

CYGAM ENERGY INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS SIX MONTHS ENDED JUNE 30, 2007

This Management's Discussion and Analysis (MD&A) is a review of operations, current financial position and outlook for Cygam Energy Inc. (Cygam or the Company) and should be read in conjunction with the interim consolidated financial statements (unaudited) for the period ended June 30, 2007, the annual consolidated financial statements as at December 31, 2006 and the annual MD&A. This MD&A is dated as of August 24, 2007.

The interim consolidated financial statements have been prepared by management and approved by Cygam's Audit Committee on behalf of the Board of Directors. These financial statements have not been independently reviewed or audited. These statements are based on certain estimates and assumptions and involve risks and uncertainties. Actual results may differ materially. Refer to the Business Risks section of this MD&A for additional information related to identified risks, estimates and uncertainties.

All financial information is reported in Canadian dollars and is in accordance with Canadian generally accepted accounting principles (GAAP) unless otherwise noted. Natural gas has been converted into barrels of oil equivalent (boe) at 6:1. The abbreviation boe, boe per day and mboe disclosed in this MD&A may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf: 1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Cautionary Statement regarding Forward-Looking Information

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

All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The risks, uncertainties, and assumptions are difficult to predict and may affect operations, including, without limitation: the risks associated with foreign operations; foreign exchange fluctuations; commodity prices; equipment and labour shortages and inflationary costs; general economic conditions; industry conditions; changes in applicable environmental, taxation and other laws and regulations as well as how such laws and regulations are interpreted and enforced; the ability of oil and natural gas companies to raise capital; the effect of weather conditions on operations and facilities; the existence of operating risks; volatility of oil and natural gas prices; oil and natural gas product supply and

demand; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; increased competition; stock market volatility; opportunities available to or pursued by us and other factors, many of which are beyond our control. The foregoing factors are not exhaustive and are further discussed herein under the heading “Business Risks and Uncertainties”.

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

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

EXPLORATION ACTIVITIES

The Company incurred the following capital expenditures and conducted the following exploration activities during quarter ended June 30, 2007:

<u>Expenditures on PP&E - 2007</u>	<u>Canada</u>	<u>Italy</u>	<u>Tunisia</u>	<u>Total</u>
Development	49,821	-	-	49,821
Seismic	-	52,526	885,944	938,470
Drilling and equipment purchase	-	2,938,656	217,425	3,156,081
Other	2,650	7,776	558	10,984
Total	52,471	2,998,958	1,103,927	4,155,356

<u>Expenditures on PP&E - 2006</u>	<u>Canada</u>	<u>Italy</u>	<u>Tunisia</u>	<u>Total</u>
Development	52,598	-	-	52,598
Seismic	-	-	29,333	29,333
Drilling and equipment purchase	-	-	445,527	445,527
Other	-	4,860	-	4,860
Total	52,598	4,860	474,860	532,318

CANADA

Routine maintenance operations were conducted in the Snipe Lake South Unit where the Company has a 0.0763814% working interest.

INTERNATIONAL

Cygam is conducting international exploration activities in Italy through its wholly owned subsidiary, Vega Oil S.p.A., and in Tunisia through its other wholly owned subsidiary, Rigo Oil Company Limited.

ITALY

Posta Nuova

The Posta Piana-1 well commenced drilling on May 6 and reached total depth at 1147 meters on May 18, 2007. The well is currently standing cased after testing of four zones of interest was completed in early July. Limited amounts of gas were recovered from one of the middle Pliocene zones, at the same structural elevation as the sandstone unit which had tested 1.3 MMcf/d of gas from the Cervaro # 1 well, located approximately 200 metres away. It is postulated that some formation damage may have occurred during drilling and/or cementing operations in these thin bedded and low pressured sands. The Corporation will monitor the well for pressure build-up in

the next few months and intends to compare the Posta Piana well performance with the limited officially released data available from nearby wells producing from similar low porosity sands.

B.R268.RG

Acquisition of approximately 300 kilometres of 2-D marine seismic data from the previous operator of the block was completed and the seismic data was delivered to our office in Rome. This seismic data is currently being interpreted and selected lines are being re-processed.

Civitaquana

Work on the Civitaquana permit, located onshore central Italy, west of the B.R268.RG Permit, in the Marche-Abruzzi basin, was limited to preliminary seismic assessment since the purchase of all existing data and acquisition of additional seismic will not be allowed until the permit receives final ministerial approval. Cygam has completed the environmental assessment requirements and expects to receive the final approval on this block in the near future.

Aretusa

Final ministerial approval for the Aretusa exploration permit, now officially named C.R148.VG, was published in the monthly Italian Hydrocarbon Bulletin on December 31, 2006. Cygam has a 100% working interest in this permit which encompasses an area of 83,267 acres. Available seismic data indicates the presence of one potential large structure on the block. Discussions on the acquisition of approximately 2,500 km of existing seismic from a previous operator are continuing.

Montalbano

Cygam and its partners have fulfilled the initial work obligation on the permit through the purchase of existing seismic data which is currently being reprocessed and interpreted. Drilling and log data from an older well which tested gas close to the northern boundary of the permit have also been acquired. During the quarter, Cygam held joint venture meetings with its two partners, J.K.X. Italia, a British company, and Gas Natural, a Spanish company.

TUNISIA

Jorf

Final reprocessing and interpretation of all the data from a new 166 km 2D seismic program, acquired at the beginning of 2007, was completed during the quarter and confirmed the presence of a large reefal structure and of several other anomalies, also interpreted as potential reef build-ups. Based on this interpretation, a surface location for the Bhayra Rigo #1 well on the Jorf permit was constructed in June and transport of the Great Walls drilling rig from its last drilling location in northern Tunisia was completed in July. Drilling of the Bhayra Rigo #1 well commenced on July 30, 2007. The exploratory well will be drilled to approximately 2,500 metres and is expected to take 30 to 35 days to reach the final depth.

Subsequent to the end of the quarter, in July, 2007, the Tunisian Department of Energy granted Cygam a six month extension of the Jorf permit, to February 5, 2008.

On August 3rd, 2007, Cygam signed a Farmout and Participation Agreement with Loon Energy Inc. ("Loon"), an international exploration company, which will participate in the drilling of the

Bhayra Rigo 1 well. Loon will pay 15% of the well cost and 15% of acquisition of 166 km of new 2D seismic data to earn a 10% interest in the Bhayra structure and surrounding lands. Loon will have a further option to participate in the potential drilling of another structure to earn an interest in the balance of the permit on the same terms. In addition to Loon, Gallic Energy Ltd. and Zappa Resources Ltd. will each pay 15% of costs to earn a 10% working interest in the Bhayra structure and surrounding lands. Pennine Petroleum Corporation, which had paid 15% of seismic costs under a similar agreement, was forced to forfeit its participation in the drilling of the Bhayra well since it did not complete a proposed financing. Pennine will retain a small net interest in the Bhayra prospect, being their proportionate earned interest based on the paid seismic costs. As a result of the additional farm-out to Loon and the reduced participation by Pennine, Cygam will now pay a net 40% of seismic costs and a net 55% of drilling costs and will have approximately 68% working interest in the Bhayra structure and surrounding lands.

Sud Tozeur

At Sud Tozeur, the original Prospecting Permit, granted on May 13, 2005, carried an obligation to re-interpret all existing seismic data and acquire 50 kilometers of new seismic lines on or before the expiry of the two year term. During 2006, Cygam acquired all existing seismic data from ETAP and previous operators. In January, 2007, Cygam completed a 61 km 2-D seismic delineation program on the permit in order to further delineate a large Ordovician structure.

On March 19, 2007, the Company received approval by the Department of Energy to convert the Sud Tozeur Prospecting Permit into a four year Exploration Permit and this agreement was officially signed in Tunis on July 5, 2007, between its wholly owned subsidiary, Rigo Oil Company Limited, and the Department of Energy.

The new seismic data will be integrated with older data coverage on the Sud Tozeur permit in order to finalize the best drilling location on a large structure with Triassic and Ordovician reservoir potential which had been drilled in late 1997, by the previous operator. Several, additional, un-drilled structures have also been identified on the permit, on trend with Algerian fields, but they will require further evaluation.

The Sud Tozeur exploration permit, located near the Algerian border and in close proximity to the Sabria and El Franig fields, covers an area of 4,380 square kilometres (1,082,283 acres) and carries a drilling commitment over a period of four years. Cygam currently holds a 100% working interest in the permit and has received expressions of interest from other companies to participate in the exploration on a promoted basis. A well may be drilled at Sud Tozeur in early 2008 pending final seismic evaluation and rig availability.

Bazma

In early 2007 the Company re-processed approximately 200 km of seismic data with good results. Final interpretation of the data is underway. Cygam has already signed letters of intent with two Canadian companies interested in participating in joint ventures in this area on a promoted basis, subject to review of seismic and other technical data. Additional companies have also expressed an interest in participating in our exploration program. Pending final interpretation of all existing seismic data and confirmation of prospective structural trends on the permit, Cygam may drill a well on this permit in early 2008.

Sud Remada

During the quarter, Storm Ventures International, the permit operator, continued the geophysical evaluation of two large Ordovician structures in the northern half of the permit and acquired a new 2-D seismic program in order to finalize the location of a planned exploratory well. Cygam

has converted its 20% working interest in the southern portion of the permit into a 10% working interest in the entire permit. This 10% working interest will apply to all future operations at Sud Remada.

FINANCIAL PERFORMANCE
Selected Financial Information

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
	\$	\$	\$	\$
Oil and gas revenue	150,943	124,671	310,825	295,736
Royalties, net of ARTC	(17,675)	(31,007)	(42,829)	(66,548)
Other revenue	144,906	158,887	276,676	303,470
Total net revenue	278,174	252,551	544,672	532,658
Operating costs	50,237	50,404	91,625	93,078
Depletion, amortization and accretion	58,236	44,292	117,174	84,302
General & administration	601,438	295,811	965,494	540,597
Interest	2,523	1,119	3,647	2,867
Exchange (gain)/loss	68	2,484	856	2,484
Stock-based compensation expense	53,993	92,062	90,410	184,124
	766,495	486,172	1,269,206	907,452
Earnings (Loss) before following items	(488,321)	(233,621)	(724,534)	(374,794)
Gain on sale of marketable securities	-	-	-	-
Unrealized loss on marketable securities	179,634	(496,988)	99,796	(341,794)
Net earnings (loss)	(308,687)	(730,609)	(624,738)	(716,099)
Current and future income tax recovery	8,500	5,000	(3,000)	5,000
Net earnings (loss) after tax	(300,187)	(725,609)	(627,738)	(711,099)

Oil and Gas Revenue

Oil and gas revenues (net of royalties) of \$ 133,268 (2006 - \$93,664) represents revenue from the Canadian operations. Production for the quarter was 36.17 boed (2006 - 32.32), comprising approximately 75% natural gas and 25% oil and NGLs, at an average price of \$45.85 per boe (2006 - \$42.39). The increase in net revenue resulted from an increase in production from the South Edson property, an increase in the average price of oil and natural gas, and a decrease in royalty following a repayment of certain prior year royalty payments due to volume adjustments made by the operator.

Crown and production royalties (net of ARTC) was \$17,675 (2006 - \$31,007) or \$5.37 (2006 -\$10.54) per boe, whilst operating expenses were \$50,237 (2006 - \$50,404) or \$15.26 (2006 - \$17.13) per boe.

Other Revenue

Other revenue for the quarter includes distributions of \$83,843 (2006 - \$83,829) received from investments in marketable securities, and interest income of \$61,010 (2006 - \$75,057) on cash balances invested in short-term fixed income securities in the form of Bankers Acceptances issued and backed by the HSBC.

Unrealized Loss on Marketable Securities

At the time of the acquisition, management had designated the units acquired as held for trading with the intent to dispose of these units when funds were required for exploration activities. At June 30, 2007 the units are stated in the financial statements at fair value of \$3,632,611 following an unrealized gain of \$179,634 during the quarter.

Net Income (loss)

The net loss after tax for the period was \$300,187 (2006 – \$725,609). After adjusting for non-cash items, including depletion, amortization and accretion, stock based compensation expense and the unrealized gain or loss on marketable securities, the Company had an adjusted net loss after tax for the quarter of \$376,092 (2006 - \$97,267).

General and Administrative Expenses

The G&A increased in the current period to \$601,438 (2006 - \$295,811). The increase compared to prior year resulted from an increase in staff and additional office space in the Rome office, and the opening of our Tunis office and the hiring of a permanent Resident Manager in July 2006 in the Tunis office. These events resulted in a increase in G&A of \$138,202 compared to prior year. During the quarter Cygam also paid a management bonus of \$100,000 (2006 - \$nil).

G&A includes \$172,200 (2006 - \$79,509) in consulting fees, including the management bonus noted above, paid to directors and officers of Cygam, or to companies whose shareholders are directors and officers of Cygam, and \$9,867 (2006 - \$9,200) in legal fees paid to a legal firm in which a director of the Company is a partner.

During the quarter, the Company capitalized \$106,006 (2006 - \$37,160) of general and administrative expenses that were directly related to the acquisition and exploration of oil & gas properties in Tunisia and Italy.

Stock-based Compensation

Stock-based compensation represents a non-cash charge resulting from applying fair value method on stock options issued by the Company during the period. Under this method, compensation expense related to this program is recorded in the statement of operations over their respective vesting periods. The amount of compensation cost recognized in the period is based on the fair value the stock options vesting in that period.

Stock-based compensation for the quarter was \$53,993 (2006 - \$92,062).

Depletion, Amortization and Accretion

Depletion, Amortization and Accretion (“DA&A”) amounted to \$58,236 including depletion and accretion amount of \$46,531 (\$14.13 /boe) for the period related to oil and gas production from Canadian properties. The cost of unproved properties of \$11,848,889 was excluded from the DA&A calculation and is assessed periodically to ascertain whether impairment has occurred.

SUMMARY OF QUARTERLY INFORMATION

The following is a summary of selected financial information for the Company for the past eight quarters.

	2007	2007		2006
	Q2	Q1	Q4	Q3
P&G sales (net of royalties)	\$ 133,268	134,729	126,633	122,459
Other revenue	144,906	131,770	240,789	153,872
	<u>278,174</u>	<u>266,498</u>	<u>367,422</u>	<u>276,331</u>
Expenses	<u>766,427</u>	<u>502,711</u>	<u>728,105</u>	<u>445,017</u>
Earnings (loss) before items below	(488,253)	(236,213)	(360,683)	(168,686)
Unrealized gain (loss) on marketable securities	179,634	(79,838)	(445,095)	(748,478)
Foreign exchange gain (loss)	(68)	-	2,045	(3,484)
	<u>(308,687)</u>	<u>(316,051)</u>	<u>(803,733)</u>	<u>(920,648)</u>
Current and future income tax recovery	8,500	(11,500)	62,461	(15,990)
	<u>(300,187)</u>	<u>(327,551)</u>	<u>(741,272)</u>	<u>(936,638)</u>
Net earnings after tax	<u>(300,187)</u>	<u>(327,551)</u>	<u>(741,272)</u>	<u>(936,638)</u>
Net income (loss) per share	<u>(0.00)</u>	<u>(0.00)</u>	<u>(0.01)</u>	<u>(0.01)</u>
Production (boe/d)	<u>36.17</u>	<u>38.94</u>	<u>37.64</u>	<u>38.28</u>

	2006	2006		2005
	Q2	Q1	Q4	Q3
P&G sales (net of royalties)	\$ 93,664	135,527	205,025	-
Other revenue	158,887	144,583	128,299	-
	<u>252,551</u>	<u>280,107</u>	<u>333,324</u>	<u>-</u>
Expenses	<u>483,688</u>	<u>421,280</u>	<u>1,179,285</u>	<u>-</u>
Earnings (loss) before items below	(231,137)	(141,173)	(840,961)	-
Unrealized gain (loss) on marketable securities	(496,988)	155,683	(932,308)	-
Foreign exchange gain (loss)	(2,484)	-	(58,486)	-
	<u>(730,609)</u>	<u>14,510</u>	<u>(1,831,755)</u>	<u>376,860</u>
Current and future income tax recovery	5,000	-	10,978	-
	<u>(735,609)</u>	<u>14,510</u>	<u>(1,820,777)</u>	<u>376,860</u>
Net earnings after tax	<u>(735,609)</u>	<u>14,510</u>	<u>(1,820,777)</u>	<u>376,860</u>
Net income (loss) per share	<u>(0.01)</u>	<u>0.00</u>	<u>(0.037)</u>	<u>0.009</u>
Production	<u>32.32</u>	<u>37.12</u>	<u>38.04</u>	<u>n/a</u>

Revenue from oil and gas sales (net of royalties) fluctuates from quarter to quarter largely due to fluctuations in the price of oil and natural gas received by the Company (see earlier comments on Revenue). The production each quarter has not changed by a significant amount except in the second quarter of 2006 when some facilities were shut-in for maintenance.

As noted earlier, the Company's expenses have increased each quarter as the Company has grown the number of employees and related office expenses in the Rome and Tunis offices to conduct the increased amount of seismic acquisition, processing and interpretation activity, and increase in drilling activity on permits in Italy and Tunisia in 2007. Expenses in the fourth quarter of 2005 include significant costs relating to the reverse take-over transaction.

LIQUIDITY AND CAPITAL RESOURCES

The Company had a net working capital balance of \$11,350,587, including a cash balance of \$10,675,762 as at June 30, 2007. Cash balances in excess of planned requirements were invested in short-term fixed income securities in the form of Bankers Acceptances backed by the HSBC Bank. These short-term deposits generated \$61,010 in interest income for the quarter, and the Company continues to receive a monthly distribution of \$27,943 from its investment in marketable securities. On May 23, 2007, the Company completed a brokered private placement to raise gross proceeds of \$10,000,000 at a price of \$1.00 per common share.

The Company's cash balance and additional funds from the liquidation of the marketable securities are expected to be sufficient to fund the planned first phase of the exploration program over the next year assuming the Company is able to negotiate and fund a portion of the exploration plan through joint ventures. The Company, through its subsidiaries in Italy and Tunisia, has either entered into agreements or has received expressions of interest from third parties to participate in the exploration program on several of the permits on the basis of "pay 60% to earn 40% interest". The Company will examine each interest on a permit by permit basis to determine the level and amount of participation offered to third parties. The planned capital expenditures program for the next twelve months, net to Cygam, of approximately \$9,000,000 will be primarily funded from the Company's cash, working capital and proceeds from equity financings and the exercise of outstanding warrants and agent's options.

SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares as well as first preferred non-voting shares. To date, no preferred shares have been issued. The Company's share capital as at August 24, 2007 is outlined below:

	Shares	Amount (\$)
Outstanding shares at December 31, 2006	72,349,640	\$ 14,303,681
Issued upon acquisition of Vittorito interest	484,614	294,498
Issued upon exercise of Series "B" warrants	147,320	119,992
Issued upon exercise of Agent's option	83,750	60,670
Private Placement	<u>10,000,000</u>	<u>9,328,412</u>
Outstanding shares at June 30, 2007	83,065,324	\$ 24,107,253
Issued upon exercise of Series "B" warrants	<u>1,914,680</u>	<u>1,689,642</u>
Outstanding shares at August 24, 2007	<u>84,980,004</u>	<u>\$ 25,796,895</u>

The Company paid a cash commission of 6% of gross proceeds to the agent on the private placement and incurred other financing costs of \$71,588.

During the quarter, the Company granted 350,000 stock options to consultants and employees with an exercise price of \$1.00 per share. No stock options were exercised during the quarter ended June 30, 2007. The total number of stock options granted as at June 30, 2007 and as at the date of this MD&A was 4,650,000, and the total number of warrants and agent options issued and outstanding was 12,961,804.

BUSINESS RISKS AND UNCERTAINTIES

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

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

The Company focuses the majority of its activities on exploration in Tunisia and Italy. Some of the Company's operations and related assets are located in countries which carry a higher degree of political and economic risk. Cygam's management has considerable expertise operating internationally and has developed solid, long-term relationships within each of the jurisdictions in which it operates. The Company adheres to all governmental and environmental regulations as they apply in each operating jurisdiction. Regulation changes could increase costs of the Company's operations.

Cygam's current production base in Canada is heavily weighted to natural gas which is subject to price fluctuations based on North American natural gas supply and demand conditions. Oil and natural gas are commodities whose prices have fluctuated widely in recent years and are determined based on world demand, supply and other factors, all of which are beyond the control of the Company.

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

RELATED PARTY TRANSACTIONS

Transactions between the Company and related parties occurred during the period, as disclosed in the notes to the interim consolidated financial statements. During the quarter, the Company paid \$172,200 (2006 - \$79,509) as consulting fees to related parties. The Company also paid \$9,967 (2006 - \$9,200) in legal fees to a legal firm in which a director of the Company is a partner.

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

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

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

Rigo Oil Company Tunisia Ltd. (ROCT) is the operator of the Jorf exploration permit, and the operator of the Sud Tozeur prospecting licence. Under the terms of the exploration permit, the operator and its partners are obligated to drill one well to the depth of 2,500 meters within the term of the permit. The Company commenced drilling a well on this permit on July 30, 2007.

The Company rents premises in Rome, Italy, and in Tunis, Tunisia, under operating leases that require payments of \$88,000 per annum in Rome and \$55,000 per annum in Tunis.

CRITICAL ACCOUNTING ESTIMATES

Cygam's significant accounting policies are disclosed in Note 2 to the audited consolidated financial statements for the year ended December 31, 2006. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discusses such accounting policies and is included in the MD&A to assist the reader in assessing our critical accounting policies and practices and the likelihood of materially different results being reported. As management, we review estimates regularly. The emergence of new information and changed circumstances, including accounting standards, may result in actual results or changes to estimated amounts that differ materially from current estimates.

Reserves Determination

The petroleum and natural gas reserves used in determining our depletion rates and the ceiling test are based upon management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of petroleum and natural gas are examined to determine quantities available for future production, given existing operating and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in crude oil and natural gas prices and costs. Consequently, the reserves are estimates which are subject to variability. We employ the services of independent oil and gas reservoir engineers (Fekete Associates Inc. and Matsalla Consulting (1981) Ltd.) to assist with the reserve evaluation process for the Canadian properties.

Full Cost Accounting for Oil and Gas Activities

Cygam uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development, are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs is amortized using the unit-of-production method based on estimated proved oil and gas reserves before royalties, as determined by qualified independent petroleum evaluation engineers. Accordingly, changes in estimated proved oil and gas reserves and estimated future development costs would result in changes to the depletion rate. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until

proved reserves have been determined or their value is impaired. These properties are assessed periodically and any impairment is transferred to the costs subject to depletion.

Asset Impairments

Under full cost accounting, a ceiling test is performed to ensure that unamortized capitalized costs in each cost centre (country) do not exceed their fair value. Impairment is recognized when the carrying value is greater than the undiscounted future cash flows. In the event of impairment, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings. Fair value is determined using expected future product prices and costs, and amounts are discounted using a risk-free interest rate.

Asset Retirement Obligations

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

Stock-Based Compensation

The Company uses the fair value method for valuing stock option grants. Under this method, compensation cost attributable to all stock options granted is measured at fair value at the grant date, using the Black-Scholes valuation model, and expensed over the vesting period with a corresponding increase to contributed surplus. Upon exercise of options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Accounting for Derivative Instruments and Hedging Activities

Cygam has not entered into any hedging arrangements.

Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Legal, Environmental Remediation and Other Contingent Matters

Cygam is required to both determine whether a loss is probable, based on judgment and interpretation of laws and regulations, and determine that the loss reasonably be estimated and included in the Company's financial statements. Management continually monitors known and potential contingent matters and makes appropriate provisions by charges to earnings when warranted by circumstances.

Disclosure Controls and Procedures

Internal controls over financial reporting and disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosures. It should be noted that while the Company's management believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

NEW ACCOUNTING STANDARDS

On January 1, 2007, the Company adopted the following new Handbook Sections: Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments – Recognition and

Measurement; and Section 3865, Hedges. These new accounting standards for Canadian GAAP emphasize the use of fair value rather than historical cost as the basis for accounting for financial instruments.

The Accounting Standards Board (AcSB) has proposed that Canadian GAAP for publicly accountable enterprises will migrate to International Financial Reporting Standards (IFRS) over a transition period in the next five years. The Company will assess the impact this proposal will have on the financial statements.

OUTLOOK

Cygam plans to focus largely on international oil and natural gas exploration. The Company intends to conduct a two-phase, success based, initial exploration program for its Italian and Tunisian Permits as well as look for additional exploration and drilling opportunities in Italy, Tunisia and other circum-Mediterranean oil prone areas. The first phase will involve seismic acquisition and interpretation plus the drilling, testing and potential completion of one well on each of the permits acquired. The second phase will involve the drilling, testing and potential completion of additional wells if Cygam determines it is warranted.

Cygam's exploration plans for the remainder of 2007 and early 2008 in Italy and Tunisia include:

- (a) **Posta Nuova Permit.** Production casing was set in the Posta Piana-1 well on May 23, 2007, and the well was production tested in late May and in early July but failed to recover commercial quantities of natural gas as discussed earlier. The Corporation will monitor the well for pressure build-up in the next few months. Additional locations on the structure or in other portions of the Posta Nuova permit may be considered.
- (b) **B.R268.RG (Miglianico East) Permit.** The Company will continue the interpretation of approximately 300 kilometers of existing marine seismic which was recently acquired from the previous permit operator. Selected seismic lines will be re-processed in order to see if a substantial improvement in data quality can be achieved. Re-processing of all seismic data will follow if deemed necessary. The additional purchase of another 120 kilometers of shallow marine seismic is currently being negotiated with a previous operator. A potential 3-D seismic program may be recommended after the assessment of all the acquired seismic data is completed. Cygam has identified three offshore structures, including the potential extension of the onshore Miglianico discovery, which will be further assessed and graded for drilling. Drilling of a well to a total vertical depth of approximately 4,500 metres is tentatively planned for late 2008 or early 2009, depending on rig availability. An assessment of jack-up rig availability for shallow offshore operations is currently underway. Discussions with operators of nearby offshore block are continuing with the intent of possibly sharing a drilling rig in the future.
- (c) **Montalbano Permit.** The Company had technical meetings with its partners in the permit and purchased 80 kilometers of existing seismic lines which are currently being reprocessed and interpreted. The acquisition of approximately 40 kilometers of new lines is planned for late 2007 or early 2008. Potential drilling of a 1,600 meters well may be considered in 2008.
- (d) **Civitaquana Permit.** Cygam submitted an updated environmental assessment for this permit and expects to receive final ministerial approval in the near future. Upon receipt of final approval, Cygam will purchase and reprocess 100 kilometers of existing seismic data and will acquire an additional 60 kilometers of 2D seismic lines.

- (e) **C. R148.VG (Aretusa) Permit** . In December, 2006, Cygam received final ministerial approval for this new exploration permit in the Mediterranean Sea, offshore south-eastern Sicily. The Company is currently discussing the acquisition terms for approximately 2,500 kilometres of existing 2-D seismic from ENI, the Italian State company which had conducted extensive marine seismic operations offshore Sicily. The potential acquisition of a new 80 to 100 square kilometres 3-D seismic program is tentatively scheduled for 2008.
- (f) **Jorf Permit.** Cygam completed the preliminary interpreting of all the available seismic data on the permit in 2006, and outlined two large carbonate reef structures on the Jorf block. In February and March, 2007, the Company conducted an additional 166 km 2-D seismic acquisition program in order to finalize the precise location for a planned exploratory well. The Company commenced drilling operations on July 30, 2007. Drilling and testing operations are expected to continue into September.
- (g) **Bazma Permit.** Reinterpretation of a large amount of acquired seismic data and potential reprocessing of additional selected lines will continue during 2007. A potential drilling location has already been outlined. The Company may drill a well at Bazma in early 2008, depending on rig availability.
- (h) **Sud Tozeur Permit.** Processing and interpretation of a new 61 km 2-D seismic survey is continuing. The survey was designed to further define with state-of-the-art seismic a large structure which was outlined based on older seismic data. This structure holds hydrocarbon potential in Triassic, Ordovician and Cambrian reservoirs. Pending complete evaluation of all seismic data and rig availability, a well may be proposed at Sud Tozeur in late 2007 or early 2008.
- (i) **Sud Remada Permit.** The permit operator, Storm Ventures International Inc., has commenced the acquisition of an additional 200 kilometers of 2-D seismic data in May, 2007, on the northern half of the permit in order to further define two large Ordovician structures. An Ordovician well may be proposed in late 2007. In the southern half of the permit, a Silurian Acacus structure, located near the Libyan border, may also be further investigated.

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