STERLING RESOURCES

Q2 SECOND QUARTER INTERIM REPORT

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012

TSXV: SLG

www.sterling-resources.com

MESSAGE TO SHAREHOLDERS

Second Quarter 2012

The second quarter saw the Company continuing its focus on its principal assets with substantial progress being made on a number of key initiatives.

The development drilling program at Breagh with the Ensco 70 jack-up rig commenced in mid May 2012, which had been delayed due to the retention of the rig on previous contracts. The two previously suspended wells, 42/13-3 and 42/13-5Z, have been re-drilled as production wells A-01 and A-02 respectively, and both wells encountered better than expected reservoir sections. The A-01 well encountered 74 feet of net pay (16 feet more than the 42/13-3 well) and the A-02 well encountered 68 feet of net pay (20 feet more than 42/13-5Z well), according to the Company's evaluation. In addition, both wells encountered approximately 25 feet of net pay in reservoir Zone 3 which was not encountered in either of the original wells; subject to production testing this could lead to increased reserves in the field. The first new well is now being drilled following which all three of the first wells will be production tested and then up to seven further wells will be drilled for the development program, which may last until 2014. The first three wells are expected to be on-stream at first production.

Development of the first phase of Breagh continues but principally as a result of delays with the completion of onshore work development gross costs have risen further to £623 million and first gas sales are now targeted for December 2012. The increase in the cost of onshore work relates to work required to complete modifications at the existing Teesside Gas Processing Plant (TGPP) in order to receive and process Breagh production, and to complete the onshore section of the export pipeline. An intensive effort has been made to address all the remaining issues for the completion of the onshore works for a target of first gas by the end of 2012.

Sanction of Phase 2 of Breagh development will be made in 2012. A decision on the appropriate form of incremental development will be made following completion of a sub-surface study being conducted jointly by Sterling and RWE, reflecting the results of reprocessed 3D seismic and the better than expected results of the first two development wells.

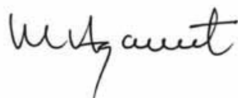
In Romania, drilling is scheduled to commence in September from the GSP jack-up rig 'Jupiter' on the Ioana gas prospect in the Midia Block, followed by drilling of the Eugenia oil prospect in the Pelican block.

As previously announced, we now have interests in four blocks offshore Romania following the latest addition of a 50 percent operated interest in the Black Sea concession Block 25 (Luceafarul). This shallow water block, to the west of and adjacent to Sterling's Midia Block, contains an existing gas discovery and multiple exploration plays, has existing 2D seismic coverage and has been assessed to contain 104 billion cubic feet (Bcf) of unrisked full field 2C Contingent Resources[1], by independent reserves evaluator RPS Energy in a report dated and effective July 4, 2012. Company's working interest share will be 52 Bcf. (For additional information please refer to the news release of July 13th, 2012 at http://www.newswire.ca/en/story/1007175/sterling-resources-announces-update-on-breagh-development-romanian-activities-and-financial-plans)

In April, as previously announced, a sale and purchase agreement was signed with TAQA Bratani Limited (TAQA) for the sale of a 13.5 percent interest in the North Cladhan area (Blocks 210/29a and 210/30a) for an initial consideration of US$47 million. This initial consideration will be received in three installments: US$22.3 million upon completion of assignment, now expected around the end of this month; US$4.3 million to be paid upon the achievement of certain milestones likely to be attained by October 2012; and the balance as a carry of a portion of Sterling's Cladhan development expenditures of up to US$53.6 million or as a cash payment of up to US$20.4 million, or a combination of the two. In addition, a further payment of up to US$10 million could be received if, after first production, proven plus probable reserves are certified to be in the range of 30 to 45 million barrels for 100 percent of the field. TAQA will assume operatorship later this year. The Field Development Program is expected to be submitted around the start of the fourth quarter with approval expected early in 2013.

The Company has embarked on a rationalization of assets in Romania and the UK. This includes a portion of our interests in the Midia, Pelican and Luceafarul blocks offshore Romania and all or part of the Company's remaining 26.4 percent interest in Cladhan. Sales will raise more funds for the Company's exploration, appraisal and development activities and, in the case of offshore Romania, a reduction in equity from the current level of 65 percent in Midia and Pelican and 50 percent in Luceafarul will be more appropriate given the very active exploration and development program planned for 2013 and beyond. A small portion of the anticipated proceeds from either one of these asset sales will be required to ensure a minimum of £20 million group cash is maintained in forward-looking cash flow statements, as required under our Breagh credit facility.

On Behalf of the Board of Directors,



Mike Azancot,
President & Chief Executive Officer
August 21, 2012

(1) Contingent Resources are those quantities of petroleum estimated at a given date to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies. The Contingent Resource volume shown represents a probabilistic total within the block area. Contingencies may include factors such as economic, legal, environmental, political, and regulatory matters, or a lack of markets. It is also appropriate to classify as Contingent Resources the estimated discovered recoverable quantities associated with a project in the early evaluation stage. Specific contingencies preventing the classification of the resources as reserves are further definition of resource volumes through further appraisal drilling, regulatory approvals and sanction, and selection of a specific field development concept, including the most viable crude offtake delivery routing and oil sales contracts. There is no certainty that it will be commercially viable to produce any portion of the Contingent Resources. The 2C is considered to be the best estimate of the quantity that, if developed, will actually be recovered. If probabilistic methods are used there is at least a 50 percent probability P(50) that the quantities actually recovered will equal or exceed the 2C estimate.

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 six month periods ended June 30, 2012 is dated August 21, 2012, and should be read in conjunction with Sterling's unaudited condensed interim consolidated financial statements as at and for the three and six month periods ended June 30, 2012 ("the financial statements") as well as Sterling's audited consolidated financial statements for the year ended December 31, 2011, which have been prepared in accordance with IAS 34 Interim Financial Reporting, and International Financial Reporting Standards (IFRS), respectively. Unless otherwise noted, all financial measures are expressed in Canadian dollars and tabular dollar amounts are in thousands.

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 domiciled 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 licences and prospects in selected core areas of the world. Sterling's strategy includes targeting 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 licence. 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 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, Cladhan and Ana/Doina fields;
- Development activities in the greater Breagh area, particularly the Phase 2 development of Breagh;
- Expectations regarding the Company's cost structure;
- Factors upon which the Company will decide whether to undertake a specific course of action;
- The quantity and timing of hydrocarbon production from the Company's development projects, including Breagh, Cladhan and Ana/Doina;
- The sale, partial sale, farming-in or farming-out of certain properties, particularly offshore Romania and Cladhan;
- 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, on any of its licences;
- 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 "2012 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 broadly 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 December 31, 2011, after adjusting for delays to first gas and cost overruns;

- 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, sell or partially sell licence 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:

- Recoverable reserves and resources estimates may prove incorrect;
- The finding, determination, evaluation, assessment and measurement of oil and gas deposits or reserves may vary materially from the estimates, plans and assumptions of the Company;
- Exploration and development activities are capital-intensive and involve a high degree of risk and, accordingly, future appraisal of potential oil and natural gas properties may involve unprofitable efforts;
- Oil and natural gas price fluctuations;
- 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 may prove more difficult or costly than planned;
- Transportation of hydrocarbons may prove more difficult or costly than planned;
- Permits, approvals, authorizations, consents and licences 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 or arrangement of debt to finance acquisitions would increase the Company's debt levels and further changes in circumstances may lead these debt levels to be beyond the Company's ability to service and repay that debt;
- Significant competition in attracting and retaining skilled personnel;

- Intense competition in the international oil and gas industry could limit the Company's ability to obtain licences and key supplies such as drilling rigs;
- Future acquisitions may not meet expectations;
- Insurance may not be sufficient to cover the full extent of all liabilities;
- Fluctuations in foreign exchange rates, interest rates and inflation may cause financial harm to the Company;
- Political or governmental changes in legislation or policy in the countries in which the Company operates may have a negative impact on those operations;
- Labour unrest could affect the Company's ability to explore for, produce and market its oil and gas production;
- 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 Company, its subsidiaries 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 16 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 or 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.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
$000s except per share information				
Revenue	**–**	329	**66**	329
Expenses	**7,129**	13,718	**14,816**	34,734
Net financing income	**(87)**	(32)	**(61)**	(40)
Net loss	**7,042**	13,357	**14,689**	34,365
Per weighted average common share – basic and diluted	**0.03**	0.07	**0.07**	0.18
PP&E and E&E asset additions	**19,600**	60,575	**42,808**	107,913

As at	**June 30, 2012**	December 31, 2011
$000s except share information and acreage		
Net working capital	**20,496**	35,988
Total assets	**402,799**	370,879
Share capital	**338,221**	337,711
Net licence acreage (000s of acres)	**2,057**	1,807
Common shares outstanding 000s – basic	**222,869**	222,644
Common share options outstanding 000s	**13,508**	14,865

For the three months ended June 30, 2012, the Company recorded a net loss of $7,042,000 ($0.03 per share) compared with a net loss of $13,357,000 ($0.07 per share) for the three month period ended June 30, 2011, the previous year's figure being affected by $6,792,000 of bad debt expensed in the period.

DRY HOLE EXPENSE

For the six months ended June 30, 2012, there were no dry hole costs. On April 12, 2012 the Company announced that the South Cladhan exploration well, 210/29c-5, was not believed to have encountered hydrocarbons and was subsequently plugged and abandoned. The well was drilled at no cost to the Company pursuant to farm-out agreements, and accordingly no dry hole costs have been recorded.

For the period ended June 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.

PRE-LICENCE AND OTHER EXPLORATION COSTS

For the second quarter of 2012 pre-licence and other exploration costs of $6,111,000 were higher compared to the $2,347,000 in the same period of the prior year.

For the six month period ended June 30, 2012, pre-licence and other exploration costs were $8,052,000, an increase of $744,000 over the same period in 2011. Of the $8,052,000 expensed in the six month period, $4,646,000 (2011 – $1,732,000) related to the Company's interests in its various licences offshore the UK, $2,095,000 related to Romania (2011 – $2,924,000) and $1,311,000 (2011 – $2,652,000) to the Netherlands and other international ventures. Employee expense and general and administrative expenditures charged to exploration licences and expensed as pre-licence costs in the period were $127,000 higher in 2012 compared to 2011 due to the contrasting mix of time spent in the quarters on different types of assets.

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. A small foreign exchange gain of $77,000 for the second quarter ended June 30, 2012 helped partly to reverse a loss of $269,000 in the first quarter primarily due to the strengthening of the US dollar against the UK pound on translation of US dollar cash balances.

Foreign exchange losses of $4,926,000 for the first half of 2011 arose chiefly in the first quarter of 2011 mainly on translation of US dollar cash balances into the respective functional currencies of the operations holding the funds. During the first quarter, the US dollar weakened from par with the Canadian dollar to US$1.00=C$0.9725, and from US$1.00=£0.6465 to US$1.00=£0.6237.

EMPLOYEE EXPENSE AND GENERAL AND ADMINISTRATION EXPENSE

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
	$000s	$000s	**$000s**	$000s
Gross employee, and general and administration expense	**4,182**	5,670	**9,893**	10,127
Recovered from third parties	**(563)**	(1,001)	**(1,360)**	(2,229)
Capitalized to assets	**(1,617)**	(881)	**(2,848)**	(2,216)
Expensed as pre-licence and other exploration expenditures	**(74)**	(81)	**(255)**	(128)
	(2,254)	(1,963)	**(4,463)**	(4,573)
Net employee, and general and administration expense	**1,928**	3,707	**5,430**	5,554

Employee Expense

Employee expense for the second quarter of 2012 has decreased by $1,746,000 over the same period in 2011 due to increased amounts capitalized to assets, though this was partly offset by reduced recoveries from third parties, and a reduced charge to non-cash share-based compensation. In addition the 2011 figure was affected by changes to the accounting for the stock option provision.

For the six month period ended June 30, 2012, net employee expense was $4,263,000, a decrease of $521,000 over 2011. Of the total, $2,533,000 relates to non-cash share-based compensation and $1,730,000 relates to wages and salaries. Overall and combined with general and administration expense, recoveries from partners and amounts capitalized to assets were consistent with the first half of 2011.

General and Administration Expense

For the six month period ended June 30, 2012, net general and administration expense of $1,167,000 was higher by $397,000 charged in the same period in 2011 after recoveries. This is due to increased office costs in the UK and Netherlands and due to the mix of recoveries and amounts capitalized to the assets.

FINANCING COSTS

Financing costs include interest expense and accretion of the discount on decommissioning obligations. Bank fees and costs pertaining to the set-up of the credit facility began to be amortized with the first drawdown in the fourth quarter of 2011 and have then been capitalized to the Breagh asset. These costs will then be depleted along with the capital costs of developing the asset when Breagh enters production.

INCOME TAXES

No deferred tax asset has yet been recognized in relation to the losses incurred because of the uncertainty regarding future taxable profits against which such losses can be offset, given the Company's lack of meaningful current production. However, the situation will be reviewed again as the Company nears large scale production in Breagh.

As at June 30, 2012, the Company had estimated UK tax losses carried forward of approximately $377,016,000 and other capital allowances of $47,818,000 available to shield future taxable income in Canada, Romania and other jurisdictions. These losses do not expire. In addition, the Company has approximately $37,626,000 of Canadian and other international non-capital allowances which expire over the next 20 years.

UNREALIZED LOSS ON DERIVATIVE FINANCIAL INSTRUMENTS

In 2011, as a requirement of its credit facility, the Company has purchased monthly cash-settled put options to hedge 40 percent of its forecast gas production volumes from proved reserves (P90) for the first phase of Breagh development, for a 24-month period starting on October 1, 2012. The strike price for the options is 55 pence per therm (1 therm equals 100,000 British thermal units) and the total volume hedged is 10.1 billion cubic feet (Bcf). Half of the put options were purchased in the third quarter of 2011 for an upfront cash premium of £2,195,000, ($3,543,000) and the other half were purchased in the fourth quarter of 2011, on a deferred premium basis for a total cost of £2,713,000.

The Company has recognized the upfront premium paid for the put options as a derivative financial asset. The derivatives are then revalued to their fair value at period-ends. For the deferred premium put options the Company has recognized a derivative financial liability for the discounted cost of those premiums offset by their revaluation at period-ends. Any gain or loss is recorded through the income statement in the period that it arises. For the six months ended June 30, 2012 the Company has recognized $786,000 as an unrealized loss on derivative financial instruments (June 30, 2011 – nil).

As at June 30, 2012 the forward curve for the period covered by the options sits in a range between 58 pence and 69 pence per therm, and so the options purchased were out-of-the-money at that date.

OVERVIEW AND SUMMARY OF RESULTS FOR THE EIGHT MOST RECENTLY COMPLETED QUARTERS

The Company had only minor commercial production in 2011 and 2012. To date, Sterling's results from operations have not been affected by seasonal factors. The following table summarizes the Company's income statements for the eight most recently completed quarters ended June 30, 2012.

	2012		2011				2010	
Quarters Ended	**June 30**	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30
$000s except per share information								
Revenues	**–**	66	136	793	329	–	–	–
Net (loss) income:								
Canada	**(1,450)**	(1,932)	(1,946)	(1,945)	(1,784)	(2,955)	914	(1,694)
United Kingdom	**(3,365)**	(4,230)	(8,447)	(4,272)	(9,311)	(12,540)	(6,105)	(5,111)
Romania	**(1,490)**	(695)	(1,165)	(1,608)	(1,732)	(2,945)	(956)	(861)
Other International	**(737)**	(790)	(1,246)	980	(530)	(2,568)	(839)	(865)
Net (loss) income	**(7,042)**	(7,647)	(12,804)	(6,845)	(13,357)	(21,008)	(6,986)	(8,531)
Net (loss) income per share								
Basic	**(0.03)**	(0.03)	(0.06)	(0.03)	(0.07)	(0.11)	(0.04)	(0.05)
Diluted	**(0.03)**	(0.03)	(0.06)	(0.03)	(0.07)	(0.11)	(0.04)	(0.05)

Note: The net income or loss per common share for each quarter is required to be calculated independently of the calculation for the year. Consequently, due to the issuance of shares in a given year, the aggregate of the four quarters may differ from the year's total.

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

Key factors relating to the comparison of the net loss for the last eight quarters are as follows:

- In the first quarter of 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;
- During the second quarter of 2011, the Company wrote-off $6,792,000 relating to overdue amounts receivable from a co-venturer in the unsuccessful Grian well, drilled on Block 48/28b in the UK Southern North Sea in the first quarter of 2011;
- Since the third quarter of 2011 the Company has recognized unrealized losses relating to the derivative financial instrument agreements which it has entered into. The total unrealized loss recognized in the income statement for the third and fourth quarter of 2011 was $2,499,000 and a further $1,716,000 in the first quarter of 2012, though this was partially offset by an unrealized gain of $930,000 in the second quarter of 2012;
- In the fourth quarter of 2011, the Company recognized an impairment of its producing UK onshore asset Kirkleatham of $2,930,000;
- Over the two-year period ended June 30, 2012, the Company has increased staffing levels significantly, but commensurate with an exploration and production company with a high proportion of operated licences including the Cladhan and Ana/Doina developments. These increases have had a progressive impact over the quarters; and
- Foreign exchange gains and losses varied significantly from quarter to quarter based on prevailing foreign exchange rates as well as amounts of monetary assets held by an entity in currencies other than its functional currency.

DEVELOPMENT ACTIVITY

Work on the Breagh gas field development project continued during the second quarter. Offshore facilities and the offshore section of the pipeline have been completed while the development drilling program commenced in May. Onshore, modifications to the Teeside Gas Processing Plant (TGPP) continue as well as laying the final sections of the onshore pipeline. The development drilling program at Breagh with the Ensco 70 jack-up rig commenced in mid May 2012, which had been delayed due to the retention of the rig on previous contracts. The two previously suspended wells, 42/13-3 and 42/13-5Z, have been re-drilled as production wells A-01 and A-02 respectively, and both wells encountered better than expected reservoir sections. The A-01 well encountered 74 feet of net pay (16 feet more than the 42/13-3 well) and the A-02 well encountered 68 feet of net pay (20 feet more than 42/13-5Z well), according to the Company's evaluation. In addition, both wells encountered approximately 25 feet of net pay in reservoir Zone 3 which was not encountered in either of the original wells; subject to production testing this could lead to increased reserves in the field. The first new well is now being drilled following which all three of the first wells will be production tested and up to seven further wells will then be drilled for the development program, which may last until 2014. The first three wells are expected to be on-stream at first production.

The operator's projected development expenditures for Breagh Phase 1 of the project is now expected to be £623 million (100 percent), £187 million net Sterling share. At the end of the period cumulative expenditure was £100.3 million with the balance of £86.7 million still to be incurred principally relating to completion of the onshore pipeline, onshore gas plant modifications, onshore gas compression and the development drilling program. Of this remaining amount, approximately £30 million is projected to be spent from July 2012 until first gas which is targeted for December 2012.

The current total Breagh Phase 1 development cost estimate represents a cost increase of around 28 percent over the original Field Development Program (FDP) budget of £485 million, and a further increase over the range of £600 to £610 million referred to in our news release on July 13, 2012. The majority of the latest increase is attributable to cost overruns in TGPP modifications with smaller increases relating to the offshore and onshore pipeline installation, and increases in development drilling costs.

A decision on the second phase of the development (Phase 2) will be made later in 2012 and governmental approval would be expected in the first quarter of 2013.

Work continues on pre-development planning for the Cladhan oil field (Sterling 26.4 per cent). A final FDP is expected to be submitted around the beginning of the fourth quarter of 2012 with approval expected early in 2013. It is planned that TAQA Bratani Limited (TAQA) will assume operatorship later in 2012.

EXPLORATION AND EVALUATION ACTIVITY

During the six month period ended June 30, 2012 and up to the date of this report key operational activity and expenditures included:

- In January, the award of 100 percent of two additional licences in the UK Southern North Sea Gas Basin (covering Blocks 43/15a, 43/20a, 49/18b and 49/19b), and a 50 percent interest in a licence in the Central North Sea (covering Block 16/3d) which contains the Cairngorm discovery, partnered with Stratic Energy Corporation (now Enquest plc);

- In February, the completion of the F17-09 well in Block F17 of the Dutch North Sea at a cost of $6,763,000. The well encountered hydrocarbons, with results suggesting an oil-water contact at approximately 2,000 metres subsea, but no testing was performed;

- In March, the award of the exploration licences E3 and F1 in the Dutch North Sea jointly with Wintershall Noord Zee BV (operator). Each company will have a 50 percent interest. These licences cover an area of 792 square kilometres and were awarded for a period of four years with a commitment to acquire approximately 600 square kilometres of 3D seismic, which was completed subsequent to the end of the quarter;

- Also in March, approval was obtained from the National Agency for Mineral Resources (NAMR) for a 40 percent interest in the Romanian Black Sea Muridava block. The shallow water block, adjacent to the Company's Pelican block, contains multiple exploration plays, has existing 2D seismic coverage and contains a hydrocarbon discovery, Olimpiyskaya, drilled in 2001;

- In April, the South Cladhan exploration well, 210/29c-5, was plugged and abandoned after no hydrocarbons were encountered. The well was drilled at no cost to the Company pursuant to farm-out agreements;

- In May, the Company exchanged its 50 percent interest in UK Block 16/3d (Cairngorm) for a 10 percent interest in the Netherlands F and L Quad licences held by Enquest plc; and

- In July, the Company gained a 50 percent interest in the 1,000 square kilometre Romanian Black Sea Luceafarul block. The Company will be operator, with the current concession owner Petro Ventures Europe BV holding the remaining 50 percent interest.

In the first two quarters of 2011 the Company's exploration and evaluation activity included:

- The four well Cladhan drilling program costing $26,968,000;

- The drilling of the non-operated East Breagh appraisal well 42/13a-6 costing $6,626,000; and

- The drilling of the operated Grian 48/28b-2 exploration well, costing a total of $9,733,000.

During the six month period ended June 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.

FINANCING ACTIVITIES

The Company has a senior secured credit facility for up to £105 million with BNP Paribas, Commonwealth Bank of Australia, GE Energy Financial Services and Societe Generale to fund the Phase 1 development of the Breagh gas field (Sterling 30 percent) and related costs (the "Credit Facility").

The Credit Facility comprises a main tranche of £95 million and a cost-overrun tranche of £10 million, with a term of six-and-a-half years. The interest rate on the main tranche currently has a margin of 4 percent over LIBOR, which will drop to 3.5 percent over LIBOR in the period following project completion, and for the cost-overrun tranche the margin is 4.5 percent over LIBOR. Availability under both tranches is redetermined semi-annually and is currently limited to approximately £80 million for the main tranche but the full amount of the cost overrun tranche is available. Utilization of the cost-overrun tranche requires a matching use of equity funds by the Company. 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 (Project Completion), which is currently expected around mid 2014. 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 group over a 12-month period, as demonstrated by forward-looking cash flow statements prepared at the end of each quarter. During the second quarter the Company announced that it had reached agreement with the lending banks to reduce this minimum group cash requirement from £35 million ($56,000,000) to £20 million ($32,000,000) from April 1, 2012 until Project Completion, £10 million of which is held as non-current restricted cash as the Company does not expect to have access to these funds within a year. The Company believes it was in compliance with the undertakings and obligations under the Credit Facility as at June 30, 2012.

In April the Company signed a sale and purchase agreement with TAQA for the sale of a 13.5 percent interest in the North Cladhan area (Blocks 210/29a and 210/30a) for an initial consideration of US$47 million including an allocation to tax allowances. In addition TAQA has earned a 12.5 percent interest in Blocks 210/29c and 210/30b through a farm-in agreement as a result of which TAQA funded Sterling's remaining equity interest in the recently drilled well 210/29c-5 on the South Cladhan prospect.

FINANCING, LIQUIDITY AND SOLVENCY

Net Working Capital

As at	**June 30, 2012**	December 31, 2011
	$000s	$000s
Cash and cash equivalents	**31,247**	49,963
Restricted cash	**4,667**	5,492
Trade and other receivables	**12,420**	8,419
Derivative financial asset	**797**	–
Prepaid expenses	**320**	158
Trade and other payables	**(26,908)**	(26,881)
Derivative financial liability	**(866)**	–
Provisions	**(1,181)**	(1,163)
	20,496	35,988

Net working capital of $20,496,000 at June 30, 2012 decreased from year-end 2011 mainly due to the continued operational activity at Breagh, and the drilling campaigns in South Cladhan and Netherlands in the North Sea.

Cash and cash equivalents at June 30, 2012 include term deposits of $6,697,000 (December 31, 2011 – $25,563,000).

Restricted cash of $4,667,000 at June 30, 2012 (December 31, 2011 – $5,492,000) comprised cash held in escrow, chiefly an amount of $4,073,000 relating to the Netherlands F17-09 well.

Under its Credit Facility, the Company is required to hold £10,000,000 ($16,039,000) in a separate account until Project Completion which is treated as non-current restricted cash, as the Company does not expect to have access to these funds within a year. This figure is not included in the net working capital above.

As at June 30, 2012, there are only minor trade and other receivables greater than 90 days.

Trade and other payables of $26,908,000 at June 30, 2012 were comprised mainly of accrued expenditures related to the Breagh development project. The level of this figure is indicative of the continued high level of activity in exploration and development assets.

A provision of $1,181,000 at June 30, 2012 was 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

Commitments as of June 30, 2012 for the remaining six months of 2012, for the years 2013 through 2016 and thereafter, excluding amounts held in escrow and shown as restricted cash are comprised of the following:

	2012	2013	2014	2015	2016	Thereafter	**Total**
	$000s	$000s	$000s	$000s	$000s	$000s	**$000s**
Facilities, oil and gas drilling	19,810	20,987	28,010	–	–	–	**68,807**
Seismic	2,738	6,988	–	–	–	–	**9,726**
Licence fees	1,090	1,558	1,968	2,674	3,260	–	**10,550**
Other operating	533	2,042	1,992	293	559	951	**6,370**
Office and other leases	575	758	671	602	602	3,012	**6,220**
	24,746	32,333	32,641	3,569	4,421	3,963	**101,673**

The above facilities, oil and natural gas drilling commitment in 2012 relates to the firm development wells contracted to be drilled and the additional facilities required as part of the Breagh Phase 1 and reflects the cost overruns.

Liquidity and Solvency

As at June 30, 2012, the Company's net working capital totaled $20,496,000. During the second quarter the Company signed a sale and purchase agreement with TAQA for the sale of a 13.5 per cent interest in the Cladhan field for an initial consideration of US$47 million. Of this, US$22.3 million should be received around the end of August 2012 and US$4.3 million by October 2012. As at June 30, 2012 the Company had access to sufficient cash to settle its trade and other payables and meet its immediate joint venture commitments and licence obligations through a combination of existing available cash, access to undrawn amounts available under the Credit Facility, and, from the start of gas sales from Breagh (targeted for December 2012), production revenues which are available to fund costs related to Breagh. Since June 30, the further cost increases and production delays at Breagh mean that the Company now expects to fully utilize both tranches of the Credit Facility. To fund all other activities prior to renegotiation of the Breagh Credit Facility envisaged in the first half of 2013, a small portion of anticipated proceeds from the asset sales either of offshore Romania or of the remaining Cladhan interest will be required to ensure a minimum of £20 million is maintained in forward-looking cash flow statements as required under the Credit Facility. For such cash flow statements prepared at the end of September 2012 or later, if for any reason it is no longer appropriate to include a portion of the proceeds, the Credit Facility allows for a period of three months for a remedial plan to rectify any shortfall which could include a relaxation of the minimum cash requirement.

Additional funding would also be required for Phase 2 of the Breagh development, for the development of Cladhan (if this has not been sold prior to FDP approval) and Ana/Doina subject to the relevant approvals, and for any material new exploration and appraisal activity not currently planned or for unforeseen materially increased expenditures under existing commitments. To meet such additional expenditure requirements, which should not arise before 2013, the Company believes that it will refinance its current Credit Facility in the first half of 2013 as well as utilizing proceeds from selling part of its interests in its Romanian offshore licences or Cladhan.

DECOMMISSIONING OBLIGATIONS

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas licences 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 decommissioning obligations to be approximately $16,060,000, all of which will be incurred between 2015 and 2036. The figure increased in 2011 due to the development of the Breagh facilities. Risk-free interest rates based on UK long-term government bond rates varying from 3.75 percent to 4.75 percent (December 31, 2011 – 3.75 to 4.75 percent) and an inflation rate of 2 percent (December 31, 2011 – 2 percent) were used to calculate the fair value of decommissioning obligations. There were no revisions to estimates in 2012.

	Six Months Ended June 30, 2012	Year Ended December 31, 2011
	$000s	$000s
At beginning of the period	**7,056**	1,814
Arising during the period	**–**	3,865
Revisions to estimates	**–**	1,134
Foreign exchange differences	**167**	55
Accretion of discount	**149**	188
Balance, end of the period	**7,372**	7,056

2012 PLANS

The Company outlined its plans for 2012 in its Annual Report for the year ended December 31, 2011. Several of the specific plans have been completed:

- An appraisal well to the existing oil discovery in Block F17 offshore the Netherlands was drilled. This well, designated F17-09, was spudded in late 2011 and completed in the first quarter of 2012; the well was originally planned to have been completed in 2011.

- An exploration well, 210/29c-5, was drilled on the South Cladhan prospect in UK Northern North Sea Block but did not encounter hydrocarbons and was subsequently plugged and abandoned.

- The Company stated in its 2011 Annual Report its plan to sell down the Company's interests in one or more of the Cladhan, Breagh and offshore Romania licences in order to release cash for reinvestment in these or other projects or to meet liquidity requirements under the Credit Facility. In April 2012, the Company signed a sale and purchase agreement with TAQA for the sale of a 13.5 percent interest in the Cladhan area. Further sales processes are underway for part of the offshore Romanian licences and all or part of the remaining Cladhan interest.

- 3D seismic has been acquired over the E3/F1 blocks offshore the Netherlands.

Other plans in the 2011 Annual Report are substantially unchanged:

- Drill two exploration wells offshore Romania. The Company plans to commence drilling the Ioana (gas prospect) well in September 2012 and the Eugenia (oil prospect) well immediately afterwards.
- Complete four to five production wells as part of the Breagh Phase 1 development. It is now likely that only three wells will have been completed with the fourth well being drilled at the end of the year.
- Move ahead with the Ana/Doina development offshore Romania, with the intention of achieving development approval in 2013.
- Farm-out 50 percent of the Company's working interest in the Craiova block onshore Romania in order to fund acquisition of seismic and potentially a well to be drilled in 2013. This plan continues from 2011.
- Reach a decision on the optimum development scheme for the Cladhan field by late 2012.
- Acquire seismic over part of the Midia block offshore Romania closest to the Exxon Mobil/Petrom Domino gas discovery made in early 2012.
- Acquire seismic over the Beverley oil prospect in the UK Central North Sea.
- Acquire seismic over part of the South Cladhan Blocks 210/29c and 210/30b.

These plans remain contingent on partner approval as well as availability of suitable financing and (if appropriate) farm-out partners or purchasers of licence interests.

Corporately, the Company is still considering a listing on the main board of the London Stock Exchange. The timing of the London listing depends on several factors including finalization of appraisal and development plans for Cladhan, progress on exploration and development activities offshore Romania, and wider equity market conditions. Management remains of the view that a London listing is appropriate for the Company. In addition, the Company intends to arrange debt financing for part of the development costs of its Cladhan project (subject to the outcome of the current sale process) by the first quarter of 2013, possibly involving a refinancing of the existing Breagh Credit Facility.

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.

CONSOLIDATED BALANCE SHEETS

As at	June 30, 2012	December 31, 2011
(Unaudited)	$000s	$000s
ASSETS (note 10)		
Current assets		
Cash and cash equivalents (note 3)	**31,247**	49,963
Restricted cash (note 4)	**4,667**	5,492
Trade and other receivables (note 5)	**12,420**	8,419
Prepaid expenses	**320**	158
Derivative financial asset (note 8)	**797**	–
	49,451	64,032
Non-current assets		
Restricted cash (note 4)	**16,039**	15,763
Exploration and evaluation assets (note 6)	**130,535**	121,152
Property, plant and equipment (note 7)	**205,143**	167,346
Derivative financial asset (note 8)	**1,631**	2,586
	353,348	306,847
	402,799	370,879
LIABILITIES AND EQUITY		
Current liabilities		
Trade and other payables	**26,908**	26,881
Provisions (note 9)	**1,181**	1,163
Derivative financial liability (note 8)	**866**	–
	28,955	28,044
Non-current liabilities		
Derivative financial liability (note 8)	**1,380**	1,624
Decommissioning obligations (note 9)	**7,372**	7,056
Long-term debt (note 10)	**111,883**	72,818
	120,635	81,498
Commitments and contingencies (note 11)		
Equity		
Share capital (note 12)	**338,221**	337,711
Contributed surplus	**16,223**	13,857
Accumulated other comprehensive loss	**(23,285)**	(26,970)
Deficit	**(77,950)**	(63,261)
	253,209	261,337
	402,799	370,879

The accompanying notes are an integral part of the condensed interim consolidated financial statements as at and for the three and six month periods ended June 30, 2012 (“the Financial Statements”).

CONSOLIDATED INCOME STATEMENTS

(Unaudited)	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
	$000s except per share	$000s except per share	**$000s except per share**	$000s except per share
Revenue	**–**	329	**66**	329
Expenses				
Operating expense	**–**	–	**138**	–
Pre-licence and other exploration expenditures	**6,111**	2,347	**8,052**	7,308
Dry-hole expense (note 6)	**–**	–	**–**	9,733
Depletion, depreciation and amortization (note 7)	**97**	394	**218**	421
Unrealized (gain)/loss on derivative financial instruments (note 8)	**(930)**	–	**786**	–
Bad debt expense (note 5)	**–**	6,792	**–**	6,792
Employee expense (note 14)	**1,445**	3,191	**4,263**	4,784
General and administration	**483**	516	**1,167**	770
Foreign exchange (gain)/loss	**(77)**	478	**192**	4,926
Total expenses	**7,129**	13,718	**14,816**	34,734
Financing income	**(162)**	(110)	**(210)**	(200)
Financing costs (note 15)	**75**	78	**149**	160
Net loss for the period	**7,042**	13,357	**14,689**	34,365
Net loss per common share (note 16)				
Basic	**0.03**	0.07	**0.07**	0.18
Diluted	**0.03**	0.07	**0.07**	0.18

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
(Unaudited)	**$000s**	$000s	**$000s**	$000s
Net loss for the period	**7,042**	13,357	**14,689**	34,365
Foreign currency translation adjustment	**(1,475)**	24,047	**(3,685)**	3,325
Comprehensive loss	**5,567**	37,404	**11,004**	37,690

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Loss	Deficit	Total
(Unaudited)	$000s	$000s	$000s	$000s	$000s
Balance at January 1, 2011	290,444	9,283	(33,489)	(9,438)	256,800
Exercise of stock options (note 12)	3,336	–	–	–	3,336
Transferred from contributed surplus on exercise of options	1,301	(1,301)	–	–	–
Share-based compensation (note 14)	–	2,872	–	–	2,872
Foreign currency translation into presentation currency	–	–	(3,325)	–	(3,325)
Loss for the period	–	–	–	(34,365)	(34,365)
Balance at June 30, 2011	295,081	10,854	(36,814)	(43,803)	225,318
Balance at January 1, 2012	**337,711**	**13,857**	**(26,970)**	**(63,261)**	**261,337**
Exercise of stock options (note 12)	**343**	**–**	**–**	**–**	**343**
Transferred from contributed surplus on exercise of options	**167**	**(167)**	**–**	**–**	**–**
Share-based compensation (note 14)	**–**	**2,533**	**–**	**–**	**2,533**
Foreign currency translation into presentation currency	**–**	**–**	**3,685**	**–**	**3,685**
Loss for the period	**–**	**–**	**–**	**(14,689)**	**(14,689)**
Balance at June 30, 2012	**338,221**	**16,223**	**(23,285)**	**(77,950)**	**253,209**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
	$000s	$000s	**$000s**	$000s
Cash flows from operating activities				
Loss for the period	**(7,042)**	(13,357)	**(14,689)**	(34,365)
Adjustments to add (deduct) non-cash items				
Unrealized foreign exchange (gain) loss	**50**	(569)	**174**	696
Unrealized (gain) loss on derivative financial instruments	**(930)**	–	**786**	–
Share-based compensation (note 14)	**1,114**	1,390	**2,533**	2,872
Accretion (note 15)	**75**	78	**149**	160
Depletion, depreciation and amortization (note 7)	**97**	394	**218**	421
Change in non-cash working capital	**94**	303	**(351)**	(988)
Cash flows (used in) operating activities	**(6,542)**	(11,761)	**(11,180)**	(31,204)
Cash flows from investing activities				
Decrease (increase) in restricted cash (note 4)	**3,055**	15,134	**825**	(7,741)
Exploration and evaluation asset additions (note 6)	**39**	(60,019)	**(7,506)**	(107,234)
Property, plant and equipment additions (note 7)	**(19,639)**	(556)	**(35,302)**	(679)
Change in non-cash working capital	**2,385**	(469)	**(3,765)**	40,841
Cash flows (used in) investing activities	**(14,160)**	(45,910)	**(45,748)**	(74,813)
Cash flows from financing activities				
Proceeds from loan funds (note 10)	**18,347**	–	**38,825**	–
(Increase) in restricted cash (note 4)	**(74)**	–	**(276)**	–
Decrease (increase) in transaction costs on debt (note 10)	**13**	–	**(111)**	–
Proceeds from exercise of share options (note 12)	**236**	68	**343**	3,334
Change in non-cash working capital	**(134)**	–	**68**	–
Cash flow provided by financial activities	**18,388**	68	**38,849**	3,334
Effect of translation on foreign currency cash and cash equivalents	**(3,069)**	454	**(637)**	(142)
Decrease in cash and cash equivalents during the period	**(5,383)**	(57,149)	**(18,716)**	(102,825)
Cash and cash equivalents, beginning of the period	**36,630**	96,948	**49,963**	142,624
Cash and cash equivalents, end of the period	**31,247**	39,799	**31,247**	39,799

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

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

As at and for the Three and Six Months Ended June 30, 2012

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 of companies: Sterling Resources (UK) Ltd., Sterling Resources Netherlands B.V., and Midia Resources SRL.

These unaudited condensed interim consolidated financial statements ("the Financial Statements") were approved for issue at a meeting of the Audit Committee on August 21, 2012.

2. BASIS OF PREPARATION

Statement of Compliance

These Financial Statements were prepared in accordance with IAS 34, *Interim Financial Reporting* on a going-concern basis, under the historical cost convention. They do not contain all disclosures required by IFRS for annual financial statements and, accordingly, should be read in conjunction with the annual consolidated financial statements and notes thereto for the year ended December 31, 2011.

The presentation currency of these Financial Statements is the Canadian dollar.

These Financial Statements have been prepared using the same accounting policies and methods as the consolidated financial statements for the year ended December 31, 2011.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

As at	**June 30, 2012**	December 31, 2011
	$000s	$000s
Cash	**24,226**	24,401
Cash equivalents	**7,021**	25,562
	31,247	49,963
Balances held in:		
Canadian dollars	**3,293**	3,914
US dollars	**5,232**	3,744
UK pounds	**19,390**	37,306
Other	**3,332**	4,999
Cash and cash equivalents	**31,247**	49,963

As at June 30, 2012, cash equivalents carried interest rates between 0.03 percent and 1.75 percent (December 31, 2011 – between 0.03 percent and 1.75 percent).

4. RESTRICTED CASH

Restricted cash of $4,667,000 at June 30, 2012 (December 31, 2011 – $5,492,000) comprised cash held in escrow, chiefly an amount of $4,073,000 relating to the Netherlands F-17 well. Under its credit facility, the Company is required to hold £10,000,000 ($16,039,000) in a separate account which is treated as non-current restricted cash as the Company does not expect to have access to these funds within a year.

5. FINANCIAL INSTRUMENTS

The Company is exposed to various financial risks arising from normal-course business exposure as well as its use of financial instruments. These risks include market risks relating to foreign exchange rate fluctuations and interest rate risk, as well as liquidity risk, commodity price risk and credit risk as described below.

Foreign Exchange Rate Risk

The Company's functional currencies for the UK and Netherlands, 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 1 percent fluctuation in translation rates would have the following impact on net income or loss, based on foreign currency balances held at June 30, 2012.

	$000s
Canadian dollar vs. UK pound	(16)
Canadian dollar vs. US dollar	43
UK pound vs. Euro	36
UK pound vs. US dollar	29

Interest Rate Risk

The interest rate charged under the credit facility is LIBOR plus a margin that varies at different stages of the life of the loan. Based on the balance at June 30, 2012, a 1 percentage point change over a six month period in the average LIBOR interest rate on the loan amount would increase or decrease net income or loss by approximately $581,000.

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 June 30, 2012, a 1 percentage point change in average interest rates over a six month period would increase or decrease net income or loss by approximately $260,000.

Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. As at June 30, 2012 the Company had access to sufficient cash to settle its trade and other payables and meet its immediate joint venture commitments and licence obligations through a combination of existing available cash, access to undrawn amounts available under the credit facility, and, from the start of gas sales from Breagh (targeted for December 2012), production revenues which are available to fund costs related to Breagh. Since June 30, the further cost increases and production delays at Breagh mean that the Company now expects to fully utilize both tranches of the credit facility. To fund all other activities prior to renegotiation of the Breagh credit facility envisaged in the first half of 2013, a small portion of anticipated proceeds from the asset sales either of offshore Romania or of the remaining Cladhan interest will be required to ensure a minimum of £20 million is maintained in forward-looking cash flow statements as required under the Credit Facility. For such cash flow statements prepared at the end of September 2012 or later, if for any reason it is no longer appropriate to include a portion of the proceeds, the Credit Facility allows for a period of three months for a remedial plan to rectify any shortfall which could include a relaxation of the minimum cash requirement. 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 when appropriate.

During the second quarter, the Company signed a sale and purchase agreement (SPA) with TAQA for the sale of a 13.5 percent interest in the North Cladhan area (Blocks 210/29a and 210/30a) for an initial consideration of US$47 million. Of this, US$22.3 million should be received around the end of August 2012 and US$4.3 million by October 2012. In addition TAQA earned a 12.5 percent interest in Blocks 210/29c and 210/30b to the south of Cladhan through a farm-in agreement. As a result, the Company incurred no net costs for the recently drilled well 210/29c-5. Completion of the North Cladhan Sale and Purchase Agreement is expected in the next few weeks; the South Cladhan farm-out completed and the proceeds received in July.

Commodity Price Risk

The Company is exposed to the risk of fluctuations in prevailing market commodity prices on natural gas produced. For Breagh, the Company sells gas produced at a price linked to the UK spot market which is a liquid market. The Company's policy is only to manage this risk to the extent required under its credit facility, through the use of derivative commodity contracts. The Company was required under its credit facility to purchase monthly cash-settled put options to hedge 40 percent of its forecast gas production volumes from proved reserves (P90) from the first phase of Breagh development, for a 24-month period starting on October 1, 2012 (see note 8). The Company would consider further hedging to provide greater certainty of its ability to meet debt service requirements, especially if the current credit facility is expanded to provide funding for Cladhan or Ana/Doina development costs.

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 to the Company. 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 natural gas industry. At June 30, 2012 there is no concentration of receivables with one joint venture partner which represents a material credit risk. Impairment to a financial asset is only made when there is objective evidence of impairment and the loss event has an impact on future cash flow and can be reliably estimated. Evidence of impairment may include default or delinquency by a debtor or indicators that the debtor may enter bankruptcy. In the second quarter of 2011, $6,792,000 had been written off against a receivable due from a partner. Collection efforts are continuing. There are no significant amounts past due at June 30, 2012.

The Company has entered into derivative financial instruments and deposited its cash, cash equivalents and restricted cash with reputable financial institutions, with which management believes the risk of loss to be remote. The maximum credit exposure associated with financial assets is their carrying values. At June 30, 2012 the cash, cash equivalents and restricted cash were held with six different financial institutions from five different countries. The derivative contracts were held with three of the same financial institutions providing the credit facility thereby further mitigating credit risk.

Capital Management

The primary objective of the Company's capital management is to ensure sufficient funds are available for operational purposes while retaining flexibility to cope with adverse movements in production rates, commodity prices and interest rates. A secondary objective is to have a capital structure broadly comparable with its peer group of international exploration and production companies, to assist in achieving an efficient market valuation. In addition, the Company must comply with the terms of its credit facility which include a cash sweep, a loan repayment schedule and undertakings relating to minimum consolidated group cash levels (refer to note 10).

The Company may amend its capital structure to fit with its corporate objectives by issuing equity or equity-linked instruments and by issuing debt or entering into, or extending, credit facilities with banks. No dividend payment or return of capital to shareholders is contemplated for the foreseeable future.

The Company assesses its capital structure on a forward-looking basis by modelling net cash flows over the next few years and considering the economic conditions and operational factors which could lead to financial stress. A range of measurement tools is used, including gearing (net debt divided by the sum of equity and net debt), net cash flow coverage of net interest payments, and the time to repay net debt from net cash flow. No specific numerical range for each of these parameters is targeted, as the overall assessment reflects a consideration of a wide range of factors.

No changes were made in the objectives, policies or processes during the period ended June 30, 2012.

6. EXPLORATION AND EVALUATION ASSETS

During the six month period ended June 30, 2012, $2,710,000 of staff and directly attributable general and overhead costs were capitalized to exploration and evaluation assets (June 30, 2011 – $2,209,000).

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 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.

	Six Months Ended June 30, 2012	Year Ended December 31, 2011
	$000s	$000s
Balance, beginning of the period	**121,152**	119,991
Additions		
Cash expenditures	**7,506**	170,693
Non-cash decommissioning costs	**–**	1,216
Dry hole expense	**–**	(9,733)
Exploration assets relinquished	**–**	(5,715)
Transfers to producing oil and gas properties	**–**	(156,786)
Foreign exchange	**1,877**	1,486
Balance, end of the period	**130,535**	121,152

7. PROPERTY, PLANT AND EQUIPMENT

Within the development oil and gas properties category is the amount transferred from exploration and evaluation assets for Breagh. This is not subject to depletion as it is not ready for its intended use. During the six month period ended June 30, 2012, $138,000 of staff and directly attributable general and overhead costs were capitalized to development oil and gas properties (2011 – $7,000).

	Six Months Ended June 30, 2012			Year Ended December 31, 2011		
	Development Oil & Gas Properties	**Corporate and Other**	**Total**	Development Oil & Gas Properties	Corporate and Other	Total
	$000s	**$000s**	**$000s**	$000s	$000s	$000s
Cost						
Balance, beginning of the period	**170,790**	**1,118**	**171,908**	–	615	615
Additions						
– Cash expenditures	**34,803**	**499**	**35,302**	9,922	496	10,418
– Non-cash decommissioning costs	**–**	**–**	**–**	3,783	–	3,783
Transfers from exploration and evaluation	**–**	**–**	**–**	156,786	–	156,786
Foreign exchange differences	**2,715**	**11**	**2,726**	299	7	306
Balance, end of the period	**208,308**	**1,628**	**209,936**	170,790	1,118	171,908
Accumulated depreciation and depletion						
Balance, beginning of the period	**(4,002)**	**(560)**	**(4,562)**	–	(402)	(402)
Depreciation and depletion	**(39)**	**(179)**	**(218)**	(1,053)	(153)	(1,206)
Impairment of oil and gas properties	**–**	**–**	**–**	(2,930)	–	(2,930)
Foreign exchange differences	**(10)**	**(3)**	**(13)**	(19)	(5)	(24)
Balance, end of the period	**(4,051)**	**(742)**	**(4,793)**	(4,002)	(560)	(4,562)
Net Book Value						
Balance, beginning of the period	**166,788**	**558**	**167,346**	–	213	213
Balance, end of the period	**204,257**	**886**	**205,143**	166,788	558	167,346

8. DERIVATIVE FINANCIAL INSTRUMENTS

As a requirement of the credit facility, described below, the Company has purchased monthly cash-settled put options to hedge 40 percent of its forecast gas production volumes from proved reserves (P90) from the first phase of Breagh development, for a 24-month period starting on October 1, 2012. The strike price for the options is 55 pence per therm (100,000 British thermal units) 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, ($3,543,000) and the other half 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 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. For the deferred premium put options the Company has recognized a derivative financial liability for the discounted cost of those premiums offset by their revaluation at period-ends. Any gain or loss arising is recorded through the income statement in the same period in which it arises. For the three month period ended June 30, 2012, the Company has recognized an unrealized gain of $930,000 (June 30, 2011 – nil) in the period, resulting in an unrealized loss of $786,000 (June 30, 2011 – nil) on derivative financial instruments for the six months.

As at June 30, 2012 the forward curve for the period covered by the options sits in a range between 58 pence and 69 pence per therm, and as a result the options purchased are currently out-of-the-money.

9. PROVISIONS

The following is a continuity of provisions:

	Six Months Ended June 30, 2012			Year Ended December 31, 2011		
	Decommissioning	**Other**	**Total**	Decommissioning	Other	Total
	$000s	**$000s**	**$000s**	$000s	$000s	$000s
Balance, beginning of the period	**7,056**	**1,163**	**8,219**	1,814	1,900	3,714
Arising during the period	**–**	**–**	**–**	3,865	–	3,865
Revisions to estimates	**–**	**–**	**–**	1,134	(653)	481
Foreign exchange differences	**167**	**18**	**185**	55	(84)	29
Accretion of discount	**149**	**–**	**149**	188	–	188
Balance, end of the period	**7,372**	**1,181**	**8,553**	7,056	1,163	8,219

Decommissioning Obligations

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas interests 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 decommissioning obligations as at June 30, 2012 to be approximately $16,060,000 which will be incurred between 2015 and 2036. This figure increased during 2011 due to the development of the Breagh facilities. Risk free interest rates based on UK long-term Government bond rates varying from 3.75 percent to 4.75 percent (December 31 2011 – 3.75 to 4.75 percent) and an inflation rate of 2 percent (December 31, 2011 – 2 percent) were used to calculate the decommissioning obligations at June 30, 2012.

Other Provisions

Provisions of $1,181,000 at June 30, 2012 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. The Company believes that resolution with the relevant parties will be reached in 2012.

10. LONG-TERM DEBT

The Company has a senior secured credit facility for up to £105 million with BNP Paribas, Commonwealth Bank of Australia, GE Energy Financial Services and Societe Generale to fund the Phase 1 development of the Breagh gas field (Sterling 30 percent) and related costs (the "Credit Facility").

The Credit Facility comprises a main tranche of £95 million and a cost-overrun tranche of £10 million, with a term of six-and-a-half years. The interest rate on the main tranche currently has a margin of 4 percent over LIBOR, which will drop to 3.5 percent over LIBOR in the period following project completion, and for the cost-overrun facility the margin is 4.5 percent over LIBOR. Availability under both tranches is redetermined semi-annually and is currently limited to approximately £80 million for the main tranche but the full amount of the cost overrun tranche is available. Utilization of the cost-overrun tranche requires a matching use of equity funds by the Company. 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 (Project Completion), which is currently expected around mid 2014. 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 group over a 12-month period, as demonstrated by forward-looking cash flow statements prepared at the end of each quarter. During the quarter, the Company announced that it had reached agreement with the lending banks to reduce this minimum group cash requirement from £35 million ($56,136,000) to £20 million ($32,078,000) from April 1, 2012 until Project Completion, £10 million ($16,039,000) of which is held as non-current restricted cash as we do not expect to have access to these funds within a year. The Company believes it was in compliance with the undertakings and obligations under the Credit Facility as at June 30, 2012.

$000s	**Six Months Ended June 30, 2012**	Year Ended December 31, 2011
Balance, beginning of period	**72,818**	–
Proceeds from loan funds	**38,825**	77,392
Transaction costs	**(111)**	(4,766)
Amortization of transaction costs	**387**	192
Foreign exchange differences	**(36)**	–
Balance, end of period	**111,883**	72,818

11. COMMITMENTS AND CONTINGENCIES

Commitments as of June 30, 2012 for the remaining six months of 2012, for the years 2013 through 2016 and thereafter, excluding amounts held in escrow and shown as restricted cash are comprised of the following:

	2012	2013	2014	2015	2016	Thereafter	**Total**
	$000s	$000s	$000s	$000s	$000s	$000s	**$000s**
Facilities, oil and gas drilling	19,810	20,987	28,010	–	–	–	**68,807**
Seismic	2,738	6,988	–	–	–	–	**9,726**
Licence fees	1,090	1,558	1,968	2,674	3,260	–	**10,550**
Other operating	533	2,042	1,992	293	559	951	**6,370**
Office and other leases	575	758	671	602	602	3,012	**6,220**
	24,746	32,333	32,641	3,569	4,421	3,963	**101,673**

The above facilities, oil and natural gas drilling commitment in 2012 relates to the firm development wells contracted to be drilled and the additional facilities required as part of the Breagh Phase 1 and reflects the cost overruns, which will be funded from the Credit Facility, from revenues when gas sales from Breagh commence (targeted for December 2012) and/or from existing cash.

12. 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:

	Six Months Ended June 30, 2012		Year Ended December 31, 2011	
	Shares	**Amount**	Shares	Amount
Continuity of Common Shares	**$000s**	**$000s**	$000s	$000s
Balance, beginning of the period	**222,644**	**337,711**	188,944	290,444
Issued for cash:				
– public equity issuances	**–**	**–**	32,143	45,000
– exercise of stock options	**225**	**343**	1,557	3,408
Share issue costs	**–**	**–**	–	(2,480)
Transferred from contributed surplus on exercise of options	**–**	**167**	–	1,339
Balance, end of the period	**222,869**	**338,221**	222,644	337,711

On August 16, 2011 the Company completed a bought-deal financing arrangement with a syndicate of underwriters for the issuance 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.

13. SEGMENTED INFORMATION

The Company has 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
Segmented Results	$000s	$000s	$000s	$000s	$000s
Three Months Ended June 30, 2012					
Revenues	**–**	**–**	**–**	**–**	**–**
Net loss	**(1,450)**	**(3,365)**	**(1,490)**	**(737)**	**(7,042)**
Six Months Ended June 30, 2012					
Revenues	**–**	**66**	**–**	**–**	**66**
Net loss	**(3,382)**	**(7,595)**	**(2,185)**	**(1,527)**	**(14,689)**
Three Months Ended June 30, 2011					
Revenues	–	329	–	–	329
Net loss	(1,784)	(9,311)	(1,732)	(530)	(13,357)
Six Months Ended June 30, 2011					
Revenues	–	329	–	–	329
Dry hole expense	–	(9,733)	–	–	(9,733)
Net loss	(4,739)	(21,851)	(4,677)	(3,098)	(34,365)

	Canada	United Kingdom	Romania	Other International	Consolidated
Other Segmented Results	$000s	$000s	$000s	$000s	$000s
As at and for the Six Month Period Ended June 30, 2012					
Exploration and evaluation assets	**–**	**93,632**	**29,496**	**7,407**	**130,535**
Exploration and evaluation asset additions	**–**	**1,761**	**1,952**	**3,793**	**7,506**
Development properties	**–**	**204,257**	**–**	**–**	**204,257**
Development properties additions	**–**	**34,803**	**–**	**–**	**34,803**
As at and for the Six Month Period Ended June 30, 2011					
Exploration and evaluation assets	–	193,580	25,258	–	218,838
Exploration and evaluation asset additions (net)	–	107,234	–	–	107,234
Development properties	–	5,635	–	–	5,635
Development properties transfers and additions	–	5,984	–	–	5,984

14. SHARE-BASED COMPENSATION

The following is a continuity of outstanding stock options:

	Six Months Ended June 30, 2012		Year Ended December 31, 2011	
	Options	**Weighted Average Exercise Price**	Options	Weighted Average Exercise Price
Continuity of Common Share Options	**000s**	**$**	000s	$
Balance, beginning of the period	**14,865**	**2.07**	11,949	2.18
Granted during the period	**195**	**1.71**	5,090	1.88
Exercised/forfeited during the period	**(225)**	**1.52**	(1,557)	2.19
Expired during the period	**(1,327)**	**–**	(617)	2.29
Outstanding, end of the period	**13,508**	**2.09**	14,865	2.07
Exercisable, end of the period	**7,135**	**2.09**	5,070	2.11

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:

	Six Months Ended June 30, 2012	Year Ended December 31, 2011
Weighted average share price	**$1.71**	$1.88
Weighted average exercise price	**$1.71**	$1.88
Risk-free interest rate	**1.12%**	1.97%
Weighted-average forfeiture rate	**1.65%**	1.98%
Expected hold period to exercise	**3.5 years**	3.5 years
Volatility in the price of the Company's shares	**75.4%**	77.3%
Expected annual dividend yield	**0%**	0%

The weighted average fair value of options granted during the six month period ended June 30, 2012 was $0.90 per share (year ended December 31, 2011 – $1.02 per share). For the second quarter ended June 30, 2012, $1,114,000 (June 30, 2011 – $1,390,000) of share-based compensation was expensed and was included in the employee expense figure of $1,445,000 (June 30, 2011 – $3,191,000). For the six month period ended June 30, 2012, $2,533,000 (June 30, 2011 – $2,872,000) of share-based compensation was expensed and was included in the employee expense figure of $4,263,000 (June 30, 2011 – $4,784,000).

The following stock options were outstanding as at June 30, 2012:

Exercise Price		Options Outstanding			Options Exercisable		
From $	To $	Options 000s	Remaining Contract Life (Days)	Weighted Average Exercise Price	Options 000s	Remaining Contract Life (Days)	Weighted Average Exercise Price
1.29	1.49	2,622	736	1.40	1,717	529	1.42
1.50	1.99	4,660	1,020	1.80	1,485	643	1.81
2.00	2.49	2,440	701	2.03	1,613	513	2.03
2.50	2.99	2,336	547	2.61	1,837	415	2.60
3.00	3.49	1,100	875	3.33	367	511	3.33
3.50	4.25	350	982	4.25	117	617	4.25
1.29	4.25	13,508	813	2.09	7,135	520	2.09

15. FINANCING COSTS

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
	$000s	$000s	**$000s**	$000s
Interest expense	**1,736**	–	**3,609**	–
Amortization of debt issue expense	**193**	–	**387**	–
Capitalization of interest and amortization of debt issue expense	**(1,929)**	–	**(3,996)**	–
	–	–	**–**	–
Accretion (note 9)	**75**	78	**149**	160
Total financing costs	**75**	78	**149**	160

16. NET LOSS PER SHARE

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

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	**2012**	2011
Weighted average shares outstanding (000s)	**222,787**	190,451	**222,739**	190,207
Net loss ($000s)	**7,042**	13,357	**14,689**	34,365
Weighted average net loss per share ($ per share)				
Basic	**0.03**	0.07	**0.07**	0.18
Diluted	**0.03**	0.07	**0.07**	0.18

For the periods ended June 30, 2012 and 2011, the dilutive effect of all the Company's outstanding options was not included in diluted shares outstanding due to the net loss incurred in each period.

17. SUBSEQUENT EVENTS

On July 13, 2012 the Company announced that its wholly owned subsidiary in Romania, Midia Resources SRL (Midia), had obtained governmental approval for an interest in the 1,000 square kilometre Romanian Black Sea concession Block 25 (Luceafarul). Midia will obtain a 50 percent interest and will be operator. The current concession owner Petro Ventures Europe BV will then hold the remaining 50 percent interest. This shallow water block, to the west of and adjacent to Sterling's Midia Block, contains an existing gas discovery, multiple exploration plays and has existing 2D seismic coverage. The Concession Agreement has an initial three year exploration period with a commitment to undertake seismic acquisition and drill one well. Seismic work is currently progressing through the permitting process.

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