

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

**For the Years Ended August 31, 2011 and 2010**

(Stated in United States Dollars)

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Porto Energy Corp.

We have audited the accompanying consolidated financial statements of Porto Energy Corp., which comprise the consolidated balance sheets as at August 31, 2011 and 2010, and the consolidated statements of operations, comprehensive income (loss) and deficit and cash flows for the years then ended, and notes to the consolidated financial statements.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Porto Energy Corp. as at August 31, 2011 and 2010 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

November 17, 2011  
Calgary, Alberta



Chartered Accountants

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

	<u>August 31,</u>	
	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
Current assets:		
Cash	\$ 44,089,305	\$ 3,315,591
Accounts receivable	2,439,655	134,528
Prepaid expenses	485,576	210,392
Total current assets	<u>47,014,536</u>	<u>3,660,511</u>
Property and equipment (Note 6)	76,693,487	35,948,178
Restricted cash deposits (Note 8)	5,063,794	135,000
Total assets	<u>\$128,771,817</u>	<u>\$ 39,743,689</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 13,130,190	\$ 1,686,357
Related party payables (Note 10)	-	107,312
Total current liabilities	<u>13,130,190</u>	<u>1,793,669</u>
Asset retirement obligation (Note 7)	37,814	98,065
Future income tax liability (Note 12)	7,945,107	5,551,255
Total liabilities	<u>21,113,111</u>	<u>7,442,989</u>
Basis of presentation (Note 2)		
Commitments and contractual obligations and contingent liabilities (Notes 11 and 13)		
Shareholders' equity:		
Share capital (Note 9 (b))	107,827,232	29,557,450
Warrants (Note 9 (c))	2,906,356	822,566
Contributed surplus (Note 9 (g))	9,359,662	4,880,226
Deficit	<u>(12,434,544)</u>	<u>(2,959,542)</u>
Total shareholders' equity	<u>107,658,706</u>	<u>32,300,700</u>
Total liabilities and shareholders' equity	<u>\$128,771,817</u>	<u>\$ 39,743,689</u>

Approved by the Directors:

/s/ Joe 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 Income (Loss) and Deficit**  
**(Stated in United States dollars)**

	<b>August 31,</b>	
	<b>2011</b>	<b>2010</b>
Revenues		
Other revenues	\$ 49,733	\$ 4,243
Expenses		
General and administrative	4,549,897	2,250,528
Professional fees	403,699	706,228
Interest expense	7,800	102,739
Stock based compensation (Note 9 (d))	2,894,442	-
Depletion, depreciation and accretion	14,530	16,450
Foreign exchange loss (gain)	(270,206)	77,073
Total Expenses	<u>7,600,162</u>	<u>3,153,018</u>
Net loss before income taxes and gain on settlement of debt	<u>(7,550,429)</u>	<u>(3,148,775)</u>
Future income taxes (Note 12)	2,393,852	1,032,809
Net loss before gain on settlement of debt	<u>(9,944,281)</u>	<u>(4,181,584)</u>
Gain on settlement of debt (Note 13)	469,279	6,198,869
Net income (loss) and comprehensive income (loss)	<u>(9,475,002)</u>	<u>2,017,285</u>
Deficit beginning of year	(2,959,542)	(4,976,827)
Deficit end of the year	<u>\$ (12,434,544)</u>	<u>\$ (2,959,542)</u>
Basic and diluted income (loss) per share	<u>\$ (0.06)</u>	<u>\$ 0.03</u>
Weighted average number of common shares outstanding - basic and diluted (Note 9 (f))	<u>150,875,684</u>	<u>67,914,393</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)**

	<b>Year Ended</b>	
	<b>August 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash Flows from Operating Activities</b>		
Net income (loss)	\$ (9,475,002)	\$ 2,017,285
Items not affecting cash:		
Depletion, depreciation and accretion	14,530	16,450
Provision for future income taxes	2,393,852	1,032,809
Stock-based compensation	2,894,442	-
Gain on settlement of debt	(469,279)	(6,198,869)
Unrealized foreign exchange loss (gain)	18,456	77,073
	<u>(4,623,001)</u>	<u>(3,055,252)</u>
Net change in non-cash working capital items:		
Accounts receivable	(2,023,824)	(29,940)
Prepaid expenses	(275,184)	(204,065)
Related party payables	(107,312)	(275,977)
Accounts payable and accrued liabilities	403,728	(445,041)
Net cash used by operating activities	<u>(6,625,593)</u>	<u>(4,010,275)</u>
<b>Cash Flows from Financing Activities</b>		
Shares and warrants issued for cash	89,135,313	7,790,000
Shares issue costs paid in cash	(7,290,369)	(472,280)
Repayments of notes payable	-	(73,700)
Repayments of related party notes payable	-	(165,251)
Net cash provided by financing activities	<u>81,844,944</u>	<u>7,078,769</u>
<b>Cash Flows from Investing Activities</b>		
Expenditures for property and equipment	(41,101,393)	(2,417,557)
Loan from Porto pre-amalgamation	-	3,583,435
Cash received on amalgamation	-	412,834
Restricted cash deposits	(4,923,077)	(60,000)
Net change in non-working capital - accounts payable and accrued liabilities	11,592,178	(1,325,116)
Net cash used by/(used by) investing activities	<u>(34,432,292)</u>	<u>193,596</u>
Foreign exchange gain (loss) on cash held in a foreign currency	(13,345)	7,991
	<u>(13,345)</u>	<u>7,991</u>
Net increase in cash	40,773,714	3,270,081
Cash at beginning of the year	3,315,591	45,510
Cash at end of the year	<u>\$ 44,089,305</u>	<u>\$ 3,315,591</u>
<b>Supplemental disclosure of cash flow information</b>		
Interest Paid	\$ 7,800	\$ 102,739
Interest Received	49,819	4,195
Cash Paid for Income Taxes	60,000	-
<b>Non-cash financing activities</b>		
Fair value of warrants issued	\$ 3,553,204	\$ -
Shares Issued for Accounts Payable	101,250	3,852,290
Shares issued for related Party Notes	-	564,413
Shares issued for related Party Payables	-	525,621
Shares issued for Net Profit Interest ("NPI")	-	885,235
Shares issued as fees	-	16,750

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

**Porto Energy Corp.**  
**Notes to the Consolidated Financial Statements**  
**For the Years Ended August 31, 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 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 preparation of the consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses in the consolidated financial statements and the disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

Measurement uncertainty

Estimates and assumptions include the carrying amounts of property and equipment, including impairment, depletion and depreciation and asset retirement obligation, as well as future income taxes are, in part, based on estimates of reserves and future costs. Management evaluates estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic and commodity price environment. The Company’s reserve estimates are reviewed annually by an independent engineering firm. Unproven properties and potential impairment indicators are reviewed and assessed for impairment based on historical experience and other available information. The amounts disclosed relating to fair values of stock options issued are based on estimates of future volatility of the Company’s share price, expected lives of options, and other relevant assumptions.

The amounts disclosed relating to the value of common shares exchanged for settlement of debt and buyouts of certain Net Profit Interests (“NPIs”) are measured at the fair value of the common shares issued which approximated the fair value of the settled debt. Concurrent with the exchange of common shares for settlement of debt and buyout of certain NPIs, the Company also completed private placements for cash with arms’ length

parties at the similar fair value in which there was a limited and illiquid market for the Company's common shares at the time of the exchange.

The valuation of the petroleum and natural gas properties is based on management's best estimate of the future recoverability of these assets. Various estimates are required in assessing the potential impairment of costs capitalized. Consideration of impairment includes estimates relating to overall costs, future cash flows, regulatory approval, timing, commodity prices, the general economic environment and the ability to finance future activities.

As a result, current credit market conditions combined with volatile commodity prices have resulted in increased uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined accurately, actual results could differ significantly from management's estimates. Additionally, by their nature, these estimates are subject to measurement uncertainty.

#### Foreign exchange and reporting currency

The Company's reporting currency is the US dollar. Transactions denominated in foreign currencies are translated using the temporal method as all of the Company's operations are considered to be financially and operationally integrated operations. Monetary assets and liabilities are translated at the rate of exchange in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical exchange rates. Revenue and expenses are translated at the average exchange rate for the year. Exchange gains and losses on translation of foreign subsidiaries are included in income in the current period.

#### Cash and cash equivalents

The Company considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents. The carrying amount reported in the consolidated balance sheet for cash and cash equivalents is fair value. Certain of the Company's cash balances are maintained in banks which are not covered by deposit insurance or may exceed federally insured limits.

#### Restricted cash

The Company has secured various performance bonds to guarantee its obligations and commitments in connection with its exploratory properties in Portugal. The performance bonds have been issued by U.S, German or Portuguese banks and their terms are dictated by the corresponding concession agreements or certain performance obligations.

### Joint operations

Substantially all of the Company's oil and gas activities are conducted jointly with others and accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

### Property and equipment

The Company follows the full cost method of accounting for petroleum and natural gas properties, whereby all costs associated with the exploration for, and development of, petroleum and natural gas reserves, whether productive or unproductive are capitalized in cost centers on a country by country basis. The Company has one cost center, Portugal. Costs capitalized include land acquisition costs, geological and geophysical expenditures, lease rentals on undeveloped properties and drilling and overhead expenses related to exploration activities. Proceeds from sales of oil and natural gas properties are recorded as reductions of capitalized costs unless the reduction of capitalized costs results in a change of 20% or more in the depletion rate. In this case, a gain or loss would be recognized into income.

The Company follows the full cost accounting method for the annual ceiling test calculation pertaining to the recognition and measurement of impairment of petroleum and natural gas properties. In applying the full cost method, the Company evaluates petroleum and natural gas assets to determine that the carrying amount in each cost centre is recoverable and does not exceed the fair value of the properties in the cost centre. The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost (less any impairment) of unproved properties exceeds the carrying amount of the cost centre. When the carrying amount is not recoverable, an impairment loss is recognized to the extent the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost (less any impairment) of unproved properties of the cost centre.

The cost of unproved properties is included in the impairment test described above but subject to a separate impairment test. In the case of impairment, the book value of the impaired properties is moved to the petroleum and natural gas depletable base.

### Depletion and depreciation

Costs related to petroleum and natural gas properties are depleted on a unit-of-production method based on the Company's share of total proved petroleum and natural gas reserves before royalties as determined by independent reserve engineers. Costs eligible for depletion include total capitalized costs, less the cost of unproved properties, plus estimated future development and abandonment costs of proved undeveloped reserves. Future development costs include costs incurred to obtain access to proved reserves, such as drilling costs and the installation of production equipment, and such costs are included in the depletion expense calculation. Future abandonment costs include costs to dismantle and relocate or dispose of production platforms, gathering systems and related structures and restoration costs of land and seabed. Estimates of these costs for each of our properties is based upon their geographic location, type of production structure, well depth, currently available procedures and ongoing consultations with construction and engineering consultants. Because these costs typically extend many years into the future, estimating these future costs is difficult and requires management to make judgments that are subject to future revisions based upon numerous factors, including changing technology and the political and regulatory environment. These assumptions and estimates of future development and future abandonment costs are reviewed annually. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether proved reserves have been established or impairment occurs. For purposes of the depletion calculation, proved petroleum and natural gas reserves are converted to a common unit of measure on the basis of the relative energy content of 6,000 standard cubic feet of natural gas per barrel of oil.

Capital assets are recorded at cost. Amortization is provided using a straight-line basis over the estimated useful

lives of the assets at annual amortization rates of 10% to 30%.

#### Asset retirement obligations

The Company records the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using the unit-of-production method over estimated gross proved reserves. Subsequent to the initial measurement of the assets retirement obligations, the obligations are adjusted at the end of each period to reflect the passage of time (accretion) and changes in the estimated future cash flows underlying the obligation. Actual restoration expenditures are charged to the accumulated obligation as incurred.

#### Revenue recognition

Revenue from the sale of petroleum and natural gas is recognized when they are realized or realizable and earned. Revenues are considered realized or realizable and earned when: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable and (iv) collectability is reasonably assured. Specifically, revenues are based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation, and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Other revenue is recorded in the period earned and includes management fees and other miscellaneous revenues related to the management of oil and gas activities in Portugal.

#### Future income taxes

The Company uses the liability method of accounting for income taxes. Under this method, future taxes and liabilities are measured using substantively enacted tax rates and laws that will be in effect when differences are expected to reverse. Future tax assets and unused tax losses are recognized to the extent that they are more likely than not to be realized. A valuation allowance is recorded against any future income tax asset if the Company is not "more likely than not" to be able to utilize the tax deductions associated with the future income tax asset.

#### Per share amounts

The income (loss) per share is calculated using the weighted-average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury method is used to determine the dilutive effect of stock options and other dilutive instruments. Diluted earnings per share equals basic earnings per share for the periods presented because the effects of potentially dilutive securities are antidilutive.

#### Stock-based compensation

The Company accounts for stock-based compensation using the fair value method. Under this method, cost is measured at the date of grant, based on the calculated fair value of the award, and is recognized as compensation expense in the Consolidated Statements of Operations ratably over the employees or non-employee's requisite service period, which is generally the vesting period of the equity grant. The fair value of stock option awards is determined using the Black-Scholes option-pricing model. The corresponding offset against compensation expense is an increase to contributed surplus. Upon exercise of the stock options,

consideration paid, together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

#### Impact of New Accounting Pronouncements and Standards

##### *International Financial Reporting Standards*

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.

#### **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 August 31, 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.

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 consolidated 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.

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 August 31, 2011 or August 31, 2010.

### Liquidity risk

The Company manages its business with a view to minimize the risk of not meeting its financial obligations as they come due. This risk is managed through management of its working capital, stringent annual budgeting process 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 with current cash balances on hand. 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 may 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 currently to the Company over which the Company has little influence. The Company is in the development stage and does not have any oil and gas production.

### Interest rate risk

The Company had no debt instruments or marketable securities outstanding at August 31, 2011. The interest risk on the cash balance is low due to depressed interest rates. If the interest rate were to increase/decrease by 1% from August 2011 levels, interest income would increase/decrease by approximately \$440 thousand per annum.

### 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, a current drilling contract and a 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 August 31, 2011 and 2010, the Company considers its foreign currency exchange rate risk to be moderate. At August 31, 2011, the non-US\$ denominated working capital would have a negligible impact on net loss and net comprehensive loss if there was a 5% change in the Canadian dollar rate

and an impact on net loss and net comprehensive loss of approximately \$719 thousand if there was a 5% change in the Euro rate.

## 5. 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, restructuring or repaying existing accounts payable and amalgamation with industry partners.

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

	<b>August 31,</b>	
	<b>2011</b>	<b>2010</b>
Working capital deficit	N/A	N/A
Shareholders' equity	107,658,706	32,300,700
	<u>\$ 107,658,706</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.

## 6. PROPERTY AND EQUIPMENT

	<b>As of August 31, 2011</b>		
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net Book Value</b>
Oil and gas assets	\$ 76,589,561	\$ -	\$ 76,589,561
Furniture and equipment	196,399	92,473	103,926
Property and equipment	<u>\$ 76,785,960</u>	<u>\$ 92,473</u>	<u>\$ 76,693,487</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 August 31, 2011 and August 31, 2010. Approximately \$307,412 was capitalized from general and administrative expense and no interest expense was capitalized during the year ended August 31, 2011. No amounts were capitalized from general and administrative expense and no interest was capitalized as at August, 31, 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.

## 7. 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 August 31, 2011 and 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 year	(62,387)
Accretion expense	2,136
Revisions in estimates during the year	-
ARO as of August 31, 2011	<u>\$ 37,814</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 August 31, 2011, is \$58,000 and at August 31, 2010, is \$112,000. The expected timing of the cash outflow required to settle the obligations is 6 to 9 years hence.

## 8. RESTRICTED CASH DEPOSITS

As of August 31, 2011 and 2010, the Company had restricted cash deposits held by banks of \$5,063,794 and \$135,000, respectively, primarily related to standby letters of credit for its properties in Portugal to insure certain performance obligations and commitments under the concessions.

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

## 9. 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.	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	99,326,683	\$ 88,897,814
Share issue cost	-	(7,290,370)
Value of warrants issued with private placement	-	(3,553,204)
Value of brokers warrants issued with private placement	-	(123,208)
Warrants exercised	475,000	237,500
Shares issued for debt	101,250	101,250
Balance, August 31, 2011	198,954,653	\$ 107,827,232

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 fiscal year ended August 31, 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 \$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 \$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. As a result, they expired unexercised on March 29, 2011.

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 \$40,000,000 at a share price equal to or greater than \$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 \$0.60 per common share. They expired unexercised on March 29, 2011.

In conjunction with this placement, 1,559,600 broker warrants were issued, exercisable at a price of \$0.85 per common share 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 year ended August 31, 2011, the Company incurred approximately \$1,930,033 in issuance costs as part of the Company's marketing efforts and this was recorded against the offering proceeds in share capital.

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. 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 associated with the private placement 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 (see assumptions in Note 9(e)) and recorded as a reduction of the gross proceeds on placement and credited to share purchase warrants.

	<b>Number of Warrants</b>	<b>Amount</b>	<b>Average Exercise price</b>
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\$ 0.31
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 warrants	29,326,683	738,299	-
Value of Liquidity warrants	29,326,683	731,015	-
Expired warrants	(58,653,538)	(1,469,414)	-
Warrants exercised	(475,000)	-	\$ 0.50
Balance, August 31, 2011	46,391,683	\$ 2,906,356	\$ 0.81

The outstanding Warrants as at August 31, 2011 are as follows:

<b>Series</b>	<b>Number of Warrants</b>	<b>Exercise Price</b>	<b>Expiry date</b>
December, 2009	9,275,000	\$ 0.50	March 29, 2012
February, 2010	1,985,000	\$ 1.00	March 29, 2012
April, 2010	5,805,000	\$ 1.00	March 29, 2012
December, 2010	29,326,683	\$ 0.85	March 29, 2013
	<u>46,391,683</u> *		

\* This amount does not include 1,559,600 broker warrants associated with the December 2010 private placement. These broker warrants are exercisable at \$0.85 each and expire on March 29, 2013.

**(d) Employee Options**

A summary of employee option activity is as follows:

	<b>Number of Options</b>	<b>Exercise Price</b>
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 August 31, 2011	<u>10,850,000</u>	<u>\$ 0.60</u>

The Company has a rolling stock option plan whereby, from time to time, at the discretion of the Board of Directors, stock options are granted to directors, officers and certain consultants. The number of shares reserved for issuance under the plan shall not exceed 10% of the issued and outstanding common shares of the Company. The exercise price of each option is based on the market price of the Company's common stock at the date of the grant less an applicable discount. The options can be granted for a maximum term of 5 years, with vesting determined by the Board of Directors.

During the year ended August 31, 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 year ended August 31, 2011, the Company recognized \$2,894,442 (2010 - \$nil) in stock compensation expense. Additionally, 1,548,208 options were forfeited due to the Company's reorganization efforts during the year ended August 31, 2011.

(e) **Black-Scholes Assumptions**

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

	August 31,	
	2011	2010
Expected life	1-3 years	1.25 years
Expected volatility	86%-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 years ended August 31, 2011 and 2010, there were 150,875,684 and 67,914,393 weighted average common shares outstanding, respectively. The weighted average number of common shares outstanding was not increased for outstanding warrants or options for purposes of calculating diluted shares outstanding for the years ended August 31, 2011 and 2010, as the effect would be anti-dilutive.

(g) **Contributed Surplus**

	Amount
Outstanding at 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	2,894,442
Fair value of agent warrants issued	123,208
Expired warrants	1,469,314
Other	(7,528)
Outstanding at August 31, 2011	\$ 9,359,662

**10. RELATED PARTY TRANSACTIONS**

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

- (a) Included in related party payables as at August 31, 2011 is \$nil (August 31, 2010 - \$107,000) in unpaid out of pocket expenses to the Company's Executive Vice President. During the year ended August 31, 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 an officer of the Company are partners of this law firm. Legal fees were incurred by the Company to the law firm for the years ended August 31, 2011 and 2010, of \$521,317 and \$146,318, respectively. Included in accounts payable and accrued liabilities as at August 31, 2011 is \$33,782 (August 31, 2010 - \$60,000).
- (c) During the years ended August 31, 2011 and 2010, the Company recorded \$38,455 and \$33,502, respectively, in rent expense for the use of office space and furniture and equipment to corporations with common officers and directors. Included in accounts payable and accrued liabilities at August 31, 2011 is \$nil (August 31, 2010 - \$514).

- (d) During the year ended August 31, 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, \$30,234 was incurred for fees and salaries to the same private company. There are no outstanding balances related to these service fees and salary at August 31, 2011 or at August 31, 2010.
- (e) During the years ended August 31, 2011 and 2010, the Company recorded \$nil and \$3,778, respectively, as consulting fees payable to a company owned by the former Chief Financial Officer. There were no outstanding balances related to these consulting fees included in related party payables as at August 31, 2011 or 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.

## 11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS

- (a) In June 2011, the Company, through its wholly-owned subsidiary, 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. The term of the contract is from August 15, 2011, to December 15, 2011, and has an estimated contract value of approximately €6.65 million.
- (b) In June 2011, the Company, through its wholly-owned subsidiary, entered into an agreement to acquire approximately 1,000 km<sup>2</sup> of 3-D seismic in its Sao Pedro de Muel-2 and Cabo Mondego-2 concessions offshore Portugal. The term of the contract is from mobilization of the Contractor Group Field Unit and personnel to the survey area to the demobilization of the Contractor Group Field Unit and personnel to a location mutually agreed to between the parties and has an estimated contract value of approximately \$10.0 million, with \$5.0 million paid in advance of mobilizing the Contractor's vessel.
- (c) 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.
- (d) 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 €15.0 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. 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 favor of DGEG.

- (e) As of August 31, 2011 and 2010, the Company had approximately \$5,063,794 and \$135,000, respectively, in standby letters of credit associated with the guarantees discussed in Note 11(c) and Note 11(d) and are recorded as restricted cash deposits.
- (f) 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.

## 12. INCOME TAXES

### (a) Future income tax expense (recovery)

The following is a reconciliation of income taxes, calculated at the combined federal and provincial income tax rates, to the income tax provision included in the consolidated statement of operations. The U.S. statutory corporate tax rates do not significantly differ from the Canadian statutory corporate tax rates.

	<u>For the Years Ended August 31,</u>	
	<u>2011</u>	<u>2010</u>
Income (loss) before income taxes	\$ (7,081,150)	\$ 3,050,094
Combined statutory corporate tax rate	<u>29.00%</u>	<u>29.00%</u>
Expected future income tax provision/(recovery)	<u>(2,053,534)</u>	<u>884,527</u>
Increases/(decreases) resulting from:		
Higher statutory tax rate on earnings of foreign subsidiaries	-	217,845
Non-deductible meals and entertainments	4,558	2,732
Asset retirement obligation accretion	-	2,000
Non-deductible life insurance premiums	49	343
Stock based compensation	839,388	-
Foreign exchange upon translation	(85,987)	-
Change in valuation allowance	1,101,693	2,926,697
Change in future tax rate	-	139,928
Other	102	13,909
Change in estimates	2,587,583	(3,155,172)
Future income tax provision	<u>\$ 2,393,852</u>	<u>\$ 1,032,809</u>

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 2023 through 2031. Net operating loss carryforwards as of August 31, 2011, were approximately \$26.0 million.

**(b) Future income tax assets (liability)**

The Canadian tax effects of temporary timing differences that give rise to significant components of the future tax assets (liabilities) are as follows:

	<u>August 31,</u>	
	<u>2011</u>	<u>2010</u>
Future income tax asset:		
Loss carry forwards	\$ 8,679,935	\$ 8,144,218
Asset retirement obligation	350	3,874
Eligible capital expenditures	19,940	-
Share issue costs	<u>767,942</u>	<u>182,702</u>
Future tax asset	<u>9,468,167</u>	<u>8,330,794</u>
Less: valuation allowance	<u>(9,468,167)</u>	<u>(8,330,794)</u>
Net future income tax assets	<u>\$ -</u>	<u>\$ -</u>
Future income tax (liability):		
Property and equipment	<u>\$ (7,945,107)</u>	<u>\$ (5,551,255)</u>
Future income tax (liability)	<u>\$ (7,945,107)</u>	<u>\$ (5,551,255)</u>

**c) Non capital losses**

As at August 31, 2011, the Company has approximately \$26,375,585 of non-capital and net operating losses which can be applied to reduce future taxable income, expiring as follows:

<u>Year of expiry</u>	<u>Canada non-capital losses</u>	<u>US operating losses</u>	<u>Total</u>
2023	\$ -	\$ 126,551	\$ 126,551
2024	-	175	175
2025	-	282,262	282,262
2026	-	471,145	471,145
2027	-	1,844,995	1,844,995
2028	-	13,492,707	13,492,707
2029	-	4,192,983	4,192,983
2030	1,738,559	-	1,738,559
2031	<u>1,656,295</u>	<u>2,569,913</u>	<u>4,226,208</u>
Totals	<u>\$ 3,394,854</u>	<u>\$ 22,980,731</u>	<u>\$ 26,375,585</u>

During the year ended August 31, 2010, the Canadian non-capital losses were reduced as a result of the

Amalgamation.

### **13. CONTINGENT LIABILITIES**

For the year ended August 31, 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 \$3.0 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 year ended August 31, 2011, the Company terminated these 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 that 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 year ended August 31, 2011, the anti-dilution rights, including the right to put 1,400,000 common shares of the Company for \$450,000, were terminated by mutual agreement. As a result, the Company recorded a gain on the settlement of debt of \$469,279 after translation adjustments during the year ended August 31, 2011.

For the twelve months ended August 31, 2010:

During the twelve months ended August 31, 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, \$6,198,869 was recorded as a gain on the settlement of debt in the statement of operations for the year ended August 31, 2010.