

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis ("MD&A") prepared effective November 17, 2011 of Porto Energy Corp, (the "Company" or "**Porto**") should be read in conjunction with the Company's audited consolidated financial statements and related notes for the years ended August 31, 2011 and 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 km² 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 March 2011, the Company completed a C\$70.0 million equity raise. 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 km² 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 November 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 the end of 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 and reached total measured depth of approximately 2,064 meters in August 2011. The well was designed to penetrate multiple stacked reef targets as delineated by the Company's 120 km² 3D seismic survey of this area. Subsequent evaluation of drilling and open-hole log data indicates the SPC-1 had oil shows. However, the well did not encounter commercial accumulations of hydrocarbons and the well was plugged and abandoned as a dry hole. The Company then moved the rig to the SPC-2 location to test a second Jurassic Reef prospect.

In August 2011, the Company reached the target depth of the SPC-2 well of approximately 1,950 meters. The well drilled through a well defined four way closure trap in the Jurassic Reef as delineated by the Company's 120 km² 3D seismic survey of this area. Logs taken from this well indicate approximately 29 meters of gross pay in the Upper Jurassic Montejunto Formation. The Company has taken sidewall cores of this interval and is currently waiting on the analysis to be completed before committing to the \$3.0 million cash outlay necessary to case and complete the well down to that interval. The sidewall core analysis is expected to be completed by the end of November 2011. In the mean time, the Company mobilized the rig back to the ALJ-4 well to finish completing and testing the Basal Brenha.

The Company also completed a 25,000 km² 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 has been concluded and interpretation is expected to be completed by November 2011.

In early September 2011, the Company completed the acquisition of more than 1,000 km² of 3D seismic data over portions of the Cabo Mondego-2 and São Pedro de Muel-2 concessions offshore Portugal using towed streamer arrays. The Company believes it has obtained good quality, analyzable data and expects processing and interpretation to be completed by February 2012. The seismic acquisition covered the Monte Real Platform Trend which is expected to define exploration well locations in an attempt to attract joint venture partners.

In June 2011, the Company entered into an agreement to acquire 3-D seismic over approximately 240 km² over the Montejunto Anticline in its Torres Vedras-3 concession onshore Portugal. The Company has performed approximately 70% of the work and is expected to be completed with the entire survey by the end of December 2011. Processing and interpretation is expected to be completed by the end of March 2012. With the completion of the Montejunto onshore 3D seismic acquisition, the Company will have fulfilled its seismic obligation under its work program commitments to the Portuguese government.

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

Selected Annual Information

	Year Ended August 31		
	2011	2010	2009
Revenues	\$ 49,733	\$ 4,243	\$ 2,566
Cash flow from operations	(6,625,593)	(4,010,275)	612,475
Net loss ⁽¹⁾	(7,550,429)	(3,148,775)	(4,273,846)
Comprehensive income (loss)	(9,475,002)	2,017,285	(4,759,900)
Oil and Gas Production	Nil	Nil	Nil
Capital expenditures, net of related accounts payable	\$ 29,509,215	\$ 3,742,673	\$ 814,212
Basic and diluted loss per share	\$ (0.06)	\$ 0.03	\$ (0.16)

Balance Sheet Data

Total assets	\$128,771,817	\$ 39,743,689	\$ 32,874,530
Long term liabilities ⁽²⁾	37,814	98,065	92,184
Cash	44,089,305	3,315,591	45,510
Working capital (deficit)	\$ 33,884,346	\$ 1,866,842	\$ (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.

Selected Quarterly Information

	Aug 31, 2011	May 31, 2011	Feb 28, 2011	Nov 30, 2010
Revenues	\$ 19,546	\$ 24,056	\$ 4,910	\$ 1,221
Cash flow from operations	(1,600,373)	(2,054,750)	(2,276,245)	(694,225)
Net loss ⁽¹⁾	(2,199,710)	(2,231,140)	(2,205,870)	(913,709)
Comprehensive income (loss)	(3,129,909)	(2,295,050)	(2,770,841)	(1,279,202)
Capital expenditures, net of related accounts payable	\$ 14,258,187	\$ 5,733,414	\$ 7,423,502	\$ 2,094,112
Basic and diluted loss per share	\$ (0.02)	\$ (0.01)	\$ (0.02)	\$ (0.01)

Balance Sheet Data

Total assets	\$128,771,817	\$118,718,653	\$ 54,877,403	\$ 38,813,700
Long term liabilities ⁽²⁾	37,814	99,667	99,133	98,599
Cash	44,089,305	59,964,680	6,439,000	471,236
Working capital (deficit)	\$ 33,884,346	\$ 60,370,591	\$ 5,186,328	\$ (1,106,145)

	<u>Aug 31, 2010</u>	<u>May 31, 2010</u>	<u>Feb 28, 2010</u>	<u>Nov 30, 2009</u>
Revenues	\$ 2,784	\$ 1,001	\$ 248	\$ 209
Cash flow from operations	(2,719,260)	(582,769)	(292,722)	(414,525)
Net loss ⁽¹⁾	(887,731)	(1,355,886)	(560,727)	(344,431)
Comprehensive income (loss)	(1,221,158)	(1,934,413)	5,337,311	(164,455)
Capital expenditures, net of related accounts payable	\$ 267,955	\$ 552,606	\$ 1,316,845	\$ 1,605,266
Basic and diluted loss per share	\$ (0.01)	\$ (0.02)	\$ 0.11	\$ -
Balance Sheet Data				
Total assets	\$ 39,743,689	\$ 41,559,763	\$ 37,097,433	\$ 33,985,277
Long term liabilities ⁽²⁾	98,065	96,595	95,125	93,654
Cash and cash equivalents	3,315,591	6,297,475	2,169,236	59,369
Working capital (deficit)	\$ 1,866,842	\$ 3,654,615	\$ (77,248)	\$(15,916,099)

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

Year Ending August 31, 2011 as compared to the Year Ending August 31, 2010

Revenues

Revenue during the year ended August 31, 2011, was \$49,733 as compared to \$4,243 for the corresponding period ended August 31, 2010. Revenue is composed primarily of interest income from cash on hand. Whereas the Company has not yet established commercial oil and natural 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 \$2,299,369 from \$2,250,528 for the year ended August 31, 2010, to \$4,549,897 for the corresponding period in 2011. The increase in G&A expense for the year ended August 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 year ended August 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 year ended August 31, 2011, was \$2,894,442 compared to \$nil for the year ended August 31, 2010. During the year ended August 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 \$403,699 were incurred during the year ended August 31, 2011, as compared to \$706,228 for the comparative period in 2010. Professional fees are related to the Company's 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 recorded against share capital.

Interest Expense

Interest expense for the year ended August 31, 2011, was \$7,800 as compared to \$102,739 for the year ended August 31, 2010. 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 year ended August 31, 2011, were \$270,206 compared to translation losses of \$77,073 in the comparative period for 2010. The foreign currency unrealized gains and losses reflect the changing value of the Canadian dollar and 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 expense of \$14,530 was recorded during the year ended August 31, 2011, as compared to \$16,450 during the comparative 2010 period. This amount is 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 year ended August 31, 2011, of \$7,550,429 compared to \$3,148,775 for the comparative year ended August 31, 2010. 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 expenses, 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.

Future Income Taxes

The Company recorded a future income tax expense of \$2,393,852 on a net loss before income tax of \$7,550,429 for the year ended August 31, 2011. During the corresponding year ended August 31, 2010, the Company recorded future income tax expense of \$1,032,809, on a net loss before income tax of \$3,148,775. 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.

Gain on Settlement of Debt Expense

The Company recorded a non-recurring gain on the settlement of debt of \$469,279 for the year ended August 31, 2011, compared with \$6,198,869 during the year ended August 31, 2010. 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 year 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 year ended August 31, 2011, of \$9,475,002 as compared to a comprehensive income of \$2,017,285 for the year ended August 31, 2010. 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 km² 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 km². The Company expects to complete a 1,000 km² 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 km² 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 August 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	\$ 5,759,000
Aljubarrota-3	Drill Alj - 5H and ALJ-6H development wells	12,000,000	nil
Aljubarrota-3	Dril Alj-7H	7,500,000	nil
Sub total		<u>28,100,000</u>	<u>5,759,000</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	6,133,000
Torres Vedras-3, São Pedro de Muel-2, and Cabo Mondego-2	Acquire 1,340 km ² of 3D onshore and offshore seismic data	19,800,000	15,341,000
Torres Vedras-3 and Aljubarrota-3	Acquire 240 km ² of 3D	12,000,000	11,504,000
Sub total		<u>47,500,000</u>	<u>32,978,000</u>
Total		<u>\$ 75,600,000</u>	<u>\$ 38,737,000</u>

Capital Expenditures

	Year Ended August 31,	
	2011	2010
Capital Expenditures:		
Acquisition of Property and Equipment	\$ 41,101,393	\$ 2,417,557
Accounts Payable and Accrued Liabilities	(11,592,178)	1,325,116
	<u>\$ 29,509,215</u>	<u>\$ 3,742,673</u>

During the year ended August 31, 2011, the Company invested a total of \$29,509,215 in property and equipment, net of related accounts payable, as compared to \$3,742,673 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, the offshore 3-D seismic program and the drilling of the Aljubarrota-4 re-entry well and the SPC-1 and SPC-2 reef wells. During the comparable period ended August 31, 2010, the costs primarily related to the buyout of two working interest partners in the oil and natural 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 August 31, 2011 is \$37,814.

Liquidity and Capital Resources

In December 2010, the Company closed the private placement of 29,326,683 units. Each unit consisted 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 entitles 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 was 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 had not closed on or prior to such date. The Liquidity Warrants expired upon the completion of a Liquidity Event.

The Anti-dilution Warrants expired 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 were also exercisable at no additional cost into common shares if an offering was 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 year ended August 31, 2011, the Company incurred approximately \$1,930,033 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 2010 private placement expired.

At August 31, 2011, the Company had working capital of \$33,884,346, comprised primarily of cash of \$44,089,305 and accounts payable and accrued liabilities, 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 and the public offering of 70,000,000 common shares at a price of C\$1.00 per common shares as previously mentioned. This amount was partially offset by the comprehensive loss of \$9,475,002 due to the lack of any significant revenues being generated as well as net cash used in property and equipment of \$41,101,393 mainly associated with the Company's exploration efforts during the year ended August 31, 2011. Both factors contributed to limited receivables, decreased cash on hand and increased current liabilities. During the year ended August 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.

During the year ended August 31, 2011, the Company had negative operating cash flow of \$6,625,593 as compared to \$4,010,275 in negative operating cash flow for the year ended August 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 expenses 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 natural 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 development 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 year ended August 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 August 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 year ended August 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 year ended August 31, 2011 and 2010, of approximately \$521,317 and \$146,318, respectively. 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 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 First Merit Group, a private company controlled by Christopher Wright, a former officer and director of the Company. Included in accounts payable and accrued liabilities at August 31, 2011, to First Merit Group is \$nil (August 31, 2010 - \$514).
- (d) For both the year ended August 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 year of 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 and 2010.
- (e) During the year ended August 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 year ended August 31, 2010, the amount of \$3,778 was 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 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.

Changes in Accounting Policies

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 implementation phase. 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 August 31, 2011, the Company valued cash and restricted cash deposits using Level 1 inputs. At August 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 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 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 years end August 31, 2011 and 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 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, 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 facilities.

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 to the Company over which the Company has little influence. The Company is in the exploration stage and currently 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 by 1% from August 2011 levels, interest income would increase 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 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 but the impact is considered to be immaterial. As of August 31, 2011, the non-US\$ denominated working capital deficit is approximately \$539,000.

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, and amalgamation with industry partners.

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

	<u>August 31,</u>	
	<u>2011</u>	<u>2010</u>
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.

Commitments

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

- (a) In June 2011, the Company, through its wholly-owned subsidiary, entered into an agreement to acquire 3-D seismic over approximately 240 km² 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 km² 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 and mobilization of the rig occurred during May 2011.
- (d) 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 €15.0 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.

- (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 in (c) and (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.

Outstanding Share Data

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

	Expiry Date	Exercise Price	Number of Securities Authorized	Number of Shares
Common Shares	N/A	N/A	Unlimited	198,954,653
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
				258,021,436

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

In August 2011, the Company's Board of Directors adopted a Shareholder Rights Plan (the "**Rights Plan**") designed to encourage the fair treatment of shareholders in connection with any take-over offer for the Company. The Rights Plan addresses the Company's concerns that existing Canadian legislation does not allow sufficient time, if a take-over bid is made, for either the Board of Directors or the shareholders to properly consider the bid, or for the Board of Directors to seek alternatives to such a bid. The Rights Plan is similar to other plans adopted by many Canadian listed companies.

The Rights Plan was effective immediately and provides the Board of Directors and the shareholders more time to fully consider any unsolicited take-over bid for the Company. It also allows more time for the Board of Directors to pursue, if appropriate, other alternatives to maximize shareholder value. Shareholders will be asked to approve the Rights Plan at the Annual General Meeting of shareholders (the "**Meeting**") expected to be held in January 2012, and upon receipt of such confirmation, the Rights Plan will have an initial term which expires at the annual meeting of shareholders of the Company to be held in 2015 unless terminated earlier. The Rights Plan may be extended for an additional three years after 2015 by resolution of shareholders at such meeting.

The rights issued under the Rights Plan (the "**Rights**") become exercisable only when a person, including any party related to them, acquires or announces its intention to acquire 20% or more of the Company's outstanding common shares ("**Common Shares**") without complying with the "Permitted Bid" provisions of the Rights Plan or without approval of the Board of Directors. Should such an acquisition occur, each Right would, upon exercise, entitle a holder of Rights, other than the acquiring person and related persons, to purchase Common Shares at one-half of the prevailing market price at the time.

Under the Rights Plan, a Permitted Bid is a bid made for all of the Common Shares to all shareholders that is open for not less than 60 days. If, at the end of the 60 days, at least 50% of the outstanding Common Shares, other than those owned by the offeror and certain related parties, have been tendered to the bid, the offeror may take up and pay for the Common Shares but must extend the bid for a further 10 days to allow other shareholders to tender.

The Board of Directors is not aware of any pending or threatened take-over bids for the Company that have been made or are contemplated.

Additional Disclosure for Venture Issuers Without Significant Revenue

Below is a breakdown of the general and administrative expenses of the Company for the years ended August 31, 2011 and 2010:

	Year Ended August 31,	
	2011	2010
General and Administrative Expenses		
Consulting	\$ 134,617	\$ 277,486
Insurance	105,930	106,180
Rent and Office Expenses	644,944	249,428
Salaries and Benefits	3,278,402	1,423,467
Travel and Other	386,004	193,967
	<u>\$ 4,549,897</u>	<u>\$ 2,250,528</u>

The Company's expenses increased between the 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 year ended August 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:

	Year Ended August 31,	
	2011	2010
Additions to Oil and Gas Assets		
Land and Acquisition Costs	\$ -	\$ 1,458,324
Drilling and Completion	14,542,034	1,569,838
Seismic Acquisition	26,196,160	975,747
	<u>\$ 40,738,194</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 year ended August 31, 2011, the expenditures primarily related to the permitting, surveying and acquisition of the Torres Vedras-, Aljubarrota-3, Offshore and Montejunto 3D seismic programs and increased drilling costs related to the re-entry of the ALJ-4 well, the drilling, plugging and abandonment of the SPC-1 well and the drilling, testing and continued evaluation of the SPC-2 well.

During the year ended August 31, 2010, the Company acquired the interests in the properties held by two of its three joint venture partners on its oil and gas properties in Portugal. The purchase price and assumption of all related outstanding joint venture receivable were recorded as part of the acquisition of oil and gas assets in property and equipment. Additionally, 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 continue to increase significantly during the balance of 2011 and into 2012.