

**Porto Energy Corp.**  
**Consolidated Financial Statements**

**For the Three And Six Month Periods Ended February 28, 2011 and 2010**  
**(Unaudited)**

(Stated in United States Dollars)

**Porto Energy Corp.**  
**Consolidated Balance Sheets**  
**(Stated in United States dollars)**  
**(unaudited)**

	<u>February 28,</u> <u>2011</u>	<u>August 31,</u> <u>2010</u>
<b>ASSETS</b>		
Current assets:		
Cash	\$ 6,439,000	\$ 3,315,591
Accounts receivable	1,666,079	134,528
Prepaid expenses	44,504	210,392
Total current assets	<u>8,149,583</u>	<u>3,660,511</u>
Property and equipment (Note 5)	46,571,614	35,948,178
Deferred offering costs	81,206	-
Restricted cash deposits (Note 7)	135,000	135,000
Total assets	<u>\$ 54,937,403</u>	<u>\$ 39,743,689</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 2,900,114	\$ 1,686,357
Related party payables (Note 9)	63,141	107,312
Total current liabilities	<u>2,963,255</u>	<u>1,793,669</u>
Asset retirement obligation (Note 6)	99,133	98,065
Future income tax liability	6,943,514	5,551,255
Total liabilities	<u>10,005,902</u>	<u>7,442,989</u>
Basis of presentation (Note 2)		
Commitments and contractual obligations and contingent liabilities (Notes 10 and 12)		
Subsequent events (Note 13)		
Shareholders' equity:		
Share capital (Note 8 (b))	41,581,366	29,557,450
Warrants (Note 8 (c))	4,375,670	822,566
Contributed surplus (Note 8 (g))	5,984,050	4,880,226
Deficit	<u>(7,009,585)</u>	<u>(2,959,542)</u>
Total shareholders' equity	<u>44,931,501</u>	<u>32,300,700</u>
Total liabilities and shareholders' equity	<u>\$ 54,937,403</u>	<u>\$ 39,743,689</u>

Approved by the Directors:

/s/ Joseph Ash  
Director

/s/ Gerald Romanzin  
Director

**The accompanying notes are an integral part of these financial statements.**

**Porto Energy Corp.**  
**Consolidated Statement of Operations,**  
**Comprehensive Loss and Deficit**  
**(Stated in United States dollars)**  
**(unaudited)**

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2011	2010	2011	2010
Revenues				
Other revenues	\$ 4,910	\$ 248	\$ 6,131	\$ 457
Expenses				
General and administrative	1,229,831	252,189	1,955,848	466,127
Professional fees	99,692	213,431	235,466	248,139
Interest expense	100	67,234	201	95,324
Stock based compensation (Note 8 (d))	927,169	-	988,145	-
Depletion, depreciation and accretion	4,399	4,248	7,861	8,495
Foreign exchange loss (gain)	(50,411)	23,873	(61,811)	87,529
Total Expenses	<u>2,210,780</u>	<u>560,975</u>	<u>3,125,710</u>	<u>905,614</u>
Net loss before income taxes and gain on settlement of debt	<u>(2,205,870)</u>	<u>(560,727)</u>	<u>(3,119,579)</u>	<u>(905,157)</u>
Future income taxes	1,034,250	233,471	1,399,743	478,552
Net loss before gain on settlement of debt	<u>(3,240,120)</u>	<u>(794,198)</u>	<u>(4,519,322)</u>	<u>(1,383,709)</u>
Gain on settlement of debt (Note 12)	469,279	6,131,509	469,279	6,556,567
Net loss and comprehensive loss	<u>(2,770,841)</u>	<u>5,337,311</u>	<u>(4,050,043)</u>	<u>5,172,858</u>
Deficit, beginning of period	(4,238,744)	(5,141,280)	(2,959,542)	(4,976,827)
Deficit, end of the period	<u>\$ (7,009,585)</u>	<u>\$ 196,031</u>	<u>\$ (7,009,585)</u>	<u>\$ 196,031</u>
Basic and diluted loss per share	<u>\$ (0.02)</u>	<u>\$ 0.11</u>	<u>\$ (0.03)</u>	<u>\$ 0.13</u>
Weighted average number of shares outstanding - basic and diluted (Note 8 (f))	<u>128,378,403</u>	<u>49,342,193</u>	<u>120,825,778</u>	<u>39,801,238</u>

**The accompanying notes are an integral part of these financial statements.**

**Porto Energy Corp.**  
**Consolidated Statement of Cash Flows**  
**(Stated in United States dollars)**  
**(unaudited)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>February 28,</b>		<b>February 28,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Cash Flows from Operating Activities</b>				
Net loss	\$ (2,770,841)	\$ 5,337,311	\$ (4,050,043)	\$ 5,172,858
Items not affecting cash:				
Depletion, depreciation and accretion	4,399	4,248	7,861	8,495
Provision for future income taxes	1,086,766	233,471	1,392,259	478,552
Stock-based compensation	927,169	-	988,145	-
Gain on settlement of debt	(469,279)	(6,131,509)	(469,279)	(6,556,567)
Unrealized foreign exchange loss (gain)	(50,411)	23,873	(61,811)	87,528
	<u>(1,272,197)</u>	<u>(532,606)</u>	<u>(2,192,868)</u>	<u>(809,134)</u>
Net change in non-cash working capital items:				
Accounts receivable	(1,551,278)	15,544	(1,529,934)	27,001
Prepaid expenses	38,566	(77,112)	165,888	(81,745)
Related party payables	(29,327)	3,175	(44,171)	(16,452)
Accounts payable and accrued liabilities	537,991	298,277	630,615	173,083
Net cash used by operating activities	<u>(2,276,245)</u>	<u>(292,722)</u>	<u>(2,970,470)</u>	<u>(707,247)</u>
<b>Cash Flows from Financing Activities</b>				
Shares and warrants issued for cash	17,595,813	1,985,000	17,595,813	1,985,000
Shares issue costs paid in cash	(1,928,633)	(148,686)	(1,976,691)	(148,686)
Repayments of notes payable	-	(58,018)	-	(58,018)
Repayments of related party notes payable	-	(23,724)	-	(23,724)
Net cash provided by financing activities	<u>15,667,180</u>	<u>1,754,572</u>	<u>15,619,122</u>	<u>1,754,572</u>
<b>Cash Flows from Investing Activities</b>				
Acquisition of property and equipment	(8,621,904)	(45,412)	(10,631,846)	(1,151,902)
Loan from Porto pre-amalgamation	-	1,550,550	-	3,583,435
Cash received on amalgamation (Note 8(b))	-	412,833	-	412,833
Restricted cash deposits	5,716	-	5,716	-
Net change in non-working capital - accounts payable and accrued liabilities	1,198,402	(1,271,433)	1,114,232	(1,770,209)
Net cash used by/(used by) investing activities	<u>(7,417,786)</u>	<u>646,538</u>	<u>(9,511,898)</u>	<u>1,074,157</u>
Foreign exchange gain (loss) on cash held in a foreign currency	(5,385)	1,479	(13,345)	2,244
	<u>(5,385)</u>	<u>1,479</u>	<u>(13,345)</u>	<u>2,244</u>
Net increase in cash	5,967,764	2,109,867	3,123,409	2,123,726
Cash at beginning of the period	471,236	59,369	3,315,591	45,510
Cash at end of the period	<u>\$ 6,439,000</u>	<u>\$ 2,169,236</u>	<u>\$ 6,439,000</u>	<u>\$ 2,169,236</u>
<b>Supplemental disclosure of cash flow information</b>				
Interest Paid	\$ 100	\$ -	\$ 201	\$ 401
Interest Received	4,880	-	6,101	29,218
Cash Paid for Income Taxes	7,484	-	67,484	-
<b>Non-cash financing activities</b>				
Fair value of agents warrants issued	\$ 3,553,204	\$ -	\$ 3,553,204	\$ -
Shares Issued for Accounts Payable	-	4,044,981	-	4,044,981
Shares issued for related Party Notes	-	564,413	-	564,413
Shares issued for related Party Payables	-	525,621	-	525,621
Shares issued for Net Profit Interest ("NPI")	-	885,235	-	885,235
Shares issued as fees	-	16,750	-	16,750

**The accompanying notes are an integral part of these financial statements**

**Porto Energy Corp.**  
**Notes to the Consolidated Financial Statements**  
**For the Three and Six Month Periods Ended February 28, 2011 and 2010**  
**(Stated in United States dollars)**  
**(unaudited)**

**1. DESCRIPTION OF BUSINESS**

Porto Energy Corp., a development stage company (the ‘Company’), was formed through the amalgamation (the ‘Amalgamation’) of Porto Energy Corp. (‘Porto’) and Mohave Exploration & Production Inc. (‘MEPI’) pursuant to the provisions of the *Business Corporations Act* (British Columbia) on January 30, 2010.

The Company, through the amalgamation of MEPI, owns 100% of the common shares of Mohave Oil and Gas Corporation (‘Mohave’) and Mohave’s wholly owned subsidiary Mohave Portugal Corporation (‘Portco’), both Texas incorporated entities.

The Company’s primary operating activities are carried out through Mohave which owns ownership positions in the Aljubarrota-3, Torres Vedras-3, Sao Pedro de Muel-2, Cabo Mondego-2, and Rio Maior-2 oil and gas concessions in Portugal (the ‘Portugal Assets’). The Company is undertaking exploration and development operations in respect of these concessions.

**2. BASIS OF PRESENTATION**

The accompanying unaudited interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. These financial statements do not include adjustments or disclosures that may result from the Company’s inability to continue as a going concern. If the Company is unable to continue as a going concern, adjustments would be necessary in the carrying value of assets and liabilities, the reported net losses and balance sheet classifications used, and such adjustments could be material.

The Company has not yet realized profitable operations, has relied on non-operational sources of financing to fund operations, and has incurred ongoing annual deficits. These conditions cast significant doubt on the validity of the going concern assumption. The Company’s ability to continue as a going concern is dependent on its ability to obtain the necessary financing and to ultimately generate profitable operations. The Company must secure additional financing to fund its operations.

The unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (‘GAAP’) and include the accounts of the Company and its wholly owned subsidiaries and branches. All intercompany balances and transactions have been eliminated. All amounts are stated in United States dollars, unless otherwise noted by C\$ for Canadian dollars or € for Euros.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and the notes thereto in the Company’s Annual Consolidated Financial Statements as at and for the year ended August 31, 2010. Certain information and disclosures normally required to be included in notes to annual consolidated financial statements have been condensed or omitted from these interim financial statements.

The accounting policies applied by the Company in these unaudited consolidated financial statements are the same as those applied by the Company in its consolidated financial statements as at and for the fiscal year ended August 31, 2010.

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that Canadian publically accountable enterprises would be required to adopt International Financial Reporting Standards (“IFRS”) for the fiscal years beginning on or after January 1, 2011. IFRS uses a conceptual framework similar to Generally Accepted Accounting Principles (“GAAP”), but there are differences in recognition, measurement and disclosures. At this time, management does not believe the impact on the Company’s financial position and results of operations from its conversion to IFRS will be material. However, management is still in the process of completing their impact analysis.

#### **4. FINANCIAL INSTRUMENTS**

The Company is exposed to various risks that arise from its business environment and the financial instruments it holds. The following outlines the Company’s risk exposures, quantifies these risks, and explains how these risks and its capital structure are managed.

The Company categorized its financial instruments carried at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. At February 28, 2011, the Company valued cash and restricted cash deposits using Level 1 inputs and it did not have any assets and liabilities measured at fair value using Level 2 and 3 inputs.

The Company classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

##### Capital management

The Company’s objective is to maintain a strong capital position in order to execute its business plans and maximize value to shareholders. The Company defines its capital as shareholders’ equity and working capital deficit. Changes to the capital structure are driven by the Company’s business plans, changes in economic conditions and risks inherent in the global oil and gas industry. During the year ended August 31, 2010, there were material changes to the capital structure due to the settlement of the Company’s working capital deficiencies accumulated during the years ended August 31, 2009 and 2008. Methods to adjust the Company’s capital structure in the future could include issue of new shares through a public offering or private placement (Note 8(b)), restructuring or repaying existing accounts payable, notes payable and related party notes payable (Note 9) and amalgamation with industry partners Note 8(b)).

The shareholders’ equity and working capital deficit for the respective periods were as follows:

	<b>February 28, 2011</b>	<b>August 31, 2010</b>
Working capital deficit	N/A	N/A
Shareholders' equity	44,931,501	32,300,700
	<u>\$ 44,931,501</u>	<u>\$ 32,300,700</u>

The Company periodically reviews certain quantitative measures of its capital structure, in order to understand its position relative to industry peers. These measures include calculations such as return on equity and return on capital employed. The Company does not set certain limits or ranges with respect to these quantitative measures.

Financial instruments are recognized initially at fair value on the balance sheet, and include cash, accounts receivable, restricted cash deposits, accounts payable and accrued liabilities and related party payables. The Company has classified its cash and restricted cash deposits as held for trading; accounts receivable is classified as loans and receivables; and accounts payable and accrued liabilities and due from related parties is classified as other liabilities. Held for trading instruments are measured at fair value, while loans and receivables and other liabilities are initially recognized at fair value and subsequently measured at amortized cost.

#### Credit risk

The Company is exposed to credit risk in relation to its cash, accounts receivable and restricted cash deposits. The cash and restricted cash deposits are held with highly rated Canadian and United States banks. Therefore the Company considers these assets to have negligible credit risk.

The Company's accounts receivable are primarily with local and federal government agencies pertaining to the refund of excise taxes paid on certain expenditures. Also included in accounts receivable are amounts due from joint venture partners which are primarily junior oil and gas partners. Its overall exposure to credit risk from joint venture partners is considered to be low given during the year ended August 31, 2010, the Company acquired the interests in the properties held by two of its three joint venture partners including any related outstanding receivables.

The carrying amounts of cash, accounts receivable, and restricted cash deposits represent the Company's maximum credit exposure. The Company does not have an allowance for doubtful accounts at February 28, 2011 or August 31, 2010.

#### Liquidity risk

The Company manages the risk of not meeting its financial obligations through management of its capital, annual budgeting of its expenditures and cash flows and cash flow forecasting.

Accounts payable and accrued liabilities and related party payables as disclosed on the consolidated balance sheet, fall due within the next year and are anticipated to be funded through future issuances of the Company's shares by private placement or public offering. The Company has no access to any further debt or debt facility.

#### Market risk

Changes in commodity prices, interest rates and foreign currency exchange rates can expose the Company to fluctuations in its net loss and in the fair value of its financial assets and liabilities.

### Commodity price risk

Price fluctuations for crude oil, natural gas liquids and natural gas are a risk to the Company over which the Company has little influence. The Company is in the development stage and does not have any production. As a result, the commodity price risk is low.

### Interest rate risk

The Company had no debt instruments outstanding at February 28, 2011. As a result the interest rate risk is low.

### Foreign currency exchange rate risk

Substantially all of the Company's operations are conducted in a foreign jurisdiction, so the Company is exposed to foreign currency exchange rate risk. Most of its contractors and activities are denominated and reported in United States dollars. Operating and capital expenditures are incurred in United States dollars, Canadian dollars (C\$) and in Euros (€). In addition, cash is primarily in bank accounts denominated in United States dollars. As of February 28 and 2011, 2010 and August 31, 2010, the Company considers its foreign currency exchange risk to be low.

## 5. PROPERTY AND EQUIPMENT

	<b>As of February 28, 2011</b>		
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net Book Value</b>
Oil and gas assets	\$ 46,502,710	\$ -	\$ 46,502,710
Furniture and equipment	143,276	74,372	68,904
Property and equipment	<u>\$ 46,645,986</u>	<u>\$ 74,372</u>	<u>\$ 46,571,614</u>

  

	<b>As of August 31, 2010</b>		
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net Book Value</b>
Oil and gas assets	\$ 35,914,823	\$ -	\$ 35,914,823
Furniture and equipment	100,934	67,579	33,355
Property and equipment	<u>\$ 36,015,757</u>	<u>\$ 67,579</u>	<u>\$ 35,948,178</u>

The Company is in the development stage and as a result all oil and gas property expenditures are considered to be unproven and all costs are in one cost center, Portugal. Management has assessed that the carrying value of these properties is not impaired as at February 28, 2011 and August 31, 2010. Approximately \$47,660 and \$89,060 was capitalized from general and administrative expense and no interest expense was capitalized during the three and six months ended February 28, 2011. No amounts were capitalized from general and administrative expense and no interest expenses were capitalized as at August, 31, 2010.

In August, 2010, the Company, through its wholly-owned subsidiary, entered into an agreement to acquire 3-D seismic in the Torres Vedras-3 and Aljubarrota-3 concessions. During the three and six months ended February 28, 2011, the Company incurred \$7.6 million and \$9.3 million, respectively, in associated cost to obtain permits

to conduct the seismic work and to survey and record the 80 sq km Torres Vedras 2010 survey, which began in November 2010.

The Company incurred an additional \$1.2 million and \$1.3 million in capital costs associated with leaseholds, furniture and fixtures and plug and abandonment charges related to the Torres Vedras – 3 concession during the three and six months ended February 28, 2011, respectively.

During the three and six months ended February 28, 2010, the Company acquired the interests in the properties held by two of its three joint venture partners on its oil and gas properties in Portugal. The purchase price and assumption of all related outstanding joint venture receivable were recorded as part of the acquisition of oil and gas assets in property and equipment during the six months ended February 28, 2010.

The Company’s ability to realize the balance of the capitalized value of its oil and gas properties is dependent on the Company obtaining additional financing sufficient to develop the oil and gas projects and the successful development of those projects.

## 6. ASSET RETIREMENT OBLIGATION

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties (“ARO”) as at February 28, 2011 and August 31, 2010:

ARO as of August 31, 2009	\$ 92,184
Liabilities incurred during the year	-
Accretion expense	5,881
Revisions in estimates during the year	-
ARO as of August 31, 2010	<u>\$ 98,065</u>
Liabilities incurred during the period	-
Accretion expense	1,068
Revisions in estimates during the period	-
ARO as of February 28, 2011	<u><u>\$ 99,133</u></u>

The key assumptions, on which the carrying amount of the asset retirement obligation is based, include a credit-adjusted risk-free rate of 7.50% and an inflation rate of 2.50%. The total, undiscounted amount of the estimated cash flow to settle the obligations at February 28, 2011 and August 31, 2010 is \$112,000. The expected timing of the cash outflow required to settle the obligations is 6 to 9 years hence.

## 7. RESTRICTED CASH DEPOSITS

As of February 28, 2011 and at August 31, 2010, the Company has restricted cash deposits of \$135,000 primarily related to standby letters of credit for its properties in Portugal to insure certain performance obligations and commitments under the concession, each maturing on December 31, 2010 (Note 10 (a)).

All standby letters of credit are held in U.S. banks and their terms are governed by the corresponding concession agreements and under customary lending practices.

## 8. SHARE CAPITAL

### (a) Authorized

Unlimited number of common shares.

(b) **Issued  
Common Shares**

<b>Mohave Exploration and Production Inc.</b>	<b>Number of Shares</b>	<b>Amount</b>
Balance, August 31, 2009	30,365,128	\$ 12,778,572
Shares issued for debt	8,503,816	2,296,761
Shares issued for purchase of net profit interests	4,426,173	885,235
Balance, January 30, 2010	43,295,117	\$ 15,960,568
 <b>Porto Energy Corp.</b>		
Shares issued on Amalgamation with MEPI	43,295,117	\$ 15,960,568
Shares issued to acquire Porto Energy Corp. (Note 5)	32,800,000	3,881,682
Shares issued for cash	15,580,000	6,967,524
Shares issued for debt	7,343,103	3,219,956
Share issue costs		
Brokers fees paid in cash	-	(472,280)
Broker fees paid in shares	33,500	-
Balance, August 31, 2010	99,051,720	\$ 29,557,450
Shares issued for cash	29,326,683	17,595,813
Value of warrants issued with private placement	-	(3,553,204)
Value of brokers warrants issued with private placement	-	(123,208)
Share issue cost	-	(1,895,485)
Balance, February 28, 2011	128,378,403	\$ 41,581,366

For the fiscal year ended August 31, 2010:

The Company was formed through the Amalgamation of Porto and MEPI pursuant to the provisions of the Business Corporations Act (British Columbia) on January 30, 2010. Pursuant to the Amalgamation, each MEPI Class A common shareholder received 0.57425 of a Company common share for each MEPI Class A common share held, each MEPI Class B common shareholder received one Company common share for each MEPI Class B common share held and each Porto common shareholder received one Company common share for each Porto common share held. The MEPI and Porto options and warrants were exchanged for options or warrants of the Company using the same exchange ratios. All share and per share amounts in these financial statements have been adjusted to give retroactive effect to the exchange ratio of the Amalgamation.

For the six-months ended February 28, 2011:

In December 2010, the Company completed a private placement of 29,326,683 units at a price of \$0.60 per unit for gross proceeds of approximately \$17,596,000. Each Unit consists of one common share; one common share purchase warrant; one Common Share liquidity warrant (a "Liquidity Warrant"); and one Common Share anti-dilution warrant (an "Anti-dilution Warrant").

Each common share purchase warrant will entitle the holder to acquire one common share at the subscription price of US\$0.85 during the 24 months following the closing date of a Liquidity Event defined as (i) an initial public offering ("IPO") and listing of the Common Shares on a recognized stock exchange with a minimum offering size of US\$40,000,000; or (ii) a reverse-takeover transaction that results in the listing of the Common Shares on a recognized stock exchange. Each Liquidity Warrant will be exercisable by the holder thereof, at no additional cost, into common shares equal to 10% of the

nominal number of Liquidity Warrants at 6, 12 and 18 months from December 3, 2010 if a Liquidity Event has not closed on or prior to such date. The Liquidity Warrants expire upon the completion of a Liquidity Event.

The Anti-dilution Warrants expire on the date that is the earlier of: (i) the date on which the Company completes one or more equity financings (by private placement, prospectus or otherwise) for not less than an aggregate of US\$40,000,000 at a share price equal to or greater than US\$0.60 per common share; and (ii) December 31, 2012. The Anti-dilution Warrants are also exercisable at no additional cost into common shares if an offering is entered into for less than US\$0.60 per common share.

In conjunction with this placement, 1,559,600 broker warrants were issued, exercisable at a price of US\$0.85 per common shares for a period of 24 months from the closing date of the private placement and approximately \$1,136,000 was paid in finders' fees and charged to share issue costs. During the six months ended February 28, 2011, the Company incurred approximately \$1,895,485 in issuance costs as part of the Company's marketing efforts and was recorded against the offering proceeds in share capital.

In March 2011, the Company closed an Initial Public Offering of 70,000,000 common shares (Note 13). This issuance qualified as a "liquidity event" under the terms of the private placement agreement in December of 2010. As a result, the Liquidity Warrants and the Anti-dilution Warrants expired unexercised.

**(c) Warrants**

The fair value of share purchase warrants issued as part of private placements has been estimated using the Black-Scholes option-pricing model and recorded as a reduction of the gross proceeds on placement and credited to share purchase warrants.

	<u>Number of Warrants</u>	<u>Amount</u>	<u>Average Exercise price</u>
Balance, August 31, 2009	8,326,426	\$ 3,608,768	C\$ 1.31
Warrants assumed on amalgamation	9,750,000	-	\$ 0.50
Value of warrants issued with private placement	7,790,000	822,476	\$ 1.00
Expired warrants	(8,326,254)	(3,608,678)	C\$ .31
Balance, August 31, 2010	17,540,172	\$ 822,566	\$ 0.72
Value of warrants issued with private placement	29,326,683	2,083,890	0.85
Value of Anti-dilution	29,326,683	738,299	-
Value of Liquidity warrants	29,326,683	731,015	-
Expired warrants	(172)	(100)	1.31
Balance, February 28, 2011	<u>105,520,049</u>	<u>\$ 4,375,670</u>	<u>\$ 0.49</u>

The outstanding Warrants as at February 28, 2011 are as follows:

<u>Series</u>	<u>Number of Warrants</u>	<u>Exercise Price</u>	<u>Expiry date</u>
December, 2009	9,750,000	\$ 0.50	12 Months Following Closing of Offering
February, 2010	1,985,000	\$ 1.00	12 Months Following Closing of Offering
April, 2010	5,805,000	\$ 1.00	12 Months Following Closing of Offering
December, 2010	29,326,683	\$ 0.85	24 Months Following Closing of Offering
December, 2010	1,559,600	\$ 0.85	24 Months Following Closing of Offering
December, 2010	58,653,366	\$ -	Upon the Closing of Offering
	<u>107,079,649</u>		

**(d) Employee Options**

A summary of employee option activity is as follows:

	<u>Number of Options</u>	<u>Exercise Price</u>
Outstanding, end of year August 31, 2009	1,105,426	C\$ 1.31
Options Issued	-	-
Options exercised	-	-
Options forfeited	(307,218)	C\$ 1.31
Outstanding, end of year August 31, 2010	<u>798,208</u>	<u>C\$ 1.31</u>
Options Issued	11,600,000	\$ 0.60
Options exercised	-	-
Options forfeited	(1,548,208)	C\$ 1.31
Outstanding, at February 28, 2011	<u>10,850,000</u>	<u>\$ 0.60</u>

On October 30, 2007, the Board of Directors approved a Stock Option Plan. The plan was subsequently amended in December 2010 to better conform to industry standards and practices such as, but not limited to, repricing guidelines, employee qualifications and other jurisdictional participation issues. This plan is subject to shareholder approval. It provides for a 5 year term with vesting requirements to be set by the Board of Directors. The aggregate number of common shares subject to options granted under the Stock Option Plan, from time to time, cannot exceed 10% of the common shares outstanding after giving effect to the issuance of the options.

During the six months ended February 28, 2011, in accordance with the Company's Long-Term Incentive Plan, the Board of Directors granted 11,600,000 options to acquire common shares to its directors, officers, employees and consultants to purchase common shares at a strike price of \$0.60 per share. The options are set to expire on September 1, 2015 and generally one-third will vest on September 1, 2011, one-third on March 1, 2012 and the remaining one-third on September 1, 2012. As part of that grant, previously issued stock options were required to be surrendered and cancelled. A fair value of approximately \$0.397 per share was assigned to the options based on the Black-Scholes model with assumptions as outlined below. During the three and six months ended February 28, 2011, the Company recognized approximately \$927,169 and \$988,145 in stock compensation expense. Additionally, approximately 1,548,208 options were forfeited due to the Company's reorganization efforts during the three months ended February 28, 2011. There was no stock compensation expense recognized during the three and six months ended February 28, 2010.

(e) **Black-Scholes Assumptions**

Assumptions used in the fair value calculation of warrants and employee options, include:

	<b>Six Months Ended February 28, 2011</b>	<b>Year ended August 31, 2010</b>
Expected life	1-3 years	1.25 years
Expected volatility	107%-110%	86-113%
Average risk-free interest rate	1.64%-1.70%	1.14-1.96%
Expected dividends	Nil	Nil

(f) **Per Share Amounts**

For the three and six months ended February 28, 2011 there were 128,378,403 and 120,825,778 weighted shares outstanding, respectively. For the three and six months ended February 28, 2010, there were 49,342,193 and 39,801,238 weighted shares outstanding, respectively. The weighted average number of shares outstanding was not increased for outstanding warrants or options for purposes of calculating diluted shares outstanding for the three and six months periods ended February 28, 2011 and 2010 as the effect would be anti-dilutive.

(g) **Contributed Surplus**

	<b>Amount</b>
Outstanding, year-ended August 31, 2009	\$ 1,271,549
Expired warrants	3,608,677
Outstanding, year-ended August 31, 2010	4,880,226
Stock based compensation	988,145
Fair value of agent warrants issued	123,208
Foreign exchange loss	(7,629)
Expired warrants	100
Outstanding, at February 28, 2011	<u>\$ 5,984,050</u>

**9. RELATED PARTY TRANSACTIONS**

Unless otherwise disclosed elsewhere in these consolidated financial statement, the related party transactions are as follows:

- (a) Included in related party payables as at February 28, 2011 is approximately \$nil (August 31, 2010 - \$107,000) in unpaid out of pocket expenses to the Company's Executive Vice President. During the six months ended February 28, 2011, all outstanding amounts owed to the Executive Vice President were paid in full.
- (b) The Company has retained a law firm to provide it with legal services where a director and officer of the Company is a partner of this law firm. Legal fees were incurred by the Company to the law firm for the three and six month periods ended February 28, 2011 of approximately \$425,565 and \$445,565, respectively. During the same periods ended 2010, fees were incurred by the Company of approximately

\$nil and \$57,000, respectively, to the same law firm. Included in accounts payable and accrued liabilities as at February 28, 2011 is approximately \$500,000 (August 31, 2010 - \$60,000).

- (c) During the three and six month periods ended February 28, 2011, the Company recorded \$18,556 and \$35,000, respectively in rent expense for the use of office space and furniture and equipment to corporations with common officers and directors. For the corresponding periods ended 2010, \$nil and \$4,724, respectively, in rent expense was incurred from the same common officers and directors. Included in accounts payable and accrued liabilities at February 28, 2011 is \$15,000 (August 31, 2010 - \$514).
- (d) For both the three and six month periods ended February 28, 2011, the Company incurred \$nil in consulting fees and salary directly or to a private company controlled by a former director of the Company. For the corresponding periods in 2010, \$nil and \$30,234, respectively, were incurred for fees and salaries to the same private company. There are no outstanding balances related to these service fees and salary at February 28, 2011 or at August 31, 2010.
- (e) During both the three and six month periods ended February 28, 2011, the Company recorded \$nil as consulting fees payable to a company owned by the former Chief Financial Officer. For the corresponding periods in 2010, \$nil and \$3,778, respectively, were incurred and recorded as consulting fees payable to the same company. There were no outstanding balances related to these consulting fees included in related party payables as at February 28, 2011 or August 31, 2010.

Transactions (a) through (e) are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## **10. COMMITMENTS AND CONTRACTUAL OBLIGATIONS**

- (a) On August 3, 2007 the Company executed five concessions contracts with the Ministry of the Industry and Innovation for petroleum exploration, development and productions rights in Portugal (the “Ministry”). The contracts provide for an initial eight year term with 2 one year extensions and a twenty-five year production period based on an approved development and production plan with a 15 year production period extension. For each of the concessions: Torres Vedras-3, Aljubarrota-3, Cabo Mondego-2, Rio Major-2 and Sao Pedro de Muel-2; the Company is committed to drill either six or seven wells with an estimated expenditure of €500,000 for well work. The minimum total contract commitment is €18.5 million starting in 2008 and expiring in 2015.

Each concession requires the Company to post an initial bond, in favour of Ministério da Economia e da Inovação - Direcção-Geral de Energia e Geologia, (“DGEG”), the regulating agency for petroleum exploration and production in Portugal, to guarantee future performance and commitments under the concession agreement upon the issuance and/or signing of the concession contract. As of February 28, 2011 and August 31, 2010, the Company had approximately, \$135,000 in standby letters of credit that are recorded as restricted cash deposits.

- (b) In the normal course of operations, the Company provides indemnifications that are often standard contractual terms to counterparties in transactions such as purchase and sale contracts, service agreements, director/officer contracts and leasing transactions. These indemnification agreements may require the Company to compensate the counterparties for costs incurred as a result of various events, changes in (or in the interpretation of) laws and regulations, or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnification agreements will vary based upon the contract, the nature of which prevents the Company from making a reasonable estimate of the maximum potential amount that could be required to be paid to counterparties. Historically, the Company has not made any significant payments under such

indemnifications and no amounts have been accrued in the accompanying consolidated financial statements with respect to these indemnification guarantees.

## **11. INCOME TAXES**

For the three and six months ended February 28, 2011, the Company recognized future income tax expense of \$1,034,250 and \$1,399,743 on a net loss before income tax of \$2,205,870 and \$3,119,579, respectively. During the corresponding periods ended 2010, the Company recorded future income tax expense of \$233,471 and \$478,552, respectively, on a net loss before income tax of \$560,726 and \$905,157, respectively. The difference between the effective tax rate recognized and the blended statutory rates of its various taxing jurisdictions in which the Company operates is primarily due to it applying a valuation allowance for the full amount of its gross future tax asset as it believes, based on the weight of available evidence, that it is more likely than not that the future tax asset will not be realized prior to the expiration of net operating loss carryforwards in various amounts at 2028 through 2031. Net operating loss carryforwards as of February 28, 2011 were approximately \$23,864,150 million.

## **12. CONTINGENT LIABILITIES**

For the three and six month periods ended February 28, 2011:

Pursuant to a debt settlement agreement dated December 21, 2009, the Company provided certain anti-dilution rights to the Company's former largest creditor such that the creditor's ownership of the Company cannot be less than 6% just prior to closing of an IPO and whose deemed value shall not be less than \$3 million at the IPO price per share. As at August 31, 2010, the creditor had been issued 5,943,103 of the Company's common shares in order to comply with the requirements in the debt settlement agreement. During the three months ended February 28, 2011, the Company terminated anti-dilution rights. In conjunction with the termination, the Company bought casing and existing drilling inventory for \$850,000 from the third party.

Pursuant to a debt settlement agreement dated December 24, 2009, the Company provided certain anti-dilution rights to the Company's former second largest creditor such the deemed value of their 1,400,000 common shares shall not be less than \$700,000 at the IPO price per share. The creditor also has the right to put the 1,400,000 common shares of the Company to the Company for \$450,000 should the IPO not be closed by November 1, 2010. During the three months ended February 28, 2011, the anti-dilution rights, including the right to put 1,400,000 common shares of the Company for \$450,000, were terminated. As a result, the Company recorded a gain on the settlement of debt of \$469,279 after translation adjustments.

For the three and six-month periods ended February 28, 2010:

During the six months ended February 28, 2010, the Company entered into debt settlement agreements for conversion of \$5,135,015 debt in exchange for issuing 15,083,514 common shares, including 5,686,255 common shares issued to related parties. These transactions were settled by the issuance of 8,503,816 common shares for settlement of \$2,296,761 debt prior to the Amalgamation and issuance of 6,579,698 common shares for settlement of \$2,838,254 debt subsequent to the Amalgamation. As a net result of the debt settlement in shares and cash, \$6,131,510 and \$6,556,567 have been recorded as a gain on settlement of debt in the statement of operations for the three and six month periods ended February 28, 2010, respectively.

## **13. SUBSEQUENT EVENTS**

Subsequent to the period ended February 28, 2011:

- (a) Under the terms of an agency agreement dated March 15, 2011, the Company qualified the sale and distribution of 70,000,000 common shares at a price of C\$1.00 per common share on March 29, 2011. The gross proceeds received by the Company were approximately C\$70,000,000, before deducting issue expenses and agents' fees in the aggregate totaling approximately C\$4,370,000. In addition, the Company granted the agents an option, exercisable until the closing of the offering to purchase up to a total of 10,500,000 additional common shares at a price of C\$1.00 per common share. As a result, deferred offering costs of \$81,206 was recorded in non-current assets until such time it can be offset against the offering proceeds which received subsequent to February 28, 2011.
- (b) On April 4, 2011, the Company entered into a drilling contract with KCA Deutag drilling GmbH. The term of the contract is for one year with a one year extension option under the same terms and has an estimated contract value of approximately €8.0 million. Additionally, the contract required a bank guarantee of €1.8 million to be placed. The Company placed the guarantee in April, 2011 with a third party bank.
- (c) In relation to the Company's 2011 work program commitments ( Note 10(a)), the Company posted a \$2.0 million work program bond with a third party bank in favor of DGEG.