



## MESSAGE TO SHAREHOLDERS

### Third Quarter 2011

Against a backdrop of extreme market uncertainty and volatility during the quarter, Sterling continued to make significant progress with its financial and operational objectives.

In July, Sterling Resources (UK) Ltd., a wholly owned subsidiary of Sterling, signed an agreement with a syndicate of banks for a £105 million senior secured loan to finance Phase 1 of the Breagh gas field. The debt facility has a maximum term of 6.5 years and is composed of a main tranche of £95 million and a contingency of a further £10 million. Also in July, the Company entered into a bought deal financing agreement with a syndicate of underwriters to issue 32,143,000 common shares at a price of \$1.40 per share. The primary purpose for this bought deal financing was to meet the liquidity threshold required as a condition of finalizing the £105 million senior secured loan. Total net proceeds of the bought deal financing after deducting underwriter fees and other expenses were approximately \$42.5 million with the offering closing in August 2011.

The first drawdown of the debt facility of approximately £36 million was paid to Sterling on September 30, 2011 as a reimbursement of eligible expenditures relating to the Breagh development already incurred by Sterling UK. Since finalizing the debt facility in July, the three existing banks in the syndicate were joined by GE Energy Financial Services; a division of US-based GE. In a difficult market we were particularly pleased to have expanded the debt facility to include a fourth lender. In October 2011 we were pleased to announce that the Breagh Alpha (Phase 1) platform had been installed in the Southern North Sea Block 42/13. We are now focused upon firming up plans for Phase 2 of the Breagh development over the next few months and remain on schedule to achieve first gas production from Phase 1 in mid-2012.

In September, the Company was pleased to announce that its wholly-owned subsidiary Sterling Resources Netherlands B.V. had signed a farm-out agreement with Petro Ventures Netherlands B.V. covering its licenses within the F-Quad and L-Quad offshore Netherlands. Subject to governmental and partner approvals, Sterling Resources Netherlands B.V. as operator will now hold a 25 percent working interest. The agreement encompasses the shallow parts of four blocks (F14, F16, F17a, and F18) in the F-Quad and L01b in the L-Quad sector covering 1550 square kilometres, located 80 kilometres offshore, in a water depth of 45 meters. The blocks currently hold four oil discoveries. Preparation works for the drilling of a block F17 appraisal well have been conducted and the jack up rig Maersk Resolute is due on location around the end of November 2011.

Subsequent to the end of the quarter on October 11, 2011 the Romanian government rescinded the Construction Permit Law, in relation to offshore requirements, an impediment upon which the Company had declared force majeure on April 28, 2011 on its Midia and Pelican Blocks in the Black Sea. Later that month we were pleased to announce that the Company had reached agreement with the Government of Romania on a package of issues that will resolve the Notice of Dispute filed in June 2011. Agreement was reached to grant assignments to Sterling's designated partners, PetroVentures Europe B.V. (20 percent) and Gas Plus International B.V. (15 percent). In addition, the Government agreed that all of Sterling's offshore licenses will now initially run to May 2014 with two additional, three year renewal terms also being available under the Concession Agreement, signed in August 2007. These agreements were formally concluded on November 18, 2011, enabling Sterling to resume work activities and investments on these highly attractive licenses in the Romanian Black Sea.

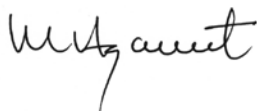
In onshore Romania we have launched an initiative, in consultation with our partner Transatlantic Petroleum, to each farm out half of our 50 percent respective interests in the Craiova Block. Our intention is to find a partner with the technical expertise to support the forward evaluation program of the Silurian shale in the area, while maintaining a 25 percent Sterling interest in this prospect.

Plans for the development of the Cladhan oil field in the Northern North Sea continue to move forward, with the intent of delivering first oil in 2014. The complexity of integrating ongoing seismic re-processed data with new seismic data acquired over the summer has meant that new resources estimates for Cladhan will not be finalized until calendar year-end. Following receipt of this report we will determine, in consultation with our partners, further drilling objectives at Cladhan.

We continue to monitor closely the regulatory environment in France, specifically as it relates to the drilling technologies to be deployed to unlock the oil potential of the Lias shale in the Paris Basin. These regulatory changes have delayed the final awarding of the blocks to Sterling and we remain hopeful that resolution of this issue can be achieved before year-end. Sterling, as operator of these blocks, does not plan to drill in the Paris Basin until late 2012 at the earliest.

Sterling has a highly attractive asset base, a strong and focused management team, material production from the middle of 2012, and a green light to proceed with significant exploration and development opportunities offshore Romania. We look forward to making solid progress with all our major projects over the next few years in order to deliver significant value for our shareholders. We thank our numerous stakeholders for your support during these economically challenging times.

On Behalf of the Board of Directors,

A handwritten signature in black ink, appearing to read "Mike Azancot". The signature is fluid and cursive, with a prominent loop at the end.

Mike Azancot  
President and Chief Executive Officer  
November 22, 2011

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) of the operating results and financial condition of Sterling Resources Ltd. ("Sterling" or the "Company") for the three and nine month periods ended September 30, is dated November 22, 2011 and should be read in conjunction with Sterling's unaudited condensed interim consolidated financial statements and accompanying notes as at and for the three months ended March 31, 2011, the three and six months ended June 30, 2011, and the three and nine month ended September 30, 2011 ("the Financial Statements") all prepared in accordance with IAS 34 Interim Financial Reporting and IFRS 1 First-time Adoption of International Financial Reporting Standards, representing generally accepted accounting principles for publicly accountable enterprises in Canada, as well as the audited consolidated financial statements for the year ended December 31, 2010, prepared in accordance with Canadian generally accepted accounting principles at that time ("previous GAAP"). All comparative figures have been restated using IFRS.

The Financial Statements for the three month period ended March 31, 2011 contain certain incremental annual IFRS disclosures not included in the annual financial statements for the year ended December 31, 2010 prepared in accordance with previous GAAP.

### Corporate Overview and Strategy

Sterling is a publicly-traded, international energy company engaged in the acquisition of petroleum and natural gas rights, and the exploration for, and the development and production of, crude oil and natural gas. The Company operates primarily in the United Kingdom, Romania, the Netherlands and France, and is headquartered in Calgary, Alberta.

The Company's primary strategy for achieving growth is to source and initiate international projects with the potential to yield large, low-cost reserves. It concentrates on accumulating, exploring and exploiting licenses and prospects in selected core areas of the world. Sterling's strategy also targets blocks with high initial working interests where possible. Financial exposure and technical risk are managed by obtaining partner participation through farm-out and other arrangements. Under these arrangements, a portion of the Company's interest is given up in exchange for the partner paying a share of the costs of exploration, appraisal or development of the license. A secondary strategy is to acquire interests in discoveries where the Company believes that its technical and operational expertise can accelerate development, especially where there are multiple development candidates or significant exploration prospectivity nearby.

### Forward-Looking Statements and Business Risks

Certain statements contained in this MD&A are forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "would", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue", "intend", or the negative of these terms or other comparable terminology. In addition, statements relating to reserves or resources are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions that the reserves and resources described can be profitably produced in future.

These statements are only predictions. Actual events or results may differ materially. In addition, this MD&A may contain forward-looking statements attributed to third-party industry sources, these sources are not endorsed or adopted by Sterling expressly or implicitly. Undue reliance should not be placed on these forward-looking statements, as there can be no assurance that the plans, intentions

or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will prove inaccurate. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to:

- Capital expenditure programs, including without limitation the timing of, the sources of capital and expenses related to, and the nature of, the development of the Breagh field;
- Development activities in the greater Breagh area;
- Expectations regarding the Company's cost structure;
- Factors upon which the Company will decide whether or not to undertake a specific course of action;
- The quantity and timing of hydrocarbon production from the Company's development projects, including Breagh, Cladhan, Ana and Doina;
- The sale, farming-in, farming-out or development of certain exploration properties using third party resources, including the potential farming-out of a portion of the Company's interest in the Craiova Block;
- The realization of anticipated benefits of acquisitions and dispositions;
- The possible impact of changes in government policy with respect to onshore and offshore drilling;
- The Company's ability to obtain certain government and regulatory approvals;
- The Company's cash requirements and funding for the next year;
- The Company's expectations regarding its ability to raise additional financing;
- The Company's drilling plans and plans for completion and installation of production platforms or other infrastructure, including in relation to offshore Romania, offshore the Netherlands, the Craiova Block, Breagh and the Paris Basin;
- The Company's tax horizon;
- The Company's strategies, the criteria to be considered in connection therewith and the benefits to be derived therefrom;
- The Company's expectations regarding government policies with respect to concerns about climate change and the protection of the environment; and
- The Company's plans and expectations that are described on page 15 under "2011 Plans".

With respect to forward-looking statements in this MD&A the Company has assumed, among other things, that the Company:

- Will, together with its subsidiaries, be able to satisfy the undertakings and conditions under the Breagh loan facility agreement;
- Will produce hydrocarbons and receive cash flows in connection therewith which are consistent with the production and cash flows as estimated in the reserves report prepared by RPS Energy evaluating the reserves of the Breagh field as at May 31, 2011;
- Operates in an environment of fiscal and political stability;
- Operates in an environment of increasing competition;
- Is able to obtain additional financing or farm-out additional interests on satisfactory terms;
- Is able to continue to attract and retain qualified personnel; and
- Is able to obtain necessary approvals from partners for a particular course of action.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. The Company cannot guarantee future results, levels of activity, performance, or achievements. Certain of these risks and other factors, some of which are beyond the Company's control, which could cause results to differ materially from those expressed in the forward-looking statements contained in this MD&A include, but are not limited to:

- Recovery and reserves and resource estimates may prove incorrect;
- Risks associated with the finding, determination, evaluation, assessment and measurement of oil and gas deposits or reserves;
- Exploration and development activities are capital intensive and involve a high degree of risk; future appraisal of potential oil and gas properties may involve unprofitable efforts;
- Oil and gas prices fluctuate;
- Without the addition of reserves through exploration, acquisition or development activities, the Company's reserves and production will decline over time as reserves are exploited;
- Production operations involve many inherent risks;
- All modes of transportation of hydrocarbons involve inherent and significant risks;
- Interruptions in availability of exploration, production or supply infrastructure;
- Third party contractors and providers of capital equipment can be scarce;
- Reliance on other operators and stakeholders limits the Company's control over certain activities;
- Availability of joint venture partners and terms of agreement between them and Sterling will depend on factors beyond the Company's control;
- Permits, approvals, authorizations, consents and licenses may be difficult to obtain, sustain or renew;
- Regulatory requirements can be onerous and expensive;
- The Company cannot completely protect itself against title disputes;
- The Company is substantially dependent on its executive management;
- Environmental legislation can have an impact on the Company's operations;
- Additional funding may be required to carry out the Company's business operations and to expand reserves and resources;
- The Company's operations are subject to the risk of litigation;
- Negative operating cash flow could increase the need for additional funding;
- Issuance of debt to finance acquisitions would increase the Company's debt levels;
- Significant competition attracting and retaining skilled personnel;
- The international oil and gas industry is highly competitive in all its phases;
- Future acquisitions may involve many common acquisition risks;
- Managing the Company's expected growth and development could be challenging;
- Insurance may not be sufficient to cover the full extent of all liabilities;
- Currency fluctuations and foreign exchange and commodity risks;
- Political or government risk;

- Labour unrest could affect the Company's ability to explore for, produce and market its oil and gas production;
- Risks relating to the countries in which the Company operates;
- Uncertainties of legal systems in jurisdictions in which the Company operates;
- Failure to meet contractual agreements may result in the loss of the Company's interests; and
- Failure to follow corporate and regulatory formalities may call into question the validity of the entity or its assets.

These factors should not be considered exhaustive. Readers should also carefully consider the matters discussed under the heading "Risk Factors" beginning on page 17 of the Company's Annual Information Form.

The forward-looking statements contained in this MD&A are expressly qualified by the foregoing cautionary statement. Subject to applicable securities laws, the Company is under no duty to update any of the forward-looking statements after the date hereof to confirm such statements to actual results or to changes in the Company's expectations. Financial outlook information contained in this MD&A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. Readers are cautioned that such financial outlook information contained in this MD&A should not be used for purposes other than for which it is disclosed herein.

### Transition to International Financial Reporting Standards (IFRS)

The Company's Financial Statements for the three and nine month periods ended September 30, 2011 have been prepared in accordance including IAS 34 Interim Financial Reporting and IFRS 1 First-time Adoption of International Financial Reporting Standards. The same accounting policies and methods of computation were followed in the preparation of the Financial Statements for the three and nine months ended September 30, 2011 as were followed in the preparation of the Financial Statements for the three month period ended March 31, 2011 and the three and six month periods ended June 30, 2011. In addition, the Financial Statements for the three month period ended March 31, 2011 contain certain incremental annual IFRS disclosures not included in the annual financial statements for the year ended December 31, 2010 prepared in accordance with previous GAAP. Accordingly, these Financial Statements should be read together with the annual financial statements for the year ended December 31, 2010 prepared in accordance with previous GAAP, as well as the Financial Statements for the three month period ended March 31, 2011.

The following is a summary of the impact on shareholders' equity of the key adjustments resulting from the application of IFRS for the third quarter of 2010:

	Note	As at September 30, 2010
(Unaudited)		\$000s
<b>Total equity under previous GAAP</b>		246,915
Adjustments:		
Dry hole costs	(a)	(15,412)
Pre-license costs and other costs expensed under IFRS	(b)	(37,982)
Foreign currency impact of change in functional currencies	(c)	(9,850)
Capitalized share-based compensation expensed under IFRS	(d)	(2,585)
<b>Total equity under IFRS</b>		181,086

#### a. Exploration and Evaluation Assets

The Company previously followed the full cost method of accounting for oil and gas assets. Under this method, all expenditures incurred in connection with the acquisition, exploration, appraisal and development of oil and gas assets were capitalized in cost centres on a country-by-country basis. As permitted under IFRS the Company has changed its policy to a successful efforts based accounting policy on a retroactive basis. Under this policy the costs of unsuccessful exploration wells are expensed as dry hole

costs in the income statement in the period in which they are determined to be unsuccessful. Successful exploration wells remain capitalized, as do subsequent appraisal and development costs as they help to define the prospect. All assets are subsequently reviewed on a quarterly basis for impairment indicators.

#### **b. Pre-License Acquisition Costs and Indirect Overhead Charges**

Under previous GAAP all costs associated with property acquisition, exploration and development activities were capitalized within a cost centre, including costs incurred prior to the acquisition of a mineral right. In addition all administrative and general overhead costs were capitalized to cost centres.

IFRS 6 only applies to activities undertaken after the acquisition of the legal rights to explore and therefore does not apply to pre-exploration costs. As these costs do not meet the definition of an asset they are expensed. In addition only directly attributable general and overhead costs have been capitalized to exploration and evaluation assets.

#### **c. Functional Currency and Foreign Operations**

IFRS requires that the functional currency of each entity of the Company be determined separately in accordance with *IAS 21 – Foreign exchange*, and should be measured using the currency of the primary economic environment in which they operate (“the functional currency”). IFRS provides IFRS indicators that are used to assist in assessing the functional currency of the entity. Under previous GAAP, foreign currency translation was determined based upon the relationship between the parent company and the respective operating division – i.e. if they are financially or operationally interdependent with the reporting entity. Based upon this, the UK pound (“GBP”) was determined to be the functional currency for all entities under previous GAAP.

Using the IFRS indicators, a change of functional currency to the Canadian dollar for Sterling Resources Ltd. and the U.S. dollar for its Romanian operations was determined necessary.

#### **d. Share-Based Compensation**

Under previous GAAP the proportion of share-based compensation attributable to exploration and evaluation activities was capitalized within a cost centre. With the adoption of a successful efforts approach under IFRS, much of the share-based compensation previously capitalized would not be permitted as it relates to pre-license activity or unsuccessful wells.

A number of new standards and amendments to standards and interpretations are not yet effective for the year ended December 31, 2011 and have not been applied in preparing these Financial Statements. The following pronouncements from the International Accounting Standards Board (“IASB”) are applicable to Sterling and will become effective for future reporting periods, but have not yet been adopted:

- *IFRS 9 Financial Instruments* – IFRS 9 deals with the classification and measurement of financial assets. In October 2010, the IASB updated IFRS 9 by incorporating requirements for the accounting for financial liabilities. In its latest exposure draft of August 2011, the proposed elective date has been changed to January 1, 2015;
- *IFRS 10 Consolidated Financial Statements* – establishes the accounting principles for consolidated financial statements when one entity controls other entities. This standard establishes a new control model that applies to all entities and replaces *IAS 27 Consolidated and Separate Financial Statements* and the related provisions of *SIC-12 Consolidation – Special Purpose Entities*;
- *IFRS 11 Joint Arrangements* – establishes the accounting principles for parties to a joint arrangement and replaces *IAS 31 Interest in Joint Ventures* and *SIC-13 Jointly Controlled Entities: Non-Monetary Contributions by Venturers*. This standard requires a party to assess its rights and obligations from the arrangement in order to determine the type of joint arrangement. The choice of proportionate consolidation accounting is now prohibited for joint ventures as equity accounting is required;
- *IFRS 12 Disclosure of Interests in Other Entities* – establishes comprehensive disclosure requirements for subsidiaries, joint arrangements, associates, and unconsolidated structured entities and replaces existing disclosures in related standards;
- *IFRS 13 Fair Value Measurement* – establishes a single framework for fair value measurement and disclosures when fair value is required or permitted under IFRS;

- *IAS 27 Separate Financial Statements* – establishes the accounting and disclosure requirements for investments in subsidiaries, joint ventures, and associates when an entity prepares separate financial statements. The standard replaces the current *IAS 27 Consolidated and Separate Financial Statements*;
- *IAS 28 Investments in Associates and Joint Ventures* – establishes the accounting for investments in associates and defines how the equity method is applied.

Except as noted above, all of the above pronouncements are effective for annual periods beginning on or after January 1, 2013 with earlier adoption permitted. Sterling is currently assessing the impact of adopting these pronouncements.

## Significant Estimates

Management is required to make judgments, assumptions and estimates in the application of IFRS that have a significant impact on the financial results of the Company. Significant estimates in the financial statements include amounts recorded for the provision for future decommissioning obligations, share-based compensation expense and capital expenditure accruals. In addition, the Company uses estimates for numerous variables in the assessment of its assets for impairment purposes, including oil and natural gas prices, exchange rates, cost estimates and production profiles. By their nature, all of these estimates are subject to measurement uncertainty and the effect on future consolidated financial statements from changes in such estimates could be significant.

## Operating Highlights

(Unaudited)	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
\$000s except per share information				
Revenues	793	–	1,122	–
Expenses	8,742	10,237	45,086	17,605
Net financing (income) expense	(119)	3	(159)	279
Net loss for the period	7,830	10,240	43,805	17,884
Per common share – basic and diluted	0.04	0.07	0.22	0.13
Development, exploration and evaluation asset additions	38,182	22,550	144,485	29,176

(Unaudited)	As at	As At
	September 30, 2011	December 31, 2010
\$000s except share information and acreage		
Net working capital	64,700	138,410
Total assets, end of period	361,693	270,316
Share capital, end of period	337,713	290,444
Net license acreage (000s of acres)	2,577	2,618
Common shares outstanding 000s – basic, end of period	222,644	188,944
Common share options 000s outstanding – end of period	14,835	11,949

For the three months ended September 30, 2011, the Company recorded a net loss of \$7,830,000 (\$0.04 per share) compared with a net loss of \$10,240,000 (\$0.07 per share) for the three months ended September 30, 2010. For the nine months ended September 30, 2011, the Company recorded a net loss of \$43,805,000 (\$0.22 per share) compared with a net loss of \$17,884,000 (\$0.13 per share) for the nine months ended September 30, 2010. The decrease in the loss in the quarter and the increase of this loss in the nine month period comprised the following key elements:



## Bad Debt Expense

During the second quarter of 2011, the Company made a write-off of \$6,792,000 against recovery of overdue amounts receivable from a co-venturer in the unsuccessful Grian well on Block 48/28b in the UK Southern North Sea drilled in the first quarter of 2011.

## Dry Hole Expense

There were no dry hole costs incurred in the third quarter of 2011. During the third quarter of 2010, the Company expensed dry hole costs of \$4,670,000 relating to the unsuccessful Macanta exploration wells in the UK Southern North Sea.

For the nine months ended September 30, 2011, the Company expensed dry hole costs of \$9,733,000 relating to the unsuccessful Grian exploration well on Block 48/28b (Sterling 57 percent) in the UK Southern North Sea. In the same period of 2010, dry hole costs of \$8,746,000 related to the unsuccessful Airidh and Macanta exploration well in Quad 42 of the UK Southern North Sea.

## Pre-License and Other Exploration Costs

For the third quarter of 2011 pre-license and other exploration costs of \$1,881,000 were comparable to the \$1,987,000 in the same period of the prior year, with most of the activity being on the Company's development assets.

For the nine month period ended September 30, 2011, pre-license and other exploration costs of \$9,032,000 increased by \$2,657,000 over the same period in 2010. Most of this increase was attributable to initial costs and purchase of seismic data associated with the start-up of operations in the Netherlands in the first quarter of 2011. The Company is currently scheduled to spud a well on its acreage in the Netherlands in the fourth quarter of 2011.

## Employee Expense

Employee expenses of \$3,817,000 for the third quarter of 2011 have increased by \$2,176,000 over the third quarter of 2010. The bulk of the increase is attributable to additional salaries and non-cash share-based compensation expense due to share options issued to a growing number of employees and consultants.

For the nine months ended September 30, 2011, employee expenses of \$9,939,000 have increased by \$5,742,000 over the same period in 2010. \$1,848,000 of this is due to non-cash share-based compensation as described in the previous paragraph, and similarly, the remainder of the increase of \$3,894,000 is due to expansion activities as described for the third quarter.

## Foreign Exchange

The Company's cash balances are largely maintained in the currencies in which they are expected to be utilized. Exchange gains and losses reflected in the income statement are then largely offset by corresponding reductions or increases in underlying capital and other expenditures. Foreign exchange losses of \$991,000 for the third quarter of 2011 due to the weakening of the US dollar against the UK pound contributed to the loss of \$5,917,000 for the nine months ended September 30, 2011. Prior to the current quarter, losses arose mainly in the first quarter of 2011 on translation of US dollar cash balances into the respective functional currencies of the operations holding the funds.

The foreign exchange loss of \$1,448,000 in the third quarter of 2010 and \$3,147,000 gain for the nine months ended September 30, 2010 arose similarly on translation of funds into functional currency. During the first quarter when most of these gains were incurred, the US dollar strengthened against the UK pound. The third quarter loss was caused by the Canadian dollar weakening against the US dollar whilst the US dollar rate to the UK pound remained similar.

## General and Administration

General and administration expense of \$697,000 for the third quarter of 2011 has increased by \$230,000 in the same quarter of 2010, due to the increase in size of the UK operations and the opening of a new office in the Netherlands in the fourth quarter of 2010. For the nine months ended September 30, 2011, general and administration expense of \$1,896,000 increased by \$544,000 over the same period in 2010 for the same reasons.

## Financing Costs

Financing costs include interest expense, amortization of debt issue costs and accretion of the discount on decommissioning obligations. Following the final repayment of the Company's secured note facility in April 2010, financing costs have consisted solely of accretion of the discount on decommissioning obligations.

## Income Taxes

The Company has not recognized the tax benefit of losses incurred to September 30, 2011. With continued progress on the Breagh development, the likelihood of being able to utilize these losses has increased, but such utilization is still several years away. Accordingly, at the present time management considers it too early to recognise a deferred tax asset, but this position will be reviewed regularly.

As at September 30, 2011, the Company had estimated UK tax losses carried forward of approximately £204,350,000 and other capital allowances of \$47,193,000 available to shield future taxable income in Canada, Romania and other international jurisdictions. These losses are not subject to expiry. In addition, the Company has approximately \$27,053,000 of Canadian and other international non-capital allowances which are subject to expiry over the next 20 years.

The Company is also required to incur eligible expenditures of approximately £57,000,000 as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area in August 2009. By September 30, 2011, eligible expenditures in excess of £57,000,000 have been incurred and hence management believes the Company will qualify for the full exemption.

## Unrealized Loss on Derivative Financial Instruments

As a requirement of the Credit Facility, the Company has purchased monthly cash-settled put options to hedge 40 percent of its forecast P90 (proved reserves) gas production volumes from Breagh Phase 1 for a 24 month period starting on October 1, 2012. The strike price for the options is 55 pence per therm and the total volume hedged is 10.1 billion cubic feet (Bcf.) Half of the put options were purchased for an upfront cash premium of £2,195,000, (equivalent to \$3,543,000) and the other half which were purchased subsequent to quarter end, on a deferred premium basis for a total cost of £2,713,000, to be settled on a monthly basis during the option exercise period.

The Company has recognized the initial up front premium paid for the put options as a derivative financial asset. The derivatives are then revalued to their fair value at period ends. Any gain or loss arising is recorded through the income statement in the same period in which it arises. Fair Value is obtained through a Monte Carlo based option pricing model. As at September 30, 2011 the Company has recognized \$1,010,000 as an unrealized loss on derivative financial instruments.

As at September 30, 2011 the forward curve for the period covered by the options sits in a range between 65 pence and 76 pence per therm, and so the options purchased are currently out-of-the money.

## Overview and Summary of Results for the Eight Most Recently Completed Quarters

The Company had only minor commercial production during the first nine months of 2011. Any other minor pre-commercial production revenues during earlier quarters have been netted against related expenses, and the net amount capitalized as test production. Up to September 30, 2011 Sterling's results from operations were not affected by seasonal considerations. The following table summarizes the Company's income statements for the eight most recently completed quarters ended September 30, 2011. Quarters previous to the Company's Transition Date to IFRS of January 1, 2010 are reported under previous GAAP.

Quarter ended	IFRS				Previous GAAP			
	2011		2010		2009			
	Sep-30	Jun-30	Mar-31	Dec-31	Sep-30	Jun-30	Mar-31	Dec-31
\$000s except per share information								
Net (loss) income								
Canada	<b>(1,945)</b>	(1,784)	(2,955)	926	(1,694)	(857)	(1,690)	(1,619)
United Kingdom	<b>(5,257)</b>	(9,537)	(13,924)	(4,859)	(6,808)	(2,956)	1,367	818
Romania	<b>(1,608)</b>	(1,732)	(2,945)	(974)	(873)	(1,809)	(1,203)	250
Other International	<b>980</b>	(530)	(2,568)	(1,020)	(865)	(476)	(20)	(1)
Net (loss) income	<b>(7,830)</b>	(13,583)	(22,392)	(5,927)	(10,240)	(6,098)	(1,546)	(552)
Net (loss) income per share								
Basic	<b>(0.04)</b>	(0.07)	(0.12)	(0.04)	(0.07)	(0.05)	(0.01)	–
Diluted	<b>(0.04)</b>	(0.07)	(0.12)	(0.04)	(0.07)	(0.05)	(0.01)	–

Under the Company's successful efforts accounting policy for exploration and appraisal activity, the Company's results from quarter to quarter are significantly impacted by the level and success of its drilling program.

## Development Activity

Development work on the Breagh gas field in the UK Southern North Sea (Sterling 30 percent) continued and first gas is still expected on schedule in mid 2012. Following receipt of approval for Phase 1 of the development from the UK Department of Energy and Climate Change ("DECC") in July 2011, the carrying value of the asset was moved from the Exploration and Evaluation category to the Property, Plant and Equipment category.

At the end of the quarter, cumulative development expenditures amounted to £66,850,000 (\$107,909,000) Sterling share. Total development expenditures for Phase 1 are currently estimated by the operator, RWE DEA UK SNS Ltd, at £527 million (\$851 million) for 100 percent or £158 million (\$255 million) Sterling share, with full implementation of the 10 wells in the Field Development Program ("FDP"). The remaining expenditure of £91 million (\$147 million) to be spent by Sterling relates to onshore pipeline and plant modifications and the development drilling program.

As described above the operator's total Phase 1 development cost is now estimated at £527 million (100 percent), representing a cost increase of 8.7 percent over the original budget contained in the FDP of £485 million. The difference has arisen primarily from increased costs in offshore pipeline installation, and onshore facilities and pipeline modifications.

An addendum to the current FDP, for Phase 2 of the Breagh development, is expected to be submitted by the operator to DECC in the next few months with approval sought in the second quarter of 2012. The incremental development concept currently comprises a second platform, Breagh Bravo, roughly 5 kilometers to the east of the Breagh Alpha platform connected by an intra-field pipeline. Some 7 wells are currently planned to be drilled from the Breagh Bravo platform while the number of wells to be drilled from the Alpha platform is then expected to decrease from 10 (as per the FDP) to 7, bringing the total Phase 1 cost down to £453 million (100 percent). The incremental cost of Phase 2 is likely to be approximately £275 million (100 percent). Breagh Bravo platform installation is expected in 2013 with first incremental gas around the end of the year.

## Exploration and Evaluation Activity

During the nine months ended September 30, 2011 key operational activity and expenditures included the following:

- The four-well Cladhan drilling program costing \$26,968,000. Pre-development work on the field commenced with the objective of working towards project sanction in 2013 and first production in 2014; and
- The operated Grian 48/28b-2 exploration well, costing a total of \$9,733,000.

During the nine months ended September 30, 2011 the Company relinquished its interest in Blocks 42/2b, 42/3 and 42/4 containing the Darach prospect in the UK Southern North Sea, following the operator's decision not to proceed with future work after the evaluation of seismic data acquired in 2010.

In the first nine months of 2010, \$29,094,000 of exploration and evaluation activity was capitalized and \$15,121,000 was expensed as pre-license and dry hole costs. Amongst those items capitalized were \$14,700,000 of Cladhan appraisal expenditure, \$7,100,000 of Breagh field development costs and \$3,600,000 on the Blakeney exploration well on Block 21/27b. Of the amounts expensed in the same period in 2010, \$4,200,000 related to the Macanta exploration well in Block 42/14 and \$2,100,000 to the Airidh exploration well in Block 42/19a.

## Financing Activities

In July 2011, the Company signed a senior secured credit facility for up to £105 million with BNP Paribas, Commonwealth Bank of Australia, and Societe Generale (the "Credit Facility"). GE Energy Financial Services joined the Facility later in the third quarter. The Credit Facility is to be used by the Company's wholly-owned subsidiary, Sterling Resources (UK) Ltd ("SRUKL"), to fund the Phase 1 development of the Breagh gas field (Sterling 30 percent) and related costs. The Credit Facility comprises a main tranche of £95 million and a cost-overrun facility of £10 million, with a loan term of 6.5 years. A step-up amount of up to £50 million for the Phase 2 development is also available on an uncommitted basis. The interest rate on the main tranche currently has a margin of 4 percent over LIBOR, but the margin will drop to 3.5 percent for a period following project completion. In common with most other asset-secured financings of this type, no proceeds of gas sales from the field are available to the Company until the satisfaction of project completion tests following the successful drilling and testing of all the Phase 1 wells. Assuming Breagh Phase 2 proceeds and the number of Phase 1 wells is reduced from 10 to 7, the completion tests are expected to be satisfied around mid 2013. Transaction costs relating to the Credit Facility incurred in the quarter amounted to £3.4 million and have been capitalized. As the assets to which the borrowing costs relate to are deemed Major Development Projects, and not yet in use, these costs are capitalized to the asset and then depleted as the asset enters production.

The loan repayment schedule runs from January 1, 2014 to the end of the loan life, but the Credit Facility contains a cash sweep mechanism whereby 75 percent of surplus cash (after meeting capital and operating costs and debt service requirements as defined in the Credit Facility agreement) is used to pay down the loan ahead of scheduled loan repayment obligations. It is the intention of the Company to renegotiate the Credit Facility upon satisfaction of the completion tests to remove the cash sweep requirement. The Credit Facility also requires the Company to maintain a minimum level of cash within the group over a 12 month period, as demonstrated by forward-looking cash flow statements prepared at the end of each quarter. The minimum cash level is currently set at £25 million, £10 million of which is held as restricted cash. The security package provided to the lending banks includes a fixed and floating charge over the assets of SRUKL, a charge over the shares of SRUKL, a parent guarantee and other security arrangements common for a loan of this nature. Under the Credit Facility, the Company is also subject to a range of other corporate, financial, operating and reporting undertakings and obligations, with all of which the Company is in compliance.

The Credit Facility agreement completed in late September and the first drawdown of £36,083,000 was received by the Company on September 30, 2011 as a reimbursement of eligible expenditures relating to the Breagh development already incurred.

As a requirement of the Credit Facility, the Company has purchased monthly cash-settled put options to hedge 40 percent of its forecast P90 (proved reserves) gas production volumes from Breagh Phase 1 for a 24 month period starting on October 1, 2012. The strike price for the options is 55 pence per therm and the total volume hedged is 10.1 Bcf. Half of the put options were purchased for an upfront cash premium of £2,195,000, and the other half were purchased subsequent to the end of the quarter, on a deferred premium basis for a total cost of £2,713,000.

On July 26, 2011 Sterling entered into a bought deal financing arrangement with a syndicate of underwriters to issue 32,143,000 common shares at a price of \$1.40 per common share for net proceeds of \$42,520,000 after fees and expenses. The offering closed on August 16, 2011. The principal use of the net proceeds is to ensure that the Company maintains sufficient cash at group level to meet the liquidity threshold set under the Credit Facility through the end of 2012. In addition, some of the net proceeds will be used to fund a potential production test on the Netherlands F17 well and other exploration and appraisal activities.

On September 1, 2011 Sterling announced that it had signed a farm-out agreement with Petro Ventures Netherlands B.V. covering its licenses within the F-Quad and L-Quad offshore Netherlands. Subject to governmental and co-venturer approvals, Sterling Resources Netherlands B.V. as operator will now hold a 25 percent working interest, Energie Beheer Nederland B.V. will hold 40 percent, Petro Ventures Netherlands B.V. will hold 25 percent and Grove Energy Limited (a subsidiary of Enquest PLC) will hold the remaining 10 percent. Further information on the accounting policy for this transaction can be seen under note 2 of the financial statements.

During the nine months ended September 30, 2011, the Company issued 1,557,000 common shares as a result of share options exercised by employees and directors under the Company's share option plan. The weighted average exercise price of the underlying options was \$2.19 and aggregate proceeds were \$3,410,000.

## Financing, Liquidity and Solvency

### Net Working Capital

	September 30, 2011	December 31, 2010
<hr/>		
\$000s		
Cash and cash equivalents	58,039	142,624
Restricted cash	22,268	963
Trade and other receivables	7,203	4,095
Prepaid expenses	195	62
Trade and other payables	(21,842)	(7,434)
Provisions	(1,163)	(1,900)
	<b>64,700</b>	138,410

Net working capital of \$64,700,000 at September 30, 2011 has decreased substantially from year-end 2010 levels mainly due to the increase in operational activity at Breagh, Cladhan and Grian in the UK North Sea. This figure is up from the second quarter due to the drawdown of the Breagh credit facility and the equity issue in this quarter.

Cash and cash equivalents at September 30, 2011 include term deposits of \$6,061,000 (December 31, 2010 – \$139,238,000).

Restricted cash of \$22,268,000 at September 30, 2011 (\$963,000 as at December 31, 2010) comprised cash held in escrow which was available only for payment of expenditures included in trade payables relating to the final reconciliations of drilling programs, primarily at Cladhan, and \$16,142,000 relating to the minimum cash balance under the Credit Facility. Under the Credit Facility, the Company currently has a minimum group cash requirement of £25,000,000, of which £10,000,000 is held in a separate account and is treated as restricted cash. The balance of the £15,000,000 may be utilized for short-term working capital requirements.

As at September 30, 2011, there are only minor trade receivables greater than 90 days.

Trade and other payables of \$21,842,000 at September 30, 2011 comprised mainly of accrued expenditures related to the Breagh development project. The increase over the \$7,434,000 as at December 31, 2010 is indicative of the ramping up of activity during the year.

Provisions of \$1,163,000 at September 30, 2011 have been reduced from \$1,900,000 at December 31, 2010. This provision was set up in 2010 to provide for an underpayment of employment taxes, associated interest and possible penalties relating to the Company's share option plan for UK employees. In the first quarter of 2011, certain affected individuals were determined to be non-resident, and therefore unaffected by the UK regulations, and the provision was reduced accordingly.

## Commitments and Contingencies

Excluding amounts held in escrow and shown as restricted cash for the Cladhan drilling program, as at September 30, 2011 commitments for the remainder of 2011 and years up to 2015 comprised the following:

	2011	2012	2013	2014	2015	Total
\$000s						
Oil and gas drilling	–	–	13,560	6,053	–	<b>19,613</b>
Seismic	319	2,391	–	–	–	<b>2,710</b>
License fees	1,391	2,961	4,354	5,747	7,140	<b>21,593</b>
Other operating	22	411	702	892	860	<b>2,887</b>
Office and other leases	195	75	43	–	–	<b>313</b>
	<b>1,927</b>	<b>5,838</b>	<b>18,659</b>	<b>12,692</b>	<b>8,000</b>	<b>47,116</b>

Effective October 11, 2011 the Romanian government rescinded the Construction Permit Law, in relation to offshore requirements, an impediment upon which the Company had declared force majeure on April 28, 2011 on its Midia and Pelican Blocks in the Black Sea. In late October the Company reached agreement with the Government of Romania on a package of issues that will resolve the Notice of Dispute filed on June 20, 2011 under the bi-lateral Treaty for the Promotion and Reciprocal Protection of Investments between Romania and Canada. Agreement was reached to grant assignments to Sterling's designated partners, PetroVentures Europe B.V. (20 percent) and Gas Plus International B.V. (15 percent). In addition, the Government agreed that all of Sterling's offshore licenses will now initially run to May 2014 with two additional, three year renewal terms also being available under the Concession Agreement, signed in August 2007. These agreements were formally concluded on November 18, 2011. In this positive scenario the Company has made no provision for impairment as at September 30, 2011.

## Decommissioning Obligations

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas licenses in which there has been exploration, appraisal and development activity. The provision is the discounted present value of the estimated cost, using existing technology at current prices. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately \$3,838,000 which will be incurred between 2015 and 2032. Risk free interest rates based on UK long-term government bond rates varying from 3.25 percent to 4.75 percent and an inflation rate of 4 percent were used to calculate the fair value of asset retirement obligations. Revisions to estimates relate primarily to the extension of anticipated field lives as a result of the respective drilling programs.

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
\$000s		
At beginning of period	<b>1,814</b>	2,199
Arising during period	<b>187</b>	–
Revisions to estimates	<b>177</b>	(337)
Foreign exchange differences	<b>83</b>	(209)
Accretion of discount	<b>68</b>	161
At end of period	<b>2,329</b>	1,814

## Liquidity and Solvency

As at September 30, 2011, the Company's net working capital totaled \$64,700,000. Together with the recently approved Credit Facility, and the new equity issue, this is considered sufficient to cover its obligations and commitments for the next year. However, additional funding would be required for Phase 2 of the Breagh development, for the development of Cladhan and Doina/Ana subject to the

relevant approvals and for any other additional exploration and appraisal activity. To meet any such additional expenditures, the Company would consider farming down or selling some existing assets, arranging additional debt facilities, or raising additional equity or quasi-equity.

The Company became cash generating through its Kirkleatham onshore UK development in the second quarter of this year, though revenues from the field are small.

## 2011 Plans

The Company outlined its plans for 2011 in the annual report for the year ended December 31, 2010 and updated these in subsequent quarterly reports. Several of the specific plans have been completed:

- Four appraisal wells were drilled on the Cladhan discovery, consistent with the previously announced intention to drill at least two such wells;
- An exploration well was drilled on Block 48/28b in the UK Southern North Sea (Grian);
- Kirkleatham was brought on-stream; and
- A resolution to certain major issues in Romania was achieved, which allows the Ana and Doina developments to move forward together with further exploration activities.

Several plans in the 2010 annual report and/or subsequent quarterly reports are unchanged:

- Progress the Breagh development towards achieving first gas in 2012;
- Continue geological and geophysical work on exploration prospects and discoveries on all its licenses;
- Continue farming out a portion of Company licenses in order to manage risks and reduce costs;
- Work with the operator to define Phase 2 of the Breagh development and to submit an addendum to the current Field Development Program to the government; and
- Drill and potentially test an appraisal well on an existing oil discovery in Block F17 offshore the Netherlands.

Other plans have been revised:

- Drilling operations on the Breagh development will not commence until quarter one 2012 owing to third party rig commitments, and will commence with tie-back operations on two existing wells. The drilling of new development wells will follow this;
- Two exploration wells offshore Romania will not be drilled in 2011;
- An exploration well on the Craiova block onshore Romania has been postponed into 2012 or 2013, in order to first acquire further seismic data and to review potential farm out opportunities, including (in conjunction with its partner doing likewise) potentially farming-out 50 percent of the Company's working interest in order to identify a partner with the technical expertise to support the forward evaluation program of the Silurian shale in the area; and
- The plan to drill an appraisal/development well on the Crosgan discovery, which could be tied-back to the Breagh facilities, has been delayed until 2012 or 2013.

These plans remain contingent on partner approval, upon availability of suitable financing and (if appropriate) farm-out partners.

Corporately, the last annual report referred to plans regarding the senior debt facility and a listing on the main board of the London Stock Exchange. The senior debt facility for Phase 1 of the Breagh development has been signed. The timing of the London listing is dependent on several factors: finalization of appraisal and development plans for Cladhan and wider equity market conditions. Management remains of the view that a London listing is appropriate for the Company.

## Additional Information

Additional information about Sterling Resources Ltd. and its business activities, including Sterling's Annual Information Form, is available via SEDAR at [www.sedar.com](http://www.sedar.com).

## CONSOLIDATED BALANCE SHEETS

	September 30, 2011	December 31, 2010
(Unaudited)	\$000s	\$000s
<b>ASSETS</b> [note 11]		
<b>Current assets</b>		
Cash and cash equivalents [note 4]	58,039	142,624
Restricted cash [note 5]	22,268	963
Trade and other receivables [note 6]	7,203	4,095
Prepaid expenses	195	62
	<b>87,705</b>	<b>147,744</b>
<b>Non-current assets</b>		
Exploration and evaluation assets [note 7]	109,535	122,359
Property, plant and equipment [note 8]	161,935	213
Derivative financial asset [note 9]	2,518	–
	<b>273,988</b>	<b>122,572</b>
	<b>361,693</b>	<b>270,316</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities</b>		
Trade and other payables	21,842	7,434
Provisions [note 10]	1,163	1,900
	<b>23,005</b>	<b>9,334</b>
<b>Non-current liabilities</b>		
Long-term debt [note 11]	58,245	–
Decommissioning obligations [note 10]	2,329	1,814
	<b>60,574</b>	<b>1,814</b>
<b>Commitments and contingencies</b> [note 12]		
<b>Equity</b>		
Share capital [note 13]	337,713	290,444
Contributed surplus	12,353	9,283
Accumulated other comprehensive loss	(17,744)	(30,156)
Deficit	(54,208)	(10,403)
	<b>278,114</b>	<b>259,168</b>
	<b>361,693</b>	<b>270,316</b>

The accompanying notes are an integral part of the interim condensed consolidated financial statements as at and for the three and nine months ended September 30, 2011 and 2010 (“the Financial Statements”).



## CONSOLIDATED INCOME STATEMENTS

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
(Unaudited)	\$000s except per share	\$000s except per share	\$000s except per share	\$000s except per share
		[note 21]		[note 21]
<b>Revenue</b>	<b>793</b>	–	<b>1,122</b>	–
<b>Expenses</b>				
Operating expenses	74	–	74	–
Bad debt expense [note 14]	–	–	6,792	–
Dry hole expense	–	4,670	9,733	8,746
Pre-license and other exploration expenditures	1,881	1,987	9,032	6,375
Employee expense [note 16]	3,817	1,641	9,939	4,197
General and administration	697	467	1,896	1,352
Unrealized loss on derivative financial instruments [note 9]	1,010	–	1,010	–
Foreign exchange loss (gain)	991	1,448	5,917	(3,147)
Depletion, depreciation and amortization [note 8]	272	24	693	82
<b>Total expenses</b>	<b>8,742</b>	10,237	<b>45,086</b>	17,605
<b>Financing income</b>	<b>(27)</b>	(60)	<b>(227)</b>	(461)
<b>Financing costs</b> [note 17]	<b>(92)</b>	63	<b>68</b>	740
<b>Net loss for the period</b>	<b>7,830</b>	10,240	<b>43,805</b>	17,884
<b>Net loss per common share</b> [note 19]				
Basic	<b>0.04</b>	0.07	<b>0.22</b>	0.13
Diluted	<b>0.04</b>	0.07	<b>0.22</b>	0.13

The accompanying notes are an integral part of the Financial Statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS)/INCOME

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
(Unaudited)	\$000s	\$000s	\$000s	\$000s
		[note 21]		[note 21]
<b>Net loss</b>	<b>(7,830)</b>	(10,240)	<b>(43,805)</b>	(17,884)
Foreign currency translation adjustment	<b>15,737</b>	3,610	<b>12,412</b>	(5,306)
<b>Comprehensive (loss) income</b>	<b>7,907</b>	(6,630)	<b>(31,393)</b>	(23,190)

The accompanying notes are an integral part of the Financial Statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Loss	Retained Earnings (Deficit)	Total
	\$000s	\$000s	\$000s	\$000s	\$000s
Balance at January 1, 2010	157,643	6,858	(20,708)	12,650	156,443
Exercise of stock options and warrants [note 13]	3,454	–	–	–	3,454
Public equity issuances (net of costs) [note 13]	41,818	–	–	–	41,818
Transferred from contributed surplus on exercise of options	1,040	(1,040)	–	–	–
Share-based compensation [note 16]	–	2,561	–	–	2,561
Foreign currency translation into presentation currency	–	–	(5,306)	–	(5,306)
Loss for the period	–	–	–	(17,884)	(17,884)
<b>Balance at September 30, 2010 [note 21]</b>	<b>203,955</b>	<b>8,379</b>	<b>(26,014)</b>	<b>(5,234)</b>	<b>81,086</b>
Balance at January 1, 2011	290,444	9,283	(30,156)	(10,403)	<b>259,168</b>
Exercise of stock options [note 13]	3,410	–	–	–	<b>3,410</b>
Public equity issuances (net of costs) [note 13]	42,520	–	–	–	<b>42,520</b>
Transferred from contributed surplus on exercise of options	1,339	(1,339)	–	–	–
Share-based compensation [note 16]	–	4,409	–	–	<b>4,409</b>
Foreign currency translation into presentation currency	–	–	12,412	–	<b>12,412</b>
Loss for the period	–	–	–	(43,805)	<b>(43,805)</b>
<b>Balance at September 30, 2011</b>	<b>337,713</b>	<b>12,353</b>	<b>(17,744)</b>	<b>(54,208)</b>	<b>278,114</b>

The accompanying notes are an integral part of the Financial Statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	\$000s	\$000s	\$000s	\$000s
		[note 21]		[note 21]
<b>Cash flows from operating activities</b>				
Loss for the period	(7,830)	(10,240)	(43,805)	(17,884)
Adjustments to add (deduct) non-cash items				
Unrealized foreign exchange gain	(843)	(1,844)	(147)	(1,766)
Unrealised loss on derivative financial instruments	1,010	–	1,010	–
Share-based compensation [note 16]	1,537	1,124	4,409	2,561
Accretion [note 17]	(92)	63	68	170
Depletion, depreciation and amortization	272	24	693	82
Amortization of debt issue costs [note 17]	–	–	–	358
Change in non-cash working capital	(528)	260	(1,516)	118
<b>Cash flows (used in) operating activities</b>	<b>(6,474)</b>	<b>(10,613)</b>	<b>(39,288)</b>	<b>(16,361)</b>
<b>Cash flows from investing activities</b>				
Increase in restricted cash [note 5]	(13,564)	(3,351)	(21,305)	(6,626)
Exploration and evaluation asset additions [note 7]	(32,984)	(22,528)	(138,608)	(29,094)
Property, plant and equipment additions [note 8]	(5,198)	(22)	(5,877)	(82)
Change in non-cash working capital	(28,896)	10,424	11,945	6,144
<b>Cash flows (used in) investing activities</b>	<b>(80,642)</b>	<b>(15,477)</b>	<b>(153,845)</b>	<b>(29,658)</b>
<b>Cash flows from financing activities</b>				
Repayment of secured notes	–	–	–	(7,437)
Premium paid on derivative financial instruments [note 9]	(3,543)	–	(3,543)	–
Proceeds from public equity issuances [note 13]	42,520	41,818	42,520	41,818
Proceeds from loan funds [note 11]	58,245	–	58,245	–
Proceeds from exercise of share options [note 13]	76	911	3,410	2,295
Proceeds from exercise of warrants [note 13]	–	–	–	1,159
<b>Cash flows provided by financing activities</b>	<b>97,298</b>	<b>42,729</b>	<b>100,632</b>	<b>37,835</b>
<b>Effect of translation on foreign currency</b>				
<b>cash and cash equivalents</b>	<b>8,058</b>	<b>3,786</b>	<b>7,916</b>	<b>(2,205)</b>
Increase (decrease) in cash and cash equivalents during the period	18,240	20,425	(84,585)	(10,389)
<b>Cash and cash equivalents, beginning of period</b>	<b>39,799</b>	<b>50,985</b>	<b>142,624</b>	<b>81,799</b>
<b>Cash and cash equivalents, end of period</b>	<b>58,039</b>	<b>71,410</b>	<b>58,039</b>	<b>71,410</b>

The accompanying notes are an integral part of the Financial Statements.

# NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For the Three and Nine Months Ended September 30, 2011 and 2010

## 1. Corporate Information

Sterling Resources Ltd. (the "Company") is a publicly traded energy company incorporated and domiciled in Canada. The Company is engaged in the exploration, appraisal and development of crude oil and natural gas in the United Kingdom, Romania, the Netherlands and France. The registered office is located at Suite 1450, 736 Sixth Avenue S.W., Calgary, Alberta, Canada.

The Company's Financial Statements comprise the financial statements of the Company and the wholly owned group companies Sterling Resources (UK) Ltd., Sterling Resources Netherlands B.V., and Midia Resources SRL.

These unaudited interim condensed consolidated financial statements ("the Financial Statements") were approved for issue at a meeting of the Audit Committee on November 22, 2011.

## 2. Basis of Preparation

These Financial Statements for the three and nine month periods ended September 30, 2011 were prepared in accordance with IAS 34 Interim Financial Reporting and IFRS 1 First Time Adoption of International Financial Reporting Standards. The same accounting policies and methods of computation were followed in the preparation of the Financial Statements as were followed in the preparation of the interim condensed consolidated financial statements for the three month period ended March 31, 2011 and the three and six month period ended June 30, 2011. In addition, the interim condensed consolidated financial statements for the three month period ended March 31, 2011 contain certain incremental annual International Financial Reporting Standards ("IFRS") disclosures not included in the annual financial statements for the year ended December 31, 2010 prepared in accordance with former Canadian generally accepted accounting principles ("previous GAAP"). Accordingly, these Financial Statements for the three and nine month periods ended September 30, 2011 should be read together with the annual consolidated financial statements for the year ended December 31, 2010 prepared in accordance with previous GAAP, as well as the interim condensed consolidated financial statements for the three month period ended March 31, 2011. The presentation currency of these Financial Statements is the Canadian dollar.

### New Accounting Policies Adopted in the Year

#### Asset Swaps

Exchanges of assets are measured at fair value unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. The cost of the acquired asset is measured at the fair value of the asset given up, unless the fair value of the asset received is more clearly evident. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. The gain or loss arising is recognized in net income (loss).

#### Farm-Out Arrangements

Farm-outs generally occur in the exploration phase and are characterized by the transferor giving up future economic benefits, in the form of reserves, in exchange for reduced future funding obligations. In the exploration phase, the Company accounts for farm-outs on a historical cost basis. As such, no gain or loss is recognized; any consideration received is credited against the carrying value of the related asset.

#### Borrowing Costs

Long-term debt transaction costs, which may include but are not limited to bank fees, legal costs and time-writing are capitalized at inception and are amortized over the life of the loan using the effective interest method. When the assets to which borrowing costs relate are deemed Major Development Projects, and are not yet ready for their intended use, these borrowing costs are capitalized to the asset and then depleted as the asset enters production.

### Derivative Financial Instruments

Derivative financial instruments are utilized to reduce commodity price risk associated with the Company's future production of natural gas. The Company does not enter into financial instruments for trading or speculative purposes.

The Company currently uses only put options to partially offset or mitigate the wide price swings commonly encountered in natural gas commodities and in so doing protects a minimum future level of cash flow in periods of low commodity prices. The Company considers these financial risk management contracts to be effective on an economic basis but has decided not to designate these contracts as hedges for accounting purposes and, accordingly, an unrealized gain or loss is recorded based on the change in fair value ("mark-to-market") of the contracts at each reporting period end. These instruments are recorded as derivative financial instruments in the consolidated balance sheet.

### **3. New Accounting Standards and Interpretations Not Yet Adopted**

The following pronouncements from the International Accounting Standards Board "IASB" are applicable to Sterling and will become effective for future reporting periods, but have not yet been adopted:

- *IFRS 9 Financial Instruments* – IFRS 9 deals with the classification and measurement of financial assets. In October 2010, the IASB updated IFRS 9 by incorporating requirements for the accounting for financial liabilities. In its latest exposure draft of August 2011 the proposed effective date has been changed to January 1, 2015;
- *IFRS 10 Consolidated Financial Statements* – establishes the accounting principles for consolidated financial statements when one entity controls other entities. This standard establishes a new control model that applies to all entities and replaces *IAS 27 Consolidated and Separate Financial Statements and the related provisions of SIC-12 Consolidation – Special Purpose Entities*;
- *IFRS 11 Joint Arrangements* – establishes the accounting principles for parties to a joint arrangement and replaces *IAS 31 Interest in Joint Ventures* and *SIC-13 Jointly Controlled Entities: Non-Monetary Contributions by Venturers*. This standard requires a party to assess its rights and obligations from the arrangement in order to determine the type of joint arrangement. The choice of proportionate consolidation accounting is now prohibited for joint ventures as equity accounting is required;
- *IFRS 12 Disclosure of Interests in Other Entities* – establishes comprehensive disclosure requirements for subsidiaries, joint arrangements, associates, and unconsolidated structured entities and replaces existing disclosures in related standards;
- *IFRS 13 Fair Value Measurement* – establishes a single framework for fair value measurement and disclosures when fair value is required or permitted under IFRS;
- *IAS 27 Separate Financial Statements* – establishes the accounting and disclosure requirements for investments in subsidiaries, joint ventures, and associates when an entity prepares separate financial statements. The standard replaces the current *IAS 27 Consolidated and Separate Financial Statements*;
- *IAS 28 Investments in Associates and Joint Ventures* – establishes the accounting for investments in associates and defines how the equity method is applied.

Except as noted above, all of the above pronouncements are effective for annual periods beginning on or after January 1, 2013 with earlier adoption permitted. Sterling is currently assessing the impact of adopting these pronouncements.

#### 4. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	September 30, 2011	December 31, 2010
	\$000s	\$000s
Cash	51,978	3,386
Cash equivalents	6,061	139,238
	58,039	142,624
<b>Balances held in:</b>		
Canadian dollars	4,282	92,123
US dollars	7,499	35,994
UK pounds	43,564	14,445
Other	2,694	62
<b>Cash and cash equivalents</b>	<b>58,039</b>	<b>142,624</b>

As at September 30, 2011 cash equivalents carried interest rates between 0.03 percent and 1.0 percent (December 31, 2010 – 0.03 percent and 1.0 percent).

#### 5. Restricted Cash

Restricted cash of \$22,268,000 at September 30, 2011 (\$963,000 as at December 31, 2010) was comprised of cash held in escrow which was available only for payment of expenditures included in trade payables relating to the final reconciliations of drilling programs, primarily at Cladhan, and \$16,142,000 relating to the minimum cash balance under the Credit Facility. Under the Credit Facility, the Company currently has a minimum group cash requirement of £25,000,000, of which £10,000,000 is held in a separate account and is treated as restricted cash. The balance of the £15,000,000 may be utilized for short-term working capital requirements.

#### 6. Financial Instruments

The Company's financial instruments, including cash and cash equivalents, restricted cash, trade and other receivables, derivative financial instruments, trade and other payables and long-term debt, have been categorized as follows:

- Cash and cash equivalents and restricted cash – held for trading;
- Trade and other receivables – loans and receivables;
- Derivative financial instruments – held for trading; and
- Trade and other payables and long-term debt – other financial liabilities.

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value of derivative financial instruments is discussed in note 9. The carrying value of all other financial assets and liabilities approximate their fair value due to their relatively short-term maturities or variable interest rates.

The Company is exposed to a number of different financial risks arising from normal course business exposures, as well as the Company's use of financial instruments. These risk factors include market risks relating to foreign exchange rate fluctuations and interest rate risk, as well as liquidity risk and credit risk.

## Foreign Exchange Rate Risk

The Company's functional currencies for UK, Canadian and Romanian operations are the UK pound, Canadian dollar and US dollar, respectively. Foreign exchange gains or losses can occur on translation of working capital denominated in currencies other than the functional currency of the jurisdiction which holds the working capital item. Excluding the impact of changes in the cross-rates, a one percent fluctuation between translation rates would have the following impact on net income (loss), based on foreign currency balances held at September 30, 2011.

	C\$000s
Canadian dollar vs. UK pound	(16)
Canadian dollar vs. US dollar	2
UK pound vs. US Euro	22
UK pound vs. US dollar	90

## Interest Rate Risk

During the third quarter the Company entered into the Credit Facility which exposed its cash flows to potentially significant interest rate risk for the first time. The details of this Facility are further explained in note 11. The interest rate used is an additional margin on top of LIBOR. Based on the balance at September 30, 2011, a one percentage point change in the average LIBOR interest rate on this loan amount would increase or decrease net income (loss) by approximately \$582,000 over a full year.

In addition, from time to time the Company may have significant cash or cash equivalent balances invested at prevailing short-term interest rates. Accordingly, cash flows are sensitive to changes in interest rates on these investments. Based on total cash and cash equivalents and restricted cash at September 30, 2011, a one percentage point change in average interest rates would increase or decrease net income (loss) by approximately \$803,000 over a full year.

## Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. As a result of the signing of the Credit Facility and a bought deal financing in August, 2011 (refer to notes 11 and 13) the Company has access to sufficient cash to settle its trade and other payables and meet its immediate joint venture commitments and license obligations. The Company monitors and manages its liquidity through comparisons of working capital with budgets and regular forecasts of cash requirements, and by adjusting discretionary expenditures where appropriate.

## Credit Risk

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due causing a financial loss. The Company's trade and other receivables are primarily with governments for recoverable amounts of value added taxes (VAT) or joint venture partners in the oil and gas industry. Receivables from partners are secured by the partner's interest in the underlying oil and gas properties. As at September 30, 2011 \$6,792,000 has been written off against a receivable due from a partner in the Grian well drilled in the first quarter of 2011. Collection efforts are continuing, and there may still be partial recovery through assumption of certain of the partner's assets.

The Company has deposited the cash, cash equivalents and restricted cash with reputable financial institutions, for which management believes the risk of loss to be remote. The maximum credit exposure associated with financial assets is their carrying values.

## 7. Exploration and Evaluation Assets

The Field Development Program for Phase 1 of the Breagh Gas Field received approval of the UK Department of Energy and Climate Change on July 25, 2011, and consequently at the end of the period the Breagh carrying values were transferred from the Exploration and Evaluation category to the Property, Plant and Equipment category. The asset was tested for impairment on transfer and none was found.



In accordance with the Company's impairment policy, exploration and evaluation assets were reviewed for indicators of impairment at the reporting dates. Based upon these reviews, management determined that no impairment test was needed.

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
	\$000s	\$000s
Balance, beginning of period	122,359	85,799
Additions		
– Cash	138,508	40,295
– Non cash decommissioning costs	100	–
Transfers to producing oil and gas properties	(156,787)	–
Foreign exchange	5,355	(3,735)
<b>Balance, end of period</b>	<b>109,535</b>	<b>122,359</b>

## 8. Property, Plant and Equipment

Within the Development oil and gas properties category is the amount transferred from exploration and evaluation assets for Breagh. This amount is not subject to depletion as it is not fully in use, nor has production started.

	Nine Months Ended September 30, 2011			Year Ended December 31, 2010		
	Development Oil & Gas Properties	Corporate and Other	Total	Development Oil & Gas Properties	Corporate and Other	Total
	\$000s	\$000s	\$000s	\$000s	\$000s	\$000s
<b>Cost</b>						
Balance, beginning of period	–	615	615	–	523	523
Additions	5,617	260	5,877	–	146	146
Transfers from exploration and evaluation	156,786	–	156,786	–	–	–
Foreign exchange differences	(264)	26	(238)	–	(54)	(54)
<b>Balance, end of period</b>	<b>162,139</b>	<b>901</b>	<b>163,040</b>	<b>–</b>	<b>615</b>	<b>615</b>
<b>Accumulated depreciation and depletion</b>						
Balance, beginning of period	–	(402)	(402)	–	(355)	(355)
Depreciation and depletion	(594)	(99)	(693)	–	(89)	(89)
Foreign exchange differences	–	(10)	(10)	–	42	42
<b>Balance, end of period</b>	<b>(594)</b>	<b>(511)</b>	<b>(1,105)</b>	<b>–</b>	<b>(402)</b>	<b>(402)</b>
<b>Net book value</b>						
Balance, beginning of period	–	213	213	–	168	168
<b>Balance, end of period</b>	<b>161,545</b>	<b>390</b>	<b>161,935</b>	<b>–</b>	<b>213</b>	<b>213</b>

## 9. Derivative Financial Asset

As a requirement of the Credit Facility, the Company has purchased monthly cash-settled put options to hedge 40 percent of its forecast P90 (proved reserves) gas production volumes from Breagh Phase 1 for a 24 month period starting on October 1, 2012. The strike price for the options is 55 pence per therm and the total volume hedged is 10.1 billion cubic feet (Bcf). Half of the put options were purchased for an upfront cash premium of £2,195,000, (equivalent to \$3,543,000) and the other half which were purchased subsequent to quarter end, on a deferred premium basis for a total cost of £2,713,000, to be settled on a monthly basis during the option exercise period.

The Company has recognized the initial up front premium paid for the put options as a derivative financial asset. The derivatives are then revalued to their fair value at period ends. Any gain or loss arising is recorded through the income statement in the same period in which it arises. Fair Value is obtained through a Monte Carlo based option pricing model. As at September 30, 2011 the Company has recognized \$1,010,000 as an unrealized loss on derivative financial instruments.

As at September 30, 2011 the forward curve for the period covered by the options sits in a range between 65 pence and 76 pence per therm, and so the options purchased are currently out-of-the money.

#### Level 1/2/3 Disclosure:

All of the Company's derivative financial instruments are transacted in active markets. The Company classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

##### - Level I

Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

##### - Level II

Pricing inputs are other than quoted prices in active markets included in Level I. Prices in Level II are either directly or indirectly observable as of the reporting date. Level II valuations are based on inputs, including quoted forward prices for commodities, time value, credit risk and volatility factors, which can be substantially observed or corroborated in the marketplace.

##### - Level III

Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Company's derivative financial instruments have been assessed on the fair value hierarchy described above and are classified as Level II. Assessment of the significance of a particular input into the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

## 10. Provisions

The following is a continuity of provisions:

	Nine Months Ended September 30, 2011			Year Ended December 31, 2010		
	Decommissioning	Other	Total	Decommissioning	Other	Total
	\$000s	\$000s	\$000s	\$000s	\$000s	\$000s
At beginning of period	1,814	1,900	3,714	2,199	–	2,199
Arising during period	187	–	187	–	1,900	1,900
Revisions to estimates	177	(653)	(476)	(337)	–	(337)
Foreign exchange differences	83	(84)	(1)	(209)	–	(209)
Accretion	68	–	68	161	–	161
<b>At end of period</b>	<b>2,329</b>	<b>1,163</b>	<b>3,492</b>	<b>1,814</b>	<b>1,900</b>	<b>3,714</b>

#### Decommissioning Obligations

The Company's decommissioning obligation results from net ownership interests in petroleum and natural gas exploration stage activity. The provision is the discounted present value of the estimated cost, using existing technology at current prices. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately \$3,838,000 which will be incurred between 2015 and 2032. Risk free interest rates based on UK long-term Government bond rates varying from 3.25 percent to 4.75 percent and an inflation rate of 4 percent were used to calculate the decommissioning obligations.

Revisions to estimates relate primarily to the extension of anticipated field lives as a result of the respective drilling programs.

## Other Provisions

Provisions of \$1,163,000 at September 30, 2011 have been reduced from \$1,900,000 at December 31, 2010. This provision was set up in 2010 to provide for an underpayment of employment taxes, associated interest and possible penalties relating to the Company's share option plan for UK employees. In the first quarter of 2011, certain affected individuals were determined to be non-resident, and therefore unaffected by the UK regulations, and the provision was reduced accordingly.

## 11. Long-Term Debt

In July 2011, the Company signed a senior secured credit facility for up to £105 million with BNP Paribas, Commonwealth Bank of Australia and Societe Generale (the "Credit Facility"). GE Energy Financial Services joined the Facility later in the third quarter. The Credit Facility is to be used by the Company's wholly-owned subsidiary, Sterling Resources (UK) Ltd ("SRUKL"), to fund the Phase 1 development of the Breagh gas field (Sterling 30 percent) and related costs. The Credit Facility comprises a main tranche of £95 million and a cost-overrun facility of £10 million, with a term of 6.5 years. The interest rate on the main tranche currently has a margin of 4 percent over LIBOR, but the margin will drop to 3.5 percent for a period following project completion. In common with most other asset-secured financings of this type, no proceeds of gas sales from the field are available to the Company until the satisfaction of project completion tests following the successful drilling and testing of all the Phase 1 wells. Transaction costs relating to the Credit Facility incurred in the quarter amounted to £3.4 million and have been capitalized. As the assets to which the borrowing costs relate to are deemed major development projects, and not yet in use, these costs are capitalized to the asset and then depleted as the asset enters production.

The loan repayment schedule runs from January 1, 2014 to the end of the loan life, but the Credit Facility contains a cash sweep mechanism whereby 75 percent of surplus cash (after meeting capital and operating costs and debt service requirements as defined in the Credit Facility agreement) is used to pay down the loan ahead of scheduled loan repayment obligations. The Credit Facility also requires the Company to maintain a minimum level of cash within the consolidated group over a 12 month period, as demonstrated by forward-looking cash flow statements prepared at the end of each quarter. The minimum cash level is currently set at £25 million, £10 million of which is held as restricted cash (see note 5). The security package provided to the lending banks includes a fixed and floating charge over the assets of SRUKL, a charge over the shares of SRUKL, a parent guarantee and other security arrangements common for a loan of this nature. Under the Credit Facility, the Company is also subject to a range of other corporate, financial, operating and reporting undertakings and obligations, with all of which the Company is in compliance.

The Credit Facility agreement completed in late September, and the first drawdown of £36,083,000 was received by the Company as a reimbursement of eligible expenditures relating to the Breagh development already incurred.

## 12. Commitments and Contingencies

Excluding amounts held in escrow, and shown as restricted cash, for the drilling programs, as at September 30, 2011, commitments for the remainder of 2011 and years up to 2015, are comprised of the following:

	2011	2012	2013	2014	2015	Total
	\$000s	\$000s	\$000s	\$000s	\$000s	\$000s
Oil and gas drilling	–	–	13,560	6,053	–	<b>19,613</b>
Seismic	319	2,391	–	–	–	<b>2,710</b>
License fees	1,391	2,961	4,354	5,747	7,140	<b>21,593</b>
Other operating	22	411	702	892	860	<b>2,887</b>
Office and other leases	195	75	43	–	–	<b>313</b>
	<b>1,927</b>	<b>5,838</b>	<b>18,659</b>	<b>12,692</b>	<b>8,000</b>	<b>47,116</b>

The Company is also required to incur eligible expenditures of approximately £57,000,000 as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area in August 2009. By September 30, 2011 eligible expenditures in excess of £57,000,000 have been incurred and hence management believes the Company will qualify for the full exemption.

## 13. Share Capital

Authorized share capital consists of an unlimited number of common shares without nominal or par value. The holders of common shares are entitled to one vote per share and are entitled to receive dividends as recommended by the Board of Directors. Share capital issued and outstanding is as follows:

	Nine Months Ended September 30, 2011		Year Ended December 31, 2010	
	Shares 000s	Amount \$000s	Shares 000s	Amount \$000s
<b>Continuity of common shares</b>				
Balance, beginning of period	<b>188,944</b>	<b>290,444</b>	132,175	157,126
Issued for cash:				
– public equity issuances	32,143	<b>45,000</b>	53,344	134,266
– exercise of stock options	1,557	<b>3,410</b>	2,045	3,325
– exercise of warrants	–	–	1,380	1,159
Share issue costs	–	<b>(2,480)</b>	–	(7,407)
Non-cash transfer from warrants	–	–	–	517
Transferred from contributed surplus on exercise of options	–	<b>1,339</b>	–	1,458
Balance, end of period	<b>222,644</b>	<b>337,713</b>	188,944	290,444
<b>Continuity of warrants</b>				
Balance, at beginning of period	–	–	1,380	517
Balance, end of period	–	–	–	–
<b>Share capital, end of period</b>	<b>222,644</b>	<b>337,713</b>	188,944	290,444

On August 12, 2010, the Company completed a bought deal financing agreement with a syndicate of underwriters for the issue of 23,423,500 common shares at a price of \$1.90 per share including an underwriters' over-allotment option of 2,368,500 common shares at the same price. The net proceeds of the issue were approximately \$42,000,000, after fees and expenses.

On December 22, 2010, the Company completed a bought deal financing agreement with a syndicate of underwriters for the issue of 29,920,500 common shares at a price of \$3.00 per share including an underwriters' over-allotment option of 3,250,500 common shares at the same price. The net proceeds of the issue were approximately \$85,000,000, after fees and expenses.

On August 16, 2011 the Company completed a bought deal financing arrangement with a syndicate of underwriters for the issue of 32,143,000 common shares at a price of \$1.40 per common share for net proceeds of \$42,520,000, after fees and expenses.

#### 14. Bad Debt Expense

During the second quarter of 2011, the Company made a write-off of \$6,792,000 against recovery of overdue amounts receivable from a co-venturer in the unsuccessful Grian well on Block 48/28b in the UK Southern North Sea drilled in the first quarter of 2011.

#### 15. Segmented Information

There are four geographical reporting segments. Canada is the location of the head office. The United Kingdom, Romania and other international locations are involved in exploration and development operations. Other international comprises operations in France and Netherlands.

	Canada	United Kingdom	Romania	Other International	Consolidated
<b>Segmented Results</b>	\$000s	\$000s	\$000s	\$000s	\$000s
<b>Three months ended September 30, 2011</b>					
Bad debt expense	-	-	-	-	-
Dry hole expense	-	-	-	-	-
<b>Net (loss) income before income tax</b>	<b>(1,945)</b>	<b>(5,257)</b>	<b>(1,608)</b>	<b>980</b>	<b>(7,830)</b>

#### Nine months ended September 30, 2011

Bad debt expense	-	(6,792)	-	-	(6,792)
Dry hole expense	-	(9,733)	-	-	(9,733)
<b>Net (loss) income before income tax</b>	<b>(6,684)</b>	<b>(28,718)</b>	<b>(6,285)</b>	<b>(2,118)</b>	<b>(43,805)</b>

#### Three months ended September 30, 2010

Bad debt expense	-	-	-	-	-
Dry hole expense	-	(4,670)	-	-	(4,670)
<b>Net (loss) income before tax</b>	<b>(1,694)</b>	<b>(6,808)</b>	<b>(873)</b>	<b>(865)</b>	<b>(10,240)</b>

#### Nine months ended September 30, 2010

Bad debt expense	-	-	-	-	-
Dry hole expense	-	(8,746)	-	-	(8,746)
<b>Net (loss) income before tax</b>	<b>(4,260)</b>	<b>(8,378)</b>	<b>(3,885)</b>	<b>(1,361)</b>	<b>(17,884)</b>

	Canada	United Kingdom	Romania	Other International	Consolidated
<b>Other Segmented Information</b>	\$000s	\$000s	\$000s	\$000s	\$000s
<b>As at and for the nine month period ended September 30, 2011</b>					
Exploration and evaluation assets	-	79,531	29,198	806	109,535
Exploration and evaluation asset additions (before transfers)	-	138,660	1,179	769	138,608
Development properties	-	161,545	-	-	161,545
Development properties additions	-	5,616	-	-	5,616

#### As at and for the nine month period ended September 30, 2010

Exploration and evaluation assets	-	86,243	26,647	-	112,890
Exploration and evaluation asset additions	-	29,063	31	-	29,094
Development properties	-	-	-	-	-
Development properties transfers and additions	-	-	-	-	-

## 16. Share-Based Compensation

The Company has established a stock option plan whereby it may grant equity-settled options to its directors, officers, employees and consultants. On September 30, 2011 there were 19,040,000 (December 31, 2010 – 13,304,000) common shares reserved for issuance under the plan. The exercise price of each option equals the market price of the Company's shares on the date of the grant. The option's maximum term is five years, with the minimum vesting period to be 18 months. Stock options currently issued vest over the initial three years.

The following is a continuity of outstanding stock options:

	Nine Months Ended September 30, 2011		Year Ended December 31, 2010	
	Options 000s	Weighted Average Exercise Price \$	Options 000s	Weighted Average Exercise Price \$
<b>Continuity of Common Share Options</b>				
Balance, beginning of period	11,949	2.18	8,627	1.90
Granted during the period	5,060	1.88	5,805	2.42
Exercised during period	(1,557)	2.19	(2,045)	1.63
Expired during period	(617)	2.29	(438)	2.45
<b>Outstanding, end of period</b>	<b>14,835</b>	<b>2.07</b>	<b>11,949</b>	<b>2.18</b>
<b>Exercisable, end of period</b>	<b>4,703</b>	<b>2.01</b>	<b>3,390</b>	<b>2.09</b>

The Black-Scholes option pricing model was used to calculate the fair value of the options granted during the period using the following weighted average assumptions:

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
Weighted average share price	\$1.88	\$2.18
Weighted average exercise price	\$1.88	\$2.18
Risk-free interest rate	1.97%	2.21%
Expected hold period to exercise	3.5 years	3.5 years
Volatility in the price of the Company's shares	72.4%	83.9%
Expected annual dividend yield	0%	0%

The weighted average fair value of options granted during the nine months ended September 30, 2011 was \$1.03 per share (2010 – \$2.21 per share). For the three months ended September 30, 2011, \$1,537,000 (2010 – \$1,125,000) of share-based compensation was expensed while \$4,409,000 (2010 – \$2,561,000) of share-based compensation was expensed during the nine month period ended September 30, 2011.

The following stock options were outstanding at September 30, 2011:

Exercise Price		Options Outstanding			Options Exercisable		
		Options 000s	Remaining Contract Life (Days)	Weighted Average Exercise Price \$	Options 000s	Remaining Contract Life (Days)	Weighted Average Exercise Price \$
From \$	To \$						
1.00	1.49	3,268	864	1.40	1,455	460	1.42
1.50	1.99	4,855	1,202	1.79	600	399	1.71
2.00	2.49	2,420	969	2.03	807	605	2.03
2.50	2.99	2,842	718	2.60	1,842	496	2.58
3.00	3.49	1,100	1,149	3.33	-	-	-
3.50	4.25	350	1,255	4.25	-	-	-
1.00	4.25	14,835	994	2.07	4,703	491	2.01

## 17. Financing Costs

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	\$000s	\$000s	\$000s	\$000s
Interest expense	-	-	-	212
Amortization of debt issue costs	-	-	-	358
Accretion [note 10]	(92)	63	68	170
<b>Total financing costs</b>	<b>(92)</b>	<b>63</b>	<b>68</b>	<b>740</b>

As mentioned in note 11 of these Financial Statements, the Company entered into a Credit Facility and made its first drawdown on September 30, 2011. As such the capitalized transaction costs relating to the Credit Facility have not yet been amortized.

## 18. Income Taxes

### Current Income Tax

No provision for current income tax is required due to availability of loss carry-forwards.

### Deferred Tax

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. As at September 30, 2011 and December 31, 2010, the Company has not recognized a deferred income tax asset arising from tax pools in excess of the net book value of capital assets, share issue costs and non-capital losses.

## 19. Net Loss Per Share

The following reflects the loss and share data used in the basic and diluted earnings per share computations:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
Weighted average shares outstanding (000s)	<b>206,055</b>	146,231	<b>195,602</b>	137,807
Net loss (\$000s)	7,830	10,240	43,805	17,884
Net loss per share (\$ per share)				
– Basic	0.04	0.07	0.22	0.13
– Diluted	<b>0.04</b>	0.07	<b>0.22</b>	0.13

In the three month period to September 30 2011, 32,143,000 common shares were issued by way of a public issue (note 13), and 905,000 options were issued to new employees. During the nine months of the year to date 1,557,000 options were exercised. In the period between the reporting date and the release of the financial statements, there have been no other transactions involving ordinary shares or potential ordinary shares. As at September 30, 2011 and 2010, the dilutive effect of all the Company's outstanding options was not included in diluted shares outstanding due to the net loss incurred during the periods.

## 20. Subsequent Events

Effective October 11, 2011 the Romanian government rescinded the Construction Permit Law in relation to offshore requirements, as a result of which impediment the Company had declared force majeure on April 28, 2011 on its Midia and Pelican Blocks in the Black Sea. This action was very welcome as it removes a major obstacle for offshore work by any operator in the Romanian Black Sea. In late October the Company reached agreement with the Government of Romania on a package of issues that will resolve the Notice of Dispute filed on June 20, 2011. Agreement was reached to grant assignments to Sterling's designated partners, PetroVentures Europe B.V. (20 percent) and Gas Plus International B.V. (15 percent). In addition, the Government agreed that all of Sterling's offshore licenses will now initially run to May 2014 with two additional three year renewal terms also being available under the Concession Agreement, signed in August 2007. These agreements were formally concluded on November 18, 2011.

In October 2011 Sterling Resources (UK) Ltd entered into a lease agreement with a minimum period of ten years for an office building in Aberdeen to replace the previous accommodation in Banchory.

Also in October 2011, we committed an amount of \$4.2 million to an escrow account as a deposit for the drilling of a well in the Netherlands F17 Quad, due to spud in the fourth quarter 2011.

## 21. Transition to International Financial Reporting Standards

The accounting policies described in note 3 of the March 31, 2011 interim condensed consolidated financial statements have been applied in preparing these Financial Statements. For details of the Company's January 1, 2010 balance sheet (the date of transition) and the full year 2010 financial statements, please refer to the March 31, 2011 interim condensed consolidated financial statements.

This note explains the principal adjustments made by the Company in restating its previously published GAAP financial statements.

### Restatement of Equity From Previous GAAP to IFRS

IFRS employs a conceptual framework that is similar to previous GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. While adoption of IFRS has not changed the Company's actual cash flows, it has resulted in changes to the Company's reported balance sheet and income statement. In order to provide the users of the financial statements with an understanding of these changes, the Company's previous GAAP balance sheet as at September 30, 2010 and the income statement and statement of comprehensive income (loss) for the three and nine month periods ended September 30, 2010 have been reconciled to IFRS, with the resulting differences explained below.



**a. Exploration and Evaluation Assets**

The Company previously followed the full cost method of accounting for oil and gas assets. Under this method, all expenditures incurred in connection with the acquisition, exploration, appraisal and development of oil and gas assets were capitalized in cost centers on a country-by-country basis. As permitted under IFRS the Company has changed its policy to a successful efforts based accounting policy on a retroactive basis. Under this policy the costs of unsuccessful exploration wells are expensed in the income statement in the period in which they are determined to be unsuccessful.

Successful exploration wells remain capitalized, as do subsequent appraisal and development costs as they help define the prospect. All assets are subsequently reviewed on a quarterly basis for impairment indicators.

**b. Pre-License Acquisition and Other Exploration Costs**

Under previous GAAP all costs associated with property acquisition, exploration and development activities were capitalized within a cost centre, including costs incurred prior to the acquisition of a mineral right. In addition certain administrative and general overhead costs were capitalized to cost centers.

*IFRS 6, Exploration of Mineral Resources*, only applies to activities undertaken after the acquisition of the legal rights to explore and therefore does not apply to pre-license costs. As these costs do not meet the definition of an asset they are expensed. In addition, only directly attributable general and overhead costs have been capitalized to exploration and evaluation assets.

**c. Functional Currency and Foreign Operations**

IFRS requires that the functional currency of each entity of the Company be determined separately in accordance with *IAS 21 – Foreign exchange* and should be measured using the currency of the primary economic environment in which they operate (“the functional currency”). IFRS provides primary and secondary indicators that are used to assist in assessing the functional currency of the entity. Under previous GAAP, foreign currency translation was determined based upon the relationship between the parent company and the respective operating division – i.e. if they are financially or operationally interdependent with the reporting entity. Based upon this, the UK pound was determined to be the functional currency for all entities under previous GAAP.

Using the IFRS indicators, the functional currency for the entities differ from the functional currency determined under previous GAAP. When considering these indicators a change of functional currency to Canadian dollars for Sterling Resources Ltd. and U.S. dollars for its Romanian operations was determined necessary.

**d. Presentation**

IFRS presentation differs from the presentation in accordance with previous GAAP. In particular:

- i. In accordance with *IFRS 6, Exploration of Mineral Resources*, E&E assets are classified as either intangible or tangible assets according to their nature. Under previous GAAP these costs were classified as tangible assets within property, plant and equipment. The Company will be classifying E&E assets as intangible assets.

- ii. In accordance with *IAS 1, Presentation of Financial Statements*, certain line items on the previous GAAP income statement have been reclassified. In particular:

(a.) Exploration and Evaluation Assets

The Company previously followed the full cost method of accounting for oil and gas assets. Under this method, all expenditures incurred in connection with the acquisition, exploration, appraisal and development of oil and gas assets were capitalized in cost centres on a country-by-country basis. As permitted under IFRS the Company has changed its policy to a successful efforts based accounting policy on a retroactive basis. Under this policy the costs of unsuccessful wells are expensed as dry hole costs in the income statement in the period in which they are determined to be unsuccessful.

(b.) Pre-License Acquisition Costs and Indirect Overhead Charges

Under previous GAAP all costs associated with property acquisition, exploration and development activities were capitalized within a cost centre, including costs incurred prior to the acquisition of a mineral right. In addition all administrative and general overhead costs were capitalized to cost centres.

IFRS 6 only applies to activities undertaken after the acquisition of the legal rights to explore and therefore does not apply to pre-exploration costs. As these costs do not meet the definition of an asset they are expensed. In addition only directly attributable general and overhead costs have been capitalized to exploration and evaluation assets.

(c.) Functional Currency and Foreign Operations

IFRS requires that the functional currency of each entity of the Company be determined separately in accordance with IAS 21 – Foreign exchange, and should be measured using the currency of the primary economic environment in which they operate (“the functional currency”). IFRS provides IFRS indicators that are used to assist in assessing the functional currency of the entity. Under previous GAAP, foreign currency translation was determined based upon the relationship between the parent company and the respective operating division – i.e. if they are financially or operationally interdependent with the reporting entity. Based upon this, the UK pound (“GBP”) was determined to be the functional currency for all entities under previous GAAP.

Using the IFRS indicators, a change of functional currency to the Canadian dollar for Sterling Resources Ltd. and the U.S. dollar for its Romanian operations was determined necessary.

(d.) Share-Based Compensation

Under previous GAAP the proportion of share-based compensation attributable to exploration and evaluation activities was capitalized within a cost centre. With the adoption of a successful efforts approach under IFRS, much of the share-based compensation previously capitalized would not be permitted as it relates to pre-license activity or unsuccessful wells.

(e.) Under previous GAAP employee benefit costs were included with other general and administrative costs unless chargeable to capital projects. Under IFRS, employee benefit costs including share-based payments are required to be shown separately from other general and administrative expenses.

## Reconciliation of Assets, Liabilities and Equity

September 30, 2010				
(Unaudited)	Note	Previous GAAP \$000s	Effect of Transition to IFRS \$000s	IFRS \$000s
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		71,410	–	71,410
Restricted cash		9,773	–	9,773
Trade and other receivables		2,253	–	2,253
Prepaid expenses		75	–	75
		83,511	–	83,511
<b>Non-current assets</b>				
Exploration and evaluation assets	(d)-i	–	112,890	112,890
Petroleum and natural gas properties and equipment	(a), (b), (c), (d)-i	178,710	(178,710)	–
Property, plant and equipment	(b)	193	(9)	184
		178,903	(65,829)	113,074
		262,414	(65,829)	196,585
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Trade and other payables		13,180	–	13,180
<b>Non-current liabilities</b>				
Decommissioning obligations		2,319	–	2,319
<b>Equity</b>				
Share capital		203,955	–	203,955
Contributed surplus		8,379	–	8,379
Accumulated other comprehensive loss	(c)	4,415	(30,429)	(26,014)
Retained earnings	(a), (b), (c)	30,166	(35,400)	(5,234)
		246,915	(65,829)	181,086
		262,414	(65,829)	196,585

## Reconciliation of Profit and Loss

		Three Months Ended September 30, 2010			Nine Months Ended September 30, 2010		
	Note	Previous GAAP	Effect of Transition to IFRS	IFRS	Previous GAAP	Effect of Transition to IFRS	IFRS
(Unaudited)		\$000s	\$000s	\$000s	\$000s	\$000s	\$000s
<b>Revenue</b>		-	-	-	-	-	-
<b>Expenses</b>							
Dry hole expense	(a)	-	4,670	4,670	-	8,746	8,746
Pre-license and other exploration costs	(b)	-	1,987	1,987	-	6,375	6,375
General and administration	(b), (d)-ii	984	(517)	467	3,312	(1,960)	1,352
Employee expenses	(d)-ii	-	1,641	1,641	-	4,197	4,197
Foreign exchange (gain) loss	(b)	1,545	(97)	1,448	(1,605)	(1,542)	(3,147)
Share-based compensation	(b), (d)-ii	603	(603)	-	1,410	(1,410)	-
Accretion	(b), (d)-ii	63	(63)	-	173	(173)	-
Depreciation	(b)	24	-	24	63	19	82
<b>Total expenses</b>		3,219	7,018	10,237	3,353	14,252	17,605
Financing income	(d)-ii	(36)	(24)	(60)	(36)	(425)	(461)
Financing costs	(d)-ii	-	63	63	384	356	740
<b>Net loss for the period</b>		(3,183)	(7,057)	(10,240)	(3,701)	(14,183)	(17,884)

## Reconciliation of Comprehensive Income (Loss)

		Three Months Ended September 30, 2010			Nine Months Ended September 30, 2010		
	Note	Previous GAAP	Effect of Transition to IFRS	IFRS	Previous GAAP	Effect of Transition to IFRS	IFRS
(Unaudited)		\$000s	\$000s	\$000s	\$000s	\$000s	\$000s
<b>Net loss for the period</b>		(3,183)	(7,057)	(10,240)	(3,701)	(14,183)	(17,884)
Foreign currency translation into presentation currency	(c)	6,383	(2,773)	3,610	(5,348)	42	(5,306)
<b>Comprehensive income (loss)</b>		3,200	(9,830)	(6,630)	(9,049)	(14,141)	(23,190)

## Reconciliation of Equity

	Note	As at September 30, 2010
(Unaudited)		\$000s
<b>Total equity under previous GAAP</b>		246,915
Adjustments:		
Dry hole costs	(a)	(15,412)
Pre-license costs and other costs expensed under IFRS	(b)	(37,982)
Foreign currency impact of change in functional currencies	(c)	(9,850)
Capitalized share-based compensation expensed under IFRS	(d)	(2,585)
<b>Total equity under IFRS</b>		181,086

# CORPORATE INFORMATION

## Sterling Resources Ltd.

### Directors

WALTER DEBONI <sup>(1)</sup> <sup>(5)</sup> <sup>(6)</sup>  
Chair  
Calgary, Canada

MICHAEL J. AZANCOT  
Farnham, England

ROBERT B. CARTER <sup>(3)</sup> <sup>(4)</sup> <sup>(5)</sup>  
Calgary, Canada

STEWART G. GIBSON <sup>(1)</sup>  
Aboyne, Scotland

TECK SOON KONG <sup>(3)</sup> <sup>(5)</sup>  
London, England

GRAEME G. PHIPPS <sup>(1)</sup> <sup>(2)</sup> <sup>(3)</sup>  
St. Helier, Jersey

(1) Reserves Committee

(2) Chair Reserves Committee

(3) Audit Committee

(4) Chair Audit Committee

(5) Governance and Compensation Committee

(6) Chair Governance and  
Compensation Committee

### Management

MICHAEL J. AZANCOT  
President and Chief Executive Officer

MARK BEACOM  
Vice President and General Manager  
Romania

DAVID M. BLEWDEN  
Chief Financial Officer

STEPHEN BIRRELL  
Vice President and General Manager  
Netherlands and France

ROBIN M. CLARKSON  
Head of Legal and General Counsel

SHERRY L. CREMER  
Treasurer and Corporate Secretary

DAVID A. FINDLATER  
Vice President Exploration

GRAEME HETHERINGTON  
Group Financial Controller

GEORGE KESTEVEN  
Manager, Corporate and Investor Relations

JOHN M. RAPACH  
Chief Operating Officer

PATRICK WHITLEY  
Vice President Exploration International

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ERNST & YOUNG LLP

### Banker

THE ROYAL BANK OF CANADA

### Legal Counsel

STIKEMAN ELLIOTT LLP

### Reserves Evaluators

RPS ENERGY

### Registrar and Transfer Agent

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Toronto, Ontario, Canada M5J 2Y1  
Tel: 800-564-6253  
Fax: 888-453-0330/416-263-9394  
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Stock Exchange Trading Symbol: SLG

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