullow farmout transaction, which has received Kenya government approval, Tullow paid the Company $0.8 million in consideration of past costs to acquire an additional 15% interest in Block 12A in Kenya. Tullow will also fund the Company's working interest share of costs related to the acquisition of 520 kilometers of 2D seismic until an expenditure cap of $3.1 million net to AOC has been met, following which AOC will be responsible for its working interest share of seismic acquisition costs. Tullow previously acquired a 50% interest in, and operatorship of, Block 12A in a transaction that was completed in February 2011.

## Horn Private Placement

In June 2012, the Company's subsidiary Horn completed a non-brokered private placement issuing an aggregate of 18.75 million units at a price of CAD$0.80 per unit for gross proceeds of CAD$15 million. Each unit is comprised of one common share and one-half of a share purchase warrant. Each whole warrant is exercisable over a period of two years at a price of CAD$1.20 per share. In the event that Horn's common shares trade above CAD$1.50 for a period of 20 consecutive days, a forced exercise provision will come into effect. A finder's fee was paid, consisting of the issuance of an aggregate of 342,500 units and the payment of $0.1 million in cash. All securities issued under the private placement are subject to a statutory hold period which expires on October 9, 2012. AOC acquired 4,315,000 of the units issued for gross proceeds of CAD$3.5 million. At June 30, 2012, AOC owned 44.7% of Horn.

Net proceeds of the private placement will be used towards Horn's ongoing work program in Puntland, Somalia and for general working capital purposes.

## Exercise of Warrants

In March 2012, the remaining 6,521,601 of AOC common share purchase warrants outstanding were converted into common shares of AOC for gross proceeds of CAD$9.8 million.

## Court Proceedings

The Company is a party to two separate court proceedings in Kenya, both of which are currently working their way through the Kenyan judicial system. Both proceedings, Judicial Review Number 30 of 2010 and Judicial Review Number 1 of 2012, involve a dispute concerning the administrative process that lead to the issuance of exploration permits in respect of, amongst others, Blocks 10BA, 10BB, 12A and 13T. The primary Respondents include the Minister and the Ministry of Energy, Republic of Kenya. The Company and certain of its affiliates are named as Interested Parties; the Applicants include Interstate Petroleum Ltd. ("IPL"). The Company has also initiated a third court proceeding, Winding-Up Cause No. 1 of 2012. This proceeding involves an application to cause IPL to be wound-up or "dissolved", which would terminate any further action in respect of Judicial Review Number 30 of 2010, which the Company considers to be the principal court proceeding.

A hearing in respect of Judicial Review Number 30 of 2010 was held in November 2010. The High Court in Kitale, Kenya found that the application was without merit and it was dismissed with costs. The Applicants have appealed that Ruling; concurrently, and as noted above, the Company is seeking to have IPL wound-up for failure to pay the costs that had been awarded against it. Hearings in respect of various preliminary matters relating to Judicial Review Number 1 of 2012 are ongoing. In due course, the Company proposes to apply to the courts to have those proceedings dismissed as frivolous. In the interim, it will vigorously defend any application made by the Applicants in either of the proceedings.

## SELECTED QUARTERLY INFORMATION

| **Three months ended** (thousands, except per share amounts) | **30-Jun 2012** | **31-Mar 2012** | **31-Dec 2011** | **30-Sep 2011** | **30-Jun 2011** | **31-Mar 2011** | **31-Dec 2010** | **30-Sep 2010** |
|---|---|---|---|---|---|---|---|---|
| Operating expenses ($) | 4,741 | 4,697 | 3,777 | 2,857 | 8,500 | 2,989 | 2,415 | 1,388 |
| Interest income ($) | 74 | 162 | 226 | 276 | 220 | 244 | 54 | 24 |
| Foreign exchange gain (loss) ($) | (123) | 1,258 | 2,067 | (6,792) | 670 | 1,582 | 1,590 | 440 |
| Fair market value gain (loss) - warrants ($) | 9,906 | (23,669) | 4,010 | 2,292 | 1,764 | 779 | 3,755 | (8,469) |
| Fair market value gain (loss) - convertible debenture ($) | - | - | - | - | 309 | 1,722 | (6,687) | (9,469) |
| Fair market gain (loss) on marketable securities ($) | - | (124) | 776 | (396) | (145) | - | - | - |
| Gain on acquisition of Lion Energy | - | - | - | - | 4,143 | - | - | - |
| Dilution loss on sale of subsidiary | - | - | - | 4,579 | - | - | - | - |
| Net income (loss) ($) attributable to common shareholders | (968) | (13,642) | 696 | (11,140) | (1,538) | 1,338 | (3,703) | (18,862) |
| Net income (loss) ($) attributable to non-controlling interest | 6,085 | (13,429) | 2,606 | (915) | - | - | - | - |
| Weighted average shares - Basic | 218,664 | 213,065 | 211,413 | 211,320 | 195,974 | 154,451 | 108,243 | 91,366 |
| Weighted average shares - Diluted | 225,319 | 213,065 | 212,656 | 212,019 | 198,859 | 162,549 | 119,960 | 91,366 |
| Basic earnings (loss) per share ($) | - | (0.06) | - | (0.05) | (0.01) | 0.01 | (0.03) | (0.21) |
| Diluted earnings (loss) per share ($) | - | (0.06) | - | (0.05) | (0.02) | (0.01) | (0.03) | (0.21) |
| Oil and gas expenditures ($) | 38,249 | 21,896 | 20,883 | 9,392 | 6,037 | 4,974 | 2,553 | 8,538 |

During 2011, Horn was formed as a new Puntland focused exploration company. The Horn Transaction has been accounted for as an acquisition of Horn's net assets by Canmex (reverse acquisition) as AOC, the sole owner of Canmex prior to the Horn Transaction, controls Horn subsequent to the Horn Transaction. Subsequent to the Horn Transaction and Horn private placement, AOC through its wholly owned subsidiary acquired 51.4% of the newly formed entity. As a result of additional private placements, option exercises and warrant exercises, the Company currently owns approximately 44.7% of Horn. While the results of Canmex have historically been consolidated in the Company's financial statements, effective September 20, 2011, the non-controlling interest in Horn has been accounted for in the consolidated results of the Company.

As the Company is in the exploration stage, no oil and gas revenue has been generated to date.

The Company's results were affected by four items occurring during the second and third quarters of 2011 for the first time:

1. The gains and losses on revaluation of marketable securities are the result of changes in the value of 10 million shares held in Encanto Potash Corp which were acquired on the acquisition of Lion. These shares were disposed of during the first quarter of 2012;
2. The gain relating to the acquisition of Lion in the second quarter of 2011 was a result of the Company acquiring net working capital and intangible exploration assets in excess of the consideration issued. The consideration paid was valued at $21.7 million, net of AOC shares acquired, versus working capital acquired of $20.1 million, excluding the value of AOC shares held by Lion, and the fair market value of intangible assets acquired estimated at $5.7 million; and
3. A dilution loss was recorded on the sale of a subsidiary as a result of the Horn Transaction. In accordance with IFRS, when a reverse acquisition occurs, any excess of the fair value of the

consideration paid over the value of the net assets acquired is recognized in the consolidated statement of net loss and comprehensive loss as an expense. The Company has recorded a loss on reverse acquisition of $4.6 million as a result of the Horn Transaction.

*Operating expenses*

Operating expenses increased $1.0 million from the third quarter to the fourth quarter of 2010 due to increased compensation costs, increased listing fees associated with our listing on the NASDAQ OMX Stock Exchange in Sweden, and increased professional fees associated with farmout activity and the Centric acquisition. Operating expenses increased a further $0.6 million in the first quarter of 2011. This increase was due to a $1.3 million increase in stock-based compensation costs associated with stock options granted in the first quarter of 2011, partially offset by a reduction in professional fees and listing fees from elevated levels experienced in the fourth quarter of 2010. The $5.5 million increase in operating expenses from the first quarter of 2011 to the second quarter of 2011 is due to a $7.0 million impairment of intangible exploration assets due to AOC relinquishing Blocks 2/6 in Ethiopia offset partially by a reduction in stock-based compensation costs. The $5.6 million decrease from the second quarter to the third quarter of 2011 can be attributed to the Block 2/6 impairment in the second quarter of 2011 offset partially by increased stock-based compensation costs associated with stock option grants in Horn, as well as professional fees and listing fees associated with the Horn Transaction. The $0.9 million increase from the third quarter to the fourth quarter of 2011 can be attributed to increased stock-based compensation costs associated with AOC stock option grants in the quarter and a $0.4 million donation made by Horn to the Lundin Foundation, a registered Canadian non-profit organization that provides grants and risk capital to organizations dedicated to alleviating poverty in developing countries. The $0.9 million increase from the fourth quarter of 2011 to the first quarter of 2012 can be attributed to a $3.1 million impairment of intangible exploration assets in Mali offset partially by decreased stock-based compensation, a donation made by Horn to the Lundin Foundation in the fourth quarter of 2011, and a reduction in professional fees from the fourth quarter of 2011 associated with a reduction in transaction related professional fees. Operating expenses were consistent from the first quarter of 2012 to the second quarter of 2012. The impairment in Mali which occurred in the first quarter of 2012 was offset by professional fees in the second quarter of 2012 associated with previously completed farmout transactions.

*Interest income*

Interest income increased in the first quarter of 2011 due to a significant increase in cash late in the fourth quarter of 2010 as a result of cash received on the exercise of warrants. The reduction in interest income each quarter since fourth quarter of 2011 can be attributed to a lower yield for cash held on deposit.

*Foreign exchange gains and losses*

The foreign exchange gains and losses are the direct result of changes in the value of the Canadian dollar in comparison to the US dollar. The Company has been holding large Canadian dollar cash balances as the result of Horn's private placement, cash acquired on the Lion acquisition and warrant exercises at the end of 2010. The Company has recorded foreign exchange gains when the Canadian dollar has strengthened versus the US dollar, and has recorded losses when the Canadian dollar has weakened versus the US dollar.

*Fair market value adjustments – warrants and convertible debenture*

The fair market value adjustments to warrants and convertible debt are performed on a quarterly basis. The warrants entitle the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. The convertible debenture entitled the holder to convert the US dollar denominated loan into common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the company's functional currency (US dollar for AOC), and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of operations as they arise.

During the second quarter of 2011, the convertible debenture was fully repaid. Accordingly, fair market value gains or losses relating to the convertible debenture have not been incurred since the second quarter of 2011.

At June 30, 2012, nil warrants were outstanding in AOC and 53.4 million warrants were outstanding in Horn. AOC holds 13.3 million of the warrants outstanding in Horn. The Company incurred a $9.9 million gain on the revaluation of warrants from the end of the first quarter of 2012 to the end of the second quarter of 2012 due to a significant decrease in the share price of Horn from March 31, 2012 to June 30, 2012. The Company will incur fair market value adjustments on the Horn warrants until they are exercised or they expire (33,572 expire October 12, 2012, 43,868,527 expire September 20, 2013, 9,375,000 expire June 8, 2014, 156,250 expire June 11, 2014, and 15,000 expire June 18, 2014).

## RESULTS OF OPERATIONS

| | Three months ended June 30, 2012 | Three months ended June 30, 2011 | Six months ended June 30, 2012 | Six months ended June 30, 2011 |
|---|---|---|---|---|
| Salaries and benefits | $ 294,409 | $ 321,271 | $ 577,097 | $ 757,888 |
| Stock-based compensation | 587,198 | 425,708 | 1,216,794 | 1,881,934 |
| Bank charges | 8,688 | 10,751 | 16,896 | 110,139 |
| Travel | 237,386 | 246,309 | 462,159 | 382,961 |
| Management fees | 74,846 | 62,610 | 139,012 | 126,732 |
| Office and general | 225,496 | 143,262 | 368,316 | 556,321 |
| Depreciation | 13,596 | 19,140 | 25,502 | 33,259 |
| Professional fees | 3,152,222 | 179,409 | 3,243,324 | 397,124 |
| Stock exchange and filing fees | 147,027 | 121,838 | 274,333 | 273,282 |
| Impairment of intangible exploration assets | - | 6,969,413 | 3,114,858 | 6,969,413 |
| Operating expenses | $ 4,740,868 | $ 8,499,711 | $ 9,438,291 | $ 11,489,053 |

Operating expenses decreased $3.8 million for the three months ended June 30, 2012 compared to the same period in the previous year due mainly to a $7.0 million impairment of intangible exploration assets relating to Blocks 2/6 in Ethiopia in the second quarter of 2011, offset partially by a $3.0 million increase in professional fees associated previously completed farmout transactions.

Operating expenses decreased $2.1 million for the six months ended June 30, 2012 compared to the same period in the previous year due to a $7.0 million impairment of intangible exploration assets relating to Blocks 2/6 in Ethiopia in the second quarter of 2011, a $0.7 million decrease in stock-based compensation costs due to stock option grants in the first quarter of 2011, and reduced salary costs resulting from moving allowances in the first quarter of 2011. These reductions were offset partially by a $3.1 million impairment of intangible exploration assets relating to Blocks 7 and 11 in Mali in the first quarter of 2012 and an increase in professional fees in the second quarter of 2012 associated with previously completed farmout transactions.

## INTANGIBLE EXPLORATION ASSETS

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Intangible exploration assets | $242,701,532 | $185,671,962 |

During the six months ended June 30, 2012, intangible exploration assets increased by $57.0 million.

AOC incurred $35.2 million of intangible exploration expenditures in Kenya in the first half of 2012. The majority of expenditures related to the Company's portion of drilling costs on the Ngamia-1 well (Block 10BB) and 2D seismic costs on Blocks 10BB, 13T, and 10BA. Of the $35.2 million expenditures in Kenya,

$2.6 million related the Company's portion of PSA related costs and general and administrative costs. AOC incurred $21.0 million of intangible exploration expenditures in Puntland in the first half of 2012. The majority of expenditures related to exploratory wells at the Shabeel-1 and Shabeel North-1 locations. Of the $21.0 million expenditures in Puntland, $1.3 million related the Company's portion of PSA related costs and general and administrative costs. AOC incurred $3.9 million of intangible exploration expenditures in Ethiopia in the first half of 2012. The majority of expenditures related to the Company's portion of a 2D seismic acquisition program in South Omo. Of the $3.9 million expenditures in Ethiopia, $0.9 million related the Company's portion of PSA related costs and general and administrative costs. Intangible exploration assets will not be subject to depletion until such time that proved oil and gas reserves are identified.

During the first quarter of 2012, management identified indicators of impairment for intangible exploration assets in Mali. As a result of the assessment of these impairment indicators, the Company has written-off $3.1M of capitalized intangible exploration assets. The remaining carrying value of the Mali intangible exploration assets is nil.

## LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2012, the Company had cash of $85.0 million and working capital of $56.1 million as compared to cash of $109.6 million and working capital of $90.2 million at December 31, 2011. Of the $85.0 million in cash at June 30, 2011, $25.2 million is cash held by Horn. The Company's liquidity and capital resource position has remained strong throughout the first half of 2012. Working capital decreased compared to year end due mainly to intangible explorations expenditures.

The Company's current working capital position is not anticipated to provide it with sufficient capital resources to meet its minimum work obligations for all exploration periods under the various PSAs and PSCs and the accelerated exploration and appraisal program which is anticipated following the Ngamia discovery in Block 10BB. To finance its future acquisition, exploration, development and operating costs, AOC may require financing from external sources, including issuance of new shares, issuance of debt or executing working interest farmout or disposition arrangements. There can be no assurance that such financing will be available to the Company or, if available, that it will be offered on terms acceptable to AOC.

## STOCK-BASED COMPENSATION

The Company uses the fair value method of accounting for stock options granted to directors, officers, consultants and employees whereby the fair value of all stock options granted is recorded as a charge to operations. Stock-based compensation for the six months ended June 30, 2012 was $1.2 million as compared to $1.9 million for the same period in 2011. The decrease can be attributed to 3.1 million options granted by AOC in the first quarter of 2011 of which one-third vested immediately. Of the $1.2 million stock-based compensation expense year-to-date, $0.4 million relates to stock-based compensation expense of Horn. The Company continues to utilize its stock option plan as a method of recruiting, retaining and motivating personnel.

## RELATED PARTY TRANSACTIONS

*Transactions with Lorito Holdings (Guernsey) Limited ("Lorito")*

During May 2009, the Company's loans payable due to Lorito in the amount of CAD$6,000,000 plus interest of $195,521 was converted to 6,521,601 Units of the Company on the basis of CAD$0.95 per Unit. Each Unit was comprised of one common share and one share purchase warrant. Each warrant was exercisable into one common share of AOC at a price of CAD$1.50 per share over a period of three years. In the event that AOC closed at or above CAD$2.00 for a period of 20 consecutive trading days, the Company may have elected to accelerate the expiry date to 30 days from the date of written notice to the warrant holder. Lorito is beneficially owned by Ellegrove Capital Ltd., a private trust the settler of which is the late Adolf H. Lundin. During the first quarter of 2012, Lorito exercised each of its 6,521,601 warrants into a common share of the Company.

*Transactions with Namdo Management Services Ltd ("Namdo")*

During the six months ended June 30, 2012, the Company incurred management fees of $139,012, respectively (2011- $126,732) for administrative support services fees to Namdo. Namdo is a private corporation owned by Lukas H. Lundin. At June 30, 2012, the Company had no outstanding amounts due to Namdo in respect of management fees (December 31, 2011 – Nil).

*Transactions with Horn Petroleum Corp. ("Horn")*

On September 20, 2011, a Share Purchase Agreement was executed between the Company and Horn. Upon completion of the Share Purchase Agreement, AOC owned 51.4% of the outstanding shares of Horn. On June 8, 2012, Horn completed a non-brokered private placement issuing 18.75 million units for gross proceeds of CAD$15.0 million. AOC participated in the non-brokered private placement acquiring 4.3 million units. As a result of AOC's participation in the Horn non-brokered private placement and common shares issued on the exercise of warrants and stock options, AOC owned 44.7% of the outstanding shares of Horn at June 30, 2012. The following transactions and resulting intercompany balances outstanding between the Company and Horn have been eliminated as the Company fully consolidates the financial statements of Horn.

Under the terms of a General Management and Service Agreement between Horn and the Company for the provision of management and administrative services, the Company invoiced Horn $448,538 during six months ended June 30, 2012 (six months ended June 30, 2011 – Nil). At June 30, 2012, the outstanding balance receivable from Horn, recorded as a due from related party, was nil (December 31, 2011 – $258,116). The management fee charged to Horn by the Company is expected to cover the cost of administrative expense and salary costs paid by the Company in respect services provided to Horn.

Under the terms of a Services Agreement between the Company and Horn, AOC invoiced Horn $140,796 during the six months ended June 30, 2012 (six months ended June 30, 2011 – $98,033) for services provided by geologists and geophysicists employed by AOC. At June 30, 2012, $53,430 was outstanding and recorded in due from related party (December 31, 2011 – $11,650).

During the six months ended June 30, 2012, AOC invoiced Horn $195,051 for reimbursable expenses paid by AOC on behalf of Horn (six months ended June 30, 2011 – $210,939). At June 30, 2012, $95,445 was outstanding and recorded in due from related party (December 31, 2011 – $109,269).

During December 2011, Horn's subsidiary Canmex Holdings (Bermuda) II Ltd. commenced the transfer of $1.5 million to Horn, via AOC. At December 31, 2011, the funds were on deposit with AOC. Accordingly, the balance had been recorded as due to related party. During the first quarter of 2012, AOC transferred the funds to Horn.

## COMMITMENTS AND CONTINGENCIES

Please note that the following commitments and contingencies are representative of AOC's net obligations at the effective date of the MD&A.

**Ethiopia:**

Under the terms of the Blocks 7/8 PSA, during the initial exploration period which was extended by the Ministry of Mines in Ethiopia and expires in July 2013, the Company and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 1,250 kilometers of 2D seismic) with a minimum gross expenditure of $11.0 million. In addition, the Company and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Blocks 7/8 is 55%. Under the Recent Developments section, see Proposed Farmout Transactions for potential future changes to the Company's working interest in Blocks 7/8.

Under the terms of the Adigala Block PSA, AOC and its partners have fulfilled the minimum work and financial obligations of the initial four year exploration period which expired in July 2011. The Ministry of Mines in Ethiopia approved the Company and its partners' entry into the next exploration period with amended minimum work commitments. Under the PSA which expires in July 2013, AOC and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 7,500 kilometers of full tensor gravity) with a minimum gross expenditure of $1.75 million. The Company's current working interest in the Adigala Block is 50%.

Under the terms of the South Omo PSA, during the initial exploration period which was extended by the Ministry of Mines in Ethiopia and expires in January 2013, AOC and its partners are obligated to complete certain G&G operations (including acquisition of 400 kilometers of 2D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $8.0 million. The Company's current working interest in the South Omo Block is 30%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding letter of credit of $294,000 in favor of Tullow Oil plc ("Tullow") which is collateralized by a bank deposit of $294,000.

**Kenya:**

Under the terms of the Block 10A PSC, during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in April 2013, AOC and its partners are obligated to complete G&G operations (including acquisition of 750 kilometers of 2D seismic) with a minimum gross expenditure of $7.8 million. Additionally, AOC and its partners are obligated to drill one exploration well with a minimum expenditure of $8.5 million. The Company's current working interest in Block 10A is 30%.

Under the terms of the Block 10BB PSC, AOC and its partner have fulfilled the minimum work and financial obligations of the initial exploration period which expired in July 2012. The Ministry of Energy for the Republic of Kenya approved the Company and its partners' entry into the next exploration period. During the next exploration period which expires in July 2014, the Company and its partners are obligated to complete G&G operations (including acquisition of 300 square kilometers of 3D seismic) with a minimum gross expenditure of $7.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Block 10BB is 50%. This commitment is supported by an outstanding bank guarantee of $0.9 million in favor of Tullow which is collateralized by a bank deposit of $0.9 million.

Under the terms of the Block 9 PSC, with the drilling of the Bogal-1-1 well, AOC and its partners have fulfilled and exceeded the minimum work and financial obligations of the initial exploration period. Effective December 31, 2010, the Company entered into the next exploration phase under the Block 9 PSC in Kenya which will expire on December 31, 2013. Under the terms of the PSC, AOC and its partners are required to drill one additional exploratory well to a minimum depth of 1,500 meters with a minimum gross expenditure of $2.5 million. The Company's current working interest in Block 9 is 100%. Under the Recent Developments section, see Proposed Farmout Transactions for potential future changes to the Company's working interest in Block 9.

Under the terms of the Block 12A PSC, during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in September 2013, the initial minimum gross exploration expenditure is $3.6 million. The Company and its partner are obligated to complete G&G operations including the acquisition of 500km of 2D seismic or 100 km2 of 3D seismic (or a combination thereof). The Company's current working interest in Blocks 12A is 35%. Under the Recent Developments section, see Proposed Farmout Transactions for potential future changes to the Company's working interest in Block 12A.

Under the terms of the Block 13T PSC, AOC and its partner have fulfilled the minimum work and financial obligations of the initial exploration period which expires in September 2012. The Ministry of Energy for the Republic of Kenya approved the Company and its partners' entry into the next exploration period. During the next exploration period which expires in September 2014, the Company and its partners are obligated to complete G&G operations (including acquisition of 200 square kilometers of 3D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $15.0 million. The Company's current working interest in Block 13T is 50%.

Under the terms of the Block 10BA PSC, during the initial exploration period which expires in April 2013, the Company and its partners are obligated to complete G&G operations (including acquisition of 200 kilometers of 2D seismic) with a minimum expenditure of $3.0 million. The Company's current working interest in Block 10BA is 50%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of the farmout agreement with Tullow which require AOC's joint venture partner to pay a disproportionate share of joint venture costs. The commitments on Block 10BA are supported by an outstanding letter of credit of $450,000 in favor of the Kenyan Government which is collateralized by bank deposit of $450,000.

**Mali:**

Under the terms of the Block 7 and 11 PSCs, the current exploration periods expire in July 2012 and June 2014, respectively. In accordance with the terms of the PSCs, the minimum gross exploration expenditures in the current exploration periods are $11.6 million (Block 7) and $8.0 million (Block 11). In exchange for 75% working interest, our partner has committed to funding all planned seismic, G&G, and drilling costs associated with both blocks.

**Puntland (Somalia):**

Under the terms of the Dharoor Valley and Nugaal Valley PSAs, during the initial exploration periods which were extended by the Puntland Petroleum and Mineral Agency (PPMA) and expire October 17, 2012, the Company, at its option, must drill one exploratory well in each of the Dharoor Valley and Nugaal Valley blocks, or two exploratory wells in the Dharoor Valley block by the date of expiration. In consideration for the extensions of the exploration periods, the Company agreed to pay the PPMA a $1 million bonus within 30 days of a commercial discovery in each of the exploration blocks, to relinquish surface area on each of the exploration blocks, to take certain enhanced abandonment and environmental safety measures, to perform a surface geochemistry survey in the Nugaal Valley block and to make $2.05 million of payments to the PPMA for development of infrastructure ($250,000 paid in paid in the first quarter of 2012 with the remainder paid prior to 2012).

With the completion of drilling Shabeel-1 and Shabeel North-1, the Company and its partners have fulfilled the minimum work obligations of the initial exploration period under both of the Dharoor Valley and Nugaal Valley PSAs and plan to enter the second exploration period in each PSA. The minimum work obligations required during the second exploration period include an exploration well in each block with minimum exploration expenditures of $5.0 million in each block.

Under the Joint Venture Agreement with Range Resources Ltd. ("Range"), relating to the Dharoor Valley and Nugaal Valley blocks, the Company was obligated to solely fund $22.8 million of joint venture costs on each of the blocks ($45.5 million in total for both blocks) during the exploration period, in exchange for a 80% working interest in each PSA.

The Company has fulfilled its sole funding obligation related to the Dharoor Valley and Nugaal Valley blocks, and as a result, Range is paying its 20% participating interest share of ongoing exploration costs related to each block. The sole funding obligation with respect to the Nugaal Valley block was reached in the June 2012.

## OUTSTANDING SHARE DATA

The following table outlines the maximum potential impact of share dilution upon full execution of outstanding convertible instruments as at the effective date of the MD&A:

| | |
|---|---|
| Common shares outstanding | 221,247,437 |
| Outstanding share purchase options | 7,855,557 |
| Full dilution impact on common share outstanding | 235,624,595 |

Subsequent to the end of the quarter the Company issued 2,582,945 common shares of which 2,162,945 related to stock options exercised and the remaining 420,000 were shares issued as a settlement of claimed professional fees relating to services provided in association with previously completed farmout transactions.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

## CRITICAL ACCOUNTING ESTIMATES

The Company's critical accounting estimates are defined as those estimates that have a significant impact on the portrayal of its financial position and operations and that require management to make judgments, assumptions and estimates in the application of IFRS. Judgments, assumptions and estimates are based on historical experience and other factors that management believes to be reasonable under current conditions. As events occur and additional information is obtained, these judgments, assumptions and estimates may be subject to change. The Company believes the following are the critical accounting estimates used in the preparation of its consolidated financial statements. The Company' significant accounting policies can be found in note 3 of the Company's Financial Statements.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates related to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from these estimated amounts as future confirming events occur. Significant estimates used in the preparation of the consolidated financial statements include, but are not limited to, recovery of exploration costs capitalized in accordance with IFRS, stock-based compensation, income taxes and fair market value of warrants and convertible debentures.

**Intangible Explorations Assets**

The Company capitalizes costs related to the acquisition of a license interest, directly attributable general and administrative costs, expenditures incurred in the process of determining oil and gas exploration targets, and exploration drilling costs. All exploration expenditures that related to properties with common geological structures and with shared infrastructure are accumulated together within intangible exploration assets. Costs are held un-depleted until such time as the exploration phases on the license area are complete or commercially viable reserves have been discovered and extraction of those reserves is determined to be technically feasible. The determination that a discovery is commercially viable and extraction is technically feasible requires judgment.

Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are recognized in the statement of operations. If commercial reserves are established and technical feasibility for extraction demonstrated, then the related capitalized intangible exploration costs are transferred into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU") within intangible exploration assets. The allocation of the company's assets into CGUs requires judgment.

Intangible exploration assets are assessed for impairment when they are reclassified to property and equipment, as intangible exploration assets, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves. In determining fair value less costs to sell, recent market transactions are taken into account, if available. In the absence of such transactions, an appropriate valuation model is used.

The key assumptions the company uses for estimating future cash flows are reserves, future commodity prices, expected production volumes, future operating and development costs, among others. The estimated useful life of the CGU, the timing of future cash flows and discount rates are also important assumptions made by management.

**Stock Based Compensation**

The Company uses the fair value method, utilizing the Black-Scholes option pricing model, for valuing stock options granted to directors, officers, consultants and employees. The estimated fair value is recognized over the applicable vesting period as stock-based compensation expense. The recognized costs 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.

**Warrants**

An obligation to issue shares for a price that is not fixed in the company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of operations as they arise. The warrants which were fully exercised in the quarter entitled the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. The Company used the fair value method, utilizing the Black-Scholes option pricing model, for valuing the warrants. The Black-Scholes model is based on significant assumptions such as volatility, dividend yield and expected term.

**Income Tax**
The Company follows the balance sheet method of accounting for income taxes whereby future income taxes are recognized based on the differences between the carrying values of assets and liabilities reported in the Annual Financial Statements and their respective tax basis. Future income tax assets and liabilities are recognized at the tax rates at which Management expects the temporary differences to reverse. Management bases this expectation on future earnings, which require estimates for reserves, timing of production, crude oil price, operating cost estimates and foreign exchange rates. Management assesses, based on all available evidence, the likelihood that the future income tax assets will be recovered from future taxable income and a valuation allowance is provided to the extent that it is more than likely that future income tax assets will not be realized. As a result, future earnings are subject to significant Management judgment.

## NEW ACCOUNTING PRONOUNCEMENTS AND CHANGES IN ACCOUNTING POLICIES

**International Financial Reporting Standards**

On January 1, 2011, the Company adopted International Financial Reporting Standards (“IFRS”) for financial reporting purposes, using a transition date of January 1, 2010. The financial statements for the year ended December 31, 2011, including required comparative information, have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB"). Previously, the Company prepared its Interim and Annual Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles ("previous GAAP"). Unless otherwise noted, 2010 comparative information has been prepared in accordance with IFRS.

The adoption of IFRS has not had an impact on the Company’s operations, strategic decisions and Cash Flow.

**Future Accounting Pronouncements**

As of January 1, 2013, the following standards and amendments issued by the IASB become effective:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB’s project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.
- IFRS 11, "Joint Arrangements", which is the result of the IASB’s project to replace IAS 31, “Interests in Joint Ventures”. The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately consolidated.
- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity’s interests in subsidiaries and joint arrangements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.
- IAS 19, "Employee Benefits", which amends the recognition and measurement of defined benefit pension expense and expands disclosures for all employee benefit plans.

- IFRS 7, "Financial Instruments: Disclosures", which requires disclosure of both gross and net information about financial instruments eligible for offset in the balance sheet and financial instruments subject to master netting arrangements. Concurrent with the amendments to IFRS 7, the IASB also amended IAS 32, "Financial Instruments: Presentation" to clarify the existing requirements for offsetting financial instruments in the balance sheet. The amendments to IAS 32 are effective as of January 1, 2014.

As of January 1, 2015, IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The impairment and hedge accounting principles to be included in IFRS 9 have not yet been issued by the IASB.

## RISK FACTORS

The Company is subject to various risks and uncertainties, including, but not limited to, those listed below. Refer to the Company's Annual Information Form for further risk factor disclosures.

***International Operations***
AOC participates in oil and gas projects located in emerging markets, including Puntland (Somalia), Ethiopia and Kenya ("East Africa"). Oil and gas exploration, development and production activities in these emerging markets, including East Africa, are subject to significant political and economic uncertainties which may adversely affect the Company's operations. Uncertainties include, but are not limited to, the risk of war, terrorism, expropriation, nationalization, renegotiation or nullification of existing or future concessions and contracts, the imposition of international sanctions, a change in crude oil or natural gas pricing policies, a change in taxation policies, and the imposition of currency controls. These uncertainties, all of which are beyond the Company's control, could have a material adverse effect on AOC's business, prospects and results of operations. In addition, if legal disputes arise related to oil and gas concessions acquired by the Company, AOC could be subject to the jurisdiction of courts other than those of Canada. The Company's recourse may be very limited in the event of a breach by a government or government authority of an agreement governing a concession in which AOC acquires an interest. The Company may require licenses or permits from various governmental authorities to carry out future exploration, development and production activities. There can be no assurance that AOC will be able to obtain all necessary licenses and permits when required.

***International Boundary Disputes***
As a result of ongoing political disputes, the legal international boundaries between Somalia (which includes Puntland, a semi-autonomous region within Somalia) and its neighbouring countries are in dispute. For instance, in September 2007, AOC was advised that the Ministry of Water and Mineral Resources of the Republic of Somaliland was claiming ownership of the Nugaal and AhlMedo Valley basins, including some or all of the areas that comprise the Puntland PSA, granted by the Government of Puntland. That claim was repeated in correspondence received by the Company in February 2012. The Republic of Somaliland and Somalia have disputed their respective borders since May 1991 when the Republic of Somaliland was established. As recently as August 2011, there have been armed confrontations at the Somalia / Somaliland border. AOC disputes the claims of the Republic of Somaliland, however, the outcome of this dispute cannot be predicted with any certainty.

***Political Instability***
Through Horn, the Company is highly exposed to significant political risk in Puntland (Somalia). The political climate in Puntland (Somalia) is characterized by strong internal political tension, turmoil and factional fighting. The political tensions sometimes escalate into violence or the threat of violence.

Through Horn, the Company continues to work and cooperate with government leaders in Somalia, however, there can be no certainty as to if, or when, the current political instability will be resolved.

***Different Legal System and Litigation***
AOC's oil production and exploration activities are located in countries with legal systems that in various degrees differ from that of Canada. Rules, regulations and legal principles may differ both relating to matters of substantive law and in respect of such matters as court procedure and enforcement. Almost all material production and exploration rights and related contracts of AOC are subject to the national or local laws and jurisdiction of the respective countries in which the operations are carried out. This means that AOC's ability to exercise or enforce its rights and obligations may differ between different countries and also from what would have been the case if such rights and obligations were subject to Canadian law and jurisdiction.

AOC's operations are, to a large extent, subject to various complex laws and regulations as well as detailed provisions in concessions, licenses and agreements that often involve several parties. If AOC were to become involved in legal disputes in order to defend or enforce any of its rights or obligations under such concessions, licenses, agreements or otherwise, such disputes or related litigation may be costly, time consuming and the outcome may be highly uncertain. Even if AOC would ultimately prevail, such disputes and litigation may still have a substantially negative effect on AOC and its operations.

***Financial Statements Prepared on a Going Concern Basis***
AOC's financial statements have been prepared on a going concern basis under which an entity is considered to be able to realize its assets and satisfy its liabilities in the ordinary course of business. AOC's operations to date have been primarily financed by equity financing. AOC's future operations are dependent upon the identification and successful completion of additional equity or debt financing or the achievement of profitable operations. There can be no assurances that AOC will be successful in completing additional financing or achieving profitability. The consolidated financial statements do not give effect to any adjustments relating to the carrying values and classification of assets and liabilities that would be necessary should AOC be unable to continue as a going concern.

***Uncertainty of Title***
Although the Company conducts title reviews prior to acquiring an interest in a concession, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise that may call into question AOC's interest in the concession. Any uncertainty with respect to one or more of AOC's concession interests could have a material adverse effect on the Company's business, prospects and results of operations.

The Company has been made aware that previous operators in Somalia have made claims concerning areas covered by the Company's concessions. The Company believes that there is no merit to any of these claims. Accordingly, the Company proposes to proceed with its exploration and development program as previously disclosed.

***Competition***
The petroleum industry is intensely competitive in all aspects including the acquisition of oil and gas interests, the marketing of oil and natural gas, and acquiring or gaining access to necessary drilling and other equipment and supplies. AOC competes with numerous other companies in the search for and acquisition of prospects.

***Risks Inherent in Oil and Gas Exploration and Development***
AOC's business is subject to all of the risks and hazards inherent in businesses involved in the exploration for, and the acquisition, development, production and marketing of, oil and natural gas, many of which cannot be overcome even with a combination of experience and knowledge and careful evaluation. The risks and hazards typically associated with oil and gas operations include fire,

explosion, blowouts, sour gas releases, pipeline ruptures and oil spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property, the environment or personal injury.

***Capital Requirements***

To finance its future acquisition, exploration, development and operating costs, AOC may require financing from external sources, including from the issuance of new shares, issuance of debt or execution of working interest farm-out agreements. There can be no assurance that such financing will be available to the Company or, if available, that it will be offered on terms acceptable to AOC. If additional financing is raised through the issuance of equity or convertible debt securities, control of the Company may change and the interests of shareholders in the net assets of AOC may be diluted. If unable to secure financing on acceptable terms, AOC may have to cancel or postpone certain of its planned exploration and development activities which may ultimately lead to the Company's inability to fulfill the minimum work obligations under the terms of its various PSAs and PSCs. Availability of capital will also directly impact the Company's ability to take advantage of acquisition opportunities.

***Foreign currency exchange rate risk***

The Company is exposed to changes in foreign exchange rates as expenses in international subsidiaries, oil and gas expenditures, or financial instruments may fluctuate due to changes in rates. The Company's exposure is partially offset by sourcing capital projects and expenditures in US dollars. AOC had no forward exchange contracts in place as at or during the six months ended June 30, 2012.

***Interest rate risk***

The Company does not have any current exposure to fluctuations in interest rates.

***Liquidity risk***

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity describes a company's ability to access cash. Companies operating in the upstream oil and gas industry, during the exploration phase, require sufficient cash in order to fulfill their work commitments in accordance with contractual obligations and to be able to potentially acquire strategic oil and gas assets.

The Company will potentially issue debt or equity and enter into farmout agreements with joint venture partners to ensure the Company has sufficient available funds to meet current and foreseeable financial requirements. The Company actively monitors its liquidity to ensure that its cash flows and working capital are adequate to support these financial obligations and the Company's capital programs. The Company will also adjust the pace of its exploration activities to manage its liquidity position.

***Credit risk***

Credit risk is the risk of loss if counterparties do not fulfill their contractual obligations. The majority of our credit exposure relates to amounts due from our joint venture partners. The risk of our joint venture partners defaulting on their obligations per their respective joint operating and farmout agreements is mitigated as there are contractual provisions allowing the Company to default joint venture partners who are non-performing and reacquire any previous farmed out working interests.

## ***OUTLOOK***

The Ngamia-1 light oil discovery in the Lokichar sub-basin of tertiary rift on Block 10BB (Kenya) has led to a significant increase in the pace of exploration. The Company and its joint venture partner Tullow aim to increase the pace of exploration in East Africa by sourcing an additional two drilling rigs before the end of 2012. One rig is intended to be mobilized to Block 10A (Kenya) to commence drilling the Pai-pai prospect and an additional rig is intended to be mobilized to the South Omo Block (Ethiopia) to commence drilling the Sabisa-1 prospect. The Weatherford rig will continue with drilling operations in the Lokichar sub-basin of the tertiary rift where the Twiga South-1 prospect has recently been spud, bringing the total number of rigs operating on the Company's Kenyan and Ethiopian acreage to three prior to the end of 2012. In addition, the Company plans to continue aggressively acquiring 2D seismic data focused on Blocks 10BA, 10BB, 13T, South Omo and 12A.

Based on the encouragement provided by the Shabeel wells, the Company and its partners plan to enter the next exploration period in both the Dharoor Valley and Nugaal Valley PSAs which carry a commitment to drill one well in each block within an additional three year term. The current operational plan would be to contract a seismic crew to acquire additional data in the Dharoor Valley block and to hold discussions with the Puntland Government regarding drill ready prospects in the Nugaal Valley block. The focus of the Dharoor Valley block seismic program will be to delineate new structural prospects for the upcoming drilling campaign.

***Forward Looking Statements***

Certain statements in this document are "forward-looking statements". Forward-looking statements are statements that are not historical fact and are generally identified by words such as "believes", "anticipates", "expects", "estimates", "pending", "intends", "plans" or similar words suggesting future outcomes. By their nature, forward-looking statements and information involve assumptions, inherent risks and uncertainties, many of which are difficult to predict, and are usually beyond the control of management, that could cause actual results to be materially different from those expressed by these forward-looking statements and information. Risks and uncertainties include, but are not limited to, risk with respect to general economic conditions, regulations and taxes, civil unrest, corporate restructuring and related costs, capital and operating expenses, pricing and availability of financing and currency exchange rate fluctuations. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements.

The Company does not undertake to update or re-issue the forward-looking statements and information that may be contained herein, whether as a result of new information, future events or otherwise.

Any statements regarding the following are forward-looking statements:

- expected closing dates for the completion of proposed transactions;
- planned exploration activity including both expected drilling and geological and geophysical related activities;
- anticipated future financing requirements
- future crude oil, natural gas or chemical prices;
- future sources of funding for our capital program;
- availability of potential farmout partners;
- government or other regulatory consent for exploration, development, farmout or acquisition activities;
- future production levels;
- future capital expenditures and their allocation to exploration and development activities;
- future earnings;
- future asset acquisitions or dispositions;
- future debt levels;
- availability of committed credit facilities;
- possible commerciality;
- development plans or capacity expansions;
- future ability to execute dispositions of assets or businesses;
- future sources of liquidity, cash flows and their uses;
- future drilling of new wells;

- ultimate recoverability of current and long-term assets;
- ultimate recoverability of reserves or resources;
- expected finding and development costs;
- expected operating costs;
- estimates on a per share basis;
- future foreign currency exchange rates;
- future market interest rates;
- future expenditures and future allowances relating to environmental matters;
- dates by which certain areas will be developed or will come on stream or reach expected operating capacity; and
- changes in any of the foregoing.

Statements relating to "reserves" or "resources" are forward-looking statements, as they involve the implied assessment, based on estimates and assumptions that the reserves and resources described exist in the quantities predicted or estimated, and can be profitably produced in the future.

The forward-looking statements are subject to known and unknown risks and uncertainties and other factors which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. Such factors include, among others:

- market prices for oil and gas and chemical products;
- our ability to explore, develop, produce and transport crude oil and natural gas to markets;
- ultimate effectiveness of design or design modification to facilities;
- the results of exploration and development drilling and related activities;
- volatility in energy trading markets;
- foreign-currency exchange rates;
- economic conditions in the countries and regions in which we carry on business;
- governmental actions including changes to taxes or royalties, changes in environmental and other laws and regulations;
- renegotiations of contracts;
- results of litigation, arbitration or regulatory proceedings; and
- political uncertainty, including actions by terrorists, insurgent or other groups, or other armed conflict,
- conflict between states.

The impact of any one risk, uncertainty or factor on a particular forward-looking statement is not determinable with certainty as these factors are interdependent, and management's future course of action would depend on our assessment of all information at that time. Although we believe that the expectations conveyed by the forward-looking statements are reasonable based on information available to us on the date such forward-looking statements were made, no assurances can be given as to future results, levels of activity and achievements.

Undue reliance should not be placed on the statements contained herein, which are made as of the date hereof and, except as required by law, we undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

# AFRICA OIL CORP.

Consolidated Balance Sheets
(Expressed in United States dollars)
(Unaudited)

| | Note | | June 30, 2012 | December 31, 2011 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | | $ | 85,032,966 | $ 109,558,445 |
| Marketable securities | | | - | 2,605,745 |
| Accounts receivable | | | 1,797,586 | 2,717,024 |
| Prepaid expenses | | | 929,763 | 599,727 |
| | | | 87,760,315 | 115,480,941 |
| Long-term assets | | | | |
| Restricted cash | 4 | | 2,019,000 | 2,919,000 |
| Property and equipment | 5 | | 77,445 | 39,395 |
| Intangible exploration assets | 6 | | 242,701,532 | 185,671,962 |
| | | | 244,797,977 | 188,630,357 |
| Total assets | | $ | 332,558,292 | $ 304,111,298 |
| **LIABILITIES AND EQUITY** | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued liabilities | | $ | 31,658,707 | $ 23,768,545 |
| Current portion of w arrants | 8 | | - | 1,512,811 |
| | | | 31,658,707 | 25,281,356 |
| Long-term liabilities | | | | |
| Warrants | 8 | | 17,711,572 | 2,882,441 |
| | | | 17,711,572 | 2,882,441 |
| Total liabilities | | | 49,370,279 | 28,163,797 |
| Equity attributable to common shareholders | | | | |
| Share capital | 7(b) | | 322,121,171 | 306,509,909 |
| Contributed surplus | | | 13,681,438 | 8,425,304 |
| Deficit | | | (89,893,917) | (75,283,481) |
| | | | 245,908,692 | 239,651,732 |
| Non-controlling interest | | | 37,279,321 | 36,295,769 |
| Total equity | | | 283,188,013 | 275,947,501 |
| Total liabilities and equity | | $ | 332,558,292 | $ 304,111,298 |

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

Approved on behalf of the Board:

*"CAMERON BAILEY"* *"KEITH HILL"*

**CAMERON BAILEY, DIRECTOR** **KEITH HILL, DIRECTOR**

# AFRICA OIL CORP.

Consolidated Statements of Net Income (Loss) and Comprehensive Income (Loss)
(Expressed in United States dollars)
(Unaudited)

| | Note | Three months ended June 30, 2012 | Three months ended June 30, 2011 | Six months ended June 30, 2012 | Six months ended June 30, 2011 |
|---|---|---|---|---|---|
| Operating expenses | | | | | |
| Salaries and benefits | | $ 294,409 | $ 321,271 | $ 577,097 | $ 757,888 |
| Stock-based compensation | 9 | 587,198 | 425,708 | 1,216,794 | 1,881,934 |
| Bank charges | | 8,688 | 10,751 | 16,896 | 110,139 |
| Travel | | 237,386 | 246,309 | 462,159 | 382,961 |
| Management fees | 12 | 74,846 | 62,610 | 139,012 | 126,732 |
| Office and general | | 225,496 | 143,262 | 368,316 | 556,321 |
| Depreciation | 5 | 13,596 | 19,140 | 25,502 | 33,259 |
| Professional fees | 16 | 3,152,222 | 179,409 | 3,243,324 | 397,124 |
| Stock exchange and filing fees | | 147,027 | 121,838 | 274,333 | 273,282 |
| Impairment of intangible exploration assets | 6 | - | 6,969,413 | 3,114,858 | 6,969,413 |
| | | 4,740,868 | 8,499,711 | 9,438,291 | 11,489,053 |
| Gain on acquisition of Lion Energy | 3(b) | - | (4,143,051) | - | (4,143,051) |
| Finance income | 11 | (9,979,826) | (2,963,663) | (1,371,178) | (7,291,237) |
| Finance expense | 11 | 122,556 | 144,675 | 13,887,325 | 144,675 |
| Net income (loss) and comprehensive income (loss) | | 5,116,402 | (1,537,672) | (21,954,438) | (199,440) |
| Net Income (loss) and comprehensive Income (loss) attributable to non-controlling interest | | 6,084,874 | - | (7,344,002) | - |
| Net Income (loss) and comprehensive income (loss) attributable to common shareholders | | (968,472) | (1,537,672) | (14,610,436) | (199,440) |
| Net income (loss) attributable to common shareholders per share | 14 | | | | |
| Basic | | $ (0.00) | $ (0.01) | $ (0.07) | $ (0.00) |
| Diluted | | $ (0.00) | $ (0.02) | $ (0.07) | $ (0.03) |
| Weighted average number of shares outstanding for the purpose of calculating earnings per share | 14 | | | | |
| Basic | | 218,664,492 | 195,974,310 | 215,859,707 | 175,171,098 |
| Diluted | | 225,318,773 | 198,859,135 | 215,859,707 | 181,509,432 |

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

# AFRICA OIL CORP.

Consolidated Statement of Equity
(Expressed in United States dollars)
(Unaudited)

| | Note | | June 30, 2012 | June 30, 2011 |
|---|---|---|---|---|
| **Share capital:** | 7(b) | | | |
| Balance, beginning of period | | $ | 306,509,909 | $ 163,231,076 |
| Acquisition of Centric Energy | | | - | 60,165,193 |
| Acquisition of Lion Energy, net of AOC shares aquired | | | - | 21,561,185 |
| Issued on conversion of convertible debenture | | | - | 52,214,817 |
| Amended farmout agreement with Lion Energy | | | - | 5,274,675 |
| Exercise of warrants | | | 14,339,826 | 3,023,756 |
| Farmout ageement finder's fees | | | - | 94,960 |
| Exercise of options | | | 1,271,436 | 508,471 |
| Balance, end of period | | | 322,121,171 | 306,074,133 |
| **Contributed surplus:** | | | | |
| Balance, beginning of period | | $ | 8,425,304 | $ 4,391,940 |
| Expiration of warrants | | | - | 3,676 |
| Exercise of Horn warrants | 8 | | 1,147,884 | - |
| Acquisition of Lion Energy | | | - | 110,606 |
| Stock based compensation | 9 | | 1,216,794 | 1,881,934 |
| Issuance of shares in lieu of finder's fee | | | - | (94,960) |
| Exercise of options | 9 | | (406,545) | (157,751) |
| Shares to be issued in lieu of professional fees | 16 | | 3,298,001 | - |
| Balance, end of period | | | 13,681,438 | 6,135,445 |
| **Deficit:** | | | | |
| Balance, beginning of period | | $ | (75,283,481) | $ (56,570,350) |
| Net loss and comprehensive loss attributable to common shareholders | | | (14,610,436) | (199,440) |
| Balance, end of period | | | (89,893,917) | (56,769,790) |
| Total equity attributable to common shareholders | | $ | 245,908,692 | 255,439,788 |
| **Non-controlling interest:** | | | | |
| Balance, beginning of period | | $ | 36,295,769 | $ - |
| Non-controlling interest on issuance of Horn shares | | | 8,327,554 | - |
| Net loss and comprehensive loss attributable to non-controlling interest | | | (7,344,002) | - |
| Balance, end of period | | | 37,279,321 | - |
| Total equity | | $ | 283,188,013 | $ 255,439,788 |

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

# AFRICA OIL CORP.

Consolidated Statements of Cash Flows
(Expressed in United States dollars)
(Unaudited)

| | Note | Three months ended June 30, 2012 | Three months ended June 30, 2011 | Six months ended June 30, 2012 | Six months ended June 30, 2011 |
|---|---|---|---|---|---|
| Cash flows provided by (used in): | | | | | |
| Operations: | | | | | |
| Net income (loss) and comprehensive income (loss) for the period | | $ 5,116,402 | $ (1,537,672) | $ (21,954,438) | $ (199,440) |
| Item not affecting cash: | | | | | |
| Stock-based compensation | 9 | 587,198 | 425,708 | 1,216,794 | 1,881,934 |
| Share-based expense | 16 | 3,298,001 | - | 3,298,001 | - |
| Depreciation | 5 | 13,596 | 19,140 | 25,502 | 33,259 |
| Loss on marketable securities | | - | 144,675 | (123,982) | 144,675 |
| Gain on acquisition of Lion Energy | | - | (4,143,051) | - | (4,143,051) |
| Impairment of intangible exploration assets | 6 | - | 6,969,413 | 3,114,858 | 6,969,413 |
| Fair value adjustment - warrants | 8(c) | (9,905,593) | (1,763,927) | 13,763,343 | (2,543,108) |
| Fair value adjustment - convertible debt | | - | (309,448) | - | (2,031,704) |
| Unrealized foreign exchange (gain) loss | | 1,477,227 | (718,405) | 86,926 | (2,313,000) |
| Changes in non-cash operating working capital | | (597,606) | 184,187 | (784,683) | 231,956 |
| | | (10,775) | (729,380) | (1,357,679) | (1,969,066) |
| Investing: | | | | | |
| Property and equipment expenditures | 5 | - | (34,366) | (63,552) | (35,850) |
| Intangible exploration expenditures | 6 | (38,248,780) | (6,037,113) | (60,144,428) | (11,010,995) |
| Farmout proceeds, net | | - | - | - | 14,900,160 |
| Cash received on business acquisitions, net of cash issued | | - | 17,897,909 | - | 18,636,869 |
| Proceeds from sale of marketable securities | | - | - | 2,689,642 | - |
| Changes in non-cash investing working capital | | 7,591,134 | 15,192,575 | 9,264,247 | 7,310,701 |
| | | (30,657,646) | 27,019,005 | (48,254,091) | 29,800,885 |
| Financing: | | | | | |
| Common shares issued, net of issuance costs | 7(b) | 13,430,798 | 2,502,829 | 24,233,132 | 2,760,587 |
| Repayment of liability portion of convertible debt | | - | - | - | (411,220) |
| Deposit of cash for bank guarantee | 4 | (375,000) | - | (375,000) | (1,451,250) |
| Release of bank guarantee | 4 | - | 1,800,000 | 1,275,000 | 1,800,000 |
| Changes in non-cash financing working capital | | - | - | - | 168,569 |
| | | 13,055,798 | 4,302,829 | 25,133,132 | 2,866,686 |
| Effect of exchange rate changes on cash and cash equivalents denominated in foreign currency | | (1,477,227) | 690,373 | (46,841) | 2,269,848 |
| Increase (decrease) in cash and cash equivalents | | (19,089,850) | 31,282,827 | (24,525,479) | 32,968,353 |
| Cash and cash equivalents, beginning of period | | 104,122,816 | 77,811,360 | 109,558,445 | $ 76,125,834 |
| Cash and cash equivalents, end of period | | 85,032,966 | $ 109,094,187 | 85,032,966 | $ 109,094,187 |
| Supplementary information: | | | | | |
| Interest paid | | Nil | Nil | Nil | 411,220 |
| Taxes paid | | Nil | Nil | Nil | Nil |

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

**1) Incorporation and nature of business:**

Africa Oil Corp. (collectively with its subsidiaries, "AOC" or the "Company") was incorporated on March 29, 1993 under the laws of British Columbia and is an international oil and gas exploration company based in Canada with oil and gas interests in Kenya, Ethiopia, Puntland (Somalia) and Mali. The Company's registered address is Suite 2610, 1066 West Hastings Street Vancouver, BC, V6E 3X1.

AOC is an exploration stage enterprise that participates in oil and gas projects located in emerging markets, in sub-Saharan Africa. To date, AOC has not found proved reserves and is considered to be in the exploration stage. Oil and gas exploration, development and production activities in these emerging markets, are subject to significant uncertainties which may adversely affect the Company's operations. Uncertainties include, but are not limited to, the risk of war, terrorism, expropriation, nationalization or other title disputes, renegotiation or nullification of existing or future concessions and contracts, the imposition of international sanctions, a change in crude oil or natural gas pricing policies, a change in taxation policies, and the imposition of currency controls, in addition to the risks associated with exploration activities. These uncertainties, all of which are beyond the Company's control, could have a material adverse effect on AOC's business, prospects and results of operations. In addition, if legal disputes arise related to oil and gas concessions acquired by the Company, AOC could be subject to the jurisdiction of courts other than those of Canada. The Company's recourse may be very limited in the event of a breach by a government or government authority of an agreement governing a concession in which AOC has or may acquire an interest. The Company may require licenses or permits from various governmental authorities to carry out future exploration, development and production activities. There can be no assurance that AOC will be able to obtain all necessary licenses and permits when required.

**2) Basis of preparation:**

a) Statement of compliance:

The Company prepares these condensed consolidated financial statements in accordance with Canadian generally accepted accounting principles, specifically International Accounting Standard 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB"). They are condensed as they do not include all the information required for full annual financial statements, and they should be read in conjunction with the consolidated financial statements for the year ended December 31, 2011.

The policies applied in these condensed consolidated financial statements are based on International Financial Reporting Standards ("IFRS") issued and outstanding as at August 24, 2012, the date the Board of Directors approved the statements.

b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the Company's consolidated financial statements for the year ended December 31, 2011. Those accounting policies have been applied consistently to all periods presented in these consolidated financial statements.

(Expressed in United States dollars unless otherwise indicated)

c) Functional and presentation currency:

These consolidated financial statements are presented in United States (US) dollars. The functional currencies of all the Company's individual entities are US dollars which represents the currency of the primary economic environment in which the entities operate.

d) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Significant estimates and judgment used in the preparation of these consolidated financial statements are described in the Company's consolidated financial statements for the year ended December 31, 2011.

**3) Acquisitions and divestitures:**

a) Centric Energy Corp.

On February 23, 2011, the Company acquired all of the issued and outstanding commons shares of Centric Energy Corp. ("Centric") for total consideration of $60.2 million. Centric was an oil and gas exploration company with operations in Kenya and the Republic of Mali. The consideration consisted of $9,917 of cash and 30,155,524 common shares of the Company valued at CAD$1.98 per share, being the trading price of the shares on the date the acquisition closed. The financial results of Centric's operations have been included in the Company's consolidated financial statements since the effective date.

The preliminary purchase price was allocated based on fair values as follows:

| **Net Assets acquired** | | |
|---|---|---|
| Cash and cash equivalents | $ | 748,877 |
| Accounts receivable | | 135,886 |
| Restricted cash | | 450,000 |
| Property and equipment | | 8,823 |
| Intangible exploration assets | | 58,831,524 |
| Total net assets acquired | $ | 60,175,110 |

| **Consideration** | | |
|---|---|---|
| Shares issued | $ | 60,165,193 |
| Cash issued | | 9,917 |
| Total purchase price | $ | 60,175,110 |

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(Expressed in United States dollars unless otherwise indicated)

b) Lion Energy Corp.

On June 20, 2011, the Company acquired all the issued and outstanding common shares of Lion Energy Corp. ("Lion") for total consideration of $21.7 million. Lion was an oil and gas exploration company with operations in Kenya and Puntland (Somalia). The consideration consisted of 17,462,447 common shares of the Company. At the date of the acquisition Lion owned 2,500,000 shares of the Company, resulting in 14,962,447 net shares of the Company being issued valued at CAD$1.41 per share, being the trading price of the shares on the date the acquisition closed. The Company also issued 287,250 stock options of the Company fair valued at CAD$0.38 based on the Black Scholes option pricing model and assumed 2,289,000 outstanding Lion warrants. The warrants were amended to acquire AOC shares at CAD$2.50. No value was attributed to the amended Lion warrants which all expired out of the money shortly after the acquisition. The preliminary purchase price was allocated based on fair values as follows:

| | |
|---|---|
| **Net Assets Acquired** | |
| Cash | $ 17,897,909 |
| Accounts receivable | 3,426,216 |
| Marketable securities | 2,453,250 |
| Intangible exploration assets | 5,681,000 |
| Accounts payable and accrued liabilities | (3,643,533) |
| Total net assets acquired | $ 25,814,842 |
| **Consideration** | |
| Shares issued, net of AOC shares acquired | 21,561,185 |
| Share options issued | 110,606 |
| Total consideration | $ 21,671,791 |
| Gain on acquisition | $ 4,143,051 |

The marketable securities acquired were 10 million shares in Encanto Potash Corp. ("Encanto") which trades the TSX Venture Exchange. These securities are stated at fair value with gains or losses on revaluation recorded on the statement of net loss and comprehensive loss. All of the Encanto shares acquired were sold during the first quarter of 2012.

c) Horn Petroleum Corporation ("Horn")

i) Initial Transaction

On September 20 2011, the Company transferred ownership of its wholly owned subsidiary, Canmex Holdings (Bermuda) I Ltd. ("Canmex"), the entity which indirectly owns a 60% interest in Production Sharing Agreements with the Puntland State of Somalia, in return for 27,777,778 shares in Horn (formerly Denovo Capital Corp.) (the "Transaction").

Prior to close of the Transaction, Horn completed a consolidation of its issued and outstanding common shares on the basis of 0.65 new common shares for each existing common share. Horn also completed a non-brokered private placement of an aggregate of 45,535,195 subscription receipts at a price of CAD$0.90 per subscription receipt for gross proceeds of $41.3 million. AOC acquired 11,111,111 of the subscription receipts. The subscription receipts were converted into common shares and warrants of Horn on September

(Expressed in United States dollars unless otherwise indicated)

20, 2011. In connection with the private placement, Horn paid a finder's fee, consisting of the issuance of an aggregate of 812,417 common shares and the payment of $0.9 million in cash. All securities issued pursuant to the offering were subject to a statutory hold period which expired December 3, 2011.

Subsequent to the Transaction, AOC held 51.4% of the outstanding shares of Horn, as well, a management services arrangement has been agreed between Horn and AOC in which the management of AOC are responsible for the operating decisions of Horn. As such, the former shareholder of Canmex, AOC, is deemed to control Horn.

In accordance with IFRS, changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances, the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be recognized directly in equity and attributed to the owners of the parent. The following table outlines the consideration received versus the non-controlling interest adjustment:

| **Net consideration received** | | |
|---|---|---|
| Cash, net of cash issued | $ | 29,923,128 |
| Accounts payable and accrued liabilities | | (179,179) |
| Warrant liability | | (7,787,410) |
| | $ | 21,956,539 |
| | | |
| **Non-controlling interest adjusted** | | 34,604,620 |
| | $ | (12,648,081) |

The total difference by which the non-controlling interests are adjusted and the fair value of the consideration received was $12.6 million of which $4.6 million is recognized as a dilution loss in the statement of net loss and comprehensive loss on the consolidation of Horn and $8.1 million was recognized as a dilution loss through equity during the three months ended September 30, 2011.

ii) 2012 Private Placement

In June 2012, Horn completed a non-brokered private placement of an aggregate of 18,750,000 units at a price of CAD$0.80 per unit for gross proceeds of $14.4 million. Each unit consisted of one common share and one-half of a share purchase warrant of Horn. A finder's fee was paid, consisting of the issuance of an aggregate of 342,500 units and the payment of $0.1 million in cash. All securities issued under the private placement are subject to a statutory hold period which expires on October 9, 2012. AOC acquired 4,315,000 of the units issued for gross proceeds of $3.4 million. At June 30, 2012, AOC owned 44.7% of Horn.

(Expressed in United States dollars unless otherwise indicated)

### 4) Restricted cash:

At June 30, 2012, the Company has a restricted cash balance of $2,019,000 (December 31, 2011 - $2,919,000) which represents the following bank deposits securing outstanding letters of credit:

| Block | In favor of | June 30, 2012 | December 31, 2011 |
|---|---|---|---|
| 10A | Tullow Oil plc | - | $ 731,250 |
| 10BB | Tullow Oil plc | 900,000 | 900,000 |
| 12A | Tullow Oil plc | - | 270,000 |
| 13T | Tullow Oil plc | - | 273,750 |
| South Omo | Tullow Oil plc | 294,000 | 294,000 |
| 9 | Republic of Kenya | 375,000 | - |
| 10BA | Republic of Kenya | 450,000 | 450,000 |
| | | $ 2,019,000 | $ 2,919,000 |

### 5) Property and equipment:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Cost, beginning of period | $ 214,868 | $ 166,599 |
| Additions | 63,552 | 39,446 |
| Business acquisitions (note 3(a)) | - | 8,823 |
| Cost, end of period | 278,420 | 214,868 |
| | | |
| Accumulated depreciation, beginning of period | (175,473) | (126,978) |
| Depreciation | (25,502) | (48,495) |
| Accumulated depreciation, end of period | (200,975) | (175,473) |
| | | |
| Net carrying amount, beginning of period | $ 39,395 | $ 39,621 |
| Net carrying amount, end of period | $ 77,445 | $ 39,395 |

As at June 30, 2012, the Company has recorded $77,445 of property and equipment (December 31, 2011 - $39,395) consisting primarily of office and computer equipment. The Company depreciates its property and equipment on a straight line basis over the useful life of the assets (one to three years). During the three and six months ended June 30, 2012, AOC recorded depreciation expense of $13,596 and $25,502, respectively (2011 - $19,140 and $33,259, respectively). The Company has reviewed property and equipment and determined that there is no indication of impairment.

### 6) Intangible exploration assets:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Net carrying amount, beginning of period | $ 185,671,962 | $ 96,468,816 |
| Additions, net | 60,144,428 | 41,285,520 |
| Impairment of Intangible exploration assets | (3,114,858) | (6,969,413) |
| Farmout proceeds, net | - | (9,625,485) |
| Business acquisitions (note 3) | - | 64,512,524 |
| Net carrying amount, end of period | $ 242,701,532 | $ 185,671,962 |

(Expressed in United States dollars unless otherwise indicated)

As at June 30, 2012, $242.7 million of exploration expenditures have been capitalized as intangible exploration assets (December 31, 2011 - $185.7 million). These expenditures relate to the Company's share of exploration projects which are pending the determination of proven and probable petroleum reserves, and include geological and geophysical expenditures, exploratory drilling expenditures, costs required under the Company's Productions Sharing Agreements with the respective governments, and general and administrative costs related to exploration activities. At June 30, 2012, no intangible exploration assets have been transferred to oil and gas interests as commercial reserves have not been established and technical feasibility for extraction has not been demonstrated.

During the six months ended June 30, 2012, the Company capitalized $3.8 million of general and administrative expenses related to intangible exploration assets (six months ended June 30, 2011 – $1.3 million). During the six months ended June 30, 2012, the Company capitalized nil interest expense in relation to its convertible debt to intangible exploration assets (six months ended June 30, 2011 – $0.2 million).

During the first quarter of 2012, management identified indicators of impairment for intangible exploration assets of Mali. As a result of the assessment of these impairment indicators, the Company has written-off $3.1 million of capitalized intangible exploration assets. The remaining carrying value of the Mali intangible exploration assets is nil.

During the second quarter of 2011, management relinquished Blocks 2/6 in Ethiopia. Accordingly, the Company has written-off $7.0 million of capitalized intangible exploration assets of which $1.2 million represents the Company's portion of settlement costs with the Government of Ethiopia related to unfulfilled work obligations on the block.

Although the Company believes that it has title to its oil and natural gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges.

**7) Share capital:**

a) The Company is authorized to issue an unlimited number of common shares with no par value.

b) Issued:

| | | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|---|
| | Note | Shares | Amount | Shares | Amount |
| Balance, beginning of period | | 211,413,059 | $ 306,509,909 | 135,806,100 | $ 163,231,076 |
| Acquisition of Centric Energy | 3(a) | - | - | 30,155,524 | 60,165,193 |
| Acquisition of Lion, net of AOC shares aquired | 3(b) | - | - | 14,962,447 | 21,561,185 |
| Issued on conversion of convertible debenture | | - | - | 25,850,100 | 52,214,817 |
| Amended Farmout Agreement with Lion Energy | | - | - | 2,500,000 | 5,274,675 |
| Exercise of warrants, net of issue costs | 8 | 6,521,601 | 14,339,826 | 1,530,000 | 3,023,756 |
| Farmout ageement finder's fees | | - | - | 103,306 | 166,858 |
| Exercise of options | 9 | 729,832 | 1,271,436 | 505,582 | 872,349 |
| Balance, end of period | | 218,664,492 | $ 322,121,171 | 211,413,059 | $ 306,509,909 |

(Expressed in United States dollars unless otherwise indicated)

c) In June of 2011, the Company acquired 2.5 million of its own shares through the purchase of Lion Energy (see note 3(b)). The total amount paid to acquire the shares was deducted from share capital. The shares were held as treasury shares until they were surrendered for cancellation, and returned to treasury on December 15, 2011. No consideration was paid to AOC in connection with the cancellation and return to treasury. No gain or loss is recognized in the consolidated statement of net income (loss) and comprehensive income (loss) on the purchase, sale, issue or cancellation of the Company's own equity shares.

**8) Warrants:**

| | Note | Number of AOC Warrants | | Amount ($) |
|---|---|---|---|---|
| **Balance, December 31, 2010:** | | **8,061,101** | **$** | **6,070,863** |
| Current portion of warrants | | 1,500,000 | | 1,512,811 |
| Long-term portion of warrants | | 6,561,101 | $ | 4,558,052 |
| Expiration of warrants | 3(b),(a) | (2,298,500) | | (3,676) |
| Exercise of warrants | (a) | (1,530,000) | | (613,889) |
| Issuance of warrants | 3(b) | 2,289,000 | | - |
| Fair market value adjustment | | - | | (3,940,487) |
| **Balance, December 31, 2011:** | | **6,521,601** | **$** | **1,512,811** |
| Exercise of warrants | (b) | (6,521,601) | | (4,463,514) |
| Fair market value adjustment | | - | | 2,950,703 |
| **Balance, June 30, 2012:** | | - | $ | - |

a) On November 22, 2010, the Company elected to accelerate the expiry date for all outstanding warrants issued as part of the April 28, 2009 private placement. The expiry date with respect to these warrants was amended to December 23, 2010. Of the 37,421,018 warrants granted in April 2009, all of which were outstanding at the beginning of 2010, 37,220,365 were exercised and 161,153 expired unexercised. The expiry for the remaining 39,500 warrants was extended to March 23, 2011. As a result of warrants exercised in 2010, the Company issued 37,220,365 common shares, realizing net proceeds of $55.2 million. The fair value of warrants transferred to share capital was $18.4 million. In the first quarter of 2011, 30,000 of the remaining warrants were exercised and 9,500 expired unexercised. As a result of warrants exercised in the first quarter of 2011, the Company issued 30,000 common shares, realizing net proceeds of $46,242. The fair value of warrants transferred to share capital was $15,389.

On November 22, 2010, the Company elected to accelerate the expiry date for 1,500,000 warrants issued to Platform as consideration for the assignment of blocks 12A and 13T (note 7(b)). The expiry date with respect to these warrants was amended to May 22, 2011. On April 20, 2011 all outstanding warrants held by Platform were exercised. As a result of the warrants being exercised the Company issued 1,500,000 common shares, realizing net proceeds of $2,362,500. The fair value of warrants transferred to share capital was $598,500.

b) On March 12, 2012, the Company's remaining outstanding warrants were exercised. As a result of the warrants being exercised, the Company issued 6,521,601 common shares, realizing net proceeds of $9,876,312. The fair value of warrants transferred to share capital was $4,463,514.

(Expressed in United States dollars unless otherwise indicated)

c) At June 30, 2012, the Company recorded $17.7 million (December 31, 2011 - $2.9 million) in long-term warrant liability on consolidation of its 44.7% owned subsidiary Horn. During the three and six months ended June 30, 2012, the Company recognized a $9.9 million gain and a $10.8 million loss, respectively, on the revaluation of Horn's warrant liability (2011 – nil). During the three months ended June 30, 2012, the Company recognized an increase in contributed surplus of $1.1 million in relation to Horn warrants exercised in the second quarter of 2012.

**9) Share purchase options:**

At the 2011 Annual General Meeting, held on May 31, 2012, the Company approved the stock option plan ("the Plan") which was last amended at the 2010 Annual General Meeting. The Plan provides that an aggregate number of common shares which may be reserved for issuance as incentive stock options shall not exceed 10% of the common shares outstanding, and option exercise prices will reflect current trading values of the Company's shares. The term of any option granted under the Plan will be fixed by the Board of Directors and may not exceed five years from the date of grant. Vesting periods are determined by the Board of Directors and no optionee shall be entitled to a grant of more than 5% of the Company's outstanding issued shares.

The Company's share purchase options outstanding are as follows:

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Number of shares | Weighted average exercise price (CAD$) | Number of shares | Weighted average exercise price (CAD$) |
| Outstanding, beginning of period | 10,830,668 | 1.54 | 3,946,667 | 1.67 |
| Granted | 35,000 | 2.09 | 8,112,250 | 1.70 |
| Expired or cancelled | (117,334) | 1.73 | (722,667) | 4.30 |
| Exercised | (729,832) | 1.23 | (505,582) | 1.16 |
| Balance, end of period | 10,018,502 | 1.55 | 10,830,668 | 1.54 |

The weighted average closing share price on the day options were exercised during the six months ended June 30, 2012 was CAD$1.99 (December 31, 2011 - CAD$1.77).

The fair value of each option granted is estimated on the date of grant using the Black-Scholes options pricing model. The fair value of each option granted by the Company during the six months ended June 30, 2012 and the year ended December 31, 2011 were estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

| | 2012 | 2011 |
|---|---|---|
| Number of options granted during the year | 35,000 | 8,112,250 |
| Fair value of options granted ($ per option) | 0.74 | 0.66 |
| Risk-free interest rate (%) | 1.12 | 1.33 |
| Expected life (years) | 2.17 | 2.17 |
| Expected volatility (%) | 58 | 68 |
| Expected dividend yield | - | - |

The following table summarizes information regarding the Company's stock options outstanding at June 30, 2012:

| Weighted Average Exercise price (CAD$/share) | Number outstanding | Weighted average remaining contractual life in years |
|---|---|---|
| 2.10 | 2,212,000 | 1.58 |
| 2.09 | 35,000 | 2.67 |
| 1.94 | 300,000 | 1.75 |
| 1.88 | 100,000 | 1.81 |
| 1.85 | 400,000 | 1.70 |
| 1.70 | 50,000 | 2.01 |
| 1.69 | 21,666 | 1.92 |
| 1.62 | 31,668 | - |
| 1.56 | 50,000 | 2.43 |
| 1.49 | 4,327,333 | 2.41 |
| 1.27 | 33,334 | 2.16 |
| 1.18 | 500,000 | - |
| 1.13 | 1,317,501 | 0.75 |
| 1.05 | 140,000 | 0.14 |
| 1.00 | 100,000 | 0.25 |
| 0.89 | 400,000 | 0.21 |
| 1.55 | 10,018,502 | 1.67 |

## 10) Segment information:

The Company determines and presents operating segments based on the information that internally is provided to the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), who are the Company's chief operating decision makers. An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses. An operating segment's operating results, for which discrete financial information is available, are reviewed regularly by the CEO and CFO to make decisions about resources to be allocated to the segment and assess its performance. The Company has a single class of business which is international oil and gas exploration. The geographical areas are defined by the Company as operating segments in accordance with IFRS. The Company currently operates in a number of geographical areas based on location of operations, being Puntland (Somalia), Ethiopia, Kenya and Mali.

| **At June 30, 2012** (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | **Total** |
|---|---|---|---|---|---|---|
| Total assets | $ 77,671 | $ 22,812 | $ 156,834 | $ 17 | $ 75,224 | **$ 332,558** |
| Intangible exploration assets | 74,031 | 21,400 | 147,271 | - | - | **242,702** |
| Property and equipment | - | - | - | 9 | 68 | **77** |

| **At December 31, 2011** (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | **Total** |
|---|---|---|---|---|---|---|
| Total assets | $ 54,452 | $ 18,794 | $ 117,065 | $ 3,132 | $ 110,668 | **$ 304,111** |
| Intangible exploration assets | 53,041 | 17,491 | 112,022 | 3,118 | - | **185,672** |
| Property and equipment | - | - | - | 9 | 30 | **39** |

# AFRICA OIL CORP.

Notes to Consolidated Financial Statements
For the three and six months ended June 30, 2012 and 2011
(Expressed in United States dollars unless otherwise indicated)
(Unaudited)

| Three months ended June 30, 2012 (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | Total |
|---|---|---|---|---|---|---|
| **Capital expenditures** | | | | | | |
| Intangible exploration assets, net | $ 13,523 | $ 1,250 | $ 23,476 | $ - | $ - | **$ 38,249** |
| Property and equipment | - | - | - | - | - | **-** |
| | $ 13,523 | $ 1,250 | $ 23,476 | $ - | $ - | **$ 38,249** |
| **Statement of operations** | | | | | | |
| Expenses | $ 5 | $ 9 | $ 154 | $ 7 | $ 4,566 | **$ 4,741** |
| Finance income | - | - | - | - | (9,980) | **(9,980)** |
| Finance expense | - | - | - | - | 123 | **123** |
| Segmented loss (gain) | $ 5 | $ 9 | $ 154 | $ 7 | $ (5,291) | **$ (5,116)** |

| Three months ended June 30, 2011 (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | Total |
|---|---|---|---|---|---|---|
| **Capital expenditures** | | | | | | |
| Intangible exploration assets, net | $ 353 | $ 2,071 | $ 3,613 | $ - | $ - | **$ 6,037** |
| Property and equipment | - | - | - | - | 34 | **34** |
| | $ 353 | $ 2,071 | $ 3,613 | $ - | $ 34 | **$ 6,071** |
| **Statement of operations** | | | | | | |
| Expenses | $ 8 | $ 6,793 | $ 16 | $ 24 | $ 1,659 | **$ 8,500** |
| Gain on Aquisition of Lion Energy | - | - | - | - | (4,143) | **(4,143)** |
| Finance income | - | 2 | (1) | - | (2,965) | **(2,964)** |
| Finance expense | - | - | - | - | 145 | **145** |
| Segmented loss (gain) | $ 8 | $ 6,795 | $ 15 | $ 24 | ($5,304) | **$ 1,538** |

| Six months ended June 30, 2012 (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | Total |
|---|---|---|---|---|---|---|
| **Capital expenditures** | | | | | | |
| Intangible exploration assets, net | $ 20,990 | $ 3,909 | $ 35,245 | $ - | $ - | **$ 60,144** |
| Property and equipment | - | - | - | - | 64 | **64** |
| | $ 20,990 | $ 3,909 | $ 35,245 | $ - | $ 64 | **$ 60,208** |
| **Statement of operations** | | | | | | |
| Expenses | $ 12 | $ 12 | $ 162 | $ 3,129 | $ 6,123 | **$ 9,438** |
| Finance income | - | - | - | - | (1,371) | **(1,371)** |
| Finance expense | - | - | - | - | 13,887 | **13,887** |
| Segmented loss (gain) | $ 12 | $ 12 | $ 162 | $ 3,129 | $18,639 | **$ 21,954** |

| Six months ended June 30, 2011 (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | Total |
|---|---|---|---|---|---|---|
| **Capital expenditures** | | | | | | |
| Intangible exploration assets, net | $ 2,565 | $ 2,551 | $ 5,895 | $ - | $ - | **$ 11,011** |
| Property and equipment | - | - | - | - | 36 | **36** |
| | $ 2,565 | $ 2,551 | $ 5,895 | $ - | $ 36 | **$ 11,047** |
| **Statement of operations** | | | | | | |
| Expenses | $ 52 | $ 6,843 | $ 66 | $ 24 | $ 4,503 | **$ 11,488** |
| Gain on Aquisition of Lion Energy | - | - | - | - | (4,143) | **(4,143)** |
| Finance income | - | 1 | (2) | - | (7,290) | **(7,291)** |
| Finance expense | - | - | - | - | 145 | **145** |
| Segmented loss (gain) | $ 52 | $ 6,844 | $ 64 | $ 24 | ($6,785) | **$ 199** |

# AFRICA OIL CORP.

Notes to Consolidated Financial Statements
For the three and six months ended June 30, 2012 and 2011
(Expressed in United States dollars unless otherwise indicated)
(Unaudited)

**11) Finance income and expense:**

Finance income and expense for the three and six months ended June 30, 2012 and 2011 is comprised of the following:

| | Three months ended June 30, 2012 | Three months ended June 30, 2011 | Six months ended June 30, 2012 | Six months ended June 30, 2011 |
|---|---|---|---|---|
| Loss on marketable securities | - | (144,675) | (123,982) | (144,675) |
| Fair value adjustment - w arrants | 9,905,593 | 1,763,927 | (13,763,343) | 2,543,108 |
| Fair value adjustment - convertible debt | - | 309,448 | - | 2,031,704 |
| Interest and other income | 74,233 | 220,403 | 236,161 | 464,089 |
| Foreign exchange gain (loss) | (122,556) | 669,885 | 1,135,017 | 2,252,336 |
| Finance income | 9,979,826 | 2,963,663 | 1,371,178 | 7,291,237 |
| Finance expense | (122,556) | (144,675) | (13,887,325) | (144,675) |

**12) Related party transactions:**

a) Transactions with Lorito Holdings (Guernsey) Limited (“Lorito”)

During May 2009, the Company’s loans payable due to Lorito in the amount of CAD$6,000,000 plus interest of $195,521 was converted to 6,521,601 Units of the Company on the basis of CAD$0.95 per Unit. Each Unit was comprised of one common share and one share purchase warrant. Each warrant was exercisable into one common share of AOC at a price of CAD$1.50 per share over a period of three years. In the event that AOC closed at or above CAD$2.00 for a period of 20 consecutive trading days, the Company may have elected to accelerate the expiry date to 30 days from the date of written notice to the warrant holder. Lorito is beneficially owned by Ellegrove Capital Ltd., a private trust the settler of which is the late Adolf H. Lundin. During the first quarter of 2012, Lorito exercised each of its 6,521,601 warrants into a common share of the Company.

b) Transactions with Namdo Management Services Ltd (“Namdo”)

During the six months ended June 30, 2012, the Company incurred management fees of $139,012, respectively (2011- $126,732) for administrative support services fees to Namdo. Namdo is a private corporation owned by Lukas H. Lundin. At June 30, 2012, the Company had no outstanding amounts due to Namdo in respect of management fees (December 31, 2011 – Nil).

c) Transactions with Horn Petroleum Corp. (“Horn”)

On September 20, 2011, a Share Purchase Agreement was executed between the Company and Horn. Upon completion of the Share Purchase Agreement, AOC owned 51.4% of the outstanding shares of Horn. On June 8, 2012, Horn completed a non-brokered private placement issuing 18.75 million units for gross proceeds of CAD$15.0 million. AOC participated in the non-brokered private placement acquiring 4.3 million units. As a result of AOC's participation in the Horn non-brokered private placement and common shares issued on the exercise of warrants and stock options, AOC owns 44.7% of the outstanding shares of Horn at June 30, 2012. The following transactions and resulting intercompany balances outstanding between the Company and Horn have been eliminated as the Company fully consolidates the financial statements of Horn.

Under the terms of a General Management and Service Agreement between Horn and the Company for the provision of management and administrative services, the Company invoiced Horn $448,538 during six months ended June 30, 2012 (six months ended June 30, 2011 – Nil). At June 30, 2012, the outstanding balance receivable from Horn, recorded as a due from related party, was nil (December 31, 2011 – $258,116). The management fee charged to Horn by the Company is expected to cover the cost of administrative expense and salary costs paid by the Company in respect services provided to Horn.

Under the terms of a Services Agreement between the Company and Horn, AOC invoiced Horn $140,796 during the six months ended June 30, 2012 (six months ended June 30, 2011 – $98,033) for services provided by geologists and geophysicists employed by AOC. At June 30, 2012, $53,430 was outstanding and recorded in due from related party (December 31, 2011 – $11,650).

During the six months ended June 30, 2012, AOC invoiced Horn $195,051 for reimbursable expenses paid by AOC on behalf of Horn (six months ended June 30, 2011 – $210,939). At June 30, 2012, $95,445 was outstanding and recorded in due from related party (December 31, 2011 – $109,269).

During December 2011, Horn's subsidiary Canmex Holdings (Bermuda) II Ltd. commenced the transfer of $1.5 million to Horn, via AOC. At December 31, 2011, the funds were on deposit with AOC. Accordingly, the balance had been recorded as due to related party. During the first quarter of 2012, AOC transferred the funds to Horn.

(Expressed in United States dollars unless otherwise indicated)

**13) Subsidiaries:**

The Company has the following wholly owned subsidiaries; 0845379 B.C. Ltd. (British Columbia), Africa Oil Holdings Cooperatief U.A. (Netherlands), Africa Oil Turkana B.V. (Netherlands), Africa Oil Kenya B.V. (Netherlands), Africa Oil Ethiopia B.V (Netherlands), Africa Oil Turkana Ltd. (Kenya), 0903658 B.C. Ltd. (British Columbia), Centric Energy Holdings (Barbados) Inc. (Barbados), Centric Energy Kenya (Barbados) Inc. (Barbados), Centric Energy (Kenya) Ltd. (Kenya), Mali Oil Development SARL (Mali, West Africa), Lion Energy Antilles N.V. (Curacao). The Company owns 44.7% of the issued and outstanding shares of Horn Petroleum Corporation (Canada), which wholly owns the following subsidiaries: Canmex Holdings (Bermuda) I Ltd. (Bermuda), Canmex Holdings (Bermuda) II Ltd. (Bermuda), and Africa Oil Holdings (Bermuda) I Ltd. (Bermuda).

**14) Earnings per share:**

| **Three months ended June 30,** | **2012** | | | **2011** | | |
|---|---|---|---|---|---|---|
| | Earnings | Number of shares | Per share amounts | Earnings | Number of shares | Per share amounts |
| Basic earnings per share | | | | | | |
| Net Income (loss) attributable to common shareholders | $ (968,472) | 218,664,492 | $ (0.00) | $ (1,537,672) | 195,974,310 | $ (0.01) |
| Effect of dilutive securities | | | | | | |
| Stock options | - | 6,654,281 | | - | 1,133,423 | |
| Warrants | - | - | | (1,763,927) | 941,768 | |
| Convertible debentures | - | - | | (309,448) | 809,634 | |
| Dilutive Income (loss) per share | $ (968,472) | 225,318,773 | $ (0.00) | $ (3,611,047) | 198,859,135 | $ (0.02) |

| **Six months ended June 30,** | **2012** | | | **2011** | | |
|---|---|---|---|---|---|---|
| | Earnings | Number of shares | Per share amounts | Earnings | Number of shares | Per share amounts |
| Basic earnings per share | | | | | | |
| Net Income (loss) attributable to common shareholders | $ (14,610,436) | 215,859,707 | $ (0.07) | $ (199,440) | 175,171,098 | $ (0.00) |
| Effect of dilutive securities | | | | | | |
| Stock options | - | - | | - | 1,242,662 | |
| Warrants | - | - | | (2,543,108) | 1,358,179 | |
| Convertible debentures | - | - | | (2,031,704) | 3,737,493 | |
| Dilutive Income (loss) per share | $ (14,610,436) | 215,859,707 | $ (0.07) | $ (4,774,252) | 181,509,432 | $ (0.03) |

**15) Commitments & Contingencies:**

*Block 7/8 exploration period extension:*

Under the terms of the Blocks 7/8 PSA, during the initial exploration period which was extended by the Ministry of Mines in Ethiopia in June 2012 and expires in July 2013, the Company and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 1,250 kilometers of 2D seismic) with a minimum gross expenditure of $11.0 million. In addition, the Company and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Blocks 7/8 is 55%.

**16) Subsequent Events:**

*Completed Block 12A farmout:*

In July 2012, the Company completed a farmout transaction with Tullow Oil plc ("Tullow"). Under the Tullow farmout transaction, which has received Kenya government approval, Tullow paid the Company $0.8 million in consideration of past costs to acquire an additional 15% interest in Block 12A in Kenya. Tullow will also fund the Company's working interest share of costs related to the acquisition of 520 kilometers of 2D seismic until an expenditure cap of $3.1 million net to AOC has been met, following which AOC will be responsible for its working interest share of seismic acquisition costs.

*Block 12A exploration period extension:*

Under the terms of the Block 12A PSC, during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in September 2013, the initial minimum gross exploration expenditure is $3.6 million. The Company and its partner are obligated to complete G&G operations including the acquisition of 500km of 2D seismic or 100 km2 of 3D seismic (or a combination thereof). The Company's current working interest in Blocks 12A is 35%.

*Block 10A exploration period extension:*

Under the terms of the Block 10A PSC, during the initial exploration period which was extended subsequent to the end of the quarter by the Ministry of Energy for the Republic of Kenya now expires in April 2013, AOC and its partners are obligated to complete G&G operations (including acquisition of 750 kilometers of 2D seismic) with a minimum gross expenditure of $7.8 million. Additionally, AOC and its partners are obligated to drill one exploration well with a minimum expenditure of $8.5 million. The Company's current working interest in Block 10A is 30%.

*Block 10BB next exploration period:*

Under the terms of the Block 10BB PSC, AOC and its partner have fulfilled the minimum work and financial obligations of the initial exploration period which expired in July 2012. The Ministry of Energy for the Republic of Kenya approved the Company and its partners' entry into the next exploration period. During the next exploration period which expires in July 2014, the Company and its partners are obligated to complete G&G operations (including acquisition of 300 square kilometers of 3D seismic) with a minimum gross expenditure of $7.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million.

*Block 13T next exploration period:*

Under the terms of the Block 13T PSC, AOC and its partner have fulfilled the minimum work and financial obligations of the initial exploration period which expires in September 2012. The Ministry of Energy for the Republic of Kenya approved the Company and its partners' entry into the next exploration period. During the next exploration period which expires in September 2014, the Company and its partners are obligated to complete G&G operations (including acquisition of 200 square kilometers of 3D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $15.0 million. The Company's current working interest in Block 13T is 50%.

*Proposed Marathon Oil Corporation farmout:*

In July 2012, the Company signed a definitive farmout agreement with Marathon Oil Corporation ("Marathon") whereby Marathon will acquire the rights to obtain an interest in two of the Company's Kenyan exploration blocks.

Under the terms of the farmout agreement, Marathon will acquire a 50% interest in Block 9 and a 15% interest in Block 12A, both in Kenya. The Company will maintain operatorship in Block 9, but Marathon has the right to assume operatorship if a commercial discovery is made. In addition, the Company and Marathon have agreed to jointly pursue exploration activities on an additional exploration area in Ethiopia. The above transactions are all subject to host country Government approvals.

Net Working Interests are subject to backin rights or carried working interests, if any, of the respective governments or national oil companies of the host governments.

In consideration for the assignment of these interests, Marathon will pay the Company an entry payment of $35.0 million which includes prior expenditures, and has agreed to fund the Company's working interest share of future joint venture expenditures anticipated to be spent over the next three years up to a maximum of $43.5 million.

*Proposed New Age (Africa Global Energy) Limited farmout:*

In July 2012, the Company entered into a definitive agreement with New Age (Africa Global Energy) Limited ("New Age") whereby New Age will acquire an additional 25% interest in the Company's Blocks 7 & 8 in Ethiopia, together with operatorship of Blocks 7 & 8 and the Adigala Area. In consideration of the assignment of the interest, New Age will pay to the Company $1.5 million in consideration of past costs.

The transfer of operatorship will occur upon completion of the acquisition of the Blocks 7 & 8 interest by New Age. This transaction is also subject to host government approvals, the waiver of preemption rights by AOC's partners and the satisfaction of any applicable regulatory requirements.

*Share based expensed:*

Subsequent to June 30, 2012, the Company issued 420,000 common shares as a settlement of claimed professional fees relating to previously completed farmout transactions. The Company has recorded $3,298,001 associated with the issuance of these shares as professional fees in the statement of net income (loss) and comprehensive income (loss) with a corresponding increase in contributed surplus. The amount will be removed from contributed surplus on the date the shares are issued and recorded as an increase in share capital.