

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis ("MD&A") prepared effective July 28, 2011 of Porto Energy Corp, (the "Company" or "Porto") should be read in conjunction with the Company's unaudited financial statements and related notes for the three and nine months ended May 31, 2011 and the audited consolidated financial statements and related notes for the year ended August 31, 2010. The Company's financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All amounts in this MD&A are stated in United States dollars, unless otherwise noted by C\$ for Canadian dollars or € for Euros.

### Description of the Company

Porto is listed on the TSX Venture Exchange ("TSXV"). The Company, through its wholly owned subsidiary, Mohave Oil and Gas Corporation ("MOGC"), is engaged in international exploration, development and production of oil and natural gas with a focus on the Aljubarrota-3, Torres Vedras-3, São Pedro de Muel-2, Cabo Mondego-2, and Rio Maior-2 oil and gas concessions in Portugal (collectively, the "Concessions" and each a "Concession"). The Concessions cover 1,444,152 acres on a net basis.

### BOE Presentation

Barrels of oil equivalent (BOE) may be misleading, particularly if used in isolation. The BOE conversion ratio used in this report is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting gas to oil at the ratio of six thousand cubic feet of natural gas to one barrel of oil equivalent (6 Mcf = 1 BOE).

### Forward Looking Statements

This MD&A contains forward-looking information within the meaning of applicable securities laws. Such forward-looking information is provided for the purpose of providing information about management's current expectations and plans relating to the future. Forward-looking information is based on a number of factors and assumptions which may prove to be incorrect. The use of any of the words "intend", "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends", "could", "might", "should", "believe" and similar expressions are intended to identify forward-looking information. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. Porto believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon by investors.

With respect to forward-looking statements contained in this MD&A, the Company has made assumptions pertaining to the following:

- the performance and characteristics of the Company's oil and natural gas properties;
- oil and natural gas production levels;
- the estimated size of the Company's oil, natural gas and natural gas liquids resources;
- projections of market prices for oil and natural gas and exploration, development and production costs;
- supply and demand fundamentals for oil, natural gas and natural gas liquids;
- expectations regarding the ability to raise capital and to continually acquire reserves through acquisitions, exploration and development;
- sale, farming in, farming out or development of certain exploration properties using third party resources;
- realization of anticipated benefits of acquisitions or dispositions;
- plans for, and results of, exploration and development activities;
- growth strategy and opportunities;
- the compensation that is expected to be paid to the executive officers and directors of the Company in 2011 and thereafter;
- the future development potential of the Company's exploration blocks;
- treatment under governmental regulatory regimes and tax laws; and
- capital expenditure programs.

The Company's actual results could differ materially from those anticipated in this forward-looking information as a result of the risk factors set forth below and elsewhere in this MD&A:

- general economic, market and business conditions in jurisdictions relevant to the Company's business;
- volatility in market prices for oil, natural gas and natural gas liquids, marketability and hedging activities related thereto;
- liabilities inherent in oil and natural gas operations;
- risks inherent in the exploration, development and production of crude oil, natural gas and natural gas liquids which may create liabilities to the Company in excess of the Company's insurance coverage;
- current global financial conditions, including fluctuations in interest rates, foreign exchange rates, inflation, commodity prices, and stock market volatility;
- risks related to the exploration, development and production of crude oil, natural gas and natural gas liquids reserves and resources;
- uncertainties associated with estimating oil, natural gas and natural gas liquids resources;
- competition for, among other things, capital, acquisitions of resources and reserves, undeveloped lands and skilled personnel;
- incorrect assessments of the value of acquisitions and the likelihood of success of exploration and development programs;
- geological, technical, drilling and processing problems, including the availability of equipment and access to properties;
- risks inherent in the Company's international operations, including security and legal risks in Portugal;
- environmental risks and hazards;
- changes in tax laws and incentive programs relating to the oil and natural gas industry;
- changes in government regulations;
- failure to obtain regulatory, industry partner and third party consents and approvals where required;
- fluctuations in foreign exchange or interest rates and stock market volatility;
- failure to engage or retain key personnel;
- claims made in respect of the Company's properties or assets;
- potential losses which would stem from any disruptions in production, including work stoppages or other labour difficulties, or disruptions in the transportation network on which the Company is reliant;
- discretion in the use of proceeds of the Offering;
- the failure of the Company to meet specific requirements of its licenses or leases;
- the inability to find a farmout partner for some of the Company's exploration assets;
- failure to accurately estimate abandonment and reclamation costs;
- the availability of capital on acceptable terms;
- failure of third parties' reviews, reports and projections to be accurate;
- risks of operating offshore in shallow water; and
- failure to realize the anticipated benefits of acquisitions.

The forward-looking information contained in this MD&A is made of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, unless required by applicable securities laws. The forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.

## **Overall Performance**

The Company's strategy for the Lusitanian Basin is a balanced appraisal and exploration approach that targets both oil and gas prospects within the seven major trend types in the Concessions. Particular emphasis will be on: (1) the appraisal and expected development of the two separate carbonate reservoirs in the Aljubarrota gas discovery utilizing underbalanced drilling technology as well as lateral and horizontal drilling, (2) exploration drilling of the Upper Jurassic Reef trend, (3) exploration drilling that targets sandstone reservoirs on large structures in Triassic pre-salt clastics and dolomites, (4) the acquisition of 3-D seismic over the 30 km

long Montejunto Anticline trend in preparation for future appraisal and exploration drilling, and (5) the acquisition of 1,100 km<sup>2</sup> of 3-D seismic offshore that will be used to identify final locations for exploration wells that will be drilled on prospects within the Monte Real Platform and Triassic pre-salt clastics and dolomites.

During the quarter ended May 31, 2011, the Company's main focus was on completing a C\$70.0 million equity raise, the 240 km<sup>2</sup> 3-D seismic program on its Aljubarrota-3 and Torres Vedras-3 Concessions as well as on long lead activities in anticipation of commencing its continued exploration of the Lusitanian Basin in Portugal. The Company entered into an agency agreement dated March 15, 2011 and 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 C\$70,000,000, before deducting issue expenses and agents' fees in the aggregate totaling approximately C\$4,370,000.

In March 2011, the Company completed the acquisition and processing of 240 km<sup>2</sup> of 3-D seismic within its Aljubarrota-3 and Torres Vedras-3 Concessions in anticipation of its 2011-2012 exploration and development work programs. Interpretation of the 3-D seismic data over the Jurassic Reef Play in Torres Vedras-3 has been completed and is being used to delineate drill sites. The interpretation of the remaining 3-D seismic data is expected to be completed by the end of September 2011.

In April 2011, the Company entered into a one year drilling rig contract with KCA Deutag drilling GmbH. Using the Deutag Rig, the Company commenced re-entry operations on the Alj-4 well on the Aljubarrota-3 concession in central Portugal in May 2011. The Alj-4 well was originally drilled in 2005 to a depth of 2,110 meters as a direct offset to the Company's Alj-2 well that discovered 366 BCF of contingent gas resources in a Jurassic fractured Brenha carbonate formation where it was temporarily abandoned above the gas accumulation due to operational constraints. The Company deepened the Alj-4 well by 450 meters to approximately 2,550 meters and recovered approximately 65.0 meters of conventional core and approximately 430 meters of open hole logs in the Jurassic Brenha gas reservoir. The Company is currently testing and analyzing the core, logs and associated data. Drilling operations, including acquisition of 60-70 meters of conventional core, took approximately one month. Analysis of the well results is expected to be completed by early first fiscal quarter end November 2011.

After completing the re-entry of the ALJ- 4 well, the Deutag rig was mobilized to the SPC-1 well in July 2011. The SPC-1 well was spud using the 3-D seismic interpretation from the 240 km<sup>2</sup> mention above. The SPC-1 well is the first well of a proposed two to four well exploration drilling program in the Company's Jurassic Reef Trend. The target depth of this well is anticipated to be approximately 1,970 meters and is expected to test multiple Jurassic Reef oil prospect levels as delineated by the Company's recently completed 120 km<sup>2</sup> 3-D seismic survey of this area. The Company expects to reach total depth by late August 2011.

In June 2011, the Company entered into an agreement to acquire 3-D seismic over approximately 240 km<sup>2</sup> over the Montejunto Anticline in its Torres Vedras-3 concession onshore Portugal. It is currently permitting the area and anticipates surveying to begin within the next few months.

The Company also completed a 25,000 km<sup>2</sup> aeromagnetic data survey in July 2011. Management expects this survey to help locate sedimentary basins, inferring the location of the thickest sedimentary section and delineate the boundaries of the Lusitanian Basin in order to help management understand the regional geology to economically focus exploration efforts. Processing is expected to be completed in August and interpretation by November 2011.

In July 2011, the Company began acquiring 1,000 km<sup>2</sup> of 3-D seismic offshore Portugal in its Sao Pedro de Muel-2 and Cabo Mondego-2 to cover the Monte Real Platform Trend which is expected to define exploration well locations in an attempt to attract joint venture partners. Completion of the offshore 3-D seismic is anticipated within approximately two months and processing and interpretation of the data is expected to be completed during the second quarter of 2012.

The following selected financial data is derived from the audited and unaudited consolidated financial statements of the Company.

## Selected Annual Information

	Three Months Ended May 31,		Nine Months Ended May 31,		Year Ended August 31		
	2011	2010	2011	2010	2010	2009	2008
Revenues	\$ 24,056	\$ 1,001	\$ 30,187	\$ 1,458	\$ 4,243	\$ 2,566	\$ 94,118
Cash flow from operations	(2,054,750)	(582,769)	(5,025,220)	(1,290,016)	(4,010,275)	612,475	(2,534,711)
Net loss <sup>(1)</sup>	(2,231,140)	(1,355,886)	(5,350,719)	(2,261,043)	(3,148,775)	(4,273,846)	(2,642,676)
Comprehensive income (loss)	(2,295,050)	(1,934,413)	(6,345,093)	3,238,445	2,017,285	(4,759,900)	(4,414,256)
Oil and Gas Production	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Capital expenditures, net of related accounts payable	\$ 5,733,414	\$ 552,606	\$ 15,251,028	\$ 3,474,717	\$ 3,742,673	\$ 814,212	\$ 9,814,310
Basic and diluted loss per share	\$ (0.01)	\$ (0.02)	\$ (0.05)	\$ 0.06	\$ 0.03	\$ (0.16)	\$ (0.16)
<b>Balance Sheet Data</b>							
Total assets	\$118,718,653	\$ 41,559,763	\$118,718,653	\$ 41,559,763	\$ 39,743,689	\$ 32,874,530	\$ 27,635,943
Long term liabilities <sup>(2)</sup>	99,667	96,595	99,667	96,595	98,065	92,184	86,302
Cash	59,964,680	6,297,457	59,964,680	6,297,457	3,315,591	45,510	110,663
Working capital (deficit)	\$ 60,370,591	\$ 3,654,615	\$ 60,370,591	\$ 3,654,615	\$ 1,866,842	\$ (14,177,022)	\$ (8,394,853)

### Notes:

- (1) Before provision on income taxes and gain on settlement of debt.
- (2) Consists of asset retirement obligation for future well abandonment costs.

## Selected Quarterly Information

	May 31, 2011	Feb 28, 2011	Nov 30, 2010	Aug 31, 2010
Revenues	\$ 24,056	\$ 4,910	\$ 1,221	\$ 2,784
Cash flow from operations	(2,054,750)	(2,276,245)	(694,225)	(2,719,260)
Net loss <sup>(1)</sup>	(2,231,140)	(2,205,870)	(913,709)	(887,731)
Comprehensive income (loss)	(2,295,050)	(2,770,841)	(1,279,202)	(1,221,158)
Capital expenditures, net of related accounts payable	\$ 5,733,414	\$ 7,423,502	\$ 2,094,112	\$ 267,955
Basic and diluted loss per share	\$ (0.01)	\$ (0.02)	\$ (0.01)	\$ (0.01)
<b>Balance Sheet Data</b>				
Total assets	\$118,718,653	\$ 54,877,403	\$ 38,813,700	\$ 39,743,689
Long term liabilities <sup>(2)</sup>	99,667	99,133	98,599	98,065
Cash	59,964,680	6,439,000	471,236	3,315,591
Working capital (deficit)	\$ 60,370,591	\$ 5,186,328	\$ (1,106,145)	\$ 1,866,842

	<u>May 31, 2010</u>	<u>Feb 28, 2010</u>	<u>Nov 30, 2009</u>	<u>Aug 31, 2009</u>
Revenues	\$ 1,001	\$ 248	\$ 209	\$ 740
Cash flow from operations	(582,769)	(292,722)	(414,525)	155,989
Net loss <sup>(1)</sup>	(1,355,886)	(560,727)	(344,431)	(341,627)
Comprehensive income (loss)	(1,934,413)	5,337,311	(164,455)	(804,053)
Capital expenditures, net of related accounts payable	\$ 552,606	\$ 1,316,845	\$ 1,605,266	\$ (150,162)
Basic and diluted loss per share	\$ (0.02)	\$ 0.11	\$ -	\$ (0.03)

#### **Balance Sheet Data**

Total assets	\$ 41,559,763	\$ 37,097,433	\$ 33,985,277	\$ 32,874,530
Long term liabilities <sup>(2)</sup>	96,595	95,125	93,654	92,184
Cash and cash equivalents	6,297,475	2,169,236	59,369	45,510
Working capital (deficit)	\$ 3,654,615	\$ (77,248)	\$(15,916,099)	\$(14,177,022)

#### **Notes:**

- (1) Before provision on income taxes and gain on settlement of debt.  
(2) Consists of asset retirement obligation for future well abandonment costs.

#### **Results of Operations**

##### Three and Nine Months Ending May 31, 2011 as compared to the Three and Nine Months Ending May 31, 2010

#### *Revenues*

Revenue during the three and nine months ended May 31, 2011, was \$24,056 and \$30,187, respectively, as compared to \$1,001 and \$1,458, for the corresponding periods ended May 31, 2010. Revenue is composed primarily of interest income from cash on hand. Whereas the Company has not yet established commercial oil and gas production from the Concessions, its sources of revenue are not of a recurring consistent nature.

#### *General and Administrative Expense ("G&A")*

G&A expense increased by \$521,140 from \$853,990 for the three months ended May 31, 2010 to \$1,375,130 for the corresponding period in 2011. G&A expense for the nine months ended May 31, 2011 was \$3,330,978 as compared to \$1,320,117 for the same period in the prior year. The increase in G&A expense for the three and nine months ended May 31, 2011 was primarily a result of hiring additional management and operations staff, higher rent and office expenses from new office facilities and increased travel costs as a result of the increased corporate and operational activity of the Company compared to the prior year periods when it was in cash conservation mode. The increase for the nine months ended May 31, 2011, includes a one-time charge of \$246,622 in severance payments to former employees.

#### *Stock Based Compensation*

Stock based compensation expense for the three and nine months ended May 31, 2011 was \$963,548 and \$1,951,693, respectively, compared to \$nil for both the three and nine months ended May 31, 2010. During the nine months ended May 31, 2011, a total of 11,600,000 options to acquire shares of common stock have been issued to officers, directors and employees in accordance with the Company's long-term incentive plan subject to vesting requirements and 1,548,208 options expired due to employment terminations.

#### *Professional Fees*

Legal, audit and engineering related expenses totalling \$128,285 and \$363,751 were incurred during the three and nine months ended May 31, 2011, respectively, as compared to \$282,014 and \$530,153 for the three and nine month comparative periods in 2010, respectively. Professional fees are related to the Company's recent audit, independent resource report and general corporate matters in the current period as compared to general corporate matters in the comparative period. The professional fees associated with the Company's private placement and IPO are offset against the offering proceeds and booked against share capital.

### *Interest Expense*

Interest expense for the three and nine months ended May 31, 2011 was \$7,569 and \$7,770, respectively, as compared to \$7,273 and \$102,597 in the comparative periods in 2010, respectively. Interest expense during the comparative period reflects interest accrued on outstanding loans and related party loans all of which were repaid during the year ended August 31, 2010.

### *Foreign Currency Translation*

Foreign currency translation gains for the three and nine months ended May 31, 2011, were \$228,431 and \$290,242, respectively, compared to translation losses of \$209,811 and \$297,340 in the comparative periods for 2010, respectively. The foreign currency unrealized gains and losses reflect the changing value of the Canadian dollar/Euro versus the US dollar at the respective period ends, in which the Company maintains its accounts.

### *Depletion, Depreciation and Accretion*

Depletion, depreciation and accretion expenses of \$9,095 and \$16,956 were recorded during the three and nine months ended May 31, 2011, respectively, as compared to \$3,799 and \$12,294 during the comparative period in 2010, respectively. These amounts are largely due to the depreciation of furniture and fixtures and the non-cash accretion expense for estimated future abandonment costs for prior wells drilled in Portugal.

### *Net Loss Before Income Taxes and Gain on Settlement of Debt*

The Company recorded net losses for the three and nine months ended May 31, 2011 of \$2,231,140 and \$5,350,719, respectively, as compared to \$1,355,886 and \$2,261,043 for the comparative periods in 2010, respectively. As the Company is in the exploration phase of operations, there are currently no oil and natural gas producing properties generating revenues. The Company's net losses for these periods were primarily generated from G&A expenses including salaries, office costs and travel costs in addition to professional fees and stock based compensation. The fair value of the stock based compensation was a non-cash expense in the current year periods.

### *Future Income Taxes*

The Company recorded a future income tax expense of \$63,910 and \$1,463,653 on a net loss before income tax of \$2,231,140 and \$5,350,719, for the three months and nine months ended May 31, 2011, respectively. During the corresponding periods ended May 31, 2010, the Company recorded future income tax expense of \$210,400 and \$688,952, on a net loss before income tax of \$1,355,886 and \$2,261,043, 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 May 31, 2011 were approximately \$24.5 million.

### *Gain on Settlement of Debt Expense*

The Company recorded a non-recurring gain on the settlement of debt of \$nil and \$469,279 for the three and nine months periods ended May 31, 2011, compared with (\$368,127) and \$6,188,440 during the three and nine months ended May 31, 2010, respectively. During the second quarter ended February 28, 2011, under the terms of the debt settlement agreement of December 2009, 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. The prior period gain was a result of settling outstanding accounts payable and accrued liabilities at discounts to the recorded value through the payment of cash and the issuance of stock in the prior period when the Company was in the process of implementing its reorganization.

### *Comprehensive Income (Loss)*

The Company recorded a comprehensive loss for the three and nine months ended May 31, 2011 of \$2,295,050 and \$6,345,093, respectively, as compared to a comprehensive loss of \$1,934,413 for the three months ended May 31, 2010, and a comprehensive income of \$3,238,445 for the nine months ended May 31, 2010, respectively. The difference between net loss and comprehensive loss and comprehensive income is comprised of the non-recurring gain on the settlement of debt and provisions for income taxes.

## Capital Projects

The Company's exploration plans for the Lusitanian Basin initially focuses on certain prospects and trends identified by the Company within the Aljubarrota-3, Torres Vedras-3, São Pedro de Muel-2, and Cabo Mondego-2 Concessions. These include the Jurassic Aljubarrota gas trend, the Upper Jurassic reef trend, Triassic pre-salt clastics and dolomites, the Montejunto Anticline, the Monte Real Platform, the Obidos Nazare trend and Upper Jurassic Arruda clastics. The Company has identified multiple prospects within each of these plays and is currently planning to drill ten onshore wells on these prospects in three of these geologic plays and trends. The work program includes exploration, appraisal and development drilling with planned drill depths of 1,500 to 3,500 metres. All of these prospects will be defined with a combination of 2D and 3D seismic data including 240 km<sup>2</sup> of 3D seismic acquired over certain areas of the Aljubarrota-3 and Torres Vedras-3 Concessions that will provide final definition for Aljubarrota gas wells, several reef wells and the pre-salt well.

The wells planned for the Aljubarrota-3 Concession includes the Alj-4 re-entry and Alj-4H appraisal wells and three subsequent development horizontal well (Alj-5H, ALJ-6H and ALJ-7H). Gas bearing carbonates zones are the reservoir target in these wells. The Company will also drill a pre-salt exploration well on this Concession, located within the Rhodochrosite Prospect, where Triassic sandstones and Lower Jurassic dolomites are the targets. On the Torres Vedras-3 Concession, the Company is planning four exploration wells targeting Upper Jurassic reefs.

The work program also includes two additional 3D seismic programs that will cover a total of approximately 1,240 km<sup>2</sup>. The Company expects to complete a 1,000 km<sup>2</sup> 3D offshore seismic program within the São Pedro de Muel-2 and Cabo Mondego-2 Concessions, from which it expects to define exploration well locations for currently mapped prospects. The Company is also planning a 240 km<sup>2</sup> 3D seismic program for the Montejunto Anticline in the Torres Vedras-3 Concession to high-grade prospects and define locations for future wells.

The following table summarized the current and anticipated capital projects, their budget and their costs as at May 31, 2011:

<u>Concession Areas</u>	<u>Project</u>	<u>Preliminary Project Estimate</u>	<u>Approximate Cost to Date</u>
Appraisal and Development Wells:			
Aljubarrota-3	Drill Alj-4 Re-entry and Alj-4H appraisal wells	\$ 8,600,000	\$ 2,681,000
Aljubarrota-3	Drill Alj - 5H and ALJ-6H development wells	12,000,000	nil
Aljubarrota-3	Dril Alj-7H	7,500,000	nil
<b>Sub total</b>		<u>28,100,000</u>	<u>2,681,000</u>
Exploration Wells and 3D Seismic:			
Torres Vedras-3 and Aljubarrota-3	Drill reef 1,2,3,4 and Presalt 1 exploration wells, and other	15,700,000	18,000
Torres Vedras-3, São Pedro de Muel-2, and Cabo Mondego-2	Acquire 1,340 km <sup>2</sup> of 3D onshore and offshore seismic data	19,800,000	255,000
Torres Vedras-3 and Aljubarrota-3	Acquire 240 km <sup>2</sup> of 3D	12,000,000	11,325,000
<b>Sub total</b>		<u>47,500,000</u>	<u>11,598,000</u>
<b>Total</b>		<u>\$ 75,600,000</u>	<u>\$ 14,279,000</u>

## Capital Expenditures

	Three Months Ended		Nine Months Ended	
	May 31,		May 31,	
	2011	2010	2011	2010
<b>Capital Expenditures:</b>				
Acquisition of Property and Equipment	4,981,849	351,030	15,613,695	1,502,932
Accounts Payable and Accrued Liabilities	751,565	201,576	(362,667)	1,971,785
	<u>5,733,414</u>	<u>552,606</u>	<u>15,251,028</u>	<u>3,474,717</u>

During the three and nine months ended May 31, 2011, the Company invested a total of \$5,733,414 and \$15,251,028 in property and equipment, net of related accounts payable, respectively, as compared to \$552,606 and \$3,474,717 in related investment for the comparative period in 2010, respectively. During 2011, the Company's investment primarily related to the permitting, surveying and acquisition of the Torres Vedras-3 and Aljubarrota-3 3D seismic programs. During the comparable period ended May 31, 2010, the costs primarily related to the buyout of two working interest partners in the oil and gas Concessions.

The Company terminated anti-dilution rights related to a debt settlement agreement dated December 21, 2009. In conjunction with the termination, the Company bought casing and existing drilling inventory for \$850,000 from the third party.

A liability has been recorded for future abandonment and remediation work at well sites. The asset retirement obligation at May 31, 2011 is \$99,667.

## **Liquidity and Capital Resources**

At May 31, 2011, the Company had working capital of \$60,370,591, comprised primarily of accounts payable and accrued liabilities, and cash of \$59,964,680 as compared to working capital of \$1,866,842 and cash of \$3,315,591 at August 31, 2010. Working capital increased as a result of the Company's completion of a private placement in December 2010 which placed 29,326,683 units at a price of \$0.60 per unit for gross proceeds of approximately \$17,596,000. This was partially offset by the comprehensive loss of \$6,184,229 due to the lack of any significant revenues being generated as well as net cash used in property equipment of \$20,391,757 mainly associated with the Company's 3D seismic acquisition during the nine months ended May 31, 2011. Both factors contributed to limited receivables, decreased cash on hand and increased current liabilities. During the nine months ended May 31, 2011, a contingent liability in the amount of \$450,000 that was included in accounts payable and accrued liability was terminated at no cost to the Company.

For the December 2010 private placement of 29,326,683 units referred to above, each unit consists of one common share; one common share purchase warrant; one common share liquidity warrant; and one common share 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 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 nine months ended May 31, 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.

Additionally, 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. Upon closing, the Company received gross proceeds of approximately C\$70,000,000, before deducting estimated issue expenses and agents' fees in the aggregate totaling approximately C\$4,370,000. This issuance qualified as a "liquidity event" under the terms of the private placement agreement in December 2010 referred to above. As a result, the common share liquidity warrants and the common share anti-dilution warrants under the December private placement expired.

During the nine months ended May 31, 2011, the Company had negative operating cash flow of \$5,025,220 as compared to \$1,290,015 in negative operating cash flow for the nine months ended May 31, 2010. The increase in cash used in operating activities was a result of hiring additional management and operations staff, higher office expenses from new office facilities and increased travel costs as a result of the increased activity of the Company compared to prior period when the Company was in cash conservation mode.

Until commercial oil and gas production is established, current revenue sources are based on investment income from the short term investment of cash.

As the Company is in the exploration phase of operations and has had no significant revenue to date, the Company has incurred negative cash flow from operations since its inception. Through the proceeds from the two recent offerings, the Company anticipates having sufficient funds on hand to sustain current operations and all material capital expenditures currently contemplated under the Company's business strategy.

#### **Off Balance Sheet Arrangements**

The Company does not have any off balance sheet arrangements.

#### **Related Party Transactions**

The related party transactions for the nine months ended May 31, 2011 were as follows and reflect officer and director changes as at the date of this filing:

- (a) Included in related party payables as at May 31, 2011 is approximately \$nil (August 31, 2010 - \$107,000) in unpaid out of pocket expenses to Patric Monteleone, the Company's Executive Vice President. During the nine months ended May 31, 2011, all outstanding amounts owed to the Executive Vice President were paid in full.
- (b) The Company has retained the law firm McCarthy Tétrault LLP to provide it with legal services where Gregory G. Turnbull, a director, and Richard W. Pawluk, an officer of the Company, are partners of the law firm. Legal fees were incurred by the Company to the law firm for the three and nine months ended May 31, 2011 of approximately \$29,309 and \$474,874, respectively. During the same periods ended 2010, fees were incurred by the Company of approximately \$150,000 and \$207,000, respectively, to the same law firm. Of this amount, \$376,000 was for services related to the December 2010 private investment and the public offering that closed in March 2011 and was recorded against both offering proceeds. Included in accounts payable and accrued liabilities as at May 31, 2011 is \$23,723 (August 31, 2010 - \$60,000).
- (c) During the three and nine month period ended May 31, 2011, the Company recorded \$3,455 and \$38,455, respectively, in rent expense for the use of office space and furniture and equipment to First Merit Group, a private company controlled by Christopher Wright, a former officer and director of the Company. 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 May 31, 2011 to First Merit Group is \$477 (August 31, 2010 - \$514).
- (d) For both the three and nine months ended May 31, 2011, the Company incurred \$nil in consulting fees and salary directly to Firebrand Ventures Corp., a private Company controlled by Nasim Tyab, a former director of the Company. For the corresponding periods ended 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 May 31, 2011 or at August 31, 2010.

- (e) During both the three and nine month period ended May 31, 2011, the Company recorded \$nil as consulting fees payable to Perpetual Ventures Inc., a private company controlled by Douglas Urch, 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 May 31, 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.

## **Changes in Accounting Policies**

### Impact of new accounting pronouncements and standards

During August 2009, the CICA issued amendments to section 3855, Financial Instruments – Recognition and Measurement. The amendments included the definitions of a financial asset or financial liability held for trading and loans and receivables, provided guidance concerning the assessment of embedded derivatives upon reclassification of a financial asset out of the held-for-trading category and requires that section 3025, Impaired Loans, be applied to assess whether held-to-maturity investments are impaired and to account for any such impairment. The amendment concerning the embedded derivatives was adopted for any reclassification made on or after July 1, 2009 and did not have any impact on the Company's consolidated financial statements. The remaining amendments to section 3855 apply to the Company's annual consolidated financial statements for the year ended August 31, 2009. The adoption of the amendments to section 3855 did not have an impact on the Company's consolidated financial statements.

During June 2009, the CICA issued amendments to section 3855, Financial Instruments – Recognition and Measurement, and section 3862, Financial Instruments – Disclosures. The amendment to section 3855 clarifies when an embedded prepayment option is separated from its host debt instrument for accounting purposes. The Company prospectively adopted the CICA amendment to section 3855 which did not have an impact on the Company's consolidated financial statements. The amendments to section 3862 enhance financial instrument disclosure requirements about liquidity risk and provide new disclosure requirements for fair value measurements. The amendments to section 3862 apply to the Company's annual consolidated financial statements for the year ended August 31, 2010. Upon adoption of the section 3862 amendments, the Company need not provide comparative information for the disclosures required by the amendments.

Effective September 1, 2009 the Company adopted CICA Handbook section 3064, Goodwill and Intangible Assets, which replaced section 3062, Goodwill and Other Intangible Assets and section 3450, Research and Development Costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. Section 3064 establishes new standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous section 3062. As the Company does not carry goodwill or intangible assets, as defined by section 3064, this new standard had no impact on the presentation and disclosures of the Company.

In January 2009, the CICA issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. The abstract provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments. This abstract is effective for the Company's interim and annual Consolidated Financial Statements for periods ending on or after March 31, 2009 with retrospective application without reinstatement of prior periods. The application of this abstract did not have a material effect on the Company's consolidated financial statements.

In December 2008, the CICA issued section 1582, Business Combinations, which will replace CICA section 1581 of the same name. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company is currently evaluating the impact of this changeover on its consolidated financial statements.

In December 2008, the CICA issued sections 1601, Consolidated Financial Statements, and 1602, Non Controlling Interests, which replaces existing section 1600. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011, with earlier application permitted. Section 1602 currently does not impact the Company as it has full controlling interest of all of its subsidiaries. The Company is currently evaluating the impact of section 1601 on its consolidated financial statements.

## International Financial Reporting Standards

In October 2009, the Canadian Accounting Standards Board issued a third and final International Financial Reporting Standards (“IFRS”) Omnibus Exposure Draft confirming that publicly accountable enterprises will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. The Company is currently evaluating the impact of adopting IFRS on its consolidated financial statements.

The Company commenced its IFRS transition project in 2010, which includes four key phases:

- Project awareness and engagement — This phase includes identifying and engaging the appropriate members for the core IFRS transition team, steering committee and other representatives as required. In addition, this phase includes communicating the key project requirements and objectives to the areas of the organization that will be impacted by IFRS conversion, including the Company’s senior executive management team, Board of Directors and Audit Committee.
- Diagnostic — This phase includes an assessment of the differences between current Canadian GAAP and IFRS, focusing on the areas which will have the most significant impact to the Company. A preliminary conversion roadmap has been prepared as part of this phase.
- Design, planning and solution development — This phase focuses on determining the specific impacts to the Company based on the application of the IFRS requirements. This includes the design and development of detailed solutions and work plans by each key area to address implementation requirements. In addition, impact analysis will be performed on all areas of the business, including tax and information technology systems. Accounting policies will be finalized, first-time adoption exemptions will be considered, draft financial statements and disclosures will be prepared and a detailed implementation plan and timeline will be developed. This phase also includes the development of a training plan.
- Implementation — This phase includes implementing the required changes necessary for IFRS compliance. The focus of this phase is the finalization of IFRS conversion impacts, approval and implementation of accounting and tax policies, implementation and testing of new processes, systems and controls, execution of customized training programs and preparation of opening IFRS balances.

The Company has completed the diagnostic assessment phase by performing comparisons of the differences between Canadian GAAP and IFRS. The Company has determined that the most significant impact of IFRS conversion is to property, plant and equipment. IFRS does not prescribe specific oil and gas accounting guidance other than for costs associated with the exploration and evaluation phase. The Company currently follows full cost accounting as prescribed in Accounting Guideline (“AcG”) 16, “Oil and Gas Accounting – Full Cost.” Conversion to IFRS will have a significant impact on how the Company accounts for future costs associated with oil and gas activities, in particular those related to the pre-exploration and development phases as well as the post evaluation and exploration phase where costs associated with geology and geophysics will no longer be permitted to be capitalized under IFRS. In addition, the level at which impairment tests are performed and the impairment testing methodology will differ under IFRS. IFRS conversion will also result in other impacts, none of which the Company anticipates to be significant in nature due to the Company being in the early stage of exploration. At this time, management does not believe the impact on the Company’s financial position and results of operations will be material for any of the IFRS conversion impacts identified. However, the Company is still in process of completing their analysis of the impacts resulting from this conversion.

The Company is currently completing the design, planning and solution development phase and it expects to transition into the implementation phase late fourth quarter ended August 31, 2011. The Company will be required to transition to IFRS by the first quarter ended November 30, 2011.

## **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 May 31, 2011, the Company valued cash and restricted cash deposits using Level 1 inputs. At May 31, 2011, the Company did not have any assets and liabilities measured at fair value using Level 2 and 3 inputs.

Levels 1, 2 and 3 are defined as follows:

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.

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 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 fiscal year end 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 May 31, 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, 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 facilities.

#### 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 exploration 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 or marketable securities outstanding at May 31, 2011. The interest risk on the cash balance is low due to depressed interest rates.

#### 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. Operating and capital expenditures are incurred in United States dollars, Canadian dollars (C\$) and in Euros (€). Most of its contractors and activities are denominated and reported in United States dollars. However, our current drilling contract as

well as one seismic contract are denominated in Euros along with various other smaller contracts. The Company manages its exposure primarily by balancing monetary assets and liabilities and maintaining cash positions in foreign currencies only at levels necessary for operating purposes. As of May 31, 2011, May 31, 2010, and August 31, 2010, the Company considers its foreign currency exchange rate risk to be moderate but the impact is considered to be immaterial.

### 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 could include issue of new shares through a public offering or private placement, restructuring or repaying existing accounts payable, notes payable and related party notes payable and amalgamation with industry partners.

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

	<u>May 31, 2011</u>	<u>August 31, 2010</u>
Working capital deficit	N/A	N/A
Shareholders' equity	109,747,665	32,300,700
	<u>\$109,747,665</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.

### Commitments

The following are the Company's commitments as of May 31, 2011:

- (a) On August 3, 2007, the Company executed five concession 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 5 three-year production period extensions. For each of the Concessions: Torres Vedras-3, Aljubarrota-3, Cabo Mondego-2, Rio Major-2 and São 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 the 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. These initial bonds are renewed annually. In relation to the Company's 2011 work program commitments, the Company posted a \$2.0 million work program bond with a third party bank in favour of DGEG.

- (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 and mobilization of the rig occurred during May of this year.
- (c) As of May 31, 2011 and August 31, 2010, the Company had approximately \$4,948,778 and \$135,000, respectively, in standby letters of credit associated with the guarantees in (a) and (b) and are recorded as restricted cash deposits.

- (d) 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.

### Outstanding Share Data

The following table sets forth the Company's outstanding number of securities as at May 31, 2011:

	Expiry Date	Exercise Price	Number of Securities	
			Authorized	Number of Shares
Common Shares	N/A	N/A	Unlimited	198,689,153 <sup>(1)</sup>
Share Options	September 1, 2015	\$0.60	11,550,000	10,850,000
Share Purchase Warrants	March 29, 2012	\$0.50	9,750,000	
	March 29, 2012	\$1.00	7,790,000	
	March 29, 2013	\$0.85	30,886,283	48,216,783
				257,755,936

### Notes:

- (1) Includes the 101,250 Common Shares to be issued as a recruitment fee in conjunction with the Company's Chief Executive Officer search. This amount does include the March 2011 IPO which resulted in 70,000,000 shares being issued.

### Additional Disclosure for Venture Issuers Without Significant Revenue

Below is a breakdown of the general and administrative expenses of the Company for the three and nine months ended May 31, 2011 and 2010:

	Three Months Ended		Nine Months Ended	
	May 31,		May 31,	
	2011	2010	2011	2010
<b>General and Administrative Expenses</b>				
Consulting	\$ 42,616	\$ 168,997	\$ 59,594	\$ 225,161
Insurance	12,595	32,627	42,292	97,010
Realized Foreign Exchange (Gain) Loss	-	(121,049)	-	(216,110)
Rent and Office Expenses	229,439	33,899	471,364	140,120
Salaries and Benefits	1,032,363	651,654	2,569,408	958,458
Travel and Other	58,117	87,863	188,320	115,479
	\$ 1,375,130	\$ 853,991	\$ 3,330,978	\$ 1,320,118

The Company's expenses increased between the current three and nine month periods with material increases in rent and office expenses, salaries and benefits and travel and entertainment. The rent and office expense increased primarily due to moving to new office facilities that resulted in higher rental costs. Salaries and benefits increased primarily due to the hiring of additional management and operational staff compared to the previous period when the Company was in a cash conservation mode. Travel and entertainment

for the nine months ended May 31, 2011, reflects the increased activity of the Company and corporate travel between the Company's offices in Portugal, the United States and Canada.

Below is a breakdown of the capitalized oil and gas property and equipment expenditures:

	<b>Nine Months Ended May 31, 2011</b>	<b>Year Ended August 31, 2010</b>
<b>Additions to Oil and Gas Assets</b>		
Land and Acquisition Costs	\$ -	\$ 1,458,324
Drilling and Completion	3,942,371	1,569,838
Seismic Acquisition	11,579,867	975,747
	<u>\$ 15,522,238</u>	<u>\$ 4,003,909</u>

The Company's capitalized expenditures during the related periods reflect the Company's investment in the oil and gas Concessions. During the nine months ended May 31, 2011, the expenditures primarily related to the permitting, surveying and acquisition of the Torres Vedras-3 and Aljubarrota-3 3D seismic programs and increased drilling costs related to the re-entry of the ALJ-4 well. During the comparable period ended May 31, 2010, the costs related to the buyout of two working interest partners in the Concessions.

During the year ended August 31, 2010, the expenditures comprised of the acquisition costs from the buyout of two working interest partners in the Concessions, the processing of existing 3D seismic data and the permitting of the 3D seismic work program. The Company expects its capital expenditures to increase significantly during the balance of 2011 and into 2012.